Principles of Cost Causation and Cost Allocation

EMUSTF

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Case Law Related to Cost Causation

- Under cost causation, "all approved rates [must] reflect to some degree the costs actually caused by the customer who must pay them." *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992).

- Courts "evaluate compliance [with cost causation principles] by comparing the costs assessed against a party to the burdens imposed *or benefits drawn by that party*" (emphasis added). *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004).

PJM Interconnection, L.L.C., 142 FERC ¶ 61,067 (2013).

From P 10 of the Order:

- PJM proposed to revise section 3.2.3(d) of Attachment K-Appendix to the Tariff and Schedule 1 of the Operating Agreement to change the manner in which PJM allocates the cost of day-ahead operating reserves for resources scheduled to provide black start service, reactive services or transfer interface control.
- The cost of operating reserves in the DA Market energy market for resources scheduled to provide black start service for the operating day when those resources would not have otherwise been committed in the day-ahead security constrained dispatch "shall be allocated by ratio share of the monthly transmission use of each Network Customer or Transmission Customer serving Zone Load or Non-Zone Load."
- The cost of operating reserves in the DA Market for resources scheduled to provide reactive services or transfer interface control because they are known or expected to be needed to maintain system reliability in a zone during the operating day and would not have otherwise been committed in the day-ahead security constrained dispatch: "shall be allocated and charged to each Market Participant in proportion to the sum of its real-time deliveries of energy to load (net of operating Behind The Meter Generation) in such Zone, served under Network Transmission Service, in megawatt-hours during that Operating Day, as compared to all such deliveries for all Market Participants in such Zone."

From P 23 of the Order

- "The proposed revisions modify the cost allocation methodology for day-ahead operating reserves to mirror the balancing operating reserves cost allocation methodology for resources scheduled in the day-ahead energy market that would not otherwise be scheduled day-ahead but for certain reliability reasons. The revisions therefore provide consistency in the manner in which these costs are allocated in the day-ahead energy market and real-time energy market and *reflect principles of cost causation*. Accordingly, we find the proposed tariff revisions to be just and reasonable." (emphasis added).

- Cost Allocation Principle 1: costs must be at least roughly commensurate with estimated benefits (P 622).
- Final Rule does not prescribe a definition of "benefits" or "beneficiaries (P 624)
- The cost allocation principles are not intended to prescribe a uniform approach
- Cost Allocation Principle 2: Those that receive no benefit must not be involuntarily allocated costs (P 637).
- Cost Allocation Principle 3: If a benefit-to-cost threshold is established, it must not be so high that participants with significant net benefits are excluded from cost allocation (P 646).
- Cost Allocation Principle 5: Cost allocation method and data requirements for determining benefits and identifying beneficiaries must be known and transparent (PP 668 and 671).

Illinois Commerce Commission v. FERC, 576 F.3d 470 (7th Cir. 2009) (PJM)

- “FERC is not authorized to approve a pricing scheme that requires a group of utilities to pay for facilities from which its members derive no benefits, or benefits that are trivial in relation to the costs sought to be shifted to its members” (2009 ICC Decision at 477).

- The Court declared that FERC must articulate *some sort* of cost-benefit analysis for the allocation of costs for new transmission facilities of 500 kV and above, even if the analysis is imprecise.

- The Court stated if FERC “cannot quantify the benefits [to particular utilities or a particular utility] … but it has an articulable and plausible reason to believe that the benefits are at least roughly commensurate with those utilities’ share of total electricity sales in [the] region, then fine; the Commission can approve [the pricing scheme proposed by the RTO for that region] …on that basis” (2009 ICC Decision at 477)

- In a 2013 ICC Decision, again written by Judge Posner of the 7th Circuit, the Court affirmed FERC's order on MVP cost allocations. The Court differentiated this case from the 2009 case by noting that MISO and FERC had articulated a cost-benefit analysis and "[i]t's not enough for [petitioners] to point out that MISO's and FERC's attempt to match the costs and the benefits of the MVP program is crude; if crude is all that is possible, it will have to suffice" (2013 ICC Decision at p. 13).

- Key takeaways from PJM 2014 remand:
- 7th Circuit waited 5 years for FERC's answer and FERC "made no effort to quantify benefits, but instead allocated costs of new transmission facilities among all members of PJM in proportion to each utility's electricity sales. The 7th Circuit equated this mechanism as "analogous to a uniform sales tax."
- Detailed dollar estimates of many of the benefits do not explain the basis of the estimates.
- The analysis on which studies are based are not described in the FERC order that was rejected by the 7th Circuit.
- Commission pointed to the following benefits as radiating from the upgraded facility and spread throughout the PJM region: reduced congestion, reduced outages, reduced operating reserve requirements and reduced losses. That was not sufficient.
- Don't just say "it's too difficult." Explain cost allocation procedure in as much detail as possible, especially analysis allocation is based on.