

124 FERC ¶ 61,306
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

American Electric Power Service Corporation

Docket No. ER08-1329-000

ORDER ACCEPTING AND SUSPENDING FORMULA RATE SUBJECT TO
REFUND AND ESTABLISHING HEARING AND SETTLEMENT JUDGE
PROCEDURES

(Issued September 30, 2008)

1. On July 31, 2008, American Electric Power Service Corporation (AEP) submitted, pursuant to section 205 of the Federal Power Act (FPA),¹ revised tariff sheets on behalf of its seven AEP East operating companies: Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, and Wheeling Power Company (collectively, AEP East Companies). The revised tariff sheets would increase transmission rates in AEP's zone by 12.15 percent in the initial year and would establish formula rates that would be automatically adjusted each year based on changes to AEP's costs as reported annually in the FERC Form No. 1, without contemporaneous requests for approval under section 205. We accept the revised tariff sheets for filing, suspend their effectiveness for five months, to be effective March 1, 2009, subject to refund and condition, and to the outcome of hearing and settlement judge procedures.

I. Background

2. The Open Access Transmission Tariff (OATT) of the PJM Interconnection, L.L.C. (PJM) contains zonal rates and allows each transmission owning member to make filings to maintain a current revenue requirement. The annual transmission revenue requirement

¹ 16 U.S.C. § 824d (2006).

for the AEP's Zone in PJM is reflected in Attachment H-14 of the PJM OATT.² Each pricing zone's transmission revenue requirement forms the basis for deriving unit charges for Network Integration Transmission Service (NITS) for load located within the pricing zone. On December 20, 2005, as amended on April 26, 2006, the Commission approved a settlement agreement that established the current stated transmission revenue requirements.³ AEP's existing zonal rate is fixed at \$1,757.40/MW-month and is based a projected 2005 transmission revenue requirement of \$487.6 million.

II. Filing

3. AEP proposes tariff sheets that would revise Attachment H-14 of the PJM OATT to provide for a forward looking formula rate, an annual true-up of that rate, and customer protocols governing such annual updates. The revised tariff sheets are in two parts: Attachment H-14A, the Formula Rate Implementation Protocols, and H-14B, the Formula Rate Template. The revised tariff sheets would convert AEP's existing transmission service rate to an annually updated cost-of-service formula rate. The proposed formula rate contains three cost-of-service provisions: (1) a historic cost-of-service, (2) a projected cost-of-service, and (3) a true-up cost-of-service, including protocols for updating the formula rate.⁴ AEP proposes to recalculate the revenue requirement under the formula rate with historical data, using FERC Form No. 1 cost data as well as data from its accounting ledgers. For each subsequent year, the historical cost-of-service data is based on the prior year's expenses and plant in service. For the projected cost-of-service, AEP proposes to calculate adjustments to recognize transmission plant additions and associated depreciation for new plant that have gone into

² The operating companies in AEP's East zone provide transmission service in Ohio, Virginia, West Virginia, Indiana, Michigan, Kentucky, and Tennessee.

³ See *American Electric Power Service Corporation*, 113 FERC ¶ 61,294 (2005); *American Electric Power Service Corporation*, 115 FERC ¶ 61,114 (2006). Different transmission revenue requirements were tied to the in-service date of the Wyoming Jackson's Ferry 765 kV transmission line. (See Exhibit AEP - 303 Revised Sheet No. 314B-01.)

⁴ AEP also provides *pro forma* Schedules 1A, Transmission Owner Scheduling, System Control and Dispatch Service, *pro forma* Schedule 7, Long-Term Firm and Short-Term Firm Point-to-Point Transmission Service, and *pro forma* Schedule 8, Non-Firm Point-To-Point Transmission Service. AEP's rates under these schedules will change after each Annual Update, these schedules however relate to multiple PJM pricing zones, as opposed to Schedule H-14 which is specific to the AEP East Companies. See Exhibit AEP - 302 for AEP's tariff sheets proposed under the PJM OATT.

service or are expected to go into service in the current calendar year in order to produce an estimate of the cost-of-service for that year.⁵ AEP notes that the only elements in its cost-of-service that are projected are those related to transmission plant in service additions and depreciation expense on new and existing plant in service. The true-up cost-of-service will use the prior year actual cost-of-service, and the difference between the collected cost-of-service and the true-up cost-of-service will be collected (or refunded) with the projected cost-of-service when AEP makes its annual update. Subject to true-up, the first year annual transmission revenue requirement for network service under the proposed formula is approximately \$586.8 million.⁶ AEP contends that its proposal for annual updates to its formula rate is similar to recently approved protocols in the PJM region.⁷

4. The return on equity is a stated rate, subject to change pursuant to section 205 or 206 of the FPA. AEP uses a proxy group of transmission owning utilities from PJM, the New York Independent System Operator, and New England RTO to determine central tendency. In calculating the return on equity, AEP proposes to apply the midpoint as opposed to the median of the proxy group, as most recently applied by the Commission for individual utilities.⁸ AEP believes that using a midpoint methodology is more appropriate for a utility of its size, serving customers in multiple RTOs, and because it raises capital as a single entity. AEP proposes a 12.1 percent return on equity, including

⁵ AEP also advises that Attachment H-14 has been modified to delete the network contract demand reservation service option used by customers with behind-the-meter generation. AEP explains that customers that used a similar option in the AEP OATT now take standard NITS service and the PJM OATT has been amended, pursuant to a settlement agreement. *See PJM Interconnection, L.L.C.*, 113 FERC ¶ 61,279 (2005) (clarifying the conditions under which behind-the-meter generation may be used to reduce a customer's Network Load).

⁶ The overall AEP zone cost of service is \$606.7 million before other transmission-related revenue credits. When the proposed annual transmission revenue requirement is divided by the single annual coincident peak (24,809.3 MW) in AEP's pricing zone, and then by twelve months, the resulting rate for network transmission service is \$1,970.92/kW-month, reflecting a 12.15 percent increase from AEP's existing \$1,757.40/MW-month stated rate. See Exhibit AEP-901.

⁷ *Citing Duquesne Light Co.*, 123 FERC ¶ 61,139 (2008) (*Duquesne*); *Commonwealth Edison Co.*, 122 FERC ¶ 61,030 (2008) (*Commonwealth Edison*).

⁸ *Citing Virginia Electric and Power Company*, 123 FERC ¶ 61,098 (2008) (*VEPCO*).

a proposed 50 basis point incentive adder for continued participation in PJM.⁹ AEP does not propose, at this time, incentive rate treatment except for the adder for its continued participation in PJM. However, in order to allow AEP to include certain rate treatments that it may seek and the Commission may authorize in the future, AEP's proposed formula rate includes a placeholder for recovery of Construction Work In Progress (CWIP), which may include 100 percent of CWIP,¹⁰ as may be allowed by the Commission. No CWIP balances have been included in rate base in the proposed formula rate proposal, and AEP does not anticipate requesting CWIP for short lead-time projects, but has provided for the possibility for projects that will require a multi-year construction period.

5. In addition, AEP proposes to use the annual beginning and ending rate base balances from FERC Form No. 1 instead of the 13-month average method to determine the true-up rate base to construct the true-up cost-of-service study. Because this information can be derived from annual FERC filings, AEP supports this methodology as administratively simple, verifiable and using readily available FERC Form No. 1 data rather than through monthly financial statements.

6. AEP explains that it has chosen to move from stated rates to a formula rate because, in addition to the Commission's encouragement,¹¹ more current cost recovery will assist AEP and PJM in developing needed transmission infrastructure. AEP requests an effective date of October 1, 2008, and that its proposed rates be accepted for filing without an evidentiary hearing or with only a nominal suspension.¹² AEP further requests that, if the Commission establishes a hearing, the Commission should specify the issues set for hearing and not permit parties to litigate formula rate provisions that the Commission has approved for other transmission owners.

⁹ AEP derives a base return on equity of 11.6 percent from a range of 7.8 percent to 15.5 percent.

¹⁰ See *Promoting Transmission Investment through Pricing Reform*, Order No. 679 at P 115, FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

¹¹ See Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 386.

¹² AEP cites instances in which the Commission has accepted formula rates with a nominal suspension, citing *Idaho Power Co.*, 115 FERC ¶ 61,281, at P 30 (2006); *Duquesne*, 118 FERC ¶ 61,087 at P 69; and *Trans-Allegheny Interstate Line Co.*, 119 FERC ¶ 61,219 (2007).

III. Notice, Intervention, Comments, and Protests and Answer

7. Notice of AEP's filing was published in the *Federal Register*, 73 Fed. Reg. 46,621 (2008), with interventions and protests due on or before August 21, 2008, which was subsequently extended to August 29, 2008.

8. IMPA, American Municipal Power-Ohio, Inc., Wabash Valley Power Association, Blue Ridge Power Agency, Buckeye Power, Inc., AEP Intervenor Group, Dominion Resources Services, Inc.,¹³ PPL Electric Utilities Corporation, Steel Dynamics, Inc., FirstEnergy Companies,¹⁴ North Carolina Electric Membership Corporation, PHI Companies,¹⁵ Ameren Services Company,¹⁶ Old Dominion Electric Cooperative, PSEG Companies, Hoosier Energy Rural Electric Cooperative, Inc., Exelon Corporation, City of Dowagiac, Indiana and Michigan Municipal Distributors Association, Consumers Energy Company, Joint Intervenors,¹⁷ Office of the Attorney General of the Commonwealth of Virginia (VA Consumer Counsel), Maryland Office of People's Counsel (Maryland OPC), and Craig Botetourt Electric Cooperative filed timely motions

¹³ On behalf of Virginia Electric and Power Company.

¹⁴ The FirstEnergy Companies are Jersey Central Power & Light Company, Metropolitan Edison Company, and Pennsylvania Electric Company.

¹⁵ On behalf of Pepco Holdings, Inc., Potomac Electric Power Company, Atlantic City Electric Company, and Delmarva Power & Light Company.

¹⁶ On behalf of Union Electric Company, Central Illinois Public Service Company, Central Illinois Light Company, Illinois Power Company, Ameren Energy Marketing Company, Ameren Energy Generating Company, and Ameren Energy Resources Generating Company.

¹⁷ The Joint Intervenors are IMPA, American Municipal Power-Ohio, Inc., Wabash Valley Power Association, Blue Ridge Power Agency, Buckeye Power, Inc., AEP Intervenor Group, Craig Botetourt Electric Cooperative, Old Dominion Electric Cooperative, City of Dowagiac, Indiana and Michigan Municipal Distributors Association, and Musser Companies.

to intervene. Protests were filed by the Joint Intervenors,¹⁸ VA Consumer Counsel, and Maryland OPC.¹⁹

9. The protestors assert numerous instances where AEP's protocols for updating the formula rate and challenging application of the formula rate are insufficient to ensure that AEP's rates are just and reasonable, are unreasonably restrictive on customers as to the scope of what can be challenged. Joint Intervenors also complain that AEP's revenue requirements are the results of seven separate companies, and its formula rate proposal is significantly more complex than that presented by the *Commonwealth Edison* and *Duquesne* formula rate proposals.²⁰ Joint Intervenors argue that AEP's proposal needs clarification and supporting workpapers, pointing to the timing, format, and scope of information to be posted as part of AEP's annual update. Joint Intervenors contend that they, and other interested parties, have the obligation and right to a thorough investigation of sufficient information to fully understand the nature of the current transmission-related costs incurred by the AEP East Companies as well as how those costs are intended to be recovered in the proposed formula rate. Joint Intervenors contend that the annual update protocols should provide for a meeting of interested parties each year to discuss the annual update, rather than trying to pursue potential issues through successive rounds of interrogatories.

10. The protestors assert that AEP's protocols impose unlawful limits on a party's statutory rights pursuant to FPA section 206. Specifically, protestors complain that the proposal seeks to include a "Preliminary Challenge" as prerequisite to an "Interested Party" filing a complaint under FPA section 206 (referred to as a "Formal Challenge" in AEP's Formula Rate Implementation Protocols).²¹ Protestors complain that the definition of Interested Party is too narrowly limited. Further, protestors complain that the protocols establishing Preliminary Challenge procedures are inconsistent with FPA section 206. Protestors also contend that the protocol's provisions to modify the formula rate pursuant to either a Preliminary or Formal Challenge establish a standard that

¹⁸ Joint Intervenors included supporting affidavits of Robert C. Smith and J. Bertram Solomon.

¹⁹ Maryland OPC included a supporting affidavit of Charles W. King. On September 5, 2008, Maryland OPC filed an erratum to the affidavit of Charles W. King.

²⁰ Joint Intervenors' Protest at 11-12.

²¹ VA Consumer Council's Protest at 7-9; Joint Intervenors' Protest at 22-27, citing *VEPCO*, 123 FERC ¶ 61,098 (2008).

exceeds the requirements of section 206 of the FPA. In addition, the protestors contend that the proposed protocols place unreasonable limits on prudence challenges, and that the protocols treatment of material accounting changes is unclear, confusing, and may be unreasonably restrictive.

11. The protestors contend that AEP's proposed total return on equity is likely to result in rates that are unjust and unreasonable. Joint Intervenors and Maryland OPC raise concern with the appropriateness, given the Commission's precedent,²² of AEP's proposal to use the midpoint rather than median of the proxy group data points for return on equity. In addition, protestors contend that AEP's proposed 11.6 percent return on equity, which is equal to the midpoint of the 7.8 percent and 15.5 percent range of the proxy group, is due to the competitive and unregulated portions of the proxy group companies' revenues that have contributed to the high growth rates, rather than the regulated transmission portion of these companies' revenues.²³ Thus, Maryland OPC and Joint Intervenors contend that AEP's proxy group has not been sufficiently screened for risk and unsustainable growth rates.²⁴ Maryland OPC argues that AEP's request is disputed by expert testimonial and factual evidence, and because expert testimony requires evaluation expert witnesses' credibility, the Commission should deny or reject AEP's request and set the case for evidentiary hearing.

12. As demonstrated within its protest, and supported with attached affidavits, Joint Intervenors contend that AEP's proposed \$63.6 million rate increase should be reduced by \$48.1 million or 75 percent, as follows:

<u>Issue</u>	<u>Reduction in Revenue Requirement</u>
1. Return on Equity	\$30,400,000
2. Prepaid Pensions in Rate Base	\$4,000,000
3. Hedging cost in LTD rates	\$6,700,000

²² Citing *VEPCO*, 123 FERC ¶ 61,098 at P 67; *Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Company*, Opinion No. 501, 123 FERC ¶ 61,047 (2008); *Northwest Pipeline Corporation*, 99 FERC ¶ 61,305 (2002).

²³ Citing Standard & Poor's "Research Summary," February 13, 2007; and Form 10-K, Public Service Enterprise Group, Inc. (accessed July 20, 2008).

²⁴ Citing *Potomac-Appalachian Highline, L.L.C.*, 122 FERC ¶ 61,188, at P 105 & n.110 (2008); see Joint Intervenors' Protest at 30-34.

4. ADIT items unrelated to Transmission	\$2,700,000
5. 13-month Average Rate Base	\$4,300,000
Total Quantifiable Impacts	\$48,100,000

13. In addition, Joint Intervenors contend that other questionable areas where discovery could well yield further reductions are to include: (a) Cash Working Capital in Rate Base, (b) Property Taxes Allocations, (c) Revenue Credits, (d) Business Development Expense, and the Wages & Salaries allocator.

14. Joint Intervenors request that the Commission reject AEP's request to accept its formula rate without a hearing or put its proposed rates into effect only after a nominal suspension period. Joint Intervenors request that the Commission follow its traditional suspension policy under *West Texas*,²⁵ and suspend AEP's rates for the full five-month suspension period, and set this matter for an evidentiary hearing. However, given AEP's history of working cooperatively toward settlement and AEP's contemplation of such process as an alternative form of relief, Joint Intervenors request that the Commission direct the Chief Administrative Law Judge to appoint a settlement judge while the evidentiary hearing is being held in abeyance.

15. On September 15, 2008, AEP filed an answer to the protests. AEP contends that its protocols for review of its annual update are adequate, and consistent with or more extensive and customer friendly than the Commission has approved in other cases.²⁶ Specifically, AEP argues that the protocols for annual updates places appropriate limits on inquiries and challenges that are related to the proper application of the formula, not to the just and reasonableness of the formula itself. AEP contends that the protestors incorrectly read the protocols as imposing limits on parties and the Commission, and that the protocols do not limit any party's FPA rights.²⁷ AEP also contends that the protocols provide a reasonable process for ensuring that application of the formula rate, once determined by the Commission to be just and reasonable, is accurate.

²⁵ *West Texas Utilities Company*, 18 FERC ¶ 61,189 (1982) (*West Texas*) (five-month suspension warranted when more than ten percent of the proposed increase is found to be excessive).

²⁶ AEP Answer at 3-4.

²⁷ *Id.* at 6-8.

16. In addition, AEP contends that the protestors seem to have confused the Formal Challenge within its protocols with a FPA section 206 complaint process. AEP argues that the protocols in its proposal contain no language prohibiting any party from raising any issue in a FPA section 206 complaint. AEP states that a complaint filed under the Formal Challenge procedures established by its protocols is filed pursuant to Rule 206 of the Commission's Rules of Practice and Procedure. In this instance, AEP has the burden of proving that its annual update is consistent with the filed rate under a preliminary challenge. However, AEP contends that complainants would have that burden in complaints filed pursuant to FPA section 206.

17. AEP differentiates provisions related to material accounting changes from other provisions to determine the accuracy of its formula rate annual update.²⁸ AEP contends that the central question surrounding the application of a material accounting change is not whether the change is consistent with the filed rate, rather whether the change renders the filed rate no longer just and reasonable. AEP contends that the question of whether a formula rate change proposed by an Interested Party in response to a material accounting change would change the original intent of the formula is relevant to the determination of the justness and reasonableness of such a proposed change. AEP contends that this is a reasonable attempt to limit unnecessary litigation over issues already addressed in the approval of the formula rate.

18. AEP objects to proposed language changes related to the burden of proof standards for challenges to the prudence of new expenditures.²⁹ AEP contends that protestors proposed language has the potential to create additional issues for litigation,³⁰ and that the language in the protocols is consistent with Commission precedent. Additionally, AEP states that it did not intend to exclude any customer who is eligible to take service from the PJM OATT, and would be willing to change the definition of Interested Party. AEP also states that it did not intend to obligate parties to coordinate information requests.

19. AEP answers that its proposed average rate base calculation is appropriate.³¹ AEP also contends that its proposed return on equity is just and reasonable and supported by

²⁸ *Id.* at 8-9.

²⁹ *Id.* at 9-10.

³⁰ *Id.* at 10, referencing Joint Intervenors' Protest at 25.

³¹ *Id.* at 11.

its analysis, and that its proxy group selection is consistent with Commission precedent.³² AEP also disputes the cost-of-service issues raised by the protestors, agrees that some issues may warrant hearing or settlement procedures, and contends that many of these issues do not warrant a hearing for the Commission to address.³³

IV. Discussion

A. Procedural Matters

20. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,³⁴ the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

21. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure,³⁵ prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept AEP's answer because it has provided information that assisted us in our decision-making process.

B. Substantive Determinations

22. We will accept, subject to a compliance filing as discussed below, and suspend AEP's proposed transmission cost of service formula rate for NITS service in PJM, to become effective March 1, 2009, subject to refund, and to the outcome of hearing and settlement judge procedures. In addition, we are granting the request for the 50 basis point adder for continued participation in an RTO. However, in conformity with *VEPCO*,³⁶ we condition our acceptance on AEP's revising its proposed protocols to remove the restriction on the rights to challenge the underlying inputs into the formula rates and file complaints with the Commission and likewise the Commission's rights to act *sua sponte* under section 206.

³² *Id.* at 15-23 citing *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2002); *Bangor Hydro-Electric Company*, 117 FERC ¶ 61,129 (2006); *Pepco Holdings, Inc.*, 124 FERC ¶ 61,176 (2008); *Atlantic Path 15*, 122 FERC ¶ 61,135 (2008).

³³ *Id.* at 24.

³⁴ 18 C.F.R. § 385.214 (2008).

³⁵ 18 C.F.R. § 385.213(a)(2) (2008).

³⁶ *VEPCO*, 123 FERC ¶ 61,098.

1. Acceptance and Suspension of the Formula Rate

23. The Commission has encouraged public utilities to explore the benefits of filing transmission-related formula rates.³⁷ Further, the Commission has found that the use of formula rates encourages the construction and timely placement into service of needed transmission infrastructure.³⁸

24. The protestors complain that AEP's proposed formula rates are unjust and unreasonable. The Maryland OPC requests that the Commission deny or reject AEP's formula rate proposal because it produces unreasonable results. Joint Intervenors and the Maryland OPC have protested various inputs to the formula rate and have requested clarification and supporting documentation for the reasonableness of many of the implementation protocols. The inputs to the formula rate are primarily from AEP companies' books and records. AEP proposes to true-up the plant estimates with actual data and provide interest on the differences.

25. We find that AEP's proposed formula rate raises issues of material fact that cannot be resolved based on the record before us, and are more appropriately addressed in the hearing ordered below. In order to allow the parties to fully investigate their concerns with the proposed formula rate inputs, we will not limit the scope of the issues included in the hearing ordered below, except to the extent that specific issues are addressed as discussed by this order.

26. Our preliminary analysis indicates that AEP's proposed revised tariff sheets have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. In *West Texas*, the Commission explained that, when our preliminary analysis indicates that proposed rates may be unjust and unreasonable and substantially excessive, the Commission will generally impose a maximum suspension (i.e., five months).³⁹ In the instant proceeding, our preliminary analysis indicates that the proposed rates may be substantially excessive. Therefore, we

³⁷ See *Promoting Transmission Investment through Pricing Reform*, Order No. 679 at P 386, citing *Allegheny Power System Operating Companies*, 111 FERC ¶ 61,308, at P 51 (2005); *Allegheny Power System Operating Companies*, 106 FERC ¶ 61,003, at P 32 (2004).

³⁸ See *Northeast Utilities Service Company*, 105 FERC ¶ 61,089, at P 23 (2003).

³⁹ 18 FERC ¶ 61,189 at 61,374-75 (the Commission will suspend a proposed rate for the maximum period, five months, if the proposed rate increase is found to be substantially excessive); *Tucson Elec. Co.*, 76 FERC ¶ 61,235 at 62,147 & nn.25-26 (1996).

will accept AEP's filing, suspend it for five months to be effective on March 1, 2009, subject to refund, and set it for hearing and settlement judge procedures.

27. AEP has proposed, as part of its formula rate, placeholders for the recovery of future incentives, should those incentives be authorized by the Commission. We direct AEP, in its formula template, to maintain a value of zero in all incentive placeholders. Should AEP seek authorization to recover incentives, AEP may file under section 205 of the FPA to replace the zero values in the placeholders with the approved amounts.⁴⁰ Specifically with respect to CWIP that might be approved by the Commission, AEP will need to demonstrate in the relevant, future filing that it meets the applicable requirements.

28. In addition, AEP has included a placeholder for regulatory assets. We direct AEP, in its formula template, to maintain a value of zero for regulatory assets, which have not been approved. AEP may file pursuant to section 205 of the FPA to replace the zero value for such regulatory assets with appropriate amounts.

29. We also direct the parties at the hearing to ensure that the formula components, including the placeholders for future incentives, will work as intended and will reflect correctly incentives that may be authorized for specific projects. For example, the formula should be able to track incentives for individual projects, since all projects might not be approved for incentives or for the same incentives.⁴¹

2. Specific Finding On Incentive ROE

30. We will grant up to 50 basis points of incentive ROE for AEP's continued participation in PJM, subject to the conditions of this order and the zone of reasonable returns determined following the hearing ordered below.⁴² Our decision to grant AEP an incentive for participation in the PJM is consistent with the stated purpose of section 219

⁴⁰ In permitting the placeholders for future incentives, we are not prejudging the outcome of future requests by AEP for authorization for such incentives.

⁴¹ *San Diego Gas & Elec.*, 118 FERC ¶ 61,073, at P 23 (2007) (SDG&E).

⁴² *See, e.g.*, *SDG&E*, 118 FERC ¶ 61,073 at P 25-26 & n.30; *American Elec. Power Serv. Corp.*, 120 FERC ¶ 61,205, at P 34 (2007), *order on reh'g*, 121 FERC ¶ 61,245, at P 4 (2007). We recognize that the actual incentive that AEP may receive (up to 50 basis points) may be limited by the top of the zone of reasonableness that we ultimately adopt in this proceeding. Accordingly, we grant AEP the full 50 basis point ROE incentive for participation in the PJM only so long as the additional 50 basis points do not result in an ROE above the zone of reasonableness.

of the FPA⁴³ – that the incentive applies to all utilities joining the transmission organization – and is intended to encourage AEP’s continued involvement with PJM.⁴⁴ Granting up to 50 basis points of incentive ROE does not remove any other issue pertaining to the ROE from consideration during the hearing and settlement judge procedures, including the appropriate proxy group and the screening criteria for the proxy group.

3. Specific Findings on Proposed Protocols

31. We address specific concerns regarding AEP’s unilaterally-filed proposed protocols raised by the protests. While we support the use of review protocols for establishing a process for the orderly review of and challenges to the application of a formula rate during any annual update, the review protocols may not place limits on a party’s ability to contest the inputs to a formula rate pursuant to a FPA section 206 complaint (or the Commission’s rights to act *sua sponte*).⁴⁵

32. The protocols define Interested Party as wholesale customers, affected utility regulatory commission or consumer advocate. Protestors contend that this limits participation, and AEP answers that this was not the intent of the protocols. The protocols may not limit participation allowed by the FPA. Accordingly, AEP needs to revise its protocols to expand the definition of the term Interested Party to include all parties having standing under section 206.⁴⁶

33. The proposed protocols establish a process for review of inputs to the formula rate, and define time limits for raising Preliminary and Formal Challenges to the application of the formula rate, including challenges related to material accounting changes.⁴⁷ Subsection 3(d) provides:

⁴³ 16 U.S.C § 824s (2006).

⁴⁴ See *SDG&E*, 118 FERC ¶ 61,073 at P 26 (finding that there are considerable benefits associated with a utility’s membership in a transmission organization).

⁴⁵ *VEPCO*, 123 FERC ¶ 61,098 at P 46.

⁴⁶ *Id.* P 45.

⁴⁷ OATT, Sixth Revised Volume No. 1, First Revised Sheet No. 314C, Attachment H-14A, Sections 2 and 3.

Subject to judicial review, each annual update shall become final and no longer subject to challenge pursuant to these Annual Review Protocols or by any other means by the FERC or any other entity on the later to occur of (i) passage of the twenty-one (21) day period (or extended period, if applicable) for making a Formal Challenge if no such challenge has been made and FERC has not initiated a proceeding to consider the Annual Update, or (ii) a final FERC order issued in response to a Formal Challenge or a proceeding initiated by FERC to consider the Annual Update.⁴⁸

34. Although AEP claims that its protocols do not take away parties' rights to challenge inputs into the formula, we read this provision as precluding such challenges after the 21 day period or an extended period. In approving any formula rate, the Commission approves the formula itself, the algebraic equation used to calculate the rates. It does not approve the inputs into the formula or the charges resulting from the application of the inputs to the algebraic equation. AEP has cited no authority permitting it to restrict the filing of a complaint under section 206 regarding the inputs used in the formula or the right of the Commission to institute a section 206 investigation. The courts have recognized that section 206 permits customers to challenge formula rates.⁴⁹

35. The Commission's long-standing precedent is that, under formula rates, parties have the right to challenge the inputs to or the implementation of the formula at whatever time they discover errors in the inputs to or implementation of the formula.⁵⁰ Indeed,

⁴⁸ *Id.*, Section 3(d).

⁴⁹ *Public Utilities Commission of California v. FERC*, 254 F.3d 250, 258 (D.C. Cir. 2001) ("Because relief can be sought pursuant to section 206 in the event a pass through of ... costs results in unjust and unreasonable rates, the Commission's acceptance of the ISO's formula rate without additional section 205 filings does not leave the [state public utilities commission] or ratepayers without any statutory recourse.").

⁵⁰ *North Carolina Electric Membership Cooperative v. Carolina Power & Light Co.*, 57 FERC ¶ 61,332, at 62,065 (1991) (rejecting the utility's efforts to limit the period of review to the prior 12 months by stating "[w]hile prompt identification of disputes is certainly a reasonable goal to strive for, the Commission cannot allow utilities to recover excessive rates through automatic adjustment clauses because the customer did not complain in as prompt a manner as the company believes the customer should have."). The Commission has held repeatedly that it may order refunds for past periods where a utility has either misapplied a formula rate or otherwise charged rates contrary to the filed rate. See *Appalachian Power Co.*, 23 FERC ¶ 61,032 at 61,088 (1983); *DTE Energy*

(continued)

customers may not uncover errors in data or imprudent or otherwise inappropriate costs until well after the challenge period.⁵¹

36. As we found in *VEPCO*,⁵² any challenge to the projected costs, True-Up Adjustment or Material Accounting Change would not require the complainant to bear the ultimate burden of proof. Rather, AEP continues to bear the ultimate burden of proof, i.e., to demonstrate the justness and reasonableness of the charges resulting from application of the formula rate, and it recognizes this burden in its proposed tariff sheets:

AEP shall bear the burden of proving that it has reasonably applied the terms of the Formula Rate, and the applicable procedures in these Formula Rate Implementation Protocols....⁵³

37. Accordingly, we will accept these provisions under the condition that AEP make a compliance filing within 30 days of the date of this order to revise the protocols so that they do not limit a customer's or the Commission's rights with respect to challenges to the inputs into the formula rate.

C. Hearing and Settlement Judge Procedures

38. Joint Intervenors indicate that AEP has a history of working cooperatively toward settlement. Accordingly, while we are setting this matter 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, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.⁵⁴ If the parties desire,

Trading, Inc. v. Midwest Independent Transmission System Operator, Inc., 111 FERC ¶ 61,062, at P 28 (2005); *Quest Energy, L.L.C. v. The Detroit Edison Co.*, 106 FERC ¶ 61,227, at P 21 (2004).

⁵¹ See, e.g., *Yankee Atomic Electric Co.*, 60 FERC ¶ 61,316, at 62,096-97 (1992) (allowing review of potentially imprudent costs charged to customers in prior-year formula rates).

⁵² *VEPCO*, 123 FERC ¶ 61,098 at P 47.

⁵³ OATT, Sixth Revised Volume No. 1, First Revised Sheet No. 314C, Attachment H-14A, Section 3(c). AEP's proposed tariff provisions correctly find that any party challenging the formula rate itself would bear the burden of proof. *Id.*, Section 2(e).

⁵⁴ 18 C.F.R. § 385.603 (2008).

they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.⁵⁵ The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, 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 commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) AEP's proposed formula rate is hereby accepted for filing and suspended for five months, to become effective March 1, 2009, subject to refund and conditions, and to the outcome of the hearing and settlement judge procedures ordered below, as discussed in the body of this order.

(B) Within 30 days of the date of this order, AEP must make a compliance filing, as discussed in the body of this order.

(C) 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 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 AEP's proposed formula rate. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (D) and (E) below.

(D) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2008), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding 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.

⁵⁵ If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).

(E) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and with the Chief Judge 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 Commission and the Chief Judge of the parties' progress toward settlement.

(F) If settlement judge procedures fail, and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in this proceeding in a hearing room of the Commission, 888 First Street, N.E., Washington, DC 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)

Nathaniel J. Davis, Sr.,
Deputy Secretary.