

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

PPL Wallingford Energy LLC

Docket Nos. ER03-421-004
ER03-563-011

ORDER ON COST INFORMATION

(Issued August 12, 2003)

1. In an order issued on May 16, 2003,¹ the Commission rejected a proposed reliability-must-run (RMR) agreement submitted by PPL Wallingford Energy LLC (PPL Wallingford), and replaced it with a Peaking Unit Safe Harbor (PUSH) bid mechanism. The Commission accepts revised PUSH bid cost inputs submitted by PPL, subject to a modification of the rate of return as well as certain other adjustments to be made by ISO New England (ISO-NE). This order benefits customers by helping to ensure the continued availability of generating resources needed for system reliability, while protecting competition in the Connecticut electric market.

Background

2. On January 16, 2003, PPL Wallingford submitted, under Section 205 of the Federal Power Act (FPA) 16 U.S.C. § 824d (2000), proposed RMR agreements with ISO-NE for four of its peaking generating units located within ISO-NE's control area. The Commission, by letter, indicated that the submission was deficient with respect to certain cost information. PPL Wallingford amended its filing on March 31, 2003.

3. Meanwhile, in an order issued on April 25, 2003,² the Commission directed ISO-NE to implement a temporary bidding mechanism that would enable high-cost generators needed for reliability to recover costs through market clearing prices, rather than through

¹PPL Wallingford Energy LLC, 103 FERC ¶ 61,185 (2003) (May 16 Order).

²Devon Power LLC, et al., 103 FERC ¶ 61,082 (2003) (Devon), on reh'g, 104 FERC ¶ 61,123 (2003) (Devon Rehearing).

RMR agreements, which hereafter would only be authorized as a last resort. Pursuant to its authority granted by section 206 of the FPA, the Commission directed ISO-NE to implement the PUSH bidding mechanism, under which peaking units in Designated Congestion Areas (DCAs) could be eligible to bid, and set market-clearing prices at an amount that included a fixed cost and variable cost component. The Commission held that the PUSH bidding mechanism would be effective June 1, 2003, and that it would only be temporary, until ISO-NE implemented (no later than June 1, 2004) a location or deliverability requirements mechanism in the installed capacity (ICAP) or resource adequacy market. The Commission also found that ISO-NE must develop initial PUSH bidding levels for units in DCAs with a 2002 capacity factor of 10 percent or less, and that affected generators could file with the Commission information to revise those levels.

4. In the May 16 Order, the Commission rejected, consistent with Devon, the RMR agreements submitted by PPL Wallingford, and reiterated its commitment to the PUSH bid mechanism as the preferred alternative. On June 13, 2003, PPL Wallingford filed cost of service information to revise the PUSH bid inputs developed for its units by ISO-NE.

Discussion

5. On June 13, 2003, PPL Wallingford filed cost information to indicate the variable and fixed cost inputs to be used to set the mitigation threshold for its energy market bids under the PUSH methodology. PPL Wallingford argues that its cost information reflects that its PUSH bid levels should be established based on a revenue requirement of \$32,416,800 and a rate of return of 16.15 percent.

6. PPL Wallingford submits that its total variable costs for the year 2002 were \$8,209,000, which yields a variable cost figure of \$51.50 per MWh produced that year. Nonetheless, PPL Wallingford argues that the Commission should not base a variable cost input on figures from 2002. According to PPL Wallingford, since gas prices have risen by 60 percent, using 2002 figures for its gas-fired units would lead to an under-recovery of its costs.

7. PPL Wallingford requests that the Commission apply its findings regarding its PUSH bid level cost inputs retroactively to June 1, 2003. It states that such an effective date is appropriate, as it considers its PUSH bid cost inputs to be a compliance filing to the May 16 Order, rather than a new filing under Section 205 of the FPA. PPL Wallingford goes on to argue that this effective date is necessary because the initial bid levels established by ISO-NE, which have been in place since that time, are erroneous. Specifically, PPL Wallingford contends that ISO-NE made five erroneous calculations in the bid levels for its units: (1) ISO-NE's treatment of \$800,000 of non-fuel variable

Operating and Maintenance (O&M) costs as fixed costs; (2) ISO-NE did not include \$402,700 in termination costs in Administrative and General (A&G) costs; (3) ISO-NE did not include \$2,543,900 in depreciation expense; (4) ISO-NE used a return on equity of 13.39 percent rather than the requested figure of 16.15 percent; and (5) ISO-NE imputed projected ICAP revenues as an offset to fixed costs, which PPL Wallingford claims is inappropriate. With respect to this last point, PPL Wallingford requests that the Commission refuse to permit any fixed cost offsets based on unforced capacity (UCAP), ICAP or other revenue contributions to fixed costs received outside of an RMR agreement. This is because PUSH bid levels, unlike RMR agreements, will not guarantee that all of a generator's fixed costs will be recovered, and that Devon only discussed RMR revenues as offsets, not ICAP payments.

Notice of Filing and Protests

8. Notice of PPL Wallingford's PUSH bid cost input filing in Docket Nos. ER03-563-011 and ER03-421-004 was published in the Federal Register, 68 Fed. Reg. 38,708 (2003) with comments, protests, or interventions due on or before July 7, 2003. Timely protests and comments were filed by NUSCO, ISO-NE, and Connecticut Municipal Electric Energy Cooperative (CMEEC). On July 11, 2003, ISO-NE moved to file a reply to CMEEC's protest. On July 21, 2003, PPL Wallingford filed a motion for clarification. On July 22, 2003, CMEEC moved to file a reply to ISO-NE's comments and protest, and on July 25, 2003, ISO-NE filed a response to PPL's motion for clarification.

9. NUSCO and CMEEC argue that the Commission should not apply any cost determinations regarding PPL Wallingford's cost submission retroactively³ and also that PPL Wallingford's submission should be treated as a Section 205 filing and not as a compliance filing. NUSCO claims that the Commission would be remiss in its responsibilities under the FPA were it not to perform a thorough analysis of PPL Wallingford's submission under FPA Section 205.

10. NUSCO, ISO-NE, and CMEEC claim that PPL Wallingford is incorrect in its contention that its fixed costs should not be adjusted downward to account for estimated annual revenues it would receive for annual UCAP value. They assert that the Commission unambiguously declared in Devon that PUSH fixed costs were "subject to

³NUSCO states that even with the cost adjustments made by ISO-NE, it appears that PUSH generators are being compensated at very high levels for certain hours. NUSCO refers to data on ISO-NE's website indicating that NRG's Norwalk Harbor Units 1 and 2 received day ahead LMPs that were close to \$1,000 per MWh during one hour on June 27, 2003.

adjustment for all revenues received from other sources."⁴ They argue that all PUSH generator fixed costs must be adjusted for revenues received from all sources. NUSCO states that these sources would include revenues received for ICAP /UCAP, voltage control, operating reserve functions, automatic generation control and other bilateral arrangements.

11. ISO-NE contends that the fixed cost analysis that it employs for PUSH eligible generators was modeled after the analysis employed by the Commission in Devon and produces a revenue requirement for each generating system station that is based on cost data provided by the generator owners. ISO-NE states, based on the guidance given by the Commission in Devon, a generic return on equity of 13.39 percent was imputed to each generating station. ISO-NE adds that projected UCAP revenues were used in the model instead of actual 2002 revenues because the introduction of a new supply auction on March 1, 2003, that is based on UCAP, will produce revenue credits that differ from 2002 ICAP revenue. ISO-NE also contends that its fixed cost amount determinations conform with the Commission's directives in the Devon Order.

12. CMEEC argues that PPL Wallingford's fixed costs should be levelized, that a proposed 16.15 percent return on equity is grossly excessive, and that an appropriate evaluation of PPL Wallingford's corporate structure should include its corporate parent, PPL Corporation. In addition, it contends that PPL Wallingford's cost of service is incorrect for a number of other reasons, including certain alleged "pro forma" adjustments, the use of an 80 percent allocator for fixed costs among the peaking units, and the inclusion of workforce reduction costs (termination fee), a \$1.2 million pipeline reservation fee, PPL overhead costs, and a Construction Work In Progress (CWIP) balance associated with a gas pipeline.

Commission Response

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(c)(1) (2003), the timely unopposed motions to intervene serve to make NUSCO, ISO-NE, and the CMEEC parties to this proceeding. Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.213(a)(2) (2003), the Commission has accepted replies to protests and motions that aid in our understanding of the case. For that reason, we are accepting the replies of ISO-NE and CMEEC.

14. We accept the basis for the PUSH bid levels for PPL Wallingford as developed by ISO-NE, subject to the modifications detailed as follows. First, ISO-NE treated certain

⁴Devon at P 53.

non-fuel variable O&M costs as 2002 fixed costs, rather than including these as variable costs. While the result is the same, we disagree with the treatment. ISO-NE should treat variable O&M appropriately as variable costs in order to avoid the potential for confusion and errors. Second, we direct ISO-NE to include the termination costs in PPL's A&G accounts. Typically the Commission broadly allocates these costs throughout the company using appropriate allocation factors. Third, the disagreement over the depreciation expenses relating to leased equipment has been resolved, according to ISO-NE's July 25 response, indicating that it has reversed its adjustment to depreciation expenses. The Commission agrees that these expenses should be included.

15. Finally, we direct ISO-NE to adjust the return on common equity to 10.88 percent, consistent with the Devon Rehearing.⁵ PPL Wallingford has not demonstrated that its risk is greater than that of the proxy group used to establish the return on common equity in Devon Rehearing. Therefore, the Commission does not believe that the return on equity submitted by PPL Wallingford in its filing can be supported. Considering both the immediate and short-term nature of the PUSH mechanism, the rationale described in Devon to develop unit specific PUSH levels (e.g., a reasonable opportunity to recover costs), and the similarity of financial and operating risks among the owners of PUSH units, we believe that developing a specific Discounted Cash Flow analysis for each owner of PUSH eligible units would not yield materially different results. Thus, we find that a 10.88 percent return on common equity is reasonable to compute fixed charges for PUSH bidding peaking units that may be required to supply power in New England during the short term period, as outlined in Devon. Therefore, we direct ISO-NE to modify PPL Wallingford's initial PUSH bid to reflect this change, as well as all changes necessary to comply with the Devon Rehearing, and to implement the revised PUSH level for PPL Wallingford's units as of the date of this order.

16. PPL Wallingford's objection to using 2002 variable costs as the basis for the PUSH bid levels was addressed in the Devon Rehearing. There, we clarified that PUSH bid cost inputs are appropriately based on 2002 costs, as they are the most useful and readily available estimate of going-forward production levels, and that a more accurate estimate has not been indicated.⁶ However, with respect to PPL Wallingford's arguments that rising gas prices render 2002 figures unreasonable, we note that ISO-NE has explained

⁵See Devon Rehearing at P 48.

⁶Devon Rehearing at P 28.

that it uses current fuel price indices to calculate fuel costs for the PUSH bid levels, and 2002 costs for all other non-fuel variable costs.⁷ We find this approach to be reasonable.

17. PPL Wallingford raises the issue of whether the fixed cost adder of the PUSH bid levels should be adjusted only for RMR contract revenues or for additional revenues from installed capacity services. We also addressed this issue in the Devon Rehearing. There, we clarified that revenues that PUSH-eligible units may earn outside of the market in which PUSH bidding is allowed need to be accounted for in the calculation of PUSH levels. Whether these revenues come from the installed capacity market, standard offer or other bilateral contracts, or from other sources, the fixed cost input must be offset by all revenues a PUSH-eligible unit may earn outside of the market.⁸ We agree with ISO-NE's projection of other revenues and its method of treatment of revenue credits is consistent with Devon and Devon Rehearing.

18. CMEEC contends that PPL Wallingford's fixed costs should be levelized rather than non-levelized. We will not require that PPL Wallingford's costs be levelized. We have consistently held that both levelized and non-levelized rates can produce reasonable results, depending on the circumstances.⁹ Moreover, given the short length of time the PUSH bid levels will be in place (no longer than one year), we find the use of non-levelized fixed costs are reasonable.

19. CMEEC objects to several specific adjustments in PPL Wallingford's cost data. CMEEC disputes the use of an 80 percent allocator for costs among the PPL Wallingford units, the inclusion of a \$1.2 million pipeline reservation fee, and the inclusion of a CWIP cost related to a gas pipeline. CMEEC also request that miscellaneous pro forma adjustments be made, and argues that the capital structure of PPL Wallingford's parent should apply. Although CMEEC questions these elements of PPL Wallingford's costs, it presents no evidence that they are unreasonable as cost input for PUSH bid levels. We therefore reject CMEEC's objections.

20. In the May 16 Order, we denied the submitted RMR agreements, but did not direct a compliance filing. Rather than a compliance filing, PPL Wallingford's filing represents

⁷See ISO-NE's Reply at 6-7.

⁸Devon Rehearing at P 54.

⁹ See, e.g., American Electric Power Service Corp., Opinion 440, 88 FERC ¶ 61,141, at 61-441-442 (1999); Allegheny Power Service Corp., Opinion 433, 85 FERC ¶ 61,275, at 62,117 (1998); Kentucky Utilities Co., Opinion 432, 85 FERC 61,274, at 62,100-03 (1998).

a Section 205 proposal, made pursuant to ISO-NE's PUSH market rules. As such, it cannot be effective retroactively. PPL Wallingford's revised PUSH bid level inputs, as modified, therefore will be effective on the date this order is issued.

The Commission orders:

PPL Wallingford's PUSH bid cost input information is hereby accepted, as modified in the body of this order. ISO-NE is hereby directed, within 10 days of the date of this order, to file the required revisions to PPL Wallingford's PUSH bid level, to be effective on the date of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.