

122 FERC ¶ 61,188
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Potomac-Appalachian Transmission Highline, L.L.C. Docket No.ER08-386-000

ORDER ACCEPTING AND SUSPENDING FORMULA RATES, SUBJECT TO
CONDITIONS, AND ESTABLISHING HEARING AND SETTLEMENT
PROCEDURES

(Issued February 29, 2008)

1. On December 28, 2007, Potomac-Appalachian Transmission Highline, L.L.C. (PATH) filed proposed tariff sheets with the Commission, pursuant to section 205 of the Federal Power Act (FPA),¹ for inclusion within the Open Access Transmission Tariff (OATT) administered by PJM Interconnection, L.L.C. (PJM). The tariff sheets seek to implement a transmission cost of service formula rate for a proposed transmission project (Project) and implement incentive rate authorization for the Project. PATH requests that the Commission affirm its proposed incentive rate treatments consistent with Order No. 679.² PATH also requests that the Commission approve its formula rate without a hearing; alternatively, PATH requests that the Commission suspend the formula rate for a nominal period to permit the rate to become effective March 1, 2008 and that the Commission limit the issues set for hearing to specified elements of the formula rate or cost of service inputs where the Commission has identified issues or concerns.

2. For the reasons discussed below, we will accept the proposed formula rate subject to conditions and suspend it for a nominal period, to become effective on March 1, 2008. Moreover, we will grant PATH's requested incentive rate treatment for the Project subject to the modifications described herein. In addition, we will establish hearing and settlement judge procedures. Granting the requested incentives and accepting the proposed formula rate will aid PATH in the development of the Project.

¹ 16 U.S.C. § 824d (2000).

² *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

I. Background

A. Description of the Company

3. PATH is a joint venture between American Electric Power Company, Inc. (AEP) and Allegheny Energy, Inc. (Allegheny). PATH consists, in part, of two operating companies including PATH West Virginia Transmission Company, L.L.C., which is owned jointly by AEP and Allegheny, and PATH Allegheny Company, L.L.C., which is owned solely by Allegheny. These companies were organized to finance, construct, own, operate, and maintain the Project.

B. The Proposed Project and Incentives

4. The Project is a proposed 290-mile transmission line that begins at AEP's Amos substation near St. Albans, West Virginia, with a terminus at the Doubs substation in Kemptown, Maryland. The Project begins as a 244 mile, 765 kV transmission line from the Amos substation to Allegheny's Bedington substation, which is northwest of Martinsburg, West Virginia. From the Bedington substation, the 765 kV line is converted into twin-circuit 500 kV lines, each 46 miles long, ending at the new Doubs substation in Kemptown, Maryland. The estimated cost of the Project is \$1.8 billion and is scheduled to be completed in 2012.

5. PATH states that the Project will require numerous upgrades to the existing substations along the route.³ For example, the Amos substation will be expanded to accommodate a new 765 kV bay by adding three new 765 kV circuit breakers and replacing two existing 765 kV circuit breakers. PATH states that two banks of 300 MVar shunt line reactors will be installed on the 765 kV portion of the line at the Bedington substation. It further needs to install a large static VAr compensator to maximize the load-carrying ability of this line and provide the required dynamic voltage regulation. Finally, PATH will need to install a new 500 kV substation at Kemptown, Maryland.

6. PATH states that the Project is a modification of two prior, Commission-approved transmission incentive projects. The first portion of the Project (*i.e.*, the 765 kV line from the Amos substation to the Bedington substation) was considered in *AEP*,⁴

³ Ex. No. PTH-100 at 14-21.

⁴ *American Elec. Power Serv. Corp.*, 116 FERC ¶ 61,059 (2006) (*AEP I*), order on *reh'g*, 118 FERC ¶ 61,041 (2007) (*AEP II*), (jointly, *AEP*).

and the second portion (two 500 kV lines from the Bedington substation to Kempton, Maryland) was considered in *Allegheny*.⁵

7. PATH notes that in both *AEP* and *Allegheny* the Commission approved the following incentives: (1) an ROE at the high end of the zone of reasonableness; (2) the ability to include 100 percent of CWIP in rate base; and (3) the option to expense and recover on a current basis the costs that the companies incur during the pre-commercial or pre-operating period. Moreover, in *Allegheny* (but not in *AEP*), the Commission approved the ability to recover abandonment costs if the project was abandoned due to factors beyond Allegheny's control.⁶

8. Here, PATH seeks authorization of the following incentives: (1) approval of a 50 basis point adder to PATH's authorized ROE in recognition of its intent to become and remain a transmission owner in PJM; (2) approval of an ROE at the high end of the zone of reasonableness or, in the alternative, approval of a 150 basis point adder (in addition to the 50 basis point adder for RTO participation) to result in an overall ROE of 14.3 percent; (3) authorization to include 100 percent of CWIP in rate base; (4) permission to file for recovery of all development and construction costs if the Project is abandoned as a result of factors beyond PATH's control; and (5) permission to use a hypothetical capital structure of 50 percent debt and 50 percent equity during the construction period.⁷

9. PATH states that it is not seeking the option to expense and recover, on a current basis, on-going costs incurred during the pre-commercial period. However, PATH states that it has been, and will continue, accruing these costs in a regulatory asset account up to the date its rates become effective. PATH requests authorization to amortize the

⁵ *Allegheny Energy Inc.*, 116 FERC ¶ 61,058 (2006) (*Allegheny I*), order on reh'g, 118 FERC ¶ 61,042 (2007) (*Allegheny II*), (jointly, *Allegheny*).

⁶ The Commission accepted a later section 205 proposal by Allegheny for rate recovery of the first portion of this project in *Trans-Allegheny Interstate Line Co.*, 119 FERC ¶ 61,219, order on reh'g, 121 FERC ¶ 61,009 (2007) (*TrAILCo*).

⁷ PATH states that it is not proposing a hypothetical capital structure as part of its request for incentives, but rather, as a reasonable approach during the construction phase of a start-up company that will facilitate financing and is consistent with Commission precedent, citing *ITC Holdings Corp.*, 102 FERC ¶ 61,182, reh'g denied, 104 FERC ¶ 61,033 (2003), order accepting letter agreement, 107 FERC ¶ 61,077, order on compliance addressing accounting for divestiture and ratemaking, 107 FERC ¶ 61,089 (2004), order authorizing disposition and confirming independence, 111 FERC ¶ 61,149 (2005); *Michigan Elec. Transmission Co.*, 105 FERC ¶ 61,214 (2003).

regulatory asset during the construction period and include the unamortized portion of the regulatory asset costs in its rate base.⁸ PATH also seeks permission to accrue Allowance for Funds Used During Construction (AFUDC) on the regulatory asset costs until the requested effective date of March 1, 2008, to reflect the time value associated with these expenditures.⁹

10. PATH argues these incentives should be granted because the Commission approved incentives in *AEP* and *Allegheny*. If, however, the Commission reviews the Project anew, PATH asserts that it satisfies the requirements of section 219 of the FPA. PATH states that it is entitled to a rebuttable presumption regarding its eligibility for transmission incentives because the Project has been approved through “a fair and open regional planning process”—*i.e.*, the PJM Regional Transmission Expansion Plan (RTEP) process. As PATH notes, the Project is a baseline upgrade in PJM’s 2007 RTEP and will relieve overloading on more than 12 locations in PJM’s base case study.¹⁰ The Project will form a high-capacity transmission “backbone” overlaying and strengthening the existing system.¹¹

11. PATH further explains that the Project’s use of 765 kV lines and twin-circuit 500 kV lines will improve reliability. For example, the 765 kV portion represents the highest voltage class in commercial operation in North America and provides the greatest capacity and operating flexibility.¹² As compared to lower voltage lines, the 765 kV line

⁸ PATH does not present its request to expense and recover pre-commercial costs deferred as a regulatory asset as one of its requested transmission rate incentives pursuant to Order No. 679. However, this rate proposal achieves the same outcome as the Order No. 679 incentive for pre-commercial costs because such costs will be fully amortized (expensed) and recovered during the construction of the Project. As explained further in this order, this request is akin to the rate incentive for pre-commercial costs and will be reviewed under Order No. 679.

⁹ PATH Filing at 15.

¹⁰ Ex. No. PTH-106 at 1-3. Specifically, PJM has found that construction of the Project will relieve overloading at the following facilities: Keystone-Airydale 500 kV line, Keystone to Conemaugh 500 kV line, Mt. Storm to Doubs 500 kV line, Airydale to Juniata 500 kV line, Prunytown to Mt. Storm 500 kV line, Harrison to Prunytown 500 kV line, Lexington to Dooms 500 kV line, Loudoun to Pleasant View 500 kV line, Greenland Gap to Meadowbrook 500 kV line, Mt. Storm to Greenland Gap 500 kV line, Hosensack to Elroy 500 kV line, and Bath County to Valley 500 kV line.

¹¹ Ex. No. PTH-100 at 16, lines 10-16.

¹² *See, e.g.*, US-Canada Power System Outage Task Force, “Final Report on the
(continued...) ”

will be free of thermal overload risk, will experience significantly fewer forced outages, and will achieve a transmission line loss profile below 0.75 percent, whereas lower voltage lines experience transmission line losses in the three to four percent range. PATH also states that the 765 kV line will improve reliability by providing a margin for operating uncertainties, which helps to “absorb voltage and current swings and thus serve as a barrier to the spread of a cascade.”¹³

12. PATH also emphasizes the reliability benefits of twin-circuit 500 kV lines between the Bedington substation and Kemptown, Maryland. PATH states that the use of twin-circuits will increase reliability in the event of a single line outage. In addition, PATH explains that twin-circuit 500 kV lines between Bedington to Kemptown will increase reliability in the event of a single line outage and will eliminate the potential for critical overloading once the project is constructed.¹⁴

13. Although PATH is not specifically requesting incentives for the use of innovative transmission technologies, the petition includes a technology statement as required by Order No. 679.¹⁵ PATH states that the Project will use “advanced technology,” including advanced conductor designs, phase and shield wire transposition, fiber optic shield wires, wide-area monitoring and control, remote station equipment diagnostics and security, independent phase operation to enhance line reliability, switchable shunt reactors, and a large static VAr compensation device.¹⁶

C. Description of Formula Rate

14. PATH states that it has structured its formula rate similar to those approved in other cases.¹⁷ PATH explains that the formula rate has (1) a statement of the annual

August 14, 2003 Blackout in the United States and Canada: Causes and

Recommendations,” at 75, 77 (April 2004) (<https://reports.energy.gov/BlackoutFinal-Web.pdf>) (Final Report on 2003 Blackout).

¹³ *Id.* at 77.

¹⁴ Ex. No. PTH-100 at 20-21.

¹⁵ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 302; Ex. No. PTH-100 at 30.

¹⁶ The Commission is not viewing PATH’s incentives request as an advanced technology incentive request.

¹⁷ *American Transmission Co.*, 97 FERC ¶ 61,139 (2001); *International Transmission Co.*, 116 FERC ¶ 61,036 (2006); *Michigan Elec. Transmission Co.*,

(continued...)

transmission revenue requirement (ATRR) that will be included as Attachment H-19 of the PJM OATT; (2) the cost of service formula itself that provides detailed calculations of the annual revenue requirements (including worksheets);¹⁸ and (3) formula rate implementation protocols in Attachment B to the ATRR.

15. PATH states that the formula rate implementation protocols describe how PATH will update the formula each year, what the review procedures will be, and how customer challenges will be resolved, and how any changes to the annual rate restatements will be implemented. For example, true-up adjustment will be determined in the following manner: the actual transmission revenues for the previous year will be compared to the net revenue requirement using its FERC Form No. 1 for that same year to determine any over or under recovery. Interest on any over or under recovery in the revenue requirement will be based on the Commission's interest rate on refunds. The Net Revenue Requirement for transmission services for the following year shall be the sum of the projected revenue requirement for the following year and a true-up adjustment for the previous year.

16. PATH states that it will recalculate its ATRR, producing the "Annual Update" for the upcoming rate year, which it will post on the PJM website on or before October 15 of each year. In addition, PATH will submit the Annual Update as an informational filing with the Commission. Each Annual Update is subject to a review procedure. Parties have 150 days after the publication date to review the calculations and notify PATH in writing of any challenges, and parties have 120 days to serve reasonable information requests on PATH. If any issues cannot be resolved, parties can make a formal challenge with the Commission.

17. PATH's formula rate implementation protocols also state that "Preliminary or Formal Challenges related to Material Accounting Changes are not intended to serve as a means of pursuing other objections to the Formula Rate. PATH notes that while it proposes that the formula rate be populated with FERC Form No. 1 numbers, it does not yet have a Form 1 on file. PATH states that therefore, it would be charging customers based on estimated costs from the requested March 1, 2008 effective date until actual Form 1 data is available in 2009, and its formula rate implementation protocols permit a true-up, in this case, on May 31, 2010. PATH states that any resulting over or under recoveries for the 2008 rate year would be reflected in customers' rates in 2011."¹⁹ The

113 FERC ¶ 61,343 (2005); *Xcel Energy Serv. Inc.*, 121 FERC ¶ 61,284 (2007) (*Xcel*).

¹⁸ The formula rate and accompanying worksheets are included as Appendix A to the annual transmission revenue requirement in Attachment H-19.

¹⁹ Ex. No. PTH-300 at 6.

formula rate implementation protocols also provide for the acceleration of crediting of any projected over recovery of the 2009 net revenue requirement, at PATH's election.

II. Procedural History, Notice of Filings and Responsive Pleadings

18. Notice of PATH's petition was published in the *Federal Register*, 73 Fed. Reg. 2237 (2008), with interventions and comments due on or before January 18, 2008.

19. Timely motions to intervene and notices of intervention were filed by: the Maryland Public Service Commission; Exelon Corporation; the Pennsylvania Public Utility Commission; Dominion Resources Services, Inc.; the Illinois Commerce Commission; Public Service Electric and Gas Company; Blue Ridge Power Agency; PPL Electric Utilities Corporation; Pepco Holdings, Inc. and certain of its jurisdictional affiliates; North Carolina Electric Membership Corporation; West Virginia Energy Users Group; Allegheny Electric Cooperative, Inc.; and PJM. In addition, timely comments and protests were filed by: American Municipal Power-Ohio, Inc. (AMP-Ohio); Virginia State Corporation Commission (Virginia Commission); the North Carolina Agencies;²⁰ Southern Maryland Electric Cooperative; the Joint Consumer Advocates (JCA);²¹ Delaware Municipal Electric Corporation; Old Dominion Electric Cooperative (ODEC); and Borough of Chambersburg, Pennsylvania.

20. On February 4, 2008, PATH filed a motion for leave to answer and answer to the protests in this proceeding. On February 5, 2008, PATH filed an errata to its motion for leave to answer and answer to the protests in this proceeding. On February 8, 2008, JCA filed a motion for leave to answer and answer to PATH's answer.

21. On February 8, 2008, Rockland Electric Company filed a late intervention.

²⁰ The North Carolina Agencies include the North Carolina Utilities Commission, Public Staff–North Carolina Utilities Commission, and the Attorney General of North Carolina.

²¹ The JCA include the Pennsylvania Office of Consumer Advocate, the Maryland Office of People's Counsel, the Office of the Ohio Consumers' Counsel, the New Jersey Department of the Public Advocate, Division of Rate Counsel, the West Virginia Consumer Advocate Division, the Delaware Division of Public Advocate, and the D.C. Office of People's Counsel.

III. Discussion

A. Procedural Matters

22. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,²² the notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Given the early stage of this proceeding, the absence of any undue prejudice or delay, and their interest in this proceeding, we grant the untimely, unopposed motions to intervene.

23. Rule 213(a) of the Commission's Rules of Practice and Procedure²³ prohibits an answer to a protest, unless otherwise permitted by the decisional authority. We will accept PATH's answer because it has provided information that assisted us in our decision-making process. However, the JCA's answer reiterates its earlier protest without new information. We are not persuaded to allow the JCA's answer, and accordingly we will reject it.

B. Discussion of Incentive Rates

24. In Energy Policy Act of 2005 (EPA 2005),²⁴ Congress added new section 219 to the FPA directing the Commission to establish, by rule, incentive-based rate treatments to promote capital investment in transmission infrastructure. The Commission subsequently issued Order No. 679, which sets forth processes by which a public utility could seek transmission rate incentives pursuant to section 219, including the incentives requested here by PATH.

25. Pursuant to section 219, an applicant must show that "the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion." Also, as part of this demonstration, ". . . section 219(d) provides that all rates approved under the Rule are subject to the requirements of sections 205 and 206 of the FPA, which require that all rates, charges, terms and conditions be just and reasonable and not unduly discriminatory or preferential."²⁵

²² 18 C.F.R. § 385.214 (2007).

²³ *Id.* § 385.213(a)(2).

²⁴ Pub. L. No. 109-58, 119 Stat. 594, section 1241.

²⁵ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 8 (*citing* 16 U.S.C. §§ 824(d) and 824(e)).

26. Finally, in addition to satisfying these section 219 requirements, an applicant must demonstrate that there is a nexus between the incentive sought and the investment being made. As explained below, we find that PATH has satisfied the requirements for incentive rate treatment for the Project and will grant PATH's requested incentives subject to the conditions noted below.

1. ROE Adder for RTO Participation

a. Protests

27. No party protested PATH's requested 50 basis point ROE adder for RTO participation.

b. Commission Determination

28. We will grant PATH's request to increase its ROE by 50-basis points conditioned upon PATH's membership application being approved by PJM and its continued participation in PJM, and conditioned upon the final ROE being within the zone of reasonable returns. As we emphasized in Order No. 679-A, the Commission will approve, when justified, incentives to each transmitting utility that joins a Transmission Organization.²⁶ The consumer benefits for participating in such an organization, including reliable grid operation, are well documented and consistent with section 219. PATH's request for an incentive based on RTO participation is consistent with the Commission's well established policy and will be granted subject to the conditions in this order.

2. Section 219 Requirements

29. Order No. 679 provides that a public utility may file a petition for declaratory order or a section 205 filing to obtain incentive rate treatment for transmission infrastructure investment that satisfies the requirements of section 219, *i.e.*, the applicant must demonstrate that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion.²⁷ An applicant will be entitled to a rebuttable presumption under section 219 if: (i) the transmission project results from a fair and open regional planning process that considers

²⁶ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 86. Under Order No. 679, a Regional Transmission Organization such as PJM qualifies as a Commission-approved Transmission Organization for purposes of eligibility for the Transmission Organization incentive. Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 328.

²⁷ 18 C.F.R. § 35.35(i).

and evaluates projects for reliability and/or congestion and is found to be acceptable to the Commission; or (ii) a project has received construction approval from an appropriate state commission or state siting authority.”²⁸ Order No. 679-A also clarifies the operation of this rebuttable presumption by noting that the authorities and/or processes on which it is based (*i.e.*, a regional planning process, a state commission, or siting authority) must, in fact, consider whether the project ensures reliability or reduces the cost of delivered power by reducing congestion.²⁹

a. Protests

30. No party questions PATH’s entitlement to a rebuttable presumption under section 219.

b. Commission Determination

31. We find the Project satisfies the requirements for a rebuttable presumption for eligibility for transmission incentives under section 219. As PATH noted in its filing, the Project has been vetted and approved as part of PJM’s 2007 RTEP, which constitutes “a fair and open regional planning process.”³⁰ Moreover, there is substantial evidence that the Project ensures reliability by substantially reducing overloads on the current system and reduces the cost of delivered power by reducing congestion on 12 major 500 kV transmission routes in the region.³¹ Accordingly, we find that PATH has satisfied the first prong of the Commission’s incentives test under section 219.

3. The Nexus Requirement on all Incentives, and Section 205 Requirements on CWIP and ROE

32. In addition to satisfying the section 219 requirement, an applicant must demonstrate that there is a nexus between the incentive sought and the investment being made. The Commission has stated that in evaluating whether an applicant has satisfied the required nexus test, the Commission will examine the total package of incentives being sought, the interrelationship between any incentives, and how any requested incentives address the risks and challenges faced by the applicant in constructing the

²⁸ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 58.

²⁹ *Id.* P 49.

³⁰ *Duquesne Light Co.*, 118 FERC ¶ 61,087, at P 62-68 (2007), *reh’g pending* (*Duquesne*).

³¹ Ex. No. PTH-106 at 2.

project.³² By its terms, this nexus test is fact-specific and requires the Commission to review each application on a case-by-case basis.³³ Applicants must provide sufficient explanation and support to allow the Commission to evaluate the incentives.

33. The Commission also finds that the Project satisfies the nexus requirement for each of the incentives as set forth below. PATH is undertaking considerable risk and challenges to develop and construct the Project. It has demonstrated a nexus between those risks and challenges and the incentives that it has requested. Accordingly, we will grant those incentives subject to the conditions set forth below.

a. 100 Percent of CWIP

34. In Order No. 679, the Commission established a policy that allows utilities to include, where appropriate, 100 percent of prudently-incurred transmission-related CWIP in rate base.³⁴ We noted that this rate treatment will further the goals of section 219 by providing up-front regulatory certainty, rate stability, and improved cash flow for applicants thereby reducing the pressures on their finances caused by investing in transmission projects.³⁵

35. PATH seeks authorization to place in rate base 100 percent of prudently-incurred transmission-related CWIP prior to the in-service date of the Project. PATH identifies the primary benefit of this incentive treatment as the reduced costs to transmission customers as a result of the lower cost of debt that the utility can obtain when it includes CWIP in rate base.³⁶

36. PATH explains that the Project is a major undertaking in terms of scope and cost, involving construction across two states, multiple siting and permitting approvals, and a significant amount of business risk. The Project also has an estimated cost of \$1.8

³² 18 C.F.R. § 35.35(d); Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 26. *See also* Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 21 (“[T]he incentive(s) sought must be tailored to address the demonstrable risks and challenges faced by the applicant in undertaking the project.”).

³³ *See* Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 18.

³⁴ *Id.* P 29, 117.

³⁵ *Id.* P 115.

³⁶ Dr. Joensen’s Testimony, Exhibit No. PTH-200 at 18.

billion.³⁷ PATH further notes the increased financial risk of the Project due to its long construction time, as the projected completion date is in 2012. For all these reasons, PATH states: “It is essential, therefore . . . for the PATH project . . . to induce the capital markets to participate in the PATH project, and to do so on terms that will be most beneficial to those assigned cost responsibility for the project.”³⁸

37. PATH points out that a start-up company, from the perspective of investors and lenders, does not have an established credit rating or a debt repayment or earnings history.³⁹ Financing for start-ups, then, is available based largely on projections of cash flow.⁴⁰ Moreover, PATH argues that including 100 percent of CWIP in rate base provides benefits to ratepayers and does not change the net present value to shareholders of the cash flow.⁴¹

i. Protests

38. While protesters do not contest the inclusion of CWIP in the formula as an individual incentive, they do take issue with the amount of CWIP to be included in the formula. These issues will be addressed in the Formula Rates and Estimated Inputs section of this order.

ii. Commission Determination

39. PATH explains that the Project is a major undertaking in terms of scope and cost, involving construction across two states, multiple siting and permitting approvals, and a significant amount of business risk. The Project has an estimated cost of \$1.8 billion and has a long construction time of approximately five years.⁴² PATH also faces risks as a start-up company. PATH notes that start-up companies do not have established credit ratings, debt repayment history, or earnings history; thus, financing for start-ups is largely influenced by a company’s cash flow.⁴³

³⁷ PATH Filing at 12.

³⁸ Ex. No. PTH-200 at 28.

³⁹ *Id.* at 23.

⁴⁰ *Id.* at 25.

⁴¹ *Id.* at 24.

⁴² PATH Filing at 12.

⁴³ Ex. No. PTH-200 at 23, 25.

40. Consistent with Order No. 679, we find that authorizing 100 percent of CWIP would enhance PATH's cash flow, reduce interest expense, assist with financing, and improve coverage ratios used by rating agencies to determine credit quality by replacing non-cash AFUDC with cash earnings. Considering the size, scope, and construction lead time of the Project, we find that authorization of the CWIP incentive is appropriate to assist in the construction of this new transmission facility.

41. This notion is especially true given PATH's status as a start-up company. Cash flow projections provided in Exhibit PTH-201 indicate that PATH expects revenues from CWIP recovery to total over \$430 million during the construction period from 2008 to 2012. The Commission believes this substantial increase in cash flow will greatly assist PATH's ability to obtain financing for the Project.

42. We also find that CWIP will result in better rate stability for customers. As we have explained before, when certain large scale transmission projects come on line there is a risk that consumers may experience "rate shock" if CWIP is not permitted in rate base.⁴⁴ By allowing CWIP for the Project, the rate impact of the Project can be spread over the entire construction period and will help consumers avoid a return on and of capitalized AFUDC.⁴⁵

43. Finally, consistent with the section 205 requirements for CWIP as required by 18 C.F.R. § 35.25, PATH has an obligation to propose accounting procedures that ensure that customers will not be charged for both capitalized AFUDC and corresponding amounts of CWIP in rate base. PATH proposes to fulfill these requirements in Exhibit No. PTH-500. PATH proposes to use a software program to maintain its accounting records for electric plant assets during construction and when the project is placed in service. Further, it states that this system can calculate and capitalize AFUDC based on specific work orders, and all work orders for construction of the Project will be identified to ensure that no AFUDC is calculated on their balances.⁴⁶ The Commission finds that these procedures are sufficient.

⁴⁴ See, e.g., *AEP*, 116 FERC ¶ 61,059 at P 59, *order on reh'g*, 118 FERC ¶ 61,041 at P 27.

⁴⁵ *Id.*

⁴⁶ See PATH Filing, Appendix H at 4-5. See also Ex. No. PTH-500.

b. Abandonment Costs

i. Protests

44. While several protesters argue the combination of incentives inclusive of the abandonment incentive, no party protests the abandonment incentive individually.

ii. Commission Determination

45. In Order No. 679, we found that this incentive is an effective means to encourage transmission development by reducing the risk of non-recovery of costs.⁴⁷ We will grant PATH's request for recovery of 100 percent of prudently-incurred costs associated with abandonment of the Project, provided that the abandonment is a result of factors beyond the control of PATH, which must be demonstrated in a subsequent section 205 filing for recovery of abandoned plant.⁴⁸

46. We find that PATH has shown, consistent with Order No. 679, a nexus between the recovery of prudently-incurred costs associated with abandoned transmission projects and its planned investment. These risks are especially significant for large scale projects, like the Project, that require multistate and federal approvals prior to completion. Granting PATH's request for an abandonment incentive will help to ameliorate these risks and help ensure the completion of the Project.

47. The Commission will not determine the justness and reasonableness of PATH's abandoned plant recovery, if any, until PATH seeks such recovery in a section 205 filing. Order No. 679 specifically reserves the prudence determination for the later section 205 filing which every utility is required to make if it seeks abandonment recovery.⁴⁹ At this stage of the proceeding, we are granting this incentive, subject to PATH making the appropriate demonstration in a future section 205 filing.

c. Pre-Commercial Costs

i. Protests

48. AMP-Ohio argues that PATH does not justify its proposal to amortize development [pre-commercial] costs over 60 months. AMP-Ohio states that PATH fails

⁴⁷ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 163.

⁴⁸ *Id.* P 165-66.

⁴⁹ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 165-66.

to explain why these costs should not be amortized over the depreciable life of the asset, consistent with traditional treatment of these types of costs.

ii. Commission Determination

49. Like CWIP, in Order No. 679, the Commission permitted public utilities to expense prudently incurred pre-commercial costs to provide up-front regulatory certainty, rate stability, and improved cash flow for applicants.⁵⁰ Although PATH states that it is not requesting this incentive rate treatment for pre-commercial costs, PATH is attempting to recover such costs by deferring them as a regulatory asset and amortizing it during the construction period of the Project.

50. PATH's proposed recovery of pre-commercial costs, like the rate incentive for pre-commercial costs in Order No. 679, is different from the Commission's traditional accounting and ratemaking treatment for pre-commercial costs. Traditionally, pre-commercial costs are deferred until construction of the project begins.⁵¹ Once construction of the project commences, the pre-commercial costs are transferred to Account 107,⁵² accrue AFUDC, and provide no cash flow during the construction period. Here, PATH proposes a mechanism where the pre-commercial costs are expensed through amortization and recovered in its formula rate during the construction period, providing the same effect as the rate incentive for pre-commercial costs in Order No. 679. Accordingly, we will review PATH's request to recover these costs as a request for incentives under Order No. 679.⁵³

51. In Order No. 679, the Commission stated the types of pre-commercial operations costs to be expensed, rather than capitalized, are the preliminary survey and investigation (PSI) costs in Account 183. The Commission also noted that it will entertain proposals to expense other types of costs for consideration on a case-by-case basis.

52. PATH generally proposes to amortize (expense) deferred PSI costs and PATH start-up and business administration costs during the construction period. Contrary to AMP-Ohio's assertion, we find that authorizing the expense and recovery of these

⁵⁰ *Id.* P 115.

⁵¹ For example, expenditures for preliminary surveys, plans, and investigations made for the purpose of determining the feasibility of utility projects under contemplation are deferred in Account 183 until construction of the project begins.

⁵² Account 107, Construction Work in Progress – Electric.

⁵³ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 115, 122.

deferred pre-commercial costs would enhance PATH's cash flow during the construction period, reduce interest expense, assist with financing, and improve coverage ratios used by rating agencies to determine credit quality. Further, considering the size, scope, and construction lead time of the Project, we find that this incentive will assist in the construction of this new transmission facility. Accordingly, we conditionally grant PATH an incentive to recover its pre-commercial costs related to the construction of the Project.

d. Hypothetical Capital Structure

i. Protests

53. While several protesters argue the combination of the hypothetical capital structure and PATH's requested ROE incentive, no party protested the hypothetical capital structure as a stand-alone incentive.

ii. Commission Determination

54. As stated in Order No. 679, use of hypothetical capital structures "can be an appropriate ratemaking tool for fostering new transmission in certain relatively narrow circumstances."⁵⁴ The Commission found, however, that adoption of such a hypothetical capital structure would require a demonstration of the required nexus between the need for a hypothetical capital structure and the proposed investment project.⁵⁵ While PATH does not request the use of the hypothetical capital structure as a formal incentive, the Commission has an obligation to determine whether the nexus has been satisfied under Order No. 679. We believe that PATH has met that burden in this case.

55. PATH has sufficiently demonstrated that permitting this treatment will result in lower debt costs for the company, while also permitting it to vary its financing vehicles to the needs of the construction process, including such issues as timing of expenditures, regulatory developments, and changes in financial market conditions. Moreover, we find that the use of a hypothetical capital structure of 50 percent debt and 50 percent equity during the Project's construction period is a pragmatic approach to address PATH's fluctuating capital structure.⁵⁶

⁵⁴ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 93.

⁵⁵ *Id.*

⁵⁶ *See TrAILCo*, 119 FERC ¶ 61,219 at P 74-76.

56. Upon completion of the Project, the Commission directs PATH to adopt a capital structure based upon its actual financing presented in its Form No. 1, consistent with Commission precedent for PJM Transmission Owners with formula rates.⁵⁷ PATH does not provide a sufficient nexus for the use of a hypothetical capital structure once the Project financing is completed or the need for flexibility when construction is completed.

e. **ROE Incentives**

57. As noted earlier, in Order No. 679-A, the Commission clarified that its nexus test is met when an applicant demonstrates that the total package of incentives requested is “tailored to address the demonstrable risks or challenges faced by the applicant.”⁵⁸ The Commission noted that this nexus test is fact-specific and requires the Commission to review each application on a case-by-case basis.

58. The Commission recently provided clarification on the nexus test. Specifically, it noted that in evaluating whether the total package of incentives requested is “tailored to address the demonstrable risks or challenges faced by the applicant,” the question of whether a project is routine is probative.⁵⁹ The Commission elaborated on how it will evaluate projects to determine whether they are routine and the effect this evaluation has on an applicant’s request for incentives.⁶⁰ The Commission stated that: (1) it will

⁵⁷ All of the PJM transmission owners with this type of formula rate calculate their capital structures based upon actual data in their FERC Form No. 1. *See* Atlantic City Electric Company, Baltimore Gas & Electric Company, Delmarva Power & Light Company, Potomac Electric Power Company, Commonwealth Edison Company, and UGI Utilities, as filed in their formula rates under the PJM OATT, FERC Electric Tariff, Sixth Rev. Vol. No. 1, Att. H-1, H-2, H-3, H-9, H-13 and H-8C, respectively.

⁵⁸ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 40.

⁵⁹ *Baltimore Gas & Elec. Co.*, 120 FERC ¶ 61,084, at P 48 (2007) (*BG&E*).

⁶⁰ In that respect, the Commission explained its determinations regarding routine investments in Order Nos. 679 and 679-A:

[W]e held in Order No. 679 that routine investments “may not always qualify” for incentives. However, we did not find that they would never qualify. Similarly, in Order No. 679-A, we held that projects with “special risks and challenges” present “the most compelling case” for incentives, but did not hold they are the only projects that can qualify for incentives. Second, we held that routine investments “to meet existing reliability standards” may not always qualify for incentives. However, we did not hold that, if a project's primary or sole purpose is to maintain reliability, it

(continued...)

consider all relevant factors presented by the applicant to determine whether or not a project is routine;⁶¹ and (2) applicants must provide detailed factual information in support of the factors they rely upon.⁶² Additionally, the Commission clarified that “when an applicant has adequately demonstrated that the project for which it requests an incentive is not routine, that applicant has, for purposes of the nexus test, shown that the project faces risks and challenges that merit an incentive.”⁶³ Finally, the Commission stated that if it determines that a project is routine, an applicant is not foreclosed from the requested incentive; it may show that its project faces risks and challenges or provides sufficient benefits to warrant incentive rate treatment.⁶⁴

i. PATH’s ROE Request

59. In its filing, PATH seeks an ROE at the high end of the zone of reasonableness or, in the alternative, approval of a 150 basis point adder (in addition to the 50 basis point adder for RTO participation) to result in an overall ROE of 14.3 percent.

60. With respect to the nexus requirement, PATH states that an incentive ROE is necessary to address the following risks: (1) the large size of the financial investment;

should not be eligible for incentives. Indeed, to do so would have been to disregard the plain language of section 219, which required the Commission to adopt a rule that “promote[s] reliable and economically efficient transmission and generation of electricity by promoting capital investment in the enlargement, improvement, maintenance, and operation of all facilities for the transmission of electric energy in interstate commerce.”

Id. P 51 (footnotes omitted).

⁶¹ These factors include, but are not limited to: (1) the scope of the project (*e.g.*, dollar investment, increase in transfer capability, involvement of multiple entities or jurisdictions, size, effect on region); (2) the effect of the project (*e.g.*, improving reliability or reducing congestion costs); and (3) the challenges or risks faced by the project (*e.g.*, siting, internal competition for financing with other projects, long lead times, regulatory and political risks, specific financing challenges, other impediments). *Id.* P 52.

⁶² *See id.* P 53.

⁶³ *Id.* P 54.

⁶⁴ *Id.* P 55.

(2) the need for coordination between Allegheny and AEP over two service territories; (3) regulatory risks; (4) the need to attract investment; (5) the need for siting approval in two states; and (6) the fact that PJM has established an aggressive timetable for the Project to be placed into service. PATH explains the risks involved with siting given the size of this Project, by referencing AEP's Jacksons Ferry-Wyoming 765 kV transmission line, located in Virginia and West Virginia spanning 90 miles. PATH states that for AEP's Jacksons Ferry-Wyoming 765 kV transmission line, the siting alone took 13 years and cost \$50 million out of the total \$306 million cost, involving two state commissions and five federal agencies.⁶⁵

61. PATH provides a discounted cash flow analysis (DCF) using a single step constant growth rate calculation, and a proxy group of northeast utilities, to result in a range of reasonable returns of 7.9 percent to 16.7 percent, with a midpoint of 12.3 percent. PATH states that based on its DCF, its requested ROE is within the range of reasonable returns and therefore, just and reasonable.⁶⁶

62. PATH proposes a proxy group of 15 transmission owners with publicly-traded stock in the Northeast,⁶⁷ consistent with the approach approved in *Opinion No. 489*.⁶⁸ PATH states that this 15 company proxy group was a result of eliminating utilities that: (1) do not pay common dividends; (2) for which no International Brokers Estimation

⁶⁵ Ex. No. PTH-100 at 34.

⁶⁶ Ex. No. PTH-400.

⁶⁷ These 15 companies are: American Electric Power Co., Central Vermont Public Service, Consolidated Edison, Inc., Constellation Energy Group, Dominion Resources, DPL Inc., Exelon Corporation, FirstEnergy Corporation, FPL Group, Inc., Northeast Utilities, NSTAR, Pepco Holdings, Inc., PPL Corporation, Public Service Enterprise Group, and UIL Holdings.

⁶⁸ The Commission authorized the establishment of ISO New England as an RTO, and permitted certain ROE incentives in a series of orders issued effective as of the date of RTO operations. *See ISO New England, Inc.*, 106 FERC ¶ 61,280, at P 249 (*RTO Order*), *order on reh'g and compliance*, 109 FERC ¶ 61,147 (2004) (*RTO Rehearing Order*) (granting the RTO operations effective date of February 1, 2005), *order on reh'g and compliance*, 110 FERC ¶ 61,111 (*February 10, 2005 Order*), *order on reh'g and compliance*, 110 FERC ¶ 61,335 (2005) (*March 24, 2005 Order*), *order on reh'g*, 111 FERC ¶ 61,344 (2005) (*June 2, 2005 Order*), *Bangor Hydro-Electric Co.*, 111 FERC ¶ 63,048 (2005) (*Initial Decision*), *Bangor Hydro-Electric Co.*, *Opinion No. 489*, 117 FERC ¶ 61,129 (2006) (*Opinion No. 489*), *reh'g pending*.

System International, Inc. (IBES) or Value Line data was available; (3) were in the process of merger proceedings;⁶⁹ and (4) have primary business operations as natural gas pipelines.⁷⁰

63. Further, PATH explains that to be consistent with the Supreme Court's findings in *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of West Virginia*⁷¹ and *FPC v. Hope Natural Gas Co.*,⁷² its DCF analysis incorporated the measures of investment risk.⁷³ PATH states that "expanding the proxy group to include utilities operating in adjacent Transmission Organizations and facing similar circumstances helps to avoid regional discriminations with no underlying economic justification, and provides greater assurance that the resulting ROEs will further the policy goals of this Commission and the Congress."⁷⁴

64. PATH explains that corporate credit ratings are widely cited in the investment community and referenced by investors as an objective measure of risk, noting that the Commission relied on corporate credit ratings as the "single defining risk indicator" in its decision to establish an allowed ROE above the midpoint of the zone of reasonableness in *Opinion No. 445*.⁷⁵

65. PATH states that the salient criteria in establishing a meaningful proxy group to estimate investor's required return is comparable risk within the proxy group, under the regulatory standards of *Hope* and *Bluefield*. Relying on the published corporate credit

⁶⁹ In Ex. No. PTH-400 at 30, PATH states that it eliminated Energy East Corporation from the proxy group because it has agreed to be acquired.

⁷⁰ *Id.* at 30. PATH states that it excluded UGI Corporation consistent with the Commission's findings in *Opinion No. 489*, 117 FERC ¶ 61,129 at P 37, given its primary status as a natural gas company.

⁷¹ 262 U.S. 679 (1923) (*Bluefield*).

⁷² 320 U.S. 591 (1944) (*Hope*).

⁷³ Ex. No. PTH-400 at 6, 36. Specifically, PATH has chosen Standard and Poor's (S&P) corporate credit ratings, Value Line's Safety Rankings, and Financial Strength Rating as the objective measures of risk in developing its proxy group.

⁷⁴ *Id.* at 34.

⁷⁵ *Southern California Edison Co.*, 92 FERC ¶ 61,070, at 61,264 (2000) (*Opinion No. 445*).

ratings of its parent companies; AEP (BBB) and Allegheny (BBB-), and relying on additional investment risk criteria,⁷⁶ PATH states that its proxy group is consistent with this standard.⁷⁷

ii. Protests

66. JCA argues that circumstances have materially changed since the granting of incentives *AEP* and *Allegheny* and that the risks to PATH have, as a result, been reduced. Specifically, the sum of the proposed costs of the two earlier projects is more than twice the cost of the current Project and would have taken twice as long to complete, according to JCA. Therefore, JCA requests that there should either be no additional ROE incentive allowed beyond the 50 basis point RTO membership incentive, or the requested 150 basis points should be greatly reduced and the exact number should be determined at an evidentiary hearing.

67. AMP-Ohio questions the need for such a high ROE since AEP has “double-leveraged” PATH and will be receiving a higher return based on this business structure.⁷⁸

68. Protesters state that PATH’s general discussions of risk do not support a finding that any particular ROE is required, let alone an ROE of 14.3 percent. Protesters state that for example, while PATH cites to the “sheer size” of the Project, it does not discuss the size of the Project in relative terms compared to the existing transmission rate base of AEP or Allegheny.⁷⁹

69. Protesters state that the risk factors identified by PATH counterbalance considerations showing that a lower ROE would be sufficient. First, protesters state that the fact that two large experienced companies are partnering on the Project ameliorates the risks of the Project and facilitates the best practices of each company. Second, protesters state that the fact that the Project is intended to go into service relatively quickly tends to offset risks. Third, protesters state that both AEP and Allegheny have extensive experience with the relevant authorities in each state where the project is to be constructed, further mitigating risk. Fourth, protesters state that PATH’s assertion that it is exposed to more risk as a start-up company is belied by the fact that both AEP and

⁷⁶ Such as Value Line’s Safety Rankings and Financial Strength Rating.

⁷⁷ Ex. No. PTH-400 at 37.

⁷⁸ AMP-Ohio Protest at 8.

⁷⁹ ODEC Protest at 10 (*citing Southern California Edison Co.*, 121 FERC ¶ 61,168, at P 45 (2007)).

Allegheny will derive benefits from the corporate structure of the Project. For example, while AEP and Allegheny create new entities to file formula rates with multiple incentives for new transmission investment, the revenue requirements for their existing transmission facilities (which are depreciating each year) are fixed under “stated rates” in PJM and remain insulated from review except through a complaint under section 206 of the FPA.

70. Protesters state that the Project will be initially financed through equity infusions from AEP and Allegheny.⁸⁰ Protesters point out that as a result of this “start-up”, both AEP and Allegheny will have an incentive to fund this “equity” infusion with debt at a lower cost, while still recovering the higher cost “equity” return on this debt capital from ratepayers. ODEC states that this problem is compounded by an ROE incentive. In this scenario, when profits from transmission subsidiaries like PATH are transferred to the parent company there is a potential that the subsidiary’s equity component (resulting from the incentive adders) will end up in the parent company equity on which further incentive adders may be sought.

71. In addition, JCA argues that it is inappropriate for the Commission “to provide incentives when AEP and Allegheny create new entities to file formulary rates with multiple incentives for new major transmission investment while the revenue requirements for the remainder of their transmission facilities (that are depreciating each year) are fixed under zonal rates in PJM.”⁸¹

72. Protesters state that PATH uses companies in its proxy group where only 16 percent or less of their revenues are derived from regulated electric utility operations.⁸²

73. Protesters point out that while PATH’s approach of including companies that own transmission assets in any of the northeast RTOs may be acceptable for determining an allowable ROE for multiple companies, such as the ISO New England case, that is not the objective here. Protesters state that here, the objective is to develop an ROE for a single company alone, and therefore the proxy group should be comprised of companies

⁸⁰ ODEC Protest (*citing* Ex. No. PTH-200 at 13-14).

⁸¹ JCA Protest at P 43.

⁸² Specifically, ODEC and JCA point to Constellation Energy Group and Exelon Corporation. ODEC Protest at 27; JCA Protest at P 48.

who truly are comparable in risk to, and representative of PATH. JCA disagrees with Dr. Avera's rejection of any linkage between a proxy company's source of revenues, the risks related to those sources, and the ultimate returns required by investors.⁸³

74. Protesters argue that PATH's proxy group deviates from the northeast proxy group permitted in *Opinion No. 489*. Protesters state that PATH's use of three companies in the proxy group, Constellation Energy Group, PPL Corporation, and Exelon Corporation, are not comparable in risk to PATH, because their high-end growth rates are not sustainable. Thus, their inclusion in the proxy group fails the test of economic logic. For example, protesters point out that the growth rate for Constellation Energy Group is 16 percent in PATH's proxy group calculation. Protesters state that this is higher than the 13.3 percent growth rate that the Commission found unsustainable in the *RTO Rehearing Order* for the New England transmission owner proxy group.⁸⁴

75. Protesters state that PATH presents its parent company's (AEP) zone of reasonable returns as 9.3 percent to 9.7 percent, with a midpoint of 9.5 percent. Protesters state that PATH does not justify or explain how the use of AEP as its parent company would not be an appropriate proxy. Protesters state that significant weight should be given to the use of the parent company in the DCF analysis.

76. Protesters state that the Commission should rely on the median of PATH's zone of reasonable returns of 9.7 percent, rather than the midpoint of 12.3 percent as the base ROE. Protesters state that in *Northwest Pipeline Corp.*,⁸⁵ the Commission determined that the median best represented the central tendency in a skewed distribution and is therefore preferable to the midpoint. The Commission stated that since the midpoint is the average of the highest and lowest numbers in the group, it is clearly subject to

⁸³ JCA disagrees, for example, with the inclusion of Exelon Corporation in the proxy group, since approximately 50 percent of its revenues are derived from power generation. See JCA Protest at P 50.

⁸⁴ In the *RTO Rehearing Order*, 109 FERC ¶ 61,107 at P 204, the Commission excluded PPL from the New England transmission owner proxy group prior to setting the ROE for hearing because PPL's growth rates were unsustainable. As part of the subsequent hearing proceedings, the Presiding Judge found that PPL's growth rates had decreased to sustainable levels after the *RTO Rehearing Order* was issued, and therefore PPL was no longer an "outlier." See *Initial Decision*, 111 FERC ¶ 61,048 at P 62. In *Opinion No. 489*, 117 FERC ¶ 61,129 at P 24-28, the Commission affirmed the Presiding Judge's finding that PPL's growth rates had decreased to sustainable levels, and subsequently included PPL in the New England transmission owner proxy group.

⁸⁵ 99 FERC ¶ 61,305, at 62,276 (2002).

distortion by extremely high or low values. The Commission supported its rationale for using the median through statistical texts and concepts that are applicable generically to any numerical distribution, not merely a pipeline DCF-calculated ROE distribution.⁸⁶

77. Applying this Commission policy, ODEC provides a DCF analysis of 7.9 percent to 14.3 percent, with a midpoint of 11.1 percent, and a median of 9.7 percent. In its DCF analysis for PATH, ODEC eliminates both the low-end and high-end returns for several companies. ODEC eliminates Dominion Resources, UIL Holdings and Central Vermont Public Service as outliers because their low-end DCF is too close to the cost of debt. ODEC eliminates Constellation Energy Group and Exelon Corporation because their high-end growth rates are not sustainable. ODEC further states that while PATH's DCF lists an IBES growth rate of 12 percent for PPL Corporation, 14 percent is the current IBES growth rate for PPL Corporation according to the latest S&P earnings guide. ODEC states that the 12 percent is very near, and the 14 percent is above, the 13.3 percent to be found unsustainable by the Commission in the *RTO Rehearing Order*. Because of this, ODEC eliminates PPL Corp. from its DCF calculation for PATH.

78. Protesters further question PATH's inclusion of certain companies based on their regional location. For example, AMP-Ohio points out that PATH only used companies from New York and New England, but failed to include companies from the Midwest ISO. Moreover, JCA takes issue with PATH's inclusion in the proxy group of companies without a direct link to PJM. JCA cites to *TrAILCo* to highlight the Commission's finding that the burden should be placed on the applicant to demonstrate why companies lacking a direct link to the relevant RTO should be included in the proxy group from which the zone of reasonableness for its ROE will be derived.

79. Protesters request that either the Commission issue a deficiency letter, reject the filing, or in the alternative, suspend the ROE and set it for a full evidentiary hearing.

iii. PATH's Answer

80. In arguing that it has met the nexus requirement, PATH states that the cash flow analysis in Dr. Joenson's testimony is based on the projected earnings of PATH during the construction period and the year when the plant is to go into service and demonstrates the need for increased cash flow. Further, PATH argues that while protesters criticize Dr. Joenson's cash flow analysis for not preparing sensitivity analyses to determine whether ROE levels other than the one requested would produce satisfactory coverage ratios, the protests ignore the other two independent bases of support for the requested 14.3 percent ROE. Specifically, PATH asserts the other two forms of support were:

⁸⁶ ODEC explains in more detail the skewed effect of PATH's proxy group distribution by its use of the midpoint. ODEC Protest at 32.

(1) the analyses presented by Dr. Joenson and Dr. Avera of the Project's risk and the nexus to the requested 150 basis point incentive adder, in light of the Commission precedent discussed in this testimony as well as in the filing's transmittal letter; and (2) the DCF analysis presented by Dr. Avera. PATH states that the absence of a sensitivity analysis does not detract from the basic conclusion that PATH has supported its request for a 14.3 percent incentive-based ROE, or, alternatively, a 150 basis point adder to the base ROE determined at hearing.

81. PATH states that protesters incorrectly assert that Dr. Joenson should have used the S&P's risk profiles of American Transmission Company and ITC Holdings Corporation in development of his coverage ratio, stating that these companies are not comparable to PATH because they hold operating assets that generate substantial cash flow, whereas PATH is a start-up company with no operating assets. PATH states that it has a greater degree of risk and is appropriately classified with companies with higher business risk profiles. Further, PATH states that ODEC's calculation of cash flows, in developing a coverage ratio analysis⁸⁷ are inconsistent with how the financial community calculates coverage ratio analyses and provide no meaningful information.

82. PATH avers that while it does not seek authorization of an incentive-based ROE adder specific to advanced technologies involved in the PATH project, it urges the Commission to consider the unchallenged support provided in the rate filings as part of its evaluation of the requested 150 basis point adder and/or PATH's requested incentive ROE of 14.3 percent.

83. PATH states that it provided three independent bases to support the requested ROE incentive: the analysis of risks in light of Commission precedent on the ROE incentive, the DCF analysis demonstrating the resulting ROE within the range of reasonable returns, and the cash flow analysis demonstrating the need for increased cash flow. PATH states that its demonstrations amply support the need for, and the justness and reasonableness of, the requested ROE incentives. PATH argues that the Commission has already found that all baseline projects within the PJM RTEP are, by definition, non-routine, and therefore worthy of incentives.⁸⁸ PATH states that consistent with prior orders granting incentives, the Commission should grant the incentives here.

84. PATH states that it developed its proxy group consistent with the Commission's direction in *Opinion No. 489* and *Duquesne* using utilities "with a direct correlation to

⁸⁷ Specifically, Earnings Before Interest and Taxes/Interest ratios.

⁸⁸ PATH Answer at 6 (citing *BG&E*, 120 FERC ¶ 61,084 at P 54, 58; *Commonwealth Edison Co.*, 119 FERC ¶ 61,238, *order on reh'g* 122 FERC ¶ 61,037, at P 27 (2008)).

PJM or to the broader markets with which PJM interacts.”⁸⁹ PATH states that after applying the Commission’s one-step DCF model to the Northeast transmission owner proxy group, the resulting cost of equity estimates ranged from a low of 1.4 percent to a high of 21.1 percent. PATH states that it then applied the same tests of economic logic adopted by the Commission in several prior cases, eliminating low-end estimates (*i.e.*, those that are essentially equal to or below the yield offered by senior long-term debt) and extreme high-end outliers that fail the fundamental tests of economic logic.⁹⁰

85. PATH states that protesters err in stating that Commission policy requires PATH to remove utilities from its proxy group that rely upon non-transmission sources of revenues. PATH states that the Commission has rejected this argument on multiple occasions, specifically, in *Midwest ISO I*, the Commission concluded that “[w]e are unpersuaded . . . that transmission investments are less risky than the other investments of the Midwest ISO TO proxy companies.”⁹¹ PATH states that similarly, in *Opinion No. 489*, the Commission upheld this position, rejecting arguments that PPL Corporation and Exelon Corporation should be removed from the northeast utility company proxy group, because these utilities “provide a sufficiently representative universe of companies for calculating an ROE in this case . . .”⁹² despite their non-transmission, non-regulated branches of operations.

86. PATH states that protesters err in their assertion that its DCF is flawed because it did not eliminate both the low-end *and* the high-end results for a company when one of these results defied economic logic. PATH states that the protesters mischaracterize the *Opinion No. 489* proceedings. PATH states that the Commission did not require that low-end *and* high-end results for a company should be eliminated when one of these results defied economic logic, but rather, the Commission was responding to protests requesting that UIL Corporation’s high-end estimate should be substituted for its illogical low-end value to establish the bottom of the zone of reasonableness. PATH argues that the Presiding Judge and the Commission rejected this approach as counter to the Commission’s accepted DCF method, which requires a separate low and high estimate

⁸⁹ *Duquesne*, 118 FERC ¶ 61,087 at P 73.

⁹⁰ PATH Answer at 8 (citations omitted).

⁹¹ *Midwest Indep. Transmission Sys. Operator, Inc.*, 100 FERC ¶ 61,292, at P 12 (2002) (*Midwest ISO I*), *order denying reh’g*, *Midwest Indep. Transmission Sys. Operator, Inc.*, 102 FERC ¶ 61,143 (2003) (*Midwest ISO II*), *on voluntary remand*, 106 FERC ¶ 61,302 (2004) (*Midwest ISO III*), *aff’d*, *Public Serv. Comm’n of Kentucky v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005).

⁹² *Opinion No. 489*, 117 FERC ¶ 61,129 at P 8.

for proxy firms. As the Commission concluded, “we agree with the presiding judge that having excluded UIL’s low-end ROE, it would have been improper to then use UIL’s high end ROE to establish the low-end ROE for the proxy group.”⁹³ PATH states that contrary to protesters’ contention, this does not require that *both* the low-end and the high-end estimates must be excluded if one is found to be illogical, only that they cannot be substituted for one another.

87. PATH states that protesters misrepresent the Commission’s prior findings, contending that the Commission found that the median should be used rather than the midpoint. PATH states that this is incorrect. PATH argues that in *Midwest ISO III*, the Commission emphasized that the objective of its discussion was not to make any generic determination that would apply to other proceedings. PATH cites to *Midwest ISO III* at P 9-10, which states:

As an initial matter, we emphasize that the primary question to be considered here is not what constitutes the best overall method for determining ROE generically (*i.e.*, the midpoint versus the median or mean); it is whether the use of the midpoint is most appropriate in this case.⁹⁴

88. PATH states that contrary to ODEC’s assertion, the Commission made no finding whatsoever that would reverse its clear preference for the midpoint in evaluating the ROE for individual electric utilities.

iv. Commission Determination

89. Since we have found that that the Project here satisfies the requirements of section 219, we are tasked with two remaining determinations on the ROE incentive; whether this incentive meets the nexus test, and whether this incentive fulfills the requirements of section 205.

90. We find that the Project satisfies the nexus test for an ROE in the high end of the zone of reasonableness.

91. First, we note that the Project is a baseline project in PJM’s RTEP. The Project has far-reaching scope and regional benefits as a backbone transmission project that will relieve transmission constraints along a critical mid-Atlantic corridor. It also faces

⁹³ PATH Answer at P 13 (*citing Opinion No. 489*, 117 FERC ¶ 61,129 at P 54).

⁹⁴ PATH Filing at 14.

significant risks related to the magnitude of the financial investment required⁹⁵ and the involvement of multiple entities and jurisdictions.⁹⁶ As described by PATH, the Project also faces significant siting issues such as the difficulty in obtaining timely approvals in various locations, which can be both protracted and challenging. PATH emphasizes that the Project requires the balancing of competing interests by state siting agencies.⁹⁷ The Project also presents a lead time which presents financial risks because a significant time period may pass before any costs are recovered and the extended time period exposes the Project potentially to additional regulatory, siting, cost increase, and other risks.⁹⁸ Additionally, in undertaking this significant capital-intensive project, PATH's ability to secure financing for transmission projects may be impacted as its borrowing needs increase overall. We find here that granting the ROE incentive conditioned on our section 205 determinations below, will encourage investment in a transmission project with substantial risks.

92. We turn to PATH's section 205 demonstration, and protesters' assertions that the resulting ROE is unjust and unreasonable.

93. A number of adjustments to PATH's proposed proxy group were proposed by several protesters in this proceeding. The Supreme Court has provided guidance in two often cited decisions regarding the range of allowed returns that may be permitted in a particular case. In *Bluefield*, the Court stated that the approved return should be "reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit, and enable it to raise the money necessary for the proper discharge of its public duties."⁹⁹ In *Hope*, the Court provided additional guidance on this issue:

From the investor or company point of view, it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other

⁹⁵ The Project is estimated to cost \$1.8 billion. See PATH Filing at 12; Ex. No. PTH-100 at 15.

⁹⁶ Ex. No. PTH-100 at 33-34.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ 262 U.S. at 693.

enterprises having corresponding risks. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.¹⁰⁰

94. As both PATH and the protesters point out, the Commission has provided additional guidance on the development of a proxy group in *Opinion No. 445*, *Opinion No. 489*, and the *Midwest ISO* series of orders. In *Midwest ISO I*, the Commission accepted a proxy group of Midwest ISO transmission owners, in setting an ROE applicable to the participating transmission owners in the Midwest Independent Transmission System Operator, Inc. (Midwest ISO).¹⁰¹ In *Opinion No. 489*, the Commission utilized a 10-company proxy group made up of northeast utility companies, *i.e.*, transmission owning entities doing business in the RTO at issue (ISO New England, Inc. (ISO-NE)), as well as in the broader, but interrelated RTO markets operated by PJM and the New York Independent System Operator, Inc. (New York ISO).

95. We find that PATH used the appropriate initial proxy group of entities within the interrelated RTO markets operated by PJM, ISO-NE and the New York ISO to begin its DCF analysis. PATH then applied the following screening criteria, consistent with this Commission precedent, as part of its analysis by excluding: (1) those utilities that are not currently paying cash dividends; (2) utilities that have announced a merger during the six-month period used to calculate the dividend yields; (3) utilities primarily operating as natural gas companies; and (4) utilities that do not have both an IBES growth rate and Value Line data.

96. However, while PATH states that it did apply a screen for risk, PATH's proxy group does not sufficiently screen for risk because it includes various companies in its proxy group whose corporate credit ratings are not comparable. Further, PATH has not sufficiently screened its proxy group for unsustainable growth rates. Finally, PATH has excluded certain low-end utilities' returns inconsistent with the Commission's policy on electric utilities. Therefore, PATH's final proxy group, as proposed, is unjust and unreasonable.

97. We agree with protesters that we must consider the proxy group consistent with *Hope*, *i.e.*, whether the proxy group is composed of companies with comparable risk to that of PATH. It is reasonable to use the proxy companies' corporate credit rating as a good measure of investment risk, since this rating considers both the financial risk and the business risk of the company.

¹⁰⁰ 320 U.S. at 603.

¹⁰¹ See *Midwest ISO I*, 100 FERC ¶ 61,292 at P 32.

98. As PATH notes, its parent companies' corporate credit ratings are BBB- (Allegheny) and BBB (AEP).¹⁰² We will apply the following additional screening criteria to PATH's proxy group presented in Ex. No. PTH-402, consistent with Commission precedent: (1) corporate credit ratings of BBB- to BBB+ or the equivalent Moody's rating;¹⁰³ (2) elimination of companies with unsustainable growth rates;¹⁰⁴ and (3) exclusion of companies whose low-end return is at or below the cost of debt.¹⁰⁵

99. Based on this, we exclude Dominion Resources, Consolidated Edison, NSTAR, and FPL Group, Inc. from the proxy group, because their corporate credit ratings are not within the "comparable risk" band outlined in *Opinion No. 445* and as detailed above.

100. We agree with protesters that the inclusion of PS Enterprise Group and Constellation Energy Group in this proxy group is inappropriate, consistent with the Commission's findings in the *RTO Rehearing Order*.¹⁰⁶ In that proceeding, we outlined that a 13.3 percent growth rate is not a sustainable growth rate over time and therefore does not meet threshold tests of economic logic. These companies' growth rates exceed that threshold established in the *RTO Rehearing Order*.¹⁰⁷ We disagree with protesters that PPL should be eliminated from the proxy group because of its growth rate. Based on the August 31 and September 28, 2007 data using Value Line and IBES,¹⁰⁸ PPL has a growth rate of 8 to 12 percent. While protesters rely upon the August 31 and September 28, 2007 data to support their own DCF analysis, they inexplicably recalculate PPL's growth rates using data from an entirely different time period.

¹⁰² Ex. No. PTH-400 at 37.

¹⁰³ *Opinion No. 445*, 92 FERC ¶ 61,070 at 61,264 (advocating the use of a proxy group of utilities with comparable bond ratings).

¹⁰⁴ *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004).

¹⁰⁵ *Opinion No. 445*, 92 FERC ¶ 61,070 at 61,266; *Opinion No. 489*, 117 FERC ¶ 61,129 at P 54-60.

¹⁰⁶ 109 FERC ¶ 61,147 at P 205.

¹⁰⁷ Specifically, Ex. No. PTH-402 lists Constellation Energy Group's growth rate as 16 percent, Exelon Corporation's growth rate is 14 percent, and PS Enterprise Group's growth rate is 18 percent.

¹⁰⁸ Ex. No. PTH-402.

101. In both *Opinion No. 445* and *Opinion No. 489*, we found that a company whose ROE is lower than its own cost of debt should not be included in the proxy group.¹⁰⁹ While *Opinion No. 445* did not establish a bright line regarding how much of a rate differential would support the inclusion or exclusion of a company from the proxy group, *Opinion No. 489* established that such a determination would be made specific to the facts of each case. Here, PATH proposes to exclude one component of UIL Holdings, but not the other. Specifically, PATH proposes to exclude the low-end return of 6.7 percent of UIL Holdings, but leave in UIL Holdings high-end return of 16 percent. As a preliminary matter, removing only the low-end return of a single company included in a proxy group, but leaving in its high-end return could impose a bias resulting in a higher ROE, since the midpoint of any zone of reasonable returns is determined by using only the low-end and the high-end returns, and none of the returns in between.

102. Further, UIL Holdings' low-end return result is above the cost of debt. PATH provides speculative forecasting of this indexed cost of debt by using data from one year (2007) to forecast bond yields into 2012, in support of excluding the low-end return result of UIL Holdings. PATH's support is insufficient to establish that this low-end result should be removed. This flawed support is exacerbated by the fact that removing only the low-end return results in a bias. We will therefore include UIL Holdings in the proxy group. With our adjustments to PATH's proxy group on the basis of risk and growth rates, UIL Holdings low-end return of 6.7 percent sets the low end of the zone of reasonable returns for the entire proxy group. Likewise, UIL Holdings high-end return of 16 percent sets the high end of the zone of reasonable returns for the entire proxy group.

103. Based on this analysis, *supra*, we find that PATH's proxy group should include: American Electric Power Corporation, Central Vermont Public Service, DPL Inc., FirstEnergy Corporation Northeast Utilities, Pepco Holdings, UIL Holdings, and PPL Corporation, which establishes a zone of reasonable returns of 6.7 percent to 16 percent.

104. Based on this revised proxy group and the risks faced by the project, the Commission will grant PATH's request for an ROE of 14.3 percent, which is within the high end of the zone of reasonableness, but not at the high end of 16 percent. This ROE being granted herein is considered inclusive of the 50 basis point ROE incentive granted for RTO participation. Thus, we will not grant a 150 basis point adder onto a midpoint or median return. Therefore, protesters' concerns, whether the midpoint or median should

¹⁰⁹ *Opinion No. 445*, 92 FERC ¶ 61,070 at 61,266.

be used, are moot. Further, by nature of the overall ROE being within the high end of the zone of reasonableness, but not at the high end, we have adjusted the ROE to reflect the total package of incentives requested herein.

105. Finally, despite our limiting PATH's proxy group, we emphasize that the 15-company proxy group PATH proposes here¹¹⁰ is a good starting point for companies in PJM to use to develop an individual proxy that takes into account comparable risks. The exclusion of certain companies in this case does not preclude other companies in the region from proposing to use these excluded companies in developing a proxy group in the future, given comparable risk characteristics. To do so would disregard the mutable nature of the market data used in the screening criteria for the proxy group consistent with *Hope*. In other words, utilities' corporate credit ratings change over time. Utilities' growth rates change over time. What may not be sustainable or comparable at this point in time, may be comparable at a future date, by a different company.

4. Total Package

a. PATH's proposal

106. PATH states that the total package of incentives is tailored to address the demonstrable risks or challenges faced in construction of the Project for several reasons. First, PATH states that the recommended ROE of 14.3 percent is well below the upper end of the zone of reasonable returns, so there is no further need for a downward adjustment.¹¹¹ Second, PATH states that while inclusion of CWIP in rate base will impact PATH's credit rating, it will not have a measurable effect on overall risk, because it changes only the timing of the recovery, not the absolute amount of recovery. Third, while the opportunity to recover costs associated with plant that is abandoned moderates regulatory risk associated with new transmission investment, this reduction in investment risk is offset by the uncertainties that accompany a section 205 filing, which the Commission requires before abandoned plant costs can be recovered.¹¹² Finally, PATH states that while the Commission elected to reduce the ROE incentive for new

¹¹⁰ Specifically, American Electric Power, Central Vermont Public Service, Consolidated Edison, Constellation Energy Group, Dominion Resources, DPL, Inc., Exelon Corporation, FirstEnergy Corporation, FPL Group, Northeast Utilities, NSTAR, Pepco Holdings, PPL Corporation, PS Enterprise Group, and UIL Holdings.

¹¹¹ Ex. No. PTH-400 at 71.

¹¹² *Id.* at 71-72.

transmission investment from 150 basis points to 125 basis points in *Southern California Edison Co.*, there are important differences in the use of advanced technologies between these projects.¹¹³

b. Protests

107. Protesters state that while they strongly support construction of new regional high voltage transmission facilities in PJM, they cannot endorse the significant quartet of incentives proposed by PATH.

108. Protesters state that the Commission should revisit the issue of whether the “incentive rate treatments such as the recovery of CWIP and pre-construction/pre-operating costs may result in a lowered risk assessment that would affect the need for an ROE rate incentive to compensate for that risk.”¹¹⁴ Protesters request that the Commission set the ROE incentive for hearing (exclusive of the 50 basis point adder for RTO participation), to determine whether it is just and reasonable in the context of the total package of incentives.¹¹⁵

109. Protesters request that the Commission adjust the ROE incentive to reflect the reduced risk effect of the total package of incentives in the event that the Commission does not set the appropriate level of ROE incentive for hearing. Protesters state that such an adjustment taking into account the total package of incentives would be consistent with the Commission’s decision in *Southern California Edison Co.* Protesters request that the Commission limit the transmission incentive to not more than 50 basis points, plus the 50 basis points for RTO participation.

110. Protesters state that based upon the Commission’s assumption that the inclusion of the Project as a baseline PJM RTEP project establishes a presumption of reliability/congestion relief benefits, the presumption that the Project provides such cost-effective benefits should not continue to apply if the Project exceeds its estimated costs or is delayed beyond the proposed 2012 in-service date. Protesters assert that reliability benefits diminish the longer the Project is delayed, and cost overruns offset any congestion benefits the Project might provide. Protesters state that in such circumstances, the predicate for granting incentives no longer holds true.

¹¹³ *Id.* at 72.

¹¹⁴ ODEC Protest at 23 (*citing Allegheny II*, 118 FERC ¶ 61,042 at P 40; *AEP II*, 118 FERC ¶ 61,041 at P 32).

¹¹⁵ ODEC Protest at 16.

111. Protesters argue that the coverage ratio analysis that PATH performs to demonstrate that it needed both the ROE incentive and the CWIP incentive combined, to maintain investment grade rating, does not take into consideration the parent companies' current investment-grade rating. Protesters state that PATH does not provide the underlying assumptions in its coverage ratio analysis, such as the assumed interest rate(s) used in the hypothetical capital structure, the assumed CWIP and plant in-service balances and resulting rate base for each year, and the overall weighted average rate of return (ROR), among other things. Protesters state that the filing to justify this combination of incentives, is devoid of work papers showing the calculations for taxes, assumed revenues and expenses. Protesters state that in addition to this, PATH does not provide any sensitivity analyses to show what the results would be if different ROEs were used. Further, when PATH reports S&P's ratings criteria for comparison purposes, it does so only with regards to criteria used for higher risk companies (with S&P's business risk profiles of 5 and higher). Protesters state that this choice does not reconcile with S&P's determination that typical business risk profiles for "large transmission systems and regulated distribution systems (the 'wires' business) business profile assessments tend to fall within the 1-4 range."¹¹⁶

112. ODEC states that with these assumptions corrected, and based upon PATH's testimony in its filing,¹¹⁷ PATH would still be able to maintain its corporate credit rating if it were given both CWIP and an overall ROE of 10.2 percent (9.7 percent plus 50 basis points for RTO participation), because the corrected coverage ratio is 3.18, given an ROE of 10.2 percent. ODEC states that this falls squarely within the 2.4 to 3.5 range to garner a BBB rating, for a company with a high business risk profile of 5.¹¹⁸

113. JCA further argues that the nature of formula rates reduces risk to investors, and therefore the Commission should reduce the amount of any "new transmission" incentives sought by PATH as a result of being granted formula rates.

114. AMP-Ohio argues that during the early stages of this project, AMP-Ohio expressly offered to participate in the Project as a partial owner. AMP-Ohio states that its participation as a public power entity would have curtailed both risk and cost of AEP. AMP-Ohio on behalf of its public power members would have contributed funds most

¹¹⁶ *Id.* at 15 (*citing* S&P's Corporate Ratings Criteria publication under Power Companies).

¹¹⁷ ODEC uses PATH's claimed 14.3 percent ROE, the requested 50/50 hypothetical capital structure, and a 7.89 percent cost of debt as presented in PATH's filing in Ex. Nos. PTH-200, PTH-300, and PTH-302.

¹¹⁸ ODEC Protest at 13-15.

likely obtained through tax-exempt rates towards the Project and thus at a lower rate than AEP faces in the financial market. AMP-Ohio states that AEP's Senior Vice President for Transmission and witness here, Michael Heyeck, advised AMP-Ohio that AEP did not want it as a partner.

115. AMP-Ohio states that the Commission extolled the value of public power participation in Order No. 679.¹¹⁹ Despite this, AEP not only failed to produce a transmission project with public power participation, it actively barred a public power entity from joining. AMP-Ohio states that if the Commission truly wishes to encourage public power participation, it would be sending exactly the wrong signal if it blesses the Project with every incentive yet devised.

c. PATH's Answer

116. PATH asserts that formula rates were not identified as a form of incentive ratemaking in Order No. 679, and therefore, are not incentive rates, as protesters assert. PATH argues that protesters incorrectly assert that it failed to state its cash flow assumptions in the underlying cash flow analysis, noting pages 26-27 of Dr. Joenson's testimony that the cash flow analysis is based on the projected earnings of PATH during the construction period and the year when the plant is to go into service.

117. Further, PATH argues that while protesters criticize Dr. Joenson's cash flow analysis for not preparing sensitivity analyses to determine whether ROE levels other than the one requested would produce satisfactory coverage ratios, these protesters ignore the other two independent bases of support for the requested 14.3 percent ROE. Specifically, PATH asserts the other two forms of support were: (1) the analyses presented by Dr. Joenson and Dr. Avera of the project's risk and the nexus to the requested 150 basis point incentive adder, in light of the Commission precedent discussed in his testimony as well as in the filing's transmittal letter; and (2) the DCF analysis presented by Dr. Avera. PATH states that the absence of a sensitivity analysis does not detract from the basic conclusion that PATH has supported its request for a 14.3 percent incentive-based ROE, or, alternatively, a 150 basis point adder to the base ROE determined at hearing.

118. PATH states that parties incorrectly assert that Dr. Joenson should have used the S&P risk profiles of American Transmission Company and ITC Holdings Corp. in development of his coverage ratio, stating that these companies are not comparable to PATH because they hold operating assets that generate substantial cash flow, whereas PATH is a start-up company with no operating assets. PATH states that it has a greater degree of risk and is appropriately classified with companies with higher business risk

¹¹⁹ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 354.

profiles. Further, PATH states that ODEC's calculation of cash flows, in developing a coverage ratio analysis¹²⁰ is inconsistent with how the financial community calculates coverage ratio analyses, and provide no meaningful information.

119. PATH answers that it did not "rebuff" AMP-Ohio's participation in PATH. PATH states that AEP did meet with AMP-Ohio, as AEP did with other potential investors, at the early stage of the planning process. PATH states that these negotiations occurred before the Project existed. PATH argues that to explain why the various alternative business arrangements did not materialize would necessarily include a full examination of all the discussions and the historical and economic context in which they occurred. PATH states that such a process would be both unproductive and inimical to the type of free and frank dialogue needed to develop such business arrangements, and the fact that such discussions did not lead to a business arrangement is not unusual.

d. Commission Determination

120. As discussed above, we find that PATH has shown that, consistent with Order No. 679-A, the total package of incentives is tailored to address the demonstrable risks or challenges faced by PATH.¹²¹ Consistent with Order No. 679, the Commission has, in prior cases, approved multiple rate incentives for particular projects.¹²² This is consistent with our interpretation of FPA section 219 as authorizing the Commission to approve more than one incentive rate treatment for an applicant proposing a new transmission project, as long as each incentive is justified by a showing that it satisfies the requirements of FPA section 219 and that there is a nexus between the incentives being proposed and the investment being made. Here, as discussed above, PATH has explained why it is seeking each incentive and how each is relevant to the proposed Project. As discussed above, we find that PATH faces significant risks and challenges in constructing the Project. Thus, we find that PATH has shown a nexus for the total package of incentives.

121. We are not inclined to limit the incentives that we are approving in this order to a specific time period or to a total cost amount of the Project. In fact, the 14.3 percent ROE that we are granting reflects the risks relating to the costs and time constraints of

¹²⁰ Specifically, Earnings Before Interest and Taxes/Interest ratios.

¹²¹ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 21, 27.

¹²² See, e.g., *Allegheny*, 116 FERC ¶ 61,058 at P 60, 122 (approving ROE at the upper end of the zone of reasonableness and 100 percent abandoned plant recovery); *Duquesne*, 118 FERC ¶ 61,087 at P 55 (granting an enhanced ROE, 100 percent CWIP, and 100 percent abandoned plant recovery).

constructing the Project. As stated above, we have adjusted PATH's ROE to reflect the total package of incentives requested herein, by nature of it being within the high end of the zone of reasonable returns, but not at the high end of the zone.

122. We find that PATH has established a nexus between each incentive and the investments being made for the Project and has demonstrated that each incentive is appropriate under section 219. Thus, we believe that the overall package of incentives reflect the significant risks and challenges faced by PATH in constructing the Project. As discussed above, the Commission did consider the overall package of incentives when determining PATH's ROE.

123. Regarding AMP-Ohio's concern on encouraging public power participation, in Order No. 679, the Commission determined that it would not condition recovery of incentives on the type of business structure and stated that it will entertain appropriate requests for incentive ratemaking for investment in new transmission projects involving participation by public power entities.¹²³ In Order No. 679-A, the Commission further stated:

While the Commission encourages public power participation, we will not require such participation as a condition of any proposed incentive rate treatment. As we state elsewhere in this order, the Commission cannot compel investment or certain types of investment. Our focus in this rule is to provide incentives that will facilitate voluntary investments by utilities. . . . In the context of a rule to provide rate incentives for the construction of new transmission and to encourage deployment of technologies to increase the capacity and efficiency of existing transmission facilities, we do not believe that mandating an opportunity for public power participation is necessary nor do we believe that failure to do so would be unduly discriminatory.¹²⁴

C. Proposed Formula Rate and Estimated Inputs

1. Protests

124. Protesters raise issues not only with the formula rate, but also with the inputs that will flow through the formula rate. Protesters request that the Commission set PATH's

¹²³ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 354.

¹²⁴ Order No. 679-A FERC Stats. & Regs. ¶ 31,236 at P 102 (emphasis in original).

formula rate request for hearing. Further, protesters request that the Commission not limit the issues set for hearing as PATH requests.

125. Protesters oppose PATH's inclusion of \$7,078,915¹²⁵ in rate base as an unamortized regulatory asset related to pre-commercial expenses incurred but not included in CWIP prior to the proposed effective date of the rate. Protesters state that PATH fails to provide data in its filing that would allow interested parties to assess the type of costs that have been incurred and included in the regulatory asset as pre-commercial costs, and at what rates the AFUDC has been capitalized on those costs. Protesters state that the formula rate lacks transparency in this regard. Protesters request that the Commission require PATH to provide a comprehensive list of the pre-commercial costs along with a description of the activities leading to those costs and to provide work papers showing the development of the AFUDC rates applied to those costs.

126. In addition, ODEC argues that the Commission recently found in *TrAILCo* that pre-commercial costs that are capitalized in the depreciation expense sections of the formula should be amortized in Account 566,¹²⁶ and the utility should address all the necessary modifications in the hearing proceedings. ODEC requests that the Commission require PATH to address this issue in the hearing proceedings.

127. Protesters state that PATH has included a projection of \$18,433,478 for CWIP in rate base without any support that would allow parties to assess whether the CWIP costs projected for the test year are legitimate and appropriately included in rate base.¹²⁷ Protesters request that PATH provide a detailed list of these projected costs.

128. AMP-Ohio requests that the Commission require PATH to use a 13-month average balance for these balances, consistent with its use of a 13-month average balance for plant-in-service.¹²⁸

129. AMP-Ohio protests PATH's use of the "hoary" 1/8th rule for determining cash working capital. AMP-Ohio states that the Commission should require PATH to perform

¹²⁵ ODEC Protest at 34 (*citing* Ex. No. PTH-302, Line 38 and 155).

¹²⁶ Account 566, Miscellaneous Transmission Expense.

¹²⁷ ODEC Protest at 34.

¹²⁸ AMP-Ohio Protest at 14-15.

a lead-lag study to support any allowance for cash working capital because much of the revenue requirement is plant and therefore, real-estate tax related, which tends to have a very substantial lag in the payment of such taxes.

130. AMP-Ohio protests PATH's development of Post Employment Benefits other than Pensions (PBOPs), stating that line 195 of the PATH-WV formula for "Amount related to retired personnel" has an amount of \$8.8 million. AMP-Ohio questions how a new stand-alone company that is not yet in operation can already have retired personnel.

131. AMP-Ohio argues that the formula rate template for PATH includes line items (lines 22 and 139) that provide an entry for accumulated depreciation of general and intangible plant. AMP-Ohio argues that Intangible plant is amortized, not depreciated, and Accumulated Amortization of Intangible Plant must be deducted from rate base. AMP-Ohio requests that the Commission require the formula rate template to be amended to show a separate line item for Accumulated Amortization of Intangible Plant.

132. Protesters state that PATH has filed 600 pages of evidence consisting of three different depreciation studies and depreciation-related testimony for the Project. Protesters state that there has been insufficient time to fully analyze the complex depreciation studies in the short amount of time allowed for interventions and protests, and requests that the Commission set this issue for hearing to allow the parties to assess the appropriateness of those rates.

133. Parties request that PATH be required to annually file with the Commission pursuant to section 205, its proposed changes in charges resulting from the formula rates. Protesters state that this approach ensures Congress' intent in enacting Part II of the FPA, that the Commission has plenary means to prevent the imposition of unjust and unreasonable rates by not awarding PATH excessive discretion in the inputs to those rates. Protesters state that the formula rate would still remain the "filed rate", and the scope of any investigation would not "open up" any formulae themselves, but rather, only the changed charges. Protesters state that if the Commission does not exercise its section 205 powers over the process, abuse is only more likely to occur.

134. Protesters state that PATH's proposal to post the Annual Update each year on or before October 15, gives customers little time between this posting, and the October 30 date when the customer meeting will be held to explain the formula rates and cost detail. Protesters request that the Commission grant the similar relief as it granted in *Xcel*, when the Commission required the utility "provide the estimated revenue requirement for the following calendar year by September 1."¹²⁹

¹²⁹ *Xcel*, 121 FERC ¶ 61,284 at P 70.

135. AMP-Ohio states that the effective two year delay in the pass-through or recovery of under or over-collected amounts at the FERC interest rate result in a perverse incentive for PATH to overstate its revenue requirements. AMP-Ohio states that this incentive to over-charge ratepayers in forecasted formula rates exists because any money PATH collects that it must ultimately refund, recovers a higher return when charged [through ROE] than the money that must be paid as interest [through the interest rate outlined in 18 C.F.R. § 35.19a] on any refunds that result from the true-up.

136. Protesters argue that PATH's proposal eliminates customer rights to challenge other aspects of the formula rates, including the projected costs, revenues, and credits. Further, ODEC protests PATH's protocols limiting any determination to whether costs are prudently incurred, and even then, only to "new costs", which suggests that as long as a description of a cost has been used before, it is no longer subject to a prudence review.

137. Protesters oppose several additional aspects of the protocols, stating that they limit customers' ability to challenge whether PATH had taken the correct number from its FERC Form No. 1, prohibit challenges on costs other than undefined new costs, prevent challenges regarding whether costs had been properly accounted for, fail to accommodate changes in the Commission's accounting policies that might modify the application of the formula rate, and fail to give interested parties sufficient time or review procedures on the Annual Update and true-up adjustment.¹³⁰ Finally, protesters state that the Protocols limit customers' ability to make a formal challenge, engrafting a statutory limitation on customers' rights to file under section 206, among other things.¹³¹

138. The Illinois Commerce Commission challenges the allocation of PATH's costs to Illinois ratepayers via Commonwealth Edison Company's (ComEd) membership in PJM. It asserts that the Project is not necessary for ComEd's zone, and therefore they do not benefit from these upgrades.

139. Separately, JCA states that it will require discovery and time to study and analyze the depreciation studies PATH has filed for its proposed facilities.

2. PATH's Answer

140. PATH argues that AMP-Ohio's criticism of PATH's use of the Commission's 1/8th policy for calculating a cash working capital allowance of \$11.8 million is

¹³⁰ ODEC Protest at 42, 46-49.

¹³¹ *Id.* at 43-45.

inconsistent with Commission policy which states in the absence of a reliable lead-lag study available on the record, utilities should apply the 45 day convention.¹³²

141. PATH explains that the depreciation rates proposed by PATH are based on recent studies of service life and net salvage which have been approved by the West Virginia Public Service Commission for its parent companies. PATH states that because the facilities will be similar in nature to facilities already owned by its parent companies, it is reasonable to use depreciation rates based on live and net salvage percentages previously developed and approved for those utilities.

142. PATH states that AMP Ohio errs in its assumptions that PATH has included costs related to retired personnel in the PBOP entry at line 195 of Attachment 4, page 5 of the populated formula rate set forth in Ex. No. PTH-303. PATH states that the adjustment removes from the formula rates, rather than includes in the formula rates, the PBOPs associated with retired employees. PATH further notes that consistent with Commission policy, the PBOPs are a stated value, requiring any changes to be made pursuant to section 205.¹³³ PATH argues that the lines in the formula that AMP Ohio references on intangible plant remove the accumulated depreciation associated with both intangible and general plant. Nevertheless, PATH states that if the Commission so directs, it will change the description on these lines to “Intangible Plant Amortization.”¹³⁴

143. PATH argues that ODEC’s suggestion that PATH’s annual informational filings be treated as section 205 filings is illogical. PATH answers that informational filings do not change the rate, *i.e.*, the formula itself. PATH states that the Commission has previously rejected the argument that the formula rate itself carries a burden of proof under section 205 in informational filings, but rather, noting that the formula rate is the rate on file, not the inputs. PATH asserts that the formula rate should not be subject to protest and review as part of each annual update as ODEC urges. PATH requests that ODEC’s position be rejected as fundamentally at odds with the Commission’s policy on formula rates.

¹³² See, e.g., *Trans-Elect NTD PATH 15, LLC*, 117 FERC ¶ 61,214 at P 32, 39-43 (holding that in the absence of a reliable lead-lag study approximating the utility’s cash working capital needs or hardships that would justify the departure from the established formula, a utility should use the Commission’s 45-day convention).

¹³³ PATH Answer at 24.

¹³⁴ *Id.* at 25.

144. PATH states that ODEC errs in its assertion that the formula rate protocols impose restrictions on the customers' section 206 filing rights. PATH states that the protocols impose no restrictions on the Commission or the customers' section 206 rights.

3. Commission Determination

145. We first address the formula rate and then the inputs to the formula rate. For the reasons discussed below, we will accept PATH's proposed formula rate,¹³⁵ effective March 1, 2008, as requested, subject to conditions and nominal suspension, and set the formula rate for hearing and settlement judge procedures. Our preliminary analysis of the components of PATH's proposed formula rate indicates that the proposed formula rate has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful.

146. We will not limit the hearing proceeding as PATH requests except as to the ROE and the specific issues described further below.¹³⁶ Formula rates must contain enough specificity to operate without discretion in their implementation.¹³⁷ As PATH notes, the formula itself is the rate on file and will be updated on a regular basis to reflect actual costs. As such, there is no need, as ODEC requests, to file the formula under section 205 on an annual basis. A formula with adequate specificity coupled with timely available, transparent inputs to the formula rate satisfies the Commission's requirements. In addition, in the instant case, the proposed tariff provides that the Annual Update shall be subject to challenge and review in accordance with H-19B with respect to the accuracy of the data and consistency with the formula of the charges shown in the Annual Update.

147. With regard to the inputs to the formula rate, protesters have raised concerns with the estimates that form the basis for the 2008 rates which will not be available, under the protocols, for true-up until 2010, and will be trued-up at the section 35.19a interest rates rather than the allowed rate of return afforded PATH. PATH has little financial/operating history, has no FERC Form 1 upon which to rely, and as such is in the necessary position of estimating what its annual costs will be. Going forward, PATH has committed to making its estimates available October 15 of each year and has provided a process by

¹³⁵ The issues set for hearing include: (1) the statement of the ATRR that will be included as Attachment H-19 of the PJM OATT; (2) the cost of service formula itself that provides detailed calculations of the annual revenue requirements (including worksheets); and (3) formula rate implementation protocols in Attachment B to the ATRR.

¹³⁶ The ROE will not be part of this hearing because we have made a summary finding on the ROE in this order.

¹³⁷ *Midwest Indep. Sys. Operator, Inc.*, 108 FERC ¶ 61,235, at P 68 (2004).

which customers, state commissions and other interested parties can review and submit challenges to specific items included in the formula.¹³⁸ That process is not available, however, for the estimates that form the basis for the 2008 rates contained in the instant application. As such, at the ordered hearing, we will allow protesters to seek additional support for the inputs included in PATH's application. We note, however, that forecasts are just that and encourage PATH and the parties to consider ways to update the 2008 rates earlier than 2010. We believe that reconciling estimates to actuals more quickly will largely address protesters' concerns and will allow PATH and parties to explore this at the hearing and settlement judge procedures ordered herein.

148. While we are setting these matters for a trial-type evidentiary hearing, we encourage the participants to make every effort to settle their disputes before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.¹³⁹ If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.¹⁴⁰ The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, concerning the status of settlement discussions.

149. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

150. We will make specific findings, and not set for hearing, the ROE and the following issues:

a. Cost Allocation

151. The Illinois Commerce Commission raises concerns on cost allocation. For large transmission projects such as this, cost allocation is first vetted through the PJM stakeholder process and ultimately determined by PJM as an independent entity. The

¹³⁸ PATH Filing at Att. H-19B, section 1; Ex. No. ATL-1.

¹³⁹ 18 C.F.R. § 385.603.

¹⁴⁰ If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).

revenue allocation responsibilities have been set by PJM in the RTEP. For transmission projects built as a result of the PJM RTEP process, cost allocation is not part of the individual transmission owner's incentive request or its rate filing, but rather, is filed by PJM.

152. PATH's cost allocation was filed by PJM in Docket No. ER07-1186-000, and accepted by the Commission.¹⁴¹ Therefore, the Illinois Commerce Commission's protest is outside the scope of this proceeding, and is a collateral attack on the Commission's order in that proceeding.

b. CWIP

153. To address certain protesters concerns regarding the transparency of including CWIP in rate base, we will require PATH to include as a part of its annual filing and formula true up, a descriptive list of the costs included as CWIP in order to give all parties the opportunity to examine the prudence of such costs, consistent with the section 205 requirements for CWIP.

c. Pre-Commercial Costs

154. As ODEC argues, the Commission has previously stated that expensed pre-commercial costs appear to be appropriately recognized as a transmission operating expense in Account 566 which includes transmission expenses not included elsewhere. Accordingly, we will require PATH to amortize all pre-commercial costs related to the Project in Account 566. Additionally, in the hearing procedures set forth below, PATH shall propose all necessary modifications to its formula rate to include pre-commercial costs using Account 566.

d. Accounting

i. Comparability of Financial Information

155. Public utilities that receive a current return on CWIP and expense pre-commercial costs recover these costs in a different period than when they would ordinarily be charged to expense under the general requirements of the Commission's Uniform System of Accounts (USofA).¹⁴² To promote comparability of financial information between

¹⁴¹ *PJM Interconnection, L.L.C.*, 121 FERC ¶ 61,034 (2007). The Illinois Commerce Commission was an intervenor in this proceeding.

¹⁴² The USofA requires an AFUDC to be capitalized as a cost of a construction project and depreciated over the service life of the asset. The USofA also requires pre-
(continued...)

entities the Commission has required a specific accounting treatment or the use of footnote disclosures to recognize the economic effects of having CWIP in rate base and expensing pre-commercial costs. To comply with this requirement, PATH requests authorization to use footnote disclosures consistent with disclosures previously authorized by the Commission.¹⁴³

156. The Commission will authorize PATH's operating companies¹⁴⁴ to provide footnote disclosures in the notes to the financial statements of their annual FERC Form No. 1 and their quarterly FERC Form No. 3-Q which: (1) fully explain the impact of the transmission rate incentives it receives insofar as the incentives provide for a deviation from the general requirements of the USofA; (2) include details of amounts not capitalized because of the transmission rate incentives for the current year, the previous two years, and the sum of all years; and (3) include a partial balance sheet consisting of the Assets and Other Debits section of the balance sheet to include the amounts not capitalized because of the transmission rate incentives.

ii. Income Taxes

157. PATH-WV and PATH-Allegheny are limited liability companies and are not subject to federal taxation. Instead, the tax obligations incurred through their operations are reported on the tax returns of their corporate parents, AEP and Allegheny.¹⁴⁵ As such, PATH-WV and PATH-Allegheny propose not to record income taxes on their books. For ratemaking purposes, PATH-WV and PATH-Allegheny are treated as corporations and receive an income tax allowance for the tax liability ultimately paid by AEP and Allegheny. Therefore, we will require PATH-WV and PATH-Allegheny to maintain their books of account based on the Commission's Uniform System of Accounts

commercial costs to be accumulated in Account 183, Preliminary Survey and Investigation Charges, before being transferred to CWIP and capitalized as a cost of the construction project.

¹⁴³ Ex. No. PTH-500 at P 14, 15 (citations omitted).

¹⁴⁴ PATH consists, in part, of two operating companies including PATH West Virginia Transmission Company, L.L.C. (PATH-WV), and PATH Allegheny Company, L.L.C. (PATH-Allegheny). These operating companies will be jurisdictional to the Commission and required to comply with the Commission's accounting and reporting regulations in 18 C.F.R. Parts 101 and 141.

¹⁴⁵ Ex. No. PTH-500 at 4-6.

as if it were a corporation, including the income tax accounting requirements of the Commission's USofA.¹⁴⁶

iii. Miscellaneous Cost of Service Issues

158. We deny AMP-Ohio's request to require PATH to perform a lead-lag study. In *Trans-Elect NTD Path 15, LLC*, the Administrative Law Judge held that long-established Commission policy provides that a company need not perform such a study, and may instead rely on the 45-day convention without further showing.¹⁴⁷ We held that the Administrative Law Judge was "correct" in finding that the Commission's policy is that: "in the absence of a reliable lead-lag study approximating the utility's cash working capital needs or hardships that would justify departure from the established formula, a utility should use the 45 day convention."¹⁴⁸ AMP-Ohio's protest in the initial proceeding did not make any assertion that there was a lead lag study available, or that the 45 day convention would produce unjust and unreasonable results.

159. We grant parties' request for an earlier posting of the Annual Update. We believe that customers should receive such information earlier than October 15 in order to allow sufficient time to review the information before the meeting on October 31. Therefore, we will require that PATH provide the estimated revenue requirement for the following calendar year by September 1. These information sharing procedures will provide customers sufficient opportunity to monitor whether PATH is implementing the rate formula correctly.

The Commission orders:

(A) PATH's requested incentive rate treatments are hereby granted, as discussed in the body of this order.

(B) PATH's proposed formula rate is hereby accepted for filing and suspended for a nominal period, to become effective March 1, 2008, as requested, and set for hearing, as discussed in the body of this order.

¹⁴⁶ 18 C.F.R. Part 101, General Instructions No. 18, Comprehensive Interperiod Income Tax Allocation; and Text to Account 190, Accumulated Deferred Income Taxes, Account 236, Taxes Accrued, Account 281, Accumulated Deferred Income Taxes-Accelerated Amortization Property, Account 282, Accumulated Deferred Income Taxes-Other Property, and Account 283, Accumulated Deferred Income Taxes-Other.

¹⁴⁷ 117 FERC ¶ 61,214 at P 32, 39-43.

¹⁴⁸ *Id.* (citations omitted).

(C) PATH is hereby directed to submit a detailed report of pre-commercial costs as part of the evidentiary hearing proceedings ordered below, as discussed in the body of this order.

(D) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning PATH's proposed formula rates. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (E) and (F) below.

(E) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2007), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(F) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(G) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in this proceeding in a hearing room of the Commission, 888 First Street, NE, Washington, DC 20426. Such conference shall be held for the purpose of establishing a

procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission. Commissioner Kelly concurring and dissenting in part with a separate statement attached.

Commissioner Wellinghoff dissenting in part with a separate statement to be issued at a later date.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Potomac-Appalachian
Transmission Highline, L.L.C.

Docket No. ER08-386-000

(Issued February 29, 2008)

Kelly, Commissioner, *concurring and dissenting in part*:

This order addresses, among other things, incentive rate authorization proposed by Potomac-Appalachian Transmission Highline, L.L.C. (PATH). The PATH project at issue in the instant proceeding is a modification of two projects presented by American Electric Power Inc. (AEP) and Allegheny Energy Inc (Allegheny).¹ Both of the previous projects were already approved for incentive treatment, including returns on equity (ROE) in the upper end of the zone of reasonableness. I fully supported granting incentive treatment for both projects because I believed them to be “excellent transmission projects,” representing precisely the kind of projects to which the Commission should grant incentives, and I support granting incentives here.² With regard to ROE, PATH requests a 50 basis point adder to the authorized ROE in recognition of its participation in PJM, as well as approval of an ROE at the high end of the zone of reasonableness or, alternatively, approval of a 150 basis point adder to result in an overall ROE of 14.3 percent.

I dissent on a point of procedure. Rather than set the determination of PATH’s ROE for evidentiary hearing, the Commission establishes an ROE directly in this order. I disagree with the majority’s decision. Instead, I would have set the ROE determination for an evidentiary hearing, which heretofore has been the Commission’s practice. Despite language in Order 679-A that indicates that the Commission will consider an up-front ROE determination where sufficient support has been presented in the application,³ I do not believe that this is an appropriate means for arriving at a just and reasonable ROE. I note that the

¹ *Allegheny Energy Inc.*, 116 FERC ¶ 61,058 (2006), *order on reh’g*, 118 FERC ¶ 61,042 (2007) and *Amer. Elec. Power Serv. Corp.*, 116 FERC ¶ 61,059 (2006) (*AEP I*), *order on reh’g*, 118 FERC ¶ 61,041 (2007).

² *See* my statements on *Allegheny Energy Inc.*, 118 FERC ¶ 61,042 (2007) (Kelly, Comm’r, concurring) and *Amer. Elec. Power Serv. Corp.*, 118 FERC ¶ 61,041 (2007) (Kelly, Comm’r, concurring).

³ *Promoting Transmission Investment through Pricing Reform*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236, at P 70 (2006), *order on reh’g*, 119 FERC ¶ 61,062 (2007).

majority, in establishing an up-front ROE in a Southern California Edison proceeding on transmission incentives, which is being issued concurrently with this order in Docket No. ER08-375-000, acknowledges that failure to provide for an evidentiary hearing is a departure from the Commission's common practice. In that case, the Commission establishes a paper hearing "in order to give all parties an opportunity to present evidence to rebut the proposed ROE determination."⁴ I believe that a paper hearing is not an adequate substitute for an evidentiary proceeding before an Administrative Law Judge where parties have the opportunity for cross-examination, rebuttal, and oral argument. Further, the majority makes no attempt to distinguish between this proceeding and the Southern California Edison proceeding and explain why one proceeding requires a paper hearing and why one does not. I believe that such disparate treatment not only undermines the majority's basis for skipping directly to an ROE determination for the PATH project but also reinforces the notion that the Commission has adopted an ad hoc approach to granting transmission incentives in general.

More generally, I believe that the approach adopted in this order will encourage applicants to seek either an ROE identical to that of a previous applicant exhibiting similar characteristics or an ROE that is slightly higher. The result would be the granting of incentives based on previous applications rather than incentives "tailored to address the demonstrable risks or challenges faced by the applicant in undertaking the project."⁵ I have previously noted that, in Order No. 679-A, the Commission discussed the care that must be taken in granting incentive ROEs. We said "[a]lthough the Commission has broad discretion to establish returns on equity anywhere within the zone of reasonableness, we must be careful in the manner in which we exercise this discretion."⁶ I fail to see how the methodology adopted in this order to make an ROE determination has appropriately and reasonably exercised the discretion discussed in Order No. 679-A.

With regard to the instant proceeding, several parties assumed that the Commission would indeed set the ROE determination for hearing and thus appear to have not presented the full breadth of their views in their submitted comments. Given that the Commission's common practice has been to set such matters for hearing, whether in proceedings on incentives or otherwise, they can hardly be faulted for such an assumption. While arguing that the applicants' proposed proxy group did not ensure comparability, Old Dominion Electric Cooperative stated that it would

⁴ *S. Cal. Edison Co.*, 122 FERC ¶ 61,187, at P 27 (2008).

⁵ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 6.

⁶ *Id.* P 7.

leave to the development of testimony for presentation at hearing the selection of a proxy group that is comprised of companies that are truly comparable in risk to PATH and its service at issue here.^[7]

The sufficiency of the record relies not only on evidence provided by an applicant but also by intervening parties. Based on the statement above, as well as requests for an evidentiary hearing from other parties,⁸ I am not convinced that the record here accurately reflects views of all interested parties on the ROE issue. More generally, a Federal Power Act section 205⁹ proceeding provides interested parties 21 days to comment, whereas the timing of an evidentiary hearing is more accommodating. Consistently determining ROEs in the absence of evidentiary hearings will require interested parties, some of which rely on outside expertise in order to participate, to meaningfully respond in 21 days. This would drastically alter the schedule for such proceedings, most probably deny the Commission a full and robust record on which to base its determination and, I fear, undermine the confidence of transmission users that we are setting incentive ROEs with the care and consideration that they deserve.

If the concern is over the pace of an evidentiary hearing, I see no reason why the Commission could not direct an expedited hearing process,¹⁰ directed at specific facts, after having made preliminary determinations in the order setting those issues for hearing.

⁷ Old Dominion Electric Cooperative Jan. 19, 2008 Motion to Intervene, Protest and Request for Evidentiary Hearing, Docket No. ER08-386-000, at 25.

⁸ *See, e.g.*, Joint Consumer Advocates Jan. 18, 2008 Motion to Intervene, Protest and Request for Hearing, Docket No. ER08-386-000, at 10; *see also* Virginia State Corporation Commission Jan. 17, 2008 Motion to Intervene and Comments, Docket No. ER08-386-000, at 3.

⁹ 16 U.S.C. § 824d (2000 & Supp. V 2005).

¹⁰ I note that the Commission could establish an expedited hearing procedure for these types of cases. For example, Commission procedural regulations already provide for fast track hearing procedures for expedited hearings of complaints before an administrative law judge. *See* 18 C.F.R. § 385.206 (2007). The Commission's Office of Administrative Law Judges has correspondingly adopted procedures to implement this fast track process that provide for hearings within as few as three days of the Commission order setting the hearing and an initial decision within as few as eight days. *See* FERC Office of Administrative Law Judges Policies and Procedures Manual, § 2.36, Attachment A (2008), available at www.ferc.gov/legal/admin-lit/time-sum.asp.

My intention is not to dissuade transmission investment with this statement, particularly investment that resembles the PATH project. This is an exemplary transmission project, given the scope of PATH's investment, the relief the project will provide to ratepayers, the cooperative efforts of AEP and Allegheny, as well as many other factors. Further, as I note above, I have eagerly supported the individual projects that were combined to create the PATH projects and I continue to support them. However, I am compelled to concur and dissent in part based on the majority's approach to determining the ROE, which I believe fails to accord all interested parties the process they are due and lacks the careful consideration necessary to set an ROE appropriate to these circumstances.

For these reasons, I respectfully concur and dissent in part from this order.

Suedeem G. Kelly