

130 FERC ¶ 61,120
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinohoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

Corporation Commission of the State of Oklahoma

Docket Nos. EL08-80-001
EL08-80-003

v.

American Electric Power Company, Inc.,
American Electric Power Service Corporation, and
Public Service Company of Oklahoma

ORDER DENYING REHEARING AND ACCEPTING REFUND REPORT

(Issued February 18, 2010)

1. On November 26, 2008, the Commission issued an order granting in part and denying in part a complaint filed by the Corporation Commission of the State of Oklahoma (Oklahoma Commission) against American Electric Power Company, Inc. (AEP), American Electric Power Service Corporation, and Public Service Company of Oklahoma (PSO).¹ In the November 26, 2008 Order, the Commission determined, among other things, that from June 15, 2000, through March 31, 2006, AEP improperly deviated from the trading margin² allocation method set out in the AEP System Integration Agreement (System Agreement). The Commission directed AEP to recalculate and reallocate the trading margins in compliance with the System Agreement and to issue appropriate refunds. On December 24, 2008, as amended on December 29, 2008,³ AEP filed a request for rehearing of the November 26, 2008 Order. In addition, on January 26, 2009, AEP filed a refund report to comply with the November 26, 2008

¹ *Corporation Commission of Oklahoma v. American Electric Power Co., Inc., et al.*, 125 FERC ¶ 61,237 (2008) (November 26, 2008 Order).

² Trading margins are profits from off-system transactions.

³ AEP amended its original request for rehearing to add a Specification of Errors/Statement of Issues section in accordance with Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c)(2) (2009).

Order. In the instant order, the Commission denies AEP's request for rehearing of the November 26, 2008 Order and accepts AEP's refund report as in compliance with the November 26, 2008 Order, as discussed below.

I. Background

2. On March 15, 2000, the Commission approved the merger of the AEP-owned electric utilities in the East (AEP East Companies) and the Central and South West (CSW) utilities (AEP West Companies), effective June 15, 2000.⁴ As part of the merger, the Commission approved the System Agreement, which provides for coordinated planning and operation of transmission and power supply resources between the AEP East Companies and the AEP West Companies, including marketing of excess power supplies off-system and the allocation between the AEP East Companies and the AEP West Companies of margins from such off-system sales.⁵

3. Under Schedule D of the System Agreement, "Trading and Marketing Realizations" (Realizations) from long-term off-system sales entered into prior to the merger were directly assigned to the zone (AEP East or AEP West) in which the sale originated. The System Agreement defines "Trading and Marketing Realization" as "the difference between (i) revenues collected from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities."⁶ Realizations from all other transactions were allocated according to a two-tier system. The first tier was to use relative historical levels of Realizations during a "Base Year" consisting of the twelve months prior to consummation of the merger. The second tier was to use Realizations above Base Year levels, allocated based on generating capacity owned by the companies in each zone.

4. Additionally, Schedule D provided that the methodology for allocating Realizations will be in effect until January 1, 2006, and it required AEP to file by November 1, 2005, a proposed methodology for allocating Realizations thereafter. On March 20, 2006, the Commission accepted AEP's proposal to revise Schedule D to include a methodology for allocating Realizations going forward.⁷ The 2006 revisions to

⁴ See *American Electric Power Co. and Central and South West Corp.*, 90 FERC ¶ 61,242 (2000).

⁵ See *id.* at 61,799.

⁶ See System Agreement, section 1.39.

⁷ *American Electric Power Serv. Corp.*, 114 FERC ¶ 61,288 (2006).

Schedule D changed the trading margin allocations to a direct assignment method, which effectively eliminated margin sharing between the AEP East Companies and the AEP West Companies. This change alleviated, for the period after April 1, 2006, the concerns raised in this proceeding.⁸

5. In its complaint, the Oklahoma Commission, which regulates PSO's retail service, stated that, during the course of a state proceeding regarding PSO's 2001 Fuel Adjustment Clause, parties alleged that AEP misallocated trading margins between the AEP East Companies and AEP West Companies and misallocated trading margins among the AEP West Companies to the detriment of PSO ratepayers. The Oklahoma Commission stated that, according to the parties, for the first six months after the merger AEP used only "realized" revenues in calculating the Base Year allocation ratio, but in December 2000, AEP adopted a new method under which AEP included the value of forward market positions that remained open at the end of the Base Year but for which the revenues were unrealized (i.e., were not yet collected) during the Base Year. Parties in the state proceedings alleged that AEP unilaterally changed the allocation formula under the System Agreement making the change retroactive to the effective date of the merger.

6. In the November 26, 2008 Order, the Commission found that AEP's inclusion of unrealized revenues in the Base Year Allocation calculation violated the System Agreement. The Commission directed AEP to recalculate the trading margins to remove the open transactions from the Base Year Allocation calculation, to issue any refunds resulting from this recalculation, and to file a report of the refunds issued.⁹

7. On December 29, 2008, AEP filed its request for rehearing, including two new affidavits as attachments—one from an employee and one from a consultant. On

⁸ See *id.* at 5 (describing the revised trade margin allocation methodology).

⁹ In the November 26, 2008 Order, the Commission also determined that the methodology AEP used to allocate trading margins among the AEP West Companies from June 2000 through March 2006 was not contained in the AEP West Companies' system agreement (West Agreement). The Commission directed AEP to submit a filing revising the West Agreement to reflect the methodology that AEP actually used. On December 29, 2008, AEP submitted its compliance filing, which was accepted for filing on February 26, 2009. See *Corporation Commission of Oklahoma v. American Electric Power Co., Inc., et al.*, Docket No. EL08-80-002 (Feb. 26, 2009) (unpublished letter order).

January 8, 2009, Oklahoma Industrial Energy Consumers (OIEC) filed a motion for leave to file an answer or brief and answer and brief on AEP's rehearing request.

II. AEP's Request for Rehearing

8. The issues on which AEP seeks rehearing are as follows: (1) the Commission erred in concluding that, under the terms of System Agreement, AEP did not have discretion to effect an equitable sharing of the benefits of trading and marketing margins between the AEP East Companies and AEP West Companies by including the mark-to-market value of open transactions in the calculation of Base Year trading and marketing margins, and (2) assuming *arguendo* that the System Agreement was violated, the Commission abused its discretion by ordering refunds.¹⁰

A. System Agreement Interpretation

9. AEP argues that the Commission's analysis of the System Agreement is based exclusively on three words in the agreement. According to AEP, the Commission found that the use of the word "realizations" to describe the amounts that will be included in the Base Year Allocation calculation, and the use of "collected" and "received" in certain definitions, demonstrates that the System Agreement did not permit AEP to include open transactions in the Base Year Allocation calculation.¹¹ AEP contends that the Commission disregarded other language in the System Agreement directing AEP to achieve equity in the allocation of coordination benefits, including off-system sales profit. AEP asserts that, at a minimum, the Commission should hold a hearing to determine whether AEP complied with the intent of the System Agreement and with understandings communicated to state regulators in the AEP West zone at the time of the merger.

10. According to AEP, the Commission's determination violates cardinal rules of contract interpretation, under which the paramount objective is to identify the principal purpose and intent of the contract, even if this requires looking beyond the words used.¹² AEP states that courts must consider the context of an agreement, even where the words appear unambiguous, in order to establish the drafter's intent.¹³ AEP adds that the

¹⁰ See AEP Request for Rehearing at 21.

¹¹ *Id.* at 5.

¹² *Id.* at 6 (citing Corbin on Contracts, § 24.20 (Joseph M. Perillo, Lexis Law Pub., Rev. Ed. 1998)).

¹³ *Id.* at 7 (citing *McAdams v. Mass. Mut. Life Ins. Co.*, 391 F.3d 287, 299-300

(continued...)

Commission has expressly rejected the “plain meaning rule” under which a court will look solely at the words used in a contract in order to interpret it, even if it believes the words are unambiguous.¹⁴

11. Pointing to section 3.1 of the System Agreement, AEP asserts that the Commission’s overriding responsibility in determining whether AEP correctly applied the System Agreement is to determine whether AEP’s allocation of off-system sales profits was consistent with the purpose of the agreement, which AEP states is to provide for an equitable sharing of the profits. AEP states that section 9.1 of the System Agreement reinforces this intent and that section 6.4(c) gives AEP exclusive responsibility for applying the System Agreement in order to achieve this purpose.

12. Additionally, AEP argues that the System Agreement did not indicate whether open transactions were to be included in the Base Year Allocation calculation. AEP reiterates the argument it made in its answer to the complaint, that the accounting rules in place at the time AEP calculated the Base Year Allocation required AEP to include open transactions in its calculation of profits achieved in a given year for financial reporting purposes, using mark-to-market accounting. Therefore, AEP states, it was reasonable for AEP to interpret “realizations” to include open transactions, because these transactions were required to be treated as profits “obtained or achieved” in its financial reports.¹⁵ AEP also argues that the Commission’s analysis relies on the use of the word “realizations” to conclude that only “closed” transactions could be included in the Base Year Allocation. AEP contends that this conclusion is not required by the dictionary definition of the term, which AEP states is “to obtain or achieve, as in a profit or gain.”¹⁶ AEP adds that section D3 of the System Agreement refers to the level of realizations “achieved” during the Base Year, which the Commission ignored and which does not reflect an intent to limit the allocation calculation to transactions that closed during the Base Year. AEP states that had it known the Commission would interpret the System Agreement to disallow the inclusion of open transactions in the Base Year Allocation

(1st Cir. 2004)).

¹⁴ *Id.* (citing *Pennzoil Co. v. FERC*, 645 F.2d 360, 369 (5th Cir. 1981); *Northern Natural Gas Co.* 43 FERC ¶ 63,015, at 65,149 (1988), *aff’d*, 48 FERC ¶ 61,177 (1989), *reh’g denied*, 50 FERC ¶ 61,288 (1990), *aff’d sub nom. South Dakota Publ. Utils. Comm’n v. FERC*, 934 F.2d 346 (D.C. Cir. 1991)).

¹⁵ *See id.* at 9-10.

¹⁶ *Id.* at 9 (citing *The American Heritage Dictionary*, 1031 (2d. College ed. 1982)).

calculation, AEP could have closed the transactions, which would have achieved the same results as under AEP's interpretation of the System Agreement.¹⁷

13. AEP also states that in the November 26, 2008 Order, the Commission found that general language stating the purpose of the System Agreement cannot override more specific language addressing the Base Year Allocation. AEP argues that specific provisions of a contract prevail over general ones only where the provisions of the contract are in conflict and irreconcilable, which is not the case with the System Agreement.¹⁸ AEP also argues that rather than choosing an harmonious interpretation of the System Agreement, the Commission creates a conflict among the terms of the contract. AEP contends that the Commission interprets the word "realizations" narrowly to exclude open transactions and uses this interpretation to render the provisions requiring AEP to achieve an equitable result superfluous.¹⁹

14. AEP adds that the Commission incorrectly found that AEP was required to make a filing pursuant to section 205 of the Federal Power Act (FPA)²⁰ if AEP believed that the existing provisions did not accomplish the intent of the System Agreement. AEP argues that it did not believe any amendment to Schedule D was required and that Schedule D contained language specifying that "[t]his allocation of trading market realizations shall be in effect until the last day of the fifth calendar year following consummation of the merger."²¹ AEP reasons that this means it could not have made an FPA section 205 filing until December 2005.

15. With regard to equity, AEP states that the AEP West Companies have already received more than three times the profits produced by their own generating assets. AEP argues that the Commission's determination added to that windfall—a result that is inconsistent with the purpose of the System Agreement and the standard that the

¹⁷ See *id.* at 14.

¹⁸ *Id.* at 10-11 (citing *Ohio Power Co. v. FERC*, 744 F.2d 162, 168 n.7 (D.C. Cir. 1984); *Colorado Milling & Elevator Co., v. Chicago, Rock Island & Pac. R.R. Co.*, 382 F.2d 834, 837 (10th Cir. 1967).

¹⁹ *Id.* at 12.

²⁰ 16 U.S.C. § 824d (2006).

²¹ AEP Request for Rehearing at 12 n.9.

Commission has used to determine whether the allocation of off-system profits among utilities in a holding company system are equitable, and therefore just and reasonable.²²

16. Next, AEP argues that the Commission's interpretation of the System Agreement does not achieve a just and reasonable result, which is contrary to the Commission's principle of avoiding interpreting jurisdictional contracts to achieve unjust and unreasonable results.²³ AEP further asserts that in cost allocation decisions the Commission held that the benefits allocated to a party should bear a reasonable relationship to the party's contribution to creating those benefits.²⁴ AEP argues that the Commission construed the System Agreement in a manner that produces a huge windfall for the AEP West Companies as compared with the AEP West Companies' contribution to those profits.

B. Refund Requirement

17. AEP argues that even if the Commission affirms its finding that AEP violated the System Agreement, the Commission is required to exercise discretion in deciding whether to order refunds.²⁵ AEP argues that the AEP West Companies have already received margins that are more than three times what their generation produced, and the AEP East Companies have produced a far greater share of these margins than they have

²² *Id.* at 12-13 (quoting *Louisiana Public Serv. Comm. v. Entergy Corp.*, 106 FERC ¶ 61,228, at P 77 n.148 (2004), *petition for review granted on other grounds*, *Louisiana Public Serv. Comm. v. FERC*, 482 F.3d 510 (D.C. Cir. 2007) (*Louisiana Public Serv. Comm.*) (“an Operating Company should participate in the profits of off-system sales only to the extent that it participates in the allocation of the generation assets that make those sales possible.”)).

²³ *Id.* at 14.

²⁴ *Id.* at 15 & n.11 (citing *Louisiana Public Serv. Comm.*, 106 FERC ¶ 61,228, *KN Energy, Inc. v. FERC*, 982 F.2d 1295, 1300 (D.C. Cir. 1992); *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 FERC ¶ 61,163, at P 587 (2004); *Cal. Indep. Sys. Operator Corp.*, Opinion No. 463-A, 106 FERC ¶ 61,032, at P 10 (2004); *Cal. Power Exchange Corp.*, 106 FERC ¶ 61,196, at P 17 (2004)).

²⁵ *Id.* at 16 (citing *Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 816 (D.C. Cir. 1998); *Laclede Gas Co. v. FERC*, 997 F.2d 936, 944 (D.C. Cir. 1993); *Gulf Power Co. v. FERC*, 983 F.2d 1095, 1099 (D.C. Cir. 1993); *Towns of Concord, Norwood & Wellesley, Mass. v. FERC*, 955 F.2d 67, 75 (D.C. Cir. 1992); *Braintree Electric Light Dept.*, 120 FERC ¶ 61,097, at P 17 (2007)).

been allocated under Schedule D. AEP asserts that it is difficult to comprehend how requiring the AEP East Companies to refund a large amount of additional money to the AEP West Companies could be viewed as an equitable result.²⁶ According to AEP, if the Commission were faced with a proposed rate schedule resulting in a seven-to-one imbalance between the causation of beneficial off-system sales and the allocation of the profits from them, it would not approve that result as just and reasonable. AEP argues that ordering refunds in the instant proceeding would create the same unjust and unreasonable result and therefore would be an abuse of the Commission's discretion.

18. AEP states that the Commission's reliance on *Louisiana Public Service Commission v. FERC*²⁷ is not appropriate. First, AEP states that in *Louisiana PSC* the Commission found that the violation resulted in benefits to the transmission provider's system as a whole, while in the instant case, AEP's actions benefited certain AEP utilities to the detriment of other AEP utilities.²⁸ Second, AEP states that the Commission found that unlike the situation in *Louisiana PSC*, here AEP's shareholders received a net gain.²⁹ AEP argues that by limiting its analysis to a comparison between the facts of the instant case and *Louisiana PSC*—which AEP states bears little similarity—the Commission misses the broader point that *Louisiana PSC* stands for the proposition that the Commission must base a refund determination on the equities of a case.

19. AEP also takes issue with the Commission's discussion of the rate freezes that were in effect in the AEP East zone. According to AEP, "[t]he logical conclusion of the Order's reasoning is that, regardless of what the equities of a case may be, the Commission will always exercise any refund power that it has if there was a rate freeze in effect in the potential refunder's retail jurisdiction."³⁰ AEP states that such a result improperly intrudes into the state ratemaking process.³¹ Pointing to the testimony of its employee affiant, AEP states that AEP agreed to or supported rate freezes in AEP East

²⁶ *Id.* at 16-17. The total refund amount, which has been transferred from the AEP East Companies to the AEP West Companies, is approximately \$251.2 million. *See* AEP January 26, 2009 Refund Report at 5 and at Attachment A.

²⁷ 174 F.3d 218 (1999) (*Louisiana PSC*).

²⁸ AEP Request for Rehearing at 17 (citing November 26, 2008 Order at P 33).

²⁹ *Id.* at 17-18.

³⁰ *Id.* at 19.

³¹ *Id.* (discussing testimony provided by AEP's consultant affiant).

jurisdictions partially in reliance on its understanding of the purpose and intent of the System Agreement and its understanding that the margins from off-system sales from generation in the AEP East zone would not be treated as an offset to its state-jurisdictional cost of service.³²

III. Discussion

A. Procedural Matters

20. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d)(1) (2009), prohibits answers to a request for rehearing. Therefore, the Commission will reject OIEC's answer.

21. The Commission also rejects the two affidavits that AEP submitted as part of its rehearing request. As the Commission has stated in other orders, the Commission is reluctant to chase a moving target by considering new evidence presented for the first time at the rehearing stage of Commission proceedings.³³

B. Substantive Matters

22. For the reasons discussed below, the Commission denies AEP's request for rehearing or, in the alternative, that the Commission hold a hearing to determine whether AEP complied with the intent of the System Agreement and with understandings communicated to state regulators in the AEP West zone at the time of the merger.

1. System Agreement Interpretation

23. AEP argues that the Commission (1) violated cardinal rules of contract interpretation by focusing on "three words" in the System Agreement while disregarding provisions describing the purpose and intent of the System Agreement, (2) ignored the equities in reaching its determination, and (3) failed to avoid an unjust and unreasonable result in its interpretation of the System Agreement. The Commission disagrees.

24. In the November 26, 2008 Order the question before the Commission in this complaint proceeding was whether AEP misallocated the trading margins between the AEP East Companies and the AEP West Companies by unilaterally changing the

³² *Id.*

³³ *Philadelphia Electric Co.*, 58 FERC ¶ 61,060, at 61,133 & n.4 (1992); *see also*, *e.g.*, *Ameren Services Co.*, 127 FERC ¶ 61,121, at P 18 & n.24 (2009); *Ocean State Power II*, 69 FERC ¶ 61,146, at 61,548 n.64 (1994).

allocation formula under the System Agreement to include unrealized revenues in the Base Year Allocation calculation six months after the effective date of the merger and by making that change retroactive to the effective date of the merger. In determining whether AEP's unilateral change in methodology violated the System Agreement the Commission conducted an extensive review of the record in this proceeding, including the supporting documents the Oklahoma Commission submitted in its complaint and documents AEP submitted in its answer. The Commission reviewed each of the provisions of the System Agreement and found that:

A reasonable interpretation of the term "realizations" under section 1.9 [defining "Base Year Allocation"] and throughout the provisions of the System Agreement addressing the sharing of off-system sales margins between the East and West companies is that such term must be read to include only transactions that had actually closed during the Base Year. Further, the use of the word "received" in section 1.9 and "revenues collected" in section 1.39 belies AEP's argument that uncollected revenues should have been included in the calculation of the Base Year allocation ratio. We find AEP's attempt to divorce section 1.39 from applicability to section D3 to be unpersuasive and inconsistent with the terms of the System Agreement taken as a whole.³⁴

25. In the November 26, 2008 Order, the Commission discussed the language of sections 1.9³⁵ and 1.39³⁶ because they contain definitions for terms used in Schedule D, under which the method for allocating the trading margins is delineated. The

³⁴ November 26, 2008 Order at P 30.

³⁵ Section 1.9 provides:

1.9 Base Year Allocation means the relative percentages of the total Trading and Marketing realization from Off-System Sales . . . received by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other hand, during the last full twelve (12) calendar month period prior to the Effective Time as defined in the Agreement and Plan of Merger (the "Base Year").

³⁶ Section 1.39 provides:

1.39 Marketing and Trading Realizations means the difference between (i) revenues collected from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities.

Commission also examined sections 3.1³⁷ and 9.1,³⁸ upon which AEP relies to support its position that open transactions were to be included in the Base Year Allocation to effect an equitable sharing of the benefits of the trading and marketing margins between the AEP East and AEP West Companies. The Commission stated that:

Sections 3.1 and 9.1 define the general purposes of the System Agreement. However, these general provisions cannot override the specific requirements of sections 1.9 and 1.39 and section D3 of Schedule D, which specify how trading margins are to be allocated between the AEP East and AEP West companies.³⁹

26. AEP misapprehends the Commission's discussion of sections 3.1 and 9.1 to conclude that the Commission disregarded the stated purpose of the System Agreement. The Commission read the purpose of the System Agreement, which includes providing for "an equitable sharing of the benefits and costs of such coordinated arrangements," together with the provisions of System Agreement specifying how that allocation was to be determined in reaching our finding that AEP violated the System Agreement. In other words, Schedule D, section D3⁴⁰ along with sections 1.9 and 1.39, which define terms

³⁷ Section 3.1, "Purpose," provides:

The purpose of this Agreement is to provide the contractual basis for coordinated planning, operation and maintenance of the power supply resources of the Combined System to achieve economies consistent with the provision of reliable electric service and an equitable sharing of the benefits and costs of such coordinated arrangements.

³⁸ Section 9.1, "Service Schedules" provides:

It is understood and agreed that all such Service Schedules are intended to establish an equitable sharing of costs and/or benefits among the Parties, and that circumstances may, from time to time, require a reassessment of relative benefits and burdens or of the methods used in the Service Schedules to apportion the benefits and burdens. Upon a recommendation of the Operating Committee and agreement among the Parties, any of the Service Schedules may be amended as of any date agreed to by the Parties, subject to receipt of necessary regulatory authorization.

³⁹ November 26, 2008 Order at P 32.

⁴⁰ Schedule D, section D3 provides, in pertinent part,

Allocation of Trading and Marketing Realizations. The Agent shall

(continued...)

used in Schedule D, set forth the method for achieving the allocation of off-system sales margins in line with the general purpose of the System Agreement set out in section 3.1— i.e., these provisions together set forth the method for achieving an equitable allocation of off-system sales margins. Thus, despite AEP’s assertions to the contrary, the Commission’s interpretation of the System Agreement did not create a conflict among the terms of the contract rendering superfluous the provisions requiring AEP to achieve an equitable result.

27. AEP also argues that the System Agreement does not indicate whether open transactions are to be included in the Base Year Allocation, and that the accounting rules in place at the time AEP calculated the Base Year Allocation required AEP to include open transactions in its calculation of profits achieved in a given year for financial reporting purposes, using mark-to-market accounting. AEP also states that these open transactions were required to be treated as profits “obtained or achieved” in its financial reports. As the Commission stated in the November 26, 2008 Order, the use of mark-to-market accounting for trading and marketing activities reflected for financial statement purposes, may have been appropriate for financial reporting purposes but could not reasonably be interpreted to govern the Base Year Allocation. However, it is unreasonable to read the System Agreement to require or allow the inclusion of open transactions in the Base Year Allocation given that the relevant sections of the System Agreement (i.e., section D3 of Schedule D, the definitions of sections 1.39 and 1.9, and the statements of the purpose of the agreement set out in section 3.1) do not refer to open transactions and do refer repeatedly to “realizations,” which, as discussed above, the System Agreement specifically defines in a manner that includes only transactions that had actually closed during the Base Year.⁴¹

determine the Trading and Marketing Realizations on an hourly basis. The sum of the hourly amounts for each billing period (adjusted to remove realizations associated with long-term Off-System Sales) shall be allocated between the AEP East Zone and the AEP West Zone up to the level of realizations achieved in the Base Year in accordance with the Base Year Allocation. Any such Trading and Marketing realizations in excess of the level of realizations achieved in the Base Year will be shared according to the ratio of owned generating capacity in the two zones. Realizations associated with long-term Off-System Sales shall be assigned to the zone in which such sales were initiated

⁴¹ Rather than relying on the specific definition of “realizations” in the System Agreement, AEP states that the dictionary definition of “realize” is “to obtain or achieve, as in a profit or gain,” and AEP argues that this definition does not preclude profits from

(continued...)

28. The Commission also disagrees with AEP's assertion that AEP could not have made an FPA section 205 filing before December 2005 if it believed that the existing provisions did not accomplish the intent of the System Agreement. It is reasonable to interpret the language AEP points to in Schedule D as a "sunset" provision, not a prohibition on any mutually-agreed to revisions given that section 9.1 of the System Agreement provides that "Upon a recommendation of the Operating Committee and agreement among the Parties, any of the Service Schedules may be amended as of any date agreed to by the Parties, subject to receipt of necessary regulatory authorization."⁴²

29. The Commission also finds unpersuasive AEP's assertion that the Commission's determination could be seen as causing an inequitable, and an unjust and unreasonable result and is contrary to the standard that the Commission has used in other cases involving the allocation of off-system profits among utilities in a holding company system. AEP quotes *Louisiana Public Serv. Comm.* in support of its position that the AEP West Companies are not entitled to any additional share of the margins from off-system sales because they have already received more than three times the profits produced by their own generating assets. The Commission finds the quoted language to be inapposite. AEP and the parties to the merger agreed to the allocation method provided under the System Agreement, which as discussed above sets forth the method for achieving an equitable allocation of off-system sales margins. Further, AEP could have filed a proposed revision to the System Agreement in accordance with section 9.1 if it believed equitable allocations had not been achieved. Instead, AEP chose to change the

open transactions. The Commission disagrees. A reasonable interpretation of "obtain or achieve" as applied to profits or gains means that profits or gains are in hand, that they are not speculative, and this supports the Commission's finding that only closed transactions qualified as Realizations. Other dictionary definitions of "realize," such as "to convert into actual money" support the interpretation that only closed transactions qualify as realizations. *See* Merriam-Webster's Collegiate Dictionary (11th ed.) (2003) Springfield, MA, Merriam-Webster; *see also* Webster's New World Dictionary (3rd College ed.) (1988) New York, NY Simon & Schuster, Inc. (definitions of "realize" include "to convert (assets, rights, etc.) into money."). This interpretation is also consistent with the definitions in sections 1.39 and 1.9 both of which assume that the transactions have been completed and the profits are in hand. *See* System Agreement, section 1.9 ("Base Year Allocation means the relative percentages of the total Trading and Marketing realization from Off-System Sales . . . received. . .") and section 1.39 ("Marketing and Trading Realizations means the difference between (i) revenues collected from Trading and Marketing Activities. . .") (emphasis added).

⁴² System Agreement, section 9.1.

Base Year Allocation unilaterally and retroactively, thereby violating the filed rate doctrine.⁴³

30. Accordingly, AEP's request that the Commission reverse its determination that AEP violated the System Agreement is denied.⁴⁴

2. Refund Requirement

31. AEP contends that, assuming *arguendo* that the System Agreement was violated, the Commission abused its discretion by ordering refunds. AEP reiterates that the AEP West Companies received a greater portion of the margins than produced by their generating assets, and that the AEP East Companies have produced a greater share of those margins than they were allocated under Schedule D. AEP contends that requiring refunds is unjust and unreasonable. AEP also argues that the Commission limited its analysis to a comparison between the facts of the instant case and *Louisiana PSC*—which AEP states are dissimilar.

32. As AEP acknowledges, the Commission has discretion to determine if refunds are appropriate in a particular case.⁴⁵ As stated in the November 26, 2008 Order, the

⁴³ See, e.g., *City of Girard, Kansas v. FERC*, 790 F.2d 919 (D.C. Cir. 1986):

The filed rate doctrine “forbids a regulated entity to charge rates for its service other than those properly filed with the appropriate federal regulatory authority.” [Citation omitted.] The purpose of the filed rate doctrine is to assure effective Commission oversight of the rates at which power is sold. “The considerations underlying the [filed rate] doctrine . . . are preservation of the agency’s primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant.” [Citation omitted.]

⁴⁴ The Commission also denies AEP's request for a hearing. The issue in this proceeding was not whether AEP complied with the intent of the System Agreement and with understandings communicated to state regulators in the AEP West zone at the time of the merger. Rather, the issue before the Commission was whether AEP misallocated the trading margins between the AEP East Companies and the AEP West Companies by unilaterally changing the allocation formula under the System Agreement, in violation of the filed rate doctrine.

⁴⁵ *Towns of Concord v. FERC*, 955 F.2d at 72 (D.C. Cir. 1992) (citing *Niagara Mohawk*, 379 F.2d 153 at 159 (D.C. Cir. 1967) (“Agency discretion is often at its ‘zenith’ when the challenged action relates to the fashioning of remedies.”)).

Commission's general policy is to order refunds for overcharges.⁴⁶ In addition, the Commission stated that in *Louisiana PSC*, it made an exception to this general policy because, while the transmission provider violated a jurisdictional agreement, that violation resulted in benefits to the transmission provider's system as a whole, including benefits to the operating companies that were allegedly injured, and the benefits were found to outweigh any injury.⁴⁷ The Commission also stated:

[I]n *Louisiana PSC*, the Commission found that refunds were not appropriate because the transmission provider as a whole received no net gain from the violation. In contrast, here AEP's violation of the System Agreement provided AEP shareholders with a net gain, due to the rate freezes in effect at the time for some of the AEP East utilities. Therefore, we find refunds to be appropriate in this case.⁴⁸

33. The Commission did not limit its analysis to a comparison of the facts of the instant case with those in *Louisiana PSC*. The Commission ordered refunds based on its general policy of ordering refunds for overcharges and for violations of a filed rate.⁴⁹ The Commission's discussion of *Louisiana PSC*, which AEP cited in its answer to the complaint, illustrated the circumstances under which the Commission has made an

⁴⁶ See November 26, 2008 Order at P 33 & n.37 (citing *Louisiana PSC*, 174 F.3d at 223; *Consolidated Edison of N.Y. v. FERC*, 347 F.3d 964, 972 (D.C. Cir. 2003)).

⁴⁷ *Id.* P 33.

⁴⁸ *Id.*

⁴⁹ See November 26, 2008 Order at P 33:

[W]e direct AEP to recalculate the trading margins to remove the open transactions from the Base Year that we have found above to have been improperly included in the Base Year. Further, we direct AEP to issue any refunds resulting from this recalculation for the June 15, 2000 to March 31, 2006 period. . . . AEP is correct that the FPA does not mandate that refunds be issued where excessive rates are charged. Further, as AEP admits, the Commission has discretionary authority to require that refunds be made. [Citation omitted.] AEP cites *Louisiana Public Service Commission v. FERC* as an instance in which a court affirmed the Commission's exercise of discretion not to order refunds. [Citation omitted.] However, as noted by the court in *Louisiana PSC*, the Commission's general policy is to order refunds for overcharges. [Citation omitted.]

exception to its general policy of requiring refunds for overcharges. The Commission noted that such circumstances (i.e., a violation resulting in benefits to the transmission provider's system as a whole, including to the operating companies that were allegedly injured, and the transmission provider as a whole receiving no net gain from the violation) are not present in the instant proceeding. Further, AEP misconstrues the Commission's discussion of the rate freezes in effect in the AEP East zone to mean that the Commission will always exercise its refund authority if there was a rate freeze in effect. AEP contends that such a result improperly intrudes into the state ratemaking process. That is not the case. The fact that there were rate freezes in effect, which meant that AEP—not its customers—received a net gain as a result of AEP violating the System Agreement, was but one factor in the Commission's determination that an exception to the general policy of requiring refunds should not be made in this case. Refunds were appropriate in this case because, as noted above, AEP violated the System Agreement, which AEP had agreed to and which had been filed with and approved by regulatory authorities including this Commission. As the courts have stated, the purpose of the filed rate doctrine is to assure effective Commission oversight of the reasonableness of the rates charged by regulated companies.⁵⁰ In this case, refunds restore the allocation of margins that would have occurred if AEP had not committed the violation.

IV. Refund Report

34. As stated above, in the November 26, 2008 Order, the Commission directed AEP to file, within 30 days of the issuance of the order, a report on its recalculation and reallocation of trading margins for the June 2000 through March 2006 period. The Commission specified that the report should detail, separately for each AEP East and AEP West company, the amount originally allocated and the amount received by the company after the reallocation. The Commission also specified that the report should provide the underlying data used to calculate the Base Year allocation ratio.

⁵⁰ See, e.g., *City of Girard, Kansas v. FERC*, 790 F.2d 919 (D.C. Cir. 1986):

The purpose of the filed rate doctrine is to assure effective Commission oversight of the rates at which power is sold. "The considerations underlying the [filed rate] doctrine . . . are preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant." [Citation omitted].

35. On January 26, 2009,⁵¹ AEP filed a report detailing, for each AEP East and AEP West company, the original amount allocated and the amount received after the reallocation, as well as the underlying data and the interest rates AEP used.

36. Notice of AEP's January 26, 2009 filing was published in the *Federal Register*, 74 Fed. Reg. 6027 (2009), with comments, protests, or interventions due on or before February 17, 2009. None was filed.

37. The Commission finds that AEP's report includes the details required under the November 26, 2008 Order. Accordingly, the Commission accepts AEP's report as compliant with the November 26, 2008 Order.

The Commission orders:

(A) AEP's request for rehearing or in the alternative, a hearing, is hereby denied, as discussed in the body of this order.

(B) AEP's report on the recalculation and reallocation of trading margins is hereby accepted for filing, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

⁵¹ On December 18, 2008, AEP requested an extension of time until January 26, 2009, to file the refund report. See *Notice of Extension of Time*, Docket No. EL08-80-002 (Dec. 18, 2008).