

HARVARD ELECTRICITY POLICY GROUP

SIXTY-SIXTH PLENARY SESSION

*Gone with the Wind:
What Will Replace the Right of First Refusal?*

March 8-9, 2012



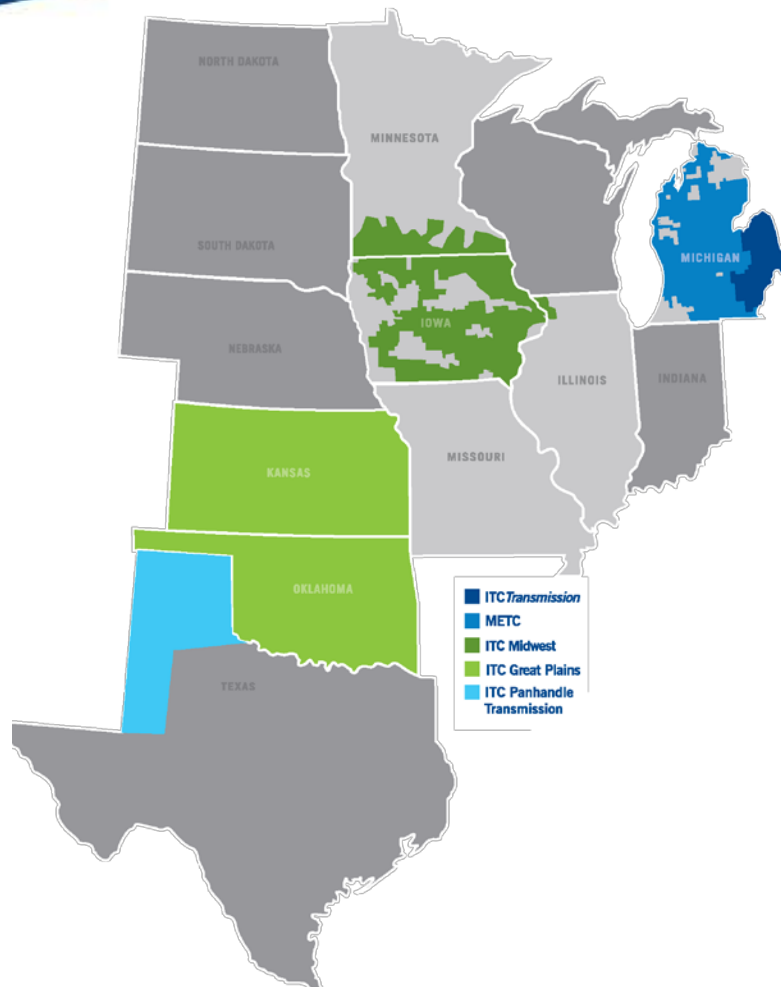
ITC Holdings Corp.



- Headquartered in Novi, MI
- March 2003: Established as ITC*Transmission* with the purchase of Detroit Edison's transmission assets
- July 2005: ITC Holdings goes public with an initial offering of stock (NYSE: ITC)
- July 2006: ITC Great Plains established, headquartered in Topeka, KS
- October 2006: Acquired Michigan Electric Transmission Company (METC) from Consumers Energy
- December 2007: Formed ITC Midwest by acquiring the transmission assets of Interstate Power and Light from Alliant



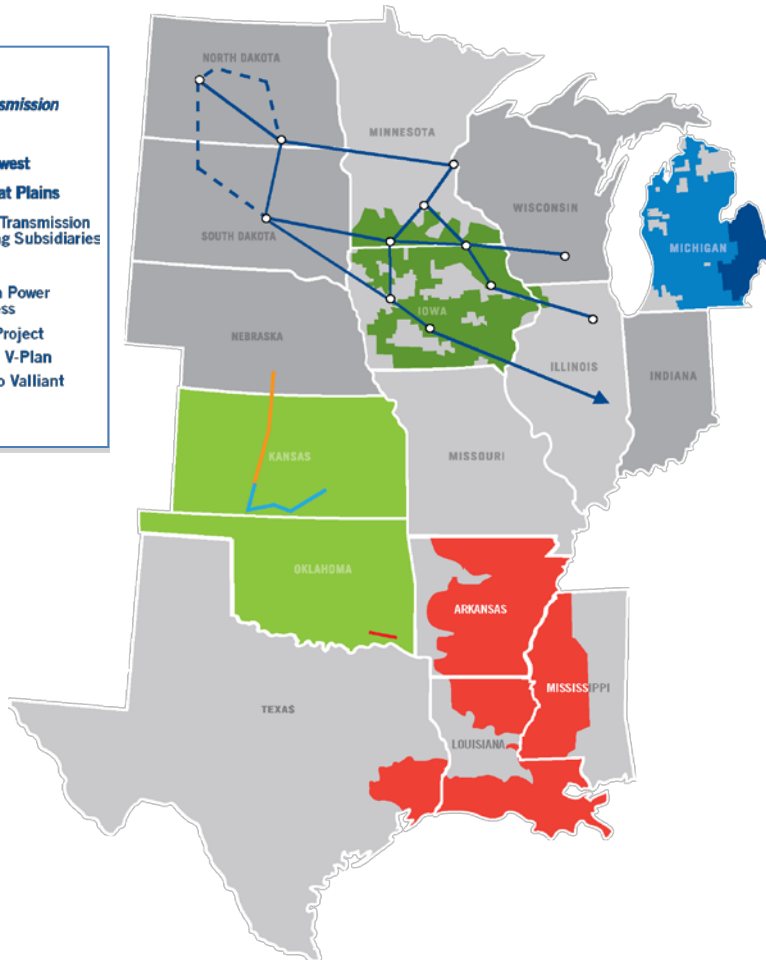
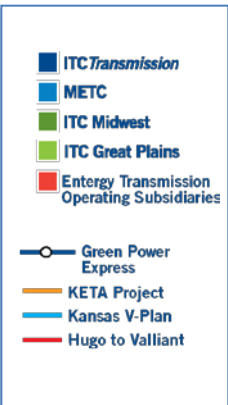
ITC Holdings Corp.



- Largest independent transmission company in the country
- Currently, the ninth largest transmission owner overall
 - Over 15,000 miles of transmission
 - Seven States
 - Over 26,000 MW of load served
- 450+ direct employees; 950+ contract employees
- Develop transmission with the goals of providing customers:
 - Best in class transmission system – top decile reliability
 - Providing access to the most efficient generation available; reduce congestion and facilitate markets
 - Support public policy needs



ITC Holdings Corp. Proposed Transaction with Entergy



System Peak Load	26,100 MW	28,000 MW
Service Area	Seven States	Four States*
Total Transmission Miles	15,100 miles	15,700 miles
Service Area Square Miles	89,850	114,669
RTO Membership	MISO/SPP	Anticipated MISO membership by 12/2013



*Entergy also owns limited assets in Missouri.

Where are we today?

Transmission Development Barriers

- There is little dispute around the following issues:
 - The nation’s transmission systems need to be upgraded and modernized
 - Public policy should be aimed at improving the grid to support a competitive wholesale energy market
 - Without significant regional transmission expansion renewable energy will be limited
- Major barriers include:
 - The lack of a collective industry vision
 - Parochialism caused by vertically integrated utilities and state regulation (e.g., siting and approval processes that differ widely from state-to-state)
 - The tension between the particular interests of generator owners and improvements in the overall efficiency of the transmission grid (i.e., the influence of market participants)
 - Cost allocation for “reliability projects” as opposed to “economic projects” as opposed to “public policy” projects
 - Transmission financing is not a barrier to transmission expansion

What’s not on the list?



What does it say?

- Right of First Refusal (“ROFR”) provisions must be removed from FERC-jurisdictional tariffs for facilities selected in a regional plan for cost allocation purposes.
- Incumbent Transmission Provider retains ROFR for:
 - A facility that is not selected in a regional plan for purposes of cost allocation;
 - Upgrades;
 - Projects on existing right of way (retention, modification, or transfer of rights-of-way remain subject to relevant law or regulation granting such rights).
- In addition, a Transmission Provider can use competitive bidding to solicit transmission projects or project developers and state or local laws/regulations (e.g., siting, permitting) are not modified.
- The rule does not require removal of ROFR from jurisdictional tariffs applicable to a local transmission facility.
- The rule does not assign any ongoing rights of sponsorship for transmission projects.

A Solution in Search of a Problem?

What does it mean?

- Rule promotes competition in regional transmission planning processes to support efficient and cost effective transmission development
- Rule requires the development of a not unduly discriminatory regional process for transmission project submission, evaluation, and selection
- Rule removes any federal right of first refusal from Commission approved tariffs and agreements with respect to new transmission facilities selected in a regional transmission plan for purposes of cost allocation, subject to limitations:
 - This does not apply to a transmission facility that is not selected in a regional transmission plan for purposes of cost allocation
 - This does not apply to upgrades to transmission facilities, such as tower change outs or reconductoring
 - This allows, but does not require, the use of competitive bidding to solicit transmission projects or project developers
- Nothing in this requirement affects state or local laws or regulations regarding the construction of transmission facilities, including but not limited to, authority over siting or permitting of transmission facilities

Can such a non-discriminatory regime be constructed and how?

- The Southwest Power Pool process provides a good example of how a region could reform its planning process to facilitate participation by non-incumbent developers.
- Prior to Order 1000, SPP chose not to eliminate ROFR, but rather provided provisions where incumbents that did not elect to build planned facilities could assign those projects to a non-incumbent developer.
- This model still gives preference for incumbent developers to construct facilities.
- With elimination of ROFR, a selection process **that is conducted subsequent to approval of the RTO plan, independent of the planning process**, is the best model to provide equal opportunities for incumbent and non-incumbent developers.
- Such a process will evaluate proposals from incumbent and non-incumbent developers on the same objective criteria, addressing any concerns of discrimination.
- Under the type of competitive selection model discussed above, proposals from incumbent and non-incumbent developers would be evaluated and scored on the same criteria.

FERC Order 1000

Right of First Refusal

How will barriers such as state siting and condemnation laws, which bestow powers on incumbents not available to other market participants, be dealt with?

- Order 1000 was not intended to circumvent any current or future state requirements.
- Legislative action would be required to address any state laws that advantage incumbents over non-incumbents.
- However, because of state concerns about Order 1000, we have seen the opposite occurring; some states are codifying a Right of First Refusal in state law to ensure that incumbents continue to have exclusive (or semi-exclusive) rights to build.

How does the removal of ROFR affect upgrading existing facilities as an alternative to building new ones?

- Since ROFR may be retained for upgrades of existing facilities and not for new facilities, where these may be alternative solutions to a problem, when this situation exists, incumbents could be incentivized to argue in favor of upgrades.
- However, this doesn't appear to be a serious threat to picking the best project in areas where an RTO provides independent oversight of transmission planning.
- From a practical standpoint, when a problem can be solved by upgrading existing facilities, it is already often preferred relative to a solution that requires new facilities simply because it may be lower cost, present fewer regulatory hurdles, etc.

Will compensation for incumbents and non-incumbent transmission owners be identical?

- There is potential for compensation to incumbents and non-incumbents to be identical in situations where both entities recover 100% of their revenue requirements under FERC jurisdictional tariffs.
- Even in this case, compensation may not be identical due to other factors that differ: costs, rate models and formulas, ROE, use of incentives, etc.

If so, how will transmission in retail rate base for incumbents be compared against facilities that derive all revenues from wholesale markets?

- In situations where an incumbent recovers significant portions of its revenue requirement through rates regulated at the individual state level, this will continue.
- There is no requirement in Order 1000 that trumps existing state rate authority.

FERC Order 1000

Right of First Refusal

Will reliability standards be effected by the new entrants, and if so, how?

- New entrants will be required to comply with the same reliability standards as incumbents.

Will the elimination of ROFR lead to competition that reduces prices paid by system users?

- This goal is present in Order 1000, but care must be taken to ensure there are real sustainable benefits from the new processes that result from Order 1000 compliance.
- You typically get what you pay for, and there may be tradeoffs between the initial costs of siting and construction and the on-going costs to maintain and operate transmission facilities that must be properly considered.

Is elimination of ROFR a disincentive for utilities to join or remain in RTOs and would this serve to disincent the formation of new RTOs?

- The provisions of Order 1000 apply equally to utilities that aren't in a RTO and to those that are in a RTO.
- If anything, Order 1000 may incentivize RTO membership or formation of new RTOs since many of the activities required by Order 1000 are performed by RTO's today – thus a utility's compliance may be facilitated by being a member of an RTO.

Should “reliability” lines be treated differently than “economic” facilities for purposes of phasing out ROFR?

- Not necessarily, depending how these categories are defined.
- These types of project categories often create false distinctions between projects.
- Most large projects have both reliability and economic benefits and strictly defined categories may ignore all of the benefits of a new project.

Will elimination of ROFR facilitate grid expansion?

- Yes, if the new processes are well designed and effective.
- This is particularly true in non-RTO areas where effective regional planning does not occur today and the lack of regional cost allocation mechanisms disincentivizes individual transmission owners from constructing projects that have broad benefits.
- The largest opportunities for enhancement of grid expansion from Order 1000 compliance lies in these non-RTO areas.
- The planning and cost allocation requirements in Order 1000 do more to facilitate grid expansion than ROFR elimination alone.

How will the entrance of new actors into the market affect the use of alternatives to building new transmission, such as locational demand reduction or strategic location of new generation?

- It could, depending on the type of model adopted for projects where ROFR is eliminated.

Concluding thoughts...

- The lack of a collective industry vision
 - “It’s hard to get there if we don’t know where we are going.”
- Parochialism caused by vertically integrated utilities and state regulation
 - “Did the elimination of a Federal ROFR simply trigger new state barriers in the form of State ROFRs?”
- The tension between the particular interests of generator owners and improvements in the overall efficiency of the transmission grid (i.e., the influence of market participants)
 - “What’s good generally may not be good for everyone.”
- Cost allocation for “reliability projects” as opposed to “economic projects” as opposed to “public policy” projects
 - “Today’s economic project is tomorrow’s reliability project.”
- Transmission financing is not a barrier to transmission expansion
 - “But could it be?”

“New paradigms will, necessarily, result in consequences, good or bad, intended or unintended.”



Thank you. . .

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