138 FERC ¶ 61,045
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

Missouri River Energy Services Docket No. EL11-45-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued January 20, 2012)

1. On June 15, 2011, Missouri River Energy Services (Missouri River) filed a petition requesting that the Commission issue a declaratory order granting three transmission incentive rate treatments pursuant to section 219 of the Federal Power Act (FPA) and Order Nos. 679 and 679-A for their investment in two transmission capacity expansion initiatives by the Year 2020 (CapX2020) projects: Fargo to Monticello (Fargo Project)[1] and Twin Cities to Brookings (Brookings Project).[2] Specifically, Missouri River seeks: (1) 100 percent of prudently incurred construction work in progress (CWIP) in rate base (100 Percent CWIP Recovery); (2) 100 percent recovery of the prudently incurred costs of transmission facilities that are cancelled or abandoned for reasons beyond the Missouri River's control (Abandoned Plant Recovery); and (3) a hypothetical capital structure of 45 percent equity and 55 percent debt (Hypothetical Capital Structure). As discussed below, we grant Missouri River's request for Abandoned Plant Recovery and Hypothetical Capital Structure incentives and conditionally grant Missouri River's request for 100 Percent CWIP Recovery.

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[1] Missouri River states that it is only seeking incentives for Phase 2 and 3 of the Fargo project, but not for Phase 1. Missouri River Petition at 5.

[2] *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).

I. Background

A. Description of Missouri River

2. Missouri River is a municipal joint agency formed under Chapter 28E of the Iowa Code and existing under the joint action laws of the States of Iowa, Minnesota, North Dakota, and South Dakota. Missouri River consists of 60 member municipalities in four states. Missouri River states that it provides supplemental wholesale power and transmission services to 59 member municipalities pursuant to power sale agreements and additional contractual arrangements.

3. Missouri River also states that it recently joined the Midwest Independent Transmission System Operator, Inc. (MISO) as a transmission owning member.[3] Missouri River has adopted for the recovery of its annual transmission revenue requirement (ATRR) the *pro forma* non-levelized version of Attachment O to the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff). Missouri River explains that, pursuant to a declaratory order issued by the Commission in a prior proceeding, it will calculate its ATRR in Attachment O by combining its financial information with that of the Western Minnesota Municipal Power Agency (Western Minnesota).[4] Missouri River states that it will make a filing with the Commission under section 205 of the FPA to implement the recovery of the requested rate incentives through amendments to Attachment O of the Tariff.[5]

4. Missouri River is participating in a comprehensive regional planning initiative by eleven utilities in the region known as CapX2020. Missouri River states that the CapX2020 projects will provide transmission infrastructure that will increase system reliability in multiple states and will accommodate new renewable energy generation resources that meet state portfolio standards in the region.[6] Both the Brookings Project and the Fargo Project are part of CapX2020.

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[3] *Missouri River Energy Services,* 135 FERC ¶ 61,203 (2011).

[4] *Missouri River Energy Services,* 125 FERC ¶ 61,300 (2008).

[5] On November 3, 2011, in Docket No. ER12-351-000, Missouri River filed proposed revisions to Attachments O-MRES, GG-MRES, and MM-MRES of the Tariff, in order to implement the requested transmission incentives.

[6] Missouri River Petition at 4.

B. Description of the Fargo Project

5. The Fargo Project is a 240-mile, 345 kV transmission line between Fargo, North Dakota, and Monticello, Minnesota. Missouri River explains that the Fargo Project is intended to improve overall electric system reliability in the southern Red River Valley and to enhance service reliability in individual communities along the planned route.[7] Missouri River states that the electric load in the project service area is expected to exceed available transmission capacity in the near future and the completion of this project will alleviate the risk of low-voltages and line-overloads. Missouri River states that the project will support wind generation in eastern North Dakota and potential new hydroelectric projects in Manitoba, Canada. Missouri River notes that in the 2008 MISO Transmission Expansion Plan, the MISO Board of Directors approved the Fargo Project as a Baseline Reliability Project. According to Missouri River, the Fargo Project is being constructed and is owned by four other MISO transmission owners: two Xcel Energy Services Inc. (Xcel) subsidiaries (Northern States Power Company, a Minnesota Corporation (NSPM), and Northern States Power Company, a Wisconsin based corporation (NSPW) (jointly, NSP Companies); Great River Energy (Great River); Otter Tail Power Company (Otter Tail Power); and ALLETE, Inc. (ALLETE).[8]

6. Missouri River explains that the Fargo Project is being constructed in three phases at a currently estimated total direct cost of $635 million. Missouri River will own eleven percent of the project for a total investment of about $71 million. Missouri River seeks incentives for Phases 2 and 3 of the project, but states that it is not seeking incentives for Phase 1.[9] Phase 2 consists of a 345 kV circuit between St. Cloud, Minnesota, and Alexandria, Minnesota, scheduled to be completed in 2013. Missouri River states that it will invest a total of $19 million in Phase 2. Phase 3 is a 345 kV circuit from Fargo, North Dakota, to Alexandria, Minnesota, with construction expected to begin in 2012 and to be completed by 2015.[10] Missouri River states that it will invest a total of $42 million in Phase 3. Also, Missouri River states that it received a Certificate of Need for the Fargo Project from the Minnesota Public Utilities Commission.

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[7] *Id.* at 5.

[8] *Id.* at 6.

[9] Phase 1 is a 345 kV circuit between St. Cloud and Monticello, Minnesota, which is already under construction. Missouri River states that it is not requesting incentives related to Phase 1, but that its eleven percent ownership share in Phase 1 of the Fargo Project is estimated at $10 million.

[10] Missouri River Petition at 4-6.

C. Description of the Brookings Project

7. The Brookings Project consists of a 250-mile, 345 kV transmission line that runs from Brookings County, South Dakota, to the proposed Hampton substation in southeast Minneapolis-St. Paul, Minnesota. Missouri River states that the total project cost is currently estimated to be $725 million. Missouri River will have a five percent share of the Brookings Project for an estimated $37 million investment. Petitioners state that the primary purpose of the Brookings Project is to deliver wind power from eastern South Dakota, northwestern Iowa, and southwestern Minnesota to load centers in Minnesota. Missouri River states that the Commission has previously determined that the Brookings Project is essential to ensuring reliable electric transmission service for integrating new generation sources with existing load.[11] In addition, by increasing transmission capacity, the Brookings Project will unlock a significant portion of the MISO queue, facilitate further development of the region's wind generation industry, and support future load growth.[12] Missouri River states that the project is currently being considered by the MISO Board of Directors for designation as a Multi-Value Project.[13] According to Missouri River, the Brookings Project is being constructed and is owned by four other MISO transmission owners: NSP Companies; Great River; Otter Tail Power; and Central Minnesota Municipal Power Agency (Central Minnesota). Additionally, Missouri River notes that the Minnesota Public Utilities Commission issued a certificate of need for the Brookings Project.[14]

II. Notice of Filing and Responsive Pleadings

8. Notice of Missouri River's filing was published in the *Federal Register*, 76 Fed. Reg. 36,913 (2011), with interventions and protests due on or before July 18, 2011. On July 18, 2011, Great River filed a motion to intervene; Xcel filed a motion to intervene

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[11] *Id.* at 7 (citing *Xcel Energy Services., Inc.*, 121 FERC ¶ 61,284, at P 53 (2007) (*Xcel*); *Otter Tail Power Co.*, 129 FERC ¶ 61,287, at P 24-27, 29-30 (2009) (*Otter Tail*); *Great River Energy*, 130 FERC ¶ 61,001, at P 26-29, 31-32 (2010) (*Great River*); *Central Minnesota Municipal Power Agency*, 134 FERC ¶ 61,115 (2011) (*CMMPA*)).

[12] Ex. MRES-6 at 22.

[13] Missouri River Petition at 6-7.

[14] The Brookings project was also given its facilities permit by the South Dakota Public Utilities Commission. Missouri River Petition at 7.

and comments on behalf of NSP Companies; and MISO Transmission Owners (MISO TOs)[15] filed a motion to intervene and comments.

9. On July 25, 2011, Missouri River filed an answer to the comments of Xcel and the MISO TOs.

III. Discussion

A. Procedural Matters

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2011), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

11. Rule 213(a) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2011), prohibits an answer to a protest or an answer to an answer unless otherwise permitted by the decisional authority. We will accept Missouri River's answer because it has provided information that assisted us in our decision-making process.

B. Substantive Matters

1. Section 219 Requirement

12. Order No. 679 provides that a public utility may file a petition for declaratory order or a section 205 filing to obtain incentive rate treatment for transmission infrastructure investment that satisfies the requirements of section 219. Discussing one of those requirements, Order No. 679 states that an applicant must show that the facilities for which it seeks incentives will either ensure reliability or reduce the cost of delivered

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[15] MISO transmission owners participating in the MISO TOs' filing consist of: Ameren Services Company, as agent for Union Electric Company, Ameren Illinois Company, and Ameren Transmission Company of Illinois; American Transmission Company LLC; Big Rivers Electric Corporation; City Water, Light & Power (Springfield, IL); Dairyland Power Cooperative; Duke Energy Corporation for Duke Energy Ohio, Inc., Duke Energy Indiana, Inc., and Duke Energy Kentucky, Inc.; Hoosier Energy Rural Electric Cooperative, Inc.; Indiana Municipal Power Agency; Indianapolis Power & Light Company; Michigan Public Power Agency; MidAmerican Energy Company; Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northwestern Wisconsin Electric Company; Otter Tail Power; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Company; Southern Minnesota Municipal Power Agency; Wabash Valley Power Association, Inc.; and Wolverine Power Supply Cooperative, Inc.

power by reducing transmission congestion.[16] Order No. 679 establishes a process for an applicant to follow to demonstrate that it meets this standard, including a rebuttable presumption that the standard is met if: (1) 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 (2) the transmission project has received construction approval from an appropriate state commission or state siting authority.[17] Order No. 679-A clarifies 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.[18]

13. Missouri River states that both projects qualify for the rebuttable presumption because they have received Certificates of Need from the Minnesota Public Utilities Commission.[19] Missouri River also states that the Fargo and Brookings projects qualify for the rebuttable presumption because each project is being developed as part of the MISO Transmission Expansion Plan process. Missouri River adds that the Fargo Project has been approved by the MISO Board of Directors as part of the MISO Transmission Expansion Plan and the project has been designated as a Baseline Reliability Project.[20] Further, Missouri River states that the Brookings Project is being considered by MISO as a Multi-Value Project, a status determined based on numerous reliability and economic benefits.[21]

14. The Commission has previously determined that both projects are entitled to the rebuttable presumption based upon the issuance of a Certificate of Need from the Minnesota Public Utilities Commission (MPUC).[22] Accordingly, the Commission finds

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[16] 18 C.F.R. § 35.35(i) (2011).

[17] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 58.

[18] Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 49.

[19] Missouri River Petition at 11.

[20] *Id.* at 10.

[21] *Id.* and *Midwest Independent Transmission System Operator, Inc.*, 133 FERC ¶ 61,221, at P 241 (2010).

[22] *Xcel*, 121 FERC ¶ 61,284 at P 53 (adopting a rebuttable presumption that a request for incentives meets the requirements of section 219 upon receipt of a certificate of need from the MPUC because "[the MPUC] considers whether the project ensures reliability or reduces congestion costs in evaluating an application for a Certificate of

(continued…)

that the Fargo and Brookings projects are entitled to the rebuttable presumption that they each satisfy the requirements of section 219.

2. <u>Nexus Requirement</u>

15. In addition to satisfying the section 219 requirement of ensuring reliability or reducing the cost of delivered power by reducing congestion, an applicant must demonstrate a nexus between the incentives being sought and the investment being made. In Order No. 679-A, the Commission clarified that the nexus test is met when an applicant demonstrates that the incentives requested are "tailored to address the demonstrable risks or challenges faced by the applicant."[23]

16. As part of the evaluation of whether the incentives requested are tailored to address the demonstrable risks or challenges faced by the applicant, the Commission has found the question of whether a project is "routine" to be particularly probative. In *Baltimore Gas & Elec. Co.*, the Commission provided guidance on the factors it will consider when determining whether a project is routine.[24] The Commission stated that it will consider all relevant factors presented by the applicant, including evidence on: (1) the scope of the project (e.g., dollar investment, increase in transfer capability, involvement of multiple entities or jurisdictions, size, effect on region); (2) the effect of the project (e.g., improving reliability or reducing congestion costs); and (3) the challenges or risks faced by the project (e.g., siting, long lead times, regulatory and political risks, specific financing challenges, or other impediments). The Commission also explained that, when an applicant has adequately demonstrated that the project for which it requests an incentive is not routine, that applicant has shown, for purposes of the nexus test, that the project faces risks and challenges that merit an incentive.[25]

17. Missouri River asserts that the incentives requested in connection with the Fargo and Brookings projects satisfy the nexus test established in Order No. 679 because the projects are non-routine and the incentives are tailored to address the risks and challenges of the projects.

Need"); *Great River*, 130 FERC ¶ 61,001 at P 29; *Otter Tail Power Co.*, 129 FERC ¶ 61,287 at P 27.

[23] Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 40.

[24] *Baltimore Gas & Elec. Co.*, 120 FERC ¶ 61,084, at P 52-55 (2007), *order denying reh'g*, 123 FERC ¶ 61,262 (2008).

[25] *Id*. P 54.

18. Missouri River states that the Fargo Project's regional planning process, scale of investment, and multi-jurisdictional route demonstrate that the project scope is not routine. Missouri River plans to invest $61 million in Phase 2 and 3 of the Fargo Project, more than doubling its existing net transmission plant balance of $27 million.[26] Similarly, Missouri River maintains that the $37 million dollar investment in the Brookings Project will also more than double the December 31, 2010 Missouri River's net transmission plant balance.[27] Missouri River states that the Fargo and the Brookings projects traverse multiple state jurisdictions, leading to such non-routine issues as the coordination of routes and permits across state lines.[28] Missouri River also states that the projects' impact on regional capacity and renewable generation demonstrates that their effect is not routine.[29] Missouri River adds that the projects' risks and challenges related to joint ownership, limited control as a minority owner over project cancellation, outstanding permits, rights-of-way, and use of advanced technologies demonstrates that the projects are not routine. According to Missouri River, these projects include additional risks that may increase costs, including the fact that several permits and rights-of-way must be obtained and that Missouri River as a minority investor has little ability to control the costs of the projects.

19. The Commission has previously determined that the Fargo Project and the Brookings Project are non-routine investments for other CapX2020 participants,[30] and, consistent with these holdings, we make a similar finding that Missouri River's request for incentives meets the nexus requirement. As discussed below, the Commission grants Missouri River's request for Abandoned Plant and Hypothetical Capital Structure incentives and conditionally grants its request for 100 Percent CWIP Recovery.

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[26] Missouri River Petition at 12.

[27] *Id*.

[28] *Id*.

[29] Missouri River notes that both projects are among the largest transmission developments in the region, providing substantial new transmission capacity to improve overall electric system reliability and access to a vast number of remote renewable generating projects. *Id.* at 15, 18-19.

[30] *Xcel*, 121 FERC ¶ 61,284 at P 59-63; *Otter Tail*, 129 FERC ¶ 61,287 at P 28-36; *Great River*, 130 FERC ¶ 61,001 at P 32-35, 38-39. In ALLETE the Commission approved incentives for ALLETE's investment in the Fargo Project. *ALLETE, Inc.*, 133 FERC ¶ 61,270 (2010). In *CMMPA*, the Commission approved incentives for investment in the Brookings Project. 134 FERC ¶ 61,115 at P 21.

a. <u>100 Percent CWIP and Abandoned Plant Recovery</u>

i. <u>Missouri River Proposal</u>

20. Missouri River states that 100 Percent CWIP Recovery will provide regulatory certainty, rate stability and improved cash flow which will reduce the financial burden of the investment in the CapX2020 projects.[31] Missouri River claims that because the Fargo and Brookings projects are large new investments, they will place significant burdens on Missouri River cash flows, increasing its long-term debt from $292 million to $390 million excluding scheduled debt payments.[32] Further, Missouri River states that the financial burdens associated with the Fargo and Brookings projects are exacerbated by the projects' long lead times;[33] assuming construction begins as scheduled, Missouri River will not be able to begin recovering costs until June of the year following the date the projects go into service.[34] However, according to Missouri River, including CWIP in its rate base could help reduce financing costs and associated risks that are part of the project investment. Moreover, Missouri River argues that 100 Percent CWIP Recovery is consistent with previous requests by the Fargo Project and Brookings Project participants that received CWIP approval by the Commission.[35] Finally, Missouri River commits to adjust its accounting procedures and take steps to avoid double recovery of Allowance for Funds Used During Construction (AFUDC) and CWIP by establishing separate CWIP accounts for the Fargo Project and the Brookings Project that will not include any AFUDC in the Missouri River Attachment O.[36]

21. Missouri River requests Abandoned Plant Recovery so that it will have the opportunity to recover prudently incurred costs if the Fargo and Brookings projects are

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[31] Missouri River Petition at 34-35.

[32] *Id.* at 35.

[33] Missouri River states that Fargo Phase 2 is expected to begin later in 2011, but will not begin service until late 2013 at the earliest. Also, Fargo Phase 3 is scheduled to begin construction in 2012 and be completed by 2015 if construction begins as scheduled. Phase 1 of the Brookings project is expected to begin in 2012 with construction likely to end in 2014. Phase 2 of the Brookings project is expected to start in 2013 at the earliest and not be complete before 2015. *Id.* at 35-36

[34] *Id.*

[35] *Id.* at 37.

[36] *Id.* at 38.

abandoned due to forces outside of its control.[37] Missouri River states that Abandoned Plant Recovery is appropriate here because of the projects' long lead times and the multiple permitting risks the projects will face, including right-of-way uncertainties.[38] Missouri River further states that the Fargo and Brookings projects are being developed by a diverse group of utilities, which adds complexity and risks to the projects' governance and regulatory approval.[39] Missouri River also contends that the Brookings Project faces considerable risks because its cost allocation methodology has not been approved by MISO as a Multi-Value Project. Failure of MISO to designate the Brookings Project as a Multi-Value Project, Missouri River argues, could lead to the withdrawal of some of its utility members or the cancellation of the project.[40]

ii. <u>Comments</u>

22. MISO TOs and Xcel do not oppose Missouri River's proposed CWIP Recovery or Abandoned Plant Recovery. However, MISO TOs state that the incentives should be subject to the review and comments submitted in any future Missouri River section 205 filing.[41] Also, Xcel states that 100 Percent CWIP Recovery is contingent upon making necessary changes to Missouri River's formula rate and accounting procedures to ensure there is no double recovery of transmission costs and that these changes would be subject to a future section 205 filing.[42] Also, MISO TOs state that Note Z on Page 2, line 23a and Page 3, line 9a of Missouri River's Attachment O is not clear because it gives the perception that Missouri River can recover abandoned plant costs without the Commission's approval.[43] MISO TOs recommend adding the following language to the end of Note Z: "however, no abandoned plant costs will be recovered until FERC approves such recovery in a section 205 filling."[44]

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[37] *Id.* at 39.

[38] Missouri River states that in a recent ruling in Minnesota, an administrative law judge recommended altering the project routing. *Id.*

[39] *Id.*

[40] *Id.* at 40.

[41] MISO TOs Comments at 6.

[42] Xcel Comments at 5.

[43] The MISO TOs' comments relate to Missouri River's Exhibit No. MRES-14 that provides proposed revisions to its Attachment O for illustrative purposes.

[44] MISO TOs Comments at 7.

iii. Missouri River Answer

23. Missouri River states that it will consider MISO TOs' suggestion about Note Z when preparing its subsequent section 205 filing.[45] Missouri River states that it will adjust its accounting procedures to accommodate the Fargo Project's Phase 2 and 3 and the Brookings Project to ensure that its resulting rates will not include both capitalized AFUDC and corresponding amounts of return on CWIP for this investment. Missouri River states that it will establish separate CWIP accounts for the Fargo Project and the Brookings Project and it will not include any AFUDC in the CWIP accounts for these projects. Missouri River commits to provide additional details and information on its procedures for preventing double recovery of CWIP and AFUDC when it submits its subsequent filing pursuant to FPA section 205.

iv. Commission Determination

24. The Commission grants Missouri River's request for Abandoned Plant Recovery and conditionally grants Missouri River's request for CWIP Recovery. We have approved similar incentives in prior orders.[46] We will not assess at this time whether Missouri River has properly implemented its CWIP Recovery and Abandoned Plant Recovery in its Attachment O formula rate. Issues related to the Attachment O are more appropriately considered in Missouri River's subsequent section 205 filings. Nonetheless, more specifically regarding CWIP, under Order No. 679 and the Commission's regulations,[47] an applicant must propose accounting procedures that ensure that customers will not be charged for both capitalized AFUDC and corresponding amounts of CWIP in rate base. Thus, our acceptance of Missouri River's request to include 100 percent of CWIP in rate base is conditioned upon Missouri River providing in its 205 filing additional information regarding its accounting methods and procedures to address this requirement. Furthermore, the Commission's acceptance of the recovery

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[45] Missouri River Answer at 10.

[46] *CMMPA*, 134 FERC ¶ 61,115 at 21-22; *Great River*, 130 FERC ¶ 61,001 at P 32-35; *Otter Tail*, 129 FERC ¶ 61,287 at P 30-33; *Xcel*, 121 FERC ¶ 61,284 at P 56-63. In *CMMPA*, *Great River*, *Otter Tail* and *Xcel,* the Commission found that the respective companies' CapX2020-related projects were not routine and that the requested incentives of CWIP and abandoned plant were designed to meet a distinct set of risks associated with the projects.

[47] 18 C.F.R. § 35.25 (2011).

of abandoned plant is conditioned upon a section 205 filing by Missouri River for recovery of abandoned plant costs in rates at the time the project is abandoned.[48]

b. Hypothetical Capital Structure

i. Missouri River Proposal

25. Missouri River is requesting a hypothetical capital structure of 45 percent equity and 55 percent debt for the full period for which the projects are financed. Missouri River explains that the Hypothetical Capital Structure directly addresses the risks associated with its investment in the projects. According to Missouri River, the substantial debt associated with the Fargo and Brookings projects will increase the amount of long-term debt on its balance sheet by 21 percent and 13 percent respectively.[49] It also contends that increased debt can strain its equity ratio.[50] Further, Missouri River maintains that the risk associated with the projects represent potential cost increases to it and thus the need for additional debt that could strain its financial metric even further. Accordingly, Missouri River states that the return provided from its current equity ratio of 21.2 percent is insufficient to cover these risks, as well as other risks currently faced by it and its members, including guaranteeing the costs of existing debt and the debt to be issued to finance the projects.[51]

26. In addition, Missouri River states that it adopted a targeted debt equity structure of 40 percent equity long before its involvement in the projects. To meet this target, Missouri River expects to maintain a target minimum debt service coverage ratio of 1.25 over the long term. Accordingly, Missouri River states that the requested hypothetical 45 percent equity level is consistent with its target of 40 percent equity when the heightened risk associated with the projects are compared to its existing assets and takes into account the fact that Missouri River members are providing the additional security for repayment of the debt to be issued for the projects.[52] Further, according to Missouri River, the use of a Hypothetical Capital Structure is appropriate because it

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[48] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 163, 166; *Green Power Express LP*, 127 FERC ¶ 61,031, at P 52 (2009), *reh'g denied*, 135 FERC ¶ 61,141 (2011); *Pioneer Transmission, LLC*, 126 FERC ¶ 61,281, at P 76 (2009), *reh'g denied,* 130 FERC ¶ 61,044 (2010).

[49] Ex. MRES-6 at 60-62.

[50] *Id.* at 32.

[51] Missouri River Petition at 24.

[52] *Id.* at 24-25.

provides a valuable cushion in its debt service coverage ratio for the debt related to the projects. In contrast, Missouri River states that, without the requested incentives, the debt service ratio applicable to the projects is projected to fall short of the targeted minimum debt service coverage ratios of 1.25.

27. Missouri River maintains that the use of the Hypothetical Capital Structure could attract additional bond investors. Given its current Moody's rating of A1 (top of single A category) with a positive outlook, Missouri River states that it believes it is close to entering the Moody's double A category (Aa). An increased credit rating will lower interest costs for MISO and Missouri River ratepayers.[53] In contrast, Missouri River states that the financial impact of a downgrade in its credit rating would be significant. Missouri River notes that the difference in borrowing costs between an entity in the AA rating category and an entity in the A rating category is estimated to be in excess of 50 basis points.[54]

28. In addition, Missouri River states that granting the use of the Hypothetical Capital Structure is necessary to ensure that it is treated comparably with investor-owned utility participants in the projects and receives an "owner's return" commensurate with the risks taken on by participating in the projects. Without the requested 45 percent equity ratio on its capitalization structure, Missouri River states that its customers will pay investor-owned utility revenue requirements that incorporate higher equity ratios while the investor-owned utility customers would receive the blended rate benefits of the comparatively lower revenue requirement of Missouri River (due to lower equity ratios, lower financing costs and no income taxes).[55] Missouri River states that its requested Hypothetical Capital Structure is lower than: (1) the equity ratios provided by the Commission to comparable transmission owners; and (2) the average equity ratios of all MISO TO's (55.9 percent) and the investor-owned utility co-owners in the Fargo Project (55.3 percent for Xcel NSP Companies, Otter Tail Power and ALLETE) and Brookings Project (54.0 percent for Xcel NSP Companies and Otter Tail Power).[56]

29. Missouri River adds that it faces substantially more risk from its participation in the projects than those investor-owned utility participants (Xcel/NSP Companies, Otter Tail Power and ALLETE) that have already received incentives. The amount of its planned investment in these projects relative to Missouri River's existing net transmission plant is much higher (around 360 percent) than for the investor-owned

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[53] *Id.* at 25-26.

[54] *Id.* at 28-29; Exh. MRES-6 at 40-41.

[55] Missouri River Petition at 30.

[56] *Id.* at 23-24, 33-34.

utility participants; and unlike investor-owned utility participants in the projects, Missouri River's member-ratepayers do not have limited exposure to the costs of poorly performing projects. According to Missouri River, its owners assume greater risk than the stockholder in an investor-owned utility because the stockholders of an investor-owned utility are only liable for the funds they have paid for stock and do not back repayment of the debt.[57] Missouri River states that use of its proposed hypothetical capital structure furthers the purpose of Order No. 679 by incentivizing Missouri River and other public power entities to invest in future transmission projects.

30. Missouri River is seeking to apply the Hypothetical Capital Structure for the full period in which Missouri River is financing the projects. Missouri River expects to finance the projects over the current remaining length of its member contracts. Assuming that the debt for the projects is issued in 2012, the length of the related debt will be 33 years (member contracts expire January 1, 2046). Missouri River acknowledges that investor-owned utility applicants have requested to apply a hypothetical capital structure only during the construction financing period. However, Missouri River explains that, whereas the investor-owned utility entities planned to issue common stock at the conclusion of the construction financing phase, Missouri River is unable to issue common stock and must apply the comparable hypothetical capital structure for the length of the financing.[58]

ii. Comments and Protests

31. Xcel states that it does not oppose Missouri River's proposed hypothetical capital structure of 45 percent equity and 55 percent debt.[59]

32. MISO TOs state that Missouri River has failed to adequately explain why it is necessary to maintain a target equity ratio of 40 percent and a target debt service coverage of 1.25.[60] They add that even if a 40 percent target equity structure is necessary, Missouri River has not justified its proposed hypothetical structure of 45 percent equity instead of 40 percent equity. MISO TOs also request that Missouri River should clarify the tax application used in the equity ratio comparison as it was unclear whether income taxes were counted twice.[61] Further, the MISO TOs state

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[57] *Id.* at 30.

[58] *Id.* at 31.

[59] Xcel Comments at 4-5.

[60] MISO TOs Comments at 5.

[61] *Id.*

that Missouri River has not adequately explained why a debt service coverage of 1.25 and the proposed hypothetical capital structure, will not result in an improper subsidization of its transmission investments other than Fargo Project Phase 2 and 3 and Brookings Project.[62]

iii. Missouri River Answer

33. Missouri River states that 40 percent has been its targeted equity ratio for several years. Missouri River re-emphasizes the importance of equity ratios in determining credit rating and the need to mitigate deterioration in Missouri River's equity ratio caused by the projects' debt. Missouri River states that the extra 5 percent above the 40 percent equity target reflects the higher risk of the two projects compared to other existing assets or future generation and routine transmission projects. Missouri River states that by backing the debt of the two projects, its members provide additional security for repayment of the debt to be issued for the projects, and reiterates that the additional five percent associated with a 45 percent equity ratio (rather than 40 percent) recognizes that Missouri River deserves an "owner's return" for assuming additional risk as compared to an investor-owned utility. Further, Missouri River contends that it has proposed the Hypothetical Capital Structure because it will yield cash that will contribute favorably to it meeting the overall company target minimum debt service coverage of 1.25.

34. Missouri River contends that its target debt service coverage of 1.25 is consistent with its goal of improving its credit rating and lowering financing costs. Specifically, Missouri River states that its average debt service coverage ratio over the last three years has been 1.31 with a budgeted debt service coverage of 1.47. This trend, according to Missouri River, is approaching the median rating of a Fitch AA rated wholesale electric utility of 1.51 (compared to the current AA- Fitch median of 1.04). Missouri River states that achieving a Aa3 rating from Moody's and AA rating from Fitch should lower financing costs for the projects and thus lower financing costs for MISO ratepayers and Missouri River ratepayers.

35. Finally, Missouri River claims that the use of a hypothetical capital structure based on 45 percent equity with a 1.25 debt service coverage ratio will not result in improper subsidization of transmission investment other than the Fargo Project and the Brookings Project. Missouri River states that, if there is any subsidization occurring, it is Missouri River's members subsidizing MISO ratepayers because: (1) MISO ratepayers are reaping the financing benefits of the higher Missouri River credit rating from higher debt service coverage ratios than MISO ratepayers would be paying on average; and (2) MISO ratepayers are enjoying the benefits of Missouri River lower cost of debt, lower

[62] *Id.* at 6.

equity ratio than MISO investor-owned utility average (55.9 percent) and Missouri River's exemption from income taxes.[63]

iv. Commission Determination

36. The Commission stated in Order No. 679 that to receive authorization to use a hypothetical capital structure, an applicant must provide support in its application for why the hypothetical capital structure incentive is needed to promote investment consistent with the goals of section 219.[64] The Commission also stated that it would evaluate each requested incentive on a case-by-case basis and would not prescribe specific criteria or set target debt to equity ratios for evaluating hypothetical capital structures.[65] We find that Missouri River has demonstrated that the requested Hypothetical Capital Structure is tailored to address the risks of their investment in the Fargo Project and the Brookings Project, and we will therefore approve it, as discussed below.

37. The Commission has permitted municipals and cooperatives to use a hypothetical capital structure for ratemaking purposes when they have relied upon non-equity financing for a project. For example, the Commission granted *Citizens* a hypothetical capital structure for a thirty-year period.[66] In addition, the Commission granted *CMMPA* a hypothetical capital structure equal to 50 percent equity and 50 percent debt over the anticipated 30 year life of its bond issuances for its investment in the Brookings Project.[67]

38. As in those cases, we find that Missouri River has provided a satisfactory explanation and justification for their request. The Commission expects that granting the requested hypothetical capital structure will assist Missouri River in attracting financing and will encourage Missouri River and its members to invest further in future transmission expansion projects. It will allow Missouri River to receive returns comparable to those of IOUs investing in the Fargo and Brookings projects and will enhance Missouri River's ability to meet its debt obligations. In addition, allowing Missouri River to receive a revenue requirement for the Fargo Project and the Brookings Project that reflects the higher capital costs of the IOUs will offset the MISO transmission rates that its members pay; the lower capital costs will, in turn, allow

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[63] Missouri River Answer at 8-9.

[64] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 123.

[65] *Id.* P 132.

[66] *Citizens Energy Corp.*, 129 FERC ¶ 61,242, at P 22-24 (2009) (*Citizens*).

[67] *CMMPA*, 134 FERC ¶ 61,115 at P 30-33.

Missouri River and its members to effectively reduce their future transmission rates to mitigate their investment risks associated with the project. In contrast, denial of Missouri River's request would decrease Missouri River's cash flow, reduce Missouri River's ability to make payments on its debt, and hinder Missouri River's ability to reach its targeted actual capital structure of 40 percent equity and 60 percent debt.

39. Also consistent with our findings in *Citizens* and *CMMPA*, we find that Missouri River has demonstrated that, without the Hypothetical Capital Structure for the entire financing period, Missouri River will not be able to receive a meaningful return on its investment once the construction period ends.[68] Approving the Hypothetical Capital Structure for the entire period of debt financing will benefit Missouri River's credit rating and allow it to receive more advantageous financing terms, which decrease the total cost of its investment in the Fargo and Brookings projects. Therefore, as discussed above, we find that Missouri River has justified the use of the Hypothetical Capital Structure for both the Fargo Project and the Brookings Project construction period and for the life of Missouri River's financing for the projects.

c. Total Package of Incentives

40. The total package of incentives requested must be tailored to address the demonstrable risks or challenges that the applicant faces. This test is fact-specific and requires the Commission to review each application on a case-by-case basis. The Commission has in prior cases approved multiple rate incentives for participants investing in the CapX2020 projects.[69] Missouri River faces significant risks and challenges in developing and constructing their interest in the Fargo Project and the Brookings Project, discussed above, and we find that they are eligible for the package of incentives that we are granting in this order.

3. Other Issues

a. Comments and Protests

41. MISO TOs state that Missouri River should update its Attachment GG-MRES and Attachment O-MRES to be consistent with the currently-effective version of the MISO Attachment O and Attachment GG when it makes its subsequent section 205 filing to implement the proposed incentives. MISO TOs state that on June 3, 2011, all

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[68] Exs. MRES-8 through MRES-13.

[69] *See, e.g.*, *CMMPA*, 134 FERC ¶ 61,115 at P 34 (finding that 100 Percent CWIP Recovery, abandonment plant recovery, and hypothetical capital structure were tailored to the unique challenges faced by the project).

transmission owners on the MISO system submitted revisions to Attachment O to clarify that the revenue requirements calculated under Attachment MM and recovered under Tariff Schedule 26-A are to be subtracted from revenue requirements calculated under Attachment O.[70] Therefore, MISO TOs state that any changes approved in that proceeding should be reflected in Missouri Rivers Attachment O and Attachment GG.

42. Xcel states that should the Brookings Project ultimately receive Multi-Value Project cost sharing, its revenue requirement would be collected through Attachment MM of the Tariff with an offset to Attachment O of the Tariff for any revenues received under Attachment MM. Accordingly, Xcel states that should Missouri River's request for incentives be approved, in order to effect a more complete review of Missouri River's proposed recovery mechanisms and to avoid duplicative Commission filings, Missouri River may wish to consider providing its Attachment MM-MRES in its subsequent section 205 filing.[71]

b. <u>Missouri River Answer</u>

43. In its answer, Missouri River states that it does not intend to include proposed Attachment MM-MRES with its future section 205 filing as requested by Xcel. However, Missouri River does state that it will take the other proposed revisions and suggestions under consideration when preparing its subsequent section 205 filing.[72]

c. <u>Commission Determination</u>

44. We find the concerns raised by the protesters related to future Attachment O-MRES and Attachment MM revisions to implement the requested incentives are beyond the scope of the instant petition. We will address issues involving Missouri River's Attachment O and Attachment MM when Missouri River seeks formal approval of revisions to implement the requested incentives in a section 205 filing. We encourage Missouri River to work with MISO and other interested parties to ensure that future filings provide the details and clarity required for approval of formula rates by the Commission.

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[70] Midwest Indep. Transmission Sys. Operator, Inc. Filing, Docket No. ER11-3704, Transmittal Letter at 1-2 (June 3, 2011). The Commission accepted these proposed revisions by Delegated Letter Order on July 28, 2011.

[71] Xcel Comments at 6.

[72] Missouri River Answer at 10.

<u>The Commission orders</u>:

Missouri River's request for a declaratory order authorizing Abandoned Plant Recovery and a Hypothetical Capital Structure is hereby granted and its request for 100 Percent CWIP Recovery is conditionally granted, as discussed in the body of this order.

By the Commission. Commissioner Norris is concurring in part with separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Missouri River Energy Services Docket No. EL11-45-000

(Issued January 20, 2012)

NORRIS, Commissioner, *concurring in part*:

As in *Central Minnesota*,[1] I remain concerned by the basis on which the majority grants the hypothetical capital structure incentive[2] that Missouri River Energy Services (Missouri River) requests as a municipal entity. By finding that municipal entities should generally be treated the same as investor owned utilities when they are in fact not the same, this Commission increases the risk of unnecessarily raising rates for consumers without providing any corresponding benefits.

Here again in this instant proceeding, the order justifies the requested hypothetical capital structure as providing a "meaningful return" that is "comparable" to the returns of the investor owned utilities investing in the Fargo and Brookings projects. The order further explains that the requested hypothetical capital structure will enable Missouri River to offset the higher capital costs of the investor owned utilities that Missouri River members pay through MISO transmission rates. By this standard, the Commission is compelled to grant similar requests for a hypothetical capital structure, as long as the requested equity level is no more than that held by another neighboring investor owned utility, irrespective of the actual equity level. This analysis is not consistent with cost of service models and does not ensure just and reasonable rates.

Unlike the case presented in *Central Minnesota*, however, I believe that Missouri River has adequately supported its request to use a hypothetical capital structure for the entire financing period in order to cover its costs and maintain its financial integrity. Missouri River has further shown that its request is no more than what it believes it needs

[1] *Central Minnesota Municipal Power Agency*, 134 FERC ¶ 61,115 (2011) (*Central Minnesota* or *CMMPA*), *Norris, dissenting in part*.

[2] Hypothetical capital structures, particularly those such as what Missouri River requests that will be in place for 30 years, can have a significant impact on rates, because part of the debt financing for transmission investment is instead treated as if it is more expensive equity for cost recovery purposes. With current return on equity rates of 10 to 12 percent (or more), and current return on debt rates that are available to public power entities of five to six percent, the additional return recovered in transmission rates can be substantial.

to continue forward as a sponsor and transmission owner of the Fargo and Brookings projects.

In particular, Missouri River has demonstrated that its requested hypothetical equity level is needed to maintain its existing target debt service coverage ratio of 1.25 and to help achieve its long-term target equity structure of 40 percent. Missouri River states that its board established these targets before its involvement in the Fargo and Brookings projects in order to maintain or improve its credit rating.[3] This credit rating is an important factor in determining Missouri River's overall borrowing costs. As the order rightly notes, the credit rating will also assist Missouri River in attracting financing and will encourage Missouri River and its members to invest further in future transmission expansion projects.

In sum, I believe that the request presented by Missouri River represents a viable model for granting incentive requests that is consistent with the Commission's support for joint ownership in transmission, while still abiding by our statutory obligation to ensure just and reasonable rates for consumers. It is my hope that Commission will take a closer look at these issues as we continue a review of our incentives policy.[4]

For these reasons, I concur in part with today's order.

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John R. Norris, Commissioner

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[3] Consistent with its target equity structure, Missouri River notes that its equity level has steadily increased from 4.8 percent in 1986 to 21.2 percent in 2010. When excluding the debt to be issued to finance the Fargo and Brookings Projects, Missouri River states its 24.7 percent anticipated equity level at the end of 2011 is expected to increase to 29 percent by 2017. If, however, such debt is considered, Missouri River estimates that its actual equity ratio would be 3.6 percent lower in 2017. (*See* Missouri River June 15, 2011 filing, transmittal letter at 24-29 and Exhibit No. MRES-1 at 27.)

[4] *Promoting Transmission Investment Through Pricing Reform*, Notice of Inquiry, 135 FERC ¶ 61,146 (2011).