

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas & Electric Company

Docket Nos. ER03-409-001 and
ER03-666-001

OPINION NO. 470

OPINION AND ORDER ON INITIAL DECISION

Issued: March 9, 2004

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Pacific Gas and Electric Company Docket Nos. ER03-409-001 and
ER03-666-001

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APPEARANCES

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

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OPINION AND ORDER ON INITIAL DECISION

(Issued March 9, 2004)

1. On September 8, 2003, the Presiding Administrative Law Judge (ALJ) issued an Initial Decision granting summary disposition of Pacific Gas & Electric Company's (PG&E) rate filing for accelerated depreciation for transmission facility construction costs in 2003.¹ This order affirms the Initial Decision and requires PG&E to reduce its rates and make refunds. This order reduces PG&E's transmission rates by approximately \$15 million per year. The action taken in this order benefits customers by ensuring that rates are just and reasonable.

Background

2. On January 13, 2003, PG&E filed proposed revisions in Docket No. ER03-409-000 to its Transmission Owner (TO) Tariff to change its revenue requirement and rates.² The proposed revision sought an approximate 45 percent rate increase. PG&E claimed the filing will recover the costs of an estimated \$300 million of transmission plant

¹ 104 FERC ¶ 63,052 (2003).

² This was the sixth revision to PG&E's TO tariff. We will refer to this revision as TO6.

additions to be added between 2001 and the end of 2003. PG&E also proposed to use a 15-year depreciation life for all new transmission plant additions put into service during calendar year 2003.³

3. The Transmission Agency of Northern California (Transmission Agency) and the Sacramento Municipal Utility District sought summary rejection of PG&E's accelerated depreciation proposal arguing that PG&E's request is unsupported and unjustified.

4. In the hearing order, the Commission rejected PG&E's argument to summarily accept an economic service life of 15 years for transmission plant additions put into service in 2003.⁴ The proposed rates were suspended, to become effective on August 13, 2003, subject to refund.

5. On March 28, 2003 in Docket No. ER03-666-000, PG&E proposed revisions to rate schedules for several of PG&E's existing wholesale transmission contracts. PG&E proposed to both update base transmission rates to reflect PG&E's current cost-of-service and to make the rate methodology consistent with the high voltage-low voltage network transmission methodology in PG&E's TO tariff and the California Independent System Operator Corporation's (California ISO) tariff. Several entities filed interventions, protests and other pleadings. On May 27, 2003, in Docket No. ER03-666-000, the Commission accepted the proposed rates for filing, ordered a five-month suspension of proposed rates, to become effective October 28, 2003, subject to refund, and consolidated the filing in Docket No. ER03-666-000 with the TO6 proceeding in Docket No. ER03-409-000 for purposes of hearing and decision.⁵

6. On June 25, 2003, Transmission Agency filed a motion before the ALJ for partial summary disposition of PG&E's proposed accelerated depreciation. On September 8, 2003, the ALJ granted the motion for summary disposition and directed PG&E to file a new tariff sheet to remove the 15-year depreciation rate costs from its rates.⁶

³ See Exh. PGE-1 at 1-13 to 1-14.

⁴ 102 FERC ¶ 61,270 at P 14.

⁵ Pacific Gas & Electric Co., 103 FERC ¶ 61,240 (2003).

⁶ 104 FERC ¶ 63,052 at P 34.

The Initial Decision

7. The Presiding ALJ found that PG&E did not support its proposed accelerated depreciation claimed in its TO6 filing but did find PG&E's testimony supported useful lives of transmission facilities in excess of 40 years.⁷ The ALJ explained that the Commission's regulations require the utility to support the requested change with depreciation studies,⁸ and that summary disposition of a filing claiming an increased depreciation rate is appropriate where the filing party fails to satisfy the requirements of the Commission's regulations governing depreciation rates.⁹

8. The ALJ also clarified¹⁰ that the Commission's Order Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States¹¹ (Order Removing Obstacles) adopted incentives, including accelerated depreciation, due to the extraordinary circumstances surrounding the imbalances in California's electricity power supply system and the resulting severe shortages. In addition, the incentives the Commission provided in the Order Removing Obstacles were narrowly tailored to a limited time frame, which expired on April 30, 2002. The Commission was specific in stating that after the expiration of the Order Removing Obstacles, "any future projects would not automatically qualify for such incentives" and that such incentives would be allowed only where warranted.¹² The Commission reiterated the emergency nature of the incentives it approved in its Order Removing Obstacles by rejecting the Midwest ISO's proposed incentive rates because "such an emergency does not exist in the Midwest."¹³

⁷ Id. at P 6.

⁸ Id. at P 17, citing 18 C.F.R. § 35.13(h)(10)(iv)(2003).

⁹ Id. at P 17, citing Mississippi River Transmission Corp., 53 FPC 1924 (1975).

¹⁰ Id. at P 22.

¹¹ 96 FERC ¶ 61,155 at 61,670 (2001)

¹² Western Area Power Administration, 100 FERC ¶ 61,331 at 62,539.

¹³ 104 FERC ¶ 63,052 at P 24, citing Midwest Independent Transmission System Operator, Inc., 98 FERC ¶ 61,064 at 61,165 (2002).

9. The ALJ also considered Order No. 2000,¹⁴ where the Commission stated that it will be open to, among other things, accelerated depreciation for new transmission facilities within an RTO.¹⁵

10. The ALJ concluded that PG&E had not demonstrated that its 2003 transmission projects qualify for incentive treatment for the following reasons. First, the PG&E 2003 transmission projects are neither subject to an RTO nor designed to open markets. Second, PG&E did not allege or demonstrate the existence of an emergency that would support a claim of need for accelerated depreciation. Rather, most of PG&E's 2003 capital expenditures involve traditional transmission infrastructure improvements designed to meet on-going system availability or reliability concerns.¹⁶ Third, PG&E agreed that the 2003 transmission expenditures are separate and apart from the Path 15 project. Finally, even if the 2003 transmission expenditures involved Path 15 facilities, the Order Removing Obstacles expired April 30, 2002. The ALJ also ordered PG&E to make refunds of excess charges for accelerated depreciation in the TO6 docket by August 13, 2003.

Exceptions to the Initial Decision

11. On October 8, 2003, PG&E filed three exceptions to the Initial Decision. These are: (1) that the ALJ erred in holding that PG&E's 2003 investments in transmission facilities do not qualify for accelerated depreciation treatment because they are not facilities within an RTO or designed to open markets;¹⁷ and (2) the ALJ erred in holding that a depreciation study was necessary to receive accelerated depreciation treatment of

¹⁴ Regional Transmission Organizations, 65 FR 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), order on reh'g, Order No. 2000-A, 65 FR 12,088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), petitions for review pending sub nom., Public Utility District No. 1 of Snohomish County, Washington v. FERC, Nos. 00-1174, et al. (D.C. Cir.).

¹⁵ 104 FERC ¶ 63,052 at P 23, citing American Transmission Co., 93 FERC ¶ 61,267 at 61,863 (2000).

¹⁶ Id. at P 26.

¹⁷ PG&E Brief on Exceptions (BOE) at 8.

newly-constructed transmission facilities.¹⁸ PG&E also objected to the ALJ's order that PG&E was required to refund excessive charges as of August 13, 2003.

Briefs Opposing Exceptions

12. On October 28, 2003, Transmission Agency filed a brief opposing PG&E's exceptions. Transmission Agency argues that the Commission should affirm the Initial Decision because the ALJ properly found that (1) PG&E's 2003 transmission assets did not qualify for incentive ratemaking and are not subject to RTO control nor to open markets, and (2) PG&E did not provide a depreciation study, as required to change its depreciation rates based on the life of the assets from 40 plus years to 15 years. The Commission Staff also filed a brief opposing PG&E's exceptions and argues that PG&E should not be allowed to collect rates which are not just and reasonable, and the Commission has a duty to direct payment of refunds at the earliest possible moment.

DISCUSSION

A. Incentive Rates for PG&E's 2003 Transmission Assets

13. PG&E raises four issues in support of its claim for accelerated depreciation allowances for its 2003 transmission investments.¹⁹ These are: (1) the California ISO is the functional equivalent of an RTO;²⁰ (2) PG&E is entitled to collect accelerated depreciation charges based on 18 CFR § 35.34(j) and (k);²¹ (3) Order No. 2000 granted incentive ratemaking allowances to members of ISOs;²² and, (4) PG&E's transmission expenditures will enhance reliability of the transmission grid, relieve congestion, and make California transmission more open and efficient.²³

¹⁸ Id. at 6.

¹⁹ Our decision herein addresses PG&E's filings in these dockets for 2003 transmission facility investments. PG&E has filed its TO7 rate proceeding in Docket No. ER04-109-000, 105 FERC ¶ 61,389 (2003).

²⁰ Id. at 8.

²¹ Id. at 9.

²² Id. at 9.

²³ Id. at 10.

1. California ISO Equivalent to an RTO

14. PG&E argues that the California ISO is the functional equivalent of an RTO for purposes of incentive rates and granting PG&E accelerated depreciation will further the Commission's goals of enhancing the reliability of California's transmission grid, relieving congestion and making the California transmission system even more open and efficient.²⁴ The Commission's requirements for an approved RTO, however, are very specific.²⁵

15. The California ISO, PG&E concedes, is not an approved RTO.²⁶ The Commission agrees that it has not yet found the California ISO is the functional equivalent of an RTO for purposes of incentive rates to grant PG&E's request for accelerated depreciation.

2. Accelerated Depreciation Under Section 35.34 of the Regulations

16. PG&E argues that the Commission should make clear that the incentives contemplated in 18 C.F.R. § 35.34 are available to participants in the California ISO, notwithstanding the fact that the California ISO has not been approved as an RTO by a Commission order.²⁷ In Allegheny Power System Operating Companies,²⁸ the Commission set the parameters for incentive depreciation allowances:

The Commission also addressed the additional incentive of allowing the [transmission owners] TOs the use of accelerated depreciation. The Commission said that this incentive is available to transmission owners that are members of RTOs. However, this innovative rate treatment must be

²⁴ Id. at 9.

²⁵ See 18 CFR § 35.34 (2003).

²⁶ The procedures by which the California ISO could become an approved RTO are set out in the regulations, specifically, section 35.34 (d). The standards for approval of an application are set out in section 35.34 and these requirements are further explained in RTO orders. See e.g., Order Provisionally Granting RTO Status, PJM Interconnection, LLC, 96 FERC ¶ 61,061(2001), Order Granting RTO Status, 101 FERC ¶ 61,345 (2002), Order On Rehearing and Compliance Filing, 104 FERC ¶ 61,124 (2003).

²⁷ BOE at 10.

²⁸ 106 FERC ¶ 61,003 (2004), rehearing granted, 106 FERC ¶ 61,016 (2004) (Allegheny).

supported with a cost benefit analysis as described in section 35.34 of the Commission's regulations.²⁹

17. PG&E has agreed that it did not provide a cost benefit analysis to support its claim for accelerated depreciation.³⁰ Further, in Allegheny, the Commission found that the TOs did not meet their burden and set a very specific standard for accelerated depreciation incentives:

The TOs' cost-benefit analysis merely quantifies the incremental costs associated with accelerated depreciation, but fails to show any incremental benefits that would justify the accelerated cost recovery. According to the TOs, the addition of transmission upgrades will benefit consumers through reduced congestion costs, improved reliability and increased access to cheaper power. Since these benefits are generic to all transmission upgrades, and not incremental to the specific transmission facilities that the TOs seek accelerated depreciation for, we will therefore deny the TOs' request for accelerated depreciation.³¹

18. Further, many of PG&E's proposed capital additions are not for new transmission facilities in the sense of additions to the grid. PG&E witness Stephen J. Metague testified in this proceeding that a significant driver of PG&E's planned capital expenditures is the replacement of aging infrastructure. Therefore, we find that the benefits of PG&E's 2003 transmission expansions are consistent with the Commission explanation of generic upgrades which do not show incremental benefits. Accordingly, based on this specific record, we find that PG&E's proposed use of accelerated depreciation pursuant to section 35.34 of the regulations is unsupported, and therefore denied.

3. Order No. 2000 Incentive Ratemaking

19. PG&E argues that Order Nos. 2000 and 2000-A granted incentive ratemaking to an ISO.³² We do not agree. In Order No. 2000-A, the Commission stated the following:

²⁹ Id. at P 5.

³⁰ BOE at 3.

³¹ 106 FERC ¶ 61,003 at P 28.

³² BOE at 9.

With respect to accelerated depreciation for new transmission investment, as with the other innovative rate treatments discussed in the Final Rule, we did not guarantee that it would be allowed in every situation. Rather, we stated that we were willing to provide the flexibility to permit RTOs to propose non-traditional depreciation schedules. All such proposals will be required to be supported by the explanations and analyses set forth in Section 35.34(e)(1).³³

20. The Commission also stated in Order No. 2000-A that an individual transmission owner could request innovative rate treatment, but that it should be done in connection with the RTO as a whole:

A proposed innovative [return on equity] ROE treatment for a transmission owner's revenue requirement can best be evaluated in the context of any other innovative rate treatments proposed for the RTO. In addition, the justification required by Section 35.34(e) involves an evaluation of factors related to the RTO as a whole, not only the revenue requirement of an individual owner. The collaborative process provides an important opportunity for the parties to consider the procedures that will apply to the filing of innovative rate treatments.³⁴

21. PG&E's planned transmission upgrades were not done through an RTO collaborative process. Accordingly, we find that PG&E's reliance on Order Nos. 2000 and 2000-A to support its request for use of accelerated depreciation is misplaced.

4. Transmission Assets Enhance the Grid

22. PG&E argues that its transmission expenditures will enhance reliability of the transmission grid, relieve congestion and make California transmission more open and efficient.³⁵ However, the record shows that many of PG&E's proposed capital additions are not for transmission facilities that would expand the grid. PG&E stated:

³³ Regional Transmission Organizations, Order No. 2000-A, FERC Statutes and Regs., ¶ 31,092 at 31,387 (2000).

³⁴ *Id.* at 31,388 and 31,389.

³⁵ BOE at 10.

A significant driver of PG&E's planned capital expenditures is the replacement of aging infrastructure. This can involve replacing equipment that is showing significant wear through diagnostic testing or replacing equipment that has failed. Much of PG&E's transmission system was constructed over 30 years ago. Over the 2002-2003 time period, PG&E will have spent \$227.3 million to replace equipment that has failed, reached or surpassed its normal service life.³⁶

23. Thus, we agree with the ALJ's finding that "most of the 2003 capital expenditures involve traditional transmission infrastructure improvements designed to meet on-going system availability or reliability concerns."³⁷

24. PG&E also argues that some of its transmission investment projects are submitted to the ISO for approval. However these projects are planned by PG&E, not the ISO. PG&E witness Metague described the approval process:

Currently, as provided in the ISO Tariff, PG&E gives the ISO a description of proposed projects intended to increase transmission capacity, as part of PG&E's five year plan, for the ISO's comment and concurrence. The ISO then publishes, via its Internet website, a list of "approved" transmission projects that will increase transmission capacity and result in new transmission plant.³⁸

25. The record shows that the ISO does not have the opportunity to approve all of PG&E's proposed upgrades. The witness Metague further stated:

PG&E also invests capital in transmission system projects that maintain and improve the PG&E transmission system but may not directly increase transmission capacity. Under current procedures, these projects are not reviewed by the ISO and are not included on the ISO list of "approved" projects. An example of this type of capital projects would be the replacement of aging facilities as described above.³⁹

³⁶ Exh. No. PGE-1 at 1-5, lines 2-8.

³⁷ See Exh. PGE-1, 9, and 10; 104 FERC ¶ 63,052 at P 26.

³⁸ Exh. No. PGE-1 at 1-8, lines 18-25.

³⁹ Id. at lines 26-31.

26. In PJM Interconnection, LLC, PJM was directed to show that:

[I]n order to fully meet the planning and expansion function for an RTO, we will require PJM to . . . fully explain how PJM's planning process will identify expansions that are needed to support competition. PJM's regional planning process plan must provide authority for PJM to require upgrades both to ensure system reliability and to support competition. Thus, we anticipate that the plan will enable PJM to (a) require the necessary additions to its . . . systems to ensure reliability; and (b) identify transmission constraints and require new construction to address those constraints.⁴⁰

27. Further, PJM transmission owners were required to participate in the regional transmission expansion plan (RTEP).⁴¹ Clearly, PG&E is not proposing transmission additions as part of a coordinated regional plan developed by an RTO or an ISO, and does not meet this requirement to qualify for incentive depreciation rates.

B. Requirement for Depreciation Study

28. PG&E asserts that the RTO regulations applicable to accelerated depreciation in incentive-based rate filings support its position.⁴² PG&E argues that these regulations make no mention of any requirement for a depreciation study to be submitted in support of a request for accelerated depreciation. Instead, PG&E argues that Section 35.34(e) merely requires the filing party to provide a cost-benefit analysis. In support of its argument, PG&E cites Order 2000-A in which the Commission stated that proposals for non-traditional depreciation schedules "will be required to be supported by the explanations and analyses set forth in Section 35.34(e)(1)."⁴³ Accordingly, PG&E asks the Commission to make clear that a depreciation study is not required in a case where the filing party seeks accelerated depreciation for new transmission facilities as part of an incentive-based rate filing.⁴⁴

⁴⁰ 104 FERC ¶ 61,124 at P 3 (2003).

⁴¹ 105 FERC ¶61,123 (2003).

⁴² See 18 C.F.R. § 35.34(e).

⁴³ FERC Order 2000-A, 90 FERC ¶ 61,201 (2000) and FERC Stats & Regs. ¶ 31,092 (2000).

⁴⁴ BOE at 8.

29. It is first important to clarify that only approved RTOs may make filings under Section 35.34(e). As found in our discussion above, neither the California ISO nor PG&E is an approved RTO. All other rate filings, such as PG&E's proposal, seeking changes in existing depreciation rates must support their filings with a depreciation study required in Section 35.13 (h)(10)(iv) of the regulations. PG&E specifically stated that its rate increase was "in compliance with Section 35.13 of the Commission's regulations."⁴⁵ Further, PG&E did not claim it was making a filing under the approved RTO regulations in Section 35.34 of the regulations.

30. In the Initial Decision, the ALJ noted that PG&E confirmed that it had no studies or work papers to support the 15-year "economic life" method of depreciation contained in its rate increase filing.⁴⁶ The Depreciation Study discussed in PG&E's testimony is a study involving the "useful life" of assets, all of which are in excess of 40 years.⁴⁷

31. We agree with the ALJ that the depreciation regulations impose an obligation on a party filing a rate increase under Section 205 of the FPA to support its proposed depreciation studies. Accordingly, we find that PG&E has failed to support its proposal for accelerated depreciation for 2003 transmission facility construction costs.

C. Rate Reductions and Refunds

32. PG&E is concerned that it may be required to provide, prior to the conclusion of this case, a separate, early refund for the accelerated depreciation portion of the TO6 Tariff rate increase.⁴⁸ PG&E asks the Commission to rule that PG&E need not provide a separate refund for that portion of its proposed TO6 rates related to accelerated depreciation, but should be allowed to provide any such refund at the conclusion of this matter, at which time PG&E will also make any other refunds necessary, because to make

⁴⁵ PG&E's Transmission Owner Tariff Filing, January 9, 2003 at 2.

⁴⁶ 104 FERC ¶ 63,054 at P 18-19.

⁴⁷ *Id.* at P 18. For example, Account No. 364, Poles, Towers and Fixtures had a proposed book balance of \$1.5 billion and an average service life of 40 years; Account No. 356, Overhead Conductors and Devices had a proposed book balance of \$527 million and an average service life of 52 years. See Exh. PGE-29 at 85-90 and 36-41.

⁴⁸ BOE at 5.

a separate refund for the accelerated depreciation portion of the rate increase now plus perhaps a further refund later would be exceedingly burdensome, inefficient and costly.⁴⁹

33. We are not persuaded that providing refunds now is such a burden that it warrants allowing PG&E to continue recovery of rates that reflect accelerated depreciation. We will order refunds at this time for that portion of the rate increase associated with PG&E's proposed accelerated depreciation. Having found above that the proposed accelerated depreciation was inappropriate and unsupported, PG&E's ratepayers should not have to pay rates that reflect the proposed accelerated depreciation. Accordingly, PG&E will be directed to reduce its rates and make refunds within 30 days of the date of issuance of this order.⁵⁰

The Commission orders:

(A) The Initial Decision is hereby affirmed, as discussed in the body of this order.

(B) Within 30 days of the date of issuance of this order, PG&E must submit a compliance filing revising its tariff removing the accelerated depreciation cost component from its revenue requirement and rates.

(C) Within 30 days of the date of this order, PG&E must refund disallowed depreciation charges collected from its customers, as described in the body of this order,

⁴⁹ Id. at 6.

⁵⁰ The Chief Administrative Law Judge issued an order on January 26, 2004 suspending the procedural schedule in these dockets, based on a filing by PG&E that a settlement in principle had been reached with some of the participants and that a settlement proposal would be filed within 60 days. Rate reductions and refunds must proceed as directed unless a uncontested, unanimous settlement is filed in the consolidated dockets prior to the issuance of this order.

with interest as required by Section 35.19(a) of the regulations, 18 CFR § 35.19(a) (2003). A refund report must be filed with the Commission and served on customers simultaneously.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.