Van Ness Feldman LLP
vnf.com

Seventh Circuit Again Rejects FERC's Approval of "Postage Stamp" Cost Allocation for High Voltage PJM Transmission Projects

JULY 1, 2014

Doug Smith, Justin Moeller, and Tom Hutton

In a reprise of the 2009 case *Illinois Commerce Commission v. FERC* (*ICC I*), the United States Court of Appeals for the Seventh Circuit has once again set aside the Federal Energy Regulatory Commission's (FERC) approval of the PJM Interconnection, LLC's (PJM) methodology for allocating the costs of certain high voltage transmission projects planned and approved by PJM before February 1, 2013. The case raises questions about what analysis of benefits is needed to show that a particular cost allocation will be "roughly commensurate" with the distribution of benefits, and in particular what support is required for proposals to "socialize" transmission project costs among the utilities within a regional transmission organization or other regional planning body.

Background

In *ICC I*, the Seventh Circuit set aside FERC's 2007 approval of PJM's cost allocation methodology with respect to high-voltage transmission lines that operate at 500 kV and above. PJM's method was to allocate those costs to entities across its entire footprint, based on each entity's load share (the "postage stamp" methodology). The *ICC I* court remanded, tasking FERC with providing some assurance that the costs imposed on a PJM member for new transmission lines are "roughly commensurate" with the benefits to that member.

On remand, FERC considered possible ways of quantifying the benefits of new projects, but ultimately determined that they were unworkable, and that high-voltage transmission lines should be treated as benefiting the entire system. Thus, FERC once again determined that PJM members, regardless of their location within PJM, could fairly be allocated the costs of new high-voltage transmission in proportion to their load.

Subsequently, in response to Order No. 1000, PJM's Transmission Owners filed a revised cost allocation methodology for new 500 kV and above transmission facilities (and 345 kV and above double-circuit facilities) that allocates 50% of the cost of such facilities using the postage stamp methodology, and 50% using a flow-based analysis to identify beneficiaries. This hybrid cost allocation was accepted by FERC for facilities approved in the PJM transmission expansion plan on or after February 1, 2013. As a result, the postage stamp methodology at issue in *ICC I* and *ICC II* applies to a limited set of facilities. FERC noted on rehearing of its remand order that cancellation of certain projects approved under the prior cost allocation regime reduced the total investment subject to the disputed postage stamp allocation from $6.6 to $2.7 billion. Most of the facilities approved prior to February 1, 2013 have been constructed already and are located in the eastern region of PJM.

Decision

In a majority decision by Judge Richard Posner (the author of the majority opinion in *ICC I*), the court once again rejected the "postage stamp" methodology as inadequately supported. The court emphasized that it was not rejecting the methodology itself, but was simply responding to "the absence from the Commission's orders of even an attempt at empirical justification." The court dismissed FERC's observations that during the 40-year lives of the high-voltage projects costs and benefits would likely shift, and utility territories would be redrawn. These future contingencies were insufficient reasons, in the court's view, not to use a cost-benefit analysis.

Judge Richard Cudahy, formerly a Wisconsin public utility commissioner, dissented from the majority decision, as he did in *ICC I*. In his view, "the majority is charging the Commission with lack of commitment in pursuing a 'two plus two equals four' solution, but the Commission is dealing with incommensurable forces and conditions as skillfully and honestly as it can." Judge Cudahy found indistinguishable the Seventh Circuit's 2013 decision of the same name, *Illinois Commerce Commission v. FERC*, wherein the court upheld a similar postage stamp cost allocation methodology (predicated on usage rather than peak demand) used by the Midcontinent Independent System Operator, Inc. (MISO) for multi-value projects (MVPs). Writing for the majority in that case, Judge Posner noted that even if MISO and FERC could only provide "crude" cost/benefit comparisons of the MVP program, "it will have to suffice."

Implications

While the postage stamp cost allocation methodology at issue in *ICC I* and *ICC II* was ultimately superseded by a hybrid methodology proposed by the PJM Transmission Owners in response to Order No. 1000, this decision has implications for transmission cost allocation beyond the limited set of facilities that will be directly affected by FERC's decision on remand. FERC's Order No. 1000 requires regional transmission planning entities to adopt cost allocation mechanisms for transmission expansion projects that are consistent with *ICC I*'s "roughly commensurate" standard, and this decision sheds light on the level of justification a reviewing court may require under that standard for regions that elect to socialize the cost of certain categories of facilities.

The court in *ICC II* was not satisfied by the FERC's general findings that benefits were broadly distributed and changing over time and that more particularized analysis of benefits was difficult. Judge Posner distinguished the Seventh Circuit's prior MVP decision, citing "crude" evidence that the MISO MVP facilities at issue "would not yield highly disparate benefits to the utilities asked to contribute to their costs," while "no such determination in the present case was made." On remand of *ICC II*, and in other cases involving cost allocation going forward, cost allocation proponents and FERC will need to delve more deeply into the distribution of benefits of high voltage projects – even those extra-high voltage facilities previously assumed to have systemic benefits justifying broad cost allocation.

For More Information

Van Ness Feldman represents clients on a full range of transmission ratemaking and transmission development matters. If you are interested in additional information regarding the Seventh Circuit's decision or its implications, please contact Doug Smith, Evan Reese, David Yaffe, Justin Moeller, or any member of the firm's Electric Practice at (202) 298-1800 in Washington, D.C. or in Seattle at (206) 623-9372.

Follow us on Twitter @VanNessFeldman and @VNFELECTRIC.