

power sales from generation used primarily for back-up and self-generation, authorized the resale of load reductions at wholesale at market-based rates, waived prior notice requirements for wholesale contract modifications to facilitate demand-side management, permitted demand side management costs to be treated consistently with other types of incremental and out-of-pocket costs, and allowed premiums on equity returns and accelerated depreciation for projects that increase electric transmission capacity and could be in service by November 1, 2002.

4. SMD NOPR

14. On July 31, 2002, we issued a notice of proposed rulemaking that proposed a framework to remedy remaining undue discrimination in the provision of interstate transmission services and in other industry practices.¹⁹ The SMD NOPR also proposed to create "seamless" wholesale power markets that allow sellers to transact easily across transmission grid boundaries, through the implementation of standardized transmission service and spot markets and through the elimination of rate pancaking, among other things. Because of their regional scope and configuration, we believe that RTOs can most quickly and efficiently implement standardized transmission service and spot markets and most effectively eliminate rate pancaking.

15. The SMD NOPR points out other concerns identified by market participants through formal complaints, hotline calls, public conferences, and pleadings. Market participants complain about the difficulties they have experienced in gaining equal access to the transmission grid to compete with vertically integrated utilities. Market participants also complain that companies that own both transmission and generation under-invest in transmission because the resulting competitive entry often decreases the value of their generation assets. Much of this problem is directly attributable to the remaining incentives and ability of vertically integrated utilities to exercise transmission market power to protect their own generation market share. Independent transmission providers and owners, operating under a common set of rules, would solve these problems.

16. The SMD NOPR noted that we have long recognized that the ITC

business model can bring significant benefits to the industry:

Their for-profit nature with a focus on the transmission business is ideally suited to bring about: (1) Improved asset management including increased investment; (2) improved access to capital markets given a more focused business model than that of vertically integrated utilities; (3) development of innovative services; and (4) additional independence from market participants.²⁰

It concluded that these characteristics of ITCs can have significant benefits for the implementation of Standard Market Design, particularly in the areas of development of transmission infrastructure and structural independence from market participants.²¹

17. The SMD NOPR also proposes that independent transmission providers institute locational marginal pricing to provide market participants with efficient price signals. We expect such price signals to facilitate efficient operation and expansion of the grid; but these price signals alone will not achieve efficient grid operation and expansion in many cases. ITCs would be more likely to relieve congestion through transmission investment than a company that benefits from the value of generation in constrained areas.

18. This proposed policy statement supports the SMD NOPR and Order No. 2000 goals of RTO formation and participation and a standardized, independent competitive wholesale electricity market by creating incentives for RTO participation, independent transmission operation, efficient transmission system operations and new transmission construction and technology investment.

5. Energy Infrastructure Conferences and Reports

19. Beginning in the fall of 2001, we have held four regional conferences on energy infrastructure issues to explore the near- and long-term needs for additional electric transmission facilities in each area of the country and the challenges to timely identification, permitting and construction of those facilities.²² Several notable reports have

been issued on these topics.²³ It is clear that over the past decade, investment in the nation's transmission infrastructure has not kept pace with load growth or with the increased demands brought about by industry restructuring, including open access transmission service and regional service provided by ISOs and RTOs.²⁴ The result has been increased transmission congestion, which is evidenced by a dramatic increase in low ATC postings and use of Transmission Loading Relief (TLR) procedures,²⁵ and in significant energy price differentials between regions.²⁶

IV. Discussion

A. A Clear Policy is Needed

20. We are committed to achieving the goals envisioned by Order No. 2000 and the SMD NOPR. Accordingly, we are proposing incentives to promote the efficient operation and expansion of the transmission grid through the development of independent RTOs and ITCs. We also propose incentives for the construction of grid enhancements or employment of innovative operating practices that should yield improved performance of the transmission grid and a more competitive wholesale electricity market. Many of our orders to date on transmission rates have been targeted more toward "hold harmless" provisions to protect a utility from adverse ratemaking consequences due to transfer of its facilities to an RTO or ITC and have not resulted in true incentive

²³ See, e.g., Transmission Planning for a Restructuring U.S. Electricity Industry, prepared for Edison Electric Institute by Eric Hirst and Brandon Kirby, June 2001 (EEI Report); Conceptual Plans for Electricity Transmission in the West, Report to the Western Governors' Association, August 2001; Financing Electricity Transmission in the West, Report to the Western Governors' Association, February 2002; National Transmission Grid Study, United States Department of Energy (DOE), May 2002 (DOE Grid Study). Cambridge Energy Research Associates is working on a similar study.

²⁴ See EEI Report at 5–8; DOE Grid Study at 7.

²⁵ In the Southeast, the incidence of TLRs increased 354 percent from the summer of 1999 to the summer of 2000. See Staff Report to the Federal Energy Regulatory Commission on the Bulk Power Markets in the United States (Nov. 1, 2000), available at <http://www.ferc.gov/electric/bulkpower/southeast.pdf>, at 3–38. In the Midwest, the incidence increased 472 percent over the same time period. See Staff Report to the Federal Energy Regulatory Commission on the Bulk Power Markets in the United States (Nov. 1, 2000), available at <http://www.ferc.gov/electric/bulkpower/midwest.pdf>, at 2–32. See also DOE Grid Study at 5–7.

²⁶ See DOE Grid Study at 16–18; Electric Transmission Constraint Study, Staff Report to the Federal Energy Regulatory Commission (December, 2001), available at http://www.ferc.gov/calendar/commissionmeetings/Discussion_papers/12-19-01/e-1xproject%20cm_121901_presentation%20v3.ppt.

²⁰ See SMD NOPR at P 132.

²¹ *Id.*

²² See transcripts of the Western Conference held on November 2, 2001 (Docket No. AD01–2), the Southeast Conference held on May 9, 2002 (Docket No. AD02–13), the Northeast Conference held on January 31, 2002 (Docket No. AD02–6), and the Midwest Conference held on November 13, 2002 (Docket No. AD02–22). These transcripts, along with presentations made at the conferences, are available on our website, <http://www.ferc.gov/electric/infrastructure.htm>.

¹⁹ Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, 67 FR 55,451, FERC Stats. & Regs. ¶ 32,563 (2002) (SMD NOPR).