

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

PJM Interconnection, L.L.C.	Docket Nos. RT01-2-005,
Allegheny Electric Cooperative, Inc.	RT01-2-006,
Atlantic City Electric Company	RT01-2-007,
Baltimore Gas & Electric Company	and RT01-2-008
Delmarva Power & Light Company	
Jersey Central Power & Light Company	
Metropolitan Edison Company	
PECO Energy Company	
Pennsylvania Electric Company	
PPL Electric Utilities Corporation	
Potomac Electric Power Company	
Public Service Electric & Gas Company	
UGI Utilities Inc.	

Allegheny Power System Operating Companies:	Docket No. ER03-738-000
Monongahela Power Company	(Not Consolidated)
Potomac Edison Company, and	
West Penn Power Company,	
all d/b/a Allegheny Power	
Atlantic City Electric Company;	
Delmarva Power & Light Company	
Baltimore Gas and Electric Company	
Jersey Central Power & Light Company	
Metropolitan Edison Company	
Pennsylvania Electric Company	
PECO Energy Company	
PPL Electric Utilities Corporation	
Potomac Electric Power Company	
Public Service Electric and Gas Company	
Rockland Electric Company	
UGI Utilities, Inc.	

ORDER ON REHEARING AND COMPLIANCE FILING
AND ON TARIFF FILING

(Issued July 24, 2003)

1. In this order, the Commission denies rehearing of its order granting Regional Transmission Organization (RTO) status to PJM Interconnection, L.L.C. (PJM). The order also accepts, with modifications, compliance filings made by PJM in response to that earlier order, effective as of March 20 and 21, 2003, as requested, and requires a further compliance filing within 30 days. Finally, this order rejects the tariff filing by PJM's Transmission Owners proposing a methodology to recover their costs for expansions, because the use of a single carrying charge applicable to all transmission owners within PJM, without regard to their individual costs, is unjust and unreasonable. Our actions in these proceedings benefit customers by continuing to ensure that the PJM tariff provisions are just and reasonable, thus encouraging increased power supply and reducing congestion on the PJM transmission system.

BACKGROUND

The Commission's December 20 Order

2. On July 12, 2001, the Commission granted PJM provisional RTO status,¹ but required PJM to make a compliance filing demonstrating that PJM met all the necessary characteristics of an RTO. PJM made that compliance filing on September 10, 2001 (September 10 Compliance Filing).

3. On December 20, 2002, the Commission issued an order granting PJM full RTO status.² The Commission found, however, that PJM's September 10 Compliance Filing "does not meet our directive that the PJM planning process identify expansions that are needed to support competition as well as reliability needs."³ The Commission further stated:

In order to fully meet the planning and expansion function for an RTO, we will require PJM to make a further compliance filing within 90 days that

¹PJM Interconnection, L.L.C, et al., 96 FERC ¶ 61,061 (2001) (July 12 Order).

²PJM Interconnection, LLC, 101 FERC ¶ 61,345 (2002) (December 20 Order).

³December 20 Order at P 24.

more fully explains how PJM's planning process will identify expansions that are needed to support competition. PJM's regional transmission 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 [transmission owners'] systems to ensure reliability, and (b) identify transmission constraints and require new construction to address those constraints.⁴

4. In addition, the Commission noted that the Delaware Municipal Electric Corporation (DEMEC) had provided a list of economic priorities that it wished PJM to consider. The Commission stated:

DEMEC, in its protest, recommends that, as PJM identifies appropriate economic upgrades, it should give priority to proposals for transmission expansion at current interconnections with utilities, in areas where transmission is constrained, and to interconnection applications by generators locating in congested areas. We will require PJM either to adopt the priorities suggested by DEMEC, or, if it believes that other priorities are superior, to state what they are and why.⁵

Rehearing Request In Docket No. RT01-2-005

5. The New York Transmission Owners (NYTOs) sought rehearing of this ruling. DEMEC filed an answer to NYTOs' rehearing request.

Compliance Filings in Docket Nos. RT01-2-006, RT01-2-007 and RT01-2-008

6. On March 20, 2003, PJM made a compliance filing, which it amended on March 27, 2003 (Docket Nos. RT01-2-006 and RT01-2-007), and which it supplemented on April 17, 2003 (Docket No. RT01-2-008). Notice of the March 20 compliance filing was published in the Federal Register, with comments, protests and interventions due on or before April 21, 2003.⁶ Notice of the March 27 compliance filing was published in the Federal Register, with comments, protests and interventions due on or before April 17,

⁴Id.

⁵Id.

⁶68 Fed. Reg. 16,278 (2003).

2003.⁷ Notice of the April 17 compliance filing was published in the Federal Register, with comments, protests and interventions due on or before May 19, 2003.⁸

7. Motions to intervene in the compliance proceedings were filed by the Public Utilities Commission of Ohio (Ohio Commission), American Electric Power (AEP), American Public Power Association (APPA), and Steel Dynamics.

8. Motions to intervene including comments or protests were filed by Jersey Central Power and Light Company (FirstEnergy), DEMEC, Reliant Resources (Reliant), Constellation Power Source, et al. (Constellation Coalition) the Delaware Public Service Commission (Delaware Commission), Transmission Dependent Utilities (TDUs), Allegheny Power, Borough of Chambersburg, PA (Chambersburg), the NRG Companies (NRG), the Virginia State Corporations Commission (Virginia Commission), Exelon Corporation (Exelon), National Grid USA (National Grid), Northeast Utilities (NU), National Rural Electric Cooperatives Association (NRECA), Public Interest Organizations (PIOs), Joint Consumer Advocates, Central Hudson Gas and Electric Corporation, et al. (Central Hudson), Coalition of Municipal and Cooperative Users (Muni-Coop Coalition), Madison Gas and Electric Company, et al. (Madison), the PSEG Companies (PSEG), PJM Industrial Customer Coalition (PJMICC), the Electric Power Supply Association (EPSA), Dominion Resources (Dominion), and Continental Cooperative Services.

9. DEMEC filed an answer to the protests of PSEG and the Constellation Coalition, to which the PSEG Companies filed a response. The Muni-Coop Coalition filed a motion to consolidate this case with Allegheny Power System Operating Companies, Docket No. ER03-738-000. PJM filed an answer to the protests, and Muni-Coop Coalition, National Grid and PIOs filed responses to PJM's answer.

Cost Recovery Proceeding in Docket No. ER03-738-000

10. On June 10, 2003, the Commission issued an order accepting and suspending for five months, subject to further orders, a tariff filing made by the PJM Transmission Owners (PJM TOs) on April 11, 2003 revising Schedule 12 of the PJM Open Access Transmission Tariff (PJM Tariff) to provide a methodology for the recovery of costs

⁷68 Fed. Reg. 16,501 (2003).

⁸68 Fed. Reg. 22,691 (2003).

incurred by the PJM TOs as a result of PJM-ordered transmission expansions.⁹ Specifically, the PJM TOs requested the Commission to accept a methodology similar to the methodology recently proposed by the Midwest Independent Transmission System Operator, Inc. (MISO), and accepted by the Commission in Docket No. ER02-485-002.

Process for Determining Cost Recovery for PJM-Ordered Enhancement

11. The proposed methodology would determine the Transmission Enhancement Charge used to recover the costs of PJM's Required Transmission Enhancements in several steps. First, the annual carrying charge rates that will apply to incremental investment were included in the tariff filing to remain in effect until they are changed pursuant to Sections 205 or 206 of the Federal Power Act.

12. Second, a transmission owner that constructs transmission expansion projects ordered by PJM in the Regional Transmission Expansion Plan Process (RTEPP) will submit to PJM the actual costs (including an allowance for funds used during construction calculated in accordance with the Commission's Uniform System of Accounts) for each project placed in service through the year as recorded in its FERC accounts. PJM will apply the carrying charges and begin collection for those costs as of January 1 of the year following the year in which the project enters service. The proposed methodology provides the prescribed formula rate mechanism that PJM will apply to develop the PJM TO's project-specific revenue requirement using the recorded project costs and the authorized carrying charges.

13. Third, for each project, PJM will independently determine and designate the market participant(s) who benefit from and therefore should pay for the transmission expansion. PJM will project the MWh usage of the market participant(s) for a year. From that information, PJM will create a Transmission Enhancement Charge Rate that will apply to the designated market participant(s).

14. Fourth, PJM will annually determine the amount of Transmission Enhancement Charges it must collect from each Responsible Customer to recover the annual Transmission charges for multiple projects. PJM will remit to the appropriate PJM TOs the amount collected. Under the proposed methodology, the PJM TOs will bear the risk of any under collection because there will be no true-up of payments for differences in actual usage compared to projected usage.

⁹Allegheny Power System Operating Companies, et al., 103 FERC ¶ 61,319 (2003) (June 10 Order).

15. Finally, PJM will make an annual information filing and maintain the information on its public Internet site containing the following information: (i) the Transmission Enhancement Investment for each Required Transmission Enhancement; (ii) the year each Required Transmission Enhancement is placed in service; (iii) the total Transmission Enhancement Charge for each Required Transmission Enhancement; (iv) the Responsible Customers for each Required Transmission Enhancement and the share of the Transmission Enhancement Charge applicable to such Responsible Customers; (v) the sum of all Transmission Enhancement Charges for each Responsible Customer; and (vi) the Transmission Enhancement Charge Rate for each responsible Customer.

Components of Cost Recovery Methodology Proposed in Tariff Filing

16. According to the PJM TOs, under the methodology proposed to be used in Schedule 12, the revenue requirement was calculated by multiplying the qualifying investment by one of 16 annual pre-determined carrying charge rates included in the proposed Schedule 12.¹⁰ The first 15 years represent the annual carrying charges associated with the investment using an accelerated 15-year life. The 16th year and beyond represents only Operations and Maintenance (O&M) related costs. The sum of the applicable carrying charges for the different projects will be the total revenue requirement the PJM TOs recover with respect to RTEPP projects.

17. The carrying charge rates proposed in Schedule 12 consist of the following components: (1) return on investment; (2) depreciation; (3) income taxes; (4) incremental operations and maintenance expense; (5) incremental Administrative & General expense; (6) incremental other taxes; (7) cash working capital; and (8) a general plant component. With the exception of long-term debt and associated interest expenses for certain companies, the PJM TOs state that the data used in developing the carrying charges was derived from the 2001 FERC Form 1 for each transmission owner.¹¹

¹⁰In Year 1, the annual carrying charge rate will be 30.23%; the annual carrying charge rate then decreases in Year 2, and so on down to Year 15, in which the annual carrying charge rate will be 15.21%. For Year 16 and beyond, the annual carrying charge rate will be 5.62%. See Exhibit ABC-5 (PJM TO-5). These annual carrying charge rates will remain part of Schedule 12 (Original Sheet No. 270C).

¹¹The PJM TOs excluded the cost of transition bonds from the long-term debt and associated interest expense for certain companies. They argue that transition bonds, a form of securitized debt and specifically associated with generation stranded costs, should not be included in developing the carrying charge rate for new transmission investment.

18. The PJM TOs state that the return on investment component in the proposed methodology is a composite cost of capital for the PJM TOs based upon the weighted cost of debt and preferred stock as well as the weighted capitalization of the TOs. The weighted cost of debt is calculated by adding up the interest expense included in Form 1 for each TO and dividing it by the total average debt outstanding for the TOs. A similar calculation was performed for preferred stock and for capitalization. The total debt, preferred, and common equity for all the TOs was totaled and ratios determined from the totals. The proposed methodology in Schedule 12 used 13.88% as the cost of equity in developing the carrying charge rate. According to the PJM TOs, the cost of equity is based on the 12.38% return on equity authorized by the Commission for MISO and adding the Commission's proposed pricing incentives of 0.5% for joining a Regional Transmission Organization and 1.0% for new investment.

19. The PJM TOs state that the depreciation component uses an accelerated 15-year life for new investment rather than 40 years to recognize the dynamics in the transmission business environment and the competitive potential of transmission. The income tax rate component used in the proposed Schedule 12 is 41.18%, based on the arithmetic average of the composite state and federal income tax rates of the TOs.

20. The 3.43% incremental operating and maintenance expense (O&M) component of the carrying charge rates was estimated by taking the average transmission O&M per dollar of the TOs' gross plant investment. The estimate was calculated by dividing the total transmission O&M expense for all the TOs by the total transmission plant of all the owners. A 1.45% incremental administrative and general expense component (A&G) was used in the proposed Schedule 12 carrying charges rates based on calculations using the relationship of the A&G expense as a percent of non-fuel O&M expense (excluding A&G). This percentage was then multiplied by the transmission O&M component to get the A&G component of the carrying charge.

21. The 1.89% other taxes component relates to investment and was established by dividing the total other taxes for all the companies, excluding revenue related taxes, by net plant to establish a cost factor. According to the PJM TOs, the resulting 1.89% factor was used in the calculation of the capital carrying charge in order to recognize that the cost declines over time as the net investment declines. The 0.73% cash working capital component was based on the Commission's one-eighth convention (one eighth of the sum of transmission O&M and A&G multiplied by the pre-tax cost of capital and then dividing by gross transmission plant). According to the PJM TOs, the one eighth is based on a default level used by the Commission. The O&M, A&G, and gross transmission plant are the totals for all the companies. And the cost of capital is the weighted average.

22. Finally, the general plant component of the carrying charge was allocated to transmission based upon the same methodology used for A&G and transmission O&M, as a percent of total non fuel O&M (excluding A&G). This estimated general plant was then divided by gross transmission plant. The resulting decimal was then added to one to get a multiplier to apply to the carrying charge rate for transmission plant. In this case, the general plant multiplier was 1.0437.

23. As described in PJM's compliance filing, the charge to customers will be calculated by PJM in four steps. First PJM will identify the customer or groups of customers designated to bear cost responsibility for a Required Transmission Enhancement (Responsible Customers) and the share of the revenue requirement associated with the Required Transmission Enhancement to be borne by those Responsible Customers. Then, PJM will divide the share of the revenue requirement borne by the Responsible Customers in question by the estimated annual total usage of those Responsible Customers. The result of that calculation will become the Transmission Enhancement Charge Rate (TECR). Next, PJM will calculate an individual customer's monthly charge (typically a load serving entity) by multiplying the TECR times that customer's monthly usage to obtain the monthly charge for that particular Required Transmission Enhancement. Finally, to the extent that a Responsible Customer is designated as the Responsible Customer for additional Required Transmission Enhancements, those amounts would be cumulated to constitute the Responsible Customer's monthly bill from PJM for all Required Transmission Enhancements. According to the PJM TOs, under the proposed Schedule 12, Responsible Customers could be designated to pay Transmission Enhancement Charges from multiple transmission owners. The PJM TOs note that there will not be a true up on revenue collection pursuant to the proposed Schedule 12, and that the Transmission Enhancement Charges will be updated every year regardless of whether new investments are included.

DISCUSSION

Procedural Matters Relating to the Compliance Filings in Docket Nos. RT01-2-006, RT01-2-007 and RT01-2-008

24. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the notices of intervention and timely unopposed motions to intervene serve to make the parties in the compliance filings in Docket Nos. RT01-2-006,

RT01-2-007 and RT01-2-008 intervenors to the proceedings in which they sought to intervene.¹²

25. DEMEC opposed the motions to intervene of PSEG and the Constellation Coalition arguing that these intervenors are seeking to intervene solely for the purpose of mounting a collateral attack on the December 20 Order. The Commission will deny the relief sought by DEMEC, and grant the intervention of PSEG and the Constellation Coalition. PSEG and the Constellation Coalition have or represent interests which may be directly affected by the outcome of the proceeding, and the Commission finds that their participation is in the public interest.

26. Under Rule 213(a) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a) (2) (2003), an answer may not be made to a protest or an answer unless permitted by the decisional authority. With the exception of PJM's answer in the Compliance Filings in Docket Nos. RT01-2-005, et al., we will reject all the answers and responses to answers filed by the intervenors in the compliance filings because they provide no new material to aid us in our consideration of this matter.

Analysis

1. Rehearing Request in Docket No. RT01-2-005

27. In their request for rehearing or clarification, NYTOs assert that the Commission's authority to require construction of facilities is limited by Sections 210 - 212 of the Federal Power Act (FPA).¹³ According to the NYTO's, the Commission's sole authority to order construction comes from Sections 210 and 211, which permit the Commission to order interconnection or wheeling. NYTOs assert, however, that the FPA provides that the Commission may only exercise that authority on a case-by-case basis in response to specific requests, after a determination that the proposed activity is in the public interest, rather than exercising that authority in a blanket fashion. NYTOs further argue that the Commission may not delegate its authority under Sections 210 and 211 to a third party such as an RTO or independent system operator (ISO).

¹²We note that, in its motion to intervene, the Muni-Coop Coalition requested the Commission to consolidate this case with Allegheny Power System Operating Companies, Docket No. ER03-738-000. We decline to do so; however, we are addressing the issues raised in all these dockets together in this order.

¹³16 U.S.C. §§ 824i - 824k (2000).

28. NYTOs also argue that the Commission may only order expansions or interconnections if it ensures, consistent with Section 212, that transmission owners who are required to construct new projects are able to recover their costs. NYTOs state that, under Commission precedent, "[c]osts associated with reliability projects are generally socialized to appropriate market participants, [but] costs associated with economic projects are properly borne by the party undertaking those projects."¹⁴ According to NYTOs, the December 20 Order did not sufficiently ensure how such costs would be recovered.

29. Finally, NYTOs raise policy objections to the Commission's ruling. They state that ideally, market forces will determine whether generation, transmission or demand response will be the best solution to congestion, but that the Commission here effectively authorizes PJM to interfere with those market forces, and that, in so doing, PJM will compromise its independence from market participants.¹⁵ NYTOs contend that a transmission organization's role should be limited to identifying needs, and allow the market to meet that need. NYTOs also state that the December 20 Order will overtake the ongoing Standard Market Design (SMD) process.¹⁶

Commission Conclusion.

30. The Commission denies the rehearing request by the NYTOs, because they are not members of PJM and, therefore, are not aggrieved by any decision in this filing.¹⁷

¹⁴NYTOs' request for rehearing at 9.

¹⁵Id. at 10.

¹⁶A similar issue was raised by PSEG in its protest of PJM's compliance filing. Additionally, FirstEnergy and PSEG asserted in their protests that PJM erred by giving itself authority to require construction of upgrades. FirstEnergy, PSEG and others argued that this act is discriminatory because generation, merchant transmission and demand response all have as much ability to address congestion problems; yet PJM did not propose to order those parties to do anything. Other protesters to the compliance filing also made the argument that this command-and-control regulation, under which PJM mandates upgrades, is inconsistent with the Commission's current market-oriented regulatory philosophy. NYTOs in their protest also reiterated the argument from their rehearing petition that the Commission went beyond its Section 210-212 powers in telling PJM it had authority to require construction.

¹⁷Section 313(a) of the FPA permits only those persons that are aggrieved by a

Moreover, under the process envisioned by the Commission the rehearing requests are premature. The crux of the December 20 Order was to require PJM to establish a procedure to "identify economic expansions that are needed to support competition,"¹⁸ but the Order did not specify how the Commission would handle the construction procedure. The Commission will provide further clarification of how that process will work.

31. Through this filing (and the rate filing by the TOs), PJM will determine areas where unhedgeable congestion exists, provide an opportunity for a market solution to address the congestion, and, absent a market solution, will determine which transmission owner or owners in the appropriate zone should construct an upgrade, what parties would be the beneficiaries of the construction, and how the regulated rates for such construction will be allocated to those beneficiaries. But the Commission also recognizes that the actual construction decision may require additional input from the parties and the states. If at the end of the PJM process, there is no agreement to build the upgrade, PJM must make a filing with the Commission as to the results of its process. Upon receipt of that filing, the Commission can determine whether to institute an individual proceeding to determine whether to require enlargement of facilities under the FPA or take other steps.¹⁹ Since the Commission is not delegating statutory authority to PJM or making any determination to require construction at this stage, the rehearing petitions are premature.

¹⁷(...continued)

Commission order to request rehearing of that order. 16 U.S.C. § 8251. See See City of Summersville, 84 FERC ¶ 61,073 (1998) and Arizona Public Service Co., 26 FERC ¶ 61,357 (1984). As noted above, in their protests to PJM's compliance filing, FirstEnergy and PSEG raised challenges to the Commission's jurisdiction similar to those raised by the NYTOs. FirstEnergy's and PSEG's arguments on this question in those pleadings are, in essence, requests for rehearing of the Commission's December 20 Order, and, are untimely. Under Section 313(a) of the FPA, any party seeking rehearing of a Commission order must do so within 30 days of issuance of that order.

¹⁸December 20 Order at P 24.

¹⁹For example, under the FPA, the Commission has the obligation to prevent unjust and unreasonable rates, and it has found that transmission owners cannot be permitted to charge opportunity costs when such costs exceed the costs of expansion in order to ensure that transmission owners have the appropriate incentive to expand their systems when it is economically efficient to do so. See Pennsylvania Electric Co., 58 FERC ¶ 61,278, at 61,874 (1992). By the same token, it may not be appropriate to permit a transmission owner or its affiliates to receive congestion-related revenues or other benefits that result from a decision not to construct facilities when such expansion would be a less expensive means of remedying congestion.

Policy Issues

32. The parties opposing the Commission's directive to PJM state that it contravenes the Commission's philosophy of market-oriented regulation, and requires PJM to interfere with the workings of the market. This argument ignores the fact that, as PJM's compliance filing demonstrates, PJM will not propose construction of a transmission upgrade until it has exhausted the possibility that the market will produce a solution to congestion or similar market failures. PJM will identify regions where an upgrade might be necessary, and will perform a cost/benefit analysis to determine whether a transmission upgrade would be the economically optimal solution. PJM will also notify its participants of this problem, provide ample time for a solution to arise through market means, and act only if no market solution arises. Only when these two conditions are satisfied – that a transmission upgrade would be the economically best solution, and the market has not produced a solution – will PJM "intervene." To prohibit such market intervention, when necessary, would contravene the Commission's obligation to ensure just and reasonable rates and prevent undue discrimination. The intent of the Commission's market-driven regulatory philosophy is to use the market to provide customers with just and reasonable rates; not to allow market failures to deprive customers of such rates and subject them to undue discrimination.

2. Compliance Filings in Docket Nos. RT01-2-006, RT01-2-007 and RT01-2-008

33. In its March 20 compliance filing, PJM submitted revised tariff sheets that provide for regional planning to support competition. PJM stated that its submittal was the result of extensive internal analysis and discussion with market participants, state commissions and state consumers advocates, and represents

PJM's balancing of the importance of allowing regional electric service markets to propose economically efficient solutions to transmission congestion with the need for a more proactive planning role for PJM as the RTO, meeting consumer needs in certain load pockets and other persistently constrained areas of the PJM transmission system.²⁰

34. PJM also noted that its proposal would recognize the role of incentive rate proposals, and of the need for the RTO to provide opportunities for generation, merchant

²⁰March 20 compliance filing, transmittal letter at 3.

transmission and demand response to serve as solutions to the problems of transmission congestion.²¹

35. PJM proposed changes to its regional planning protocol and tariff that would:

- (1) clarify that PJM's Regional Transmission Expansion Plan (RTEP) will include any transmission expansion that is proposed by a party that will assume responsibility for all costs of that expansion;
- (2) ensure that the RTEP will identify and require construction of transmission upgrades that are needed to support competition;
- (3) provide a mechanism for transmission owners with PJM to establish charges (subject to the Commission's approval) to recover the costs of transmission upgrades that they are required to build through PJM's RTEP process; and
- (4) provides for PJM to collect such charges.

36. PJM states that, through the RTEP process, it will identify transmission upgrades that it considers necessary to address "unhedgeable" congestion, and if market forces do not resolve such congestion within "an appropriate period," PJM will order construction of the transmission upgrade needed to resolve it. PJM will identify whether congestion is "hedgeable" or "unhedgeable," based on the capability of PJM markets and the transmission system to provide for hedging, using the same analysis that it uses to determine the system's simultaneously feasible Financial Transmission Rights (FTRs).²² If PJM finds congestion to be hedgeable, it will not order solutions for it. Thus, PJM

²¹Id. at 4.

²²PJM states that it will:

determine the appropriate assumptions regarding general hedging patterns for the region as a whole and then will use its analytical tools to calculate the ability to hedge for each congestion event. Where necessary, PJM will evaluate multiple hedging vehicles or patterns and will calculate a weighted average to determine the extent to which a particular congestion event can be hedged.

March 20 filing, transmittal letter at 6. PJM also notes (id., fn. 5) that the economic planning methodology set forth here will not be in its tariff, but in the PJM manuals.

asserts, its planning process will allow for competition among all possible solutions for congestion, in that, where congestion is hedgeable,

market forces can be relied on to enable generation resources, merchant transmission projects, and demand side measures to provide competitive alternatives to load-serving entities' [LSEs] use of hedging instruments and/or continuing to bear the costs of congestion.²³

37. PJM states, however, that under its proposal, it will not use its authority to propose economic transmission upgrades to compete with such other options when congestion is hedgeable, so as to avoid market distortions and economic inefficiency. PJM asserts that this proposal, however, will be sufficient to relieve customers in load pockets from having to tolerate the costs of congestion indefinitely when no "realistic, competitive alternatives are forthcoming."²⁴ PJM stresses that it will provide the information to the marketplace necessary to elicit competitive solutions to congestion before it proposes a specific transmission upgrade.

38. Once PJM has identified an area that is experiencing unhedgeable congestion, it will use timing triggers to demonstrate whether the market will respond to a congestion problem. PJM anticipates that it will initially permit the market a year to provide a solution to unhedgeable congestion, and will establish a minimum accumulated cost associated with a particular congestion event that would trigger the opening of that one-year window. Both the minimum and the duration of the window will be subject to periodic review by PJM stakeholders. PJM states, however, that it does not anticipate using a cost trigger in its economic planning analysis. PJM proposes to compare the costs of upgrades to the level of accumulated, unhedgeable congestion to determine when to require construction of an upgrade.

39. PJM will also conduct a cost/benefit analysis of transmission solutions to congestion to ensure that it will order a transmission upgrade solely if the upgrade's benefits (the congestion costs it is expected to eliminate) are likely to exceed the costs of building it. If the timing trigger (i.e., the one-year window) passes without a market solution having been proposed, and PJM determines that the benefits of an upgrade will outweigh its costs, PJM will propose construction of a transmission upgrade. PJM will also work collaboratively with state commission and siting authorities to ensure that the upgrades it recommends are feasible from a state regulatory and siting perspective.

²³Id.

²⁴Id. at 7.

40. PJM's proposed tariff changes provide that the RTEP will designate the party or intervenors responsible for constructing, owning and/or financing each transmission upgrade. PJM states that, except with regard to merchant transmission facilities, that responsibility will generally be allocated to the PJM transmission owner(s) that own facilities in the zone(s) where the new facilities will be built. However, this provision also provides for construction by entities other than traditional transmission owners, so long as those entities accept full cost responsibility. The RTEP will also designate the market participants who will bear the costs of each upgrade.

41. PJM also proposes a new Section 12 of its tariff, which sets out a framework for transmission owners to establish a fixed monthly Transmission Enhancement Charge (TEC) for each required upgrade, which PJM will translate into a charge per megawatt-hour of monthly system usage by the appropriate market participants, and will incorporate into that tariff provision the designation of each customer from whom it proposes to collect the TEC for each upgrade. PJM currently anticipates applying such charges on a zonal basis only, although in the future it may be able to apply the charges on a sub-zonal basis.

42. In its April 17 filing clarifying and supplementing its March 20 filing, PJM provides its response to the Commission's requirement that it explain why it does not propose to accept the priorities suggested by DEMEC.²⁵ PJM states that DEMEC's proposal is discriminatory and inconsistent with PJM's integrated planning process.

43. PJM asserts that its regional planning process is designed to integrate the needs of all stakeholders throughout the PJM region, and that establishing rules to govern the priorities to assign to competing stakeholder demands for transmission capacity is critical to PJM's ability to integrate all regional needs into a single plan. The established rules currently assign priorities based on the timing of each party's request for interconnection or new service – a "first come, first served" plan which is identical to that of the pro forma open access tariff set forth by Order No. 888. This regimen assures all intervenors that the planning process is fair, and all market participants have equal access to transmission capability.

44. PJM further states that, now that it has proposed (in the March 20 filing) a method for alleviating congestion in load pockets, DEMEC's proposal would undercut PJM's ability to elicit market-based solutions to congestion before using its power to compel

²⁵As noted above, DEMEC had suggested that PJM give priority to proposals for transmission expansion at current interconnections with utilities, in areas where transmission is constrained, and to interconnection applications by generators locating in congested areas. See December 20 Order at P 24.

construction; thus, PJM states that DEMEC's priorities would lead ultimately to the market-distorting inefficiencies that are an inevitable result of centralized planning. According to PJM, DEMEC's proposal would eliminate the ability of market participants to make their own assessments of congestion events and to develop economically efficient solutions. PJM states that it is appropriate to limit its exercise of its authority solely to those situations in which (a) congestion cannot be hedged, and (b) no market solution is forthcoming.

45. In its March 20 filing, PJM asks for an effective date for its Volume 1 changes (compliance changes to the regional planning process) of March 20, 2003, and an effective date for its Volumes 2 and 3 changes (changes to the PJM Operating Agreement, PJM Reliability Assurance Agreement and the PJM West Reliability Assurance Agreement) of March 21, 2003.

46. The intervenors who filed protests or comments to the compliance filings made the following arguments.

47. Many intervenors said PJM's filing is not clear enough, particularly, that it lacked a clear definition of the "hedgable/unhedgable" distinction. Some said this definition gave PJM too much discretion as to when to require construction of upgrades. Some intervenors wanted more Commission oversight of this decisionmaking (i.e., have PJM make a filing with the Commission each time it proposes to order construction of an upgrade).

48. Generally, intervenors state that they support the filing, but have some specific problems. Although there are exceptions, most of the consumer advocate and public power intervenors support giving PJM authority to order construction, and complain that PJM would not be proactive enough in addressing future congestion, and had erred by not ordering interim relief until upgrades are built. Several intervenors argued that PJM's plan would not go far enough soon enough; they assert that under PJM's plan, it will take months to develop a study, more months or years to determine if there is a problem, and then further months or years to see if the market will solve it before PJM will order any expansion for economic purposes.

49. DEMEC states that the compliance filing does not satisfy the requirements set forth by the Commission in its Order, and that PJM's plan fails to provide detail necessary to understand or effectuate the plan and leaves too much for future discussion and decisionmaking. DEMEC states that it and other wholesale customers on the Delmarva peninsula have tried and relied on market forces for over five years, and congestion charges have increased almost every year for over five years. Thus, DEMEC argues,

there is no competitive market on the Delmarva peninsula, and market forces cannot solve the congestion problems there.

50. Several intervenors raised issues regarding who would bear the costs of the required upgrades. Some intervenors also say that customers within load pockets might end up shouldering costs of upgrades necessitated by transactions outside the load pocket. Several intervenors said this was PJM's attempt to prematurely require "participant funding" of upgrades. Other intervenors raised the issue of zonal pricing. Some intervenors (largely those public intervenors who want the plan to go farther) stated that PJM's proposed compensation plan, and/or the plan proposed in Docket No. ER03-738-000, will provide excessive recovery to transmission owners, and will work against necessary upgrades getting built, because the price of building new upgrades under this rate will be so high that PJM's cost/benefit analysis will come down on the side of not building.

51. Some intervenors said PJM had to be sensitive to confidentiality issues as it considered and requested information on which to base its decisions regarding ordering construction of upgrades.

52. FirstEnergy and PSEG expressly said that PJM erred by giving itself authority to require construction of upgrades. FirstEnergy, PSEG and others argued that this act is discriminatory because generation, merchant transmission and demand response all have as much ability to address congestion problems; yet PJM did not propose to order those intervenors to do anything. Other intervenors also made the argument made by NYTOs in their rehearing petition that this command-and-control regulation is inconsistent with the Commission's current market-oriented regulatory philosophy.

53. NYTOs, in their protest, reiterate the argument they made on rehearing that the Commission went beyond its Section 210-212 powers in telling PJM it had authority to require construction. PSEG also makes this argument, and also states that Sections 205 and 206 do not give FERC this authority. PSEG claims that the Commission only has authority to require construction to remedy undue discrimination.

Commission Conclusion.

54. We find that PJM's compliance filing provides a framework for a regional planning process that complies with our earlier order. However, we find that the proposal leaves many unanswered questions. Thus, we will require that PJM make an additional compliance filing within 30 days to clarify its proposal.

55. PJM proposes to create a screening mechanism for congested areas to determine whether the area is sufficiently congested to require intervention. Once PJM has determined that an area is sufficiently congested, it then performs a cost/benefit analysis as to whether new transmission expansion would provide net benefits. If the answer to this question is yes, then PJM announces the beginning of the one-year (or other appropriate) period for the market to produce a solution to the congestion in question. And if, at the end of that period there is no solution, at that point PJM will require a transmission owner to construct an upgrade.

56. Under the proposal, the screening mechanism for determining whether economic expansions are needed is whether there is "unhedgeable congestion." However, this concept is not fully defined in the proposed tariff. The following areas need to be clarified. How does PJM define hedgeable versus unhedgeable congestion? Is there any situation in which there are an insufficient number of simultaneously feasible FTRs to permit all market participants in that zone to be hedged? If, as one protester suggests, there are sufficient FTRs for all parties to be hedged, but those FTRs are obtainable only at very high prices, would PJM consider this to be hedgeable congestion? Is there a projected price for acquiring FTRs that might be so prohibitive that PJM would consider congestion "unhedgeable" at that price for FTRs?

57. PJM states at page 8 of its compliance filing that it will screen for "a minimum accumulated cost associated with a particular congestion event" to trigger the one-year window for eliciting market-based solutions. It then states, at pages 8-9, that it will not use a cost trigger in its economic planning analysis, which it conducts on a continuous basis, but will evaluate the cost of upgrades against "the level of accumulated, unhedgeable congestion" to determine when to require construction of an upgrade. What does the term "accumulated cost" mean with regard to both a single congestion event, and total congestion? Does it mean the cost to all customers within the relevant area? PJM must clarify this point.

58. Additionally, PJM's filing is not clear as to how paying for construction will affect the allocation of FTRs or ARR. Presumably, the customer(s) that pay for the construction should receive these benefits. However, this is not clear from the tariff. Consequently, PJM should also clarify who will receive any FTRs or ARRs that might be created as a result of new upgrades that PJM orders its transmission owners to build.

59. The cost allocation provisions of the proposal are not clear. At page 13 of its March 20 compliance filing, PJM has stated that it will determine the transmission customers from which it will collect each Transmission Enhancement Charge associated with a required upgrade, and that initially PJM "will apply such charges only on a zonal basis." Does this mean that, if PJM identifies appropriate customers to pay for an

upgrade within a zone, all customers within that zone will be charged the Transmission Enhancement Charge? Or, will PJM identify particular customers, either within that zone or outside of the zone, who will benefit from a transmission upgrade? PJM states that in future it will consider "the feasibility of applying such charges on a sub-zonal basis." If so, what prevents PJM from applying such charges on a sub-zonal basis at this time? In its compliance filing, PJM should further explain how the cost allocation provisions of its proposal will operate.

60. We will also require PJM to clarify how the cost allocation provisions for upgrades compare with the cost allocation provisions for merchant transmission projects in PJM and whether the provisions for cost recovery for projects under this proposal would encourage or discourage construction of merchant transmission during the one-year period after the need for a project is identified. PJM must also state whether, after the one-year period has expired, it envisions including merchant transmission proposals as a method of providing the necessary construction. For example, through the RTEP Process, would PJM issue a Request for Proposals for merchant transmission proposals to cure the congestion at a cost equal to or less than the regulated cost if the project was built by a regulated entity?

61. Finally, we will require PJM within 30 days of the date of this order to make two further changes to its tariff. First, it must place all procedures, standards, and requirements for proposing that a transmission owner construct a specific upgrade, and all procedures for charging customers, in its tariff, not in its manuals. Second, PJM must place in its tariff a provision that, on each occasion when it requires a transmission owner to construct an economic upgrade through the RTEP process, it must file a report with the Commission identifying the upgrade, the projected cost of the upgrade, and identifying who will be responsible for paying for the upgrade.

62. PJM's plan is designed to operate as a backstop in cases where the market has failed to respond to persistent congestion and where the benefits of expansion exceed the costs. This approach is generally supported or not opposed by the stakeholders and state commissions in the region. We believe this is a reasonable approach to take. Some protestors, primarily those facing congestion on the Delmarva Peninsula, have argued for a more activist role for PJM in anticipating and relieving congestion. However, this approach finds little support from outside the Delmarva Peninsula. The Commission has established a separate fact-finding proceeding to investigate congestion issues on the Delmarva Peninsula.²⁶ The presiding Administrative Law Judge is due to issue her report on August 12. Rather than requiring changes in PJM's general proposal here, we believe

²⁶103 FERC ¶ 61,163 (2003).

it would be better to focus on the issues involving the Delmarva Peninsula in the separate proceeding that is nearing completion.

3. Cost Recovery Proceeding in Docket No. ER03-378-000

63. With regard to the filing made by PJM TOs in Docket No. ER03-378-000, the intervenors who submitted protests or comments raised the following issues.²⁷

64. Some intervenors oppose the pre-determined carrying charge rates that would apply to all transmission investment ordered by PJM under the RTEP process. These intervenors also oppose the addition of a 15-year accelerated depreciation plan. The intervenors state that the annual carrying charges will result in unjust and unreasonable rates. Intervenors state that the PJM TOs have no justification for the 50 -basis point adder to the return on investment for the carrying charges. The intervenors object to the PJM TOs' assertion that the RTO membership adder incentive is necessary because otherwise the PJM Tos might be tempted to "RTO hop" to the Midwest Independent System Operator (MISO), where a 50-basis point adder has already been approved.

65. Intervenors also point out that PJM has not demonstrated the necessity of a separate surcharge for the cost of new transmission facilities in addition to the current zonal rates. They assert that by artificially raising the cost of transmission expansions, PJM TO's proposal would skew PJM's cost-benefit analysis away from requiring construction of an expansion. These intervenors state that under the PJM TOs' proposal, the avoided congestion costs would need to exceed not only the transmission solution's actual cost, but also the substantial carrying charge rates associated with the accelerated depreciation rate and the incentive adders. Thus, these protesters claim, PJM's proposal is less likely to meet the Commission's directive that PJM's regional plan enable PJM to require new construction to ensure reliability and address transmission constraints.

Commission Decision.

66. As noted above, on June 10, 2003, the Commission issued an order accepting and suspending this tariff filing for five months, until November 10, 2003, subject to refund

²⁷On June 23, 2003, the Coalition of Municipal and Cooperative Users of New PJM Companies' Transmission (Coalition) notified the Commission that it had been omitted from the list of entities that filed timely protests and motions to intervene in Paragraph 7 of the Commission's June 10, 2003 order in Docket No. ER03-738-000. The Coalition filed a timely motion to intervene and protest and is therefore a party to this proceeding pursuant to Rule 214 of the Commission's regulations. See 18 C.F.R. § 385.214 (2003).

and further orders. The Commission will reject the proposal filed by the PJM TOs to modify the Transmission Enhancement Charge proposed by PJM in its RTO compliance filing. The major change proposed by the PJM TOs is to incorporate a carrying charge in the tariff that would apply to future expansions regardless of the zone in which the facilities are constructed. We find the use of a single carrying charge for all of PJM to be unjust and unreasonable.²⁸

67. The carrying charge is developed using the same return on equity for all PJM TOs, a capital structure based on the average of all PJM TOs, and charges for expenses based on an average of certain other costs of the PJM TOs. The Commission has previously accepted the use of the same return on equity for transmission owners within an RTO.²⁹ The use of the same return on equity for all PJM TOs would also be acceptable. However, in this proposal the PJM TOs have proposed to average nearly all costs across the region to develop a carrying charge that would apply only to new construction. The Commission has not previously accepted such an approach in an RTO. We are concerned about the impact on customers of using an average for other elements of the cost-of-service. There is a wide variety in both the capital structure and the cost factors among the PJM TOs. For example, the average equity ratio is 50.91% of capitalization. However, the equity ratios range from 86.30% of capitalization to 27.27% of capitalization.³⁰ Similarly, the average cost of debt is 6.5%. However, the debt costs range from 5.42% to 8.31%. Because of the wide range in costs and capital structure, the use of an average carrying charge rather than the use of an individual utility's cost and capital structure will result in increased costs for construction in some parts of PJM.

68. Intervenors argue that this cost recovery methodology will skew the results of the PJM cost benefit analysis. We agree. We are particularly concerned that the use of an average carrying charge will result in higher costs for construction in the Delmarva Peninsula, a portion of PJM where there has been significant interest in construct of transmission to benefit competition. The equity ratio, debt cost, working capital ratio, and general plant ratio for Delmarva shown in the workpapers are all below the averages used for calculating the carrying charges proposed. Thus, the use of an average approach would increase the cost of construction on the Delmarva Peninsula.

²⁸Since we are rejecting this proposal as unjust and unreasonable, we need not reach the procedural issues raised by this filing, such as whether the PJM TOs can make an FPA 205 filing to modify a still-pending compliance filing submitted by the RTO.

²⁹Midwest Independent System Operator, 100 FERC ¶ 61,292 (2002), rehearing denied, 102 FERC ¶ 61,143 92003).

³⁰See Exhibit ABC-2

69. The use of an average carrying charge is a change from the current rate design that relies on license plate rates. The PJM TOs argue that this change is appropriate in light of the regional nature of the transmission planning process. PJM already has a regional planning process in place for reliability upgrades and license plate rates that are based on the costs of individual utilities. The addition of regional planning for economic considerations to this process does not justify the proposed change in rate design, particularly where it is likely to result in significantly higher costs for customers within the region. Consequently, we will reject the proposal as unjust and unreasonable.

70. The Commission would consider proposals allowing the individual transmission owners to timely recover the cost of transmission expansions.³¹ This could include the use of a carrying charge for expansions based on the cost of an individual utility.

71. The Commission is interested in providing appropriate incentives for the expansion of transmission systems that are part of an RTO. Consequently, while we are rejecting the proposal, we will give guidance on the incentives proposed by the PJM TOs.

72. The use of the same return on equity for all transmission owners within an RTO is acceptable and consistent with the rates we have approved for MISO. However, the PJM TOs cannot rely solely on the fact that the Commission accepted this rate of return in the MISO proceeding to justify using that same figure in this cost recovery methodology. The 12.38% return allowed in the MISO proceeding was based on a discounted cash flow (DCF) analysis of a proxy group containing nine MISO transmission owners or their parent corporations. Since the PJM TOs will not be members of MISO, the DCF analysis used in that proceeding does not measure the risks that would be faced by the PJM TOs. A separate DCF analysis would need to be done for the PJM TOs using an appropriate proxy group. We reject the PJM TOs' claim that the PJM TOs should be allowed the same return as the MISO TOs to reduce incentives to join one RTO or the other. In their proposal, the PJM TOs have themselves proposed different returns than are included in the MISO rates because of the incentive features of their proposal. Consequently, we fail to see why this should be a rationale for using a DCF analysis based on an appropriate proxy group for the PJM TOs. Consequently, if a proposal is made to allow the PJM TOs to use the same return on equity, it must be supported by a DCF analysis with an appropriate proxy group.

³¹The Commission has approved the use of formula rates for transmission owners within MISO. Formula rates ensure the timely recovery of the cost of transmission expansions. We would consider such an approach for the PJM TOs.

73. Additional support would also be needed for the use of accelerated depreciation by the PJM TOs. Accelerated depreciation is one of the innovative transmission rate treatments available to transmission owners that are members of RTOs. However, these innovative transmission rate treatments must be supported with a cost benefit analysis as described in Section 35.34 of the Commission's regulations.³² The PJM TOs have not included such an analysis in their filing.

74. With regard to the 50-basis point RTO Membership Adder, we have accepted a similar adder in the MISO proceeding. In that proceeding, the return on equity was based on the midpoint of the range of returns plus 50 basis points. Since our acceptance in that proceeding was based on a policy justification for recognizing the value of independent operation of transmission facilities, a similar adjustment would be allowed for the PJM TOs.

75. However, the 100-basis point adder proposed by the PJM TOs for the Transmission Capacity Adder is based on a proposed Commission policy on which the Commission has sought comment. Since the policy has not yet been adopted by the Commission, the proposed policy cannot be used as the sole support for this proposal. Consequently, if such an adder is sought, additional information would be required to support this proposal. This would include support for why the 100 basis point adder is needed to incent investment in transmission facilities. Additionally, the filing would also need to address whether the proposed adder should apply to all types of transmission expansion or if it should be more narrowly focused on transmission expansions that utilize innovative technologies that result in lower costs than traditional technology.

The Commission orders:

(A) NYTOs' request for rehearing in Docket No. RT01-2-005 is denied for the reasons discussed above.

(B) PJM is directed to make a compliance filing in Docket Nos. RT01-2-006, RT01-2-007 and RT01-2-008, as discussed above, within 30 days of the date of this order.

³²18 C.F.R. § 35.34 (2003).

(C) The cost recovery proposal filed by the PJM TOs in Docket No. ER03-738-000 is rejected.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.