

125 FERC ¶ 61,027
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.

Westar Energy, Inc.

Docket No. ER08-1396-000

ORDER ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued October 10, 2008)

1. On August 13, 2008, Westar Energy, Inc. (Westar) filed what it characterizes as a Petition for Approval of Settlement Agreement (Settlement Agreement) between Westar and the City of Wathena, Kansas (Wathena) requesting the Commission to approve without condition or modification the Settlement Agreement and an associated *pro forma* rate schedule (Cost-Based Formula Rate Agreement for Full Requirements Electric Service) between Wathena and Westar (Formula Rate Agreement).

2. As discussed below, this order sets Westar's proposed Formula Rate Agreement for hearing and settlement judge procedures.

I. Background

3. Westar is a public utility primarily engaged in the generation, transmission, distribution and sale of electric energy with its principal office located in Topeka, Kansas. Westar's transmission system is located in eastern and central Kansas and is under the control of the Southwest Power Pool, Inc. (SPP), which is a Commission-approved regional transmission organization. Westar provides firm capacity and energy to Wathena pursuant to an Agreement for Wholesale Electric Service (WES) between Wathena and Westar effective August 20, 2007. The WES Agreement is a fixed-rate agreement for bundled service. The WES Agreement was for the period of October 1, 2007, through August 31, 2008.

4. Wathena is a municipality located in Doniphan County, Kansas. Wathena purchases electric power and energy and sells it to its customers within the franchised or certificated retail service territory that it has a statutory or contractual obligation to serve.

5. On September 27, 2004, as amended on September 30, 2004, Westar submitted an updated market power analysis in compliance with the Commission's Implementation

Order.¹ Westar's updated market power filing indicated that it passed the pivotal supplier screen in all markets considered, and that it passed the wholesale market share screen in all of the markets except for its home control area and the Midwest Energy, Inc. (Midwest) and Aquila Networks-West Plains Kansas (WPEK) control areas.

6. On March 23, 2005, the Commission instituted a proceeding under section 206 of the Federal Power Act (FPA)² concerning the justness and reasonableness of Westar's market-based rates in the Westar, Midwest and WPEK control areas. Westar proposed to use cost-based measures to address the Commission's requirements to mitigate market power. On September 26, 2006, the Commission issued an order, finding that Westar should make sales with terms of more than one year on an embedded cost-of-service basis.³

7. Westar states that, in light of the anticipated August 31, 2008 termination date of the WES Agreement and the Commission's findings in the Mitigation Order, it engaged in extensive negotiations with Wathena regarding the terms and conditions under which Westar would provide capacity and firm energy to Wathena. According to Westar, the proposed Formula Rate Agreement is the result of those discussions. Westar further states that the Formula Rate Agreement, by its terms, does not become effective until the first day of the month following the date that a Commission order becomes final approving, without condition or modification, or accepting, without condition or modification, the Formula Rate Agreement.

II. Description of Filing

8. Under the proposed Formula Rate Agreement, Westar will sell capacity and firm energy to Wathena. Westar will provide generation-related service at a cost-based formula rate under which: (a) the Variable Operations and Maintenance (VOM) component of the Energy Charge and the Demand Charge will change from year to year;⁴

¹ *Acadia Power Partners, LLC*, 107 FERC ¶ 61,168 (2004) (Implementation Order), *order on reh'g*, 110 FERC ¶ 61,178 (2005). The Implementation Order addressed the procedures for implementing the Commission's new interim generation market power analysis and mitigation policy announced in the Commission's April 14, 2004, Order in *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018, (2004).

² 16 U.S.C. § 824(e) (2000).

³ *Westar Energy Inc.*, 116 FERC ¶ 61,219 (2006) (Mitigation Order), *order on reh'g* 123 FERC ¶ 61,123 (2008).

⁴ The components of these charges are set forth in Appendix 1 to Attachment D of the Formula Rate Agreement.

and (b) the Energy Charge will change from month to month.⁵ Westar will also arrange for transmission, ancillary and distribution services and pass through the costs it incurs for arranging those services. The initial term of the Formula Rate Agreement is for twenty years and shall continue year to year thereafter until cancelled by one of the parties, with three years' prior written notice to the other party.

9. Under the Formula Rate Agreement, the Demand Charge and VOM Charge will not exceed Westar's average embedded cost. The Energy Charge includes the VOM Charge and fuel-related costs.

10. The Demand Charge for each contract year, except the final contract year, will be the lesser of (a) the latest Demand Charge produced by the formula rate template included in Appendix 1 to Attachment D; or (b) 110 percent of the prior contract year's Demand Charge.⁶ Westar proposes to derive the return on equity (ROE) annually under a formula that adds 535 basis points to the average of the daily Moody's Investors Service's Long-Term Baa Corporate Bond Index for December, subject to a floor and a ceiling of 9 percent and 18 percent, respectively. Under the proposed Formula Rate Agreement, a "public interest" standard of review will govern any proposed changes to the proposed ROE methodology.⁷

11. Westar states that Westar and Wathena entered into an attached Settlement Agreement to provide for the continuation of the WES Agreement during the period that the Formula Rate Agreement is pending Commission action. Westar requests that the WES Agreement remain in effect during this period. Westar emphasizes that by providing that the WES Agreement continue both Westar and Wathena will avoid any confusion and uncertainty as to the terms that will govern the service that Westar provides Wathena during this period.

III. Notice of Filing and Responsive Pleadings

12. Notice of Westar's filings was published in the *Federal Register*, 73 Fed. Reg. 50,805 (2008), with interventions and protests due on or before September 3, 2008. On September 3, 2008, Occidental Chemical Corporation and Occidental Power Marketing, L.P. (collectively, Occidental) filed a timely motion to intervene and protest and a motion

⁵ The Energy Charge will be subject to a true-up set forth in Attachment D of the Formula Rate Agreement.

⁶ The Demand Charge for the final contract year will be the latest Demand Charge produced by the formula rate template.

⁷ Article XII.2 of the Formula Rate Agreement.

to consolidate this proceeding with Docket No. ER08-808-000.⁸ The City of Arma, Kansas (Arma) filed a Motion to Intervene and Protest on September 3, 2008, as well.

13. Occidental argues that Westar incorrectly filed the Formula Rate Agreement under Rule 207(a)(5) of the Commission's Rules of Practice and Procedure.⁹ Occidental explains that Westar's rate filing is for new service with an existing customer and contends that Westar's filing must comply with the requirements set forth in section 35.13 of the Commission's regulations.¹⁰ Occidental maintains that Westar has failed to comply with these regulations.

14. Occidental states that Westar's proposed rate of return on common equity is not cost-based and is unjust and unreasonable. Occidental asserts that Westar has not explained its rationale for applying the formula rate's 535 basis point adder, nor has it shown it to be an appropriate measure of Westar's risk profile now or in the next 20 years under the Formula Rate Agreement. Lastly, Occidental asserts that Westar's proposed cap on Demand Charge increases is inconsistent with the embedded cost rate for long term sales as determined in the Mitigation Order.

15. Occidental asserts that Westar has failed to provide any incremental cost information or any assurance that captive customers will not subsidize the cost of serving Wathena. Specifically, Occidental contends that Westar failed to provide any assurance that its customers without caps on increases in their charges will not subsidize service to Wathena if Westar's costs exceed the Demand Charge under the Formula Rate Agreement due to the 10 percent cap on Demand Charge increases. Occidental contends that, because the Formula Rate Agreement may involve a subsidy from captive customers, it may unjustly support Westar's wholesale sales activity, thus frustrating competition by giving Westar an undue competitive advantage.

16. Occidental asks the Commission to either reject Westar's filing or set it for hearing. Occidental further requests that the Commission direct Westar to file all of the information required by section 35.13 of the Commission's regulations.

⁸ On June 6, 2008, the Commission issued an order establishing hearing and settlement judge procedures in Docket No. ER08-808-000, wherein Westar proposed an almost identical Formula Rate Agreement with the City of Mindenmines, Missouri. *See Westar Energy, Inc.*, 123 FERC ¶ 61,252 (2008).

⁹ *See* 18 C.F.R. § 385.207(a)(5) (2008).

¹⁰ *See* 18 C.F.R. § 35.1(c) (2008).

17. In its motion to consolidate, Occidental requests that the Commission consolidate this proceeding with the ongoing proceeding in Docket No. ER08-808-000, stating that such consolidation will promote administrative efficiency by saving time and resources. Further, Occidental emphasizes that consolidation will ensure that the issues are considered in a comprehensive manner, at one time, without the need for multiple successive proceedings.

18. Arma's protest raises concerns regarding its inability to evaluate the economics of the formula rate proposal due to lack of cost or financial information from Westar. Arma further notes concerns on the proposed non-rate terms, including, but not limited to, the twenty year term, lack of credit for customer generation, an ability to participate in generation (Westar's or other), the standard of review for certain items, and renewable portfolio standards. Finally, Arma notes a provision in a nearly identical agreement between Westar and the City of Burlingame, Kansas,¹¹ under which Burlingame would be prohibited from even intervening in any case involving Westar for at least the next twenty years.

IV. Discussion

A. Procedural Matters

19. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), their timely, unopposed motions to intervene serve to make Occidental and Arma parties to this proceeding.

B. Hearing and Settlement Judge Procedures

20. Occidental's argument that Westar incorrectly filed the Formula Rate Agreement because it did not comply with the requirements of section 35.13 of the Commission's regulations amounts to an argument that Westar's filing is patently deficient. Having evaluated Westar's filing, we find that it minimally satisfies our threshold filing requirements and is not patently deficient. Therefore, we shall deny the request for rejection.

21. Westar's proposed Formula Rate Agreement raises issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

¹¹ Docket No. ER08-1037-000.

22. We agree with Occidental that Westar has not adequately supported its proposed formula-based ROE. Westar's reliance on *Indiana Michigan Power Co.*¹² is misplaced. *Indiana Michigan Power Co.* is an unpublished letter order and does not constitute legal precedent binding on the Commission.¹³ Notwithstanding *Indiana Michigan Power Co.*, the Commission's policy is that ROEs must be supported through a discounted cash flow (DCF) analysis subject to review by the Commission and that increases in cost-based ROEs must be accompanied by individual filings under FPA section 205.¹⁴ The standard to deviate from this general policy is very high. To be specific, in order for the administrative law judge to approve the formula-based ROE, Westar must provide unequivocal evidence indicating that the proposed ROE is just and reasonable,¹⁵ despite our policy to the contrary.

23. In addition, in light of *Maine Pub. Util. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008), the Commission may not accept the standard of review as currently written with regard to third parties in this new agreement. As such, the standard of review provision in the Formula Rate Agreement is accepted conditioned on the parties revising the standard of review applicable to third parties consistent with the Commission's decision in *Duke Energy Carolinas, LLC*, 123 FERC ¶ 61,201, at P 10 & n.10 (2008). Westar should, within thirty days of the date of this order, file a revised standard of review provision consistent with this precedent. Thus, the standard of review is not set for hearing.

24. Our preliminary analysis indicates that Westar's proposed Formula Rate Agreement has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore,

¹² *Indiana Michigan Power Co.*, Docket No. ER06-140-000 (Feb. 15, 2006) (unpublished letter order).

¹³ See, e.g., *Idaho Power Co.*, 95 FERC ¶ 61,482 (2001); *Cambridge Electric Light Co.*, 95 FERC ¶ 61,162 (2001).

¹⁴ See, e.g., *Southern California Edison Co.*, 92 FERC ¶ 61,070, at 61,262-63 (2000); *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2002), order affirming initial decision, 102 FERC ¶ 61,143 (2003), reh'g denied, 106 FERC ¶ 61,302 (2004), order on remand, *Public Serv. Comm'n of the Commonwealth of Kentucky v. FERC*, 397 F.3d 1004 (2005); and *New England Power Co.*, 31 FERC ¶ 61,378, at 61,841-42 (1985).

¹⁵ *New England Power Co.*, 31 FERC ¶ 61,378, at 61,841-42, n.11 (discussing limited exceptions to the general policy against automatically adjustable rates).

we will set Westar's proposed Formula Rate Agreement (filed as a pro forma rate schedule) for hearing and settlement judge procedures.¹⁶

25. Based on the record before us, it is unclear whether the common questions of law or fact are such that consolidation of this matter with Docket No. ER08-808-000 will result in administrative efficiencies. Therefore, we will reserve the issue of whether to grant Occidental's motion to consolidate these two matters for determination in the course of the hearing or settlement judge procedures.

26. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before the 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.¹⁷ If the parties desire, 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.¹⁸ 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.¹⁹ 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. Should the settlement judge ultimately determine that a hearing is warranted, Westar shall file a full case in chief pursuant to the Commission's regulations to support its proposed rate structure at hearing.

¹⁶ Ultimately, actual tariff sheets would need to be filed to replace the pro forma tariff sheets.

¹⁷ 18 C.F.R. § 385.603 (2008).

¹⁸ 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 the date 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).

¹⁹ The issues in this matter may bear a significant relationship to those posed in Docket No. ER07-1344-000. On September 30, 2008, the Settling Parties in that matter filed a settlement agreement and offer of settlement. The Chief Judge should therefore consider deferring initiation of hearing procedures here, pending Commission action on the settlement in that proceeding.

27. In order to ensure continued service to Wathena, we will accept Westar's proposal for the continuation of the WES Agreement to be in effect while the Formula Rate Agreement is pending before the Commission.

The Commission orders:

(A) Westar's proposed Formula Rate Agreement is hereby set for hearing and settlement judge procedures.

(B) Westar is directed to file a revised standard of review provision, as discussed in the body of the order, within thirty (30) days of the date this order issues.

(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 Westar's proposed Formula Rate Agreement. 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.

(E) 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.

(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 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. Commissioners Wellinghoff and Kelly dissenting in part with a separate statement.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

