Order 1000:
Can We Make the Transmission Providers' Obligations Effective and Enforceable?

Scott Hempling
March 2012[1]

The landmark Order 1000 requires transmission providers to participate in regional planning processes for transmission. Transmission providers must produce plans through processes that (a) take into account public policy requirements that might require transmission service, and (b) give comparable consideration to alternatives to conventional transmission projects. The Order leaves many details to the regional processes. This memorandum identifies the legal principles available to guide, and where necessary constrain, these processes so that the transmission providers who control them act consistently with their obligation under Federal Power Act Section 205—the obligation to provide electricity services under terms and conditions that are "just and reasonable" and not "unduly preferential."

Part I presents an overview of this topic. It summarizes Order 1000's mandates, describes FERC's goals, and identifies the Order's gaps that need filling for transmission providers to be accountable.

Part II discusses the statutory principles that form the foundation for transmission-provider accountability.

Part III applies those legal principles to the major requirements of Order 1000: a plan, planning processes that provide for consultation with stakeholders, consideration of grid needs driven by public policy requirements, and "comparable" consideration of transmission and non-transmission alternatives.

Part IV addresses three miscellaneous issues: cost allocation for non-transmission alternatives, the appropriateness of FERC itself presenting non-transmission solutions, and the special jurisdictional complexity associated with interconnection service for distributed generation.

---

[1] shempling@scotthemplinglaw.com; www.scotthemplinglaw.com; 301-754-3869. I wish to acknowledge the contributions of John Moore, Allison Clements and Terry Black. I am, however, solely responsible for the content. This paper was prepared at the request of The Sustainable FERC Project and was funded by a grant from the Hewlett Foundation and Energy Foundation.

Table of Contents

I. Introduction and Overview

A. Order 1000 imposes on all transmission providers three main obligations

1. Participate in regional planning processes

Transmission providers must "*participate* in a regional transmission planning process that produces a *regional transmission plan* and complies with existing Order No. 890 transmission planning principles…." Further, " transmission planning *region* is one in which public utility transmission providers, in consultation with stakeholders and affected states, *have agreed to participate…."* (P68)

2. Create processes for stakeholders concerning Public Policy Requirements

Transmission providers must have in place "*processes* that provide *all stakeholders* the opportunity to provide input…into what they [i.e., the stakeholders] believe are transmission needs driven by Public Policy Requirements, rather than the public utility transmission provider planning only for its own needs or the needs of its native load customers." (P203)

3. Evaluate alternatives

Transmission providers "have an *affirmative obligation*...to *evaluate alternatives* that may meet the needs of the region more efficiently or cost-effectively [than transmission solutions]." (P80). In the regional processes there must be "*comparable consideration* of transmission and non-transmission alternatives....[T]ransmission providers are required to identify how they will evaluate and select from competing solutions and resources such that *all types of resources* are considered on a comparable basis." (P155) Transmission providers must conduct the evaluations "*in consultation with* stakeholders...." (P148)

B. Underlying these obligations are two distinct FERC goals

The first goal is to ensure that the transmission planning "process," "plans," and ultimately transmission projects accommodate "public policy requirements" enacted by the state or federal government. The goal focuses transmission providers on designing projects cost-effectively to support policies that the public requires, rather than only on projects that support the pecuniary business objectives of transmission owners. This goal ensures that transmission providers do not discriminate against market players who need transmission services for purposes that might conflict with the transmission provider's private priorities.

The second goal is to ensure that any transmission project for which a transmission provider seeks cost recovery is the survivor of objective, head-to-head comparisons with

non-transmission alternatives. This goal prevents transmission charges that are not "just and reasonable" because transmission project proponents ignored less-costly alternatives.

The lawfulness of any plans, processes, plan considerations, and comparisons depends on whether they support or undermine these goals.

C. Despite its length and landmark status, Order 1000 leaves much unstated

The lack of clarity falls into three categories:

> ***Definitions:*** FERC has not defined the key terms: "plan," "participate," "planning process," "evaluate," "consider," and "region."
>
> ***Statutory bases:*** All FERC orders need a basis in the statutory phrases "just and reasonable," "not unduly preferential," or both. While Order 1000 cites these phrases, it does not always explain how each of the key requirements—plan, planning process, comparable consideration and region—connect to the two statutory phrases. This gap (a) leaves transmission providers with much discretion about how to apply these terms, and (b) leaves everyone else unsure of their legal leverage in insisting that particular features in the process are required by, or violate, the Federal Power Act.
>
> ***Consequences of non-compliance:*** FERC has not described the consequences for a transmission provider whose decisions about plan, planning process, consideration and/or region are insufficient.

By not specifying these terms, Order 1000 creates a risk that transmission providers will pay insufficient attention to alternatives to conventional transmission projects. FERC's decision to have transmission providers frame the process through their own definitions and interpretations (arrived at "in consultation with" others) has positive and negative attributes. On the positive side, FERC leaves room for creative solutions that reflect differences in regional needs. On the negative side, allowing those who control the highways to frame the conversations about alternatives to those highways risks producing solutions that reflect the self-interests of those whose economic and political resources give them an edge in the regional processes.[2]

This memorandum describes ways to use the Federal Power Act to channel transmission provider discretion toward public interest outcomes. The Federal Power Act

[2] See my essay "Framing: Does It Divert Regulatory Attention?" in Hempling, *Preside or Lead? The Attributes and Actions of Effective Regulators* (National Regulatory Research Institute 2011). The essay is also available at http://www.scotthemplinglaw.com/monthly-essays/obstacles-to-effective-regulation.

talks only of "transmission or [wholesale] sale of electric energy"; it does not talk of “plans,” “processes,” “regions,” or “considerations.” The memorandum therefore seeks to describe (a) the minimum features a particular solution must have to satisfy the statutory language, (b) features that a solution must not have to avoid violating the statute, and (c) the consequences to a transmission provider of satisfying or violating the statute. By translating the Order 1000 obligations into clear statutory obligations, the failure of which constitutes an unlawful act or omission, this memorandum can help participants inject accountability into the process at the front end. Absent this early accountability, there is risk that FERC will accept suboptimal proposals because those with the resources to hold out for favored solutions will have worn down the less-resourced, producing "settlements" to which FERC "defers."

First, some clarification of terms: The term "non-transmission alternative" (NTA) has achieved official, acronymic status even as its meaning has become ambiguous. (Order 1000 never defines the phrase.) To understand “NTA” one must distinguish among three concepts. The first is conventional transmission service, consisting of poles and wires. The second is "ancillary services," which is a phrase used in Order 888 to describe ***a category of transmission service***. FERC there described ancillary services as services that

> "are needed to provide basic transmission service to a customer. These services range from actions taken to effect the transaction (such as scheduling and dispatching services) to services that are necessary to maintain the integrity of the transmission system during a transaction (such as load following and reactive power support). Other ancillary services are needed to correct for the effects associated with undertaking a transaction (such as energy imbalance service)."[3]

The third category is alternatives to transmission service (which is what I assume FERC means when it uses the term NTA). An alternative to transmission service is, by definition, not transmission service; it is a substitute for transmission service.

Confusion sometimes arises when someone discusses a service that is an "alternative" to conventional transmission service, but which can function as an ancillary service. If it can function as an ancillary service, then it is "transmission service," because FERC defined ancillary services as part of transmission service. And if it is “transmission service,” it cannot logically be an alternative to transmission service. If it cannot function as an ancillary service, but still can substitute for transmission (such as demand response which, by lowering demand in a particular location, makes it unnecessary to use transmission service to carry power from another location), then it is an alternative to transmission—an NTA.

[3] The D.C. Circuit has paraphrased FERC’s definition to mean, roughly, "services that ensure the availability of sufficient electricity at all times to meet fluctuating levels of demand." *Blumenthal v. FERC*, 552 F.3d 875, 878 (D.C. Cir. 2009).

II. Legal Principles

After setting forth the statutory language, this Part II address three topics: FERC's authority for imposing the Order 1000 obligations, what entities and activities under Order 1000 are protected by the statutory prohibition against "undue preference," and the key relationship between Order 1000's requirements and "just and reasonable" prices for generation and transmission. Fluency with the legal analysis will allow readers to develop a set of required practices and to head off unlawful practices, so as to channel transmission providers' discretion toward public interest outcomes.

A. Statutory language

All of Order 1000's obligations flow from the two core requirements in Section 205 of the Federal Power Act: that rates be "just and reasonable," and that no provider of a FERC-jurisdictional service grant any "undue preference or advantage." Section 205 provides, in relevant part:

> ***(a) Just and reasonable rates.*** *All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.*
>
> ***(b) Preference or advantage unlawful****. No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.*

This language applies to both types of FERC-jurisdictional transactions: transmission in interstate commerce and wholesale sales in interstate commerce.

B. What is FERC's authority for imposing the Order 1000 requirements?

While Order 1000 mandates each of the actions listed in Part I.A above, it does not state explicitly how each mandate flows from Section 205's requirement of justness and reasonableness and its prohibition against undue preference. The FPA provisions mention no utility obligation to make plans, host processes that "consult" with "stakeholders," consider public policy-driven transmission needs, or give comparable consideration to alternatives to conventional transmission. The phrases "just and reasonable" and "no undue discrimination" apply explicitly only to the acts of providing transmission service and wholesale sales service; they do not explicitly apply to these other activities. The legal basis for Order 1000's requirements is indirect: that transmission service and wholesale sales service themselves will be unjust and unreasonable, and/or unduly preferential, if the transmission provider has formulated them without conducting, properly, the processes FERC has described.

There is a need to clarify, and tighten, Order 1000's legal foundations. A rate or tariff proposed by a transmission provider is either just and reasonable and not unduly preferential, or it is not. It is lawful or unlawful on its own terms, regardless of whether the applicant held meetings, visited an oracle or just thought the tariff up while taking a walk. It is not clear that FERC could lawfully reject a transmission provider's proposal, otherwise lawful, on grounds that the provider did not follow the Order 1000 process. This situation creates risk that transmission providers aiming to promote their own projects could honor Order 1000 in letter but not in spirit: a real possibility given that despite the 600 pages, Order 1000 has more spirit than letter.

A clearer, tighter legal approach, one that spells out the risks of non-compliance, is to state that when a transmission provider proposes a service or rate borne of a non-compliant process, FERC will rebuttably presume it to be unlawful, thereby placing on the provider the burden to prove affirmatively its prudence and lack of undue preference.

Under either approach to a noncompliant provider—FERC outright rejects the proposed services and rates, or rebuttably presumes their unlawfulness—it is necessary to define those elements of the plan, process, consideration, and region that a provider must complete to win FERC's deference. To do so, I recommend locating technical experts in planning generally, and transmission specifically, that can inform about prudent and imprudent practices and omissions.

C. Order 1000's requirement of comparable treatment, and Section 205(b)'s prohibition against undue preference: What *entities* are protected? What *actions* are unlawful?

The Federal Power Act is a consumer-protection statute. *Public Systems v. FERC*, 606 F.2d 973, 979, n.27 (D.C. Cir. 1979) ("Both the Natural Gas Act and the Federal Power Act aim to protect consumers from exorbitant prices and unfair business practices. This purpose can be seen in the statutory requirement that rates be just, reasonable, and nondiscriminatory...."); *City of Detroit v. FPC*, 230 F.2d 810, 817 (D.C. Cir. 1955) (the Natural Gas Act's "primary aim" is "to guard the consumer against excessive rates"; numerous other court decisions hold that the NGA and the FPA are to be interpreted consistently). The mandates in Order 1000, and the means of enforcing them, must have their bases in the Act's consumer-protection purpose.

Order 1000 requires transmission providers to evaluate transmission and non-transmission alternatives comparably. The connection to the Act's consumer-protection purpose is threefold.

1. Failing to give comparable treatment to all feasible alternatives to transmission in the transmission planning process is an imprudent act. Consider a transmission provider that ignores a non-transmission congestion solution costing $25 million, while insisting on a transmission solution costing $75 million. Installing the more expensive solution will cause the provider to overcharge the consumer. That charge is not "just and reasonable," in violation of Section 205(a).

2. It is possible that failing to give comparable planning treatment to the non-transmission alternatives is the result of the transmission provider's misuse of a "rule[] [or] regulation[] affecting or pertaining to [transmission] rates or charges," thereby making transmission service unjust and unreasonable to the ultimate consumers of transmission service in violation of Section 205(a). (I have never seen this interpretation used, so cannot be certain of its value, but it is worth keeping available.)

3. The offeror of a non-transmission solution itself could be a prospective transmission customer. A storage device that reduces congestion might need interconnection to the transmission system. If the transmission provider ignores the device's need for interconnection while giving preference to its own transmission solution's interconnection needs, it would violate Section 205(b)'s prohibition against undue preference in the provision of interconnection service. (Caution: The statutory violation occurs when the transmission provider denies the interconnection service—not when the transmission provider downplays storage's desirability in the planning process. The reason is that the planning process is not itself the provision of transmission service and the storage device's plea for comparable treatment in planning is not consumption of transmission service.)

The importance of the Act's consumer-protection purpose is this: When one observes, or seeks to prevent, non-comparable treatment in the planning process, ***one must frame the concern from the perspective of the customer, because the discrimination prohibited by Section 205(b) is discrimination against customers, not suppliers.***

It is true that we often think of Order 888's prohibition of discrimination in transmission service as preventing discrimination against suppliers of generation. But Order 888 protects suppliers of generation because they (or their generation buyers) are ***prospective customers of transmission service***, not because the Federal Power Act has a supplier-protection purpose. Similarly, non-comparable treatment of an NTA in the planning process, if it violates the Act, violates the Act because the non-comparable treatment hurts customers, not because it hurts the alternative supplier (unless that alternative supplier is also a customer of a FERC-jurisdictional transmission service and the non-comparable treatment amounts to discrimination in the provision of FERC-jurisdictional service). Put another way: No one has a claim of discrimination under the Federal Power Act just because she was not selected to provide a service. An independent coal supplier rejected in favor of a wholesale utility's affiliated coal supplier, an independent merchant generator rejected in favor of utility's own generator, an independent storage provider rejected in favor of the utility's own transmission solution: none of these entities has a claim of "undue preference" under the Federal Power Act—unless the denial was a denial of FERC-jurisdictional service.

The key to understanding this point is that ***planning is not a FERC-jurisdictional service***. It is an activity that is essential to the prudent performance of that service but is not itself a service. A FERC-jurisdictional service, like transmission of electricity or wholesale sale of electricity, is a binding arrangement in which seller and buyer exchange money for value. Interconnection service, for example, is transmission service that involves mutual commitments between generation owner and transmission provider. That is not what occurs in planning; there is no binding exchange of money for value. Non-comparable treatment in planning is a violation of planning principles that can amount to imprudence, but it is not denial of a FERC-jurisdictional service. Therefore, a planning process itself cannot be "unduly preferential" in a statutory sense.[4]

---

[4] FERC seems to say otherwise, in Order 890 para. 452:

> "We emphasize that the purpose of the coordination requirement is to eliminate the potential for undue discrimination in planning by opening appropriate lines of communication between transmission providers, their transmission-providing neighbors, affected state authorities, customers, and other stakeholders...."

I believe FERC's order writers here were inadvertently imprecise. Statutorily, undue discrimination can occur only with respect to providing or denying a service. The link to planning is the failure to take into account all alternatives and plan for all needs, which becomes evidence

Alternative view: While I believe the preceding paragraph in the text to be the correct statutory analysis—that FPA-forbidden discrimination is discrimination against ***customers***—FERC's Order 755 creates ambiguity on this point.

Order 755 declares "unjust, unreasonable, and ***unduly discriminatory or preferential***" (emphasis added) RTO ***compensation paid to providers*** of regulation frequency service, to the extent the compensation does not reflect the service's full value to the RTO. Specifically, Order 755 (at para. 64) finds that "existing market rules for the compensation of frequency regulation resources are unjust and unreasonable, and unduly discriminatory or preferential." See also para. 65 ("CAISO's market design is no different from other RTOs and ISOs in that it compensates frequency regulation resources in a manner we find to be unduly discriminatory") and para. 68 (stating that Order 755's purpose is "protecting against undue discrimination among resources," meaning, undue discrimination by a utility-as-buyer of resources supplied by providers of frequency regulation).

Other than quoting the mid-sentence phrases stated above, FERC does not explain its reasoning in terms of the full statutory provision and context. Section 205(b) prohibits any undue preference by a public utility "with respect to any transmission or sale...." That language seems to speak only about undue preference in the ***selling*** of a jurisdiction service, i.e., granting undue preferences to, or discriminating against, ***customers*** of that service. Section 205, therefore, does not provide the basis for Order 755.

Section 206(a) is worded differently. It prohibits any "rule, regulation or practice, or contract affecting" a rate for transmission service, if such item is "unjust, unreasonable, unduly discriminatory or preferential." It is possible, therefore, that FERC views the RTO's payments for frequency regulation service as a discriminatory "practice" affecting transmission rates.

I am not aware of any case, in the many cases addressing discrimination, in which the statute was applied to ***the utility-as-buyer, discriminating against sellers***. In all the cases I know of, the discrimination at issue was discrimination by the ***utility-as-seller, discriminating against customers.*** This is in keeping with the case law declarations that the Federal Power Act is a consumer-protection statute.

D. Order 1000's connection to "just and reasonable" wholesale power prices

Although Order 1000 focuses on transmission planning, its reasoning also has implications for wholesale power prices.

In its demand response orders (Orders 719 and 745), FERC declared that unless RTOs treated demand response comparably to generation when designing and implementing energy

---

that a TP has unduly discriminated against a customer.

markets, the prices produced by those markets would not be just and reasonable. Demand response, by reducing demand, reduces the market clearing price directly; it also reduces the market clearing price indirectly by disciplining generation sellers. Absent demand response's contribution, wholesale prices would be higher than necessary, thus unjust and unreasonable.

Similar reasoning is available to support Order 1000's requirements. Consider Order 1000's two main goals. The first goal is to ensure that the transmission planning and projects accommodate "public policy requirements." The purpose of utility service is to serve the utility customer. The purpose of transmission service is to serve the transmission customer. In transmission, the "customer" is not merely the customer of the transmission owner, i.e., the utility's native load; Order 888 declares that the transmission owner must give comparable treatment to non-native customers. If each utility designs its transmission projects to serve only its own native load, disregarding another state's public policy requirements, the sum of these projects will be more costly than if each utility took into account other states' needs. That excess cost violates the just and reasonable standard. Further, a transmission provider's refusal to plan, design and build for another state's prospective transmission customers will violate the prohibition against undue preference. Moreover, if transmission is insufficient to accommodate public policy requirements, the resulting transmission shortage will lead to wholesale prices exceeding levels that would exist if transmission capacity were sufficient.

Order 1000's second goal is to ensure that each transmission project can prove its superiority relative to other solutions, including non-transmission alternatives. If a transmission project is more costly than alternatives, generation sellers who compete with transmission will be able to charge prices higher than if the lower cost alternatives were implemented in the region. The result, again, is wholesale power prices exceeding just and reasonable levels.

In short: by FERC's own reasoning, its entire market-based pricing program is legally vulnerable if the regional processes do not accommodate public policy requirements and treat non-transmission alternatives comparably.

III. Application of Legal Principles to Order 1000's Main Requirements

A. Plan

The center of Order 1000 is a planning process that produces a plan. The problem is that ***Order 1000 does not define "plan,"*** making it difficult to assess whether a transmission provider's process has achieved the desired objective. A process will be flawed if it has characteristics that undermine its purpose – to produce a plan. That reason makes it necessary for participants to have a common vision of what a plan is. Here is an attempt to fill that gap.

I would define a "plan" ***as a set of intended future actions, based on a stated set of assumptions, designed to achieve one or more stated objectives, and representing an intent to***

take those actions as long as the assumptions and objectives hold. In the context of Order 1000, a plan should create a presumption that the transmission provider will take the stated actions, unless the stated assumptions change so as to make some other actions better suited for the objective. Under Order 1000, the assumptions and actions would become part of the plan only after the utility has given comparable consideration to all plausible actions and assumptions, then selected the set of actions that achieves the stated objectives at lowest reasonable cost, taking into account non-cost factors.

While a plan does not create a legal obligation to take the stated actions***, it must have some constraining effect***. Otherwise the plan is merely paper spit out by someone's word processor, and the planning process diverts everyone's time, resources and attention while the transmission provider pursues its own objectives. To have any legal effect under the Federal Power Act (and thus to make a violation of Order 1000 a violation of the Act), the plan must constrain the transmission provider somehow.

There are two possible ways for the plan to constrain. Where the TP did not use an appropriate process, and it then seeks cost recovery for a project, FERC has two choices: (a) ***reject the cost recovery outright, as inherently unjust and unreasonable; or (b) remove the traditional presumption of prudence, requiring the utility to prove prudence affirmatively***.[5] Common to both paths is a positive statement: Where a plan is created through an appropriate process, any transmission project consistent with the plan would enjoy a rebuttable presumption of reasonableness and nondiscrimination. Opponents would have the burden of showing unreasonableness or undue discrimination. (This presumption would apply to the project choice, not necessarily to its costs.)

How do a plan's constraining effects matter to the planning process? ***The transmission provider must face some risk for noncompliance with Order 1000's requirements***. That risk would be the risk of prudence disallowance. An inappropriate plan certainly causes risk to consumers in the form of unnecessary costs, and to competitors in the form of lost market opportunities. A college student with a plan to be a lawyer does not bind herself to attend law school. But if she takes no chemistry courses, and later chooses medicine over law, there are consequences: more costs, more time, and the risk of non-acceptance to medical school. A

[5] FERC presumes prudence until strong evidence arrives to rebut the presumption. This evidence includes a finding of imprudence by another federal or state agency. *Minnesota Power and Light*, 11 F.E.R.C. para. 61,312 at pp. 61,644-45 (1980). Thus an imprudence finding by the California commission had shifted the burden to the company for purposes of the FERC proceeding. Before FERC, the utility had offered only "vague generalizations about the problems inherent in all building projects. No specific evidence regarding the Vidal project was ever introduced." *Southern California Edison Co.*, 8 FERC para. 61,198 at 61,680 (1980*), aff'd sub. nom., Anaheim, Riverside et al. v. F.E.R.C.*, 669 F.2d 799 (D.C. Cir. 1981).

change in transmission plans has similar cost effects. If the planning process is improper, the risk of those costs should be on the transmission provider.

The question, then, addressed in the following sections, concerns what features the planning process must have for the utility to avoid this cost risk.

B. Planning process

To qualify as capable of producing a plan whose proposed actions satisfy the Federal Power Act, the planning process must be a ***prudent process.*** A prudent process will have the following characteristics:

1. It must state a ***clear objective.*** To give comparable treatment to all possible solutions, ***the transmission provider must develop the possible objectives first, prior to supporting particular options***. That way, the provider's preferred option does not influence the framing of the objective. The objective must be stated as a benefit to consumers; for example, some mix of reliability and cost. "Build 100 MW transmission facility" is not a plan objective. "Reduce congestion charges in Zone XX" is an objective.

The transmission provider must develop a range of possible objectives with entities that will be affected by the objective, and compared with other possible objectives. For a particular region, the initial set of objectives should be the sum of all objectives established by state commissions or legislatures, along with objectives stated by utilities with load-serving obligations, provided those utility objectives are designed to carry out its legal service obligations. Where these objectives are not consistent, or can be made more cost-effective, such as by combining objectives or coordinating their timing, the objective-writing process should achieve this.

2. It must give ***comparable treatment to all possible solutions*** to that objective, even if the solutions lie outside the applicant's expertise or business strategy ***and even if the solutions are not proposed by participants.*** As explained in Part II above, a process itself cannot be unjust, unreasonable or unduly preferential, in the Federal Power Act sense. But it can be ***imprudent*** if it excludes or unreasonably inhibits parties from presenting reasonable alternatives. That exclusion or inhibition would occur if the transmission provider (a) does analytical and planning work behind the scenes, then limits parties' opportunity to comment; (b) fails to give comparable consideration to alternatives, instead treating the TP's proposal as the lead proposal with other proposals having the burden of dislodging it; or (c) fails to share the data and consultant time necessary to fashion and critique proposals.[6]

[6] While prudence requires the utility to study and compare all feasible alternatives, it does not require the utility to pay participants to present or analyze those alternatives. The utility is free to choose its own consultants—***provided it chooses them for their expertise and objectivity, not for their predispositions.*** Hiring a biased consultant is an imprudent act.

There appears to be a fundamental difference between FERC staff and myself on this point. Please note the phrase in the first sentence of the immediately preceding paragraph, "***and even if the solutions are not proposed by participants.***" A utility's obligation to perform prudently, in terms of identifying, vetting and comparing solutions, is an obligation to perform at lowest feasible cost.[7] A utility cannot perform at lowest feasible cost if it restricts its consideration to its favored project plus only those projects proposed by others. Yet I am informed that senior FERC staff believe that, in the case of NTAs, a transmission provider need assess only those ideas brought by "stakeholders;" i.e., that the transmission provider has no independent obligation to scour the field of ideas for solutions. That narrow view of a utility's obligation is inconsistent with a century of precedent on prudence. A utility's prudence obligation is defined by what a reasonable person would do in the same circumstances.[8] A reasonable person

---

[7] Prudence review is regulation's substitute for competitive forces. Companies whose survival depends on winning competitively must be alert to all options. This logic is echoed in decades of court decisions applying regulatory law. *See Midwestern Gas Transmission Co*., 36 F.P.C. 61 (1966) ("Managements of unregulated businesses ... have no alternative to efficiency," utility management "does not have quite the same incentive."), *aff'd sub nom., Midwestern Gas Transmission Co. v. FPC*, 388 F.2d 444 (7th Cir.), *cert. denied*, 392 U.S. 928 (1968); *Democratic Central Committee of the Dist. of Columbia v. Washington Metropolitan Area Transit Comm'n*., 485 F.2d 786, 808, 810-11, 822 (1973) (price regulation substitutes for the "pressures of competitive markets, to prevent regulated companies from becoming 'high cost-plus compan[ies]' and to secure efficiency in the allocation of resources."), *cert. denied*, 415 U.S. 935 (1975); *Gulf States Utilities Co. v. Louisiana Public Service Commission*, 578 So. 2d 71, 94 (La. 1991) ("If a competitive enterprise tried to impose on its customers costs from imprudent actions, the customers could take their business to a more efficient provider. A utility's ratepayers have no such choice. A utility's motivation to act prudently arises from the prospect that imprudent costs may be disallowed.") (*quoting Long Island Lighting Co*., 71 P.U.R. 4th 262 (N.Y. Pub. Serv. Comm'n, 1985)).

The just and reasonable standard therefore imposes on utilities an affirmative obligation: "to operate with all reasonable economies," *El Paso Natural Gas Co. v. FPC*, 281 F.2d 567, 573 (5th Cir.), *cert. denied*, 366 U.S. 912 (1960); to charge prices based on "lowest feasible cost," *Potomac Electric Power Co. v. Public Service Comm'n*, 661 A.2d 131, 138 (D.C. App. 1995); and to use all available cost saving opportunities, *Midwestern Gas Transmission Co*., *supra*, 36 F.P.C. at 70. The utility must demonstrate that it "went through a reasonable decision-making process to arrive at a course of action and, given the facts as they were or should have been known at the time, responded in a reasonable manner." *Cambridge Electric Light Co*., 86 P.U.R. 4th 574 (Mass. D.P.U. 1983).

[8] As one FERC Administrative Law Judge wrote: "The standard for determining whether utility management has acted imprudently is akin to the common-law standard for negligence: Did the utility act in a manner consistent with the performance of other similarly-

would not restrict her options to those suggested by others—especially when those others consist of self-interested entities looking to sell their own projects, consumers hoping to minimize their short-term costs, and underfunded non-governmental organizations. This last sentence is not intended to degrade the value of listening and collaborating, but to recognize the reality that the utility (here, the transmission provider) ***is the only one with the statutory obligation to serve, the one on whom everyone else depends for prudent service***. The prudence obligation is to find the best idea, whether or not someone else recommended it.

On this point, a sentence from Paragraph 148 of Order 1000 is susceptible to misinterpretation and misapplication. The sentence is: "When evaluating the merits of such alternative transmission solutions, public utility transmission providers in the transmission planning region also must consider proposed non-transmission alternatives on a comparable basis." This sentence creates ***an affirmative obligation to consider proposed alternatives comparably***; it does not somehow authorize the transmission provider to restrict consideration to "proposed alternatives."

C. Consultation with stakeholders when evaluating the need for transmission and the feasibility and cost-effectiveness of alternatives

Order 1000 requires "consultation." This general term is susceptible to a range of relationships. A prudent planning process, one that ensures comparable consideration of all feasible alternatives, would treat "consultation" as a process in which those being consulted have full opportunity to influence the statement of objectives, the listing of alternatives, the methodologies for examining those alternatives, the design of sensitivity studies and a review of all results. This approach to consultation is consistent with the interpretation given the term, albeit under Section 216 rather than Section 205, by the Ninth Circuit in *California Wilderness Coalition v. U.S. Dept. of Energy*, No. 08-71074 (9th Cir. Feb. 1, 2011). Some background on this case will help guide expectations under Order 1000.

---

situated contemporary utilities? If it did, its action cannot fairly be deemed the result of imprudent management." *Arizona Public Service Corp*., 21 F.E.R.C. para. 63,007 at p. 65, 103 (1982) (initial decision), *aff'd in relevant part*, 23 F.E.R.C. para. 61,419 (1983). *See also Appeal of Conservation Law Foundation*, 127 N.H. 606, 507 A.2d 652, 673 (N.H. 1986) (describing the prudence standard as "essentially apply[ing] an analog of the common law negligence standard for determining whether to exclude value from rate base").

1. Statutory and procedural background

In 2005, Congress added Section 216, which authorized FERC to grant, under certain circumstances, preemptive siting permits for transmission located in areas designed by U.S. Department of Energy as "national interest electric transmission corridors." This complicated provision included this requirement:

> *(a) DESIGNATION OF NATIONAL INTEREST ELECTRIC TRANSMISSION CORRIDORS.*
>
> *(1) Not later than 1 year after the date of enactment of this section and every 3 years thereafter, the Secretary of Energy (referred to in this section as the `Secretary'), in consultation with affected States, shall conduct a study of electric transmission congestion.*
>
> *(2) After considering alternatives and recommendations from interested parties (including an opportunity for comment from affected States), the Secretary shall issue a report, based on the study, which may designate any geographic area experiencing electric energy transmission capacity constraints or congestion that adversely affects consumers as a national interest electric transmission corridor.*
>
> *(3) The Secretary shall conduct the study and issue the report in consultation with any appropriate regional entity referred to in section 215 [a "regional entity is an organization to which the FERC-certified "electric reliability organization" has delegated authority to establish and enforce reliability standards"].*

DOE designated a "Mid-Atlantic Corridor" and a "Southwest Area National Interest Electric Transmission Corridor." 72 *Fed. Reg.* 56,992 (Oct. 5, 2007).

2. DOE error: Failure to consult[9]

The Court of Appeals found that DOE made two legal errors. The error relevant here concerned the phrase "consultation with affected states." DOE had issued a notice inviting comments and a notice of a technical conference. At the technical conference states attended and participated. DOE also ***held a separate "invitation-only" meeting to review the contractor study; no state was invited.*** DOE received and responded to over 400 comments on draft Corridor designations.

As quoted and paraphrased by the Court, DOE said it was "committed to fulfilling its obligation to consult with States" but asserted that "***there are practical difficulties in conducting the level of consultation that some may prefer in the context of a study of this magnitude,"***

[9] Bold italics within the quotes from the Court's opinion are mine, not the Court's.

and that it "is difficult to know which States are 'affected' until the conclusions of the congestion study are known." DOE claimed to have met its obligation because it: (1) had "provided States with numerous opportunities for input and [ ] held meetings with officials representing individual States and groups of States;" (2) had made the Congestion Study available on August 8, 2006; and (3) had, "in addition to [having made] the draft National Corridor designations described in this notice available for comment, . . . simultaneously contact[ed] the Governors of each State in which the draft National Corridors would be located to arrange consultation meetings."

This was not enough, said the Court:

"... DOE ***did not extend an invitation to potentially affected States to attend an "invitation-only" workshop*** on the Congestion Study that was held in May 2006. Also, DOE ***did not disclose to the affected States the congestion modeling data it*** used to conduct the Congestion Study. Furthermore, DOE ***never extended any invitation to the affected States or their Governors to "consult***" on the preparation of the Congestion Study."

"DOE's claim that it met its obligation to consult with the affected States is based on the argument that ***it had the discretion to determine what "consultation" required***, that it met its obligation by inviting comments from the public (including the affected States) while it was preparing the Congestion Study, that it ***subsequently considered all objections*** to the Congestion Study raised by the affected States, and that ***any failures in this process of "consultation" were harmless."***

"An ordinary meaning of the word consult is to "seek information or advice from (someone with expertise in a particular area)" or to "have discussions or confer with (someone), ***typically before undertaking a course of action."***

"DOE was to confer with the affected States *before it completed the study*. This conclusion is supported by all the applicable rules of statutory construction. It is required by the statutory context as the juxtaposition of the two sections indicates that Congress intended consultation to be more than responding to comments."

"Moreover, requiring DOE to actually confer with the affected States is consistent with the purpose of the EPAct. In reaction to black-outs and brown-outs, Congress sought to give the federal government a greater role in the development of transmission lines and to circumscribe somewhat the States' traditional authority over the placement and construction of power lines. In recognition of this impact on the States' traditional authority, Congress intended that affected States would participate in a study that might ultimately result in some limitation of their traditional powers."

"[B]y failing to provide the affected States with the modeling data on which it based the Congestion Study, DOE prevented the affected States from providing informed criticism and comments."

"We have already held that DOE's duty to consult in preparing the Congestion Study is separate from, and requires greater interaction with the affected States, than DOE's obligation to the States when preparing the NIETC report. Accordingly***, its post-study release of the information does not excuse its failure to consult*** with the affected States in preparing the Congestion Study."

"DOE's argument that the proprietary interests in the modeling data justified their retention is not well taken. First, as noted by the States, there is ***no factual or legal basis for DOE's unstated assumption that the States would not, or could not, respect any legitimate proprietary interests in the modeling data***. Second, and more importantly, the case cited by DOE."

"The exclusion of the affected States from the decisionmaking process ***not only limited the information available to DOE, it altered the way in which DOE made its discretionary decisions***."

Court's remedy: "DOE must prepare a Congestion Study in consultation with the affected States which thereafter may be judicially reviewed. We express no opinion as to the form or results of the collaboration. Indeed, presumably DOE could, in the exercise of its sound discretion, come to the same or similar conclusions that it did in the initial study. Of course, it might reach very different conclusions. What is critical is that it follow the statute's mandate and consult with affected States, particularly as sec. 216 requires DOE to prepare a congestion study every three years."

Conclusion on "consultation": The Court's reasoning squares with the prior recommendations about involvement in establishing objectives, assumptions, and options; access to data and consultants; and opportunities to comment and offer alternatives.

D. "Comparable" consideration of transmission and non-transmission alternatives

1. Comparable consideration means equal opportunity skepticism.

In electric industry planning, proponents of conventional solutions sometimes describe less conventional solutions as "speculative." But any assumption about any energy source's cost—whether the costs of demand response, wind, a nuclear accident, burying and guarding nuclear waste for 10,000 years, or the cost of continuing to search and dig for ever-diminishing fossil fuels and clean up after their combustion—has high uncertainty. The total costs of conventional fuels are often not merely speculative, but unknowable. Before transmission providers reject a solution as "speculative," they must apply that same standard to their own solutions.

This recommendation pushes the needle to equality between transmission provider and others, whereas Order 890 did not. Para. 454 in Order 890 declined to create this equality, due to the transmission provider's unique tariff-proposing role under the FPA:

> "454. In response to the suggestion by some commenters that we require transmission providers to allow customers to collaboratively develop transmission plans with transmission providers on a co-equal basis, we clarify that transmission planning is the tariff obligation of each transmission provider, and the pro forma OATT planning process adopted in this Final Rule is the means to see that it is carried out in a coordinated, open, and transparent manner, in order to ensure that customers are treated comparably. Therefore, the ultimate responsibility for planning remains with transmission providers. With this said, we fully intend that the planning process adopted herein provide for the timely and meaningful input and participation of customers into the development of transmission plans. This means that customers must be included at the early stages of the development of the transmission plan and not merely given an opportunity to comment on transmission plans that were developed in the first instance without their input."

Order 890 emphasized "input" and "participation." Order 1000, as interpreted here, requires that transmission providers ***not just accept input but comparably consider all alternatives***. The emphasis now is not merely on stakeholders' opportunity but also on the transmission provider's obligation.

2. The transmission provider cannot rely solely on participant suggestions

When proposing a transmission project after Order 1000, the transmission provider cannot discharge its evidentiary burden by saying merely, "We looked at the solutions others proposed." Prudence requires the TP itself to identify and examine every feasible solution, regardless of whether someone else proposed it. Otherwise the quality of the TP's performance will depend on the resources and abilities of others. The transmission provider, not the participants, has the burden of proof.

3. Because the transmission provider may have a transmission or generation horse in the race, structural protections are necessary.

Order 1000 expects each transmission provider to analyze objectively solutions that would displace the TP's own product. The very concept is illogical. The TP's for-profit interest will always be to favor transmission over non-transmission alternatives. It may want transmission to certain locations to help lower its own costs, or to advance its own affiliated generation, while disfavoring non-transmission alternatives that make its next rate-based generation plan unnecessary. It is not different than an audition committee asking a parent to pick the best musician when his child is a contestant. This illogic is no fault of FERC's, because under the Federal Power Act only a transmission provider can propose a transmission solution for cost recovery. But FERC must acknowledge that the TP will not be objective and create a workaround.

And while an RTO is a nonprofit, it does have the risk of a transmission-first culture, within which employees who oppose transmission projects have less smooth career paths, and in which expertise in non-transmission alternatives does not exist to the same extent as expertise in transmission.

The TP's predilection is unavoidable, but FERC and the TP can reduce its effect, with these five measures:

a. ***No presumption of prudence should attach to the TP's proposals to FERC.*** The TP must prove its prudence by demonstrating that it gave comparable treatment to all alternatives.

b. ***There should be a functional separation within the TP between those employees who advocate for a transmission solution and those responsible for analyzing all solutions.*** This functional separation has ample precedent: it is the core of Orders 888 and 889, and their natural gas industry counterparts, where the FERC has required separation between the transportation functions and

the generation or marketing functions, to reduce favoritism's effects.

c. ***There should be an independent entity, funded by but not accountable to the TP, to run the process of soliciting solutions, conducting the comparisons and identifying the best solutions.*** As the FERC well knows, from its discoveries of utilities violating the functional separation rules, functional separation is insufficient. Regulatory deference to the actor's discretion is defensible only when the actor's interests are aligned with the public interest. When they are not aligned, deference is abdication. (This reasoning echoes the courts' insistence that FERC may allow wholesale sellers to charge market prices only when they lack market power; because it is only when they lack market power that their self-interest, disciplined by effective competition, is aligned with the public interest.) Without an independent entity, we have a "comparable consideration" leader whose interests are not aligned with the public interest.

d. ***The TP's tariff should specify the evaluation criteria and apply them to all options comparably.*** Evaluation criteria are necessarily subjective, and subjectivity creates risk of bias. As the FERC stated in Order 890, para. 39:

> "As the Commission found in Order No. 888, it is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is inferior to that which they provide to themselves. Such an incentive can lead to unduly discriminatory behavior against third parties, particularly if public utilities have unnecessarily broad discretion in the application of their tariffs."

The same tendency will exist when carrying evaluations of alternatives to transmission. The antidote to bias is exposure.[10]

[10] See Order 1000, n.149: "*See, e.g., Northwestern Corp.,* 128 FERC 61,040 at P 38 (2009) (requiring the transmission provider's OATT to permit sponsors of transmission, generation, and demand resources to propose alternative solutions to identified needs and identify how the transmission provider will evaluate competing solutions when determining what facilities will be included in its transmission plan); *El Paso Elec. Co.,* 128 FERC 61,063 at P 15 (2009)

e. The FPA gives the transmission provider a right to propose whatever it wishes—it cannot legally be bound by the independent entity's analysis or recommendation. But ***if the independent entity's recommendation differs from the transmission provider's, the TP's proposal should have a rebuttable presumption of imprudence,*** which the TP must overcome with its own evidence of prudence.

4. What about the transmission provider's lack of expertise in non-transmission alternatives?

A transmission provider will not likely have internal expertise in non-transmission alternatives. And if it does, the expertise will not likely attach to a career ladder favoring the upwardly mobile, because non-transmission alternatives are not a profit source for a transmission company. When a matter is outside an institution's expertise or inclinations, the tendency is to over-emphasize its costs and under-estimate its benefits.

The consideration must be of comparable sophistication, using comparable expertise and comparable resources. And, less easy to document but equally important, the company culture must provide a comparable incentive to those presenting the alternative's case. If the alternative's analyst is treated as a mere devil's advocate, the alternative will receive less serious attention and fewer resources than a transmission proposal backed by the CEO and the Board. As the Commission knows well from its findings of discrimination in transmission service, the roots of discrimination can be deep within a company's culture.[11]

(same); *New York Indep. Sys. Operator, Inc.*, 129 FERC 61,044, at P 35 (2009) (same). In each of these cases, the Commission stated that tariff language could, for example, state that solutions will be evaluated against each other based on a comparison of their relative economics and effectiveness of performance. Although the particular standard a public utility transmission provider uses to perform this evaluation can vary, the Commission explained that it should be clear from the tariff language how one type of investment would be considered against another and how the public utility transmission provider would choose one resource over another or a competing proposal. *Northwestern Corp.*, 128 FERC 61,040 at P 38, n.31; El Paso Elec. Co., 128 FERC 61,063 at P 15, n.25; *New York Indep. Sys. Operator, Inc.*, 129 FERC 61,044 at P 35, n.26."

[11] See the 21 pages of detail in Appendix C of Order 888, entitled "Allegations of Public Utilities Exercising Transmission Dominance." This Appendix describes, for the strong-stomached reader, several dozen examples of "refusals to wheel, dilatory tactics that so protracted negotiations as to effectively deny wheeling, refusals to provide service priority equal to native load, or refusals to provide service flexibility equivalent to the utility's own use."

These reasons support the aforementioned requirement of an independent entity.

IV. Miscellaneous Legal Considerations

A. Cost allocation for non-transmission alternatives: The problem and possible solutions

FERC can allocate costs—meaning impose costs—only for products and services subject to its jurisdiction. If something is an "alternative" to transmission, it necessarily is not transmission; therefore FERC cannot allocate its costs. This jurisdictional reality does not budge, even if the non-allocation means the service faces a market disadvantage relative to transmission. Order 1000's comparability requirement requires comparable consideration, but it cannot require comparable cost recovery. Where does this leave proponents of non-transmission alternatives?

To make the service jurisdictionally eligible for cost allocation, it has to be part of a jurisdictional service—either transmission service or wholesale sales. In Order 888, FERC declared that various generation services, like spinning reserve, supplemental reserve and imbalance service, are part of "transmission service" and thus subject to FERC's jurisdiction, even though Section 201(b) explicitly denies FERC authority over "generating facilities." FERC even has ruled that the hotel, airfare and staffing costs associated with involving state commissions in RTO matters is also eligible for recovery through transmission rates, even though the FPA does not give FERC jurisdiction over hotel, airfare and staffing.

It will be necessary, therefore, to determine whether any of the possible NTAs can be treated as transmission costs. This analysis must include care with words: once one labels a service an "alternative to transmission," it cannot be a part of transmission—and therefore cannot be FERC-jurisdictional and cannot be eligible for FERC-ordered cost allocation. A more direct solution would be legislative change so that NTAs become FERC-jurisdictional, and thus eligible for cost allocation.

There may be an indirect way to achieve the objective of allocating non-transmission costs. While FERC cannot order cost recovery for NTA proposals, it can deny cost recovery for transmission proposals that emanate from a flawed transmission planning process which failed to give comparable consideration. If the unavailability of comparable cost recovery means a non-transmission alternative does not receive comparable consideration, FERC could apply the consequences discussed in Part II, i.e., rejection or loss of the prudence presumption. An advance statement by FERC, that transmission projects will not receive approval unless they emerge from a process where somehow the parties found a way to ensure comparable cost recovery for non-transmission alternatives, could create an incentive in the regions to solve the problem.

B. Can and should FERC be a source of (a) potential solutions and/or (b) public policy requirements?

Order 1000 leaves solution generation to the transmission providers and other participants. But FERC should play a role also. The sum of contributions from numerous private interests, plus variously positioned state interests, is not necessarily equal to the national public interest. There is no statutory reason why FERC, at the commissioner level or through its staff (both advisory and litigation staff), should not inject possible solutions that are receiving insufficient attention from the participants. FERC can also be a source of public policy requirements. FERC can say: "There is an X% likelihood that carbon legislation will pass, leading to Y% probability of closure of Z% of coal plant capacity. Assume this fact for purposes of planning."

The X, Y, and Z probabilities are indisputably greater than zero; therefore a prudent plan must provide for them. FERC should not leave it to parties, many of whom will resist the near-term cost consequences of accepting a probability exceeding zero. And there is no reason to have multiple different answers to the "X% likelihood" portion of the statement ("Y" and "Z" will vary by region.) It is one thing for a regulator to invite a variety of creative answers from different regions. It is another thing to ignore the certainty that today's parties downplay tomorrow's costs. FERC is accountable to all consumers, today's and tomorrow's, and it must press parties to include assumptions like this.

C. Comparability in interconnection service for distributed generation is a multi-jurisdictional puzzle.

For distributed generation to substitute for generation, interconnection service is necessary. This service may be state-jurisdictional or FERC-jurisdictional, depending on several factors.

1. If the distributed generation is connecting to the transmission system, the interconnection service is FERC-jurisdictional.

2. If the distributed generation is connecting to the distribution system, there are several possible jurisdictional outcomes for interconnection service.

   a. If the distributed generation is serving only retail customers (i.e., the self-generator and/or other retail customers who contract with the generator, the interconnection service is state-jurisdictional).

   b. If the distributed generation is in a net metering arrangement (where the generated amount runs the meter backward), the interconnection service is state-jurisdictional.

c. If the distributed generation owner is selling wholesale power, using the distribution system to carry the power, the interconnection service is FERC-jurisdictional. This odd conclusion stems from FERC's longtime view that whereas the Section 201(b) denies FERC authority over "local distribution," it (FERC) necessarily has authority over "non-local distribution." That service, FERC has found, is the transportation of wholesale power over the distribution system.

3. If distributed generation is to receive comparable treatment in the regional planning process, there must be certainty that it will receive comparable treatment in interconnection service. Comparable treatment in FERC-jurisdictional interconnection service is covered by FERC Orders 2003 and 2006. But comparable treatment in state-jurisdictional interconnection service depends on the practices of state-regulated utilities. FERC therefore must ensure that utility participants in the regional planning process are all providing interconnection service to distributed generation on a basis comparable to how the utility provides that service to itself.