

**Responses of Attachment H Transmission Owners to Comments on
Proposed Cost Allocation Principles for Order No. 1000 Compliance
August 28, 2012**

Background

On June 13, 2012, PJM Interconnection, L.L.C. (“PJM”), at the request of the Attachment H Transmission Owners (“TOs”),¹ posted to the PJM website the TOs’ proposed Cost Allocation Principles (“Proposed Principles”). The Proposed Principles will form the basis of the TOs’ proposed section 205 filing for compliance with the requirements of Order No. 1000 for the allocation of the costs of new PJM Board-approved Regional Transmission Expansion Plan (“RTEP”) projects. The posting included a notice of a meeting on July 18, 2012 (“July 18 Meeting”) at which the TOs presented the Proposed Principles to the PJM stakeholder community and invited the submission of written comments via email by August 1, 2012. In addition, the notice advised that the TOs would host a conference call on September 5, 2012 (“September 5 Call”) to discuss any revisions to the Proposed Principles as a result of the comments received during the July 18 Meeting and via timely submitted written comments.

The TOs appreciate the comments and questions from stakeholders on the Proposed Principles. During the July 18 Meeting, TO representatives responded to several questions and heard comments regarding the Proposed Principles. In addition, the TOs have received nine sets of written comments from stakeholders on a variety of topics. The TOs’ responses to the comments are set forth below.

¹ PJM Transmission Owners with revenue requirements provided in Attachment H of the PJM Open Access Transmission Tariff.

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Hybrid Methodology

Two commenters expressed concern about the use of the postage stamp methodology in the Hybrid Methodology for allocation of regional extra high capacity (“EHC”) baseline reliability, operational performance and market efficiency projects and reiterated positions previously taken with regard to the postage stamp methodology in the pending Opinion No. 494 litigation. Both commenters indicated that the use of solution-based DFAX was an improvement over a 100% postage stamp allocation. Another commenter questioned the deviation from the use of the postage stamp methodology approved in Opinion No. 494 but expressed cautious support for the Proposed Principles. Two commenters expressed concern regarding the application of the postage stamp methodology to EHC market efficiency projects.

One commenter suggested that the Hybrid Methodology should be subject to periodic review to assure reasonable allocation in the event of changes in the industry or technology. Another commenter suggested the need for cost allocation to reflect planning, construction and operational characteristics for EHC reliability projects and further suggested the subdividing of the PJM region into three subregions with three categories of cost responsibility based on identified beneficiaries in those subregions.

Historically, there have been very disparate views on transmission cost allocation within the PJM region. The Hybrid Methodology reflects a significant compromise among the TOs and is a substantial change from the current 100% postage stamp methodology. The Seventh Circuit decision on Opinion No. 494² requires that allocation of costs be at least roughly commensurate

² *Illinois Commerce Comm’n v. FERC*, 576 F.3d 470 (7th Cir. 2009).

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with the distribution of estimated benefits. Order No. 1000 establishes five additional principles. The TOs are confident that the Commission will find the Hybrid Methodology compliant with these six principles.

With respect to the need for a periodic review of the Hybrid Methodology, the TOs invite stakeholders to bring to the attention of the Administrative Committee of the Consolidated Transmission Owners Agreement any future concerns that the Hybrid Methodology has become unjust and unreasonable. In such event, the TOs will review those concerns and determine whether a change should be submitted to the Commission pursuant to their section 205 rights. Because stakeholders will have the opportunity to bring these concerns to the attention of the TOs and will also have the ability to exercise their rights under section 206, the need for a periodic review provision is unnecessary.

Because the need for PJM Board-approved reliability, operational performance and market efficiency projects is determined on a regional basis, rather than a subregional basis, the approach to cost allocation reflected by the Proposed Principles is consistent with the PJM planning process. In addition, to the extent cost allocation on a subregional basis would require changes to the planning process set forth in Schedule 6 of the Operating Agreement (“Schedule 6”), such changes are beyond the transmission cost allocation rights and responsibilities of the TOs under section 205.

Market Efficiency Projects

One commenter requested clarification of the terms “decreased load payments” and “project selection and approval purposes” as used in the Proposed Principles. The TOs clarify

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that the term “decreased load payments” refers to a change in load energy payment that is a decrease in such payments. A change in load energy payment will be calculated consistent with the methodology set forth in section 1.5.7(d) of Schedule 6. The TOs also clarify that the term “project selection and approval purposes” refers to the method used by PJM pursuant to Schedule 6 to select and approve market efficiency projects for inclusion in the RTEP.

Another commenter suggested that revisions to the PJM method for project selection and approval purposes are not necessary. The TOs will defer to the PJM stakeholder process to determine whether complementary revisions are needed with regard to the method used by PJM to determine benefits under Schedule 6 for market efficiency projects, specifically EHC market efficiency projects.

DC Lines

Two commenters noted that the TOs had not addressed cost allocation of direct current (“DC”) lines. One commenter suggested that DC lines below the double circuit 345 kV threshold should not be subject to a postage stamp allocation. The TOs’ proposal with regard to cost allocation for DC lines will be included in the revisions to the Proposed Principles issued prior to the September 5 Call.

Double Circuit 345 kV Lines

One commenter sought clarification regarding the recovery of construction work in progress (“CWIP”) associated with double circuit 345 kV lines. The TOs clarify that recoverable CWIP for a double circuit 345 kV project will be allocated as an EHC project after

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the project is approved for inclusion in the RTEP and prior to being energized as a double circuit 345 kV facility.

Another commenter suggested that only incremental costs associated with the upgrade of a single circuit 345 kV line to a double circuit 345 kV line should be subject to the Hybrid Methodology. The addition of the second circuit converts the project from a lower capacity project to an EHC Project. As a part of the entire proposal the TOs intend to submit to the Commission, the TOs believe it is just and reasonable and consistent with Order No. 1000 principles to include in the Hybrid Methodology the original cost (less accumulated depreciation) of the pre-existing single circuit 345 kV facility that is converted to a double circuit 345 kV facility if the pre-existing facility had been previously cost-allocated in Schedule 12 Appendix of the PJM Tariff.

Public Policy and Multi-Driver Projects

Some commenters suggested that public policy projects should be included in the RTEP and addressed by revisions to the Proposed Principles. Two commenters questioned whether such projects should be considered as Supplemental Projects under Schedule 6. One commenter recommended that federally-mandated public policy projects should be allocated on the basis of solution-based DFAX and state-mandated public policy projects should be allocated to load in that state while another suggested that if such projects benefit regional public policy they should be allocated to regional load. One commenter noted that the Proposed Principles do not address cost allocation for projects with multiple drivers.

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The Proposed Principles state that cost allocation for multi-driver and public policy projects that are not yet defined in Schedule 6 will be addressed upon further development of the planning criteria for those projects in Schedule 6. The TOs are following PJM's ongoing discussions with OPSI regarding public policy projects and the expected developments within the RPPTF and senior stakeholder committees regarding the treatment of public policy and multi-driver projects. The Proposed Principles reflect the current status of Schedule 6 which identifies three types of PJM Board-approved RTEP projects – reliability, operational performance and market efficiency. As OPSI and RPPTF discussions proceed and the development of planning criteria for inclusion of public policy and multi-driver projects in Schedule 6 advances and become reasonably certain of inclusion in Schedule 6, the TOs will propose cost allocations for these additional types of projects.

Under the current provisions of Schedule 6, if a TO or other entity is required to construct a public policy project, driven by either a federal or state mandate, and the project is not included in the RTEP for reliability, operational performance or market efficiency purposes, the TOs believe the project would be classified for Schedule 6 purposes as a Supplemental Project subject to allocation by the TO or other entity that proposes or is required to construct the project.

Recalculation of Solution-Based DFAX

As noted in the Proposed Principles and as discussed during the July 18 Meeting, there are many options for the recalculation interval for solution-based DFAX but frequency of recalculation should balance the benefits of recalculation against the administrative burden to PJM and price uncertainty to customers. One stakeholder suggested that provisions relating to

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recalculation should include mitigation mechanisms addressing the potential volatility in cost responsibility for EHC projects resulting from recalculation. Another commenter suggested that if the recalculation period is greater than five years, an appeal process should be instituted to allow for recalculations outside the normal cycle.

As indicated in the revisions to the Proposed Principles, the TOs will propose an annual recalculation of cost allocations premised on solution-based DFAX. After consideration of the comments and consultation with PJM regarding the mechanics and administrative burden associated with recalculation, the TOs have concluded that an annual recalculation is appropriate and administratively feasible. As to price certainty, the TOs believe this frequency of recalculation appropriately balances more accurate cost allocations with the potential volatility of changes in cost allocations.

Generation Interconnection

One commenter stated that generator lead lines should be paid for by generators. The TOs agree and note that the Proposed Principles do not propose any change in cost allocations associated with new facilities required for generation interconnection.

Aging Infrastructure

One commenter suggested that if aging infrastructure is replaced, only the incremental capacity created by the project should be allocated regionally with the portion used to replace existing capacity subject to the same cost allocation applicable to the existing facility. With regard to aging infrastructure projects, the Proposed Principles reflect the current status of

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Schedule 6 which identifies three types of PJM Board-approved projects – reliability, operational performance and market efficiency. If aging infrastructure is replaced as part of a PJM directed project for reliability, operational performance or market efficiency purposes, the project or portion of the project, to the extent of its inclusion in the RTEP as a PJM-Board approved project, will be allocated on that basis.

Revisions required by the Commission or Judicial Review

One commenter expressed concern regarding the impact on cost responsibility for an EHC project if the cost allocation methodology submitted to the Commission by the TOs is subsequently revised as a result of regulatory or judicial review and suggested that the TOs address the issue of any changes to the methodology they propose which could be required as a result of regulatory or judicial review subsequent to the proposed effective date. The TOs believe the Commission will find the proposed cost allocation methodology satisfies the requirements of both section 205 and Order No. 1000 and that the risk of changes after the proposed effective date is minimal. However, to the extent such changes do occur, PJM will adjust past billings as may be required by the ultimate outcome of the regulatory and judicial review processes.

Miscellaneous

During the July 18 Meeting, PJM was asked to verify that the illustrative examples included in the presentation contain accurate values. PJM has confirmed to the TOs that the values are accurate.

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PJM was also asked to provide a tool to permit stakeholders to determine cost allocations for specific projects. PJM has provided the following link: <http://pjm.com/planning/rtep-upgrades-status/cost-allocation-view.aspx>. PJM notes that clicking on the Excel icon will populate the spreadsheet with the data needed to determine all of the allocations to a particular zone.