

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

ISO New England Inc.)	
New York Independent System)	Docket No. RT02-3-000
Operator, Inc.)	
)	

**NOTICES OF INTERVENTION AND COMMENTS OF THE MAINE PUBLIC
UTILITIES COMMISSION AND THE RHODE ISLAND PUBLIC UTILITIES
COMMISSION ON THE NERTO PROPOSALS FOR TRANSMISSION
PLANNING AND EXPANSION**

The Maine Public Utilities Commission (MPUC) and the Rhode Island Public Utilities Commission (collectively MPUC) hereby submit their comments regarding one aspect of the Petition for Declaratory Order (Petition) filed on August 23, 2002 by ISO New England (ISO-NE) and the New York Independent System Operator, Inc. (NYISO). The Petition requests an order finding that the proposed Northeastern Regional Transmission Organization (NERTO) would qualify as a Regional Transmission Organization (RTO). The MPUC strongly disagrees with the NERTO proposal to socialize (either across the NERTO region or across a sub-region) the costs of so-called “reliability” transmission upgrades. The NERTO proposal is inconsistent with the Commission’s requirement that any transmission planning function must “encourage market driven-operating and investment actions for preventing and relieving congestion.” 18 C.F.R. § 35.34(k)(7)(i). In addition, the proposal is inconsistent with the Commission’s determination that cost allocations should not be determined on the basis of questionable distinctions between economic and reliability upgrades. *See, e.g., ISO New England, Inc.*, 91 FERC ¶ 61,311 at 62,076 (2000). Finally, the MPUC suggests

that the NERTO's transmission planning process should be coordinated with a new resource adequacy program.

I. NOTICES OF INTERVENTION

In accordance with Rules 211 and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (Commission),¹ the Maine Public Utilities Commission (MPUC) and the Rhode Island Public Utilities Commission (RIPUC) hereby submit their notices of intervention in the above-captioned proceeding.

MPUC designates the following person for service and communications with respect to this matter and requests that her name be placed on the official service list for this case:

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Under Maine law, the MPUC is the state commission designated by statute with jurisdiction over rates and service of electric utilities in the state. *See* 35-A M.R.S.A. § 101 *et seq.* Accordingly, the MPUC hereby provides its notice of intervention pursuant to 18 C.F.R. § 385.214(a)(2).

RIPUC designates the following person for service and communications with respect to this matter and requests that his name be placed on the office service list for the case:

¹ 18 C.F.R. § 385.214 (2000).

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II. COMMENTS ON THE PROPOSED TRANSMISSION PLANNING AND COST ALLOCATION METHODOLOGY

A. Description of Proposal

1. Cost Allocation Methodology

NERTO proposes a default cost allocation methodology, which will apply in the absence of any agreement by an entity to pay for a project, based on distinctions between (1) “Reliability Transmission Upgrades” and “Market Efficiency Transmission Upgrades” and (2) different voltage levels of reliability upgrades. If an upgrade is determined in the NERTO System Plan (NSP) to be a Reliability Transmission Upgrade, the costs of the upgrade will be socialized across the entire NERTO region for the construction of facilities 345 kV or above. The costs of a below-345 kV- “Reliability Transmission Upgrade” will be socialized across the entire sub-region (either New York or New England) in which the facilities are built. If, on the other hand, the NSP defines the project as a “Market Efficiency Transmission Upgrade, “ the NERTO Board will have the discretion to determine whether socialization or some other cost allocation methodology is appropriate”). Petition at 104.

Reliability Transmission Upgrades are defined as:

those additions and upgrades not required by the interconnection of a generator that are nonetheless necessary to ensure the continued reliability of the NERTO system, taking into account load growth and known resource changes, and include those upgrades necessary to provide acceptable stability response, short circuit capability and system voltage levels, and those facilities required to provide adequate thermal capability and local voltage levels that cannot otherwise be

achieved with reasonable assumptions for certain amounts of generation being unavailable (due to maintenance or forced outages) for purpose of long-term planning studies. In evaluating proposed Reliability Transmission Upgrades, NERC, NPCC, NERTO, and other reliability agency, and Transmission Owner criteria, rules, standards, guides, and policies will be used to define the system facilities required to maintain reliability.

Petition at 99, n.115. “Market Efficiency Reliability Upgrades” are defined as

those additions and upgrades that do not qualify as Reliability Transmission Upgrades, are not related to the interconnection of a generator, and are designed to improve the efficiency of the markets, by for example, reducing congestion in load pockets and relieving “bottled generation.”

Id., n.116. The NSP, which must be approved by the NERTO Board, determines whether a project meets the criteria for a “Reliability Transmission Upgrade” and thus is eligible for socialization.

2. The NSP Process and Planning Horizon

An NSP, based on “the results of a new comprehensive system enhancement and expansion study,” is issued at least every three years. The NSP has a ten-year planning horizon, “reflecting a ten-year capacity and load forecast.” Petition at 98. The NSP will produce a list of proposed Reliability Transmission Upgrades and Market Efficiency Transmission Upgrades for “the next five years.” In the intervening years, the NSP can be updated and transmission upgrades can be added or removed. However, if a transmission upgrade on the NSP list is removed by NERTO because it is no longer necessary, the entity responsible for the construction of the upgrade will be reimbursed for any prudently incurred costs (plus a reasonable return on investment) relating to “the planning, designing, engineering, permitting, procuring and other preparation for construction, and or construction of the Transmission Upgrade proposed for removal from the plan.” The cost allocation applicable to the type of upgrade will be

used for the allocation of these “stranded” costs. NERTO Planning and Expansion Process Attachment 7 § 3.4 to Petition.

In determining whether to include a particular “Market Efficiency Transmission Upgrade” in approving the NSP, the Board of Directors “shall consider the relative severity of the congestion addressed by that Market Efficiency Transmission Upgrade.” *Id.* § 4.4. Thus, if a Market Efficiency Transmission Upgrade is included in the Board-Approved NSP, but is later cancelled because the market has met the need that would have been addressed by the upgrade, the costs expended on the project would be paid in accordance with whatever cost allocation methodology—whether NERTO socialized, intra-region socialized or localized--the Board chose for the upgrade.

B. Socializing Transmission Upgrade Costs Is Fundamentally Inconsistent With LMP

The NERTO filing’s distinctions between (1) “Reliability Transmission Upgrade” and “Market Efficiency Transmission Upgrade” and (2) “Reliability Transmission Upgrades” of 345 kV and above and those below 345kV for the purpose of determining cost allocation set forth a two (and possibly three) tiered socialization scheme. The extremely broad definition of a reliability upgrade could include upgrades that provide reliability benefits within a given zone or within the whole region. Thus, a project that promotes reliability within a specific zone would be socialized either across the entire NERTO region or within either of the sub-regions (New York or New England), depending on the project’s location. There would be no inquiry about what specific entities or areas benefit from the upgrade. Under the NERTO proposal, for example, consumers in all of NERTO could pay for a 345 kV line that primarily promotes reliability in one area of one sub-region. Similarly, any project below 345 kV

that meets the broad definition of a reliability upgrade would be socialized across the entire sub-region even if it provides “reliability” benefits to only one small portion of the region.

Socialization as a cost allocation methodology is fundamentally inconsistent with an LMP congestion management system. In bid based competitive markets, LMP conveys price signals that are intended to elicit market responses – either through changed consumption behavior, new generation, or transmission system upgrades (merchant or regulated). Consumers² should be spurred to action by the prices, and should have the freedom to choose from a number of competing alternatives that remedy the problem. Consumer decisions to invest in alternative remedies to congestion-impacted prices also involve risks.³

Region-wide transmission planning, if combined with socialization of the cost of transmission found to be "needed," will change risk analyses for both generators and consumers and disastrously deter investment in any non-transmission solution because it will provide incentives for the construction of *non-economic* transmission upgrades. For example, under a cost-causation cost allocation methodology, if either a transmission upgrade or new generator location could relieve congestion in a high-cost congested area, the consumers (or their representatives) in the area that would benefit from a transmission upgrade might reject the upgrade proposal if the cost to build it is higher than the cost of the congestion or the cost of load response programs. In such a

² Load servers who buy at wholesale will translate wholesale market prices into retail prices, and may do so in a variety of ways.

³ E.g. technology risks, assumptions about future generation bid behavior, about generation fuel prices, or alternative fuel prices, etc.

circumstance, the project would likely not proceed and there would be an incentive for investment in generation and load response programs within the load pocket. If, on the other hand, the costs of an upgrade are spread over a much larger group, even an uneconomic transmission project may be attractive to those who can get the benefit of the project while only having to pay a portion of the cost. Therefore, such areas may encourage a non-economic solution to transmission congestion in place of other economic alternatives such as generation or load response.⁴ Accordingly the following results are likely if costs are socialized:

- Inefficient generators operating at high cost within a load pocket will not invest to upgrade plants because competition from lower cost generation outside the load pocket will be brought in as competition and they will receive no returns from their investment.
- Consumers will not make significant commitments to alternative technologies with long term paybacks because of the possibility that the return on their investment will be undercut through a socialized transmission project.
- Load servers will not start any innovative pricing programs or invest in real-time metering technologies if they perceive that a socialized solution will reduce prices.
- New generators will be reluctant to develop projects in such a region because prices can soon be expected to fall.
- Transmission providers assured of cost recovery on transmission projects will work to delay the market responses.

In a competitive market, the Commission must ensure that centrally planned transmission projects are accompanied by mechanisms that allocate the project costs according to the perceived benefits. Instead of the current NERTO proposal that

⁴ As discussed below, while socialization may encourage the development of non-economic transmission projects, it may also discourage the siting of economic projects that do not provide a benefit to the area in which they would be sited.

has socialization as the default mechanism for all “Reliability Transmission Upgrades,” ISO-NE and the New York ISO should develop procedures to facilitate voluntary project financing and allow those who will bear the increased costs or reduced reliability to decide whether the planning results are sufficient to warrant investment in the proposed solution.⁵ Prices will provide incentives to investigate alternatives for load interests, and once again state regulators will be able to work with their jurisdictional utilities to determine whether the benefits of such projects exceed their costs. Paying for projects in any other way will harm the competitive process, impoverish those who are bystanders, and unfairly enrich those who are beneficiaries.

C. Socializing Transmission Upgrade And Expansion Costs Under LMP Will Delay – Not Hasten -- The Construction Of New Facilities

The new market rules, when combined with efforts to socialize transmission costs, create incentives for utilities and political bodies to resist transmission expansion. LMP returns the cost of congestion to its rightful owners - the consumers who cause them. When congestion is relieved through transmission upgrades, these consumers alone benefit from lower prices while prices in proximate nodes or zones will increase. There is no mechanism available to share the relief, and no mechanism for creating “Savings Shares” as was done in New England in the past.⁶ Merchant generators will use revenues in excess of marginal costs to reduce fixed costs and are not likely to “split the savings” as regulated companies once did voluntarily. Since these savings will no longer be shared with them, public utility commissions and siting councils in states

⁵ This would restore the same standard that was in place before the socialization of congestion costs. See Appendix A, A Brief History of Cost Allocation Prior to Restructuring in NEPOOL.

⁶ See, Appendix A at 1.

where the transmission will be constructed, but where the new lines will not provide access to lower priced generation, will almost certainly resist issuing permits as there will be no benefit and only increased costs for their consumers. Even transmission utilities are likely to resist expansion projects if the result of those projects is to raise rates and thereby depress sales in their service areas.

D. NERTO's Socialization-based Cost Allocation Methodology is Inconsistent with Commission Policy

The Commission has clearly, and on several occasions, rejected a cost allocation methodology that broadly socializes costs across New England without any determination of which entities will benefit. *See ISO New England*, 95 FERC ¶ 61,384 at 62,439 (2001) (finding that NEPOOL's compliance filing that assigned the costs of transmission upgrades in Northeastern Massachusetts to the entire pool was not in compliance with the Commission's earlier order that directed NEPOOL or ISO to develop cost allocation methodology that "assign[s] expansion costs to those parties who benefit from their expenditure, to the extent those parties can be identified."); *ISO New England, Inc.*, 98 FERC ¶ 61,173 at 61,647 (2002) (allowing socialization of transmission upgrades only as an *interim* measure until LMP can be implemented in New England); *ISO New England, Inc., Inc.* 100 FERC ¶ 61,029 at 61,078 (2002) (granting the clarification sought by the MPUC and the Vermont Department of Public Service that when LMP is proposed in New England, ISO-NE or NEPOOL is required to replace its current socialization cost allocation methodology with a "revised default cost allocation methodology consistent with an LMP scheme."); *New England Power Pool*, 100 FERC ¶ 61,287 at 62,286 (2002) (granting the MPUC request that ISO-NE or NEPOOL be

directed to file as part of SMD implementation in New England a new cost allocation methodology that requires parties that will benefit from transmission upgrades to bear the cost of the upgrades and finding that under LMP “parties will be able to see more readily which areas would most benefit from transmission upgrades, and what party or parties will most benefit.”)

The NERTO proposal simply perpetuates the current NEPOOL cost allocation methodology that broadly socializes transmission upgrades regardless of which entities benefit from the upgrade. Because this methodology has already been rejected by the Commission as inconsistent with an LMP congestion management system, NERTO should be required to replace its proposed socialization-based cost allocation methodology with one that assigns cost of upgrades to the entities that benefit from the upgrade.⁷

E. The Distinction Between Reliability and Economic Upgrades Has Already Been Rejected by the Commission

In its June 28, 2000 Order on ISO-NE’s proposed congestion management and multi-settlement system proposal, the Commission rejected the ISO’s proposed distinction between economic and reliability upgrades for the purpose of determining whether the cost of an upgrade should be socialized. The ISO had proposed that the costs

⁷ NERTO’s socialization cost methodology also is inconsistent with the Commission’s NOPR on Standard Market Design. Socialization is not the Commission’s preferred alternative for an independent RTO. Rather, the Commission stated:

Our preference is to allow recovery of the costs of expansion through participant funding, *i.e.*, those who benefit from a particular project (such as generator building to export power or load building to reduce congestion) pay for it.

Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, Notice of Proposed Rulemaking, Docket No. RM01-12-000 (July 31, 2002) at ¶ 197. The

of reliability upgrades be socialized. The definition of a reliability upgrade proposed by the ISO in that case (quoted below) is nearly identical to that in the NERTO filing:

The ISO defines reliability upgrades as those necessary to ensure continued reliability of [the] NEPOOL system taking into account load growth and known resource changes. Reliability upgrades include those upgrades necessary to provide: (a) acceptable stability response; (b) short-circuit capability; (c) system voltage levels; (d) facilities necessary to provide adequate thermal capability; and (d) local voltage levels that cannot be otherwise achieved. They are determined using NERC, Northeastern Power Coordinating Council (NPCC), NEPOOL, ISO New England, and transmission owner criteria, rules, standards and policies to define the system facilities needed to maintain reliability.

ISO New England, Inc., 91 FERC at 62,074. The costs of reliability upgrades would be socialized while the costs of economic upgrades generally would not be socialized (although there were broad exceptions).

The Commission rejected the distinction between economic and reliability upgrades:

While the ISO describes technical differences between reliability upgrades and economic upgrades, it does not explain why such distinctions are important or relevant to cost recovery. As the ISO notes, there are instances in which an upgrade marked as economic today may in the future be considered reliability. Thus, many (if not all) upgrades serve both purposes to various degrees. *Particular cost responsibility does not necessarily follow from the stated purpose of the upgrade.*

Our general principle is to assign costs of various upgrades to those who benefit to the extent that they can be identified, regardless of how the upgrade is classified.

Id at 62,076 (emphasis added). While the Commission did not rule out socialization in some circumstances if all parties agreed that the upgrade benefited the entire system, it found that the distinction between reliability and economic upgrades was arbitrary. *Id* at

NOPR proposes a region -wide“roll-in” of costs of transmission upgrades of 138kV or higher only *in the absence of a regional planning process conducted by an independent entity.* *Id.* ¶ 200.

62,077. The Commission also found that parties were likely to contest the classification of a project. “Pool-wide support for reliability projects may fail if all parties do not agree on whether particular projects are required solely for reliability purposes.” *Id.*

The NERTO proposal simply disinters an earlier distinction that the Commission rejected as arbitrary, unworkable and inconsistent with its general policy in favor of assigning costs of upgrades to those that cause the costs to be incurred. And while it is difficult, if not impossible, to determine whether a project is needed for “reliability” or “market efficiency,” under an LMP system it will be relatively easy to see which areas and parties “will most benefit” from the upgrades.⁸ *ISO New England, Inc.*, 100 FERC at 62,286. Accordingly, the Commission should reject the arbitrary and unworkable distinction proposed by NERTO and direct NERTO to replace it with the cost causative methodology that the Commission directed ISO-NE to adopt upon the implementation of LMP in New England.

F. The Commission Should Direct NERTO To Propose A Cost Allocation Process That Matches The Costs To The Benefits

Work is already underway to develop a planning process and cost allocation process that is compatible with LMP. The Regional Transmission Expansion Planning process underway in New England is an initial step toward a sound cost allocation proposal. The planning process continuously identifies problems and evaluates a wide range of solutions in a comprehensive and integrated manner. At the conclusion

⁸ As discussed below, ISO-NE’s RTEP process already provides a basis for determining which parties or areas will most benefit from the upgrade. For example, ISO-NE’s draft RTEP-02 models the congestion costs that will be paid in Connecticut due to congestion in Southwestern Connecticut. The relief of these congestion costs in addition to local reliability benefits clearly indicates that Connecticut will most benefit from any transmission upgrade in Southwestern Connecticut.

of the annual process, a report is produced that includes the ISO's recommendations for remedying problems that have been identified. The process is open to all, and opportunities for input are available through the Transmission Expansion Advisory Committee.

The "Projected Congestion Cost Analysis" in Section 7 of the report, gives a reference case that projects sub-area congestion costs without any transmission projects. From the reference case, the amount of benefit to each sub-region from various projects has also been calculated. These calculations should form the basis for cost allocation. Naturally, as the ISO has noted, this type of scenario analysis necessarily relies on multiple assumptions that are imprecise by nature, but it will align the costs of projects to the beneficiaries more fairly and more consistently with the principles of LMP than the pro-rata apportionment produced by socialization. This is not to suggest that none of the costs of new transmission should ever be socialized. First, there could be a determination that a project primarily benefited the entire region rather than one area. Second, even where one area clearly benefits most from a project, it may be appropriate to socialize a small percentage of the costs of a major project based on the assumption that there may be some regional reliability benefits from any major project.

While there will always be a certain degree of imprecision in such cost allocations, there is a much greater degree of imprecision in simply socializing all the costs without regard to who the beneficiaries are. Moreover, regulators frequently make cost allocation decisions in rate design cases, and we are aware that cost allocation is imprecise by nature. The determination by the Commission of whether the rates designed

to recover transmission expenditures are “just and reasonable” will be made easier, rather than more difficult, if the costs are allocated in this manner instead of socialized.

Finally, it would be reasonable to create a trigger mechanism⁹ that allows the costs to be reallocated if there is a discrete change in the use of the system that provides quantifiable benefits to those left out of the initial recovery scheme.

G. The Commission Should Direct NERTO to Incorporate a Resource Adequacy System into its NSP

The Commission’s NOPR on Standard Market Design proposes a new system for assuring that there is adequate capacity to avoid reliability problems and dampen energy price volatility. The extended deadline for comments will allow interested parties to further develop and refine proposals for ensuring adequate capacity.

In our view, any resource adequacy proposal should meet the following objectives:

- It should interfere minimally in the competitive market, and should be compatible with retail as well as wholesale markets;
- It should advance an acceptable level of reliability at a reasonable price;
- It should create a level playing field in which demand side contributions toward maintaining reliability are equally valued and encouraged; and
- it should be flexible enough to allow for modification and, at least in principle, elimination.

None of the current capacity programs meet these objectives. We envision a new system that would link capacity payment to delivery within a specific area during a specific time period. At the heart of the new system is a relatively short-term (three or four years) plan of what type of capacity will be needed in specific areas.

Because of the shorter planning horizon, the capacity program may be able to be more sensitive to demand side contributions. Importantly, the system would differ from current systems because it contains a much greater degree of accountability.

Under the current system in New England, load makes capacity payments based on the theory that the stream of revenues produced by the payments will provide incentives for investors to build new generation. However, there is no requirement for them to do so. Here load would pay in advance for the capacity (contracted for on behalf of load by the ISO over the multi-year planning period), but the capacity payments would not be provided to the capacity supplier until the target year and then only if the supplier performs its obligation. Further, the locational aspect when linked to the delivery requirement may provide a lower cost and more flexible response to transmission congestion. Accordingly, we suggest that serious consideration be given to incorporating into the NSP process a requirement to consider the future effects (both in terms of reliability and price stability) of the contracts entered into as part of the resource adequacy program.

We look forward to working with other interested parties, ISOs and the Commission in developing a workable and efficient plan for ensuring capacity adequate to provide reliability and limit the exercise of market power that now characterizes periods of scarcity while preserving the locational pricing signals at the heart of LMP.

⁹ This could be a formal trigger, or could be a 206 filing.

III. CONCLUSION

Based on the foregoing, NECPUC respectfully asks the Commission to:

- I. reject the cost allocation mechanism proposed by NERTO;
- II. direct ISO-NE and NYISO to develop a cost allocation

methodology that allocates costs on the basis of which areas or entities benefit from the upgrade; and

- III. coordinate the NSP process with a location based resource

adequacy system that ties payment of resource adequacy support funds to the provision of energy at a specified target date or period.

Respectfully submitted,

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Dated: November 8, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document by first class mail upon each party on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 8th day of November, 2002.

John E. McCaffrey