OMS Transmission Cost Allocation Working Group
Feedback on Cost Allocation Issues Whitepaper
10/14/2015

The Organization of MISO States ("OMS") Transmission Cost Allocation Working Group ("TCAWG") offers the following feedback to MISO regarding its Cost Allocation Issues Whitepaper (the "Whitepaper"), presented to the Regional Expansion Criteria and Benefits Task Force ("RECBTF") on September 14, 2015:

A. MISO should substantiate certain claims contained in the Whitepaper

Before moving forward, MISO should substantiate some of the claims it makes in its Whitepaper. For instance, MISO states in the Whitepaper that "although [it] is committed to considering all projects regardless of voltage," the current 345 kV voltage threshold for Market Efficiency Projects ("MEPs") "introduces the risk that beneficial lower-voltage economic projects *could be* overlooked because processes are primarily constructed to evaluate only projects that are 345 kV and higher."[1] However, the Whitepaper did not demonstrate with quantifiable data that beneficial lower-voltage economic projects in fact *are* being overlooked.

The TCAWG is particular puzzled by MISO's claims concerning MISO's treatment of lower voltage projects in its economic planning processes. The current economic planning processes (i.e., the Market Congestion Planning Studies (MCPS)) do not prohibit participants from proposing projects that do not meet the 345 kV threshold. MISO staff have emphasized again and again during recent MCPS workshops that MISO's economic planning processes *are not* designed to identify only potential MEPs, but *all* project proposals that could increase efficiency by decreasing overall production costs. The TCAWG is aware that on a few occasions,

[1] Whitepaper at 6-7 (emphasis added).

incumbent transmission owners elected to construct a sub-345 kV project that was studied by MISO yet failed to meet the current voltage threshold.

Before moving forward, MISO should substantiate its claim that beneficial lower-voltage economic projects maybe overlooked in the current processes. It should evaluate prior MCPS and its forerunner, the Market Efficiency Planning Study, to determine: (a) how many lower voltage projects were studied; (b) how many projects proved beneficial (i.e., meet or exceed a 1.25 B/C ratio); and (c) the ultimate fate of those projects (e.g., constructed by incumbent TO).

Finally, the TCAWG supports the exploration of improved granularity in benefits measurement and cost allocation.[2] However, MISO should explanation its evolution on this issue, particularly in light of MISO's previous stance regarding "false precision." Previously, MISO has argued that although production cost models calculate results at the pricing zone level, "there is 'false precision' in using those results to determine a fixed allocation of costs to each pricing zone over the long life of a transmission line due to the uncertainty in accurately forecasting each party's transactions in the market."[3]

B. Comments regarding Risk Metrics

[2] Several members of the TCAWG are open to considering and analyzing potential changes to the current definitions and cost allocations for regional transmission projects, but oppose any changes to the same during the MISO South Transition Period. Other members of the TCAWG are more willing to consider changes during the Transition Period.

[3] MISO Motion for Leave to Answer and Answer, FERC Docket ER12-1577 (May 25, 2012), at 7-8 ("May 2012 Answer").[4] Whitepaper at 7.

In the Whitepaper, MISO claims that each of the MEP eligibility criteria "gives recognition to the risk of future uncertainties and thus accounts for the *same risk* multiple times." MISO argues that a change to any one of the current MEP criterion (e.g., benefit-to-cost (b/c) ratio, benefits considered) requires a re-evaluation of all of the criterion because a change to one "could impact the overall risk profile of the project." [4]

The OMS TCAWG is currently not yet persuaded of the need for change to the current MEP eligibility. Rather than controlling for the same risk multiple times, each of the current MEP eligibility criteria – the B/C ratio, project term and discount rate – control for *different risks*. For example, the current 1.25 B/C ratio captures the economic uncertainty of transmission projects while the 20 year project term balanced the consideration of benefits with the uncertainty of predicting benefits in the later years of a project's life. Put differently, the B/C ratio recognizes the risk associated with all economic transmission expansion that costs may exceed benefits due to variety of reasons (e.g., changes in system topology, available generation), while limiting the project term recognizes the risk inherent in predicting future economic conditions twenty plus years in the future.

Moreover, the Whitepaper miscategorizes the benefit MISO considers in its economic planning processes (i.e., adjusted production cost (APC) savings) as a "risk metric."[5] MISO argues that "evaluating only one benefit … is another way to counter the risk that future events will diminish project benefits." It is unclear how not considering certain alleged benefits controls for the likelihood that they will not occur. More importantly, risk metrics control for the possibility that some future occurrence(s) will diminish a project's expected benefits. Thus,

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[4] Whitepaper at 7.
[5] *Id*.

before MISO can employ risk metrics, it must first assess a project's expected benefits based on some preset definition of "benefit." Expected benefits are therefore independent from the risk metrics.

While it does not currently support any changes to existing MEP benefits and criteria, the OMS TCAWG suggests that MISO conduct additional analysis regarding its use of the investor discount rate when performing net present value (NPV) computations. The investor discount rate is the average after-tax weighted cost of capital of the MISO Transmission Owners. This rate reflects an investor perspective. However, as MISO notes in the Whitepaper, which discount rate to use depends on what perspective the decision or policy maker is using. A utility's management would naturally use its average after-tax weighted cost of capital, presently such values are around 8.00 to 9.50 percent, to reflect best investment decisions for their shareholders. The value for ATC is 8.42 percent.

[redacted]

ATC	Amount	Percent	Annual	Weighted
Common Equity		50.00%	12.20%	6.10%
Preferred Stock		0.00%	0.00%	0.00%
Long-Term Debt		50.00%	4.63%	2.32%
Short-Term Debt		0.00%	0.00%	0.00%
Total Utility Capital		100.00%		8.42%

This is from page 4 of ATC's 2016 Rate Formula (Attachment O).

However, other discount rates can be used to reflect other perspectives. The OMS TCAWG believes that a value that reflects public policy interests and future ratepayers argues for MISO to perform NPV scenarios using a lower value than the investors' perspective. Some states that have or had integrated resource planning have used discount rates lower than the investors' rate, as a way to better capture both the investment perspective and future ratepayers. One consumer-oriented rate is to use the interest rate on home mortgages, since such a value reflects a 30 year consumer horizon. For that reason, the OMS TCAWG suggests that MISO consider performing sensitivity NPV analyses, perhaps 100-300 basis points lower than the investors' rate.[6]

C. MISO should address the gap between the MISO South Transition Period and Interregional Cost Allocation.

The Whitepaper correctly identifies a gap in MISO's cost allocation scheme for interregional projects approved during the MISO South Transition Period. According to Attachment FF-6, MEPs approved by the MISO's Board of Directors during the Transition Period which terminate in both MISO South and MISO N/C are allocated to both sub-regions, while MEPs that terminate exclusively within one sub-region are allocated solely to that sub-region.[7] Attachment FF-6 does not address projects that terminate outside of MISO's geographic footprint or the allocation of interregional project costs approved during the Transition Period.

MISO should work with stakeholders to address this issue. The OMS TCAWG believes MISO staff could help stimulate stakeholder discussion and encourage a possible solution by crafting a few examples to address the issue and submitting the examples for stakeholder review and comments.

[6] For example, a 9 percent rate could be used as the bench mark, but a consumer-oriented ratepayer sensitivity using a discount rate of between 5 and 7 percent may be warranted.
[7] Tariff, Attachment FF-6, Section IV.A.2.