

139 FERC ¶ 61,144
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Pepco Holdings, Inc.

Docket No. ER08-686-002

ORDER DENYING REHEARING

(Issued May 22, 2012)

1. This order addresses individual requests for rehearing filed by the Maryland Office of People's Counsel (People's Counsel) and the Maryland Public Service Commission (Maryland Commission) in response to the Commission's August 22, 2008 order,¹ which granted Pepco Holdings, Inc. (PHI)² incentive rate authorizations for eight transmission owner-initiated projects (PHI Projects) under Order No. 679.³ For the reasons discussed below, we will deny People's Counsel's and Maryland Commission's requests for rehearing.

I. Background

2. The PHI Projects are PJM Regional Transmission Expansion Plan (RTEP)-approved baseline projects. At the time of the application, the PHI Projects were estimated to go into service between the summer of 2008 and 2012. The PHI Projects consist of various upgrades to the 230/500 kV system, the addition of new substations, rebuilding and reconductoring existing lines of 500 kV and below, and building new transmission lines in Maryland, New Jersey, and the Delmarva Peninsula area.

¹ *Pepco Holdings, Inc.*, 124 FERC ¶ 61,176 (2008) (August 22 Order).

² PHI submitted the request on behalf of PHI's transmission-owning public utility affiliates, which are: Atlantic City Electric Company, Delmarva Power & Light Company, and Potomac Electric Power Company (collectively, the PHI Companies).

³ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 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).

3. In the August 22 Order, the Commission granted a 150-basis point return on equity (ROE) transmission incentive for the PHI Projects. The Commission found that the PHI Projects met the requirements of section 219 of the Federal Power Act (FPA)⁴ as a result of a rebuttable presumption established in Order No. 679.⁵ Based on an examination of the scope,⁶ effects,⁷ and risks or challenges⁸ associated with the PHI Projects, in addition to other factual information provided by PHI, the Commission concluded that PHI had demonstrated that the projects were not routine and, thus, that there was a nexus between PHI's risks and challenges and the requested incentives, both as a package and for each individual project.⁹

4. In evaluating PHI's demonstration that its requested ROE fell within a range of reasonable returns, the Commission also accepted the PHI Companies' implementation of the Commission's preferred one-step discounted cash flow model. The Commission found that PHI appropriately applied Commission precedent to exclude from the proxy group: (1) companies that do not pay common dividends; (2) companies for which no Institutional Brokers Estimation System International, Inc. (I/B/E/S) or Value Line data is available; (3) companies that were involved in merger activities; and (4) companies whose business is comprised mainly of natural gas operations.

5. In addition to the screens PHI applied, the Commission applied two additional screens for risk. First, the Commission noted that it is reasonable to utilize corporate credit ratings as a screen for risk, and eliminated companies from PHI's proxy group with corporate credit ratings that were outside the band of BBB- to BBB+. Second, the Commission excluded companies with unsustainable growth rates. Applying these two additional screens to PHI's proffered proxy group, the Commission found that seven companies should be used as the PHI Companies' proxy group in the one-step discounted cash flow model: American Electric Power Company; DPL Inc.; Exelon Corp. (Exelon); FirstEnergy Corp.; Northeast Utilities; PHI; and UIL Holdings. This

⁴ 16 U.S.C. § 824s (2006).

⁵ August 22 Order, 124 FERC ¶ 61,176 at P 49.

⁶ *Id.* PP 63-69.

⁷ *Id.* P 69, 75.

⁸ *Id.* PP 71-73.

⁹ *Id.* PP 62-65, P 76.

final proxy group resulted in a range of reasonable returns of 7 percent to 15.9 percent.¹⁰ The Commission found that an overall ROE of 12.8 percent for the PHI Projects, comprised of PHI's previously authorized base ROE of 11.3 percent and the above-noted 150 basis point incentive ROE adder, was within the range of reasonable returns established in the Commission's analysis.¹¹

6. On September 22, 2008, Maryland Commission filed a request for rehearing and People's Counsel filed a request for rehearing, attaching the affidavits of Peter J. Lanzalotta and Charles W. King. On September 30, 2008, PHI filed an answer to the rehearing request and affidavits filed by People's Counsel.

II. Discussion

A. Procedural Matters

7. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2010) prohibits an answer to a request for rehearing. Accordingly, we will reject PHI's answer to the rehearing requests.

8. We will reject the two affidavits attached to People's Counsel's request for rehearing as the Commission generally does not permit parties to introduce new evidence for the first time on rehearing.¹²

B. Substantive Matters

1. Section 219 and Nexus Test Demonstration

a. Rehearing Requests

9. On rehearing, People's Counsel argues that: (1) the Commission should have required the PHI Companies' application to satisfy all four goals of section 1241 of the

¹⁰ *Id.* P 116.

¹¹ *Id.* P 112-28.

¹² *Potomac-Appalachian Transmission Highline, L.L.C.*, 133 FERC ¶ 61,152, at P 15 (2010) (*citing Ocean State Power II*, 69 FERC ¶ 61,146, at 61,548 & n.64 (1994) (holding that "[t]he Commission generally will not consider new evidence on rehearing, as we cannot resolve issues finally and with any efficiency if parties attempt to have us chase a moving target.")).

Energy Policy Act of 2005 (EPAAct 2005)¹³ to be eligible to receive incentives; (2) the Commission failed to consider all of the relevant factors for each of the eight PHI Projects and how other incentives or facts reduce PHI's transmission risk; and (3) because the Orchard and Mickleton Projects were substantially completed, they did not satisfy the nexus test.

10. On rehearing, Maryland Commission argues: (1) the Commission refused to adopt specific factors that should be considered in examining each project to determine whether it is routine and whether there is a sufficient nexus between the project and the incentive; (2) the Commission summarily concluded without a reasoned basis or analysis that all eight projects were equally entitled to the 150-basis point incentive ROE adder; (3) the Commission failed to apply the nexus test to each project in PHI's application to determine whether the incentive was tailored to fit the project without any reasonable explanation; and (4) PHI provided insufficient detail regarding the use of advanced technology to factor into the Commission's ROE determination.

b. Commission Determination

11. As discussed below, we deny the requests for rehearing.

12. We recognize that the requests for rehearing raise significant issues about the incentives granted in the August 22 Order. Indeed, it can be argued that if a similar request for incentives were submitted to the Commission at this time, the result might be different in light of the Commission's evolving policy with respect to application of the Order No. 679 nexus test.¹⁴ As relevant here, in December 2010 the Commission

¹³ Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594, 315 & 1241 (2005). Section 1241 added section 219 to the FPA. FPA section 219(b) provides that the Commission's rule shall: (1) promote capital investment in interstate transmission facilities; (2) provide an ROE "that attracts new investment in transmission facilities (including related transmission technologies);" (3) "encourage deployment of transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities" and improve their operations; and (4) "allow recovery of a company's prudently-incurred costs."

¹⁴ See, e.g., *PJM Interconnection, Inc.*, 133 FERC ¶ 61,273, at P 45 (2010) (holding that, in this and future cases involving application of Order No. 679, a company may file for incentives for numerous individual and unconnected projects at the same time, but the company must provide sufficient justification for why each project qualifies for incentives); accord *Oklahoma Gas & Electric Co.*, 133 FERC ¶ 61,274, at PP 38-40 (2010).

announced that an applicant may demonstrate that several individual projects are appropriately considered as a single overall project based on their characteristics or combined purpose, and seek incentives for that single overall project.¹⁵ The Commission also stated that if an applicant is unable to satisfy that criterion, then the applicant may still file a single application seeking incentives for numerous individual and unconnected projects, but the Commission will consider each individual project separately in applying the nexus test and determining whether each project is routine or non-routine.¹⁶ Thus, the Commission found that it would no longer apply the nexus test on an aggregated basis to individual and unconnected projects simply because an applicant sought incentives for those projects in a single application. In announcing that policy evolution, however, the Commission stated that it would apply this revised policy only prospectively.¹⁷

13. In the August 22 Order, the Commission applied the Order No. 679 nexus test consistent with its clear practice at that time, which allowed for application of the nexus test on an aggregated basis to individual and unconnected projects. As noted above, the Commission determined, in part on that basis, that the record was sufficient to find that the PHI Projects were non-routine,¹⁸ and to justify granting the requested 150 basis-point incentive ROE adder for each of those projects. In light of the findings in the August 22 Order and the issues raised on rehearing with respect to whether the Commission applied the nexus test appropriately, the Commission finds that on balance it is more appropriate to deny rehearing. We reach this conclusion based on the record on which the Commission relied in the August 22 Order when it applied the nexus test consistent with then-existing precedent. We also note the potential inequity to PHI of rescinding the previously granted incentives at this time, long after PHI relied on those incentives in

¹⁵ *PJM Interconnection, Inc.*, 133 FERC ¶ 61,273, at P 45 (2010); *Oklahoma Gas & Electric Co.*, 133 FERC ¶ 61,274, at P 39 (2010).

¹⁶ *Id.*

¹⁷ *See id.*

¹⁸ People's Counsel suggests that the PHI Projects' status as PJM RTEP baseline projects inappropriately had conclusive effect in the Commission finding that the projects were non-routine. People's Counsel Rehearing Request at 18-19. To the contrary, in reaching that conclusion, the August 22 Order considered both the PHI Projects' status as baseline RTEP projects and other factors such as the scope of the projects, their effect on the transmission system, and other project-related risks or challenges.

proceeding with the projects in question.¹⁹ In addition, we find that granting rehearing at this time would contribute to unnecessary confusion and uncertainty,²⁰ and that the regulatory uncertainty resulting from such action is likely to cause greater harm than allowing these incentives previously granted to PHI to remain in place.

14. We also find that the other, above-noted arguments raised on rehearing, many of which the Commission has rejected in other cases involving requests for incentives pursuant to Order No. 679, provide insufficient grounds to rescind the incentives at issue here. We are not persuaded by People's Counsel's argument that PHI's proposal must be denied unless all four goals identified in section 1241 of EPCRA 2005 have been met. The Commission has previously rejected this argument, stating:

We do not read section 219(b) as establishing a checklist of conditions that must be met before the Commission may authorize incentives in any particular case; rather, we read it as establishing general policy objectives to guide the rulemaking mandated in section 219(a) (and satisfied by the Commission in Order No. 679).²¹

15. We also reject People's Counsel's argument that because the Orchard and Mickleton Projects were substantially completed, they did not satisfy the nexus test. Contrary to People's Counsel's argument, the Commission has distinguished between projects that are ineligible for incentives under Order No. 679 because they are already complete at the time that an application for incentives is filed,²² and projects that remain

¹⁹ *Accord Northeast Utilities Service Co.*, 124 FERC ¶ 61,044, at P 62 (2008) (recognizing that denial of the incentive at a late stage could create regulatory uncertainty with project developers and may deter the development of future projects).

²⁰ *See Bangor Hydro-Electric Co.*, 122 FERC ¶ 61,265, at P 70 (2008) (“Remanding this case back to the Presiding Judge under these circumstances for the presentation of project-by-project evidence would also create unnecessary confusion and uncertainty concerning the availability of an ROE incentive for a number of important projects included in the 2004 [ISO New England regional transmission plan], many of which were required to move forward while this case was pending before the Commission.”), *aff'd sub nom. Connecticut Dep't of Pub. Util. Control v. FERC*, 593 F.3d 30, 37 (D.C. Cir. 2010) (noting the Commission's statement that holding a new hearing “would also create unnecessary confusion and uncertainty”).

²¹ *Baltimore Gas and Elec. Co.*, 127 FERC ¶ 61,201, at P 25 (2009).

²² *See, e.g., Commonwealth Edison Co.*, 122 FERC ¶ 61,037, at PP 30-37 (2008).

eligible for such incentives even if they are nearly complete.²³ The projects at issue here fall into the latter category because they were not complete at the time that PHI filed its application for incentives. Finally, we note that the August 22 Order found that PHI had satisfied Order No. 679's technology statement requirement.²⁴

2. Section 205 ROE Analysis

a. Rehearing Request

16. People's Counsel states that the Commission erred because it *sua sponte* reformulated the PHI Companies' proffered proxy group used to determine the zone of reasonableness after finding the proposed proxy group to be unjust and unreasonable. People's Counsel argues that PHI was required, but failed, to meet its burden of proof, both the burden of persuasion under section 205²⁵ and the burden of production under 18 C.F.R. § 35.13(e)(3), to show that its requested incentive and overall ROE was just and reasonable. People's Counsel argues that the Commission determined that the proxy group was unjust and unreasonable, and then acted on behalf of PHI by supplementing the testimony.²⁶

17. People's Counsel also argues that the Commission's summary disposition denied it the right and opportunity to respond. People's Counsel argues that it is constitutionally entitled to "notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."²⁷ People's Counsel argues that the due process clause forbids an agency to use evidence in a way that forecloses an opportunity to offer a contrary presentation,²⁸

²³ See, e.g., *Northeast Utilities Serv. Co.*, 126 FERC ¶ 61,052, at P 26 (2009).

²⁴ August 22 Order at P 80.

²⁵ People's Counsel Rehearing Request at 37 (citing *City of Winfield, La. v. FERC*, 744 F.2d 871, 877 (D.C. Cir. 1984)).

²⁶ *Id.* at 36, 38.

²⁷ *Id.* at 36-37 (citing *Dirt, Inc. v. Mobile County Comm'n*, 739 F.2d 1562, 1566 (11th Cir. 1984); U.S.C.A. Const. Amend. 5; 5 U.S.C.A. § 554(b)(3)).

²⁸ *Id.* at 37, citing *Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 63 (D.C. Cir. 1999).

and therefore, the Commission should accept and consider new testimony of Charles W. King, on behalf of People's Counsel.²⁹

18. Finally, People's Counsel argues that the Commission should abandon (or at least reduce) its reliance on the $br+sv$ growth rate³⁰ used in the Commission's one-step discounted cash flow model.

b. Commission Determination

19. We reject People's Counsel's argument that the Commission impermissibly supplemented the record on behalf of PHI. The Commission's findings in the August 22 Order were based on evidence in the record, and not on a "supplement" to the record, as People's Counsel argues.³¹ The Commission considered three discounted cash flow (DCF) analyses,³² two capital asset pricing models,³³ and one comparable earnings approach,³⁴ all of which were record evidence. The August 22 Order explains in detail why the Commission rejected several proposed models, including People's Counsel's

²⁹ *Id.* at 36.

³⁰ See August 22 Order, 124 FERC ¶ 61,176 at P 92, n.86. People's Counsel refers to this formula as the "book value growth methodology." The formula is $G-(br+sv)$, where:

G = sustainable growth rate

b = earnings retention rate, or 1 minus the payout ratio

r = return on equity

s = percentage increase in new stock raised from sale

v = fraction of sales of new stock that accrues to current stockholders.

³¹ PHI's response to the Commission's May 23, 2008 letter, filed in Docket No. ER08-686-001, Ex. No. PHI-1, Att. 4 (listing the corporate credit ratings of all of the companies in PHI's proposed proxy group).

³² As submitted in Docket No. ER08-686-000 by PHI in Ex. No. PHI-3 and supplemented in Docket No. ER08-686-001, People's Counsel in Ex. No. MOCA-3, and DEMEC in Att. 1-2.

³³ As submitted in Docket No. ER08-686-000 by PHI in Ex. No. PHI-4, and DEMEC in Att. 5.

³⁴ As submitted in Docket No. ER08-686-000 by PHI in Ex. No. PHI-5.

analysis, as contrary to long-standing Commission policy.³⁵ Contrary to People's Counsel's assertion that the Commission acted "on behalf of" PHI, the effect of applying additional screens to PHI's proxy group, based on corporate credit ratings and unsustainable growth rates, was to *lower* both the upper and lower bounds of the range of reasonableness that PHI proposed (from 16.5 percent to 15.9 percent and from 7.9 percent to 7 percent, respectively).³⁶ The Commission also denied PHI's request to take into consideration flotation costs in the final ROE determination.³⁷ People's Counsel's assertion is, therefore, belied by the Commission's actions.

20. Moreover, we reject People's Counsel's contention that the Commission's summary disposition failed to provide it with due process. Notice of PHI's section 205 application was proper and legally sufficient.³⁸ Further, in Order No. 679-A, the Commission recognized that its hearing procedures for determining ROE can create uncertainty, constituting a disincentive for investors.³⁹ Therefore, the Commission allowed incentives applicants to submit single-issue section 205 rate proceedings in which the Commission would attempt to render a decision on the paper submissions wherever possible, without routinely convening trial-type evidentiary hearings.⁴⁰ The Commission addressed a similar issue in *Pioneer Transmission, LLC*.⁴¹ In *Pioneer*, the Commission rejected the claim that it must always order trial-type hearings in ROE cases. As the Commission explained in *Pioneer*, a formal trial-type hearing is unnecessary where there are no material facts in dispute, or where disputed issues may be adequately resolved on the written record.⁴² Likewise, the August 22 Order denied requests for a trial-type evidentiary hearing as contrary to established case law.⁴³ Here, People's Counsel had a sufficient opportunity to dispute PHI's evidence and supplement the record

³⁵ August 22 Order, 124 FERC ¶ 61,176 at PP 118-27.

³⁶ *Id.* P 116.

³⁷ *Id.* P 117.

³⁸ *Federal Register*, 73 Fed. Reg. 37,947 (2008).

³⁹ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at PP 69-70.

⁴⁰ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 79.

⁴¹ 130 FERC ¶ 61,044 (2010) (*Pioneer*).

⁴² *Id.* P 35 (citing *Moreau v. FERC*, 982 F.2d 556, 568 (D.C. Cir. 1993)).

⁴³ August 22 Order, 124 FERC ¶ 61,176 at P 130.

through submittal of its own expert testimony.⁴⁴ Accordingly, the August 22 Order was issued on the basis of all the evidence that the parties submitted in this proceeding, and parties were given ample opportunities to explain and rebut one another's evidence.

21. Finally, for the same reasons cited in the August 22 Order we reject People's Counsel's suggestion that we revisit our use of the br+sv growth rate in this case.⁴⁵ The br+sv growth rate is a long-standing Commission policy, and we decline to change that policy based on a single party's position in an isolated case.⁴⁶

22. For these reasons, we will deny People's Counsel's request for rehearing on the section 205 ROE determination.

⁴⁴ See People's Counsel Protest filed April 8, 2008 in Docket No. ER08-686-000, attaching Affidavits from Charles W. King and Peter J. Lanzalotta in support; see also People's Counsel Protest filed July 14, 2008 in Docket No. ER08-686-001, attaching Affidavits from Charles W. King and Peter J. Lanzalotta in support.

⁴⁵ August 22 Order, 124 FERC ¶ 61,176 at P 124.

⁴⁶ *Generic Determination of Rate of Return on Common Equity for Public Utilities*, Order No. 420, FERC Stats. & Regs. ¶ 30,644; *Orange and Rockland Utilities, Inc.*, Opinion No. 314, 44 FERC ¶ 61,253, at 61,953 (1988); *Appalachian Power Co.*, Opinion No. 423, 83 FERC ¶ 61,335 (1998); *Systems Energy Resources, Inc.*, 92 FERC ¶ 61,119, at 61,465-66 (2000); *Southern California Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070 (2000); *Consumers Energy Co.*, 98 FERC ¶ 61,333, at 62,416 (2002); *Midwest Independent Transmission System Operator, Inc.*, Initial Decision, 99 FERC ¶ 63,011, order approving initial decision, 100 FERC ¶ 61,292 (2002); order affirming initial decision with modification, 100 FERC ¶ 61,292 (2002), order on reh'g, 102 FERC ¶ 61,143 (2003), order on remand, 106 FERC ¶ 61,302 (2004), *aff'd in pertinent part and rev'd in other parts sub nom. Publ. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005); *Bangor Hydro-Electric Co.*, Opinion No. 489, 117 FERC ¶ 61,129 (2006), order on reh'g, 122 FERC ¶ 61,265 (2008).

The Commission orders:

The requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.