

MEMORANDUM

TO: RTO Responsiveness and Governance Working Group Members
FROM: Scott Myers and Jennifer Galiette, NEPOOL Counsel
DATE: January 8, 2009
RE: Maine Inquiry Regarding Continued Participation of Maine Utilities in ISO-NE

For your information in discussing the various questions raised by the Federal Energy Regulatory Commission ("FERC") concerning the responsiveness of RTOs like ISO New England ("ISO-NE"), we have summarized in this memorandum the status of proceedings before the Maine Public Utilities Commission ("MPUC") regarding the advisability of the continued participation by Maine's utilities in the New England RTO arrangements. Those proceedings, designated Docket 2008-156, most recently produced a recommended decision by the MPUC Staff (the "Recommended Decision") for consideration by the MPUC, which is expected to issue a final decision on or by January 15, 2009 in compliance with directives of the Maine legislature.¹

As explained more fully below, the Staff concludes in the Recommended Decision that the "governance" provisions of the current ISO-NE arrangements are significantly "flawed" because they fail to require that ISO-NE ensure that costs of reliability and other improvements are reasonable or to choose the most cost effective solution. The Recommended Decision concludes that remedying those "flaws" would require: (1) modifying ISO-NE's governing documents to expressly require that ISO-NE consider as part of its decision-making process the impact on costs and consumers of its decisions on reliability initiatives; (2) increasing representation of

¹ A copy of the Recommended Decision can be obtained from the MPUC website at: http://mpuc.informe.org/easyfile/cache/easyfile_doc212377.DOC.

consumer interests on the ISO-NE board, for example either by having one board member appointed by consumers or by having one of the existing board member slots reserved for a candidate that has extensive background in representing consumers or adjudicating issues relating to retail electric rate regulation; and (3) increasing consumer representation throughout the transmission planning process, for example by establishing a regional consumer advocate entity, potentially through NESCOE. (Recommended Decision at 73-75)²

We will report on the MPUC's decision after it is issued. The rest of this memorandum provides for context some history of the Maine proceeding and a high level summary of other aspects of the Recommended Decision.

BACKGROUND

The Maine legislature has directed the MPUC to issue an order reflecting its determination as to whether the continued participation in New England's regional transmission organization (*i.e.*, ISO-NE) of Central Maine Power Company and Bangor Hydro Electric Company (the "Maine PTOs") is in the interest of Maine consumers, and, if so, under what conditions. If the MPUC concludes that such continued participation is not in Maine consumers' interests, the legislature has directed the MPUC to identify what alternative structure Maine should pursue.

The MPUC proceeding in Docket 2008-156 was preceded by an earlier MPUC investigation, which was directed by Maine's governor, that resulted in a January 2008 report concluding that participation of the Maine PTOs in ISO-NE provided various benefits to Maine consumers, but

² The Recommended Decision did not endorse the suggestion by some parties in their briefs that filing rights under Section 205 of the Federal Power Act should be accorded to NEPOOL and/or NESCOE on certain issues to act as a counterbalance to ISO-NE decision-making.

that there were substantial “flaws” in the MPUC’s view with the existing ISO-NE arrangements that exposed Maine consumers to costs and other burdens such that any one of the following three options were “potentially superior” to the existing ISO-NE arrangements:

- (1) Allowing the Maine PTOs to participate in ISO-NE arrangements “reformed” to remedy the identified flaws (the ISO-NE Market Reform Option).
- (2) Directing the Maine PTOs to withdraw from ISO-NE to form one or more Maine independent transmission company/ies and a state-wide load serving entity (the Maine/ITC Option or Maine Stand-Alone Option).
- (3) Directing the Maine PTOs to withdraw from ISO-NE to form a transmission organization covering a market with New Brunswick and other Canadian maritime provinces (the ME/NB Common Market Option).

MPUC STAFF’S RECOMMENDED DECISION

After examining the merits of each of the Options in the January 2008 report, as well as two additional proposals referred to as “hybrid options,” the MPUC Staff on December 16, 2008 issued a 92 page report in the form of the Recommended Decision for consideration by the MPUC in issuing its anticipated January 15, 2009 order. Among the conclusions in the Recommended Decision are the following:

- (1) The existing ISO-NE arrangements are “significantly deficient in the areas of transmission cost containment, transmission cost allocation, and ... governance” such that continued participation of the Maine PTOs in the existing arrangements is “undesirable and perhaps unacceptable when compared to [available alternatives].”
- (2) The Maine ITC or Maine Stand-Alone Option is the “least promising” of the alternatives.
- (3) The ME/NB Common Market Option does not hold sufficient prospects for success now to justify further development.

- (4) The ISO-NE Reform Option “poses the least transaction risk and the opportunity for maximum consumer benefits and should be considered the first best alternative to the [existing ISO-NE arrangements].”³
- (5) The Maine PTOs should “actively and aggressively” seek to achieve the desired reforms to ISO-NE through or concurrently with the negotiations regarding the terms of renewal of the Transmission Owners Agreement (TOA).
- (6) An alternative “Best Hybrid Option” is less desirable than ISO-NE reform but should be developed to enable the MPUC to fully evaluate this Option against the existing ISO-NE arrangements and the ISO-NE Reform Option.⁴

On process, the Recommended Decision proposes at 91-92 three specific procedural steps: (1) that the Maine PTOs report to the MPUC on March 31, 2009 and on June 15, 2009 on the efforts to secure the “necessary” reforms; (2) that the MPUC determine steps needed to develop the Best Hybrid Option as an alternative to the ISO-NE Reform Option based on the March 31, 2009 Maine PTO report; and (3) that, based on the Maine PTO June 15, 2009 report,

³ This Option was also noted to preserve retail competition in Maine, an outcome that was “not certain with the other options” and “would result in processes and decisions that could be synchronized with the region’s policy and environmental goals.” (Recommended Decision at 67)

⁴ As defined by the Recommended Decision, the Best Hybrid Option is similar to the ISO-NE Reform Option and is discussed as an option for proceeding in the event Maine is unable to secure the desired reforms under the ISO-NE Reform Option in which Maine’s utilities would withdraw from ISO-NE while contracting with ISO-NE to provide certain services. As described in the Recommended Decision, the Best Hybrid Option includes the following features: (1) remaining within the ISO New England control area (or balancing authority area), in terms of the reliability and operational aspects of the Maine system; (2) continued participation in the ISO-NE markets; (3) transmission cost allocation that moves from 100% socialization toward “hybrid/beneficiary pays;” (4) disciplined and cost-conscious decision-making about investments, particularly transmission; and (5) consumer representation in governance. The Recommended Decision acknowledged that a fundamental question to be addressed is not whether Maine would be permitted to participate in ISO-NE on an “a la carte” basis as would occur under this Option but rather whether and to what extent ISO-NE would be required to provide “a la carte” services at cost. (Recommended Decision at 84-86, 89-90)

the MPUC determine whether the Maine PTOs should exercise their right to non-renewal of the TOA by submitting notices of withdrawal.

On substance, the Recommended Decision (at 58-66) summarizes Staff's view of the following three perceived interrelated "flaws" in the existing ISO-NE arrangements that are "detrimental to Maine ratepayers and have resulted in substantial costs to Maine consumers" and some proposed reforms to address them:

- Socialized transmission cost allocation, which Staff concludes inappropriately incentivizes investment in transmission as the solution even where transmission may not represent the most efficient solution.⁵ The proposed reform is movement over the longer term to a "beneficiary pays" model, potentially with a transition mechanism that allows continued socialization of certain levels of transmission investment.
- Inadequate transmission cost containment mechanisms, which Staff concludes reflects a transmission planning and rate-making regime that fails to adequately address transmission project cost escalations and overruns. The proposed reforms are (1) that ISO-NE be required to explicitly consider cost as a factor in its decisions about reliability; (2) that ISO-NE assume greater responsibility for ensuring that in the regional planning process all reasonable alternatives to the transmission project are credibly presented and fully considered; and (3) that before granting initial approval for any project, ISO-NE should independently review the reasonableness of the sponsoring TO's cost estimates, escalation figures and cost control measures.⁶
- Inadequate governance mechanisms as discussed earlier in this memorandum.

⁵ The Recommended Decision notes that the problems with this cost allocation mechanism are exacerbated by the FERC's Return on Equity adder, which Staff concludes "not only creates a strong, and perhaps irrational incentive to invest in transmission, but also provides an incentive to invest in transmission over other alternatives which might be more cost effective." (Recommended Decision at 58)

⁶ The Recommended Decision also concludes that the states and ISO-NE should press for changes in FERC ratemaking to develop a performance mechanism that allows projects that meet or beat their estimated project costs to earn a higher ROE than projects that exceed cost estimates. (Recommended Decision at 72-73)