

Southern, Indiana Michigan, Kentucky, and Ohio; collectively, AEP East Zone Companies) with those of the former CSW operating companies (Texas Central, Texas North, Oklahoma, and Southwestern; collectively, AEP West Zone Companies). The SIA governs the distribution of certain costs and benefits between the AEP East and West Zones, while separate pool agreements control the distribution of costs and benefits within each zone.

3. Schedule D of the SIA addresses the allocation of “Trading and Marketing Realizations” (Marketing Realizations), *i.e.*, net revenues or margins from off-system sales. Under the currently effective Schedule D, Marketing Realizations from long-term off-system sales entered into prior to the merger are directly assigned to the zone in which the sale originated. Marketing Realizations from all other transactions are allocated according to a two-tier system. The first tier uses relative historical levels of Marketing Realizations during a base year consisting of the twelve months prior to consummation of the merger. The second tier consisting of Marketing Realizations above base-year levels, are allocated based on generating capacity owned by the companies in each zone.

4. This schedule contains a “sunset” provision, providing that the methodology for allocating Marketing Realizations shall be in effect until January 1, 2006, and that AEP shall file by November 1, 2005 a proposed methodology for allocating Marketing Realizations thereafter.³

5. In order to comply with the “sunset” provision, AEP submitted for filing the instant proposed revisions to Schedule D. The proposed revisions would allocate Marketing Realizations based on a direct assignment method in lieu of using a pre-merger test period and owned generation as a proxy for actual sales. Under this direct assignment methodology, Marketing Realizations will be allocated to the zone in which the underlying transaction occurred or originated. Under AEP’s proposal, as amended in its January 19, 2006, filing,⁴ Marketing Realizations would be allocated as follows:

The AEP East Zone Companies will be assigned: (1) Marketing Realizations resulting from transactions that either originate at

³ Transmittal Letter 1 at 2-3.

⁴ On December 20, Commission staff issued a deficiency letter requesting, among other things, that AEP clarify certain aspects of its proposed allocation methodology. AEP, in its January 19, 2006 amendment, provided the requested clarification, including proposed revisions to its originally-proposed tariff sheets reflecting that clarification.

locations served by Midwest Independent Transmission System Operator, Inc. (Midwest ISO) or PJM Interconnection, LLC (PJM), or terminate at such locations but do not originate at locations served by Electric Reliability Council of Texas (ERCOT) or the Southwest Power Pool (SPP); and (2) Marketing Realizations resulting from trading at other locations that are initially to originate or terminate within Midwest ISO or PJM and are ultimately settled financially without physical delivery or are settled with power from a location different than Midwest ISO or PJM.

The AEP West Zone Companies will be assigned: (1) Marketing Realizations resulting from transactions that either originate at locations served by ERCOT or SPP, or terminate at such locations but do not originate at locations served by Midwest ISO or PJM; and (2) Marketing Realizations resulting from trading at other locations that are initially to originate or terminate with ERCOT or SPP and are ultimately settled financially without physical delivery or are settled with power from a location different than ERCOT or SPP.

Any other Marketing Realizations that cannot be directly assigned in the manner described above will be allocated in proportion to the Marketing Realizations directly assigned to each zone for the current month plus the Marketing Realizations allocated to each zone for the preceding eleven months.

6. AEP states that the proposed direct assignment method for allocating Marketing Realizations is just and reasonable because it reflects the relative contribution from off-system sales revenues by the operating companies in each zone, and does so more accurately than the currently-effective two-tiered allocation methodology. It states that the first tier of the current allocation methodology, based on a pre-merger base year, does not take account of any circumstances that have changed over time. Similarly, it states, the second tier, based on generation capacity, does not provide a strong correlation with Marketing Realizations from each zone because it does not account for native load requirements or the relative ability of generation in each zone to make off-system sales economically. AEP states that it anticipates adding significant generation resources in both zones over the next decade. It states that, to the extent the new generation resources result in additional Marketing Realizations, under the proposed methodology, these will be received in greater proportion by the operating companies that acquire or build the resources producing the Marketing Realizations. It states that this is just and reasonable because the cost of generating resources in each zone is primarily borne by the operating

companies in each zone. It asserts that the proposed methodology correctly provides that customers who bear the cost of generating resources should be assigned the benefits made possible by those resources.

7. AEP proposes that the currently-effective allocation methodology under Schedule D remain in effect until after the Commission issues an order accepting or approving its proposal without suspension or potential refund. It requests that the revised allocation methodology be accepted to become effective the first day of the month following the month in which the Commission issues an order accepting or approving its proposal without suspension or potential refund. It states that this proposal is consistent with the Commission's practice in exercising its discretion to order refunds in cases involving allocation of costs among the operating companies of holding company systems.

Notice of Filing and Responsive Pleadings

8. Notice of AEP's November 1, 2005 filing was published in the *Federal Register*, 70 Fed. Reg. 69,334 (2005), with comments, protests, and interventions due on or before November 22, 2005. A timely notice of intervention, without substantive comments, was filed by the Arkansas Public Service Commission. The Louisiana Public Service Commission (Louisiana Commission) filed a timely notice of intervention and protest. On December 6, 2005, AEP filed an answer to the Louisiana Commission's protest.

9. The Louisiana Commission submits that AEP has failed to demonstrate that the proposed amendment is just and reasonable and argues that the filing is deficient. The Louisiana Commission argues that while the filing provides summary results of the impacts of the proposed revisions to the SIA, AEP fails to provide workpapers or supporting documentation to permit verification of that data. It also argues that it is impossible to determine whether the proposed changes will produce just and reasonable rates based on the single year of data provided in the filing, and suggests that data for the past five years is necessary.

10. AEP, in its answer, states that while it does not believe that the filing is deficient, it respects the Louisiana Commission's desire for more information in order to more fully understand the proposal, and had discussions with the Louisiana Commission staff regarding their request for information. Based on those discussions, the information requests were refined and AEP stated that it would provide additional information intended to help the Louisiana Commission better understand the proposal.

11. Commission staff, in its December 20, 2006 Deficiency Letter, in addition to requesting clarification of the proposal as indicated above, also noted AEP's statement in its answer that it would be providing information to the Louisiana Commission and requested that AEP file all of the information that it provided to the Louisiana

Commission. On January 19, 2006, AEP filed its response to the December 20, 2005 Deficiency Letter.

12. Notice of AEP's January 19, 2006 response to the deficiency letter, amending its original proposal to revise Schedule D, was published in the *Federal Register*, 71 Fed. Reg. 5,825 (2006), with comments, protests, and interventions due on or before February 9, 2006. None were filed.

Discussion

Procedural Matters

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the timely, unopposed notices of intervention serve to make the entity that filed them parties to the proceeding. Rule 213(a) (2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a) (2) (2005), prohibits an answer to a protest 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.

Substantive Matters

Direct Assignment Methodology

14. The Louisiana Commission complains that, because AEP's basis for the proposed change in allocation methodology is its experience with the "actual contributions of the respective zones during the last five years," while at the same time it only provided a single year of data, it is impossible to determine whether the proposal is appropriate.

15. We will accept the proposed revisions as modified by the clarifications and revisions submitted in AEP's January 19, 2006 filing. We note that the Louisiana Commission does not contend that the proposed methodology for allocating Marketing Realizations is unjust and unreasonable; nor did it file a protest to the January 19, 2006 filing containing additional data that it requested. Given that the costs of generating resources in each zone are primarily borne by the operating companies in each zone, a fact that the Louisiana Commission does not dispute, the proposed direct assignment allocation methodology will assign the benefits realized from resources to the customers who bear the costs of the resources. This approach is reasonable. The present methodology, using a proxy based on pre-merger Marketing Realizations by each zone, and each zone's generation capacity, was reasonable at the time it was approved. However, as AEP notes, that proxy may not be representative of the contributions by each zone to Marketing Realizations today, because the pre-merger test period data is stale. Moreover, generation capacity alone does not reflect the native load commitments

or the ability of generation in each zone to make off-system sales economically. In contrast, the proposed direct assignment allocation methodology ensures that customers who bear the costs of resources receive the benefits of Marketing Realizations generated by those resources.

16. We find that five years of data is not necessary to demonstrate the reasonableness of the proposal. AEP's comparison of the allocation of Marketing Realizations under the present allocation methodology to the allocation of Marketing Realizations under the proposed direct assignment allocation methodology, for the 12 months ending June 30, 2005, sufficiently demonstrates the proposal's impact.

Work-papers and Supporting Documentation

17. The Louisiana Commission, in its protest to the original filing, asserts that the filing includes a summary of the impacts of the proposal compared to the present allocation methodology, for the 12 months ending June 30, 2005, but does not contain workpapers or supporting documentation to permit verification of that data.

18. We do not agree that additional data and workpapers are needed to demonstrate that the proposal is just and reasonable. As discussed above, we accept the proposed direct assignment allocation methodology because we find it appropriately provides customers who bear the costs of resources the benefits generated by those resources.

19. However, we believe that access to data and workpapers underlying AEP's implementation of the allocation methodology will help interested parties verify that the methodology is being implemented properly. Accordingly, we direct AEP to make such data available to each customer buying from the AEP operating companies at cost-of-service rates and each state commission.

Retail Competition, ERCOT, and the Addition of Significant Generation Resources

20. The Louisiana Commission contends that the filing does not identify and explain the following: (1) the impact retail competition has had or will have on the past; (2) the impact of retail competition going forward on the allocation of Marketing Realizations; and (3) the impact of AEP's anticipated addition of significant generation resources in both zones over the next decade.

21. With respect to the impacts of retail competition on the allocation of Marketing Realizations, AEP in its answer explains that in the AEP East Zone none of its retail customers in Virginia and Michigan have chosen alternative suppliers, and that less than one percent of its retail customers in Ohio have switched suppliers. Accordingly, AEP explains, substantially all of the generation resources of the AEP East Zone Companies

remain committed to the bundled retail load in the states that have not adopted retail choice, and to default or provider of last resort service to the customers that have not switched to alternative suppliers in the states that have adopted retail choice. Thus, retail competition in the AEP East Zone has had no appreciable effect on Marketing Realizations.⁵

22. Furthermore, AEP explains that the AEP operating companies in ERCOT have almost completely exited the generation and power sales business pursuant to Texas electric restructuring law and that, as a practical matter, this means that there currently is and will be significantly less generation in the AEP West Zone to contribute to Marketing Realizations. The Louisiana Commission does not explain how these developments render the proposal to directly assign Marketing Realizations unreasonable, and we do not find that they do, as the proposed allocation methodology would continue to allocate the benefits of Marketing Realizations made possible by generating resources to the customers who bear the costs of those resources.

23. With respect to the impacts of adding new generation in each zone, we find that additional information demonstrating projected impacts is unnecessary. Consistent with our discussion above, when new generation is added to each zone, we find that Marketing Realizations made possible by those resources should be assigned to the customers who bear the costs of the resources.

Merger Approval Benefits

24. The Louisiana Commission asserts that the proposal will adversely impact the benefits associated with approval of the AEP/CSW merger by the Louisiana Commission. According to the Louisiana Commission, AEP committed to increase off-system sales for the former CSW operating companies. It states that AEP alleged that there would be savings as a result of the merger and that it would share those savings between ratepayers and shareholders. The Louisiana Commission asserts that the instant proposal will reduce the amounts payable to Southwestern that were part of the merger benefits.⁶

25. As an initial matter, the Commission does not require a demonstration that a merger will produce a certain level of net benefits to customers in order to find that it is

⁵ See AEP Answer at 3.

⁶ See Louisiana Commission Protest at 5.

in the public interest. Instead, it requires that customers are not harmed by the merger.⁷ The Louisiana Commission does not allege that the instant proposal will conflict with any of the bases the Commission relied on to approve the merger or that it violates any customer protection mechanisms approved by the Commission in the merger proceeding; nor do we find that it does. The proposal is just and reasonable for reasons stated above, notwithstanding that it may change the allocation of benefits that the Louisiana Commission relied on in its own evaluation of the merger. Moreover, our approval of the merger was conditioned upon AEP revisiting the methodology for allocating Marketing Realizations after five years.⁸ Accordingly, there was no guarantee that the allocation methodology would remain the same.

Effective Date

26. We agree with AEP's proposed effective dates. Its proposal to maintain the currently-effective allocation methodology under Schedule D, without retroactive refunds, until the first day of the following month following the issuance of this order approving the new methodology without suspension or potential refund is consistent with Commission precedent.⁹ In the past, the Commission exercised discretion by not ordering refunds in analogous cases involving allocation of costs among the operating companies of holding company systems. AEP's proposal is consistent with this practice, and we find no reason to deviate from this here. Accordingly, we accept the proposed amendments to the SIA effective January 1, 2006, allowing the revised allocation methodology to take effect April 1, 2004, as requested.

⁷ See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs. ¶ 31,044 at 30,123 (1996), *order on reconsideration*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997).

⁸ See *American Electric Power Company*, 89 FERC ¶ 63,007 at p. 65,038 (1999) (describing five-year section 205 filing obligation of July 13, 1999 Stipulation) approved by Opinion No. 442, 90 FERC ¶ 61,242 at 61,800 Ordering Paragraph (K).

⁹ See, e.g., *Southern Company Services, Inc.*, 64 FERC ¶ 61,033 (1993).

The Commission orders:

AEP's proposed amendments to the SIA are hereby accepted for filing, without suspension, effective January 1, 2006.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.