

Interconnection Animus: The Readers React

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The previous essay argued that procedural narrowness, in the form of project-by-project litigation, yields zero-sum relationships that fail to identify long-term benefits. Citing Garrett Hardin's seminal article, I asserted that our dependence on party-focused, facility-specific litigation produces a procedural "Tragedy of the Commons." I argued for broadening the decisional context so that in any proceeding, benefits exceed costs.

The essay prompted an unusual number of responses. I am grateful for this thoughtfulness, examples of which appear below. All the writers emphasized that they spoke only for themselves, not for their organizations or clients.

Several writers noted the coincidence of an essay on Hardin's "Tragedy of the Commons" appearing in the same week that the Nobel Committee awarded the Economics Prize to Dr. Elinor Ostrom. One of you wrote that she won the prize "primarily for her research in dissecting the 'Commons Problem' and advancing the idea of sustainability. She is also the first woman to win this coveted prize. Hardin is the indeed the 'father' of the Tragedy concept, but Ostrom gave it new life."

On a wonderful personal note, Indiana Commissioner Larry Landis wrote:

"[W]hen I told you earlier that I had been introduced to Garret Hardin's essay nearly 40 years ago, it was by the professor with whom I took the last class required for my master's in political science, a crossover political science/economics class ... [T]hat professor was Elinor Ostrom of Indiana University, who this week was named co-recipient of the Nobel Prize in economics. And by the way, the class was phenomenal. Life is amazing that way."

Finance expert Stephen Hill wrote:

"One reason for the electric transmission building 'boom' is FERC's change in the allowed return rewards. They elected to provide profit levels above the cost of equity to encourage such building and have based the cost of equity on market-based estimates of integrated utility costs (DCF/CAPM). However, FERC also allows those operations to recover their costs through a 'formula rate,' in which the allowed return on equity (profit) is recovered monthly, without fluctuation, like a cost. A steadily earned profit is not a risky income stream and the yield of such an income stream to an investor would have to be substantially less than that appropriate for a publicly traded integrated company. My point here is that the Commons Tragedy you reference, I believe, has been set in motion by misguided regulatory policy at FERC. I don't have a problem with profit incentives (i.e.,

letting the ‘market’ work); it seems to me that what’s being allowed, due to the manner in which transmission equity returns are collected, far exceeds the actual cost of equity capital for those firms.”

Dr. Ken Zimmerman of the Oregon Commission wrote:

“Scott, perhaps you miss the point here. Perhaps the issue is not cost allocation per se but rather who, by what parties, and by what process that allocation should occur. In other words, are regulators, courts, hearings, and the like the best (in whatever sense of the word) parties/process to construct either the pie to be allocated or the allocations themselves? I would suggest not. Perhaps we need to turn the process and parties around. We could begin from the bottom up and build both the understanding of the projects/operations and the costs involved, as well as the goals they will serve and the consequences of not moving forward with the work. This process still has the chance of failure, but it would help reduce the ‘zero-sum gaming’ you mention, as well as the opportunistic last-minute ‘shots across the bow’ of old adversaries.”

Edith Pike-Biegunska of Regulatory Assistance Project wrote:

“You claim (and I agree) that important societal considerations are disadvantaged in the current ratemaking process. The battle that most recently culminated in the Seventh Circuit decision in *Illinois Commerce Commission v. FERC* illustrates the type of drawn-out controversy that current ratemaking procedures often yield. Your discussion uses this as an example of how the narrow interests of a few stakeholders can waylay projects that are, in fact, beneficial to society at large. While your essay focuses on procedure as the main culprit in thwarting socially constructive proposals, I wonder whether the problem does not actually lie in the substantive statutory provisions of the FPA.

“In the last section of your essay, you highlight the fact that ‘just and reasonable’ ratemaking does not take into consideration important factors such as environmental values and employment growth. Do you think that one way to address this problem might be by amending the FPA itself to directly apportion societal resources to projects with the types of benefits that the current system ignores? The FPA might, for example, mandate ‘clean first’ policies. Clean first policies would provide access to clean energy generation ahead of traditional, fossil fuel-intensive generation through: (1) rate design; (2) new interconnections; and (3) transmission access. Such an approach might avoid the need to curtail stakeholders’ rights to contest proposals, while ensuring that environmentally and socially beneficial policies are considered. I wonder whether this sort of substantive amendment to the FPA itself would address your concerns?”

Jason Zeller of the California Public Utilities Commission added:

“A couple of possible changes might improve the transmission approval process: one would be the creation of interstate compacts between adjacent states that would establish rules for cost allocation for lines that cross state lines. For example, one could posit developing a single criterion for evaluating the merits of new lines, such as a positive cost/benefit ratio. The compact or the individual state commission would approve established values for enhanced reliability, transfer capacity, access to renewable resources, economic development opportunities, increases in property taxes, and reductions in line losses. NARUC or NRRI could provide some economic and technical expertise for modeling these values. Concerning siting, the inherent conflict between the localized effects and dispersed benefits of new transmission projects could be mitigated by developing compensation formulas that are targeted to affected communities. Compensation for affected communities could become part of the transmission tariff itself, e.g., a mil per kWh. Finally, any transmission approval process should include a mandatory ADR component with a dedicated facilitator to resolve conflicts prior to formal litigation.”

And this from Ron Edelstein of the Gas Research Institute:

“We often face similar issues on justifying public or consumer interest R&D. It turns into a contested rate case, with multiple parties, consumer advocates, large industrials, commission staff, and gas companies, even before it gets to the commissioners. Free riders (like electric utilities, who benefit from O&M cost reduction and supply R&D but don’t have to pay for gas R&D) abound. Questions of ‘Will this R&D happen anyway without ratepayer funding?’, ‘Why should my consumer class pay?’, and ‘Why should my state pay?’ are all raised. Benefit/cost ratios are discussed and can be quantified, but how much of the benefit goes to the gas company and how much to the consumers, how much to manufacturers of equipment, how much to producers and service companies, and how much to the general public (like clean air) are contentious issues.

“So good R&D programs go unfunded or underfunded, and all, including the consumers of all classes, the general public, the gas companies, and the nation, pay the price in lost opportunities. EPRI faces a similar problem, and of course Bellcore was eventually sold by the baby bells to SAIC when they started competing with each other.”

Larry Nordell, an economist with the Montana Consumer Counsel, said:

“Scott, I think you are wrong on this one—at least you are painting with way too broad a brush. The arguments for spreading the costs of new transmission over all customers is a favorite one of resource developers, who want access to markets without paying the costs of transmission and who know their projects will look cheaper to the purchasing utilities if they are not tied to transmission expansion costs. And the arguments are a favorite for renewable advocates who simply assert that the benefits are obvious and don’t want to be bothered with details. But

in fact, (and my experience is in the west and may be different from the eastern interconnection) there are usually clear beneficiaries for most of these transmission lines and clear target markets for the generation projects. Why should those who don't benefit have to subsidize them? If wind developers in Montana want transmission to market to California, shouldn't they have to get the agreement of California buyers to pay for their power and the transmission costs before the lines are built? Your proposal would have such lines built, and the costs spread over the western interconnection, without any hard look by California utilities at whether they want the energy—that is, whether the benefits are great enough to warrant the costs, given the available alternatives. That is a basic tenet of economic reasoning, and it is not helpful to discard it simply by raising the specter of the tragedy of the commons.

“Further, I find your use of the ‘tragedy of the commons’ analogy to be ironic. The usual formulation is that when people do not face the costs of their resource use they tend to overuse it. Spreading the costs of new transmission to all parties and separating transmission costs from the resource decisions leading to the need for the new lines will lead exactly to that result.

“The west has a long history of cooperation on interstate lines that belies your claim of regulatory myopia, a cooperation that would be sorely tested by trying to force the non-benefiting states to pay for the lines as well as to accept the impacts. Here's the reasoning Northern Tier Transmission Group (which I have worked with) has used with regard to cost allocation: preferable cost allocation proposals are those that have the voluntary support of the parties on whom costs are proposed to be allocated. In the event that a party asks Northern Tier Transmission Group to devise a cost allocation for a project which has not been able to gain voluntary acceptance, costs will be allocated in accordance with beneficiary pays and cost causer pays. But the parties are cautioned that estimates of benefits are uncertain and subject to risk, and turning estimates into a mandatory cost allocation is not a simple technical exercise. I should note that Northern Tier Transmission Group does not have authority to do anything more than recommend a cost allocation to the relevant Commissions. MISO, which does have that authority, appears to be heading in a similar direction.”

“It is entirely too easy, when one is proposing that one's favorite project be paid for by others' money, to succumb to optimism in projecting benefits and to ignore risks and less favorable outcomes. The best and most careful judges of how big and how likely benefits will be are the people whose money is at stake. Mandatory cost spreading would lead to bad judgments on which lines to build, how big to build them, and when to build them. This would be an irresponsible outcome for the regulatory community. And that leads to my final comment: Your essay reads like a position of advocacy by an enthusiast for a favored result. In my view it is an inappropriate position for you to take as the head of NRRI. There is a full court press on currently promoting the spreading of transmission costs

without regard to benefits. We need well reasoned responses from the regulatory community, and we need and expect your help.”

Hannes Pfeifenberger of Brattle wrote:

“Scott—very much true and very well put . . . The RTOs’ formulaic cost-benefit and cost-allocation approaches (addressed in the attached) have pretty much undermined transmission investment for anything but reliability reasons. Luckily, the industry has figured that out now. The only question is whether we can find the vision and political will to do something about it. I think not even the state commissions working together will get us there. It may require regional governors to get together.”