

107 FERC ¶ 61,272
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

New PJM Companies
and PJM Interconnection, L.L.C.

Docket No. ER03-262-009

ORDER APPROVING CONTESTED SETTLEMENT

(Issued June 17, 2004)

I. Introduction

1. PJM Interconnection, L.L.C. (PJM), American Electric Power Service Corporation (AEP) as agent for certain operating companies of the American Electric Power Service Corporation, and the Public Service Commission of the Commonwealth of Kentucky (Kentucky Commission) (collectively, Settling Parties) submitted an Offer of Settlement (Settlement). The Settling Parties state that the Settlement, if approved without condition or modification, would render moot that portion of the on-going proceeding in Docket No. ER03-262-009 which addresses the laws, rules, and regulations of Kentucky.

2. In this order, the Commission approves the contested Settlement without condition or modification. The Commission also provides clarification, as requested. The Settlement represents a reasonable resolution of the complex matters at issue in this proceeding as they pertain to the laws, rules, and regulations of Kentucky.

II. Background

A. Kentucky Commission Proceeding

3. On December 19, 2002, AEP's Kentucky operating company, Kentucky Power Company (AEP-Kentucky) filed an application with the Kentucky Commission requesting approval to transfer functional control of its transmission assets to PJM. On July 17, 2003, the Kentucky Commission issued an order denying AEP-Kentucky's request, finding that AEP-Kentucky had not shown that the benefits to Kentucky from joining PJM outweighed the costs. The order also indicated that the Kentucky Commission could not grant such approval because PJM's tariff is inconsistent with a

Kentucky statute with respect to curtailment. On August 25, 2003, the Kentucky Commission granted rehearing of AEP-Kentucky's request, allowing it to submit a Kentucky-specific analysis. The cost-benefits analysis was filed on December 23, 2003, and a hearing before the Kentucky Commission was scheduled to begin on April 21, 2004.

4. On April 19, 2004, two days prior to the scheduled hearing date, all of the parties in the AEP-Kentucky case entered into an Agreed Stipulation (Kentucky Stipulation), recommending that the Kentucky Commission approve AEP-Kentucky's application, subject to specified terms and conditions. On May 19, 2004, the Kentucky Commission granted conditional authority to AEP-Kentucky to transfer functional control of its transmission assets to PJM, subject to the Commission accepting the Kentucky Stipulation without any additions, modifications or conditions.

B. AEP Proceedings before the Commission

5. On November 25, 2003, the Commission issued an order¹ setting for hearing, *inter alia*, the question of whether the Commission should exempt AEP from the provisions of Kentucky and Virginia law or rule or regulation that would prevent AEP from voluntarily joining PJM under section 205(a) of the Public Utility Regulatory Policies Act of 1978 (PURPA).² On March 12, 2004, the Administrative Law Judge in that proceeding issued an Initial Decision.³ AEP and the Kentucky Commission filed exceptions to the Initial Decision.

6. In an opinion being issued contemporaneously with this order, the Commission affirms the Initial Decision, finding that the Commission may act under section 205(a) of the PURPA and permit AEP to integrate into PJM over the objection of the Commonwealth of Virginia.⁴ As a result of our approval of the Settlement in this order, the companion opinion does not need to address any of the exceptions to the Initial Decision raised by the Kentucky Commission in that proceeding.

¹ New PJM Companies, *et al.*, 105 FERC ¶ 61,251 (2003).

² 16 U.S.C. § 824a-1(a) (2000).

³ New PJM Companies, *et al.*, 106 FERC ¶ 63,029 (2004) (Initial Decision).

⁴ New PJM Companies, *et al.*, 107 FERC ¶ 61,271 (2004).

III. Offer of Settlement

7. On June 1, 2004, the Settling Parties submitted the Settlement pursuant to Rule 602 of the Commission's Rules of Practice and Procedure.⁵ The Settling Parties agree, stipulate, and recommend that the Commission approve the Settlement without additions, modifications, or conditions. They further recommend that the Commission find this proceeding moot as to the laws, rules, and regulations of the Commonwealth of Kentucky.

8. The Settlement and the Kentucky Commission's approval of AEP-Kentucky's application are based on the Kentucky Stipulation. The major provisions of the Kentucky Stipulation are discussed below:

- Paragraph 1 of the Kentucky Stipulation provides that the Kentucky Commission's approval is premised on PJM's operation of markets that are designed such that AEP's purchases and sales of capacity and energy in PJM's regional capacity and energy markets on behalf of its operating companies are voluntary. Paragraph 1 also recognizes that AEP's retail cost of service is subject to appropriate review by the Kentucky Commission. Paragraph 1 also states that the parties "agree to resist" any proposal to mandate PJM member participation in PJM's Capacity Credit Market or Interchange Energy Market. Paragraph 1 expressly notes, however, that the Kentucky Stipulation does not address the Commission's authority with respect to remedies for anticompetitive behavior, and it preserves the rights of the signatory parties to take a position on any alleged anticompetitive withholding.
- Paragraph 2 requires PJM to provide information and give due consideration to the findings of the Kentucky Commission and other state commissions within the PJM footprint for PJM to determine the appropriate reserve margin necessary to maintain safe and reliable service. Paragraph 2 also specifies that nothing in the stipulation shall supercede PJM's obligation to ensure an adequate reserve margin consistent with maintaining an acceptable level of reliability, consistent with applicable reliability principles and standards. Further, Paragraph 2 recognizes PJM's anticipation that AEP's participation in PJM should result over time in lower reserve margins than AEP would otherwise be required to maintain, all else being equal.

⁵ 18 C.F.R. § 385.602 (2003).

- Paragraph 3 specifies provisions related to PJM's curtailment protocols.
 - PJM will not direct AEP to curtail the retail customers of any AEP operating company for capacity deficiencies elsewhere on the PJM system so long as AEP has maintained adequate capacity in accordance with the applicable requirements.
 - PJM will not direct AEP to curtail retail load in any AEP-specific state jurisdiction, including Kentucky, for a transmission system emergency unless PJM has exercised all other available opportunities to remedy the emergency without curtailing such retail load.
 - The curtailment protocols apply except in extraordinary circumstances such as where load shedding would be beneficial to preventing separation from the Eastern Interconnection, preventing voltage collapse, or in order to restore system frequency following a system collapse.
 - Nothing in the approval of the Kentucky Stipulation shall alter the Kentucky Commission's authority over the application by AEP-Kentucky of curtailment practices to its retail customers.
- Paragraph 4 provides that any PJM-offered demand side response or load-interruption programs will be made available to AEP-Kentucky for its retail loads (at AEP-Kentucky's election) and that no such program will be made available by PJM directly to a retail customer of AEP-Kentucky.
- Paragraph 5 provides that nothing in the Kentucky Stipulation shall be construed to alter the jurisdictional authority of the Commission or the Kentucky Commission. Paragraph 5 also provides that the Kentucky Commission's approval of the Kentucky Stipulation shall not be construed as approval of the removal of the AEP-Kentucky assets from rate base and the authority to determine revenue requirements from such assets. Finally, Paragraph 5 affirms the Kentucky Commission's jurisdiction over AEP-Kentucky's retail rates.
- Paragraph 6 provides that nothing in the Kentucky Stipulation, or its approval by the Kentucky Commission, shall be deemed to alter AEP-Kentucky's existing obligation under Kentucky law to seek a certificate of public convenience and necessity prior to commencing construction of generation or transmission facilities.
- Paragraph 7 provides that nothing in the Kentucky Stipulation alters Kentucky laws, rules, or policies that service to retail customers be provided through the provisions of bundled retail electric service.

- Paragraphs 8, 9 and 10 address procedures for the approval of the Kentucky Stipulation, including each party's right to terminate if the Commission does not accept it and the May 19 Kentucky Commission Order as an offer of full settlement of this proceeding as to Kentucky.

IV. Comments

9. On June 1, 2004, PJM filed a supplemental statement in support of the Settlement.
10. Notice of the Settlement was issued on June 2, 2004, with initial comments due on June 10, 2004 and reply comments due on June 14, 2004.
11. Edison Mission Energy, Edison Mission Marketing & Trading, Inc. and Midwest Generation EME, LLC, and the Commission Trial Staff filed initial comments in support of the Settlement. Cinergy Services, Inc. (Cinergy) filed initial comments in support of the Settlement, but requests clarification of one issue. The Coalition of Municipal and Cooperative Users of New PJM Companies' Transmission (Muni-Coop Coalition) filed initial comments conditionally opposing the Settlement. Public Service Electric and Gas Company and PSEG Energy Resources & Trade LLC (collectively, PSEG) filed initial comments conditionally supporting the Settlement.
12. The Kentucky Commission, PJM, and FirstEnergy Service Company filed reply comments.
13. On June 15, 2004, the Muni-Coop Coalition filed a Statement of position in response to the reply comments. It states that the reply comments do not allay its concerns and that its opposition to the Settlement should be treated as no longer conditional.
14. The issues raised in the comments and reply comments are discussed below.

V. Discussion

15. As discussed below, the Commission approves the contested Settlement without condition or modification. The Commission finds that the concerns raised by the Muni-Coop Coalition in its conditional opposition to the Settlement have been adequately explained by the Kentucky Commission and/or PJM and thus do not pose an impediment to approval of the Settlement. The Commission also provides requested clarifications. Finally, the Commission also notes that the Settlement does not change the authority of this Commission or of the Kentucky Commission. In sum, the Commission approves the Settlement as a reasonable resolution of the complex matters at issue in this proceeding as they pertain to the laws, rules, and regulations of Kentucky.

A. LMP Market-Based Structure

16. Cinergy supports the Settlement so long as AEP, like any other market participant, will be bound by all aspects of the currently effective Amended and Restated Operating Agreement of PJM, the PJM Open Access Transmission Tariff, and the applicable Reliability Assurance Agreement. Cinergy notes that as a full participant in the PJM structured market, AEP's net settlement obligation with the PJM RTO Interchange Energy market will be dependent on the locational value of energy, and, therefore, self-scheduling to meet native load energy requirements may result in residual settlement obligations based not only on quantity deviations between total energy generated and total load, but also based on the impacts of congestion and losses. Cinergy therefore requests that the Commission clarify that nothing in the Kentucky Stipulation exempts AEP from full integration into the PJM LMP-based market structure.

17. The Commission grants clarification. Since AEP will become a member of PJM, it will sign the requisite agreements and abide by any resulting obligations. The Commission finds that nothing in the Settlement exempts AEP from meeting the obligations of a PJM member and signatory to the relevant PJM Agreements. In fact, Paragraph 2 of the Kentucky Stipulation states, for example, "Nothing stipulated in this agreement shall supercede PJM's obligation to ensure an adequate reserve margin consistent with maintaining an acceptable level of reliability." Of course, as long as AEP supplies the energy needed to meet its own needs and maintains adequate capacity to meet PJM's determination of AEP's capacity requirements, AEP will not be obligated to purchase energy or capacity in PJM's markets.

B. Curtailments During Emergencies

1. PJM's Authority Over Curtailments

18. The Settling Parties state that the curtailment provisions in the Settlement are consistent with PJM's existing practices, which specify that under transmission system emergencies, actions are to be directed at the area where the problem arises. However, for informational purposes, the Settling Parties included a pro forma revision to PJM's Operating Agreement. The Settling Parties state that the revision will be submitted for filing following a stakeholder process prior to the effective date of AEP's integration into PJM.

19. The Muni-Coop Coalition notes that in its July 17, 2003 Order, the Kentucky Commission found that AEP-Kentucky's participation in PJM would be inconsistent with a Kentucky statute⁶ which provides that retail customers be the last to suffer curtailment

⁶ Section 278.214 of the Kentucky Revised Statute.

or interruption of service resulting from an electric system emergency. To address the Kentucky statute's requirements, the Muni-Coop Coalition asserts that it appears that the Kentucky Stipulation establishes certain priorities of service during emergency conditions that would grant a discriminatory preference to Kentucky retail service. Specifically, the Muni-Coop Coalition states that the provisions of the Kentucky Stipulation can be interpreted as exempting Kentucky retail customers from curtailment under conditions in which other customers within PJM's footprint would be subject to curtailment. The Muni-Coop Coalition argues that a provision which would provide Kentucky retail customers a higher priority of service than is furnished to others in the PJM footprint would be unjust, unreasonable and unduly discriminatory and contrary to the principles of Order No. 2000.⁷

20. As noted above, the Settling Parties state that the curtailment principles are consistent with PJM's existing practices. However, the Muni-Coop Coalition questions why the curtailment provisions are deemed necessary, if PJM's existing practices already establish such protections. Further, the Muni-Coop Coalition contends that the pro forma tariff language which was submitted with the Settlement for informational purposes does not provide enough detail on how many control zones will be used and how curtailment and load shedding will be applied across the control zones. Further, in its statement of position, the Muni-Coop Coalition seeks assurance that the Settlement terms will not change to conform to section 13.6 of the PJM tariff. The Muni-Coop Coalition contends that without such information, it is impossible to determine whether the Kentucky Stipulation deviates from existing PJM practices.

21. In its reply comments, PJM states that the Settlement does not change the curtailment provision contained in section 13.6 of PJM's tariff, which states that "[i]f multiple transactions require Curtailment, to the extent practicable and consistent with Good Utility Practice, Curtailments will be proportionately allocated among Native Load Customers, Network Customers, and Transmission Customers taking Firm Point-to-Point Transmission Service." PJM further explains that curtailment of wholesale transmission tariff transactions under section 13.6 do not necessarily require load shedding. However, when PJM must shed load to resolve a transmission system emergency, PJM will do so,

⁷ See Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 at 31,033 (1999), order on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (Feb. 25, 2000), FERC Stats. & Regs. ¶31,092, petitions for review dismissed sub nom. Pub. Util. Dist. No. 1 of Snohomish County, Washington v. FERC, 272 F.3d 607 (D.C. Cir. 2001).

to the extent practicable, on a non-discriminatory and functional basis so that the minimum load is shed to resolve the problem and prevent it from spreading. When such emergency circumstances arise, PJM will inform the electric distribution company serving load of the quantity and location of load that must be shed, and the distributor, which directly serves the affected load, will effectuate the load-shedding. PJM states that this is its existing practice and is not a special procedure created only for AEP or as a result of the Settlement.

22. The Commission finds that the terms of the Settlement will not need to change to conform with PJM's tariff. In addition, the Commission notes that the Kentucky Commission in its May 19, 2004 Order, explains that PJM will not be in violation of the Kentucky statute, since it will not be determining or directing which customers would be curtailed during an emergency. Rather, that task will remain with AEP-Kentucky. In the event of a transmission emergency, PJM is only responsible for determining the location, quantity, and timing of any curtailment. PJM is not responsible for determining or directing the manner in which load is to be curtailed during an emergency.

23. Under the Settlement language at issue here, the issue is not whose transmission service is curtailed first or last, but whether end users will be shed before other options are exhausted. We construe the Settlement as requiring that shedding of end users be a last resort, after PJM has exhausted all other options that do not involve shedding end users. We understand the Settlement language to not provide AEP any additional rights regarding curtailment than it would otherwise have. On this basis, the Settlement is acceptable.⁸

2. AEP-Kentucky as a Separate Control Zone

24. PSEG conditions its support of the Settlement based on its understanding of the curtailment provisions. PSEG understands that the first three subparts of Paragraph 3 of the Kentucky Stipulation are designed to recognize the current status of AEP as a physically-separate control zone. PSEG understands that a separate control zone is necessary because, at present, there is insufficient transmission transfer capacity between the area covered by the "classic PJM," the Allegheny Power transmission zone, the Commonwealth Edison Company transmission zone and the new AEP-Kentucky transmission zone. PSEG further believes that the curtailment protocols are transitional in nature, and will be terminated when the operational restriction requiring treatment of

⁸ We further note that if the transmission of service provided by a utility to a class of customers is of inferior quality compared to the service provided by the utility to its native load, lower rates may be warranted.

the AEP-Kentucky as a separate control zone have been alleviated. The Muni-Coop Coalition argues that the determination of whether AEP will be its own control zone should not be left for later resolution, because it is fundamental to understanding how the existing curtailment and load shedding practices will be applied.⁹

25. In its reply comments,¹⁰ PJM responds that the Commission does not have to decide the control zone in which AEP will reside before it approves the Settlement. PJM's control zones have been established, as its "footprint" has grown, to accommodate requirements, such as ancillary services and load-shedding considerations, which are better addressed in a geographic area smaller than the entire PJM region. PJM explains that its tariff permits one or more control zones to be established in each of the ECAR and MAIN reliability regions, but does not prescribe the boundaries of the operational zones. In addition, PJM explains that it will soon be making a final determination regarding the most efficient control zone structure for the newly integrated companies and will file with the Commission any conforming or related tariff changes. PJM states that it will advise the Commission at that time of the control zone in which AEP will reside.

26. In its Statement of position, the Muni-Coop Coalition notes that the scope and effect of the Kentucky Stipulation load-shedding provisions will depend in substantial measure upon the configuration of the control zones. Depending on what control zone AEP is folded into, the Muni-Coop Coalition avers it could enjoy greater protection from curtailment during an emergency. The Muni-Coop Coalition believes that the Commission needs information on control zones in order to evaluate this aspect of the Settlement.

27. We believe that it is premature to address this issue. When PJM makes its filing in July, all parties will have the opportunity to evaluate the control zone issue and file comments with the Commission addressing their concerns.

⁹ The Muni-Coop Coalition also suggests that PJM is delaying submitting the pro forma amendment to the PJM Members Committee, contrary to the spirit of collaboration with stakeholders envisioned by Order No. 2000. Muni-Coop coalition's Initial Comments at 7, n.4.

¹⁰ PJM styles its reply on this issue as a response to the Muni-Coop Coalition's initial comments.

C. Voluntary Participation in PJM Markets

28. The Muni-Coop Coalition notes that the Kentucky Commission's approval of AEP-Kentucky's participation in PJM is based in part on the voluntary nature of AEP-Kentucky's participation in the PJM energy market for purchases and sales of energy. The Muni-Coop Coalition contends that the language in Paragraph 1 of the Kentucky Settlement has the effect of prohibiting PJM from contesting a decision by AEP to opt out of complying with a Commission mandate. The Muni-Coop further states that Paragraph 1 seems to bind PJM to join AEP in "resisting" any proposal for mandatory participation, regardless of its merits. The Muni-Coop questions whether it is appropriate for PJM to agree in advance to resist any proposal that would require any level of market participation, without regard to the merits, such as a requirement to sell into a market to mitigate the effects of high market concentration. The Muni-Coop Coalition contends that for PJM to agree in advance to "resist" any proposal seems inadvisable as a matter of preserving RTO independence and discretion.

29. The Muni-Coop Coalition also states that Paragraph 1 raises the question of whether the benefits of the PJM expansion will be realized if AEP is free to keep its entire fleet of generators on the sidelines. The Muni-Coop Coalition states that if AEP is free to self-schedule all or most of its fleet of generators, Paragraph 1 could be viewed as a potential justification for a "new and exceedingly potent form of market power."

30. In its reply comments, PJM states that voluntary participation is a hallmark of the PJM markets. PJM states that because the Kentucky Commission had expressed concern that membership in PJM would result in a mandatory requirement that AEP-Kentucky sell the output of its generation into the PJM market, the Kentucky Stipulation affirms that participation in the PJM market is voluntary. PJM states that the Muni-Coop Coalition misunderstands this aspect of the Kentucky Stipulation when it suggests that PJM could not advocate mandatory participation in circumstances in which sales into a market might be required for some period to mitigate the effects of high market concentration. PJM notes that the Kentucky Stipulation explicitly preserves PJM's (and other signatory parties') ability to address anticompetitive withholding, notwithstanding the voluntary nature of the markets.

31. The Commission finds that Settlement is premised on PJM's markets being voluntary. The Commission finds nothing in the Settlement changes this premise. Moreover, the May 19, 2004 Kentucky Commission Order explains that Paragraph 1 of the Kentucky Stipulation affirms the voluntary nature of the PJM energy market for purchases and sales of energy. It further affirms that AEP can elect to either participate in PJM's spot energy market to meet AEP-Kentucky's native load energy requirements, contract bilaterally with other entities to supply energy, or schedule its own generation to meet those requirements. In addition, the order explains that in the event that the

Commission proposes mandatory purchases or sales of energy into PJM's market, the Kentucky Stipulation provides that PJM and the other parties are "obligated not to contest AEP's decision to not participate in any such mandatory market." The Commission finds that under the terms of the Settlement, PJM is free to advocate any position before this Commission that it deems appropriate. PJM is only restricted in contesting an AEP decision not to participate in a mandatory market; PJM is not restricted in advocating the pros or cons of such a market.

32. Finally, the Muni-Coop Coalition raises a concern about a new form of market-power abuse which could occur if AEP keeps its entire fleet of generators on the sidelines. The Commission finds that this concern is unfounded. First, while market purchases and sales are voluntary, the experience of other vertically integrated members of RTOs indicates that in any given time period they are likely to have either an excess to sell or a shortfall to cover due to normal variation in supply and load, and will actively participate in the market for these purposes. Second, nothing in the Settlement or the Kentucky Stipulation prohibits the Commission from exercising its authority under the Federal Power Act¹¹ to address market-power concerns. In fact, the last sentence of Paragraph 1 notes that the Kentucky Stipulation does not address the authority of the Commission with respect to remedies for anti-competitive behavior.

The Commission orders:

The Settlement is in the public interest and is hereby approved, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.

¹¹ 16 U.S.C. § 824b (2000).