

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Duke Energy Lee, LLC

Docket Nos. ER04-641-000
ER04-641-001

ORDER ACCEPTING AND SUSPENDING RATE SCHEDULES AND
ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued May 27, 2004)

1. In this order we accept for filing Duke Energy Lee, LLC's (Duke Lee) proposed rates, suspend them for a nominal period, to become effective June 1, 2004, subject to refund and establish hearing and settlement judge procedures. This order benefits customers by ensuring a timely inquiry into whether the proposed rates are just and reasonable.

Background

2. Duke Lee is a 640 MW gas-fired merchant power plant located in Lee County, Illinois that began operations in 2001. At that time Duke Lee was interconnected with ComEd's transmission facilities, and Duke Lee's interconnection agreement with ComEd did not provide compensation for reactive power. However, on May 1, 2004, ComEd integrated into PJM. Duke Lee states it has applied for PJM membership, and is working towards becoming a PJM member before it receives revenues under the rates at issue here.

Duke Lee's Filing

3. On March 12, 2004, and as amended on April 1, 2004, Duke Lee filed rate schedules stating its revenue requirement for providing cost-based Reactive Supply and Voltage Control from Generation Sources Service (reactive power) that it will provide to PJM Interconnection, LLC (PJM) under Rate Schedule No. 2 of PJM's Open Access Transmission Tariff (PJM OATT). Duke Lee requests an effective date to coincide with Commonwealth Edison Company's (ComEd) integration into PJM.

4. Schedule 2 of PJM's OATT allows generation owners to specify revenue requirements for reactive power and provides that PJM will pay "each generation owner an amount equal to the generation owner's monthly revenue requirement as accepted or

approved by the Commission.”¹ Duke Lee requests the Commission to approve its revenue requirement in order to qualify under PJM’s OATT to receive payments for its reactive power deliveries.

5. Duke Lee states it developed its reactive power revenue requirement using two components: (1) a fixed capability component which represents that portion of the plant fixed costs attributed to reactive power; and (2) the heating loss component which allows for recovery of the increased generator heating losses resulting from producing reactive power. Duke Lee states this method is consistent with Commission policy.²

6. Duke Lee states that because neither it nor its parent, Duke Energy North America LLC, issues publicly traded stock, Duke Lee is unable to apply the Commission’s standard discounted cash flow technique to establish a rate of return on equity. Since Duke Lee is a merchant generator not generally subject to traditional rate regulation, it states it has incorporated, in its fixed charge rate, a rate of return on equity (and an overall rate of return) that is based on a proxy derived from the capital structure and returns of ComEd.

7. Duke Lee proposes a 12.5 percent rate of return on equity, which it states does not include any of the Commission-approved adders. Duke Lee states ComEd’s filing for ancillary service rates is currently under Commission review, and so Duke Lee will collect any charges based on this rate of return subject to refund and to the outcome of the ComEd proceeding.³ Duke Lee adds this 12.5 percent rate is 0.1 percent lower than the rate used by PECO Energy Company (PECO), a ComEd affiliate, and has been the basis of similar proxies for PJM generators interconnected to PECO. Additionally, Duke Lee argues this is a conservative rate since Duke Lee’s market risks are greater than a monopoly transmission provider’s risk.⁴

¹ Duke Lee transmittal letter at 3 citing PJM FERC Electric Tariff, Fifth Revised Volume No. 1, Substitute Original Sheet No. 112.

² Duke Lee cites American Electric Power Service Corp., 88 FERC ¶ 61,141 (1999). The Commission subsequently has recommended that all generators seeking recovery for reactive power that have actual cost data and support employ this methodology. WPS Westwood Generation, LLC., 101 FERC ¶ 61,290 at P 14 (2002).

³ See Commonwealth Edison Company, et al., 105 FERC ¶ 61,186 (2003) (order conditionally accepting ComEd’s filing and establishing hearing and settlement judge procedures).

⁴ Duke Lee also reserves the right to later present evidence to increase this rate of return proxy, or to propose a different methodology in the future if market conditions warrant.

8. With regard to heating losses, Duke Lee states that when a generator produces reactive power, there are significant heating losses associated with the generator and the generator step-up transformer. Duke Lee states these losses are the real power consumed to produce reactive power, and consequently, are costs directly attributable to the production of reactive power.

9. Finally, Duke Lee states, under PJM's OATT, it is entitled to receive lost opportunity costs if PJM directs Duke Lee to restrict its real power output to increase reactive power support to PJM.

10. Duke Lee requests the Commission waive its prior notice requirement⁵ to allow the rates to become effective when ComEd integrates into PJM. Duke Lee states since it has filed the rates for this service before the service has commenced, it meets the standard for waiver of prior notice.

Notices and Interventions

11. Notice of Duke Lee's March 12, 2004 filing was published in the Federal Register, 69 Fed. Reg. 15,317 (2004), with protests or interventions due on or before April 2, 2004. Notice of Duke Lee's April 1, 2004 supplemental filing was published in the Federal Register, 69 Fed. Reg. 19,998 (2004), with protests or interventions due on or before April 15, 2004. PJM filed a motion to intervene and Exelon Corporation (Exelon) filed a motion to intervene and protest. Duke Lee filed an answer.

12. Exelon argues the Commission is not required to accept all reactive revenue requirement filings even though they are consistent with the transmission provider's OATT. Exelon argues it is not just and reasonable to require transmission customers to pay a cost-based revenue requirement without the generator demonstrating the reactive power is needed to support the transmission system. Exelon argues Duke Lee has failed to show that, given its location and restricted operational hours, its reactive power is necessary to support reliability. Exelon argues that customers should only be required to pay for reactive power that is, in fact, needed for reliable system operations.

13. Exelon states the reliability that reactive power provides a transmission system is dependent upon the location of the generating plant supplying the reactive power and the needs of the transmission system. Exelon argues that, since Duke Lee did not coordinate its location with PJM, its reactive power may not be needed by PJM; therefore, customers should not be charged for something that provides them no benefits.

14. Furthermore, Exelon states, Duke Lee lacks the operational capacity to reliably supply reactive power to PJM. Exelon states that due to legal limitations in Duke Lee's air permit, it has a maximum operating capacity of 2500 hours per year. Exelon acknowledges that a peaking generating unit can supply reactive power needed to

⁵ 18 C.F.R. § 35.3 (2003).

maintain system reliability at high load periods. However, Exelon argues customers should not be charged a revenue requirement based on unlimited availability. Exelon asserts to do so would result in a 20 percent increase in revenue requirement that customers would be required to pay for only a 4 percent increase in reactive capability that is available less than 30 percent during the year.

15. Exelon argues that Commission policy established in Order 2003,⁶ supports that compensation is not required for a generator's reactive power production unless the transmission provider requests it operate outside its established power factor range so as to produce more reactive power.

16. Exelon also asserts that Duke Lee has calculated its rates to recover revenues for reactive power on an improper proxy rate of return on equity and argues Duke Lee has failed to show that the use of this proxy is appropriate.

17. Exelon further argues that Duke Lee failed to provide sufficient supporting information, including: (1) test year data; (2) support for total general and administrative expense; and (3) support for its depreciation expense. Finally, Exelon argues that because Duke Lee does not use Form 1 data that has already undergone a review for prudence and reasonableness, there is no way to assess the data presented by Duke Lee.

Discussion

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2003), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept Duke Lee's answer and will, therefore, reject it.

19. PJM's OATT does not require any analysis of the location or of the availability of the unit providing reactive power on its system in order for that unit to be eligible to charge for reactive power. Therefore, under PJM's OATT, Duke Lee is eligible for compensation for producing reactive power.⁷ However, the reasonableness of the cost estimates and of Duke Lee's proposed rate of return on equity present issues of material

⁶ Standardization of Generator Interconnection Agreements and Procedures, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs. ¶ 31,146 (2003), order on reh'g, Order No. 2003-A, 69 Fed. Reg. 15,932 (March 5, 2004), FERC Stats. & Regs. ¶ 31,160 (2004), reh'g pending.

⁷ Exelon's concerns over PJM's compensation methodology in Schedule 2 should be addressed through PJM's stakeholder process or through a section 206 complaint, as appropriate.

fact that cannot be resolved on the record before us, and are more appropriately addressed in the hearing ordered below.

20. The Commission's preliminary review indicates that Duke Lee's filing has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Accordingly, the Commission will accept the proposed rates, suspend them for a nominal period, to become effective on June 1, 2004, subject to refund, and set them for hearing.

21. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their disputes before hearing procedures are commenced. To aid the parties in their settlement efforts, the hearing will be held in abeyance and a settlement judge will be appointed pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.⁸ If the parties desire, they may, by mutual agreement, request a specific judge as a settlement judge in this proceeding; otherwise the Chief Judge will select a judge for this purpose.⁹ The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for the commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) The proposed rate schedules are hereby accepted for filing, and suspended for a nominal period, to be effective June 1, 2004, subject to refund, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred on the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and 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 the justness and reasonableness of Duke Lee's proposed reactive power rates. However, the hearing will be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (C) and (D) below.

⁸ 18 C.F.R. § 385.603 (2003).

⁹ If the parties decide to request a specific judge, they must make their request to the Chief Judge by telephone at 202-502-8500 within five days of the date of this order. The Commission's website contains a listing of Commission judges and a summary of their background and experience (www.ferc.gov - click on Office of Administrative Law Judges).

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2003), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge 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.

(D) Within sixty (60) days of the date of this order, the settlement judge shall file a report with the Chief Judge and the Commission 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 Chief Judge and the Commission of the parties' progress toward settlement.

(E) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding administrative law judge, to be designated by the Chief Judge, shall convene a prehearing conference in these proceedings in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 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.

(S E A L)

Linda Mitry,
Acting Secretary.