

## Organization of MISO States

Hot Topic Response

Cost Allocation

March 2017

The Organization of MISO States (OMS)<sup>1</sup> appreciates this opportunity to provide the MISO Board of Directors, MISO Staff and other stakeholders the State Regulatory Authorities' sector perspective on transmission cost allocation. State regulators<sup>2</sup> are "first among equals" in developing regional transmission cost allocation policy because, in reviewing any cost allocation proposal, the Federal Energy Regulatory Commission (FERC) focuses its inquiry (at least in part) on whether the proposal is generally supported by state regulators. As FERC stated in Order 890, "[t]he states, which have primary transmission siting authority, may be reluctant to site regional transmission projects if they believe the costs are not being allocated fairly."<sup>3</sup>

### 1. Primary drivers for cost allocation changes

**MISO's last major cost allocation enhancement was made with the addition of Multi-Value Projects, which incorporated public policy needs. Going forward, identify and explain what drivers (which may include but are not limited to generation mix changes, FERC policy such as Order 1000, changes in footprint size) should initiate a review for possible cost allocation changes. How should these drivers inform cost allocation methodologies going forward, including the categories of transmission project (such as Market Efficiency Projects, Multi-Value Projects, other economic projects)?**

MISO's cost allocation criteria should generally remain stable and not be changed unless for very clear, sound, and well-supported reasons. State Regulators consider cost allocation methodologies and the existing transmission landscape when planning for resource adequacy. That said, resource adequacy planning would become far more difficult if State Regulators are forced to account for endlessly shifting cost allocation criteria and varying levels of transmission development.

While State Regulators prefer MISO's cost allocation criteria remain relatively stable, MISO must be responsive to significant changes which may cause the cost allocation criteria to merit revision to comport with the beneficiaries-pay and cost-causation principles.<sup>4</sup> For example, significant changes in footprint size or federal and state legislation/regulation that affect MISO's conduct of reliably and economically delivering energy may necessitate a review for possible cost allocation changes. This is evident in the Regional Expansion Criteria and Benefits Working Group (RECBWG)'s on-going review of MISO's MEP criteria that is tied, at least in part, to the recent addition of the MISO South.

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<sup>1</sup> The Public Utility Commission of Texas abstains from this response.

<sup>2</sup> For purposes of these responses, "State Regulators" and "state(s)" shall include the Council of the City of New Orleans.

<sup>3</sup> *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 720 Fed. Reg. 12266 (Mar. 15, 2007), 118 FERC ¶ 61,119, at P 559-60.

<sup>4</sup> Revisions to MISO's cost allocation criteria should only apply on a prospective project basis.

Before initiating a review for possible cost allocation changes, MISO should first identify the specific cost allocation criteria which may, in its view, merit revision to comport with the beneficiaries-pay and cost-causation principles. MISO should provide detailed reasoning, corroborated by quantitative analysis, to support its conclusion. MISO should also remain open to providing additional analysis on the cost allocation change if requested by stakeholders, in particular State Regulators.

MISO should consider initiating a review for possible cost allocation changes if a stakeholder can demonstrate that the current cost allocation methodology is no longer compliant with the beneficiaries-pay and cost-causation principles. Any stakeholder(s) seeking to alter MISO's existing cost allocation methodologies should identify specific cost criteria at issue and demonstrate through analysis that they are no longer compliant with the beneficiaries-pay and cost-causation principles. The majority of stakeholders could make this demonstration through the MISO issue submittal process. The OMS has additional authorities defined in the Transmission Owners Agreement to request that MISO examine changes in the regional cost allocation methodologies and enable OMS to directly file an alternative cost allocation methodology at FERC.

## **2. Transmission value evaluation**

**In the Regional Transmission Overlay Study, three scenarios (also called futures) are being used to assess future system needs:**

- 1. Existing Fleet**
- 2. Policy Regulation**
- 3. Accelerated Technology**

**What additional benefits, beyond Adjusted Production Cost (APC) savings, could be captured to reasonably justify appropriate transmission project recommendations under these scenarios and why?**

The OMS believes that any benefits considered in the justification of transmission projects must be financially quantifiable, highly certain, and stable over time. At this time, MISO has not presented evidence to stakeholders that any benefit metrics beyond APC have demonstrated all three of these characteristics, but OMS acknowledges the ongoing evaluation of additional metrics through the stakeholder process.

The OMS has concerns with some of the benefits that have been discussed to this point in the stakeholder process.<sup>5</sup> For example, the OMS is concerned that using the Planning Resource Auction (PRA) results as a proxy for the cost of new capacity may make it difficult to quantify capacity benefits in this context.<sup>6</sup> PRA results do not represent the costs of capacity for the vast majority of MISO that does not rely on the PRA for resource adequacy.

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<sup>5</sup> See Benefits Metrics for Transmission Justification: Past and Future, EPUG, at 11 (Jan. 31, 2017).

<sup>6</sup> OMS is only speaking to capacity benefits used to justify projects within the RTOS. OMS takes no position regarding the use of capacity benefits for other purposes.

From a procedural perspective, OMS believes that all discussion of benefits used to justify transmission projects should occur at the RECBWG. Recently, MISO presented potential new benefits to consider for the first time at a stakeholder committee other than the RECBWG.<sup>7</sup> Although projects need to be planned with the intended benefits in mind, it's important that the appropriateness of any benefits metric is first comprehensively vetted at the appropriate stakeholder committee, which is the RECBWG.

### **3. Granularity of benefit and cost allocation determination**

#### **What is the best way to balance the desire for precise cost and benefit matching with the limitations of the planning models – local vs. regional allocation, postage stamp allocation vs. targeted beneficiary, more scenarios, etc.?**

The OMS<sup>8</sup> believes that MISO should focus on the principle of cost allocation to the beneficiaries or cost causers, and ensure that any associated modelling is as robust and accurate as possible. Reasons for this conclusion are indicated below:

A key economics cost allocation principle is that attributable beneficiaries should pay, or, alternatively, attributable cost causers should pay. Economic theory supports that when positive network externalities<sup>9</sup> exist, or if a service is a true public good, then postage stamping costs as a form of cost allocation may be a reasonable method to use since in some sense all customers are benefitting by the improvement or upgrade. Essentially this is another important cost allocation principle to keep in mind when beneficiaries are indeed identified to be the whole MISO footprint.

Another essential consideration in addressing this question is that more powerful computers and complex power modeling software are available since MISO's inception. This means today's modeling techniques are better able to accurately identify cost causers or beneficiaries. At the same time, the markets have continued to evolve and mature to incorporate additional ancillary services and FERC-ordered inter-regional coordination. That said, computer models require projected inputs and future scenario assumptions that are inherently uncertain, which can affect the results, meaning some uncertainty still remains such as future generation ownership assumptions. That uncertainty can be scoped and managed through good planning and the application of risk assessment and mitigation practices.

Because of this background, OMS believes the answer to this question is that MISO should focus on the principle of cost allocation to the beneficiaries or cost causers, and ensure that any associated modeling is as robust as possible. Cost allocation policy that evolves would

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<sup>7</sup> See Benefits Metrics for Transmission Justification: Past and Future, EPUG, at 11.

<sup>8</sup> The Council of the City of New Orleans does not join in the response to question 3.

<sup>9</sup> A positive network externality is when an additional user or service is added to a network that results in increased value to all users. The classic case of a positive network externality in the economics literature is the telephone. As more users get phones, the network becomes more valuable to all.

remain properly based on cost effectiveness, common sense and sound economic principles. As such, MISO should determine whether Market Efficiency Projects (MEPs) lend themselves to cost allocation at the pricing zone level. In unique situations, perhaps an even smaller area, such as a local balancing authority, might be appropriate to consider.

In addition, the fact that there is modeling uncertainty should not imply that the only appropriate cost allocation method to use is a postage stamp or sub-regional cost allocation. In the future, MEPs may include lower voltage projects, as brought up in MISO's December 2016 MEP Straw Proposal December. The engineering dynamics are such that it is unlikely that lower voltage projects will provide widely experienced benefits.

As MISO and its stakeholders reconsider cost allocation, bearing in mind the likelihood that modeling may continue to improve with even further technological advances and that changes in the generation and transmission mix are on the horizon, perhaps MISO should periodically compare the modeling results for previously approved MEPs to actual market results, say every 3 to 5 years. A periodic review process is particularly important since the distribution of benefits is more likely to change over time due to unrealized planning assumptions regarding transmission and generation expansion. Information gained during the periodic review could reveal the need for modeling improvements or future changes to the cost allocation criteria.

MISO might also consider that the changing generation fleet, increased distributed energy resources (DER), and new types of transmission assets (*e.g.*, storage) might lead to additional system assets for local cost/benefit cost allocation which would be primarily linked to the transmission pricing zone (TPZ) in which they are located. Such new transmission system assets might also bring marginal aggregate benefits to local reliability and area market economics.

In summary, OMS supports cost allocation based on economic principles that rely on beneficiaries pay principles or that costs be borne by cost causers. Due to modeling advances, OMS supports more granular application of cost allocation methods, as long as such effort is based on robust quantitative analysis. Imprecision should not be a reason for the application of postage stamp type of cost allocations for MEP projects. Postage stamp cost allocations should only be used when there is sufficient quantitative evidence that a positive network externality exists or that there is a provision of a true public good benefiting all in the MISO footprint.