Congress of the United States
House of Representatives
Washington, DC 20515

May 11, 2012

The Honorable Jon Wellinghoff
Federal Energy Regulatory Commission
88 First Street, NE
Washington, DC 20426

Dear Chairman Wellinghoff:

I am writing regarding the Commission's use of incentive rates as a means to encourage transmission investment generally, as well as elevated transmission rate making in New England specifically. Increasing the efficiency, reliability, and flexibility of the electricity grid has the potential to be beneficial to consumers, the electric industry, and the environment. While investments in new transmission facilities can be a part of this modernization effort, I am concerned that the Commission's policies regarding transmission investment—in particular those developed in response to Section 1241 of the Energy Policy Act of 2005 (which I opposed at the time)—have resulted in consumers paying excessive charges. As you will recall, I raised concerns about the Commission's approvals of incentive rates in a June 12, 2009 hearing I chaired on the future of the nation's electricity grid. I applaud the Commission's willingness since that time to initiate a review of its incentive policies and hope that it will implement needed reforms after considering all comments (submitted in Docket No. RM11-26-000). I also strongly support the Commission's order last week setting a hearing for the New England transmission base return on equity (ROE) complaint led by the Massachusetts Attorney General, Martha Coakley (Docket No. EL11-66-000).

The boom in transmission construction in New England since 2003 has led to a 500 percent increase in transmission costs for consumers and pushed the region's transmission rates to some of the highest in the country. This trend is anticipated to continue, as ISO New England expects more than $6 billion in new transmission investments in the region over the next four years. As a percentage of total power costs, transmission costs will increase from less than 6 percent in 2008 to approximately 21 percent in 2014.

Transmission investments may be necessary to relieve congestion, bring renewable energy to market, and enhance reliability. However, it is not clear that all new transmission investments for which incentives have been authorized in fact required special rate treatments. Nonetheless, the last several years has seen a prolific use of ROE "adders" for new transmission that, in some cases, have given transmission owners risk-free, formula-based returns of up to

13.5 percent on new projects. Such returns on equity for predictable infrastructure investments seem even more inflated given the current state of economic growth and interest rates. Over the last three years, long-term Treasury bond index funds have returned less than 6 percent annually.

In June of 2009, we exchanged letters on this topic of transmission incentives. In response to the question I posed regarding the risks or considerations that merit an incentive-based return on equity (ROE), you stated "For example, without an ROE incentive, some applicants could suffer a credit ratings downgrade to junk bond status as a direct result of undertaking the transmission project, and thus need the incentive in order to attract investors to fund the project."

Transmission expenditures in New England come from a highly concentrated, well-capitalized group of companies. Between 2000 and 2010, 99 percent of the region's transmission investments were made by six companies. And just two of these companies, National Grid and Northeast Utilities, accounted for nearly three quarters of that investment.[1] Standard & Poor's rates the long-term credit of both National Grid and Northeast Utilities as "A," which indicates a strong capacity to meet financial commitments. All six of the major transmission companies in the region have credit ratings that make them "investment grade," according to Standard & Poor's. At the same time, transmission is becoming a greater revenue driver in recent years for these companies. For example, earnings within the transmission segment of Northeast Utilities' business have grown from $138 million in 2008 to $200 million in 2011. I am concerned that with large, well-capitalized companies with strong credit ratings increasingly dominating the regional market for new transmission, excessive and unwarranted incentive transmission rates are disproportionately benefitting the bottom lines of transmission builders at the expense of electricity consumers.

Further, there are other methods for relieving congestion, increasing reliability, and achieving clean energy targets that are not eligible for incentive adders. Using ROE adders for transmission may reduce the relative attractiveness of other important and cheaper non-transmission alternatives like demand response, energy efficiency, distributed generation, and smart grid systems and infrastructure. Transmission adders have the potential to incentivize large new expenditures on transmission and lead to regional planning rules that advantage transmission over these other resources.

Three years ago, in the letter exchange mentioned earlier, I asked if the Commission had a process to determine whether the various incentives available for transmission development continue to be necessary to encourage new investments. There were none at that time at FERC beyond the project-by-project evaluation for granting incentives. The current inquiry is an ideal opportunity to revisit and, as necessary, modify transmission incentive policies. The goal should be the establishment of a regulatory framework that will ensure that incentive rates are not

[1] This includes NStar, which recently merged with Northeast Utilities.

simply an added cost borne by consumers on investment that would have been made in any event.

Along with addressing incentive policies, the quickest and potentially most meaningful step the Commission could take in terms of addressing spiraling transmission costs in New England would be to reduce the base ROE for the region's transmission owners from the current level, 11.1 percent, to 9.2 percent, which a group of state attorney generals and regulators are requesting. Reducing the rate could save New England ratepayers between $100 million and $200 million annually, according to the complainants. The Commission's decision last week to agree to hear this complaint is a very positive step.

I appreciate the Commission's consideration of these comments and am hopeful that refinements can be made to transmission policies so that transmission investments may go forward in the context of a balanced and cost-effective grid modernization strategy.

Sincerely,

Edward J. Markey

Edward J. Markey
Member of Congress