125 FERC ¶ 61,237
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Corporation Commission of the State of Oklahoma

v. Docket No. EL08-80-000

American Electric Power Company, Inc.,
American Electric Power Service Corporation, and
Public Service Company of Oklahoma

ORDER ON COMPLAINT

(Issued November 26, 2008)

1. On August 11, 2008, the Corporation Commission of the State of Oklahoma (Oklahoma Commission) filed a complaint against American Electric Power Company, Inc. (AEP Inc.), American Electric Power Service Corporation (AEP), and Public Service Company of Oklahoma (PSO) alleging that, from June 15, 2000 through March 31, 2006, AEP violated the AEP System Integration Agreement (System Agreement) and the AEP West Operating Agreement (West Agreement) by improperly deviating from the trading margin[1] allocation methods set out in each agreement.

2. In this order, the Commission finds that AEP violated the System Agreement and directs AEP to recalculate and reallocate the trading margins in compliance with the System Agreement and to issue appropriate refunds within 30 days of the date of issuance of this order. Additionally, the Commission finds that AEP used an allocation method not on file with the Commission as part of the West Agreement, to allocate trading margins not otherwise addressed by that agreement. However, because we find that the allocation method AEP used appears to be reasonable, we direct AEP to submit a filing within 30 days of the date of issuance of this order revising the West Agreement for the period in question, as discussed below.

[1] Trading margins are profits from off-system transactions.

I. **Background**

3. On March 15, 2000, the Commission approved the merger of the AEP-owned electric utilities in the East (AEP East)[2] and the Central and South West (CSW) utilities (AEP West),[3] effective June 15, 2000.[4] As part of the merger, the Commission approved the System Agreement, which provides coordinated planning and operation of transmission and power supply resources between AEP East and AEP West, including marketing of excess power supplies off-system and allocation between AEP East and AEP West of margins from such off-system sales.[5] The West Agreement provides for coordinated planning and operation of resources among the AEP West utilities, including allocation of trading margins among the AEP West utilities. The West Agreement, accepted by the Commission in 1998,[6] remained largely unchanged as a result of the merger.

4. Under Schedule D of the System Agreement, as approved in the Merger Order, "Trading and Marketing Realizations" (Realizations) from long-term off-system sales entered into prior to the merger were directly assigned to the zone (East or West) in which the sale originated. "Realizations" are defined as "the difference between (i) revenues collected from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities."[7] Realizations from all other transactions were allocated according to a two-tier system. The first tier was to use relative historical levels of Realizations during a

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[2] AEP East Companies consists of Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, and Ohio Power Company.

[3] At the time of the merger, AEP West Companies consisted of PSO, Southwestern Electric Power Company, AEP Texas Central Company (TCC), and AEP Texas North Company (TNC). Effective May 1, 2006, TCC and TNC were removed from the System Agreement.

[4] *See American Electric Power Co. and Central and South West Corp.*, 90 FERC ¶ 61,242 (2000) (Merger Order).

[5] *See id.* at 61,799.

[6] *See Central Power and Light Co.*, 83 FERC ¶ 61,070 (1998).

[7] *See* System Agreement, section 1.39.

"Base Year" consisting of the twelve months prior to consummation of the merger.[8] The second tier transactions, consisting of Realizations above Base Year levels, were to be allocated based on generating capacity owned by the companies in each zone.[9]

5. Additionally, Schedule D contains a "sunset" provision, providing that the methodology for allocating Realizations will be in effect until January 1, 2006, and requiring AEP to file by November 1, 2005 a proposed methodology for allocating Realizations thereafter. On March 20, 2006, in Docket No. ER06-141-000, the Commission accepted AEP's revised Schedule D submitted in compliance with the sunset provision effective April 1, 2006.[10] The 2006 revisions to Schedule D changed the trading margin allocations to a direct assignment method, which effectively eliminated margin sharing between the East and West zones and which alleviates, for the period after January 1, 2006, the concerns raised in this proceeding.[11] In addition, Article

[8] Under Article I, section 1.9 of the System Agreement, "Base Year" means:

> the relative percentages of the total Trading and Marketing realization from Off-System Sales (other than Off-System Sales having a term of one-year or longer entered into prior to the Merger) received by the AEP Operating Companies [AEP East], on the one hand, and the CSW Operating Companies [AEP West], on the other hand, during the last full twelve (12) calendar month period prior to the Effective Time as defined in the Agreement and Plan of Merger (the "Base Year").

[9] The two-tier allocation system is set forth in section D3 of schedule D and provides, in pertinent part:

> D3 - <u>Allocation of Trading and Marketing Realizations</u> The Agent shall determine the Trading and Marketing Realizations on an hourly basis. The sum of the hourly amounts for each billing period (adjusted to remove realizations associated with long-term Off-System Sales) shall be allocated between the AEP East Zone and the AEP West Zone up to the level of realizations achieved in the Base Year in accordance with the Base Year Allocation. Any such Trading and Marketing realizations in excess of the level of realizations achieved in the Base Year will be shared according to the ratio of owned generating capacity in the two zones. Realizations associated with long-term Off-System Sales shall be assigned to the zone in which such sales were initiated…

[10] *American Electric Power Serv. Corp.*, 114 FERC ¶ 61,288 (2006).

[11] *See id.* P 5 (describing the revised trade margin allocation methodology).

IV, section 4.1 of the System Agreement provides that the System Agreement "is intended to

apply in addition to and not in lieu of the AEP Interconnection Agreement [which governs the AEP East operations and is not at issue in this proceeding] and the [West Agreement]."

II. <u>Oklahoma Commission's Complaint</u>

A. <u>System Agreement</u>

6. The Oklahoma Commission, which regulates PSO's retail service, states that, during the course of a state proceeding regarding PSO's 2001 Fuel Adjustment Clause, parties in that proceeding alleged that AEP misallocated trading margins between AEP East and AEP West and misallocated trading margins among the AEP West utilities to the detriment of PSO ratepayers.[12] Specifically, the Oklahoma Commission states that for the first six months after the merger, AEP used only "realized" revenues in calculating the Base Year allocation ratio. However, in December 2000, AEP adopted "mark-to-market" accounting for the Base Year allocation ratio, under which AEP included the value of forward market positions that remained open at the end of the Base Year but for which the revenues were *un*realized (i.e., were not yet collected) during the Base Year. According to the Oklahoma Commission, parties to the state proceedings alleged that AEP unilaterally changed the allocation formula under the System Agreement making the change retroactive to the effective date of the AEP merger. Further, the Oklahoma Commission notes that AEP's inclusion of *un*realized revenues as "Realizations" in the Base Year allocation violated section 1.9 of the System Agreement, which requires the margins to be allocated based on the actual "Realizations" from off-system sales. According to the Oklahoma Commission, the change in the formula caused an increase in the Base Year levels in AEP East by $84.2 million and a decrease to the Base Year level allocation to the AEP West operating companies from 12.95 percent to 9.029 percent. The Oklahoma Commission also notes that parties argued that this change in allocation method directly benefitted AEP because the AEP West utilities share trading margins on off-system sales with their ratepayers while many of the AEP East operating companies do not share any trading margins with ratepayers. Instead, AEP shareholders retain 100 percent of the benefits.[13]

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[12] *See* Oklahoma Commission Complaint at 8. The Oklahoma Commission notes that these allegations were also made in the 2006 and 2007 annual reviews of PSO's Fuel Adjustment Clause. *Id.* at n.8.

[13] *Id.* at 9.

B. West Agreement

7. The Oklahoma Commission states that, under the terms of the West Agreement, PSO received revenue from its participation in economy electricity sales and other non-firm wholesale opportunity sales to unaffiliated entities made by AEP West, i.e., off-system sales. The Oklahoma Commission also states that the Schedule F of the West Agreement specifies that these trading margins are to be allocated among the AEP West companies using a "participation ratio," which is the degree to which each utility contributed its generating plants to the production of off-system sales.

8. According to the Oklahoma Commission, for the first six months after the merger AEP used the participation ratio to allocate among the AEP West utilities AEP West's share of the combined AEP East and AEP West trading margins. The Oklahoma Commission states that in December 2000, AEP unilaterally changed from the use of the participation ratio to the use of a "peak load factor," i.e., the ratio of each AEP West utility's maximum demand during a month to the combined maximum demand of the AEP West utilities during that month. AEP used the peak load factor retroactively to the effective date of the merger and going forward. Further, the Oklahoma Commission states that AEP's unilateral change to the use of a peak load factor from the use of a participation ratio violated the West Agreement and caused PSO's share of the allocation among the AEP West utilities to decrease from 31 percent to 26 percent.

9. Further, the Oklahoma Commission states that in August 2007, it issued an order finding that the Commission is the only entity with jurisdiction to interpret and enforce the application of the System Agreement and West Agreement.[14] Additionally, the Oklahoma Commission notes that similar allegations regarding AEP's allocations of trading margins under the System Agreement have also been raised before the Public Utility Commission of Texas but that AEP successfully challenged that state Commission's assertion of jurisdiction.[15]

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[14] *See id.* at 10.

[15] *Id.* at 14-15 (citing *AEP Texas North Co. v. Hudson,* 389 F.Supp.2d 759 (W.D.Tex. 2005); *aff'd AEP Texas North Co. v. Texas Indus. Energy Consumers,* 473 F.3d 581 (5th Cir. 2006); *cert. denied sub. nom. Hudson v. AEP Texas North Co.*, 128 S.Ct. 59 (2007)). The Texas Commission also asserted jurisdiction over AEP's allocations of trading margins under the West Agreement, which AEP also successfully challenged. *See AEP Texas Central Co. v. Hudson,* 441 F.Supp.2d 810 (W.D. Tex.

(continued…)

10. The Oklahoma Commission requests that the Commission determine whether it has jurisdiction to interpret and enforce AEP's application of the System and West Agreements; whether AEP properly interpreted and implemented those agreements; and the proper allocations that should have been made if the Commission finds that AEP violated the agreements. The Oklahoma Commission also requests that the Commission perform an audit of AEP's allocations under the System Agreement and West Agreement from the effective date of the merger through the effective date of the revised System Agreement, direct AEP to refund any amounts improperly allocated, and order any other appropriate remedies.

III. Notice of Complaint and Responses

11. Notice of the Oklahoma Commission's complaint was published in the *Federal Register*, 73 Fed. Reg. 48,379 (2008), with interventions and answers due on or before September 2, 2008. On August 14, 2008, AEP filed an unopposed motion for an extension to September 12, 2008, to file its answer, which was granted on August 15, 2008. The Oklahoma Industrial Energy Consumers (OIEC) filed a timely motion to intervene and comments. On September 12, 2008, AEP filed its answer in response to the complaint and in response to OIEC's comments. The Arkansas Public Service Commission, the Oklahoma Attorney General, and the Public Utility Commission of Texas filed motions to intervene out of time. On October 31, 2008, OIEC filed an answer to AEP's answer and on November 17, 2008, AEP filed an answer to OIEC's answer.

12. In its comments, OIEC states that it was one of the parties that raised the allegations before the Oklahoma Commission. OIEC reiterates the allegations made in the complaint and states that it supports the complaint. OIEC adds that in one of the state proceedings AEP admitted that it modified the allocation methodologies under both agreements without receiving appropriate concurrence to make those modifications. OIEC argues that, by unilaterally changing the allocation methodologies set forth in the agreements without seeking approval from the Commission, AEP violated the filed tariff, i.e., the System and West Agreements.

13. Additionally, OIEC asserts that the Oklahoma Commission has jurisdiction to enforce the terms of the System and West Agreements where the Commission has not exercised such jurisdiction. It states that, if the Commission decides to exercise jurisdiction over this matter, OIEC supports the Oklahoma Commission's request for the Commission to determine if AEP violated the System and West Agreements and to direct AEP to issue refunds.

2006), *aff'd AEP Texas Central Co. v. Hudson*, unpublished opinion 259 Fed. Appx. 625 (2007).

IV. AEP's Answer

A. System Agreement

14. AEP acknowledges that in December 2000 it adopted mark-to-market accounting for the Base Year allocation ratio in order to include unrealized revenues in the Base Year. AEP defends its inclusion of unrealized revenues in the Base Year in three ways. First, AEP states the Oklahoma Commission's reading of section 1.39 of the System Agreement suggests that AEP should have based the Base Year Allocation on only a portion of the trading and marketing activity on the AEP East system in the year prior to the merger even though section 1.9 refers to "total" realizations. AEP argues that section 1.39 is not the relevant provision, because Schedule D, section D3, which defines the amounts to be allocated, does not use the defined term "Trading and Marketing Realization." Further, AEP argues, even assuming that section 1.39 is relevant, that definition does not suggest an intent to eliminate a significant portion of the trading and marketing activity from the Base Year Allocation.[16]

15. Second, AEP states that the use of mark-to-market accounting conformed to a 1999 change in U.S. Generally Accepted Accounting Principles (GAAP) issued by the Financial Accounting Standards Board. AEP states that use of mark-to-market accounting was the industry practice during the Base Year; therefore, its use reflected the same methods required to value these transactions in AEP's books and records. AEP states that for the first months after the merger, however, the individuals responsible for the System Agreement calculated the Base Year Allocation incorrectly by leaving out open transactions. Further, AEP states, while it initially implemented the System Agreement incorrectly, it subsequently fixed that incorrect allocation. AEP argues that this was not a change in its method under the System Agreement but a correction to implement how the System Agreement should have been administered.

16. Third, AEP states that the System Agreement does not contain a precise formula for calculating marketing and trading margins. Rather, AEP states, section 3.1 of the System Agreement requires that it ensure an equitable allocation of the costs and benefits from coordinated operations,[17] and section 9.1 provides that that the service schedules are

[16] *See* AEP Answer at 16.

[17] Section 3.1, "Purpose," provides:

(continued…)

intended to and should be applied to achieve an equitable allocation.[18] AEP states that the Base Year allocation was designed to allow the AEP East and West Companies to retain a level of trading margins after the merger comparable to what they would have had without the merger. In addition, AEP states the AEP East Companies were heavily engaged in physical and financial trading of electricity prior to the merger while the AEP West Companies were not. AEP argues that unless open transactions were included, the Base Year allocations would not have represented the respective contributions of AEP East and AEP West and would have unfairly understated AEP East's contributions.

17. AEP argues that its allocation of margins was more than equitable to the AEP West Companies. AEP states that its inclusion of open transactions resulted in an allocation to the West Companies of off-system margins that far exceeded the value of their own activities. AEP states that the average annual amount allocated to AEP West during the 2000-2006 period was $82.1 million compared to the $25.1 million in CSW's actual margins during the Base Year. AEP adds that the corresponding post-merger share of margins allocated to PSO under the System Agreement was $25.2 million per year, which is 5.7 times its Base Year margin contribution. AEP argues that while AEP West received a greater amount of margin revenues as a result of the merger, the AEP West Companies' post-merger contribution decreased to below Base Year levels and averaged $14.1 million during the period at issue.

18. Additionally, AEP acknowledges that during the period at issue, several AEP East utilities were subject to rate freezes, resulting in AEP having to share a smaller amount of the margins with retail customers in AEP East. However, AEP argues, the System

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> The purpose of this Agreement is to provide the contractual basis for coordinated planning, operation and maintenance of the power supply resources of the Combined System to achieve economies consistent with the provision of reliable electric service and an equitable sharing of the benefits and costs of such coordinated arrangements.

[18] Section 9.1, "Service Schedules," provides:

> It is understood and agreed that all such Service Schedules are intended to establish an equitable sharing of costs and/or benefits among the Parties, and that circumstances may, from time to time, require a reassessment of relative benefits and burdens or of the methods used in the Service Schedules to apportion the benefits and burdens. Upon a recommendation of the Operating Committee and agreement among the Parties, any of the Service Schedules may be amended as of any date agreed to by the Parties, subject to receipt of necessary regulatory authorization.

Agreement directed AEP to allocate benefits between the two zones in an equitable manner including ensuring that AEP East retained the benefits of its own off-system transactions associated with the Base Year amounts. AEP argues that the Commission and the courts have long held that cost allocation should be based on equity,[19] including as it applies to allocation of costs in a regulated holding company.[20] AEP points to *Louisiana Public Service Commission v. Entergy Corporation*[21] for the premise that equitable sharing of profits from off-system sales should reflect the relative contributions that the East and West Companies make individually to those profits.

B. <u>West Agreement</u>

19. AEP argues that it did not violate the West Agreement. AEP notes that section 6.7 of the West Agreement anticipates certain energy exchanges and that, prior to the merger, the CSW companies participated in physical off-system sales and purchases only. AEP adds that the West Agreement anticipates margins from physical energy exchanges with non-associated entities, which under section 6.7 are "implemented by decremental or incremental System Economic Dispatch."[22] According to AEP, any margins generated from those physical sales and purchases were allocated pursuant to Schedule F. However, AEP states, the West Agreement, which was approved long before the merger, does not expressly address the allocation methodology to be used to allocate AEP West's share of the trading margins received from AEP East activities after the merger.

20. AEP states that for the first months after the merger, the individuals responsible for administering the West Agreement mistakenly used participation ratios to allocate all off-system margins, including the margins from the transactions on the East system. AEP states that it realized that under this method certain West companies with negative participation ratios would be allocated a negative share of the margins for some billing periods. For example, AEP states, in October 2000, the participation ratio method would

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[19] *See* AEP Answer at 20 (*citing Colorado Interstate Gas Co. v FPC*, 234 U.S. 581, 591 (1945).

[20] *Id.* (*citing Middle South Energy, Inc.*, 31 FERC ¶ 61,305 (1985), *reh'g denied*, 32 FERC ¶ 61,425 (1985), *aff'd sub nom. Mississippi Industries v. FERC*, 808 F.2d 1525 (D.C. Cir. 1987), *reh'g granted, vacated in part and remanded*, 822 F. 2d 1104 (D.C. Cir. 1987), *order on remand*, 41 FERC ¶ 61,238 (1987), *reh'g denied*, 42 FERC ¶ 61,091 (1988))

[21] 106 FERC ¶ 61,228, at P 77 n.148 (2004), *petition for review granted on other grounds*, *Louisiana Public Serv. Comm. v. FERC*, 482 F.3d 510 (D.C. Cir. 2007).

[22] AEP Answer at 22 (*citing* West Agreement, section 6.7).

have required TNC to pay $1.4 million to the other West companies over and above the margins allocated to the other West companies under the System Agreement. According to AEP, such a result "made no sense in circumstances where all of the AEP Companies were supposed to receive an allocation of the beneficial trading allocated under the [System Agreement]."[23] AEP states that in order to rectify this anomalous result, it began to use a peak load allocation methodology.

21. AEP argues that this peak load methodology was consistent with Commission precedent for allocation of wholesale costs and revenues and with the way in which the same allocation was conducted under the agreement for coordinated planning and operation of resources among the AEP East utilities. It adds that this method was based on readily available data, was easy to administer, and resulted in positive allocations to all of the West companies. AEP notes that it continued to use the participation ratio methodology to allocate margins that were physically generated by West generating resources, as required under the West Agreement. AEP adds that the use of the peak load benefited PSO in comparison to using the participation ratios and that, regardless of that benefit, AEP applied the West Agreement consistently with the intent of achieving an equitable allocation of benefits from trading activities other than the profits produced from generating assets on the AEP West Companies' systems.

22. In response to OIEC's comment that AEP admitted to modifying the allocation methodologies under the System and West Agreements, AEP argues that its witness answered in the negative in response to questions about whether AEP had changed the System Agreement or the West Agreements.

23. Additionally, AEP argues that the Commission should not order refunds even if it disagrees with AEP's implementation of the System and West Agreements. AEP argues that because the issue in this case involves whether AEP complied with the filed rate, section 309 of the Federal Power Act (FPA)[24] provides that refunds are discretionary.[25] AEP also argues that the refunds are not mandated under the FPA when the rate charged

[23] *Id.* at 23-24.

[24] 16 U.S.C. § 825h (2000).

[25] AEP Answer at 27 (*citing Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967) (*Niagara Mohawk*).

exceeds that filed.[26] AEP states that in *Koch Gateway Pipeline Co. v. FERC*,[27] the court vacated a Commission order requiring refunds for a tariff violation because the violation did not implicate the concerns of the filed rate doctrine (notice to customers), there was no windfall to the pipeline, and it was not clear that a refund would deter future abuses.[28]

24. AEP also states that, like the instant case, *Louisiana Public Service Commission v. FERC*[29] involved an agreement among companies of a multi-state holding company system. AEP argues that there the court upheld the Commission's orders finding a tariff violation but held that the equities of that case did not support a refund because the end result of the tariff violation was not unjust, unreasonable, or unduly discriminatory.[30] AEP argues that the allocations of trade margins between the East and West companies and subsequently among the West companies were consistent with the System and West Agreements and were more than fair to the West companies. Thus, AEP argues equities weigh against requiring refunds. Additionally, AEP also supports its position that refunds should not be required by pointing to section 206(c) of the FPA, which provides that the Commission may order refunds only if it first "determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of such increase."[31]

V. Discussion

A. Procedural Matters

25. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), OIEC's timely, unopposed motion to intervene serves to make OIEC a party to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedures, 18 C.F.R § 385.214(d) (2008), the Commission will

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[26] *See id.* at 28 (*citing Towns of Concord v. FERC*, 955 F.2d 67, 72 (D.C. Cir. 1992)).

[27] 136 F.3d 810 (D.C. Cir. 1998) (*Koch Gateway*).

[28] AEP Answer at 28 (*citing Koch Gateway*, 136 F.3d at 816-18).

[29] 174 F.3d 218 (1999) (*Louisiana PSC*).

[30] AEP Answer at 28 (*citing Louisiana PSC*, 174 F.2d at 223).

[31] *Id.* at 29 (*citing* 16 U.S.C. § 824e(c) (2006)).

grant the late-filed motions to intervene of the Arkansas Public Service Commission, the Oklahoma Attorney General, and the Public Utility Commission of Texas given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

26. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to an answer unless otherwise ordered by the decisional authority. We are not persuaded to accept the answers filed by OIEC and AEP and will, therefore, reject them.

B. Analysis

27. As discussed further below, we grant in part and deny in part the Oklahoma Commission's complaint.

1. System Agreement

28. We find that AEP's inclusion of unrealized revenues in the Base Year ratio calculation violated the System Agreement. AEP argues that reflecting unrealized revenues, gains or losses on transactions that were open during the Base Year, was consistent with the System Agreement. We disagree. The System Agreement provides in pertinent part:

> 1.9 Base Year Allocation means the relative percentages of the total Trading and Marketing realization from Off-System Sales . . . *received* by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other hand, during the last full twelve (12) calendar month period prior to the Effective Time as defined in the Agreement and Plan of Merger (the "Base Year").[32]

29. Additionally, "Marketing and Trading Realizations" is defined under section 1.39 of the System Agreement as "the difference between (i) *revenues collected* from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities."[33]

30. We find AEP's reading of the System Agreement to allow it to include the value of unrealized transactions to be unreasonable. A reasonable interpretation of the term "realizations" under section 1.9 and throughout the provisions of the System Agreement addressing the sharing of off-system sales margins between the East and West companies

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[32] System Agreement, section 1.9 (emphasis added).

[33] System Agreement, section 1.39 (emphasis added).

is that such term must be read to include only transactions that had actually closed during the Base Year. Further, the use of the word "received" in section 1.9 and "revenues collected" in section 1.39 belies AEP's argument that uncollected revenues should have been included in the calculation of the Base Year allocation ratio. We find AEP's attempt to divorce section 1.39 from applicability to section D3 to be unpersuasive and inconsistent with the terms of the System Agreement taken as a whole. The way in

which the System Agreement uses the term "realization" leads to the conclusion that only closed, realized transactions, not estimates of future values to be collected, were to be included in the Base Year ratio.

31. Further, we find that the use of mark-to-market accounting for trading and marketing activities reflected for financial statement purposes, as allowed under the 1999 change in GAAP, may have been appropriate for financial reporting purposes (i.e., statements submitted to the U.S. Securities and Exchange Commission, the public, and others). However, the use of mark-to-market accounting was inappropriate for calculating the Base Year ratio under the System Agreement, where "realizations" was a defined term specifying only the use of realized revenues.

32. We also find unconvincing AEP's reliance on general provisions of sections 3.1 and 9.1 of the System Agreement to support its position that its inclusion of unrealized transactions was a reasonable application of the System Agreement's requirement that allocations be made in an equitable manner. Sections 3.1 and 9.1 define the general purposes of the System Agreement. However, these general provisions cannot override the specific requirements of sections 1.9 and 1.39 and section D3 of Schedule D, which specify how trading margins are to be allocated between the AEP East and AEP West companies. Furthermore, section 9.1 requires not just that allocations be equitable, but also that if the allocations are reassessed, that any subsequent reapportionment be done by amending the Service Schedules, subject to receipt of necessary regulatory authorization.[34] In December 2000, AEP reapportioned the trading margins without amending the relevant Service Schedule (D3) and without receiving Commission

[34] It is understood and agreed that all such Service Schedules are intended to establish an equitable sharing of costs and/or benefits among the Parties, and that circumstances may, from time to time, require a reassessment of relative benefits and burdens or of the methods used in the Service Schedules to apportion the benefits and burdens. Upon a recommendation of the Operating Committee and agreement among the Parties, *any of the Service Schedules may be amended as of any date agreed to by the Parties, subject to receipt of necessary regulatory authorization*. System Agreement, section 9.1 (Emphases added).

authorization. Thus, the Commission finds that AEP's inclusion of unrealized revenues as part of the Base Year realizations violated the System Agreement.

33. Accordingly, we direct AEP to recalculate the trading margins to remove the open transactions from the Base Year that we have found above to have been improperly included in the Base Year. Further, we direct AEP to issue any refunds resulting from this recalculation for the June 15, 2000 to March 31, 2006 period. AEP asserts that refunds should not be required. AEP is correct that the FPA does not mandate that refunds be issued where excessive rates are charged. Further, as AEP admits, the Commission has discretionary authority to require that refunds be made.[35] AEP cites *Louisiana Public Service Commission v. FERC* as an instance in which a court affirmed the Commission's exercise of discretion not to order refunds.[36] However, as noted by the court in *Louisiana PSC*, the Commission's general policy is to order refunds for overcharges.[37] In *Louisiana PSC,* the Commission made an exception to this general policy because, while the transmission provider violated a jurisdictional agreement, that violation resulted in benefits to the transmission provider's system as a whole, including benefits to the operating companies that were allegedly injured, and the benefits were found to outweigh any injury.[38] In contrast, here AEP's actions benefitted certain AEP utilities to the detriment of certain other AEP utilities. Moreover, in *Louisiana PSC*, the Commission found that refunds were not appropriate because the transmission provider as a whole received no net gain from the violation.[39] In contrast, here AEP's violation of the System Agreement provided AEP shareholders with a net gain, due to the rate freezes in effect at the time for some of the AEP East utilities. Therefore, we find refunds to be appropriate in this case. Additionally, the Commission finds to be misplaced AEP's reliance on section 206(c) of the FPA, which addresses the Commission's authority to issue refunds with regard to utilities in registered holding companies. Section 206(c) applies to refunds directed under section 206(b) of the FPA,[40] not to those directed as a

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[35] *See Consolidated Edison of N.Y. v.* FERC, 347 F.3d 964, 972 (D.C. Cir. 2003) (*ConEd*); *Towns of Concord v. FERC*, 955 F.2d at 72 ("As to the necessity of refunds to deter violations of the statue, the Act leaves this determination to the Commission's expert judgment.") (*Towns of Concord*); *Niagara Mohawk*, 379 F.2d at 159.

[36] *Louisiana Public Serv. Comm. v. FERC*, 174 F.3d 218 (1999) (*Louisiana PSC*).

[37] *Id*. at 223; *see also ConEd*, 347 F.3d at 972.

[38] *Id*. at 225; *see also ConEd*, 347 F.3d at 972; *Towns of Concord*, 955 F.2d at 73.

[39] *Id*. at 229.

[40] 16 U.S.C. § 824e(b) (2006).

result of a violation of the filed rate as the Commission has found here. Accordingly, we direct AEP to recalculate the trading margins, issue refunds with interest calculated pursuant to section 35.19a of the Commission's regulations,[41] and file a report describing the reallocation between AEP East and AEP West for the June 15, 2000 through March 31, 2006 period, within 30 days of the date of issuance of this order. The report

should detail, separately for AEP East and AEP West companies, the amount originally allocated and the amount received by each company after the reallocation. The report should also provide the underlying data used to calculate the Base Year allocation ratio.

2. West Agreement

34. The Commission finds that AEP's use of a peak load factor to allocate AEP East-derived trading margins did not violate the West Agreement, which as AEP states, did not anticipate or specify the allocation of trading margins generated by the East companies among the West companies. However, we find that by using a methodology that was neither specified under the West Agreement nor filed with or approved by the Commission, AEP violated section 205(c) of the FPA,[42] which requires that all terms and conditions of service be on file with the Commission.

35. AEP states that it initially allocated the trading margins received from the East companies pursuant to Schedule F of the West Agreement. Schedule F provides:

> Schedule F
> 14.1 Purpose
> The purpose of this Schedule is to establish the basis for distributing among the Companies the Margin on off-System Energy purchases and sales.
>
> 14.2 Distribution of Margin
> Any Margin on off-System Energy purchases and sales shall be distributed to the Companies in proportion to the relative magnitude of the sums for each Company of the Energy generated or not generated by such Company in order to participate in Internal Economy or off-System purchases or sales.

36. Under the West Agreement's definitions, "Company" and "Companies" means one or all of "the Central and South West Corporation operating companies," and "System" means "the coordinated Generating Units of the Companies."

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[41] 18 C.F.R. § 35.19a (2008).

[42] 16 U.S.C. § 824d(c) (2000).

37. The Commission agrees with AEP that the participation ratio provision did not apply to margins resulting from AEP East trading. The West Agreement's participation ratio provision refers to margins from off-*System* sales and purchases, and the West Agreement defines "System" as AEP West generating units. Therefore, we find that the Schedule F of the West Agreement does not apply to margins resulting from other generating units, i.e., AEP East generating units.

38. However, having concluded that no West Agreement provision applied to margins resulting from AEP East generating units, AEP was not free to proceed on its own. Instead, section 205(c) of the FPA required AEP to file to amend the West Agreement to govern the allocation.[43] Nevertheless, while the Commission finds that AEP's use of a peak load factor for allocating AEP East-derived revenues without filing the methodology with the Commission violated the FPA, we will not require AEP to issue refunds for this violation. As AEP explained, use of the participation ratio would have yielded anomalous results. AEP demonstrated that, at least in one instance, use of participation ratios would require a West company to pay other West companies when all of the West companies should have received a positive portion of such margins. Under the terms of the System and West Agreements, none of the West companies should have been worse off as a result of the West system receiving additional revenues from the East system. Further, the use of an easy to administer, readily available allocation method that was similar to one used to allocate margins among AEP East companies does not appear to be unreasonable. However, AEP was required first to seek Commission approval prior to using such a method. Accordingly, to remedy this violation we will require AEP to submit a filing within 30 days of the date of issuance of this order revising the West Agreement for the June 15, 2000 to March 31, 2006 period to reflect the methodology that it actually used to allocate margins derived from AEP East among the West companies.

C. <u>Other Issues</u>

39. The Oklahoma Commission requests that this Commission perform an audit of AEP's allocations under the System Agreement and the West Agreement. The Commission finds an audit to be unnecessary. While the Oklahoma Commission asserts

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[43] Section 205(c) of the FPA, 16 U.S.C.§ 824d(c) (2006), states, in relevant part:

> [E]very public utility shall file with the Commission . . . schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

that AEP used methods for allocating margins other than those identified in the System and West Agreements, it does not allege any defects in the data or the calculations AEP used. Accordingly, the Oklahoma Commission's request for an audit is denied.

The Commission orders:

(A) The Oklahoma Commission's complaint is hereby granted, in part, and denied in part, as discussed in the body of this order.

(B) AEP is hereby directed to recalculate the trading margins associated with the System Agreement, issue refunds and file a report within 30 days of the date of issuance of this order, as discussed above.

(C) AEP is hereby directed to submit a filing to reflect the methodology it used to allocate margins derived from AEP East among the West companies within 30 days of the date of issuance of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.