WIRES

FERC's Order No. 679 Transmission Incentive Policy
THE CONSTRUCTION WORK IN PROGRESS INCENTIVE LOWERS COSTS

Construction Work in Progress is a rate treatment that allows developers to recover the financing costs of infrastructure during construction, which limits the financial strains of transmission development and saves customers money in the long run.

In 2006, FERC issued Order No. 679, which allowed utilities to apply for and include 100% of Construction Work in Progress in rate base – the "CWIP Incentive" – for transmission projects that meet certain criteria and receive FERC approval. This Incentive was designed to promote cost-effective transmission development by reducing cash flow challenges caused by long lead times and large capital commitments. Per traditional electric ratemaking principles, project costs, including financing, are usually only recoverable through rates once an asset enters service and is "used and useful." However, given the specific characteristics of electric transmission, FERC tailored the CWIP Incentive as an exception to this principle to benefit both customers and transmission developers by improving cash flows, stabilizing rates, and ultimately lowering costs to customers.

HOW IT WORKS

The CWIP Incentive allows transmission developers to include 100% of construction costs in rate base prior to the commercial operation of the facilities. During this period, the transmission utility is allowed to collect from customers the financing cost of the associated capital ("return on") but may not collect any depreciation expense ("return of"). Absent the CWIP Incentive, a project's financing costs during the development period would accumulate and be added to the final project cost that goes into a utility's rate base, which the utility is allowed to recover and earn a return on over time.

BY THE NUMBERS

- Since 2006, FERC has granted the CWIP Incentive to transmission developers in **over 130 projects.**
- Those projects receiving the CWIP Incentive amounted to more than **$30B of transmission infrastructure** to serve customers.
- Customers are likely to experience lower costs from projects using CWIP. Over the life of a sample project, when compared to traditional ratemaking, the CWIP Incentive is estimated to deliver **9-11% customer savings** on a nominal basis.

IMPROVED CASH FLOW MEANS REDUCED COSTS FOR CUSTOMERS

The CWIP Incentive reduces customers' costs in two principal ways. **First**, the CWIP Incentive facilitates stable cashflows during the construction period. It also can improve credit ratings for transmission developers, which in turn reduces the cost of borrowing and facilitates raising equity on favorable terms. The reduced cost of capital shows up in the form of lower transmission rates. **Second**, in traditional ratemaking, developers accrue and capitalize financing costs during construction. That compounded financing cost, as well as the actual construction investment, are then added to the rate base when the project enters service. Under CWIP, the financing costs are collected concurrently with the construction period. This treatment results in a lower amount being added to rate base when the project enters service, ultimately leading to lower costs for customers. Even if one adjusts for the time value of money – which is dependent on discounting assumptions – customers are no worse off with the CWIP Incentive. Altogether, on the investment scale involved in transmission development, **use of CWIP can translate to billions of dollars of customer savings**.

CWIP SMOOTHS CUSTOMER RATE IMPACTS

One benefit of the CWIP Incentive is the rate smoothing effect for customers. Absent CWIP treatment, when a large project enters service, the result can be a significant and immediate rate increase, sometimes referred to as "rate shock." With CWIP, project costs are more gradually introduced into rates, thus limiting rate shock concerns.