New Hampshire
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Ted C. Feigenbaum
Presider t and
Chief Executive Officer

NYN-91193

December 13, 1991

United States Nuc'car Regulatory Commission
Washington, D.C. 20555

Attentioa: Document Control Desk

Refere ıces: Facility Operating License No. NPF-86, Docket No. 50-443

Subject: N .ESCO/NAEC Operating License Amendment Applications/FERC Hearing

Gentlemen:

Enclosed for your information is an order from the Federal Energy Regulatory Commission (FERC) that schedules Oral Argument on January 8, 1992 on two cases before it that deal with native load transmission priorities, one of these cases being the Northeast Utilities/PSNH merger case. The Order also contains a proposed FERC Staff Transmission Pricing Proposal.

If you have any questions, please contact Mr. Terry L. Harpster, Director of Licensing Services, at (603) 474-9521 extension 2765.

Very truly yours,

Ted C Feigenbaum

Ted C. Feigenbaum

Enclosure

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Martin L. Allday, Chairman;
Charles A. Trabandt, Elizabeth Anne Moler,
Jerry J. Langdon and Branko Terzic.

Northeast Utilities Service Company (Re. Public Service Company of New Hampshire)	) Docket Nos. EC90-10-004, ER90-143-004, ER90-144-004, ER90-145-004 and EL90-9-004
Northeast Utilities Service Company	) Docket Nos. ER90-373-003, ER90-390-003 and ER90-374-002

ORDER SCHEDULING ORAL ARGUMENT

(Issued December 10, 1991)

Each of these cases presents questions concerning the appropriateness of permitting the recovery of so-called "opportunity costs" and/or incremental costs in rates for the transmission of electric energy in interstate commerce and in the NU merger, procedures for so-called immutable constraints. Before deciding the matters pending before the Commission in these dockets, the Commission believes that oral argument, limited to the question of the appropriateness of recovery of opportunity/incremental costs in the jurisdictional transmission rates at issue here, should be held.

Accordingly, as ordered below, the Commission is scheduling oral argument on these matters to be held on January 8, 1992, in Hearing Room 1, 810 First Street, N.E., Washington, D.C. 20426. The Commission will address the above cases sequentially. In addition, as shown on Attachment A to this order, the Commission is grouping various parties by interest group and affording each interest group a block of time at the oral argument. Speakers for each group should be determined by the group. In addition, the Commission intends that each speaker(s) within a group will initially state its group's position and will then be subject to questions from the Commission. Speakers may reserve a portion of their time for closing remarks.

The Commission requests that speakers specifically address the attached pricing proposal and questions developed by Commission staff to resolve this issue in these cases as described in Attachment B to this order.

<u>The Commission Orders</u>:

(A) Oral argument, limited to the subject of opportunity/incremental cost pricing and immutable constraints procedures, is hereby ordered to begin at 10:00 a.m. in Hearing Room 1, 810 First Street, N.E., Washington D.C. 20426 on January 8, 1992.

(B) Speakers of the various groups listed on Attachment A should notify the Commission of their designation by the Group (specifying the parties they are appearing for) no later than December 30, 1991. Prepared statements, limited to twenty pages, may be filed by the speakers no later than December 30, 1991 and must be served on all parties in the respective cases.

By the Commission.

(S E A L)

Lois D. Cashell

Lois D. Cashell,
Secretary.

ATTACHMENT A

10:00 A.M. - 3:00 P.M.

Northeast Utilities Service Company (Re. Public Service Company of New Hampshire)

Docket Nos. EC90-10-004, et al.

Time	Grouping
10:00 A.M. - 10:30 A.M.	Northeast Utilities Service Company
10:30 A.M. - 11:00 A.M.	Connecticut Department of Public Utility Control and New Hampshire Public Utilities Commission
11:00 A.M. - 11:45 A.M.	Other New England State Public Utilities Commissions
11:45 A.M. - 12:15 P.M.	Other State Agencies
12:15 P.M. - 1:15 P.M.	Lunch
1:15 P.M. - 1:40 P.M.	New England Investor-Owned Utilities (Connecticut, Massachusetts, Rhode Island)
1:40 P.M. - 2:00 P.M.	New England Investor-Owned Utilities (Maine, New Hampshire, Vermont)
2:00 P.M. - 2:30 P.M.	Municipal and Cooperative Utilities
2:30 P.M. - 2:45 P.M.	QFs
2:45 P.M. - 3:00 P.M.	IPPs

3:30 P.M. to 5:00 P.M.

Northeast Utilities Service Company

Docket Nos. ER90-373-003, ER90-390-003 and ER90-374-002

Time	Grouping
3:30 P.M. - 4:00 P.M.	Northeast Utilities Service Company
4:00 P.M. - 4:15 P.M.	Massachusetts Municipal Wholesale Electric Cooperative
4:15 P.M. - 4:30 P.M.	Towns of Concord, Norwood and Wellesley, Massachusetts
4:30 P.M. - 4:45 P.M.	ELCON
4:45 P.M. - 5:00 P.M.	Vermont Department of Public Service

ATTACHMENT B

STAFF'S PROPOSED TRANSMISSION PRICING PROPOSAL

There are two Northeast Utilities cases currently pending before the Commission which present important and interrelated transmission pricing issues -- rehearing of Opinion No. 364 1/ (the Northeast Utilities/Public Service Company of New Hampshire merger proceeding) and the paper hearing in which the Commission set the issue of opportunity cost pricing for briefing. 2/ The transmission pricing issues in these proceedings offer an opportunity for the Commission to consider certain aspects of its current approach to pricing electric transmission service. Accordingly, the Commission staff is recommending a transmission pricing proposal which seeks to address the interrelated transmission pricing issues in these cases in a comprehensive manner.

When a utility commits a portion of its existing transmission system to provide wheeling service to third parties, and due to a lack of capacity availability its transmission system becomes constrained, the cost of providing service to its r[illegible]e load customers 3/ may be increased. If legitimate and v[illegible]ied, these additional costs (or lost benefits) are costs which should be paid for by the wheeling customer. A primary example involves situations where a utility that has undertaken to provide third-party transmission service must forego the opportunity to engage in a non-firm economy sale or purchase on behalf of its native load customer because its transmission system is constrained. Opportunity cost pricing would enable the utility to recover a rate for third party wheeling service which would "compensate" the utility's native load customers for any potential "lost opportunities" to engage in such economy energy sales and purchases.

1/ Northeast Utilities Service Company, Opinion No. 364, 56 FERC ¶ 61,269 (1991).

2/ Northeast Utilities Service Company, 52 FERC ¶ 61,143 (1990), reh'g denied, 53 FERC ¶ 61,135 (1990). Northeast Utilities Service Company, 52 FERC ¶ 61,077 (1990), reh'g denied, 53 FERC ¶ 61,159 (1990). Northeast Utilities Service Company, 52 FERC ¶ 61,214 (1990), reh'g denied, 53 FERC ¶ 61,116 (1990).

3/ As the Commission noted in Opinion No. 364, native load customers are "those customers on whose behalf [Northeast Utilities], by statute, franchise or contract has undertaken the obligation to plan, construct, and operate its system to provide reliable service." 56 FERC at 62,014, n. 259.

Opportunity cost pricing protects native load customers from additional costs caused by the provision of wheeling service that do not directly benefit the transmitting utility's native load. Native load customers are held harmless because opportunity cost revenues recovered from wheeling customers are credited back to reduce the rates of native load customers.

Legitimate opportunity costs do not include lost trade benefits when capacity is not constrained. In particular, they do not include the loss of revenues that result from losing a wholesale sale because of competition. They also exclude the trade benefits lost in purchase-and-resale arrangements that might substitute for unbundled transmission service. Legitimate opportunity costs occur <u>only</u> when the requested transmission service would produce real power flows that cannot be reliably accommodated on existing transmission capacity. In other words, when there is insufficient transmission capacity to accommodate both trades.

Because the Federal Power Act relies (in large measure) upon the voluntary provision of transmission service, at present a utility can protect its native load customers by simply refusing to offer transmission service, thereby retaining the unfettered right to use its transmission system. Similarly, a utility may assign a lower priority to third party transmission service by reserving the right to interrupt the wheeling customer in order to take advantage of any economy sale or purchase opportunity that might benefit its native load customers when transmission capacity becomes constrained. A non-firm rate is generally lower than a firm rate to reflect the nature of the interruptible wheeling service. 4/

The Northeast Utilities cases present the Commission with a chance to examine whether the traditional approach to pricing transmission service is still appropriate in light of changing market conditions and to explore how a utility might protect the legitimate economic interests of its native load customers through appropriate pricing. In the order on rehearing in the merger case, the Commission could accept opportunity cost pricing for firm transmission service as an efficient pricing mechanism so long as certain safeguards are in place to fully mitigate market power over transmission. In the context of the merger, these safeguards may include:

4/ <u>See, e.g.</u>, New England Power Company, Opinion No. 335, 49 FERC ¶ 61,129 (1989); <u>reh'g denied</u>, Opinion No. 335-A, 50 FERC ¶ 61,181 (1990); <u>aff'd sub nom</u>. Towns of Concord, Norwood, and Wellesley, Massachusetts v. FERC, No. 90-1179 (D.C. Cir. 1991) unpublished.

an obligation to provide firm transmission service out of existing capacity (including the right to resell/reassign such capacity);

an obligation to construct new facilities, when necessary, to accommodate third party wheeling requests;

a validation process to ensure that opportunity costs are real and properly assignable to third party wheeling service; and

a cost cap which would prohibit a utility from collecting opportunity costs that exceed the incremental cost of expanding the transmission system to alleviate the constraint.

In the order in the cases set for a paper hearing, the Commission could permit validated opportunity cost pricing for non-firm transmission without a cost cap. This is based, in part, upon the fact that Northeast Utilities has committed to provide firm transmission service in the merger proceeding and that a firm transmission "backstop" will effectively cap the rate that Northeast Utilities can charge for non-firm service. However, the question remains whether the Commission could, in the abstract, accept opportunity cost pricing for non-firm transmission service without a firm transmission backstop in place.

Finally, with respect to the merger case, the term "immutable constraint" suggests that a transmission request could not be satisfied in any manner or at any cost. If that is true, there is nothing that anyone (including this Commission) can do to satisfy the wheeling request that would not affect system reliability or existing firm contracts. Consequently, the Commission may want to address further the fundamental issue of determining the incremental cost of expanding the transmission system. There may be any number of ways to expand the system to alleviate a constraint. "Immutability" suggests that, after examining all feasible alternatives, the cost of expanding the system may be very (and perhaps prohibitively) high, or that there may be no feasible alternatives. In the merger proceeding, NU has agreed to provide an estimate of the cost of any necessary transmission upgrades which will serve as a cap on the wheeling customer's cost responsibility. NU's estimate of the incremental cost of expansion may, in some instances, be the subject of a Commission hearing in which all affected states may participate. In that case, it will be this Commission's responsibility to determine whether NU's estimate of the incremental cost of expansion is reasonable.

Under this proposal, the Commission would not retain Opinion No. 364's procedures for the allocation of existing transmission capacity in the event of a complaint under immutable constraint conditions.

The goals of the proposed pricing model for firm transmission service are, consistent with reliable services:

(a) Hold Native Load Customer Harmless

(b) Provide The Lowest Reasonable Cost-Based Third Party Firm Transmission Rate

(c) Prevent Collection Of Monopoly Rents By Transmission Owner and Promote Efficient Transmission Decisions

Based upon these goals, three potential transmission system conditions and pricing rules should be followed:

1. System is not constrained

All transmission service requests can be met and utility can continue to engage in economic purchases and sales on behalf of native load.

Transmission rate is the utility's embodded cost.

2. System Is Constrained But Expansion Not Undertaken

Utility cannot simultaneously accommodate third party wheeling request and economy purchases and sales on behalf of its native load customers.

Transmission rate cannot exceed the higher of:

a. Embedded costs or

b. Opportunity costs capped at incremental cost of expanding the system to alleviate the constraint.

3. System Is Constrained And Expansion Undertaken

Utility cannot accommodate third party wheeling request without jeopardizing reliability of service to its native load customers -- utility must expand its transmission system.

Transmission rate cannot exceed the higher of:

5

a. Embedded costs ~~or~~

b. Incremental cost of expanding the system.

EFFECT ON NATIVE LOAD

Under each of these three potential sytem conditions, native load customers are held harmless.

1. Where the system is not constrained such that the utility is able to provide wheeling service out of existing transmission capacity, there are no legitimate lost opportunities. Because the utility is permitted to charge the embedded costs to the new transmission customer, the native load customer is better off because the fixed costs of transmission are being spread over a larger customer base (i.e., the embedded cost rate is reduced).

2. Where the system is constrained and expansion is not undertaken because the utility is able to provide wheeling service out of existing transmission capacity without degrading system reliability, there are three possible rate outcomes:

a. When opportunity costs are less than embedded costs, the utility is permitted to charge embedded costs. The native load customer is better off because the embedded cost rate recovers the opportunity costs and leaves the native load customer with a net benefit (the difference between embedded costs and opportunity costs).

b. When opportunity costs exceed embedded costs but are less than the incremental cost of expanding the transmission system, the utility is permitted to charge legitimate opportunity costs. The native load customer is held harmless because all opportunity costs are borne by the transmission customer.

c. When opportunity costs exceed embedded costs and exceed the incremental cost of expanding the transmission system, the utility is permitted to charge the incremental costs of expanding the system to alleviate the constraint. This is the one situation where the native load customer may pay higher rates if the utility does not act in an economically rational manner. Where opportunity costs are greater than expansion costs, the rate is capped at the cost of expansion. Because the transmission rate does not recover all opportunity costs, there is an economic incentive for the utility to expand its transmission system to recover additional revenue.

3. Where the system is constrained and expansion is undertaken

existing capacity without degrading system reliability, there are two possible rate outcomes:

a. When expansion costs are less than embedded costs, the utility builds and is permitted to charge embedded costs. The native load customer is better off because the embedded cost rate reflects the shared economies of scale. The net benefit to the native load customer is the difference between embedded costs and expansion costs.

b. When expansion costs exceed embedded costs, the utility builds and is permitted to charge the incremental costs of expansion. The native load customer is held harmless because the native load customer does not incur any of the higher expansion costs. The expansion costs are borne by the transmission customer.

EFFECT ON THE PROSPECTIVE WHEELING CUSTOMER

In all cases, the wheeling customer is provided with the lowest reasonable cost-based wheeling rate (i.e., there is no cross-subsidy from the third party transmission customer to the native load customer). Imposing an obligation to build and/or capping opportunity costs associated with firm transmission service at the incremental cost of expanding the system ensures that opportunity cost pricing will not be a vehicle for a utility to artificially restrict the supply of transmission in order to collect monopoly rents.

The proposed policy for opportunity cost pricing for firm service will allow Northeast Utilities to recover validated lost opportunity costs capped at the incremental cost of expanding its system. If the Commission determines that the cost of expanding NU's system is very, very high (i.e., immutable), then the incremental cost cap will be correspondingly high and Northeast Utilities will be able to recover a greater amount of opportunity costs associated with the constrained transmission interface. These are scarcity rents not monopoly rents. 3/

EFFECT ON EFFICIENCY

The proposed pricing model will promote short-term efficiency because the transmission price will reflect the value of the transmission system to the utility that owns the system.

3/ Monopoly rents are earned when output is withheld by a monopolist in order to increase a price or rate. In contrast, scarcity rents are earned by those producers in a competitive market that are more efficient than other suppliers -- a common occurrence during periods of temporary imbalances between supply and demand.

Accordingly, the transaction of the party that most benefits from using the transmission system will be accommodated.

The proposed pricing model will also promote long-term efficiency. Allowing opportunity cost pricing for firm service allows a utility to reduce its own transmission use when doing so would be cheaper than building a new line. This will permit the transmission customer to, in effect, trade places with the utility, use existing transmission capacity better, and avoid inefficient or premature expansion of the transmission grid. Furthermore, capping the recovery of opportunity costs at the incremental cost of expanding its system provides an incentive to add capacity when it is economically efficient to do so.

QUESTIONS TO BE ADDRESSED DURING ORAL ARGUMENT

1. What types of costs may appropriately be considered "opportunity costs" and therefore eligible for recovery from third party transmission customers? Should the pricing policy attempt to achieve other goals than those set out on page 4?

2. Does the proposed pricing policy adequately protect the interests of native load customers?

3. Does the proposed pricing policy adequately protect the interests of third party transmission customers?

4. Is it realistic to believe that opportunity costs can be validated? Is this important so long as the burden of proof with regard to justifying opportunity costs remains clearly on the utility?

5. What safeguards are necessary as a prerequisite for allowing opportunity cost pricing for: a) firm transmission service; and b) non-firm transmission service to ensure that market power over transmission is fully mitigated?

6. Should opportunity costs be calculated on a forecasted basis or collected through some form of tracker clause as they are incurred?

7. Should the Commission allow opportunity costs as an addition to embedded costs, or only as an alternative to embedded costs?