

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Allegheny Power

Docket No. ER02-136-004

Opinion No. 469

OPINION AND ORDER AFFIRMING FINDINGS IN INITIAL DECISION  
AND MAKING FINDING ON CONTRIBUTION IN AID OF CONSTRUCTION  
ISSUE

Issued: March 9, 2004

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Appearances

*Leonard W. Belter, Patricia J. Clark, and John J. Dempsey III* on behalf of  
Allegheny Power (Allegheny Power)

*Robert Weinberg and Eli D. Eilbott* on behalf of Allegheny Electric Cooperative,  
Inc. (AEC)

*Joseph H. Long and James R. Keegan* on behalf of the Federal Energy Regulatory  
Commission Trial Staff (Trial Staff)

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Before Commissioners:

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1. This proceeding is before the Commission on exceptions to the initial decision (ID) in this proceeding issued by the presiding judge on May 5, 2003.<sup>1</sup> In this opinion and order, we affirm the judge's findings in the ID. In addition, we make a finding on a contribution in aid of construction issue, which was not addressed in the ID.

**I. Background**

2. This matter began on October 19, 2001, when West Penn Power Company, doing business as Allegheny Power (Allegheny Power), submitted for filing an addendum to its current agreement with Allegheny Electric Power Cooperative, Inc. (AEC). The addendum represents Allegheny Power's proposed revised charges, terms, and conditions for a one-year (December 1, 2001-November 30, 2002) extension of the existing agreement. The addendum would also govern the rates for partial requirements service from Allegheny Power to AEC since November 30, 2002.<sup>2</sup>

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<sup>1</sup> Allegheny Power, 103 FERC ¶ 63,001 (2003).

<sup>2</sup> In an October 19, 2001 transmittal letter, at p. 2, Allegheny Power explains that under § 2.6 of the parties' 1994 settlement agreement, for partial requirements service to AEC, the contract automatically renews for one year periods unless a notice of termination is filed at least two years in advance of the termination date. Neither party filed such a notice of termination as both want this service to continue to be offered. Thus, this case involves the ongoing rates that Allegheny Power will charge AEC for partial requirements service.

3. By Order issued December 8, 2001, Allegheny Power, 97 FERC ¶ 61,274 (2001), the Commission accepted the proposed addendum for filing, suspended it for a nominal period, made it effective subject to refunds, established hearing procedures, but held the hearing in abeyance pending settlement judge procedures. When settlement efforts failed, the matter was set for hearing. A hearing was held, briefs were filed, and the presiding judge issued the ID. The matter is now before us on exceptions to the ID.

## **II. Summary of Findings in ID**

4. The ID found that this case basically involves three issues. The first issue is whether Allegheny Power should be directed to develop its subtransmission/distribution service charges on a system-wide rolled-in basis. This issue arose when Allegheny Power proposed that the low voltage subtransmission facilities used to serve AEC should be directly assigned to AEC and not rolled-in among the total costs of the integrated subtransmission/distribution network serving Allegheny Power's entire system. By contrast, both AEC and Trial Staff recommended that these costs be rolled-in as part of a company-wide rolled-in subtransmission charge. In the ID, the judge found that the facilities constitute part of Allegheny Power's total integrated network and thus, these costs should be rolled-in.

5. The second issue addressed in the ID is whether the costs of Allegheny Power's 138kV transformer substations should be entirely allocated to its lower voltage customers or partly allocated to its higher voltage customers and partly allocated to its lower voltage customers. The ID recounts that AEC had argued that some of these costs benefited higher voltage customers and thus, should not be allocated entirely to lower voltage customers. The ID rejected this approach and found that these facilities were designed and built to serve lower voltage customers and should be allocated entirely to Allegheny Power's lower voltage customers.

6. The third issue addressed in the ID is return on equity. Allegheny Power proposed a rate of return on equity of 12.9%, and its witness further recommended that this rate of return should be adjusted upwards to 14.65%. By contrast, AEC and Trial Staff each recommended a return on equity of 10.59%. The ID found that the record supports a return on equity of 10.59%, as recommended by AEC and Trial Staff. The ID also found that the record supports a capital structure of 64.76% long-term debt and 35.24% common equity, as recommended by Trial Staff, based on Allegheny Power's actual capital structure.

## **III. Briefs on Exceptions and Briefs Opposing Exceptions**

7. In response to the ID, briefs on exceptions were filed by AEC and Allegheny Power, and briefs opposing exceptions were filed by AEC, Allegheny Power, and Trial

Staff. Allegheny Power argues that the judge erred when he: (1) rolled-in AEC's subtransmission charge and rejected Allegheny's request for direct assignment of this charge; (2) failed to address additional cost of service issues, related to his finding on the roll-in of AEC's subtransmission charges; (3) when he adopted a return on equity of 10.59% based on a proxy group of utilities, rejecting Allegheny Power's proposed rate of return based on an Allegheny-only analysis; and (4) when he rejected Allegheny Power's proposed 50% debt, 50% equity hypothetical capital structure.

8. Trial Staff argues that the judge properly decided that the subtransmission service charge should be computed based on a roll-in of the subtransmission facilities serving AEC. AEC supports the judge's finding on the roll-in of subtransmission facilities, but argues that the judge erred when he ignored its proposed adjustment to include a contribution in aid of construction it made. Allegheny Power argues that AEC's arguments supporting the judge's roll-in of subtransmission facilities are inconsistent with its argument seeking credit for a contribution in aid of construction. AEC responds that the judge properly rejected Allegheny Power's proposed direct assignment of subtransmission facilities, which it argues were based on flawed arguments and assumptions. Further, contrary to Allegheny Power's position, Trial Staff, and AEC each argue that the judge properly decided Allegheny Power's return on equity and capital structure.

9. In addition, Allegheny Power's brief on exceptions and AEC's brief opposing exceptions each discuss the issue of the age of the lines used to serve AEC. This issue was not discussed in the ID and becomes relevant only if the Commission reverses the judge's decision to roll-in the cost of the subtransmission facilities used to provide service to AEC. In this regard, AEC argues that the lines used by Allegheny Power to serve AEC are significantly older than average (for the West Penn system), while Allegheny Power disputes this.

#### **IV. Discussion**

10. As a preliminary matter, we note that none of the parties filed exceptions to the judge's finding concerning the allocation to lower voltage customers of the costs of Allegheny Power's 138kV transformer substations. Thus, we will affirm this finding without further discussion.

##### **A. Rolled-In Rates**

11. The dispute here is whether the judge properly found that Allegheny Power should calculate AEC's subtransmission service charges based on the system-wide costs of Allegheny Power's subtransmission facilities (*i.e.*, that the charges should be calculated on a rolled-in basis). Allegheny Power argues that the judge erred and that these charges

should be directly assigned. To this end, Allegheny Power argues that the company's 25 kV lines used to serve AEC are not part of its integrated network, and thus, should not be rolled-in when computing AEC's subtransmission service charge. Allegheny Power further argues that its position on this issue was misunderstood and that it developed this charge based on accepted load flow models, and not on geography. Finally, Allegheny Power argues that the rolled-in approach was not used in developing the subtransmission charges for its other former wholesale requirements customers, and is contrary to the approach approved in the PJM open access transmission tariff (OATT).

12. AEC responds that Allegheny Power's arguments are misplaced because Allegheny Power failed to meet its burden to distinguish between distribution-level facilities that should be included and facilities that should be excluded from the proposed charge. AEC argues that merely identifying the proper universe of facilities to be excluded is not sufficient. AEC argues that Allegheny Power had the additional burden of justifying those distinctions and failed to do so. Thus, AEC concludes that the judge properly determined that a rolled-in approach would be preferable because Allegheny Power did not perform a system-wide load flow study that simultaneously analyzed AEC-related load flows on all West Penn facilities used to provide subtransmission service at AEC's 18 delivery points. Instead, AEC argues, Allegheny Power merely looked at a sample of "cost allocation zones" that were arbitrarily selected to bolster Allegheny Power's arguments. AEC argues that such a demonstration did not constitute adequate support for Allegheny Power's proposed direct assignments.

13. AEC also points out that, on cross-examination, Allegheny Power's witness conceded that Allegheny Power's method for defining cost allocation zones was based on a pre-set notion of a purely radial electrical path that disregarded the actual power flows and impacts into and out of each such zone.<sup>3</sup>

14. Thus, AEC argues, the ID was exactly right to conclude that Allegheny Power provided an unsatisfactory description of how it identified (for cost allocation purposes) the facilities serving AEC, and that Allegheny Power provided little support for its contention that only certain discrete facilities serve AEC. AEC concludes that the ID finds, and the record wholly supports, a conclusion that Allegheny Power's facility identification method improperly presumed, contrary to the evidence, that the subtransmission facilities serving AEC do not operate as part of an integrated network.

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<sup>3</sup>Tr. 159-60; *see also* Exh. S-3 at 5 ("AP identified those facilities that are directly connected from the AEC interconnection point to the transmission system **without regard to how power flows over the facilities**") (emphasis supplied).

15. Trial Staff also supports the judge's finding on this issue and disputes Allegheny Power's attempted characterization of the issue. Trial Staff contends that the real question presented is whether the Commission will require a specific subtransmission service provider to assess a charge for a specific subtransmission/distribution customer by rolling in all the service provider's costs of providing subtransmission/distribution service when: (1) that service provider has failed to present a coherent analysis of any other way to charge for the service; and (2) the record shows that the customer's service is provided primarily through network subtransmission facilities. Trial Staff argues that those are the facts in this case and that those facts support the judge's finding in the ID.

16. Commission Trial Staff further argues that Allegheny Power is overlooking that this case does not concern "participant funding" of new transmission facilities. It concerns setting a charge to recover the costs or providing subtransmission/distribution service to a specific customer over existing facilities.

### **Commission Finding**

17. We will affirm the judge's finding that Allegheny Power's subtransmission service charges to AEC should be calculated based on the system wide average costs of Allegheny Power's subtransmission facilities (i.e., they should be calculated on a rolled-in basis) for the reasons stated by the judge in the ID and highlighted by Trial Staff and AEC in their respective briefs opposing exceptions. Specifically, we find that the facilities used by Allegheny Power to serve AEC are part of an integrated subtransmission/distribution network in which various facilities support both the load to which they are connected and other loads. Trial Staff states that 9 of the 18 Allegheny Power interconnection points with AEC are normally served in network configurations and that the integrated nature of Allegheny Power's facilities are based on the following: (1) the facilities are looped, not radial; (2) energy does not flow in just one direction over these Allegheny Power facilities; (3) Allegheny Power serves not only AEC but also its own customers over these facilities; (4) the looped configuration enables Allegheny Power to provide support and added reliability to the other looped lines; and (5) an outage on any one of these facilities affects the power flows on other facilities. Further, as noted by Trial Staff, the remaining 9 AEC interconnection points, while radially connected to Allegheny Power, are typically backed up by an Allegheny Power network of 25 kV lines.<sup>4</sup> Finally, as pointed out by the Judge and the opposing parties, Allegheny Power failed to provide adequate justification for its proposed direct assignment.

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<sup>4</sup> Commission Trial Staff Initial Brief at 5-6.

18. As we are affirming the judge's finding on the roll-in of subtransmission facilities, we need not address the issue related to the age of the lines used to serve AEC.

**B. Contribution in Aid of Construction**

19. The dispute here is whether the judge erred by not finding that AEC made a contribution in aid of construction (CIAC) of \$168,740, related to certain substations used by Allegheny Power to serve AEC. AEC argues that the judge failed to discuss this issue in the ID, even though it appeared on the Joint Issue List. AEC maintains that the record shows that it spent \$168,740 related to subtransmission facilities used by Allegheny Power to serve AEC's delivery points and argues that it should be given a CIAC credit reflecting this expenditure. AEC states that under a 1994 agreement, AEC agreed to a \$835,000 annual rate increase in its rates from Allegheny Power that was approved by the Commission in Docket No. ER94-1659. AEC maintains that this agreement provided that Allegheny Power was obligated to make capital improvements of up to \$325,000 and, further, that Allegheny Power and AEC would jointly determine if additional improvements were needed. AEC states that Allegheny Power and AEC later jointly determined that further improvements, in the amount of \$168,740, were needed. As this exceeded the amount Allegheny Power was obligated to fund, AEC contributed the additional \$168,740 to fund the improvement. AEC argues that the \$168,740 constitutes a CIAC and should be deducted from Allegheny Power's cost of service, since it was paid for by AEC, not Allegheny Power.

20. Allegheny Power does not dispute AEC's contention that it spent the money at issue. However, it argues that AEC's argument on CIAC is inconsistent with AEC's position on the roll-in of subtransmission costs. In Allegheny Power's view, the basis for rolling in Allegheny Power's subtransmission costs for facilities used to serve AEC is that those facilities are an integral part of Allegheny Power's system. By contrast, Allegheny Power argues, AEC's contention that the \$168,740 constitutes a CIAC presumes that Allegheny Power's share of the project's expenses (*i.e.*, the \$325,000) was dedicated to serving AEC. Allegheny Power argues that this shows that AEC wants it both ways. Further, Allegheny Power argues that the amount of CIAC that would be credited is problematic as AEC received the benefit of the investment and rates reflecting that investment, for 7 years. In Allegheny Power's view, any CIAC due AEC has already been adequately repaid.

21. Trial Staff does not oppose AEC's exception.

**Commission Finding**

22. We agree with AEC that the ID did not address this issue. We will grant AEC's exception and direct Allegheny Power to credit AEC for a CIAC of \$168,740, because

AEC funded this improvement of Allegheny Power's system. AEC should be given a credit reflecting this amount because it is undisputed that the money was spent and that Allegheny Power and AEC jointly agreed that the improvement was needed. Furthermore, we find that Allegheny Power has not supported its contention that AEC already obtained the benefit of reduced rates reflecting this investment in past years. Moreover, contrary to Allegheny Power's arguments, our finding directing Allegheny Power to credit AEC for a CIAC of \$168,740 is consistent with our finding affirming the judge's finding on the roll-in issue because -- while the improvement originally was made to accommodate AEC's obtaining service from Allegheny Power -- this is not pertinent to whether those facilities form part of Allegheny Power's integrated network.

### C. Return on Equity

23. The dispute here is whether the judge erred when he found that the record supported a return on equity (ROE) of 10.59%, based on a group of proxy utilities, rather than a 12.9% or higher rate of return,<sup>5</sup> based on an Allegheny-only DCF analysis.

### Commission Finding

24. We will summarily affirm the judge's finding on this issue, with two additions. First, in our view, Allegheny Power's brief on exceptions merely restates arguments that were adequately considered and rejected in the ID. Second, we find that the judge's ROE finding properly follows the Commission's approved DCF methodology for determining ROE as explained by the Commission in Opinion No. 445.<sup>6</sup> We reject Allegheny Power's attempt to import --out of context-- the rate of return awarded in Midwest Independent Transmission System Operator, Inc., 99 FERC ¶ 63,011, affirmed, 100 FERC ¶ 61,292 (2002).

### D. Capital Structure

25. With regards to capital structure, the judge adopted a capital structure of 64.76 percent long-term debt and 35.24 percent common equity, based on the company's actual

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<sup>5</sup> Allegheny Power's witness recommended that its ROE should be adjusted upward from 12.9% to 14.65%, to reflect Allegheny Power's market to book ratio.

<sup>6</sup> Southern California Edison Company, Opinion No. 445, 92 FERC ¶ 61,070 (2000).

capital structure.<sup>7</sup> The dispute here is whether the judge erred when he rejected Allegheny Power's proposed use of a hypothetical capital structure and found that a capital structure based on Allegheny Power's actual capital structure should be used. Allegheny Power argues that a hypothetical capital structure should be used here because Allegheny Power's current actual capital structure is an aberration because the company is currently facing some liquidity issues. Thus, Allegheny Power maintains that a hypothetical capital structure would be more appropriate.<sup>8</sup>

26. In response, AEC points out that under the Transcontinental cases, which were relied on by the judge, a hypothetical capital structure is only used if the actual capital structure is so far out of line that its use would result in an anomalous result. AEC argues that the record evidence here supports a contrary result, *i.e.*, that use of the actual capital structure would produce reasonable results and that Allegheny Power has presented no evidence contradicting this. Thus, AEC argues that the judge's finding is fully supported by the record. AEC further argues that, contrary to Allegheny Power's assertions, WAPA does not support its proposed use of a hypothetical capital structure either. AEC notes that, in WAPA, the Commission based its conclusion on the presence of unique circumstances that are not present here.<sup>9</sup> Trial Staff also argues that the cases cited by Allegheny Power do not support the conclusions that Allegheny Power seeks to draw from them and that the judge's finding should be affirmed. Trial Staff argues that the judge's finding rejecting the use of a hypothetical capital structure is proper because, consistent with Commission precedent, use of Allegheny Power's actual capital structure would not produce an anomalous result.

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<sup>7</sup> ID at P 20.

<sup>8</sup> Allegheny Power cites Transcontinental Gas Pipeline Corp., 90 FERC ¶ 61,279 at 61,928-9 (2000), citing Transcontinental Gas Pipeline Corp., 84 FERC ¶ 61,084, Opinion No. 414-A (1998) (collectively referred to as the "Transcontinental cases") and Western Area Power Administration, 100 FERC ¶ 61,331 at 62,539 (2002) (WAPA) as examples of instances where the Commission sanctioned use of a hypothetical capital structure.

<sup>9</sup> In WAPA, 100 FERC ¶ 61,331 at P 9, the Commission allowed the use of a hypothetical capital structure for a new venture for which no comparable independent firms already conducting the same type of business could be found. WAPA also involved the special circumstance of the Commission promoting the prompt construction of transmission facilities along a heavily constrained transmission path in California (Path 15) in the midst of California's pressing problems with insufficient transmission capacity. Neither of these factors is present here.

**Commission Finding**

27. We will affirm the judge's findings on this issue for the reasons stated by the judge in the ID as buttressed by the arguments presented by Trial Staff and AEC in their briefs opposing exceptions. For the reasons stated by the judge, Trial Staff, and AEC, we disagree with Allegheny Power's contention that our precedent in WAPA and in the Transcontinental cases supports its proposed use of a hypothetical capital structure.

The Commission orders:

(A) We hereby affirm the Judge's findings contained in the Initial Decision issued in this proceeding on April 3, 2003, as discussed in the body of this order. In addition, as discussed in the body of this order, we will grant AEC's exception requesting that we find that it made a contribution in aid of construction in the amount of \$168,740.

(B) Within thirty (30) days of the date of issuance of this order, Allegheny Power shall file a compliance filing consistent with the findings in this order.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.