

DEPARTMENT OF ENERGY

Federal Energy Regulatory
Commission

18 CFR Part 35

[Docket No. PL03-1-000]

Proposed Pricing Policy for Efficient
Operation and Expansion of
Transmission Grid

January 15, 2003.

AGENCY: Federal Energy Regulatory
Commission, DOE.**ACTION:** Notice of proposed policy
statement

SUMMARY: The Federal Energy Regulatory Commission (Commission) proposes a new pricing policy for the rates of transmission owners that transfer operational control of their transmission facilities to a Regional Transmission Organization (RTO), form independent transmission companies (ITCs) within RTOs, or pursue additional measures that promote efficient operation and expansion of the transmission grid. The proposed policy would create rate incentives that reward RTO and ITC formation and grid investment, because independent regional grid operation and coordination will improve grid performance, reduce wholesale transmission and transactions costs, improve electric reliability, and make electric wholesale competition more effective in ways that benefit all customers. We invite comments on the proposed policy statement.

DATES: Comments are due March 13, 2003.**ADDRESSES:** Federal Energy Regulatory
Commission, 888 First Street, NE.,
Washington, DC 20426.**FOR FURTHER INFORMATION CONTACT:**
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Information), Office of Markets, Tariffs
and Rates, Federal Energy Regulatory
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Office of General Counsel, Federal
Energy Regulatory Commission, 888
First Street, NE., Washington, DC 20426,
(202) 502-8560.**SUPPLEMENTARY INFORMATION:****I. Introduction**

1. The Federal Energy Regulatory Commission proposes a new policy for the rates of transmission owners operating within a Regional Transmission Organization (RTO). Because they are independent of market participants, RTOs and Independent Transmission Companies (ITCs) make

competitive wholesale electric markets more efficient, fair, trustworthy, and cost-effective. This new policy will reward transmission owners for joining RTOs and turning their assets over for RTO operation. It will reward transmission owners for forming ITCs or taking other measures which make their transmission facilities operationally independent from the activities of other market participants. It will reward transmission owners for pursuing additional measures to operate and expand the transmission grid efficiently in ways that solve RTO-identified system needs using either classic transmission investments or innovative technologies. However, only transmission owners which participate in RTOs will be able to take advantage of these incentives. This policy will promote competitive wholesale electric markets, reduce wholesale electric costs and improve electric reliability.

II. Summary of Proposed Incentives

2. Under this proposed policy: (1) Any entity that transfers operational control of transmission facilities to a Commission-approved RTO would qualify for an incentive adder of 50 basis points on its return on equity (ROE) for all such facilities transferred; (2) ITCs that participate in RTOs and meet the independent ownership requirement (discussed below) would qualify for an additional incentive equivalent to 150 basis points applied to the book value of facilities at the time of the divestiture; and (3) we also propose a generic ROE-based incentive equal to 100 basis points for investment in new transmission facilities which are found appropriate pursuant to an RTO planning process.

III. Background*A. Order No. 2000*

3. We adopted Order No. 2000¹ to encourage voluntary and timely formation of RTOs. Order No. 2000 found that transmission facilities can be operated more reliably and efficiently when coordinated over large geographic areas, and that RTOs would achieve this result by establishing: regional transmission pricing and the elimination of rate pancaking; improved congestion management; more accurate estimates of available transmission capacity (ATC); more effective management of parallel path flows;

more efficient planning for transmission and generation investment; and improved grid reliability. It concluded that RTOs would help eliminate the opportunity for unduly discriminatory practices by transmission providers, reduce the need for overly intrusive regulatory oversight, and instill trust among competitors that all are playing by the same rules.

4. Order No. 2000 recognized that realization of "effective and efficient RTOs is dependent in large measure on the feasibility and vitality of the stand-alone transmission business."² It also found that transmission pricing reforms may be needed to facilitate both RTO formation and the formation of stand-alone transmission businesses such as ITCs. The order discussed various innovative rate options and identified specific innovative rate mechanisms that we would consider for entities that meet the minimum characteristics of RTOs.³ In identifying the specific innovative rate mechanisms (including performance-based rates) that we would consider for entities that meet the minimum characteristics of RTOs, Order No. 2000 neither prescribed a specific transmission pricing method nor guaranteed approval of any particular innovative pricing proposal. All innovative pricing proposals should be fully justified:

The [a]pplicant [for innovative rate treatments] must explain how the proposed rate treatment would help achieve the goals of RTOs, including efficient use of and investment in the transmission system and reliability benefits to consumers; provide a cost-benefit analysis, including rate impacts; and explain why the proposed rate treatment is appropriate for the RTO proposed by the Applicant. This means that filings under section 35.34(e) must be complete and fully explained; must demonstrate that the resulting rates are just, reasonable, and not unduly discriminatory or preferential; must identify how the rate treatment promotes efficiency and what benefits result; and must demonstrate that the rate treatment does not impede the RTO from meeting the minimum characteristics and functions required under Order No. 2000.⁴

B. Experience since Order No. 2000

5. Order No. 2000 called for RTOs to be in operation across the nation by December 2001. While the industry is making significant progress in the development of RTOs and we have preliminarily approved seven RTO proposals, only two of those have become fully approved RTOs—Midwest

¹ Regional Transmission Organizations, Order No. 2000, 65 FR 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 FR 12,088 (Mar. 8, 2000), FERC Stats. & Regs. ¶ 30,092 (2000), *aff'd sub nom.* Public Utility District, No. 1 of Snohomish County, Washington v. FERC, 272 F.3d 607 (D.C. Cir. 2001).

² Order No. 2000 at 31,170.

³ See § 35.34(e) of our regulations, 18 CFR 35.34(e) (2002) (innovative rate treatments for RTOs).

⁴ *Id.* at 31,171.