

DEPARTMENT OF WATER RESOURCES

1416 NINTH STREET, P.O. BOX 942836
SACRAMENTO, CA
94236-0001 (916)
653-5791



**Opening Statement of Peggy Bernardy
Office of the Chief Counsel
California Department of Water Resources**

**Federal Energy Regulatory Commission AD16-18-000
Competitive Transmission Development Technical Conference
June 27-28, 2016**

The California Department of Water Resources

The California Department of Water Resources (“CDWR”) is an agency of the State of California. It is responsible for monitoring, conserving, and developing California’s water resources. In fulfilling that mission, one of its primary responsibilities is the operation of the State Water Project, which transports water across nearly the entire state. It delivers water to meet the needs of more than 24 million Californians, as well as for a large portion of the state’s agriculture.

The State Water Project is the largest electric load in the State of California, using about 3% of the power within the state. It also has four FERC-licensed hydroelectric generating facilities located along its span, some of which provide significant storage and which mean it is one of the largest single generation owners in the CAISO Balancing Authority Area. The State Water Project is also the largest individual demand response provider in California.

For all these reasons, CDWR is keenly interested in ensuring both that adequate transmission is built (or adequate alternative transmission solutions deployed) and that it be done cost-effectively. It is an active participant, where allowed, in the CAISO Transmission Planning Process. It also actively participates at the Commission in matters bearing on the California energy markets or on transmission rates within the state.

Transmission Incentives, Generally

In recent years, CDWR and other customers in California have seen enormous increases in transmission rates. Since 2008, the CAISO's Transmission Access Charge has more than tripled. As a result, customers like CDWR are keenly aware of the need to balance encouragement of needed transmission development with measures to ensure costs are kept under control.

The Commission has long been clear that maintaining that balance is integral to its consideration of transmission incentives. Incentive rates are intended to encourage transmission infrastructure investment while maintaining just and reasonable rates. Both parts of that test are important— incentives cannot be granted when they will result in rates that are not just and reasonable, but also should be withheld if transmission investment will occur without the grant of an incentive. If a robust competitive process is already occurring without, for instance, developers being granted particular incentives, reforming that process to provide for additional incentives is not necessary.

At this time, at least in California, transmission is being built. The competitive transmission process¹ is accomplishing the Commission's desired goal of encouraging transmission development. Absent a showing of insufficient interest in projects put forth by the CAISO, incentive rates (other than those that are already routinely granted) are not necessary.

To the extent it may be shown that projects are not attracting bidder interest in some area of the country, CDWR believes the Commission's general incentives policy already provides the necessary framework and that it is fully applicable to projects resulting from a competitive process. That policy, particularly the clarifications in the Commission's 2012 Policy Statement on Incentives, should serve as the basis for any action taken here, particularly when it comes to ROE incentive adders. In the 2012 statement, the Commission clarified that it "expects incentives applicants to seek to reduce the risk of transmission investment not otherwise accounted for in its base ROE by using risk-reducing incentives before seeking an incentive ROE based on a project's risks and challenges." 141 FERC ¶ 61,129, P 16. An applicant must also "demonstrate that it is taking appropriate steps and using appropriate mechanisms to minimize its risk during project development." P 24.

This clarification reinforced the Commission's long-standing rule and policy on incentives: they should be proposed and reviewed on a case-by-case basis. An applicant should continue to be required to "tailor its proposed incentives to the type of transmission investments being made and to demonstrate that its proposal meets the requirements of section 219." Order 679, P 2.

¹ CDWR notes that the term "competitive solicitation" can be misleading. While RTOs do solicit bidders to propose transmission projects in response to identified constraints, they are not always seeking bidders for clearly defined projects; and they apply selection criteria other than cost. The result is that bids are not necessarily comparable on an apples-to-apples basis. And, while the process may succeed in their intended purpose of eliciting a variety of solutions to an identified problem, they are not sufficiently competitive to provide for market discipline of prices.

When it comes to ROE incentives, the Commission should continue to require that applicants demonstrate that they have sought to reduce the risk of transmission investment through other means before seeking an incentive ROE. It should also continue to require a demonstration that the resulting ROE is within the zone of reasonableness—and recognize that the upper end of the zone of reasonableness may change over time, requiring the incentive ROE to be adjusted. All of these rules and policies can and should apply to all applicants participating in RTO competitive solicitation processes.

Transmission Incentives and Competitive Solicitation

Participating in an RTO competitive solicitation process should not constitute a *per se* demonstration of risks that can only be mitigated with an ROE incentive. Indeed, in many circumstances a competitive solicitation process may enable bidders to structure their bids to encompass risk-mitigating components which may or may not be transparently apparent. Even where an RTO competitive solicitation process attracts a small number of bidders, this does not necessarily indicate that the project is so risky as to require incentives. When the identified need expressly or implicitly calls for an innovative or uncommon solution, the number of bidders may be small, but the process still sufficiently robust to ensure the project gets built without additional rate incentives. Thus, before any new incentives, especially novel ROE incentives, are employed to increase the number of bidders in those processes, either the developers or the RTOs themselves should be required to make a showing that the process as it stands isn't working.

In California, which CDWR is obviously most familiar with, the CAISO has completed ten competitive solicitations since 2013 and all but one involved multiple qualified bidders. Many, but not all, bidders offered cost containment mechanisms—ranging from commitments not to seek ROE incentives to binding cost caps on project expenditures. And CAISO has cited cost containment mechanisms as a significant factor in selecting winning bidders (though bidders offering cost containment commitments have not always prevailed). This experience suggests that, at least in California, no additional incentives are needed to encourage more bidders or to encourage more of them to propose cost containment measures. Novel incentives should not be deployed where healthy interest in bidding already exists.

In addition, developers participating in RTO competitive transmission development processes can and do already invoke a number of options under the current incentive policy, which can mitigate their risks and increase their ability to compete with incumbent developers, including:

- ❖ Requesting a regulatory asset, to allow collection of pre-commercial costs with a return.
- ❖ Using a hypothetical capital structure.
- ❖ Filing a formula rate with the Commission prior to having any bids chosen by the RTO (or even prior to bidding).

This package of non-ROE incentives, to date, has appeared sufficient to support robust competition among developers in California and to allow RTOs to identify appropriate project sponsors.

Project-Specific Incentives and Cost-Capped Bids

All developers building transmission face risks. As a general matter, once a developer is awarded the right to build a project in an ISO competitive solicitation, it likely faces less risk than it did before it had the ISO's imprimatur.

Developers, however, have now sought new types of incentive to address what they claim is a new risk arising from the voluntary inclusion of a cost cap in their bids: the risk that a cost-capped bid will lead to a lower effective rate of return on the project than that which they would otherwise earn. Developers have gone so far as to ask for those "cost capped" bids to become a floor of their cost recovery, to be protected under *Mobile-Sierra*, and to allow for "exceptions" that would ratchet the rate upwards. See *ITC Grid Dev., LLC*, 154 FERC ¶ 61,206 (2016). Or they have asked for the Commission to set an ROE floor even when the developer has not set an ROE ceiling. See *NextEra Energy Transmission West, LLC*, 154 FERC 61,009 (2016). Such one-sided proposals are inappropriate under all circumstances—customers should not bear all down-side risk for a project that a developer's shareholders have chosen to pursue.

Even if a developer makes a non-contingent cost-capped bid, however, novel incentives or an ROE adder may not be appropriate. In addition to ensuring that any incentive, including an ROE adder, is actually necessary to mitigate the risks of the particular competitive project in question, the Commission should consider the nature of the RTO process and several additional factors.

First, one of the criteria that RTOs use to determine a winning bidder is cost effectiveness, and voluntary cost caps are included for the purpose of enhancing the project developer's bid as compared to other proposed projects. Incentive adders that make a winning bid less cost-effective after the fact—and which, in truth, merely offset the potential cost savings from the cost cap—should be rejected. Certainly, any potential incentive adder must be evaluated as part of the initial bid. Otherwise, the cost effectiveness prong of the solicitation process will be thwarted.

Second, incentive ROEs should be time limited and subject to on-going Commission review to ensure that they continue to be just and reasonable and that the resulting ROE is not outside the zone of reasonableness. Certainly any form of *Mobile-Sierra* protection is inappropriate given the long timeframes involved and the uncertainty for consumers about the actual costs of any given project.

Finally, the Commission should take into account the fact that RTO selection processes lack the due process, public participation and transparency characteristic of a review by the Commission. CDWR participates in the CAISO Order 1000 transmission planning process during Phase 1 (identification of need) and Phase 2 (identification of solutions), where there are opportunities for stakeholder review and comment. However, the competitive transmission solicitation process for identified solutions

occurs during Phase 3, where ratepayers have no opportunity to review or evaluate bids, or to provide input. The CAISO alone makes those selections and reports later on its decision. It would be inappropriate to accord any transmission developer a rebuttable presumption related to incentives as a result of a closed process where ratepayers have no say. Accordingly, Commission review is and will remain necessary to ensure that rates associated with projects selected in these competitive processes are just and reasonable as a package, including any incentives.

This is especially important because RTO processes as currently structured are not designed to produce the lower possible rate, or even the lowest possible competitive rate. In selecting a winning bidder, they consider a myriad of factors, of which cost is only one. For instance, in California, the CAISO uses its process to elicit bids for identified transmission solutions. The projects themselves are not necessarily identical and may vary in design and configuration. In addition to cost effectiveness, the CAISO considers numerous factors: the Project Sponsor's existing rights of way and experience in acquiring rights of way; its proposed schedule and demonstrated ability to meet that schedule; and its technical engineering qualifications and experience, among other things. CAISO Tariff § 24.5.4. Where the CAISO deems a particular proposal superior on some of these other factors, it will select a project lacking voluntary cost containment commitments.

Cost containment is important, but it is not the only or even the most important factor considered. The variety of factors to be considered means that a strict apples-to-apples comparison is impossible. The competitive process thus lacks sufficient rigor to discipline prices. It is also outside the CAISO's expertise or authority to determine whether the rates that would result if the selected project is built and incorporated into rates are just and reasonable, or even entitled to a rebuttable presumption.

Alternatives to Incentives Could Benefit Both Developers and Consumers

If a need to encourage greater participation in competitive development processes is demonstrated, the Commission should consider whether it can encourage participation in transmission planning processes by looking beyond traditional incentive rates. For instance, the Commission's supplemental agenda discussed a fixed revenue requirement bid, under which customers would pay a stated revenue requirement each year regardless of what the developer actually spends. That proposal would make developers responsible for cost overruns, but not provide consumers with any cost savings if developers do not exceed their costs. This would amount to an unapproved, potentially limitless ROE adder.

If the Commission does determine that this type of fixed revenue requirement is necessary, it should consider ways that would also benefit consumers. For instance, the Commission could rule that if a developer's actual costs came in under the revenue requirement, they could recover half of the savings; if their actual costs come in over, they could recover half of the overrun. In the first case, half of the benefits would accrue to consumers and half to the developers; in the second, the downside risk would

likewise be split. Mechanisms like these would allow developers and consumers to share the risks and benefits of fixed revenue bids.

Ultimately, competitive solicitation processes provide the Commission and RTOs with a chance to develop creative solutions that benefit all parties. At this time, CDWR believes the process in California to be working without the need for new incentives or a change in how the Commission grants incentives. The Commission already has the necessary rules and guidelines in place to appropriately incentivize transmission development.

CDWR appreciates this opportunity to speak; and it looks forward to working with stakeholders and the Commission to ensure that RTO processes balance incentivizing transmission with mechanisms to ensure the resulting rates are just and reasonable.