UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Transmission Planning Processes Under Order No. 890	Docket No. AD09-8-000

Comments of the
Electricity Consumers Resource Council
(ELCON)

The Electricity Consumers Resource Council (ELCON) appreciates the opportunity to comment on the October 8, 2009 Notice of Request for Comments (the "Request") regarding transmission planning processes. ELCON agrees that the issue of allocating the cost of transmission is becoming "more acute" as a result of the increased costs of siting transmission, the growth of regional power markets, and the needs imposed by renewable energy projects.

ELCON is the national association representing large industrial consumers of electricity. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community. As operators of hundreds of major facilities and major consumers of electricity, ELCON members are significantly impacted by charges imposed for the cost of new transmission.

Executive Summary

The Request calls for stakeholder commentary on two central topics: cost allocation and regional planning. With respect to cost allocation, FERC states that technical conference participants have identified a "lack of mechanisms to allocate and recover the costs of certain types of new transmission facilities and upgrades to existing facilities" as a primary barrier to new transmission. The Request goes on to state that these barriers have "become more acute as the need for transmission infrastructure has grown." Consequently, FERC seeks stakeholder commentary on alternate cost allocation methodologies that might reduce barriers to new transmission.

ELCON recognizes that the grid will require new transmission and upgrades to existing transmission to maintain reliability in coming years. However, as FERC notes in the Request, how to allocate costs is "not a new problem." Indeed, courts have developed a carefully crafted body of law to guide the allocation of the costs of transmission investment, centering on the principle that the beneficiaries of a service are to pay for it. These cases, going back over seventy years, have reaffirmed time and again that a pricing scheme will not pass muster if it subjects ratepayers to costs for facilities from which they derive no benefits, or benefits that are insufficient in relation to the costs sought to be shifted to the ratepayers.

ELCON is supportive of innovative cost allocation methodologies, so long as they conform to the guiding principle that the "beneficiary pays." FERC must resist the temptation to socialize the costs of new transmission, contrary to the "beneficiary pays" formula. Political pressure for inter-regional transmission projects, such as may be

considered in conjunction with the development of renewable projects, is not a reason to depart from the long-standing and statutorily required doctrine of just and reasonable rates. In fact, given the high costs and uncertainties associated with the construction of long transmission lines, careful application of "beneficiary pays" will help to ensure that the costs of such projects are justified by their benefits. This will implement FERC's recently-reiterated central mission to "assist consumers in obtaining reliable, efficient and sustainable energy services at a reasonable cost . . . ."

With respect to regional planning, ELCON supports a more rational and effective regional planning process. That said, regional planning should be closely coordinated with more traditional regulatory proceedings. ELCON is concerned that, if not carefully crafted, alterations to the regional planning process will continue the trend of regulatory outsourcing that has been prevalent in recent years. ELCON supports increased stakeholder participation, provided that it permits meaningful involvement and is not intended to replace traditional regulatory proceedings.

ELCON Comments

I. Responses to FERC Questions

In the Request, FERC posed a number of questions on which it seeks stakeholder commentary. Rather than responding to each question in turn, ELCON offers the following general comments on the two principle topics – Transmission Planning and Cost Allocation. These comments should be interpreted in light of the broad legal principles and policy considerations discussed in the sections following, which discuss

in greater detail the legal underpinnings of the principles of "cost causation" and "beneficiary pays."

A. Allocating the Costs of Transmission

ELCON members recognize that the grid will require substantial investment to accommodate shifting load and the addition of alternative energy resources. As the grid is modernized, ELCON proposes that regulatory policy be guided by two central tenants: (1) economic efficiency and (2) the duty of regulators to carefully review rates.

As discussed in the following sections, ELCON supports the application of cost benefit analysis to any proposed investment to ensure that it will be economically efficient. The analysis is the same whether a project is based primarily on reliability considerations or on economic considerations. The surest way of protecting consumer interests is to require any party proposing new transmission to fully justify their investment with concrete evidence as to the likely benefits. FERC raises the issue of how "non-quantifiable costs and benefits" should be "identified, factored in or otherwise weighted." To the extent that costs or benefits cannot be accurately measured, the appropriate response it to address them through other forms of regulation. Rather than attempting to measure negative externalities such as environmental degradation and then factoring them directly into the cost benefit analysis, these externalities are better approached by means of environmental rules and regulation passed through a legislature. In the experience of ELCON, unquantifiable costs or benefits that will purportedly be realized as a result of an investment are all too often a fig leaf justification for a project that does not make economic sense.

Regulators will have a vital role to play in the development of new transmission. Although the electric industry has been subject to partial deregulation, it is still in many areas – such as transmission – dominated by monopoly providers. The traditional regulatory bargain is to allow these monopolies to exist because of their network efficiencies, but to subject them to a degree of regulatory scrutiny that would be considered intrusive in other markets, but that is necessary to protect consumers from unduly high rates in markets where such monopolies exist. This regulatory *quid pro quo* places a burden on the regulator to act as an advocate for the ratepayers who will frequently have no voice due to the familiar problems of collective action. Although consumer groups like ELCON monitor regulatory proceedings, they lack the resources to participate in every single meeting or hearing.

Excess capacity investments require particularly stringent regulatory scrutiny – e.g., such investments must be both "used and useful" and "prudent" – to establish whether they are recoverable in rates. In such cases, costs may need to be reallocated over time, by increasing rates for some users and decreasing them for others, to reflect changes in the mix of benefits. However, ELCON continues to question whether the concept of a new 765-kV national electric transmission overlay or "superhighway" project to wheel wind resources to distant regions could meet the required test, even with recalculations built into the process over time. Planning for such projects inherently will be suboptimal, in view of the practical challenges to properly identify the beneficiaries of such projects and then to properly allocate the costs in relation to the benefits on a multi-region (not just multi-state) basis.

B. Enhancing Regional Transmission Planning Processes

ELCON supports the introduction of a more streamlined and rationalized regional transmission planning process. However, ELCON notes two interrelated trends that pose concerns – regulatory outsourcing and the potential for an over proliferation of stakeholder meetings.

The trend since the 1990's has been to move away from traditional quasi-judicial proceedings towards a decentralized model that relies heavily on external stakeholder processes. Stakeholder processes can, in the right circumstances, be a valuable addition to the regulatory toolbox. However, in some cases a move towards stakeholder participation can result in a multitude of meetings that pose burdens, both economic and time related, on consumer ratepayers who wish to participate in the regulatory process. ELCON is concerned that, if not properly managed, the transmission planning process may not enhance stakeholder involvement, but rather could become a process that is both too time consuming and too expensive for stakeholders to adequately participate. Industrials appreciate the opportunity to participate in the development of regulatory policy, but realize that this policy may be better served channeled through traditional regulatory proceedings.

Such proceedings, including approved Order 890 transmission planning, should be adequate to meet the current challenges provided that each of the parties fulfills its responsibilities. The owners of the existing transmission system bear the responsibilities to prudently plan for the future needs of ratepayers and to respond to reasonable requests by other developers to accommodate their requests for new or

upgraded facilities. The "adequacy" of such planning is a responsibility of the transmission owners' regulators, who must balance the interests of utility shareholders with the utility's ratepayers. In the ISOs and RTOs, the not-for-profit regional administrators have the responsibility of maintaining independence from the transmission asset owners. All parties must strive to correct for the perverse economic incentives created by joint ownership of transmission and generation. The ultimate goal should be transmission projects that deliver measurable economic and reliability benefits and that are timely planned, constructed and operated.

II. Under Well Established Law, Rates for New Projects Follow the "Beneficiary Pays" Formula

According to a long series of judicial decisions, including most recently a Seventh Circuit opinion issued in August, *Illinois Commerce Comm'n v. FERC*, No. 08-1306 et al. (7th Cir. decided Aug. 6, 2009), the cost of projects via approved rates must be allocated to the beneficiaries of the projects. The Seventh Circuit summarized the two key prongs of the "beneficiary pays" analysis as follows:

- "FERC is not authorized to approve a pricing scheme that requires a group of utilities to pay for facilities from which its members derive no benefits, or benefits that are trivial in relation to the costs sought to be shifted to its members. '[A]ll approved rates [must] reflect to some degree the costs actually caused by the customer who must pay them.' *KN Energy, Inc. v. FERC,* 968 F.2d 1295, 1300 (D.C. Cir. 1992); *Transmission Access Policy Study Group v. FERC,* 225 F.3d 667, 708 (D.C. Cir. 2000); *Pacific Gas & Elec. Co. v. FERC,* 373 F.3d 1315, 1320-21 (D.C. Cir. 2004)."

- "Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party. *Midwest ISO Transmission*

> *Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004); see also *Alcoa Inc. v. FERC*, 564 F.3d 1342, 1346-47 (D.C. Cir. 2009); *Sithe/Independence Power Partners,L.P. v. FERC*, *supra*, 285 F.3d at 4-5; Federal Power Act, 16 U.S.C. § 824d."

Illinois Commerce Comm'n, supra, slip op. at pp. 9-10.

The principle of "beneficiary pays" developed in natural gas pipeline cases, which have a similar investment profile to the long transmission lines currently under proposal. And the statutory "just and reasonable" standard for rates is the same under the Federal Power Act. The long line of "beneficiary pays" cases trace their origin to a seminal 1945 Supreme Court decision, which stated, in a opinion frequently cited by FERC, that "[t]he problem [to be addressed by a rate case] is to allocate to each class of the business its fair share of the costs." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 588 (1945).

The *Colorado Interstate Gas* principles subsequently were elucidated in a series of D.C. Circuit cases, beginning with *Algonquin Gas Trans. Co. v. FERC*, 948 F.2d 1305 (D.C. Cir. 1991), and including *Complex Consol. Edison Co. of New York v. FERC*, 165 F.3d 992 (D.C. Cir. 1999), and *Transcontinental Gas Pipe Line Corp. v. FERC*, 518 F.3d 916 (D.C. Cir. 2008). All three cases involved allocating the costs of new facilities, with the D.C. Circuit addressing whether the costs of the new or expanded facilities should be allocated to the beneficiaries ("incremental pricing") or to all of the gas company's customers ("rolled-in pricing").

In all three cases, the court required FERC to "outline[ ] with reasonable particularity the system-wide benefits which each new facility produces" to justify

rolled-in pricing. *Algonquin*, 948 F.3d at 1313, 1315 (this is not a theoretical exercise, but a question of fact dependent on "the impact the order would actually have on ultimate consumers"); *see Complex Consol.*, 165 F.3d at 998, 1006 (affirming FERC's holding that rolled-in rates were not just and reasonable based on FERC's conclusion that "the alleged system benefits postulated by JMC Power [were] insubstantial"); *Transcontinental*, 518 F.3d at 920 (affirming FERC's order adopting incremental rates where "FERC . . . correctly concluded that existing customers would have . . . subsidized the Cherokee shippers if [the gas company] had been allowed to roll in rates").

Under these cases, there must be substantial and specific benefits to the system as a whole for just and reasonable rates to socialize the costs of new facilities, otherwise those ratepayers that do not benefit subsidize those that do. *See, e.g., Transcontinental*, 518 F.3d at 921 ("Rolling in the power costs of the Cherokee compressors forced existing Transco customers to subsidize the power costs of compressors they had no need for . . . ."), *Algonquin*, 948 F.2d at 1313 ("What we do require, however, is that the Commission, before ordering a roll-in . . . offer more than a conclusionary statement that the existence of system-wide benefits renders it unjust to allocate facilities costs incrementally."); *Complex Consol.*, 165 F.3d at 997 ("[T]he weight of the evidence favored the conclusion that the [new] facilities provided neither operational benefits nor additional reliability to Tennessee's system customers.").

The principle of "beneficiary pays" has been considered by the courts, particularly in electricity cases, under the rubric of "cost causation." As the D.C. Circuit

has explained, although "just and reasonable" provides a "spartan" statutory standard, "FERC and the courts have added flesh to these bare statutory bones, establishing what has become known . . . as the 'cost-causation' principle." *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992). The cost-causation principle is the "touchstone in any legal analysis of FERC-approved rate schemes," and it requires "that all approved rates reflect to some degree the costs actually caused by the customer who must pay them." *Id.; see also Village of Bethany v. FERC*, 276 F.3d 934, 937 (7th Cir. 2002) ("The overriding policy concern in a ratemaking proceeding is to establish rates that require each customer to bear a fair and proportional share of . . . costs.").

Reiterating the point made by the Seventh Circuit, the D.C. Circuit has stated that compliance with the cost-causation principle must be evaluated "by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party." *Midwest ISO Transmission Owners*, 373 F.3d 1361, 1368-69 (D.C. Cir. 2004). The court in *Midwest ISO* described FERC's cost-causation principle as "requir[ing] that all approved rates reflect to some degree the costs actually caused by the customers who must pay them.... Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or the benefits drawn by that party." *Id.* (Citations omitted); *see also, United Distribution Cos. v. FERC*, 88 F.3d 1105, 1188-89 (D.C. Cir. 1996) ("[c]ost causation correlates costs with those customers for whom a service is rendered or a cost is incurred"); and *Cities of Riverside and Colton, California v. FERC*, 765 F.2d 1434, 1439 (9th Cir. 1985).

Although FERC need not "allocate costs with exacting precision," *Midwest ISO*

Transmission Owners, 373 F.3d at 1369, it may depart from the principle of cost-causation only in extraordinary circumstances and for a limited purpose. *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 707 (D.C. Cir. 2000); *see also Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002) (remanding to FERC to explain why it did not apply "a different method of refunds, based more closely on cost-causation principles"). A rate design that results in some ratepayers subsidizing the service of others is *prima facie* inconsistent with cost-causation and presumptively invalid. *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 188 (D.C. Cir. 1986); *Nat'l Ass'n of Sec. Dealers, Inc. v. SEC*, 801 F.2d 1415, 1420 (D.C. Cir. 1986) ("Avoidance of cross-subsidization of services is a legitimate, non-arbitrary reason for requiring difficult cost allocations.").

Cost causation principles also govern choice of rate structure. *See e.g., Midwest Independent Transmission System Operator, Inc.*, 118 FERC ¶ 61,209 (2007) (Applying cost causation analysis to proposed revisions to MISO's Open Access Transmission and Energy Markets Tariff that included special cost allocation for regionally beneficial projects, which were defined in part as facilities with voltages of 345 kV or higher). The importance of rate structure as part of the cost causation analysis was emphasized in the recent Seventh Circuit decision in *Illinois Commerce Commission v. FERC*. In that case, the court reversed a FERC decision approving PJM's proposed pricing mechanism for new transmission facilities having a capacity of 500 kV or higher, in part because FERC had not adequately applied cost causation analysis to justify differential treatment of lines with capacity above 500 kV.

III. FERC Has Consistently Applied Beneficiary Pays/Cost Causation Principles

FERC has described its "long standing policy" on utility cost allocation in these words: "Properly designed rates should produce revenues from each class of customers which match, as closely as practicable, the cost to serve each class or individual customer." *New Dominion Energy Cooperative*, 122 FERC ¶ 61,174, P 41 (2008), *citing Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982). FERC has treated as black-letter law the principle that customers using a facility or service, or benefiting from a facility or service, must pay their fair share of the costs of the facility or service. FERC refers to this principle as "cost causation." *See, e.g., California Power Exchange Corp.*, 106 FERC ¶ 61,196, P 17 (2004), (the "well-established principle of cost causation requires that costs should be allocated, where possible, to customers based on customer benefits and cost incurrence"). *See also CAISO*, 103 FERC ¶ 61,114, P 26 ("[w]hile this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which 'should be borne by those who benefit from them'" (*quoting Gulf Power Co. v. FERC*, 983 F.2d 1095, 1100 (D.C. Cir. 1993))). Implicit in the cost-causation analysis is the principle that each "customer pay[s] for the service [it] receive[s] and do[es] not subsidize service rendered on behalf of others." *Empire State Pipeline and Empire Pipeline, Inc.*, 116 FERC ¶ 61,074 at P 115 (2006).

Moreover, FERC has found that a claim of "generalized system benefits" is insufficient to justify charges, there must be a tangible, non-trivial benefit supported by

the record. *See e.g.*, *FPL Energy Marcus Hook, L.P. v. PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,289 at P 50 (2008) (noting that "[e]very addition to the system could be characterized as providing some possible intangible system benefit by adding transmission capacity redundancy"); *Transcontinental Gas Pipe Line Corp.*, 112 FERC ¶ 61,170, 61,924-25 (2005).

FERC has acknowledged that the principle of fairly allocating transmission costs among those who use and benefit from transmission facilities fully applies to RTO transmission rates. *See Alliance Companies*, 94 FERC ¶ 61,070, 61,311-13; *Midwest Independent Transmission System Operator, Inc.*, 104 FERC ¶ 61,105, PP 50-51; *Ameren*, 105 FERC ¶ 61,216, PP 32, 57; *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,262, P 6 n.10 (2004) (approving the Going Forward Principles).

IV. Policy Considerations Support the Beneficiary Pays/Cost Causation Approach

Practical considerations of economic efficiency and public policy also counsel in favor of a "beneficiary pays" model of cost allocation. In a nutshell, the "beneficiary pays" model establishes more economically justified incentives for new construction than cost allocation models that socialize transmission costs, while also minimizing public opposition to potentially beneficial projects.

The "beneficiary pays" model of cost allocation results in greater economic efficiency by retaining a direct tie between the costs and the benefits of a given project, enabling the potential beneficiaries to appropriately determine whether the costs are worthwhile. Socialization distorts the economic incentives of participants by insulating

the beneficiaries from the full costs. *See Certification of New Interstate Natural Gas Pipeline Facilities*, 90 FERC ¶ 61,128, at 61,391-93 (2000) (Clarified Policy Statement) (recognizing that subsidies send the wrong price signals to the market, leading to inefficient investment decisions). When market beneficiaries are not required to bear the full costs of a proposed project, they may push forward with a project even if it is economically inefficient (i.e. total costs exceed total benefits) because their private gain exceeds their reduced costs. Requiring beneficiaries to bear the costs of investment, encourages an honest and fair accounting of the merits of a project, thus preventing wasteful investment.

Public policy considerations also argue in favor of a "beneficiary pays" model, because those who are allocated costs based on actual, demonstrable benefits are less likely to object to the construction of new transmission facilities than those who are allocated costs based on an assumption that they will receive some general, unquantifiable benefit. The "beneficiary pays" model is, therefore, more likely to reduce controversy and assure that future transmission would be built where the costs truly are justified. On the other hand, where the project would not pass a cost-benefit test, the parties subject to the costs would have an undiluted incentive to object. The construction of transmission is perhaps the most controversial form of energy investment. Socialization of costs simply increases the coalition of interests that will oppose potentially beneficial system upgrades.

NOTICES AND COMMUNICATIONS

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Dated: November 23, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary of this proceeding.

Dated at Washington, D.C.: November 23, 2009

/s/ MARK W. WALKER
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