139 FERC ¶ 61,078
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

PJM Interconnection, L.L.C. Docket No. ER12-1173-000
American Electric Power Service Corporation
Indiana Michigan Power Company

ORDER ACCEPTING FORMULA RATE PROPOSAL AND
ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued April 30, 2012)

1. On February 29, 2012, American Electric Power Service Corporation (AEP) filed on behalf of Indiana Michigan Power Company (I&M) a formula rate template under Section D.8 of Schedule 8.1 – Appendix to the PJM Interconnection, L.L.C. (PJM) Reliability Assurance Agreement (RAA) for compensation for capacity made available by I&M in accordance with the capacity obligation of the Fixed Resource Requirement (FRR) Alternative of the PJM Reliability Pricing Model (RPM). As discussed below, the Commission accepts the filing, suspends the tariff revisions for a five-month period, to be effective October 1, 2012, subject to refund, and to the outcome of hearing and settlement judge proceedings. The Commission also denies the request for waiver of section 35.13 concerning submission of cost-of-service data.[1]

I. Background

2. The RAA, a rate schedule on file with the Commission, contains an alternative method for meeting the RPM capacity obligation, the FRR Alternative, which applies to entities that choose not to participate in the RPM auctions. The RAA requires an eligible load-serving entity that chooses the FRR Alternative (FRR Entity) to submit a capacity plan, for all load in the FRR service area, to meet the capacity requirement with specific

[1] 18 C.F.R. § 35.13 (2011).

capacity resources, as an alternative to participation in the RPM auction process. Section D.8 of Schedule 8.1 of the RAA provides:

> In a state regulatory jurisdiction that has implemented retail choice, the FRR Entity must include in its FRR Capacity Plan all load, including expected load growth, in the FRR Service Area, notwithstanding the loss of any such load to or among alternative retail LSEs. In the case of load reflected in the FRR Capacity Plan that switches to an alternative LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail.

3. Section D.8 of Schedule 8.1 of the RAA further provides:

> In the absence of a state compensation mechanism, the applicable alternative retail LSE shall compensate the FRR Entity at the capacity price in the unconstrained portions of the PJM Region, as determined in accordance with Attachment DD to the PJM Tariff, provided that the FRR Entity may, at any time, make a filing with FERC under Sections 205 of the Federal Power Act proposing to change the basis for compensation to a method based on the FRR Entity's cost or such other basis shown to be just and reasonable, and a retail LSE may at any time exercise its rights under Section 206 of the FPA.

4. Michigan Public Act 141 of 2000 and Public Acts 286 and 295 of 2008 serve as the authorizing legislation for electric choice in the state of Michigan. Michigan's electric choice program provides for retail customers that choose service providers other than their traditional utility to be served by an alternative electric supplier.

II. AEP's Filing

5. I&M currently participates in the PJM capacity market under the FRR Alternative as an FRR Entity. AEP states that, though the program has a 10 percent cap on the amount of load eligible for shopping, to date there is no load shopping in the I&M Michigan jurisdiction. AEP further states that, to the extent a Michigan alternative electric supplier secures shopping load and chooses to have that load reflected in I&M's FRR capacity plan, the alternative electric supplier would be required to compensate I&M for its capacity obligation in accordance with Section D.8 of Schedule 8.1 of the RAA.

6. AEP asserts that Michigan has not established a compensation mechanism for FRR capacity and that I&M, pursuant to its rights under Section D.8, elects to establish a cost-based method as the basis for compensation for its capacity obligation (Formula Rate). AEP asserts that the proposed Formula Rate is designed to recover from Michigan alternative electric suppliers the appropriate share of I&M's total generation revenue requirement through an annually-adjusted formula that tracks actual capacity costs. AEP states that the Formula Rate is consistent with Commission-accepted formulas used by other AEP utilities. However, AEP notes a significant difference between the Formula Rate proposed in this proceeding and the typical two-step formula rate process: the Formula Rate is based on actual data shown on the most current FERC Form 1 submitted by I&M, rather than on projected costs, and therefore will not require true-up calculations and potential surcharges. AEP states the input data are in most cases FERC Form 1 data, but in certain cases are also derived from workpapers provided in Attachment B to AEP's filing. AEP states that under the proposed Formula Rate, the FRR capacity rate will adjust each June 1 and remain in effect through the following May 31.

7. AEP states that the Formula Rate Implementation Protocols (Protocols), which are attached to the formula, provide the procedures under which I&M will prepare and circulate annual updates to the formula (Annual Update). AEP notes that, according to the Protocols, I&M must post the Annual Update on an AEP website and submit the Annual Update as an informational filing with the Commission. In addition, AEP states the Protocols provide that alternative electric suppliers will have the opportunity to review the Annual Update, request information related to the inputs, and confirm that I&M correctly applied the formula.

8. AEP states that the proposed Formula Rate uses year-end plant balances, including construction work in progress (CWIP) to determine the annual net revenue requirement.[2] AEP states that these plant balances will be adjusted to remove the portion of the balance representing Allowances for Funds Used During Construction (AFUDC) to ensure the Formula Rate does not include a charge for

[2] AEP states that the Formula Rate is intended to permit I&M to recover 100 percent of CWIP expenditures for Pollution Control Facilities and Fuel Conversion Facilities (as defined in section 35.25 of the Commission's regulations) and 50 percent of all other CWIP expenditures by including CWIP in rate base according to its proposed formula rate template, Appendix 1, Page 5. AEP notes that it will submit I&M's CWIP balances to be included in the Formula Rate for the following rate year in the Annual Update filed with the Commission.

both capitalized AFUDC and corresponding amounts of CWIP included in rate base. AEP states that the Formula Rate does not provide for recovery of costs related to energy or fuel and does not include transmission costs.

9. AEP states the proposed Formula Rate provides for the recovery of costs related to post-employment benefits other than pensions and post-employment benefits, and that, similar to the process for the recovery of CWIP, AEP will submit I&M's post-employment benefits other than pensions and post-employment benefits expenditures in the Annual Update filed with the Commission. AEP notes that the Formula Rate also provides for I&M's capacity revenue requirement to reflect a credit for I&M's off-system sales of capacity and energy.

10. AEP proposes an initial rate of return on common equity (ROE) of 10.2 percent, and provides the affidavit of Dr. William Avera in support of the reasonableness of this figure.[3] AEP notes that the proposed ROE is the same ROE that the Michigan Public Service Commission (Michigan Commission) recently accepted in an order approving a settlement of I&M's retail rates,[4] and that using the same ROE is reasonable in this case because the RAA capacity charges ultimately will be recovered from retail customers located within I&M's service territory who have the choice of being served by I&M or by an alternative electric supplier.

11. AEP proposes to make the formula rate effective on May 1, 2012.

12. AEP requests waiver of the provisions in section 35.13 of the Commission's regulations that would require it to submit any cost-of-service data beyond the information provided in Attachments A and B of the filing.

III. Notice of Filing and Responsive Pleadings

13. Notice of I&M's filing was published in the Federal Register, 77 Fed. Reg. 14,357 (2012), with interventions and protests due on or before March 21, 2012. Timely motions to intervene were filed by PJM Industrial Customer Coalition, Exelon Corporation, Old Dominion Electric Cooperative. FirstEnergy Service Company, on behalf of FirstEnergy Solutions Corp. (FirstEnergy), and the Retail Energy Supply

[3] AEP states that the proposed ROE falls well below the top of a range of just and reasonable ROEs calculated by Dr. Avera using the Commission's standard discounted cash flow methodology.

[4] *Order Approving Settlement*, Case No. U-16801 (Feb. 15, 2012).

Association and Energy Michigan (collectively RESA)[5] filed timely motions to intervene and protests. The Michigan Commission filed a notice of intervention. On March 22, 2012, the Indiana Utility Regulatory Commission (Indiana Commission) filed a motion to intervene out of time and a notice of intervention. On April 5, 2012, AEP filed an answer to the protests submitted by FirstEnergy and RESA. On April 13, 2012, FirstEnergy filed an answer to AEP's April 5, 2012 answer. On April 18, 2012, the Michigan Commission filed an answer in response to AEP's April 5, 2012 answer. On April 20, 2012, AEP filed an answer to FirstEnergy's April 13, 2012 answer.

IV. Procedural Matters

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2011), the notices of intervention and timely unopposed motions to intervene serve to make the entities filing them parties to the proceeding. Given the lack of undue prejudice or delay, the parties' interest, and the early stage of the proceeding, the Commission finds good cause to grant the Indiana Commission's unopposed, untimely motion to intervene.

15. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2011), prohibits an answer to a protest unless otherwise ordered by the decisional authority. The Commission, therefore, rejects the answers filed by AEP, FirstEnergy, and the Michigan Commission.

V. Discussion

16. As discussed more fully below, the Commission will accept the filing and suspend it for the maximum suspension period of five months, subject to refund and to the outcome of hearing and settlement judge proceedings. We will also deny the request for waiver of section 35.13.

[5] RESA's members include Champion Energy Services, LLC.; ConEdison Solutions; Constellation New Energy, Inc.; Direct Energy Services, LLC; Energetix, Inc.; Energy Plus Holdings LLC; Exelon Energy Co.; GDF SUEZ Energy Resources NA, Inc.; Green Mountain Energy Co.; Hess Corp.; Integrys Energy Services, Inc.; Just Energy; Liberty Power; MC Squared Energy Services, LLC; Mint Energy, LLC; NextEra Energy Services, Inc.; Noble Americas Energy Solutions LLC; PPL EnergyPlus, LLC; Reliant and TriEagle Energy, L.P.. Energy Michigan's members include Constellation NewEnergy, FirstEnergy, Glacial Energy, Integrys Energy, Noble Americas Energy Solutions, and Summit Energy.

A. Formula Rate

1. Protests

17. FirstEnergy and RESA allege that AEP cannot demonstrate that its proposed capacity rate of approximately $394/MW-Day is just and reasonable. FirstEnergy asserts that AEP has not sufficiently demonstrated the absence of a state capacity compensation mechanism. FirstEnergy argues that AEP has improperly assumed that I&M is entitled to a rate design based on fully embedded costs rather than on avoided costs and that AEP has failed to demonstrate that costs proposed under the formula rate are not already recovered through the AEP pooling agreement, existing requirements customers, the RAA, or elsewhere. FirstEnergy further asserts that AEP has failed to show that Michigan alternative electric suppliers will pay only their "appropriate share" and that AEP has not shown that the proposed rate is consistent with AEP's retail rate or its merchant affiliate rate. In addition, FirstEnergy argues that AEP has not shown that it is only seeking recovery of costs consistent with the purpose and intent of RPM. Finally, FirstEnergy argues that AEP has not demonstrated that its historical costs were prudently incurred and has failed to provide information that, in the absence of a waiver, would be required by the Commission's regulations.

18. RESA protests that I&M's proposed rate is not based on cost causation principles and is excessive and intended to prevent customers from choosing an alternative electric supplier. RESA argues the Formula Rate improperly includes costs not assessed on I&M's own retail customers and not related to PJM-related capacity products. In addition, RESA asserts the Formula Rate improperly includes costs, including CWIP and post-employment benefits, not related to serving current customers. RESA argues, moreover, that I&M's proposed rate is unduly discriminatory because the $394/MW-day for capacity I&M proposes to charge departing customers is nearly three-times the demand rate it charges customers who remain.

19. RESA and FirstEnergy request that the Commission reject the proposed formula rate. In the alternative, FirstEnergy requests that the Commission suspend the proposed tariff records for the maximum suspension period of five months after the 60 day notice period and set the matter for full evidentiary hearings including discovery. Additionally, as discussed further below, FirstEnergy argues that in no event should I&M's alternative capacity rate be permitted to go into effect before June 1, 2015.

2. Commission Determination

20. The Commission accepts I&M's proposed formula rate, subject to maximum suspension, as discussed below. I&M'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 procedures ordered below.

21. Preliminary analysis indicates that I&M's filing has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful.[6] In *West Texas,* the Commission explained that when the Commission's preliminary analysis indicates that the proposed rates may be unjust and unreasonable, and may be substantially excessive, as defined in *West Texas*, the Commission will generally impose a five-month suspension.[7] The Commission's preliminary analysis in this proceeding indicates that the proposed rate may be substantially excessive.[8] As noted above, protestors have challenged the calculation of the rate base and components of I&M's proposed formula rates. The Commission, therefore, suspends the proposed tariff records for the maximum suspension period of five months, to be effective October 1, 2012 subject to refund, and sets them for hearing and settlement judge procedures.

22. The Commission finds that AEP has not justified its request for waiver of section 35.13 and therefore denies the request. To the extent additional data is required during the hearing proceedings directed herein, we direct AEP to provide the data. However, having evaluated AEP's filing, the Commission finds that it minimally satisfies the Commission's threshold filing requirements and is not patently deficient. Therefore, the Commission denies the requests for rejection.

23. The Commission sets the entire rate and its design for hearing and settlement proceedings. The hearing should address the issues raised by the protestors in addition to other issues including, but not limited to, whether the inclusion of CWIP in rate base is consistent with the Commission's regulations and accounting procedures; [9] whether proper procedures are in place to ensure there is no double recovery of capitalized AFUDC and corresponding amounts of CWIP included in rate base; whether the costs included in the formula rate have already been paid for by other customers through other rate schedules; the extent to which alternative suppliers have relied on RPM clearing prices through June 2015; the inclusion of derivative hedges in the calculation of the

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[6] *W. Tex. Utils. Co.*, 18 FERC ¶ 61,189, at 61,374 (1982) (*West Texas*). In *West Texas*, the Commission held that "rate filings should generally be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust and unreasonable . . . ."

[7] *West Texas*, 18 FERC ¶ 61,189.

[8] *Id.* at 61,374-61,375; *accord Tucson Elec. Power Co.*, 76 FERC ¶ 61,235, at 62,147, n.25 (1996); *see also Ky. Utils. Co. v. FERC*, 125 FERC ¶ 61,242 (2008).

[9] *E.g.*, 18 C.F.R. § 35.13 and § 35.25 (2011).

overall rate-of-return; customer review procedures; the proper level of the ROE; and the resulting rate.

B. Effective Date

24. AEP requests that the proposed formula rate become effective May 1, 2012.

1. Protest

25. FirstEnergy rejoins that in no event should I&M's proposed rate be permitted to go into effect before June 1, 2015, the start of the delivery year corresponding to the next base residual auction, which (1) is the first opportunity for alternative electric suppliers to self-supply and (2) will prevent "toggling" between market-based and cost-based rates. FirstEnergy asserts that allowing the proposed formula rate to become effective before June 1, 2015 would leave alternative electricity suppliers "trapped" for the next three years with AEP's exponentially higher capacity prices and likely result in a "near freeze of new competitive activity" in Michigan.[10]

2. Commission Determination

26. The RAA provides that, in the absence of a state compensation mechanism, an alternative electric supplier "shall compensate the FRR Entity at the capacity price in the unconstrained portions of the PJM Region," provided that "the FRR Entity may, at any time, make a filing with FERC under Sections 205 of the Federal Power Act proposing to change the basis for compensation to a method based on the FRR Entity's cost or such other basis shown to be just and reasonable." AEP has made just such a filing, in accordance with the RAA. All signatories to the RAA, including FirstEnergy, were aware at the time they became parties to the agreement that, while the RPM auctions set capacity prices three years in advance, an FRR Entity is entitled to make a filing with the Commission under section 205 of the FPA for an alternate form of compensation "at any time." Moreover, section 205(e) of the FPA provides the Commission the authority to suspend for a period no longer than five months, and the Commission has suspended the filing for the full period permitted by the statute.

The Commission orders:

(A) I&M's proposed Formula Rate is hereby accepted for filing and suspended for five months, to become effective October 1, 2012, subject to refund, as discussed in the body of this order.

[10] FirstEnergy Protest at 14-15.

(B) 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 (C) and (D) below.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2011), 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.

(D) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and 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.

(E) 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 these proceedings in a hearing room of the Commission, 888 First Street, NE, Washington, DC 20426. Such a 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)

Kimberly D. Bose,
Secretary.