FERC Proposes Significant Transmission Planning and Cost Allocation Reforms

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On June 17, 2010, the Federal Energy Regulatory Commission (FERC or Commission) issued a notice of proposed rulemaking (NOPR) that would amend its requirements for transmission planning and cost allocation. In this NOPR, FERC seeks to address perceived deficiencies in its transmission planning process and cost allocation requirements that may have inhibited the development of new transmission facilities. The NOPR comes against the backdrop of congressional efforts to pass a comprehensive energy bill prior to the November elections, the enactment of state and federal policies designed to promote increased use of renewable resources and “smart grid” technology, and a perceived need for significant transmission investment nation-wide. Comments on the NOPR are due 60 days after publication in the Federal Register, which will be sometime in mid- to late August.

With respect to transmission planning, the NOPR proposes to build upon the transmission planning reforms in 2007’s Order No. 890, by: (1) providing that local and regional transmission planning processes must account for transmission needs driven by state or federal public policy requirements, (2) improving coordination between neighboring transmission planning regions, and (3) removing the traditional right of first refusal (ROFR) that incumbent transmission providers have maintained to construct, own, and propose cost recovery for transmission projects in their service territories under the existing pro forma open access transmission tariff (OATT). FERC emphasizes in the NOPR that neither incumbent nor non-incumbent transmission providers should receive any preference in the regional transmission planning process.

The NOPR also proposes to establish: (1) a closer link between the transmission planning process and cost allocation in which beneficiaries of new transmission facilities are identified, and (2) new cost allocation principles for intra- and interregional transmission facilities.

Transmission Planning Reforms

The NOPR builds on the procedural framework established under Order No. 890 to tackle three very specific aspects of the economic framework for approving transmission projects. As discussed below, the NOPR proposes to:

1) facilitate new investors in the grid by reforming FERC’s right of first refusal policy (“ROFR”);

2) lift burdens for independent and renewables developers by mandating planning criteria include economic and environmental considerations; and

2) mandate procedural and substantive reforms to the regional planning process initiated under Order No. 890.

Right of First Refusal

Existing FERC policy recognizes that incumbent traditional public utilities have a "right of first refusal" that essentially gives them priority to own, construct, and operate transmission facilities within their respective footprints. The NOPR defines a right of first refusal as "the right of an incumbent transmission owner to construct, own, propose cost recovery for any new transmission project that is: (1) located within its service territory; and (2) approved for inclusion in a transmission plan developed through Order No. 890." NOPR at n.21.

The NOPR states that "the Commission in recent years has seen increasing interest in transmission investment" from non-incumbent transmission developers (merchant and "independent transmission project developers" and utilities proposing transmission outside of their retail franchise) and that certain "deficiencies" present the opportunity for "undue discrimination [that] could discourage these developers from presenting projects in regional transmission planning processes." NOPR at P 38. FERC defines the "deficiency" as follows: "Where an incumbent transmission provider has a right of first refusal, a non-incumbent transmission developer risks losing its investment in developing a proposal for submittal to the regional transmission plan the rights of an incumbent transmission provider that are created by a transmission provider's OATT or agreements subject to the Commission jurisdiction." NOPR at P 87.

The NOPR proposes to give merchant and "independent transmission project developers" the same ROFR rights as incumbent utilities. To support this change, the NOPR seeks comments on requiring utilities to implement a series of tariff changes, as follows:

- First, the NOPR proposes to require utilities to establish "appropriate qualification criteria" for non-incumbents to qualify for ROFR rights to "construct, own, operate, and maintain transmission facilities." NOPR at P 90.
- Second, the NOPR requires utilities to create a standardized application "form by which a prospective project sponsor would provide information in sufficient detail to allow the proposed project to be evaluated in the regional transmission planning process." NOPR at P 91. The NOPR also contemplates that these applications would be submitted together at a specified date every year, presumably so that proposals could be evaluated in a clustered manner. *Id.*
- Third, the NOPR proposes to require each public utility to "participate in a regional transmission planning process," and describe in its tariff the procedures to be "used for evaluating whether to include a proposed transmission facility in the transmission plan." NOPR at P 92.
- Fourth, FERC proposes to require for facilities included in a regional transmission plan that transmission providers remove from their tariffs or agreements "provisions that establish a federal right of first refusal" for an incumbent transmission provider. NOPR at P 93.
- Fifth, the NOPR proposes to create an automatic "right to develop" for proposed projects that are resubmitted for evaluation in a regional transmission plan after being excluded from such plan at an earlier date. NOPR at P 95.
- Sixth, the NOPR proposes to require cost parity for non-incumbents, such that "if an

incumbent transmission project developer may recover the cost of a transmission facility for a selected project through a regional cost allocation method, a non-incumbent must enjoy that same eligibility." NOPR at P 96. In order to receive this treatment, whether for an incumbent or non-incumbent transmission provider, the project must be included in the regional transmission plan. *Id.*

Incorporation of Economic and Environmental Planning Criteria

Building on Order No. 890's principle that required "Economic Planning Studies", the NOPR requires transmission providers to evaluate economic and "state policy" criteria in transmission planning. The NOPR notes that action is needed because "when choosing whether to include a proposed transmission project in its local or regional transmission plan, a public utility transmission provider has no explicit obligation under Order No. 890 or the *pro forma* OATT to evaluate the project based on its potential to facilitate the achievement of public policy requirements." NOPR at P 58.

The NOPR states that the "Commission preliminary finds that transmission needs driven by public policy requirements established by state or federal laws or regulations should be taken into account in the transmission planning process." NOPR at P 63. To remedy this perceived "deficiency", the NOPR proposes to require each public utility transmission providers to "amend its OATT such that its local and regional transmission planning process explicitly provide for consideration of public policy requirements established by state or federal laws or regulations that may drive transmission needs." NOPR at P 64. This requirement is intended to "supplement" the existing planning criteria, including reliability factors; however, it is unclear to what extent FERC expects these criteria to be weighed against existing criteria. Although FERC specifically mentions renewable portfolio standards and economic criteria, the NOPR fails to specify precisely which "public policy" requirements should be incorporated. Instead, it requires "transmission providers to coordinate with [their] customers" to identify these requirements. NOPR at P 65. To incorporate these proposed requirements, the NOPR proposes to require a compliance filing demonstrating compliance with these objectives. NOPR at P 66.

Procedural Reforms

Order No. 890 imposed on transmission providers a regional participation "principle", which required public utilities to coordinate with interconnected systems to share data and attempt to identify joint system enhancements. The NOPR notes that this requirement, however, did not require development of a comprehensive regional transmission plan, NOPR at P 45, and that on compliance with this principal many transmission providers simply "relied on existing regional entities and transmission planning processes, modified as necessary, to comply with the regional participation principle." NOPR at P 49.

Finding that Order No. 890's mandate may be insufficient, the NOPR proposes to require transmission providers to "participate in a regional transmission planning process that produces a regional transmission plan and that meets" the transmission planning principles under Order No. 890.

In addition, the NOPR also proposes a series of *interregional* planning reforms. Specifically, the NOPR proposes to require each transmission provider through its regional planning process, discussed immediately above, to coordinate with neighboring transmission providers "within its interconnection" to address transmission planning issues. NOPR at P 114. The NOPR further requires the development of an "interregional transmission planning agreement" to be filed with the Commission. *Id*. The NOPR proposes to require each of these agreements to include:

1) a commitment to coordinate and identify possible interregional transmission solutions;

2) an agreement to meet at least annually;

3) a formal procedure to identify and jointly evaluate transmission facilities proposed in more than one region; and

4) a commitment to maintain up-to-date contacts. NOPR at P 117.

Although the scope of such interregional coordination is not defined by the NOPR, the Commission "encourage[s] public utility transmission providers to explore possible . . . planning agreements among several, or even all, regions within an interconnection." NOPR at P 115.

Cost Allocation Reforms

In Order No. 890, FERC left the particular cost allocation methodologies up to individual transmission providers. Many providers, particularly those outside RTOs and ISOs, adopted participant funding principles, under which the costs of new facilities are borne by entities that agree to pay for them. In the NOPR, FERC expresses concern that this approach has prevented the development of new transmission facilities, and has proven particularly difficult for integrating wind and other types of renewable generation, many of which are distant from load centers, and for constructing interregional facilities. Participant funding also presents the risk of free rider problems, especially for facilities that affect multiple utilities' transmission systems. FERC finds in the NOPR that, while there is a consensus that costs should be borne by those who benefit from new facilities, there is no consensus about the types of benefits that should be considered or how such benefits should be calculated. NOPR at P 135.

To address these difficulties, FERC proposes in the NOPR to modify its cost allocation process, to tie it more closely to the regional transmission planning process, NOPR at P 156, and to ensure that costs allocated to an entity are "roughly commensurate" with the benefits expected to accrue to that entity. NOPR at P 147. The NOPR would require individual transmission providers to propose a cost allocation method or methods that meet several principles. Each transmission provider's planning process should identify which types of benefits are relevant for cost allocation purposes, which entities are receiving those benefits, and the relative benefits that accrue to various beneficiaries. Transmission providers may have a single cost allocation method for all new transmission facilities or different methods for different types of facilities (such as those facilities that are driven by needs associated with maintaining reliability, relieving congestion, and achieving public policy requirements established by state or federal law/regulations). NOPR at PP 159-160.

The NOPR also seeks to address interregional facilities, by requiring that transmission providers located in neighboring regions develop a mutually agreeable method for allocating between the regions the costs of a new facility that is located in both regions and that is eligible for interregional cost recovery pursuant to the region's interregional transmission planning agreement. NOPR at P 161. A group of three or more transmission planning regions within an interconnection may, but is not required to, agree on and file a common method for allocating costs among their regions. NOPR at P 173.

FERC notes that transmission providers will have the first opportunity to develop cost allocation methods in consultation with customers, stakeholders, and neighboring transmission providers. In the event agreement cannot be reached, FERC will use the record in the relevant compliance proceeding to develop a cost allocation method or methods that meets FERC's proposed requirements. NOPR at P 163.

FERC will assess each utility's cost allocation method based upon several cost allocation principles set forth in the NOPR, which principles apply both to intraregional and interregional facilities. NOPR at PP 164, 174. FERC's proposed cost allocation principles are:

- Costs must be allocated to those that benefit from new facilities in a manner that is at least roughly commensurate with estimated benefits. Benefits may include, but are not limited to: the extent to which the facilities provide for maintaining reliability and sharing reserves, production cost savings and congestion relief, and/or meeting public policy requirements established by state or federal laws or regulations that may drive transmission needs.
- Those entities or regions that receive no benefit, either at present or in any likely future scenarios, must not be involuntarily allocated costs.
- If a benefit-to-cost threshold is used to determine which facilities have sufficient net benefits to be included in a regional transmission plan, the threshold must not be so high that facilities with significant positive net benefits are excluded from cost allocation. Any threshold may not exceed 1.25 unless the region or transmission provider justifies and FERC approves the use of a higher threshold.
- For intraregional facilities, costs must be allocated solely within that transmission planning region unless another entity outside the region voluntarily agrees to assume a portion of the costs. For interregional facilities, costs must be assigned only to transmission planning regions in which the facility is located. The transmission planning process in the original region or regions must identify consequences for other transmission planning regions (such as necessary upgrades), and if the region or regions within which the facility is located agree to bear the costs associated with such upgrades, the cost allocation method must include provisions for allocating the costs of upgrades within the original region or regions.
- The cost allocation method and data requirements must be transparent with adequate documentation to allow stakeholders to determine how they were applied to a proposed facility.
- A transmission planning region may choose to use a different cost allocation method for different types of transmission facilities in the regional plan.

FERC emphasizes in the NOPR that its proposed cost allocation principles would not prohibit voluntary participant funding. However, the NOPR would permit a transmission developer that believes its project would benefit others could propose its project in the regional planning process, which will evaluate the transmission project's beneficiaries. NOPR at P 168.

Compliance Filings

FERC proposes to require each public utility transmission provider to make a compliance filing within six months of the final rule in this proceeding, revising its OATT to demonstrate it meets the requirements of the rule that do not relate to proposed requirements relating to interregional transmission planning agreements and interregional cost allocation. NOPR at P 179.
FERC proposes to require each public utility transmission provider to make a compliance filing within one year of the final rule demonstrating it meets the requirements with respect to interregional transmission planning agreements and interregional cost allocation methods. *Id*.

Applicability of the NOPR's Reforms

FERC expects that all transmission providers will participate in the regional transmission planning and cost allocation processes laid out in the NOPR, including those transmission providing entities that do not fall under the Commission's traditional FPA jurisdiction. FERC also indicates that its reciprocity requirement dictates that non-jurisdictional transmission providers that take advantage of open access are subject to the same transmission planning and cost allocation requirements as jurisdictional transmission providers. FERC also notes that, while it does not find it necessary at this time to exercise the expanded authority it was granted in the Energy Policy Act of 2005 (under Section 211A of the Federal Power Act) to order public entities to provide open access, if FERC finds that these entities are not participating in the regional planning process, it may exercise that authority on a case-by-case basis.

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