

MEMORANDUM

TO: Metropolitan Water District of Southern California

FROM: Bonnie Blair
Meg McNaul
Rebecca Shelton

DATE: March 6, 2018

RE: Update to March 22, 2016 Memorandum on FERC Policy on Rolling In the Costs of Integrated Transmission Facilities

This memo addresses Federal Energy Regulatory Commission (“FERC” or the “Commission”) policy with regard to circumstances under which the costs of transmission facilities are rolled in to a single, system-wide rate. As a general matter, under Commission policy, the costs of network transmission facilities are rolled in to a single rate when the facilities are part of an integrated system. This memorandum focuses on the attributes of integration that the Commission considers when determining whether to apply its rolled-in rate policy to a particular facility.

While this memo was originally prepared on March 22, 2016, the research contained has been updated as of February 2018. Based on the updated research, we have concluded that the analysis and conclusions contained herein have not changed. The substance of this memo continues to represent FERC’s policy in this area.

FERC Policy on Rolled-In Ratemaking for Integrated Facilities

The Commission’s policy is that “when facilities are integrated and thus provide system-wide benefits, facilities’ costs are generally rolled-in and charged to all customers served.” *Pinnacle West Capital Corp.*, 131 FERC ¶ 61,143, at P 42, *reh’g denied*, 133 FERC ¶ 61,034 (2010); *see also Sierra Pacific Power Co. v. FERC*, 793 F.2d 1086, 1088 (9th Cir. 1986) (“FERC favors rolled-in cost allocation when a system is integrated.”) In making that determination, “a showing of any degree of integration is sufficient.” *Northeast Texas Electric Coop., Inc.*, Opinion No. 474, 108 FERC ¶ 61,084, at P 48 (2004), *order denying reh’g*, Opinion No. 474-A, 111 FERC ¶ 61,189 (2005). Where customers “enjoy the benefits of reliable service by their association with [an] integrated system,” the Commission has found that they “should share the cost of the entire transmission system.” *Niagara Mohawk Power Corp.*, Opinion No. 296, 42 FERC ¶ 61,143, at 61,531 (1988). The Commission has explained that to justify a single, rolled-in rate,

a utility “must demonstrate that all of its facilities function as a single, integrated transmission system that is used to serve [its] customers.” *Pinnacle West*, 131 FERC ¶ 61,143 at P 43. Further, the Commission has determined that “[d]ue to the integrated nature of the transmission network, network facilities benefit all network users,” even if “the facilities were installed to meet a particular customer’s request for service.” *Northeast Texas*, 108 FERC ¶ 61,084 at P 47. Indeed, “[t]here is no need to identify further actual benefits in order to include the costs of network transmission facilities in transmission rates.” *City of Anaheim, Cal.*, 113 FERC ¶ 61,091, at P 58 (2005) (“*City of Anaheim*”), *reh’g denied*, 114 FERC ¶ 61,311 (2006) (“*City of Anaheim Rehearing Order*”).

The Commission has explained that its “policy favors rolled-in pricing of transmission systems” except when there are special circumstances, which “have generally been the lack of a fully integrated system.” *Niagara Mohawk*, 42 FERC ¶ 61,143 at 61,531; *see also Pinnacle West*, 131 FERC ¶ 61,143 at P 42 (explaining that direct assignment is used to allocate costs to customers who use particular facilities when those facilities “are not integrated and thus do not provide system-wide benefits.”) Moreover, the Commission has stated that it “allows direct assignment to the customer of only non-grid facilities, such as radial lines and generator interconnection facilities (on the generator’s side of the point of interconnection with the grid) that do not serve a system-wide function.” *Northeast Texas*, 108 FERC ¶ 61,084 at P 47.

The following is a survey of some of the characteristics the Commission has looked at in applying its “any degree of integration test” for determining whether costs of facilities should be rolled-in:

- In *Niagara Mohawk*, 42 FERC ¶ 61,143, the Commission considered the appropriate transmission rates for a group of industrial customers taking service over Niagara Mohawk’s transmission system. The customers claimed that they “are legally and physically constrained so that power may only come directly from the Niagara Switchyard to their locations near the Niagara Project, at the extreme edge of the Niagara transmission system, and within 30 miles of the generation source,” such that they should not have to pay for the rolled-in costs of Niagara’s entire transmission system. *Id.* at 61,530. The Commission required the use of a rolled-in methodology for determining the cost of service to the customers, rather than allowing direct allocation of only certain costs. In making this determination, the Commission looked at the following characteristics of the service taken over Niagara Mohawk’s system: (1) the customers take service at about 40 locations over Niagara’s lines, which are not radial lines, but part of the integrated system; (2) because the customers take service at 40 locations, they use many more of the transmission lines than would be used if power were delivered at only one location; (3) Niagara must ensure continuous service to the customers, even if service is normally provided only from the Niagara Switchyard; and (4) the transmission service at issue is firm and involves a very high level of reliability. *Id.* at 61,531.
- In *Mansfield Municipal Electric Dept. v. New England Power Co.*, 97 FERC ¶ 61,134 (2001), the Commission set forth a five-factor test to determine whether facilities exhibit any degree of integration such that their costs should be part of a system-wide rolled-in rate. The Commission considers the following five factors when determining “whether a facility is integrated with the rest of the network:”

1. Whether the facilities are radial, or whether they loop back into the transmission system;
2. Whether energy flows only in one direction, from the transmission system to the customer over the facilities, or in both directions, from the transmission system to the customer, and from the customer to the transmission system;
3. Whether the transmission provider is able to provide transmission service to itself or other transmission customers . . . over the facilities in question;
4. Whether the facilities provide benefits to the transmission grid in terms of capability or reliability, and whether the facilities can be relied on for coordinated operation of the grid; and
5. Whether an outage on the facilities would affect the transmission system.

Mansfield, 97 FERC ¶ 61,134 at 61,613-61,614.

- In *City of Anaheim*, the Commission interpreted *Mansfield* and explained that the factors are not used to determine whether a facility is a network facility, but rather “whether special circumstances exist such that a facility is *not* a network facility,” is “*not* integrated with the transmission network,” and “its costs should *not* be rolled into transmission rates.” *City of Anaheim*, 113 FERC ¶ 61,091 at P 35 (emphasis in original). “[I]t is not necessary that a facility make a positive showing with regard to all five *Mansfield* factors to be a network facility.” *Id.*

Further, in *City of Anaheim*, 113 FERC ¶ 61,091, the Commission determined that the cost of contract entitlements (as opposed to facilities owned directly by a utility) should be rolled in to a system-wide rate because they met its “any degree of integration” test and are integrated network transmission facilities. *Id.* at P 34. The Commission explained that “[t]he record shows that these entitlements are rights to use high voltage lines that are designed to and do carry bulk power,” and “[i]t also shows these lines are interconnected with other utilities and other transmission systems” *Id.* at P 48. Therefore, the Commission determined that “the evidence shows that entitlements can be used to transmit power from other generators.” *Id.* Because the entitlements were placed under the operational control of the California Independent System Operator Corporation (“CAISO”), they were available to all CAISO market participants, who “can request scheduling of the entitlements through the CAISO and only have to pay one rate” – features that show they are integrated with the CAISO grid. *City of Anaheim Rehearing Order*, 114 FERC ¶ 61,311 at P 46.

Additionally, the Commission relied on the following characteristics of the entitlements in determining that they are integrated facilities: (1) power can flow in either direction on the transmission lines subject to the entitlements; (2) the entitlements provide reliability benefits to the CAISO; (3) “other market participants were able to and did use the . . . entitlements to

transmit power”;¹ and (4) the entitlements “are not physically limited to serving only the Cities [holding the entitlements] and they do not serve only generation” from a specific generator. *City of Anaheim*, 113 FERC ¶ 61,091 at PP 48-49.

- In *Pinnacle West*, 131 FERC ¶ 61,143, the Commission determined that the cost of 69 kV and higher voltage facilities should be rolled in to a single rate because these facilities “serve a system-wide transmission function” and “function as a single, integrated transmission system.” 131 FERC ¶ 61,143 at P 43. There, 12 kV and lower voltage facilities were found to be radial facilities that serve only certain customers and provide no system-wide benefit. *Id.* at P 47. Therefore, the costs of those facilities were not rolled in to the system average rate charged for transmission service, and the Commission allowed for them to be recovered through direct assignment. *Id.* at P 50.
- In *Northeast Texas*, 108 FERC ¶ 61,084, when determining that the costs of transmission system upgrades must be rolled into transmission rates, the Commission relied on the following characteristics: (1) the facilities operate in-line with the transmission network; (2) the facilities “perform a switching function to maintain the reliability of service over the network transmission lines;” (3) the transmission network “cannot be dismembered,” because “it is a cohesive network moving energy in bulk that operates as a single piece of equipment,” which is “true even if the facilities would not currently be needed for a particular customer’s service;” (4) there is an ability to switch existing network facilities to maintain continuation of service in the event of a fault on adjacent lines; and (5) the upgrades allow faster restoration of looped transmission lines, benefitting other loads. *Id.* at PP 49-50.
- In *Buckeye Power, Inc. v. American Transmission Systems, Inc.*, 148 FERC ¶ 61,174 (2014), *reh’g denied*, 151 FERC 61,091 (2015), the Commission determined that a dual-voltage rate design with different rates based on voltage should be replaced with a single rolled-in zonal rate reflecting the cost of all zonal transmission facilities, because the facilities are part of an integrated transmission system, and no special circumstances warrant an exception. *Id.* at P 12. According to the Commission, the lower voltage facilities “were not constructed to serve specific customers, operate in a parallel network with the 138 kV transmission facilities, support the reliability of higher-voltage facilities, and are used to serve all customers and transmit power on a system-wide basis.” *Id.*
- In *California Dept. of Water Resources v. FERC*, 489 F.3d 1029 (9th Cir. 2007), the Court of Appeals for the Ninth Circuit upheld the Commission’s approval of inclusion of the costs of facilities that performed both network transmission and generation tie functions in CAISO transmission rates. The Court determined that the facilities were properly classified as “transmission” because they serve a network transmission function while also benefiting generation. *Id.* at 1036-37. In determining that the costs should be rolled in, the Court applied the Commission’s rationale that where “a system [is] integrated,” “a rolled-in allocation [is] appropriate,” and found that under this rationale, “it is irrelevant whether the

¹ While the Commission noted this factor, it provided the caveat that “it is not necessary that the entitlements provide service to other market participants in order for them to be network facilities, but it is further evidence that they do perform network functions.” *City of Anaheim*, 113 FERC ¶ 61,091 at P 48. The Commission also explained that “the relative actual use of the . . . entitlements is not relevant . . . to determine whether a facility is a network facility,” because “[t]he issue is whether there is any degree of integration,” and while “[u]se of the entitlements by other customers may be additional proof of network integration . . . it is not necessary that other customers make actual use of the entitlements for them to be network facilities.” *Id.* at P 51.

loops and transformer banks directly serve the power requirements of a third-party generator.” *Id.* at 1038.



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