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August 21, 2008

Bob Ethier, Vice President of Market Development  
ISO New England  
One Sullivan Road  
Holyoke, MA 01040

**Re: Economic Studies under Attachments N and K**

Dear Mr. Ethier:

The Massachusetts Attorney General concurs with the central premise behind the economic studies processes set forth in Attachments N and K, namely, that ISO New England should “ensure that the transmission planning process encompasses more than reliability considerations.”<sup>1</sup> That is, in addition to ISO New England’s obligation to operate the bulk power system according to mandatory reliability standards, ISO New England must also plan the system prudently in a manner that results in just and reasonable rates.

During the course of the Economic Studies Working Group discussions, stakeholders have raised concerns regarding the process to be used to identify Market Efficiency Transmission Upgrades. This letter highlights the Massachusetts Attorney General’s concerns pertaining to the use of the production cost metric, the derivation of the discount rate to be applied in the net present value analysis, and the sufficiency of the processes for market solutions to respond to the findings presented by the economic studies.

One central concern is that the production cost metric that ISO New England proposes to apply may lead to the imposition of new transmission costs that will be unjust and unreasonable. A production cost metric may be reasonable for a vertically integrated transmission provider to apply to reduce the costs of serving native load, because those production cost savings are passed through to end users. In the current New England market structure, however, it is inappropriate for ISO New England to rely on a production cost metric, because the cost of new transmission proposed under Attachment N may be borne by load serving entities (“LSE”) and their customers, but production cost savings will inure to certain generation developers, and end users may not benefit through lower energy costs.

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<sup>1</sup> *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890 at P 542, 72 Fed. Reg. 12266 (Mar. 15, 2007) (“Order 890”).

Both the Federal Power Act and Order 890 make it clear that transmission owners have an obligation “to act in a way that facilitates the planning and expansion of facilities *to meet the reasonable needs of LSEs.*”<sup>2</sup> Therefore, a more appropriate metric for determining the economic benefit of a proposed transmission project is to determine the reduction in LSE expense.

ISO New England has maintained that the completion of economic study findings will neither mandate that transmission be built nor determine cost allocation. Schedule 12 and Planning Procedure 4, as referenced in Attachment N, provide for further stakeholder processes to provide input to ISO New England as to the classification of a Market Efficiency Transmission Upgrade for purposes of cost allocation. However, these additional processes provide no clear protection to end users against the possibility of having the costs of a subsidy to certain generation developers being foisted upon them unjustly based on the production cost analysis provided by ISO New England. The state commissions of Massachusetts and Connecticut, for good reasons, have raised objections to the current process until cost allocation issues are addressed. It is important to address the potential allocation of costs of economic upgrade projects at the outset. In this regard, the existing treatment of the rules does not address the Commission’s cost allocation planning principle adequately.<sup>3</sup>

With regard to calculating the benefits of reduced costs to end users, it is unclear what methodology is proposed to discount the future stream of savings that may be realized through economic upgrade requests. It is unclear why a 4 percent real discount rate was assumed and what the basis is for such a low discount rate, given that the development of renewable generation resources in a region in Northern Maine where no such generation currently exists is still speculative at this point.<sup>4</sup> If the renewable generation developers contemplated in this study are responsible for the transmission investment costs, then it may be appropriate to use the developers’ cost of capital. If end users are allocated the cost of the new transmission, it will be necessary adjust the appropriate discount rate for the risk that the developers will not actually build. The question of the appropriate discount rate for new transmission deserves significant stakeholder discussion.

Finally, although the impetus behind promoting economic upgrades is to promote market efficiency, Attachment N solicits transmission projects, regulated solutions that involve shifting risk to ratepayers. Before taking such a step backwards, stakeholders should first assess whether there is an identifiable market failure to explain why the markets have not already provided a solution. Both Attachments K and N contemplate that providing the results of economic studies to participants will provide a signal to the market and that there will be an opportunity to “assess the adequacy of proposed market responses in addressing identified system needs.”<sup>5</sup> However, the case may be that under the existing market rules, that efficient response is not cost effective to a resource developer. If so, then merely providing the economic study results will not elicit a

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<sup>2</sup> *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890-A at P 172, 73 Fed. Reg. 2984 (Jan. 16, 2008) (emphasis added) (“Order 890-A”); *see also* Federal Power Act § 217(b)(4), 16 U.S.C. § 824q.

<sup>3</sup> *See* Order 890 at PP 557–561.

<sup>4</sup> Economic Analysis of the Maine Power Connector (MPC): Draft Study Inputs at slide 31 (April 2008).

<sup>5</sup> Attachment N, Section III.A.2.

market response. The appropriate solution is an examination of the existing market rules to determine whether there is a market failure and whether it can be resolved by market rule revisions. That is, the question of the necessity of a Market Efficiency Transmission Upgrade should always be referred to the Markets Committee after economic studies have been completed before either the Planning Advisory Committee or the Reliability Committee take further steps towards approving such upgrades.

The Massachusetts Attorney General believes that the existing tariff is amenable to the foregoing treatment of Market Efficiency Transmission Upgrades. In the event that ISO New England disagrees that such treatment of the Attachment K and N processes is consistent with the tariff, the Economic Studies Working Group should consider appropriate tariff revisions to address these concerns.

Please feel free to contact me directly, if you have any questions.

Very truly yours,

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cc: Economic Studies Working Group