



National Regulatory  
Research Institute

## **Postage Stamp Transmission Pricing: The Seventh Circuit Reverses FERC**

**An NRRI Teleseminar Addressing  
*Illinois Commerce Commission, et al. v. FERC,*  
Nos. 08-1306, *et al.* (7th Cir. Aug. 6, 2009)**

**Course Materials Prepared by**

**Scott Hempling, Esq.  
Executive Director, NRRI**

**October 1, 2009**

# Table of Contents

<b>I.</b>	<b>Case History .....</b>	<b>1</b>
A.	FERC opinions.....	1
B.	Seventh Circuit opinion .....	1
<b>II.</b>	<b>Background: Law, Terminology, and Concepts.....</b>	<b>1</b>
A.	Federal Power Act Section 201(b)(1).....	1
B.	FPA Sections 205 and 206.....	1
C.	Regional transmission organization (RTO).....	2
D.	Postage stamp rate .....	2
E.	License plate rate .....	2
F.	FERC's general views on transmission pricing.....	2
G.	Existing facilities vs. new facilities .....	3
H.	The main dispute.....	3
<b>III.</b>	<b>FERC's Decision: Existing Facilities and New Facilities, Sub-500 kV and Above-500 kV.....</b>	<b>4</b>
A.	Existing facilities .....	4
1.	License plate rates recognize cost causation .....	4
2.	License plate avoids cost-shifting that would discourage transmission owners from joining RTOs .....	5
3.	Allocation of sunk costs is unrelated to efficiency.....	5
4.	Benefits of existing facilities vary across territories.....	5
5.	Majority stakeholder views matter .....	5

6.	Integration does not require averaging .....	6
B.	New facilities .....	6
1.	FERC principles.....	6
2.	Below 500 kV: Beneficiary pays .....	8
3.	Special situation: New facilities for local purposes.....	8
4.	500 kV and above: Postage stamp .....	8
<b>IV.</b>	<b>Seventh Circuit Decision .....</b>	<b>10</b>
A.	Setting PJM's transmission charges for the use of <i>existing facilities</i> at marginal cost only, rather than marginal cost plus sunk cost, does not violate the "just and reasonable" standard .....	10
1.	No economic basis .....	10
2.	Monopoly rent.....	10
B.	For transmission over new facilities exceeding 500 kV, FERC has not shown that postage stamp pricing produces a "just and reasonable" price .....	11
1.	No data, no explanation .....	11
2.	Court is unimpressed with the "backbone" metaphor.....	11
3.	Postage stamp causes western utilities to pay for eastern utilities' benefits.....	12
4.	History is irrelevant .....	12
5.	On the difficulty of measuring benefits, FERC is inconsistent .....	12
6.	Litigation uncertainty: FERC failed to quantify the cost.....	13
7.	"Integration" benefits: They exist, but FERC failed to quantify them .....	13
8.	Bottom line.....	15

<b>V.</b>	<b>Comments and Questions .....</b>	<b>16</b>
A.	Cost-benefit analysis after the 7 <sup>th</sup> Circuit decision .....	16
B.	Presumptions, burdens, and "insouciance" .....	16
C.	Is the majority's understanding of "benefits" too narrow? .....	17
D.	Is deference to FERC appropriate? .....	17
E.	How might FERC respond to the 7 <sup>th</sup> Circuit decision? .....	17
F.	What are the decision's consequences? .....	18

# Postage Stamp Transmission Pricing: The Seventh Circuit Reverses FERC

## An NRRI Teleseminar Addressing *Illinois Commerce Commission, et al. v. FERC*, Nos. 08-1306, et al. (7th Cir. Aug. 6, 2009)<sup>1</sup>

### I. Case History

- A. **FERC opinions:** *PJM Interconnection, L.L.C.*, 119 F.E.R.C. 61,063 (2007) (Order 494), rehearing denied, 122 F.E.R.C. 61,082 (2008) (Order 494-A).
- B. **Seventh Circuit opinion:** *Illinois Commerce Commission, et al. v. FERC*, Nos. 08-1306, et al, (7th Cir. (Aug. 6, 2009).

### II. Background: Law, Terminology, and Concepts

- A. **Federal Power Act Section 201(b)(1)** grants FERC authority over --
  - 1. the “transmission of electric energy in interstate commerce” and
  - 2. the “sale of electric energy power at wholesale in interstate commerce.”<sup>2</sup>
- B. **FPA Sections 205 and 206** require FERC to prevent unjust and unreasonable rates and undue discrimination “with respect to any transmission or sale subject to the jurisdiction of the Commission.”

---

<sup>1</sup> Style notes for this document: (1) Paragraph numbers within quotes refer to paragraph numbers in the FERC order. (2) Bolding within the text is inserted for presentation purposes; it is not the original. (3) Footnotes in the original are omitted.

<sup>2</sup> Note on “interstate commerce”: In *FPC v. Florida Power & Light Co.*, 404 U.S. 453 (1972), the U.S. Supreme Court upheld Federal Power Commission rulings that even when the contractual origin and contractual destination of a transaction lie within a single state, the transaction is in “interstate commerce” for purposes of the Federal Power Act if it is within the continental U.S., because the interconnectedness of the transmission network means that electrons from different states commingle. Transactions within Alaska, Hawaii, and most of Texas are not in “interstate commerce” because of the absence of interstate interconnectedness.

- C. **Regional transmission organization (RTO):** “RTOs are voluntary associations in which each of the owners of transmission lines that comprise an integrated regional grid cedes to the RTO complete operational control over its transmission lines.” Richard J. Pierce, Jr., “Regional Transmission Organizations: Federal Limitations Needed for Tort Liability,” 23 *Energy L.J.* 63, 64 (2002). The RTO at issue in this case is PJM.
- D. **Postage stamp rate:** Every transmission customer pays a single rate for any transmission transaction within a defined region, *regardless of the contractual origin and contractual destination of the electricity transmitted*. That rate is the same rate for every customer. The rate is an “average rate” because the total costs of the region's transmission network are divided by the total units transmitted, resulting in an average cost per unit. In the present case, the disputed postage stamp rate applies to transactions using facilities exceeding 500 kV.
1. A postage stamp rate means that every customer *pays the same average rate* regardless of whether the cost caused or benefit derived by that customer from a given transaction varies from the average.
  2. Also known as a “*rolled in*” rate because all transmission facility costs of the network are “rolled in” to the total cost before dividing that total cost by the units transmitted.
  3. Also called a “*peanut butter*” rate because all transmission facility costs in the network are spread evenly over all users of the network.
- E. **License plate rate:** Like the postage stamp rate, every transmission customer pays a single rate for any transmission transaction within a defined region, regardless of the contractual origin and contractual destination of the electricity transmitted. Unlike the postage stamp rate, however, the license plate rate is not the same for every customer in the region. Instead, *each customer's rate is a rate reflecting the cost of transmission facilities within that customer's service territory*. A customer residing in a high-transmission-cost territory will pay a higher rate than a customer in a low-cost territory. But having paid that single rate, the customer is entitled to “drive,” have power transmitted, between any two locations in the region. Also known as “zonal rates.”
- F. **FERC's general views on transmission pricing**

[From FERC Order 890]

“Our decisions regarding transmission cost allocation reflect the premise that allocation of costs is *not a matter for the slide rule*. It involves judgment on a myriad of facts. It has no claim to an exact science. We

therefore allow *regional flexibility in cost allocation* and, when considering a dispute over cost allocation, exercise our judgment by weighing several factors. First, we consider whether a cost allocation proposal fairly assigns costs among participants, including those who *cause them to be incurred and those who otherwise benefit* from them. Second, we consider whether a cost allocation proposal provides adequate *incentives* to construct new transmission. Third, we consider whether the proposal is *generally supported* by state authorities and participants across the region.”

- G. Existing facilities vs. new facilities:** In this proceeding, the parties, FERC, and the Court distinguish existing facilities from new facilities.
1. For existing facilities, FERC approved rates that allocated their costs on a “license plate” basis.
  2. For new facilities, FERC allocated the cost differently, depending on whether the facilities were above or below 500 kV. FERC allocated the costs of sub-500kV facilities based on *benefits derived* by the customers. FERC allocated the costs of above-500 kV facilities on a *postage stamp* basis.
- H. The main dispute** in the case concerns FERC's approval of PJM's transmission rates for facilities above 500 kV. Illinois, Ohio, and others opposed FERC's use of the average, postage stamp rate because they felt they derived below-average benefits from the facilities whose costs were “rolled in” to that rate.

### III. FERC's Decision: Existing Facilities and New Facilities, Sub-500 kV and Above-500 kV

#### A. Existing facilities

[The 7th Circuit did not reject this aspect of FERC's orders]

Reversing the Administrative Law Judge, FERC approved PJM's decision to allocate existing (also labeled "sunk cost") facilities on a license plate basis. Here is FERC's reasoning:

#### 1. License plate rates recognize cost causation

- a. Order 494-A, fn 28. "The use of license plate rates is essentially the same as *allocating existing system costs to the parties for whom the investment was originally made.*"
- b. Order 494: "42. The existing facilities of these transmission systems were not developed under common ownership and planning, and were not designed to benefit the entire footprint of PJM. These transmission facilities *were developed by the individual companies to benefit their own systems* and their own customers. It is therefore consistent with the principles of cost causation to continue to allocate the costs of these facilities to the customers for whom they were constructed and whom they continue to serve to date."
- c. ***[Changes in use do not alter cost causation conclusion]*** Order 494: "51. The [Administrative Law] Judge found that a license plate rate design 'fails to account for new uses and fails to consider fairness and conformance of the rate design to cost causation/benefit allocation principles.'... We do not agree. The current zonal rate design is consistent with cost causation principles because it allocates costs to the customers for whom those facilities were constructed. As explained above, the transmission owners in PJM built their existing infrastructure primarily to accommodate the needs of their own customers. The fact that the *transmission system is used today in ways that differ from when the facilities were first constructed does not, standing alone, provide a basis for finding that a license plate rate design is no longer just and reasonable.*"

**2. License plate avoids cost-shifting that would discourage transmission owners from joining RTOs**

- a. Order 494: “43. ... The record here shows that replacing the existing license plate rate design for existing facilities (using any of the approaches advocated at the hearing) would result in large cost shifts among the transmission owners, thereby causing adversely affected transmission owners to *second guess their participation* in PJM.”
- b. Order 494: “58. ... In designing transmission rates for RTOs ... we cannot ignore the effects that cost shifts can have on RTO participation. Substantial shifts in cost responsibility could *encourage a utility with below-average transmission costs to remain independent of* or leave an RTO and, as a result, might destabilize an RTO.”

**3. Allocation of sunk costs is unrelated to efficiency**

- a. Order 494: “43. In this regard, in our Policy Statement on Transmission Pricing, we stated that ‘[t]he major purpose of transmission pricing reform should be to provide more efficient price signals, particularly for new transmission uses, and not simply to reallocate sunk costs.’”
- b. Order 494: “57. Shifting cost responsibility for existing transmission facilities also *would do nothing to promote economic efficiency* -- a primary goal of our transmission pricing policy.”

**4. Benefits of existing facilities vary across territories**

Order 494: “52. ... [T]ransmission facilities in individual zones do not serve all customers equally. The PJM system is subject to significant transmission constraints, and the record shows that these constraints result in congestion costs of \$2 billion annually.... The *existence of significant congestion costs indicates that transmission facilities in each zone do not have equal value* to all PJM load...”

**5. Majority stakeholder views matter**

Order 494: “56. ... [W]e ... do not find the position of the majority of the transmission-owning members of PJM to be of so little value that it can be ignored. ... [R]egional or stakeholder consensus is an

important factor to consider in reviewing the justness and reasonableness of a rate design....”

## 6. Integration does not require averaging

Order 494-A: “30. Simply because the RTO transmission system is operated by PJM on an integrated basis does not mean that the costs of that system necessarily must be distributed uniformly across all participants. In establishing an RTO, *the transmission owners engaged in a joint enterprise* and *each contributed its assets to that enterprise*. We, therefore, cannot find unjust and unreasonable the existing rate design, under which *each transmission owner's contribution of its existing facilities is deemed of equal value to those of other transmission owners* without reallocation of costs among the transmission owners. This is particularly true for existing facilities which were not built as part of the RTO or as a result of its joint planning.”

## B. New facilities

### 1. FERC principles

a. Order 494, para. 45. “[For new facilities,] ... in general, who benefits from the facilities should be the appropriate measure for determining cost allocation.”

b. “Beneficiary pays” promotes new investment

Order 494 “61. ... “[A] proposal that allocates costs fairly to participants who benefit from them is more likely to support new investment than one that does not. Adequate financial support for major new transmission projects may not be obtained unless costs are assigned fairly to those who benefit from the project.” (quoting Order 890)

c. Upfront clarity promotes new investment, reduces litigation delays

(1) “Moreover, it is important that each region *address these issues up front*, at least in principle, *rather than having them relitigated* each time a project is proposed. Participants seeking to support new transmission investment need some degree of certainty regarding cost allocation to pursue such investments....” [Order 890 at para. 561]

- (2) Order 494: “65. ... [T]he existing methodology for allocating the costs of new facilities within PJM is no longer just and reasonable because, although it seeks to allocate costs to beneficiaries, it does so without providing any ex ante certainty. The methodology is not set forth in the tariff and, because of that, the assumptions and criteria for cost allocation are relitigated each time a new project is approved by PJM. ***This deprives entities seeking to build new infrastructure from any certainty*** as to who will pay for such infrastructure. As PJM recently stated, ‘The ***continuous cycle of litigation*** challenging each RTEP determination . . . must be stopped in order to further the efficiency and certainty required to see that needed transmission is in fact developed.’”
- (3) Order 494: “66. We therefore find that PJM must have a ‘***beneficiary pays***’ methodology that is set forth in its tariff and is applied consistently (and without relitigation) each time a new project is approved. There are ***two principal means*** by which PJM and other RTOs can satisfy this objective.
- (a) “First, an RTO can allocate costs using a ***well-defined modeling approach that identifies beneficiaries based on specific criteria*** or metrics (e.g., the alleviation of reliability violations or reductions in production costs or locational marginal prices). For such a method to provide ***ex ante certainty***, the key criteria, metrics and assumptions must be set forth in the tariff with sufficient specificity that they are not relitigated each time a new project is approved by the RTO.”
- (b) “Alternatively, an RTO can provide ex ante certainty by allocating costs using a ***fixed, postage-stamp allocation*** of certain high voltage facilities. An RTO can also use a combination of these approaches.”

## 2. Below 500 kV: Beneficiary pays

[not rejected by 7th Circuit]

Order 494, para 45: FERC requires parties to work on a “beneficiary pays” methodology for allocating the costs of both reliability projects and economic projects, in existing Docket ER06-1271. The methodology must go into PJM's tariff, to avoid facility-by-facility litigation.

**3. Special situation: New facilities for local purposes**

Order 494, fn 56: “Separately, we note that PJM uses a zonal rate design to allocate the costs of new transmission facilities that are planned by individual utilities for local purposes and that do not directly advance PJM's objectives as an RTO, i.e., that do not enable utilities in other zones to avoid a potential violation of reliability standards or realize a reduction in locational marginal price. This methodology has not been contested and we find it to be just and reasonable.”

**4. 500 kV and above: Postage stamp**

a. Court's summary of FERC's three reasons (slip op. at 5):

“FERC's stated reasons are that some of PJM's members entered into similar pro rata sharing agreements with each other *more than forty years ago and would like to follow that precedent*, that figuring out who benefits from a new transmission facility and by how much is *very difficult* and so *generates litigation*, and that *everyone benefits* from high-capacity transmission facilities because they increase the *reliability* of the entire network.”

b. [*Backbone facilities benefit the entire region*] Order 494, “80. ... As the Initial Decision states, PJM observes ‘that a bright line demarcation at 500 kV and above for regional allocation of the cost of EHV facilities would be consistent with the PJM market design,’ because ‘[s]uch facilities ... are properly characterized as backbone facilities that benefit the entire region.’ Adoption of this approach would encourage development of backbone facilities benefiting the entire PJM region, would eliminate controversy over future cost allocations, and would be consistent with the goals of the Energy Policy Act of 2005 (EPAAct 2005), which support the development of critical new transmission infrastructure.”

- c. [**Greater reliability**] Order 494-A: “65. In choosing a 500 kV threshold, we looked at record evidence that showed that such facilities do provide for greater reliability.”
- d. [**Benefits need not be equal across the region**] Order 494: “81. In adopting a postage stamp allocation for new facilities at 500 kV and above, we do not suggest that every 500 kV project will benefit every load in PJM in equal measure. Nor are we required to find that every customer will benefit equally from every project. Rather, we need to find and we do find only that the benefits of such facilities are, as described above, sufficiently broad that they support a postage stamp allocation.”
- e. [**A modeling approach has limitations**] Order 494: “82. ... Although such modeling methodologies provide greater specificity in identifying particular beneficiaries, they have certain limitations. For example, **it is not possible for a computer model to capture all economic, reliability, and environmental benefits that may be produced over the useful life of a given transmission project.** There are many reasons for this limitation, including the difficulty of identifying the range of benefits that accrue from a project over time and quantifying those that are identified. For example, **benefits calculations require projections of future fuel prices, load growth, generator retirements and entry,** etc. These projections are not only imperfect by definition, but increase in difficulty over time. **Moreover, these projections must have a defined time horizon (e.g., 5-15 years), despite the fact that the useful life of new transmission investments can be 40 years or longer.** Given these inherent limitations, we believe it reasonable, under appropriate circumstances, to adopt a postage stamp allocation of some or all of the costs of the highest voltage facilities that provide the broadest regional benefits.”

## IV. Seventh Circuit Decision

### A. **Setting PJM's transmission charges for the use of *existing facilities* at marginal cost only, rather than marginal cost plus sunk cost, does not violate the “just and reasonable” standard**

Recall that for existing facilities, FERC approved a license plate rate: allocating the sunk costs to each zone. AEP complained that under this license plate approach, it cannot recover sunk costs through charges for transmission service across PJM. AEP would have to recover those costs from its core customers for whom it build the facilities originally.

As the Court explained (slip op. at 3-4): “PJM wants that transmission to be priced on the basis of the cost to American Electric of transmitting one more unit of electricity, that is, the marginal cost; and FERC agrees. Such a price excludes the cost that the company incurred when it built the transmission facilities.”

The Court upheld FERC. Its reasoning follows.

- 1. No economic basis:** “FERC emphasizes that the company's existing facilities, which are all that are involved in this case, were built before 2001 when PJM became a Regional Transmission Organization, and were intended to serve American Electric's customers only. So even if the facilities had not been fully paid for, there would be no economic basis for shifting any part of their costs to other members, because American Electric did not expect when it built the facilities that any part of their cost would be defrayed by anyone besides its customers. PJM and FERC have made clear that American Electric will be allowed to charge a price that covers its costs for transmission to other utilities over new or upgraded facilities.”
- 2. Monopoly rent:** “The company may be trying to extract a monopoly price for the use of its facilities. It stands between western sellers of electricity and their eastern customers and would like to extract a toll for giving the former passage to the latter, a toll that has no relation to its costs of rendering that service. It charged its customers for the costs of building its existing facilities and recovered those costs fully and now wants to recover them all over again from another group of consumers. And it's not as if American Electric were being required to provide transmission to the east at zero price. It is permitted to charge for the service just not to include in the charge its sunk costs.”

**B. For transmission over *new facilities* exceeding 500 kV, FERC has not shown that postage stamp pricing produces a “just and reasonable” price**

For transmission service over facilities 500 kV and above, “FERC has decided that all the utilities in PJM's region should contribute pro rata; that is, their rates should be raised by a uniform amount sufficient to defray the facilities' costs.” Slip op. at 5.

The Court found FERC’s explanations insufficient.

**1. No data, no explanation**

“Despite the stakes in the dispute -- the new policy might, for example, force Commonwealth Edison to contribute hundreds of millions of dollars to an above-500 kV eastern project called ‘Project Mountaineer,’ when it would not have had to pay a dime under the benefits-based system applicable to lower-voltage transmission facilities -- ***no data are referred to*** in FERC's two opinions (the original opinion and the opinion on rehearing). ***No lawsuits*** are mentioned. ***No specifics concerning difficulties in assessing benefits are offered.*** No particulars are presented concerning the ***contribution that very high-voltage facilities*** are likely to make to the reliability of PJM's network. ***Not even the roughest estimate*** of likely benefits to the objecting utilities is presented....”

Slip op. at 5.

**2. Court is unimpressed with the “backbone” metaphor**

“The first sentence in this paragraph is an adequate summary of the Commission's reasoning, ***minus recourse to metaphor***, as in the Commission's repeated references to very high-voltage facilities as the ‘backbone’ of PJM's network.”<sup>3</sup>

Slip op. at 5.

---

<sup>3</sup> The “first sentence” referred to is this one: “FERC's stated reasons are that some of PJM's members entered into similar pro rata sharing agreements with each other more than forty years ago and would like to follow that precedent, that figuring out who benefits from a new transmission facility and by how much is very difficult and so generates litigation, and that everyone benefits from high-capacity transmission facilities because they increase the reliability of the entire network.” Slip op. at 5.

3. **Postage stamp causes western utilities to pay for eastern utilities' benefits**

“The objections to the Commission's ruling pivot on an asymmetry between the eastern and western portions of PJM's region. *In the west the electrical generating plants usually are close to the customers* -- Chicago for example is ringed by power plants. As a result, relatively low-voltage transmission facilities -- mainly 345 kV -- are preferred. *In the east, where the power plants generally are farther away from the customers*, 500 kV and even higher voltage transmission facilities are preferred, *because high voltage is more efficient than low for transmitting electricity over long distances*. So far as appears, few if any such facilities will be built in the objectors' service areas, that is, in the Midwest, within the foreseeable future. FERC seems not to care whether any will ever be built, because the reasons it gave for approving PJM's new pricing method are independent of where the facilities are located.”

Slip op. at 6.

4. **History is irrelevant**

“The fact that some of the same members of PJM who agreed to share the costs of such facilities with each other many years ago would like contributions from midwestern utilities carries no weight. The eastern utilities that created PJM refer to themselves revealingly as the ‘classic’ PJM utilities, and the fact that these utilities thought it appropriate to share costs in 1967 says nothing about the advantages and disadvantages of such an arrangement in the larger, modern PJM network.”

“... [T]he fact that *one group of utilities desires to be subsidized by another* is no reason in itself for giving them their way.”

Slip op. at 6.

5. **On the difficulty of measuring benefits, FERC is inconsistent**

“The second reason the Commission gave for approving PJM's pricing scheme -- the difficulty of measuring benefits and the resulting likelihood of litigation over them -- fails because of the *absence of any indication that the difficulty exceeds that of measuring the benefits to particular utilities of a smaller-capacity transmission line*.”

“Like the D.C. Circuit in *Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002) (citation omitted), we acknowledge that feasibility concerns play a role in approving rates, indicating that FERC is not bound to reject any rate mechanism that tracks the cost-causation principle less than perfectly.”

Slip op. at 7.

**6. Litigation uncertainty: FERC failed to quantify the cost**

“No doubt the more a transmission facility costs, and therefore the greater the stakes in a dispute between potential contributors to that cost, the more litigation there is likely to be. ***But how much more (at least approximately)*** is the critical consideration and the Commission ***ignored*** it.”

Slip op. at 7-8.

**7. “Integration” benefits: They exist, but FERC failed to quantify them**

The Court does not deny the benefits of integration arising from interconnection, but criticizes FERC for failing to quantify—for failing to attempt any comparison of cost to benefit. The Court viewed the FERC position as saying that any benefit justifies any cost:

- a. ***[Reliability benefits: asserted but not quantified]*** “That leaves for consideration the benefits that the midwestern utilities might derive from the greater reliability that the larger-capacity transmission facilities might confer on the network as a whole. The reason for building such facilities is to satisfy the demand of eastern consumers for electricity, but the more transmission capacity there is, the less likely are blackouts or brownouts caused by surges of demand for electricity on hot summer days or by accidents that shut down a part of the electrical grid. Because the transmission lines in PJM’s service region are interconnected, a failure in one part of the region can affect the supply of electricity in other parts of the network. So utilities and their customers in the western part of the region could benefit from higher-voltage transmission lines in the east, but ***nothing in FERC’s opinions in this case enables even the roughest of ballpark estimates*** of those benefits.”

- b. [***Minimal benefits relative to cost***] FERC counsel admitted that for the Mountaineer Project, the benefit to Commonwealth Edison would be ***\$1 million while the transmission cost allocated to the company would be \$480 million***. The Court turned FERC's own words on itself: "As FERC itself explained in *Transcontinental Gas Pipe Line Corp.*, 112 F.E.R.C. 61,170, 61,924-61,925 (2005), 'a claim of generalized system benefits is not enough to justify requiring the existing shippers to subsidize the uncontested increase in electric costs caused by the Cherokee project. . . .'"
- c. [***East-West disparity***] Mismatch between "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. . . . To the extent that a utility benefits from the costs of new facilities, it may be said to have 'caused' a part of those costs to be incurred, as without the expectation of its contributions the facilities might not have been built, or might have been delayed. ***But as far as one can tell from the Commission's opinions in this case, the likely benefit to Commonwealth Edison from new 500 kV projects is zero.*** The opinion on rehearing attributes the need for new transmission capacity in PJM to the threat of 'degraded reliability in Eastern PJM,' 122 F.E.R.C. 61,082, p. 13 (emphasis added), and nowhere do the Commission's opinions suggest that degraded reliability is a danger in Midwestern PJM."
- d. [***Some benefit does not mean enough benefit***] "No doubt there will be some benefit to the midwestern utilities just because the network is a network, and there have been outages in the Midwest. ***But enough of a benefit to justify the costs*** that FERC wants shifted to those utilities? Nothing in the Commission's opinions enables an answer to that question. Although the Commission did say that a 500 kV transmission line has twice the capacity of a 345 kV line, it added that 'the reliability of 500 kV and above circuits in terms of momentary and sustained interruptions is 70 percent more reliable than 138 kV circuits and 60 percent more than 230 kV circuits on a per mile basis,' *PJM Interconnection, L.L.C.*, *supra*, 119 F.E.R.C. 61,063, p. 23; 122 F.E.R.C. 61,082, p. 16 (emphasis added)—but did not compare the reliability of a 500 kV line to that of a 345 kV line, even though network reliability is the benefit that the Commission thinks the midwestern utilities will obtain from new 500 kV lines in the East."

- e. [***Cost-benefit precision: perfection not required***] “We do not suggest that the Commission has to calculate benefits to the last penny, or for that matter to the last million or ten million or perhaps hundred million dollars. *Midwest ISO Transmission Owners v. FERC, supra*, 373 F.3d at 1369 (***‘we have never required a ratemaking agency to allocate costs with exacting precision’***); ... If it cannot quantify the benefits to the midwestern utilities from new 500 kV lines in the East, even though it does so for 345 kV lines, 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 PJM's region, then fine; the Commission can approve PJM's proposed pricing scheme on that basis. For that matter it can presume that new transmission lines benefit the entire network by reducing the likelihood or severity of outages.... But it cannot use the presumption to avoid the duty of ‘comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party.’ *Midwest ISO Transmission Owners v. FERC, supra*, 373 F.3d at 1368. ...”

\* \* \*

8. **Bottom line:** The Court imposed two main requirements -- commensurateness of benefits and costs; and careful explanation of conclusions. Conversely, the Court rejected disproportionalities and generalities.

## V. Comments and Questions

### A. Cost-benefit analysis after the 7th Circuit decision

1. Must we align costs and benefits in each cost-allocation transaction?
2. Or can we align costs and benefits over longer periods of time and over larger scopes of transactions?
3. Does the 7th Cir treat “cost causation” and “beneficiary pays” as synonymous principles? Does FERC treat them as different concepts?

### B. Presumptions, burdens and “insouciance”

The majority and dissent differ over a presumption that the full network benefits from a backbone facility:

1. Judge Cudahy in dissent writes (slip op. at 18): “Since there is a presumption that enhanced reliability benefits all of the systems members, Commonwealth Edison (ComEd) can be required to bear a proportional share of an improvement's costs even where it is not possible to determine precisely how much it benefits. Put otherwise, the burden is on ComEd to show that it would not benefit from the newly planned transmission facilities; the burden is not on FERC to estimate how much ComEd would benefit from a more reliable grid.”
2. Dissent at 20: “FERC responded to ComEd's objections by indicating that the proposed projects would improve reliability and reduce congestion.... It did not explain how PJM's members benefit from a reliable network because no court had hitherto required it to do so. Until now, it went without saying that network reliability benefits the network's members. This is not insouciance; ‘[e]xplanations come to an end somewhere.’ Ludwig Wittgenstein, *Philosophical Investigations* 1 (G.E.M. Anscombe trans., 1968).”<sup>4</sup>
3. For decades, participants and practitioners accepted the principle that large facilities benefit the entire network. What has changed?
4. Where does the burden belong?

---

<sup>4</sup> Insouciant: “Careless; heedless; indifferent; unconcerned.... marked by blithe unconcern;...” (Webster's Online Dictionary).

**C. Is the majority's understanding of “benefits” too narrow?**

1. The dissent asserts that the majority's understanding of “benefits” is an “unusually narrow conception of cost-causation....” Slip op. at 20.
2. What do you think of Justice Roberts's analogy of the transmission network to the court system, cited in Judge Cudahy's dissent? He asserts that we need not allocate costs based on “use”: simply having the network is a benefit if the utility does not use it (Midwest ISO Transmission Owners v. FERC, 373 F.3d 1361, 1371 (D.C. Cir. 2004) (Roberts, J.)):

“[E]ven if they are not in some sense using the ISO [roughly a term for a power pool], the MISO Owners still benefit from having an ISO. In this sense, MISO is somewhat like the federal court system. It costs a considerable amount to set up and maintain a court system, and these costs—the costs of having a court system—are borne by the taxpayers, even though the vast majority of them will have no contact with that system (will not use that system) in any given year... The MISO Owners' position is tantamount to saying that if they are not a litigant, they should not be made to pay for any of the costs of having a court system. Since the MISO Owners do, in fact, draw benefits from being a part of the MISO regional transmission system, FERC correctly determined that they should share the cost of having an ISO.”

**D. Is deference to FERC appropriate?**

1. Dissent at 22: “Pro rata assignment of costs eliminates not only lawsuits but nitpicking controversies of every sort and delays standing in the path of action. From that point of view, I think FERC may be in a better position to implement a policy leading to prompt improvement in a deficient transmission grid than this court, focused as it is on the inevitable complaints of utilities demanding more for their money.”
2. What must FERC do to earn the deference that the dissent asserts is due FERC?

**E. How might FERC respond to the 7th Circuit decision?**

1. The majority opinion did not find that postage stamp rates are per se unlawful. It objected to FERC's approving them without quantifying benefits to all customers, without explaining why benefit estimation is difficult or imprecise, and without specifying the costs associated with the “litigation” problem arising from other allocation methods. FERC now

has the choice of either justifying the postage stamp methodology or dropping it altogether.

2. If FERC stays with postage stamp, how might it address the Court's concerns about the disproportionality of costs to benefits for certain PJM members?
3. If FERC drops the postage stamp methodology, what alternative methodologies would best facilitate the construction of cost-effective regional high-voltage transmission projects?
4. How might these alternative methodologies be superior or inferior to postage stamp rates for producing the optimal amount of transmission?

**F. What are the decision's consequences?**

1. Does the ruling add to uncertainty over the development of high-voltage transmission? With what consequences?
2. Will this ruling increase or decrease litigation over the allocation of high-voltage transmission costs? With what consequences?
3. In a Midwest ISO FERC proceeding regarding allocation of transmission interconnection costs between generators and transmission owners, a transmission-owning party cited this 7th Circuit decision. The party asserted that the opinion prohibited FERC from requiring a group of utilities to pay for transmission from which its members derive no benefits, or benefits that are trivial in relation to the costs sought to be shifted to its members.
  - a. Does the 7th Circuit's decision have bearing on this issue?
  - b. In what other situations could this ruling have implications?