

Competitive Transmission Development Rates Technical Conference

Docket No. AD16-18-000

Panel 2: Commission Consideration of Rates that Contain Cost Containment Provisions and Result from Competitive Transmission Development Processes

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About the Speaker

Mr. Sundararajan is the Vice President of Transmission Finance, Strategy, and Siting for American Electric Power Company, Inc. (“AEP”). AEP is the nation’s largest transmission owner, with more than 40,000 line-miles in ERCOT, PJM, and SPP. AEP is also an 86.5% owner of Transource Energy, LLC (“Transource”), which was formed to compete for and develop transmission projects identified in post-Order No. 1000 regional planning processes. Transource is currently developing projects in SPP and PJM, and actively participating in ongoing competitive processes in both of those planning regions, as well as MISO.

Key Points

AEP and its transmission-owning subsidiaries and affiliates have significant experience utilizing formula rates to recover the cost of owning and operating an extensive network of transmission facilities. Recent Commission rate orders have demonstrated that formula rates under existing Commission policies are flexible enough to accommodate cost containment bids in competitive process and apply project-specific incentive rate treatments that have been awarded by the Commission, such as ROE risk adders or construction work in progress (“CWIP”). For example, a formula rate could include a worksheet that defines the negotiated cost cap for project cost or project O&M, identify actual costs for the project as reported in the FERC Form No. 1, and limit recovery in the ATRR to only those costs which do not exceed the cap. Under current policies, developers have the flexibility to define the terms of and exceptions to cost caps in competitive bids, but any such terms and conditions should be clearly stated in a formula rate to ensure that the rate is administered in a manner that is consistent with the competitive outcome. If changes to an existing formula rate are required to incorporate competitive concessions agreed to by a developer in a competitive solicitation, the Commission should allow such changes to be made in a single-issue filing rather than forcing a developer to potentially re-litigate unrelated issues in its formula rate.

While mechanically incorporating competitive cost containment commitments into existing formula transmission rates is manageable, any meaningful cost containment provision (limiting recovery of capital costs) does transfer the risk of cost overruns from ratepayers to developers. It is unquestionably riskier to develop a project subject to

capital cost containment provisions than under the traditional utility cost-of-service model. This risk transfer can be mitigated by one of two approaches. The Commission may provide upfront clarification concerning the incentives that will be available to developers competing for the project. Alternatively, the Commission, subsequent to project developer designation, can recognize the transfer of risk by adjusting the base ROE or ROE incentives. The problem with the second approach is that developers are required to take on significant risk during the bidding process without foreknowledge of the return that will be available in exchange. Furthermore, the developer could request incentives or other rate treatments from the Commission which were not part of the original competitive solicitation subsequent to project award, but which would have had a meaningful impact on an ISO/RTO's selection. AEP would support the first approach which provides upfront certainty while not changing the traditional cost of service rate making process.

Some of the questions posed to this panel also reference the criteria articulated in Order No. 784 for competitive solicitations. So long as competitive outcomes fit within the existing cost-of-service model – up to and including a cost-of-service rate potentially supplemented by a cap on capital costs – no additional requirements or criteria need to be imposed on the competitive process as the rate can still be established under current Commission policy by implementing a cost-of-service formula that is subject to traditional cost-of-service scrutiny under Sections 205 and 206 of the Federal Power Act. If the Commission were to consider allowing developers to recover in rates a fixed-ATRR arising from the competitive process, which in AEP's opinion is a fundamentally different construct from anything contemplated with Order No. 1000's competitive developer reforms, additional criteria such as those discussed in Order No. 784 would need to be established to ensure that the level of competition is sufficient to ensure that the resulting rate is just and reasonable. A fixed-ATRR bidding process is also a fundamentally different regulatory construct than the current regulatory policy on cost-of-service transmission rates, including the use of the DCF methodology to establish a just and reasonable ROE.