UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promoting Transmission Investment Through Pricing Reform	**)** **)**	**Docket No. RM11-26-000**

COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION

The Natural Gas Supply Association ("NGSA") hereby submits comments in response to the Federal Energy Regulatory Commission's ("FERC" or "the Commission") Notice of Inquiry ("NOI") regarding the promotion of transmission investment through pricing reform. [1]

NGSA is a trade association which represents integrated and independent companies that produce and market domestic natural gas. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy, and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. customers. Members of NGSA supply natural gas to power gas-fired generators and also are large consumers of power. For these reasons, policy changes that may occur as a result of this NOI will have a direct impact on NGSA.

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[1] *Promoting Transmission Investment Through Pricing Reform*, Notice of Inquiry, 135 FERC ¶ 61,146 (2011) ("NOI").

I. COMMUNICATIONS

Any communications with respect to this pleading and this proceeding should be addressed to:

Patricia W. Jagtiani
Senior Vice President
Natural Gas Supply Association
1620 Eye Street, NW, Suite 700
Washington, DC 20006
(202) 326-9300
pjagtiani@ngsa.org

II. EXECUTIVE SUMMARY

On May 19, 2011, the Commission issued an NOI seeking comment on the scope and implementation of its transmission incentives regulations and policies under Order No. 679.[2] The Commission stated that it was interested in determining what steps it should take to ensure its transmission incentive policies appropriately encourage the development of infrastructure in a manner consistent with its statutory responsibilities. In order to undertake this evaluation, the Commission posed a number of questions related to its existing incentive policies for electric transmission.

As natural gas suppliers to gas-fired generators as well as large users of electricity, NGSA's members have a strong interest in ensuring that the power grid is operating reliably and efficiently and that sufficient, cost-effective transmission is available to reduce congestion, ease market pressures and improve competitive

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[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) (hereinafter "Order No. 679").

efficiencies. Below, we provide our evaluation of the Commission's incentives program for electric transmission and ask that the Commission take our views into consideration as additional changes to the current policies under Order No. 679 are contemplated.

As the Commission reevaluates its current incentive program for electric transmission, we encourage the Commission to apply the same general principles outlined in its longstanding and successful interstate pipeline certificate rate policy to its electric transmission cost allocation and ratemaking process. The pipeline certificate policy is designed to encourage market participants to select the most efficient projects without adversely impacting existing customers.

To ensure adequate electric transmission, project developers should receive a rate of return that adequately compensates them commensurate with the risk of their proposed project. However, the Commission must be cautious about the use of transmission incentives which go beyond the FERC risk-adjusted approved ROE. If incentives are unwarranted, these *de facto* subsidies can inappropriately impact market decisions, leading to negative long-term implications for consumers by raising the price of our nation's energy and adding further financial stress on industry and jobs. Given the possible adverse implications, prior to granting special incentives, the Commission must require the applicant to provide strong justification that the project serves the public interest, provides significant system-wide benefits, exceeds normal risks not reflected in traditional discounted cash flow (DCF) analysis, and, absent special incentives, would not go forward.

Section 1241 of Energy Policy Act of 2005 required the Commission to establish rules for incentive-based rate treatments to benefit consumers by ensuring reliability and reducing the cost of delivered power through reductions in transmission congestion.

> *…the Federal Energy Regulatory Commission (Commission) is amending its regulations to establish incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.*[3]

Thus, based on this language, if a project applicant cannot demonstrate that a project increases system reliability and reduces the cost to consumers after including the cost of any incentive, then FERC's public interest test and the requirements of Section 1241 have effectively not been met. Furthermore, any potential reduction in delivered costs can be substantially negated if high costs to consumers are incurred by an over-reaching incentives program and/or by socializing the increased costs associated with each applicant's approved incentive package without consideration of good market design principles.[4]

Unnecessary incentives, like subsidies, can encourage project developers to opt for building more expensive transmission projects that otherwise may have not been financially viable, particularly when other more efficient, lower cost options exist. While adequate electric transmission is beneficial to electricity consumers, in

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[3] Order No. 679 at P 1.

[4] The Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005). ("EPAct of 2005") requires the Commission to establish rules that promote reliable and efficient transmission and generation by promoting capital investment. That mandate is not inconsistent with the Commission's longstanding desire to promote the most cost efficient projects which meet this legislative requirement.

those instances where incentives result in less efficient projects, incentives only serve to increase cost to consumers. Therefore, we ask the Commission to carefully balance competing interests and refrain from granting unnecessary transmission incentives.

Similarly, socialization of added transmission costs to consumers as a result of these incentives further raises the cost of power. Thus, FERC should hold firm to cost causation principles and require the costs of any transmission incentives to be allocated to those that most benefit from new transmission. In fact, overly broad socialization coupled with unnecessary incentives creates regulatory subsidization that is likely to favor more remote and costly projects over more economic alternatives that may exist closer to electricity consumers.

III. COMMENTS

A. Rates of Return Higher Than Those Commensurate With the Project Risk Result in Market Inefficiencies and Unnecessary Burdens on Consumers.

The Commission must effectively limit its incentives program to proposed transmission projects that qualify based on exceptional circumstances. Absent strict application of incentives, multiple ROE adders coupled with other special cost recovery incentives will enrich project developers with returns beyond what is commensurate with the transmission project's associated risk and lead to the building of electric transmission that otherwise may have not gone forward due to its lack of financial viability. Such excessive incentives only serve to increase the cost of energy as consumers are forced to pay for relatively less efficient and economical energy options .

In fact, awarding added financial inducements above the calculated risk-adjusted ROE does not directly address the true problems associated with development of new transmission. Rather than focusing solely on providing higher returns that increase costs to consumers, efforts should also be focused on the larger challenges that must be addressed, including local and state resistance, the lack of federal siting authority, the impact of the economic recession, as well as efforts to develop organized competitive markets and eliminate non-competitive market barriers.

For the reasons outlined above, the Commission should refrain from any generic application of transmission incentives. Also, applicants should be required to support their request for incentives by making a strong case that their project will face extraordinary circumstances that warrant incentives above and beyond the calculated rate of return, which already includes adjustments that reflect the overall project risk. Thus, prior to approval of special incentives, the Commission must be certain that the applicant can provide strong justification that the project provides significant system-wide benefits, exceeds normal risks not reflected in traditional discounted cash flow (DCF) analysis, and, absent special incentives, would not go forward.

B. The Commission Should Simplify Its Transmission Rate Program Given That the Approved ROE Already Adjusts for Project Risk.

Since the existing FERC-approved ROE calculation includes adjustments that take into account the relative risk associated with any given project, it is difficult to assess when a project should appropriately qualify for additional incentive adders and other special cost recovery provisions that "exceed the normal risks undertaken by a utility (and hence are not reflected in a traditional discounted cash flow (DCF) analysis)."[5] In fact, over time, one would expect it to be increasingly difficult for the Commission to: (1) provide sufficient justification for incentives beyond a risk-adjusted return and (2) assess and determine the appropriate balance and inter-relationship between the approved ROE and awarded incentives. [6] Moreover, multiple types of incentives appear to be counter-intuitive and at the very least, needlessly complex.

Given the extensive list of incentives already provided for in Order No. 679, FERC should not expand its current transmission incentives program. Instead, as detailed below, the Commission should consider simplifying this incentive program by adopting the basic principles it set out over a decade ago for the certification of interstate natural gas pipelines.

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[5] Order No. 679 at P 27.

[6] A truly perverse outcome could ultimately result whereby, absent strong legal justifications to distinguish future cases, the application of the Commission's incentive policy could become the standard instead of the exception; allowing all new transmission to be eligible for incentive treatment. This slippery slope could occur unless FERC is careful to ensure that the instances in which incentives are rewarded are truly exceptional cases in which such actions are warranted.

C. Strictly Adhering to Its Cost Causation Principles, the Commission Should Apply the Same General Principles Outlined in the Interstate Pipeline Certificate Policy to Electric Transmission Investment and Pricing.

For over a decade, applicants proposing to build new natural gas pipeline facilities have been required to meet the standards for certification outlined in the Commission's 1999 Statement of Policy regarding the certification of new interstate natural gas pipeline facilities.[7] As outlined in the 1999 Certificate Policy Statement, "[t]he threshold requirement . . . for existing pipelines proposing an expansion project is that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers."[8] "The next step is to determine whether the applicant has made efforts to eliminate or minimize any adverse effects the project might have on the [applicant's] existing customers . . . , existing pipelines in the market and their captive customers, or landowners and communities affected by the route of a new pipeline."[9] If the proposed project cannot

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[7] *Certification of New Interstate Natural Gas Pipeline Facilities*, Statement of Policy, 88 FERC ¶ 61,227 (1999) ("1999 Certificate Policy Statement").

[8] 1999 Certificate Policy Statement at p. 61,746 (footnote omitted).

[9] *Id*. at p. 61,745. *See also Equitrans*, 136 FERC ¶ 61,046 at P 11 (2011) ("*Equitrans*"):

> Under this policy, the threshold requirement for pipelines proposing new projects is that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers. The next step is to determine whether the applicant has made efforts to eliminate or minimize any adverse effects the project might have on the applicant's existing customers, existing pipelines in the market and their captive customers, or landowners and communities affected by the route of the new pipeline. If residual adverse effects on these interest groups are identified after efforts have been made to minimize them, [the Commission] will evaluate the project by balancing the evidence of public benefits to be achieved against the residual adverse effects. This is essentially an

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be financially supported absent help from existing shippers, the applicant must make a strong showing that the project benefits outweigh the adverse effects. "Only when the benefits outweigh the adverse effects on economic interests will [the Commission then] proceed to complete the environmental analysis where other interests are considered."[10]

Prior to the 1999 Certificate Policy Statement, the Commission had a relatively low threshold for "rolling in" or socializing the new project costs into existing rates instead of insisting that the project finance itself independently. Fortunately, after a broad generic examination of the best means to balance the benefits associated with the infrastructure with the possible adverse consequences, the Commission reasoned that the most appropriate way to adhere to its regulatory responsibilities was to ensure that impacts on existing customers were minimized.

Conversely, it appears that the Commission's process for encouraging electric transmission follows an entirely different path that provides incentives to projects that may not be capable of being financially self-sufficient absent added revenue support. In instances where such incentives are applied, and grid reliability is not increased nor are delivered costs lowered, then it follows that ratepayers will be adversely impacted, contrary to the public interest and the EPAct of 2005.

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> economic test. Only when the benefits outweigh the adverse effects on economic interests will [the Commission then] proceed to complete the environmental analysis where other interests are considered.

[10] *Equitrans* at P 11.

Although natural gas pipeline infrastructure developers may not encounter the same intense level of challenges experienced by applicants proposing to build new electric transmission, there is no sufficient basis for the Commission not to adhere to the same general principles regarding incentives and subsidization of newly proposed infrastructure for both industries. Both the Natural Gas Act and the Federal Power Act require the Commission to protect ratepayers from excessive rates and, to ensure this protection, a project must be financially viable without incentives (or subsidies) that mask its true economic efficiencies.[11] The EPAct of 2005 is consistent with this basic public interest requirement, given that EPAct of 2005 allows for incentives to be provided only when specific benefits (e.g. reliability and lower delivered costs) result.

Question 25 on page 18 of the NOI asks whether the existence of a contractual commitment to build is a relevant factor when considering applications for rate incentives. We believe the commitment level is a relevant factor in terms of the overall risk assessment of a proposed project. As the Commission explained in its 1999 Certificate Policy Statement, contract commitments are one of the factors that applicants can identify to show that the benefits of a proposed pipeline facility outweigh the adverse consequences in order to prove that a project is in the public convenience and necessity. Projects that are backed significantly by creditworthy

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[11] EPAct of 2005 requires that all rates approved under FERC's incentive rules be subject to the requirements of Section 205 and 206 of the FPA, which require that all rates be just and reasonable and not unduly discriminatory or preferential.

customers are less risky than projects in which there are no binding commitments. Thus, the existence of contractual commitments should reduce the overall risk of a proposed transmission project and therefore should be properly reflected as a lower risk in the determination of the approved ROE.

D. *Pre-Commercial Cost Recovery Should Be Limited and Used Sparingly to Limit Subsidization by Customers Not Benefitting from New Transmission*.

As explained in the NOI, the Commission allows applicants pre-commercial cost recovery by expensing and recovering certain costs through rates during the construction period in order to improve project cash flow and financial metrics, and to mitigate the uncertainty of cost recovery prior to regulatory approval and commercial operation. Otherwise, pre-commercial costs would be capitalized as part of CWIP and would subsequently earn a return on equity as well as ROE through depreciation, once a project goes into service; allowing the project developer to collect costs incurred during construction from existing customers, irrespective of whether these customers will benefit from the proposed project.

If the Commission finds that it is appropriate in some circumstances to provide rate recovery of pre-commercial costs by charging existing customers, it should be done sparingly and not applied on a generic basis. To the extent that pre-commercial recovery is permitted, the applicant's return should be reduced accordingly to account for the reduced risk. Moreover, these costs should not be automatically assessed to existing customers absent a showing of how the project will benefit them. Finally, pre-commercial cost recovery should not guarantee a sponsor full cost recovery for a project that ultimately does not go forward or is abandoned.

E. NOI Q69-Q73: Advanced Technology Incentives Should Not Continue Once Technologies Become Proven.

In Question 69 on page 29 of the NOI, the Commission asks how it should account for what Order No. 679 identified as the evolving nature of technology with respect to the list of defined advanced technologies. NGSA believes that the defined advanced technology incentives should be limited in terms of scope and duration. Since the purpose of stimulating new technology is to prove its practical feasibility, items that may currently be on the list of eligible advanced technologies should not remain permanently on the list as the technology evolves. At some finite point, new technology becomes either disproven or accepted by the market and once that occurs, perhaps after a limited number (two or three) of smaller pilot projects, that technology should be designated as proven or failed and no longer eligible for incentive treatment. Given that technology is always changing, the Commission should regularly review each of the currently eligible advanced technologies and revise the list of eligible advanced technologies.

Question 71 on page 39 asks whether an applicant's level of previous experience with a technology should be a factor in determining whether that technology is "advanced" for purposes of evaluating a request for incentives. To do so would amount to undue discrimination in that it is the technology and not the applicant that warrants such incentives, if needed. However, as noted above, the overall industry experience with a given technology, irrespective of the applicant, should be considered in any determination of whether it should continue to qualify for advanced technology incentives.

Question 72 on page 40 asks whether an ROE adder granted for an advanced technology should apply to the entire cost of a project, or just to the advanced technology. NGSA believes such adders are appropriately limited to the costs associated with the advanced technology. As stated earlier, unnecessary or excessive adders only serve to add costs to consumers and we do not believe this was Congress' intent. Thus, incentives should be granted sparingly and should be limited in scope to maintain a balance of interests between the applicant and electricity customers.

Similarly, Question 73 on page 40 asks whether incentives for advanced technology should continue to be assessed on a case-by-case basis. Certainly, if the Commission continues to provide such incentives for advanced power technologies, it must look at the individual circumstances as they arise to ensure that the technology is still in its infancy and that the proposal requires the use of special incentives. The Commission previously clarified that it retains discretion to make these determinations on a case-by-case basis and that it encourages advanced technologies through incentives "as appropriate." [12] We fully agree with this

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[12] *See* NOI at P 42 citing *The Nevada Hydro Co., Inc*. 122 FERC ¶ 61,272, at P 84 (2008); *NSTAR Electric Co.*, 127 FERC ¶61,052, at P 27 (2009). Adders to encourage advanced pipeline technologies have not been provided or considered and are not a common practice that appears necessary in the natural gas pipeline regulatory arena.

assessment given that generic approval would not allow for adequate review of the qualifying technologies proposed.

V. CONCLUSION

NGSA appreciates and supports the legislative and regulatory goals of encouraging the development of electric transmission. In implementing the incentive program aimed at achieving those goals, however, we ask the Commission to tread lightly when awarding incentives to ensure there are no unintentional adverse long-term consequences for the market and consumers alike. As the President recently pointed out in his letter to independent agencies, "Wise regulatory decisions depend on public participation and on careful analysis of the likely consequences of regulation … such decisions should be made only after consideration of their costs and benefits."[13]

Therefore, in the context of this proceeding, the Commission should minimize adverse consequences on consumers by ensuring that incentives for transmission are only granted in those few instances in which they are truly justified. Also, the

[13] *See* Executive Order issued July 11, 2011, *available at* http://www.whitehouse.gov/the-press-office/2011/07/11/executive-order-regulation-and-independent-regulatory-agencies. In order to streamline regulations and reduce burden on regulated entities, President Obama issued an Executive Order on July 11, 2011, requiring independent agencies to review their regulations and to identify any regulations that are ineffective or excessively burdensome on industry. This order gives independent agencies until mid November 2011, to release a public plan explaining how the agency will review its existing regulations to determine whether any should be modified to make the agency's regulatory program more effective or less burdensome. *See id.*

Commission can help to minimize adverse consequences by simplifying its incentives program for electric transmission and adhering to cost causation principles that are consistent with good market outcomes. This can be accomplished by following the general principles set out in the Commission's 1999 Certificate Policy Statement. Like the Natural Gas Act, the Federal Power Act requires the Commission to protect ratepayers from excessive rates, and rationalizing the incentives policy on the power side with the longstanding, well-functioning natural gas pipeline rates policy would ensure consistent, fair rates are set for all transmission developers.

Respectfully Submitted,

/s/ Patricia W. Jagtiani

Patricia W. Jagtiani
Senior Vice President
Natural Gas Supply Association
1620 Eye Street, NW, Suite 700
Washington, DC 20006
pjagtiani@ngsa.org