

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

PJM Interconnection LLC

Docket No. EL05-121-006

**COMMENTS OF THE  
ELECTRICITY CONSUMERS RESOURCE COUNCIL (“ELCON”)**

The Electricity Consumers Resource Council (“ELCON”) appreciates the opportunity to file comments in this proceeding. ELCON filed a motion to intervene herein on February 5, 2010.

ELCON considers this proceeding to be of critical importance as it is likely to set precedents respecting the nature and amount of evidence needed to support allocation methods for new transmission capacity in PJM and other regions, particularly related to the crucial issue of reliability. In view of the current significance of this issue in the context of efforts to bring variable energy resources to load, ELCON urges the Commission to carefully consider these comments and to recognize the long-term implications of its action in this docket.

## **Description and Standing of ELCON**

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 and users of transmission, both within and outside the footprint of PJM, ELCON members are significantly impacted by charges imposed for the cost of new transmission. ELCON has significant expertise in these matters, having participated extensively in other Commission proceedings addressing cost allocation and variable energy resources.

## **Summary**

ELCON considers this proceeding to be of critical importance as it is likely to set precedents respecting the nature and amount of evidence needed to support allocation methods for new transmission capacity in PJM and other regions, particularly related to the crucial issue of reliability.

ELCON believes that transmission resources should be developed at the lowest possible cost, and this requires that a cost allocation method send appropriate price signals for efficient siting decisions. Transmission facilities necessary to meet NERC reliability standards are routinely built and the costs are allocated to the planning areas where the investments are required to meet the standards. However, broad socialization of costs tends to mask the price signal and lead to poor resource selection and siting decisions – and rates that are not “just and reasonable”.

For proper implementation of the “just and reasonable” standard, ELCON supports three principles for efficient transmission cost allocation:

- Prudent transmission planning that includes identification of beneficiaries.
- “Cost causation” or “beneficiary pays”: a showing of measurable economic or reliability benefits to those who are asked to bear the costs of new facilities.
- Periodic adjustment of cost allocation to reflect changes in power flows.

The principle of “beneficiary pays” or “cost-causation” is well established through both court cases and Commission cases. As the “touchstone” in any legal analysis of FERC-approved rate schemes, it requires that all approved rates reflect to some degree the costs actually caused by the customer who must pay them. Although the Commission need not allocate costs with exacting precision, it may depart from the principle of cost-causation only in extraordinary circumstances and for a limited purpose. A rate design that results in some ratepayers subsidizing the service of others is *prima facie* inconsistent with cost-causation and presumptively invalid. The claim of “generalized system benefits”, such as amorphous reliability improvement, is insufficient to justify regionalized charges; rather, there must be a tangible, non-trivial benefit supported by the record.

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. Under this approach, the Commission should allocate costs to a region or sub-region only if the costs are reasonably proportionate to measurable economic and

reliability benefits. For example, costs of new transmission investments required to meet NERC reliability standards should be allocated to the planning area(s) where the investments are required to meet the standards. The costs of transmission facilities needed to maintain reliability (*i.e.*, prevent violations of NERC reliability standards) should be allocated to zones that risk potential NERC violations.

There is no reason to (or need to) regionalize or socialize the costs of any of these facilities, which would distort the economic incentives of participants by insulating the beneficiaries from the full costs. Attempts to socialize costs across FERC-created organized markets are ironic because the locational (nodal) pricing regime was intended to facilitate locational – not regional – solutions to reliability, congestion and resource adequacy. The Commission cannot have it both ways.

The transmission cost allocation debate is primarily driven by the need to integrate large tracts of wind energy resources with potential loads. Thus the debate is, first and foremost, a generation-to-load or generation-to-market issue. This is especially true if the transmission facilities would not have been built in the near future but for the need for wind integration with its markets. For that reason, such transmission facilities cannot be treated as pure public goods for the provision of enhanced reliability and worthy of public funding or broad-based socialization in rates.

## Comments of ELCON

### I. INTRODUCTION AND BACKGROUND OF THIS PROCEEDING

This proceeding relates to the Commission's 2007 approval of PJM's transmission cost allocation methodology for facilities above 500 kV. Several Midwestern states opposed the postage-stamp rate methodology because the costs rolled-in to rates charged to consumers in those states were deemed in excess of the actual benefits. The Illinois Commerce Commission challenged the rates before the Seventh Circuit.

The current new phase of this prolonged proceeding arose from the Seventh Circuit's decision overturning the Commission's prior order in this docket and its October 28, 2009 remand to the Commission. The Seventh Circuit agreed with the Commission that setting PJM's transmission rates for the use of existing transmission facilities at marginal cost only – rather than marginal cost plus sunk costs – did not violate the “just and reasonable” standard.

For new transmission facilities, however, the Seventh Circuit ruled that the Commission had failed to demonstrate that postage-stamp rates for facilities at or exceeding 500 kV would be just and reasonable. Specifically, the court ruled that cost regionalization (*i.e.*, socialization) was not adequately supported by FERC's general claims of widespread benefits in the form of improved reliability and reduced congestion.

In its decision, the Seventh Circuit provided new guidance on the nature and degree of evidence required to support transmission cost allocation methodologies:

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." [citations omitted]. 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.<sup>1</sup>

The Seventh Circuit determined that the Commission, in implementing this standard, needs to carefully support its conclusions respecting the reliability benefits of new transmission, potentially including "ballpark estimates" of those benefits. In particular, the court focused on the need to "compare the reliability of a 500 kV line to that of a 345 kV line."<sup>2</sup>

The significant new demands imposed by the Seventh Circuit decision are reflected in the substantial, broad ranging questions that the Commission posed to PJM and other parties in its January 21, 2010 Order in this proceeding, including: how PJM determines the relative priorities of resolving numerous priority issues with one project; the anticipated reliability requirements addressed by the PJM RTEP; the differences in regional benefits between 500 kV and lower voltage facilities; the relevant types of benefits that transmission expansions that operate at or above 500 kV; and whether the reliability, economic, or other benefits of transmission expansions are greater for customers located in areas that import electricity than for customers located in areas that export electricity.

---

<sup>1</sup> 576 F.3d 470 at 476.

<sup>2</sup> *Id.* at 476-77.

## II. ASSESSMENT OF COSTS AND BENEFITS BASED ON SUBSTANTIAL EVIDENCE

Following the Seventh Circuit's decision, the Commission's obligation in reviewing and approving cost allocation proposals from RTOs such as PJM is to ensure that there is a reasonable consideration of benefits, and to compare the costs assessed against a party to the burdens imposed or benefits drawn by that party based on substantial evidence in the record. If FERC cannot reasonably quantify the benefits then it must identify "articulable and plausible" reasons to believe that the benefits are at least roughly commensurate with those utilities' share of total electricity sales.<sup>3</sup>

ELCON believes that getting transmission cost allocation right is essential to ensuring that all consumers benefit from the lowest cost energy alternatives. ELCON supports the development of clean energy resources -- both local and remote -- and increased transmission capacity. However, we should develop such resources at the lowest possible costs, and this requires that a cost allocation method send appropriate price signals for efficient siting decisions.

The transmission cost allocation debate is primarily driven by the need to integrate large tracts of wind energy resources with potential loads. Thus the debate is, first and foremost, a generation-to-load or generation-to-market issue. As such, the costs of transmission facilities should be allocated and recovered in the same manner as traditional generation-to-load and interconnection projects. This is especially true if the

---

<sup>3</sup> "We do not suggest that the Commission has to calculate benefits to the last penny, or for that matter to the last million or ten million or perhaps hundred million dollars... If it cannot quantify the benefits to the Midwestern utilities from new 500 kV lines in the East ..., but it has an articulable and plausible reason to believe that the benefits are at least roughly commensurate with those utilities' share of total electricity sales in PJM's region, then fine; the Commission can approve PJM's proposed pricing scheme on that basis." 576 F.3d at 477.

transmission facilities would not have been built in the near future but for the need for wind integration with its markets. For that reason, such transmission facilities cannot be treated as pure public goods worthy of public funding or broad-based socialization in rates.

In the PJM case that was remanded by the Seventh Circuit, FERC attempted to use secondary (and almost specious) benefits – improved reliability and reduced congestion – as the basis for regionalizing costs. To further market its objectives, FERC called such transmission lines “backbone” facilities. Transmission facilities necessary to meet NERC reliability standards do get built and the costs are allocated to the planning areas where the investments are required to meet the standards.<sup>4</sup> This is a working example of “beneficiary pays.”

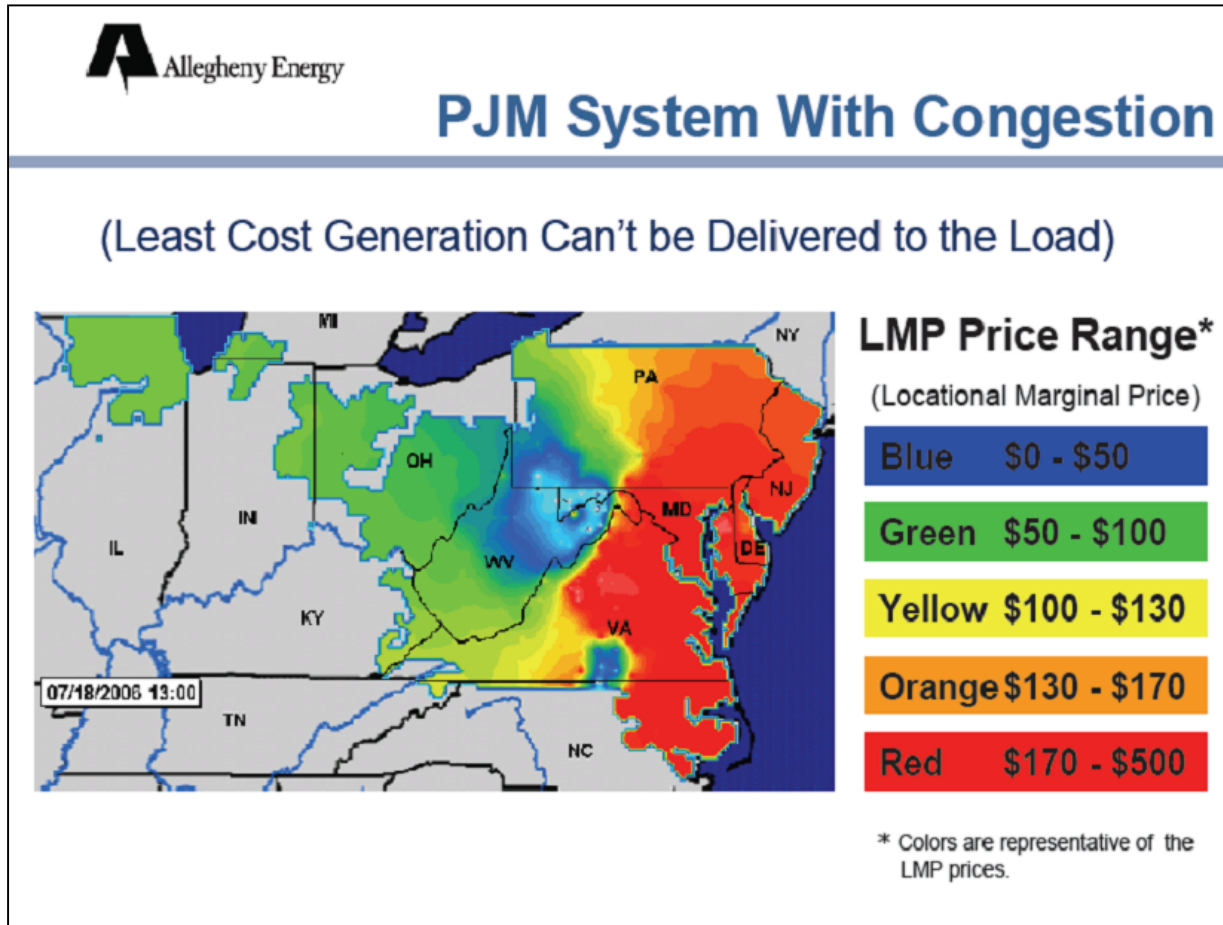
However, broad socialization of costs based solely on reliability does not work. Almost any addition to the interconnected transmission grid can be characterized by some interests as “improving reliability.” But the experiences of PJM shows that appropriate price signals are needed that reflect market conditions. It has been practically impossible to site major transmission facilities for the purpose of reducing

---

<sup>4</sup> According to the Edison Electric Institute, “[t]he trend in increased investment in the Nation’s transmission infrastructure that began several years ago continues in response to various needs including reliability and generator interconnection. Despite the economic downturn, the investment being made by EEI member companies is significant and growing, and reflects preparation for future customer needs. From 2001 to 2008, EEI members invested nearly \$57.5 billion in transmission infrastructure improvements to meet these various needs.” *Transmission Projects: At A Glance*, Prepared by the Edison Electric Institute with assistance from Navigant Consulting, Inc. February 2010, at iii.



congestion. The situation in PJM is well-known: the Eastern zones are congested (red and orange on the map) and the Western zones are not (green and blue).<sup>5</sup>



Efforts to interconnect the two are resisted for many reasons. Environmental interests oppose such “coal by wire” proposals because they increase the eastern zones’ dependence on coal-fired generation and reduce the incentive to develop local energy solutions including local renewable resources. Consumers in the west do not want to share low-cost generation with consumers in the east because it would raise average

<sup>5</sup> Source of graphic: Sierra Club Maryland Chapter, “Pull the Plug on Coal by Wire,” <http://maryland.sierraclub.org/action/p0204.asp>

rates in the west. Consumers in the east also resist having all the costs of new transmission facilities allocated to them.

In sum, broad socialization of costs tends to mask the price signal and lead to poor resource selection and siting decisions – and rates that are not just and reasonable. 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. 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 otherwise 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 (*i.e.*, “lumpy”) 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.

### III. PRINCIPLES FOR EFFICIENT TRANSMISSION COST ALLOCATION

Those who benefit from the development of the resource must see the true costs of the resource to make an efficient decision. It is, and always has been, the job of regulators to allocate costs of utility investments, including transmission, based on a determination of which customers or groups of customers benefit from those investments. Getting cost allocation right is essential to ensuring that those developing generation choose the best locations and that customers benefit from the most cost-effective resources, including variable energy resources.

It is not only possible to determine who benefits from transmission projects; it is done all the time. The Commission has approved many different cost allocation methods, many of which are based on a “beneficiary pays” concept, and there are many specific projects proceeding on that basis. Some argue that identifying beneficiaries will lead to litigation. But there has always been litigation in utility rate cases around cost allocation questions.

Socialization of costs is only justified if benefits are uniformly distributed to all or most affected consumers. It is never justified if the degree of benefits is unknown or cannot be reasonably estimated. Projects should not be approved based on speculation. The Commission should allocate costs to a region or sub-region only if “the costs are reasonably proportionate to measurable economic and reliability benefits.” This “measurable” language does not mandate mathematical precision in defining benefits although the locational market design of PJM and other ISOs and RTOs would seem to facilitate such precision by intent.<sup>6</sup> Grid operators “measure” project benefits all of the time, using standard industry modeling tools and studies. Courts will give the Commission substantial flexibility.

Accordingly, for proper implementation of the “just and reasonable” standard, ELCON supports three principles for efficient transmission cost allocation:

- A. Prudent transmission planning that includes identification of beneficiaries.

---

<sup>6</sup> There is some irony with attempts to socialize costs across FERC-created organized markets because the locational (nodal) pricing regime was intended to facilitate locational – not regional – solutions to reliability, congestion and resource adequacy.

- B. “Cost causation” or “beneficiary pays”: a showing of measurable economic or reliability benefits to those who are asked to bear the costs of new facilities.
- C. Periodic adjustment of cost allocation to reflect changes in power flows.

- A. Prudent Transmission Planning

Any effort to improve transmission planning must build on existing successful, coordinated, open, and transparent regional processes, and be inclusive of all stakeholders. States also have a major role in approving transmission. It is difficult to ask States to approve construction of transmission lines if their residents are asked to pay for the lines but don’t receive commensurate benefits.

Of necessity, this requires a bottom-up transmission planning processes. Transmission planning must be initiated at the local and regional level based on the needs of the customers who bear the burden and benefits of the decisions driven by the planning processes. Voluntary interconnection-wide coordination should be a complement to, and not a substitute for, local and regional processes.

An essential requirement of transmission planning should be the identification of the entities that will reasonably benefit from new transmission facilities. Transmission also must be planned to ensure cost-effective compliance with NERC reliability standards, and alternative transmission solutions must be considered as part of the planning process.

- B. Cost Causation

The principle of “beneficiary pays” is well established through both court cases and Commission cases. The judicial application of the principle first developed in early

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 an 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." *KN 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. *See 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.

The Commission 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, the Commission 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). The Commission also 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).

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. On the other hand, 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. 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.

C. Periodic Adjustment of Cost Allocation to Reflect Changes in Power Flows

Power flows change as loads grow or decline, as new generators are added to the grid (or retired), and as a result of new or upgraded transmission infrastructure. The changes in flows cannot always be anticipated and therefore a transmission cost allocation methodology should be recalculated on a periodic basis. This does not change the amount of total costs that are recovered and therefore adds no regulatory uncertainty to cost recovery. Only the mix of and allocations to beneficiaries changes. There is precedent for periodic review of the manner in which cost recovery is allowed for network upgrades under FERC Pro Forma Open Access Transmission Tariff (OATT). Under the OATT, most recently revised in Order No. 890, the generator must initially finance the costs of network upgrades, but upon completion of the project the transmission provider spreads the cost among customers and rebates to the generator its initial investment by providing it with transmission credits against its tariff expenses. This mechanism in effect enables a review to properly allocate costs to beneficiaries of the investment.

#### IV. CONSIDERATIONS FOR THE VARIOUS TYPES OF TRANSMISSION PROJECTS

There are three broad classes of new transmission facilities at or exceeding 500 kV that require individual consideration: facilities needed to wheel power from new generation (*e.g.*, wind) to load centers; facilities needed to wheel power from existing generation to load centers (*e.g.*, to reduce congestion by expanding economic dispatch over broader region); and facilities needed to maintain reliability.

##### A. Facilities Needed to Wheel Power from New Generation to Load Centers

It is important that the actual delivered cost of electricity from new resources be allocated to the entities that are intended to directly benefit. The result should be the alignment of cost responsibility with cost causation. This can be worked out between the generation owners and its customers (loads). If the generation is being built on spec, the costs should be initially allocated to the generation owners. While transmission is a relatively small portion of customers' bills on a historic basis, the cost of new transmission associated with remote generation projects can far outweigh the cost of the generation itself. If remotely located renewable resources provide the most cost-effective option, then transmission should be built to access that resource. But that cost effectiveness assessment should include the cost to deliver the power. It is essential that the total delivered cost for new resources of any type is evaluated to ensure that consumers are getting the most efficient and least-cost resource mix.<sup>7</sup>

---

<sup>7</sup> Almost 99,000 MWs of generation interconnection requests are in all PJM queues that are in-service, under construction or active in PJM's interconnection process as of January 31, 2010. Renewable resources account for 46% or over 45,000 MWs of the total queued resources (43% or 43,843 MWs are wind resources). Source: PJM 2009 RTEP Report.

B. Facilities Needed to Wheel Power from Existing Generation to Load Centers

The costs of new or upgraded transmission facilities should be allocated to the beneficiaries and the beneficiaries can be easily identified. The costs should not be allocated to electricity consumers whose average rates might actually increase as a result.

C. Facilities Needed to Maintain Reliability

Costs for new transmission investments required to meet NERC reliability standards should be allocated to the planning area(s) where the investments are required to meet the standards. Transmission facilities needed to maintain reliability (i.e., prevent violations of NERC reliability standards) may be local public goods and the costs of such facilities allocated to zones that risk potential NERC violations but they are not regional public goods in a broader sense. There is no reason to (or need to) regionalize or socialize the costs of any of these facilities.

Subsidizing long-distance transmission places local renewable resources, which may be more cost-effective based on delivered costs, at a competitive disadvantage. States should have the ability to determine how best to meet standards locally. States that do not need to or want to rely on remote wind resources should not be required to subsidize the costs of transmission needed by others to access those resources.

There should be no consideration of, or attempt to monetize broader “societal benefits.” Such external costs and benefits (“externalities”) are ubiquitous, and can only

---

be monetized – if at all – on a limited, piece-meal basis. Nothing in economic theory suggests that the internalization of externalities on a piece-meal basis improves overall economic or social welfare. Selective consideration of external costs is a form of goal seeking.

## V. INAPPLICABILITY OF THE “PUBLIC GOODS” CONCEPT

Apart from the criteria of the Federal Power Act, discussed above, some commenters assert, from an academic, classic economics perspective, that broad-based public funding of transmission is appropriate because it is a “public good.” According to standard economics, public goods are characterized by (1) non-excludability and (2) non-rivalry.<sup>8</sup> Although transmission facilities may be non-excludable, they are not pure public goods because they fail the non-rivalry prong. Accordingly, any assertion that high voltage transmission is a public good does not hold water and is not a sound basis for socialization of costs.

A good is “non-rivalrous” when consumption by one entity does not reduce availability of the good to others, or when the benefits of the good extend to others at essentially no marginal cost. Classic public goods that are non-rivalrous include: an environmental or health benefit that can be freely enjoyed by all, without restriction: lighthouses; the GPS navigation system; public radio; and national defense. This is not an accurate description of transmission facilities; as Commission staff has recognized,

---

<sup>8</sup> These characteristics of public goods are consistently identified by the economics literature. See, e.g., Tyler Cowan, “Public Goods,” The Concise Encyclopedia of Economics, Library of Economics and Liberty. <http://www.econlib.org/library/Enc/PublicGoods.html>; Kiesling and Giberson, “Electric Network Reliability as a Public Good,” paper submitted to CMU conference *Electricity Transmission in Deregulated Markets*, at p. 2.

transmission is not a public good since the bulk electric system is frequently constrained.<sup>9</sup> Some “users” and “owners” of the grid can in fact restrict the availability of the system to other users and FERC’s open-access transmission policies and regulations are an artful way for rationing use of the transmission system.

This position is supported by the testimony of Roy J. Shanker, Ph.D. in Docket No. EL05-121-006, concluding that “transmission does not have the basis attributes of a public good.”<sup>10</sup> Dr. Shanker stated:

Non-rival consumption means that separate parties can each simultaneously consume up to the total available amount of the public good. . . . [N]ational defense is a good example. Once procured, we all receive the benefit of national defense, whether we pay for it or not, and similarly there is no way, short of deportation, to keep a non-payer from receiving the benefit of that public good.

. . . [T]ransmission does not exhibit these properties. Transmission is not characterized by non-rival consumption. One party’s use of the transmission system clearly can preclude others from “consuming” transmission and receiving the benefit of a finite resource. . . . As one party “loads” the transmission system via injections into the power grid, the ability of others to use the grid is reduced and constrained, with the logical limit being that certain patterns of generation injections and load may result in completely restricting the ability of a party to use the transmission system or receive any benefit from the ability to transfer power on the system. Congestion – the limitation in the use and capability of the transmission system and the associated use of the system by one party to the use of another – is a true physical property of transmission.<sup>11</sup>

---

<sup>9</sup> FERC Staff Report, “Principles for Efficient and Reliable Reactive Power Supply and Consumption” (Feb. 4, 2005) at pp. 22-23 (“[w]hen a transmission line is congested, the line no longer has a public good characterization”).

<sup>10</sup> Prepared Cross-Answering Testimony and Exhibits of Roy J. Shanker, Ph.D., Docket No. EL05-121-000 (Feb. 15, 2006) at p. 3.

<sup>11</sup> *Id.* at pp. 6-7. See also Kiesling and Giberson, *supra*, at p. 1 (“as the grid becomes more heavily loaded, continued access to grid services become rivalrous in nature and the public good aspects of reliability are diminished”).



The second criterion for a public good -- “non-excludability” -- means that no one can be excluded from benefiting from the good. This may or may not be true in the case of extra-high voltage transmission lines, depending on the particular features of the applicable regulatory regime. Although open access tariffs would tend to favor a finding of non-excludability, as Dr. Shanker has noted, it is not the case under the Financial Transmission Rights (“FTRs”) that are fundamental design features of the PJM market: “[p]articipants that hold such rights hold them to the exclusion of others, and those without these rights may face exposure to significant costs in the form of transmission congestion.”<sup>12</sup>

In any event, any assertion that high voltage transmission is a public good does not hold water and is not a sound basis for socialization of costs especially if the primary “driver” for such facilities is a generator or wind farm’s need to access markets for its power.

## VI. CONCLUSION

For the reasons set forth in these comments, socialization of costs of high voltage transmission would not satisfy the statutory standard for “just and reasonable” rates. Instead, cost allocation must be based on three central principles: (i) prudent transmission planning that includes identification of beneficiaries; (ii) “cost causation” or “beneficiary pays” -- a showing of measurable economic or reliability benefits to

---

<sup>12</sup> Shanker Testimony, *supra*, at p. 8.

those who are asked to bear the costs of new facilities; and (iii) periodic adjustment of cost allocation to reflect changes in power flows.

### 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  
1111 - 19<sup>th</sup> Street, NW, Suite 700  
Washington, DC 20036  
Email: [jhughes@elcon.org](mailto:jhughes@elcon.org)  
Phone: (202) 682-1390

W. Richard Bidstrup  
CLEARY GOTTLIEB STEEN &  
HAMILTON LLP  
2000 Pennsylvania Avenue, NW  
Suite 9000  
Washington, DC 20006  
Email: [rbidstrup@cgsh.com](mailto:rbidstrup@cgsh.com)  
Phone: (202) 974-1500

Respectfully submitted,

/s/ W. Richard Bidstrup  
W. Richard Bidstrup  
CLEARY GOTTLIEB STEEN & HAMILTON  
LLP  
2000 Pennsylvania Avenue, NW, Suite 9000  
Washington, D.C. 20006  
Telephone: (202) 974-1500

*Counsel for ELCON*

Dated: May 28, 2010

### 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.:            May 28, 2010

/s/ W. Richard Bidstrup  
W. Richard Bidstrup