

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's  
Electric Transmission Incentives  
Policy

Docket No. PL19-3-000

**COMMENTS OF THE CALIFORNIA  
DEPARTMENT OF WATER RESOURCES STATE  
WATER PROJECT**

The California Department of Water Resources (“CDWR”) State Water Project (“SWP”) appreciates the opportunity to comment on the March 21, 2019 Notice of Inquiry regarding the Commission’s transmission incentives policy.<sup>1</sup> As the largest single ratepayer in California, transmission costs are of crucial importance to SWP. Likewise, SWP is keenly interested in ensuring that transmission is planned and developed in a coherent and intelligent fashion.

The Commission’s inquiry is timely. California ratepayers face spiraling transmission costs spread over a smaller demand base, as loads statewide are decreasing. Accordingly, SWP seeks ways to ensure that needed facilities continue to be constructed and maintained in cost-effective ways. California has seen great successes in its competitive solicitation processes, and SWP welcomes the continued—if not expanded— injection of competition into the transmission planning process. To the extent that the Commission implements policy changes, SWP urges the Commission to consider actions that will target incentives more precisely, and permit them only where there has been a compelling demonstration of need. From our perspective, competition and the natural

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<sup>1</sup> *Inquiry Regarding the Commission’s Electric Transmission Incentives Policy*, 166 FERC ¶ 61,208 (2019).

benefits of owning transmission can, in many cases, be relied upon to produce positive outcomes for customers without awarding costly incentives.

## **I. COMMUNICATIONS**

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## **II. CDWR**

CDWR is an agency of the State of California headquartered in Sacramento. It is responsible for monitoring, conserving, and developing California's water resources, providing public safety, and preventing property damage related to water resources. A primary responsibility of CDWR is the construction, operation, and maintenance of SWP.

SWP is the largest state-owned, multi-purpose water project in the country. Its operations are critical to the resources and economy of the state. SWP's system spans nearly the entire state, from Lake Oroville in Northern California to the Pyramid, Castaic,

Silverwood, and Perris reservoirs in Southern California. SWP delivers an average of 3.3 million acre-feet of water per year to twenty-nine public agency water contractors throughout California. Approximately 40% of the deliveries are used to irrigate some 750,000 acres of farmland. The rest of the deliveries serve the water needs of more than twenty-four million Californians.

SWP's water conveyance system includes twenty-nine water storage facilities; approximately 675 miles of aqueducts and pipelines; twenty-one pumping plants; three pumping-generating plants; and five hydroelectric power plants. SWP's power-generating sources have capacity of over 1,900 megawatts, and generate an average of five billion kilowatt-hours of energy per year. SWP's pumping facilities have a combined demand of approximately 2,600 megawatts and consume an average of nine billion kilowatt-hours of energy per year. In addition to the output from SWP's hydroelectric facilities, SWP receives power under long-term contracts. SWP manages its power operation through self-generation; load management, including demand response; power exchanges; purchase and sales transactions with other entities; and participation in the power markets administered by the California Independent System Operator Corporation ("CAISO").

SWP's aqueducts and reservoirs are designed to provide water storage that enhances SWP's ability to choose (within the constraints of water delivery, environmental, and other obligations) the hours and locations in which specific generators and pumps will run. SWP has some ability to operate its pumps to provide demand response services that respond to price signals in the CAISO markets and

enhance the reliability of the grid. SWP is the largest individual demand response provider in California.

Nonetheless, SWP is able to use its demand-side resources to provide reliability support to the power grid only when water management conditions so permit. For example, California frequently experiences drought conditions and environmental restrictions on operating SWP pumps, which increase SWP's need for reliable transmission service for its pumping load, particularly when that load is not bid into the CAISO market for reliability services. Thus, it is essential that SWP retain its ability to pump as much as possible whenever environmental and other conditions allow. If involuntary transmission interruptions preclude pumping, irretrievable water resources will be lost.

### **III. COMMENTS**

As the State of California's largest electric load, transmission costs, including the incentives used to promote transmission investment, are a matter of paramount importance to SWP. SWP supports development of transmission necessary to maintain a robust and reliable grid, but encourages the Commission to ensure that the policies to incentivize such development promote needed investment without unnecessarily burdening ratepayers. SWP submits that the Commission's current risks and challenges framework, developed through Order Nos. 679 and 679-A,<sup>2</sup> as refined through the 2012 Incentives Policy Statement<sup>3</sup> (together, the "risks and challenges framework"), does this.

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<sup>2</sup> *Promoting Transmission Investment Through Pricing Reform*, Order No. 679, 116 FERC ¶ 61,057 ("Order 679"), *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006) ("Order 679-A"), *clarified*, 119 FERC ¶ 61,062 (2007).

<sup>3</sup> *Promoting Transmission Investment Through Pricing Reform*, 141 FERC ¶ 61,129 (2012) ("2012 Incentives Policy Statement").

But while the current process is generally working well, there are opportunities for improvement. Specifically, SWP urges the Commission to:

- limit eligibility for the fifty basis point return on equity (ROE) adder for participation in an independent system operator or regional transmission operator (“RTO Adder”) to transmission owners (“TOs”) whose participation in those organizations is voluntary, and to cap collection to no more than ten years; and
- reconsider the use of an ROE adder to encourage development of stand-alone transmission companies (“Transcos”).

**A. *Incentives Based on Project Risks and Challenges***

*Q 1. Should the Commission retain the risks and challenges framework for evaluating incentive applications?*

SWP strongly urges the Commission to retain its current risks and challenges framework for awarding incentives, and to continue the case-by-case application of that framework.

In California in particular, this policy appears, by all measures, to be working to ensure transmission is built, albeit sometimes at excessive cost to ratepayers. Transmission investment is robust: transmission costs across the CAISO footprint have more than tripled over the last decade,<sup>4</sup> and investors are touting the low risk and high

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<sup>4</sup> Compare CAISO, *High Voltage Access Charge Rates Effective Jan 1, 2019*, at 1 (rev. Mar. 21, 2019), [http://www.caiso.com/Documents/HighVoltageAccessChargeRatesEffectiveJan01\\_2019\\_RevisedMar21\\_2019.pdf](http://www.caiso.com/Documents/HighVoltageAccessChargeRatesEffectiveJan01_2019_RevisedMar21_2019.pdf) (reflecting total high-voltage Transmission Access Charge (TAC) rate of \$2.3 billion for 2019), with CAISO, *High Voltage Access Rates Effective Jan 1, 2009*, at 1 (rev. Nov. 19, 2012), [http://www.caiso.com/Documents/HighVoltageAccessChargeRatesEffectiveJan1\\_2009\\_RevisedNov19\\_2012.pdf](http://www.caiso.com/Documents/HighVoltageAccessChargeRatesEffectiveJan1_2009_RevisedNov19_2012.pdf) (reflecting a total high-voltage TAC rate of \$712 million in 2009).

returns these investments offer.<sup>5</sup> Given the strong impetus to build, the Commission should be focused on making sure that ratepayers do not pay too much for the projects that are being constructed rather than on incentivizing new projects. Furthermore, in the CAISO, competition is strong where permitted: since the implementation of the Commission's Order No. 1000<sup>6</sup> competitive planning reforms, the CAISO has administered ten competitive project sponsor solicitations, with robust competition in nearly every one.<sup>7</sup> The majority of transmission investment in California occurs outside the CAISO process without either competition or review by the CAISO or stakeholders. Those projects certainly are not in need of incentives. And indeed, even within the CAISO process, CAISO is now finding that projects previously approved for specific needs are no longer necessary, and is canceling projects as a result.<sup>8</sup> In California,

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<sup>5</sup> See, e.g., Berkshire Hathaway Inc., *Berkshire's Performance vs. the S&P 500*, at 12, <http://www.berkshirehathaway.com/letters/2016ltr.pdf> (last visited June 25, 2019) (highlighting "recession-resistant earnings" from utility investment due to essentiality of electricity service and steady demand).

<sup>6</sup> *Transmission Planning & Cost Allocation by Transmission Owning and Operating Pub. Utils.*, Order No. 1000, 136 FERC ¶ 61,051 (2011), *reh'g denied*, Order No. 1000-A, 139 FERC ¶ 61,132, *on reh'g*, Order No. 1000-B, 141 FERC ¶ 61,044 (2012), *review denied sub nom. S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41 (D.C. Cir. 2014) (per curiam).

<sup>7</sup> See Comments of the California Department of Water Resources State Water Project, Att. A at 1-2, *Competitive Transmission Dev. Tech. Conf.*, Docket No. AD16-18-000 (Oct. 3, 2016), eLibrary no. 20161003-5364. The competitive solicitation with a single bidder involved a reactive power support project to connect to a 500 kV bus that was owned by the winning bidder. See CAISO, *Miguel 500 kV 375 MVar Reactive Power Support Description and Functional Specifications for Competitive Solicitation* (2014), <http://www.caiso.com/Documents/Description-FunctionalSpecificationsMiguel500kVReactivePowerSupport.pdf>. CAISO's 2016-2017 and 2017-2018 planning processes did not identify any projects eligible for competitive solicitation. See CAISO, *2016-2017 Transmission Plan* at 383 (2017), <http://www.caiso.com/Documents/Board-Approved-2016-2017-TransmissionPlan.pdf>; CAISO, *2017-2018 Transmission Plan* at 338 (2018), <http://www.caiso.com/Documents/BoardApproved-2017-2018-Transmission-Plan.pdf>.

<sup>8</sup> See CAISO, Notice of Termination of the Approved Project Sponsor Agreement, *Cal. Indep. Sys. Operator Corp.*, Docket No. ER19-2073-000 (June 7, 2019), eLibrary No. 20190607-5073 (cancelling new 230 kV transmission line between PG&E's Gates and Gregg substations "because the economic benefits of the Project are not sufficient to justify its cost and there is no other identified need for the Project, the CAISO recommended canceling the Project in the 2018-19 Transmission Plan.).

therefore, there is no evidence that the current process fails to attract investors or to build needed projects.

Because there is no shortage of construction of necessary projects, and possibly over-construction of unreviewed projects, the Commission's risks and challenges framework has become even more important. The framework requires that an applicant demonstrate both that a project "benefit[s] consumers by ensuring reliability and . . . reducing . . . congestion,"<sup>9</sup> and that the requested incentives are "tailored to the risks and challenges" of the particular investment.<sup>10</sup> Additionally, the Commission has required that applicants look toward risk-reducing incentives (e.g., construction work in progress ("CWIP"), recovery of pre-certification expenses, recovery of prudent plant costs abandoned for reasons beyond the control of the TO) prior to seeking ROE adders to mitigate risk.<sup>11</sup> By adjudicating incentives requests on a case-by-case basis, the Commission ensures that the resulting rates are just and reasonable, and can identify and exclude projects whose circumstances do not justify incentives.

This scalpel-like approach achieves the investment promotion goals embodied in Section 219 of the FPA by ensuring that incentives awarded by the Commission are tailored to ameliorate actual barriers<sup>12</sup> rather than speculative risks, and appropriately

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<sup>9</sup> Federal Power Act ("FPA") § 219(a), 16 U.S.C. § 824s(a).

<sup>10</sup> Order 679, P 26.

<sup>11</sup> 2012 Incentives Policy Statement PP 15-16.

<sup>12</sup> See, e.g., *City of Detroit v. FPC*, 230 F.2d 810, 817 (D.C. Cir. 1955) ("If the Commission contemplates increasing rates for the purpose of encouraging exploration and development . . . it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose."); *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1503 (D.C. Cir. 1984) (rejecting incentive rates as inconsistent with *City of Detroit*).

avoids the award of incentives for “business as usual” projects, or projects facing few, if any, risks. This approach works well and should be retained.

*Q 7. Should transmission projects with a demonstrated likelihood of benefits be awarded incentives automatically? How could the Commission administer such an approach?*

The Commission should continue to require a case-by-case analysis of transmission incentive requests, and should not automatically award incentives. At core, such an approach is necessary to ensure that “there [is] a relationship between the rate treatments sought and the attraction of new capital,”<sup>13</sup> and that “incentives are not provided in circumstances where they do not materially affect investment decisions.”<sup>14</sup> Case-by-case review is also necessary to ensure that the resulting rates meet section 219’s express requirement that rates be just and reasonable.<sup>15</sup> And while in many cases the Commission has found that an incentive applicant had indeed demonstrated a need for the requested incentives, there have also been cases where it found such requests were *not* warranted.<sup>16</sup> Accordingly, and as noted in response to Question 1, case-by-case review

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<sup>13</sup> Order 679-A, P 21; *see also Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, & Elec. Utils.*, 61 FERC ¶ 61,168, at 61,594 (1992) (“1992 Policy Statement”) (When providing incentives, the Commission must ensure “there is a correlation between the incentive and the result to be induced.”), *reh’g denied*, 63 FERC ¶ 61,110 (1993); *Farmers Union Cent. Exch., Inc.*, 734 F.2d at 1502 (While “non-cost factors may legitimate a departure from the rigid cost-based approach[,] . . . when FERC chooses to refer to non-cost factors in ratesetting, it must specify the nature of the relevant non-cost factor and offer a reasoned explanation of how the factor justifies the resulting rates.”).

<sup>14</sup> Order 679-A, P 25.

<sup>15</sup> 16 U.S.C. § 824s(d).

<sup>16</sup> *See, e.g., Pac. Gas & Elec. Co.*, 160 FERC ¶ 61,018, P 64 (2017) (denying request for abandoned plant incentive where applicant “ha[d] not demonstrated that the risks and challenges presented by the . . . projects [were] sufficient to satisfy the Order No. 679 nexus test”), *on reh’g*, 163 FERC ¶ 61,187 (2018), *petition for review filed sub nom. Pac. Gas & Elec. Co. v. FERC*, No. 18-1207 (D.C. Cir. filed Aug. 2, 2018); *United Illuminating Co.*, 167 FERC ¶ 61,126, P 64 (2019) (rejecting request for ROE incentive adder because the applicant failed to “present sufficient risks and challenges” warranting such adder), *reh’g pending*.



ensures that only projects facing sufficient risks and challenges justifying incentives are awarded such treatments and should remain the standard.

**B. ROE Adder Incentives**

*Q 58. Should the Transco incentive remain available to Transcos that are affiliated with a market participant? If so, how should the Commission evaluate whether a Transco is sufficiently independent to merit an incentive?*

SWP urges the Commission to reconsider the use of an ROE incentive to encourage development of stand-alone transmission companies (“Transco Adder”).

At the time the Commission established the Transco Adder,<sup>17</sup> it did so based on its conclusion that such “stand-alone” companies with a “singular focus on transmission investment” would “respond[] more rapidly and precisely to market signals indicating when and where transmission investment is needed” and would “provide non-discriminatory access to all grid users.”<sup>18</sup>

As an initial matter, the availability of risk-reducing rate treatment incentives such as regulatory asset treatment, recovery of pre-commercial costs, CWIP, and the abandoned plant incentive ensure that a Transco can compete on equal footing with incumbent TOs whose investments are backed by guaranteed rate recovery. To the extent the Commission is concerned by lack of non-incumbent development, the problem appears not to be lack of incentives, but lack of opportunity: between 2013 and 2017,

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<sup>17</sup> While the Commission did not in Order 679 establish a specific level for the Transco Adder, it subsequently determined that a fifty basis point adder was appropriate. *See, e.g., Midcontinent Indep. Sys. Operator, Inc.*, 150 FERC ¶ 61,252, P 45 (2015) (finding that “50-basis points [sic] is an appropriate size for the Transco Adder,” and “strikes the right balance by appropriately encouraging independent transmission consistent with Order No. 679, while acknowledging . . . concerns regarding the rate impacts of such adders”), *on compliance, clarification and reh’g*, 154 FERC ¶ 61,004 (2016), *petition for review filed sub nom. Resale Power Grp. v. FERC*, No. 16-1088 (D.C. Cir. filed Mar. 4, 2016).

<sup>18</sup> *See* Order 679, P 224.

only \$540 million out of the \$20 billion of average annual transmission investments in the U.S. (less than 3%) were procured through competitive processes.<sup>19</sup> Transcos confirm that they are interested in investing, but have been stymied by lack of competition.<sup>20</sup> Thus, rather than focus on additional incentives to spur Transco formation, the Commission should address at the root those continued barriers to competition in transmission development.

To the extent that the Commission nonetheless determines that continued use of an ROE adder is necessary to incentivize the Transco business model, SWP urges elimination of incentives for Transcos that are less than fully independent of market affiliates operating within the same region. Transcos that are not fully independent may be motivated to plan and invest in transmission to serve their affiliates' directives or needs, and do not provide the investment agility and non-discriminatory access benefits on which the Transco Adder and its increased costs to consumers are premised. Commissioner Glick's dissent in *Consumers Energy Co.*<sup>21</sup> summarizes the hazards inherent in less than fully independent ownership structures:

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<sup>19</sup> Johannes P. Pfeifenburger et al., The Brattle Group, *Cost Savings Offered by Competition in Electric Transmission: Experience to Date and the Potential for Additional Customer Value* at 18 (Apr. 2019), [https://brattlefiles.blob.core.windows.net/files/15987\\_brattle\\_competitive\\_transmission\\_report\\_final\\_with\\_data\\_tables\\_04-09-2019.pdf](https://brattlefiles.blob.core.windows.net/files/15987_brattle_competitive_transmission_report_final_with_data_tables_04-09-2019.pdf).

<sup>20</sup> See, e.g., GridLiance Holdco, LP, Post-Technical Conference Comments of GridLiance Holdco LP and Request for Order to Show Cause at 6–7, *Competitive Transmission Dev. Tech. Conf.*, Docket No. AD16-18-000 (Oct. 3, 2016), eLibrary No. 20161003-5231 (asserting that “ratepayers are not realizing the full benefits of competitive transmission development,” because “too few projects are making their way to competitive solicitations,” and urging the Commission to take a hard look at Order 1000 exemptions); LSP Transmission Holdings, LLC, Post-Technical Conference Initial Comments of LSP Transmission Holdings, LLC at 10–12, *Competitive Transmission Dev. Tech. Conf.*, Docket No. AD16-18-000 (Oct. 3, 2016), eLibrary No. 20161003-5366 (discussing erosion of projects subject to competitive planning processes since Order 1000's inception).

<sup>21</sup> 165 FERC ¶ 61,021, at 61,120-21 (2018) (footnotes omitted).

In 2016, the ITC Companies were acquired by Fortis, Inc. (Fortis) and GIC (Ventures) Pte. Ltd (GIC), both of which have extensive natural gas and electric holdings in the Eastern Interconnection, including natural gas and electric transmission, distribution utilities, and merchant generation. In the aftermath of this transaction, the ITC Companies must now compete for capital with Fortis and GIC subsidiaries that own generation and distribution assets and may now face an incentive—even a subtle one—not to undermine the value of its sisters [sic] companies' assets through its transmission investments.

. . . . [And while] the ITC Companies are permitted to develop their own capital and business plans, Fortis and GIC retain ultimate authority with respect to those plans. . . . [T]he ITC Companies will receive capital to invest in transmission facilities only if Fortis, its majority owner, concludes that investments in transmission through ITC are appealing relative to the other investment options presented by its subsidiaries. Fortis and GIC representatives also hold multiple seats on ITC Holdings' board of directors, giving Fortis an opportunity to shape ITC Holdings' investment plan even before it is considered as part of Fortis' consolidated capital expenditure plan.

. . . . Fortis and GIC have interests in companies, including Central Hudson, FortisOntario, and Duquesne, all of which participate in the wholesale electricity market in or around the Midcontinent Independent System Operator, where the ITC Companies' assets are located. Although the ITC Companies contend that there [is] little risk that it would operate its assets in a manner that benefited one of its sister companies, the potential for the ITC Companies to use its assets to benefit nearby affiliates only strengthens the case that the ITC Companies no longer possess the type of independence that the Commission sought to incentivize in Order No. 679. Whether or not the ITC Companies are likely to deploy their transmission assets in a manner that benefits their neighboring subsidiaries, the fact that the ITC Companies' assets could have that effect is powerful evidence that they are not truly independent.<sup>22</sup>

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<sup>22</sup> *Id.* PP 4–6 (Glick, Comm'r, dissenting).

Put simply, the circumstances and inherent conflicts associated with Transcos that are not fully independent cannot justify the increased burden ROE adders have on consumers, and should be eliminated.

*Q 61. Should the Commission revise the RTO-participation incentive?*

The Commission is at an important juncture to reevaluate and recalibrate the RTO Adder to ensure that the incentive is appropriately tailored to incentivize future, voluntary behavior without saddling ratepayers with undue burden.

In Order 679, the Commission established the RTO Adder in “recognition of the benefits that flow from membership . . . and the fact continuing membership is generally voluntary.”<sup>23</sup> In California, however, such continuing membership is *not* generally voluntary.<sup>24</sup> Recently, the Ninth Circuit determined that the Commission had acted arbitrarily in awarding the RTO Adder to Pacific Gas & Electric Company despite the fact that the California Public Utilities Commission would need to approve any withdrawal.<sup>25</sup> And as the Ninth Circuit explained, Orders 679 and 679-A “did not make ongoing membership in a transmission organization the sole criterion for an incentive adder,” nor did they “preclude challenges based on the voluntariness of a utility’s membership in a transmission organization.”<sup>26</sup>

In light of these developments, the Commission should clarify that the RTO Adder will be awarded only to TOs whose participation in an RTO is voluntary. “An

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<sup>23</sup> Order 679, P 331.

<sup>24</sup> Decision No. 98-01-053, *Joint Application of Pac. Gas and Elec. Co., et al.*, Application No. 97-11-038, 78 C.P.U.C. 2d 307, 1998 Cal. PUC LEXIS 200, at \*17–\*18 (Nov. 25, 1997).

<sup>25</sup> *See Cal. Pub. Utils. Comm’n v. FERC*, 879 F.3d 966, 970 (9th Cir. 2018). The Commission has yet to act on remand.

<sup>26</sup> *See id.* at 975.

incentive cannot ‘induce’ behavior that is already legally mandated,”<sup>27</sup> and imposing the RTO Adder where a TO is obliged to join or remain in the RTO would increase costs to consumers without providing a benefit in return—commensurate or otherwise—and would constitute a windfall rather than a spur to motivate beneficial conduct. Accordingly, where voluntariness is raised as an issue, the Commission should engage in a case-specific inquiry and deny or revoke recovery of the RTO Adder where voluntariness is not demonstrated. Even where membership is truly voluntary, the RTO Adder should still be time-limited—it does not make sense to “incentivize” conduct that is on-going, settled, and to everyone’s benefit. A ten-year time frame would ensure that the adder is serving its true purpose.<sup>28</sup>

*Q 95. The Commission’s current policy is that the total ROE may not exceed the zone of reasonableness. If a transmission project qualifies for ROE incentives, should there be an upper limit or range that the total ROE cannot exceed? If so, what is the appropriate limit or range? Should this vary based on how the Commission sets base ROE?*

The overall ROE awarded to a TO should not exceed the zone of reasonableness, inclusive of incentives.

#### **IV. CONCLUSION**

SWP supports the Commission’s continuing efforts to improve electric transmission development and appreciates the opportunity to respond to the Commission’s inquiry. SWP respectfully requests that the Commission consider these

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<sup>27</sup> *Id.* at 974. *See also* 1992 Policy Statement at 61,599 (“A ‘reward’ for past behavior does not induce future efficiency and benefit consumers.”).

<sup>28</sup> Application of a ten-year limitation on the RTO Adder would reduce the need to assess continued voluntariness as to many TOs currently collecting the RTO Adder.

comments and undertake the refinements to its electric transmission incentives policy identified herein. Additionally, SWP notes that incentives policies address only one aspect of transmission development. SWP urges the Commission to revisit the record compiled in Docket No. AD16-18-000 and examine with fresh eyes whether there are enhancements to the planning process that could be undertaken to harness additional cost-savings opportunities and remove persistent barriers to competition.

Respectfully submitted,

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