

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Part 35

(Docket No. PL05-11-000)

Policy Statement Regarding Evaluation of Independent Ownership and Operation of
Transmission

(Issued June 27, 2005)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Policy Statement.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is adopting this Policy Statement to clarify the ownership structures that could qualify for passive ownership in regards to independent ownership and operation.

EFFECTIVE DATE: The Policy Statement will become effective immediately.

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SUPPLEMENTARY INFORMATION:

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Policy Statement Regarding Evaluation of Independent Ownership and Operation of Transmission Docket No. PL05-11-000

Policy Statement

(Issued June 27, 2005)

I. Introduction

1. The Commission is issuing this Policy Statement to provide clarity and remove barriers to the formation of independent transmission companies. Specifically, the Policy Statement clarifies that the Commission would be willing to accept proposals from independent transmission companies (ITCs) which have market participants as passive minority equity owners. On various occasions, the Commission has allowed innovative rate treatments both to facilitate the creation of ITCs and to stimulate investment in transmission infrastructure by ITCs.¹

¹ These incentive proposals include: enhanced returns on equity, within the zone of reasonableness; hypothetical or imputed capital structures; recovery of deferred income tax liabilities; cost deferrals; Construction Work in Progress (CWIP) in rate base; accelerated book depreciation; and expensing of pre-certification costs associated with new transmission. In addition, the Commission is willing to consider further incentives for independent transmission companies, among which are 100 percent recovery of CWIP, 100 percent recovery of abandoned plant costs, and accelerated depreciation. *See Michigan Electric Transmission Co., LLC*, 105 FERC ¶ 61,214 (2003) (*METC*); *ITC Holdings Corp.*, 102 FERC ¶ 61,182, *reh'g denied*, 104 FERC ¶ 61,033 (2003); *American Transmission Co. and Midwest Independent Transmission Operator, Inc.*, 105 FERC ¶ 61,388 (2003), *order dismissing reh'g as moot, providing clarification and approving uncontested settlement*, 107 FERC ¶ 61,117 (2004) (*ATC*).

2. The Policy Statement describes a non-exclusive list of the factors which the Commission will consider when evaluating rate proposals by ITCs to ensure that passive ownership does not affect the independent operation, planning and construction of their transmission systems. The Commission will evaluate the merits of such proposals on an individual basis.

3. The Commission recently demonstrated additional flexibility in a case involving the initial public offering of shares in an ITC that allows for the potential that market participants could purchase a small percentage of its shares in the public equity markets. In *ITC Holdings II*,² the order authorizing the disposition of jurisdictional facilities and confirming the independence of *ITC Holdings*, the Commission confirmed that International Transmission would continue to be independent of market participants and remain eligible for innovative rate treatment after a change in ownership is effected through an initial public offering of its shares. International Transmission adopted certain safeguards to ensure its continued independence, including limits on potential ownership by market participants as well as a corporate governance structure that assures that market participants that do purchase limited stakes in the company would not be able to influence its independent operation. Several commenters at an April 22, 2005 technical conference at the Commission noted that allowing market participant sellers to retain a passive ownership stake in stand-alone transmission companies (with appropriate safeguards to ensure their independence) could facilitate transactions creating such stand-alone transmission companies as ITCs.³

II. Factors the Commission Will Evaluate in Determining if Market Participants Are Passive Equity Owners in Proposed Independent Transmission Companies

4. In this Policy Statement, the Commission is identifying a non-exclusive list of the relevant considerations that it intends to take into account in evaluating if market participants are truly passive owners in any application for incentive rate treatment filed by ITCs or stand-alone transmission companies under section 205 of the Federal Power

² *ITC Holdings Corp. and International Transmission Co.*, 111 FERC ¶ 61,149 (2005) (*ITC Holdings II*).

³ *E.g.*, *Transmission Independence and Investment*, Docket No. AD05-5-000, Tr. 190-91 (Paul McCoy, Trans-Elect, Inc. (Trans-Elect)); Tr. 195-97 (Dale Landgren, American Transmission Company); Docket No. AD05-5-000, Supplemental Comments of Trans-Elect at 3-4; Supplemental Comments of National Grid USA at 18-19.

Act (FPA).⁴ These factors include:

- the percentage ownership held by market participants;
- composition of the board of directors and the responsibilities and rights of the board;
- the corporate governance structure of the applicant;
- the nature of the applicant's capital investment planning and policies;
- the relationship, if any, of capital investment policies with those governing capital contributions or dividend reinvestment by passive equity holders;
- the role of executive compensation agreements and other management incentives in shaping independent operation and investment decisions; and
- the nature and strictness of limits on contractual service and legacy relationships with ex-affiliates that are market participants.

5. In evaluating any proposed passive ownership structure in an ITC application, the Commission will focus on the ability of the applicant to operate free of market participant control or influence. When determining if an applicant could qualify as an ITC, the Commission will consider proposals involving passive minority participation of up to 49 percent ownership by a single market participant. In addition, as in *ATC*, the Commission would be willing to consider applications in which multiple market participants owned greater than 49 percent of the applicant's equity. The Commission is concerned about the level of voting control (if any) held by market participants. In *ITC Holdings II*, for example, the applicants committed to prohibit a market participant that does acquire five percent or more of any class of ITC Holdings' stock from voting, giving consent in respect of, or directing or controlling five percent or more of ITC Holdings stock, in order to limit direct or indirect voting control over the applicant. The Commission will continue to use this standard in evaluating ITC applicants with passive ownership. In determining the applicant's level of independence from market participant control or influence to determine if it should qualify as an ITC, the Commission will also consider the applicant's governance structure and any rights that could allow market participant owners to directly or indirectly affect the applicant's operation, planning or investment decisions.

⁴ 16 U.S.C. § 824d (2000).

6. Evaluation of the ITC applicant's board of directors will weigh the representation (if any) by market participants, and consider factors such as the composition and responsibilities of the board committees (e.g., compensation, audit and investment committees) and the extent and nature of corporate actions for which company management must obtain prior board approval. We appreciate the need for market participant representation to consider significant business decisions such as a sale of or merger of the company. However, the Commission will review the need (if present) for management to seek board approval in the normal course of operations for capital investments above a certain size. The degree to which market participant board members have granular knowledge of or ability to influence individual investment decisions would influence the appropriateness of allowing incentive rate treatments.

7. The Commission will consider the potential role that equity holders that are market participants play in financing ongoing investments by the independent transmission company, to gauge if there is a risk that those equity holders could frustrate investment in transmission infrastructure either by disapproving a plan or by denying capital to projects in the plan.

8. In evaluating the independence of applicants, the Commission will review executive compensation and deferred compensation plans to understand if those plans involve financial interests in market participants that would be inconsistent with independent operation, planning and expansion of the applicant's transmission system.⁵

⁵ In discussing independence, the Commission has previously highlighted the importance of separation from financial interests in market participants. *See Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Statutes & Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), FERC Statutes & Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,092 (2000), *aff'd sub nom. Public Utility District. No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001), where the Commission stated:

We reaffirm the NOPR proposal that the RTO, its employees and any non-stakeholder directors must not have any financial interests in market participants. As noted in the NOPR, our focus will be on current financial interests. Since this principle raises a number of specific issues, especially with respect to pension rights and benefits, we will continue our current policy of implementing this principle on a case-by-case basis.

9. In evaluating the applicability of incentive rate treatment for structures allowing equity interests by market participants, the Commission will not limit its consideration to passive participation by integrated sellers who wish to retain a financial stake. The Commission will also consider ownership structures that facilitate participation by municipalities, cooperatives, and other transmission dependent users of the grid to the degree that corporate governance structures provide for independent operation, planning and investment. The Commission has approved the creation of a stand-alone transmission company, and allowed innovative rate treatments, for American Transmission Company (ATC), which is jointly-owned by investor-owned utilities which contributed their systems, and by public power customers which contributed cash in return for equity stakes in ATC with limited voting and governance rights.⁶ The Commission remains comfortable that the governance structure of ATC allows some degree of participation by market participants, but ensures the operational and managerial independence of the stand-alone transmission company.

Document Availability

10. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426.

⁶ See *American Transmission Co. and Midwest Independent Transmission Operator, Inc.*, 105 FERC ¶ 61,388 at P 24-31 (2003) (allowing ATC to apply innovative rate treatment, but only to projects that are accepted by Midwest ISO's Transmission Expansion Plan, and providing that ATC's incentive rates could remain effective only so long as ATC remains a member of Midwest ISO), *order dismissing reh'g as moot, providing clarification and approving uncontested settlement*, 107 FERC ¶ 61,117 (2004) (ATC), which is also discussed further in the Appendix to this Policy Statement; see also Docket No. AD05-5-000, Tr. 195-96 (Dale Landgren, ATC) ("Our form of governance is a variation on passive ownership in that the larger owners each have a seat on our board along with independent members. ATC demonstrates that this form of governance does not inhibit us from operating independently from market participants, which is after all the real objective."). Further, each ATC board member has one vote per owner, regardless of their size. Docket No. AD05-5-000, Tr. 196 (Dale Landgren, ATC).

11. From FERC's Home Page on the Internet, this information is available in the eLibrary. The full text of this document is available on elibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

12. User assistance is available for eLibrary and the FERC's website during normal business hours from our Help line, toll-free at (866) 208-3676 or for TTY, contract (202) 502-8659. The Public Reference Room may be reached at (202) 502-8371, or by e-mail at, public.referenceroom@ferc.gov

Effective Date

13. This Policy Statement is effective immediately.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.