

122 FERC ¶ 61,265
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeem G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellingshoff.

Bangor Hydro-Electric Company
Central Maine Power Company
NSTAR Electric & Gas Corporation
New England Power Company
Northeast Utilities Service Company
The United Illuminating Company
Vermont Electric Power Company
Central Vermont Public Service Corp.
Green Mountain Power Corporation

Docket No. ER04-157-014

Florida Power & Light Company –
New England Division

Docket No. ER04-714-006

ORDER ON REHEARING

(Issued March 24, 2008)

1. The Transmission Owners,¹ the New England Consumer-Owned Entities (NECOE),² and the Public Parties³ seek rehearing of *Opinion No. 489*.⁴ For the

¹ Bangor Hydro Electric Company; Central Maine Power Company; NSTAR Electric & Gas Corporation (NSTAR); New England Power Company; Northeast Utilities Service Company (Northeast Utilities); The United Illuminating Company; Vermont Electric Power Company; Central Vermont Public Service Company; Green Mountain Power Company; Florida Power & Light Company – New England Division; Until Energy Systems, Inc.; and Fitchburg Gas and Electric Light Company.

² Connecticut Municipal Electric Energy Cooperative, Massachusetts Municipal Wholesale Electric Company, Vermont Public Power Supply Authority, New Hampshire Electric Cooperative, Inc., Braintree Electric Light Department, Reading Municipal Light Department, and Taunton Municipal Lighting Plant.

reasons discussed below, we grant in part and deny in part rehearing and order a compliance filing.

I. Background

2. In *Opinion No. 489*, the Commission affirmed in part and reversed in part an *Initial Decision* issued May 27, 2005,⁵ regarding a return on equity (ROE) rate component sought by the Transmission Owners in conjunction with their proposed establishment of the ISO New England, Inc. (ISO New England) regional transmission organization (RTO).⁶ *Opinion No. 489* adopted a base-level ROE of 10.2 percent, the midpoint ROE indicated by the range of reasonable returns for a proxy group made up of 10 northeast utility companies.⁷

3. In addition, the Commission also found that three ROE adjustments were warranted: (i) a 50 basis point incentive for RTO participation (as previously granted by the Commission in the *Suspension Order*); (ii) a 100 basis point incentive for new transmission investment; and (iii) a 74 basis point adjustment reflecting updated bond data, as applicable to the period commencing as of the

³ The Connecticut Department of Public Utility Control; the Connecticut Office of Consumer Counsel; the Maine Public Utility Control; the Vermont Department of Public Service, the New England Conference of Public Utility Commissioners; Richard Blumenthal, Attorney General of the State of Connecticut; and the Maine Office of the Public Advocate.

⁴ *Bangor Hydro-Electric Company*, 117 FERC ¶ 61,129 (2006) (*Opinion No. 489*).

⁵ *Bangor Hydro-Electric Company*, 111 FERC ¶ 63,048 (2005) (*Initial Decision*).

⁶ Additional issues relating to the start-up of the ISO New England RTO have been addressed by the Commission in other orders issued in this proceeding. *ISO New England, Inc.*, 106 FERC ¶ 61,280 (*Suspension Order*), *order on reh'g and compliance*, 109 FERC ¶ 61,147 (2004), *order on reh'g and compliance*, 110 FERC ¶ 61,111, *order on reh'g and compliance*, 110 FERC ¶ 61,335, *order on reh'g*, 111 FERC ¶ 61,344 (2005).

⁷ The 10 proxy group companies are: PPL Corporation (PPL), Consolidated Edison, Inc. (Con Ed), Northeast Utilities, Public Service Enterprise Group, Exelon Corporation, Constellation Energy, FirstEnergy Corp., Pepco Holdings, Inc., Energy East Corp., and NSTAR.

issuance date of *Opinion No. 489*. The Commission noted that the resulting ROEs for existing transmission, *i.e.*, without the 100 basis point adjustment which applies only to new transmission, are 10.7 percent for the locked-in period (*i.e.*, from the rate effective date through the issue date of *Opinion No. 489*) and 11.4 percent for the going-forward period. The Commission further noted that the ROEs that will apply to new transmission include the 100 basis point adjustment and are 11.7 percent for the locked-in period and 12.4 percent for the going-forward period.

II. Requests for Rehearing

4. On rehearing, four assertions of error are raised. First, the Transmission Owners challenge the updated input values relied upon by the Commission in calculating the base-level ROE (*see* section IV. A, below). Second, NECOE and the Public Parties challenge the Commission's grant of a 74 basis point adjustment for the going-forward ROE, based on Treasury bond yields (*see* section IV. B, below). Third, NECOE and the Public Parties challenge the Commission's grant of a 100 basis point ROE adjustment for new transmission investment (*see* section IV. C, below). And fourth, NECOE asserts as error the Commission's finding that the ROE incentive adder for new transmission investment apply to projects approved in the ISO New England regional transmission expansion plan (RTEP) (*see* section VI. D, below).

III. Procedural Matters

5. On December 1, 2006, the California Electricity Oversight Board (CEOB) submitted a motion to intervene out-of-time. When late intervention is sought after the issuance of a dispositive order, the prejudice to other parties and burden upon the Commission of granting the late intervention may be substantial. Thus, movants bear a higher burden to demonstrate good cause for granting such late intervention.⁸ CEOB has not met this higher burden of justifying its late intervention. As such, we deny CEOB's motion to intervene out-of-time.

6. Answers to the parties' requests for rehearing were filed by the Transmission Owners, on December 15, 2006, by the Public Parties, on December 21, 2006, and by NECOE, on January 3, 2007. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a request for rehearing unless otherwise ordered by the

⁸ *E.g., Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,250 at P 7 (2003).

decisional authority. We are not persuaded to accept the answers submitted by the Transmission Owners, the Public Parties and NECOE and will, therefore, reject them.

IV. Discussion

A. Whether *Opinion No. 489* Erred in Calculating the Growth Rate of the Proxy Companies

1. *Opinion No. 489*

7. In *Opinion No. 489*, the Commission used a single-step, constant growth, discounted cash flow (DCF) analysis to calculate base-level ROEs for each of the public utilities included in the proxy group. The DCF methodology determines ROE by summing the dividend yield and expected growth rate. The formula is applied as follows: $D/P(1 + .5) + g = k$, where D = Dividend, P = Price, D/P = Dividend Yield, g = the growth rate of dividends per share, and k = the resulting ROE. The Commission calculated the growth rate for each proxy company using the following formula: $g = br + sv$, where b is the expected retention ratio, r is the expected earned rate of return on common equity, s is the percent of common equity expected to be issued annually as new common stock, and v is the equity accretion rate.

8. Using the latest available financial information in the record, as required by Commission policy,⁹ the Commission determined a low-end, base-level ROE of 7.3 percent, as represented by Con Ed, and a high-end, base-level ROE of 13.1 percent, as represented by PPL. The Commission then set the New England Transmission Owner's base-level ROE at the 10.2 percent midpoint of this range of reasonable returns.

9. On rehearing, only one issue is raised concerning the Commission's determination of unadjusted base-level ROE. The Transmission Owners contend that the Commission incorrectly calculated each proxy company's "r" factor in the $br + sv$ growth rate formula. *Opinion No. 489* adopted the base-level ROE calculations in the Transmission Owners' Exh. No. NETO-15, as updated (NETO-15), presented by their witness, Dr. Avera.¹⁰ NETO-15 calculates a low- and high-end base-level ROE for the ten proxy companies, based on the financial

⁹ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 80.

¹⁰ *Id.* P 79.

projections provided by *Value Line* in December 2004. Those projections included projections of each proxy company's earnings per share (EPS), book value per share (BV) and expected earned rate of return on equity per share (the "r" in the br + sv growth formula) for three periods: 2004, 2005, and 2007-09. In determining the growth rate of each of the proxy companies pursuant to the br + sv formula in NETO-15, Dr. Avera did not use the *Value Line* projections of "r" for the three periods. Instead, he calculated an "r" for each of the periods 2004, 2005, and 2007-09 by dividing the *Value Line* EPS projections for each period by the *Value Line* BV projections for each period. He then averaged the resulting returns for the three periods to obtain the "r" to be used in the br + sv formula.

10. In relying on NETO-15, *Opinion No. 489* rejected, without discussion, several alternative exhibits that had also supplied updated financial projections, including Exh. No. NETO-17 (NETO-17). Dr. Avera presented NETO-17 in his rebuttal testimony in order to correct what he asserted was a methodological flaw in NETO-15. Specifically, he stated that NETO-15 failed to adjust the "r" factor in the br + sv formula as required by *Southern California Edison Company*.¹¹

11. In that case, the Commission noted that the projections of "r" in the *Value Line* reports represent projections of year-end returns on common equity for each period, and therefore those returns should be adjusted to account for the growth in common equity during the relevant period to derive an average yearly return. The "r" projections in *SoCal Edison* were for the periods 1999, 2000 and 2003. The Commission determined the average annual growth in common equity during the 1999-2003 period by determining SoCal Edison's outstanding equity in base year 1998 and its forecasted outstanding common equity at the end of 2003 and, based on these numbers, determined the annual percentage growth in common equity during the intervening period.¹²

¹¹ 92 FERC ¶ 61,070, at 61,263 (2000) (*SoCal Edison*) (holding that *Value Line*'s forecasts for return on book value, i.e., the "r" in the "br + sv" equation, "are forecasted year-end returns which must be adjusted by the growth in common equity for the period to derive an average yearly return.").

¹² *Value Line* reported SoCal Edison's "r" as 12.5 percent for both 1999 and 2000 and 11.5 percent for 2003. The average for the three was 12.17 percent. The Commission then determined that SoCal Edison's outstanding common equity in 1998 was \$5.1 billion by multiplying the *Value Line* number for its total capital at the end of 1998 by the common equity ratio of 37.4 percent reported by *Value Line*. The Commission then performed the same calculation for the forecasted year of 2003, using the *Value Line* projections of total capital and an equity ratio of 46 percent to calculate outstanding common equity of \$6.8 billion. The

(continued)

12. In NETO-17, Avera adjusted the “r” amounts he had calculated in NETO-15, using the same method that the Commission used in *SoCal Edison*. Thus, he determined each proxy company’s outstanding common equity in the base year of 2003 and its projected outstanding equity in 2007-09, used those numbers to determine the average annual growth in common equity, and then adjusted his figures for “r” for 2004, 2005, and 2007-09, accordingly. In NETO-17, the low-end implied cost of equity, as represented by Con Ed, was 7.3 percent as in NETO-15. However, the NETO-17 adjustment had the effect of increasing the “r” value for PPL (whose ROE determined the high-end of the zone of reasonableness) from 15.6 percent to 16.5 percent. This, in turn, increased the high-end implied cost of equity, as represented by PPL, from 13.1 percent to 13.7 percent.

13. While the Transmission Owners contended in their brief on exceptions that the Commission should rely on NETO-17 for the correct growth calculations, including the correct figures for “r” in the $br + sv$ formula, *Opinion No. 489* nevertheless relied on NETO-15.

2. Request for Rehearing

14. On rehearing, the Transmission Owners renew their argument below that it was error to rely on NETO-15 and not on NETO-17. Consistent with the argument advanced in their brief opposing exceptions, the Transmission Owners assert that NETO-15 incorrectly calculates the “r” factor (i.e., the return on book value) used in the “ $br + sv$ ” growth component because it is based on a year-end projection from *Value Line*, rather than an average value as used in *SoCal Edison*. The Transmission Owners argue that the average value is methodologically correct because the use of the end-year number fails to account for the growth in common equity during the year and thus understates the actual return on equity. The Transmission Owners argue that unlike NETO-15, NETO-17 is based on average values, consistent with *SoCal Edison*.

15. The Transmission Owners note that NETO-17 was submitted in Dr. Avera’s rebuttal testimony. The Transmission Owners argue, however, that in response to this exhibit, no party requested an opportunity to supplement the record, no discovery was served, and no cross-examination testimony was elicited

\$1.7 billion increase in common equity (\$6.8 billion minus \$5.1 billion) represented an annual growth in common equity (g) of 5.9 percent. The adjustment factor of $2(1+G)/(2+G)$ or 1.0287 was then applied to the average year-end “r” of 12.17 percent to derive the 12.52 percent average yearly return. *SoCal Edison*, 92 FERC ¶ 61,070 at 61,263.

from Dr. Avera. The Transmission Owners conclude that, as such, the evidentiary record in this case contains no basis for rejecting NETO-17.

16. The Transmission Owners add that following the close of the record, NECOE (in its brief to the Presiding Judge) and Staff (in its brief opposing exceptions), advanced factual claims to the effect that NETO-17 contained an adjustment that incorrectly calculated the $br + sv$ growth factor. The Transmission Owners argue that these claims are unsupported by any record evidence and therefore must be rejected.¹³ The Transmission Owners further argue that a reliance on these claims, here, would violate the Transmission Owners' rights to due process, given that the Transmission Owners have not been permitted to respond.

17. The Transmission Owners also offer a substantive response to NECOE and Staff on rehearing. First, the Transmission Owners acknowledge that the "r" value used to compute the $br + sv$ growth rate in both NETO-15 and NETO-17 was calculated by dividing end-of-year earnings per share (EPS) by end-of-the-year book value per share (BV), i.e., that the "r" values reported by *Value Line* were not utilized by Dr. Avera.

18. The Transmission Owners assert, however, that even with their adjusted "r" value, the resulting cost of equity estimates would still have shown a downward bias unless they are further adjusted, even though the BV projections are based on an average number of shares outstanding during the year. The Transmission Owners conclude that, as such, NETO-15 does not fully reflect the growth expectations that are consistent with the theory underlying *SoCal Edison*. The Transmission Owners conclude that to correct for this deficiency, Dr. Avera appropriately revised his calculation of "r," in NETO-17, to account for the growth in book equity, utilizing the same adjustment specified by the Commission in *SoCal Edison*.

¹³ Transmission Owners rehearing request at 4, citing *Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 232-33 (D.C. Cir. 1986); *Transcontinental Gas Pipeline Corp.*, 94 FERC ¶ 61,066, at 61,278 (2001); *Northeast Pipeline Corp.*, 92 FERC ¶ 61,287, at 62,015 (2000); and *Kentucky West Virginia Gas Co.*, 43 FERC ¶ 61,496, at 62,224 (1988).

3. Commission Findings

19. We grant rehearing in part. In *SoCal Edison*, the Commission calculated an ROE using a single-step,¹⁴ constant growth DCF analysis. For “r,” i.e., the expected earned rate of return on common equity, the Commission relied on *Value Line* projections. However, the Commission also noted that these projections are based on year-end returns which must be adjusted by the growth in common equity for the period to derive an average yearly return. This adjustment is appropriate because, as the Transmission Owners argue, the use of an end-year number fails to account for the growth in common equity during the year and thus, if not adjusted, understates the actual return on equity.

20. To accomplish this adjustment, *SoCal Edison* utilized an adjustment factor which reflected the projected growth in common equity based on *Value Line* data as described above.¹⁵ We agree with the Transmission Owners that the adjustment applied by the Commission in *SoCal Edison* should be applied here, consistent with our precedent. We also acknowledge that this adjustment was reflected, in part, in NETO-17. Specifically, NETO-17 adjusts the average “r” values for each of the proxy companies, including, as relevant here, PPL (from 15.6 percent to 16.5 percent). The resulting midpoint, base-level ROE is 10.5 percent.

21. However, NETO-17, as well as NETO-15, reflects an additional adjustment that was not applied by the Commission in *SoCal Edison*. Specifically, neither NETO-17 nor NETO-15 utilizes the *Value Line* inputs for “r,” as required by *SoCal Edison*. Instead, these exhibits calculate “r” by dividing two other inputs provided by *Value Line*, i.e., by dividing EPS by BV. This calculation is reflected in Dr. Avera’s workpapers (NECOE Exh. No. 35) and is further acknowledged by the Transmission Owners in their rehearing request.¹⁶ The effect of this adjustment increases “r” from 15.3 percent to 15.5 percent.

¹⁴ The single-step, constant growth DCF analysis relies on a single growth projection, as supplied by *Value Line*. The two-step methodology relies on a second, long-term growth projection representing the forecasted growth of the economy as a whole as reflected in gross domestic product (GDP). See *SoCal Edison*, 92 FERC ¶ 61,070 at 61,261-63.

¹⁵ See *supra* note 12, describing the relevant *SoCal Edison* calculations.

¹⁶ Transmission Owners’ request for rehearing at 5.

22. Consistent with *SoCal Edison*, then, this adjustment must be backed out. As revised, the appropriate “r” is 15.3 percent (applying the *SoCal Edison* adjustment) and the resulting midpoint, base-level ROE is 10.4 percent, as opposed to 10.5 percent. Accordingly, we direct the Transmission Owners to make a compliance filing, within 30 days of the date of this order, addressing their refund obligation from the rate-effective date going forward, based on this revision.

23. Finally, the Transmission Owners assert that NETO-17 was not challenged at hearing and therefore may not be revised or rejected (in whole, or in part) on rehearing. We disagree. The revision we require here is consistent with *SoCal Edison* and does not rely on post-hearing evidence.

B. Whether Opinion No. 489 Erred in Adjusting the Allowed Return on Equity Based on Updated Treasury Bond Yields

1. Opinion No. 489

24. In *Opinion No. 489*, the Commission accepted an upward adjustment to the midpoint, base-level ROE based on the use of the most recent bond data. The Commission noted that, because capital market conditions may change significantly between the time the record closes and the date on which the Commission issues a final decision, it has consistently required the use of updated data in setting a public utility’s ROE for the period subsequent to the date of the Commission’s ruling. The Commission further found that the monthly yields on ten-year constant maturity U.S. Treasury bonds provide a good indicator of these trends and should be relied upon, consistent with Commission precedent.¹⁷

25. The Commission found that for the six-month period reflected in Staff’s updated financial projections, i.e., for the period July 2004 through December 2004, the average monthly yield on Treasury bonds was 4.2 percent, while the most recent bond data (for the period March 2006 through August 2006), produces an average monthly yield of 5.0 percent (a difference of 74 basis point).¹⁸ The Commission found that adjusting the ROE for the going-forward period by this amount (inclusive of the base-level ROE and the other incentives noted above)

¹⁷ *Id.*

¹⁸ *Id.* P 19, citing the Federal Reserve Board, *Statistics: Releases and Historical Data* (2006).

raised the ROE from 11.7 percent to 12.4 percent, an ROE level that falls within the zone of reasonableness.¹⁹

2. Requests for Rehearing

26. On rehearing, NECOE and the Public Parties challenge the Commission's 74 basis point adjustment. First, the Public Parties argue that while the Commission should in some circumstances (e.g., under the circumstances presented in *Union Electric*) reduce a going-forward ROE to reflect current financial conditions, the ROE should never be increased, given the unilateral right of the public utility to file a new section 205 rate case. The Public Parties add that any such revision should be based on average monthly yields for utility bonds, not Treasury bonds.

27. NECOE and the Public Parties also challenge the assumption that the Transmission Owners' costs of transmission equity capital rise or fall on a one-for-one lockstep basis with monthly yields on 10-year Treasury bonds. The Public Parties argue that, to the contrary, testimony presented in this proceeding by Dr. Avera demonstrates that changes in the cost of debt correlate with a much smaller change in the cost of equity, so that equity returns can be expected to increase only about 100 basis points for each 200 basis points increase in interest rates. The Public Parties also rely on a 1995 analysis examining 13 years of data relating to 30 electric utilities.²⁰ The Public Parties argue that, according to this study, the equity risk premium increased approximately 37 percent for each 100 basis-point change in Treasury bond yields.

28. NECOE adds that assuming any such adjustment should be made here, it should be no larger than half of the Treasury yield movement, as Dr. Avera testified. NECOE asserts that, as such, reliance on a 74 basis point increase in Treasury yields should have resulted in, at most, a 37-basis point going-forward increase in the applicable ROE.

29. NECOE also argues that the Commission's reliance on *Union Electric* is unsupported. NECOE asserts that on appeal of that case, the Court of Appeals for the District of Columbia Circuit held that the Commission had failed to give the

¹⁹ *Id.*

²⁰ Farris M. Maddox, Donna T. Pittert, and Rodney N. Sullivan, *An Empirical Study Ex Ante Risk Premiums for the Electric Utility Industry*, Financial Management, Vol. 24, No. 3 (Autumn 1995).

parties a fair evidentiary opportunity to test the Commission's reliance on a one-for-one correlation. NECOE adds that, on remand, the Commission held that no such adjustment was warranted.²¹ The Public Parties argue that in *S.C. Generating Co., Inc.*,²² the Commission acknowledged that a one-for-one correlation between fluctuations in Treasury bond rates and fluctuations in the cost of utility equity capital has not been established.

3. Commission Findings

30. We deny NECOE's and the Public Parties' requests for rehearing regarding the Commission's 74 basis point upward adjustment to the Transmission Owners' base-level ROE for the going-forward period. The Commission's policy is to update prospective rates of return when there has been a passage of time between the close of the record and the date the Commission issues a final decision. This ensures that the prospective ROE is as accurate as possible.²³

31. NECOE and the Public Parties argue that there is not a sufficient relationship between changes in Treasury bond yields and equity returns to support use of changes in bond yields for the purpose of this adjustment. The Public Parties argue that the Commission's order in *S.C. Generating* provides support for this argument. However, the Commission has long endorsed the use of ten-year, constant maturity U.S. Treasury bonds as a good financial indicator of trends in market costs of capital and has therefore consistently used these Treasury bond rates to adjust an allowed ROE, subject only to the requirement that the adjustment fall within the zone of reasonable returns indicated by the applicable DCF analysis and then a finding under Federal Power Act (FPA) section 205 that the resulting rate is not unjust or unreasonable.²⁴ The Commission has done so, moreover, in *S.C. Generating* and other cases based on the understanding that

²¹ NECOE request for rehearing, *citing Union Elec. Co.*, 51 FERC ¶ 61,321 (1990).

²² 44 FERC ¶ 61,008, at 61,039 (1988) (*S.C. Generating*).

²³ *See City of Vernon, California*, 112 FERC ¶ 61,207, at P 63 (2005).

²⁴ *See System Energy Resources, Inc.*, 92 FERC ¶ 61,119, at 61,447 (2000); *Northeast Utilities Service Co.*, 83 FERC ¶ 61,184 at 61,765, *reh'g denied*, 84 FERC ¶ 61,159 (1998); *Orange and Rockland Utils., Inc.*, 45 FERC ¶ 61,252, at 61,753 (1988); *compare SoCal Edison*, 92 FERC ¶ 61,070 at 61,267 (updating not required in the case of a reopened record).

these bond rates are intended reflect changes in capital costs, in general, not changes in company-specific business or financial risk.²⁵ As such, the Commission is not required to establish a specific, mathematical correlation of the sort advocated by the Public Parties.

32. Moreover, as the court found in *Boston Edison Co. v. FERC*,²⁶ quoting the Supreme Court, “even if we assume, for the sake of argument, that changes in reasonable utility share returns do not exactly track changes in bond interest rates, ... ‘infirmities’ in Commission methodology are ‘not ... important,’ provided that the ‘result reached,’ the ‘impact of the rate order,’ cannot be said to be unjust and unreasonable.”

33. We also reject the Public Parties’ argument that, given the right of a public utility to file a new rate case, ROE adjustments to reflect updated bond data should only be made to lower an allowed ROE. Because the purpose of the adjustment is to ensure that the prospective return reflects current capital market conditions, the adjustment should be made regardless of whether bond yields have gone up or down. Moreover, the initial filing submitted in this case was made subject to our existing policy that the ROE, once established, would reflect current capital conditions.

34. We also disagree with NECOE that the remand proceeding in *Union Electric* supports a different result. *Union Electric*, on appeal, was remanded to the Commission not because the Commission had adjusted the ROE based on a one-on-one debt to equity correlation. Rather, the case was remanded for further proceedings because the resulting ROE was outside the zone of reasonable returns.²⁷ In the instant case, by contrast, the Commission’s 74 basis point adjustment is well within the zone of reasonable returns.

²⁵ See *SC. Generating*, 44 FERC ¶ 61,009 at 61,039.

²⁶ 885 F.2d 962, 967 (1st Cir. 1989), quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

²⁷ *Union Electric Co. v. FERC*, 890 F.2d 1193, 1204 (D.C. Cir. 1989).

C. **Whether *Opinion No. 489* Erred in Finding that the Base-Level Return on Equity Should Be Increased By 100 Basis Points To Encourage Investment in New Transmission**

1. ***Opinion No. 489***

35. In *Opinion No. 489*, the Commission reversed the *Initial Decision*'s rejection of the Transmission Owners' proposed 100 basis point ROE adder for new transmission investment. The rejection was based on the Presiding Judge's finding that the proposed incentive would not: (i) assist applicants in obtaining financing for their transmission projects; (ii) lead to the timelier implementation of these projects; (iii) cause these projects to be built; or (iv) allow the transmission owners to overcome the problems inherent in siting new transmission.²⁸

36. In *Opinion No. 489*, the Commission rejected these findings, noting as a threshold matter that the *Initial Decision* had applied an inappropriate "but for" analysis in its consideration of the requested incentive. The Commission found that the "but for" standard was inappropriate because it required the Transmission Owners to demonstrate that the construction of new transmission facilities would not occur without the ROE incentive. The Commission found, however, that this standard would be impossible to meet. The Commission explained that it would be difficult to quantify the extent to which an ROE incentive would help overcome risks and obstacles involved in constructing a new transmission project. As a result, the Commission stated that it could not conceive of a case in which an applicant could ever make a showing with certainty that, absent a 100 basis point incentive, a transmission project would not be built.

37. In place of this "but for" standard, the Commission adopted a two-prong analysis: (i) whether the proposed incentive falls within the zone of reasonable returns; and (ii) whether there is some link, or nexus, between the incentives being requested and the investment being made, i.e., whether the proposed ROE incentive is rationally related to the investments being proposed.²⁹ In applying this standard, the Commission noted, first, that the proposed ROE incentive, when added to the authorized base-level ROE, falls within the zone of reasonable returns as identified in the applicable DCF analysis, thus satisfying the first prong of the Commission's analysis.

²⁸ *Initial Decision*, 111 FERC ¶ 63,048 at P 158-66.

²⁹ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 105.

38. The Commission also found that the second prong of the analysis was satisfied, i.e., there was sufficient evidence demonstrating a link between the cost of the ROE incentive and the benefits to be derived from it. The Commission observed that there is a need for the projects to which the proposed incentive will apply, as evidenced by ISO New England's RTEP study and the analyses made pursuant to this process. The Commission noted that, under ISO New England's open access transmission tariff (OATT), ISO New England is responsible for independently assessing system reliability and market efficiency needs, providing information about regional system needs to market participants, and identifying regulated transmission solutions in the event a market solution is not forthcoming in response to ISO New England's identified needs. The Commission also found that the 2004 RTEP had identified specific projects necessary to satisfy the needs of the region. The Commission found that, as such, the proposed incentive will apply only to projects that meet a demonstrated need.

39. The Commission also found that the proposed incentive will assist ISO New England in bringing these projects on line in a timely fashion. Specifically, the Commission agreed with the Transmission Owners that the proposed incentive will give project owners a significant impetus to push hard for their projects at all phases of the approval process. The Commission also found that the proposed incentive will assist the Transmission Owners in obtaining favorable financing terms for their projects. The Commission found that, as such, ratepayers would benefit from the proposed incentive.

40. The Commission rejected the *Initial Decision's* finding that an ROE incentive could lead to the construction of unnecessary projects. The Commission noted that the incentive will apply only to projects approved through ISO New England's RTEP process. Finally, the Commission noted that approval of the applicants' incentive rate request was consistent with the Commission's prior decisions with respect to analogous incentive rate requests,³⁰ as well as Order No. 679.³¹

³⁰ *Id.* P 113, citing, *PJM Interconnection LLC*, 104 FERC ¶ 61,124, at P 75 (2003); *Allegheny Energy, Inc.*, 116 FERC ¶ 61,058 (2006); and *American Electric Power Service Corp.*, 116 FERC ¶ 61,059 (2006).

³¹ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

2. Requests for Rehearing

41. On rehearing, NECOE argues that *Opinion No. 489* erred in not requiring the Transmission Owners to demonstrate, as a condition to receiving their proposed incentive rate, that new transmission investment would not have been undertaken “but for” the incentive rate. NECOE argues that this standard is consistent with Commission precedent. Specifically, NECOE asserts that to be just and reasonable, an incentive element of a rate must assure that the rate increase that would be authorized will not be levied upon consumers unless accompanied by increased supplies.³² NECOE also argues that rewriting the evidentiary standard on this issue, in an opinion following the issuance of the *Initial Decision*, violates the parties’ due process rights.³³

42. The Public Parties argue that the two-prong analysis applied by the Commission is so indiscriminate that it would ratify virtually every proposal for an inflated ROE. The Public Parties assert that the standard that should be applied is whether the Transmission Owners’ performance with an incentive adder will exceed their performance without it, thereby better serving the public.³⁴

43. NECOE and the Public Parties add that there is no link, nexus, rational relationship, or any other connection between the payment by ratepayers of the proposed incentive and the transmission investments that have or will be made by the Transmission Owners. NECOE argues that the record, in this regard, clearly demonstrates that an incentive rate is not needed to incent investment in new

³² NECOE request for rehearing at 16, *citing Mobil Oil Corp. v. FPC*, 417 U.S. 283, 318 (1974); *Farmers Union Cent. Exch. Inc. v. FERC*, 734 F.2d 1486, 1503 (D.C. Cir. 1984) (the Commission must at least attempt to calibrate the relationship between increased rates and the attraction of new capital); *Public Serv. Comm’n of New York v. FERC*, 589 F.2d 542, 553 (D.C. Cir. 1978); *Public Serv. Comm’n of Kentucky v. FERC*, 397 F.3d 1004, 1012 (D.C. Cir. 2005) (*Kentucky Commission*).

³³ *Id.* 13, *citing Kentucky Commission*, 397 F.3d at 1012 (the Commission may not establish one governing standard of proof and then reach its conclusion based on a different standard); *Hatch v. FERC*, 654 F.2d 825, 833-38 (D.C. Cir. 1981) (refusing to uphold a Commission conclusion reached based on standard of proof different from that required at trial).

³⁴ Public Parties request for rehearing at 15, *citing City of Detroit v. FPC*, 230 F.2d 81-0 (D.C. Cir. 1955).

transmission. NECOE relies on applicants' witness, Jeffrey Scott, the chief operating officer for National Grid, who stated, at hearing, that "projects would be built regardless of whether the adder was granted."³⁵ NECOE also relies on applicants' witness, Michael Schnitzer, who testified that "[i]t's a question of when and how expeditiously the projects get completed, not if the projects get completed."³⁶ The Public Parties add that if the Commission had evaluated the record as a whole, it would be clear that awarding a 100 basis point adder will do nothing to expedite or facilitate needed transmission improvements.

44. NECOE and the Public Parties also challenge the Commission's finding that there is a need for the projects to which the applicants' proposed incentive rate will apply. NECOE responds that this need, as reflected in the existence of a RTEP project list, does not support a bonus ROE payment in order to get the projects at issue built, or built faster. NECOE and the Public Parties argue, to the contrary, that the inclusion of a project in ISO New England's RTEP triggers a contractual and regulatory obligation to build on the part of the transmission owner with, or without, the ROE incentive.

45. NECOE and the Public Parties also challenge the Commission's finding that utilities can be expected to respond to financial motivations and, in so responding, to expend the time and effort necessary to sell the importance of their projects at the local level. NECOE asserts that there is no evidence of this correlation in the record. NECOE further argues that applicants failed to demonstrate that raising the price for a given transmission project, through the grant of an incentive rate, will render the project more palatable to state siting authorities or to customers. In addition, NECOE argues that an incentive rate cannot be expected to provide a significant impetus to the applicants to push harder for their projects if they are already expending their fullest possible efforts. NECOE adds that any additional "push," in this regard, may well be met with a corresponding "push back" by any entity at the local level determined to defeat the project.

46. NECOE challenges the Commission's reliance on witness Schnitzer's testimony, at hearing, that an incentive of 100 basis points is sufficient in size to incent a transmission owner to expend the time and effort necessary to sell the

³⁵ Tr. 718 and 775.

³⁶ *Id.* 987:20-988:1.

importance of its projects at the local level.³⁷ First, NECOE challenges Mr. Schnitzer's qualifications to offer evidence on this issue. NECOE also argues that Mr. Schnitzer's testimony was contradicted by additional statements made by Mr. Schnitzer at hearing. Specifically, NECOE points to Mr. Schnitzer's statement, on cross-examination, that the incentive rate, if granted, would not trigger an investment response by the transmission owners.³⁸ NECOE also argues that Mr. Schnitzer's conclusions were not supported by quantified findings.

47. NECOE and the Public Parties also challenge the Commission's finding that the proposed incentive rate will assist the Transmission Owners in obtaining favorable financing terms for their projects. NECOE asserts that the only support cited by the Commission was witness Scott's testimony explaining that while it was unlikely that National Grid would be unable to fund its obligations, the "question is at what price will [it] be able to raise the capital to do that and what the share price would be as a result of the effect." NECOE responds that Mr. Scott did not address this issue in his pre-filed testimony, nor did he elaborate at hearing on the "effect" to which he testified, let alone whether it was needed to incent transmission investment. The Public Parties add that to justify a 100 basis point ROE incentive, the Transmission Owners were required to demonstrate that they had been unable to obtain capital to fund their transmission projects.

48. NECOE also challenges the Commission's finding that the favorable impact of the incentive rate on financing costs will also support the timely construction of the needed transmission. NECOE responds that how or why this is true was never explained by the Commission. NECOE argues that, in fact, Mr. Schnitzer conceded at hearing that the contrary was true, i.e., that there was no way to know whether paying for the incentive rate would result in more timely construction of new transmission.³⁹

49. NECOE also challenges the Commission's finding that, on balance and based on the specific record evidence presented here, the timely, successful completion of ISO New England's requested additions to its transmission grid will inure to the benefit of ratepayers. NECOE responds that the validity of this

³⁷ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 109, *citing* Tr. 217; 220; 725-27; 955-59; Exh. Nos. NETO-19 at 24-25 and NETO-23 at 31.

³⁸ Tr. 987:20-24.

³⁹ NECOE request for rehearing at 32, *citing* Exh. No. NETO-23 at 32:7-8; Tr. 941:12-942:1.

finding is dubious, given the possibility that the rate incentive will lead to the construction of unnecessary projects. NECOE also argues that it has not been demonstrated here that ISO New England, through its RTEP approvals, will be able to operate as a check on this over-building. NECOE adds that regardless, the Commission's finding is irrelevant because the issue presented here is not whether it would be cost effective to build new transmission, but whether payment of the proposed incentive is needed to incent construction.

50. Finally, the Public Parties argue that the Commission's authorizations are inconsistent with Order No. 679. The Public Parties argue that, under Order No. 679, the Commission's policy is not to grant incentive-based ROEs to every new investment that increases reliability or reduces congestion.

3. Commission Findings

51. We grant rehearing in part. For the reasons discussed below, we reaffirm the Commission's approval of a 100 basis point ROE incentive for existing RTEP-approved projects, provided that these projects are completed and come on line as of December 31, 2008. However, we will not extend a pre-approved authorization for any future projects without a specific showing justifying the incentive on a project-by-project basis, consistent with the requirements of Order No. 679. Accordingly, we grant rehearing, in part, and require that all subsequent projects for which an incentive rate is sought satisfy the Commission's policy, as set forth in Order No. 679.

a. Incentive Rate Requirements

52. In *Opinion No. 489*, the Commission noted that it was not relying on Order No. 679 because that order did not issue until after the close of the record in this case. However, the Commission found that the ROE incentive it was approving and the analysis used to evaluate the incentive are consistent with the policy established in Order No. 679.⁴⁰

53. We continue to believe that *Opinion No. 489* was consistent, in most respects, with our general policy on incentive rates adopted in Order No. 679. We also reaffirm, as discussed more fully in the next section, that our granting of incentive rates was supported by substantial evidence in the record and was

⁴⁰ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 113.

otherwise consistent with our discretion to adopt incentive adders as affirmed by the Court in *Maine Public Utilities Commission v. FERC*.⁴¹

54. However, we also believe that the New England region should, over time, be held to the same standards for incentive rates as each other region that is subject to Order No. 679. In this regard, we note that Order No. 679 authorizes incentive rates for specific projects that are identified in, and supported by, an application for incentive rates, whereas *Opinion No. 489* granted incentive rates for all future projects in New England that met certain conditions. While this difference is not meaningful for recently constructed projects in New England because the record contained substantial evidence regarding those projects, the same is not true for all future projects. Therefore, we believe it is appropriate for New England to transition from the approach taken in *Opinion No. 489* to the policy adopted in Order No. 679.

55. Specifically, we find that the *Opinion No. 489* standard will continue to apply to the Transmission Owners' existing RTEP-approved projects if completed and placed into service by December 31, 2008, i.e., the cut-off date applicable to ISO New England's annual formula rate filing. We note that while ISO New England's 2008 annual rate filing is made in July of each year, it is based on calendar-year cost projections, reflecting both anticipated and actual transmission project additions over the 12 month calendar year. Given the project owners' reasonable reliance on these filed rates and the lead time needed to prepare this year's filing, a December 31, 2008 cut off date is appropriate. However, for the reasons discussed below, an incentive rate applicable to any future projects will require a separate filing demonstrating that these projects satisfy the requirements of Order No. 679.

56. We now explain in further detail below how our general policy adopted in Order No. 679, including its evolution as applied in specific cases, compares to the approach taken in *Opinion No. 489* and we further articulate our reasons for adopting a transition for the New England region to the requirements of Order No. 679.

57. In section 1241 of the Energy Policy Act of 2005 (EPAAct 2005),⁴² Congress added section 219 to the FPA, directing the Commission to establish, by rule, incentive-based (including performance-based) rate treatments. In response, the

⁴¹ 454 F.3d 278, 289 (D.C. Cir. 2006) (*Maine PUC*).

⁴² Pub L. No. 109-58, § 1241, 119 Stat 594, 961 (2005).

Commission issued Order No. 679, setting forth the processes by which a public utility can seek transmission rate incentives pursuant to FPA section 219.

58. Pursuant to Order No. 679, a public utility may file either a petition for a declaratory order or a section 205 filing to obtain incentive rate treatment for transmission infrastructure investment that satisfies the requirements of section 219, *i.e.*, the applicant must demonstrate that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion.⁴³ Order No. 679 also established a process for an applicant to follow to demonstrate that a transmission project meets this standard, including a rebuttable presumption that the standard is met if: (i) the transmission project results from a fair and open regional planning process that considers and evaluates projects for reliability and/or congestion and is found to be acceptable to the Commission; or (ii) a project has received construction approval from an appropriate state commission or state siting authority.⁴⁴

59. In Order No. 679-A, the Commission clarified the operation of this rebuttable presumption by noting that the authorities and/or processes on which it is based (*i.e.*, a regional planning process, a state commission, or siting authority) must, in fact, consider whether the project ensures reliability or reduces the cost of delivered power by reducing congestion.⁴⁵ Order No. 679-A also clarified that to meet the nexus test, an applicant will be required to demonstrate that the total package of incentives requested by the applicant is tailored to address the demonstrable risks and challenges faced by that applicant in undertaking the projects at issue.⁴⁶

60. In *Baltimore Gas & Electric Co. (BGE)*,⁴⁷ the Commission further clarified the operation of this nexus test. The Commission held that when an applicant has adequately demonstrated that the project for which it requests an incentive is not routine, that applicant has, for purposes of the nexus test, shown that the project

⁴³ 18 C.F.R. § 35.35(i) (2007).

⁴⁴ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 58.

⁴⁵ *Id.* P 49.

⁴⁶ *Id.* P 21.

⁴⁷ 120 FERC ¶ 61,084 (2007), *order on reh'g*, 122 FERC ¶ 61,034 (2008) (*BGE Rehearing Order*).

faces risks and challenges that merit an incentive. The Commission added that, by definition, projects that are not routine face inherent risks and challenges and/or provide benefits that are worthy of incentives.⁴⁸ In the *BGE Rehearing Order*, the Commission also clarified that it would not approve a rate incentive rate applicable to future projects, absent the submission of a separate application seeking this authorization on a project-specific basis.⁴⁹

61. As noted above, the hearing in this case was held prior to Order No. 679. In addition, both the parties' briefs on exceptions and the *Initial Decision* came before the issuance of this new policy. *Opinion No. 489*, moreover, was issued prior to the policy clarifications made by the Commission in Order No. 679-A and prior to the interpretations and further clarifications of this policy, as set forth in a number of proceedings that have subsequently been decided by the Commission.⁵⁰

62. In *Opinion No. 489*, the Commission noted that the standard it had used to approve the Transmission Owners' proposed ROE incentive was "consistent" with Order No. 679.⁵¹ However, based on the clarifications set forth by the Commission in Order No. 679-A and subsequent cases, we find that it is not consistent with Order No. 679 to authorize incentives for all future projects approved in the ISO New England RTEP. *Opinion No. 489*, in addition to requiring that the requested ROE incentive not exceed the zone of reasonable returns, required only that there be a rational relationship between the investment being made and the requested incentive, i.e., that there be "some link, or nexus" between the two.

63. The Commission also found that an evidentiary record that focused on the RTEP process in its broadest contours was sufficient to carry this burden, without the need to consider the various classes of RTEP projects involved, or the specific projects themselves. Accordingly, the Commission's authorizations extended to

⁴⁸ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 54.

⁴⁹ *BGE Rehearing Order*, 122 FERC ¶ 61,034 at P11; *San Diego Gas & Electric Co.*, 118 FERC ¶ 61,073 at P23 (2007).

⁵⁰ See, e.g., *BGE*, 120 FERC ¶ 61,084 at P 46-55; *American Electric Power Service Corporation*, 116 FERC ¶ 61,041 (2006), *order on reh'g*, 118 FERC ¶ 61,041 (2007); *Commonwealth Edison Co.*, 119 FERC ¶ 61,238 (2007), *order on reh'g*, 122 FERC ¶ 61,037 (2008).

⁵¹ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 113.

all RTEP-approved projects, in perpetuity, without the need for any further factual showings of any kind. By contrast, and as noted above, Order No. 679 requires, among other things, a case-by-case consideration of the projects at issue. Given this distinction, we decline to extend the *Opinion No. 489* rate incentive authorizations in perpetuity. Specifically, projects that have not come on line, or have not been proposed or even envisioned, should not be exempt from our new policy. In fact, such a result would cause transmission investment in New England to be treated differently than transmission investment in the remainder of the country.

64. Accordingly, we grant rehearing regarding the prospective effect of *Opinion No. 489*. Project owners seeking a transmission investment incentive for a project scheduled to be completed after December 31, 2008 are required to make a section 205 filing and, in so doing, satisfy the requirements of Order No. 679. A project owner required to make such filing will not be prejudiced provided that its project satisfies the requirements of Order No. 679.

**b. Application of the *Opinion No. 489* Standard
To the Locked-In Period**

65. For the reasons discussed below, we will not apply the requirements of Order No. 679 to the locked-in period at issue here. First, we note that the hearing in this case was held under a different standard. In March 2004, when the Commission accepted, suspended, and set for hearing the Transmission Owners' ROE incentive proposal, the Commission cited a proposed policy statement allowing applicants to seek "a generic ROE-based incentive equal to 100 basis points for investment in new transmission facilities [that have been] found [to be] appropriate pursuant to an RTO planning process."⁵² Under the proposed policy statement, the proposed incentive would also have been required to fall within the range of reasonable returns established by the proxy group. The *Suspension Order* stated that its acceptance of the Transmission Owners' proposed incentive would be subject to the application of this policy statement, when issued.⁵³

66. The *Suspension Order* also stated that, consistent with *PJM Interconnection, L.L.C.*,⁵⁴ the applicants "would be required to demonstrate why

⁵² *Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid*, 102 FERC ¶ 61,032, at P 32 (2003).

⁵³ *Suspension Order*, 106 FERC ¶ 61,280 at P 249.

⁵⁴ 106 FERC ¶ 61,124 at P 75 (2004).

the adder is needed to incent investment in new transmission facilities and whether the adder should apply to all types of transmission expansion or be more narrowly focused on transmission expansions that utilize innovative, less expensive technologies.”⁵⁵ On rehearing of the *Suspension Order*, the Commission reiterated that the 100 basis point adder would encourage vital capital investment and clarified that the parties should consider whether the adder should apply to all projects approved through the RTEP process or be applied more narrowly to certain specified types of projects.⁵⁶

67. *Opinion No. 489* applied the standard required by the *Suspension Order* and order on rehearing. *Opinion No. 489* summarized this standard as requiring a showing that the proposed incentive: (i) falls within the range of reasonable returns; and (ii) bears some link or nexus between the incentive requested and the investment being made, *i.e.* that the incentive is rationally related to the investments being proposed.⁵⁷ As such, the *Suspension Order* and order on

⁵⁵ *Suspension Order*, 106 FERC ¶ 61,280, at P 249.

⁵⁶ The rehearing order stated:

[A 100-basis-point adder] is an appropriate first step to encouraging vital capital investment in the enlargement, improvement, maintenance, and operation of facilities for the transmission of electric energy in interstate commerce. In order to avoid any potential delay in the hearing as a result of this directive, we find it necessary to provide guidance regarding the types of investments that would qualify for this adder. We direct the parties and the presiding judge to develop a record, in this case, addressing the pros and cons of applying a 100 basis point adder for investment that, among other things: (i) are approved through the RTEP process; (ii) are capable of being installed relatively quickly; (iii) include the use of improved materials that allow significant increases in transfer capacity using existing rights-of-way and structures; (iv) utilize equipment that allows greater control of energy flows, enabling greater use of existing facilities; (v) has sophisticated monitoring and communication equipment that allows real-time rating of transmission facilities, facilitating greater use of existing transmission facilities; or (vi) is a new technology and/or innovation that will increase regional transfer capability.

109 FERC ¶ 61,147 at P 206.

⁵⁷ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 105.

rehearing did not require the type of project-by-project analysis we have subsequently required in Order No. 679 and its progeny. Rather, these orders essentially directed the parties to address the more general issue whether the 100 basis point adder was needed to provide an incentive for investment in any new transmission facilities which might be included in a future RTEP or whether the incentive should be limited to certain narrower types of facilities that might be approved in the future.

68. The Presiding Judge conducted the hearing in this case in late January 2005, before Congress' August 2005 adoption of EPAct 2005 and before the July 2006 issuance of Order No. 679. Consistent with the guidance the Commission gave in the *Suspension Order* and the order on rehearing of the *Suspension Order*, most of the evidence presented at the hearing focused on the questions of: (i) whether the 100 basis point adder was needed to provide an incentive for the transmission owners to invest in the overall category of RTEP-approved new transmission facilities; and (ii) whether the facilities in question should be limited to narrower categories of facility as described above.⁵⁸ As such, the record does not include the evidence that Order No. 679 would require, including project-specific evidence and testimony.

69. However, we find that remand of this case to the Presiding Judge to give the parties an opportunity to present additional evidence required by Order No. 679 is neither necessary nor appropriate. This is so given our finding, below, that the authorizations granted by the Commission in *Opinion No. 489*, for the locked-in period, while decided under a standard that is distinguishable from the Order No. 679 standard, nonetheless fall within the zone of reasonable returns. These findings support our determination, under FPA section 205, that the ROE incentive is just and reasonable.

70. Remanding this case back to the Presiding Judge under these circumstances for the presentation of project-by-project evidence, would be an administrative burden on the Commission and on the parties themselves. It would also create unnecessary confusion and uncertainty concerning the availability of an ROE

⁵⁸ For example, on the first issue, NECOE and the Public Parties argued that the Transmission Owners are already contractually bound to construct all facilities listed in the RTEP, and thus argued that no special financial incentive was necessary. The Transmission Owners acknowledged this obligation, but countered that a 100 basis point adder would give project owners a significant impetus to expend the time and effort necessary to obtain the various approvals required from local and other regulatory authorities.

incentive for a number of important projects included in the 2004 RTEP, many of which were required to move forward while this case was pending before the Commission. Accordingly, we deny rehearing regarding our incentive rate authorizations for the locked-in period.

71. We note, first, that an ROE incentive is not susceptible to a precise calculation. Rather, the incentive is based on a range of reasonable ROEs, which takes into account a number of factors that may be both cost-related and policy-related.⁵⁹ In *Maine PUC*, the court reviewed the Commission's authority to approve incentive rates, holding that the Commission's determinations "involve matters of rate design . . . [and] policy judgments [that go to] the core of [the Commission's] regulatory responsibilities."⁶⁰ The court further stated that, "the court's review of whether a particular rate design is just and reasonable is highly deferential."⁶¹ In addition, the court rejected the argument that the Commission was required to calibrate the level of benefits that an incentive is designed to produce beyond a finding that the incentive is within the zone of reasonableness.

72. Here, the Commission authorized an ROE incentive within the range of reasonable returns with the objective of encouraging transmission investment. The adjustment attributable to this incentive produced a 12.4 percent ROE, well below the 13.1 percent high-end ROE indicated by the DCF analysis. Moreover, the Commission limited the application of this incentive, holding that it would be available only with respect to new, RTEP-approved, Pool Transmission Facility (PTF) projects that are completed and come on line.⁶²

73. While NECOE and the Public Parties question the extent to which this ROE incentive will produce a consumer benefit that can be definitively calculated, they offer no competing quantification of their own. Nor do they dispute the New England region's need (the need of all customers in the region and the public at

⁵⁹ *Maine PUC*, 454 F.3d at 289.

⁶⁰ *Id.* 288.

⁶¹ *Id.*

⁶² The Transmission Owners initially proposed that their 100 basis point adder apply to both PTF and non-PTF facilities. However, the Commission, in the *Suspension Order*, rejected a blanket adder for non-PTF facilities. *Suspension Order*, 106 FERC ¶ 61,280 at P 249.

large) for additional transmission capacity.⁶³ Under these circumstances, the Commission acted well within its authorized discretion in granting the ROE incentive.

74. We also reject NECOE's and the Public Parties' arguments that the record evidence failed to support the required nexus finding. In fact, the Transmission Owners presented three witnesses on this issue: Dr. Avera, an economist; Mr. Scott, a utility executive with experience in transmission operations and construction; and Mr. Schnitzer, an expert on regulatory policy, finance, and industry restructuring.

75. Dr. Avera testified that the Commission's approval of an incentive ROE would send a message to utilities and public officials involved in siting matters "to try solve some of these problems."⁶⁴ Dr. Avera further testified that "[w]hen you have incentives for private companies, you get better results [by] creat[ing] a level of interest and excitement and commitment on the part of the utility community."⁶⁵ Dr. Avera added that "looking at the world in the narrow view of the economist, if you have economic incentives, people figure out ways to solve problems."⁶⁶

76. Mr. Scott addressed the roles that incentives can play with respect to performance objectives. He testified that, while the full range of actions that can

⁶³ See, e.g., RTEP 2004 (executive summary at 3), Exh. No. NETO-25:

Reliability is at risk in load pockets due to a number of factors, including: continued growth in electricity use, generating unit retirements, continued transmission bottlenecks, and inadequate development of new resources, i.e., new or repowered generation and demand response programs. Resource reliability could also become a major system-wide issue for New England in two to four years, especially if the region continues to experience the factors noted above. Moreover, heavy reliance on natural gas-fired generators that are subject to interruption of fuel supply poses potential reliability issues for the winter peak load periods.

⁶⁴ Tr. 219:4-220:19.

⁶⁵ *Id.* 216:13-217:6.

⁶⁶ *Id.* 217:22-25.

be taken in order to facilitate the development of new transmission is difficult to identify *ex ante*, his own experience as a utility executive under an incentive regime in the United Kingdom demonstrates that utilities respond to such financial motivations.⁶⁷

77. Mr. Schnitzer testified that a higher ROE can incent companies to work their way through the complicated technical, political, regulatory issues associated with the transmission construction process.⁶⁸ He added that economic theory supports the expectation that the 100 basis point ROE adjustment encourages behavior to overcome barriers to transmission investment and that theory shows that an incentive-based regime is a consistently superior approach to achieve a given objective as compared to relying on a purely enforcement-based regime to achieve that objective.⁶⁹ Mr. Schnitzer also explained that the need to address reliability limitations in the New England region could lead to higher consumer costs that could be avoided by the timely implementation of projects currently identified in the RTEP. Specifically, Mr. Schnitzer concluded that the total cost of the incentive, on a pre-tax basis, is \$148.2 million, while the annual benefits will be at least \$76 million.⁷⁰

78. We also reject NECOE's argument that *Opinion No. 489* articulated a new post-hearing analysis contrary to the requirements of due process. In fact, the analysis applied by the Commission in *Opinion No. 489* was the same analysis established by the Commission in the *Suspension Order*.⁷¹ Even assuming that *Opinion No. 489* did rely on a new standard, in whole or in part, this standard, if new, was also less onerous than the "but for" standard applied in the *Initial Decision*. Regardless, NECOE has been given a full and fair opportunity to address the merits of this standard on rehearing.

79. We also reject NECOE's and the Public Parties' arguments that because the Transmission Owners are subject to an obligation to build, an ROE incentive for transmission construction is unnecessary. In fact, a transmission owner's

⁶⁷ *Id.* 725-27; Exh. No. NETO-19 at 24-25.

⁶⁸ *Id.* 955:2-22.

⁶⁹ *Id.* 955-59.

⁷⁰ Exh. No. NETO-23 at 15-26.

⁷¹ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 249.

“obligation” to build does not address the manner or circumstances under which this obligation can, or will, be met in a given case and only applies subject to “the requirements of applicable law, government regulations and approvals ...; the availability of required financing; the ability to acquire necessary rights-of-way; and satisfaction of ... other conditions.”⁷² Moreover, NECOE’s and the Public Parties’ arguments would deny the Commission the authority to grant an ROE transmission investment incentive under *any* circumstances -- an authority that Congress expressly granted the Commission in FPA section 219.

80. We also reject NECOE’s and the Public Parties’ argument that there was insufficient evidence presented at the hearing demonstrating that the proposed incentive rate will assist the Transmission Owners in obtaining favorable financing terms for their projects. As the Commission found in *Opinion No. 489*, record evidence was submitted in support of this proposition.⁷³ NECOE asserts that the specific impact was neither identified nor explored at hearing. However, as noted above, the analysis relied upon by the Commission in *Opinion No. 489* does not turn on a project-by-project analysis. Nor does our just and reasonable standard require the degree of calibration insisted upon by NECOE.

81. Finally, we reject the Public Parties’ argument that granting an ROE incentive, under the rationale relied upon by the Commission in *Opinion No. 489*, is inconsistent with Order No. 679. For the reasons noted above, we are not relying on Order No. 679 regarding the locked-in period at issue here. As such, we are not required to determine whether, or to what extent, Order No. 679 would justify the grant of an ROE incentive for this period.

D. Whether *Opinion No. 489* Erred in Finding that the Return on Equity Incentive for New Transmission Should Apply to all RTEP-Approved Transmission, Rather Than a Narrower Category

1. *Opinion No. 489*

82. The Commission, in *Opinion No. 489*, reversed the *Initial Decision’s* finding that the ROE incentive for new transmission, if allowed, should be applied only to new transmission expansions that can be installed relatively quickly and

⁷² Exh. No. CT-32 (ISO New England Transmission Owners’ Agreement at schedule 3.09(a)).

⁷³ See Exh. No. NETO-23 at 15-16.

that utilize innovative, less expensive technologies. Instead, the Commission accepted the proposed ROE incentive as applicable to *all* projects identified as necessary by ISO New England in its regional planning process.⁷⁴

83. The Commission found that its policy, as it relates to transmission investment, is to promote the development and maintenance of a healthy transmission infrastructure, including the promotion of all transmission projects designed to provide efficient, reliable, and non-discriminatory transmission service. The Commission held that this policy has also served as a fundamental principle underlying the RTEP process. The Commission also found that this policy will be appropriately served by applying the transmission investment ROE incentive to all RTEP-approved projects in order to ensure that all decisions relating to technology options, including the cost-effectiveness of these options, will be made fairly and independently by ISO New England. The Commission also found that this allowance will not lead to over-building, given the approval process itself and its focus on “necessary” additions.

84. The Commission also agreed with the Transmission Owners that, as a practical matter, any effort to narrow the scope of the allowed incentive is unworkable and unnecessary. The Commission noted, for example, that attempting to identify a transmission technology that is “innovative” *and* “less expensive” *and* that can be installed “relatively quickly” may exclude projects that should be encouraged and may be unfair if the measure of these values fails to give sufficient weight to siting considerations, in-service dates, long-term needs, or other important intangibles. The Commission found that a failure to consider each of these factors, or to give sufficient weight to the factors that are considered, could lead to arbitrary results and could provide perverse incentives as it relates to the proposal and selection of new transmission projects.

85. Finally, the Commission held that it could be difficult to “calculate” any qualitative differences between these approved projects, either as a generic matter or in a given case and could lead to an overly litigious process that could operate as a drain on the Commission’s resources.

2. Request for Rehearing

86. NECOE asserts as error the Commission’s finding in *Opinion No. 489* that any effort to limit applicants’ proposed incentive rate to innovative or less costly projects would be unworkable and unnecessary. NECOE argues that, assuming an incentive rate is authorized in this case, it should be narrowly applied because its

⁷⁴ *Opinion No. 489*, 117 FERC ¶ 61,129 at P 122.

purpose is to incent transmission owners to take actions that they would not otherwise perform. NECOE argues that the Commission should apply, here, the standards set forth by the Commission in Order No. 679, limiting ROE incentives to projects that: (i) face substantial risks; (ii) can be undertaken only at the election of investors; or (iii) present special risks or considerations. NECOE asserts that not all RTEP projects satisfy these criteria, given the Transmission Owner's contractual obligation to build.

3. Commission Findings

87. We deny NECOE's request for rehearing. NECOE asserts, in effect, that the *Opinion No. 489* erred because it failed to apply the policy and underlying analysis set forth by the Commission in Order No. 679. However, for the reasons stated above, we are not required to follow the requirements of Order No. 679, here, as they relate to the locked-in period. As we also stated above, the scope and reach of the tariff provisions approved in *Opinion No. 489* have not been shown to be unjust or unreasonable.

The Commission orders:

(A) Rehearing of *Opinion No. 489* is hereby granted, in part, and denied, in part, as discussed in the body of this order.

(B) The Transmission Owners are hereby directed to make a compliance filing, within 30 days of the date of this order, addressing their refund obligations based on our acceptance of NETO-17, as revised in the body of this order.

By the Commission. Commissioner Kelly dissenting in part with a separate statement attached.
Commissioner Wellinghoff concurring in part and dissenting in part with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

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NSTAR Electric & Gas Corporation
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Vermont Electric Power Company
Central Vermont Public Service Corp.
Green Mountain Power Corporation

Docket No. ER04-157-014

Florida Power & Light Company-
New England Division

Docket No. ER04-714-006

(Issued March 24, 2008)

KELLY, Commissioner, *dissenting in part*:

This order grants rehearing to the extent that it will not apply a 100 basis point ROE incentive for any future projects without a specific showing justifying the incentive on a project-by-project basis, consistent with the requirements of Order Nos. 679 and 679-A. This order also reaffirms the Commission's approval of a 100 basis point ROE incentive for existing RTEP-approved projects for projects that are completed and come on line as of December 31, 2008, on the basis that *Opinion No. 489*¹ "was consistent, in most respects, with our general policy on incentive rates adopted in Order No. 679."

As with *Opinion No. 489*, I must dissent in part from this order because I do not agree that approval of the 100 basis point ROE incentive was consistent with our general policy on incentive rates, and indeed I continue to believe that approving the 100 basis point adder is arbitrary and capricious. My dissent in the earlier proceeding sets forth in great detail my reasoning, and therefore I will not repeat the discussion here.

In all other respects, I support the findings set forth in this order.

Sudeen G. Kelly

¹ *Bangor Hydro-Electric Company*, 117 FERC ¶ 61,129 (2006).

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WELLINGHOFF, Commissioner, concurring in part and dissenting in part:

In today's order, the majority reaffirms its decision in Opinion No. 489 to grant a 100 basis point incentive ROE adder for transmission projects approved through ISO New England's RTEP process.¹ The majority also recognizes in today's order, however, that it is inappropriate to apply that incentive to all such projects in perpetuity. Under today's order, any such project that comes on line by December 31, 2008 will automatically receive the 100 basis point incentive ROE adder, but an entity seeking incentives for a project that will come on line after that date must demonstrate in a separate filing that its project satisfies the Commission's policy as set forth in Order No. 679.

I dissented in part from Opinion No. 489. I stated in my dissent that, contrary to the majority's conclusion, I agreed with the Presiding Judge that the proponents of an incentive ROE adder had not satisfied their evidentiary burden. I also stated that incentive ROE adders should focus on encouraging investment decisions beyond the upgrades required by a utility's service obligations or good utility practice. Elaborating on that point, I stated that incentive ROE adders

¹ *Bangor Hydro-Electric Company*, 117 FERC ¶ 61,129 (2006) (Opinion No. 489).

should be more narrowly targeted to types of investment that provide incremental benefits, such as increased energy efficiency.

Unfortunately, the majority adopted a very different approach in Opinion No. 489. The majority reversed the Presiding Judge on the above-noted evidentiary issue and granted an unsupported incentive ROE adder to virtually all new transmission projects in the ISO New England footprint, including those that the record indicated would be built even without that incentive. With regard to RTEP-approved projects that come on line by December 31, 2008, the majority now reinforces those mistakes. Therefore, for the reasons that I identified in my dissent to Opinion No. 489, I respectfully dissent from today's order.

By contrast, I agree with the majority that an entity seeking incentives for a project in New England that will come on line after December 31, 2008 should be required to demonstrate that its project satisfies the Commission's policy as set forth in Order No. 679. Referring to Order No. 679, the majority correctly concludes that "projects that have not come on line, or have not been proposed or even envisioned, should not be exempt from our new policy." I also agree with the majority that Order No. 679 requires case-by-case consideration of projects for which an incentive is being sought. I believe that case-by-case consideration of incentives applications is a step forward when compared to Opinion No. 489.

I concur in part with today's order because I believe that it is important to add a cautionary note regarding the implementation of Order No. 679. One important component of Order No. 679 is the requirement that each applicant must demonstrate a nexus between the incentive sought and the investment being made.¹ The Commission has clarified that this nexus requirement means that the incentives sought must be tailored to address the demonstrable risks and challenges faced by the applicant in undertaking the project.²

I have previously expressed concern that the majority is not applying a sufficiently rigorous nexus requirement as it implements Order No. 679.³ I also recently expressed concern that as a result of that approach, the majority has

¹ Order No. 679 at P 26.

² Order No. 679-A at P 21. In making this clarification, the Commission also stated that it retained its discretion to provide policy-based incentives. *Id.* n. 37.

³ See, e.g., *Commonwealth Edison Co.*, 122 FERC ¶ 61,037 (2007), Wellinghoff dissent in part at 5-7.

effectively returned to the misguided policy reflected in Opinion No. 489 that makes incentive ROE adders applicable to virtually all new transmission projects.¹ With those concerns in mind, I note that in addition to considering incentives applications on a case-by-case basis, applying the nexus requirement and other requirements of Order No. 679 with sufficient rigor is essential to ensuring that rates including an incentive ROE adder are just and reasonable.

For these reasons, I concur in part and dissent in part on today's order.

Jon Wellinghoff
Commissioner

¹ *Id.* at 6.