M E M O R A N D U M

**TO:** NEPOOL Transmission Committee

**FROM:** Eric Runge, NEPOOL Counsel

**DATE:** March 21, 2019

**RE:** Recovery of Past CIP-Related Costs

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At its February 20 meeting, the Transmission Committee discussed the ISO’s proposal for cost recovery for Critical Infrastructure Protection (“CIP”)-related expenditures by generators (and similarly situated transmission entities). During that discussion, there were questions regarding whether such costs incurred prior to Federal Energy Regulatory Commission (“FERC” or the “Commission”) acceptance of cost recovery provisions would be recoverable through rates. In brief, the answer depends on the nature of the costs. For costs that are operating expenses incurred before the effective date for rates permitting such recovery, the filed rate doctrine and the rule against retroactive ratemaking would preclude recovery. If the costs, however, are properly considered capital expenditures amortized over the useful life of the asset, a reasonable case can be made for recovery through rates of those costs not yet fully amortized as of the effective date of the rates permitting such recovery. More information and legal precedent supporting this answer is provided below. If you have any questions about this memo or its subject, please contact Eric Runge, 617-345-4735, ekrunge@daypitney.com.

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**Background**

ISO-NE has put forward a proposal for a new schedule of Section II of the ISO-NE Tariff to allow certain generators (and potentially a merchant transmission provider) that ISO-NE designates as critical to the determination of Interconnection Reliability Operating Limits (“IROL”) to submit individual FERC Section 205 filings to recover incremental CIP-related costs that are not otherwise reimbursed.[[1]](#footnote-1) The new Tariff schedule would authorize ISO-NE to act as billing agent to conduct the necessary settlement activity to pay for the CIP-related costs. The schedule would also contain provisions regarding timing of payments, cost allocation, and any other required process and settlement-related provisions.

Over the past several years some generators and a merchant transmission provider in New England that are or were IROL-critical have incurred costs to comply with NERC CIP requirements. We understand that some of these costs are in the nature of operating expenses while others are capital expenditures that could be amortized over a time period that would include the future. In the February 20 presentation to the Transmission Committee meeting, ISO-NE states on slide 12 that: “Some generators have incurred costs in the past when previously designated as “IROL-critical”, but are no longer "IROL-critical. These costs will be eligible for compensation, if approved by FERC”. During the discussion of the presentation, the general question came up of whether past CIP-related costs that were incurred prior to the filing and acceptance of a rate proposal that allows for cost recovery would be recoverable through rates.

**Legal Precedent**

The FERC would look at a proposal for the recovery of costs that are incurred before a rate is filed through the lens of the filed rate doctrine and the rule against retroactive ratemaking, which are corollaries to one another. The filed rate doctrine “forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority.”[[2]](#footnote-2) The related rule against retroactive ratemaking “prohibits the Commission from adjusting current rates to make up for a utility’s over- or under-collection in prior periods.”[[3]](#footnote-3) A central purpose of the filed rate doctrine and the rule against retroactive ratemaking is “to protect ratepayers from being subjected to an additional surcharge above the rate on file for service already performed.”[[4]](#footnote-4)

The effect of these rules is that, to the extent that new charges are being imposed on ratepayers, they can only be for prospective services based on rates filed with and accepted by the Commission, and cannot be for recovery of costs that were incurred for services rendered prior to the rate for such costs being on file with the Commission.[[5]](#footnote-5) Further, the Commission has no discretion to retroactively “waive the operation of a filed rate or to retroactively change or adjust a rate for good cause or for any other equitable considerations.”[[6]](#footnote-6) As a general exception to these bars against recovery of past costs, courts and the Commission have recognized that rates can be subject to change in the future for past periods provided that adequate advance notice has been given that a rate could change and that ratepayers could be responsible for certain costs in the future.[[7]](#footnote-7) Primary examples of this kind of acceptable change in a rate based on past cost changes are the treatment of regulatory assets that are booked by a utility for future recovery and a formula rate that provides in advance for true-ups to the rate after actual data is gathered.

**Conclusion**

Based on the filed rate doctrine and the rule against retroactive ratemaking, CIP-related operating costs that were incurred and paid prior to an effective filed rate allowing for recovery of such costs would not be recoverable. Recovery of such costs would allow a utility to charge rates for services already provided before a rate was properly filed with the Commission, a violation of the filed rate doctrine. Recovery of such costs would also allow a utility to adjust current rates to make up for under-collection in prior periods, a violation of the rule against retroactive ratemaking. These bars to collection of past paid costs would not apply in a situation where customers had adequate advance notice that they would be subject to past costs through prospective changes to the rate. The facts of this situation do not appear to support such a case.

Despite the bar to recovery of past operating costs, entities that have made capital investments to comply with CIP requirements should be able to make a reasonable case for recovery of amortized capital expenses that are properly allocated to a period after a filed rate allowing for such recovery is effective. These costs, although arising from a past commitment, reasonably could be viewed as present and future payments, made after the filing and acceptance of a rate schedule, that relate to the ongoing provision of reliability service. To the extent this case can be made, these costs should not be barred from recovery by the filed rate doctrine and the rule against retroactive ratemaking. This treatment of such costs should be addressed in the initial Section 205 filing of rate schedules allowing for the recovery of such costs.

Further, the Commission has a stated policy of facilitating the recovery of prudently-incurred, reliability-related costs, as articulated in a 2012 order to PJM regarding its proposal to allow for recovery of blackstart costs, including NERC CIP compliance.[[8]](#footnote-8) In that order the Commission stated:

In a Statement of Policy issued September 14, 2001, the Commission provided assurances to regulated entities that the Commission “will approve applications to recover prudently incurred costs necessary to further safeguard the reliability and security of our energy supply infrastructure in response to the heightened state of alert. Companies may propose a separate rate recovery mechanism, such as a surcharge to currently existing rates or some other cost recovery method.” The Commission has stood by this policy and clarified that the policy extends to the recovery of prudent reliability expenditures, including those for vegetation management, improved grid management and monitoring equipment, operator training and compliance with NERC standards.[[9]](#footnote-9)

 Given this policy, and the fact that amortized capital expenditures for CIP compliance reasonably can be viewed as relating to the provision of ongoing reliability service, there is a reasonably good chance that the FERC would allow the recovery of such costs that are properly allocated to the period on and after the filing and acceptance of a rate schedule for such cost recovery.[[10]](#footnote-10)

1. ISO-NE’s February 20 presentation to the Transmission Committee can be accessed here: <https://www.iso-ne.com/static-assets/documents/2019/02/a03_tc_2019_02_cip_irol_present.pptx> [↑](#footnote-ref-1)
2. *Old Dominion Electric Coop*., 151 FERC ¶ 61,207 at P 46 (2015) (*citing*, *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 577 (1981)). Note that this case involved generators in PJM seeking to recover costs related to their performance obligations during a cold snap in the winter of 2014. [↑](#footnote-ref-2)
3. *Id.* (*citing*, *Town of Concord v. FERC,* 955 F.2d 67, 71 and n. 2 (D.C. Cir. 1992) [↑](#footnote-ref-3)
4. *Old Dominion Electric Coop*., 154 FERC ¶ 61,155 at P 19 (2016) [↑](#footnote-ref-4)
5. *See, e.g., Midcontinent Indep. Sys. Operator, Inc., et al*., 161 FERC ¶ 61,020 at P 7 (2017) (“The filed rate doctrine and prohibition against retroactive ratemaking bar a public utility from charging a rate other than the rate properly filed with the Commission, and similarly bar the retroactive imposition of an increased rate for service already provided.”) (*citing*, *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 579 (1981). [↑](#footnote-ref-5)
6. *Old Dominion Electric Coop. v. FERC*, 892 F.3d 1223, 1230 (D.C. Cir. 2018). The court in this proceeding described the filed rate doctrine and the rule against retroactive ratemaking as “corollary rules [that] operate as a nearly impenetrable shield for consumers, ensuring rate predictability and preventing discriminatory or extortionate pricing.” As an aside, the Commission has stated that it may have discretion to waive retroactively non-rate terms and conditions of service. See, *Old Dominion Electric Coop*., 154 FERC ¶ 61,155 at n. 40 (“A retroactive waiver of a non-rate term and condition that does not subject ratepayers to an additional surcharge may not violate the filed rate doctrine or the rule against retroactive ratemaking. For example, a retroactive waiver of a deadline for participating in a capacity auction may only affect rates for future service.”) [↑](#footnote-ref-6)
7. *See*, *Old Dominion Electric Coop. v. FERC*, 892 F.3d 1223, 1231; *Old Dominion Electric Coop*., 154 FERC ¶ 61,155 at P 20; *CPUC v. FERC*, 988 F.2d 154, at 164 ("It is not that notice relieves the Commission of the bar on retroactive ratemaking, but that it changes what would be purely retroactive ratemaking into a functionally prospective process by placing the relevant audience on notice at the outset that the rates being promulgated are provisional only and subject to later revision.') [↑](#footnote-ref-7)
8. *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,020 (2012). [↑](#footnote-ref-8)
9. *Id.* at P 50. [↑](#footnote-ref-9)
10. Note that on March 28 the FERC will hold a technical conference on “Security Investments for Energy Infrastructure” in Docket No. AD19-12-000. Among the topics on the agenda is “Incentives and Cost Recovery for Security Investments”. The Supplemental Agenda can be accessed here: <https://www.ferc.gov/CalendarFiles/20190301142538-AD19-12-000Suppl%20Notice%20of%20TConf.pdf?csrt=12327922935652733278>. There is the potential for a rulemaking proceeding or a policy statement addressing cost recovery that will come out of this proceeding. [↑](#footnote-ref-10)