

# RISK AND RETURN ASSESSMENT IN THE MATTER OF ELECTRIC TRANSMISSION INCENTIVES

## 2 FERC PROPOSED ROE INCENTIVES ARE MERITED BASED ON ECONOMIC THEORY OF RISK AND ADEQUATE COMPENSATION FOR SUCH RISK

Two return on equity (“ROE”) incentives proposed in FERC’s Electric Transmission Incentives Notice of Proposed Rulemaking (Docket No. RM20-10-000) are warranted, with potential modifications, under the financial theory of risk and return:

- **RTO-Participation Incentive**
- **Transmission Technology Incentive**

Both activities (participating in an RTO and deploying advanced transmission technology) expose transmission owners to **elevated levels of risk**. Transmission companies deploying projects with such increased risk should be compensated for that risk through the proposed ROE adders.

According to the financial theory of risk and return, **higher risk must be accompanied by a higher expected return** in order to motivate a rational entity to engage in an economic activity.

Including adders to risk premiums is common practice, where their inclusion helps to compensate for additional risks faced by investors in a situation where that risk is **asymmetric** and **non-diversifiable**.

## RTO PARTICIPATION AND DEPLOYING ADVANCED TECHNOLOGY INCREASES RISKS FOR TRANSMISSION COMPANIES

### RTO PARTICIPATION



#### RTO governance

Transmission must cede control over regional planning and operations to the RTO, which limits decision-making ability



#### Federal policy

Imposes changes such as introducing competition and additional challenges/market complexities which raise uncertainty



#### State/local policy

Pursuing decarbonization accelerates the pace of industry transformation and creates uncertainty about transmission system use

### ADVANCED TECHNOLOGY

High technical risk	Commercial / market risk
Lengthy time interval considerations	Limited scope of market participants
Evolving nature of markets	Difficulty in intellectual property right assignment
Costs of market entry	Lack of customer understanding

## BENEFITS OF RTO PARTICIPATION AND DEPLOYING ADVANCED TECHNOLOGY OUTWEIGH RISKS AND COSTS

- Participating in RTOs provides access to large, competitive markets, and lower cost power for consumers. RTO participation also optimizes use of the transmission system.
- Widespread adoption of advanced technologies can reduce consumer costs and improve the productivity and quality of electric service.

Ultimately, the additional compensation offered through these two incentives should **stimulate transmission investment, attract diverse capital** to the sector, and facilitate the deployment of transmission projects that **advance technological innovation**.