ORDER ON RATE INCENTIVES, ACCEPTING AND SUSPENDING PROPOSED TRANSMISSION OWNER TARIFF AND TRANSMISSION REVENUE REQUIREMENT AND ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued March 31, 2008)

1. In this order, we address a filing by Startrans IO, L.L.C. (Startrans) under section 205 of the Federal Power Act (FPA)\(^1\) of a proposed Transmission Owner Tariff (TO Tariff) and associated transmission revenue requirement (TRR) associated with Startrans’ acquisition (Transaction) of certain transmission line interests from the City of Vernon, California (Vernon). We accept Startrans’ TO Tariff, with a nominal suspension, to be effective March 31, 2008, as requested, subject to refund, and establish hearing and settlement judge procedures. In addition, we conditionally approve certain of Startrans’ requests for rate incentives.

I. **Background**

2. Startrans is a newly-formed, transmission-only limited liability company. Startrans states that it does not currently own any jurisdictional assets, but will do so and thus will become a public utility once the Transaction closes. Startrans is indirectly owned by Starwood Energy Infrastructure Fund (SEI Fund), which is owned by SEI Management L.P. (SEI Management) as a general partner, and by various passive investors as limited partners. SEI Management is owned by SEI Management Holdings (SEI Holdings) as a general partner, and by SEI Investors, L.P., as its sole limited partner. SEI Holdings is wholly owned by Starwood Energy Group Global, L.L.C. (SEG), which is owned by various private investors. SEG is primarily involved in the development of,

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acquisition of, and investment in energy infrastructure assets. Through its affiliates, it also owns passive minority interests in another transmission system and has made development loans related to transmission projects.²

3. Vernon is a California municipal utility that is a Participating Transmission Owner (PTO) within the California Independent System Operator Corporation (CAISO). Vernon has ownership interests in two transmission line projects that are the subject of this proceeding: the Mead-Adelanto Project (MAP) and the Mead-Phoenix Project (MPP) (collectively, Mead Transmission Interests). The MAP is a 1,296 MW transmission line extending 202 miles from the Marketplace Switching Station in Southern Nevada to the Adelanto Switching Station in Southern California. Vernon owns a 6.25 percent interest in the MAP. The MPP is a 1,300 MW transmission line extending 256 miles from the Perkins Switchyard near Sun City, Arizona to the Marketplace Switching Station. The MPP consists of three primary components, in which Vernon holds interests of 2.15 percent, 3.79 percent, and 4.05 percent, respectively.

4. Startrans has agreed to purchase the Mead Transmission Interests, with an expected closing date of March 31, 2008. It states that, upon acquisition of the Mead Transmission Interests, it will be an independent, stand-alone transmission company (Transco) and public utility that will own and manage transmission facilities subject to the jurisdiction of the Commission. Startrans states that the Mead Transmission Interests will be under the functional control of the CAISO and that Startrans will be a non-load serving PTO.

5. Startrans submitted a proposed TO Tariff and associated TRR to establish itself as a new PTO within the CAISO.³ Startrans states that its proposed TO Tariff is similar to the TO Tariffs submitted by other CAISO PTOs and approved by the Commission.

² Request for Approvals Pursuant to Section 203 of the Federal Power Act and for Expedited Consideration and a Shortened Notice Period, Docket No. EC08-33, at 3-6 (Section 203 Application).

³ On January 4, 2008, the same date as the instant filing, in Docket No. EC08-33, Startrans requested approval of the Transaction under section 203 of the FPA. On January 11, 2008, in Docket No. ES08-24, Startrans requested authorization for the issuance of securities under section 204 of the FPA in connection with the Transaction. An order was issued in Docket No. ES08-24 on March 20, 2008. An order will be issued in Docket No. EC08-33 simultaneously with this order.
Startrans proposes a base TRR of $6,106,987, which will be used to develop the High Voltage Access Charge in the CAISO Tariff.

6. Startrans is requesting certain rate incentives established by the Commission in Order No. 679, including an incentive return on equity (ROE), an acquisition adjustment and 100 percent construction work in progress (CWIP), discussed further below. Startrans states that these incentives are necessary to encourage the growth of independent transmission, consistent with the Commission’s incentive policies. It states that by acquiring the Mead Transmission Interests and establishing itself as a PTO, Startrans will be in a good position to propose expansion of the MAP and MPP, which will in turn promote the development of significant new renewable power sources in California, Nevada, and Arizona. Startrans states that the transaction provides the additional benefit of bringing facilities that are now owned by a municipal corporation under the Commission’s jurisdiction. It also asserts that approval of its TRR, including the incentives, will have a negligible impact on CAISO rates.

7. Startrans requests that the Commission approve its TRR and accept its TO Tariff effective March 31, 2008.

II. Notice of Filing and Responsive Pleadings


9. The California Public Utilities Commission (CPUC) filed a timely notice of intervention and motion for extension of time until February 1, 2008, to submit substantive comments. The CAISO filed a timely motion to intervene raising no issues but noting that Startrans had agreed to extend until February 1, 2008, the CAISO’s right to comment. On January 25, 2008, Startrans filed a response stating that it did not object

4 Exhibit ST-6 of Startrans’ filing shows the current Vernon TRR for the Mead Transmission Interests as $3,396,328.

5 All of the facilities Startrans will own are high voltage facilities.


7 Startrans estimates that its proposed TRR would increase the CAISO’s High Voltage Access Charge by about $0.01/MWh (Testimony of James H. Drzemiecki, Exhibit ST-6).
to an extension of time to February 1, 2008, for the CPUC and the CAISO to file comments, but opposing an extension for any other party.

10. Timely motions to intervene raising no substantive issues were filed by the M-S-R Public Power Agency, San Diego Gas & Electric Company (SDG&E) and the California Department of Water Resources State Water Project.

11. Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (SoCal Edison) (together, California PTOs) filed a timely, joint motion to intervene and protest. The Cities of Anaheim, Azusa, Banning, Colton, Pasadena and Riverside, California (California Cities) filed a timely motion to intervene and comments. On February 1, 2008, the CAISO filed comments. In addition, the California PTOs and SDG&E filed timely motions to consolidate this proceeding with the section 203 proceeding. On February 8, 2008, Startrans filed answers to the comments and protests.


13. On February 22, 2008, the Director, Division of Tariffs and Market Development – West, acting under delegated authority, issued a letter seeking additional information relating to Startrans’ application (Deficiency Letter).


III. Discussion

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), the notice of intervention and timely, unopposed motions to intervene serve to make the parties that filed them parties to this proceeding.

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8 In its protest, the CPUC noted that the Commission granted an extension of time until February 15, 2008, for the CPUC to file comments in Startrans’ proposed issuance of securities filing in Docket No. ES08-24.
16. Rule 213(a) of the Commission’s Rules of Practice and Procedure\(^9\) prohibits an answer to a protest, unless otherwise permitted by the decisional authority. We will accept Startrans’ answers because they have provided information that assisted us in our decision-making process.

B. Rate Incentives

(1) Incentives for Transco Formation

17. We find that Startrans is a Transco, because it has demonstrated that it has a stand-alone business structure and that it will be engaged in selling transmission services at wholesale.\(^10\) In addition, it has shown a propensity to make new transmission investments.\(^11\) Therefore, it is eligible to request rate incentives under Order No. 679. Here, in granting certain of Startrans’ requested incentives, we are taking action under FPA section 205 consistent with the provisions of FPA section 219. Moreover, our decision is consistent with Commission precedent encouraging investment in infrastructure through the application of incentive pricing.\(^12\) We address Startrans’ specific rate incentive requests below.

18. Congress determined that there is a need for rate incentives to encourage investment in transmission infrastructure that will help ensure the reliability of the bulk power transmission system or reduce the cost of delivered power to customers by reducing transmission congestion. In the Energy Policy Act of 2005 (EPAct 2005), Congress added a new section 219\(^13\) to the FPA directing the Commission to establish, by rule, incentive-based (including performance-based) rate treatments for electric transmission. Accordingly, the Commission issued Order No. 679, which sets forth processes and standards under which a public utility can seek transmission rate incentives under section 219. Before adopting Order No. 679, however, the Commission exercised


\(^10\) 18 C.F.R. § 35.35(b)(1)(2007) (defining Transco as a “stand-alone transmission company that has been approved by the Commission and that sells transmission services at wholesale and/or on an unbundled retail basis, regardless of whether it is affiliated with another public utility”).

\(^11\) See Zaminski Testimony, Exhibit No. ST-7 at 3-11.

\(^12\) See, e.g., Trans-Elect, Inc., 98 FERC ¶ 61,142, order on reh’g, 98 FERC ¶ 61,368 (2002); ITC Holdings Corp., 102 FERC ¶ 61,182, reh’g denied, 104 FERC ¶ 61,033 (2003); ITC Holdings Corp., 121 FERC ¶ 61,229 (2007).

its authority under section 205 of the FPA, on a case-by-case basis, to encourage investment in infrastructure through incentive pricing.

19. Recognizing the proven and encouraging track record of Transco investment in transmission infrastructure and the need for increased transmission in general, Order No. 679 concluded that certain incentives are appropriate to encourage Transco formation and new transmission infrastructure investment. Moreover, Transcos’ for-profit nature, combined with a transmission-only business model, enhances asset management and access to capital markets and provides greater incentives to develop innovative services. Order No. 679 also observed that this business model responds more rapidly and precisely to market signals. Accordingly, Order No. 679 determined that Transcos satisfy section 219 of the FPA because this business model promotes increased investment in new transmission, which in turn reduces costs and increases competition.

(2) Return on Equity

(a) Proposals

20. Initially, Startrans requested an ROE of 13.5 percent, which it states is supported by a Discounted Cash Flow (DCF) study using a proxy group consisting of a single independent transmission company and 10 other transmission and distribution companies that have reasonably representative risk and business profiles when compared to Startrans. Startrans stated that the ROEs produced by this proxy group range from 8.75 percent to 18.32 percent, with a mid-point of 13.5 percent. It requested that, if the Commission applies a different DCF study or proxy group that results in an ROE of less than 13.5 percent, the Commission allow Startrans up to 150 basis points for transmission rate incentives under Order No. 679.

21. Later, in its Supplemental Filing, Startrans revised its ROE testimony to reflect the single step DCF methodology and proxy group as approved by the Commission in the recent Atlantic Path 15 Order. Startrans states that the ROEs resulting from this DCF analysis range from 7.63 percent to 13.67 percent and it believes this justifies its requested 13.5 percent ROE.

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14 Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 224.

15 Drzemiecki Testimony, Exhibit No. ST-1 at 12-16.

(b) Pleadings

22. The CPUC asserts that Startrans’ proposed ROE is excessive. It notes that certain merchant transmission companies have sought ROEs of this magnitude in connection with new projects, where there are significant permitting and construction cost risks. The CPUC argues that, in contrast, Startrans faces no such risk in connection with its takeover of Vernon’s existing facilities. The CPUC objects to Startrans’ request to reserve the right to obtain an adder of up to 150 basis points if the Commission does not grant the requested ROE.

23. Startrans responded that the CPUC merely claims that the proposed ROE is “excessive” without any substance to back up its argument. Startrans stated that its original DCF study was performed consistent with Commission precedent.

24. In its Supplemental Filing, Startrans submitted a revised DCF analysis using the same proxy group the Commission approved in *Atlantic Path 15*. Startrans states that its requested 13.5 percent ROE fits within the range of the selected proxy group and is therefore supported by the revised DCF analysis. Startrans also states that as an entity that was created only to own and develop transmission infrastructure, it bears significant operational and economic risks that a utility with multiple revenue sources does not face.

(c) Commission Determination

1. Range of Reasonableness

25. We accept Startrans’ use of the proxy group recently defined in *Atlantic Path 15*. As we explained in our orders involving *Atlantic Path 15* and *Southern California Edison*, as well as in *Bangor Hydro* and *Midwest ISO*, we find that it is appropriate to use a proxy group for calculating an ROE using the DCF method that is made up of companies from the region in which the utility is located. We find that being located in the same geographic and economic region is relevant in determining whether companies face similar business risks.

26. Once the appropriate proxy group is identified, it should be screened to ensure that only comparable companies are included. Our analysis and calculation of the just and

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17 Supplemental Filing Exhibit Nos. ST-9 and ST-10.


reasonable ROE for Startrans are based on a Western Electricity Coordinating Council-wide proxy group as proposed by Startrans and recently accepted in 

Atlantic Path 15 and Southern California Edison. We have used the screening parameters we accepted in our recent Atlantic Path 15 Order, including: (1) using only those utilities that are currently paying cash dividends; (2) using utilities that are covered by two generally recognized utility industry analysts; (3) using utilities that have similar senior bond and/or corporate credit ratings of BBB- to BBB+; (4) using utilities that had not announced a merger during the six-month period used to calculate dividend yields; and (5) using utilities that both have a Thompson Financial First Call growth rate and are covered by Value Line. These screening parameters result in a nine-company proxy group, the same as in Atlantic Path 15. Therefore, we accept Startrans’ filed range of reasonable ROEs of 7.63 percent to 13.67 percent. Startrans’ proposed overall ROE of 13.5 percent falls in the upper end of this zone and is reasonable because it includes appropriate incentives for current and future investments by a Transco.

2. Eligibility for an Incentive ROE

27. The Commission stated in Order No. 679 that it would provide to Transcos a ROE that both encourages Transco formation and is sufficient to attract investment after the Transco is formed. The Commission based its decision on the proven and encouraging track record of Transco investment in transmission infrastructure.

28. We conclude that Startrans has satisfied the requirements of Order No. 679. We find that an incentive ROE is appropriate here because of Startrans’ status as a Transco. In Order No. 679, we found that the for-profit nature of the transmission-only business model provides more incentive to increase infrastructure investment. Further, Transcos, such as Startrans, have demonstrated an inclination to react more rapidly to market signals indicating when and where transmission investment is needed. Last, we find that, as a PTO in the CAISO, Startrans qualifies for an enhanced ROE based on its membership in the CAISO.

We therefore find that the 13.5 percent ROE is reasonable and that, as discussed above, it falls within the range of reasonableness. Accordingly, we

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20 Opinion No. 445, 92 FERC ¶ 61,070, at 61,264 (2000) (advocating the use of a proxy group of utilities with comparable bond ratings). Due to the lack of a published Corporate Credit Rating (CCR) for Startrans, we will adopt the CCR of International Transmission Company as an appropriate screening proxy for a Transco.

21 This result is derived by using the DCF results from the appropriate proxy group as shown in Startrans’ Supplemental Filing, Exhibit No. ST-10.

22 Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 221.

23 Id. at P 326-33.
accept Startrans’ use of a 13.5 percent ROE, conditioned upon Startrans’ continued participation in the CAISO.

29. We reject the CPUC’s assertion that Startrans’ proposed ROE is excessive because Startrans does not have the permitting and construction risks that Commission approved merchant transmission entities have had. Our determination that incentives are appropriate for Startrans is made because it is a Transco and a member of the CAISO. This is consistent with our policy objectives in Order No. 679 and our general rate-making authority.

30. Several protestors have raised questions about Startrans’ independence, since its owner, SEG, has recently purchased (jointly with Tyr Capital, LLC) CalPeak Power, LLC, which owns entities holding five natural gas-fired, simple-cycle generating facilities in the CAISO’s control area. We need not decide here whether Startrans is independent. Order No. 679 did not predicate incentives upon such a finding; rather, we held that an entity can qualify as a Transco “regardless of whether it is affiliated with another public utility.”24 As we note above, Startrans has committed to significant capital expenditures. We find an incentive ROE to be appropriate under these circumstances.

(3) Acquisition Adjustment

(a) Proposal

31. Startrans requests that the Commission approve an acquisition adjustment of approximately $3.17 million, which it states is approximately 14.4 percent of the actual premium it paid, based on Order No. 679 and the benefits resulting from the independent ownership of the Mead Transmission Interests. Startrans explains that this amount is based on Commission precedent involving similar acquisitions in which the Commission approved adjustments above book value based on the accumulated deferred income tax (ADIT) balances recorded at the time the transmission assets were sold.25 On that basis, Startrans states that it calculated a proxy ADIT balance for the Mead Transmission Interests as if Vernon had been a federal tax-paying entity. Startrans also notes that it reset book depreciation accruals based on a new depreciation rate that it developed.

32. Startrans asserts that its proposal would provide incentives for the acquisition of assets owned by non-jurisdictional entities comparable to the incentives for acquisitions

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24 18 C.F.R. § 35.35(b)(1)(2007).

when there is tax liability associated with sale of the assets. Startrans notes that the acquisition adjustment is approximately 17.6 percent of Startrans’ net plant, and is a small percentage (approximately 14.4 percent) of the total premium actually paid. Startrans states that this is comparable to the acquisition adjustments approved in *Trans-Elect* and *ITC Holdings* – 15.4 percent and 16 percent of net plant, respectively.

33. Startrans argues that its requested acquisition adjustment is justified due to the minimal impact on rates and substantial benefits arising from independent ownership of the Mead Transmission Interests. Startrans argues that without an acquisition adjustment, public power entities like Vernon cannot be paid the needed premium and would be at a disadvantage compared to investor-owned utilities when attempting to voluntarily divest transmission assets. Startrans contends that this first-ever independent acquisition of municipally-owned transmission will bring a different perspective to transmission ownership within the CAISO.

(b) Pleadings

34. The California PTOs argue that Startrans’ proposed acquisition adjustment violates the Commission’s policy of allowing a premium based upon recorded ADIT because Vernon does not pay federal income tax and therefore does not have ADIT. They also argue that by using a newly-proposed book depreciation rate that is lower than Vernon’s historic rates, Startrans has overstated its proxy ADIT amount. The CPUC asserts that the proposed acquisition adjustment is simply an unjustified adder to existing rates. The California PTOs state that the Commission should carefully assess, through hearing and evidentiary submissions, whether it is appropriate to provide this new incentive for the acquisition of existing facilities that have not been shown to provide additional benefits.

35. Startrans responds that the proposed acquisition adjustment is neither novel nor unprecedented. Order No. 679 endorses acquisition adjustments, particularly such limited ones as proposed here, to encourage infrastructure investment by independent entities. Startrans contends that without rate treatments such as acquisition adjustments, independent transmission companies would have little ability to acquire publicly-owned assets, as public entities would have little incentive to sell. Startrans states that a

26 Startrans states that the purchase price it paid for the Mead Transmission Interests is $39.5 million compared to the depreciated original cost is $18 million, meaning that Startrans paid a total premium of $21.5 million (Supplemental Filing at 9).

27 The California PTOs state that Startrans used a book depreciation rate of 2.078 percent, not the book depreciation rates of 2.857 percent (pre-2001) and 3.14 percent (2001-on) that Vernon would have used if it had actually paid federal income taxes and recorded any ADIT.
regulatory policy that inflexibly caps rate base at the book value of the acquired assets will not permit public power entities to be paid the premium needed to promote these types of transactions, nor will it permit purchasers to recover these costs.

36. Startrans further contends that its business culture will result in more funding of infrastructure investments and technology improvements than under pre-existing ownership arrangements. As an example, Startrans states that it has committed to participate in the recently announced East of River upgrade project, and has publicly indicated its willingness to absorb the pro rata cost responsibility for any interest owners declining to participate. Startrans claims that this philosophy contrasts with that of municipal utilities, whose interests are generally local and whose ability to finance capital improvements is typically more limited.

(c) Commission Determination

37. The Commission, in Order No. 679, articulated two categories of acquisition adjustments that a public utility could request to recover through its rate base. First, the Commission stated that it would continue to consider proposals to adjust the book value of transmission assets being sold to a Transco to reflect the effect of accelerated depreciation on the federal capital gains tax liabilities faced by the divesting party. The Commission explained that this approach was necessary because transmission owners are unlikely to sell transmission assets if they are not able to include an adjustment for the taxes associated with those sales and thereby be held harmless from capital gains taxes. Second, aside from the tax issue, the Commission stated in Order No. 679 that we would not discard our traditional standard for allowing an acquisition adjustment in rates; that traditional standard requires a specific showing of ratepayer benefits. This means that even a Transco must make some showing of customer benefits beyond simply the fact that it is a Transco. Where that showing is made, any entity requesting this incentive must also show that the size of the adjustment is reasonable, as discussed in Order No. 679.

38. As support for its proposed acquisition adjustment, Startrans cites the ITC Holdings and Trans-Elect Orders, in which the Commission allowed the applicants to recover an adjustment equal to the tax paid by the divesting party due to differences between the book and tax basis of the transmission assets, less any deferred income taxes and investment tax credits associated with the assets that had been normalized for rate purposes. In a previous International Transmission Co. Order, however, the Commission found that limiting the adjustment to a figure that could be directly quantified

“...addresses concerns that might otherwise arise as to whether favorable rate treatments for premiums cause unwarranted increases in the sales price of transmission assets.”

39. We reject Startrans’ request for an acquisition adjustment here because it represents a significant increase in the revenue requirement and Startrans has not shown that the adjustment is reasonable. Startrans’ acquisition adjustment for the Mead Transmission Interests does not fit the categories of adjustments contemplated by Order No. 679. First, the Commission’s acceptance of the acquisition adjustments proposed in *ITC Holdings* and *Trans-Elect* was based on the fact that ADIT was part of the purchase price, and hence was an actual cost to the Transco of purchasing transmission assets. ADIT is not applicable here because the City of Vernon is a municipal utility, and thus is not subject to federal income tax liability. Therefore, the acquisition adjustment Startrans proposes is neither directly quantified by an actual tax liability, nor is it a reflection of an actual cost faced by the divesting party that will be passed on to the acquiring Transco.

40. Second, Startrans has not met the standard described above for allowing a non-tax-related acquisition adjustment in rates. The Commission continues to recognize the numerous general benefits to consumers of Transco formation. However, here Startrans is purchasing facilities already being used for open access service under the CAISO tariff. Startrans has made no showing of customer benefits, instead relying entirely on the claim that it is an independent Transco. This is insufficient, and we reject Startrans’ request for an acquisition adjustment. If, in the future, a Transco requests an acquisition adjustment and makes an adequate showing of customer benefits, we will consider that request.

(4) **Construction Work in Progress**

(a) **Proposal**

41. Startrans requests to include in its rate base approximately $395,000 representing 100 percent of CWIP costs associated with Startrans’ commitment to invest in the East of River upgrade project. Startrans states that the East of River upgrade project will increase the transfer capability of the northern part of the Arizona to California East of River transmission system, which includes the Mead-Phoenix and Navajo-Crystal 500 kV lines. The upgrade project will increase the non-simultaneous rating of the East of River path by 1,245 MW from 8,055 to 9,300 MW. Startrans states that the total cost of the project is estimated to be $18 million, which will be allocated on the basis of component ownership interests in the facilities. Startrans claims that its base cost share of the total investment will be approximately $389,000. Startrans contends that including 100 percent of transmission-related CWIP in rate base will promote new construction, and that the East of River project is the kind of investment envisioned by the Commission.

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Startrans also contends that its participation in this project, and its willingness to absorb the cost responsibility for any MPP interest owner\textsuperscript{31} that declines to participate, prove Startrans’ commitment to expand its independent ownership portfolio beyond the initial investment in the Mead Transmission Interests.

(b) Pleadings

42. The California PTOs argue that Startrans has provided no factual support for its CWIP request and has not demonstrated that the East of River upgrade project is eligible for this type of incentive treatment. They note that Order No. 679 requires each applicant to demonstrate that there is a nexus between its request for 100 percent CWIP and the investment being made.\textsuperscript{32} The California PTOs also argue that Startrans has failed to comply with certain Commission regulations relating to accounting methods and procedures required of utilities requesting CWIP in rate base. They contend that, without such information, the Commission cannot approve Startrans’ CWIP proposal. The CPUC argues that Startrans’ CWIP request is premature since there is no actual project under way that is incurring costs.

43. Startrans responds that the regulations cited by the California PTOs do not apply to transmission-only companies. In addition, Startrans states that the data supporting the project for which CWIP is requested are in the workpapers supporting Statement AM. Startrans asserts that its request for CWIP is not premature because construction on the East of River project will begin within the test period – specifically, during the third quarter of 2008.\textsuperscript{33}

44. In its Supplemental Filing, Startrans provides an affidavit from Vernon confirming that Vernon does not intend to invest in the East of River upgrade or any other future projects designed to improve the Mead Transmission Interests.\textsuperscript{34} Startrans has committed to help fund this project, as well as other upgrades to the Mead Transmission Interests, to bring solar power generation to the California market. Startrans states that there is a demonstrated nexus between the requested CWIP rate treatment and its willingness to invest in this project.

\textsuperscript{31} As noted above, there are multiple co-owners of the MPP facilities besides Vernon (at present) or Startrans (after the Transaction).

\textsuperscript{32} Citing Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 117.

\textsuperscript{33} Startrans’ February 19 answer to the CPUC’s protest at 6.

\textsuperscript{34} Supplemental Filing Exhibit ST-11.
45. In their comments on the Supplemental Filing, PG&E and SDG&E argue that Startrans still does not show how this project meets the conditions established in Order No. 679 for approval of this type of incentive.

(c) **Commission Determination**

46. In Order No. 679, the Commission said that under certain circumstances utilities may include 100 percent of prudently-incurred transmission-related CWIP in rate base.\(^{35}\) The Commission noted that this rate treatment will further the goals of section 219 by providing up-front regulatory certainty, rate stability, and improved cash flow for applicants, thereby reducing the pressures on their finances caused by investing in transmission projects.\(^{36}\) Granting a CWIP incentive increases cash flow, thereby reducing financial risks that might otherwise discourage new transmission investment. CWIP also improves rate stability by mitigating rate shock resulting from large-scale transmission projects.

47. However, Order No. 679 requires that an applicant for an incentive show that there is a nexus between the incentive sought and the investment being made. In evaluating whether an applicant has satisfied the required nexus test, the Commission will examine how any requested incentives address the risks and challenges faced by the project.\(^{37}\) As discussed below, we find that Startrans has not demonstrated a nexus between the proposed CWIP incentive and its investment in the East of River project.

48. The Commission has authorized the inclusion in rate base of 100 percent of prudently incurred CWIP associated with transmission projects where the utility demonstrated that, due to the size, scope, and/or construction time of the projects, there was an increased risk to the company’s credit rating.\(^{38}\)

49. In Order No. 679, the Commission stated that “[g]iven the long lead time required to construct new transmission, and the associated cash flow difficulties faced by many entities wishing to invest in new transmission, the Final Rule provides that, where appropriate, the Commission will allow for the recovery of 100 percent of CWIP in rate base.”\(^{39}\) Accordingly, the Commission’s intention for the CWIP incentive was to provide

\(^{35}\) Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 29, 117.

\(^{36}\) Id. P 115.

\(^{37}\) Id. P 26; 18 C.F.R § 35.35(d) (2007).

\(^{38}\) See, e.g., *Southern California Edison Co.*, 121 FERC ¶ 61,168, at P 58 (2007); *see also Duquesne Light Co.*, 118 FERC ¶ 61,087, at P 59 (2007).

\(^{39}\) Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 29.
immediate cash flow for companies who take on projects with long lead times and, as a result, face cash flow difficulties or an adverse effect on their credit ratings.

50. The cases in which we have approved the 100 percent CWIP incentive involved projects with long lead times, such as Xcel Energy Services, Inc., Potomac-Appalachian Transmission Highline, LLC.\(^40\) Additionally, in those cases, the applicants demonstrated that they faced financial risks.\(^41\) These facts are not present here. Startrans’ East of River project has a short lead time, as it is expected to be completed by mid-2009.\(^42\) Additionally, Startrans has failed to provide any analysis demonstrating that it will face cash flow difficulties as a result of its transmission investment in this project. Nor has Startrans addressed whether the East of River project will adversely affect its credit rating. Due to the short construction time frame and Startrans’ failure to demonstrate that it faces sufficient financial risks associated with construction of the East of River project, we deny Startrans’ request to include 100 percent of CWIP in rate base. While we reject Startrans’ request, we reiterate that, consistent with Order No. 679, any future application that demonstrates a nexus between the project it proposes and its request for 100 percent CWIP inclusion in rate base may qualify for incentive CWIP treatment.

C. Capital Structure and Cost of Debt

(1) Proposal

51. Startrans proposes to use its actual capital structure, which is expected to consist of 40 percent debt and 60 percent equity at the time of closing, and an estimated cost of long-term debt of 7.64 percent. Startrans states that this is the capitalization approved by the Commission in other similar cases involving the formation of stand-alone transmission companies.\(^43\)

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\(^40\) See, e.g., Xcel Energy Services, 121 FERC ¶ 61,284 (2007); Potomac-Appalachian Transmission Highline, LLC, 122 FERC ¶ 61,188 (2008).

\(^41\) See, e.g., Xcel Energy Services, 121 FERC ¶ 61,284 at P 18; Potomac-Appalachian Transmission Highline, LLC, 122 FERC ¶ 61,188 at P 36.

\(^42\) Zaminsky Testimony, Exhibit ST-7 at 6 (stating that the project is expected to go into operation in April 2009); Supplemental Filing, Workpapers in Response to Item 5a (stating that the project goes into operation June 2009).

52. The California PTOs argue that, based on apparent discrepancies between Startrans' filing in this docket and its section 204 securities filing, Startrans may not be using the proper debt-to-equity ratio, and may also be inflating its estimated cost of debt. First, they note that according to Statement AV in this docket, Startrans' capitalization will include $8,628,449 in long-term debt, but the section 204 filing indicates that Startrans plans to obtain credit facilities totaling $11.4 million. Thus, they contend, Startrans may be understating the share of long-term debt and overstating the share of common stock equity. Second, the California PTOs state that Statement AV shows an estimated cost of long-term debt of 7.64 percent; this is the sum of a credit facility cost rate of 6.9 percent and an amortization of various fees and expenses estimated at 0.74 percent. However, Startrans’ section 204 filing indicates that the estimated cost rate of 6.9 percent is a maximum rate. The California PTOs state that it is therefore unclear whether the 7.64 percent figure for long-term debt is the actual figure that will be used. Finally, the California PTOs state that, in this docket, Startrans calculates the amortization of various fees and expenses based on the assumption that the issuance of debt securities will mature in 15 years, but in its section 204 filing, Startrans states that they will mature in 17 years. They state that this incorrect calculation further inflates Startrans’ proposed cost of debt.

53. Startrans responds that its proposed capital structure is its actual capital structure during the test period, and will be supported in Startrans’ compliance filing at the conclusion of this proceeding. Startrans adds that because the transaction has not closed, final capitalization numbers are simply not available. Startrans states that its future compliance filing will also reflect the actual, post-closing debt cost.

54. Consistent with Opinion No. 235, the Commission conditionally accepts Startrans’ proposed use of an actual capital structure. We find that when Startrans issues debt in accordance with our order in the parallel section 204 proceeding, Startrans must submit an updated capital structure to reflect the actual amounts of debt and equity. Additionally, Startrans is required to make the appropriate adjustments to the TRR within 30 days after its debt is issued.
D. **TRR Issues**

55. Intervenors raise a number of other issues relating to Startrans’ TRR. They object to Startrans’ proposed restatement of accumulated depreciation and plant balances back 12 years to the in-service date of the Mead Transmission Interests. They state that Startrans proposes to use the book depreciation rates of Arizona Public Service Company as a proxy for the appropriate depreciation rate for the Mead Transmission Interests, instead of the depreciation rates established for Vernon in a 2001 settlement. They state that the proposed depreciation rate, which is lower than the depreciation rates established for Vernon, artificially inflates Startrans’ proposed TRR. Intervenors object to the inclusion of $200,000 in plant additions for the new test year, arguing that the number is not supported by historical trends or actual plant forecast. They also object to Startrans’ proposal to use the California state income tax rate for facilities that are in Nevada and Arizona, and question whether the appropriate deferred tax has been computed and reflected in the proposed TRR.

56. These remaining TRR items raise issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

E. **Other Issues**

57. The CAISO and California PTOs state that Startrans’ proposed TO Tariff should be revised to remove the reference to “Net FTR Revenue” and to revise the definition of Transmission Revenue Credit to be appropriate for Startrans’ status as a non-load serving PTO. The CAISO states that updates to the TO Tariff will be needed to be consistent with the CAISO’s Market Redesign and Technology Upgrade (MRTU). The CAISO also requests that the Commission condition the effective date of the TO Tariff on the date of closing of the Transaction.

58. Intervenors also raise a number of issues that relate to the transfer of the Mead Transmission Interests, such as the need for Vernon to remove the facilities from its TRR, the effect of Vernon’s over-collection dispute with the CAISO, consent from the CAISO of the transfer, and whether the transfer will allow the CAISO to fully utilize the facilities. Intervenors also raise issues related to accounting entries and the purchase price of the facilities, and question whether Startrans plans to attempt to include the full purchase price in its rates.\footnote{46} We note that intervenors filed identical protests in this

\footnote{46} Specifically, intervenors note that the purchase price of $39.5 million is approximately $18 million above the plant amount (book value of the facilities plus the proposed acquisition adjustment) included in Startrans’ rate base.
docket and Docket No. EC08-33 and we will address those arguments in a contemporaneously issued order in that docket. 47

59. Startrans states that it will remove the Net FTR language 48 and update its TO Tariff with any revisions necessary to comply with the CAISO’s MRTU Tariff. Startrans does not oppose an effective date for the TO Tariff coinciding with the closing of the transfer of ownership 49 and approval of Startrans as a PTO under the CAISO Tariff and TCA. Startrans states that it will make a compliance filing after closing to reflect these changes.

60. In their comments on the Supplemental Filing, PG&E, SDG&E, and SoCal Edison state that the TO Tariff still contains errors that must be corrected. For example, they state that the definition of Transmission Revenue Credit contains incorrect cross-references to the CAISO Tariff, and is still written in a way that is not applicable to Startrans.

61. Although Startrans’ responses and commitments may address some of these concerns, we conclude that the protests concerning the TO Tariff should be resolved in the hearing and settlement judge procedures ordered below.

F. Requests for Consolidation

62. The California PTOs and SDG&E request that the Commission consolidate this filing with Startrans section 203 filing in Docket No. EC08-33, arguing that the proceedings are intertwined in facts and law. 50 They contend that the Commission cannot determine whether Startrans’ section 203 filing satisfies the FPA without fully exploring the effects of that acquisition on the California rate payers in Startrans’ TRR filing.

47 In its Supplemental Filing, Startrans states that it classified the $18 million difference as “goodwill” for accounting purposes, and will not propose to recover this amount from ratepayers. In their comments, PG&E, SDG&E, and SoCal Edison state that they accept Startrans’ response and consider that question resolved.

48 In its Supplemental Filing, Startrans includes a revised TO Tariff showing the removal of Net FTR Revenue.

49 As stated above, this is expected to occur on March 31, 2008.

50 In Startrans’ section 204 filing in Docket No. ES08-24, the California PTOs and SDG&E requested that the Commission consolidate that docket with both this one and the section 203 filing.
63. Startrans objects to the motions to consolidate, arguing that the proceedings do not involve common issues of law and fact.

64. We deny the requests to consolidate. The Commission consolidates matters only if a hearing is required to resolve common issues of law and fact and consolidation will ultimately result in greater administrative efficiency. Startrans, however, has satisfied all the requirements under FPA sections 203 and 204, and there is nothing in those proceedings that needs to be set for hearing.

G. Hearing and Settlement Judge Procedures

65. Startrans’ TO Tariff and its associated TRR raise issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

66. Our preliminary review of Startrans’ filing indicates that the proposed rates (with the exception of the incentives discussed in Section III. B. of this order) have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will accept Startrans’ proposed TO Tariff for filing with a nominal suspension, make it effective March 31, 2008, subject to refund and the conditions set forth in this order, and set it for hearing and settlement judge procedures.

67. While we are setting these matters for trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission’s Rules of Practice and Procedure. If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise the Chief Judge will select a judge for this purpose. The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.


52 If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission’s website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).
The Commission orders:

(A) Startrans requested incentive rate treatments are hereby granted in part, and denied in part, as discussed in the body of this order.

(B) Startrans’ proposed TO Tariff is hereby accepted for filing and suspended nominally, to become effective March 31, 2008, subject to refund, as discussed in the body of this order.

(C) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning Startrans’ proposed TO Tariff and rates. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (D) and (E) below.

(D) Pursuant to Rule 603 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2007), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(E) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties’ progress toward settlement.

(F) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge’s designation, convene a prehearing conference in this proceeding in a hearing room of the Commission, 888 First Street, NE., Washington, DC 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and
to rule on all motions (except motions to dismiss) as provided in the Commission’s Rules of Practice and Procedure.

By the Commission. Commissioners Kelly and Wellinghoff dissenting in part with separate statements attached.

(SEAL)

Nathaniel J. Davis, Sr.,
Deputy Secretary.
This order addresses, among other things, a request for certain transmission rate incentives filed by Startrans IO, L.L.C. (Startrans). Startrans is a newly-formed, transmission-only limited liability company that has agreed to purchase interests in two transmission line projects owned by the City of Vernon, California (Vernon). Vernon holds a 6.25% interest in the Mead-Adelanto Project (MAP) and interests of 2.15%, 3.79%, and 4.05% various components of the Mead-Phoenix Project (MPP). Startrans indicates that it intends to pursue ownership of additional transmission assets within the Western Interconnect Region.

Startrans requests a number of incentives, including an incentive return on equity (ROE). However, I do not believe that the investment presented by Startrans in its application is sufficient to merit incentive ROE treatment. It is true that the Commission has, and I as a member of the Commission have, as a matter of policy, encouraged the development of Transcos because they have a greater interest in getting new transmission built than integrated utilities, thereby benefiting transmission users. However, that policy is not being furthered by the investment proposed in this case. The transmission assets being acquired by Startrans have been in existence for 12 years and Startrans will only come to own a small stake in them. Pacific Gas & Electric and Southern California Edison point out that the transmission lines in question are presently under the operational control of the California Independent System Operator and argue that the transaction before the Commission will not facilitate greater use of these facilities by market participants. They also argue that there is no basis to conclude that the transaction will increase the capacity or reliability of CAISO’s grid. I agree. While Startrans pledges to pursue future investment, I do not believe the specific

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1 Pacific Gas & Electric and Southern California Edison Company’s Motion to Intervene and to Protest the filings made by Startrans at p 10, filed January 25, 2008.
transaction described in the instant proceeding offers a level of ratepayer value sufficient to merit incentive treatment.

However, I take this decision only with regard to Startrans’ acquisition of Vernon’s stakes in the MAP and MPP transmission projects. In the future, were Startrans to undertake significant new construction or expansion of transmission infrastructure, I would consider supporting incentive treatment.

Finally, I do not support establishing Startrans’ requested ROE of 13.5% in this order as opposed to doing so through an evidentiary hearing. As I have noted in previous proceedings, I do not believe that establishing an ROE in the absence of an evidentiary hearing exercises the careful discretion discussed in Order 679-A. Specific to the instant proceeding, I view the majority’s decision to rely on International Transmission Company’s credit rating in the absence of a published Corporate Credit Rating for Startrans as a further departure from careful discretion.

For these reasons, I respectfully dissent in part from this order.

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Suedeen G. Kelly

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WELLINGHOFF, Commissioner, dissenting in part:

In today’s order, the majority accepts a zone of reasonableness from an ROE of 7.63 percent to an ROE of 13.67 percent. The majority then states that “Startrans’ proposed overall ROE of 13.5 percent falls in the upper end of this zone and is reasonable because it includes appropriate incentives for current and future investments by a Transco.” The majority also states, “Our determination that incentives are appropriate for Startrans is made because it is a Transco and a member of the CAISO.”

I dissent in part because I believe that the majority has not adequately explained why Startrans’ status as a Transco and its participation in the CAISO justify granting the company’s requested ROE of 13.5 percent. For example, today’s order does not explain what portion of the ROE incentive is being provided based on Startrans’ status as a Transco, or how much of that incentive is attributable instead to Startrans’ participation in the CAISO. The majority also fails to explain why either of those amounts, or the total incentive included in Startrans’ overall ROE, is “appropriate.” I am concerned that the discussion in today’s order could be seen as boiling down to granting Startrans’ requested ROE simply because Startrans is eligible for an ROE incentive and requested an ROE within the zone of reasonableness. Such analysis is insufficient to fulfill the Commission’s responsibility to ensure just and reasonable rates.

I agree with the majority that Startrans should receive an ROE incentive based on its participation in the CAISO. In numerous previous orders, the Commission has found that participation in an RTO or ISO warrants a 50 basis point incentive ROE adder.\textsuperscript{1} I believe that this same level of incentive ROE adder is appropriate to recognize Startrans’ participation in the CAISO.

I also agree with the majority that Startrans should receive an ROE incentive based on its status as a Transco. As a starting point in determining the appropriate amount of that incentive, I note that the Commission granted International Transmission Company a 100 basis point incentive ROE adder in recognition of its “early effort at independent transmission company formation.”\(^2\)

In Order No. 679, the Commission relied in significant part on International Transmission Company as evidence of “the proven and encouraging track record of Transco investment in transmission infrastructure.”\(^3\)

I believe that important benefits will arise from the formation of Startrans as a Transco in the CAISO. I note, however, that Startrans will have a very small percentage of ownership in the Mead Transmission Interests, and that there is some question as to the role Startrans will play in determining how those facilities are maintained or expanded. Such questions present a distinction between Startrans and Transcos that the Commission has approved in the past. In addition, I note that Startrans Witness Zaminski states that the company views its acquisition of the Mead Transmission Interests as “the springboard for future infrastructure investment through independent ownership.”\(^4\) Although I share the majority’s hope that Startrans will act on its “propensity to make new transmission investments,” I believe that the existing record does not support an incentive ROE adder the size of or greater than that granted to International Transmission Company. With these factors and precedents in mind, I would grant Startrans a 50 basis point incentive ROE adder in recognition of its status as a Transco.

The midpoint of the zone of reasonableness accepted in today’s order is 10.65 percent. Accounting for the above-noted incentive ROE adders, I would support an overall ROE for Startrans of 11.65 percent.

For these reasons, I respectfully dissent in part.

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\(^2\) *ITC Holdings Corp.*, 102 FERC ¶ 61,182 at P 68 (2003).

\(^3\) Order No. 679 at P 222-23.

\(^4\) Exh. No. ST-7 at 6.