

Appendix A

A Brief History of Cost Allocation in NEPOOL Prior to Restructuring

The New England Power Pool (NEPOOL) has a long history of cooperative development and cost sharing¹ for transmission projects where the utilities in New England could gain and share the benefits of access to lower cost generation. This cooperation evolved over time as relatively small, vertically integrated utilities attempted to meet the needs of their customers at the lowest cost using all of the remedies and economies available in a vertically integrated structure. The structure that made this cooperation desirable and possible in the past, however, has changed dramatically over the last six years. Those structural changes require the abandonment of cost allocation approaches that, while they may have worked well in the past, are fundamentally inconsistent with the new market structures.

Two major projects illustrate the cost causative aspects of transmission cost allocation prior to NEPOOL's restructuring. The MEPCO line was built in order for several utilities to acquire low cost energy from New Brunswick Power. Later, the HQ Phase II facility was built to gain access to low cost energy from Hydro-Quebec. In each instance, the transmission projects provided access to lower cost energy for utility customers, so the affected utilities cooperated on the development and funding of the projects. In both instances, formal agreements negotiated voluntarily among the companies dictated how the projects would be funded. Regulators approved expenditures on such projects because utilities demonstrated that the financial benefit to customers exceeded the costs they would have to pay. Contrary to some assertions made today, the transmission facilities of the pool were never built without a demonstration that those paying for them would directly and demonstrably benefit from the upgrade or expansion.

This cooperatively developed and funded transmission system allowed NEPOOL to share in lower energy costs. Structured as a "tight power pool," NEPOOL used a single, common economic dispatch center to dispatch all generation in the region. By dispatching the lowest cost generation available to meet the load, the New England Power Exchange (NEPEX) was able to lower the total cost of serving New England load. Economies from operating the system in this way were directed to a "Savings Fund," and allocated to individual NEPOOL utilities as "Savings Shares." Savings shares were determined by comparing the total cost of each utility using its own generation to serve its own load to the cost of dispatching the most economic generation in the pool to serve the load. Utilities with low cost generation whose generators ran more than they would have under "Own Load" dispatch were compensated for their operation. The system for

¹ Cooperatively sharing costs is not the same as forced socialization of them being imposed on non-beneficiaries

sharing the benefits of low cost generation across the region was a primary justification for sharing the costs of the transmission system built to allow relatively unconstrained dispatch. The history of joint economic dispatch and cooperation also made possible the development of the nation's only "postage stamp" transmission rate. The Regional Network Agreement (RNA) is a voluntarily negotiated network transmission rate that recovers the bulk transmission system revenue requirements for seven separate utilities through a single rate.

Congestion costs existed, but they were borne locally and were an important consideration for utilities and their regulators in deciding whether to build transmission where it was needed. In transmission constrained "load pockets" the operation of high cost "Reliability Must Run" generation was reflected in the host utility's Own Load dispatch modeling and in the power pool's system dispatch algorithm. The result was that the cost of congestion was imposed squarely upon load located within the transmission-constrained region. The economic factors in the decision of whether to build transmission to relieve the constraint and gain access to lower cost generation were fully internalized within the vertical utility structure in place at the time. Utilities and regulators were able to make rational economic decisions about whether and how² they should relieve the constraints. Likewise, the cost of building transmission to alleviate this congestion was borne by the local utility and its customers through a cost of service rate that was approved by the FERC. These costs were not socialized among the NEPOOL members. Projects with multiple beneficiaries might negotiate joint support or partnership agreements similar to those developed for projects such as the Maine Electric Power Company (MEPCO) line and the Hydro-Quebec Phase II project.

The world in which the benefits of generation cost saving were shared, along with the burdens of transmission costs to achieve those savings, however, no longer exists. In 1992, the EPACT allowed EWGs to compete in wholesale electric markets at market based rates and granted them access to the transmission grids on the same terms as the utilities that owned the facilities. In 1996 NEPOOL filed a comprehensive proposal to restructure the NEPOOL agreement³. That proposal allowed for the socialization of congestion costs, and was approved by the FERC in 1998⁴. FERC allowed socializing as an interim measure until NEPOOL could develop a Congestion Management System (CMS) and because it believed that the congestion charges "should be small and predictable because there are presently no known internal constraints in NEPOOL⁵." Also beginning in 1996, New England states adopted laws to restructure their retail markets. As part of this restructuring, utilities sold their generating facilities. Virtually all generation in New England⁶ is now owned by companies competing at market-based rates. They access the grid through a bid based system dispatch, and they have no obligation to "native" loads. Transmission-only utilities that remain have no

² Vertically integrated companies could choose the least cost solution among load response, generation, or transmission solutions.

³ Docket No. OA97-237-000

⁴ *New England Power Pool*, 83 FERC P. 61,045 at 61,237 (1998)

⁵ *Id.*

⁶ Also in New York

responsibility to reduce energy cost as they did when they were vertically integrated. Until the implementation of LMP, however, there remains a transient justification for socializing transmission costs, because under existing (pre-LMP) market rules the costs of congestion are shared, as are the benefits (to the extent achievable) of low cost generation wherever located. However, the Commission has recognized that when congestion costs are no longer socialized once LMP is implemented there is no longer any justification for broadly socializing transmission upgrade costs instead of allocating these costs to the parties that will benefit from the upgrade. *See, New England Power Pool*, 100 FERC ¶ 61,287 at 62,286 (2002).