April 3, 2012

FERC Upholds Postage Stamp Cost Allocation Methodology

Countering an earlier remand from the Seventh Circuit, the Commission explains why a regional transmission organization should use a postage stamp methodology to allocate the costs of its new high-voltage transmission lines.

In an order issued on March 30,[1] the Federal Energy Regulatory Commission (FERC or Commission) issued an order requiring "postage stamp" pricing to allocate the costs of new 500 kV and above transmission projects in the PJM Regional Transmission Organization Region. *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,230 (2012). The Commission acknowledged that other just and reasonable cost allocation methodologies may exist to allocate the costs of high-voltage transmission facilities. It concluded, however, that PJM Interconnection, L.L.C.'s (PJM's) use of a static-flow-based model is unjust and unreasonable.

The Commission's March 30 order responds to a criticism from the U.S. Court of Appeals for the Seventh Circuit. In *Illinois Commerce Commission v. FERC*, 576 F.3d 470 (7th Cir. 2009), the Seventh Circuit had remanded an earlier FERC order finding that a postage stamp methodology was an appropriate way to allocate the costs of new high-voltage transmission projects included in PJM's Regional Transmission Expansion Plan (RTEP). The court held that FERC's imposition of a postage stamp methodology was not supported by the record in the proceeding. The court was particularly troubled by the Commission's decision to justify its imposition of a postage stamp methodology on the grounds that the relative benefits to the various parties from 500 kV and above facilities are difficult to measure. Concluding that cost allocation must have some connection to the benefits resulting from the project, the court found that FERC had failed to provide "even the roughest of ballpark estimates of those benefits."

PJM's static-flow methodology measures the flows across constrained facilities prior to the addition of a new transmission upgrade and identifies the effect of the various system loads on that constraint. PJM then uses the measure of each load's effect on the constraint to allocate the costs to resolve that constraint. In responding to the Seventh Circuit's remand, FERC stated that such models do not capture all the benefits resulting from high-voltage transmission projects. According to the Commission, allocating the costs of high-voltage transmission facilities to all transmission customers based on a uniform rate for service or "postage stamp" rate will ensure that those entities benefitting from "greater reliability, greater transfer capability, greater opportunities for reserve sharing, and reduced transmission losses, as well as various market efficiency benefits" will bear the costs of those projects.

According to the Commission, PJM's static-flow-based model, while appropriate for allocating the costs of low-voltage transmission facilities, is not a just and reasonable method for allocating the costs of high-voltage transmission facilities because it cannot identify the causes of multiple transmission constraints that will be addressed by a new facility, fails to account for the benefits resulting from the resolution of any constraints other than the constraint that is the focus of the flow-based analysis, and fails to address the changes in transmission system usage and flow that will occur over the life of the new facility. The Commission also concluded that the static-flow model does not recognize the reliability benefits of high-voltage projects that accrue to all system users. The Commission found that 500 kV and above transmission facilities provide essential reliability benefits

1. View the full order at http://www.ferc.gov/EventCalendar/Files/20120330144130-EL05-121-006.pdf.

throughout the region by providing voltage support; ensuring that the system is operated within thermal and stability limits; increasing the ability of the system to deliver power in normal and emergency conditions; responding to daily, seasonal, and long-term changes in system conditions; and providing greater protection against significant system disruptions. The Commission stated that new projects are identified in the PJM RTEP process because they provide such benefits. The Commission therefore concluded that the static-flow-based methodology “misaligns the costs and benefits of 500 kV and above transmission facilities to such an extent that it is an unjust and unreasonable basis for allocating the costs of these facilities.”

The better approach, the Commission stated, is a postage stamp cost allocation methodology that, according to FERC, allocates costs roughly commensurate with the benefits of high-voltage projects. The Commission noted that the Seventh Circuit had not required a comparison of costs and benefits on a party-by-party or utility-by-utility basis. Instead, the Commission stated, “the correct cost-causation principle is whether the planned 500 kV and above facilities will provide sufficient benefits to the entire PJM region to justify a regional allocation of those costs.” High-voltage facilities, the Commission concluded, do provide benefits that are widely shared across the PJM region, and therefore a postage stamp methodology for allocating these facilities’ costs is just and reasonable.

In addition to reliability benefits, the Commission stated that high-voltage transmission facilities provide significant economic benefits to the entire region, including lower congestion costs, fewer outages, lower operating reserve requirements, and lower transmission losses. While the Commission acknowledged that it is difficult to quantify each of these benefits, the Commission nevertheless concluded that because these benefits flow to all utilities in the region, cost-causation principles require that all utilities pay a share of the costs of such facilities. To that end, the Commission concluded that the postage stamp cost allocation method, which allocates costs according to load ratio shares, is a just and reasonable way to allocate the costs of a facility that creates reliability benefits throughout the region because it allocates costs roughly in proportion to the use of the transmission system that is realizing those reliability benefits.

Commissioner Cheryl LaFleur dissented from the order, stating that while PJM’s earlier use of a static-flow-based allocation methodology as the sole method of allocation is not just and reasonable, the Commission should not reject all uses of a flow-based methodology for high-voltage facilities. Commissioner LaFleur explained that she favors a hybrid approach that combines the static-flow-based methodology and a postage stamp allocation on the grounds that this would combine the short-term reliability benefits that led PJM to identify the project while also accounting for the wider, longer-term, and less quantifiable benefits that led the Commission to impose a postage stamp methodology. Commissioner LaFleur urged transmission planning regions to consider such an approach when developing their Order No. 1000 transmission planning proposals.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Washington, D.C.

Glen Bernstein	202.739.5994	gbernstein@morganlewis.com
John McGrane	202.739.5621	jmcgrane@morganlewis.com
Stephen M. Spina	202.739.5958	sspina@morganlewis.com