129 FERC ¶ 61,300
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer and Philip D. Moeller.

Public Service Electric and Gas Company Docket No. ER10-159-000

ORDER ON TRANSMISSION RATE INCENTIVES

(Issued December 30, 2009)

1. On October 30, 2009, Public Service Electric and Gas Company (PSE&G) submitted proposed tariff revisions pursuant to sections 205 and 219 of the Federal Power Act (FPA)[1] and Order No. 679,[2] to implement requested transmission rate incentives for the 50-70 mile Branchburg-Roseland-Hudson 500 kV Line (Branchburg Project). Specifically, PSE&G requests: (1) a 150 basis-point return on equity (ROE) adder for the Branchburg Project; (2) recovery of 100 percent of construction work in progress (CWIP) in rate base; and (3) authorization to recover all prudently-incurred costs if the Branchburg Project is abandoned or canceled for reasons beyond PSE&G's control. PSE&G also requests authority to assign its rate incentive authorization to an affiliate. For the reasons discussed below, the Commission will grant PSE&G's requests, with one modification, and accept for filing the related proposed tariff revisions, effective January 1, 2010.

I. Background

2. PSE&G, a wholly-owned subsidiary of Public Service Enterprise Group Inc., is located in New Jersey and is responsible for providing transmission and distribution service to approximately 1.7 million gas customers and approximately 2.1 million electric customers. PSE&G is a transmission-owning member of the PJM Interconnection, L.L.C. (PJM) regional transmission organization (RTO). The PJM Open Access

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[1] 16 U.S.C. §§ 824d and 824s (2006).

[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).

Transmission Tariff (OATT) governs transmission service over PSE&G's transmission facilities.

3. PSE&G recovers its annual revenue requirement for transmission service provided within the PSE&G zone of PJM through a formula rate. The formula rate is set forth in Schedule H-10A of PJM's OATT. PSE&G's formula rate incorporates an ROE of 11.68 percent, which is comprised of a base ROE of 11.18 percent and a 50 basis-point adder for continued membership in PJM.[3]

II. Incentive Rate Proposal

4. As further detailed below, PSE&G states that the Branchburg Project is a 500 kV large-scale PJM RTEP-approved backbone transmission line that will traverse 50-70 miles of heavily-populated and environmentally-sensitive areas in New Jersey. PSE&G estimates that the Branchburg Project will cost $1.1 billion and be in-service by the summer of 2013. PSE&G submits proposed tariff revisions to PJM's OATT in order to implement the following transmission rate incentives for the Branchburg Project: (1) a 150 basis-point ROE adder, which would be added to PSE&G's existing ROE of 11.68 percent, resulting in an overall ROE of 13.18 percent; (2) recovery of one hundred percent of CWIP in rate base; and (3) authorization to recover all prudently-incurred costs if the Branchburg Project is abandoned or canceled for reasons beyond PSE&G's control. PSE&G also requests authority to assign its rate incentive authorizations to an affiliate, if PSE&G so chooses. PSE&G requests an effective date of January 1, 2010.

A. Risks and Challenges

1. Financial Risks

5. PSE&G contends that the Branchburg Project poses substantial financial risks and "will constitute a significant addition to PSE&G's already substantial transmission expenditure plans."[4] PSE&G states that its current net transmission plant in service as of December 31, 2008, totals $957 million and that the Branchburg Project will more than double this amount when all of PSE&G's approved RTEP backbone transmission projects are completed (totaling $1.85 billion in costs). PSE&G states that its net transmission plant will increase from below $1 billion to nearly $3 billion. PSE&G argues that the significant increase in its costs associated with these projects will require significant cash outlays and dramatically increase PSE&G's debt levels. Additionally, PSE&G states that over the next four to five years, the annual average investment by

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[3] *Public Service Electric & Gas Company*, 124 FERC ¶ 61,303 (2008) (PSE&G Formula Rate Order).

[4] PSE&G Transmittal Letter at 9.

PSE&G in transmission facilities will increase from about $70 million to approximately $270 million.[5] PSE&G states that it will be difficult to meet the financial requirements of the Branchburg Project while maintaining adequate cash flows and favorable coverage ratios. PSE&G states that its investments will be of concern to financial rating agencies and may ultimately impact PSE&G's credit rating. PSE&G states that, in order for it to be competitive with other utilities that are constructing large backbone transmission projects, an incentive ROE would help attract the necessary investors needed for the Branchburg Project.

6. PSE&G contends that its financial risk is compounded by the project's lead time of about four years, which could significantly impact the total cost due to increases in material and labor costs. PSE&G states that the long lead time and the associated cost increases could further impact PSE&G's credit rating and impact its ability to attract investment. PSE&G argues that if it cannot give investors reasonable assurances of cost recovery, PSE&G will face difficulties in attracting the capital necessary to construct the Branchburg Project.[6] PSE&G asserts that all of its requested incentives are necessary so that it can maintain its credit standing, remain an attractive opportunity for external investors, and continue to be a financially stable company.

2. Regulatory Risks

7. PSE&G contends that the Branchburg Project requires numerous regulatory approvals, as well as a number of siting and construction permits. PSE&G states that it may need five federal permits, 15 state permits, six regional permits, and 19 municipal permits.[7] PSE&G states that failure to obtain any of the necessary authorizations could jeopardize the entire Branchburg Project.[8] These authorizations include: (1) approval of a Remedial Action Work Plan by the New Jersey Department of Environmental Protection (NJDEP) if a Superfund site is used; (2) approval from the New Jersey Board of Public Utilities (NJBPU), as opposed to seeking the approval of multiple municipalities[9]; (3) Freshwater Wetlands permits from the NJDEP; (4) Flood Hazard

[5] *Id.* at 9.

[6] *Id.* at 13.

[7] PSE&G Exhibit No. PEG-1E.

[8] PSE&G Transmittal Letter at 15-16.

[9] PSE&G states that a "utility may seek review of an adverse decision of a municipal zoning or planning body with the NJBPU. A utility may seek direct approval from the NJBPU in lieu of local approval only if the project would require approval from more than one municipality, which is the case for the [Branchburg] Project." *Id.* at 15 n.25.

Area permits from NJDEP should specific areas be disturbed as a result of construction activities; (5) New Jersey Meadowlands Commission Zoning approvals and Construction Plan Reviews; (6) New Jersey Green Acres approvals for specific properties needing new easements; (7) review by the National Park Service since a portion of the line might pass through the Great Swamp National Wildlife refuge in northern New Jersey; (8) joint permit review by the U.S. Environmental Protection Agency and the U.S. Fish and Wildlife Services; and (9) certain authorizations from the U.S. Army Corps of Engineers for all wetland disturbances.

3. **Environmental Risks**

8. PSE&G contends that it will face significant environmental risks given the terrain and geographical features (such as wetlands and waterways) that the Branchburg Project is expected to traverse. PSE&G argues that the environmental challenges could significantly impact the permitting process, which would also impact the project's cost and construction schedule. For example, PSE&G notes that if the Branchburg Project passes through the Great Swamp National Wildlife Refuge, it will require National Park Service review and approval; if the project disturbs more than five acres, its mitigation plans will require joint approval by the U.S. Environmental Protection Agency and the U.S. Fish and Wildlife Services. In addition, if the project passes through the New Jersey Meadowlands Area or crosses navigable waterways, PSE&G will require permits from the U.S. Army Corps of Engineers. PSE&G further states that if it encounters insurmountable hurdles, it will be forced to identify a new route that will require new environmental studies and permits that could cause significant delays and additional costs without a guarantee that the new proposed route would be approved.[10] Finally, PSE&G contends that should the Branchburg Project cut through environmentally sensitive areas, there are various timing restrictions with respect to certain species, their habitats and when construction activities can take place in these areas.[11] PSE&G argues that the uncertainty it faces with regard to the Branchburg Project's route and acquisition of environmental permits could significantly impact the cost and duration of the project's construction.

4. **Technical Challenges**

9. PSE&G contends that the Branchburg Project faces a number of technical challenges with regard to the actual construction of the line. First, PSE&G states that the line will likely run through wetlands and highly populated areas, and that both types of environments present unique construction challenges. Second, PSE&G states that construction must be closely coordinated with other electric generating stations to ensure

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[10] PSE&G Transmittal Letter at 16.

[11] PSE&G Exhibit No. PEG-1 at 25.

safe operation of the line and avoid outages. Finally, PSE&G states that 500 kV lines, such as the Branchburg Project, and related equipment must be custom designed and proof-tested. Since there are relatively few experts in the manufacture, testing and installation of such infrastructure, PSE&G argues that there is a risk that the necessary equipment might not be available when needed.[12]

5. Timing Risks

10. PSE&G states that the potential for significant delays on a large project, such as the Branchburg Project, is exacerbated by the many facets of the project, including: (1) obtaining rights-of-ways; (2) performing environmental studies; (3) filing for necessary permits; (4) holding public hearings; and (5) procuring the materials and hiring the labor.[13] PSE&G further states that, due to the many other large transmission projects in various stages of development throughout the world, there are undue strains on the limited pools of: (1) specialized electrical construction resources; (2) manufacturing capacity for transmission structures and hardware; and (3) electrical equipment. PSE&G further states that natural disasters, such as hurricanes, can cause price spikes and limit the availability of labor and materials. Finally, PSE&G states that although sound requirements planning, procurement and contracting methods help to mitigate these risks, the long-term nature of the project ensures that such risks will always be present.

B. Technology Statement

11. PSE&G provides a technology statement in support of its assertion that the Branchburg Project will utilize "advanced transmission technologies" under section 1223(a) of the Energy Policy Act of 2005 (EPAct 2005)[14] and, thereby, allow the Branchburg Project to be operated as a Smart Grid. PSE&G states that the Branchburg Project will be one of the most modern and sophisticated transmission projects being designed in the United States due to its incorporation of advanced technologies and smart grid technology. Those advanced transmission technologies include: (1) advanced conductor materials; (2) gas insulated substations (GIS); (3) microprocessor-based relays and digital fault recorders; and (4) fiber optic protection and communication links.

12. PSE&G states that it will utilize advanced materials in the manufacture and design of conductors to maximize power transfer capabilities and the spacing of towers to minimize visual and environmental impacts on sensitive areas as required. PSE&G also states that it will use GIS stations instead of the traditional Air Insulated Substations,

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[12] PSE&G Transmittal Letter at 17.

[13] PSE&G Exhibit No. PEG-1 at 25.

[14] Energy Policy Act of 2005, Pub. L. No. 108-58, 119 Stat. 594 (2005).

since using GIS stations will reduce the overall physical size of the station – a crucial consideration in the densely-populated State of New Jersey. GIS stations also provide high levels of reliability, require far less maintenance, and lend themselves more readily to station automation and the integration of Smart Grid technologies. PSE&G explains that microprocessor-based relays improve performance sensitivity and speed, reliability, availability and efficiency, and contain many new capabilities unavailable in older electromechanical relays to enhance overall operation of the Branchburg Project. PSE&G states that the only components of the line that will not incorporate advanced technologies are the pole and tower designs. PSE&G explains that new composite materials cannot be used since the Branchburg Project is a 500-kV transmission line.[15]

13. PSE&G plans to utilize a variety of Smart Grid technologies at both the switching station and line levels of the project. PSE&G states that implementing Smart Grid features will allow it to: (1) optimize assets and operate the line more efficiently; (2) minimize disturbances on the line; (3) correct any problems quickly and with a minimum amount of intervention from the grid operator; and (4) self-monitor, analyze and diagnose the condition of the equipment, and predict and address failure before it occurs.[16] PSE&G states that it will utilize open architecture, open protocols and interoperability concepts so that the Branchburg Project will be able to work alongside other utilities' modern products and systems. Specifically, PSE&G plans to use fiber optic communication, protective relays with embedded phasor technology, stand-alone Phasor Measurement Units, microprocessor-based relays, digital fault recorders, integrated substation automation equipment, and high speed Synchro-Phasor measurement technologies. PSE&G states that its application of Smart Grid technologies is in line with the objectives of the Grid Wise Alliance – a consortium of public and private stakeholders that share a vision of an integrated electrical system that maximizes efficiency and controls costs – of which PSE&G and PJM are members.

III. Notice of Filing and Responsive Pleadings

14. Notice of PSE&G's filing was published in the *Federal Register*,[17] with interventions and comments due on or before November 20, 2009. The New Jersey Board of Public Utilities filed a notice of intervention. The Public Service Commission of Maryland (Maryland Commission) filed a notice of intervention and comments. Timely motions to intervene were filed by Exelon, PJM, and Old Dominion Electric Cooperative. The New Jersey Department of the Public Advocate, Division of Rate Counsel (NJ Rate Counsel) filed a timely motion to intervene and protest.

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[15] PSE&G Exhibit No. PEG-1F at 17.

[16] *Id.* at 13.

[17] 74 Fed. Reg. 59,155 (2009).

15. On December 8, 2009, PSE&G filed an answer to the protest and comments. On December 18, 2009, NJ Rate Counsel filed a response to PSE&G's December 8 answer.

IV. **Discussion**

A. **Procedural Matters**

16. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2009), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

17. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2009), prohibits answers to protests unless otherwise ordered by the decisional authority. The Commission is not persuaded to accept PSE&G's answer or NJ Rate Counsel's response, and therefore, will reject them.

B. **Section 219 Demonstration**

18. In EPAct 2005, Congress added section 219 of the FPA,[18] directing the Commission to establish, by rule, incentive-based rate treatments to promote capital investment in transmission infrastructure. The Commission subsequently issued Order No. 679, which sets forth the criteria by which a public utility may obtain transmission rate incentives pursuant to section 219.

19. Order No. 679 requires that an applicant seeking incentive rate treatment for transmission infrastructure investment demonstrate that the facilities for which it seeks an incentive either ensure reliability or reduce the cost of delivered power by reducing transmission congestion.[19] Order No. 679 establishes a rebuttable presumption that this standard is met if 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 a project has received construction approval from an appropriate state commission or state siting authority.[20] In Order No. 679-A, the Commission clarified the operation of this rebuttable presumption by noting that the authorities and/or processes on which the transmission project is based (i.e., a regional planning process, a state commission, or siting authority) must, in fact, consider whether

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[18] 16 U.S.C. § 824s (2006).

[19] 18 C.F.R. § 35.35(i) (2008).

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

the project ensures reliability or reduces the cost of delivered power by reducing congestion.[21]

1. Proposal

20. PSE&G states that the Branchburg Project was approved as a PJM baseline project under the PJM RTEP process in 2008 to address more than 20 thermal and reactive reliability criteria violations and therefore qualifies for the rebuttable presumption under Order No. 679. PSE&G emphasizes that the Branchburg Project will help ensure reliability, reduce congestion, and provide reliability benefits to the entire mid-Atlantic region, as well as significant improvements for import capability and congestion relief, particularly to the northern New Jersey region. PSE&G contends that the project will help resolve reliability and congestion issues triggered by those portions of the PJM transmission system that support west-to-east flows of power and the load centers of New Jersey. PSE&G states that the Branchburg Project will also result in economic benefits to the region by reducing transmission congestion by approximately $31 million per year in the PSE&G zone.[22]

2. Protests

21. NJ Rate Counsel argues that PSE&G has failed to show that the Branchburg Project is needed for reliability reasons. NJ Rate Counsel further argues that "the dramatic change in the regional economy, together with increased availability of demand response and energy efficiency resources in the eastern PJM [region] has called into question the need for other PJM-approved projects that have begun the process of siting before the Pennsylvania and Virginia regulatory commissions."[23] In addition, NJ Rate Counsel contends that the 2008 RTEP is outdated and should not be used as a determining factor by the Commission because it does not contain enough information to ascertain whether the Branchburg Project is needed for reliability reasons, nor does it contain the level of detail needed to determine actual congestion cost savings should the Branchburg Project be constructed.

3. Commission Determination

22. The Commission finds that the Branchburg Project satisfies the rebuttable presumption. The Branchburg Project was included in the 2008 PJM RTEP, a regional

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[21] *Id.* at P 49.

[22] PSE&G Exhibit No. PEG-1 at 14.

[23] NJ Rate Counsel Protest at 5.

planning process that the Commission has consistently found to be fair and open.[24] Moreover, the Branchburg Project is a RTEP baseline project, which shows that PJM determined that the project is regional in nature and will mitigate congestion or ensure PJM's ability to continue to serve load reliably. The Branchburg Project is designed to address more than 20 thermal and reactive reliability criteria violations in northern New Jersey that are anticipated to take place between 2013 and 2023.[25] It will also connect 345 kV circuits at the Farragut substation in New York to the PJM 500 kV system which will further relieve the flow in the northern PSE&G 230 kV cable circuits.[26] Therefore, contrary to the assertions of NJ Rate Counsel, the Commission finds that there are significant region-wide benefits attributable to the Branchburg Project, including increased import capability, and improved reliability in New Jersey, New York and Pennsylvania.[27] In addition, the Commission rejects NJ Rate Counsel's argument that the 2008 PJM RTEP is outdated; the 2008 PJM RTEP was published on February 27, 2009 and was intended to forecast PJM's needs for five-year and 15-year horizons.

C. Nexus Demonstration

23. Order No. 679 also requires an applicant to 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 total package of incentives requested is "tailored to address the demonstrable risks or challenges faced by the applicant."[28]

24. 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 *BG&E*, the Commission provided guidance on the factors that it will consider when determining whether a project is routine.[29] 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

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[24] *See Baltimore Gas & Electric Company*, 127 FERC ¶ 61,201, at P 24 (2009).

[25] PSE&G Exhibit No. PEG-1B at 7.

[26] PSE&G Exhibit No. PEG-1 at 12.

[27] PSE&G Exhibit No. PEG-1B at 13-14.

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

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

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, 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.[30]

25. PSE&G states that the Branchburg Project is not routine because of its size and scope. PSE&G states that the 500 kV line will cross densely-populated, environmentally-sensitive lands. It further states that the 50-70 mile PJM RTEP project will have beneficial reliability impacts on facilities in PJM. For example, PSE&G notes that other major transmission facilities in the region will experience overloads without the construction of the project. PSE&G states that the construction of the Branchburg Project will relieve such overloads.[31] In addition, PSE&G states that the Branchburg Project will reduce congestion costs by approximately $24 million annually for all of New Jersey.[32] Finally, PSE&G states that the Branchburg Project is not routine because it will incorporate advanced transmission technologies as set forth in section 1223 of EPAct of 2005, including advanced conductor materials, microprocessor-based relays, gas-insulated substations, fiber optic protections and communication links, and integrated substation automation and equipment and line monitoring.[33]

26. The Commission finds that PSE&G has demonstrated that the Branchburg Project is not routine. The Commission also concludes that PSE&G has demonstrated that the total package of incentives, as modified in this order, is tailored to the risks and challenges faced by the Branchburg Project. The Commission discusses below the finding that the Branchburg Project is not routine and the nexus between each requested incentive and the particular risks and challenges PSE&G faces in connection with the Branchburg Project.

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[30] *Id*. at P 54.

[31] PSE&G Transmittal Letter at 24.

[32] PSE&G Exhibit No. PEG-1 at 14.

[33] PSE&G Transmittal Letter at 25.

D. Requested 150 Basis-Point Incentive ROE Adder

1. Proposal

27. PSE&G requests a 150 basis-point ROE adder for the Branchburg Project, which, when added to the current ROE of 11.68 percent in its formula rate, would result in an ROE of 13.18 percent (i.e., 11.18 percent base, plus a 50 basis-point adder for RTO membership, plus the requested 150 basis-point adder for the Branchburg Project). PSE&G states that it could have sought an adder resulting in an ROE in the higher end of the zone of reasonableness but asserts that 150 basis-points is appropriate, because: (1) it "provides greater certainty immediately to the investment community"; (2) an "'ROE at the higher end of the zone of reasonableness' today may not be so tomorrow"[34]; (3) the additional cash flow generated by a 150 basis-point adder to ROE provides a cushion to mitigate the impact on credit metrics from the debt required to support the large capital needs associated with the Branchburg Project; (4) the technical and logistical complexity of the Branchburg Project far exceeds that of other transmission projects of its kind, particularly given the population density along parts of its potential route; and (5) the incentive ROE is consistent with those authorized or sought by other companies involved in projects with considerable risk, both technical and financial.[35]

28. PSE&G states that its financial risks are substantial and that it will have significant cash outlays which will dramatically increase its debt levels. Specifically, PSE&G notes that the combined costs of the Branchburg Project at $1.1 billion and the Susquehanna Line[36] at $750 million will increase its net transmission plant from below $1 billion to nearly $3 billion. In addition, PSE&G states that its planned investments are a continuing concern for the financial rating agencies. Specifically, Moody's Investors Service states that while PSE&G's upcoming "investments should contribute to incremental earnings and cash flows, the realization of those earnings and cash flows will be dependent on achieving an acceptable level of regulatory support and regulatory incentives."[37] Finally,

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[34] On this point, PSE&G contends that a 150 basis point adder makes it more likely that PSE&G can continue to attract the capital needed over the Branchburg Project's extended construction period, since the incentive is guaranteed and will still be there when needed in the future. PSE&G Exhibit No. PEG-2 at 13.

[35] *Id.* at 13-14 (citing *Virginia Electric and Power Co.*, 124 FERC ¶ 61,207 (2008); *Public Service Electric & Gas Company*, 126 FERC ¶ 61,219 (2009) (PSE&G/MAPP Project Order) *reh'g pending.*

[36] *PPL Electric Utilities Corporation and Public Service Electric & Gas Company*, 123 FERC ¶ 61,068, at P 56 (2008) (Susquehanna Line Order), *reh'g denied*, 124 FERC ¶ 61,229 (2008).

[37] PSE&G Exhibit No. PEG-2C at 3.

PSE&G contends that absent the requested incentives, its investment in the Branchburg Project would lower its credit metric from Moody's from 16.1 percent to 14.7 percent – a 9 percent reduction.[38]

29. PSE&G states that it estimated its cost of equity in accordance with several recent Commission orders.[39] PSE&G states that applying the Commission-approved discounted cash flow model to a proxy group of regulated electric utilities[40] results in a range of reasonableness of 8.39 percent to 16.17 percent. PSE&G states that the total requested ROE of 13.18 percent is well below the upper end of this range of reasonableness.[41] PSE&G further states that each company selected for the proxy group: (1) is publicly traded and pays dividends; (2) has had no dividend cuts or substantial merger or acquisition activity over the last six months; (3) has available growth rate data from Value Line or IBES; and (4) has an investment grade bond rating.[42] PSE&G further states that it eliminated companies whose Standard & Poor's credit ratings are not within one notch of PSE&G's BBB corporate credit rating and whose operations are primarily related to natural gas transmission or distribution.[43]

2. Protests

30. The NJ Rate Counsel asserts that the Branchburg Project fails Order No. 679's nexus requirement. NJ Rate Counsel concedes that the project "is not a 'routine' transmission project,"[44] but further argues that it is premature to conclude that the project will be needed for reliability or will reduce delivered costs of power to New Jersey consumers. Additionally, NJ Rate Counsel asserts that, given the "size of the investment

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[38] PSE&G Exhibit No. PEG-2 at 17.

[39] PSE&G Exhibit No. PEG-3 at 3.

[40] The chosen utilities are transmission-owning members of PJM, New York Independent System Operator, Inc. (NYISO) and ISO New England Inc. (ISO-NE).

[41] PSE&G Exhibit No. PEG-3 at 6 (citing *PSE&G Formula Rate Order; Westar Energy, Inc.*, 122 FERC ¶ 61,268 (2008)*; Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188 (2008); and *Atlantic Path 15, LLC*, 122 FERC ¶ 61,135 (2008)).

[42] *Id.* at 24 and n.5.

[43] *Id.* at 4 and 24.

[44] NJ Rate Counsel Protest at 7.

and associated scale of equity"[45] a 150 basis-point adder could lead to excess return and unjust and unreasonable rates if the CWIP and abandonment incentive provisions are also granted.[46] To that end, NJ Rate Counsel argues that, if the Commission grants the CWIP and abandonment incentives, the Commission should lower the overall ROE for the proposed investment. NJ Rate Counsel also contends that, if PSE&G will incur expenditures for the Branchburg Project in late 2009, but does not expect the incentives to be approved until 2010, the timing calls into question the need for the incentives. NJ Rate Counsel asserts that PSE&G's incentive proposals should be rejected or set for hearing to resolve the foregoing rate issues.

31. Also asserting that the Branchburg Project fails the nexus requirement, the Maryland Commission objects to the 150 basis-point adder, stating that the project will solely address local reliability criteria violations in PSE&G's service territory and provide congestion cost relief only to New Jersey ratepayers.[47] The Maryland Commission further argues that the route for the Branchburg Project is uncertain, and therefore, many of PSE&G's asserted regulatory and environmental risks related to the project might be avoided. In any case, the Maryland Commission argues that the risks, as well as the technology, associated with the project are routine and that a long lead time and risk of cancellation do not justify an enhanced ROE.[48] The Maryland Commission requests an evidentiary hearing or settlement judge proceedings to resolve these issues and determine what level (if any) of an ROE adder should be granted to PSE&G for the Branchburg Project.

3. Commission Determination

32. The Commission finds that the Branchburg Project satisfies the nexus requirement for a ROE incentive adder. With an estimated project cost of approximately $1 billion,

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[45] *Id.* at 8.

[46] *Id.* at 8. NJ Rate Counsel estimates that PSE&G will earn an incremental $14.6 million during the first year, and that over the course of the book life of the asset the ROE adder will cost ratepayers tens, if not hundreds, of million dollars.

[47] Maryland Commission Comments at 7.

[48] On this point, the Maryland Commission explains that there does not appear to be any significant new, risky or untested technology involved with the Branchburg Project, unlike the aforementioned MAPP Project, which requires technology used for underwater crossing of the Chesapeake Bay. Concerning the long lead time, the Maryland Commission also states that the passage of time might produce better financing opportunities as the economy recovers from its "current woes." Maryland Commission Comments at 11.

the Commission finds that the scope of the project is significant. PSE&G's net transmission plant in service as of December 31, 2008 totaled $957 million,[49] and PSE&G's construction of the Branchburg Project alone will more than double its transmission plant in service. In addition, as PSE&G states, the Branchburg Project will require a substantial investment in transmission facilities well over PSE&G's average annual investment of $70 million over the last five years. The Branchburg Project will require an average annual investment of $270 million over approximately four to five years, thereby representing more than four times PSE&G's historical average annual transmission investment.[50]

33. The Commission further finds that the Branchburg Project will enhance the reliability of the PJM transmission system. The Commission disagrees with arguments that the effects of the project will be only local in nature. By eliminating identified reliability criteria violations in New Jersey, the Branchburg Project will have beneficial reliability impacts on other facilities in PJM. Indeed, the Branchburg Project is expected to address reliability issues related to increasing loads in the northeastern portion of PJM, current and impending retirements of generation in eastern PJM, and transmission capacity in PJM which is approaching its limits.[51]

34. In addition, the Commission finds that the Branchburg Project involves significant risks. It involves financial risks because PSE&G's cash outlays will increase its debt levels and could jeopardize its credit ratings. It faces regulatory risks since the project is expected to traverse waterways, wetlands, and densely populated areas. While the Maryland Commission asserts that many of the regulatory risks might be avoided depending on the final route of the project, the Commission finds that the status of the route planning in this case is similar to other RTEP projects for which the Commission has awarded incentives.[52] Indeed, the exact route of a project this size cannot be finalized until the necessary siting and permitting approvals are issued – and the possibility that they might not issue contribute to regulatory risk.

35. Based upon the foregoing, the Commission will grant an incentive ROE adder for the Branchburg Project. However, as discussed below, the Commission will approve an

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[49] PSE&G Transmittal Letter at 9 (citing PSE&G 2008 FERC Form 1 at pp. 207-219).

[50] PSE&G Transmittal Letter at 9.

[51] PSE&G Exhibit No. PEG-1 at 13.

[52] *See, e.g.*, *PSE&G/MAPP Project Order*; *PPL Electric Utilities Corp. and Public Service Electric and Gas Co.*, 123 FERC ¶ 61,068 (2008).

incentive ROE adder of 125 basis-points, rather than the 150 basis-points requested by PSE&G.

36. The Commission finds that PSE&G's overall risk is reduced by the CWIP and abandonment incentives. In light of these considerations, the Commission finds that a 125 basis-point adder is appropriately tailored to address the demonstrable risks and challenges -- discussed above -- faced by the Branchburg Project. The Commission directs PSE&G to reflect this change when it files its annual update to the 2011 rate year.[53]

37. The Commission denies the requests for an evidentiary hearing concerning the risks posed by the Branchburg Project, relevant to determination of the ROE adder. The Commission finds that the record in this proceeding provides sufficient basis for evaluating the risks and challenges posed by the Branchburg Project.

E. Abandonment Incentive

1. Proposal

38. PSE&G requests authorization to recover 100 percent of its prudently-incurred development and construction costs if the Branchburg Project is abandoned or cancelled for reasons beyond the control of PSE&G's management. PSE&G states that it faces significant risk that the Branchburg Project might be cancelled for regulatory reasons. PSE&G argues that construction of the Branchburg Project depends on approval by multiple jurisdictions and that the project faces cancellation or modification through PJM's RTEP process. PSE&G states that these risks are beyond its control, and, in order for it to fund initial outlays, PSE&G needs assurance that it will be entitled to full recovery of costs should the Branchburg Project be cancelled.[54]

2. Protests

39. NJ Rate Counsel and the Maryland Commission state no objection to the proposed abandonment incentive, but assert that, if it is granted, the proposed ROE adder should be reduced or rejected.[55]

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[53] *See* PSE&G Exhibit No. PEG-2 at 19.

[54] PSE&G Transmittal Letter at 14.

[55] NJ Rate Counsel Protest at 6-7; Maryland Commission Comments at 6.

3. Commission Determination

40. The Commission finds that PSE&G has demonstrated a nexus between the risks of the Branchburg Project and the need to recover prudently incurred costs associated with abandonment of the project. As emphasized in other proceedings, an abandonment incentive is an effective means to encourage transmission development by reducing the risk of non-recovery of costs.[56] Accordingly, the Commission grants PSE&G's request for recovery of 100 percent of prudently-incurred costs associated with abandonment, provided that the abandonment is a result of factors beyond PSE&G's control. This incentive is effective January 1, 2010.

F. Construction Work in Progres

1. Proposals

41. PSE&G seeks authorization for inclusion of 100 percent of CWIP in its rate base. PSE&G states that such an incentive would have direct benefits to PSE&G's cash flow by allowing PSE&G to recover the cost to finance the Branchburg Project immediately as incurred. PSE&G explains that it typically capitalizes the costs to finance construction expenditures in an account for Allowance of Funds Used During Construction (AFUDC) and then depreciates them over the useful life of the facilities. In such situations, PSE&G's cost recovery is deferred until the project is placed in service. PSE&G states that, without authorization for 100 percent of CWIP in its rate base, it would be unable to recover its financing costs related to the Branchburg Project for at least four years, when the project is expected to be in service. This, in turn, would reduce PSE&G's cash flow and negatively impact its ability to raise capital in today's volatile credit market. PSE&G asserts that 100 percent recovery of CWIP in its rate base provides assurance to lenders that there will be a stream of cash available to service the cost of debt (i.e., interest) over the four-year period prior to the Branchburg Project being placed in service.

2. Protests

42. As with the abandonment incentive, NJ Rate Counsel and the Maryland Commission state no objection to the proposed CWIP incentive, but assert that, if it is granted, PSE&G's requested ROE adder should be reduced or rejected.[57]

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[56] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 163.

[57] NJ Rate Counsel Protest at 6-7; Maryland Commission Comments at 6.

3. **Commission Determination**

43. In Order No. 679, the Commission established a policy that allows utilities to include, where appropriate, 100 percent of prudently-incurred, transmission-related CWIP in rate base.[58] Order No. 679 stated 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.[59] The Commission finds that PSE&G has shown a nexus between its proposed CWIP incentive and its investment in the Branchburg Project.

44. Consistent with Order No. 679, the Commission finds that authorizing 100 percent of CWIP treatment for PSE&G would enhance its cash flow as it pursues an investment that will more than double its net transmission plant in service, reduce interest expense, assist PSE&G with financing, and improve PSE&G's coverage ratios used by rating agencies to determine credit quality, by replacing non-cash AFUDC with cash earnings. This, in turn, will reduce the risk of a downgrade in PSE&G's debt ratings. The Commission also finds that allowing PSE&G to recover 100 percent of CWIP in its rate base will result in better rate stability for customers. As explained in prior orders,[60] when certain large-scale transmission projects come on line, there is a risk that consumers may experience "rate shock" if CWIP is not permitted in rate base. By allowing CWIP in rate base, the rate impact of the Branchburg Project can be spread over the entire construction period and will help consumers avoid a return on and of capitalized AFUDC.[61]

45. The acceptance of PSE&G's proposal to recover 100 percent of CWIP in rate base is conditioned upon PSE&G's fulfilling the Commission's requirements for CWIP inclusion for these transmission facilities in a future section 205 filing to implement a stand-alone balancing account mechanism to recover the CWIP revenue requirement.[62] PSE&G must provide a detailed explanation of its accounting methods and procedures to:

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[58] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 29, 117.

[59] *Id.* P 115.

[60] *See, e.g., Susquehanna Line Order*, 123 FERC ¶ 61,068 at 43; *American Electric Power Service Corp.*, 116 FERC ¶ 61,059, at P 59 (2006), *order on reh'g*, 118 FERC ¶ 61,041, at P 27 (2007).

[61] *See, e.g., Susquehanna Line Order*, 123 FERC ¶ 61,068 at 43.

[62] *Construction Work in Progress for Public Utilities; Inclusion of Costs in Rate Base*, Order No. 298, FERC Stats. & Regs. ¶ 30,455 (1983), *order on reh'g*, Order No. 298-B, FERC Stats. & Regs. ¶ 30,524 (1983).

(1) implement the stand-alone balancing account; (2) comply with Commission regulations at 18 C.F.R. § 35.13(h)(38) and § 35.25 (2009); and (3) maintain comparability of financial information.[63]

G. Assignment of Incentives to Affiliates

1. Proposal

46. PSE&G asks that the Commission approve its request to assign the proposed incentives to an affiliate if construction and/or ownership of the Branchburg Project are assigned to such an affiliate. PSE&G states that it has not made a decision to assign construction of the Branchburg Project to an affiliate, but would like to ensure that the requested incentives are passed through to an affiliate in case of reassignment of construction and/or ownership of the Branchburg Project.

2. Protests

47. The NJ Rate Counsel and the Maryland Commission raise no objections to allowing the incentives approved by the Commission to be assigned to a PSE&G affiliate.

3. Commission Determination

48. Consistent with the findings in the *Susquehanna Line Order* and the *PSE&G/MAPP Order*, the Commission grants PSE&G's request for authority to assign the above-granted incentives to an affiliate, subject to the following clarification.[64] If PSE&G elects to assign its incentives to an affiliate, that affiliate will be required to make a filing under section 205 of the FPA to incorporate into its rates any such incentives.

H. Total Package of Incentives

1. Proposal

49. PSE&G states that it did not request all of the incentives available to it, but rather, tailored its request to specifically match the incentives sought with the risk and challenges the Branchburg Project faces. Specifically, PSE&G contends that the entire package of requested incentives is necessary to make the Branchburg Project financially

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[63] *See, e.g.*, *American Transmission Co., LLC*, 105 FERC ¶ 61,388 (2003), *order providing clarification*, 107 FERC ¶ 61,117, at P 16-17 (2004); *Trans-Allegheny Interstate Line Co.*, 119 FERC ¶ 61,219, at P 44-45 (2007), *reh'g denied*, 121 FERC ¶ 61,009 (2007).

[64] *Susquehanna Line Order*, 123 FERC ¶ 61,068 at P 51-52; *PSE&G/MAPP Project Order*, 126 FERC ¶ 61,219 at P 70.

feasible. PSE&G avers that the total package of incentives will appropriately mitigate the Branchburg Project's risks, thereby allowing PSE&G to attract the necessary investment capital at reasonable rates and raise the large amount of capital necessary to meet all of its commitments in its transmission and distribution business. PSE&G states that external financial sources will take account of PSE&G's cash flows, financial metrics, and credit ratings when evaluating PSE&G as an investment opportunity, all of which can be negatively impacted without the requested incentives. PSE&G further asserts that the requested incentives will allow it to fairly compete for funding with other utilities that have significant capital programs (including constructing backbone transmission projects) and have already been granted incentive ROE adders and other incentives.[65] Finally, PSE&G contends that the 150 basis-point adder is within the range of reasonableness based on its discounted cash flow analysis.

2. <u>Protests</u>

50. NJ Rate Counsel argues that PSE&G's request for the abandonment incentive lowers PSE&G's need for the ROE incentive because PSE&G's siting and permitting risks are reduced. In addition, it contends that PSE&G's formula rate reduces its financial risks. NJ Rate Counsel states that if PSE&G "were allowed to collect its development and construction costs in the event the Project does not proceed through no fault of the Company, that recoupment coupled with the Company's ability to cover its costs on a forecasted basis through formula rates and the generous base ROE would provide more than adequate assurances to investors."[66]

51. The Maryland Commission states that PSE&G's application does not provide a sufficient basis for the Commission to make a reasoned determination that PSE&G should be awarded the total package of incentives it requested.[67] It further contends that granting PSE&G the 150 point basis adder in addition to the CWIP and abandonment incentives would result in unjust and unreasonable rates for ratepayers.

52. The Maryland Commission argues that a project approved under PJM's RTEP does not automatically entitle a transmission owner to the requested incentives under the nexus test. The Maryland Commission states that no additional incentive should be granted to transmission owners beyond the 50-basis-point PJM membership adder if the transmission owner must make the investment to fulfill its obligation to provide reliable electric service to customers located in its own service territory.[68] The Maryland

[65] PSE&G Exhibit No. PEG-2 at 14-15.

[66] NJ Rate Counsel Protest at 5.

[67] Maryland Commission Comments at 2.

[68] *Id.* 4.

Commission also states that PSE&G, by possessing a formula rate, has removed the problem of regulatory lag which also decreases the financial risks to which it is exposed by undertaking this project. The Maryland Commission concludes that the Commission should exercise greater discretion when approving incentive packages using the nexus test, and avoid approving incentives for "*any* new transmission investment that improves reliability (and virtually all do)"[69] which could result in unjust and unreasonable rates.

3. Commission Determination

As noted earlier, in Order No. 679-A, the Commission clarified that its nexus test is met when an applicant demonstrates that the total package of incentives requested is tailored to address the demonstrable risks or challenges faced by the applicant. The Commission noted that this nexus test is fact-specific and requires the Commission to review each application on a case-by-case basis. Consistent with Order No. 679,[70] the Commission has, in prior cases, approved multiple rate incentives for particular projects.[71] This is consistent with the Commission's interpretation of FPA section 219 as authorizing the approval of more than one incentive rate treatment for an applicant proposing a new transmission project, as long as each incentive is justified by a showing that it satisfies the requirements of FPA section 219 and that there is a nexus between the incentives being proposed and the investment being made. As discussed in greater detail above, the Commission finds that the ROE incentive of 125 basis-points, the CWIP incentive, and the abandonment incentive are tailored to address the demonstrable risks or challenges faced by PSE&G.

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[69] *Id.* at 5.

[70] Order No. 679, FERC Stats. & Regs. ¶ 31, 222 at P 55.

[71] *See, e.g.*, *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188 (2008); *Southern California Edison Co.*, 121 FERC ¶ 61,168 (2007).

The Commission orders:

PSE&G's proposed tariff revisions related to its incentive proposal are hereby accepted for filing, to become effective January 1, 2010, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.