



SPARK

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The on-line gateway for readers of Public Utilities Fortnightly magazine.



Is your utility accurately reporting financial results? Don Bjerke will help you through the maze that is the FASB/IASB Preliminary Views on the Conceptual Framework.

Is your IT organization providing higher strategic value to keep up with new challenges from climate change, energy shortages and security issues? Mark Vorholt tells you what to look for in these ever-changing times.

Have you heard about the proposed Green Line project? Spark takes a look at the newest underwater transmission line that may come to the Northeast and the issues faced by its developers.

L. A. Burkhart
Editor

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UTILITY FINANCIAL REPORTING

A Look at the IASB/FASB Conceptual Framework

By DON BJERKE



Underwater Electric Transmission New England's "Green Line" Debated

By Lori A. Burkhart

The Federal Accounting Standards

These letters strongly support the initiative to

concerned, as economic concepts are being incorrectly used within financial statements. This results in inaccurate interpretation of financial results.

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Robert Herz, Chairman of the Financial Accounting Standards Board (FASB), "from where I sit, I believe the *status quo* is neither acceptable nor sustainable" (Herz, p.12, 2006). Similar views are expressed by the SEC (2005) and the FASB (2006). Yet as CL50 states, "one aspect of the frameworks that is unlikely to change is the basic structure of the

A Commendable Effort
Over 175 CLs have been received by FASB/IASB on the conceptual framework.

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UNDERWATER ELECTRIC TRANSMISSION

New England's "Green Line" Debated

By Lori A. Burkhart

A proposed underwater electric transmission line stretching from Maine to Boston moved closer to fruition with a Feb. 20, 2007 finding by the Federal Energy Regulatory Commission (FERC) that the project meets the "independence" and "capability" requirements of the ISO-New England's open access transmission tariff (OATT).

The high-voltage, direct-current transmission line is the brain child of management at the New England Inde-

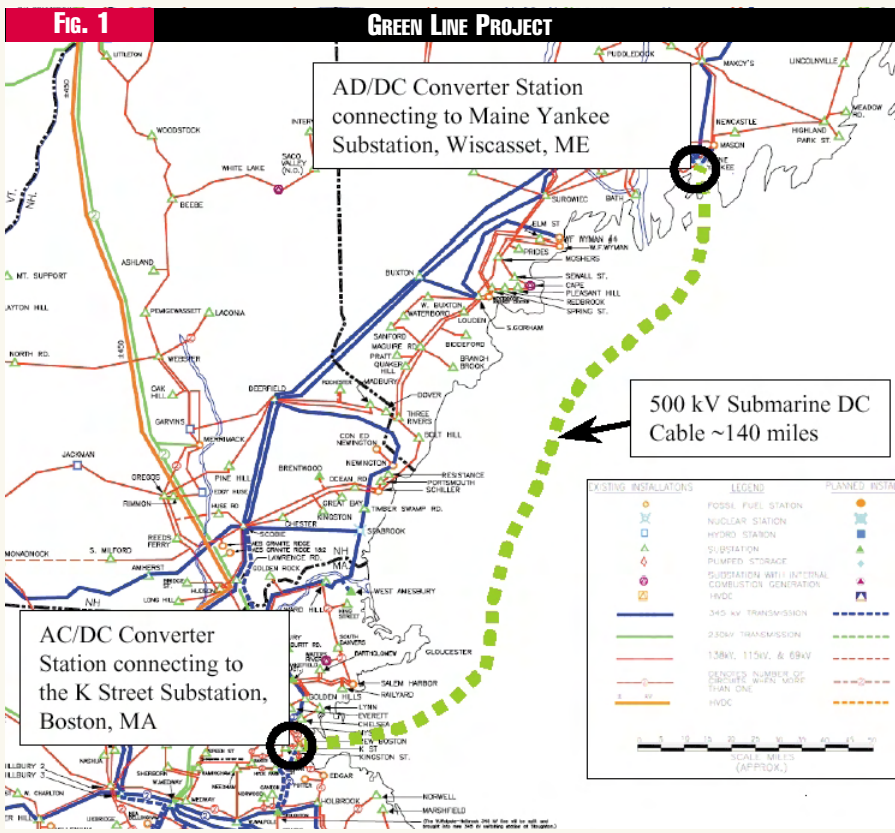
pendent Transmission Co. LLC (New England ITC), and would carry as much as 660 MW from a substation at Central Maine Power Co.'s decommissioned Maine Yankee nuclear plant in Wiscasset, Maine to a substation in Boston Harbor owned by NSTAR. It aptly is named the "Green Line" partly to draw attention to its promise to provide much-needed transmission access to renewable energy sources (*i.e.*, wind, biomass and tidal) from the state of Maine and adjacent Canadian



provinces.

New England ITC filed the petition for declaratory order at FERC in early December 2006 stating that the line would meet the requirements of Attachment M of ISO-NE's OATT governing independent transmission companies (ITCs), and at the same time filed an introductory project proposal for the Green Line with the ISO-New England. The project sponsors said they sought the FERC order to allow it to participate in the ISO-NE Regional System Plan (RSP) process with a new status as an ITC.

The FERC order, however, is significant for what it does not do. FERC looked only at the two narrow issues of independence and capability. It did agree that New England ITC has the necessary capabilities to carry out the responsibilities and functions of an ITC within the framework of ISO-NE, and that at this point in development it has the necessary capabilities to continue its development as an ITC pursuant to Attachment M of the OATT. But FERC stated the petition as filed was not intended to address the merits of the Green Line project as to inclusion in the ISO-NE's RSP process as a reliability transmission upgrade. Nor did FERC make any determination regarding constraints that may exist in Maine, New Hampshire, or Massachusetts, nor on cost allocation, regional cost >>>



support and/or transmission development. FERC said those issues will be reserved for another proceeding.

New England ITC is governed by a managing member (Green Power Ventures, L.L.C.) and will not issue stock or have shareholders. It is owned by: (1) Green Power Ventures; (2) Anbaric Power Ventures, L.L.C.; (3) Catamount Management Corp.; (4) Starwood Energy Investors IV, L.L.C.; and (5) EIF Green Line, L.L.C. The ownership boasts considerable experience in underwater electric transmission cable development, as New England ITC is headed by Edward Krapels, managing director of Energy Security Analysis Inc., who was a founding member of Atlantic Energy Partners L.L.C., which in 2005 began development of the Neptune Regional Transmission System. Neptune is an underwater line designed to serve a congested area and runs from Sayreville, N.J. to Long Island, N.Y. That power will originate from the PJM RTO and will be sold to the Long Island Power Authority within the New York ISO, with delivery scheduled starting this summer. The managing member, Green Power Ventures, is owned by Edward Stern, the CEO of New England ITC and chairman of Neptune. Krapels is the chairman of New England ITC.

Independence and Capability

Two questions were debated at FERC. The commission said it would decide only whether New England ITC met the independence and capability requirements criteria of Attachment M of the ISO-NE's OATT. New England ITC aims to become the first ITC in New England, and then as an ITC would move forward to participate in the ISO-NE RSP. But New England ITC cautioned it would not construct the Green Line unless approved by the ISO-NE as part of the RSP.

New England ITC said it wants to help resolve the transmission constraints among Maine, New Hamp-

shire and Massachusetts as identified in studies by the U.S. Department of Energy, and to address reliability needs outlined in ISO-NE's 2005 and 2006 RSPs. It argues the Green Line would "unlock generating capacity in Maine and provide a transmission superhighway to facilitate the development of renewable energy projects in Maine that will improve fuel diversity in New England."

New England ITC told FERC it meets the capability requirements as it plans to draw on its experience with >>



TRANSMISSION COST ALLOCATION

MAINE PREPARES UTILITIES TO LEAVE RTO

Reflecting a long-running dispute with ISO-New England and federal regulators, the Maine Public Utilities Commission (PUC) recently presented to the Maine legislature its preliminary report regarding participation of Maine utilities in ISO-New England and possible alternatives to remaining in that regional transmission organization (RTO). The report responds to an April 13, 2006 resolution by Gov. John E. Balducci directing the PUC to undertake an inquiry to determine the legal consequences of directing the state's electric transmission and distribution companies that are part of the RTO to withdraw from it. The PUC also was asked to determine the costs of such a withdrawal and to examine other options for providing services presently provided by ISO-New England, including options involving Canadian agencies. The ultimate goal is to create proper incentives to expand New England's energy infrastructure, while lowering the subsidies Maine consumers pay to the consumers of other states, the PUC said.

The PUC made the following three preliminary findings:

- Significant inequities exist in the current ISO-NE transmission-cost allocation system and the pricing of generation services;
- There are no insurmountable legal, economic or technical barriers to Central Maine Power Co. (CMP) and Bangor Hydroelectric (BHE) withdrawing from the ISO-NE regime, although such action would require consent of the utilities and FERC approval;
- There are reasonable alternatives to continued participation in ISO-NE, including formation of one or more Maine Independent Transmission Companies (ITCs) and development of a Maine/Canadian Maritimes market.

The PUC stressed it intends to continue the inquiry and aggressively pursue alternatives to the ISO-NE *status quo*. It plans to submit a final report consistent with the resolution containing concrete plans for alternatives. In 2007, the PUC said it will engage New Brunswick and other Maritime provinces in high-level negotiations to expand international electricity trade between Maine and New Brunswick, and to develop a plan for a common market. The PUC also will explore creation of one or more independent ITCs in Maine. Finally, it will engage the New England Conference of Public Utilities Commissioners (NECPUC) or the New England State Committee on Energy, as applicable, to form a transmission-cost-allocation regime that creates incentives for development of the diverse generation needed to power New England.

The PUC chose a five-year period beginning 2007 to estimate the costs and benefits of remaining in ISO-NE versus alternative arrangements. The PUC said it found the five-year

period most appropriate as it is the period in which the ISO-NE's transmission-expansion plan is the most amenable to estimates and the period in which capacity costs have been established the most clearly in the recent FERC-approved forward capacity market settlement. (See *Devon Power, LLC*, June 16, 2006, 115 FERC ¶ 61,340.)

The PUC said it cannot reach a definitive cost/benefit conclusion at present, but it stated that "the RTO's current transmission cost allocation methodology is inequitable and results in a transfer of payments from Maine consumers to consumers in southern New England." The PUC believes that inequity is likely to grow substantially in coming years as significant transmission investments are made in Connecticut and Massachusetts. Also, the PUC noted that ISO-NE's administrative costs, which have grown by 8% since 2003, and are expected to grow by 3.5% during coming years, appear "somewhat high" when compared to RTO peer-group costs.

The PUC emphasized that the cost increases associated with the socialization of out-of-state transmission upgrades must be balanced against the benefit of having costs of new Maine transmission projects socialized and covered by the rest of the region. CMP estimates that over the next five years it will need transmission investments of \$229 million and BHE of \$165 million. The PUC believes it is "substantially prejudiced" by the RTO's transmission-cost allocation methodology, and said if all transmission investments for New England were allocated by location rather than by ratio as under the *status quo*, Maine's investment share would decrease by \$200 million, or about \$40 million on an annual-cost basis.

The PUC pointed out that to the extent withdrawal from the RTO by BHE and CMP lowers costs to consumers, that failure to withdraw then may be considered imprudent. The PUC said precedent exists for withdrawal from an RTO and that while withdrawal at the end of the term of the Transmission Operating Agreement (TOA) between the two utilities and the RTO, which ends Feb. 2010, is straightforward, that withdrawal prior to the end of the term of the TOA is also possible under certain circumstances. But in either case, the state has a "limited ability" to compel the utilities to withdraw, the PUC said. [Pursuant to "A Resolve to Direct the Public Utilities Commission to Examine Continued Participation by Transmission and Distribution Utilities in this State in the New England Regional Transmission Organization," Interim Report, Jan. 16, 2007 (Maine P.U.C.)] **L.A.B.**



FERC that it believes it meets the independence criteria because it is not being created by a spin-off of transmission assets from an existing market participant, but instead is a new, independent, stand-alone transmission company drawing on the resources, experience and capabilities of an established transmission developer. It further finds a benefit in its financing in that it will draw on private equity first rather than relying on existing vertically integrated utility shareholders for equity.

FERC explained that in 1999 it set forth its RTO independence criteria to require an applicant to show that the RTO: (1) is independent of market participants, defined as sellers of energy or ancillary services to the RTO; (2) employees have no financial interests in a market participants; and (3) decision-making is independent of market participants. [*Regional Transmission Organizations*, Order No. 2000, 89 FERC ¶ 61,285 (1999), order on reh'g., Order No. 2000-A, 90 FERC ¶ 61,201 (2000)]. FERC later issued rulings that added increased flexibility to its independence criteria for ITCs, especially if the transmission facilities will be placed under the operational control of an RTO, as is planned for the New England ITC. [*Policy Statement Regarding Evaluation of Independent Ownership and Operation of Transmission*, 111 FERC ¶ 61,473 (2005); and *Promoting Transmission Investment* ►►]

the Neptune project in order to move the Green Line forward, with an expected operational date of 2013. National Grid USA, on behalf of its New England utility subsidiaries, also pointed to such experience with the Neptune project as to why it did not oppose FERC finding the Green Line developers to be capable.

Part of the ITC's plan is to turn over operational control of the transmission line to the ISO-NE. ISO-NE conducts an annual RSP in order to identify system reliability and market efficiency needs that may not be met by market participants through market solutions such as demand response, distributed generation or merchant transmission.

The ISO-NE OATT establishes standards and procedures for identifying reliability transmission upgrades (RTUs) and market efficiency transmission upgrades (METUs). The RSP process includes on-going studies of the New England transmission system that identify the location and nature of any problems. Such problems are reported to the Planning Advisory Committee and posted on the ISO-NE Web site to serve as market signals to stimulate market-based solutions that can be addressed through solutions such as generation, merchant transmission and demand management.

New England ITC wants to join in that RSP process and so explained to

Through Pricing Reform, Order No. 679, 116 FERC ¶ 61,057 (2006)].

New England ITC further explained that it specifically was structured to satisfy FERC's independence criteria for ITCs, such that its managing member is not a market participant and its officers and employees are not employed by market participants or their affiliates and do not have any direct financial interest in any market participants. Also, its other investors have no role in day to day operations, and only one minority investor has any interest in a producer or seller of power in the ISO-NE market, which it added constitutes a *de minimus* interest through an affiliate's ownership in a 245-MW generating facility in ISO-NE, with output fully committed under a multi-year reliability must-run contract with ISO-NE. New England ITC pointed out that as a must-run project, with output controlled by ISO-NE, that the 245-MW facility especially is immune to actions of New England ITC.

ISO-NE RSP Review

Comments filed in the proceeding generally were supportive of FERC finding the New England ITC to be capable and independent, but questions were raised as to timing—specifically whether such an order was necessary prior to, or only after, negotiation of an ITC agreement with ISO-NE. Questions also were raised concerning funding of the project. And while FERC ultimately issued the declaratory order on capability and independence in favor of New England ITC, the debate provides insight into what issues will come before the ISO-NE in its RSP process.

The New England Power Pool (NEPOOL) came straight to the point. It called the petition "premature," arguing that for FERC to make findings on independence and capability, that FERC first needed a clear understanding of the respective obligations of New England ITC and ISO-NE. The Maine Public Utilities Commission

(PUC) said it agreed with NEPOOL, as did the ISO-NE, which also asked FERC to defer a ruling in the proceeding (*for more on the Maine PUC, see Box, "Maine Prepares Utilities to Leave RTO.*). ISO-NE argued its OATT contemplates negotiation of an ITC agreement as a predicate to FERC determinations on independence and capability. It said Attachment M specifies a sequential process: (1) NE-ISO and participating transmission owners (PTOs) negotiate respective responsibilities to be carried out by one or more ITCs to be formed by one or more PTOs; (2) the resulting ITC agreement then is filed at FERC together with requests for ITC capability and independence findings based on the responsibilities to be carried out by the ITC; and (3) the ITC agreement is executed and the ITC is implemented.

NEPOOL, although arguing that the ISO-NE OATT Attachment M does not require a fully executed and FERC-reviewed agreement prior to issuance of a declaratory order in the case, asked FERC to dismiss the proceeding without prejudice anyway, allowing it to be re-filed once an understanding with ISO-NE has been achieved and discussed with NEPOOL. NEPOOL thought it best that New England ITC first participate in the RSP process at ISO-NE for a determination on the threshold question of whether there exists a system need for the Green Line project. In that process, also to be considered is whether the Green Line "is more appropriately considered a merchant transmission facility, and if not, how it will be treated under the current ISO tariff provision." A finding of being a merchant transmission facility is important as it determines the method of cost recovery in that merchant facilities cannot recover costs from regional customers, but an ITC can.

Green Line Funding

New England ITC is proposing that the Green Line be considered a Reliability



Transmission Upgrade (RTU) by the ISO-NE so it qualifies for regional-cost recovery. That means the costs would be rolled into regional rates paid by all New England load. However, New England ITC noted no matter what happens, it will invest up to \$10 million in the project prior to finding out whether it is approved by the ISO-NE as a facility eligible for cost recovery as part of the 2007 RSP.

The Northeast Utilities Cos. (NU), with five subsidiary utility companies in New England, argued it is premature for FERC to determine benefits or efficacies of the Green Line project: "For instance there may be less costly market or regulated solutions that could ameliorate some of the same issues that the Green Line Project proposes to solve and simultaneously also address other system issues that Green Line cannot solve."

NU added it reserves judgment on whether the Green Line project qualifies for inclusion in ISO-NE's regional planning process and asked FERC not to prejudice that issue, but rather leave that up to ISO-NE.

ISO-NE also took up the cost issue. It argued New England ITC's approach to Green Line cost allocation may not conform to the provisions of ISO-NE's Transmission, Markets and Services Tariff. It explained that while the ITC intends to seek regional cost recovery for the Green Line, that under New >>

England arrangements, only the costs of Regional Benefit Upgrades (RBUs) are rolled into regional transmission rates. It further noted that in order to be an RBU, an upgrade must be classified as a Pool Transmission Facility (PTF) and be either a Reliability Transmission Upgrade (RTU) or a Market Efficiency Transmission Upgrade (METU). But ISO-NE expressed its belief that based on existing needs assessments reflected in recent RSPs, the Green Line project as described is not "needed" as an RTU that would qualify for regional cost recovery. It contrasted the Green Line with Neptune, which it noted is a merchant transmission line, for which no region-wide rate recovery is being sought in PJM and NY-ISO. Instead, the line's cost is being paid by the Long Island Power Authority under a firm trans-

mission capacity purchase agreement with Neptune Regional Transmission System, LLC.

ISO-NE said an RTU under the definition in its tariff, "is a project that is required to ensure the continued transmission reliability of the system, *i.e.*, to provide acceptable stability response, short circuit capability and system voltage levels, and those facilities required to provide adequate thermal capability and local voltage levels that cannot otherwise be achieved." But ISO-NE concluded that neither the petition nor its attachment assert that the Green Line is intended to meet any of those needs in New England. ■

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and debt.

- level of risk assessment depending on the importance of the decision to be made. This would include sensitivity analysis, probabilistic analysis, and risk metrics.
- faithful representation of the real world economic phenomena including a detailed market analysis with environmental or social assessment. It is important to realize that these are special studies that can consume a large amount of time and energy and hence are not prepared periodically. A specialized group is usually called upon to conduct these studies to enhance the efficiency of the organization.

The problem with the CF is that it displays economic-study results in a financial statement. The result of an economic study is an economic statement. Although economic statements may be displayed in an accounting format as *pro-forma* statements, they still remain economic statements. Only economic statements contain the proper information for decision-making purposes. As the CF states, information for decision-making purposes must be prospective, have fair value, and reflect future market conditions. The use of existing plant must be appraised at fair value if it is to be used as a capital expenditure cash flow in an economic study. »

Utility Financial Reporting

(Cont. from p. 2)

external investors do decide whether or not to buy and sell shares, the fact is that the buying and selling of shares is a relatively unimportant set of decisions." Anyone that is working or has worked in a capital-intensive company will know this to be true. In the telecommunication industry, for example, dozens of economic studies are conducted on an on-going basis in deciding the type, size and timing for installing facilities. What has started off as engineering economic studies has evolved into managerial economics and now is commonly referred to as economic analysis. Most of these studies are comparative cost studies with little or no difference in revenue. In this case, the recommended alternative would have the least negative Net Present Value (NPV). The same methodology is used in conducting an economic

profitability study where the total revenue and the total (incremental) costs are used. In this case, the recommended alternative should be viable (have a positive NPV). This is the exact methodology that FASB/IASB is proposing in the CF. The qualitative characteristics in meeting the economic objective should be:

- projection of six current and/or future cash flows consisting of revenue, capital expenditure, cash expense, income tax, gross salvage and cost of removal.
- use of a study period to provide service equivalency.
- use of time value of money operators to present worth and to annualize these cash flows.
- use of a discount rate based on a corporate cost of capital using a weighted average cost of equity