UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Midwest Independent Transmission System Operator, Inc. and American Transmission Systems, Inc. — Docket No. ER06-800-000

ORDER CONDITIONALLY ACCEPTING AND SUSPENDING RATE FILING

(Issued May 22, 2006)

1. On March 28, 2006, as modified by an answer of May 3, 2006 (May 3 Answer), the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) and American Transmission Systems, Inc. (American Transmission)[1] jointly filed[2] proposed revisions to American Transmission's Attachment O transmission rate formula (Attachment O) under Midwest ISO's Open Access Transmission and Energy Markets Tariff (Midwest ISO Tariff). The proposed revisions would allow American Transmission to recover deferred costs associated with its Vegetation Management Enhancement Project (VMEP) over a five-year period beginning June 1, 2006. For the reasons described below, we will conditionally accept and suspend for a nominal period the proposed revisions, as modified by the May 3 Answer, to become effective June 1, 2006, subject to refund and to review and acceptance of the compliance filing that we will require.

I. Background

2. Electric transmission owners and operators conduct vegetation management, *i.e.*, tree trimming, vegetation pruning and removal, etc., to prevent physical contact between transmission lines and nearby vegetation that could cause a transmission line to fail.

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[1] American Transmission is a wholly-owned transmission subsidiary of FirstEnergy Corp. (FirstEnergy). It owns the bulk transmission systems formerly owned by several FirstEnergy electric utility operating subsidiaries located in Ohio and western Pennsylvania. These companies constitute a single control area in the East Central Area Reliability (ECAR) region. In 2003, American Transmission joined Midwest ISO.

[2] FirstEnergy Service Company, acting on American Transmission's behalf, made the instant filing jointly with Midwest ISO. In this order, we will refer for simplicity just to American Transmission, the actual party in interest.

Such failures precipitated the August 14, 2003 power blackout that affected large portions of the Midwest and Northeast United States and Ontario, Canada. The report of the joint U.S.-Canada Power System Outage Task Force (Task Force) that investigated the causes of this blackout and how to reduce the possibility of future outages identified a failure to adequately trim trees and manage vegetation in transmission rights-of-way as one of the primary causes of the blackout.[3] The Blackout Report recommended that regulators clarify that prudent expenditures and investments to maintain or improve bulk system reliability will be recoverable through rates.[4]

3. In March 2004, the Commission released a detailed study on utility vegetation management practices that examined the vegetation management practices of American Electric Power Corporation, Cinergy Corporation, and FirstEnergy against industry benchmarks.[5] The CNUC Report found that the vegetation management practices of all three utilities were consistent with common industry practices at the time the blackout occurred.[6] However, it also found that those industry requirements and standards were inadequate to achieve the level of utility vegetation management necessary to improve reliability by reducing tree-caused transmission outages.[7] The CNUC Report concluded that common industry practices needed significant improvement to ensure greater transmission reliability. It offered specific recommendations to the industry, oversight agencies, and other organizations to achieve such improvements.[8]

4. On April 19, 2005, the Commission issued its Policy Statement on Matters Related to Bulk Power System Reliability.[9] The Commission stated that it expected public utilities to comply with the reliability standards of the North American Electric

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[3] *Final Report on the August 14, 2003 Blackout in the United States and Canada: Causes and Recommendations* at 20, 57-64 (April 2004) (Blackout Report). The Task Force investigation focused on FirstEnergy's operations in ECAR.

[4] *Id.* Report at 146.

[5] CN Utility Consulting, *Utility Vegetation Management Final Report* (March 2004) (CNUC Report).

[6] *Id.* at 38-39, 46-51.

[7] *Id.* at 39.

[8] *Id.* at 67.

[9] *Policy Statement on Matters Related to Bulk Power System Reliability*, 107 FERC ¶ 61,052 (2004), *supplemented*, 110 FERC ¶ 61,096 (2005) (Reliability Policy Statement).

Reliability Council (NERC) and to remedy any deficiencies identified in NERC compliance audit reports and recommendations. The Commission also recognized that public utilities may need to expend significant amounts of money to implement measures necessary to maintain bulk electric system reliability, including enhanced vegetation management practices. In order to address potential rate uncertainty, the Commission assured public utilities that it would "approve applications to recover prudently incurred costs necessary to ensure bulk electric system reliability, including prudent expenditures for vegetation management."[10]

5. On November 1, 2004, American Transmission[11] requested Commission authorization to defer, for accounting purposes, $54 million of certain extraordinary vegetation management costs that it would incur during 2004-2007, *i.e.*, the estimated costs of the VMEP, which it had already begun. It also requested amortization of these costs over a five year period beginning June 1, 2006. American Transmission stated that it would seek recovery of the deferred costs through a surcharge that it would propose in a separate rate filing at a later date.

6. On March 4, 2005, the Commission approved American Transmission's request to defer the VMEP costs for accounting purposes, adding that such approval did not guarantee ultimate rate recovery of the VMEP costs. However, the Commission denied the proposed five-year amortization proposal as premature and more appropriately addressed in the future rate case for ultimate recovery of the deferred costs. The Commission stated that, if it allows recovery of the VMEP costs, the deferred costs shall be amortized over a period that is consistent with the recovery in rates.[12]

7. American Transmission's March 28, 2006 filing presents its five-year amortization proposal for ultimate recovery of the deferred costs.

II. Proposed Tariff Revisions

8. American Transmission describes the VMEP as enhancements to its existing vegetation management practices that represent adoption of newly identified industry "best practices." It states that these programs should not be considered "catch up" activities, but rather as necessary improvements to existing practices to reflect industry-wide changes in vegetation management standards. American Transmission asserts that its former vegetation management practices were consistent with industry-wide standards at the time.

[10] *Id.* at P 27.

[11] Actually, FirstEnergy, on behalf of American Transmission.

[12] *FirstEnergy Service Compa*ny, 110 FERC ¶ 61,230 at P 17 (2005).

9. American Transmission describes the costs associated with the VMEP as extraordinary costs above and beyond its baseline vegetation management program costs. It states that the VMEP activities began in 2004 and will continue through 2007. The VMEP project consists of three major categories: (1) the 2004 Summer Readiness program; (2) a system-wide right-of-way reclamation program; and (3) a comprehensive helicopter patrol program. American Transmission expects the costs of the VMEP to total approximately $51 million, compared with projected "ordinary" vegetation management costs of $15.7 million for the same time period.

10. American Transmission describes the 2004 Summer Readiness program, which cost $12 million, as consisting of accelerated and comprehensive inspections of American Transmission's rights-of-way and performance of vegetation clearing to comply with Commission and NERC recommendations. While system-wide inspections and preventative vegetation clearing normally occur on a multi-year cycle and are part of its baseline program, American Transmission states that the 2004 Summer Readiness program represents extraordinary activities because of the program's accelerated activities, *e.g.*, inspections of the total system in less than one year.

11. The most costly element of the VMEP is the $36 million transmission right-of-way reclamation project. American Transmission describes these activities as the clearing of entire right-of-way corridors across the American Transmission system and proactive measures to remove or mitigate potential problems with vegetation encroaching on the right-of-way. American Transmission explains that the comprehensive nature of this program includes full enforcement of existing right-of-way easement rights, negotiating to expand easement rights to remove potentially incompatible vegetation and to enhance vegetation-to-conductor clearances such that, upon completion of the VMEP, the expanded corridors can be included in American Transmission's routine vegetation management program.

12. The final element of the VMEP is the enhanced use of helicopter patrols to inspect American Transmission's lines and take corrective action as necessary. The total cost of this program element is relatively small ($3 million). American Transmission explains that these expanded aerial patrols enhance reliability by inspecting transmission towers and accelerating hardware repair by using live-line aerial techniques. American Transmission plans to continue the enhanced level of helicopter patrols beyond 2007.

13. American Transmission asks for authorization to recover the costs associated with the VMEP through rates. It states that, prior to the VMEP initiative, its vegetation management practices were consistent with NERC guidelines and industry standards at the time. American Transmission states that it initiated the VMEP in response to Commission and NERC recommendations for improvements in existing vegetation management practices. It states that the VMEP activities are designed to bring the American Transmission vegetation management program to a level considered "best

practice" in accordance with these new and more stringent industry standards. American Transmission states that the VMEP costs are extraordinary expenses because the enhanced activities are operationally separate from and incremental to its previous vegetation management program.

14. American Transmission proposes to recover the costs of the VMEP over a five year amortization period beginning June 1, 2006. American Transmission states that its amortization period is appropriate because it will achieve rate predictability by recovering the VMEP costs through five approximately equal installments added to American Transmission's transmission revenue requirement under the Attachment O transmission rate formula. Also, it notes that the five-year amortization period is consistent with American Transmission's routine five-year vegetation management cycle.

15. American Transmission proposes to recover its carrying costs on the unamortized deferred balance of VMEP costs beginning June 1, 2006, even though it has incurred carrying costs on the VMEP expenses since 2004. American Transmission also urges that its proposed recovery of the VMEP expenses is consistent with the Reliability Policy Statement's assurance of the recovery of prudently incurred costs to enhance bulk power system reliability, including vegetation management expenses.

III. <u>Notice and Responsive Filing</u>

16. Notice of American Transmission's filing was published in the *Federal Register*, 71 Fed Reg. 18,313 (2006), with interventions and protests due on or before April 18, 2006. The Pennsylvania Boroughs of Ellwood City, Grove City and Zelienople (Pennsylvania Boroughs) and American Municipal Power-Ohio, Inc. (AMP-Ohio) filed timely motions to intervene and protests. The Public Utilities Commission of Ohio (Ohio Commission) filed a notice of intervention and a timely motion to submit its comments one day out-of-time. On May 3, 2005, American Transmission filed its May 3 Answer.

17. The Pennsylvania Boroughs assert that recovery of the VMEP costs proposed by American Transmission has not been shown to be just and reasonable. They request that the filling be rejected or set for hearing.

18. AMP-Ohio argues that American Transmission fails to demonstrate that the $51 million cost of the VMEP is truly out-of-the-ordinary expenses incurred in response to the need for better vegetation control after the August 14, 2003 blackout and not expenses incurred to cure imprudent failure to manage vegetation in the years leading up to the blackout. AMP-Ohio cites the findings of the Blackout Report and the CNUC Report that, had the tree growth in FirstEnergy's transmission rights-of-way been adequately trimmed, the FirstEnergy transmission lines would not have suffered outages and the blackout would likely not have occurred. AMP-Ohio argues that, given FirstEnergy's involvement with the blackout, more information is needed before the

Commission can find that American Transmission's increased vegetation management costs are not the product of past imprudence. AMP-Ohio states that American Transmission should have provided a history of its vegetation management program, with costs, beginning earlier than 2004. AMP-Ohio also asserts that American Transmission should explain why, if the VMEP costs are in fact the incremental costs of a better and long-term vegetation management policy, most of the VMEP costs ($32 million) were incurred in 2004 and 2005 alone. Finally, AMP-Ohio states that it appears that all of the additional costs have been allocated to the transmission function and none to the distribution function, and that American Transmission has provided no support for this allocation.

19. The Ohio Commission supports American Transmission's efforts to enhance its vegetation management program and states that it has no reason to believe that American Transmission's vegetation management program is not currently in compliance with applicable standards. The Ohio Commission asks, though, that the Commission require American Transmission to file annual reports, with the Commission and the Ohio Commission, documenting the benefits of the VMEP in terms of outage performance and cost as measured against past transmission outage performance and non-extraordinary vegetation management program costs.

20. Both the Ohio Commission and AMP-Ohio urge that American Transmission should not be allowed to recover carrying costs on the VMEP costs. The Ohio Commission states that American Transmission failed to request recovery of carrying costs for the deferred VMEP costs when it first filed its request for deferral, on November 1, 2004, and argues that it is inappropriate for American Transmission to revise its request at this late date. The Ohio Commission speculates that the Commission may have reached a different conclusion on the deferral request had the carrying costs been included in that original request, especially given that the carrying costs increase the rate impact of the VMEP program costs by 25 percent in first year of recovery. In the event that carrying costs are permitted, AMP-Ohio contests American Transmission's proposal to apply its overall rate of return of 9.95 percent, and requests instead that the Commission impose its standard refund interest rate.

21. In the May 3 Answer, American Transmission agrees to provide the Commission and the Ohio Commission with informational reports, on April 1, 2007 and April 1, 2008, that summarize the benefits of the VMEP activities in terms of outage performance and costs, as measured against the new vegetation management standard that NERC approved in February 2006.[13] American Transmission also states its willingness to adopt the Commission's refund rate under section 35.19a(a)(2) of the Commission's Regulations,

[13] Standard FAC-003-1 "Transmission Vegetation Management Program," adopted by the NERC Board of Trustees on February 7, 2006, effective April 7, 2006.

18 C.F.R. § 35.19a(a)(2) (2005), in lieu of the carrying charges that it had originally proposed. American Transmission also provides additional information in response to AMP-Ohio's requests.

22. Lastly, American Transmission posits that the VMEP costs are properly allocated to transmission. It describes the VMEP activities, and their costs, as relating solely to transmission facilities rated at 69 kV and above. It adds that because the corridor minimum clearance for transmission facilities is necessarily much wider than for distribution facilities, no incremental cost is associated with clearing a transmission corridor on where there are under-built distribution facilities; therefore, there are no incremental costs to allocate to distribution.

IV. Discussion

A. Procedural Matters

23. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the Ohio Commission's notice of intervention and the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will grant the Ohio Commission's motion to file its comments one day out-of-time as doing so will not disrupt the proceeding or place undue burdens on the parties.

24. 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 American Transmission's May 3 Answer because it has provided information that assisted us in our decision-making process.

B. Recovery of Costs

25. We will conditionally accept and suspend for a nominal period, subject to refund and to review and acceptance of a compliance filing, American Transmission's March 28, 2006 filing, as modified by its May 3 Answer regarding carrying charges and reporting, to become effective June 1, 2006. In these filings, American Transmission proposes recovery of the costs of its VMEP through the American Transmission Attachment O formula rate under the Midwest ISO tariff, over a five-year period beginning June 1, 2006.

26. In the wake of the August 14, 2003 blackout, the Commission has recognized the need for improved reliability standards and enhancements to utility systems and practices to ensure the reliability of the bulk power system. More specifically, the Commission has recognized that reliability standards at the time of the blackout did not address certain topics that are important in maintaining system reliability, or addressed these topics so

vaguely as to be ineffective.[14] Such was the case for vegetation management practices prior to the blackout.[15] The CNUC Report on vegetation management specifically found that the industry standards for vegetation management practices needed to be improved.[16]

27. Through the CNUC Report, efforts by NERC, and the Commission's Electric Reliability Organization (ERO) rulemaking proceeding,[17] the Commission and the industry have taken steps towards developing new electric reliability standards, including improved standards for vegetation management practices. In recognizing that utilities would likely incur increased costs for reliability improvements, the Commission stated that it would "approve applications to recover prudently incurred costs necessary to ensure bulk electric system reliability, including prudent expenditures for vegetation management, improved grid management and monitoring equipment, operator training, and compliance with NERC reliability standards and Good Utility Practices."[18]

28. AMP-Ohio essentially questions the prudence of the VMEP costs, arguing that the Commission should not grant rate recovery unless American Transmission demonstrates that the VMEP expenses were not incurred in order to "catch-up" for past imprudent vegetation management practices in the years leading up to the blackout. However, AMP-Ohio has not presented evidence to support its assertion. While AMP-Ohio argues that American Transmission should have the burden of demonstrating that the VMEP costs are prudent, long-standing Commission precedent is to the contrary and provides that "good faith is presumed on the part of the utility absent a showing of inefficiency or improvidence."[19] Accordingly, the Commission generally does not require that utilities seeking to recover costs through their rates demonstrate initially that all expenditures for which they seek recovery were prudent. Rather, participants in rate proceedings seeking

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[14] Reliability Policy Statement, 107 FERC ¶ 61,052 at P 15.

[15] *Id*.

[16] CNUC Report at 2-4.

[17] Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards, Order No. 672, 71 Fed. Reg. 8662, FERC Stats. & Regs. ¶ 31,204, order on reh'g, Order No. 672-A, 71 Fed. Reg. 19,814, FERC Stats. & Regs. ¶ 31,212 (2006).

[18] Reliability Policy Statement, 107 FERC ¶ 61,052 at P 27.

[19] New England Power Co., Opinion No. 231, 31 FERC ¶ 61,047 at 61,082, *reh'g denied*, Opinion No. 231-A, 32 FERC ¶ 61,113 (1985) (*citing* West Ohio Gas Co. v. Public Utilities Commission of Ohio, 294 U.S. 63, 72 (1935)).

to challenge the expenditures must first create a serious doubt as to the prudence of the expenditures before the burden shifts to the filing utility.[20] Here, no party has presented such evidence.

29. AMP-Ohio correctly notes that tree-conductor contact on the American Transmission system was a major cause of the blackout.[21] However, AMP-Ohio ignores the finding in the CNUC Report that American Transmission's vegetation management practices were consistent with what one would expect of other utility companies in the industry at the time, and that no evidence was uncovered to suggest that American Transmission's vegetation management practices could be considered substandard compared to the rest of the industry.[22] In fact, the CNUC Report found that the tree/power line contacts that contributed to the August 14, 2003 blackout did not reflect isolated conditions limited to the utilities involved in the blackout; rather, they reflected conditions that could be found throughout the United States and Canada.[23] While the experience of the blackout has led to calls for industry-wide improvements to vegetation management standards and practices, we have no basis to think, on existing evidence, that American Transmission's pre-blackout vegetation management practices, reflecting commonly accepted standards and practices in the industry at the time, were imprudent. That overgrown trees on the American Transmission system contributed to the blackout is alone insufficient to doubt the prudence of American Transmission's pre-blackout vegetation management practices.

30. We disagree with the Ohio Commission that American Transmission should be denied recovery of any carrying costs because it did not request such recovery when it requested authorization to record the VMEP expenses as a regulatory asset for accounting purposes. Because American Transmission is proposing to recover current carrying costs only on the unamortized balance of deferred VMEP costs after June 1, 2006, it did not, and does not, require special accounting treatment for the carrying costs. Therefore, it was not necessary for it to discuss, in November 2004, whether it intended to seek

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[20] *See Minnesota Power and Light Co.*, Opinion No. 86, 11 FERC ¶ 61,312 at 61,644-45 & n.45, *reh'g denied*, Opinion No. 86-A, 12 FERC ¶ 61,264 (1980) (generally, the party seeking to call the prudence of an expenditure into question must do so by adducing evidence or citing to material of which the Commission may take official notice). *See also Indiana Municipal Power Agency v. FERC*, 56 F.3d 247, 253 (1995) (complainant urging that utility's rate is unjust must present evidence).

[21] AMP-Ohio Protest at 5-6, (*citing* the Blackout Report and the CNUC Report).

[22] CNUC Report at 38-39.

[23] CNUC Report at 2.

recovery of carrying costs on VMEP expenses when it sought authorization to record the expenses as a regulatory asset.

31. AMP-Ohio's reliance on *American Electric Power Co.*[24] as precedent for Commission imposition of its standard refund interest rate to calculate the carrying costs on deferred costs is misplaced. The Commission reversed that determination on rehearing,[25] and generally does not impose a unique carrying charge on individual assets.[26] Nevertheless, American Transmission has agreed to use the Commission's refund rate under section 35.19a(a)(2) of the Commission's Regulations, 18 C.F.R. § 35.19a(a)(2) (2005),[27] in lieu of the carrying charges originally proposed. Accordingly, we direct American Transmission to file, within 30 days of the date of issuance of this order, revisions necessary to reflect the application of the Commission's refund rate as the carrying charge on the unamortized deferred balance of the VMEP costs.

32. We will accept American Transmission's agreement to the Ohio Commission's request for informational reports summarizing the benefits of American Transmission's VMEP both in terms of outage performance and cost, as proposed in the May 3 Answer.[28]

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[24] AMP-Ohio Protest at 8 (referencing *American Electric Power Co.*, 111 FERC ¶ 61,180 at P 35, *reh'g granted*, 113 FERC ¶ 61,050 (2005)).

[25] *Id.*, 113 FERC ¶ 61,050 at P 28.

[26] *See Union Electric Company*, Opinion No. 279, 40 FERC ¶ 61,046 at 61, 134-35, *reh'g denied in pertinent part*, Opinion No. 279-A, 41 FERC ¶ 61,343 (1987) at 61,924 (1987) *rev'd and remanded on other grounds sub nom. Union Electric Co. v. FERC*, 890 F.2d 1193 (D.C. Cir. 1989). The Commission approved use of the utility's overall weighted cost of capital to calculate the carrying costs on deferred revenues, rejecting the intervenor's argument that the standard refund interest rate should be used to calculate carrying costs. Opinion No. 279-A, 41 FERC at 61,924 (*citing Connecticut Yankee Atomic Power Company*, 10 FERC ¶ 63,018, at 65,098 (1980), *aff'd*, 13 FERC ¶ 61,154 (1980), *reh'g denied*, 17 FERC ¶ 61,184 (1981)).

[27] May 3 Answer at 10.

[28] *Id.* at 11.

33. With respect to the allocation of VMEP expenses between transmission and distribution functions, we will allow American Transmission to recover only deferred VMEP costs that would have been included in the Attachment O formula rates had the costs been recorded in the appropriate operation and maintenance expense accounts for the period in which the costs were incurred, rather than deferred as a regulatory asset. Although American Transmission states in the May 3 Answer that all of the VMEP costs relate solely to transmission facilities, it does not indicate the operation and maintenance expense accounts associated with the VMEP costs. Therefore, we will require American Transmission, in the compliance filing described above: (1) to identify the operation and maintenance expense accounts to which the VMEP costs would have been properly recorded, had they not been deferred and recorded as a regulatory asset, and the amount of VMEP costs that would have been appropriately recorded in each account in each year, along with supporting explanation and work papers demonstrating that such determinations are consistent with the Uniform System of Accounts;[29] and (2) to revise the American Transmission Attachment O formula rate to recover only deferred VMEP costs that would have been included in the Attachment O formula rates had the costs been recorded in the appropriate operation and maintenance expense accounts for the period in which the costs were incurred, rather than deferred as a regulatory asset.

<u>The Commission orders:</u>

(A) The revisions to American Transmission's Attachment O transmission rate formula, proposed on March 28, 2006 and modified on May 3, 2006, are hereby accepted conditionally and suspended for a nominal period to become effective on June 1, 2006, as requested, subject to refund and to our review and acceptance of the compliance filing ordered below.

(B) American Transmission is hereby required to make a compliance filing, within 30 days of the date of issuance of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

[29] 18 C.F.R. § 101 (2005).

Magalie R. Salas,
Secretary.