125 FERC ¶ 61,280
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.

Dynegy Midwest Generation, Inc. Docket No. EL05-72-003

ORDER DENYING IN PART, AND GRANTING IN PART, REHEARING

(Issued December 9, 2008)

1. Dynegy Midwest Generation, Inc. (Dynegy) requests rehearing of the Commission's decision in Opinion No. 498.[1] In Opinion No. 498, among other things, the Commission examined Dynegy's revenue requirement for Reactive Supply and Voltage Control from Generation Sources Service (reactive power service) and found that Dynegy's use of a plant-by-plant approach to calculate the numerator of the second ratio used to develop the remaining power plant investment allocator (RPPIA)/balance of plant (BOP) allocator was unjust and unreasonable and directed that Dynegy instead use a simultaneous approach. The Commission also found that a separate heating losses component in Dynegy's reactive power revenue requirement to recover the fixed costs associated with heating losses was not just and reasonable because the fixed costs associated with heating losses were already reflected in Dynegy's reactive power revenue requirement. Additionally, the Commission found that Dynegy failed to justify recovery of any variable costs associated with heating losses. For the reasons discussed below, we deny Dynegy's rehearing request with respect to these issues. However, we grant rehearing to clarify our policy concerning recovery of variable costs associated with heating losses in the context of prior Commission precedent and we establish a separate rate for recovery of variable costs associated with heating losses.

[1] *Dynegy Midwest Generation, Inc.*, Opinion No. 498, 121 FERC ¶ 61,025 (2007) (Opinion No. 498).

I. Background

2. In November 2004, Dynegy proposed a cost-based revenue requirement for providing reactive power service to Illinois Power Company (Illinois Power). The proposed revenue requirement consisted of two components: a fixed capability component that Dynegy claimed was calculated according to the *AEP* methodology,[2] and a heating losses component designed to recover the cost of real power caused by increased generator and transformer heating losses resulting from the actual production of reactive power.[3] Dynegy's rate schedule was accepted by a delegated letter order.[4]

3. In March 2006, the Commission denied rehearing of the delegated letter order, but instituted an investigation into Dynegy's rates pursuant to section 206 of the Federal Power Act (FPA).[5] Following unsuccessful settlement discussions, a hearing was held and the Presiding Judge issued an Initial Decision,[6] which the Commission affirmed in part and reversed in part in Opinion No. 498.

II. Request for Rehearing

A. Appropriate Method for Determining the RPPIA/BOP Allocator

1. Initial Decision and Opinion No. 498

4. Under the *AEP* methodology, allocators are developed to separate the reactive power production function of: (1) the generator-exciter, (2) generator step up transformers, (3) accessory equipment and (4) remaining production plant investment

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[2] The *AEP* methodology was developed for American Electric Power Service Corp. (AEP) in *American Electric Power Service Corp.*, Opinion No. 440, 88 FERC ¶ 61,141 (1999) (*AEP*). It is discussed in detail in Opinion No. 498, 121 FERC ¶ 61,025 at P 3-5.

[3] Dynegy proposed a $5,015,854 revenue requirement for the fixed capability component and a $2,568,946 revenue requirement for the heating losses component, for a total proposed annual reactive power revenue requirement of $7,584,800.

[4] *Dynegy Midwest Generation, Inc.*, Docket No. ER05-270-000 (Jan. 25, 2005) (unpublished letter order), *reh'g denied*, 110 FERC ¶ 61,358 (2005) (March 2006 Order).

[5] 16 U.S.C. § 824d (2006). The Commission set a refund effective date of June 7, 2005.

[6] *Dynegy Midwest Generation, Inc.*, 116 FERC ¶ 63,052 (2006) (Initial Decision).

from their real power production function. As a result, entities are able to develop a fixed capability component that accounts for the reactive power costs associated with these four components of production plant. The RPPIA/BOP allocator is the allocator used to determine the reactive power costs associated with remaining production plant investment. The RPPIA/BOP allocator is the product of two ratios. The first ratio, which was not contested in this proceeding, is Exciter MW/Generator MW. The second ratio, which is at issue in this proceeding, is maximum MVars/nameplate MVars. Dynegy calculated maximum MVars on a plant-by-plant basis; that is, it calculated maximum MVars for each of its plants individually. Illinois Power argued that Dynegy should have calculated maximum MVars for all of its plants simultaneously. In the Initial Decision, the Presiding Judge held that it was reasonable for Dynegy to use the plant-by-plant approach.

5. In Opinion No. 498, the Commission reversed the Presiding Judge and found that Dynegy's use of the plant-by-plant approach was unjust and unreasonable. The Commission explained that the plant-by-plant approach deviates from the *AEP* methodology, whereas the simultaneous approach is equivalent to the approach followed in *AEP*. The Commission further explained that the *AEP* methodology was initially developed for AEP, which, like Dynegy, operates a fleet of generating units, and that the cases where the Commission accepted the plant-by-plant approach involved independent power producers (IPPs) that did not operate a fleet:

> [T]he simultaneous approach [is] just and reasonable for a fleet of generating units because not all generators provide maximum reactive power output at the time of system peak. In other words, different generators provide their maximum reactive power output at different times (i.e., diversity among reactive power outputs of generators) so that some generators always have reactive power available to the transmission operator as reactive reserves to respond to changes in system voltage due to unexpected transmission or generation outages. Thus, the simultaneous method most closely represents the way that a fleet of generators would provide reactive power by recognizing the diversity of the generators. A plant-by-plant approach does not reflect this diversity in reactive power output because it allows the fleet operator to selectively choose which times to model each generator, resulting in higher rates. The simultaneous method precludes fleet operators from cherry-picking the best days for each generator in order to inflate rates.[7]

2. Argument on Rehearing

6. Dynegy objects to the Commission's strict application of the *AEP* methodology, arguing that strict compliance with all aspects of its original expression may not always

[7] Opinion No. 498, 121 FERC ¶ 61,025 at P 39.

be feasible or make the most sense in a particular case, ignores its evolution, and unduly discriminates against Dynegy, which as an IPP should be permitted to use the plant-by-plant approach like other IPPs.[8] Dynegy also claims that Illinois Power failed to meet its burden of demonstrating that the plant-by-plant approach is unjust, unreasonable, or unduly discriminatory *per se*.

7. Dynegy challenges the Commission's attempt to distinguish between it and other IPPs based on the fact that Dynegy operates a fleet of generating units. Dynegy contends that it is not unique in operating a fleet of generating units, and that "the same could be said of any other IPP operating throughout the United States in some fashion."[9] Dynegy argues that it differs from other IPPs only in that its facilities are held within a single corporate entity while other IPPs establish a separate corporate entity for each facility.

8. Dynegy argues that characterization of an IPP's generation assets as a fleet does not, standing alone, provide any meaningful standard in this proceeding, provide any guidance for future cases, and does not have a basis on any discernable rationale. Dynegy claims that in rejecting the plant-by-plant approach as a deviation from the *AEP* methodology, the Commission did not even attempt to consider whether it achieves the Commission's stated aim of reflecting true diversity in reactive power output among an entity's generation portfolio. Dynegy criticizes the Commission for merely adopting the simultaneous approach used in *AEP* to define diversity instead of explaining how Dynegy fails to provide diversity.

9. Dynegy also contends that justifying strict adherence to the *AEP* methodology on the assertion that Dynegy operates a fleet of generators improperly compares Dynegy to AEP. Dynegy states that AEP is a traditional vertically-integrated public utility subject to state regulation and with a defined control area, while Dynegy is an IPP without its own control or service area. Dynegy states that AEP is subject to planning reserve margin requirements, while Dynegy does not plan, build, own, or operate its facilities on an integrated basis in order to serve load. Dynegy asserts that as an integrated utility, AEP is responsible for operating a control area where it has an obligation to balance load with its fleet of generation on a real-time basis, while as an IPP, Dynegy has no such obligation or requirement. Dynegy argues that the Commission failed to evaluate whether these differences make the plant-by-plant approach, which the Commission has accepted for other IPPs, just and reasonable in this proceeding.

10. Dynegy further challenges the Commission's implied concern about "cherry-picking." Dynegy asserts that this concern focuses on the rate level itself rather than on

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[8] Dynegy Request for Rehearing at 29 (Dynegy).

[9] Dynegy at 30.

any form of diversity. Dynegy argues that Trial Staff submitted an alternative calculation of the RPPIA/BOP allocator based on operating data and adjusting for diversity, but that the Commission failed to even address Trial Staff's position. Dynegy argues that the common thread in the Commission's decision appears to be that any departure from the simultaneous approach used in *AEP* violates diversity (as defined by the fleet approach) and constitutes cherry-picking to the extent that it produces a higher rate than the rate using the *AEP* methodology. Dynegy contends that this falls short of the standard of reasonable decision-making and lacks an intelligible rationale.

3. Commission Determination

11. We deny rehearing of our finding that the just and reasonable approach in this proceeding is the approach that most closely follows the *AEP* methodology—that is, the simultaneous approach. The *AEP* methodology calculates just and reasonable capability-based reactive power rates that recover the fixed costs associated with providing reactive power service.[10] In fact, the Commission has required that IPPs with actual cost data use the *AEP* methodology.[11] In this case, Dynegy does not contest that the *AEP* methodology requires the simultaneous approach; it argues that the *AEP* methodology has evolved and that the Commission has allowed other IPPs to use the plant-by-plant approach.[12]

12. Although the Commission requires IPPs to use the *AEP* methodology to calculate capability-based revenue requirements, it has recognized that following the *AEP* methodology may not be feasible in every case. For example, in *WPS Westwood*[13] the Commission stated that IPPs without actual cost data may use a proxy, and in *Bluegrass*[14] the Commission ruled that IPPs may use the interconnecting transmission owner's return on common equity (ROE) as a proxy. The Commission has even demonstrated flexibility

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[10] *Bluegrass Generation Company, L.L.C.*, 118 FERC ¶ 61,214 (2007) (*Bluegrass I*), *order on reh'g*, 121 FERC ¶ 61,018, at P 12 (2007) (*Bluegrass II*); *Calpine Oneta Power, L.P.*, 116 FERC ¶ 61,282 (2006) (*Calpine Oneta I*), *order on reh'g*, 119 FERC ¶ 61,177, at P 24 (2007) (*Calpine Oneta II*); *see also WPS Westwood Generation, LLC*, 101 FERC ¶ 61,290, at P 14 (2002) (*WPS Westwood*).

[11] *FPL Marcus Hook*, 110 FERC ¶ 61,087 at P 16, *order on reh'g*, 111 FERC ¶ 61,168 (2005); *Calpine Oneta II*, 119 FERC ¶ 61,177, at P 26 (2007).

[12] Dynegy at 29.

[13] *WPS Westwood*, 101 FERC ¶ 61,290 at P 15.

[14] *Bluegrass I*, 118 FERC ¶ 61,214 at P 86.

in this proceeding, when in Opinion No. 498 it affirmed the Presiding Judge's ruling that Dynegy could use actual operating data rather than available flowgate capacity (AFC) models to determine a generator's maximum MVar production.[15] Thus, the Commission has demonstrated that while it requires IPPs to follow the *AEP* methodology, it will make exceptions where adherence to the *AEP* methodology is shown to be infeasible or unjust and unreasonable under the circumstances. Here, there is nothing infeasible or unjust and unreasonable in requiring Dynegy to calculate the RPPIA/BOP allocator using the simultaneous approach.

13. Dynegy is correct in stating that the Commission has previously allowed some IPPs to follow the plant-by-plant approach; however, this is because those IPPs have only a single facility within a control area and are thus unable to follow the simultaneous approach. For these IPPs that have only a single facility within a control area, the plant-by-plant approach is a reasonable and necessary application of the *AEP* methodology. In contrast, when generators have multiple affiliated facilities in the same control area, we would expect them to file their reactive power rates using the simultaneous method. Dynegy controls multiple facilities within a single control area,[16] making its situation more akin to AEP, with its fleet of generators, than to an IPP with a single unit.

14. The Commission concluded that Dynegy's situation is closer to that of AEP after carefully examining the record in this proceeding. Dynegy purchased the eight electric generating plants whose provision of reactive power is at issue in this proceeding from Illinois Power. Each turbine-generator set at these eight facilities connects to Illinois Power's transmission grid through its own generator step-up transformer owned by Dynegy.[17] Moreover, as the Commission noted in Opinion No. 498, Dynegy is Illinois

[15] Like the dispute over whether Dynegy should follow the plant-by-plant or simultaneous approach, this issue affects calculation of the numerator of the second ratio used to develop the RPPIA/BOP allocator. In Opinion No. 498, the Commission found that adhering to the *AEP* methodology and using AFC models would produce an unjust and unreasonable result in this case because the AFC models did not provide a reasonable representation of the steady state reactive power needs of the Illinois Power zone of the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) system. The Commission recognized that IPPs generally have limited access to the load flow data necessary to determine generator reactive power production, and thus allowed Dynegy to use actual historical operating data instead. *See* Opinion No. 498, 121 FERC ¶ 61,025 at P 37.

[16] This proceeding is the first fully-litigated case where an IPP has filed reactive power rates for multiple units within the same control area.

[17] Dynegy Transmittal Letter in transmittal letter filed on November 30, 2004, in Docket No. ER05-270-000 accompanying the rate schedule at issue in this proceeding.

(continued)

Power's main source of reactive power.[18] Consequently, for the limited purpose of providing reactive power in the control area, Dynegy has essentially replaced Illinois Power as the control area operator. Thus, Dynegy is more like AEP, which itself is a control area operator, than a typical IPP. Accordingly, the Commission required Dynegy to follow the *AEP* methodology and use the simultaneous approach in order to more accurately reflect the diversity of reactive power output among its units.

15. In Opinion No. 498, the Commission explained that the plant-by-plant approach fails to account for diversity among the reactive power output of a fleet of generators because not all generators provide maximum reactive power at the time of system peak.[19] In other words, because Dynegy operates its fleet as a whole, all eight of its generators will not produce their maximum MVars at the same time, and calculating the fleet's maximum MVars based on each plant's maximum MVars overstates the maximum MVars for how the fleet actually operates. Thus, the Commission found that following the plant-by-plant approach in this case was not just and reasonable, while following the simultaneous approach, which adheres to the *AEP* methodology, will produce just and reasonable results. As we explained above, the Commission permits deviations from the *AEP* methodology only when it is infeasible to apply or produces results that are not just and reasonable; here, it is the proposed deviation from the *AEP* methodology (the plant-by-plant approach) that produces results that are not just and reasonable, and nothing Dynegy has argued on rehearing persuades us otherwise. Accordingly, no deviation from the *AEP* methodology is warranted in this case.

16. Similarly, we reject Dynegy's assertion that the Commission's decision rests on its corporate structure. Reactive power is a localized service that is quickly used by transmission system components and cannot be transported over long distances.[20] Thus, IPPs with multiple generators that are far enough apart to render the simultaneous approach meaningless may be able to use the plant-by-plant approach regardless of the corporate structure. As we have explained, this is not the case with Dynegy, which provides the bulk of the reactive power in the Illinois Power control area.

17. Finally, we disagree with Dynegy that Trial Staff has proposed a suitable alternative to the simultaneous method. Trial Staff's calculations depart from the *AEP* methodology without justification; that is, without any showing that the *AEP*

(November 2004 Rate Schedule).

[18] Opinion No. 498, 121 FERC ¶ 61,025 at n.14.

[19] *Id*. P 39.

[20] Initial Decision, 116 FERC ¶ 63,052 at P 13.

methodology's application here is infeasible or generates unjust and unreasonable results. Trial Staff states that it used the plant-by-plant approach mostly because Dynegy presented the information on a plant-by-plant basis[21] which is not a sufficient reason to depart from the *AEP* methodology. Trial Staff also suggests that it may be appropriate to use the plant-by-plant approach because of differing generator ratings and differing unit costs;[22] however, we reject this argument. First, the same sorts of differences were present in *AEP*. Second, while we would consider adopting deviations from the *AEP* methodology if they were shown necessary to accurately reflect Dynegy's cost of providing reactive power service, neither Dynegy nor Trial Staff has demonstrated that the *AEP* methodology understates Dynegy's cost of providing reactive power service, or that the plant-by-plant approach, with its overstatement of maximum MVars produced by failing to account for diversity of MVar production among plants, does not overstate Dynegy's cost of providing reactive power service. Finally, Trial Staff states that it would be more consistent and accurate to use the plant-by-plant approach, but does not explain with what it would be more consistent or why it would be more accurate.[23] Moreover, because Trial Staff utilized the methodology and data presented by Dynegy, Trial Staff's approach fails to account for diversity.

B. Heating Losses Component

1. Initial Decision and Opinion No. 498

18. The Presiding Judge found that Commission precedent signals a clear intent to permit IPPs to recover all costs associated with providing reactive power, including heating losses. The Presiding Judge examined the record, found that Dynegy incurs costs due to heating losses, and concluded that Dynegy should recover a separate heating losses component as part of its reactive power revenue requirement.

19. The Commission reversed the Presiding Judge. The Commission agreed that generators should be compensated for *fixed* costs related to heating losses, but found that these costs are already recovered in the fixed capability component calculated under the *AEP* methodology and that allowing them to be recovered in a separate heating losses component would constitute double recovery.[24] The Commission stated that it would consider accepting a separate heating losses component that recovered *variable* costs

[21] *See* Exhibit No. S-16, page 6, lines 4-5.

[22] *See* Exhibit No. S-16, page 6, lines 5-8.

[23] *See* Exhibit No. S-21, page 3, lines 6-7.

[24] Opinion No. 498, 121 FERC ¶ 61,025 at P 68-70.

associated with heating losses, but that the record in this proceeding did not demonstrate the amount of variable costs that Dynegy has incurred for heating losses. The Commission stated that Dynegy failed to provide the actual amount of heating loss costs incurred based on the MW-hours of actual reactive power production, providing only a hypothetical calculation assuming maximum reactive power production for all operating hours.

20. The Commission affirmed the Presiding Judge's conclusion that Dynegy incurs no opportunity costs due to heating losses. The Commission also stated that Dynegy failed to cite any cases supporting inclusion of a separate heating losses component in addition to the recovery of heating losses allowed under the *AEP* methodology, and thus rejected Dynegy's argument that Commission precedent permits IPPs to include a separate heating losses component as part of its reactive power revenue requirement.[25]

2. Argument on Rehearing

21. Dynegy argues that in rejecting its separate heating losses component the Commission departed from established precedent, failed to address evidence in the record, and unduly discriminated against it as an IPP. Dynegy claims that the Commission erred by holding that it cannot recover a separate heating losses component as part of its reactive power revenue requirement, denying the existence of precedent permitting the recovery of heating losses, and finding that it failed to provide the cost support necessary to justify recovering a separate variable heating losses component. Dynegy also claims that to the extent that the Commission rejects its heating losses calculation, the record contains an alternative measure of its variable costs.

22. Dynegy claims that the Commission "sullied" its precedent by stating that the cases it cited failed to support inclusion of a separate heating losses component.[26] Dynegy asserts that the Commission reached this conclusion, in part, by incorrectly finding that the cases where it had authorized inclusion of a separate heating losses component were not cases where the heating losses issue was affirmatively decided by the Commission. Dynegy claims that the principal cases it relied on its Brief on Exceptions—*Duke Fayette*,[27] *Conectiv*,[28] and *VEPCO*[29] —are cases where the

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[25] *Id*. P 72.

[26] *See id*. Dynegy at 12.

[27] *Duke Energy Fayette, LLC*, 104 FERC ¶ 61,090 (2003) (*Duke Fayette*).

[28] *Conectiv Bethlehem, LLC*, 106 FERC ¶ 61,272 (2004) (*Conectiv*).

[29] *Virginia Elec. and Power Co.*, 114 FERC ¶ 61,318 (2006) (*VEPCO*).

Commission squarely addressed the heating losses issue and allowed the recovery of a separate heating losses component.[30]

23. Dynegy explains that in *Duke Fayette* and *Conectiv* the Commission accepted the use of proxy data and peak locational marginal prices (LMP) to calculate heating losses, and in *VEPCO*, it set the amount and method of calculating heating losses for hearing. Dynegy asserts that in these cases the Commission was concerned with the method used to recover heating losses, not with the threshold question of whether heating losses could be recovered. Dynegy contends that the Commission departed from this precedent without explanation or discussion of these cases.[31]

24. Dynegy also argues that the Commission erred by failing to address how it calculated its heating losses component, which it claims is consistent with the approach the Commission accepted in *Duke Fayette* and *Conectiv*. Dynegy claims that its heating losses component is a proxy designed to recover the variable costs it incurs in meeting its reactive power obligation to Illinois Power.[32] Dynegy states that it derived the heating losses component by using rated reactive capability as a proxy for operation between

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[30] In a footnote, Dynegy cites *Duke Energy Vermillion, LLC*, 109 FERC ¶ 61,370, at P 6 & n.7 (2004), as another example of a case where the Commission set a heating losses issue for hearing.

[31] Dynegy also argues that the Commission's use of *Northeast Utilities Service Co.*, 74 FERC ¶ 61,065 (1996) (*NUSCO*) to show that the Commission must affirmatively resolve an issue before a case can be relied on as precedent is off-point and does not take away from *Duke Fayette*, *Conectiv*, or *VEPCO*. Dynegy states that in *NUSCO* the Commission rejected a variation from its *pro forma* Open Access Transmission Tariff (OATT) that it had accepted in two previous cases, finding that it had not ruled on the variation in those cases. The difference here, Dynegy argues, is that the Commission specifically addressed heating losses in *Duke Fayette*, *Conectiv*, and *VEPCO*.

[32] Dynegy at 19. Dynegy asserts that it is required by its interconnection agreement to provide reactive power inside and (when called upon by Illinois Power) outside the deadband. Dynegy states that in maintaining its ability to provide reactive power outside the deadband up to its maximum capability, it experiences heating losses over and above any heating losses incurred to provide reactive power inside the deadband. Dynegy states that it also experiences a corresponding reduction in real power output.

maximum reactive capability and no reactive output,[33] the number of actual annual operating hours for its facilities, and the average LMP of energy in the Illinois Power control area.[34] Dynegy explains that it used the rated power factor to measure losses associated with armature and field winding, stray load losses, and generator step-up transformer losses, determined the number of hours its facilities were expected to operate, and established the cost of the total heating losses associated with providing reactive power. Dynegy asserts that this method of calculating heating losses captures the variable costs of meeting its reactive power obligation both inside and outside the deadband.

25. Dynegy speculates that the Commission misinterpreted its use of rated reactive capability as an attempt to recover fixed heating losses, and that this confusion caused the Commission to incorrectly find that Dynegy failed to support the inclusion of any variable costs in its heating losses component.[35] Dynegy states that it used rated reactive power capability as a proxy for variable heating losses, and that the Commission misunderstood the difference between rated reactive capability and maximum reactive capability.

26. Dynegy argues that the Commission accepted the use of proxy data and peak LMP prices to calculate heating losses in *Duke Fayette* and *Conectiv*, and that although the generators in those cases lacked operating history, while Dynegy does not, it may still rely on proxy data. Dynegy claims that the Commission allows the use of proxy data when the source relied on is "representative of" and "shown to be comparable" to the generating units of the entity seeking reactive power compensation. Dynegy argues that the use of LMP pricing appropriately recognizes that the real power costs of IPPs are either set by contract or the market (and not by traditional cost-of-service ratemaking

[33] Dynegy states that a unit's rated reactive capability lies between its maximum reactive capability and no reactive output, and that its units are obligated under the interconnection agreement to operate between these limits.

[34] Dynegy states that because the Midwest ISO (MISO) Day 2 Market was not yet in place, its testimony reflected a cost of production that was a three-year average market price of energy in the Illinois Power control area, adjusted for the run hours of each of the plants. Dynegy states that it used the MISO average Day-Ahead LMP prices from April 1, 2005 through January 4, 2006.

[35] Dynegy at 20.

standards),[36] that LMP pricing is a transparent and efficient mechanism that reflects the true marginal cost to supply generation in discrete locations, and that LMP pricing is both representative of and comparable to Dynegy's actual marginal costs of producing real power. Dynegy further argues that its reliance on LMP to reflect the true costs of its heating losses is fully consistent with MISO's requirement that reactive power rate schedules be cost-based and that no party has sufficiently shown its filed revenue requirement as a whole to be unjust and unreasonable.

27. Dynegy argues that the Commission erred by failing to address the evidence that it provided justifying its heating losses component. Dynegy argues that it is inconsistent for the Commission to conclude that it failed to support recovery of variable costs related to heating losses while failing to examine the evidence that Dynegy presented concerning its calculation of heating losses. Dynegy states that Trial Staff and Illinois Power also provided testimony and exhibits demonstrating that Dynegy incurred variable heating losses, and that their calculations were based on the actual amount of power provided in operation of Dynegy's facilities and on Dynegy's average fuel and transportation costs per MWh of generation. Dynegy states that Exhibit No. AIP-11, its response to an Illinois Power data request, shows its fuel and transportation costs on a per MWh basis. Dynegy states that these are variable cost inputs, and that the Commission either overlooked or ignored these portions of the record. Dynegy argues that the Commission had an obligation to address this evidence.

28. Finally, Dynegy claims that although it is an IPP, the Commission treated it like AEP, a load serving vertically integrated public utility. Dynegy argues that as an IPP it is not similarly situated to AEP because AEP is required to meet planning reserve margins to ensure resource adequacy. Moreover, in addition to recovering fixed costs associated with the planning reserve margin,[37] Dynegy states that AEP can use its planning reserves to produce the real power associated with heating losses because those reserves cannot be sold on a firm basis in the market. Dynegy states that it does not have planning reserves from which it can produce real power for heating losses and that its heating losses are valued by the LMP. Consequently, Dynegy argues that while the RPPIA/BOP allocator

[36] Dynegy explains that the cost to an IPP to replace a MW used for heating losses is the market price of that MW. Dynegy states that it has relied on a proxy cost to simulate the true cost of energy at the location where the lost MWs would have been delivered.

[37] Dynegy states that there is no indication in *AEP* that the incremental costs associated with generation built to meet planning reserves are excluded from the *AEP* methodology.

recovers certain fixed costs associated with heating losses under the *AEP* methodology, it fails to capture variable costs associated with heating losses.

3. Commission Determination

29. We deny rehearing of our decision to reject Dynegy's heating losses component. However, we grant rehearing to establish a separate heating loss component to facilitate recovery of the variable costs of providing heating losses associated with reactive power.

30. We perceive two separate, but closely related arguments in Dynegy's rehearing request. First, Dynegy claims that the Commission departed from precedent by concluding that it cannot recover a separate heating losses component.[38] Second, it argues that the Commission should have found that its method of calculating a separate heating losses component is the same method that the Commission accepted in *Duke Fayette* and *Conectiv* and accepted it as reasonable.

31. With respect to the claim that the Commission departed from precedent, Dynegy appears to have misunderstood both the Commission's observation that Dynegy failed to cite precedent supporting inclusion of a separate heating losses component and its statement that precedent does not permit recovery of a separate heating losses component.[39] In isolation, these statements appear to show the Commission prohibiting the recovery of any separate heating losses component. However, when read in the context of the preceding paragraphs, it is readily apparent that the Commission was referring to the lack of precedent supporting the recovery of *fixed* costs in a separate heating losses component. In those paragraphs, the Commission engaged in a careful discussion that distinguished between fixed and variable costs associated with heating losses, explained that fixed costs are recovered under the *AEP* methodology, and clarified that recovery of a separate heating losses component is appropriate only when it recovers variable costs that are actually incurred and supported by the record.[40] Dynegy's interpretation is rendered even more implausible by the fact that the Commission rejected its heating losses component on the specific grounds that Dynegy failed to support

[38] *See*, *e.g*. Dynegy at 2 ("[T]he Commission inexplicably found that it had never passed on the issue of heating losses before."), 9 ("[T]he Commission denied the existence of any prior precedent permitting recovery of heating losses as relied upon by [Dynegy].").

[39] *See* Opinion No. 498, 121 FERC ¶ 61,025 at P 72.

[40] *See id*. P 68-71.

recovery of variable costs,[41] not because of a general prohibition on the separate recovery of heating losses.

32. Dynegy speculates that the Commission misinterpreted its use of rated reactive capability as an attempt to recover fixed heating losses, and that this confusion caused the Commission to find that it failed to support recovery of variable costs.[42] We agree that the Commission regarded Dynegy's heating losses component as an attempt to recover fixed costs—hence, the Commission's statements that it failed to cite precedent supporting the separate recovery of such costs. However, now that we have examined Dynegy's heating losses component as an attempt to recover variable costs, we still find that it has not adequately supported its proposed recovery of variable costs.

33. We agree with Trial Staff's assertion in the proceeding before the Presiding Judge that Dynegy's calculation of variable costs is based on the assumption that its generators operate at rated power factor and rated real power during all operating hours.[43] We find that this assumption overstates the amount of heating losses because generators can and do operate below rated power factor and rated real power some of the time. If a separate heating losses component is included to allow recovery of variable costs, it must be based on actual operating data and not rated capability. Actual operating data reflects the actual variable cost of heating losses; using rated capability to calculate variable heating losses costs assumes that the plant always operates at rated capability. Trial Staff presented evidence in this proceeding that the plants in question do not operate at rated capability during all hours and Dynegy has not asserted otherwise.[44]

34. We also reject Dynegy's assertion that the Commission must accept its approach to calculating heating losses because it is consistent with the approach in *Duke Fayette* and *Conectiv*. While it is true that the Commission did not object to the use of proxy data in *Duke Fayette* and *Conectiv*, it is also true (as Dynegy acknowledges) that the generators in those cases lacked operating history while Dynegy does not.[45] The

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[41] *Id*. P 68, 71.

[42] Dynegy at 20.

[43] Exhibit S-4 at 18-20. In Exhibit S-4, Trial Staff provided a calculation based on actual operating data to represent the variable costs of heating losses.

[44] Exhibit No. S-4 at 17; Trial Staff Initial Brief at 51-57.

[45] Dynegy at 22.

Commission only allows proxy data when actual operating data is not available;[46] actual operating data was present in the record in this case.[47]

35. Moreover, Dynegy's reliance on *Duke Fayette* and *Conectiv* to support the use of LMPs in calculating its heating losses component ignores subsequent developments in the Commission's understanding in this area. In *Ameren*, the Commission explained that there is a potential for parties to over recover when they attempt to recover costs through a combination of embedded cost recovery and opportunity-cost recovery based on LMPs; consequently, the Commission directed the parties to develop appropriate mechanisms to avoid over recovery.[48] Here, Dynegy seeks to recover its reactive power costs through a similar combination—the *AEP* methodology, which recovers fixed (or embedded) costs associated with reactive power heating losses[49] and a variable heating losses component based on LMPs. We find that the same potential for over recovery that existed in *Ameren* exists in this case; thus, we reject Dynegy's LMP-based approach. To the extent that *Ameren* is in tension with *Duke Fayette* and *Conectiv*, we choose to follow *Ameren*, which represents a further development of our understanding with respect to this issue.

36. For the same reasons, we find that Dynegy's argument that recovery of variable costs valued by LMP is needed by IPPs that do not have planning reserves is unpersuasive. Planning reserves are available to control area operators to ensure that enough generation and transmission capacity gets built to meet future load growth. IPPs can enter into capacity contracts to provide capacity, including planning reserves.

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[46] *See, e.g., WPS Westwood*, 101 FERC ¶ 61,290 at P 15.

[47] *See, e.g.*, Exhibit S-4.

[48] *Ameren Energy Marketing Co.*, 117 FERC ¶ 61,334, at P 16 (2006) ("Nonetheless, although opportunity costs can be a valid basis for rates, Applicants' proposed rates include: (1) an opportunity cost component; (2) a stated component designed to provide 100 percent recovery of embedded costs; and (3) an energy charge equal to locational marginal prices. The opportunity cost component and energy charge provides recovery of infra-marginal rents contributing to embedded costs. The combination of the embedded cost component, the opportunity cost component, and the locational marginal price energy charge, provides for the potential to over-recover embedded costs and opportunity costs. Therefore, in the hearing ordered below, parties should develop appropriate mechanisms to ensure that the cost of service rates do not provide for recovery of more than embedded costs or opportunity costs, whichever is higher.").

[49] Opinion No. 498 at P 69.

Nothing in Dynegy's reactive power rate precludes it from entering into a capacity contract. Moreover, in markets such as those operated by Midwest ISO and PJM Interconnection, LLC, in which Dynegy and AEP operate, utilities can, and in certain instances are *required* to, offer output from their planning reserves into the energy markets. However, these facts still do not persuade us that Dynegy should be allowed recovery of heating losses based on LMP. As noted above, and as Dynegy admits, the *AEP* methodology already provides for recovery of the embedded fixed costs associated with reactive power heating losses, and allowing Dynegy to also recover a contribution to fixed costs based on opportunity costs would result in over-recovery of costs.

37. Nonetheless, since the Commission instituted this proceeding as an investigation of Dynegy's reactive power rates under section 206 of the FPA, the Commission is obligated to establish a just and reasonable rate when it finds the existing rate is not just and reasonable. In Opinion No. 498, the Commission found Dynegy's existing heating loss component of its revenue requirement to be unjust and unreasonable. However, the Commission stated in Opinion No. 498 that Dynegy may file to recover its variable costs of providing reactive power service. We conclude that it was our burden to establish a rate under section 206 of the FPA. Accordingly, after reviewing the record, we find that the heating losses component developed by Illinois Power in this proceeding to recover Dynegy's variable costs of heating losses is just and reasonable because it uses actual variable costs and actual operating data, which for the reasons discussed above, are required. Thus, we direct Dynegy to file a compliance filing reflecting a revenue requirement of $182,364 to recover the variable costs of heating losses associated with the provision of reactive power.[50]

The Commission orders:

Dynegy's request for rehearing is hereby denied in part, and granted in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[50] *See* Exhibit No. AIP-1 at 18, referencing Exhibit No. AIP-11.