

**FEDERAL ENERGY REGULATORY COMMISSION**  
WASHINGTON, DC 20426

March 14, 2011

**OFFICE OF THE CHAIRMAN**

The Honorable Bob Corker  
United States Senate  
Washington, D.C. 20510

Dear Senator Corker:

Thank you for your letter dated February 17, 2011 regarding transmission planning and cost allocation matters pending before the Commission. Like you, I believe it is necessary to address challenges associated with transmission planning and cost allocation in order to ensure the continued provision of reliable electric service to consumers at a reasonable cost. I therefore appreciate the opportunity to respond to your questions and, more generally, provide my preliminary views on these issues.

While the focus of your letter is on the proposed transmission rule issued by the Commission in June 2010 and decisions on cost allocation proposals developed by the Southwest Power Pool, Inc. (SPP) and Midwest Independent Transmission System Operator, Inc. (MISO), to explain the context of the actions taken by the Commission in these proceedings, I believe it is necessary to consider the significant changes that have occurred in the electric industry over the past decade. Building on Congressional action in the Energy Policy Act of 1992 to support the expansion of competition in the market for electric generation, the Commission in 1996 required public utility transmission providers to open their transmission systems to use by others on a non-discriminatory basis. Over time, these actions significantly increased regional and inter-regional trade in wholesale power, with utilities increasingly importing power during times of need and exporting power during times of surplus. As a result, many utilities began to trade regularly, and extensively, with others in their region to take advantage of diversity in consumption patterns and resource portfolios. This expansion in trading activity, in turn, has altered the way the transmission system is used, with an increasing number of transactions occurring across longer distances.

With the increased regional use of the transmission system came the need to address transmission planning and cost allocation over larger footprints than single utility systems. The Commission acted in 2007 to require all public utility transmission providers to coordinate the planning of their transmission systems on a regional basis and to study the potential benefits of transmission system enhancements that could relieve congestion or integrate new resources on a regional basis. This requirement was generally well-received and supported by most industry participants and state regulators.

During this same time period, utilities in regions that were already jointly planning for certain transmission facilities petitioned the Commission for approval of cost allocation mechanisms that provide for the sharing of costs for new transmission facilities jointly planned within the region. Although these cost allocation mechanisms vary across the ISOs and RTOs, each represents a determination by member utilities and other stakeholders that it is appropriate to share in the costs of transmission facilities that are built to serve the common needs of customers in the region. Moreover, each cost allocation mechanism has been designed to reflect the particular characteristics of the region and stakeholder views as to how the benefits of new transmission facilities are distributed within the region. Over time, as system characteristics and stakeholder views have evolved, so too have the mechanisms proposed to the Commission for governing the allocation of new transmission costs.

Utilities, states, and customers outside of the ISO and RTO regions have also enhanced their transmission planning activities to address the increase in wholesale power trades and state-mandated renewable portfolio standards. Although these regions have improved their coordination in transmission planning, most continue to rely exclusively on a “requestor pays” approach to cost allocation for new transmission facilities. During extensive stakeholder outreach that preceded the Commission’s June 2010 proposed transmission rule, many commenters indicated that further reforms in the area of transmission planning and cost allocation may be necessary to address the emerging trade patterns and the needs of wholesale customers outside the ISO and RTO regions, as well as in the ISOs and RTOs. The package of proposals contained in the pending rulemaking represents the Commission's attempt to address these concerns.

With this general background in mind, I turn to your specific questions. The first question relates to the proposed transmission rule’s plan for compliance with public policy requirements. As explained below, under the proposed transmission rule, the transmission providers in a region, working with their customers and other stakeholders, would determine how to resolve potential differences in state requirements that are selected for inclusion in the transmission planning process. Specifically, the Commission proposed to require that transmission planning processes be enhanced to explicitly provide for consideration of public policy requirements established by state or federal laws or regulations that may drive transmission needs. In my view, the inclusion of public policy requirements in the transmission planning process is an appropriate “next step” in the evolution of transmission planning. As utilities search for cost-effective resources to comply with public policy requirements, the regional planning processes provide valuable information to allow the regions to evaluate access to potential sources of supply and to determine the costs of delivered energy. Indeed, the implications of compliance with state-enacted renewable portfolio standards already has prompted three regions, SPP, MISO, and the California Independent System Operator, Inc., to voluntarily develop reforms to their transmission planning processes to include public policy requirements. In each of these regions, the RTOs have coordinated with their stakeholders to identify how public policy requirements will be included in the transmission planning process and the possible solutions to meeting those requirements, including how the cost of transmission facilities needed to comply with those requirements will be allocated to those that benefit.

In our proposed transmission rule, the Commission declined to specify the public policy requirements that the regions must consider in the transmission planning process. As you note, this could require resolution of differences in conflicting public policies adopted by states in the region. I expect these differences would be resolved by regional stakeholders during their planning process and not resolved by the Commission. That is, it would be up to the transmission providers in a region, working with their customers and other stakeholders, to resolve potential differences in those public policy requirements that are selected for inclusion in the transmission planning process. While involving a new set of challenges, this requirement could be a logical extension of existing regional transmission planning processes in which varying interpretations of reliability rules and differences in the operational requirements of individual transmission providers have been harmonized as part of coordinated transmission planning at the regional level.

In your second and third questions, you ask about the beneficiary and cost allocation analyses undertaken by SPP and MISO in support of the reforms in each region. Because these cases remain pending before the Commission, I am limited in my ability to discuss them. In response to your specific question, however, I note that in each case the Commission reviewed the RTOs' processes for planning new transmission facilities and not the specific public policy requirements that would be considered by either RTO. Moreover, as explained in each case, each RTO's proposal built on existing cost allocation mechanisms that already provided for cost sharing for transmission lines with regional benefits, reflecting each region's prior determination to depart from a "requestor pays" approach used in non-RTO regions. In each case, the full Commission found that the RTOs presented evidence that their revised planning analyses undertaken in each region would continue to ensure that the costs of projects included in the SPP and MISO transmission plans are allocated "roughly commensurate" with the benefits of the projects. Given that these cases were decided while the proposed transmission rule was pending, the Commission's evaluation of the proposals was undertaken pursuant to rules and regulations in effect at the time. The extent to which the SPP and MISO planning and cost allocation mechanisms comply with the proposed transmission rule was not before the Commission.

With regard to your fourth and sixth questions, as you note, the preliminary view underlying the proposed transmission rule is that sections 201, 205 and 206 of the Federal Power Act (FPA) may allow the Commission to order an entity that benefits from new transmission facilities to bear a portion of the cost of those facilities, even in the absence of a voluntary agreement to do so. Transmission facilities have many of the characteristics of economic public goods that can be exploited by free riders - persons who consume more than their fair share of a resource or shoulder less than their fair share of the costs associated with the resource. Electricity flows over the transmission grid according to the laws of physics, not the wishes or voluntary agreements of those who provide and receive transmission service. For this reason, the absence of a voluntary contractual arrangement does not generally preclude a party from

benefiting from a transmission facility. In the proposed transmission rule, the Commission preliminarily found that it was necessary to address this free rider problem associated with new transmission facilities in order to ensure that rates remain just and reasonable and not unduly discriminatory or preferential, as required by sections 205 and 206 of the FPA.

In particular, the courts have ruled that FPA sections 205 and 206 require that the costs of jurisdictional transmission facilities be allocated in a way that satisfies the "cost causation" principle.<sup>1</sup> One possible view is that applying the cost causation principle to new transmission facilities leads to a potential for involuntary allocation of costs to entities benefiting from the transmission facilities. The proposed transmission rule recognizes that regional transmission planning processes identify needed transmission facilities as well as beneficiaries of those facilities. In this context, the proposed transmission rule has preliminarily determined that such identification of beneficiaries warrants establishing a closer link between the transmission planning process and cost allocation.

This proposed application of the cost allocation principle would apply equally to ISO/RTO regions and non-ISO/RTO regions. As explained above, however, utilities in the ISOs and RTOs already have implemented mechanisms to provide for the sharing of costs for transmission facilities jointly planned by the region. In light of these existing cost allocation mechanisms, I noted in my testimony before the Senate Energy and Natural Resources Committee last year that the Commission has greater ability to assign transmission costs over broad geographic regions, i.e., the ISO and RTO footprints themselves. This remains true today. However, the current existence of cost allocation mechanisms does not in any way limit the Commission's authority under the FPA to require the development of new cost allocation mechanisms.

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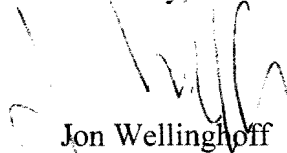
<sup>1</sup> The U.S. Court of Appeals for the Seventh Circuit recently defined the cost causation principle as follows: "All approved rates must reflect to some degree the costs actually caused by the customer who must pay them. Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party. To the extent that a utility benefits from the costs of new facilities, it may be said to have 'caused' a part of those costs to be incurred, as without the expectation of its contributions the facilities might not have been built, or might have been delayed. . . . 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, even though it does so for 345 kV lines, 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. For that matter it can presume that new transmission lines benefit the entire network by reducing the likelihood or severity of outages." *Illinois Commerce Comm'n v. FERC*, 576 F.3d 470, 476-77 (7<sup>th</sup> Cir. 2009).

Finally, in your fifth question you inquire as to the relationship between judicial precedent under section 202(a) of the FPA<sup>2</sup> and the proposed transmission rule's proposal for neighboring transmission regions to coordinate transmission planning activities. Section 202(a) mandates that the "interconnection and coordination of facilities" be voluntary and, therefore, an argument can be made that it does not implicate transmission planning, which occurs well before facilities are interconnected and operated in a coordinated fashion. The proposed transmission rule does not propose any requirements with respect to the interconnection or coordinated operation of facilities.

This view of section 202(a) is also arguably consistent with the language that you noted from *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 29 (D.C. Cir. 2002) (*Atlantic City*). That language restates a holding from *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156 (D.C. Circuit 1979) (*Central Iowa*). In *Central Iowa*, the court upheld the Commission's rejection of a request that the Mid-Continent Area Power Pool (MAPP) Agreement require that MAPP participants construct larger generation units and "engage in single system planning with central dispatch." The request was essentially for an enhanced level of power pooling, which the court characterized as the establishment of "a fully integrated electric system." The court stated that, given "the expressly voluntary nature of coordination under section 202(a), the Commission could not have mandated adoption" of some higher level of power pooling than agreed to by the MAPP participants. Similarly, *Atlantic City* addressed coordinated operation of facilities. As the proposed transmission rule does not propose this type of coordinated operation of facilities, it is not clear that the provisions of section 202(a) are implicated by the proposed transmission rule.

I appreciate the attention that you are giving to these important matters. So that we may fully consider your concerns, the Commission will place your letter and this response in the public record for the appropriate dockets. Please know that I am committed to helping our nation's energy consumers receive access to affordable and reliable electric service. As part of this effort, I believe that it is essential that our nation has a legal and regulatory framework that facilitates an appropriate, efficient expansion of the transmission grid. I look forward to working with you and your colleagues in the Senate on this endeavor.

Sincerely,



Jon Wellinoff  
Chairman

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<sup>2</sup> Section 202(a) states reads, in relevant part, as follows: "For the purpose of assuring an abundant supply of electric energy throughout the United States with the greatest possible economy and with regard to the proper utilization and conservation of natural resources, the Commission is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy." 16 U.S.C. § 824(a) (2006).