UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Allegheny Power System Operating Companies: Monongahela Power Company, Potomac Edison Company, and West Penn Power Company, all d/b/a Allegheny Power; PHI Operating Companies: Potomac Electric Power Company, Delmarva Power & Light Company, and Atlantic City Electric Company; Baltimore Gas and Electric Company; Jersey Central Power & Light Company; Metropolitan Edison Company; PECO Energy Company; Pennsylvania Electric Company; PPL Electric Utilities Corporation; Public Service Electric and Gas Company; Rockland Electric Company; and UGI Utilities, Inc.	Docket No. ER04-156-007
PJM Interconnection, L.L.C.	Docket No. ER05-513-001
PJM Interconnection, LLC	Docket No. EL05-121-001

ORDER ON REHEARING AND CLARIFICATION

(Issued May 8, 2006)

1. In this order, the Commission denies rehearing and grants clarification of its May 31, 2005 Order[1] that accepted a tariff filing providing options for transmission owners within PJM Interconnection, LLC (PJM) to recover the costs of constructing new upgrades, and set for hearing the continued validity of PJM's current modified zonal rate structure.

[1] *Allegheny Power Systems Operating Companies*, 111 FERC ¶ 61,308 (2005) (May 31 Order).

Background

A. PJM's Rate Structure

2. PJM currently uses a modified zonal or "license plate" rate design. Under license plate rates, the Regional Transmission Organization (RTO)'s footprint is segregated into transmission pricing zones, typically based on the boundaries of individual transmission owners (TOs) or groups of TOs; customers taking transmission service for delivery to load anywhere within the RTO pay a rate based on the embedded costs of the transmission facilities in the transmission pricing zone where the load is located. The rates for each TO's transmission zone have historically remained in effect until amended by the TO or modified by the Commission. PJM's rate design is a modified zonal rate design because facilities constructed under the PJM Regional Transmission Expansion Plan (RTEP) process may be located in one zone, but the costs of those facilities may be allocated to load in other zones. The RTEP process is the means by which PJM identifies and requires the construction of particular upgrades to maintain reliability and enhance competition.

3. On November 4, 2003, the PJM TOs filed revisions to PJM's Open Access Transmission Tariff (OATT) to recover the costs of transmission enhancements designated by PJM pursuant to its RTEP. By order issued January 2, 2004 in Docket No. ER04-156-000,[2] the Commission accepted and suspended those proposed revisions subject to refund, initiated a hearing and instituted an investigation pursuant to section 206 of the Federal Power Act (FPA).[3] Subsequently, in an order dated August 9, 2004, the Commission accepted a settlement agreement in that docket (May 26 Settlement) which required that: (1) the PJM parties address by January 31, 2005, whether the existing zonal rate design within PJM should be changed after May 31, 2005, and if so, what new rate design should be considered, and (2) the settling parties make a future filing addressing the harmonization of existing transmission rates with new proposals for the recovery of transmission investment.[4]

4. On January 31, 2005, PJM and several PJM TOs submitted three filings related to the recovery of the costs of upgrades designated through PJM's RTEP process. In

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[2] *Allegheny Power System Operating Companies*, 106 FERC ¶ 61,003 (2004) (January 2, 2004 Order).

[3] 16 U.S.C. § 824e (2005).

[4] *Allegheny Power System Operating Companies*, 108 FERC ¶ 61,167 (2004) (August 9 Order).

Docket No. ER04-156-006, the parties fulfilled the requirements of the May 26 Settlement by proposing to continue a modified zonal rate design for the PJM footprint.

5. In Docket No. ER05-513-000, the PJM parties proposed revisions to Schedule 12 of the PJM OATT to establish the procedures by which the PJM TOs may recover the costs incurred in constructing transmission upgrades that are ordered by PJM through the RTEP process. The proposal would enable PJM TOs to choose among three cost recovery options. Under Option 1, the TO could defer recovering the costs of RTEP upgrades until it filed to make a general revision to its zonal transmission rates. Under Option 2, the TO could file under section 205 of the FPA[5] to establish an incremental revenue requirement for the new transmission project without a general revision to its modified zonal transmission rates. Under Option 3, the TO could establish a revenue requirement for both the new and existing transmission facilities under a formula rate.[6]

B. The Commission's May 31 Order, Requests for Rehearing and Clarification, and Motion for Late Intervention

6. In its May 31 Order, the Commission issued an order accepting these filings. In Docket Nos. ER04-156-006 and EL05-121-000, the Commission established a hearing under section 206 of the FPA to examine the justness and reasonableness of the continuation of PJM's modified zonal rate design. In Docket No. ER05-513-000, we accepted the tariff sheets establishing the general methodology for recovery of costs incurred under the RTEP process, subject to a compliance filing amending PJM's OATT to require the PJM TOs to make informational filings for the annual formula rates with the Commission and specifying that the Commission review the cost responsibility determinations to customers under the RTEP process. The PJM TOs,[7] and a smaller

[5] 16 U.S.C. § 824d (2005).

[6] One of the filings, in Docket No. ER05-515-000, was resolved through a settlement accepted by the Commission, *Baltimore Gas and Electric Co.*, 115 FERC ¶ 61,066 (2006).

[7] Allegheny Power on behalf of Monongahela Power Company, the Potomac Edison Company and West Penn Power Company; BG&E; Exelon, on behalf of Commonwealth Edison Co. and PECO Energy Company; Jersey Central Power & Light Company, Metropolitan Edison Company and Pennsylvania Electric Company (the FirstEnergy Companies); PHI Operating Companies: Potomac Electric Power Company, Delmarva Power & Light Company, and Atlantic City Electric Company; PPL Electric Utilities Corporation; Public Service Electric and Gas Company; Rockland Electric Company; and UGI Utilities Inc.

group of transmission owners[8] filed requests for rehearing or clarification of the May 31 Order. Allegheny Power and BG&E (collectively, APS) filed a motion in Docket No. EL05-121-000 to expand the scope of the proceeding, alternative request for consolidation, and motion for clarification.

7. Further, on June 23, 2005, Duquesne Light Company (Duquesne) filed a motion to intervene out of time in Docket No. ER04-156-006. In its May 31 Order, the Commission set the matters at issue in that docket for hearing in Docket No. EL05-121-000. Duquesne sought intervention in Docket No. EL05-121-000, and was granted intervention by order of the administrative law judge (ALJ) dated July 26, 2005. Thus, Duquesne's motion for intervention in Docket No. ER04-156-006 has been rendered moot by its subsequent grant of intervention in Docket No. EL05-121-000, and the Commission denies Duquesne's motion for intervention in Docket No. ER04-156-006 on that basis.

Discussion

A. Issues regarding the establishment of a hearing regarding PJM's rate design (Docket Nos. ER04-156-007 and EL05-121-001)

1. Petition for rehearing and motion for expansion of scope of hearing and/or consolidation

8. In the May 31 Order, we stated that the Commission has previously recognized that in an RTO environment, it is no longer clear that a zonal rate design is necessarily just and reasonable.[9] We noted American Electric Power Service Company (AEP)'s concerns regarding its significant upgrades to the system and its allegations that only load within AEP's zone is bearing the costs of AEP's system, although that system is now serving all PJM members. We viewed AEP's arguments as potentially demonstrating that the zonal rate design is no longer just and reasonable. Accordingly, in Docket No. EL05-121-000, we established a hearing under section 206 of the FPA to examine the justness and reasonableness of PJM's continuing the modified zonal rate design.

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[8] Virginia Electric and Power Company (VEPCO), BG&E, Dayton Power and Light Company, the PHI Companies, PPL Electric Utilities Company, Public Service Electric and Gas Company and PSEG Energy Resources & Trade LLC, and Rockland Electric Company (collectively, the VEPCO TOs).

[9] May 31 Order at P 39, *citing Midwest Independent Transmission System Operator*, 110 FERC ¶ 61,107 at P 3 (2005).

9. The VEPCO TOs request rehearing of the Commission's decision to set this issue for hearing. They point to the existence of other proceedings in which the Commission is considering the rate design of both PJM and the Midwest Independent Transmission System Operator, Inc. (Midwest ISO), and propose that the existing modified zonal rate design should be retained until the rate design within PJM can be considered as part of these inter-regional initiatives.

10. APS, in its motion to expand the scope of the proceedings or in the alternative a request for consolidation, and motion for clarification, requests that the scope of the section 206 investigation in Docket No. EL05-121-000 be enlarged to include all of the entities whose rates may have to be adjusted to reflect a just and reasonable allocation of the cost of the AEP high voltage facilities – namely, entities within the Midwest ISO.[10] APS urges the Commission either to expand the scope of Docket No. EL05-121 to include Midwest ISO parties, or, alternatively, to consolidate the PJM rate design investigation here with the investigation ordered in the Commission's November 18 Order. APS recognizes that the Commission noted in the May 31 Order that the parties could seek consolidation of this docket with Docket No. EL02-111-000 before the respective presiding ALJs,[11] but asserts that since this docket only involves rates within PJM, and Docket No. EL02-111-000 only involves issues relating to the SECA compliance filings, such consolidation would not ensure that Midwest ISO TOs are joined as respondents here.

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[10] APS states that Docket No. EL05-121-000 deals only with intra-PJM rate design issues. In Docket No. ER05-6-023, the PJM and Midwest ISO transmission owners have sought similar cost allocation treatment for cross RTO border projects. In Docket No. EL02-111-000, *et al.*, the Commission is considering the long-term pricing structure (LTPS) for transmission between the Midwest ISO and PJM. *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,313 (2004). Subsequently, in an order issued on November 18, 2004 in Docket No. EL04-135-000, the Commission eliminated regional through and out rates between PJM and Midwest ISO, continued the existing PJM and Midwest ISO rates, and imposed transitional Seams Elimination Charge/Cost Adjustments/Assignments (SECA) charges through March 31, 2006. *Midwest Independent Transmission System Operator, Inc*., 109 FERC ¶ 61,168 (2004) (November 18 Order). The Commission has further directed the PJM and Midwest RTOs and their transmission owners to make a filing at least six months before February 1, 2008, to reevaluate the fixed cost recovery policies for pricing transmission service between the two RTOs and propose a rate design to take effect February 1, 2008. *Id.* at P 62.

[11] *See* May 31 Order at P 42 n. 37.

11. APS also seeks clarification with regard to the refund date that the Commission established, namely, 60 days after publication of the May 31 Order. It states that the Commission previously provided that the SECA mechanism would extend through March 2006, and that the section 206 hearing established in the May 31 Order contemplates the possibility of a new rate structure also making some of the adjustments that the SECA makes. To eliminate double recovery, APS asks the Commission to clarify that the date for implementation of any rate remedy resulting from the section 206 investigation in the instant proceeding should be after the date of termination of the SECA recovery mechanism.

2. Commission ruling

12. We will deny the VEPCO TOs' request for rehearing and APS' motion. The VEPCO TOs maintain that there is a lack of record evidence that PJM's existing rate design is unjust and unreasonable sufficient to warrant establishing a section 206 proceeding. The Commission, however, finds that there is a reasonable question as to the appropriateness of license plate rates for an integrated RTO.

13. In Order No. 2000,[12] the Commission indicated that license plate rates may not be just and reasonable for RTOs after a transition period. We stated that each independent system operator (ISO) has struggled with the problem of cost shifting among the various individual transmission owners and that the Commission has allowed the flexibility to adopt a "license plate" rate for a transition period of five to ten years before moving to a single uniform access charge. We emphasized that we were not requiring that an RTO continue or abandon the use of license plate rates, but the RTO would be required to justify its choice to continue or discontinue the use of license plate rates based on the factual situation of the particular RTO.[13]

14. AEP has alleged that such a reconsideration is warranted here. After termination of the SECA revenues in March 31, 2006, AEP claims it will be unable to recover all of its costs from those benefiting from the use of its transmission system. AEP contends that prior to its joining PJM, PJM members were paying for some of the cost of its transmission system and that its joining PJM should not eliminate such responsibility.

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[12] *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs.¶ 31,092 (2000), *aff'd sub nom. Public Utility District No. 1 of Snohomish County, Washington* v. *FERC*, 272 F.3d 607 (D.C. Cir. 2001).

[13] Order No. 2000 at 31,176-8.

It argues that the current license plate structure does not impose costs equally on those who use and benefit from transmission facilities.

15. The VEPCO TOs have not shown that AEP's concern about continuation of license plate rates is unwarranted. Rather, they only argue that AEP is the only party complaining about license plate rates. The Commission finds that it is reasonable to establish a hearing into the proper rate design for an integrated system in which parties can purchase energy from generators on any of the existing TOs' facilities. At the hearing, any party can put forward evidence as to why the existing license plate rate system should be retained.

16. The VEPCO TOs and APS further maintain that given the number of other proceedings in which the Commission is considering rate issues relating to the rate design of PJM and Midwest ISO, the Commission should either terminate the hearing in this proceeding (Docket No. EL05-121) so as to permit resolution of the SECA proceedings first, or alternatively consolidate the proceedings in Docket No. EL05-121 with those in Docket No. EL04-135-000 to enable Midwest ISO parties to be appropriately joined. The VEPCO TOs finally contend that the Commission does not have any reasonable basis for modifying the continuation of the existing rate design until at least February 1, 2008,[14] and ask that the Commission should at least wait until after the SECA mechanism terminates on March 31, 2006, before adding more uncertainty to the market.

17. The Commission will deny both the VEPCO TOs' request to terminate the proceedings in Docket No. EL05-121 and APS' motion to expand or consolidate those proceedings. The issue here is the proper rate design for facilities of TOs within PJM regardless of how costs are allocated among PJM and Midwest ISO TOs. This issue can be resolved at hearing without further complicating other proceedings that have already been in process for considerable periods of time and on which the Commission already has issued orders. Thus, the Commission finds no basis to terminate or consolidate with other proceedings the section 206 inquiry into PJM's rate design.

18. The VEPCO TOs and APS contend that setting this issue for hearing now creates uncertainty as to rate design. It is the nature of a section 206 proceeding to put in question the reasonableness of an existing rate or practice. Although the Commission

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[14] The Commission previously directed the PJM and Midwest RTOs and their transmission owners to make a filing at least six months before February 1, 2008, to reevaluate the fixed cost recovery policies for pricing transmission service between the two RTOs and propose a rate design to take effect February 1, 2008. November 18 Order at P 62.

approved license plate rates for PJM in its order establishing PJM as an independent system operator (ISO), those rates applied only through the transition period ending on December 31, 2002. The Commission, in fact, directed PJM to file a proposal outlining the implementation of a uniform, system-wide rate that would apply to transmission services throughout PJM.[15] Also, as noted above, in accepting the May 26 settlement in its August 9 Order, the Commission required the PJM parties to address by January 31, 2005, whether the existing zonal rate design within PJM should be changed after May 31, 2005, and if so, what new rate design should be considered. This issue has been outstanding for many years and the parties were on notice of the possibility that this issue would be set for hearing.

19. APS requests clarification that the Commission in ordering refunds pursuant to the refund effective date of August 13, 2005 will ensure that there is not a double collection of costs already being recovered by AEP under the SECA. The question as to which APS seeks clarification here is both premature and beyond the scope of this proceeding. The refund effective date established pursuant to section 206 of the FPA is the earliest date on which refunds can be ordered. The Commission's policy is not to allow duplicative refunds for the same costs. However, the determination of the appropriateness of any refunds will be made at the conclusion of the continuing proceedings in Docket No. EL05-121-000, and the parties at the hearing may introduce evidence as to whether refunds should be required, or whether other considerations would render refunds inappropriate. The Commission therefore denies APS's request for clarification.

B. Issue relating to adders to return on equity (Docket No. ER05-513-001)

1. Petition for rehearing

20. The PJM TOs argue in their request for rehearing that, with regard to Option Two above (under which a TO constructing a new upgrade would make a filing for a new incremental revenue requirement for that project, without revising its transmission rate), the Commission misstated the nature of that rate mechanism. The PJM TOs point to the Commission's statement that:

> The filing in Docket No. ER05-513-000 does not address the question of [incentive adders to a transmission owner's Return on Equity (ROE)] with respect to Option Two, and the Commission therefore will not address here

[15] *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257 at 62,283 (1997) (*PJM Interconnection*) ("PJM . . . is hereby ordered to file a proposal, on or before July 1, 2002, concerning the implementation of a uniform, system-wide rate that would apply to transmission services throughout the PJM Control Area").

> whether such adders are appropriate in light of the incentive already provided by Option Two to construct upgrades.[16]

21. The PJM TOs argue that "[t]his statement indicates that the Commission believes that it has provided an extra incentive to the TOs, over and above the potential 50 and 100 basis point adders that were set for hearing in [Docket No. ER05-515-000] by approving Option 2"[17] – *i.e.*, that the Commission believes that Option 2 is already a type of incentive rate. The PJM TOs assert that Option 2 will bring about a reduction in a TO's existing transmission rate, due to the offset for such incremental costs recovered under Schedule 12, and that rates under Option 2 may decrease, rather than increase. The PJM TOs state that, therefore, the only "incentive" that is available under Option 2 is the opportunity to recover adders to ROE, if those adders are approved by the Commission. They then state that they

> are concerned . . . that the Commission may incorrectly believe that it would be appropriate to deny them the 50 or 100 basis point adders or some other incentive rate proposal because of a non-existent separate incentive associated with the approval of Option 2.[18]

22. On this basis, the PJM TOs request rehearing of the May 31 Order and ask the Commission to clarify that Option 2 does not include any extra incentive to the TOs over and above the potential adders to ROE, and that Option 2 already addresses the issue of harmonization between the incremental rates for specific projects and a TO's zonal transmission rate by providing that the incremental revenues recovered for new transmission construction would be offset by a revenue credit to the existing rates.

2. Commission ruling

23. Since the PJM TOs' request for rehearing is essentially a request for clarification, we will clarify our understanding of Option 2. The Commission agrees that under Option 2, a TO constructing an RTEP upgrade will develop an incremental charge to the customers responsible for the upgrade, credit those charges to the customers in its own zone, and, therefore, retain only any ROE adders that may have been accepted by the Commission. We clarify that we do not view the Option 2 proposal, by itself, as a transmission incentive rate.

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[16] May 31 Order at P 45 n. 38.

[17] PJM TOs request for rehearing at 2.

[18] *Id.* at 6

24. However, as we stated, we are making no determination of whether ROE adders are appropriate for transmission owners within PJM. And, we are making no determination with respect to a specific section 205 filing made to implement Option 2. As we stated, "depending on the form of such a filing, we may need to impose certain reporting requirements or true-up mechanisms with respect to such a filing."[19] Issues raised by a specific filing will have to be resolved based on the facts of that proceeding.

The Commission orders:

For the reasons stated above, we deny the requests for rehearing, as discussed in the body of this order.

By the Commission. Commissioner Kelly dissenting in part with statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

[19] May 31 Order at P 47.

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PJM Interconnection, LLC	Docket No. ER05-513-001
PJM Interconnection, LLC	Docket No. EL05-121-000

(Issued May 8, 2006)

KELLY, Commissioner, *dissenting in part*:

In the underlying May 31, 2005 Order in this proceeding, I disagreed with the Commission's decision to accept Option 2 as a method that PJM transmission owners may employ to recover the costs of new transmission facilities constructed pursuant to the RTEP process. Option 2 allows the transmission owner to file to establish a revenue requirement to recover the cost of constructing a new transmission facility, without having to revise its transmission rates for existing facilities.

In the order at bar, the majority grants clarification that Option 2, by itself, is not a transmission incentive rate. The applicants now indicate that the incremental revenues collected under Option 2 will be credited against the existing transmission rate. While I am otherwise comfortable with the order, I continue to harbor doubts about the reasonableness of Option 2 and I am not convinced that it does not, in fact, constitute an incentive rate by itself.

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Suedeen G. Kelly