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**Southwest Power Pool**  
**REGIONAL STATE COMMITTEE**  
**Conference Call**  
**August 19, 2011**

• M I N U T E S •

**Administrative Items:**

The following members were in attendance:

Bob Vandewater, proxy for Jeff Cloud, Oklahoma Corporation Commission (OCC)  
Jeff Davis, Missouri Public Service Commission (MOPSC)  
Patrick Lyons, New Mexico Public Regulation Commission (NMPRC)  
Donna Nelson, Public Utility Commission of Texas (PUCT)  
Pat Mosier, proxy for Olan Reeves, Arkansas Public Service Commission (APSC)  
Mike Siedschlag, Nebraska Power Review Board (NPRB)  
Thomas Wright, Kansas Corporation Commission (KCC)

President Jeff Davis called the meeting to order at 11:00 a.m. with roll call and a quorum was declared. There were 35 in attendance (Attendance – Attachment 1).

**Business Meeting**

Bill Reid (OCC) provided the Cost Allocation Working Group's (CAWG) response to the FERC NOPR on transmission incentives (FERC NOPR Comments – Attachment 2). Mr. Reid stated that the draft report had been distributed and entertained any questions. Pat Mosier (APSC) added that Olan Reeves recommended the questions be taken out of the Appendix and incorporated into the document. Ms. Mosier also suggested editing the document to include an executive summary rather than the opening bullet points. No substantive change will be made to the document's content. Following discussion, President Davis presented the following motion for approval:

**Approve CAWG's FERC NOPR comments subject to minor editing, incorporating the questions into the document, and replacing the opening bullet points with an Executive Summary; none of which alter the substantive content of the document.**

**Pat Lyons moved to approve the motion; Tom Wright seconded. The motion passed unanimously.**

**Scheduling of Next Regular Meeting, Special Meetings or Events**

President Davis reminded the group of the next regularly scheduled meeting on October 24, 2011 in Santa Fe, New Mexico and asked that any agenda requests be sent to him.

With no further business, the meeting adjourned at 11:25 a.m.

Respectfully Submitted,

Paul Suskie

Friday, August 19, 2011

11:00 a.m. CDT

Conference Call - 877-932-5833

Passcode: 157403

1. CALL TO ORDER
2. PRELIMINARY MATTERS
  - a. Declaration of a Quorum
  - b. Recognition of Conference Call Participants
3. REPORTS
  - a. CAWG Draft Comments for FERC NOPR on Transmission Incentives ..... Bill Reid
4. BUSINESS MEETING
  - a. RSC Comments for FERC NOPR on Transmission Incentives (Action Item)..... Jeff Davis
5. FUTURE RSC MATTERS
  - a. Officer Elections – October 2011 (Santa Fe, NM)
  - b. Adoption of 2012 Budget – October 2011(Santa Fe, NM)
6. SCHEDULING OF NEXT REGULAR MEETING, SPECIAL MEETINGS OR EVENTS

Friday, August 19, 2011

Teleconference

**ATTENDANCE LIST**

<b>Name</b>	<b>System</b>
Jeff Davis	Missouri Public Service Commission
Bob Vandewater	Oklahoma Corporation Commission
Patrick Lyons	New Mexico Public Regulation Commission
Donna Nelson	Publix Utility Commission of Texas
Pat Mosier	Arkansas Public Service Commission
Mike Siedschlag	Nebraska Power Review Board
Thomas Wright	Kansas Corporation Commission
John Bell	Kansas Corporation Commission
James Brack	New Mexico Public Regulation Commission
Christina Conway	Oncor
Walt Cecil	Missouri Public Service Commission
Phil Crissup	Oklahoma Gas & Electric
Bruce Cude	Xcel Energy
Richard Greffe	Public Utility Commission of Texas
Patrick Peters	Public Utility Commission of Texas
Anjuli Winker	Public Utility Commission of Texas
Jeff Knottek	City Utilities of Springfield
Rich Kosch	Lincoln Electric System
Charles Locke	Kansas City Power & Light
Josh Martin	SPP Board Director
Adam McKinnie	Missouri Public Service Commission
Mike Moffet	Sunflower
Mel Perkins	Oklahoma Gas & Electric
Dennis Reed	Westar
Bill Reid	Oklahoma Corporation Commission
Doug Collins	Omaha Public Power District
David Ried	Omaha Public Power District
Richard Ross	American Electric Power

**Name**

Patrick Smith  
Heather Starnes  
Keith Tynes  
Carol White  
Mitch Williams

**System**

Kansas Corporation Commission  
Southwest Power Pool  
GDS Associates  
FERC  
Western Farmers

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**From:** Davis, Jeff [jeff.davis@psc.mo.gov]  
**Sent:** Friday, August 19, 2011 11:03 AM  
**To:** Cheryl Robertson; Paul Suskie  
**Cc:** Cloud, Jeff  
**Subject:** Commissioner Cloud's Proxy

Dear Cheryl,

Please note that I have just received notification from Commissioner Cloud's office that Bob Vandewater will be Commissioner Cloud's proxy on today's phone call. If this email message is not sufficient for RSC purposes, please let me know.

Sincerely,

Jeff Davis

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**Subject:** RSC Conference Call next Friday, August 19, at 11:00 a.m.

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**From:** Davis, Jeff [<mailto:jeff.davis@psc.mo.gov>]  
**Sent:** Wednesday, August 17, 2011 1:51 PM  
**To:** Cheryl Robertson; Paul Suskie  
**Cc:** Nelson, Donna; 'Peters, Patrick'  
**Subject:** FW: Availability for RSC Conference Call next Friday at 11:00 a.m.???

Please accept this notification that Commissioner Nelson from Texas has designated Richard Greffe as her proxy for this Friday's meeting.

Do we need anything else?

JND

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**From:** Nelson, Donna [<mailto:Donna.Nelson@puc.state.tx.us>]  
**Sent:** Wednesday, August 17, 2011 1:43 PM  
**To:** Davis, Jeff  
**Subject:** RE: Availability for RSC Conference Call next Friday at 11:00 a.m.???

Jeff,

Richard Greffe has my proxy. Would you please forward this to anyone else who needs notice of the proxy? Thanks so much.

Donna

Donna L. Nelson  
Chairman  
Public Utility Commission  
1701 N. Congress  
Austin, TX 78701

(512)936-7015

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**Subject:** FW: Proxy

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**From:** Butch Reeves [<mailto:OReeves@psc.state.ar.us>]

**Sent:** Tuesday, August 23, 2011 11:36 AM

**To:** Paul Suskie

**Subject:** RE: Proxy

I gave Pat Moser my proxy for voting on the comments to FERC for the phone call meeting on August 19, 2011. Thanks.

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

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**Promoting Transmission Investment Through Pricing Reform** ) **Docket No. RM11-26-000**  
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**COMMENTS OF THE SOUTHWEST POWER POOL  
REGIONAL STATE COMMITTEE**

Pursuant to the Federal Energy Regulatory Commission’s (“Commission”) Notice of Inquiry (“NOI”) issued on May 19, 2011, and the Notice Extending Comment Period issued on June 14, 2011, the Southwest Power Pool Regional State Committee (SPP RSC) respectfully submits the following comments regarding the Commission’s transmission incentive regulations and policies. The SPP RSC-sponsored recommendation represent a reasonable compromise of the positions of those SPP RSC-states which support these comments and, in no way, should be seen as in conflict with the comments any of the SPP RSC states may have filed individually. Each state reserves its right to assert its own position.

**I. INTRODUCTION**

The rules related to Promoting Transmission Investment through Pricing Reform were promulgated by the Commission in Order No. 679 to implement the directives of Section 1241 of the Federal Power Act to “establish incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.”<sup>1</sup> Prior to specifically addressing the questions

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<sup>1</sup> *Promoting Transmission Investment through Pricing Reform*, 116 FERC ¶ 61,057, 18 CFR Part 35 (Docket No. RM06-4-000; Order No. 679), Issued July 20, 2006. (“Order 679” p.1)



regarding potential changes in Order 679 rules, the SPP RSC presents a comprehensive proposal which both addresses the SPP RSC's concerns as well as responds to a significant number of the Commission's questions regarding the existing rules on transmission investment incentives.

## **II. A COMPREHENSIVE APPROACH TO THE TRANSMISSION INCENTIVE POLICY**

### **A. Overview and Outline**

By the specific questions posed within its current inquiry, the Commission implicitly acknowledges the need for reform to its currently effective transmission incentive policy. To that end, the SPP RSC, proposes, herein, a comprehensive approach to effectively provide for transmission incentives which more appropriately balances the Commission's statutory mandate to encourage transmission investment with that of its mandate to ensure just and reasonable rates. The SPP RSC's recommended approach responds to a significant number of the questions included in the Commission's inquiry, as set out in Section III of these comments.

The SPP RSC recommends a two-step approach which, in the first step, addresses any financial barriers to promoting the development of transmission investment and the incentives which more appropriately overcome those barriers, while, under step-two, marries the offer of incentives with effective performance, thereby more properly balancing the Commission's competing mandates by providing incentives to construct projects on time and on budget. Time between the first and second steps is allowed for the applicant to resolve uncertainties related to citing of specific routes including receiving state regulatory approval when required. In addition, the SPP RSC recommendation lays out provisions to ensure that proposed projects which enjoy

the incentives under the Commission's policy will be supported by on-going evidence of the projects' cost effectiveness.

- SPP RSC Proposal Outline: Recommended Two-Step Process
  - Step 1: Addresses Incentives for Financial Barriers for Project Development
    - Not a required step
    - Requires a Study estimate<sup>2</sup>, not a Definitive Cost Estimate<sup>3</sup>
    - Applicant must submit a Cost Cap<sup>4</sup> and Return on Equity (ROE) Cap
    - Projects are to be identified as to purpose<sup>5</sup>
  - Step 2: Provides for Performance Based Incentives
    - A required step for all projects granted incentives in Step 1
    - Requires a Definitive Cost Estimate
      - Cannot exceed revenue requirements in excess of Cost Cap and ROE Cap granted in the first step.
- First-Step Determinations and Incentives
  - Focuses on financial barriers and the applicant's need for scarce capital.
    - Projects are to be identified as to purpose
    - ROE Cap is to be determined either by
      - A properly executed DCF analysis, or
      - A competitive solicitation
    - No ROE adder is needed
    - Financial incentives that can be granted include:
      - Recovery of abandoned plant
      - Recovery of Construction Work in Progress (CWIP) prior to completion of plant<sup>6</sup>

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<sup>2</sup> A Study Cost Estimate is one prepared by the applicant(s) for projects that pass the screening portion of the RTO planning process and require a more refined cost estimate for project approval.

<sup>3</sup> A Definitive Cost Estimate is one that comes after the applicant has an approved route for the transmission upgrade and has performed detailed engineering studies necessary to provide a cost estimate that has a high degree of certainty.

<sup>4</sup> The Cost Cap reflects the maximum level of variance which could be expected to prudently occur, given this early stage in planning and construction, and is stated as a percentage of the study cost estimate.

<sup>5</sup>I.e., The project is needed to meet reliability conditions, public policy goals or is estimated to be cost-beneficial in improving economic efficiency.

<sup>6</sup> CWIP recovery may be limited by state statute and not appropriate for use as an incentive.

- Second-Step Performance-Based Incentives
  - Definitive Cost Estimate determines cost base from which performance-based incentives are granted.
  - Costs below the cost base receive an increase in ROE equal to a 50% sharing of savings between investor and rate payers
  - Costs in excess of cost base by greater than 10% receive a decrease in ROE equal to a 50% sharing of cost increases between investor and rate payers
  
- Assurance of Cost-Effectiveness
  - Require Definitive Cost Estimates to be detailed by cost components
    - Reviewed and approved as reasonable by stakeholders, including any regional state committee
    - Schedules for construction must be included with Definitive Cost Estimate
  - Cost tracking reports must be provided on a regular basis
  - Revisions in Definitive Cost Estimate are allowed if such cost increases are prudently incurred

## **B. Description of and Support for SPP RSC Two-Step Process**

As noted, the SPP RSC's proposed two-step process is structured to target different issues related to provision of incentives, with its first step designed to target *financial barriers to project development* that restrict the ability to raise the capital necessary to finance the transmission project and its second step designed to appropriately *match incentives to performance*.

### **1. First-Step: Financial Barriers to Project Development**

The SPP RSC recommends that, at this step, the Commission focus on the general conditions of financial markets as well as the specific financial conditions of the applicant. The Commission should also require the applicant to identify the purpose of the project, i.e. whether the project is needed to meet reliability conditions, public policy goals or is estimated to

be cost-beneficial in improving economic efficiency.<sup>7</sup> Additionally, it is the SPP RSC's recommendation that financial barriers to project development be addressed by the Commission through non-ROE incentives, such as recovery of abandoned plant cost or CWIP incentives as needed.

**Maximum Capital Needs:** The SPP RSC notes, first, that of importance here is the *total* amount of capital an applicant seeks to raise for which incentives are sought. Thus, we propose that an applicant asking for incentives should file not only its initially expected capital requirement, but also a cap set for the maximum level of capital it could be required to raise<sup>8</sup> and provide evidence which supports any resultant difference. Any incentives granted by the Commission in this first step would not be applicable to costs in excess of the originally filed maximum level, or filed cap.

**ROE Incentives:** The SPP RSC recommends that no ROE incentive is needed at this stage and that ROE be set, using a DCF (Discounted Cash Flow) analysis which reflects an applicant's financial position as well as current and expected conditions of the financial markets.

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<sup>7</sup> The SPP RSC realizes that projects built to maintain reliability standards or meet other public policy requirements can provide economic benefits, but such benefits are not required for the approval of such projects. In addition, projects designed to maintain reliability or meet public policy requirements may not be designed at least cost, but to the extent that costs exceed the least costs of meeting these requirements, there must be incremental benefits from the project that exceed its incremental costs (i.e., cost above least-cost). Finally, the SPP RSC also understands that policy driven or economic projects can displace or delay reliability upgrades, and recognizes that the SPP tariffs account for this by counting the costs of the displaced or delayed reliability upgrade as a benefit to the economic or policy driven project that results in displacement or delay.

<sup>8</sup> In response to concerns regarding cost overruns initiated by the SPP RSC, the SPP Strategic Planning Committee constituted a Project Cost Task Force (PCTF) to address the SPP RSC concerns. The PCTF finalized its report at the July 11-12, 2011 meeting of the SPP Markets and Operations Policy Committee (MOPC). The complete report is posted on the SPP web site (spp.org) under Documents & Filings/Organizational Groups/Project Task Force/Meeting Materials and Minutes. In this report, the PCTF distinguishes various levels of cost uncertainty based on how far a project is into the various stages of the SPP project development process. The PCTF defines the Study Estimate as "the estimate prepared by the [Designated Transmission Owners] DTO(s) for projects that pass the Conceptual Estimate screening process and require a more refined cost estimate for project approval." The level of uncertainty assigned to the study estimate by the PCTF is  $\pm 30\%$ . In essence, the study estimate plus an increase of 30% provides the basis for a cost cap.

If a proper DCF analysis is performed, the SPP RSC asserts that no “incentive ROE adder” is needed to overcome financial barriers<sup>9</sup>. The SPP RSC does not agree that ROE adders are either needed or beneficial in addressing regulatory, environmental or engineering uncertainties that exist at this stage of the process<sup>10</sup> nor do we agree they are appropriate for those projects deemed by the Commission to involve “higher cost risks.” The SPP RSC notes that projects approved in a regional planning process with associated cost allocation and, in some cases, enjoying formula rate treatment, no longer need the same tradeoff between risk and return.

However, the SPP RSC could support ROE determination which recognizes that tradeoff via a competitive solicitation process whereby those submitting offers under the process would be required to make those offers subject to caps on both costs and ROEs. Under this process, those making offers would explicitly reveal their willingness to take on the risk of higher costs by submitting a lower maximum cost level (i.e. lower cost cap), and a higher ROE as compensation for taking on the higher risk of costs exceeding the cost cap. Absent this competitive selection process, the SPP RSC does not support providing ROE incentives to projects that appear to have higher cost risk, and asserts doing so provides a perverse incentive for cost overruns by giving a higher rate of return on those overruns.

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<sup>9</sup> The SPP RSC understands that the differing financial positions of individual applicants may result in differing ROEs and that providing a higher ROE to an applicant over another because of these differences does not constitute an “incentive ROE adder.”

<sup>10</sup> In its report, the PCTF defines the Study Estimate as “the estimate prepared by the DTO(s) for projects that pass the Conceptual Estimate screening process and require a more refined cost estimate for project approval.” Such estimates typically include a specification of the voltage level of a new line, the starting and ending points of the line and the need for substations to connect the project to the existing transmission system, but do not include the specific route of the line, any needed regulatory approvals from the state(s) in which the line is to be located, and therefore do not encompass specific engineering studies regarding the installation costs associated with the terrain on which the towers must be constructed.

The SPP RSC also notes that, in a properly executed DCF analysis, the resultant capital structure of an applicant will directly impact the appropriate ROE, reflecting the relationship of the applicant's level of debt to that of its level of equity and such relationship should also be evident in the sample companies upon which the DCF analysis is applied. It is, therefore, imperative that, in setting appropriate ROE, the Commission not allow an "effective" excessive ROE which is garnered by virtue of an inappropriate imbalance between the debt-to-equity components of an applicant's capital structure. Thus, competitive selection processes should also require applicants to submit a cap on the equity component of their capital structure. In the DCF analysis, to address those instances when no suitable sample of similar companies may be available upon which to base an appropriate debt-to-equity ratio (e.g., Independent Transcos), the Commission should also consider implementing caps on the equity component of the capital structure in setting overall returns.

**Abandoned Plant Recovery:** The SPP RSC recommends the *appropriate* use of abandoned plant recovery as an incentive to address financial barriers to the development of transmission expansion. In this regard, abandoned plant cost recovery should: (a) be conditioned on the appropriate review and approval of the project cancellation through the RTO stakeholder process; (b) be amortized over a period of time giving consideration to both the magnitude of the amount to be recovered and resulting rate impact; (c) allow, in the amount to be recovered, only the interest on debt incurred during construction; and (d) provide for a Commission determined interest rate applicable over the amortization period.

Addressing its last two recommendations related to recovery of abandoned plant, the SPP RSC understands the argument that, for a corporate utility, the cost of money to a utility, as a

corporate entity, is considered to be that utility's average costs which includes various form of debt and equity. The SPP RSC, however, notes that abandoned plant projects, because they are not used and useful, do not normally garner rate treatment, either for cost recovery or return. Here, the SPP RSC supports cost recovery as a reasonable incentive to overcome financial barriers to transmission investment. However, the question of fairness and balance is raised if ratepayers are required, not only to reimburse stockholders all costs for projects which will never provide service, but to also pay them full return on those costs, including profits to shareholders, until fully recovered. The SPP RSC asserts that recovery of the full costs of abandoned projects, including interest paid to fund those projects and interest until fully recovered, provides sufficient incentive to overcome financial barriers to investment. At the same time, the SPP RSC recommendation appropriately balances this incentive with the Commission's mandate to establish rates which are just and reasonable.

**CWIP Recovery:** The SPP RSC recommends that recovery of CWIP prior to commercial operation of the plant should only be considered in instances where the applicant's cash flow is insufficient to cover expenses, including interest expense, and that use of CWIP recovery as an incentive be subject to the limitations imposed by any state statute<sup>11</sup>.

## **2. Second-Step: Performance-Based Incentives**

In the second step of the SPP RSC recommendation, incentives are directly tied to performance measures for cost and schedule containment. Filing under this step is required for those granted incentives under the first step but also available to any applicant seeking performance based incentives. The Commission may also consider requiring all transmission

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<sup>11</sup> E.g. Statutes in both Texas and Missouri address the rate treatment for CWIP.

projects exceeding a certain level (e.g., \$20 Million) be required to file for performance-based incentives.

Application for these performance-based incentives would be made at such time that an applicant is prepared to file a *Definitive Cost Estimate*, as previously described. Higher, incentive ROEs would be enjoyed by applicants who can bring their costs in below the Definitive Cost Estimate, while applicants who overrun the Definitive Cost Estimate would be penalized with lower ROEs. In addition, it is recommended that a relatively narrow +10% dead band be applicable to the definitive estimate before penalties would apply, which not only recognizes the nature of estimates but at the same time encourages project investors to more sufficiently capture unknowns before filing a definitive estimate.<sup>12</sup>

SPP RSC recommends that there be a fifty-fifty sharing between investors and ratepayers of costs which exceed this +10% upper bound accomplished through lowering the overall ROE.<sup>13</sup> For those applicants whose costs fall below the definitive estimate, the SPP RSC recommends commensurate treatment such that a higher ROE would be applied which would

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<sup>12</sup> In its report, the PCTF defines the Design and Construction Estimates as “provided by the DTO to SPP after the DTO engineering and construction are being completed, including any environmental, routing or siting requirements and that has a known route. This would include but not be limited to any known material and labor costs. This cost estimate will also include any known condemnation costs.” The level of uncertainty that the PCTF assigns to this estimate is  $\pm 20\%$ . The report states that what is known at the Design and Construction Phase is: line length; line route; station location; commodity prices; labor costs; and right of way costs. What is unknown at this stage is: weather impacts; construction change orders; operational constraints; and material delivery issues. The PCTF uncertainty band allowed for a range of 40% to 100% of the level of project scope definition. We propose a dead band for costs in excess of the definitive cost estimate to move the scope of project development closer to 100% before an applicant makes its second step application to the Commission.

<sup>13</sup> For example, \$1 million of investment with a 30 year life, at an ROE of 11% with a 50% debt equity ratio at a 6% interest rate, and a 40% tax rate has a levelized fixed charge of \$103,446 per year for 30 years. If this project comes in at \$1,150,000, a 15% increase, at the 11% ROE the levelized fixed charge goes up to \$118,963 per year for thirty years. For a 10% increase, the levelized fixed charge rate is \$113,791. To split the cost difference between shareholders and ratepayers for the costs over the 10% increase, the levelized fixed charge should be targeted at \$116,377 per year, and this is accomplished by lowering the ROE to 10.51%.



effect a fifty-fifty sharing of the cost savings between the investor and the rate payers.<sup>14</sup> In no event should any ROE incentives be so large as to wipe out the cost savings and should, therefore, be subject to an upper limit. For example, if costs are 5% below the definitive estimate, the non-incentive ROE times the 5% savings sets the upper limit on what can be added to the ROE that is applied to the entire cost of the project.

Differentiation of Projects – Reliability, Public Policy, and Economic: In addition, in order for the applicant to receive financial incentives for projects which are built to improve economic efficiency (e.g., reduced congestion), but are not needed to meet reliability requirements or public policy objectives<sup>15</sup> (e.g., state or federal renewable energy standards), these projects must show greater benefits than costs, not only in the planning stage, but also at the time a Definitive Cost Estimate is filed with the Commission. At the second-step, these economic projects must continue to be cost-beneficial via the Definitive Cost Estimate, as would be required of all economic projects seeking performance-based incentives.

### **3. Cost-Effectiveness**

Finally, to assure that definitive cost estimates are not inflated, the SPP RSC recommends the Commission require that these Definitive Cost Estimates be detailed by cost components which have been reviewed and approved as reasonable by RTO stakeholders, including the state

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<sup>14</sup>Using the above example, assume the project comes in at \$850,000, 15% under the definitive estimate. The levelized fixed charge at 11% ROE goes down to \$87,929 per year for 30 years. To split the savings between shareholders and ratepayers, the levelized fixed charge should be targeted at \$95,688 per year and this is accomplished by raising the ROE to 12.73 %.

<sup>15</sup> A public policy project is defined as a portfolio of upgrades that have been found to minimize the overall cost of meeting the public policy objective. For example, the integration of wind into the SPP energy market involves a tradeoff between locating wind resource near load centers with lower transmission costs but higher capacity costs for wind generators, compared to locating wind resources in areas with the best wind resources with higher transmission costs but lower capacity costs for wind generators.

regulatory authorities involved, both in their state regulatory as well as their Regional State Committee roles. The purpose of this step is to ensure that the project is being designed in the most cost-effective manner. Also, for projects that are required to meet a benefit-cost test by the RTO's tariffs, this step would ensure that costs have not increased to the point where these projects are no longer cost-beneficial.

In addition, the SPP RSC recommends the Commission require regular updates that track the costs of the project during implementation as compared to the originally filed Definitive Cost Estimate. The implementation schedule should include both the expected dates for completion of various parts of the project and the associated costs.<sup>16</sup> This will provide a basis for filings that compare not only costs, but also schedule implementation. It is also recommended the Commission require that these updates be provided to the RTO as a part of their cost tracking process.

The SPP RSC also recognizes the vagaries associated with any type of construction and therefore also recognizes that, under its proposed second step, reevaluation of the Definitive Cost Estimate may be necessary. The SPP RSC, thus, additionally recommends that the Commission allow an approved applicant the opportunity to petition the Commission for a revision to its Definitive Cost Estimate if that estimate should exceed 10%, but that the Commission also requires the applicant to provide evidence that such costs increases were prudently incurred and

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<sup>16</sup> The PCTF recommended "the development and implementation of a Standardized Cost Estimate Reporting Template (SCERT) that will be utilized for all approved project cost estimates and applicable monthly/quarterly updates. The PCTF developed the SCERT by assessing the appropriate information to be provided in response to the SPP Project Tracking inquiries. The SCERT includes: (i) estimated/actual expenditures spent to date; (ii) estimate at completion; (iii) projected in-service date; (iv) direct and indirect costs; (v) AFUDC estimates and if project has CWIP in rate base; and (vi) proposed route map." The stated purpose of the SCERT is to: a) provide a consistent format among all estimates; b) facilitate the Project Tracking process; c) ensure the required level of detail is provided; and d) Facilitate the transition of a completed project into the proper Annual Transmission Revenue Requirement (ATRR) recovery process through SPP's OATT."

outside the control of the project developer. In this regard, the Commission should require that specific changes that have occurred be subject to review under the RTO stakeholder process<sup>17</sup> and that the RTO be required to make a recommendation to the Commission regarding any proposed change in the Definitive Cost Estimate. Any change to an applicant's Definitive Cost Estimate should require a final Commission finding.

The SPP RSC asserts that its proposed two step process effectively addresses three significant issues associated with the Commission's current incentive policy. First, it isolates and addresses separately the financial barriers to project development (its first step) at the time of initial project approval by the RTO from other risks related to building transmission (its second step) which may include regulatory approvals, environmental issues and cost uncertainties associated with specific transmission line routes requiring detailed engineering studies. Second, by providing a delay, until its second step, for the filing of a Definitive Cost Estimate, many of the regulatory, environmental and engineering uncertainties will have been resolved prior to requests for further incentives. This step in the recommended process provides more certainty and assurance as to the nature and amount of the costs for which incentives are sought. Third, and perhaps most importantly, the SPP RSC recommendation, which ties incentives to cost containment, removes any incentive for cost overruns and more appropriately balances the provision of incentives with just and reasonable rates. Under current incentive policy, ROE incentives have not been limited to original project estimates but applied to all subsequent costs.

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<sup>17</sup> The process recommending by the PCTF is that SPP establish a permanent Project Cost Working Group (PCWG) that would require periodic reports (at least quarterly) to the SPP staff, and the staff would inform the PCWG if cost estimates are expected to be above 10% of the definitive cost estimate. "If an Applicable Project deviates or is expected to deviate +/-20% from its established baseline cost, the DTO will immediately notify SPP staff detailing the cost variances with an updated SCERT with comments and explanations regarding the variances. The PCWG will oversee a quarterly report to be submitted to the MOPC, RSC, and BOD prior to their quarterly meetings."

This policy gives rise to either an indifference to or preference for excessive project costs resulting in related excessive consumer rates.

The SPP RSC asserts that its proposal as outlined herein offers the Commission the opportunity to meet both its mandate to encourage transmission investment through its policies with that of its mandate to continue to ensure just and reasonable rates.

### **III. QUESTIONS AND RESPONSES**

In this section of its comments, the SPP RSC has attempted matching its comprehensive approach to effectively provide for transmission incentives to the questions set out in the Commission's NOI.

**Q4. How can the Commission's rate incentives policies balance the need for regulatory certainty with the changing investment climate over time? Are there metrics the Commission should monitor to achieve this balance, and if so, what are they? Are there other factors that change over time that the Commission should consider in evaluating incentives applications? Should the Commission consider these changes over time on a generic or case-by-case basis?**

Adoption of the SPP RSC's recommended two step process requires that the Commission base its provision of incentives on both the state of capital markets related to utility investment and the individual needs of the project investor. In this regard, the SPP RSC recommends Commission staff monitor metrics of scarcity of financial capital, choosing those metrics from publicly available information and that, based on the accumulation of data, the Commission evaluate individual proposals for incentives within the proposed two-step process.

**Q6. Are there other factors or considerations which the Commission should consider as part of its transmission incentive policies, in order to be consistent with the goals of section 219?**

As previously discussed in the SPP RSC's comprehensive approach to transmission incentives, the Commission should require a cost-benefit test for the projects being built to improve economic efficiency to receive incentives. Such cost-benefit tests should be included in the RTO's tariff. In this regard, it is important for the Commission to include not only the Engineering and Construction costs in such cost-benefit test, but also to include the rate of return being requested, and a calculation of the costs that ultimate beneficiaries will have to pay.<sup>18</sup>

**Q9. How should the Commission best balance the promotion of transmission investment with the assurance of just and reasonable rates?**

In order to promote necessary, beneficial and prudent transmission investment that is consistent with just and reasonable rates the Commission should implement policies related to cost and schedule containment as well as providing incentives to overcome barriers to project development of transmission investment. In order to do this, the Commission should implement the comprehensive two step process recommended by the SPP RSC. The SPP RSC contends its recommendation appropriately balances the Commission's separate mandates to both encourage transmission investment and provide for just and reasonable rates.

As reflected in that recommendation, within the first step of the process, requests for incentives should relate only to financial barriers to project development. In this step, the applicant must identify whether the project is needed to meet reliability conditions, public policy goals or is estimated to be cost-beneficial in improving economic efficiency, and must include

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<sup>18</sup> The SPP currently provides a calculation of the costs that are allocated to each pricing zone for projects that have received a Notice to Construct (NTC) from the SPP Board.

estimates of the expected cost of the project, estimates of the maximum level, or cost cap, for the amount of capital needed, with an explanation of the uncertainties that result in the difference between the expected cost and the cost cap, the maximum ROE being requested, and the maximum equity component being requested in its capital structure. Any incentives granted in this step should be designed to address only the issue of capital scarcity and should primarily focus on financial needs and non-ROE incentives required to meet those needs. If not determined through a competitive solicitation process, the Commission should determine the appropriate ROE in this step through a properly executed DCF analysis.

In the second step, the applicant will submit to the Commission its Definitive Cost Estimate and schedule for implementation upon which any incentive for cost containment will be measured. Definitive Cost Estimates, including specific line routes, require detailed engineering studies and may also require state determination of the routes for the transmission project; both of which may occur a year or longer after the initial request for incentives. For projects requiring a cost-benefit test, such projects must continue to prove to be cost-beneficial.

For any projects, irrespective of the purpose for which it was approved, there should be a showing that the investment is cost-effective. This will require detailed elements for the cost estimate, and a determination that these estimates are not out of line with industry experience<sup>19</sup>.

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<sup>19</sup> In July 2011, SPP published on its website its *Study Estimate Design Guide* (Guide) which contains the standard criteria for development of transmission construction cost estimates. The Guide notes that “[t]his document outlines the Design Best Practices and Performance Criteria (DBP&PC) to be used by the Transmission Owner (TO) when developing Study Estimates for the SPP footprint projects rated at voltages of 100 kV and greater. These DBP&PC have been incorporated into this Study Estimate Design Guide and are intended to promote consistency in TO Study Stage estimates. Recognizing the importance of well defined scopes when developing cost estimates, this document also contains scoping guidelines for the Conceptual and Study estimate phases. These guidelines will promote mutual understanding of the project definition between SPP and the TOs as the project is developed and estimates are prepared for the applicable phase of the potential project. TO Study Estimate assumptions will be detailed in the Standardized Cost Estimate Reporting Template (SCERT) as used by the SPP project cost tracking process.”

The SPP RSC recommends that in order to ensure that projects chosen are cost-effective and, where applicable, cost-beneficial, they be reviewed and approved as reasonable by stakeholders,<sup>20</sup> including the state regulatory authorities involved, both in their state regulatory as well as in their Regional State Committee roles.

And finally under step two, once the Definitive Cost Estimate is accepted, the SPP RSC recommends application of a framework of incentives and penalties associated with: 1) incentives earned for being below the cost estimate or completing the project before scheduled completion date; and 2) incentives taken away for being above the cost estimate or completion of the project after the scheduled completion date.<sup>21</sup> It is the SPP RSC recommendation that incentives be set which adjust the ROE such that cost savings are shared equally between shareholder and ratepayer and that cost overruns, in excess of 10% of the estimate, are shared equally between shareholder and ratepayer.

**Q14. How should the Commission balance the value of and need for the requested incentives in promoting project development and financing with the potential uncertainty surrounding project scope?**

SPP RSC's recommended 2-step proposal directly addresses this issue. First, within its proposed initial step, project development and financing are promoted early in the planning

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<sup>20</sup> In its report, the SPP PCTF recommends that from the study estimate stage through the design and construction estimate stage, a standardized cost estimate reporting template (SCERT) be used by the DTOs in reporting their cost estimates to the SPP. In addition, subsequent to the Design and Construction Estimate, the DTO should provide quarterly updates to the SPP. If the estimated cost of the project exceeds +10%, a report would be forwarded to a new Project Cost Working Group for determination of whether or not to recommend to the SPP Board of Directors an increase in the baseline cost estimate or to restudy the project.

<sup>21</sup> Such incentives and penalties have effectively been used for interstate highway upgrades. For example, the upgrade of Interstate 64, which is a main artery from the west suburbs of Saint Louis, Missouri to the downtown area, used such incentives, and the project was completed before schedule. The schedule was critical, as this major artery was shut down during the two-year construction period, placing traffic congestion on other routes downtown to Saint Louis City.

process. The recommended proposal then provides a second opportunity to establish performance-based incentives later in that process by which time most of the uncertainties are identified and more assurances related to final cost can be provided.

Additionally, SPP RSC's proposed process requires not only a cost estimate but additionally a cost cap, with full explanation of the uncertainties which could cause the cost estimate to be exceeded. This requirement provides the Commission, at the developmental stage, a record of potential variances and impacts. At the second step, most of these uncertainties should be resolved, and the focus then turns to performance-based incentives for cost containment.

**Q15. Pursuant to section 219(b)(1), what steps could the Commission take to “promote reliable and economically efficient transmission and generation of electricity by promoting capital investment in the enlargement, improvement, maintenance, and operation of all facilities for the transmission of electric energy in interstate commerce”?**

Promotion of private investment for a public good faces a major pitfall – investments that are either not most cost-effective (e.g., transmission upgrades for reliability or to achieve public policy goals), or that are not most cost-beneficial (e.g., transmission upgrades for improved economic efficiency).<sup>22</sup> The Commission should, therefore, focus on promotion of transmission investments which avoids this pitfall. In this regard, the second step of the SPP RSC's proposed two-step process provides this protection by putting in place incentives for cost containment. In addition, within this second step, the SPP RSC also provides the crucial requirement that a reasonable base cost (i.e. Definitive Cost Estimate) is established which requires stakeholder

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<sup>22</sup> A portfolio of projects can include all three. SPP has an integrated transmission planning process that includes reliability, public policy and economic upgrades. Upgrades driven by integrating wind into SPP markets can correct some reliability issues, they can also create new reliability issues that must be addressed. Economic upgrades are typically projects that are added to or modifications of cost-effective solutions for reliability and public policy, whose addition to those solutions result in higher incremental benefits compared to their incremental costs.



review and approval including the state regulatory authorities involved, both in their state regulatory as well as their Regional State Committee roles.

**Q16. How would these steps affect other aspects of the Commission's rate-making policy?**

Of major concern to the SPP RSC under the Commission's current incentive policy is its provision of unconditional incentives for promotion of private investment in projects for public good. As noted previously, it is paramount that the Commission, as part of its appropriate ratemaking policy, avoid providing incentives for transmission investments that are not most cost-effective (e.g., transmission upgrades for reliability or to achieve public policy goals), or most cost-beneficial (e.g., transmission upgrades for improved economic efficiency). Adopting the SPP RSC's comprehensive approach to transmission incentives would enhance the Commission's overall rate-making policy by appropriately requiring that these cost objectives be met under the Commission's incentive policy which would then more closely mirror the Commission's ratemaking practices outside of providing incentives. It is the position of the SPP RSC that the policy of unconditionally granting incentives provides an incentive to investors to drive up costs in order to receive higher rates of return on larger amounts of investments and results in unjust and unreasonable rates. It is, therefore, imperative that these types of incentives be tied to cost and implementation containment as recommended herein.

**Q20. Would focusing on project characteristic or effects be a more effective means than focusing on a project's risks and challenges as the basis for granting incentives? What characteristics or effects would be appropriate for the Commission to consider for that purpose, consistent with section 219?**

Focusing on project effects would be a more effective means of achieving the goals of section 219. As previously recommended under the SPP RSC's comprehensive approach to

transmission incentives, tying incentives to aggregate benefits delivered by a transmission project and to cost containment would motivate developers to look for those projects that would deliver the most value to consumers, and through cost containment, would maximize benefits over costs.

**Q29. Should the Commission limit the application of incentives to the cost estimate utilized for including or retaining the project in the plan submitted through the regional planning process? If so, which incentives should be applied to the cost estimate, and which should be applied to all prudently incurred costs?**

As addressed previously herein, cost estimates used in the regional planning process (i.e., at the developmental stage, study cost estimates) are not Definitive Cost Estimates and have been shown to be off by as much as 50% when compared to estimates established at latter stages of development in which engineering studies have been performed on specifically determined line routes and more details are known.<sup>23</sup> The Commission currently sets incentives based on cost estimates made at the time those incentives are requested. Application of that incentive adder to unlimited future costs rather than limited to an appropriately determined cap will likely encourage overspending and result in unwarranted ratepayer cost. Therefore, it is the SPP RSC position that incentive mechanisms should be designed to reward utilities that succeed in reducing costs, expanding services, and streamlining operations and should not be used as a safety net that unnecessarily shifts project risk from developers to the ratepayers.

The SPP RSC recommendation appropriately addresses this unwanted result through its two-step process. The first step of the process, which deals with financial barriers to project

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<sup>23</sup> It was seeing very large increases in cost estimates as projects moved from the study phase to the definitive cost estimate stage that caused the SPP RSC to raise questions regarding the cost estimation process being used at the SPP. The work of the PCTF was in response to those questions.

development, is implemented before a definitive estimate is available. However, under the SPP RSC recommendation a cap would be placed on the costs to which these incentives for capital scarcity would apply.<sup>24</sup> The proposed second step is implemented after a Definitive Cost Estimate is submitted, and any additional incentives and penalties would be based on performance relative to the Definitive Cost Estimate and scheduled time for completion.

**Q30. How could such an approach be implemented? Would this approach work in all regions of the country? What processes for developing, evaluating, and updating cost estimates must be in place within regional transmission planning processes to facilitate such an approach?**

The SPP RSC proposed two-step process appropriately identifies two separate mechanisms which respectively provide appropriate incentives to address capital scarcity issues that are based on information available during the developmental stage and allow incentives for effective cost and schedule containment which are based on information in the mature stages of development. The SPP RSC recommendation requires additional reporting which, within the SPP region, reflects the prudent processes currently in place for both design and cost reporting, as discussed previously, and is easily adapted to the proposed comprehensive process recommended. Prudent review and reporting and design requirements should already be in place for transmission planning and on-going projects in all regions. These types of currently effective prudent procedures can be incorporated with the SPP RSC proposed process for incentives, matching the timing proposed for each step.

The steps set out in the SPP RSC's comprehensive approach to transmission incentives could be implemented in regions of the country where either RTO stakeholder review of

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<sup>24</sup> As indicated previously, the report of the PCTF indicates that study estimates submitted by the designated transmission owners should have a cap of +30%.

Definitive Cost Estimates is in place or state regulatory approval of Definitive Cost Estimates has taken place.

**Q31. If a change in cost estimate is not due to the failure to contain costs but instead reflects the real cost in building the proposed transmission line, should the Commission take that consideration into account, and if so, how?**

Actual resultant costs of transmission expansion may or may not reflect prudent and cost effective expenditures. Therefore, as recommended within its proposed two step process, the SPP RSC proposal limits the application of incentives under both steps one and two, with a subsequent Definitive Cost Estimate required under step two which may be exceeded up to 10% of the estimate provided. At the same time, the proposal allows a petition to the Commission for redetermination of the Definitive Cost Estimate, presenting evidence to the Commission for support of the proposed change in the definitive estimate as prudent and that the increases in cost were outside the control of the project developer. The SPP RSC recommendation would also require that, with the details of the Definitive Cost Estimate in evidence and a determination that this estimate is consistent with industry experience, the RTO stakeholder process must first review the specific changes that have occurred and make a recommendation to the Commission regarding the estimate change. The Commission would then make a final determination of whether or not the Definitive Cost Estimate should be increased.

**Q32. Should new reporting requirements be in place to allow the Commission to audit compliance with a requirement to limit incentives to some project cost estimate?**

Yes. As recommended in the SPP RSC's comprehensive approach to transmission incentives, the Commission should require regular updates that indicate how well the project implementation is doing compared to the Definitive Cost Estimate. The implementation schedule

should include expected dates for completion of various parts of the project and associated costs. This will provide a basis for filings that compare not only costs, but also schedule implementation. The Commission should require that these updates be provided to the RTO as a part of their cost tracking process.

**Q35. What risks and challenges are appropriately addressed by the incentive ROE adder? Is it appropriate for the Commission to evaluate these risks and challenges on a project-by-project basis or on an aggregate basis for the applicant?**

The SPP RSC does not support the current policy related to ROE adders. As previously recommended by the SPP RSC under its proposal in step one, for those applicants that can show a need for incentives due to capital scarcity, only risks and challenges that cannot be reduced through non-ROE incentives or other project-tailored Commission provision should be considered for granting a higher ROE. However, the appropriate higher ROE applicable in this step should either reflect the results of a competitive solicitation process or a properly executed DCF analysis which will capture the current market conditions, and the applicant's specific financial situation. The SPP RSC supports adjustments to ROE under its second step which are tied to cost and schedule containment.

**Q37. Does the base ROE adequately compensate investors for the financial risk of the company, including risks associated with the particular transmission project for which incentives are sought?**

To the extent that non-ROE incentives which address financial barriers are granted, ROE incentives are not necessary. As stated previously, the base ROE determined through a properly executed DCF analysis or a competitive solicitation process adequately compensates investors for the financial risk of the company, including risks associated with transmission projects that have been approved through the RTO planning process.

The SPP RSC does not recommend that the Commission attempt to make an administrative determination of the “risks associated with the particular transmission project for which incentives are sought,” when an applicant has not undergone a competitive solicitation process. Under the SPP RSC proposal, use of a competitive selection process is an option whereby applicants are required to submit offers that include both a cost cap and an ROE cap. In this selection process, applicants clearly reveal their willingness to take on cost risk by submitting a lower cost cap, and the compensation they require to take on greater risk by submitting a higher ROE cap. Absent a competitive process, there is no reason to believe that the higher ROE being sought is appropriate to the risks associated with a particular transmission project.

**Q38. In determining the incentive ROE adder, should the Commission make a distinction between financial barriers to transmission development such as the ability to attract capital, and regulatory barriers, such as siting or environmental challenges? If so, how?**

Yes, as recommended by the SPP RSC in its comprehensive approach to incentives, its two-step process recognizes the distinction between financial barriers to transmission development and other incentives to promote appropriate cost and schedule containment. The first step of the proposed comprehensive approach to incentives addresses financial barriers to transmission development by focusing on the applicant’s ability to attract capital. The second step of the proposal addresses regulatory barriers, such as siting or environmental challenges, by requiring these uncertainties to be resolved prior to submitting a Definitive Cost Estimate.

**Q40. In determining the incentive ROE adder, how should the Commission balance the impact of other risk-reducing incentives (such as CWIP and abandoned plant recovery)?**

The determination of appropriate level of return on equity is inextricably tied to the level of risk for a project. In the first step of the reforms being proposed herein, the SPP RSC recommends that no incentive ROE be applied. The SPP RSC notes that, when granting incentives that reduce risk (such as abandoned plant recovery and CWIP), the Commission must incorporate the impact of those factors upon its determination of the overall level of ROE to ensure rates are just and reasonable. Appropriately, projects which were granted risk reducing incentives should not be granted incentive ROE adders that move the overall ROE beyond the midpoint of the zone of reasonableness in a DCF analysis that properly takes into account financial market conditions and the financial condition of the applicant through comparison to companies with comparable corporate risk/return profiles. Indeed, because these measures lower the risk to transmission companies, higher, incentive ROEs are not necessary or appropriate.

However, should the Commission reject the SPP RSC recommendation under its step one, the Commission should consider first applying non-ROE incentives and, once these are established, determine if a higher ROE is really necessary.

**Q41. Does regulatory assurance of cost recovery, either at the state or regional levels, mitigate the risks and challenges facing a transmission project? If so, how should the Commission give consideration to this mitigation in evaluating a request for incentive ROE adder based on a project's risks and challenges?**

As addressed previously, the SPP RSC asserts that a properly executed DCF in determining ROE will appropriately capture all risks evident both in current markets and for individual companies. In setting ROE, an appropriately executed DCF will give consideration to all regulatory assurances which mitigate the risk and challenges facing transmission projects

relative to the general corporate risks facing the sample companies employed. Regulatory assurance of cost recovery at any level certainly mitigates the downside risk of under recovery of and on investment. Thus, projects that are approved by an RTO in a regional planning process will have significantly lower downside risk of under recovery.<sup>25</sup> While additional transmission infrastructure is needed, the Commission must keep the costs of that additional infrastructure within reasonable bounds to ensure just and reasonable rates. This is the primary function of step two in the reforms proposed herein.

**Q42. Is it appropriate to promote voluntary formation of Transcos, as defined in Order No. 679, through an ROE adder? Would other incentives promote Transco formation more effectively?**

First, it is the position of the SPP RSC that the Commission's provision of incentives for transmission investment should be indifferent to the corporate entity making that investment. The SPP RSC understands that the Commission's intent in its incentive policy here may be to encourage competition for transmission investment. However, by offering ROE adders for Transco formation, the Commission is not only providing encouragement from independent investors to form Transcos, but is also providing an incentive for utility companies to restructure their current operations and form Transcos for the sole purpose of artificially increasing profits. In addition, that newly formed transmission affiliate has the benefit of the utility's financial position, may need no incentive to attract capital, and would enjoy a competitive advantage over an independent Transco which would thwart the Commission's intent here in offering incentives. The result would, therefore, be simply a higher cost to ratepayers without justification, violating the Commission's mandate to set just and reasonable rates.

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<sup>25</sup> This includes having a cost allocation in place which determines who will pay for the transmission upgrade.



If the Commission determines that there are benefits to promoting the voluntary formation of Transcos using incentives, the SPP RSC recommends that any ROE adder should be available strictly to stand-alone transmission companies that have no affiliation with a utility and only in the case where the independent transmission company has undergone a competitive solicitation that includes a cost cap as well as a cap on ROE.

**Q43. Order No. 679 does not distinguish between Transcos that are independent of generation owning market participants and Transcos that are affiliated with such market participants. Would such a distinction be appropriate in terms of eligibility for, or the amount, of a Transco adder?**

See answer to question 42. If the Commission finds it necessary to provide incentives for Transcos, these incentive adders should be limited to Transcos that qualify as stand-alone transmission companies with no utility affiliation and have undergone a competitive solicitation process that includes a cost cap as well as a cap on ROE.

**Q44. Further, Order No. 679 did not distinguish between Transcos that result from divestiture of a vertically-integrated utility's existing transmission system and Transcos that are created for the purpose of developing a particular new transmission facility. Would such a distinction be appropriate in terms of eligibility for, or the amount of, a Transco adder?**

The question appears to address the formation of a Transco by a group of utilities to combine their expertise and their knowledge regarding their specific service territories for the construction of different types of facilities (such as 765 kV or DC lines). It is the SPP RSC's recommendation that the Commission consider special projects on a case-by-case basis.

In this regard, the Commission should consider whether the circumstances warrant incentives to be applicable to this type of Transco and must be cautious that providing this incentive will not result in a competitive advantage for this type of Transco. Moreover, the Commission should have significant assurance that the Definitive Cost Estimate submitted by

this type of Transco is reasonable and will result in lower overall costs when compared to more traditional transmission facilities. This can be accomplished by requiring the transmission planning process to compare special types of upgrades proposed by these types of Transcos to more traditional facilities that can meet the same requirements. Once alternative transmission plans are formulated, the Commission should also require a competitive solicitation process that requires an evaluation of benefits compare to expected costs as well as a cost cap and a cap on ROE.

**Q47. Should the existing 50 basis point adder be increased to better encourage the formation and continuance of RTO/ISO arrangements?**

No. There is no evidence to support additional incentives are needed for either attracting or retaining membership within an RTO/ISO arrangement.

**Q49. How does the current incentive allowing recovery of 100 percent of prudently incurred abandoned plant costs affect the sharing of risks between investors and customers? Are there reasonable conditions or safeguards that could be imposed to ensure risks are appropriately allocated? For example, should recovery of abandoned plant costs be exclusive of carrying charges? Should carrying charges exclude any ROE incentive?**

The Commission's current policy allocates 100% of the risk of abandoned plant to ratepayers. The SPP RSC notes that 100% recovery could be considered appropriate if it is determined, within an appropriately conducted stakeholder process of an ISO/RTO, that abandoning one project and starting an alternative project would be more cost effective. However, it is the recommendation of the SPP RSC that the Commission evaluate all requests for recovery of abandoned plant on a case- by-case basis.

The SPP RSC provides, within its proposed comprehensive approach to incentives, appropriate treatment for any abandoned plant which the Commission has deemed a necessary

incentive for financial barriers to transmission investment. In that recommendation, the SPP RSC recommends abandoned plant recovery (a) be conditioned on appropriate review and the approval of the project cancellation through the RTO stakeholder process, (b) be amortized over a period of time giving consideration to both the magnitude of the amount to be recovered and resulting rate impact, (c) allow, in the amount to be recovered, only the interest on debt incurred during construction, and (d) provide for a Commission determined interest rate applicable over the amortization period.

**Q52. Some interveners in various transmission incentives proceedings have raised concerns that the incentive of allowing 100 percent recovery of prudently-incurred abandoned plant costs could encourage applicants to pursue projects of greater risk. How should the Commission consider and address this factor?**

The SPP RSC notes that risk assessment should be already incorporated into an ISO/RTO planning process. The Commission should require the RTO planning process provide clear written direction related to risk assessment and that an analysis of the risks of alternatives be subject to complete stakeholder vetting and full transparency as part of the final determination of the ultimate choice of projects. As part of the planning process, transmission planners need to account for cost-side risks in developing a range of likely costs. (For example: a transmission upgrade through existing right of way has a lower risk than transmission planned along new right of way; transmission through or close to environmentally sensitive land will have a higher risk of being rerouted than transmission that is more distant from these areas; or certain types of non-standard transmission upgrades may have higher risks than more standard types of upgrades. All of these various risk factors should be taken into account in the RTO planning processes.) .

In the case of upgrades associated with improved economic efficiency, the benefits from various projects may have different risks. The SPP RSC suggests that sensitivity analysis be used to determine comparable ranges of benefits for alternative projects and, thus, ultimately, projects will be chosen in a way that takes into account varying risks associated with competing alternatives. At this time, the SPP RSC is not recommending a formulaic approach, as this type of analysis is in its beginning stages. But the Commission should set a policy that requires transmission planners to include and evaluate risks related to both costs and benefits.

**Q55. If a project developer is granted the incentive for 100 percent recovery of abandoned plant costs, but is denied a request to recover abandoned plant costs under this incentive, then is it appropriate to recover those costs through other accounting treatments in a subsequent section 205 filing? If so, what accounting treatments would be appropriate?**

The form of recovery the SPP RSC supports for abandoned plant in all cases is amortization of the costs over an appropriate period of time with the application of an appropriate interest rate. The appropriate period of time should be determined by the amount to be amortized and its impact on rates.

**Q56. If a utility receives recovery of abandoned plant costs incentives and subsequently abandons its project, what rate of return (including incentive ROE adders), if any, should be applied to the abandoned plant costs until the costs are ultimately recovered in rates?**

In its proposed comprehensive approach to incentives, the SPP RSC recommends that *no* ROE be allowed on any abandoned plant recovery and, as such, certainly no incentive ROE adders. While the SPP RSC understands that normally a return allowed on plant is based on some combination of the equity and debt of the investing company, clearly abandoned plant recovery is unique. As addressed previously, the SPP RSC asserts that recovery of the full costs of abandoned projects, which includes interest paid to fund those projects and interest on any

unrecovered balance, provides sufficient incentive to overcome financial barriers to investment. Fairness dictates that ratepayers should not be required to fund any additional “profit” on plant that has never been in service<sup>26</sup>. And, importantly, the SPP RSC recommendation appropriately balances this incentive with the Commission’s mandate to establish rates which are just and reasonable.

**Q 63) Is there a reasonable debt to equity split, or a procedure for determining such, that should be applied generally to future applications, or that can be applied generally to classifications, such as a general split for publicly owned projects and a general split for investor owned projects? Or is this best suited for case by case determination? What kind of information should an applicant provide in order to support an application for a hypothetical capital structure?**

Granting a hypothetical capital structure with a higher than actual level of equity component of the company investing in a transmission project has the same result as granting a higher ROE; i.e., raising costs to ratepayers and giving higher earnings per share to shareholders. Therefore, the debt-equity ratio is as critical an element to both the DCF analysis and the competitive selection process as the ROE. The Commission should consider placing a cap on the equity component for applicants requesting and showing a need for a hypothetical capital structure,<sup>27</sup> and competitive selection processes should also include the applicant submitting a cap on equity for any request it might make of the Commission for a hypothetical capital structure.

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<sup>26</sup> For example, \$1 Million amortized over a 10 year period at a 6% interest rate results in a levelized fixed charge of \$135,868 per year. If an ROE of 11% is allowed on 50% of this amount, then the levelized fixed charge increases to \$171,208 per year. This is a 26% increase in cost to ratepayers coming not only from the higher ROE on 50% of the amortized amount but also from the taxes paid on this return.

<sup>27</sup> For example, a cap on equity was filed in Docket No. ER09-548-000 on page 6 of the **Exploratory Statement in Support of the Settlement Agreement** where it states: "The Settlement Terms cap the equity component of ITC Great Plains' capital structure at 60%, calculated on the basis of a 13-month average."

#### **IV. CONCLUSION**

The SPP RSC provides herein a comprehensive approach to policies for the encouragement of transmission investment and with that recommendation answers many of the questions the Commission raises regarding its current transmission investment incentive policy. The SPP RSC recommends the Commission reevaluate its current application of ROE adders as a standard incentive and that it consider adoption of the SPP RSC proposed two-step process, by which the Commission would first address any financial barriers to project development of transmission investment using non-ROE incentives and subsequently offer performance-based incentives for appropriate cost and schedule containment for transmission construction. The SPP RSC recommendation provides a balanced and equitable approach to encouraging transmission investment while ensuring that Commission policies continue to result in just and reasonable rates.

# SPP RSC Comments on FERC NOI on Transmission Incentives

CAWG Proposed Comments

## Basic Overview

- The FERC asks if incentives for financial barriers to project development should be separated from project specific risks.
- The basic premise of the proposed comments is a two-step process that occurs at different times:
  - First Step occurs at the project development stage and relates to financial barriers that an applicant is facing.
  - Second Step occurs at the time that the project has a definitive cost estimate where many if not most of the uncertainties related to project costs are resolved.

## First Step: Incentives for Financial Barriers

- Incentives only include non-ROE incentives
  - Recovery of abandoned plant – requires RTO approval, including Regional State Committee
  - CWIP – requires cash flow constraints where expenses (including interest expense) exceeds revenues.
- ROE Determination
  - Competitive Solicitation that includes caps on costs and ROE.
  - DCF analysis that takes into account market conditions and specific financial conditions of the applicant.

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## Second Step Incentives Performance-Based

- Sets cost base at definitive cost estimate.
- Costs below definitive estimate receive a higher ROE, with a 50% sharing between ratepayers and shareholders.
- Costs more than 10% above definitive estimate receive a lower ROE, with a 50% sharing between ratepayers and shareholders.

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## Limits and Requirements

- Any applicants receiving incentives in step 1 are required to submit in step 2.
- Any applicant receiving incentives in step 1 are limited to the cost plus ROE cap (revenue recovery) in step 2.
- Those not asking for incentives in step 1 can file for performance based incentives in step 2.

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## What Does the Two-Step Proposal Accomplish?

- Deals with the difficult issue of granting incentives for project development whose costs significantly increase when uncertainties regarding specific routes and construction costs are resolved.
- Provides a rational basis for determining ROEs, based on financial barriers rather than uncertainties that are resolved prior to construction.
- Introduces performance-based incentives needed for cost and schedule containment:
  - Incentive to having projects built on time and under budget; and
  - Prevents ROE incentive adders being applied to cost overruns.

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## Other Recommendations

- No ROE Incentives for Transcos, but if any, they be limited to Independent Transcos
  - Prevents setting up Transcos as utility affiliates just to earn a higher ROE.
- No additional ROE incentives to incent joining RTOs
  - No evidence supporting that incentives attract or retain membership in RTOs.
- Abandoned plant cost recovery should not include ROE
  - Should include only interest costs incurred during construction and apply FERC interest rate over amortization period.
- Cap on Debt/Equity ratios be required in competitive selection process and taken into account in Commission's determination of ROE in step 1 DCF analysis.
  - Higher equity components increase costs to ratepayers and a cap should be required whether using a competitive selection or DCF analysis to determine ROE.

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