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Public Service Commission

March 6, 2003

VIA ELECTRONIC FILING

The Honorable Magalie R. Salas
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

RE: Docket No. PL03-1-000, Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid

Dear Ms. Salas:

Forwarded herewith are comments of the Florida Public Service Commission in the above-mentioned docket regarding Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid.

Should you have questions, please contact Jim Dean at (850) 413-6058, Kathy Lewis at (850) 413-6594 or Connie Kummer at (850) 413-6701, our primary staff in the matter.

Sincerely,

/ s /

Cynthia B. Miller, Esquire
Office of Federal and Legislative Liaison

CBM:tys
Enclosure

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. PL03-1-000

Proposed Pricing Policy for Efficient Operation and
Expansion of the Transmission Grid

EXECUTIVE SUMMARY

The Florida Public Service Commission (FPSC) supports the Federal Energy Regulatory Commission's (FERC's) goal of providing incentives as opposed to mandates, to achieve the goal of more competitive electric markets. The wide variability in market structure and opportunities across the country makes such flexibility necessary and prudent. The FPSC offers the following concerns to the FERC for attention in developing and applying an incentive program.

- Incentives should be based on guiding principles or defined guidelines stating when they would be appropriate and why. The FERC incentives appear to be designed to entice companies to divest assets based upon its belief that no other structure will work, without empirical evidence supporting this belief. Any incentives paid should be balanced by the benefits received by the customers paying the bill for those incentives. We strongly agree with the FERC that development of adequate measurements of success is vital to determine if the steps implemented truly yield the expected results.
- The level of transmission investment eligible for incentives should be narrowly defined. For example, we do not believe that incentives are appropriate or necessary to maintain system reliability. Similarly, facilities appropriate for participant funding should be excluded from incentives.

- FERC should be cautious in committing ratepayer dollars for a significant length of time. The longer Regional Transmission Organization (RTO) rates support incentive payments, the longer it will take for ratepayers to realize benefits from the competitive market the incentives were designed to foster.
- We support FERC's inclusion of alternatives to construction of additional pole and cables but urge that any innovative technology be consistent with NERC standards and good engineering practice.
- We are also concerned that FERC's proposal directed primarily toward divestiture could be a disincentive to participation in an Independent System Operator (ISO)-type RTO structure like GridFlorida.
- FERC should not adopt a policy that will be enforced with the authority of a rule without subjecting the policy to full analysis. Also, notice to all state commissions should be provided when the FERC applies this in an individual case.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. PL03-1-000

Proposed Pricing Policy for Efficient Operation and
Expansion of the Transmission Grid

COMMENTS OF THE FLORIDA PUBLIC SERVICE COMMISSION

I. Introduction

A. Three Fundamental Tenets

The Florida Public Service Commission (FPSC) offers the following comments on the FERC's proposed "incentive" policy for transmission system improvements. Our comments reflect our shared belief in three fundamental tenets. First, any incentives must meet established criteria or be consistent with the core guiding principles set forth herein. Second, any incentives should not favor one type of corporate structure over another with respect to Regional Transmission Organization (RTO) participation. Third, any costs associated with RTOs must be balanced against the benefits received by the retail customers who will ultimately pay the costs, whether for RTO formation and operation or incentives for RTO participation.

B. GridFlorida

In addition, in Florida we found – *after a full evidentiary hearing on the costs and benefits of the GridFlorida proposal* – that divestiture of assets to either an Independent Transmission Company (ITC) or an RTO is premature for Florida. The GridFlorida Companies were ordered to modify their proposal to form an Independent System Operator (ISO). The FPSC has reviewed the ISO proposal and approved many of the provisions in that filing. The order addressing the ISO proposal is currently on appeal before the Florida Supreme Court. Action on a Florida RTO prior to resolution of that appeal would be a premature and potentially costly mistake for Florida ratepayers. Accordingly, we are concerned that the incentives described in the Policy Paper encourage divestiture either to an RTO or an ITC in lieu of other forms of RTO participation that may yield greater economic benefit at lower costs. Also, the incumbent expiration date for applying for incentives may well result in a rush to act without adequate concern for state interests and impact on state ratepayers.

C. Specific Areas of Concern

While the FPSC supports the general concept of incentives as set forth in these comments, we have some specific concerns and comments on the approach outlined in the Policy Paper.

- **Incentive Guidelines.** Incentives should be based on clearly defined principles stating when an incentive would be appropriate and why. The FERC incentives appear to be designed to entice companies to divest assets based upon its belief that other corporate structures for RTO participants are inferior and will not achieve the desired objectives articulated in Order 2000. The FPSC rejects this premise, especially since there is little to no empirical evidence that the goals of independence for RTO operations can not be achieved without such divestiture.
- **Costs and Benefits.** Any incentives should be balanced against benefits received and costs paid by the ultimate ratepayers. To that end, not only the amount of any incentives paid, but also the time frame over which incentives apply, must be carefully scrutinized to ensure a matching of costs and benefits. To our knowledge, this analysis has not been done.

- **<u>Potential Perverse Impacts.</u>** The proposed incentives associated with divestiture of assets appear likely to discourage other types of RTO participation, notwithstanding that these other types of RTO participation may provide better protection for, or more benefits to, ratepayers. Further, the approaching deadline for qualifying for incentives appears likely to provoke a decision prior to adequate assessment of the costs and benefits for the plan.

- **<u>Eligible facilities.</u>** We have several concerns. First, the application of incentives to new construction must be narrowly defined. Second, applying incentives to all transmission is counter to the FERC's policy of participant funding. Third, we also believe any incentives for maintaining reliability are fundamentally inappropriate. Reliability is an existing regulatory requirement of doing business. Reliability is not an option. Fourth, any new technology eligible for an incentive must adhere to all NERC standards and not jeopardize the safety or reliability of service to existing customers in the guise of expanding the system capability to new entrants.

- **<u>More Review and Public Input Needed.</u>** FERC should not adopt a policy that will be enforced as a rule without subjecting the policy to a full opportunity for public input. Input should be sought from state regulators and other policy makers, industry, and consumer interests.

II. Incentive guidelines

As a general matter, the FPSC believes that incentives can be an effective way to achieve a particular outcome and are appropriate in certain circumstances. For example, Florida uses incentives to encourage high availability of fossil-based generation units. FERC should establish guidelines or principles for when incentives are appropriate and why. Then, when situations warrant, FERC should use the established criteria to develop and implement incentives. FERC's currently proposed incentives appear to be based on a belief - one not shared by the FPSC - that divestiture is a superior strategy to achieve independence in the context of RTO participation. The disproportionately higher "basis point return on equity" incentive for ITC participation reflects this belief. As noted above, the FPSC has concluded (after a full evidentiary hearing) that a utility's divesture of assets to an ITC (or RTO) is premature for Florida.

III. Costs and Benefits

A. Expected Benefits Not Apparent

We disagree with FERC's assertion in Paragraph 21 that significant benefits from competition are expected to result from RTOs and ITCs. The incentives proposed by FERC increase the cost of capital and cost of service. This artificial increase in cost must be paid by the end user. Any incentives offered should be balanced by the benefits received by the customers paying the bill for those incentives.

B. Adequate Measurement Required

We strongly support FERC's position on adequate measurement of the effectiveness of any measures which impose costs on end users of the system. We believe the goal or desired outcome should be clearly identified so success can be measured and that measurement of success is vital in determining if the steps implemented truly yield the expected results. The goal should be a more reliable, more efficient, lower cost electric system for consumers and equal access to the grid by generators, not the divestiture of assets.

C. Incorrect Generalization

In an effort to justify the incentives, FERC states that some market participants complain that companies which own both transmission and generation under-invest in transmission because the resulting competitive entry often decreases the value of their generation assets. However, load serving utilities and ratepayers are the participants who ultimately pay these increased costs and who must be heard in these proceedings. The generalizations cited by FERC ignore: (1) whether load growth in a particular region or utility service territory requires additional transmission investment; (2) whether vertically-integrated utilities (and/or state commissions) determined after analysis that an alternative other than transmission expansion was more economical, and; (3) the difficulties of siting new transmission.

D. Cost Recovery Relationship is Lacking

Paragraphs 24 through 28 describe in some detail how the proposed incentives would be applied. FERC likens the ITC incentive to the decision in the Trans-Elect case. However, in that decision, the amount of the incentive was tied to a specific cost incurred by the divesting utility. The proposed incentive plan, in contrast, does not require that the recipient identify any particular costs to be recovered. The proposed 150-basis-points increase in transmission rates for 18 years, with no identifiable costs offsetting those additional revenues, has not been justified.

E. Must Avoid Permanent Subsidies

Incentives for a particular one-time action should not become permanent subsidies. Long term subsidies reduce the likelihood that ratepayers, who are paying the incentives through higher transmission rates, will realize the benefits from a competitive market. A shorter time frame may be more reasonable, and evidence on this point is needed. In addition, the deadline for qualifying for incentive treatment may be counterproductive. FERC should continue to allow time for meaningful collaboration with states and utilities to develop RTOs so that the benefits to the consumers of a more competitive market can be fully realized.

IV. Potential Perverse Impacts

The FPSC has undertaken an extensive review of the impact of an RTO upon Florida ratepayers. We held three days of evidentiary hearings in October 2001 to explore the prudence of GridFlorida and of RTOs in general. We found that an RTO may be beneficial to Florida ratepayers but disagreed, based on the evidence, with the original GridFlorida formation as a Transco. Order PSC-01-2489-FOF-EI states that:

> Although we have found that the GridFlorida Companies were prudent in proactively forming an RTO that should yield benefits to Peninsular Florida and its ratepayers, we believe that *certain aspects of GridFlorida are not in the best interests of Florida's retail ratepayers at this time, most particularly the transfer of ownership*

> *of transmission assets that would take place under GridFlorida.* We believe that the benefits associated with the transco structure of GridFlorida can be achieved under an ISO structure, in which participants would continue to own their transmission assets while the RTO would have operational control over those assets. [Page 11][Emphasis added]

In order to take advantage of the proposed incentives in a needlessly rushed time frame, the incentives proposed by FERC could encourage GridFlorida utilities to circumvent the carefully considered decision by this Commission to require utilities to retain ownership of transmission facilities. We acknowledge that the passive ownership restrictions contained in this current FERC incentive pricing policy would not have necessarily provided incentives for the divestiture of assets to a GridFlorida transco. However, the policy does provide a large basis point incentive for ITCs to participate by acquiring assets of vertically integrated utilities. This incentive artificially increases the market value of vertically integrated utilities' transmission assets and thereby offers them an incentive to sell these inflated assets.

The pending deadline for qualifying for incentives further exacerbates the issue by possibly forcing an imprudent decision that could later be in conflict with a state court decision. As a result of the FERC incentives geared towards divestiture as proposed, we fear Florida ratepayers may be saddled with significant increased costs which provide few if any benefits.

V. Eligible facilities

A. <u>Scope of Transmission Improvements Shoud be Narrow</u>

Paragraph 30 appears to state that the 100 basis point incentive applies to "investment in new transmission facilities which are found appropriate pursuant to an RTO planning process." The Policy Paper is unclear about who would be eligible for this incentive. More importantly, the FPSC believes that only a very narrow subset of transmission improvements should be eligible for any incentives - even in cases where transmission improvements result as a part of an RTO planning process. Florida, in fact, already facilitates investment in transmission under its Transmission Line Siting Act as well as through incremental reliability-based upgrades.

B. <u>No Reliability Incentives</u>

FERC also appears to state in Paragraph 22 that incentives are appropriate and/or necessary to maintain system reliability. We respectfully disagree. Incentives are not appropriate to encourage a transmission operator/owner to maintain reliability. A transmission provider, whatever its structure, is required to maintain reliability as condition of continued operation. The one narrow exception is in the case of reliability improvements that use non-traditional or what the policy paper defines as "new technologies that can be installed relatively quickly". If there is some additional risk due to the uncertain performance characteristics of such equipment or the perception on the part of lenders that such "new technology" warrants a higher cost of capital, then we could arguably support such incentives.

C. Unfounded Reliance on "Restructuring" Argument

FERC states in Paragraph 19 that transmission construction has not kept pace with demands of restructuring. However, only a minority of states have elected to pursue retail access. Some that have, such as California, have regretted their haste in doing so. A number of other states have suspended, cancelled, or delayed their decision to pursue retail choice. Most evidence suggests that any delays in transmission construction are more related to opposition to siting and not a reluctance from the investment community to fund such projects.

More importantly, it appears that the increased demand for transmission brought about by industry restructuring is the core issue in the participant funding debate. It appears that FERC is advocating commitment of ratepayer dollars for a significant length of time to encourage the construction of transmission facilities that may be candidates for the participant funding mechanism. In particular, (i) any upgrades requested by a third party for purposes of taking network access service, (ii) any upgrades to relieve congestion (regardless who builds the upgrades), or (iii) any improvements designed to build additional interface, transfer capability for purposes of wheeling out or through one or more RTOs should qualify for incentives. A contrary policy would fundamentally conflict with the regulatory philosophy of "participant funded" transmission improvements. The FPSC has strongly supported participant funding of upgrades for parties seeking network access service or for parties seeking to build merchant transmission facilities for grid improvements designed to reduce congestion or allow additional inter-RTO transactions.

The FPSC approach of limiting eligible facilities is wholly consistent with the FERC's strategic objectives of using LMP and other market based signals to ensure the most efficient development of the nation's transmission system. Those who undertake transmission improvements for reasons of economic gain should be entitled to the benefits of such improvements, but no further incentives should be available.

D. Alternatives to Poles/Cables

We support FERC's inclusion of alternatives to construction of additional poles and cables as discussed in Paragraph 32. However, caution should be exercised in applying these alternatives. Any measures that require facilities to be utilized beyond the normal physical and thermal limits should be carefully reviewed to ensure compliance with all applicable NERC standards. Any such measures should also take into account first and second contingency constraints that may be locational in nature.

E. Tie Incentives to Results

Further, incentives should be tied to results. The magnitude of the incentives should reflect the savings or efficiencies induced by these alternatives. Flat rate incentives could well be too large or too small to initiate the type of action desired, especially if significant research and development is necessary to achieve engineering advances. Such an incentive structure also results in the opportunity to "pad" project costs. Since there is no prudency review offered in the proposal, this type of policy is an open invitation to overspend on projects with little concern that unnecessary costs will be removed from ratebase.

VI. More Review and Public Input Needed

FERC states in Paragraph 20 that the policy statement provides *the regulatory certainty the industry needs*.[emphasis added] We do not believe it is appropriate to adopt a policy, intending to enforce it with the authority of a rule, without subjecting the policy to the greater review inherent in rulemaking. Additional scrutiny of a cost-benefit analysis and work on open discussion can only improve any final product and may produce yet more ideas to accomplish the goal. Since a formal rule is not being adopted at this time, we request that, in the first instance where this new policy is applied, all state regulatory commissions be duly noticed that the policy is being implemented.

VII. <u>Conclusion</u>

The FPSC supports the FERC's goal of providing incentives as opposed to mandates, to achieve the goal of more competitive electric markets. The wide variability in market structure and opportunities across the country makes such flexibility necessary and prudent. The FPSC offers the following concerns to the FERC for attention in developing and applying an incentive program.

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FERC that development of adequate measurements of success is vital to determine if the steps implemented truly yield the expected results.

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Respectfully Submitted,

/ s /

Cynthia B. Miller, Esquire
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DATED: March 6, 2003