Federal Energy Regulatory Commission

Competitive Transmission Development Technical Conference **Docket No. AD16-18-000**

Statement of Joseph T. Kelliher on Behalf of NextEra Energy, Inc.

Panel 3: Transmission Incentives and Competitive Transmission Development Processes

On behalf of NextEra Energy, Inc., and its competitive transmission development subsidiary, NextEra Energy Transmission, LLC ("NEET"), I thank the Commission for this opportunity to address you today with respect to interactions between the Commission's transmission return on equity ("ROE") and incentives policies and the competitive planning processes implemented by Regional Transmission Organizations ("RTOs") and Independent System Operators ("ISOs") under Order No. 1000. NEET is committed to working with the Commission, system operators, and others to assure competitive transmission processes benefit electric customers.

As noted by earlier panelists, cost containment mechanisms are being offered by developers in the RTO/ISO competitive transmission development processes as a tool to ensure that a bid, if selected, results in consumer benefits. Cost estimates used in transmission planning are just that – estimates. Under traditional transmission development and cost of service ratemaking, consumers bear the full risk of overruns when costs exceed estimates but are otherwise not deemed imprudent. Cost containment mechanisms shift this risk from consumers to the developer, with the latter becoming responsible for cost overruns falling within the cost containment mechanism. It is reasonable, however, for equity investors to expect a higher return on investment in a cost-contained project in exchange for assuming cost overrun risk, as compared to the return required for a full cost-of-service investment. This return is not an attempt to recoup unrecoverable cost overruns, as suggested by some in comments filed in advance of this conference. The higher return is part of a beneficial tradeoff that secures protection for consumers against unknown and potentially significant cost overruns in exchange for a return that reflects the risk assumed by the investor.

Because of the significant consumer benefits that cost containment provisions can provide, NEET believes the Commission's ROE and incentives policies should be aligned with the goals of Order No. 1000. At present, however, there is a disconnect between the Commission's rate policies and the competitive transmission development process. Rate policies should be designed to support the expanded use of cost containment in the RTO/ISO competitive transmission development processes. The discounted cash flow ("DCF") analysis establishes base ROEs in reference to a proxy group of investor-owned utilities that own billions of dollars in existing assets not subject to cost containment. By definition, the DCF analysis cannot capture the true cost of equity for the developer of a cost-capped project, which is facing very different risks than the proxy group. The competitive transmission model is fundamentally different than the risk profile of the traditional utility, where all prudently incurred costs related to used and useful transmission facilities are presumed recoverable. Similarly, the Commission's ROE incentive polices are also grounded in pre-Order No. 1000 fact patterns, where eligibility for an ROE adder is considered in the context of the risks and challenges facing traditional project development, excluding the risk of financial losses to the developer associated with cost containment.

To reflect the differences between the traditional utility development of transmission and the competitive development of transmission subject to cost containment mechanisms, the Commission should consider an upward adjustment to a developer's total ROE, whether as a consideration in setting the base ROE or an incentive ROE adder, for new transmission-only entities that develop projects through the competitive developer selection process and that agree to binding cost caps that benefit consumers. The Commission could adjust its base ROE policies to account for the risks assumed by equity investors in cost-capped projects, or the Commission could use project-specific ROE incentive adders to reflect the cost containment risk borne by the developer. From the perspective of a developer, total ROE impacts the ability to secure equity capital to finance a transmission project. How the total ROE is constituted as between the base ROE and the incentive ROE is immaterial.

The fact that a developer chooses to participate in the competitive process and its decision to offer a cost cap voluntarily are not valid reasons to disregard the risk associated with providing consumers the benefit of cost containment mechanisms. Every utility's cost of capital reflects risks associated with management and investment decisions that are discretionary, such as the decision to utilize a new technology when constructing a new asset or enter into a service agreement. To the extent such risks have not otherwise been embedded in the DCF analysis, the Commission has entertained incentive requests to compensate for risks and challenges unique to the project. Risks associated with cost containment mechanisms, even if voluntarily offered, are not reflected in the DCF analysis and, similarly, should not be categorically disregarded by the Commission.

The Commission encouraged competitive transmission in Order No. 1000 because it believed competition would lower transmission costs and result in more innovative solutions. Indeed, the consumer benefits that the Commission hoped to obtain by eliminating rights of first refusal for regional projects depend entirely on voluntary participation by nonincumbent developers in competitive solicitations. Otherwise, needed transmission projects will continue to be developed by the incumbent utility as the provider of last resort, with minimal incentives to shift risks and costs away from consumers. This was not the outcome the Commission envisioned when it issued Order No. 1000.

It is important to recognize that there is not a level playing field in competition for regional transmission projects. Incumbents enjoy significant advantages over new entrants in the RTO and ISO regions, such as state siting laws, use of existing rights of way, and recovery of development costs. The Commission can address some of these incumbent advantages, but others are beyond its jurisdiction. Cost containment is one way new entrants can offset some of the formidable incumbent advantages.

To implement the adjustment in rate policies suggested by NEET, the Commission could encourage a system whereby the competitive developer is required to indicate to the RTO/ISO its anticipated base ROE and incentive assumptions in its competitive bid, along with its binding cost containment commitments, and if the developer is selected based on that combination of factors, its total ROE assumption, while not binding on the Commission, will be afforded either a rebuttable presumption or some level of persuasiveness when subsequently requested in an application under Section 205 or Section 219 of the Federal Power Act. This would resolve the current disconnect between the Commission's rate policies and the competitive transmission development process, in which developers incorporate assumptions regarding the cost of equity needed to attract capital to a project only to have those assumptions afforded little or no weight in a subsequent rate case. Failure to resolve this disconnect could discourage developers from continuing to offer fulsome cost containment commitments, depriving consumers of the benefits of competition sought by Order No. 1000.

We would like to thank the Commission for holding this technical conference. Competitive transmission is beginning to deliver savings to customers and we hope that our comments are helpful in assisting the Commission realize the promise of competitive transmission.