

112 FERC ¶ 61,047
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

AEP Power Marketing, Inc.	Docket Nos. ER96-2495-026
AEP Service Corporation	ER97-4143-014
CSW Power Marketing, Inc.	ER97-1238-021
CSW Energy Services, Inc.	ER98-2075-020
Central and South West Services, Inc.	ER98-542-016
	EL04-131-000

ORDER ACCEPTING AND SUSPENDING PROPOSED UP TO COST-BASED
RATES AND TARIFF REVISIONS,
AND ESTABLISHING HEARING PROCEDURES

(Issued July 7, 2005)

1. In this order, the Commission accepts for filing American Electric Power Service Corporation's¹ (AEP's) proposed tariff revisions providing for up to cost-based rates applicable to sales of electric power at wholesale that sink within the AEP-Southwest Power Pool, Inc. (AEP-SPP) control area,² suspends them for a nominal period to become effective March 6, 2005, subject to refund, and establishes hearing procedures. This order benefits customers by assuring that wholesale power rates charged by AEP are just and reasonable.

Background

2. On August 9, 2004, as amended on August 10, 2004, September 16, 2004, and November 19, 2004, AEP submitted for filing generation market power screens in

¹ "AEP" includes the following entities: AEP Power Marketing, Inc., AEP Service Corporation, CSW Power Marketing, Inc., CSW Energy Services, Inc. and Central and South West Services, Inc.

² The AEP-SPP control area is comprised of AEP's service territories in Arkansas, Louisiana, Oklahoma, and Texas that fall within the SPP boundaries.

compliance with the Commission's orders issued on April 14, 2004 and July 8, 2004.³ The filing indicated that, among other things, AEP passed the pivotal supplier screen but failed the wholesale market share screen for each of the four seasons considered in the AEP-SPP control area. As the Commission stated in the April 14 Order, where an applicant is found to have failed either generation market power screen, such failure provides the basis for instituting a proceeding pursuant to section 206 of the Federal Power Act (FPA)⁴ and establishes a rebuttable presumption of market power in the section 206 proceeding.⁵ Accordingly, because AEP's filing indicated that it failed the wholesale market share screen, the Commission instituted on December 17, 2004, a section 206 proceeding⁶ to investigate generation market power in the AEP-SPP control area. The Commission also established a refund effective date pursuant to the provisions of section 206.

3. As discussed in the April 14 and July 8 Orders, the screens are conservatively designed to identify the subset of applicants who require closer scrutiny. Accordingly, for the AEP-SPP control area, AEP was directed within 60 days from the date of issuance of the December 17 Order to: (1) file a Delivered Price Test analysis; (2) file a mitigation proposal tailored to its particular circumstances that would eliminate the ability to exercise market power; or (3) inform the Commission that it will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.⁷

4. On February 15, 2005, as amended on February 17, 2005, AEP submitted a compliance filing in accordance with the December 17 Order, in which it proposed revisions to its market-based rate tariffs for sales in the AEP-SPP control area. According to AEP's cover letter, these revisions would provide for up to cost-based rates applicable to sales of electric power at wholesale that sink within the AEP-SPP control area. Noting that the Commission found in the December 17 Order that AEP satisfied both of the indicative screens in all first-tier markets interconnected with the AEP-SPP

³ *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (April 14 Order), *order on reh'g*, *AEP Power Marketing, Inc.*, 108 FERC ¶ 61,026 (2004) (July 8 Order).

⁴ 16 U.S.C. § 824e (2000).

⁵ April 14 Order, 107 FERC ¶ 61,018 at P 201.

⁶ *AEP Power Marketing, Inc.*, 109 FERC ¶ 61,276 (2004) (December 17 Order).

⁷ *Id.* at P 26.

control area, AEP stated that it would continue to use its market-based tariff to arrange capacity and energy sales transactions with entities that serve load outside the AEP control area in SPP and/or third parties on their behalf.

5. In making this up to cost-based rate proposal, AEP states that it does not concede that it has market power or that it has exercised market power, but that it makes the instant proposal “to avoid the burden of regulatory uncertainty and potential refunds that would be entailed in further litigating the issue of alleged market power in the AEP-SPP control area.”⁸ AEP also states that it reserves the right to seek market-based rate authority for wholesale power transactions sinking in the AEP-SPP control area after SPP places into effect a market monitoring plan satisfying the Commission’s conditions, or if the Commission adopts new or modified standards for analyzing market power issues.

6. AEP proposes to cap the overall rate for sales at the sum of a demand charge, an energy charge, and a transmission charge. The particular terms of AEP’s proposal are contained in Schedule A to AEP’s February 17 proposal, titled “Price Mitigation for Certain Sales” (Schedule A). AEP supports its proposed demand charge based on the weighted cost of the AEP generating units within the AEP-SPP control area that are likely to be used to provide the service at issue. To determine these units, AEP performed a “stacking analysis” whereby AEP’s generating units were stacked in increasing order based on their fuel costs and units and selected units by analyzing AEP’s minimum and maximum monthly peak demands. AEP states that the fixed costs of these units were calculated using a fixed charge rate for each AEP operating company for non-operation and maintenance costs, plus the actual operation and maintenance expenses for each unit. Per-kilowatt fixed costs were determined by dividing the fixed costs of the unit by the product of its installed capacity and equivalent availability factor (EAF). The proposed energy charge is equal to the anticipated incremental cost of energy expected to be purchased or produced plus ten percent, and the ten percent adder is capped at 1 mill per kWh in connection with power purchased specifically for resale. The transmission charge reflects a pass through of charges incurred by the seller pursuant to an open access transmission tariff.

⁸ AEP Feb. 15, 2005, cover letter at 3.

Notice of Filing and Responsive Pleadings

7. Notice of the compliance filing was published in the *Federal Register*, 70 Fed. Reg. 10,388 (2005), with comments, interventions, and protests due on or before March 10, 2005. East Texas Electric Cooperative, Inc. and Northeast Texas Electric Cooperatives, Inc. (collectively East Texas Cooperatives) and Oklahoma Municipal Power Authority (OMPA) filed protests. AEP filed an answer to the protests on March 25, 2005.

8. East Texas Cooperatives assert that AEP's proposal is ambiguous on rates for sales of long-term power, and take issue with AEP having chosen to adopt up to cost-based rates which, according to East Texas Cooperatives, contravene the Commission's April 14 Order by applying the up to cost-based rates to long-term sales. That is, East Texas Cooperatives argue that the Commission should not allow AEP incremental cost-based rates for long-term sales. Instead, East Texas Cooperatives argue that the remedy is to either properly mitigate market power or sell long-term power at embedded cost-based rates, not under up to rates and not at incremental cost-based rates. East Texas Cooperatives request that the Commission conditionally reject AEP's compliance filing until AEP affirmatively states that it will file any long-term sales contract with the Commission and will either properly mitigate market power as to that contract or charge average embedded cost rates for sales under that contract. East Texas Cooperatives urge the Commission to reject AEP's tariff until that tariff is clarified to apply only to short-term sales. Last, East Texas Cooperatives argue that in reserving the right to seek market-based rate authority for wholesale power transactions sinking in the AEP-SPP control area after SPP places into effect a market monitoring plan satisfying the Commission's conditions, AEP is seeking to preserve a right that is subject to rehearing and should not be granted, and also that the request should be denied because the SPP market monitoring and mitigation plan cannot mitigate AEP's market power.

9. OMPA states that it generally supports the notion of up to cost-based rates for AEP's sales into the AEP-SPP control area, but that the Commission should require certain clarifications of and changes to the proposed tariff terms, suspend the proposed tariff provisions for a nominal period, and set them for hearing to determine whether the rates, terms, and conditions thereof are just and reasonable. First, OMPA asserts that a discrepancy, perhaps unintentional, exists between AEP's cover letter and tariff. OMPA asks the Commission to require AEP to clarify that AEP does not intend to exempt from Schedule A sales to parties such as OMPA, that have load both within the AEP-SPP control area and outside of that control area, where the sales are to serve such parties' loads within AEP's SPP control area. Second, OMPA states that AEP's statement that the proposed mitigation does not apply to "sales into markets administered by

[SPP]”requires clarification. OMPA requests that the Commission provide for application of its default mitigation or, at a minimum, make clear that before AEP is permitted to make any sales into SPP-administered markets, the Commission will examine AEP’s market power in light of SPP’s proposed market design, and impose measures that fully mitigate the market power found with regard to AEP.

10. OMPA states that AEP’s proposal to cap the energy charge at the “anticipated incremental cost of energy expected to be purchased or produced by Seller plus ten percent” requires clarification, and urges the Commission to require AEP to provide further explanation as to how this charge will be determined. OMPA also takes issue with several aspects of how AEP proposes to derive the demand rate cap, such as the 11 percent return on equity (ROE) reflected in AEP’s fixed charge rate, calculation of the EAF and use of the EAF in the calculation of the demand rate for non-firm sales, the use of a company-wide fixed-charge rate versus unit specific operation and maintenance, and the reasonableness of calendar-year 2003 test-year data.

11. OMPA strongly urges the Commission to consider whether any demand charge may be appropriately recovered for certain sales under the market tariff; for example, OMPA states that there should be no demand charge where the sale is just a pass-through of energy purchased by AEP. Last, OMPA asks the Commission to reject AEP’s request to be permitted to include demand charges on sales of a week or less duration.

12. In its answer, AEP urges the Commission to reject the protests, arguing that the claims contained therein are unpersuasive and do not raise issues that should detain the Commission from approving AEP’s filing. In response to OMPA, AEP clarifies that purchases which serve load within the AEP-SPP control area are subject to the Schedule A up-to cost-based rates, while purchases which serve load outside the AEP-SPP control area, regardless of the identity of the purchaser, are not.

13. AEP notes that, with regard to OMPA’s request for clarification concerning the exclusion from Schedule A of sales into markets that SPP may administer in the future, Schedule A will not automatically apply to markets for which rules have yet to be devised or implemented. Once SPP’s market rules have been approved by the Commission, AEP states that it will have the opportunity to file appropriate tariff revisions, if necessary.

14. In response to OMPA’s question regarding what is meant by the phrase “anticipated incremental cost of energy,” AEP clarifies that, consistent with standard industry practice, AEP will quote for the term of the requested transaction a price based

on the incremental resource(s) and the projected running costs of those resources. AEP states that customers arranging transactions under Schedule A can rely on the price quoted for the proposed transaction.

15. AEP notes that the proposed 11 percent ROE tracks the ROE approved or agreed to in the AEP-SPP utilities' most recent retail rate proceedings.⁹ AEP notes that its proposal to utilize the EAF as a divisor in its demand rate calculation for sales that are not fully firm is appropriate. AEP states that the Commission has routinely used the firm rate as the cap for non-firm service.¹⁰ AEP states that OMPA apparently misunderstands the levelized, fixed-charge methodology underlying the filing. AEP responds there is no relevant comparison between the operating and maintenance costs of the units expected to serve and other units on the system, and that the Commission's long-standing matching principle requires only that the units most likely to be used be the basis for the fixed costs when the energy rate is based on incremental costs. With regard to the 2003 data that AEP used, AEP notes that it was both necessary and appropriate for AEP to use the 2003 Form 1 because it was the most recent version available.

16. AEP states it has reviewed the impact of using three- and five-year averages of the operating and maintenance data for the plant most likely to serve. AEP states the demand rate caps would increase by \$0.02 MWh or \$0.03 MWh, respectively.

17. In response to East Texas Cooperatives' argument that the filing did not address long-term sales and that AEP should be required to include language limiting the price of such sales to average embedded costs, AEP states that the April 14 Order did not impose an obligation to set out the rates and terms for long-term sales under a tariff. AEP states that it would be inappropriate and unnecessary to add such a provision to the cost-based Schedule A, because long-term sales generally address unique, customer-specific needs that are negotiated on a case-by-case basis. AEP also states that it did not suggest that any cost-based long-term agreements be based on the incremental cost caps set out in Schedule A or that those caps necessarily would be appropriate for every long-term arrangement. AEP states that, to the extent that it enters into a long-term, cost-based sales arrangement with a customer seeking capacity and energy to serve load in the

⁹ AEP notes that Southwestern Electric Power Company's rate was approved in Louisiana at 11.1 percent, and a recent settlement agreed to by Public Service Company of Oklahoma contains a rate of 10.75 percent. AEP Answer at 5.

¹⁰ See *American Elec. Power Serv. Corp.*, 88 FERC ¶ 61,141 at 61,449 (1999); *Wisconsin Pub. Serv. Corp.*, 25 FERC ¶ 61,101 at 61,325 (1983).

AEP-SPP control area, it will negotiate the appropriate rates and terms for that arrangement and file the agreement with the Commission for its review, consistent with the Commission's direction in the April 14 Order.

18. In response to East Texas Cooperatives' concerns regarding AEP's statement that it reserves the right to seek market-based rate authority for wholesale power transactions sinking in the AEP-SPP control area after SPP places into effect a market monitoring plan satisfying the Commission's conditions, AEP states that the language about which East Texas Cooperatives complain is not in the proposed tariff revisions. AEP submits that, in the future, like any other utility operating in the SPP, AEP will have the right to seek market-based rate authority for wholesale power transactions sinking in the AEP-SPP control area when it judges such a filing appropriate, and on such grounds as it believes are appropriate, including the effectiveness of a Commission-approved SPP market monitoring plan. AEP submits that East Texas Cooperative's attack on a filing that has not occurred is pointless in the current context.

Discussion

Procedural Matters

19. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385(a)(2) (2004), prohibits an answer to a protest unless otherwise ordered by the decisional authority. The Commission will accept AEP's answer because it provided information that assisted in our decision-making process.

Analysis

20. The Commission finds that a number of the issues raised by intervenors have been addressed by AEP in its answer. In response to East Texas Cooperatives' argument that AEP's proposal is ambiguous with regard to the rates for sales of power for more than one year, AEP has subsequently clarified that "[t]o the extent AEP enters into a long-term, cost-based sales arrangement with a customer seeking capacity and energy to serve load in the AEP-SPP control area, AEP will negotiate the appropriate rates and terms for that arrangement and file the agreement with the Commission for its review, consistent

with the Commission's direction in the [April 14] Order."¹¹ The Commission accepts this AEP commitment and finds that this commitment addresses East Texas Cooperatives' concerns.

21. With regard to East Texas Cooperatives' argument that AEP should not be permitted to reserve the right to seek market-based rate authority in the AEP-SPP control area after SPP places into effect a market monitoring plan satisfying the Commission's conditions, and that the Commission should "reject AEP's condition that its filing applies only until the start of the SPP's market monitoring and mitigation program,"¹² the Commission believes that East Texas Cooperatives misconstrue AEP's proposal. As AEP makes clear in its answer, it is not proposing that its up to cost-based rate proposal will apply only until such time as SPP has in place a market monitoring plan that satisfies the Commission's conditions. AEP acknowledges that it will first have to make a filing with the Commission. In the meantime, AEP's statement that it "reserves the right to seek market-based rate authority . . . after SPP places into effect a market monitoring plan satisfying the Commission's conditions" merely serves to put interested persons on notice of its intent to make such a filing at some point in the future. Should such a filing be made, East Texas Cooperatives will have the opportunity to intervene in that proceeding and to pursue its arguments at that time.

22. AEP's response in this regard also addresses OMPA's request that the Commission provide for application of its default mitigation or, at a minimum, make clear that before AEP is permitted to make any sales into SPP-administered markets, the Commission will examine AEP's market power in light of SPP's proposed market design, and impose measures that fully mitigate the market power found with regard to AEP. At such time as the Commission approves a market monitoring and mitigation plan for SPP, to the extent that AEP seeks to make market-based rate sales into that market, it will have to make a filing with the Commission to obtain such authority. In the meantime, however, the instant up to cost-based rate proposal will apply, subject to the outcome of the hearing established in this order.

¹¹ AEP Answer at 10. Consistent with the April 14 Order, the Commission "require[s] all long-term sales (one year or more) into any market where the applicant has market power to be filed with the Commission for review and approval prior to the commencement of service, and to be priced on an embedded cost-of-service basis." April 14 Order, 107 FERC ¶ 61,018 at P 155.

¹² East Texas Cooperatives Protest at 5.

23. We also believe that AEP has responded to OMPA's request that AEP clarify a discrepancy between its cover letter and proposed tariff by stating that AEP does not intend to exempt from the proposed up to cost-based rates sales to parties such as OMPA, that have load both within the AEP-SPP control area and outside of that control area, where the sales are to serve such parties' loads within AEP's SPP control area. AEP states that it agrees that OMPA's interpretation reflects AEP's intent: purchases which serve load within the AEP-SPP control area are subject to the Schedule A up to cost-based rates while purchases which serve load outside the AEP-SPP area, regardless of the identity of the purchaser, are not subject to the Schedule A up to cost-based rates.

24. The remaining arguments raised by intervenors relating to the rates, terms and conditions of AEP's proposed up to cost-based rates raise issues of material fact that cannot be resolved based on the record before us, and are more appropriately addressed in the trial-type evidentiary hearing ordered below.

Hearing Procedures

25. In the April 14 Order, the Commission adopted default rates tailored to three distinct products, as follows: (1) sales of power of one week or less will be priced at the applicant's incremental cost plus a 10 percent adder; (2) sales of power of more than one week but less than one year will be priced at an embedded cost "up to" rate reflecting the costs of the unit(s) expected to provide the service; and (3) sales of power for more than one year will be priced on an embedded cost of service basis and each such contract will be filed with the Commission for review and approved prior to the commencement of service.¹³ The Commission stated that it will set the just and reasonable rate at the default rate unless it approves different cost-based rates for that applicant based on case-specific circumstances.¹⁴

26. AEP states that its proposed rates contained in Schedule A comport with the Commission's default rates identified in the April 14 Order with one exception. Specifically, AEP proposes that it be permitted to negotiate a cost-based contribution to

¹³ April 14 Order, 107 FERC ¶ 61,018 at P 151.

¹⁴ April 14 Order, 107 FERC ¶ 61,018 at P 148.

its fixed costs for sales of power of one week or less in addition to incremental cost plus 10 percent. AEP seeks to use the same rates for sales of one week or less as it proposes for sales of more than one week but less than one year.

27. With regard to AEP's proposed rate for sales of power of one week or less, our preliminary analysis indicates that the proposed rates at issue have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, the Commission sets AEP's proposed mitigation rate for sales of power of one week or less for hearing.

28. In addition, with regard to AEP's proposed rate for sales of power of more than one week but less than one year, AEP has not provided sufficient cost support for the rate levels proposed and therefore our preliminary analysis indicates that the rates proposed for these sales have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Accordingly, the Commission sets AEP's proposed mitigation rate for sales of power of more than one week but less than one year for hearing.

29. Finally, with regard to AEP's proposal to cap the energy charge for sales less than one week and sales of one week to one year at the "anticipated incremental cost of energy expected to be purchased or produced by Seller plus ten percent" the hearing established herein should also address the specific formulas and methodology according to which AEP intends to calculate incremental costs.

30. Accordingly, we will accept the proposed tariff revisions for filing, suspend them for a nominal period, make them effective March 6, 2005, subject to refund, and set them for hearing.

The Commission orders:

(A) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly section 205 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 AEP's proposed up to cost-based rates, as discussed in the body of this order.

(B) A presiding judge, to be designated by the Chief Judge, shall, within approximately fifteen (15) days of the presiding judge's designation, convene a pre-hearing conference in these proceedings in a hearing room of the Federal Energy

Docket No. ER96-2495-026, *et al.*

-11-

Regulatory Commission, 888 First Street, NE, 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. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.