Indiana Utility Regulatory Commission

Transmission Infrastructure Investments
FERC Order 679

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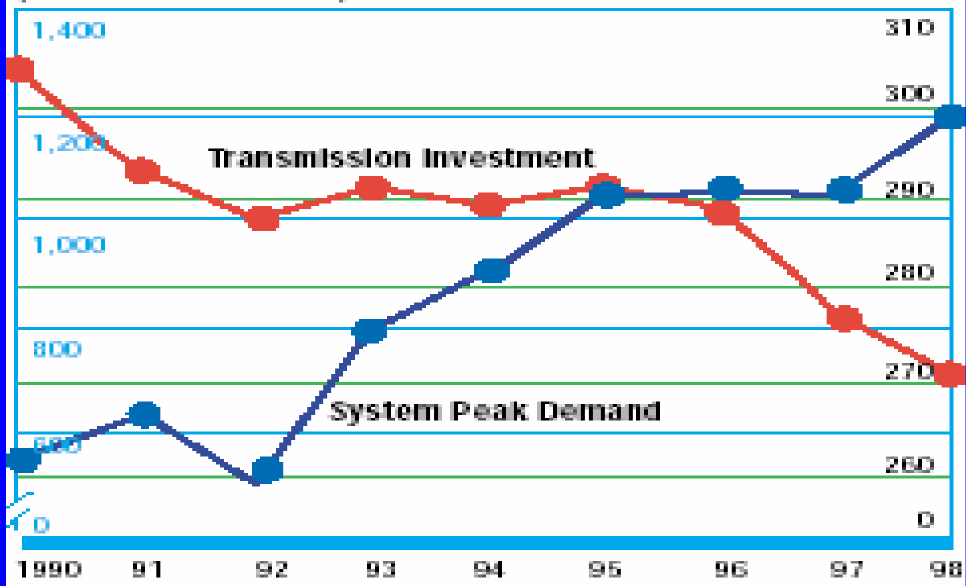
FERC Concern with Transmission Investment

- FERC
  - Federal Energy Regulatory Commission
- Investment in transmission facilities in real dollar terms declined significantly between 1975 and 1998
- Data for the most recent year available, 2003, shows investment levels below 1975 in real dollars
- Electric load using the grid more than doubled during this investment decline
- The growth rate in transmission mileage since 1999 was not sufficient to meet the expected 50 percent growth in consumer demand over the next two decades

FERC Transmission Investment Incentives

U.S. Investment in New Electric Power Transmission

(Millions of 1990 Dollars)



Growth in peak demand for electricity has far outstripped investment in transmission capacity. As a result, transmission constraints could aggravate already limited supplies of power and could result in high prices in some areas of the country.

Source: PA Consulting Group, based on data from the UDI data base.

Purpose of FERC Order 679

- Promote investment in transmission infrastructure
- Promote electric power reliability
- Lower costs for consumers
- Reduce transmission congestion
- NOTE
  - For the first time in its history, FERC will also approve and enforce mandatory power grid reliability standards through other orders

FERC Rule 679 Philosophy

- As long as the project ensures reliability or reduces the cost of delivered power by reducing congestion, regardless of where it is located on the nationwide transmission grid, the project is eligible for incentive ratemaking.

Investment Incentives

- Ten different forms of incentives are included in the new rules
- Incentives would be based on a case-by-case analysis of individual transmission proposals
- Each proposal could receive a different group or combination of incentives

Transmission Investment Risk Factors

- Time delays
  - Time is money and costs escalate
- Negative public opinion
  - Not in my backyard concerns
- Siting uncertainties
  - Approvals in multiple states
- Cancellation by project developers
- Recovery of project costs
  - After the fact prudency reviews
  - Delayed cost recovery at State level

Incentive Guidelines

- Is the “end result” just and reasonable, balancing the needs of consumers and investors
- Incentives recognize construction risks, they are not a “bonus” for good behavior
- Not every incentive will be available for every investment
- Applicants may request incentives that are not in the final rule
- New investment in existing facilities will be eligible for incentive treatment

Incentive Rates of Return on Equity (ROE) for New Investment by Public Utilities

- The most direct and effective means of attracting capital
- ROE level will be determined on a case-by-case basis
- Routine investment to meet reliability standards may not qualify
- Discounted Cash Flow (DCF) analysis will continue to be used

Full Recovery of Prudently Incurred Construction Work in Progress (CWIP)

- Reduces cash flow difficulties associated with the long lead time to construct new transmission
- Up to 100% of CWIP can be recovered on case-by-case basis
- This will balance short-term and long-term rates by increasing the rates during construction and lowering the rates during operation of a facility

Full Recovery of Prudently Incurred Pre-operations Costs

- A utility may make a large investment in pre-operation costs
- Reduces cash flow difficulties associated with the long lead time to construct new transmission
- Prudently incurred pre-commercial costs can be expensed
- This will balance short-term and long-term rates by increasing the rates during construction and lowering the rates during operation of a facility

Full Recovery of Prudently Incurred Costs of Abandoned Facilities

- A utility may have investment in a project abandoned for reasons outside the control of the public utility
- Recovery of up to 100% of prudently incurred costs of facilities that are cancelled or abandoned
- A generation developer may decide to terminate a project
- A developer may have difficulty in obtaining state or local siting approvals
- Order 679 reduces this barrier, the potential lack of recovery of costs
- Determination made on a case-by-case basis

Deferred Cost Recovery for Utilities with Retail Rate Freezes

- Utilities with a retail rate moratorium may have concerns with cost recovery for new transmission facilities
- This incentive is a cost recovery mechanism which allows them to commence recovery of new facility costs in FERC jurisdictional rates at the end of a retail rate moratorium.

Use of Hypothetical Capital Structures

- A rigid approach to acceptable capital structures could threaten the viability of some projects
- Gives applicants the flexibility to refinance or employ different capitalizations as needed
- Proposals for this incentive evaluated on a case-by-case basis
- These structures may be effective for development of consortium projects

Use of Accelerated Depreciation Over Shorter Time Periods

- Provides improved cash flow and better positions public utilities for longer term transmission investments
- Depreciation over a shorter 15 year time period, rather than the useful life of the facilities
  - Shorter time periods on a case-by-case basis
- Determined on a case-by-case basis
- Accounting and tax issues must be carefully considered

Transcos

- Transco – a stand alone transmission company approved by FERC
  - May also own distribution facilities
  - Not conditioned on membership in an ISO or RTO
- Sells transmission service at wholesale and/or on an unbundled retail basis
- Does not have to be (but may be) affiliated with another public utility
- Active ownership by market participants is permitted

Higher ROE for Utility Investments in Transmission Organizations

- FERC will consider the positive impact Transcos have on transmission investment
- Suitably structured Transcos will receive an ROE that both encourages Transco formation and is sufficient to attract investment
- The portion of a utility investment in a Transco would earn the higher ROE

Accumulated Deferred Income Taxes for Transcos

- This is to remove any disincentives that might prevent the sale or purchase of transmission assets to form Transcos
  - Such as capital gains taxes on the sale of assets
- Incentive provides cost assurance of recovery in rate base of adjustments for taxes associated with asset sales

Adjustments to Book Value for Transco Sales / Purchases

- A Transco may propose the addition of an acquisition premium to book value as an incentive
- Proposals to recover these premiums associated with the purchase of transmission facilities will be considered on a case-by-case basis
- Provides an incentive for Transco formation

FERC Transmission Investment Incentives

- Discussion

- Questions

- http://www.ferc/industries/electric/indus-act/trans-invest.asp