

The Legal Foundation for Congestion Revenue Rights

Presentation By:

Sidley Austin LLP

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Congestion Revenue Rights Enhancements Initiative for the California
Independent System Operator, Inc.

The Origin of CRRs and FTRs: Order 888 (1996)

- As FERC regulation and precedent demonstrates, CRRs and FTRs are integral to the transmission open access principles set forth by statute and regulation.
- Originating from the transmission open access principles established by the Energy Policy Act of 1992 and later with Order No. 888, the Commission has viewed price signals as essential to promoting “the efficient use of and investment in generation, transmission, and consumption.”
- More specifically, Order No. 888 called for ISO-RTO markets to develop pricing methods for addressing network congestion. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992) § 824.
- *Promoting Wholesale Competition through Open Access*, Order No. 888, 75 FERC ¶ 61,080, at p. 284 (1996) (explaining ISO principle 8 whereby pricing should promote efficiency in investment and use).
- Order No. 888 at 284-285 (explaining that ISO pricing policies should reflect a number of attributes, including affording non-discriminatory access to services, ensuring cost recovery for transmission owners and those providing ancillary services, ensuring reliability and stability of the system and providing efficient price signals of the costs of using the transmission grid).

The Origin of CRRs and FTRs: Order 888 (1996), cont...

- The “old” pricing model utilized contract path transmission based rights allowing for the purchase and sale of congestion free supply from a given source to sink, but rather, congestion does arise with binding constraints from time-to-time due to power flows on the transmission network and this reality is not represented in the “old’ contract path paradigm.
- Indeed, Order No. 888 recognized the fallacy of contract path pricing, explaining that an alternative pricing model is needed to afford greater flexibility and bring about a “flow-based pricing [to establish] a price based on the costs of the various parallel paths actually used when power flows.”

The Origin of CRRs and FTRs: Order 2000 (1999)

- In Order No. 2000, the Commission recognized the need for “a workable market approach [to] establish clear and tradable rights for transmission usage, promote efficient regional dispatch, support the emergence of secondary markets for transmission rights, and provide market participants with the opportunity to hedge locational differences in energy prices.”
- Ultimately, Locational Marginal Pricing (LMP) was developed to correct for the contract path fallacy and more accurately assess marginal cost of meeting demand at the point where load withdraws power from the network (sink) and the point that suppliers and generators inject power in the system (source). The LMP would price the marginal cost of energy, congestion, and marginal cost of losses.
- Accordingly, LMP pricing provided a methodology to ensure least-cost dispatch and efficient usage of the transmission system, with CRRs and FTRs as the design element for market participants and competitors to hedge congestion.
- *Regional Transmission Organizations*, Order No. 2000, 89 FERC ¶ 61,285, at p. 333 (1999); inherent in this purpose was the need to be able to fund the congestion between any source and sink pair desired for such equivalent of firm transmission.

Precedent Regarding CRRs and FTRs

- In 2006, the Commission affirmed transmission open access principles, LMP pricing, and the capability to hedge congestion with FTR markets in the implementation of Order No. 681 in response to the statutory obligations of the Energy Policy Act of 2005. The Commission addressed the need to hedge long-term firm transmission rights, ordering that the ISO-RTOs develop FTR tenors of one-year and greater consistent with the statutory objectives of promoting long-term transmission open access. Here, the Commission clearly recognized that the function of FTRs are to serve as a hedge, particularly for congestion.

- *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 116 FERC ¶ 61,077 (2006).

- In 2017, the Commission affirmed that FTRs, particularly in the PJM context, serve to provide a congestion hedging function:

- **“We reject the arguments that the sole purpose of FTRs is to return congestion revenue to load and the market should therefore be redesigned to accomplish that directive. FTRs were designed to serve as the financial equivalent of firm transmission service and play a key role in ensuring open access to firm transmission service by providing a congestion hedging function.”**

- The D.C. Circuit denied petitions to overturn, and thus deferred to the Commission’s order rejecting the IMM’s arguments. *PJM Interconnection, L.L.C.*, 158 FERC ¶ 61,093 at P 11 (2017).

Additional Precedent Regarding CRRs and FTRs

In 2022, FERC reiterated, “Consistent with Commission precedent, we reiterate that **‘[t]he purpose of FTRs to serve as a congestion hedge has been well established.’** FTRs were designed to serve as the financial equivalent of firm transmission service and play a key role in ensuring open access to firm transmission service by providing a congestion-hedging function.”

- Commissioners Glick, Danly, Clements, Christie and Phillips, 3/11/22 ER22-797 Order Accepting PJM 205 filing (2022)

- These FERC precedents are grounded in an independent analysis by London Economics International (“LEI”), which estimated that FTRs save consumers in a market like PJM up to \$1.2 billion annually by enhancing liquidity, transparency, and hedging in the forward market. Another LEI analysis for the Midcontinent Independent System Operator, Inc. (“MISO”) showed that Stage 2 Auction Revenue Rights (“ARRs”) would not be fully funded without the liquidity provided by financial participants in the FTR market. These findings demonstrate the value of FTRs/CRRs and ARR to consumers and to overall market efficiency.

- London Economics International LLC, *Review of PJM’s Auction Revenue Rights and Financial Transmission Rights* at 16 (Dec. 16, 2020) (“LEI PJM Report”); *see also*, London Economics International LLC, *Independent Evaluation of MISO’s Auction Revenue Rights (“ARRs”) and Financial Transmission Rights (“FTRs”)* at 48 (Jan. 12, 2022).

Precedent Regarding FTR Underfunding

- FERC precedent recognizes underfunding is a severe problem and clearly supports allocation of costs based on cost-causation principles. FERC precedent regarding cost allocation is clear: assign costs specifically when specific beneficiaries can be identified and assign costs broadly when this is not possible. As FERC has recognized, underfunding harms CRR holders and harms transmission customers by devaluing the congestion rights that are allocated to them. *PJM*, 158 FERC ¶ 61,093 at P 78.
- FERC directed PJM to resolve its underfunding problems, finding that underfunding devalued Auction Revenue Rights and resulted in a discounted value for the transmission network. In that proceeding, FERC ordered PJM to allocate balancing congestion costs to real-time load and exports, rather than to FTR holders, as FTR holders were not causing such costs to be incurred. FERC found that PJM's previous allocation was unjust and unreasonable and violated the cost causation principle.

Conclusion

In summary, CRRs and FTRs are crucial to the open access reforms as set forth by statute and long-standing FERC regulatory precedent.

As FERC has consistently reiterated, CRRs and FTRs serve as instruments for suppliers, generators, and market participants to provide the financial equivalent of transmission service and to hedge against the potential congestion risks that could arise from such transmission service.

Congress affirmatively reviewed the whole market design construct which includes CRR and FTR instruments in the Energy Policy Act of 2005, and we do not see such a statutory change in the offing.

Attempts to redesign CRR and FTR instruments to bring about a contract path model and one-dimensionally seek to return congestion to load, are contrary to the Federal Power Act and long-standing FERC precedent.