STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

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January 10, 2006

Honorable Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Room 1-A209
Washington, D.C. 20426

Re: Docket No. RM06-4-000 – Promoting Transmission Investment through Pricing Reform

Dear Secretary Salas:

For filing, please find the Notice of Intervention and Comments of the New York State Public Service Commission in the above-entitled proceedings. Should you have any questions, please feel free to contact me at (518) 473-8178.

Very truly yours,

David G. Drexler
Assistant Counsel

Attachment

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment through Pricing Reform	) Docket No. RM06-4-000)

NOTICE OF INTERVENTION AND COMMENTS
OF THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK

On November 18, 2005, the Federal Energy Regulatory Commission (FERC or Commission) issued a Notice of Proposed Rulemaking (Notice) seeking comments on proposed regulations implementing provisions of the Energy Policy Act of 2005 (2005 Act), which mandates incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities.[1] These incentives are intended to benefit consumers by ensuring system reliability

[1] Specifically, the 2005 Act requires FERC to establish rules to: 1) 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, regardless of the ownership of the facilities; 2) provide a return on equity that attracts new investment in transmission facilities (including related transmission technologies); 3) encourage deployment of transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities and improve the operation of the facilities; and 4) allow the recovery of all prudently incurred costs necessary to comply with mandatory reliability standards established pursuant to section 215 of the FPA, and all prudently-incurred costs related to transmission infrastructure development, pursuant to section 216 of the FPA (transmission national interest corridors). FPA §219.

and reducing the cost of delivered power through reduced transmission congestion.

The New York State Public Service Commission (NYPSC) hereby submits its Notice of Intervention and Comments pursuant to the Notice and Rule 214 of FERC's Rules of Practice and Procedure. Copies of all correspondence and pleadings should be addressed to:

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EXECUTIVE SUMMARY

The NYPSC supports Congress' mandate to develop incentives that promote investment in transmission facilities. Transmission infrastructure acts as the backbone of the electric grid, and ensuring that it functions efficiently and effectively will further the goals of enhancing reliability and reducing consumers' costs for electricity. As part of this effort, it is also critical that proper economic signals are sent to investors and that barriers to investment are minimized.

The Commission should carefully craft incentives to avoid investments in inefficient facilities, which may ultimately result in unnecessarily higher consumer costs.[2] Providing inefficient incentives could affect the economics of transmission alternatives, such as generation and demand response, and artificially favor transmission projects over other alternatives, which may be more efficient and economical.

The Commission should also limit its proposal to allow the recovery of costs of abandoned facilities. Allowing such recovery by merchant developers would be antithetical to the market, as the participation of such developers in electric markets is premised on their assumption of financial risks. Expanding incentives for merchant developers to recover the costs of abandoned facilities would shift that risk to ratepayers and could unnecessarily raise costs. Moreover, such recovery is not appropriate in places like New York, which utilize a planning process that publicly announces congestion costs and future reliability needs, and allows for market-based

[2] The Commission proposes the following incentive-based rate treatments for investments by public utilities in new transmission capacity: 1) a return on equity sufficient to attract new investment in transmission facilities; 2) 100% of prudently incurred Construction Work in Progress in rate base; 3) recovery of prudently incurred pre-commercial operations costs; 4) hypothetical capital structure; 5) accelerated regulatory book depreciation; 6) recovery of 100% of prudently incurred cost of transmission facilities that are cancelled or abandoned due to factors beyond the control of the public utility; 7) deferred cost recovery; and, 8) other just and reasonable and not unduly discriminatory or preferential incentives.

solutions to meet those needs. This process allows merchant developers to step forward with solutions in the first instance if economically viable.[3]

The Commission should also clarify that its incentives for public utilities will not apply to those that have already joined a Transmission Organization.[4] If the Commission's purpose is to provide a financial incentive for public utilities to transfer control of their transmission assets to a Transmission Organization, and the utilities have already transferred operational control, then an added return on investment serves no purpose.[5] Moreover, such incentives would be duplicative

[3] Only when market-based solutions are not forthcoming, regulated backstop solutions to maintain reliability are provided for by traditional transmission-owning entities. New York Independent System Operator, Inc. (NYISO), Open Access Transmission Tariff, Attachment Y.

[4] The term "Transmission Organization" is defined under the 2005 Act to include a Regional Transmission Organization, Independent System Operator, independent transmission Provider, or other transmission organization finally approved by the Commission for the operation of transmission facilities.

[5] New York’s IOUs have already divested essentially all of their generation assets from their transmission assets and transferred operational control over the transmission facilities to the NYISO. See, e.g., Case 96-E-0897, In the Matter of Consolidated Edison Company of New York, Inc.’s Plans for (1) Electric Rate/Restructuring Pursuant to Opinion No. 96-12; and (2) the Formation of a Holding Company Pursuant to PSL, Sections 70, 108 and 110, and Certain Related Transactions, et al., Opinion and Order Adopting Terms of Settlement Subject to Conditions and Understandings (issued November 3, 1997); see also, Case 99-E-0745, Joint Petition of Central Hudson Gas & Electric Corporation, et al. (issued August 19, 1999).

where investor-owned utilities (IOUs) and public authorities, such as those in New York, were previously provided incentives for divesting their generation and cooperating in the development of the NYISO.

Finally, we ask that the Commission establish specific criteria for transmission projects to demonstrate that they achieve Congress' goals of promoting reliability and economic efficiency, before such projects receive an incentive. For example, a demonstration that the benefits of a transmission project will exceed the costs of the project may be appropriate. Establishing such criteria through a separate technical conference or notice and comment rulemaking would act to prevent over-development of transmission and keep prices from rising unnecessarily.

DISCUSSION

I. The Commission Should Carefully Craft Incentives To Avoid The Construction Of Inefficient And Unnecessary Facilities That May Ultimately Raise Prices

Although the NYPSC supports the use of incentives to further enhance reliability and reduce costs through the construction of transmission facilities, we encourage the Commission to carefully craft these incentives to avoid investments in inefficient facilities that result in unnecessary consumer costs. Incentives weighted so heavily toward transmission projects could affect the economics of generation or demand response alternatives, which may be more efficient and economical.

Providing only transmission developers with incentives would give such projects an advantage over generation or demand-response solutions, and could interfere with market signals for the efficient construction and operation of transmission and generation resources. For example, the NYISO already provides price signals for efficient market-based investments through energy congestion rents resulting from locational pricing, and capacity congestion rents resulting from locational installed capacity payments.[6] These price signals are used to identify where transmission and generation expansions will be most efficient and economical.[7]

We recommend, therefore, that the Commission tie transmission investment returns closely to the risks associated with those investments. While the Commission seeks comments on whether alternatives to using a discounted cash flow (DCF)

[6] Market rules for transmission expansion are currently under review at the NYISO and are being developed to ensure that transmission congestion contracts and Unforced Capacity deliverability rights are being provided to transmission developers.

[7] As noted below, the NYISO's planning process has begun to provide market participants with information on congestion to facilitate the identification of transmission investment opportunities.

analysis should be used,[8] we urge the Commission to complete an exhaustive study of any such alternatives before choosing to employ them. Until alternative approaches are carefully analyzed, we support the use of a DCF analysis as an appropriate means to determine a return on equity that reflects commensurate risks and thus would attract new investments. The DCF approach produces returns that have exhibited limited volatility recently because they tend to track interest rates fairly close over time. However, we do not support the use of return on equity adders in addition to DCF analysis because it may interfere with efficient market outcomes by providing a greater return than is commensurate with the investment risk.

We also suggest that developers be required to demonstrate a need for including Construction Work In Progress in rate base.[9] While this proposal may be appropriate in some cases, such as where a developer is facing restricted cash flow, it may be unnecessary in others. In addition, we note that a 15 year timeframe for recovery of transmission investments appears to be an unduly short period for facilities that have much longer

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[8] Notice at ¶20.

[9] Notice at ¶23.

useful lives and are typically depreciated over periods between 40 and 65 years.[10]

II. <u>The Commission Should Not Allow Merchant Developers To Recover The Costs of Abandoned Facilities</u>

The Commission proposes to authorize "incentive-based rate treatments for investment by public utilities, including Transcos, in new transmission capacity that reduces the cost of delivered power by reducing transmission congestion and ensures reliability."[11] One such incentive would "permit recovery of 100 percent of the prudently incurred costs of transmission facilities that are cancelled or abandoned due to factors beyond the control of the public utility because it will reduce regulatory uncertainty associated with investments in new transmission capacity and therefore meet the objectives of [the] FPA."[12]

Because this incentive would apply to merchant developers whose projects are canceled or abandoned, the Commission should clarify that this incentive would not apply to those merchant

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[10] Notice at ¶30.

[11] Notice, Proposed Regulation §35.35(d)(1). A Transco is defined as a "stand-alone transmission company that has been approved by the Commission and that sells transmission services at wholesale and/or on an unbundled retail basis, regardless of whether it is affiliated with another public utility."

[12] Notice at ¶34.

projects.[13] Allowing such developers to recover these costs would defeat the purpose of moving toward deregulated markets. Merchant developers assume the financial risks associated with undertaking a project, in exchange for the ability to reap the rewards of market-based prices.

Moreover, allowing merchant developers to recoup their costs for facilities they have canceled or abandoned would be an unnecessary incentive. The NYISO administers a Comprehensive Reliability Planning Process (CRPP) that identifies reliability needs ten years in advance and provides mechanisms for ensuring those needs are met. Under this CRPP, merchant developers may propose projects that satisfy identified reliability needs, and where a market-based solution is not forthcoming, IOUs may be called upon to provide a regulated backstop solution.[14] Therefore, the IOUs are ultimately responsible for ensuring that

[13] A "public utility" is defined as "any person who owns or operates facilities subject to the jurisdiction of the Commission," which include facilities used for the "transmission of electric energy in interstate commerce and…the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. §824.

[14] We support allowing the recovery of abandoned facilities in situations where an IOU undertakes a backstop solution, but subsequently halts its project in deference to a viable market-based solution that meets the same reliability need. In such cases, the utility is entitled to recover all reasonably incurred costs through the time of cancellation, including any forward commitments made. NYISO Open Access Transmission Tariff, Attachment Y.

reliability needs identified by the NYISO are met. Consequently, there is no need to incent merchant developers in order to meet reliability needs.

III. **<u>The Commission Should Limit Incentives For Utilities That Have Already Joined Transmission Organizations</u>**

Section 1241 of the 2005 Act requires the Commission to "provide for incentives to each transmitting utility or electric utility that joins a Transmission Organization" and "ensure that any costs…[are] recovered by such utility. While New York supports Congress' goal of encouraging participation in independent Transmission Organizations, incentives should only be provided for utilities that have not already joined a Transmission Organization. If the purpose is to incent public utilities to join these organizations by transferring control of their transmission facilities and they have already done so, than added returns on equity serve no purpose. Thus, a FERC-approved increase in New York IOUs' returns on equity would not be an incentive, but rather an unnecessary burden on consumers. The New York IOUs have already received various incentives in exchange for divesting their generation facilities and cooperating in the development of the NYISO. Moreover, the IOUs have been authorized by the Commission to recover their costs incurred in joining the NYISO, through a schedule of charges.[15]

IV. **The Commission Should Establish Specific Criteria For Demonstrating That A Transmission Project Promotes Reliability And Is Economically Efficient**

As mandated by Congress, the Commission is charged with developing incentives that "promote reliable and economically efficient transmission and generation of electricity…"[16] However, the Notice does not propose any criteria or definitions to determine whether a project meets Congress' stated goals, beyond reducing transmission congestion costs, which is a low threshold. Because this low threshold would be relatively easy to meet, it could result in an over-development of transmission in a very short period of time.[17] Therefore, we recommend that the Commission commence a separate technical conference or notice and comment rulemaking to establish criteria for projects to demonstrate that they meet the goals of promoting reliability and economic efficiency. For instance, criteria may be appropriate to demonstrate that the benefits of a transmission

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[15] See, 92 FERC ¶61,180 (2000), Letter Order (approving settlement resolving all issues related to the recovery of the costs associated with the start-up and formation of the NYISO).

[16] 2005 Act §219.

[17] The NYISO already utilizes a planning process to identify transmission facilities needed to ensure reliability, and provides compensation for IOUs that invest in such facilities, making incentives unnecessary in those cases.

project will exceed the costs of the project. Any such criteria that are established should be satisfied before a projects is provided with an incentive.

CONCLUSION

We request that the Commission revise and clarify its final regulations in accordance with the comments above.

Respectfully submitted,

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