

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's
Electric Transmission Incentives Policy

Docket No. PL19-3

Inquiry Regarding the Commission's Policy
for Determining Return on Equity

Docket No. PL19-4

COMMENTS OF PUBLIC CITIZEN, INC.

We applaud FERC for opening a Notice of Inquiry on the scope and implementation of its electric transmission incentives regulations and policy,¹ and whether and how to revise its rate of return on equity (ROE) policy.² These comments are in addition to those Public Citizen joined in PL19-4.³

About Public Citizen, Inc.

Public Citizen is one of America's largest advocacy organizations representing household consumers. We are active before FERC promoting just and reasonable rates, and supporting efforts for utilities to be accountable to the public interest. Financial details about our organization are available on our web site.⁴

Transmission Owners Already Receive Overly-Generous Returns, And the Commission's Recent Four-Part ROE Change Will Exacerbate The Problem

The transmission industry is inherently monopolistic, exposing household consumers to significant risk if regulators grant excessive financial returns to transmission operators.

Since the mid-1980s the United States has been in era of declining financing costs, reflected partly by Federal Reserve policy promoting low interest rates (as measured by the yield on U.S. Treasuries). It is important that FERC policy on transmission ROE provides returns commensurate with the lower cost of capital in which the industry operates.

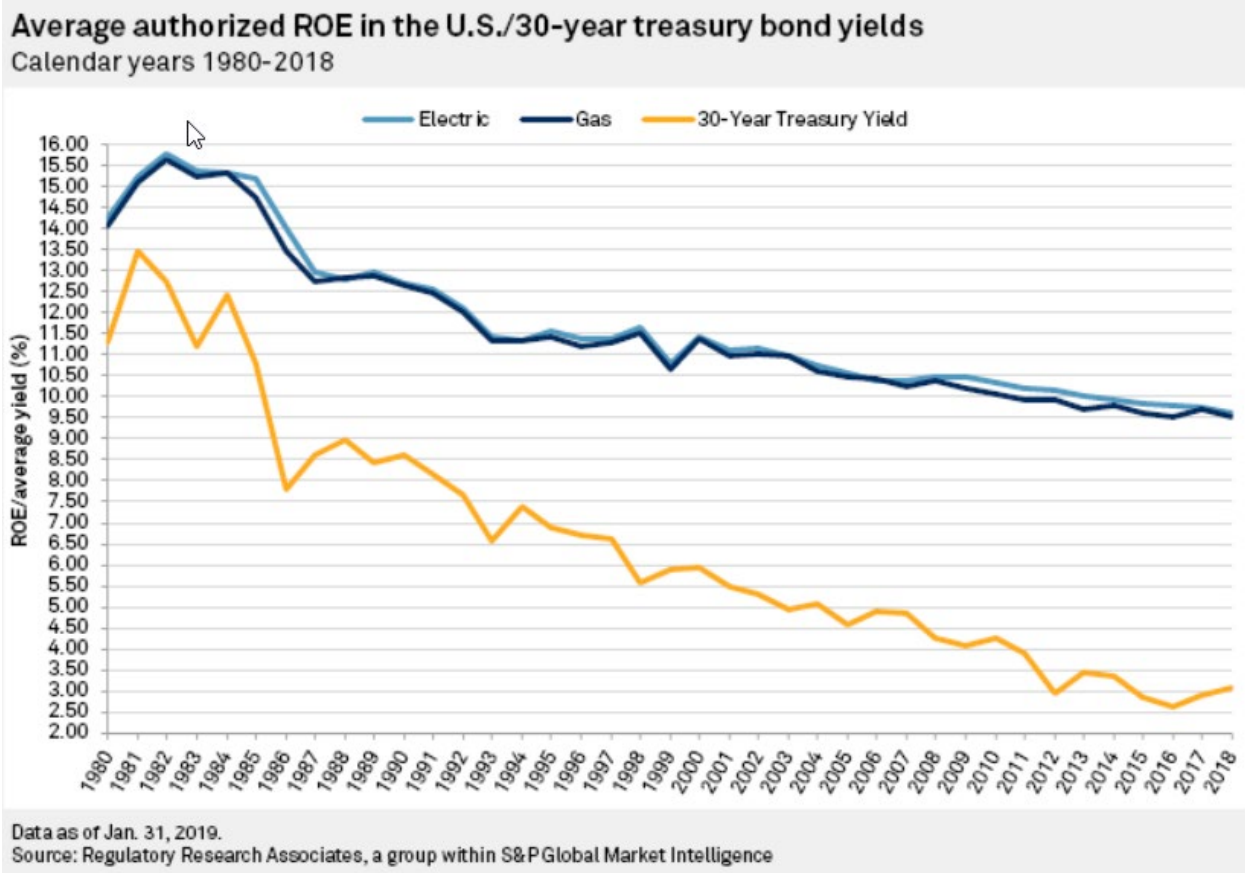
¹ Docket No. PL19-3, www.ferc.gov/whats-new/comm-meet/2019/032119/E-1.pdf

² Docket No. PL19-4, www.ferc.gov/whats-new/comm-meet/2019/032119/E-2.pdf

³ *Comments of Public Interest Organizations.*

⁴ www.citizen.org/about/annual-report/

Unfortunately, the Commission’s recent landmark order appears to ignore this lower cost of capital, and threatens to nudge up the “zone of reasonableness” of ROE rates by adopting a new, complex, four-part methodology favorable to transmission project owners.⁵ The Order expanded the current two-step Discounted Cash Flow methodology with an equally-weighted methodology derived from four financial models: Discounted Cash Flow, the Capital Assets Pricing Model, Expected Earnings Per Book-Value Equity, and Risk Premium. Public Citizen believes this change will bump up the “zone of reasonableness” of ROE rates, and could set a higher bar for rate complaints. The Initial Brief filed by parties in the paper hearing following the Order, led by the Attorney General of the Commonwealth of Massachusetts, does an excellent job detailing the flaws in the Commission’s proposed four-part methodology, namely that earnings on book equity do not measure investors’ opportunity costs and do not correlate with risk, and that Risk Premium analysis is rife with problems.⁶



⁵ Docket Nos. EL11-66, et al, Issued October 16, 2018, www.ferc.gov/CalendarFiles/20181016190812-EL11-66-001.pdf

⁶ Filed January 11, 2019, <https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=15141453>

According to the chart above, the typical ROE in the early 1980s was roughly 200 basis points above the yield on 30-year U.S. Treasuries. In the years since, the gap has significantly widened in favor of ROE yields, to the point that in 2018, the gap was roughly triple that from the early 1980s. It is therefore clear that FERC policy on transmission ROE should more accurately reflect the cost of capital by lowering allowed ROEs.

Transmission Projects In RTOs Should Not Automatically Qualify For An Extra 50-Basis Point ROE

A January, 2018 decision by the U.S. Court of Appeals for the Ninth Circuit, remanding FERC's decision authorizing a California utility to recover a 50 basis point ROE adder just for being a member of an RTO,⁷ now raises questions about the appropriateness of handing transmission owners an extra profit bonus just for being a part of an RTO. We agree with the Ninth Circuit that RTO "membership itself as the sole criterion for receipt of the incentive adder" is problematic, and that a "case-by-case review" is warranted.

Indeed, just because a transmission project is within an RTO does not mean that it was competitively developed. A recent report by the Brattle Group on behalf of a competitive transmission company found that seven years after FERC's Order 1000—which mandated competition in transmission planning—only 5.1% of transmission investments in PJM were subject to competitive processes; only 6.8% in CAISO; 7.0% in NYISO, and zero percent in ISO-NE.⁸

Gas Pipeline ROE In Need of Reform

In a 2017 report co-authored by Public Citizen, we noted that for many natural gas pipelines, applicants often involve self-dealing contracts between pipeline developers and their regulated utility affiliates.⁹ These utility affiliates can then pass costs onto its captive ratepayers. This affiliate abuse is then combined with FERC's high rates of return, which provide

⁷ <http://cdn.ca9.uscourts.gov/datastore/opinions/2018/01/08/16-70481.pdf>

⁸ *Cost Savings Offered by Competition in Electric Transmission*, April 2019, The Brattle Group, at page 5.

⁹ *Art of the Self-Deal: How Regulatory Failure Lets Gas Pipeline Companies Fabricate Need and Fleece Ratepayers*, September 2017, http://priceofoil.org/content/uploads/2017/09/Gas_Pipeline_Ratepayer_Report.pdf

financial incentives to overbuild capacity—and again, the project developers mitigate that overbuild risk by shifting the risk onto captive ratepayers.

An Office of Public Participation Would Facilitate More Robust And Detailed Public Interest Comments

In 1978, Congress directed FERC to establish an Office of Public Participation. Among the duties of such an office would be to encourage public participation in FERC rulemakings, including the authority to provide intervenor funding to qualifying public interest participants. Despite the Congressional mandate, the Commission has never established the Office. In 2016, Public Citizen led a coalition of 30 national and regional organizations to petition FERC for a rulemaking to establish and fund the Office.¹⁰ To date, the Commission has failed to respond to our Petition.

Had such an office been in place, with the full authorities offered by Congress, the Commission could now reap far more extensive feedback from public interest stakeholders on its two Inquiries.

Respectfully submitted,

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¹⁰ Docket RM16-9, www.citizen.org/wp-content/uploads/public-citizen-ferc-public-participation-petition.pdf