UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's Electric Transmission Incentives Policy	**:**	**Docket No. PL19-3-000**
Inquiry Regarding the Commission's Policy For Determining Return on Equity	**:**	**Docket No. PL19-4-000**

COMMENTS OF THE PUBLIC UTILITIES COMMISSION OF OHIO'S OFFICE OF THE FEDERAL ENERGY ADVOCATE

I. Introduction

The Federal Energy Regulatory Commission (FERC or the Commission) seeks comment on its existing policies for transmission incentives and base Return on Equity (ROE) to determine whether those policies properly encourage infrastructure development that ensures grid reliability, contains congestion and reduces costs for consumers. The Public Utilities Commission of Ohio's Office of the Federal Energy Advocate (Ohio FEA) was created by the Ohio legislature in 2008 to "monitor the activities of the Federal Energy Regulatory Commission and other federal agencies and to advocate on behalf of the interests of retail electric service consumers."[1] The Ohio FEA is to "examine the value of the participation of this state's electric utilities in regional transmission organizations,"[2] and offers its perspectives here.

II. Background

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1 Ohio Revised Code (ORC), Chapter 4828.24

2 *Id.*

The Commission on March 21, 2019 issued two Notices of Inquiry (NOI) seeking comments on the efficacy of its existing policy that has primarily used the same financial model to determine transmission ROEs since the 1980s; and its 13-year-old electric transmission incentives contained in section 1241 of the Energy Policy Act of 2005 (EPAct 2005).[3] This law was codified as section 219 of the Federal Power Act,[4] which was intended to address congestion and a lack of transmission development at the time. The Commission issued Order 679[5] in 2006 to establish transmission incentives to encourage transmission investment at a time that could be termed the infancy of regional transmission organizations. The Commission took steps first to encourage and later to require transmission companies by late 2001 to participate in third-party, regional transmission organizations. Meanwhile, Ohio moved to retail competition in 2001, and required transmission companies to join RTOs by 2004 for transmission planning and provided for capital spending oversight independent of utilities' interests in their distribution and generation enterprises.[6] Other states did as well.

Midwest Independent System Operator, now Midcontinent ISO (MISO), was designated an independent system operator in 2001. PJM became the nation's first fully functioning RTO in 2002. The push for RTO membership and transmission investment coincided with even more events that were changing the transmission landscape. For reasons including population shifts, closing of coal-fired plants, emergence of renewable energy resources, changes in the planning criteria and compliance standards, and advanced technologies, transmission investment skyrocketed.

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3 Energy Policy Act of 2005, Pub. L. No. 109-58, sec. 1261 *et seq.*, 119 Stat. 594 (2005).

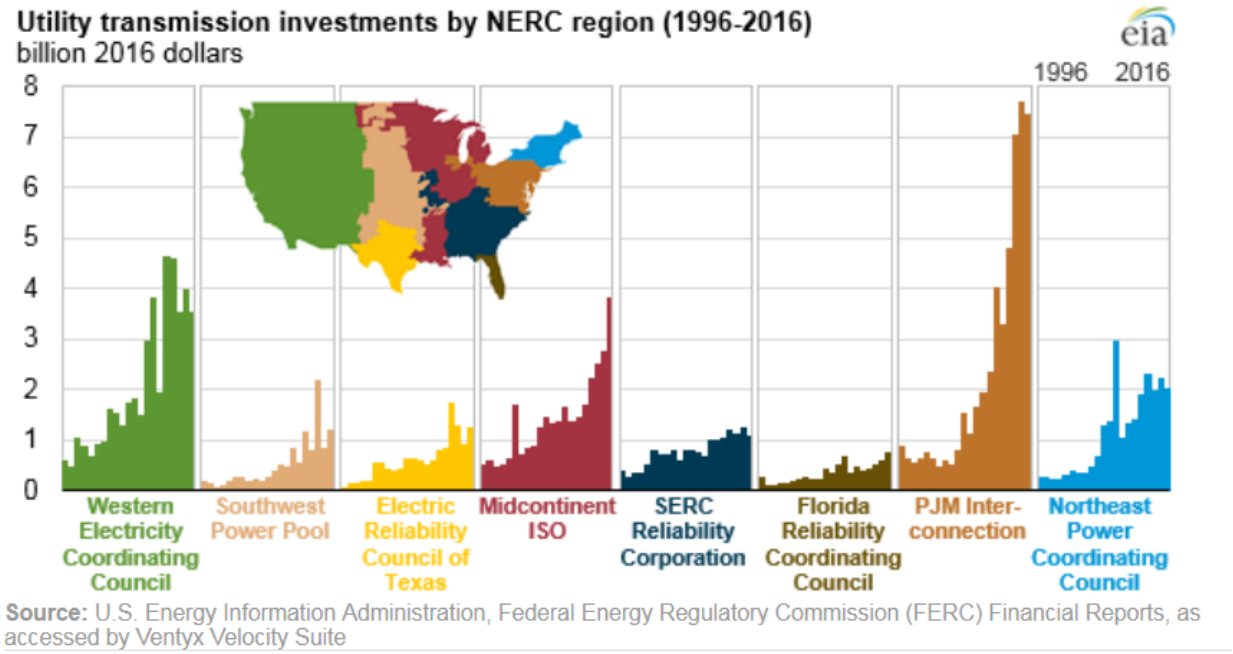
4 16 U.S.C. 824s

5 *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 116 FERC 61,057, *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007). (Order 679)

6 ORC § 4928.12.

Annual transmission investment by investor-owned utilities in Reliability First Corporation, comprised of PJM and parts of MISO, doubled between 2006 and 2012, according to the U.S. Energy Information Administration. It continues on an upward trajectory. The graph below in *Figure 1* demonstrates the increase in utility transmission investments in recent years:

Figure 1.



Clearly, transmission underinvestment is no longer a problem and utilities' participation in ISO/RTOs is all but universal - and not at all new. In Ohio, Cinergy, for instance, now part of Duke Energy Corp., joined MISO as long ago as 1997, well before MISO was recognized as an independent system operator. FirstEnergy's Ohio companies, Ohio Edison, Toledo Edison and Cleveland Electric Illuminating, joined MISO in 2003. Dayton Power & Light and American Electric Power (AEP) joined PJM in 2004. Ohio companies have joined and switched RTOs and several participate in more than one RTO. For example, AEP is developing transmission in the Electric Reliability Council of Texas and the Southwest Power Pool, Inc. in addition to MISO and PJM.

Today's transmission landscape has matured dramatically. RTOs have grown in size and scope, and have become the rule rather than the exception. RTOs such as PJM and MISO perform transmission planning studies in order to develop projects that address both reliability and economics by reducing congestion. In addition, under the umbrella of PJM's supplemental projects, transmission owners can identify future transmission "need" drivers and incorporate them into the planning process.

The Commission should improve and reform its transmission ROE and incentive policy to ensure that transmission owner actions are properly aligned with the public interest and to prevent overinvestment from being passed on to ratepayers. The Ohio FEA also advocates inclusion of non-transmission alternatives in the development of transmission improvement plans. Energy storage technologies are increasingly being deployed in Ohio and provide ancillary grid services to the bulk electric system. They and other advanced technologies should be recognized in any revision to FERC's transmission policies.

III. Comments

A. Return on Equity NOI

In FERC Docket PL19-4, FERC seeks information regarding how it should modify its policies regarding the determination of the base ROE in jurisdictional rates of transmission utilities. The Ohio FEA applauds FERC for seeking comment on the appropriate base ROE policy in its NOI. The Ohio FEA understands and supports the objective that public utilities should have the opportunity to earn a reasonable return "sufficient to assure confidence in the financial integrity of the enterprise," and "should be commensurate with returns of investments in other enterprises having corresponding risks."[7] However, the Ohio FEA believes that base

[7] FERC Docket No. EL11-66-001, et. al., October 16, 2018 at ¶ 24.

ROEs should be prudently awarded to reflect the actual levels of risk faced by the transmission utility. Traditionally, because of regulation, the risk of transmission investment is low in most cases. Thus, base ROEs should be sufficient to attract capital but not set so high as to result in unjust and unreasonable rates paid by FERC-jurisdictional transmission service customers.

The Ohio FEA generally agrees with the direction of FERC's ROE policy issued in response to the remand of the US District Court of Appeals for the District of Columbia in the *Emera Maine* proceeding.[8] In its order, FERC stated that it would propose to establish a new just and reasonable base ROE for the New England transmission owners by providing equal weight to four different financial models currently utilized by investors to compare investment opportunities: the two-step discounted cash flow (DCF), Capital Asset Pricing Model (CAPM), Risk Premium, and Expected Earnings approach. Previously, FERC had relied solely upon the DCF model for determining utility companies' cost-of-equity in order to set a base ROE within a zone of reasonableness. Under this new approach, FERC stated that it will average the cost-of-equity results of all four models using the midpoint/medians of the models to obtain one average figure for the cost-of-equity to establish a just and reasonable ROE. FERC established a paper hearing to examine how its policy would apply to the pending proceedings.

While the Ohio FEA does not have an opinion on each financial model presented by FERC in its October 16, 2018 Order[9] and this NOI, it appears reasonable for FERC to use models, in addition to DCF, to provide more evidence to support a just and reasonable ROE.

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8 *See,* FERC Docket Nos. EL11-66-001, et.al., *Order Directing Briefs,* October 16, 2018. (October 6, 2018 Order)

9 The FEA notes FERC staff's objections to the use of the Expected Earnings approach as the only accounting-based model among the four models and its lack of status as a generally accepted investor model. Initial Brief of the Commission Trial Staff, Docket Nos. EL11-66-001, et.al, January 11, 2019, at 6-10.

The Ohio FEA agrees with FERC that combining estimates from different models to determine a base ROE is more accurate than relying on a single model, and lessens the risk by model error or otherwise of adopting an ROE that is not just or reasonable. By using four financial models currently utilized by the investment community, FERC should have a more complete picture of the actual financial risk profile of that utility.

However, because no model can perfectly represent the future, the Ohio FEA recommends that FERC analyze the outcomes of the models in comparison to historical ROEs of the transmission utility along with forecasted interest rates and economic projections available from sources such as the Federal Reserve System and the U.S. Energy Information Administration (EIA). FERC can use this publicly available data, much like state-approved ROEs, to further inform its decision-making with regard to the actual risk profile of a utility.

Finally, the Ohio FEA cautions FERC in allowing transmission incentives to automatically raise the upper bound or cap of the base ROE. Again, the Ohio FEA believes that the purpose of the base ROE is to account for the utilities' risk sufficient to attract capital to that utility. Any additional transmission incentives should be targeted and exceptional and applied to an individual project that meets certain criteria.

B. Incentive ROE NOI: Policy Objectives/Approach

1. Incentives Based on Project Risks and Challenges

To receive a transmission incentive, an applicant must demonstrate that there is a "nexus" between the requested incentive and the risks and challenges of that investment. FERC seeks comment as to whether this approach should remain central to its approach to evaluating incentive applications. The Ohio FEA believes that, consistent with the base ROE calculation,

risk should continue to be considered in the granting of an incentive ROE. But the incentive ROE should be limited to risks that are not otherwise recovered by the base ROE calculation. As previously stated, the base ROE should account for risk sufficient to attract capital to that utility. An incentive ROE, therefore, should be targeted and exceptional to account for risks not already recognized and recovered by the base ROE. This is fair to both the transmission utility and the retail electricity customer paying for the additional transmission incentive.

2. Incentives Based on Project Characteristics and Objectives

FERC seeks comment on whether it should evaluate certain project characteristics in the incentive ROE determination. Further, FERC asks what it should incentivize in order to satisfy Congress's directive in section 219 of the FPA. The Ohio FEA finds merit in targeting incentives to transmission projects with certain characteristics that are limited to areas of *greatest* need for transmission investment. The Ohio FEA believes that transmission incentives should not be granted automatically but, rather, evaluated on a project-by-project basis. It would be helpful for FERC to establish applicable principles and criteria that require the applicant to demonstrate that the project characteristic(s) are targeted or address areas of greatest transmission need and that the risk and challenges of the project are unique. The applicant should prove that absence of the incentivized ROE would jeopardize the project and the problem would not otherwise be mitigated.

The Ohio FEA recommends that FERC should not offer incentives for projects that enhance transmission reliability above and beyond what is required by the NERC reliability standards or other established planning criteria. This could result in unnecessary overinvestment. If states wish to pursue policies that achieve this goal, they can do so; it should not be a matter of

federal policy. Likewise, the Ohio FEA urges FERC to not approve incentives for projects on the basis of enhanced economic efficiency or to relieve chronic/long-term congestion in an RTO/ISO region. PJM already administers a robust Market Efficiency process for projects that may not be needed for reliability but produce net benefits through reduced congestion and load costs. The Ohio FEA submits that it may be more beneficial to address RTO/ISO design flaws rather than to grant transmission incentives for these projects.

Furthermore, the Ohio FEA does not support transmission incentives for projects that enhance the physical and cyber-security of existing transmission facilities, resilience, or for interregional transmission projects. RTOs/ISOs and states are better situated to identify the facilities that should be prioritized and the compensation they should receive for cybersecurity investments. For example, PJM and its transmission owners have recently begun an examination of facilities within its footprint that are identified as CIP 14 critical assets and what steps should be taken to add redundancies to these facilities or otherwise mitigate their potential impact on the bulk power system. The Ohio FEA notes that resilience of the bulk power system is a term lacking industry consensus and could potentially be used to justify projects over and above the economically prudent level of investment. Finally, PJM has a process for identifying interregional projects with its existing planning framework; incremental incentives for these initiatives are not necessary.

3. Existing Incentives

a. Transmission-Only Companies

The Ohio FEA submits that the rationale behind Order No. 679's provision of automatic "Transco ROE Incentive[s]" may no longer be needed. Order No. 679 addressed two specific concepts within the Transco entity.[10] The Order outlined (1) the ROE incentive and (2) Transco level of independence. In relation to the ROE incentive, FERC stated that the level of incentive should "provide to Transcos a ROE that both encourages Transco formation and is sufficient to attract investment after the Transco is formed."[11] Giving credence to this assertion, FERC indicated that the expansion plans of existing – albeit new – Midwest ISO Transcos showed that they were investing at a rate that was over seven times that of the average non-Transcos. Today's reality is that Transcos are investing aggressively in transmission-related assets. There may be a need to encourage Transco formation in situations where integrated utilities still exist. However, incenting investment by recognition of the benefits of Transcos through "higher ROE (that falls within a zone of reasonableness),"[12] may no longer hold as much weight.

Additionally Order No. 679 initially sought comment on whether there should be a specific methodology to factor the level of independence into any ROE-based incentives. Ultimately, FERC did not "establish a specific methodology to factor the level of independence into any request for ROE-based incentives for Transcos."[13] The Ohio FEA submits that it may be time for FERC to revisit this question. A lack of independence could have a dampening effect on the level of ROE if the adder is not meeting the original intent of FERC's order. A Transco should exist as an independent entity at the parent level of the organization and should continue

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10 Order 679 at ¶221
11 *Id.*
12 *Id.*at ¶206
13 *Id.*at ¶239

with true separation over time. If there is a change in organization or ownership, the Ohio FEA recommends that FERC re-evaluate the applicability and/or level of the Transco adder.

b. RTO/ISO Participation

Section 219(c) of the FPA requires that the Commission provide incentives to transmitting utilities or electric utilities that join an RTO or ISO. The Ohio FEA believes that this incentive has outlived its usefulness. The transmission landscape has matured dramatically in the years since this policy went into effect. RTOs/ISOs have grown in size and scope, and have become the rule rather than the exception in much of the country. The Ohio FEA notes that RTOs/ISOs such as PJM and MISO have robust planning processes that address reliability and allow for projects to be built for economic reasons, including reduced congestion.

The Ohio FEA notes that under state law, no entity shall own or control transmission facilities as defined under federal law and located in this state on or after the starting date of competitive retail electric service unless that entity is a member of, and transfers control of those facilities to, one or more qualifying transmission entities.[14] Public utilities should not receive incentives for behaviors that they are already required by law to perform. The ROE incentives for RTO/ISO participation should be eliminated.

c. Advanced Services

The Ohio FEA notes the changing landscape in power delivery in Ohio includes the integration and deployment of new and improved technologies that offer a range of opportunities as well as challenges. Some technologies are ready for deployment or are already being deployed. This is particularly true of energy storage technologies, which are increasingly being deployed in Ohio and provide ancillary grid services to the bulk electric system that support the

[14] ORC §4928.12(A)

reliable delivery of electricity. These ancillary services include frequency regulation, voltage support, and reactive power compensation. The Ohio FEA believes that any transmission incentive should not stifle consideration of emerging technologies that could provide incremental value at the bulk power level.

The Ohio FEA notes that advanced technologies, among other grid modernization investments, require a review of traditional regulatory approaches to utility incentives on both the state and federal levels. The Ohio PowerForward Roadmap[15], which outlines the state's grid modernization vision and continues through the PowerForward Collaborative,[16] recognizes that the PUCO "will need to deploy Performance Based Ratemaking that has greater weight."[17] The roadmap also recommends that the Commission determine the metrics to be utilized for each grid modernization plan or investment on a case-by-case basis.[18] The Ohio FEA submits that we are very early in the development of these advanced services and therefore, transmission incentives for these services should be considered but should not be granted without further investigation and review by the states and FERC.

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15 PowerForward: A Roadmap to Ohio's Electricity Future, https://puco.maps.arcgis.com/apps/Cascade/index.html?appid=59a9cd1f405547c89e1066e9f195b0b1

16 The PowerForward Collaborative is an overarching grid modernization group led by PUCO staff. The Collaborative functions as an interactive forum to monitor and facilitate the evolution of a marketplace that promotes innovation and the delivery of innovative products and services consistent with the principles and objectives identified in the PowerForward: A Roadmap to Ohio's Electricity Future.

17 PowerForward Roadmap p.27

18 *Id.*

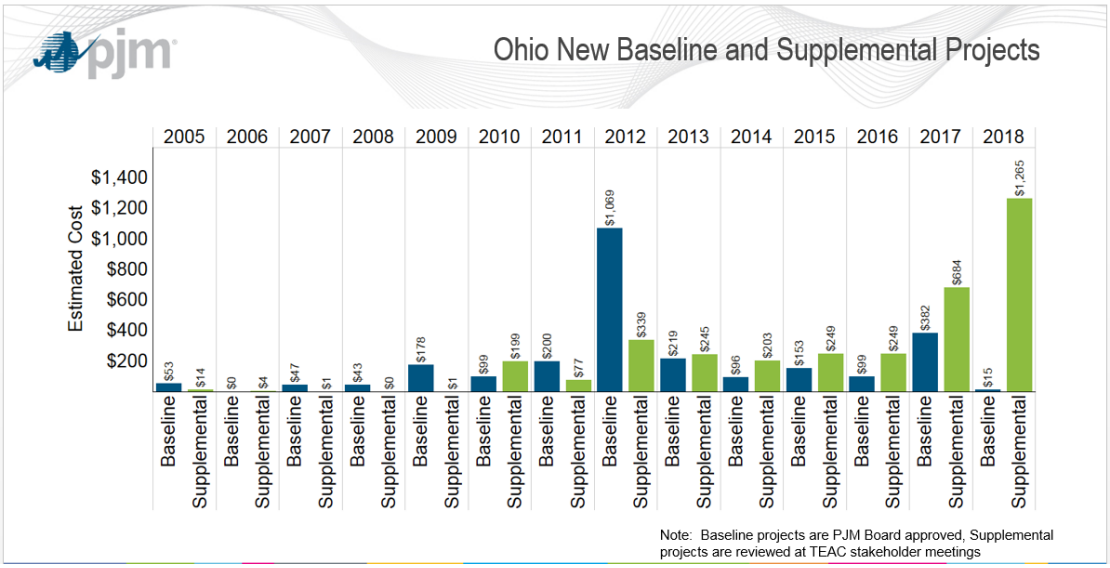
4. Transmission Incentives Going Forward

a. Supplemental Transmission Projects

Investment in supplemental transmission projects in the PJM region has greatly increased in recent years. For example, as shown in the PJM graph in *Figure 2*, below, Ohio had $4 million in incremental transmission investments approved in the PJM footprint in 2006. By 2018, that number had soared to $1.28 billion. Through PJM's supplemental projects, transmission owners can identify future transmission need drivers and input these criteria into the planning process. While these projects may be necessary for system maintenance, improvements, and replacements along with economic development initiatives including customer satisfaction, the Ohio FEA is concerned because there is no formal determination of need for these projects by PJM or FERC.

The Ohio FEA submits that concerns about underinvestment in transmission have been replaced by concerns about overinvestment. This is particularly true for supplemental transmission projects that are not necessary under PJM's Regional Transmission Plan to alleviate a NERC criteria violation or other PJM-determined reliability need but are nonetheless permitted under PJM's planning process. The Ohio FEA urges FERC to examine the current supplemental project process and cost allocation as part of the review of appropriate transmission investment policy.

Figure 2. Graph sourced from PJM, Year-End 2018. Estimated Cost in Millions.



5. Performance-Based Ratemaking for Transmission

The Ohio FEA supports FERC's inquiry into performance-based incentives and ratemaking for transmission services. The Ohio FEA notes the incentive performance-based formula rate plan of Commonwealth Edison and Ameren in Illinois. The Illinois Energy Infrastructure and Modernization Act requires a range of performance targets while allowing the companies to recover prudent investments in transmission and distribution.[19] The performance-based formula rate plan includes "specific ROE penalties related to the failure to achieve each performance metrics." [20] In addition to Illinois, other states are considering or implementing

19 220 ILCS 5/16-108.5(b)

20 Illinois staff presentation, https://www.greentechmedia.com/articles/read/more-states-explore-performance-based-ratemaking-but-few-incentives-in-plac#gs.kob0g9, October 10, 2017 at 9.

performance-based ratemaking. According to a recent industry article, nineteen states and DC have legislative and/or regulatory activity related to performance-based ratemaking.[21]

The Ohio FEA believes a performance-based approach that requires demonstration by a transmission utility that it is prudently investing or utilizing its existing facilities in order to receive, or continue to receive, a transmission incentive would benefit both the transmission utility and the retail customer paying for the incentive. The transmission utility would be incented to meet certain metrics or face financial consequences. The retail electricity customer benefits by paying less for the transmission investments of the utilities where those performance measures are not met.

Such an approach would require FERC to implement verifiable and quantifiable metrics to measure the performance of the transmission utility. The Ohio FEA suggests review of existing transmission facility utilization factors prior to granting incentives for additional facilities. Under such an approach, the Ohio FEA recommends that FERC expand its existing Form-730 to require utilization information and other metrics it determines necessary to measure performance of the transmission utility. The Ohio FEA believes that performance-based ratemaking should be further explored by FERC and interested stakeholders through a technical conference or other means.

6. Mechanics and Implementation

The Ohio FEA supports limiting the duration of transmission incentives if there is a material modification of a project or a significant change in the expected benefits. If a project is

[21] https://www.greentechmedia.com/articles/read/more-states-explore-performance-based-ratemaking-but-few-incentives-in-plac#gs.kob0g9, June 13, 2019.

no longer meeting the criteria that were necessary for the incentive to be granted, then that project clearly should no longer be receiving the incentive. Regarding mechanisms for measurement and verification, the Ohio FEA encourages FERC to require information pertinent to the incentive be included as part of the transmission developer's existing Form-730 reports.

The Ohio FEA supports a case-by-case review of transmission incentives rather than an automatic granting. The burden of proof for the necessity of an incentive ought to be borne by the project developer. Each project must be required to demonstrate that it produces benefits or faces exceptional risks for which an incentive is appropriate. An automatic approach removes any such obligation. Evaluating incentives on a case-by-case basis is the only way to ensure that only projects that truly justify preferential treatment are granted incentives. If the incentive is perceived by transmission developers as the default, rather than the exception, then it is no longer serving its purpose.

The Ohio FEA urges FERC to ensure that the incentive, considered in conjunction with the base ROE, is still producing a rate that is just and reasonable. FERC recognizes, and FEA agrees, that "it can sometimes be difficult to identify the extent to which a particular incentive motivates a transmission developer to take a particular action."[22] We believe this reality illuminates why the granting of incentives ought to occur only in exceptional circumstances. If the Commission cannot reasonably determine that the incentive actually motivated a change in behavior, then the incentive should not be granted.

IV. Conclusion

[22] Notice of Inquiry Regarding the Commission's Transmission Incentives Policy at ¶ 44

The Commission is right to consider substantial revisions to transmission incentive policies that have outlived their usefulness or overcompensate developers at the expense of ratepayers. Some elements can be abolished altogether while others should be rewritten to ensure just and reasonable compensation for the risks and rewards of transmission projects. Prudency reviews, metrics, performance-based ratemaking and other controls can add to the integrity of federal policy and we support any movement toward greater accountability – from inception and throughout the useful life of projects. The Ohio FEA thanks FERC for raising sweeping questions about the present and future state of transmission development, and for considering our recommendations on how to address that future.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing has been served in accordance with 18 C.F.R. Section 385.2010 upon each person designated on the official service list compiled by the Secretary in this proceeding.

/s/ Thomas W. McNamee
Thomas W. McNamee
Assistant Attorney General

Dated at Columbus, Ohio, this June 26, 2019.

Document Content(s)

NOI Transmission Incentives and ROE 6.26.19 final.DOCX.....1-17