UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Boston Edison Company Docket No. ER05-69-001

ORDER ON REHEARING

(Issued May 27, 2005)

1. In this order, we address the request for rehearing filed by the Eastern Massachusetts Consumer-Owned Systems (EMCOS)[1] of the Commission's order issued in this proceeding on December 21, 2004 (December 21 Order).[2] In the December 21 Order, we accepted Boston Edison Company's (Boston Edison) proposal to include a 50 percent construction work in progress (CWIP) in its rate base for three underground transmission circuits, subject to Boston Edison submitting annual informational filings. On rehearing, EMCOS primarily argues that the December 21 Order permits Boston Edison to "pancake" its incentive rates. As discussed below, we will grant in part, and deny in part, EMCOS' rehearing request.

2. This order benefits customers by providing the vital funding to support necessary transmission upgrades in the Boston, Massachusetts area.

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[1] EMCOS includes: Braintree Electric Light Department, Concord Municipal Light Plant, Hingham Municipal Lighting Plant, Reading Municipal Light Department, Taunton Mun icipal Lighting Plant, and Wellesley Municipal Light Plant.

[2] *Boston Edison Co.*, 109 FERC ¶ 61,300 (2004).

Background

3. Boston Edison's principal function is the transmission of energy in the Greater Boston Area, and it is a member of ISO New England, Inc., an authorized regional transmission organization (RTO-NE).[3]

4. On October 25, 2004, Boston Edison submitted proposed tariff changes in order to, among other things, include a 50 percent CWIP in its rate base. More specifically, Boston Edison sought to include a 50 percent CWIP in its overall Local Network Service (LNS) transmission rate formula during the proposed construction period, rather than accruing and capitalizing Allowance for Funds Used During Construction (AFUDC) charges on the entire construction expense balance. Boston Edison also sought to capitalize, during the construction period, the remaining construction expenses that were not included in the 50 percent CWIP in the LNS rate base, under AFUDC within its Regional Network Service (RNS) rate. The most imminent project in which Boston Edison sought to apply this treatment involved three new underground transmission circuits to reinforce the regional transmission system in the Greater Boston area through a 345kV underground transmission project 18 miles in length and estimated to cost $234 million.

5. EMCOS protested the filing, stating that, while inclusion of CWIP in a utility's rate base is a useful incentive mechanism for promoting needed construction and reflects an effective and preferred use of transmission customers' money compared to other non-cost-based "incentive adders," it is inappropriate for Boston Edison to seek 50 percent CWIP in this proceeding, when it has already been granted non-cost-based incentives in the RTO-NE Orders. It argued that the differential between Boston Edison's 10.5 percent rate of return on common equity on CWIP and its cost of construction financing is another incentive in addition to the incentives already granted in the RTO-NE Orders. EMCOS asserted that Boston Edison must choose which incentive it wants and forego the others.

6. EMCOS further argued that Boston Edison failed to provide a mechanism for Commission review of CWIP balances prior to inclusion in the formula rate. Noting that, under its LNS formula rate, Boston Edison updates its transmission revenue requirements on a monthly basis, EMCOS asserted that it would be extremely difficult to monitor the justness and reasonableness of CWIP inputs into Boston Edison's formula rates.

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[3] *ISO New England, Inc.*, 106 FERC ¶ 61,280 (2004), *order on reh'g*, 109 FERC ¶ 61,147 (2004) (collectively, RTO-NE Orders).

7. In the December 21, 2004 Order, the Commission accepted Boston Edison's proposed tariff changes for filing, to become effective January 1, 2005, subject to an informational reporting requirement.[4] We noted that, in *Order No. 298*,[5] the Commission acknowledged that CWIP in rate base would be a less costly solution to cash flow inadequacy than an increased rate of return, since CWIP results in a lower future rate base than if the cost is recorded as AFUDC, and thus, future rates to customers would be lower.[6] We rejected EMCOS' request that Boston Edison be required to choose between incentive rates, stating that the Commission did not make a finding in *Order No. 298* that 50 percent CWIP in rate base was an "incentive rate," comparable to other incentive rates outlined in the Proposed Pricing Policy.[7] We further stated that CWIP inclusion in the rate base is not an incentive rate, but rather is intended as a modest offset to the bias against new investment.[8]

8. We further declined to require a mechanism for Commission review of CWIP balances prior to inclusion in the formula rate. We found that Boston Edison already has mechanisms in place that assure allocators based on actual wholesale customer usage. We stated that any return revenues based on misstated CWIP are subject to annual true-up and refund with interest pursuant to the Commission's Regulations, 18 C.F.R. § 35.19(iii)(A), and as stated in Boston Edison's tariff.[9]

Rehearing Request

9. On rehearing, EMCOS reiterates that allowing the CWIP in this case adds another layer of incentive rates atop the non-cost based incentives (such as a higher rate of return) already permitted by the RTO-NE Orders. EMCOS argues that, per *Order No. 298*,

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[4] Specifically, we directed Boston Edison to file an annual report updating the Commission on the status of the long-term transmission projects listed in its long-term plan. The report must contain an updated needs assessment, timelines, costs and alternatives, and updated in-service dates for these projects. December 21 Order at P 33.

[5] *Construction Work In Progress for Public Utilities; Inclusion of Costs in Rate Base*, *Order No. 298*, 48 Fed. Reg., 24,323 (June 1, 1983), FERC Stats. & Regs. ¶ 30,455 (1983), *order on reh'g*, *Order No. 298-B*, 48 Fed. Reg. 55,281 (December 12, 1983), FERC Stat. & Regs. ¶ 30,524 (1983).

[6] December 21 Order at P 30.

[7] *Id.* at P 32; *Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid*, 102 FERC ¶ 61,032 (2003) (Proposed Pricing Policy).

[8] *Id.*

[9] *Id.* at P 38.

CWIP in rate base is intended to be an alternative to higher rates of return, not an additional source of supplementation to utility earnings.[10] EMCOS asserts that, without explanation, the Commission ignored this principle in the December 21 Order.

10. EMCOS further argues that the Commission failed to meaningfully address concerns regarding the difficulty of monitoring whether CWIP inputs into Boston Edison's monthly-estimated, annually trued-up, revenue requirements formula are just and reasonable. EMCOS states that the Commission's reliance on Boston Edison's annual true-up was misplaced for several reasons. First, EMCOS asserts that, according to its own terms, the true-up can occur 18 months after charges are first imposed, and in practice may take even longer. Second, EMCOS argues that the December 21 Order is inconsistent with Commission precedent, which, according to EMCOS, requires a filing with respect to the return on common equity and CWIP balances.[11] Third, EMCOS contends that the Commission has recognized in other similar contexts the importance of

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[10] EMCOS contends that, in *Order No. 298*, the Commission described CWIP in rate base as an alternative to higher rates of return, not an additional source of supplementation to utility earnings, by stating as follows:

> There are two ways of addressing the problem of cash flow inadequacy. One way is to simply increase the allowed rate of return to produce higher earnings and cash flow. The other way is to allow a cash return on construction investments by including CWIP in rate base. While both approaches have the immediate effect of raising rates, the allowance of CWIP in rate base causes the future rate base, and thus future rates to customers, to be lower than they otherwise would be. On the other hand, raising allowed returns would not be matched by future reductions in rate base and rates. For this reason the Commission has recognized that where increased cash flow is desirable, the allowance of CWIP in rate base would be the least costly alternative to ensure a utility's financial integrity and to enable it to attract the capital necessary to meet its capital needs. *Order No. 298* at 30,499.

[11] EMCOS cites *Southwestern Electric Power Co.*, 36 FERC ¶ 61,081 at 61,201 (1986): "A utility which proposes to recover CWIP in its rates must conform to the limitations and cost support requirements of [Commission regulations]. SWEPCO's recovery of CWIP costs via a formula rate should not place it in a position different than that of a utility which does not employ a formula rate. Accordingly, SWEPCO's use of the OMPA formula as a rate shall be restricted . . . with respect to the recovery of CWIP. The annual update of OMPA's rate pursuant to the formula will require a filing with respect to the return on common equity and CWIP balances."

ensuring utility accountability.[12] Lastly, EMCOS states that transmission customers cannot avail themselves of the recourse provided by section 206 of the Federal Power Act (FPA)[13] with respect to the misapplication of formula rates or the billing dispute provisions of Boston Edison's LNS tariff, unless they have access to transparent and verifiable data underlying the inputs used to develop charges under a formula rate. EMCOS asserts that, in light of the absolute size of anticipated CWIP over the next several years, the impacts of a possible misapplication of the Boston Edison revenue requirements formula on customers are sufficiently substantial to require periodic and detailed informational filings, and customer audit rights, to allow transmission customers to verify the basis for CWIP billings under that formula.

Discussion

11. We will grant in part, and deny in part, EMCOS' rehearing request. We will deny rehearing with respect to EMCOS' argument that, under *Order No. 298*, the inclusion of 50 percent CWIP in rate base is intended to be an alternative to higher rates of return. While it may be true that *Order No. 298* states that an increased rate of return and CWIP are two ways of addressing the problem of cash flow inadequacy, the order further discusses how higher rates of return and CWIP respectively address two other different problems, i.e., the bias against the creation of new capacity due to the inability to earn a return equal to the actual cost of capital, and the bias in favor of minimizing capital costs, due to the difficulty in financing large-scale construction programs, particularly when the bulk of CWIP is large in relation to rate base. The Commission noted in *Order No. 298* that "CWIP is more directly responsive to the second source of bias" (the bias in favor of minimizing capital costs) and may ease the difficulty in financing construction programs.[14] If higher rates of return and CWIP were mutually exclusive, utilities would be forced to choose between resolving these two different problems. *Order No. 298* does not require such a choice, and we will not do so here.

12. However, we will grant EMCOS' request with respect to the annual reporting requirement. As we have found in similar cases where the accounting transparency was lacking due to projections of data or other factors, a company has the potential to exercise

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[12] EMCOS cites *ISO New England, Inc.*, 100 FERC ¶ 61,130 at 61,501 (2002) (requiring quarterly filing and posting of quarterly subcomponent cost data consisting of "historical cost accruals from the previous two years and forecasted costs for each of the next two years.").

[13] 16 U.S.C. § 824e (2000).

[14] *Id.* at 30,498.

discretion in calculating the charges, and we have instituted reporting requirements.[15] We will direct Boston Edison to include, as part of the annual report directed in the December 21 Order, information indicating the actual amounts of CWIP recorded for each project, related accounts, such as AFUDC and regulatory liability,[16] all subaccounts,[17] and the resulting effect on the CWIP revenue requirement, in line item detail. Boston Edison is required to file this report to coincide with the timing of its Annual True-up; no later than six months after the close of the Service Year to which the Annual True-up relates.[18]

The Commission orders:

(A) EMCOS' request for rehearing is granted in part, and denied in part, as discussed in the body of this order.

(B) Boston Edison is hereby directed to submit an annual report, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

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[15] *Midwest Independent System Operator, Inc.*, 108 FERC ¶ 61,235 at 68 (2004). *See also*, *ISO New England, Inc.*, 100 FERC ¶ 61,140 (2002).

[16] Boston Edison relies upon the Commission's Regulatory Liability (Account 254) as defined in 18 C.F.R. Part 101 (254) (2004), to balance the accounting for CWIP and to offset the CWIP recorded in rate base.

[17] Subaccounts include operations and maintenance, and administrative and general expenses attributable to CWIP, as well as the classification of CWIP (such as distribution, transmission, etc.).

[18] ISO New England Inc., FERC Electric Tariff No. 3, Section II, Schedule 21-BECO, Article 4.1.