UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

Reply Comments of the
Electricity Consumers Resource Council
(ELCON)

The Electricity Consumers Resource Council (ELCON) offers the following reply comments regarding transmission planning under Order 890. ELCON urges FERC to reaffirm that the principles of Beneficiary Pays and Cost-of-Service ratemaking will govern cost allocation for all transmission investments. The numerous comments filed in this docket present a wide range of viewpoints, typically reflecting the commenter's own particular economic interests. However, there was little discussion of the applicable statutory framework and case law. For decades, the Federal Power Act and court decisions interpreting it, have specified Beneficiary Pays as FERC's standard cost allocation model – with good reason – because it forces the sponsor of an investment to fully justify the costs of the project by clearly identifying who will benefit. By contrast, socialization of the costs of transmission distorts vital price signals and puts the Commission and its jurisdictional utilities in the dangerous position of picking winners and losers associated with the outcome of resource planning.

Reply Comments

ELCON urges FERC to continue following the two core principles that have guided cost allocation for decades: (1) the beneficiary of a service pays for it and (2) rates are based on the cost of service. Any cost allocation methodology that calls for socializing the costs of new transmission investments would conflict with these principles and would violate the Federal Power Act's requirement of "just and reasonable" rates and the Commission's long-standing practice applying that standard. Political pressure for inter-regional transmission projects, such as may arise in conjunction with the development of renewable projects, is not a reason to depart from the statute. In fact, given the high costs and uncertainties associated with the construction of transmission infrastructure, careful application of Beneficiary Pays and Cost-of-Service ratemaking will help to ensure that the costs of such projects are justified by their benefits and properly allocated.

A. Cost-of-Service

Rates based on the actual cost of service are necessary to comply with the Federal Power Act's requirement of "just and reasonable" rates, and also offer major advantages over other cost recovery schemes. Such rates should be designed to properly reflect energy (variable) and demand (fixed investment) costs. Demand costs should be apportioned on the basis of each class' contribution to peak demand, as transmission systems are built to accommodate peak – not average – demand.

A significant benefit of Cost-of-Service ratemaking is that it encourages economically efficient usage of electricity. Transmission service is a regulated monopoly in which rates are established to recover the authorized revenue requirement. Only when rates are based on actual costs do customers receive an accurate and appropriate price signal against which to make their consumption decisions. If rates are not based on costs, then customers may be induced to use electricity inefficiently in response to distorted price signals.

Cost-of-Service ratemaking results in equitable rates by focusing on who benefits, and allocating the costs to those groups. It also tends to minimize the role of partisan politics in resource selection by requiring transmission providers to take a technology neutral, least-cost approach to determining the resource mix. Additionally, Cost-of-Service ratemaking permits potential purchasers of power or transmission services the option to consider alternatives (e.g., local generation versus imports from another state) in order to select the lowest cost option. Cost based rates are also advantageous for utilities, because they promote revenue stability by minimizing the impact of changes in customer use patterns. This obviates the need for constant tinkering with rates to align them with the authorized revenue requirement.

B. Beneficiary Pays

Cost-of-Service ratemaking is closely intertwined with the cost allocation principle of Beneficiary Pays. Beneficiary Pays, in keeping with Cost-of-Service principles, encourages economically efficient investment by retaining a direct tie between the costs and the benefits of a given project. When the beneficiaries of a project are insulated from its full costs, they will often have an incentive to push forward with the 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 and discriminatory rates.

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 may receive some nebulous, unquantifiable "system-wide" benefit. The Beneficiary Pays model can, therefore, reduce controversy by highlighting the link between costs and benefits. On the other hand, when costs are allocated without regard to who actually benefits, the non-beneficiary parties subject to the costs 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.

One criticism of Beneficiary Pays raised by some commenters is that as a practical matter it can be difficult to determine who benefits, and to what extent. Yet, the difficulty of quantifying benefits is, as FERC recognizes, "not a new problem." Moreover, secondary benefits are often trivial compared to the primary reason (or cause) for the upgraded or new facility. Regulators have successfully applied Beneficiary Pays principles for decades with great success. This is not to say that it is always an easy process to properly determine the beneficiaries of a proposed investment, but the advantages of a Beneficiary Pays approach are so great as to more than justify the time and effort required.

C. Socialization of Costs

As discussed with greater detail in ELCON's initial comments in this docket, socialization of costs is contrary to decades of FERC practice, and would violate the Federal Power Act's standard of "just and reasonable" rates. Nevertheless some commenters, such as the American Wind Energy Association ("AWEA"), argue that socialization is appropriate because "all network customers use *and* benefit from the entire regional network…."[1] In other words, AWEA contends that because some benefits resulting from the addition of new transmission may accrue to all grid users, therefore all costs should be allocated equally to all users. Yet, the conclusion AWEA draws – that socialization is an appropriate cost allocation system – does not necessarily follow from the premise that certain secondary benefits may be system-wide. AWEA is essentially saying that because *some* benefits are spread system-wide, *all* costs should be spread system-wide. The advocates of new investments bear the burden of demonstrating the scope and magnitude of any such system-wide benefits. Such benefits, to the extent that they are real, should be apportioned in the Beneficiary Pays analysis, rather than arbitrarily spreading the costs on an indiscriminate basis.

AWEA's argument is also flawed in that it seems to assume that all transmission investments have equivalent system-wide benefits. In fact, a poorly planned transmission investment could actually harm the grid as a whole by increasing

---

[1] Comments of the American Wind Energy Association at 7.

congestion. Transmission investments are highly location dependent; the level of system-wide benefits can range all the way from a negative figure (for an investment that increases congestion) to almost 100% (for a pure reliability investment).

D. The Superiority of Beneficiary Pays over Socialization of Costs

An ever-growing corpus of economic literature attests to the significant disadvantages of socialization as a cost allocation scheme. Most significantly, socialization distorts price signals by shielding beneficiaries of an investment 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). The result is an implicit subsidy to the ratepayers who are the greatest beneficiaries of the new transmission, and a hidden tax on the ratepayers who benefit the least. Such price distortions can lead to the construction of economically inefficient transmission.

In addition to distorting price signals, codifying the socialization of costs as FERC policy places RTOs, ISOs and utilities in the position to pick winners and losers for special rate treatment without the benefit of thorough cost-benefit analysis. The RTOs, ISOs and utilities become, in effect, mini central planners deciding which projects have sufficient - although non-quantifiable - benefits to require socialization of costs. However, economic theory and practice weighs in favor of the superiority of cost allocation principles based on consistent application of cost-benefit analysis. The comments of the New England States Committee on Electricity ("NESCOE") in this docket recognize as much, stating that, "it is imperative that planners not, in effect, select renewable resources to serve New England consumers."[2] NESCOE argues, rather, that it is best to identify the "renewable resources and associated transmission that can serve our customers most cost-effectively through competitive markets or processes."[3] ELCON agrees.

Comments submitted by the Illinois Commerce Commission ("ICC") also recognize the superiority of Beneficiary Pays based on its fair and economically efficient allocation of costs. Indeed the ICC unequivocally urges FERC to "adhere to the long-standing cost causation/beneficiary pays methodology as the fundamental principle for transmission cost allocation" noting that cost allocation methodologies that "require some entities to contribute to project costs without benefiting … end up with allocations that are inherently unjust and unreasonable in violation of the Federal Power Act." [4]

E. Conclusion

The potential for wasteful and inefficient construction of new transmission is a critical concern for industrial ratepayers. Industrials will in many markets bear the brunt of any cost hikes that would follow if costs were socialized. Transmission charges are a significant cost input for energy intensive industries and have a direct impact on every manufacturer's bottom line. Industrials are currently facing the most difficult economic climate in almost thirty years; they can ill afford to pay for unnecessary and wasteful transmission investment. Unreasonably high transmission costs will place

---

[2] Comments of the New England States Committee on Electricity at 1.

[3] Id.

[4] Comments of the Illinois Commerce Commission at 2.

Industrials in the U.S. at a severe disadvantage to their global competition, with dire results for the nation's continuing economic competitiveness. How best to pay for expensive investments in infrastructure will always be a contentious issue, and proper cost allocation under a Beneficiary Pays system can indeed be a complex process, but the practical difficulties are well worth the benefits.

NOTICES AND COMMUNICATIONS

Notices and communications with regard to these proceedings should be addressed to:

John P. Hughes
Vice President, Technical Affairs
ELECTRICITY CONSUMERS RESOURCE COUNCIL
The West Tower, 8th Floor
1333 H Street, NW
Washington, DC 20005
Email: jhughes@elcon.org
Phone: (202) 682-1390

W. Richard Bidstrup
Mark W. Walker
CLEARY GOTTLIEB STEEN & HAMILTON LLP
2000 Pennsylvania Avenue, NW, Suite 900
Washington, DC 20006
Email: mwwalker@cgsh.com
Phone: (202) 974-1500

Respectfully submitted,

/s/ W. RICHARD BIDSTRUP
W. Richard Bidstrup
CLEARY GOTTLIEB STEEN & HAMILTON LLP
2000 Pennsylvania Avenue, N.W.
Washington D.C. 20006
Counsel for ELCON

Dated: December 18, 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.: December 18, 2009

/s/ MARK W. WALKER
Mark W. Walker