

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Supplemental Notice of Proposed Rulemaking)
on Electric Transmission Incentives Policy)**

Docket No. RM20-10

COMMENTS OF POTOMAC ECONOMICS, LTD.

Pursuant to the above-captioned Supplemental Notice of Proposed Rulemaking on Electric Transmission Policy (“Supplemental NOPR”) initiated by the Federal Energy Regulatory Commission (the “Commission”), Potomac Economics hereby submits these comments. The comments address the Commission’s proposed changes in the Transmission Organization Incentive (“TOI”) for transmitting and electric utilities that join Independent System Operators (“ISOs”) or Regional Transmission Organizations (“RTOs”).¹

Potomac Economics is the Independent Market Monitor (“IMM”) for Midcontinent ISO (“MISO”) and ERCOT, the Market Monitoring Unit for the New York ISO (“NYISO”), and the External Market Monitoring Unit (“EMMU”) for ISO New England. In these roles, we are

¹ For the remainder of these comments will refer only to RTOs as Transmission Organizations, although we recognize that the Commission’s policy extends to other Transmission Organizations.

responsible for monitoring and evaluating the performance of each RTO's energy and operating reserve markets. We also recommend market design changes to improve the performance of the markets and evaluate design changes proposed by the RTOs or market participants.

I. NOTICE AND COMMUNICATIONS

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II. INTRODUCTION AND SUMMARY

In its initial NOPR on Electric Transmission Incentives Policy, the Commission proposed to increase the current 50 basis point TOI to a 100 basis points for any utility that is a member of an ISO or RTO.² In the Supplemental NOPR, the Commission seeks comment on a proposal to modify this incentive, the as stated in the March 20, 2020 notice of proposed rulemaking in this proceeding. Rather than increasing the TOI basis from 50 to 100 basis points, the Supplemental NOPR proposes to reverse the proposed change by reducing it to zero for any utility that is a member of a transmission organization for three or more years. Additionally, the Supplemental NOPR proposes to adopt the clarification in the March NOPR that in order to qualify for the TOI, the transmitting utility must turn over operational control of its transmission facilities to the Transmission Organization.

² Notice of Proposed Rulemaking Regarding the Commission's Electric Transmission Incentives Policy, 18 CFR Part 35, 170 FERC 61,204, March 20, 2020 ("March NOPR").

Potomac Economics appreciates Commission’s past recognition of the importance of incentives to encourage RTO membership. RTOs are now a proven structure to ensure reliability at lower costs through competitive markets and market-based congestion management processes. Yet, membership generally remains voluntary and large portions of the Eastern Interconnect continue to be outside of RTOs. We find that the Commission’s policy reversal in the Supplemental NOPR is not well-reasoned and will jeopardize the substantial benefits that RTO’s currently provide. In particular, the Commission’s proposal seems to be predicated entirely on:

- a false distinction between the decision to “join” an RTO and the decision to “remain in an RTO;
- unsupported assertions that all utilities benefit from being members of an RTO; and
- a disregard of the additional obligations and costs borne by members of an RTO, which the Commission previously recognized in the March NOPR.

Our comments discuss each of these problems. Although we take no position on the absolute size of the TOI, our comments demonstrate that eliminating the TOI entirely after three years of RTO membership is not reasonable. Therefore, we respectfully recommend that the Commission retain the TOI, even if at a reduced level. We also recommend that the Commission consider more targeted market-based incentives that would allow transmission owning members of RTOs to earn higher revenue by taking actions that increase the utilization of the transmission system.

Finally, we provide comments on the value of clarifying the definition of transferring “operational control” to an RTO.³ Improving this definition could further increase the benefits of RTO membership to consumers and support the retention of the TOI.

³ FERC uses the term operational control. The MISO TO Agreement appears to use the terms “operational control” and “functional control” interchangeably.

III. COMMENTS

A. The Commission’s proposal falsely distinguishes between the decision to “join” and “remain” in a Transmission Organization

Economists have long recognized that there is no distinction between a decision to do something and a decision not to take an opposite action – that, effectively, it is the same decision. For example, the decision to buy a stock in Company A or not to sell stock in Company A that I already own is the same decision. In both cases, my decision reflects the fact that I believe the future value of the company is greater than the market price of the stock.

In the same way, the decision at any particular time to “join” an RTO is effectively the same as the decision to “remain” in an RTO in which a company is already a member. In both cases, the company is deciding that the benefits of future membership are greater than its costs. Therefore, to provide an incentive for joining and not for remaining in an RTO is logically inconsistent, and inconsistent with the economic rationale for providing any incentive for RTO membership in the first place.

Offering an incentive for joining an RTO must be justified on the basis that this decision produces benefits for other entities and the overall system. On this basis, providing an incentive is reasonable. However, it must then follow that the decision not to remain in an RTO must harm other entities and the overall system. Therefore, such a decision should be negatively incented in the same manner that the decision to join the RTO is positively incentive. Currently, such a negative incentive exists because a utility that leaves an RTO would lose its TOI. Under the Supplemental NOPR, however, this penalty would be eliminated for any utility that has been a member of an RTO for more than three years.

Hence, all else equal, it is much more likely that some existing members of RTOs will choose not to remain RTO members to the detriment of the RTO markets and placing at risk the substantial benefits that they provide.

B. Removing the TOI on the basis that utilities benefit from RTO membership is not reasonable because these assertions are not consistently valid

The primary basis provided by the Commission in the Supplemental NOPR for removing the TOI after membership in an RTO for three years is that utilities that have joined an RTO will be receiving other benefits of RTO membership:

We believe that providing the Transmission Organization incentive indefinitely may not be necessary to incentivize a transmitting utility to join a Transmission Organization and . . . may not appropriately balance utility and ratepayer interests, particularly given the substantial benefits of Transmission Organization membership to participating utilities.

We note that there are many benefits of Transmission Organization membership, and that many of these benefits accrue to transmitting utilities. These benefits include optimization of the transmission system, and regional transmission planning as well as access to numerous types of markets.⁴

While it is true that RTOs provide substantial benefits, most of these benefits accrue consumers and generators. Very few of these benefits accrue to transmission owners (TOs) that are responsible for the decision to join an RTO. While it is true that some TOs are also Load-Serving Entities (“LSEs”) or own generation, many do not. Hence, it is not reasonable to base the elimination of the TOI on RTO benefits that do not accrue to all transmission owners.

The only benefit mentioned by the Commission that could potentially benefit an entity that is only a TO is regional transmission planning. Even this benefit only accrues to those TOs for which the planning studies have or will justify additional transmission investment. Other

⁴ Supplemental NOPR at ¶ 14.

benefits, such as the “optimization of the transmission system” and “access to numerous types of markets” are benefits that accrue to consumers and generators, not to TOs. For example, optimizing congestion management lowers costs for consumers, but may also reduce the need for new transmission investment, which would lower the future revenues of the TOs.

In addition, RTO membership results in increased transparency and reduced operational control of the transmission operations. Again, while this enhances reliability and efficiency, it is not in the direct interests of a profit maximizing Transmission Owner compensated through cost-of-service.

Importantly, the Commission previously recognized that membership in an RTO can also increase costs or risks for TOs:

The duties and responsibilities associated with RTO/ISO membership have also increased since Order No. 679. These include: loss of operational control of transmission facilities to a third party; an obligation to build new transmission facilities at the direction of the RTO/ISO; diminished decision-making control over assets while retaining the responsibility of maintaining the system; meeting reliability standards; obligations to obey RTO/ISO rules; and an obligation to provide electric service even when foundational agreements can change, thereby changing the terms and conditions under which the transmitting utility initially agreed to participate in the RTO/ISO. These responsibilities similarly persist regardless of the voluntariness of RTO/ISO membership.⁵

These costs and risks are valid and provide a reasonable basis for maintaining the TOI. In the Supplemental NOPR, the Commission dispenses with these issues without explanation or support. We believe many TOs would find that the costs of these issues exceed the benefits of remaining an RTO member.

Finally, although some TOs likely do benefit from RTO membership on a net basis, (either because they are also LSEs, own generation, or have made transmission investments

⁵ March 20 Order, ¶ 96.

because of regional planning processes), this cannot be reasonably be argued to be the case for all TOs. We believe a large number of TO members of RTOs would find that RTO membership is no longer financially beneficial if the TOI is eliminated. If even some of the entities decide to resign their membership, the economic costs and lost reliability benefits could be enormous.

C. ROE incentives could be reduced and supplemented with more targeted incentives

While we believe it is generally true that joining an RTO will improve the utilization of transmission by increasing coordination of injections into and withdrawals from the transmission network, RTO membership alone does not ensure full utilization of transmission. The Commission has thus far not considered more targeted incentives. We provided some suggestions on targeted incentives in both our comments in the NOI and in this docket. While the Supplemental NOPR only addresses the ROE basis adder, we still believe more targeted incentives would be valuable. Such incentive could allow the TOs to receive transmission rights or marginal transmission congestion revenue associated with actions they may take to increase transmission capability or utilization as a member of an RTO. Providing compensation in this manner would align the TOs incentives with the value of these actions to the system.

For example, assume a TO can take actions that would increase transfer capability on a path by 5 percent by optimizing the configuration of the network, employing grid-enhancing technologies, or providing dynamic line ratings. The TO could be granted financial transmission rights associated with the 5 percent increase, or the equivalent auction revenue rights, or simply the day-ahead congestion value associated with the capability increase. This would provide incentives that would likely lead to substantial additional benefits beyond the benefits of simply joining an RTO.

D. The Commission should clarify the definition of operational control

The Supplemental NOPR proposes to adopt the clarification in the March NOPR that, in order to qualify for the Transmission Organization Incentive, the transmitting utility must turn over operational control of its transmission facilities to the Transmission Organization.

However, neither the initial NOPR, nor the Supplemental NOPR provide definitions for this term and it is subject to a wide range of interpretation. For example, MISO's interpretation of the MISO TO Agreement⁶ and MISO's implementation of the operational control of facilities is limited, by their own admission, to a clearing house function of Facility ratings⁷ and with few exceptions limited to only congestion management through control of generation commitment and dispatch rather than any meaningful operational control of Transmission facilities such as Ratings verification, grid reconfiguration or grid optimization including breaker status, transformer tap settings, or flow-control devices. In addition, MISO does not optimize or coordinate transmission outages but rather only reviews and disapproves plans for outages that cannot be managed for reliability, regardless of the expected cost of such outages. FERC should clarify that such a narrow interpretation of "operational control" was not the intention of the TOI.

Therefore, to be a meaningful obligation, operational control should be defined to include important aspects of operating transmission facilities that are key for providing benefits to consumers in the RTO's area. We recommend that these aspects include:

- i. The provision of sufficient information and data on facilities to the RTO to verify the accuracy of the facility ratings and ensure that the maximum reliable rating is available to the RTO;

⁶ Agreement Of Transmission Facilities Owners To Organize The Midcontinent Independent System Operator, Inc., A Delaware Non-Stock Corporation, Rate Schedule 1 to the MISO TEMT.

⁷ "Because MISO simply populates the value submitted by the Transmission Owner, MISO's process is agnostic to how those ratings are developed.", MISO Comments in RM20-16, p. 30.

- ii. Delegation of authority to the RTO to approve transmission outages that would generate substantial congestion costs or potential reliability concerns;
- iii. Cooperating in developing reasonable operating guides that the RTO would have the authority to implement to reconfigure the network to reduce congestion or address reliability concerns. Such reconfiguration options should include, modifying breaker status, transformer tap settings, or flow-control devices.

MISO's interpretation of its operational control and authority falls well short in these three key areas. We have identified substantial economic and reliability benefits that would be associated with improving these aspects of its operational control. Making the ROE adder contingent on a clearer and broader definition of operational control would likely bring about substantial progress in these areas, increase transmission utilization, and ensure that the economic benefits of RTO membership continue to many times larger than the magnitude of the TOI.

IV. CONCLUSION

For the reasons described in these comments, we find the proposal in the Supplemental NOPR to eliminate the TOI to be unreasonable and ill-advised. The Commission's long-standing support of RTOs and the competitive markets they operate have produced countless benefits for the nation's electricity consumers. To put even a portion of these benefits at risk to save transmission costs that are a very small fraction of these benefits is not prudent. Therefore, we respectfully recommend that the Commission abandon its proposal to eliminate the TOI or, in the alternative, to modify the TOI to a level that would likely still allow the RTOs to retain all of their existing members.

Additionally, we recommend that the Commission consider more targeted market-based incentive that would allow TOs that are members of RTOs to earn higher revenue by taking

actions that increase the utilization of the transmission system. Finally, we respectfully recommend that the Commission clarify and expand the definition of operational control to ensure that RTOs have the appropriate authority and control to fully achieve the benefits of operating the transmission system efficiently.

Respectfully submitted,

/s/ David B. Patton

David Patton
President
Potomac Economics, Ltd.
June 25, 2021

CERTIFICATE OF SERVICE

I hereby certify that I have this day e-served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 25th day of June 2021 in Fairfax, VA.

/s/ David B. Patton
