ORDER ON REHEARING

(Issued April 19, 2007)

1. This order addresses requests for rehearing and clarification of Order No. 679-A,\(^1\) which reaffirmed in part and granted in part rehearing of the Final Rule on Promoting Transmission Investment through Pricing Reform.\(^2\) Order Nos. 679 and 679-A amended Commission regulations to provide incentives for transmission infrastructure investment to help ensure the reliability of the bulk power transmission system in the United States or reduce the cost of delivered power to customers by reducing transmission congestion. As discussed below, we deny rehearing and grant clarification in part of Order No. 679-A.

II. Background

2. In 2005, Congress enacted section 1241 of the Energy Policy Act of 2005, which added a new section 219 to the Federal Power Act (FPA) to promote the operation, maintenance and enhancement of transmission infrastructure.\(^3\) Pursuant to section 219, the Commission issued Order No. 679, which amended Commission regulations to establish incentive-based (including performance-based) rate treatments for the

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transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability or reducing the cost of delivered power by reducing transmission congestion. In general, Order No. 679 identified ratemaking treatments available under section 219 and required each applicant to tailor its proposed incentives to the type of transmission investments being made and to demonstrate that its proposal meets the requirements of section 219.

3. Many entities sought rehearing of Order No. 679. In response, the Commission issued Order No. 679-A reaffirming its determinations in part and granting rehearing in part. In general, Order No. 679-A retained the rate treatments adopted in Order No. 679, but modified the way in which the rate treatments are applied.\(^4\)

II. Requests for Rehearing

4. In response to Order No. 679-A, a number of parties submitted timely requests for rehearing and clarification: Transmission Access Policy Study Group (TAPS); American Public Power Association and National Rural Electric Cooperative Association (APPA/NRECA); Transmission Dependent Utility Systems (TDU Systems); Certain Midwest ISO Transmission Owners (Midwest ISO TOs); and FirstEnergy Service Company (FirstEnergy).

5. As discussed below, TAPS, APPA/NRECA and TDU Systems seek rehearing of Order No. 679-A’s determination that the Commission would entertain a public utility’s request to determine the public utility’s rate of return on equity (ROE) for a particular project by declaratory order in advance of the public utility’s filing of rates pursuant to section 205 of the FPA.\(^5\) Midwest ISO TOs seek clarification with respect to Order No. 679-A’s statement that reliability projects may only be eligible for incentives to the extent that such projects have special risks and challenges. FirstEnergy seeks clarification regarding the eligibility of a public utility member of a Regional Transmission Organization (RTO) for the Transmission Organization incentive.

III. Discussion

A. ROE Determination in a Declaratory Order

6. In Order No. 679, the Commission stated that it will allow, when justified, an incentive-based ROE for all public utilities (i.e., traditional public utilities and Transcos)

\(^4\) Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 4-7.

making new investments in transmission facilities that benefit consumers by ensuring 
reliability or reducing the cost of delivered power by reducing congestion.\footnote{Order No. 679, FERC Stats 
& Regs. ¶ 31,222 at P 91.} In Order No. 679-A, the Commission recognized that the traditional ratemaking process may 
create uncertainty for investors.\footnote{Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 69.} Traditionally, an ROE determination occurs in a 
hearing convened to determine the justness and reasonableness of the costs of the 
investment for purposes of setting rates under section 205. Because such a hearing 
often occurs only after an investment decision is made and the facility is constructed, 
it may create uncertainty as to the ultimate return and thereby result in disincentives 
for new investment. Therefore, in Order No. 679-A, the Commission clarified the 
approach for reviewing ROE incentive requests and allowed an applicant seeking up-
front certainty regarding the ROE it may receive to submit, by means of a request for 
declaratory order, a specific proposed ROE for its project.\footnote{\textit{Id}. P 70. The Commission also noted that applicants may request in a petition 
for declaratory order, and may be eligible for, a specific, incentive ROE that is in the 
upper end of the zone of reasonableness. However, the Commission also stated that, “the 
fact that an up-front ROE determination is itself an incentive that tends to reduce risk will 
be taken into account in considering any such request.” \textit{Id}.} The Commission noted that 
such declaratory order requests must include the appropriate support for the ROE, e.g., 
a discounted cash flow (DCF) analysis, and will have to meet the required nexus 
requirement.\footnote{\textit{Id}.}

1. **Rehearing Requests**

7. APPA/NRECA and TDU Systems argue that the Commission erred in Order 
No. 679-A by allowing a public utility’s ROE for a particular project to be determined by 
a declaratory order prior to the public utility’s filing of rates pursuant to section 205 of 
the FPA, without reserving the Commission’s authority to modify the ROE or other 
aspects of the resulting rates. They assert that without this reservation of authority, the 
Commission would not be able to ensure that the rates comply with the requirements of 
section 219 of the FPA, are not unduly discriminatory or preferential, and represent a 
“package of incentives [that] is tailored to address the demonstrable risks or challenges
faced by the applicant in undertaking the project.”10 TDU Systems also contend that customers would not have adequate opportunity to raise any discriminatory rate design issues before the Commission under the two-step process for ROE approval.11

8. Further, TAPS asserts that the Commission erred in Order No. 679-A because it clarified that applicants may secure an early ruling that a particular ROE is appropriate, while the issue as to who will pay the incentive may generally be deferred to a later stage. TAPS requests the Commission to confirm that before granting final approval to any incentive it will consider (a) whether such collection would be discriminatory as applied, and (b) whether the placement of payment responsibilities will undo the rational nexus between a project and its incentive. Such consideration should include consideration of pertinent facts, including who else will pay the incentive.12 TAPS argues that absent such consideration, there can be no rational basis for the findings of non-discrimination and rational tailoring that both the regulatory text and FPA sections 205, 206, and 219 require.13 TAPS also suggests that applicants who want early certainty about their

10 APPA/NRECA at 5-6; TDU Systems at 2-3. APPA/NRECA also cite a 2004 hearing order in which the Commission set for hearing an incentive rate proposal to apply an ROE adder to unbundled transmission customers but not bundled retail customers, noting its concerns about possible undue discrimination. Midwest Independent Transmission System Operator, Inc. and Ameren Services Co., 109 FERC ¶ 61,167, at P 14 (2004). They contend that the declaratory order procedure adopted in Order No. 679-A could allow the Commission to approve a similar proposal without setting the discrimination issue for hearing.

11 TDU Systems at 7-8.

12 TAPS proffers an example of a transmission-dependent municipal system that seeks to join a consortium of investor-owned market participants in developing a transmission project, but is rebuffed. In that situation, TAPS contends that, as a matter of due process and reasoned decisionmaking, the excluded municipal system should be allowed to demonstrate that it would be unduly discriminatory to make it pay the higher return, even if that return level satisfied other relevant standards. TAPS also argues that where a project’s costs are directly assigned to a customer (e.g., through participant funding), an above-average rate charged to that customer-funder would discourage the customer-funder from approving construction.

13 TAPS at 4.
incentives in a declaratory order should have to give the Commission some early assurance about who will pay for those incentives.\textsuperscript{14}

9. APPA/NRECA also offer an example of a utility that seeks and obtains an incentive ROE in a declaratory order, but seeks additional incentives such as construction work in progress and pre-commercial operations costs in a subsequent 205 rate filing. They express concern that if the Commission cannot change the ROE determined in the declaratory order, its options would be limited to approving or denying the additional incentives. They argue that the declaratory order should not preclude customers from arguing in the section 205 case that – in light of the additional, proposed, risk-lowering incentives for the project – the incentive ROE is no longer tailored to the demonstrable risks or challenges faced by the applicant in undertaking the project.\textsuperscript{15}

2. **Commission Determination**

10. The Commission denies rehearing. In Order No. 679, the Commission allowed applicants to seek incentives either in a request for declaratory order or a section 205 rate proceeding. In Order No. 679-A, the Commission affirmed that approach, adding that an applicant has two options when seeking an incentive ROE in a declaratory order proceeding. It may either seek a specific, proposed incentive ROE for its project within the upper end of the zone of reasonableness as determined, e.g., by a DCF analysis, if it can meet the required nexus requirement, or it may seek an incentive ROE generally within the upper end of the zone of reasonableness (in which case the Commission would determine in a subsequent hearing under section 205 where in the upper end the ROE would fall).\textsuperscript{16}

11. The Commission also explained that an applicant is required to demonstrate that the total package of incentives it seeks is tailored to address the demonstrable risks or challenges faced by the applicant in undertaking the project. If some of the incentives in the package reduce the risks of the project, that fact will be taken into account in any request for an enhanced ROE.

12. In response to the concerns raised by APPA/NRECA, we clarify that the declaratory order approach adopted in the Final Rule will in no way undermine the Commission’s ability to ensure that all incentives sought by an applicant are tailored to

\textsuperscript{14} Id. at 6.

\textsuperscript{15} APPA/NRECA at 7.

\textsuperscript{16} See supra note 8.
address the risks and challenges faced by that applicant and are consistent with section 219. If an applicant obtains a specific incentive ROE determination from the Commission in a declaratory order proceeding, and, in a later section 205 proceeding, seeks additional non-ROE incentives that were not proposed in the earlier declaratory order proceeding, the Commission will still be required to ensure that the total incentive package is tailored to the risks and challenges faced by the project when it evaluates section 205 filing. In this circumstance, customers would not be precluded from arguing that newly proposed incentives that might lower risks must be balanced against the previously granted incentive ROE. Depending upon the facts presented, the Commission may or may not grant the additional non-ROE incentives. Also, depending upon the facts, it is possible that an applicant would have valid reasons to voluntarily forgo the earlier granted ROE incentive if the Commission concluded that the non-ROE incentives were justified on a stand-alone basis but not in conjunction with the specific, incentive ROE granted previously in a declaratory order. As a result, no applicant will receive an incentive package that does not meet the standards of section 219, section 205, and the test adopted in Order Nos. 679 and 679-A. Though we encourage applicants to seek all requested incentives in the same proceeding (whether in a request for declaratory order or a section 205 filing), we do not require it. Additionally, where an applicant receives authority for an incentive rate in a declaratory order, but then proposes in a section 205 proceeding to apply that incentive ROE in a manner that may be unjust and unreasonable or unduly discriminatory or preferential, the Commission retains the authority to set the matter for hearing at that time.

13. Finally, the Commission has previously addressed TAPS’ assertion that cost allocation decisions must be made before an incentive request may be considered. In response to TAPS’ first request for rehearing on this point, we noted in Order No. 679-A that section 205 proceedings are the appropriate proceedings in which to consider cost allocation and rate design issues. We reiterate that finding here.

17 “We repeat the finding in the Final Rule that the section 205 proceedings addressing recovery of the costs of incentive-based rate treatments are the appropriate forum for determining whether the resulting rates are just, reasonable and non-discriminatory, and therefore are the appropriate proceedings to consider cost allocation and rate design issues. The primary purpose of the declaratory petition proceeding is to determine if the proposed incentives meet the requirements of section 219, and therefore cost allocation and rate design issues will not be considered. Finally, we consider rate design issues, such as roll-in of rates to [be] beyond the scope of this proceeding, and
B. **Eligibility of Reliability Projects for Incentives**

14. While Order No. 679 provided incentive-based ROEs, when justified, to all public utilities for new investments in transmission that benefit consumers by ensuring reliability or reducing the cost of delivered power by reducing congestion, the Commission noted that not every investment that increases reliability or reduces congestion will qualify for such an incentive. The Commission stated that pursuant to section 219, its mandate is to encourage new investment and to strike the appropriate balance between the investor and consumer interests. In that respect the Commission, while stating that it will consider applications for ROE incentives for all projects, reaffirmed this finding, stating that the “most compelling case” for incentive-based ROEs are new projects with special risks or challenges, not routine investments made in the ordinary course of expanding the system to provide safe and reliable transmission service.

15. Additionally, Order No. 679 granted a rebuttable presumption that projects resulting from regional planning qualify for incentive rate treatments. The Commission affirmed that finding in Order No. 679-A, but also stated that the incentive rate treatments are not limited to projects that result from regional planning process. The Commission noted that there may be transmission projects that arise outside of the regional planning process that help to ensure reliability or reduce the costs of delivered power and thereby qualify for incentive rate treatment.

1. **Request for Clarification**

16. Midwest ISO TOs seek clarification of Order No. 679-A regarding the Commission’s statement that reliability projects may only be eligible for incentives to the extent that such projects have special risks and challenges. They state that it is unclear how the Commission will implement this policy, as it has elsewhere established a rebuttable presumption that projects that are approved through a regional planning

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\[18\] Order No. 679, FERC Stats & Regs. ¶ 31,222 at P 91, 94.

\[19\] Order No. 679-A, FERC Stats & Regs. ¶ 31,236 at P 60.

\[20\] Id. P 111.
process will be eligible for incentives.\textsuperscript{21} They state that the Commission indicated that it may be less likely to grant an incentive for projects needed for routine reliability than those projects that present special risks or challenges.\textsuperscript{22} Midwest ISO TOs state that the Commission does not define what it means by routine projects, what it would consider special risks or challenges, or explain how this will be implemented in the context of RTOs.

17. Midwest ISO TOs state that they support the Commission’s policy to apply a rebuttable presumption to projects that result from a RTO planning process and are found to be necessary and appropriate for reliability purposes. However, they seek guidance to ensure that the necessary transmission facilities are constructed to promote and preserve reliability and that there is no disincentive provided to the construction of reliability projects. In that respect, they seek clarification that the Commission’s statement regarding routine investment is not intended to disrupt or modify this rebuttable presumption.\textsuperscript{23} Therefore, the Commission should clarify, in the context of an RTO planning process, what it means by the statement that reliability projects may only be eligible for incentives to the extent that such projects have special risks and challenges.

2. \textbf{Commission Determination}

18. We deny Midwest ISO TOs’ request for clarification because these arguments were raised and resolved on rehearing of Order No. 679. In response to a request for rehearing by TAPS, we clarified in Order No. 679-A that the rebuttable presumption related to a regional planning process applies only to the threshold requirement under section 219 that an applicant demonstrate that a project is needed to ensure reliability or to reduce congestion. It does not apply to any other requirement in 18 C.F.R. § 35.35, such as the requirement that the applicant demonstrate the required nexus between the incentive sought and the investment being made. It is in the context of this latter demonstration – that there be a nexus – that we stated that routine investments may not qualify for an incentive-based ROE. Incentives for reliability projects will be based, on a case-by-case basis, on the challenges and risks of the particular reliability project, e.g., long-term, high-cost reliability projects with siting issues may justify a higher incentive than small scale, maintenance reliability projects that can be completed within a year. What the Commission finds to be a routine project, and what it would consider special

\textsuperscript{21} Midwest ISO TOs at 2.

\textsuperscript{22} \textit{Id.} at 3.

\textsuperscript{23} \textit{Id.} at 5.
risks or challenges, as well as how this will be implemented in the context of RTOs, will be determined on a case-by-case basis.

C. **Eligibility of an RTO Member for the Transmission Organization Incentive**

19. Order No. 679 provided that public utilities that join a Transmission Organization, including RTOs, are eligible to file for incentive rate treatment, in the form of a higher ROE. It also clarified that public utilities that are currently members of a Transmission Organization could apply for such incentive treatment. The Commission affirmed that finding in Order No. 679-A, noting that the incentive applies to all utilities joining Transmission Organizations, irrespective of the date they join. The Commission stated that an inducement for utilities to join, and remain in, Transmission Organization is consistent with the purpose of section 219, which is to provide incentive-based rate treatments that benefit consumers by ensuring reliability and reducing the cost of delivered power. Among other things, the Commission also noted in Order No. 679-A that incentive ROEs will not apply to existing transmission rate base that has already been built because the purpose of section 219 is to attract investment in transmission.

1. **Request for Clarification**

20. FirstEnergy requests the Commission to clarify that under Order Nos. 679 and 679-A, a public utility that is a member of an RTO is eligible to apply for higher ROE incentive rate treatment for all of its jurisdictional transmission facilities. It requests clarification that the Transmission Organization ROE incentive is not tied to the construction of new transmission facilities. It asserts that section 219(c) states that the Commission must provide incentives to utilities that join a Transmission Organization, and that section is not tied to a requirement that such eligibility is only for new transmission facilities. According to FirstEnergy, the plain language of section 219(c), together with the policy goals expressed by the Commission in Order Nos. 679 and 679-A, establish an incentive for utilities that join Transmission Organizations that is

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24 Order No. 679, FERC Stats & Regs. ¶ 31,222 at P 331.


26 Id.

27 Id. P 61.

28 FirstEnergy at 1.
separate and apart from the incentive established for new transmission construction.\(^{29}\)

Therefore, FirstEnergy requests the Commission to clarify that a public utility member of an RTO is eligible for the Transmission Organization incentive as to all of its jurisdictional transmission facilities based on its participation in a Transmission Organization only and not on any requirement linked to its transmission construction program.

2. **Commission Determination**

21. FirstEnergy is correct that a public utility member of an RTO is eligible for the Transmission Organization incentive rate treatment as to all of its jurisdictional transmission facilities that have been turned over to the operational control of the Transmission Organization. This incentive is separate from incentives related to a utility’s transmission construction program.\(^{30}\) Therefore, we clarify that Transmission Organization ROE incentive is not tied to the construction of new transmission facilities.

The Commission orders:

(A) The requests for rehearing of Order No. 679-A are hereby denied, as discussed in the body of the order.

(B) The requests for clarification of Order No. 679-A are granted in part and denied in part, as discussed in the body of the order.

By the Commission.

( S E A L )

Philis J. Posey,
Deputy Secretary.

\(^{29}\) *Id.* at 4.

\(^{30}\) *See* Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 87 (“Section 219(c), applicable to the Transmission Organization incentive, is separate from the construction incentives in subsection (b), and therefore was not intended to directly encourage construction.”) (footnote omitted).