

rate mechanisms.²⁷ Other rate orders have been narrow and fact-specific, including *Trans-Elect*, where our allowance of a positive monetary incentive was based, in part, on unique circumstances involving stipulations with the affected transmission-dependent utilities and the relevant state commission. Similarly, the incentives we provided in the Western Orders were premised on circumstances unique to California and the Western United States during 2000–2001. Our goal with this proposal is to provide the regulatory certainty the industry needs to move forward.

21. While significant benefits from competition are expected to result from RTOs and ITCs, these benefits will be shared among end-use customers and generators, among others. To assure that transmission owners receive benefits from RTO formation, we believe that it is reasonable to allow an adjustment to be applied to the rates of transmission owners participating in an RTO, or in an ITC within an RTO, as discussed further below.

22. Similarly, significant benefits from increased competition and improved reliability will occur from the construction of needed grid expansions and from other measures that make additional transmission capacity available to market participants. Therefore, it is reasonable to encourage investments in grid capacity expansion by adjusting the rates of transmission owners for investment in certain new transmission facilities that will be under operational control of RTOs and for other actions that result in additional transmission capacity under RTO management being made available to market participants.

23. We believe that this policy could encourage the industry to achieve an independent and regional approach to transmission and to adopt other measures to improve the performance of the transmission grid.

B. Incentive Policy

1. RTO Participation and ITC Formation

24. We propose to provide generic ROE-based incentives to transmission owners that participate in RTOs, and ITCs under RTOs. Under this proposed policy, 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 ROE for all such facilities transferred.

25. 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. Such ITCs would be allowed to recover, through transmission rates, a lump sum dollar amount calculated on the basis of a 150 basis point ROE adder. The lump sum dollar amount would be determined at the time of divestiture but would be amortized and recovered over the period during which the incentive is applied. Recovery of the lump sum dollar amount would yield the same amount, after taxes, on a present value basis, as the increase in after-tax returns resulting from application of the ROE adder to current rate base over the period during which the incentive is applied.

26. An ITC will qualify for the incentive based on independent ownership by becoming a participant in a RTO. There must be no active or passive ownership interests in the ITC by market participants and no financial interests by the ITC or its employees in any market participant. For the purpose of applying this independent ownership criterion, “market participant” is defined in 18 CFR 35.34(b)(2) with respect to the RTO in which the ITC participates.²⁸

27. The ROE-based lump sum incentive for independent ownership would apply prospectively to ITCs.²⁹ We have already provided an incentive for creation of an ITC for the Michigan Transco system in *Trans-Elect*. We recognize that parties may be currently negotiating divestiture of transmission assets to form ITCs.³⁰ To avoid delaying

such transactions, we propose to permit the parties to any divestiture to an ITC filed with us within 6 months of adoption of this policy statement to propose either the allowance tied to deferred taxes that was approved in *Trans-Elect* or the ROE-based lump sum payment incentive for independent ownership proposed herein.

28. To encourage timely participation in RTOs and formation of ITCs, we propose a deadline of December 31, 2004, to qualify for these incentives. A public utility would qualify for the RTO incentive adder as soon as it has transferred operational control of its transmission facilities to an approved and operating RTO, and would be authorized to receive the incentive for RTO participation until December 31, 2012, with such recovery contingent upon continued participation in a Commission-approved RTO. A public utility that has divested its transmission facilities to an ITC would qualify for the ITC incentive adder once the ITC has transferred operational control of its transmission facilities to an approved and operating RTO and meets the independent ownership criteria, and would receive the incentive for independent ownership until December 31, 2022, with such recovery contingent upon continued independence from market participants and continued participation in a Commission-approved RTO.

29. We seek comment on any clearly defined levels between these two levels of independence (*i.e.*, RTO participation and ITC formation within an RTO) that could merit incentives above the basic 50 basis point incentive proposed for RTO participation. For example, if the ITC directly employs all of the people who work on the transmission system, it will operate with greater independence than if it were staffed by employees of transmission owners affiliated with market participants. Should such behavior be encouraged?

2. Enhanced Grid Performance

30. 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.

31. We are especially interested in encouraging investment in new technologies that can be installed relatively quickly (*i.e.*, do not require the long siting process for procurement of new rights-of-way, have designs that accommodate modular and portable

²⁷ For instance, this is true of the allowance for amounts necessary to hold a seller of transmission assets harmless from the income tax consequences of the divestiture, as approved in *International Transmission*.

²⁸ Order No. 2000 requires case-by-case review of passive ownership proposals to determine if they are adequately independent by design, and also requires follow-up compliance audits to ensure that independence is fully realized. Even so, passive ownership arrangements may not give market participants adequate confidence that transmission service is being provided without undue discrimination. Because of the resources required for case-by-case review and compliance audit, and potential for continued perception of undue discrimination, we do not believe that extending additional incentives for independent ownership to passive ownership arrangements is justified.

²⁹ Our incentive for RTO participation would be available to public utilities that have already turned over operational control of their facilities to a Commission-approved RTO, but have not yet received the incentive of 50 basis points.

³⁰ Two transactions have recently been filed and are currently pending our review. Illinois Power Company, *et al.*, (Illinois Power) filed in Docket No. EC03–30–000, *et al.*, for, among other things, the sale of all of Illinois Power’s right, title, and interest in its jurisdictional transmission facilities and related assets. Additionally, ITC Holdings Corporation *et al.*, filed in Docket No. EC03–40–

000, *et al.*, for approval of DTE Energy’s sale of International Transmission Company.