

CAN INDEPENDENT TRANSMISSION REMAIN A VIABLE
BUSINESS IN THE US:
RECENT POLICY AND FEDERAL CASES RAISE CONCERNS

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On June 2, 2011, Standard & Poor's issued a research report *Tracking Investment In New U.S. Electric Transmission Infrastructure*. The 12 page report is a detailed look into the current state of U.S. transmission infrastructure and the scope of possible new investment opportunities in that sector of the utility industry. While the S&P report is generally bullish, predicting \$11 billion to \$15 billion in new transmission spending annually through at least 2015, it also expresses serious concerns about whether regulators will approve rates that will allow transmission developers to recover their investment. Specifically, the S&P report states: "Perhaps the most significant downside from a credit perspective is the continued lack of clarity from lawmakers and regulators on the regulatory framework concerning how costs will be split among various stakeholders."

From the perspective of the independent transmission developer, S&P has accurately summed up their concerns: a lack of clarity from lawmakers and regulators. Recent actions and policy initiatives at the national level have led many industry participants to express concern at the continuing viability of the independent electric transmission business in the United States. These concerns are exacerbated by the action of stakeholders in the utility industry. Consumer advocacy groups and state utility commissions are taking an ever more aggressive posture targeting the rate of return and rate incentives that independent transmission developers require to attract sufficient equity investment and lower cost debt financing necessary to construct and operate their capital intensive projects. Even some transmitting utilities, who may themselves be developing new transmission projects, are taking the position in some cases that existing projects should not be allowed to continue to receive the rates they have previously been granted and relied on in making the decision to invest in transmission infrastructure. Such advocacy adds to the regulatory risk facing transmission developers, which may no longer be able to rely on the ratemaking principles that resulted in a project being financed and constructed in the first place.

There also seems to be an increasing and widening gap between the companies that take the huge risks necessary to develop and construct new independent transmission and the users of that transmission. And while independent transmission developers respond that their projects are only being developed in response to clearly identified regional market needs, they are meeting increasing resistance from the users of those lines when the time comes to pay the rates necessary to support their development. In some cases, resistance to the continuation of agreed upon rate principles has arisen after the projects have been financed and built, notwithstanding clearly demonstrated benefits a project has provided to transmission users. While all parties are "stakeholders" in this debate, some stakeholders seem to be trying to impose regulatory and return parameters that will certainly guarantee less independent transmission development being built, all at a time that the U.S. needs it the most.

The issue of whether independent transmission development can remain a viable business depends in many cases on the rate support given to such projects by the Federal Energy Regulatory Commission. These projects operate in the wholesale electricity markets and as such, their rate structures are regulated by FERC as a matter of Federal law. While states may have siting jurisdiction, the ability to charge a particular rate and earn an acceptable return on equity is wholly within FERC's purview. For projects being developed under "market based rate" approval, these issues are not as much of a concern because the project relies on directly negotiated rates with "tenants" under long term contracts to use the capacity of the line. Numerous current example of such market based rate

transmission lines exist.

The real concerns lie with those projects which rely on a FERC approved cost based rate. For those projects, recovery of all costs and return on equity is subject entirely to FERC approval of their rates and it is here that the question is being asked most often, can independent transmission survive as a business under the evolving policies of the FERC?

Though the Federal Energy Regulatory Commission continues to profess support for new independent transmission and has provided healthy incentives for several new development proposals, the same Commission has issued several recent orders which call into question its willingness to continue providing already granted incentives to several fully developed, financed and operating independent transmission lines. The impact of these orders raises the question as to whether they are signaling a change in policy. Or perhaps these orders are foundation of new bifurcated policy where FERC will continue to support incentives for new transmission lines, while pursuing a course of action to reduce the value of those same incentives after a few years of project operation. Without an express proclamation from the agency as to its intent, the industry is left with the prospect of uncertainty and being forced to labor under the development of a new policy being implemented on a case-by-case basis. For anyone seeking to develop a new major transmission line (with current installed cost of \$4 million/mile) this prospect is unsettling and adds to the regulatory risk facing developers.

Further adding to the policy uncertainty as to FERC's true intentions, on May 19th, the agency issued a public notice of inquiry looking into Promoting Transmission Investment Through Pricing Reform. The 42 page Notice of Inquiry contains 74 individual and specific questions for which the Commission is soliciting public comment. Some of the questions clearly signal possible changes in Commission policy. Those questions look at the effects of the existing incentives policy, whether those policies balance the need for regulatory certainty with changing investment climates, and how to best promote investment "with the assurance of just and reasonable rates." The outcome of this Notice of Inquiry may well result in a formal change in national policy goals for supporting the development of new independent transmission. Participation in this FERC proceeding will be important for anyone interested in developing, owning, operating or financing a new transmission project.

At the same time that FERC seems to be well down the path toward articulating a new transmission development policy, its current policy apparently being formulated on a case-by-case basis may give a preference to incumbent companies building new transmission, while ignoring proposals for independently developed transmission. This concern was recently recognized by the President of the California Public Utilities Commission, Michael Peevey. In a letter he sent in May to the California Independent System Operator concerning the CAISO's 2010-2011 Transmission Plan, the CPUC President makes note of the fact that the plan rejects all projects submitted by independent transmission developers as "unnecessary," the net result being a transmission plan for the state of California that is a "a significant step back from the use of competitive solicitations for transmission projects." The letter expresses concern that the current trend (since 2006, 190 projects have been approved costing \$7.5 billion but only Transbay Cable was not incumbent sponsored) "will have the effect of strongly discouraging continued efforts by independent transmission developers to pursue projects in California." The letter concludes by asking the CAISO to "find a more balanced approach to transmission planning at this critical juncture in California's path to greater utilization of renewable resources." It's a powerful letter that could very well influence several ongoing FERC proceedings, including the final rule on transmission planning and cost allocation currently pending at FERC. The letter also expresses the frustration being felt by many in the industry that current policy trends will not give independently developed transmission the chance to compete to build the massive new transmission infrastructure that is needed in the U.S. At the end of the day, it seems clear that FERC's ratemaking policies for transmission development are changing. What is not as clear is whether the changes will provide more regulatory certainty to independent transmission developers or add to the significant risks they already face when the smoke clears.
