

UNITED STATES OF AMERICA 116 FERC ¶63,007  
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.

Docket No. EL05-121-000

**INITIAL DECISION**

(Issued July 13, 2006)

**APPEARANCES**

*Steven J. Ross, Esq., Kevin Duffy, Esq., Stephen Angle, Esq.,* on behalf of American Electric Power Service Corporation

*Kathryn Patton, Esq. and Randall B. Palmer, Esq.,* on behalf of Allegheny Power

*Gary A. Guy, Esq., and Kimberly A. Curry,* on behalf of Baltimore Gas and Electric Company and Old Dominion Electric Cooperative, members of the Transmission Owner Proponents

*Gerard A. Clark, Esq., William S. Scherman, Esq., Eugene H. Bernstein, Esq., A. Karen Hill, Esq., and Denise Buffington, Esq.,* on behalf of Exelon Corporation as agent for Commonwealth Edison Company, Commonwealth Edison Company of Indiana, and PECO Energy Company, members of the Responsible Pricing Alliance

*David Goroff, Esq., and Allen C. Barringer, Esq.,* on behalf of Pepco Holdings, Inc., Potomac Electric Power Company, Atlantic City Electric Company and Delmarva Power & Light Company, members of the Responsible Pricing Alliance

*Michael Regulinski, Esq., and John R. Lilyestrom, Esq.,* on behalf of Virginia Electric and Power Company, a member of the Responsible Pricing Alliance

*Paul E. Russell, Esq., Donald A. Kaplan, Esq., William M. Keyser, Esq., and Courtney A. Gregoire, Esq.,* on behalf of PPL Electric Utilities Corporation, a member of the Responsible Pricing Alliance

*Kathy Fogel, Esq. and Sandra Barbulescu, Esq.,* on behalf of Ormet Primary Aluminum Corporation

*Steven A. Weiler, Esq., and Tamir Ben-Yoseph, Esq.*, on behalf of Dayton Power & Light Company

*David E. Pomper, Esq., and Stephen C. Pearson, Esq.*, on behalf of the Participants for Purposeful Pricing

*Richard P. Sparling, Esq.*, on behalf of Jersey Central Power & Light Company, Metropolitan Edison Company, and Pennsylvania Electric Company

*Tamara L. Linde, Esq., and Jodi L. Moskowitz*, on behalf of Public Service Electric and Gas Company

*John D. McGrane, Esq., and Erin M. Murphy, Esq.*, on behalf of UGI Utilities, Inc.

*Craig Glazer, Esq., Vincent P. Duane, Esq., Barry S. Spector, Esq., and Carrie Bumgarner, Esq.*, on behalf of PJM Interconnection, L.L.C.

*Shaun C. Mohler, Esq., and John H. Conway, Esq.* on behalf of Illinois Municipal Energy Agency

*Christine F. Ericson, Esq.*, on behalf of the Illinois Commerce Commission

*Sandra L. Hall, Esq.*, on behalf of the Public Service Commission of Maryland

*Matthew Loftus, Esq., and Carmen Gastilo Machuga, Esq.*, on behalf of the Trial Staff of the Federal Energy Regulatory Commission

***William J. Cowan***, Presiding Administrative Law Judge

## **I. PROCEDURAL HISTORY**

1. In 1997, the Commission approved a proposal by the original PJM transmission owners (TOs) to restructure the PJM Office of Interconnection power pool as an Independent System Operator (ISO), together with a PJM-wide open access transmission tariff (PJM OATT). The Commission approved a rate proposal for non-pancaked charges for firm transmission in PJM, with a rate which varied based on the zone in which the subject load was located. The rate proposal was approved by the Commission subject to the supporting companies' commitment to propose a uniform, system-wide rate methodology within five years. PJM was 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. A settlement was reached in May of 2004 in Docket No. ER04-156-000, which extended the July 2002 filing deadline until January 31, 2005, the date for the PJM TOs to make a filing regarding the continuation of a license plate rate design within PJM.

2. On January 31, 2005, the PJM Settling TOs submitted a filing (January 31 filing) in which they proposed to continue the existing modified zonal rate design until: (a) a future filing pursuant to Section 205 of the Federal Power Act (FPA) to change the PJM rate design or (b) a filing, if appropriate, proposing to change the rate design as of February 1, 2008, following an evaluation to be conducted in conjunction with MISO's evaluation of the intra-MISO rate design. On March 7, 2005, a protest was filed by American Electric Power Service Company (AEP) which argued that the PJM Settling TOs' request was inconsistent with their obligation to re-evaluate the existing PJM rate design, discussed changing conditions which had expanded PJM beyond its classic PJM area, and discussed the cost shifts which occurred following the elimination of regional through-and-out rates (RTOR). AEP requested authority to propose an alternative rate design for PJM, due to the negative consequences it described.

3. The Commission issued an order on May 31, 2005 addressing the January 31 filing and the subsequent protests. The Commission, pursuant to its authority under section 206 of the Federal Power Act, found that PJM's current modified zonal rate design may not be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. The Commission set PJM's modified zonal rate design for hearing and required PJM to address the justness and reasonableness of the zonal rate design in that hearing. *Allegheny Power System Operating Companies, et al.*, 106 FERC ¶ 61,003, *order on reh'g*, 106 FERC ¶ 61,016 (2004).

4. On June 9, 2005, Chief Judge Curtis L. Wagner designated me to preside over the hearing. On June 10, 2005, I issued an order establishing rules for conduct of the hearing and scheduling a pre-hearing conference for June 23, 2005 to consider the procedural schedule and other procedural issues. In the prehearing conference, the proposed procedural schedule was developed and the parties agreed that each entity seeking to propose a new PJM rate design change would file notice of its intention to do so by September 1, 2005. On June 23, 2005, the Chief Judge issued an order establishing the procedural schedule and extending the Track Two hearing guidelines.

5. On September 1, 2005, notices of intent to propose a new PJM transmission rate design were filed by AEP, Allegheny Power (AP), Baltimore Gas and Electric Company (BGE), Old Dominion Electric Cooperative (ODEC), and Ormet Primary Aluminum Corporation (Ormet). As the testimony and exhibits emerged, a total of four proposed rate design changes were submitted for consideration: (1) AEP/AP; (2) BGE/ODEC, who call themselves the Transmission Owner Proponents (TOP); (3) the self-designated

Participants for Purposeful Pricing (PPP), comprised of Blue Ridge Power Agency, Central Virginia Electric Cooperative, Craig-Botetourt Electric Cooperative, City of Dowagiac, Michigan, Indiana Municipal Power Agency, Harrison Rural Electric Association, and Virginia Municipal Electric Association No. 1, and (4) Commission Trial Staff (Staff).

6. The self-designated Responsible Pricing Alliance (RPA), comprised of Virginia Electric and Power Company; Exelon Corporation, as agent for Commonwealth Edison Company, Commonwealth Edison Company of Indiana, Inc., and PECO Energy Company; The Dayton Power and Light Company; Pepco Holdings, Inc., and its transmission-owning affiliates 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; UGI Utilities, Inc.; and the First Energy Companies: Jersey Central Power & Light Company, Metropolitan Edison Company, and Pennsylvania Electric Company, submitted testimony defending the justness and reasonableness of the existing PJM rate design, and questioning whether any of the proposed changes would be just and reasonable.

7. On April 7, 2006, the parties submitted a joint statement of contested issues, an order of witnesses and estimated times for cross-examination. Hearings began on April 18, 2006, and concluded on April 21, 2006.

## II. INTRODUCTION

8. The parties are in general agreement that this case “presents a refreshingly straightforward issue.” AEP/AP I.B. at 2. That is, whether PJM’s current modified zonal rate design is unjust, unreasonable, unduly discriminatory, preferential, or otherwise unlawful. The current rate design is typically described as a modified zonal, or “license plate” design.

### A. The existing PJM Modified Zonal Rate Design

9. When PJM was initially formed as an Independent System Operator (ISO), the Commission approved the use of a license plate or zonal rate design. Under that design, all PJM transmission customers were assured non-discriminatory network access to the PJM-wide grid, and all customers paid for such service based on the zone(s) in which their loads were located. The current PJM modified zonal rate design retains this zonal rate system with respect to *existing* transmission facilities. A different system, however, applies to *new* transmission facilities in PJM. Specifically, new facilities are planned centrally by PJM for the integrated needs of the region as a whole. Under Schedule 6 of the PJM Operating Agreement (Schedule 6) and Schedule 12 of the PJM Open Access Transmission Tariff (Schedule 12), PJM determines when and where transmission facilities should be expanded or enhanced both for reliability reasons and for economic

purposes, *i.e.* to relieve congestion. PJM also determines independently who causes and thereby benefits from the upgrades and hence who should pay the associated costs. Thus, significant portions of the costs of new facilities may be assigned outside of the zones in which the facilities are built. This combination of zonal pricing for existing facilities and RTO-determined cost allocation for new facilities makes up the PJM modified zonal rate design.

10. Significantly however, current, ongoing and future transmission owner initiated investment in the refurbishment, enhancement, maintenance and operation of existing transmission facilities in PJM are not subject to the mechanism adopted for new facilities. This additional investment would continue to be recovered via the current modified zonal, or license plate, rate design. Tr. at 372-373. Also of some importance in the general scheme of the existing rate design are two changes from the original zonal rate design in the PJM system. The first is the elimination of RTOR for transactions occurring within the PJM/MISO Combined Region and for transactions between entities that have newly joined PJM and the original PJM members.<sup>1</sup> This means that revenue requirements associated with existing facilities that contribute to transactions in the PJM/MISO Combined Region are allocated to native load customers. Exh. TOP-3 at 8-10.

11. Second, the “lost revenues” from the elimination of the RTOR were accommodated for a transitional period, ending March 31, 2006, through a Seams Elimination Charge/Cost Adjustment/Assignment (SECA) charge. A long term replacement rate design for the PJM/MISO Combined Region is scheduled to take effect on February 1, 2008.<sup>2</sup> The SECA charge has been eliminated, so that the current rate design has no RTOR or SECA component. Meanwhile, the Commission, as noted in the Procedural History above, concluded that the PJM current modified zonal rate design needed to be examined against the legal standards in the Federal Power Act, and this proceeding was established for that purpose.

12. As noted above, this proceeding was established to investigate whether the current PJM modified zonal, or license plate, rate design is unjust, unreasonable, unduly discriminatory or otherwise unlawful, and, if it is so determined, what would be a reasonable rate design to take its place. The record contains extensive testimony and exhibits designed to provide a basis for those determinations. To provide a guidepost for the development of answers to the issues in dispute, it will be helpful to first review the positions of the parties.<sup>3</sup>

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<sup>1</sup> *Midwest Independent Transmission System Operator, Inc.*, 104 FERC ¶ 61,105, order on reh’g, 105 FERC ¶ 61,212 (2003).

<sup>2</sup> *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168 (2004).

<sup>3</sup> This decision is organized to first discuss the Positions of the Parties on all

### III. POSITIONS OF THE PARTIES

#### A. Responsible Pricing Alliance

13. RPA argues that PJM's current modified zonal rate design is not unjust, unreasonable, unduly discriminatory, preferential or otherwise unlawful. RPA notes that a proponent of rate design change bears the burden of proof to show that the existing rate design is unjust, unreasonable, unduly discriminatory or preferential and, if that showing is made, that the proposed alternative is just and reasonable. Federal Power Act § 206, 16 U.S.C. § 824e (2000). RPA disputes TOP's contention that the modified zonal rate design has expired and thus need not be proven unjust and unreasonable by rate change proponents. According to RPA, the cases relied upon by TOP are inapposite because they did not address Section 206 burdens. Rather, under the filed rate doctrine, only the current design can be applied in PJM at this time until it is proven unjust and unreasonable.

14. RPA first explains why the current rate design is reasonable and appropriate. Second, RPA asserts that the current rate design for existing facilities has not been shown to be unjust and unreasonable. Third, RPA contends that the current rate design for new facilities has not been shown to be unjust and unreasonable. Fourth, RPA avers that the current rate design has not been shown to be unjust and unreasonable prior to implementation of the joint PJM/MISO rate design.

##### 1. The current modified zonal rate design is reasonable and appropriate

15. According to RPA, the current rate design is reasonable and appropriate because it aligns cost responsibility with congestion-free usage of the transmission system in an economically efficient manner. RPA states that the evolution of the assignment of cost-responsibility and congestion-free usage rights in PJM illustrates the essential link between the two concepts. Almost all of the transmission facilities at issue in this proceeding were originally located and sized to deliver local generation to local loads, and historically there was no mechanism for explicit congestion charges. See, e.g., Exh. AEP-104 at 6; Exh S-1 at 4; Exh. RPA-14 at 5-6. Later, the facilities jointly constructed by the original PJM companies were approved on the basis that each company would bear a level of costs consistent with the company's needs for additional supply and in return would be able to serve its local load from the output of the jointly owned generation facilities.

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issues, and then, relates those positions to the issues identified by the parties in the Joint Statement of Contested Issues. The decisional rationale for each contested issue is set forth in the latter portion of the decision.

16. RPA further posits that the linkage between cost responsibility and congestion-free use was preserved when PJM became an ISO, through both the allocation of congestion-free rights in the form of Financial Transmission Rights (FTRs) and Auction Revenue Rights (ARRs) and the system of centralized transmission planning. Exh. RPA-26 at 11–12, 14. RPA points out that PJM agrees that ARR are a fundamental feature of the PJM market design. PJM I.B. at 3. Additionally, congestion-free transmission and PJM transmission planning, both elements of the current system, are linked to Locational Marginal Pricing (LMP), which is the centerpiece of an efficient market structure. According to RPA, the Commission has recognized the important link between cost and usage.<sup>4</sup>

17. RPA argues that changing the current system would cause “serious efficiency and fairness implications,”<sup>5</sup> and would require systematic redesign of the PJM market structure. Exh. RPA-1 at 37–38; Tr. at 403–07. Moreover, RPA states that reallocating the costs of transmission facilities on the basis of voltage, as some of the rate change proponents recommend, would be economically irrational. Exh. RPA-20 at 13–14. This is because all facilities are essential to delivery of power in the PJM system, and thus a facility cannot be classified as providing more or less benefit than all other facilities. According to RPA, even assuming all zones benefit from all or some of the existing facilities, customers primarily use and benefit from the facilities in their own zones, and thus allocating costs to those customers is appropriate. See Exh. AEP-200 at 5; Tr. at 169; Exh. RPA-6 at 10, and Table 1. RPA also states that the current system facilitates new transmission investment by promoting certainty.

## **2. The license plate rate design for existing facilities is not unjust or unreasonable**

18. RPA further argues that the zonal or license plate rate design for existing facilities has not been shown to be unjust and unreasonable. RPA submits that a host of equitable factors supports the continued use of zonal rates for existing transmission facilities. RPA lists four equitable factors in particular. First, the majority of transmission owners in PJM support the zonal rate design for existing facilities. Specifically, RPA, which represents 70 percent of the total PJM system peak load, supports the current design. RPA maintains that, when deciding whether to approve a rate design, the Commission affords considerable weight to whether a regional or stakeholder consensus favors the

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<sup>4</sup> *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257 at 62,261 (1997), *as clarified*, 82 FERC ¶ 61,068 at 61,236 (1998); *PJM Interconnection, L.L.C.*, 108 FERC ¶ 61,269 at 61,453 (2004); *PJM Interconnection, L.L.C.*, 109 FERC ¶ 61,067 at 61,266 (2004); *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 at 61,434, *reh’g denied*, 105 FERC ¶ 61,123 (2003).

<sup>5</sup> RPA I.B. at 24

design. *California Independent System Operator*, 109 FERC ¶ 61,301 at 61,479 (2004), *reh'g denied*, 111 FERC ¶ 61,337 (2005). RPA states that there is a regional consensus in favor of the current rate design at least until February 1, 2008. Exh. TOP-15 at 5; Exh. RPA-81; Tr. at 229. Indeed, RPA notes that TOP, JCA, and the ICC all support continuation of the current rate design for existing facilities until February 1, 2008. TOP I.B. at 91; Tr. at 230; Exh. RPA-78 at 5–6; JCA I.B. at 2–6; ICC I.B. at 2–4.

19. Second, RPA contends that zonal rates allocate costs to those for whom the facilities were planned, designed, and built, and it is fair and reasonable for those same entities to continue to bear the costs because they had notice and a chance to review the costs and the design of the facilities. Moreover, it is equitable for those entities to shoulder the costs because it preserves the efficiency-based need determinations and cost assignments that originally supported the facilities and avoids shifting costs to entities that did not cause the facilities to be built and that do not benefit optimally from the facilities. For instance, RPA notes that AEP's transmission system appropriately serves in-zone needs, but its design is suboptimal to serve a regional function. Exh. RPA-10 at 22–23; Exh. RPA-6 at 15–17. Cost shifting would be especially dramatic in the case of PJM because it is a large and diverse Regional Transmission Organization (RTO). RPA posits that the current cost allocations are reasonable for the additional reason that the existing facilities were built for the purpose of providing in-zone customers with the property rights necessary for congestion-free usage of those facilities. The current rate design thus allows the facilities to continue to be used for the precise purpose for which they were constructed.

20. Third, RPA submits that there is no economic efficiency reason to change the rate design for existing transmission facilities. The Commission has stated that the purpose of pricing reform is to provide more efficient price signals, rather than simply to reallocate sunk costs. *Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act; Policy Statement*, FERC Stats. & Regs. ¶ 31,005 at 31,144 (October 26, 1994) (*Transmission Pricing Policy Statement*). RPA alleges that under the zonal rate design the sunk costs of existing transmission facilities, which are allocated in-zone, do not factor into generation purchase or siting decisions or impact investment incentives, and thus do not harm market efficiency. See, e.g., *Midwest Independent Transmission System Operator, Inc.*, 104 FERC ¶ 61,105 at 61,357; Exh. RPA-20 at 7; Exh. S-2 at 16; Tr. at 454.

21. The fourth equitable factor that RPA cites to support the continued use of the zonal system for existing facilities is administrative efficiency. See *Transmission Pricing Policy Statement*, FERC Stats & Regs. ¶ 31,005 at 31,144. RPA points out that since the zonal system is already in place, no studies or compliance filings are required to maintain it. RPA argues that administrative efficiency is especially important in this case because the system may be overhauled again in February, 2008, when the Commission considers a rate design for the combined PJM/MISO region. RPA maintains that the Commission

has not precluded consideration of the justness and reasonableness of the current rate design during this interim period. It argues that the resources of the PJM stakeholders would be better spent focusing on the proceedings to implement the long-term rate design for the combined PJM/MISO region.

22. In addition to offering reasons to support the zonal rate design for existing facilities, RPA attacks the arguments proffered against the design. First, RPA argues that the contention that all PJM transmission zones now use and benefit from PJM transmission facilities does not prove that zonal rates are unjust and unreasonable. RPA notes that none of the proponents of rate change quantify the amount or value of the uses and benefits that they allege are shared by all zones. Tr. at 273; Exh. RPA-89. “Without evidence quantifying the uses and benefits realized by each zone,” states RPA, “there is no principled way for the Commission to determine whether transmission costs are so misaligned with those unquantified uses and benefits that the existing rate design has become unjust and unreasonable.” RPA I.B. at 37. RPA argues that AEP’s exhibits containing its point-to-point revenues fail to demonstrate extensive usage of AEP’s system by out-of-zone customers, fail to address usage of transmission facilities in all the other zones, and actually show that MISO customers use AEP’s system more than PJM customers. Tr. at 165–66. Moreover, RPA points out that, even if outside zones benefit from a host zone’s transmission facilities, no zone gets a free ride from any other zone under the current system because, under a key feature of the PJM zonal rate design, each zone provides the other zones reciprocal access free of charge. Exh. RPA-5 at 7. In response to claims that an AEP facility helped stop the August 2003 blackout, RPA alleges that AEP did not join PJM until later and thus AEP provided at most reliability benefits in the Eastern Interconnection; interconnected operations have never been enough to require a company to pay a share of another’s facilities. In the same vein, RPA states that there is no Commission precedent stating that the sunk costs of existing facilities must be reallocated whenever beneficiaries, other than those who caused the costs to be incurred, appear.

23. RPA also submits that the arguments made against the zonal rate design for PJM merely represent general objections that would apply equally to any RTO. If the Commission were to reject a zonal rate design for PJM based on the arguments espoused in this case, it would likewise have to reject zonal rate designs for all RTOs. Therefore, the Commission’s general endorsement of zonal rate designs precludes a finding that the use of such a system in PJM is unjust and unreasonable.

24. Second, RPA argues that the elimination of RTORs and SECA revenues has not caused the zonal rate design to become unjust and unreasonable. Specifically, RPA suggests that the impact of the elimination of RTORs and SECA revenues is minimal. For instance, although the Commission recognized the cost-shifting implications of eliminating RTORs, it authorized the SECA method to ameliorate the cost shifts only temporarily. Also, by eliminating RTORs for utilities that had not yet joined an RTO, the

Commission signaled that all PJM utilities could lose transmission revenues from through-and-out transactions. Additionally, in its November 2004 Order, the Commission concluded that the shifting of costs from through-and-out customers to in-zone customers that could result from elimination of RTORs was not unreasonable because it was balanced by broader transmission access available under a regional tariff.

25. Also according to RPA, the loss of SECA revenues harmed only three PJM transmission zones, and the other zones lost no net revenue. Exh. AEP-207 at 1; Tr. at 181. Of the harmed zones, only AEP supports changing the rate design, and the majority of the harm to AEP is attributable not to PJM's zonal rate design but rather to the zonal rate design adopted by the Commission as between PJM and MISO. Exh. AEP-207 at 2; Tr. at 185. On the same note, a historical comparison of the AEP's transmission rates over the past ten years shows that AEP ratepayers are in the same or better economic position as they were prior to through-and-out revenues following Order No. 888. Exh. RPA-1 at 11; Exh. RPA-10 at 14. Any revenues AEP has lost as a result of the elimination of RTORs and SECAs are more than offset by the benefits AEP has gained from participating in PJM, and the bulk of such lost revenues are from MISO, not PJM, customers. Moreover, RPA argues that if the Commission deemed the zonal rate design unjust and unreasonable for PJM, such a finding would mean that the zonal rate design is also unjust and unreasonable for MISO and that the Commission wrongly imposed the design on MISO in its November 2004 Order.

26. Third, RPA argues that the current design is consistent with Judge Young's holding in, *California Independent System Operator Corp.*, that "an entity may be deemed to have caused costs either if it is directly responsible for imposing the cost burden at issue or if the entity benefits from the cost incurrence." *California Independent System Operator Corp.*, 113 FERC ¶ 63,017 at 65,124 (2005) (emphasis in original). According to RPA, *KN Energy v. FERC*, 968 F.2d 1295 (D.C. Cir. 1992) (*KN Energy*), and *Louisiana Public Service Commission v. FERC*, 184 F.3d 892 (D.C. Cir. 1999), are inapposite because they did not involve the allocation of the costs of transmission facilities. RPA also argues that the cases on rolled-in pricing for transmission facilities do not support the position that the cost of facilities in an integrated system should be spread to all users. The rolled-in pricing cases, according to RPA, did not involve valuable property rights, and the Commission has never applied those cases to an RTO.

27. Fourth, RPA submits that the EHV agreements<sup>6</sup> are fully consistent with the

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<sup>6</sup> The EHV Agreements are: (i) the Extra High Voltage Transmission System Agreement, dated April 27, 1967, as amended; (ii) the Transmission Enhancement Facilities Agreement, dated September 23, 1983, as amended; (iii) the Susquehanna-Eastern 500 kV Transmission System Agreement, dated April 30, 1976, as amended; and (iv) the Lower Delaware Valley Transmission Agreement, dated September 30, 1977, as amended, and two supplements to the latter, The Smithsburg Substation Supply

current rate design, and are actually inconsistent with the highway/byway designs, because they link payment of transmission costs with property rights, do not apply to all high-voltage facilities, and represent contractual agreements rather than allocation of costs by fiat. Fifth, RPA maintains that the zonal rate design for existing facilities is consistent with the current rate design for new facilities because those who caused the costs to be incurred pay for the facilities under both designs. Sixth, RPA argues that it has not changed its position on distance sensitive rates. Even if the zonal rate design did not capture distance sensitivity and was thus flawed, the alternative approaches also do not capture it and thus would also be flawed.

### **3. The existing rate design for new facilities is reasonable and appropriate**

28. Just as RPA contends that the proponents of rate design change have not established that the rate design in PJM for existing facilities is unjust and unreasonable, it maintains that neither have they established that the rate design for new facilities is unjust and unreasonable. Instead, RPA alleges that the current rate design for new facilities is well-designed and reasonable and serves its intended purposes of identifying needed transmission and allocating costs to parties that caused the costs or that benefit from the new facilities or upgrades. This approach squelches possible opposition to new facilities based on concerns that costs may be assessed to parties that do not benefit from the new construction. The current design also appropriately links cost allocation with congestion-free transmission use by allowing the paying parties to receive ARRs.

29. According to RPA, AEP/AP's argument that the current system allocates only minimal costs out of zone<sup>7</sup> relies on outdated data, and in actuality a significant amount of new transmission costs has been allocated outside local zones.<sup>8</sup> Exh. RPA-1 at 29; Tr. at 565; Exh. TOP-3 at 24. RPA also notes that the current system makes sense because it bases cost allocation on expected impacts demonstrated through specific studies, which is preferable to adjusting allocation costs due to the mere possibility that the expected impacts of the project may change. RPA contests the suggestion that the current system inhibits the building of new transmission and notes that a significant amount of new transmission has been authorized under RTEP. Exh. RPA-73 at 1-2. Moreover, regionalizing new transmission costs would not necessarily facilitate new transmission construction because entities that do not stand to benefit from a proposed project are likely to oppose it. RPA notes that PJM fails even to allege that the current system is unjust and unreasonable, and thus its suggestion to use an alternative system-wide

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Agreement and the East Windsor Substation Supply Agreement. Exh. FE-100.

<sup>7</sup> Exh. AEP-100 at 30 and Exh. AP-800 at 4

<sup>8</sup> In its Reply Brief, RPA notes that AEP/AP have conceded that economic upgrades should be allocated under the Schedule 6/Schedule 12 Process and thus AEP/AP must also support applying that process to reliability upgrades.

allocation should not be considered.

30. RPA notes that the existing rate design will continue to apply only for a limited period ending on February 1, 2008, when the joint PJM/MISO rate design takes effect. RPA maintains that changing the design for this limited period would: (a) interfere with the efficiency of the electricity market in the PJM/MISO Region; (b) create administrative and procedural complications; (c) result in inconsistent and incomplete rate designs in the MISO and PJM regions; and (d) cause cost shifts to several PJM zones<sup>9</sup> which would be especially troublesome in the case of parties that have rate freezes in effect during the interim period since rate freezes can trap costs. See *Alliance Cos.*, 99 FERC ¶ 61,105 at 61,444 (2002) (*Alliance*). RPA points out that in *Regional Transmission Organizations*, Order No. 2000,<sup>10</sup> the Commission found license plate rates appropriate for avoiding costs shifts during transitional periods occurring after companies join RTOs, and thus leaving the current rates in place during the interim period would benefit the many transmission owners that only recently joined PJM.

#### 4. Alternative Rate Design proposals

31. RPA first addresses AEP/AP's highway/byway rate design and argues that AEP/AP has not met its statutory burden to show that the proposed design is just and reasonable. RPA offers five reasons to show that AEP/AP's design for existing facilities is flawed. First, the proposed design fails to link the allocation of sunk costs and the allocation of ARRs. Specifically, AEP/AP's design would shift a portion of AEP's sunk costs to other PJM members but would unreasonably deny those parties any corresponding right to congestion-free usage of AEP's facilities, according to RPA. Exh. AEP-203 at 1; Tr. at 74. Second, AEP/AP bases its design on generalized notions of usage and benefits that have no nexus to proposed cost allocations. RPA extensively describes the "two-sided platform" element of a transmission system and states that each participant in a transmission system depends on each other participant in the system in order to realize benefits that no participant could realize on its own. Thus, a PJM member that happens to have particularly high capacity transmission facilities provides no more value to the PJM system than any other member and has no basis to impose the costs of its facilities on the other participants as AEP/AP's proposal would allow. Exh. RPA-20 at 7, 12-13. Third, under AEP/AP's proposal and its corresponding view of uses and benefits, PJM load would bear the costs of transmission facilities that are used by and

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<sup>9</sup> See, e.g., Exh. AEP-203, Exh. TOP-5, and Exh. S-4

<sup>10</sup> *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 at 31,177 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 at 31,177-178 (Mar. 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd sub nom. Public Utilities District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. 2001) (Order No. 2000)

that benefit MISO customers more than PJM customers. This is because, although MISO usage far exceeds PJM usage of highway facilities, the Commission has eliminated the rates that would allow PJM to collect costs from within MISO. Tr. at 205. RPA notes that some of the proponents of rate change have stated, and RPA agrees, that it would be unjust and discriminatory to allocate all of these costs to PJM members.

32. Fourth, RPA contends that AEP/AP's proposal allocates costs based on an unsupported and arbitrary voltage cut-off. RPA explains that the Commission, in its November 2004 Order, has expressed concerns about voltage-based distinctions based on generalizations about the function of transmission facilities operating at different voltage levels where there was no analysis of the actual function of the facilities throughout the region. Focusing on these concerns, RPA asserts that AEP/AP bases its proposal on mere generalizations and that its analyses are limited to the AEP/AP zones and shed little light on the actual function of the facilities. For example, the maps AEP uses to support its voltage proposals are inadequate to demonstrate the respective uses of varying voltage level facilities. Additionally, the 345kV/highway category is both over and under inclusive because it encompasses facilities not designed to serve regional functions and fails to include facilities that may operate regionally. The fact that AEP/AP and TOP present differing proposals regarding the proper voltage cut-off point further illustrates the arbitrary nature of a voltage-based design and shows that the voltage cut-off points chosen are self-serving.

33. Fifth, RPA states that implementation of the AEP/AP proposal would impose significant administrative burdens on PJM transmission owners. Specifically, the proposal requires that each zone determine revenue requirements for its 345 kV and above facilities. Transmission owners (TOs) do not currently maintain revenue requirements, accounting records, or transmission substation or depreciation costs by voltage. Thus, TOs would be required to break down the relevant costs by voltage level, which would involve complex studies. AEP's studies illustrating the process involved in breaking down the relevant costs are incomplete, and AEP/AP has not shown that it is reasonable to impose this burden on all PJM TOs. Sixth, according to RPA, AEP/AP fails to support its assertion that its proposal would result in less cost shifting than the other proposals. The supporting analyses AEP/AP provides incorrectly assume that the status quo design includes SECA charges and MISO revenues. Thus, AEP/AP's argument mischaracterizes the cost shifting that would occur under its proposal.

34. Further, RPA argues that AEP/AP's rate design for new facilities has not been shown to be just and reasonable. Because AEP/AP propose to apply the same design to both new and existing facilities, RPA has the same objections to the design for new facilities as it has to that for existing facilities. Additionally, RPA posits that using AEP/AP's design for new facilities would engender controversy regarding, and thus hinder the development of, new facilities in PJM. RPA provides as an example a proposed AEP project that is currently pending and that, under AEP/AP's rate design,

would be funded in significant part by customers in the AEP zone. Because the project would primarily serve customers outside the AEP zone, one of AEP's customers is protesting the project on the basis that it should not have to pay for facilities that provide it essentially no benefit. The Public Utility Commission of Ohio, a state commission that significantly influences AEP's decisions on whether to construct new facilities, also opposes cost allocations that would ignore actual benefits with respect to the proposed AEP project. RPA notes that AEP/AP, in their Initial Brief, abandons their proposal, and proposes to keep the current system, for new facilities built for economic purposes. However, RPA argues that distinguishing between economic and reliability expansions has no support in the record and further undermines AEP/AP's case.

35. RPA also opposes TOP's proposed rate design. RPA asserts that TOP's highway/byway treatment of existing facilities suffers from numerous flaws. In addition to the problems seen in the AEP/AP proposal for existing facilities, including the failure to address the allocation of ARRs/FTRs, the TOP proposal should be rejected because TOP admits that it would be unjust and unreasonable to apply two different rate designs within PJM, one for purely PJM transactions and one for combined PJM/MISO transactions. Through that admission, RPA argues that TOP effectively concedes that the Commission cannot properly accept its proposal since the design for the combined PJM/MISO Region is fixed until February 1, 2008. RPA also rejects TOP's assertion that consideration of ARRs/FTRs exceeds the scope of this proceeding.

36. With respect to TOP's proposed voltage cut-off points, RPA alleges that TOP provides no studies, analyses, or other evidence about the function of PJM transmission facilities to support its proposal; in contrast, it notes that the company in *TRANSLink Development Co.*, 101 FERC ¶ 61,316 (2002), *order on reh'g*, 103 FERC ¶ 61,208 (2003), supported the voltage-based element of its proposal with power flow studies demonstrating the functions of transmission facilities in the region. Additionally, RPA states that TOP's method of determining actual rates involves a number of assumptions, which TOP has not proven to be reasonable or accurate. Nor has TOP proven the reasonableness of its proposal for a five-year freeze on the highway rate. RPA argues that a freeze would undermine a TO's ability to recover highway facility costs from other zones and temporarily eliminates cost recovery for newly constructed transmission facilities.

37. RPA also objects to TOP's plan for existing facilities because TOP fails to support its proposed use of the 12-CP cost allocation method. According to RPA, the Commission has held that the 12-CP method is inappropriate for PJM ratemaking purposes when the single coincident peak load (1 CP) method is being used for FTR allocation. See, e.g., *American Electric Power Service Corp.*, 103 FERC ¶ 61,008 at 61,032, *order on reh'g*, *New PJM Cos.*, 103 FERC ¶61,008 (2003). TOP has not explained how its proposed stakeholder process would mesh with the stakeholder process for the PJM/MISO Region.

38. Similarly, RPA avers that TOP's cost allocation proposal for new facilities, which would involve a stakeholder process for determining the details of the rate design, is too undeveloped to support a ruling by the Commission on its justness and reasonableness. Additionally, RPA contends that the proposed stakeholder process could duplicate or conflict with the stakeholder process that is currently scheduled to decide the long-term rate design in the Combined Region.

39. RPA asserts that PPP's rate design is not just and reasonable because it suffers from the same flaws as AEP/AP's and TOP's proposals, including the failure to link sunk cost allocation and FTR allocation.<sup>11</sup> Additionally, RPA opposes PPP's proposed cost allocation for "middle tier" voltages for several reasons, namely that there is no Commission precedent concerning this method of allocation and the Commission cases cited by PPP did not involve a three-tiered approach, PPP has presented no studies or analyses in support of the plan, and the required calculations are overly complex and rife with potential error. Finally, RPA objects to the fact that PPP would allow the voltage-based determinations for characterizing facilities as highway versus byway to be rebutted subject to certain evidentiary showings. RPA characterizes this feature of PPP's test as poorly developed and subject to additional complexity and uncertainty.

40. RPA argues that Staff's rate design is not just and reasonable. Initially, RPA notes that "Staff – which is the only participant in this proceeding with no actual pecuniary interest in the rate design – is the only participant...that has proposed the use of postage stamp rates." RPA I.B. at 83. RPA further avers that Staff has not established that postage stamp rates are a Commission directive, goal, or ideal, and that to the contrary the Commission is neutral on whether an RTO should adopt a postage stamp or license plate rate design for existing facilities. According to RPA, the Commission has stated its neutrality on this issue numerous times, for instance in Order No. 2000<sup>12</sup>, and in *PJM Interconnection L.L.C.*, 96 FERC ¶ 61,060 at 61,220 (2001), as well as in two policy

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<sup>11</sup> RPA asserts that PPP is wrong that congestion charges are insignificant in the PJM market because they are a fraction of the total billings. Rather, RPA says that congestion charges represent a significant charge to customers transmitting power across a constraint. Consequently, FTRs provide important insurance for customers needing to move power across oft-constrained transmission paths, regardless of whether a customer has scheduled power delivery along the particular path, and thereby allow customers to avoid the added cost of high congestion. RPA argues that the FTR holders that paid for the transmission system are entitled to this benefit. RPA states that PPP also is wrong that congestion revenue rights are awarded only for historic, in-zone network resources. Rather, ARR are allocated to load within the PJM zones on a pro rata basis and reflect historic transmission usage, rather than contractual or ownership entitlements.

<sup>12</sup> Order No. 2000, FERC Stats. & Regs. ¶ 31,089.

statements in 2003 and in its approval of the proposed rate design for the Southwest Power Pool RTO. See *Southwest Power Pool, Inc.*, 106 FERC ¶ 61,110 at 61,397(2004); *Southwest Power Pool, Inc.*, 111 FERC ¶ 61,118 at 61,653 (2005). RPA contests the reluctance of the proponents of rate change to support their preference for a single-system rate in *Alliance*, which did not even involve consideration of a single-system rate. Even if the Commission preferred a uniform, system-wide rate, RPA maintains that Staff's two-tiered approach would not yield that result because the Schedule 6/Schedule 12 Process probably would not spread the costs of new transmission facilities evenly among the zones.

41. Moreover, because Staff's proposal fails to address the allocation of the important property rights in PJM represented by ARRs and FTRs, RPA posits that Staff's approach would result in unacceptable inequities. Exh. RPA-26 at 10. RPA states that there is no basis for Staff's claim that ARRs/FTRs are not linked to the allocation of transmission. Tr. at 127. Although Staff contends that under its approach in the long run there will be no congestion and thus FTRs will be worthless, RPA responds that a congestion-free transmission system is not ideal or economically efficient and predicating a rate design on a utopian vision is not just and reasonable because in reality billions of dollars worth of congestion costs do exist and cannot be ignored.

42. RPA further disputes Staff's characterization of the transmission system as a public good. RPA states that transmission exhibits neither of the two defining characteristics of a public good, namely non-rival consumption and the inability to exclude non-payers. Exh. S-2 at 8. Moreover, Staff has not demonstrated that any benefits that may result from the interconnectivity of the PJM system are spread evenly across PJM and has not supported its definition of "transmission facilities" for purposes of allocating costs regionally; thus Staff has not justified allocating the costs of facilities equally to each zone.

43. RPA additionally argues that Staff's proposal will yield the most severe costs shifts. For instance, Dominion would experience a 73.2 percent cost increase, which would be unreasonable even if the extra costs could be passed along to retail customers. Staff's proposal to phase-in its rate change would only mitigate the short-term impacts of the cost shifts and would complicate any rate design change that may occur on February 1, 2008. Finally, RPA submits that Staff's proposal should not be adopted because it will engender controversy over which facilities should be included in transmission rates. RPA notes that some TOs classify certain lower voltage facilities as distribution, to be funded locally, whereas other TOs classify the same facilities as transmission, to be funded regionally under Staff's plan. This variance in classifications would cause particular controversy because customers would object to paying for facilities in other zones if they could not spread out the cost of comparable facilities in their own zones.

## **B. Joint Consumer Advocates**

44. The District of Columbia Office of the People's Counsel, the Maryland Office of the People's Counsel, the Pennsylvania Office of the Consumer Advocate and the New Jersey Division of Ratepayer Advocate (collectively referred to as Joint Consumer Advocates or JCA) submitted a brief which presents this coalition's position.

**1. PJM's current modified zonal license plate rate design is not unjust, unreasonable, unduly discriminatory, or preferential, or otherwise unlawful.**

45. JCA notes that a proponent of an alternative rate design bears the burden of showing that the current rate design is unjust and unreasonable and that the alternative is just and reasonable. *See, e.g., ANR Pipeline Co. v. FERC*, 771 F.2d 507 (D.C. Cir. 1985); *Public Service Commission v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980). JCA agrees with RPA that the proponents of alternative rate designs in this case have not met the requisite burdens of proof, and thus the current rate design should be retained.

46. JCA maintains that the current modified zonal license plate rate design is not unjust, unreasonable, or unduly discriminatory, preferential or otherwise unlawful because it matches cost responsibility with cost causation for both existing and new facilities. Specifically, existing facilities were built for and benefit the TO's native load customers, who in turn pay for those facilities. Likewise, the costs of new facilities are paid by those who PJM determines will benefit from them on a regional basis.

47. Additionally, JCA contends that the current system operates in an economically efficient manner. Any entity in the footprint can obtain power at the same transmission delivery cost, which comports with the Commission's goal of fostering a system-wide power procurement market. Exh. JCA-1 at 7. According to JCA, the fact that an alternative rate design may also provide economic efficiency does not justify a change, and the parties requesting a change have not shown that the current system is not economically efficient. Tr. at 676.

48. Likewise, JCA asserts that PJM's expansion does not justify a change in rate design. JCA explains that the same laws of physics apply in the expanded PJM footprint, and the physical operations of the grid have not changed. Tr. at 244-45. Power used locally "continues to be dispatched over lines that are used locally and paid for locally." JCA I.B. at 4. The rate change proponents have offered no studies to show the contrary, JCA contends. Moreover, according to JCA, the evidence does not show that the current system is inequitable or results in cross-subsidization. *See, e.g., Exh. JCA-3 and Exh. JCA-4.* JCA submits that the provision of transit service is paid for by the beneficiaries of that service, which is consistent with the justifications for regional transmission rate design. Exh. AEP-400 at 4.

49. JCA further avers that one of AEP's exhibits, the Cambridge Energy Research

Associates (CERA) study, shows that under the current rate design AEP/AP benefits from the increased use of its system despite the elimination of through-and-out rates. Exh. AEP-402 at 7. For instance, AEP witness Henderson testified that AEP will receive \$333 million in increased profits over a five-year period due to increased flows on the transmission system. Tr. at 69. According to JCA, the CERA study also indicates that AEP customers will continue to receive the lowest cost generation and that off-system sales of higher cost generation will lower AEP's cost of service. Exh. AEP-402 at 17. Thus, AEP has not shown that the current rate design harms its customers or results in substantial revenue loss to AEP, JCA claims.

50. Moreover, JCA asserts that the current rate design allows for power procurement throughout PJM. Additionally, the fiscal local accountability that results from having the benefiting customers pay for transmission service ensures that decisions are made judiciously and transmission is built where it is needed most. Changing the rate design would require corresponding changes in the function of the PJM system, for example in the allocation of congestion revenue rights. Accordingly, JCA maintains that the current rate design is just and reasonable and should be retained.

## **2. Alternative rate design proposals**

51. According to JCA, none of the alternative rate design proposals are just and reasonable. As a general matter, JCA contests the alternative proposals because they are all based on the false assumption that all PJM customers in all zones have equal access to generation.

52. JCA objects specifically to AEP/AP's proposal because AEP/AP provides no evidence showing how voltage distinctions will facilitate the regional system. JCA notes that AEP witness J. Craig Baker testified that the Commission rejected a voltage-based distinction in a past case because the proposal was not adequately supported. Exh. AEP-100 at 7. JCA asserts that AEP/AP's proposal should be rejected for the same reason.

53. Also, according to JCA, AEP/AP's proposal would shift the cost of transmission facilities constructed for AEP/AP's native loads to the rest of PJM, while allowing AEP/AP to retain low-cost generation to serve its native loads. JCA alleges that AEP is attempting to collect 52 percent of its net transmission plant assets from all PJM transmission service through a single, system-wide rate. Exh. AEP-203 at 4. Exhibit AEP-203 shows that under AEP/AP's proposal, AEP would shift to other transmission owners \$125,049,587 of its current revenue requirement, and by contrast Dominion would bear an additional \$48,673,932 in costs. Such dramatic cost shifts would be unjust and unreasonable. JCA further submits that, if a single, system-wide rate is to be adopted, the proponents of the new rate design must show that the benefits of PJM transmission grid operations flow equally to all PJM participants. AEP/AP have failed to show that their proposal satisfies this requirement.

54. Moreover, JCA argues that AEP/AP have not shown that applying RTO rules to PJM or changing the PJM rate design would significantly increase power flows. For example, JCA claims the CERA study illustrates that removal of the wheeling rates would increase power flows from AEP to PJM by only 1.4 percent. Exh. AEP-402 at 7, 29. Thus, according to JCA, AEP/AP have failed to show that their proposal results in a significant increase in “public good” benefits related to operation of the PJM grid or a more equitable distribution of any such benefits.

55. JCA also argues that TOP’s proposal is not just and reasonable. Like AEP/AP’s proposal, TOP’s proposal would result in cost shifts from native load customers to PJM customers as a whole. JCA argues that TOP has provided no evidence that cost shifting is necessary to achieve a just and reasonable result. Exh. JCA-3, Exh. JCA-4, and Exh. JCA-6.

56. JCA opposes TOP’s use of voltage as a proxy to determine which existing transmission facilities provide local service and which provide system-wide or regional service. According to JCA, the fact that AEP/AP and TOP define high versus low voltage facilities differently illustrates the subjective nature of voltage-based systems. JCA submits that, because both high and low voltage facilities can provide both local and long distance transmission, voltage should not be determinative of which customers bear the costs of certain facilities.

57. Additionally, JCA asserts that proponents of a pricing scheme that differentiates between regional and local facilities must specify the key distinguishing factors between the two types of facilities. Exh. JCA-1 at 9; Tr. at 678. Both TOP and AEP/AP fail to specify any such factors, which affirms that their proposals are not just and reasonable. *Id.*

58. JCA contests PPP’s proposal on the basis that it is merely a variant of AEP/AP’s and TOP’s proposals, and thus suffers from the same shortcomings. Also according to JCA, PPP’s proposal is incomplete because it fails to characterize facilities between 200 kV and 500 kV as high or low voltage.

59. Like the other alternative rate design proposals, JCA avers that Staff’s proposal is not just and reasonable. JCA alleges that Staff’s proposal would create the same cost-shifting problem as the other proposals and would result in cost reductions for some TOs but cost increases for others. Staff’s proposal thus creates inequities that do not justify the purported benefits.

## **C. American Electric Power Service Corporation and Allegheny Power**

### **1. License Plate Rates are unjust and unreasonable**

60. AEP/AP contends that the existing PJM modified zonal rate design is unjust, unreasonable, unduly discriminatory, preferential, and otherwise unlawful, based upon what it considers critical defects related to two elements of the rate design. First, it argues that the existing design contravenes the Commission's policy regarding cost causation. In addition, AEP/AP asserts that rate treatment of transmission system enhancements under PJM's Regional Transmission Expansion Plan's (RTEP) cost allocation rules also contravenes cost causation principles by locking in a snapshot view of use that fails to take into account changes in use over time. AEP/AP suggests that PJM's recent westward expansion and the elimination of through-and-out rates for transmission service have made continuation of the existing rate design unjust and unreasonable. Other factors contributing to the problem with the existing rate design include growth of regional markets, and changes in use by third parties under the Commission's open access policies, AEP/AP contends.

61. AEP/AP believes that the existing rate design fosters an uneven distribution of transmission costs within PJM, resulting in a mismatch between those who benefit from transmission facilities and those assigned the cost of those facilities. AEP/AP also argues that the existing rate design regionalizes the cost of the pre-expansion extra-high voltage (EHV) facilities in the classic PJM system without regionalizing the cost of other EHV facilities. Exh. EHV-1 at 6-9; Tr. at 242-243.

62. AEP/AP further believes that the current zonal rates have resulted in an unfair and unreasonable shift in costs. The elimination of through-and-out rates between PJM and MISO and between PJM companies, such as AEP, which the Commission believed to be situated in "seams" between PJM and MISO, created significant economic harm to ratepayers in AEP's zone, according to AEP/AP. The transitional remedy adopted by the Commission, SECA, was intended, AEP/AP maintains, to provide parties time to develop a long term rate design solution to efficiently price transmission service between RTOs. AEP/AP asserts that the Commission was well aware in approving the transitional remedy that it would have been unfair to simply do away with rates that reflected the way the system was being used.

63. AEP/AP argues that the record amply supports the conclusion that AEP's transmission system has been heavily used by wholesale customers to implement deliveries over the AEP system. Exh. AEP-200 at 5. Before joining PJM, AEP collected annual through-and-out revenues in excess of \$133 million. Exh. AEP-202. Leaving these revenues unrecovered would result in serious economic harm to ratepayers in AEP's zone, AEP/AP contends. AEP's witness Mr. Bethel testified that this factor alone would account for a 60 percent increase in AEP's zonal network rates. AEP/AP's witness Mr. Henderson testified that these revenues directly reflect the uses made by and the benefits obtained by third party transmission customers throughout PJM. Exh. AEP-204 at 7-9. This comports with the Commission's policy, AEP/AP contends, to assign the

costs of the system to the users of the system on a basis that equitably tracks projected uses. Parties intent on keeping the existing zonal rate design without the association with usage and benefits, AEP/AP argues, overlook reality and the basis for appropriate design of rates.

64. AEP/AP questions whether the defenders of the existing design have identified properly the use of existing plant. For example, AEP/AP argues that an allocation of fixed costs to the originally identified need that prompted the construction of the plant fails to capture the fact that flows have changed materially under the expanded central dispatch of a larger PJM. It suggests that the existing design presumes that energy still flows largely from local generation over local transmission to meet local need.

65. AEP/AP notes that Commission policy requires that transmission facilities that support an integrated transmission service be allocated on a rolled-in basis. It argues that the fundamental nature of PJM is an integrated transmission network, dispatching all generation on a least cost dispatch basis. Expansion of the PJM system has created greater usage of the transmission facilities, creating constraints and congestion, it is asserted. Tr. at 149. The Commission has long treated transmission as an indivisible network that collectively serves the needs of all customers connected to the network. *Missouri Utilities Co.*, 10 FERC ¶ 61,297 at 61,599. (1980). Assigning the costs of such a system to particular users based on vintage is simply not something that has been done by the Commission, AEP/AP argues. Instead, Commission policy has always reflected a preference for rolling-in additions to plant that is part of an integrated system.

66. AEP/AP contends that advocates of continuing the existing PJM modified zonal rate design have not justified a departure from the Commission's policy of rolled-in rates. PJM uses its mix of installed generation and available transmission to implement a merit order dispatch of generation, AEP/AP maintains, so that the overall transmission grid benefits users from centralized economic dispatch of the entire PJM system. Increased access to lower cost generation has been made possible by PJM's westward expansion. These integration benefits could not have been achieved without the regional transmission facilities that have enabled significant power transfers from west to east, AEP/AP argues. Since integration, AEP's interfaces with neighboring utilities have experienced greater power flows, indicating greater usage of the system by customers throughout the region. Exh. AEP- 300 at 20. All of AEP's transmission facilities, especially those at 345 kV and above, have experienced those increases, AEP/AP argues. See Exhs. AEP-304 and 305. The integration benefits came about because of the high voltage facilities that permit large transfers of lower-cost power to load serving entities in the east (the original PJM footprint). Exh. AEP- 306.<sup>13</sup> AEP/AP concludes that there is

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<sup>13</sup> Other evidence in the record confirms the significant increases in transfer across AEP's interfaces following AEP's integration into PJM. See, e.g., Exh. AEP-402, RPA-58 at 306-307

clear evidence that inclusion of AEP and AP into PJM has had significant effects on the patterns of delivery of power across the expanded PJM footprint and the integration of AEP's and AP's higher voltage transmission facilities into the classic PJM system have been a major part of achieving those effects.

67. AEP/AP suggests that the Commission has recognized the availability of such benefits in its prompts to RTOs to file justifications for rate designs predicated on zonal rates. It observes that the Commission, in Order No. 2000<sup>14</sup> made clear that it was reluctant to announce generically that license plate rates may be a permanent feature of an RTO. The Commission stated further: “[W]e stress that we view the use of license plate rates as transitional; while acceptable to control abrupt cost shifts during a transition period of limited duration, license plate rates are not an end but only a step towards an end – a single, system-wide average rate which reflects the regional nature of the service provided.” *Alliance Companies, et al.*, 99 FERC ¶ 61,105 at 61,444. *See also TRANSLink Development Company, LLC*, 101 FERC ¶ 61,316 at 62,278.

68. From this, AEP/AP contends that the existing PJM modified zonal rate design is unjust and unreasonable.

## **2. Schedule 12 cost allocation**

69. AEP/AP further argues that the current Schedule 12 cost allocation, which allocates to zones based on an Outage Transfer Distribution Factor (OTDF) that is a snapshot projection of flows at a single point in the future, is not appropriate. AEP/AP maintains that no prediction of loads, generation resources and other conditions at one point in time can predict accurately how the continuing use of a transmission enhancement will evolve. A required transmission enhancement (RTE) constructed for reliability becomes just another element in an integrated grid, serving the energy transfer needs of the physical system as uses of the system evolve over time, argues AEP/AP. So, even though constructed for one specific purpose, the RTE serves additional purposes through time, it is contended. AEP/AP maintains that the current RTEP process for assigning the costs of Reliability RTE is unjust and unreasonable because of its inherent assumption that a particular improvement can be isolated and shown to have been made necessary in a local zone. Operation of the integrated grid in a regional control area suggests that the cost of enhancements should be allocated on a system-wide basis, particularly for higher voltage elements that most obviously have system-wide impacts, AEP/AP argues. Otherwise, it is contended, the costs of improvements that bring enhanced benefits to the system will be allocated only to those customers in the zones identified in a snapshot of expected conditions at a future point in time. That is unjust and unreasonable, according to AEP/AP. AEP/AP urges that all Reliability RTE constructed at 345 kV and above be allocated to the zones on the basis of their

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<sup>14</sup> Order No. 2000, FERC Stats. & Regs. ¶31,089 at 31,092.

contribution to PJM's 1 CP load, which reflects grid-wide reliability and market benefits from the construction.<sup>15</sup>

### 3. AEP/AP's proposed rate design

70. AEP/AP has proposed a "highway/byway" rate design to recognize the regional system-wide impacts of its \$1.45 billion investment in high-voltage lines that serve as the backbone of the PJM transmission system and which AEP/AP contends provide benefits throughout the region. Defining 345kV and above as the appropriate voltage level for regional transmission facilities (RTF) recognizes the benefits currently derived from these facilities and, according to AEP/AP, would fairly allocate costs to those customers throughout the PJM system who benefit from the enhanced reliability and broader market access achieved through integration of these facilities into the expanded PJM configuration. AEP/AP I.B. at 29. The two utilities propose a voltage-based, regional rate design under which the costs of certain new and existing higher voltage (highway) transmission facilities are recovered on a "regional" basis from customers throughout PJM. The proposal envisions that lower voltage facilities would continue to be recovered through a license plate rate; each transmission owner's revenue requirement for the lower voltage facilities would continue to be recovered from customers within a local zone. Exh. AEP-100 at 31-32. The regional rate design would effectively reallocate the costs of existing higher voltage lines and would assign responsibility for new Reliability RTE to better align usage and benefits of these facilities more broadly. Exhs. AEP-204; AEP-100 at 32, AEP-200 at 8-12.

71. AEP/AP cites to Commission precedent for the proposition that those customers who benefit from regional transmission facilities should pay their fair share of the costs, regardless of the original purpose of the construction. *California Power Exchange Corp.*, 106 FERC ¶ 61,196 at 61,680 (2004); *California Independent System Operator Corp.*, 106 FERC ¶ 61,032 at 61,109 (2004). AEP/AP argues that cost allocation based solely on the reason the facilities were originally built, as opposed to how they are and will be used, is incorrect in that it fails to reflect the benefits to be enjoyed by customers in PJM as long as the facilities are in service, and the associated responsibility for the costs of the facilities that will provide the benefits.

72. AEP/AP argues that its proposed rate design accurately reflects the way the PJM RTFs are operated and correctly allocates costs to the customers benefiting from those facilities. A report from Energy Security Analysis, Inc. (ESAI) for PJM noted that the "beneficial impact of integration makes itself felt across all of the various dispatch levels of the market, from relatively low to the higher load conditions." Exh. AEP-212 at 59. Further, AEP/AP argues that facilities at 345 kV and above also provide reliability

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<sup>15</sup> AEP/AP proposes, however, that Economic RTE designed to improve the LMP prices for specific zones be allocated to those zones.

benefits. Testimony supports the conclusion that the overlay of higher voltage facilities on the lower voltage facilities increases the ability of the network to absorb power swings, AEP/AP asserts. Exh. AEP- 300 at 16-18. Costs of administering PJM have also been reduced through expansion of the PJM footprint, to the tune of \$40 to \$45 million per year, it is contended. Exhs. AEP-100 at 20; AEP-101, AEP-102.

#### 4. Cost Shifting

73. AEP/AP observes that any rate design change will engender a change in cost responsibility among the affected parties. Exh. AEP-206 at 6. Current PJM rates without a through-and-out rate or SECA resulted in significant cost shifts, according to AEP/AP. It claims that \$157.7 million per year of transmission costs that had been allocated to transmission customers via through-and-out rates will not be so allocated to those customers, notwithstanding that these customers continue to make regional use of the AEP transmission system. AEP/AP suggests that its proposal provides the least amount of cost shifting:<sup>16</sup>

	RPA License Plate	AEP/AP 345+ kV	TOP 200+ kV	Staff Postage Stamp
Zones with decreases	12	5	5	10
Average decrease	\$8,243,852	\$11,505,909	\$34,847,908	\$12,227,113
Zones with increases	3	10	10	5
Average increase	\$71,068,420	\$17,330,858	\$29,001,858	\$47,610,034

#### 5. Selection of 345 kV as the regional boundary voltage

74. AEP/AP contends that facilities rated at 345 kV and above serve as the backbone of the electricity markets that have developed in the region, and which benefit customers and other market participants. Facilities below this level provide more of a local delivery function, according to AEP/AP. Here, AEP/AP suggests that the record contains convincing analyses supporting selection of 345 kV and above as the appropriate boundary between regional and local transmission facilities.<sup>17</sup> AEP witness Mr. Pasternack offered testimony that the 345 kV and above system developed by AEP not

<sup>16</sup> Exhs. AEP- 206 at 5-7; AEP- 207; Tr. at 137-138; AEP/AP I.B. at 36.

<sup>17</sup> Exhs. AEP-300 at 4-25; AEP-403 at 19-20; AEP-100 at 2-3, 19-32; AP-900 at 3-4, 9-12, 15; AP-800 at 3, 6-10.

only serves as the backbone for the AEP system, but also provides regional benefits, enabling long distance transmission of electricity in PJM markets. His basis for choosing the 345 kV demarcation point is set forth in Exh. 309, at 3-4. The location, span and strongly interconnected nature of PJM's regional facilities above 345 kV demonstrate their highly integrated and regional nature, according to Mr. Pasternack. Exh. AEP- 310; AEP- 309 at 4; Tr. at 132. He maintains that actual loading conditions confirm that these facilities serve a "highway" function, as compared with those of lower voltage. AEP/AP argues that AEP has provided a highway system to move less expensive energy to PJM load centers in the east. This system, it is contended, has the ability to transfer large amounts of power over long distances, to the benefit of the entire region. Exh. AEP-300 at 18. Confirming these benefits, AEP/AP maintain, is a study by CERA in late 2003, which showed AEP's integration into PJM would result in increased energy trading and significant savings to consumers in Eastern markets. Exh. AEP-400 at 5-6; AEP- 402.

75. AP witness Mr. Mattiuz testified as well that AP's 345 kV and above system is similarly part of the highway, providing large regional benefits. Exh. AP-900 at 3. The AP system runs over 700 miles of circuits, most over 500 kV. These facilities, the witness argued, are a part of a highly developed integrated system that plays a pivotal role in the efficient operation of the PJM markets. *Id.* at 4.

76. Further, analyses of power carrying capability (reactance), loadability, Total Participation Factors, and First Contingency Total Transfer Capability demonstrate that the network of these facilities serves regional needs, AEP/AP contends. The testimony shows that line reactance at 230 kV is sixteen times that of the 765 kV lines, and nearly 3 times that of the next typical voltage, 345 kV. Exh. AEP-300 at 11. Lower voltage lines have lower power carrying capability. Likewise, 345 kV lines have nearly 3 times the loadability of 230 kV lines, according to AEP/AP, further demonstrating the demarcation level proposed between highway and local lines. *Id.*

77. AEP/AP additionally notes that engineers have distinguished EHV lines from lower voltage systems based upon intrinsic differences and functionality, usually using 345 kV and above as the point of demarcation for EHV facilities. Exh. AP-900 at 19; AEP-309 at 3; AP-902 at 7.

## **6. Reliability RTE**

78. Similar principles apply to Reliability RTE constructed under the RTEP process, according to AEP/AP. Any new EHV facility constructed for reliability reasons will operate as part of the backbone network that provides the conduit for least cost dispatch throughout the region, AEP/AP argues. It would be inappropriate, according to AEP/AP to focus on a defined outage analysis limited to a single point in time to define the character of the new facility.

## **7. ARR/FTR allocation**

79. AEP witness Mr. Henderson testified that the existing arrangements for allocation of FTRs/ARRs within PJM is required in order to preserve the value of access to generating resources historically relied upon by load serving entities. It is important to protect an allocation based upon historical usage of generation assets, AEP/AP contends, because load serving entities have subordinated their established transmission rights to PJM for the goal of optimal economic dispatch.

## **8. Other proposals**

80. AEP/AP argues that inclusion of facilities down to 200 kV, such as advocated by TOP's highway/byway proposal, has not been justified, and would not be proper. It contends that the analyses submitted in support of the lower threshold are inferior to those offered in support of its own line of demarcation, suggesting that accounting simplicity is not a strong enough basis to support the 200 kV level. Seeing little else in the record to support the TOP level, AEP/AP argues that there is insufficient support in the record for drawing the line in a highway/byway rate design at 200 kV. It is based upon generalizations not supported by an actual functional analysis, AEP/AP contends. AEP/AP continues to maintain that voltages down as low as 200 kV or 230 kV provide a local delivery function.

81. As for PPP's proposed three-tier rate design, AEP/AP maintains that it is not supported sufficiently by the record and that it would result in an inequitable allocation of transmission costs. The introduction of a middle tier of transmission facilities presents an arbitrary line of demarcation, AEP/AP suggests, that has no bearing on how the facilities are used and the benefits they convey. It sees the PPP proposal as a poor compromise lacking any substantive basis or engineering justification. In addition, AEP/AP argues that the PPP plan for allocating the costs of the middle tier facilities overallocates costs to the local part of the rate. AEP/AP further sees no precedent that supports adoption of an arbitrary vintage allocation of high voltage lines, and believes that the three tier proposal unnecessarily complicates the rate design, making it difficult to administer.

82. According to AEP/AP, Staff's proposal presents a "second-best" solution, but the postage stamp proposal of Staff sweeps too broadly and would fail to account sufficiently for the regional nature of the PJM transmission system. AEP/AP contends that Staff has correctly viewed the current rate design as unjust and unreasonable, however, it disagrees with Staff that existing plant cannot rationally be separated by predominant use characteristics. The fact is, AEP/AP argues, that differently rated voltage facilities are used predominantly for different purposes on the PJM system. This, it concludes, compels adoption of a rate design that reflects that fact.

## **D. Participants for Purposeful Pricing**

83. PPP argues that the current license plate rate design does not adhere to the fundamental principles of fixed cost allocation. PPP explains that through the expanded PJM, users use and pay for the same transmission product from the same transmission provider, but pay very different rates for that service. A user pays high rates for PJM's network if that user is within corporate ownership boundaries, which include large amounts of transmission cost per unit of load. A user pays lower rates for the same service, if that user is located in a zone where the in-area investment is less and there is a lower operating expense per unit of load. PPP explains that cost allocation must be forward looking with ongoing utility plant costs recovered from current users. PPP argues that all participants agree that transmission facilities, both existing and new in the PJM area, are used, in a substantial part, to enable region-wide energy and capacity markets. Exh. PPP-10 at 4-6.<sup>18</sup> Since all parties recognize that the use has changed, PPP believes that continuation of the existing cost allocation method is unreasonable.

84. PPP also contends that the current rates do not promote economically efficient development of the PJM transmission system, because when planning, siting, and financing new regional facilities, there is great uncertainty regarding whether costs will be regionalized and to whom they will be charged. *See New England Power Pool.*, 109 FERC ¶ 61,252, at 61,201 (2004); PPP-1 at 20-21; PPP-10 at 16-18. Due to this, PPP argues, regionally beneficent grid development is being delayed.

### **1. License-plate rates are unjust and unreasonable**

85. PPP argues that there is clear precedent supporting a change away from the license plate rate design. First, in *Louisiana Public Service Commission v. FERC*, 184 F.3d 892 at 896, the court held that the Commission adopted a cost causation principle that was inherently forward looking and rejected an argument that future capacity planning is not to be considered in cost allocation. The court decided that it was important to determine whether there is a need to plan for future capacity based on the need for it required by the type of transmission service at issue. PPP emphasizes that both old and new uses of a constrained facility cause a need for expansion. Exh. PPP-11 at 11. PPP indicates that in PJM, inter-zonal needs are contributing to the need for expansion of transmission capacity as acknowledged by the current PJM RTEP.<sup>19</sup>

86. PPP argues that system planning due to joint use calls for sharing of fixed costs.

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<sup>18</sup> *See also*, Exhs. AEP-100 at 32, AEP-201, AEP 403 at 8-9 & Tr. at 52; Exh. TOP-1 at 9 & Tr. at 244; Exh. RPA-20 at 9-11 & Tr. at 451; Exh. PPP-10 at 6; Exh. JCA-1 at 9, 11, Tr. at 683-684; S-2 at 10 & Tr. at 737-738.

<sup>19</sup> PJM Regional Transmission Expansion Plant (Feb. 22, 2006) available at <http://www.pjm.com/planning/reg-trans-exp-plan.html>

*See Richmond Power & Light v. FERC*, 574 F.2d 610, at 612-22 (D.C. Cir. 1978). Setting aside system planning, since PJM is operating its grid as an integrated system, a move beyond disparate zonal rates is needed. *Fort Pierce Authority v. FERC*, 730 F.2d 778, at 785 (D.C. Cir. 1984), *decided after remand, Florida Power & Light Co.*, 31 FERC ¶ 61,007 (1985). PPP asserts that PJM operations are integrated, and the current license plate rate design is unreasonable because it ignores this integration. Exh. PPP-1 at 16-18; Exh. TOP-1 at 9. PPP argues that normally, the Commission requires a single transmission provider providing an integrated service, to unify its rates, even where the transmission provider's area encompasses multiple legal entities' transmission ownership zones. *Southern Company Services*, 55 FERC ¶ 61,173 at 61,556 & n. 7, *order on reh'g*, 57 FERC ¶ 61,093 (1991) *aff'd sub nom., Alabama Power Co. v. FERC*, 993 F.2d 1557 (D.C. Cir. 1993).

87. PPP argues that it is well established that market structure costs should be regionalized<sup>20</sup> and the costs for existing transmission facilities that are used regionally should not be exclusively borne by in-zone loads. Further, PPP points out that several RPA witnesses, Ms. Crawford (Tr. at 663), Mr. Spencer (Tr. at 428), Mr. Naumann (Tr. at 574-575), and Mr. Brown (Tr. at 501-502) testified that it is a well settled principle that cost allocation should follow forward looking use, instead of being allocated to what was forecast during the planning period. These RPA witnesses however, PPP asserts, in order to justify their position, must then redefine what it means to use the system. The RPA witnesses contend that the grid is not being used to import power from remote zones, but PPP maintains that a very substantial MWh did, does, and will cross PJM inter-zonal boundaries. PPP indicates that power brought in from other zones is arriving and will continue to arrive in RPA member zones and will flow to their loads. PPP indicates that that record clearly demonstrates that these intra-zonal deliveries have been large and are even larger under the integrated PJM market. Exh. AP-902 at 4-6. PPP also contends that the record shows that these occur consistently, even if their volume varies over time. Exhs. AEP-211 & AEP-403 at 21.

88. PPP asserts that all load benefits from the existence and ongoing maintenance of the grid as evidenced by the August 14, 2003 blackout that was triggered by three 345kV lines that tripped due to contact with trees.<sup>21</sup> PPP contends that the existence of the high voltage system in PJM and AEP regions are what was found to have prevented the spread of the cascading blackout. Exh. PPP-12 at 2. PPP argues that these are real benefits of

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<sup>20</sup> *See e.g. Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004)

<sup>21</sup> *See, e.g., U.S.-Canada Power System Outage Task Force, Final Report on the August 14, 2003 Blackout in the United States and Canada: Causes and Recommendations 57-64* (2004) [Blackout Report], available at <https://reports.energy.gov/BlackoutFinal-Web.pdf>

the grid that should be paid by all users, despite RPA witness' Dr. Shanker's assertions to the contrary. Tr. at 385.

89. PPP also indicates that RPA attempts to redefine use, by arguing that the delivery price for MWh of imported energy isn't hedged by congestion revenue rights and so the MWh recipients do not enjoy congestion-free use of remote zones' facilities. Tr. at 386-387. PPP counters that this attempted redefinition is flawed for several reasons. First, the definition ignores the fact that this case concerns the geographic pricing structure for the transmission access charge, which pays for the right to import capacity and/or energy from any source in the PJM region. PPP indicates that if the congestion is persistent and uneconomic, it will be relieved by transmission construction which is what PJM is now planning towards achieving. Additionally, when compared to markets for which base network services charges provide the access ticket, these costs are 10 times smaller.<sup>22</sup>

90. Further, PPP contends that Dr. Shanker is wrong in his belief that congestion revenue rights are awarded only for historic, in-zone network resources, because PJM now provides equal FTR allocation priority to customers taking long-term-firm point-to-point service. *PJM Interconnection, L.L.C.*, 110 FERC ¶ 61,254, at 62,036-037 (2005), *order clarified*, 111 FERC ¶ 61,187 (2005). Additionally, new firm resources, wherever located, have available to them a second round of ARR/FTR awards. *Id.* at 62,036. Congestion revenue rights are also supposed to be allocated for both old and new long-term firm use<sup>23</sup> and ARR/FTRs relate only to the delivery of scheduled energy. RPA's assertion that it does not use other zones' transmission facilities is incorrect and loads in every PJM zone should share the costs of the regional highway's costs.

91. PPP also asserts that RPA's argument that license plate rates have been widely used at the outset of ISO and RTO operations, does not make their permanent use reasonable. PPP argues that these rates were only transitionally approved, and there was an expectation that they would be redesigned to reflect regionalized operations. Further contrary to RPA's assertions, license plate rates are not being used in the other regions as: (i) New England regionalizes its costs of existing and new Pool Transmission Facilities which are generally facilities rated above 69 kV, *Boston Edison Co.*, 104 FERC ¶ 63,031, at 65,078 (2003), *aff'd* 107 FERC ¶ 61,248 at 62,056-057 (2004), *aff'd sub nom. Boston Edison Co. v. FERC*, 441 F.3d 10 (1<sup>st</sup> Cir. 2006); (ii) the California ISO is more than halfway through a transition away from license plate rates to postage stamp rates,

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<sup>22</sup> PJM Annual Report at 7, *available at* <http://www.pjm.com/about/downloads/2005-ar-final-singlepg.pdf>

<sup>23</sup> *Long-Term Firm Transmission Rights in Organized Electricity Markets, Long-Term Transmission Rights in Markets Operated by Regional Transmission Organizations and Independent System Operators*, "Notice of Proposed Rulemaking," 114 FERC ¶ 61,097 at 61,331 (2006).

*California Independent System Operator Corp.*, 91 FERC ¶ 61,205 at 61,275 (2000); and (iii) MISO is also slated to move to regionalized rates in February 2008. RPA's assertion that a license plate rate design has been used in PJM since 1927 is also erroneous, as the region-wide transmission service did not begin until the late 1990's, and even then for some continuing transactions, the rate design within Classic PJM was pancaked. *PJM Interconnection LLC*, 81 FERC ¶ 61,257 at 62,281 (1997); *Potomac Electric Power Co., et al.*, 93 FERC ¶ 61,111 at 61, 313-314 (2000).

92. PPP contends that RPA's assertion that most TOs support the continuation of license plate rates is also not a justification for keeping the rates as those are likely the TOs whose loads are not being allocated the costs of facilities that they use but are owned by others. While TOs are constructively presumed to pay for other facilities through reciprocal access of their own facilities, in reality this results in many zones bearing a share much smaller than what their costs should be. Additionally, RPA's argument that license plate rates allocate costs to those who have created the need for the facilities is in error for several reasons: (1) inter-zone open access usage has been a historical cause of facilities construction since 1997; (2) the real issue is whose continued or new use is contributing to the need to retain and expand the PJM grid; (3) AEP's 756 kV lines are designed to service regional needs; and (4) the Commission has rejected the idea that TDU's may avoid paying TO's embedded transmission costs because TOs planned their systems for their own needs, and so will also likely reject the arguments that the RPA TOs should bear embedded costs only for those facilities that they helped plan or were optimally designed to serve their needs. *Richmond Power & Light v. FERC*, 574 F.2d 610.

93. PPP explains that broadly regionalizing costs promotes construction and the record indicates that siting motivates opposition, if it is likely that transmission construction costs will not be spread to the loads attached or other TOs. Exh. PPP-1 at 11-15. Financial markets will also more readily support transmission investment if the costs are spread through a geographically large service territory. *Id.* at 13-15. The Commission has also acknowledged that broad cost spreading facilitates the construction of facilities that are regionally needed. *New England Power Pool*, 109 FERC ¶ 61,252 at 62,201.

94. PPP counters RPA's contentions that Schedule 12 already provides the appropriate approach to regionalizing new facility costs, and that it no longer matters how existing facilities costs are treated. PPP explains that for new facilities, both when and whether the costs are regionalized are equally important. Since Schedule 12 does not adopt a presumption of regionalization of the costs of high-voltage facilities receiving RTEP regional approval, it unnecessarily discourages needed new construction. Tr. at 335-336. Further, existing facilities have ongoing costs, and regionalizing their costs can also assist the obtaining of approval to site and build additional transmission facilities. PPP argues that RPA's attempt, through the introduction of an April 2006 PJM press release (Exh. RPA-73), to show that the current license plate rates promote necessary grid

development, instead indicates that PJM grid investment is not keeping up with load growth and depreciation. PPP calculates that PJM would have to add \$600 million per year in annual transmission system additions in order to keep pace with load growth and depreciation.

95. PPP further argues that RPA's claims that advocates of non-license plate rates have failed to trace benefits from particular zones' costs to other zones' beneficiaries while indicating its impossibility is incorrect. PPP maintains that finer grained tracing of the benefits of particular high voltage facilities to particular beneficiaries is unnecessary, as Commission policy assumes that widespread benefits are equally widespread. *Northeast Texas Electric Cooperative, Inc.*, 111 FERC ¶ 61,189, at 61,109 n. 10 (2005) (citations omitted). RPA's claim that license plate rates come closer than other rate designs to matching the distribution of benefits from use of AEP's facilities is misleading, as it is based on usage before AEP joined PJM and RPA omits usage of AEP's facilities for deliveries to loads outside of PJM. RPA's claim that no PJM zone is benefiting from any other zone due to reciprocal access is also incorrect because PJM's congestion hedging rights are currently being applied in a context where all PJM network loads are effectively providing cost support on some level for all PJM transmission. Further, adoption of a highway byway rate design does not need to change PJM's rules for allocation of congestion revenue rights.

## 2. PPP's Rate Design Proposal

96. PPP witness Mr. Solomon explains that broadly regionalizing costs promotes construction because it removes collective-action inhibitions to transmission investment and can reduce capital costs. PPP-1 at 12-13. Mr. Solomon recommends using a three tiered approach which would place the dividing line as to which high-voltage facilities would be regionalized at 200 kV, 345 kV, or 500 kV. *Id.* at 21. Costs of facilities that are rated 500 kV and up would be allocated entirely to an interstate highway tier that would qualify for regionalization. *Id.* at 22. These facilities have broad regional benefits, so it is consistent with regional traditions and operations to regionalize their costs. *Id.*

97. Facilities that are rated below 200 kV would have their costs localized. This low voltage tier avoids a source of controversy regarding the PJM TOs that have undertaken a seven factor functionalization and those that have not. *Id.* Mr. Solomon explains that allowing low voltage tier loads to be localized, allays other zones' fears that they are bearing the costs of remote TOs for which the comparable local costs are being borne locally through wholesale or retail distribution rates. *Id.* The middle voltage tier, which is between 200 kV and 500 kV would be split between regionalized and localized. *Id.* The splitting would be determined based on the percentage of the owning TO's in-service transmission investment in transmission lines of that voltage booked in 1997 or later. *Id.*

98. Mr. Solomon explains that PPP's proposal would not require a rate case for each

zone, but instead the rate structure would take the stated or formulaic revenue requirement in Attachment H of the PJM OATT for each zone. *Id.* at 22-23. Since the outputs would formulaically update and those Commission accepted inputs change, this would yield a regionalized percentage and a localized percentage for each zone. *Id.* at 23. The two percentages would be applied to the Commission accepted revenue requirement and divided into an accepted revenue requirement that is recovered on a postage stamp basis and one that is recovered on a license plate basis. *Id.*

99. Mr. Solomon explains that the percentages would change over time, and the regionalized percentage should grow gradually, and eventually approach the level at which both the high and middle tier would be entirely allocated to the regionalized highway recovery mechanism. *Id.* The percentages would be updated when the PJM OATT Attachment H revenue requirements change, allowing each regionalization package to update together with the filed revenue requirement that the percentage splits. *Id.* In connection with each subsequent update, and upon compliance, the 1997 gross investment used to split the middle tier is to be updated in order to remove the gross investment in facilities of the vintages that were associated with facilities that have been completely depreciated, retired from service, or otherwise taken off the books. *Id.* at 23-24. This would eventually fully regionalize the middle tier. *Id.* at 24.

100. In order to implement PPP's three tiered recommendation, Mr. Solomon recommends a specific process. *Id.* at 28. First, each TO would submit or join in a compliance filing, starting from whatever Attachment H revenue requirement was in effect at the time of the filing, or for TOs with formulaic rates, the formula result as being billed at the time of the filing. *Id.* This filing would:

identify and subtract out the portion of that revenue requirement covered by loads other than PJM OATT network service loads; (ii) separate the residual, Network Integrated Transmission Service (NITS) revenue requirement into the three voltage tiers; (iii) identify the percentage of middle-tier gross investment booked after its OATT start year; and (iv) calculate its current "regionalized" and "localized" revenue requirements. *Id.*

101. Second, the NITS rate would be calculated as the existing unit rate minus the share proportionate to its regionalized revenue requirement, plus a second unit rate designed to collect that zone's share of the aggregate regionalized revenue requirement for the PJM TO's that have stated unit rates. *Id.* For the TOs with formula rates, the NITS rates would be calculated by removing the costs being regionalized from the formula inputs. *Id.* at 29. Mr. Solomon explains that the approach will not require changes to the language of Schedule 12. *Id.* at 30. Finally, Mr. Solomon indicates that PPP does not support the double recovery of revenues from transmission services other than network service to loads within PJM. *Id.* at 31.

102. PPP explains that these three tiers are well supported by both testimony and history. The high tier costs have been regionalized from the outset across the PJM region as it extended. Exh. PPP-1 at 21-22. AP witness Mattuiz testified that this system is used primarily for regional transfers, not to serve native load. Exh. AP-902 at 4-6. Further, PPP points out that no witness identified any 500 kV or above facility in PJM that only serves local functions. PPP indicates that the middle tier is supported by TOP witnesses' technically grounded case which indicated that these mid voltage facilities, down to the 200 kV breakpoint provide region wide benefits. Exhs. TOP-1 at 12, TOP-10 at 6. As for AEP witness Pasternack claims that 230 kV facilities should be distinguished from 345 kV or above facilities, PPP contends that Mr. Pasternack's arguments are unpersuasive as both are two points on a continuum along which higher rates indicate that there is more regional value, with both voltages having some regional value.

103. The low tier is supported by all parties, except for Staff, who contends that facilities less than 200 kV should be regionalized. PPP argues that Staff's main argument against the low tier is that it would localize some regional facilities, but under Staff's proposal, facilities providing predominately local benefits would be regionalized. PPP argues that the record shows that a 200 kV breakpoint advances the matching of benefits to burdens and resolves the non-comparability problem between zones that have and have not undergone a seven factor test functionalization to distinguish transmission from distribution.

104. PPP explains that RPA's contention that PPP's rate design is too original to be adopted due to its reference to facility vintage is erroneous, as prior Commission-approved RTO rate designs have looked to facilities' vintage to determine the extent of cost spreading. *See e.g., California Independent System Operator Corp.*, 91 FERC ¶ 61,205 at 61,725 (2000). PPP's proposal also uses a 1997 breakpoint as the specific vintage dividing line, which is suggested by the logic of RPA's own position that pre-1996 investment should be regionalized because it predated open access. Further criticisms that PPP's rate design calculations are too complex are unfounded, as the calculations required to implement the PPP allocation method are quite simple in relation to the costs at issue and simpler than the calculations used by PJM. PPP also maintains that its presumptions are not bright lines, and allow for flexibility. PPP contends that RPA's position is unnecessarily complicated.

105. Staff's assertion that PPP's proposal, or any voltage based proposal for that matter, may produce too strong an incentive which could encourage gaming is faulty because the PJM planning process contains safeguards that would prevent this. PPP argues that no institutional structure is perfect, but there is no evidence that PJM's safeguards would be evaded to the extent that could warrant the regionalization of lower voltage transmission facilities just to avoid having to make a distinction. Further, the Commission has stated that the RTO should carefully monitor the project to prevent gaming. *Midwest Independent System Operator, Inc.*, 114 FERC ¶ 61,106 at 61,355-356 (2004). Further,

according to PPP this is a second order concern and the benefits of PPP's proposal outweigh it.

106. PPP also refutes AEP/AP's contention that the 2.3 percent regionalization of mid voltage costs shown illustratively in Exh. PPP-4 indicate that PPP's approach is wrong. PPP argues that that was an illustrative percentage as of 2003, which would be larger now and would continue to grow. Exh. PPP-1 at 27. Further, what matters is the degree of regionalization of all costs aggregated across voltage tiers, not what share of mid voltage costs are regionalized, says PPP.

107. RPA's contentions regarding Mr. Solomon not having an engineering background and not having performed engineering studies are also unfounded, according to PPP. Both AEP/AP witnesses and TOP witnesses performed the studies and those studies supported divergent voltage-based criteria. Mr. Solomon simply identified a compromise approach, and further these studies only have limited value in reaching a cost-allocation judgment. Also, RPA has admitted that every PJM facility now serves both a region-wide and a local purpose, so the task is to find an allocation that reasonably reflects that blend of uses. PPP witness Mr. Solomon indicated that high-voltage lines cost more per mile, but can carry energy longer distances, while low voltage lines expand network coverage to reach more generation sites and distribution nodes and offer more redundancy; therefore, although low voltage has some regional value and high voltage has some local value, splitting the costs between regionalization and localization by voltage facilitates cost allocation. Exh. PPP-10 at 23-24.

108. PPP indicates that the issue is how to fairly allocate the costs of facilities that jointly serve multiple localities and have both regional and local value, which are issues that require a judgment call.<sup>24</sup> RPA's reliance on *TRANSLink Development Co.*, 101 FERC ¶ 61,316 (2000), for the proposition that parties can only support a voltage rate design through engineering studies is unfounded, as in a subsequent order on clarification, the Commission indicated it would accept a voltage delineation based on generalized judgment regarding how an area's transmission functions, without first receiving and considering engineering studies. *TRANSLink Development Co.*, 103 FERC ¶ 61,208, at 61,786-787 (2003)

109. RPA's questioning of whether the allocation of sunk costs can affect the incentives to incur new costs is similarly unfounded, PPP argues, as Mr. Solomon has indicated ways through which it can do so, and Dr. Henderson has also testified to like effect. Exh. PPP-10 at 17-18, Tr. 62-63. RPA's argument that PPP's proposed rate treatments would

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<sup>24</sup> See *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, at 590 (1945); *Consumers Energy Co.*, 86 FERC ¶ 63,004 at 65,018 corrected by 86 FERC ¶ 63,005 (1999), *aff'd in part, rev'd in part on other grounds*, 98 FERC ¶ 61,333 (2002).

be presumptions which would be open to different treatment of individual facilities on a case by case basis is countered by the fact that PJM's current rate design operates in the same way. Currently PJM generally presumes that all transmission investment will be rolled in across each corporate ownership pricing zone, even though individual facilities can receive other treatment if justifiable on a case by case basis. PPP indicates that PJM operates thousands of individually identified system elements. Tr. at 723. PPP points out that its proposal would not lead to re-shuffling of congestion revenue rights, as loads are effectively paying for the entire regional grid. Mr. Solomon has confirmed this and the Commission has found that even under pure license plate pricing with no through and out charge, Load Serving Entities (LSEs) should receive congestion revenue rights since they pay the network service rate for their zone and provide a form of support, through reciprocity, for the entire regional transmission system. *Midwest Independent Transmission System Operator*, 109 FERC ¶ 61,168, *order clarified*, 109 FERC ¶ 61,243 (2004).

### **3. Other Parties' proposals are not the best available replacement for the current rate design.**

110. PPP contends that, while AEP/AP's proposal is not unreasonable and would be an improvement over the current rate design, PPP's rate design has significant advantages because:

(1) it naturally transitions over time from a small initial degree of regionalization to a larger eventual degree of regionalization, which helps to meet concerns about rate stability and retail rate implementation; (2) it leverages regionalization as a construction enhancing incentive, and does not charge ratepayers in the aggregate any more than actual cost; (3) it recognizes that facilities booked during the open access era are more likely to be well-configured to provide regional value for their cost than earlier facilities; (4) it satisfies the objection of the eastern PJM TOs that they use 230kV facilities to serve functions comparable to those for which AEP used 345 kV facilities. PPP I.B. at 29-30.

111. The issues raised in regard to AEP/AP's proposal apply to TOP's proposal, and additionally, PPP believes that its proposal is superior because:

(1) it echoes the 500 kV cut-off in the PJM West Transmission Owners Agreement; (2) it would encounter less disapproval from stakeholders favoring license plate rates than TOP's approach because of its high starting regionalization level; (3) it begins sooner than TOP's proposal, which would not take effect until February of 2008. PPP I.B. at 30-31.

112. PPP considers Staff's proposal inferior to PPP's, because unlike PPP's proposal which creates an incentive to undertake the regionally-reviewable upgrades needed by

PJM, Staff only proposes to structure the transition to postage stamp rates in a way that it is merely a function of time and comparative rates. Also, Staff's proposal is not the best available replacement, because its details are uneven and imprecise, PPP contends. First, PPP notes that Staff's proposal seeks pooling across PJM revenue requirements that are not comparable, since various zones have taken different approaches to drawing the functional boundary between distribution and transmission. Exh. PPP-10 at 25. PPP explains that in some zones facilities rated as low as 13.2kV are classified as transmission facilities, and in other zones those facilities have been reclassified from transmission to distribution. Exhs. PPP-19 & PPP-22. PPP argues that Commission precedent requires classification of transmission facilities using the seven factor test<sup>25</sup>, which would not be completed until late 2008, after the February 2008 date for effectiveness of a new MISO-PJM cross-regional rate design. In contrast, PPP's approach would leave the low-voltage tier to presumptive license plate treatment, so that these issues of inconsistent rate base composition and distribution functionalization are avoided.

113. Staff's phase-in also is ambiguous, as it does not address what the impact limitation would exactly be or how countervailing adjustments to other zones rates would be needed to ensure proper balance between PJM revenues and revenue distribution. Further, Staff's proposal does not clearly address whether the adjustments would be based on uplift across all other zones, or paring high-increase zones with high-decrease zones, or which year's rate would be the phase-in baseline. PPP contends that these ambiguities create complications and Staff's proposal should therefore be rejected.

114. Finally, PPP indicates that the ICC's attempt to revive the concept of allocating regional grid costs to zones with higher generation costs should be rejected. PPP indicates that this has been rejected by the commission in its November 18, 2004 Order. *Midwest Independent Transmission System Operator, Inc.* 109 FERC ¶ 61,168, at 61,821-822. PPP argues that this approach would only burden import transactions with a hurdle rate too similar to the through-and-out rates that the Commission eliminated in Docket No. EL02-111. PPP contends that Illinois load does benefit from the regional grid as shown by the evidence. RPA-34.

#### **4. PPP's proposal moots the question of termination of payment obligations under the EHV agreements.**

115. PPP argues that under its proposal all PJM load will pay their costs regardless of which PJM TO's revenue requirement they are included in, as 500 kV facilities' costs will be regionalized. PPP explains that the EHV agreements will divide the 500kV facilities among multiple TO's revenue requirements which will pool the facilities region

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<sup>25</sup> *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,219, at 61, 776 (2004), *reh'g granted in part*, 112 FERC ¶ 61,351 (2005).

wide for revenue recovery. If the EHV agreements are not used, the facilities would be placed in one TO's revenue requirements and then pooled with other 500kV facilities in the region for revenue recovery, which would have the same effect as the distribution of ongoing costs of the facilities to everyone in PJM. Since both approaches would yield the same results PPP does not take a position on which approach is preferable but makes three observations on what this issue reveals about other issues in this case:

(1) PPP's rate design use of the 500kV threshold is supported by the fact that the 500 kV threshold has played a major role in cost allocation within PJM; (2) Staff's proposal would have to resolve this issue in connection with its 10 percent phase-in feature, but PPP's rate design makes this issue moot; (3) this is a regulatory decision regarding what rate design should be applied, not a contractual regulatory compact that cannot be changed, so no contract prevents regulators from approving a highway-byway rate design. PPP I.B. at 40.

**5. The effective date of the revised rate design should be April 1, 2006.**

116. PPP asserts that the revised rate design should take effect on April 1, 2006 because although the refund effective date established in the proceeding was August 13, 2005, SECA charges were in effect, providing an alternative mechanism for allocating costs across intra-PJM corporate boundaries, until April 1, 2006. Further, deferral of the effective date is undesirable because if license plate rates without significant revenue crediting from through-and-out service or replacement revenue streams like SECA are unjust and unreasonable, then there is no reason to wait until 2008 to remedy that unreasonableness.

117. PPP indicates that RPA asserts that MISO's rate design is locked down until February 2008 and so PJM's rate design should not change before then due to the MISO-PJM cross border rate design for existing facilities. This argument is also advanced by TOP and AP. Exh. TOP-3 at 22; Tr. at 168-169, 230, 239. However, without relief through this proceeding, the wholesale level rate design applicable to almost one fifth of PJM's load will increase by about 63 percent. Exh. PPP-16. Staff witness' Siemens has testified that a 10 percent per year change in transmission charges constitutes a rate shock and this change would be six times that. S-2 at 19-20. PPP explains that when PJM became an ISO and then an RTO the expectation was that regional rates would transition to uniform postage stamp rates. Also, future changes to intra-MISO and MISO-PJM rate design support the April 1, 2006 effective date because it would allow the rate design to be in effect for some time. This will give the Commission an opportunity to review completed compliance filings and observe the new rate design.

118. The RPA's suggestion that the five to ten year transition period should restart each time a new TO owner joins PJM is not workable, according to PPP. PPP argues that regardless of whether the transition calendar resets for all PJM TOs every time a new TO

enters, or that each TO gets its own date for transitioning from license plate rates, the former approach would cause unpredictability while the latter would create a period of sharply increased zonal rates. Further the ICC's call for deference to state commissions is unpersuasive as state commissions have had ample time to organize themselves and begin active ordered collective consideration, but have failed to do so.

119. Finally, PJM's geographic allocation of fixed costs can be reformed without changing or freezing the rules for hedging variable congestion costs. The congestion rights and revenues of other PJM network service customers do not need to be linked to changes in the rate design for geographically allocating PJM's fixed costs. PJM's transmission services do integrate resources across the zones and TOs, and allocation should follow suit.

### **E. Transmission Owner Proponents**

120. TOP<sup>26</sup> argues that the Commission is not bound first to determine anew that the existing PJM license plate rate design is unjust and unreasonable under traditional Section 206 criteria. TOP suggests that the Commission has already decided that the current rates are temporary, to be applied only in a transition period, to be followed by a uniform system-wide rate that would apply throughout PJM. *Allegheny Power System Operating Cos., et al.*, 115 FERC ¶ 61,156 (2006). There is no bar, TOP argues, to the Commission following through here with its stated objective to revisit PJM rate design anew, and to find that a modification developed in this record is just and reasonable.

121. TOP suggests that the policy that ought to guide the Commission in its exercise here is one that links the incurrence of costs with the beneficiaries of the incurrence of those costs. It decries any system that would allow beneficiaries to escape cost responsibility through a fortuity of timing. Thus, the fact that an integrated network operated by an independent operator under open access was not contemplated when transmission was built, and costs were originally "caused" by a different need (to serve native load customers), should not preclude the proper assignment of responsibility now that these facilities, which require ongoing maintenance and upgrading, are providing regional service. TOP states: "While regional service may not have been the first cause, it is the current cause for continuing to operate existing facilities." TOP I.B. at 15; *See also* Tr.at 647; 663.

122. TOP argues that regional service within PJM is now the rule and requires a rate design that reflects this fact. All transmission facilities, new and existing, are involved in the provision of regional service, according to TOP. Indeed, TOP claims that it is largely the embedded PJM transmission infrastructure that gives PJM the independence, scope and markets that make the system a thriving example of the regional open access market

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<sup>26</sup> Baltimore Gas and Electric Company and Old Dominion Electric Cooperative

system that Commission policy has fostered. However, the rate design does not comport with the regional nature of the system or the Commission's policy objectives, according to TOP. TOP further suggests that rates, such as reflected in the existing PJM zonal rate design, that "ignore entirely services being performed by rate base facilities to one set of customers by being applied solely to another set of customers is patently unjust, unreasonable, unduly discriminatory and preferential, and otherwise unlawful under Sections 205 and 206 of the Federal Power Act." TOP I.B. at 58.

123. TOP witness Mr. Bourquin testified that current zonal rates for existing facilities no longer have validity with regard to PJM tariff offerings, because the PJM footprint has expanded and the prior through-and-out rate between PJM and MISO no longer exists. Exh. TOP-1 at 8-9. Combined region services, TOP contends, are being treated for ratemaking purposes as if they did not exist. TOP suggests that the Commission has created "an 'attractive nuisance' by making the PJM system work so well that everyone wants to use it; but the Commission is not making everyone pay, only the poor native load that used to have the system all to itself." TOP I.B. at 60.

124. TOP argues that the function, uses, obligations, purposes and benefits of existing network high-voltage transmission facilities are not aligned with the rate design employed to charge for their revenue requirements. While license plate rates assume a logical nexus between proximity to high voltage transmission facilities and benefits derived from their use, the fact is that entities making use of these facilities are widely dispersed and may be physically remote from the transmission facilities they use to acquire power, TOP contends. Exh. TOP-1 at 10. TOP agrees that there may be instances where high voltage lines serve local needs and low voltage lines serve a regional need, however, it sees no reason to ignore the dual role of these facilities and to assume that all facilities primarily serve local needs, as the license plate rate design does. TOP argues that costs of the bulk power network should be assigned to those customers who receive service from these lines regardless of whether they are located inside or outside of a particular rate zone. *Id.*

125. TOP goes on to argue that the Section 12 regional allocation of new facilities is not an adequate fix for the rate design problem, in that it ignores the mis-allocation of existing investment, which constitutes the vast majority of transmission rate base costs. Moreover, TOP points out that the elimination of through-and-out rates upset the prior expectations that license plate rates would act in tandem with credits from off-system transactions, so that a departure from license plate rates cannot be now challenged as upsetting expectations. Expectations have been upset already, according to TOP, and the historic rate design is no longer recognizable. As TOP witness Mr. Scarpinato testified:

I am not advocating the elimination of something that has been in place and working well for a long time. I am pointing out that something that was in place and working well for a long time has been recently distorted, and will work

increasingly poorly as these license plate rates continue to accrue added revenue requirements previously collected through an entirely different mechanism. The existing rate design has not been renamed over time, but it has changed nonetheless and now bears little resemblance to what it was in terms of its prior adherence to the most basic principles of sound ratemaking. Exh. TOP-3 at 11.

126. TOP concludes that moving to a highway/byway design will cure this problem. It suggests that its proposed rate design will provide the Commission with what it wants: a rate design that will meet the objective of promoting competition and will reflect the proper assignment of cost responsibility to those benefiting from the integrated system. TOP observes that the benefits extend beyond facilitated energy transactions, to include increased reliability from the integrated grid, facilitation of competitive energy and capacity markets, facilitation of a reserve market and reserve sharing, and mitigation of congestion. Exh. TOP-3 at 11-12. TOP argues that these benefits are regional and should be reflected in regional rates. It maintains that the license plate rate increases the payment obligation of the transmission owner's native load customers by not properly reflecting the extent to which the high voltage network is used to render service to those customers. TOP concludes this argument thusly:

...for transmission owners to charge native load customers a full allocation of the cost of facilities that are also used to provide substantial non-native load customer regional services is tantamount to a willful overcharge for which restitution should be imposed upon a finding that 'money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it.' *Towns of Concord and Wellesley v. FERC*, 955 F.2d 67, 75 (D.C. Cir. 1992) (quoting *Atlantic Coast Line R.R. v. Florida*, 295 U.S. 301, 309 (1935)). TOP I.B. at 68.

127. TOP also contends that the license plate rate design now in effect is even more egregious when one considers that all current, ongoing and future TO initiated investment in the refurbishment, enhancement, maintenance, and operation of existing transmission facilities is not recovered in the mechanism adopted for new facilities investment, i.e., the so-called Section 12 process, but are instead included in the calculation of the 100 percent zonal license plate rate design. Thus, the license plate design for existing facilities would be perpetuated by the renewal and upkeep required for those facilities, so that the allocation problem will not simply go away as new facilities are added to the system under the Section 12 regional process. Exh. TOP-15 at 8; tr. at 372-373.

### **1. TOP's rate design proposal**

128. TOP offers a proposal that consists of dual regional/zonal rates for existing facilities. Under this rate design, a portion of the revenue requirements for each transmission owner's existing facilities will continue to be borne by native load because

of the continuing service obligation to such load. A portion of revenue requirements for each transmission owner's existing facilities would be apportioned to a regional rate because regional customers outside of the zone where the facilities are located are also being served, as noted in the above arguments. TOP would allocate facilities with a voltage level of over 200 kV to the regional, or highway, rate, because it believes that these are the facilities over which power is transmitted over large distances within PJM. TOP's engineering witnesses testified that 200 kV should be the cut-off point to recognize the disparity in uses at different voltage levels within PJM East and PJM West. It is their contention that PJM East predominantly relies on facilities with voltage levels at 500 kV and 230 kV, while PJM West relies on facilities with voltage levels of 765 kV and 345 kV to perform similar regional functions. Exh. TOP-17 at 7. TOP rejects the AEP recommended split at 345 kV, because, in its view, it would be discriminatory to put all facilities with equivalent functions in PJM West in the regional rate, but only some of them that reside in PJM East in the regional rate. It disagrees also with Staff's plan to implement regional rates for PJM over time, suggesting that the Staff plan would ignore the distinctly native load function predominantly provided by lower voltage facilities.

129. As for new facilities, TOP supports the Schedule 12 system of identifying and allocating costs to beneficiaries located in different zones of new transmission construction approved under the PJM RTEP. However, TOP believes that the costs of truly regional benefit projects should be spread uniformly over the region. It further suggests the need for a stakeholder process to allow stakeholders to define regional benefits that justify allocation of cost responsibility.

## **F. Commission Trial Staff**

130. Staff argues that PJM's current modified zonal license plate rate fails to adhere to the rate making principle of cost causation because it does not allocate costs to beneficiaries located outside of the zone where a transmission facility is situated. Staff contends that the Commission did not intend for the current license plate rate design to remain, but instead implemented the rate design only on a transitional basis. The Commission, Staff argues, encourages the use of a single postage stamp rate for RTOs, even recently discussing its original requirement that a uniform rate design should be implemented for PJM.

### **1. The existing license plate rate design is unjust and unreasonable**

131. The existing rate design consists of zonal rates for existing transmission facilities and provides a separate access charge for network transmission service for each rate zone. Exh. RPA-1 at 5. These are designed to cover transmission facilities' costs located within that zone. All load occurring within each rate zone is responsible for the revenue requirement of each transmission owner. Nearly all of the PJM TO's cost of service is recovered through network transmission charges to LSEs. These charges are based on

transmission zone LSE's coincident peak demands. LSEs can receive power from anywhere in PJM but pay only network transmission charges in the zone to which the power is delivered. *Id.*

132. Under Schedule 6, RTEP is conducted by PJM in order to determine the need for new transmission facilities, and also considers expansions and upgrades that may be needed for reliability or economic reasons. *Id.* at 23. PJM considers the applicable regional transmission reliability planning criteria when it evaluates the overall system. *Id.* If any criteria violations are identified in the RTEP process, PJM assigns the associated transmission upgrades to be built to one or more of the transmission owners. *Id.* at 24. Cost recovery for these upgrades occurs under Schedule 12. PJM can specify the allocation of costs, either locally or regionally, consistent with the underlying reliability or economic criteria that drove the justification for new transmission facilities. *Id.* at 25. Under Schedule 12, PJM can allocate the costs of new transmission facility construction to the beneficiaries of those facilities. *Id.*

133. Staff argues that the license plate rate design does not allocate any of the costs of existing transmission facilities to customers not in the zone in which those facilities are located. The problem is that those customers receive benefits from existing transmission facilities throughout PJM, but do not necessarily pay their fair share of the costs. Staff indicates that Commission precedent establishes that an entity can be responsible for costs if it is directly responsible for imposition of the cost burden at issue or if it receives benefits from the incurrence of the cost. The license plate rate design does not allocate any of the costs to entities receiving benefits that are outside of the zone where a transmission facility is located, and therefore the license plate rate design fails to adhere to the principle of cost causation.

134. Staff explains that in *KN Energy*, the Court of Appeals addressed whether the Commission could prohibit a natural gas pipeline operator from allocating certain portions of its take or pay claims solely to its sales customers in a commodity rate surcharge. 968 F.2d 1295 at 1300. This would have required the pipeline to spread the costs among both transportation and sales customers based on volume. The Commission had found, based on its interpretation of Order 500, which stemmed from Order 436<sup>27</sup>, that there were a set of 'open access' regulations that were directed toward requiring interstate gas pipelines to transport natural gas owned by others on a nondiscriminatory basis, and overcoming the pipelines' refusal to move gas that would compete with their own sales. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 52 Fed. Reg. 30,334 (1987) ("Order No. 500).

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<sup>27</sup> *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (1985) ("Order No. 436").

135. The appellant in the case argued that the Commission had abandoned the cost causation principle, because under the Commission's decision transportation customers would have to pay for costs they did not contribute to. *KN Energy*, 968 F.2d 1295 at 1301. The Court of Appeals indicated that the benefit principle advocated by the Commission could be viewed as an extension of the chain of cost causation. *Id.* at 1302. Staff argues that this benefit principle is also applicable to the allocation of the costs of existing facilities to the PJM TOs.

136. In Orders No. 888<sup>28</sup> and 2000<sup>29</sup>, the Commission's goal has been to eliminate electric transmission inefficiencies and to encourage electric industry competition. Staff argues that the present proceeding is similar to the situation in *KN Energy* because both involve regulated industries during a transition time and the transitions both resulted from Commission orders that were implemented in order to ensure and facilitate greater competition for all ratepayers. Further, both cases involve costs incurred prior to the transition period that must be allocated fairly in order for the complete transition to be effectuated. Staff indicates that the costs in question are different, as in this proceeding they are related to transmission facilities which provide ongoing benefits to TOs, while *KN Energy* involved take or pay costs that were tied up to pre existing contracts. Staff argues that this makes the costs in this proceeding more easily connected to widespread benefits among all current ratepayers and the *KN Energy* decision is applicable to the facts in this proceeding.

137. Staff argues that Commission precedent also allows for an entity to be allocated costs if it is directly responsible for imposing those costs or if the entity benefits from the incurrence of those costs. In *California Power Exchange Corp.*, the Commission indicated that costs should be allocated based on customer benefits and cost incurrence. 106 FERC ¶ 61,196 at 61,680. The Commission in *California Independent System Operator Corp.*, also found that costs should be allocated to those that benefit. 106 FERC ¶ 61,032 at 61,609. Similarly, in *Midwest ISO Transmission Owners v. FERC*, the court held that the evaluation of compliance with the cost causation principle is done by comparing the assessed costs with the burdens imposed or benefits obtained by the

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<sup>28</sup> *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs., ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274, (March 4, 1997), FERC Stats. & Regs., ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order no. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002) ("Order No. 888")

<sup>29</sup> Order No. 2000, FERC Stats. & Regs. ¶ 31,089.

parties. 373 F.3d 1361 (citations omitted). Finally, in implementing the SECA charges for PJM, the Commission found that SECA implementation was consistent with cost causation and the principle that those who benefit should pay. *Midwest Independent Transmission System Operator, Inc., et al.*, 104 FERC ¶ 61,105.

138. Staff explains that today facilities which were originally intended to ensure reliable service for local network customers are now used in supporting regional transfers. Staff indicates that RPA witness Evans and Schmalensee explained that electric transmission systems are two sided platforms and each participant is important to every other participant for generating the usage and scale economy externalities; no member of the platform can claim to be more valuable than another. *Midwest Independent Transmission System Operator, Inc., et al.*, 104 FERC ¶ 61,105, *order on reh'g* 105 FERC ¶ 61,212 at 62,110 (2003). Further, the benefits are created jointly by network participants. Exh. RPA-20 at 7.

139. Additionally, RPA witness Shanker testified that TOs, through their association with the large PJM system, are receiving material reliability and operating benefits. Exh. RPA-1 at 13. RPA witness Smatlak also provides multiple examples of low voltage transmission facilities that provide regional benefits and well as low voltage transmission facilities that primarily provide local benefits. Exh. RPA-6 at 13. Staff argues that these witnesses' statements bolster Staff's proposal, because in two sided markets like PJM it is impossible to allocate responsibility for those benefits to higher voltage facilities alone. Staff asserts that a permanent rate design based on a postage stamp rate is supported by the fact that each member of a two sided platform is equally important and beneficial.

140. Staff asserts that RPA inconsistently supports the allocation of costs to beneficiaries for new transmission facilities, but not for existing transmission facilities. Staff acknowledges that RPA's argument that an assessment on the benefits provided by existing facilities cannot be reasonably performed is true, but asserts that a benefits analysis is not required by the Commission in order to justify the spreading of existing costs to all transportation customers. *KN Energy*, 968 F.2d 1295, at 1304.

141. Staff refutes RPA's suggestion that under Schedule 12, new regionally planned transmission facilities are evaluated to determine who should pay their costs based on who caused the facilities to be built. Staff contends that this view is different from RPA witness Shanker's testimony which indicated that under Section 12 regional allocations are based on who benefits from the facilities. RPA-1 at 27. Further JCA also acknowledges that Schedule 12 assigns facility costs to those who benefit. Staff argues that RPA must attempt to limit Schedule 12 in order to support the conclusion that PJM uses the fundamental principle of cost causality in allocating existing and new costs. Staff argues that Schedule 12's ability to allocate costs to all beneficiaries is precisely what does not exist in PJM's current license plate rate design for existing facilities.

142. Staff explains that the Commission has specified that using a license plate rate design would be transitional, and initially required PJM to submit a unified rate design. Recently the Commission has noted this initial requirement, encouraging RTOs to use a postage stamp rate. Staff explains that several Commission orders related to PJM have expressed concerns about continuation of the license plate rate design. When the license plate rate proposal was first approved in 1997, the Commission's approval was conditioned on the companies' commitment to propose a uniform, system-wide rate methodology within five years. *Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 81 FERC ¶ 61,257. Later the Commission approved PJM's request to allow continuation of the rates until December 31, 2004, because of a similar approval for PJM West. *PJM Interconnection, Inc.*, 96 FERC ¶ 61,060 at 61,220s. PJM was granted another extension when a settlement was approved in Docket No. ER04-156, which required that by January 31, 2005 the parties address whether the license plate rates should be changed after May 31, 2005 and what new rate design should be considered. *Allegheny Power System Operating Cos., et al.*, 108 FERC ¶ 61,167 (2004). The Settlement also required that the parties make a future filing addressing the harmonization of existing transmission rates with new transmission investment recovery proposals. *Id.*

143. The Order on Rehearing and Clarification in Docket Nos. ER04-156-007, ER05-513-001, and EL05-121-001 also indicated that the license plate rate design was adopted transitionally and PJM was directed to file a proposal for a new uniform, system wide rate applicable to transmission systems throughout PJM. *Allegheny Power System Operating Cos.*, 115 FERC ¶ 61,156 at 61,542. In Order No. 2000, the Commission allowed the RTOs to use license plate rate design, even though it was not ideal, at the RTOs' request. The Commission was reluctant to require the suspension of license plate rates after some arbitrary date, but also did not wish to announce that license plate rates could be a permanent feature for an RTO. Order No. 2000, FERC Stats. & Regs. ¶31,089 at 31,177. The Commission allowed the use of license plate rates for a fixed term, but required the RTOs to complete an evaluation of fixed cost recovery policies and file recommendations on changes that should be instituted. *Id.* In the May 8, 2006 Order the Commission affirmed that the rates were for a transition period after which the RTO would have to justify its choice to either continue or change to other rates. *Allegheny Power System Operating Companies*, 115 FERC ¶ 61,156 at ¶ 61,542.

144. In 2002, the Commission issued an Order addressing the Alliance Companies, who had requested to participate in MISO. The Commission indicated that the license plate rates were transitional. *Alliance Cos.*, 99 FERC ¶ 61,105 at 61,144. The Commission has also encouraged the use of a single postage stamp rate in a Southwest Power Pool order. *Southwest Power Pool, Inc.*, 111 FERC ¶ 61,118. The Commission approved, in that order, a new cost allocation plan for SPP which allocated a portion of new transmission costs on a postage stamp basis; the rate design assigned one third of the costs of new network upgrades on a regionalized basis. *Id.* at ¶ 61,653. Staff asserts that

the Commission's intent was to allow license plate rate design for a transitional period and for parties to eventually move to a more uniform rate design for PJM.

145. Staff explains that all of the costs of existing transmission facilities are allocated exclusively on a local basis, as load located in zones that benefit from transmission facilities located in other zones continue to receive the same level of reliable transmission service, achieve the same economic dispatch savings, and have improved and expanded transmission access throughout the PJM system. However, these loads do not make any contribution to the costs of facilities outside their zone, and are therefore subsidized by loads within the zone. These subsidies will likely force AEP, AP, BGE, and others to seek an increase in rates and in fact AEP has stated that its customers will experience an ongoing 50 percent rate increase for network transmission service if a replacement rate is not implemented. Exh. AEP-200 at 7.

146. Staff indicates that TOP also maintains that the elimination of the RTOR was intended to eliminate a seam, which is a price differential in procuring one source of power rather than another in order to promote competition by removing any barrier to the lowest cost supplier entering a market once the cost of transmission is factored in. Staff argues that while it is a good objective, it is essentially giving a free service to one customer class at the expense of another.

147. Staff explains that RPA argues that a zonal rate design is supported by TOs representing the majority of load in PJM, is administratively simple, there is no economic efficiency reason to change the current rate design, and there is an imposition of an additional burden upon the rate change proponents because of the upcoming joint MISO/PJM proceeding. Staff contends that none of these arguments raise issues significant enough to overcome the fact that the license plate rate design does not adhere to cost causation principles.

148. First Staff argues that the fact that TOs representing the majority of load in PJM support license plate rates is not dispositive. Staff acknowledges that past Commission orders have cited the support of commenters when implementing a rate design, but the design was allowed for a fixed term only. Order No. 2000, FERC Stats. & Regs. ¶31,089 at 31,177. Staff indicates that RPA cites orders that are not fully consistent with the facts in this proceeding. While there is no stakeholder process in this proceeding which has resulted in a decision to continue the current PJM modified zonal rate, RPA cites *California Independent System Operator*, 109 FERC ¶ 61,301 at 62,477, in which there was a cost shift cap ratio derived as a result of a stakeholder process. This argument is undermined by the fact that subsidies currently exist as a result of the license plate rate design, so clearly the TOs who are benefiting at the expense of others are the ones that are advocating maintaining the current rate design.

149. Second, Staff argues that simply because the license plate rate design is the one

currently in place is not enough of a justification to continue with these rates. RPA indicates that the Commission has found that transmission pricing should be easy to administer and practical, and therefore RPA contends that continuing license plate rates is the most administratively efficient option. Staff contends that the Commission should consider administrative efficiency, but only in light of other factors which are more relevant, such as the fact that the present rates do not adhere to cost causation principles and are therefore creating subsidies.

150. Staff also counters RPA's argument that the reallocation of sunk costs of existing transmission facilities will have no impact on new transmission facility investment. Staff argues that even if economic efficiencies are not created by the reallocation of sunk costs, the Commission should consider fairness issues and reallocate sunk costs in order to eliminate existing subsidies and conform the rate design to cost causation principles. Staff asserts that if sunk costs have no impact on price signals, then this will be true even if license plate rates are preserved and therefore this should not be a factor that is considered when the Commission determines an appropriate rate design.

151. Staff maintains that RPA's argument that rate change proponents have failed to meet their burden of proof is in error, as the burden of proof is not increased due to the fact that a joint rate design proceeding will begin in 2007 for both MISO and PJM. *See Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168 at 61,821(2004). Further, Staff argues that the Commission has previously dismissed this argument several times.<sup>30</sup> The Commission has clearly dismissed the option of continuing the current PJM rate design until the joint MISO/PJM rate proceeding is concluded and has found that the current rate may be unjust and unreasonable and that new rate design options should be considered, Staff asserts. Therefore, Staff argues that there is no additional burden of proof on rate change proponents simply because a new joint rate design may be implemented at some point in the future.

152. Staff argues that state rate freezes should also not prevent a change in PJM's rate design as TOs who chose to join PJM knew that the license plate rate design was transitional and would be subject to the outcome of periodic analyses and perhaps a rate design change. *Allegheny Power System Operating Cos.*, 115 FERC ¶ 61,156 at 61,544. Further, Staff suggests that the Commission should not allow state regulatory bodies to dictate Commission decisions. Staff argues that this would be an issue of federal versus state preemption in regards to utility rate making. Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,966. Staff asserts that in *Nantahala Power & Light Company v. Thornburg* the US Supreme Court held that FERC had exclusive jurisdiction over the rates to be

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<sup>30</sup> *See Allegheny Power System Operating Cos.*, 111 FERC ¶ 61,308 at 62,324-325 (2005) & Order on Rehearing and Clarification in Docket Nos. ER04-156-007, ER05-513-001 and EL05-121-001.

charged interstate wholesale customers, and stated that when “FERC sets a rate between a seller of power and a wholesale-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate.” 476 U.S. 953 at 970 (1988).

153. The Court also upheld *Nantahala* in *Mississippi Power v. Miss. ex rel. Moore*, where it reversed a Mississippi Supreme Court decision that had prohibited Mississippi Power and Light Company from recovering FERC-ordered nuclear power costs through its retail rates. 487 U.S. 354 (1988). Also, in *Narragansett Electric Co. v. Burke*, the Rhode Island Supreme Court held that the FPC had exclusive jurisdiction over interstate and wholesale rates and so the state Commission was precluded from disallowing the filed rates and an operating expense. 381 A.2d 1358 (1977). Staff argues that, although exceptions exist, the general rule is that FERC approved rates can be recovered as an operating expense in intrastate rates and states must allow them. Staff asserts that state commissions could not legally prohibit a utility from including the transmission costs as an operating expense and therefore the Commission should not consider retail rate freezes in determining whether to implement a new rate design for PJM.

154. Staff refutes Dominion’s cost trapping argument, asserting that in *Midwest Transmission Owners, et al. v. FERC* a similar argument was made where the Commission found that it was appropriate for bundled and grandfathered load to pay a cost adder to insure the loads will bear a proportionate share of MISO’s costs. 373 F.3d 1361 at 1372. The Court of Appeals agreed with FERC and invalidated the argument as a matter of law stating that normally a cost trapping claim accrues when a state exercises its jurisdiction over retail sales to prevent the wholesale-as-seller from recovering the costs of paying the FERC approved rate, but the MISO owners had argued the reverse. *Midwest ISO Transmission Owners, et al. v. FERC*, 373 F.3d 1361 at 1372.

## **2. Staff’s proposal**

155. Staff proposes a postage stamp rate design based primarily on the fact that existing transmission facilities provide widespread benefits which fall outside the zone of their location and those benefits cannot be partitioned. Exh. S-5 at 8-9. Staff uses the PJM Operating Agreement’s definition of transmission facilities, because, Staff argues, it better ensures that facilities providing regional benefits will be subject to the postage stamp rate design. Staff’s proposal would also keep the PJM rate design for new transmission facilities. Staff feels the RTEP process and the allocation of costs to new transmission facilities to beneficiaries under Schedule 12 provide proper investment incentives. Finally, Staff asserts that it would not be appropriate to abandon PJM’s current rate design with respect to new transmission facilities, at it has only been recently approved by the Commission. Exh. S-3 at 17.

156. Staff contends that a postage rate design is preferable to the other proposals,

because it treats all transmission facilities' costs equally, yielding a non-discriminatory rate design for PJM. Staff asserts that Schedule 12 will both ensure that beneficiaries of new investment are allocated costs and does not create a risk of bias, which could lead to inefficient investment. The postage stamp rate design adheres to the principle of cost causation, eliminates current subsidizations, is consistent with the Commission's recent encouragement of postage stamp rates, and is administratively feasible, Staff maintains.

157. Staff believes that the postage stamp rate design will eliminate subsidies because it would require all customers to make a contribution to the cost of all facilities located outside their own zone. Staff also explains that its phase-in periods, which would limit the impact on the zonal revenue requirement paid by the customers in the zone by an annual change of no more than 10 percent, would ease the transition from license plate rates to postage stamp rates. Exh. S-3 at 20. Further, if the Commission wants to give TOs the ability to recover new allocated transmission costs in spite of retail rate freezes or caps, then once retail rate restrictions are lifted or expire by their own terms, the TOs could be allowed to defer the trapped costs for future recovery. Exh. S-6 at 6.

158. Staff explains that its proposal is forward looking and therefore Staff was able to evaluate the justness and reasonableness of the continued use of license plate rates and then determine the most appropriate replacement. Staff determined which assumptions it should use, and that the design should be based on a forward looking, congestion free, long-run perspective of the PJM RTO. Staff assumed that the benefits were widespread and could not be reasonably apportioned, a concept that is supported by other parties in the proceeding, including RPA and JCA witnesses Shanker, Evans and Schmalensee. Exhs. RPA-2- at 7, RPA-26 at 4, JCA-2 at 6. Staff also used the PJM Operating Agreement's definition of transmission facilities, which provided that all transmission facilities integrated into the planning and operation of PJM are necessary for regional and interregional operations, and determined that all transmission facilities as defined by PJM should be regional transmission facilities. Exh. S-1 at 4, 11.

159. Staff's counters RPA witness Mr. Naumann's criticism that the postage stamp rate design fails to adhere to cost causation because it regionalizes the costs of all existing facilities. Exh. RPA-31 at 10. Staff argues that Mr. Naumann's definition of cost causation is too narrow, and the Commission enables a broader definition that not only allows for costs to be charged to the entity that is directly responsible for the costs burden but also to one that is benefiting from the incurrence of the cost. Staff asserts that the postage stamp proposal allocates the costs on a socialized basis, because the existing facilities provide widespread benefits. The postage stamp rate design therefore adheres to the cost causation principle and is supported by precedent.

160. Staff counters RPA's and other parties' arguments that the PJM rate design should not be changed because of cost shifts, asserting that cost shifts generally will occur when a rate design change is implemented, and cost shifts have already occurred in PJM due to

the elimination of SECA charges. *Midwest Independent Transmission Operator, Inc.*, 109 FERC ¶ 61,168. Staff argues that cost shifts should be considered in light of reasonable state regulator expectations and current circumstances. Staff refutes RPA's assertion that a postage stamp rate design would be contrary to state regulators' historical expectations, arguing that in light of RTO development, the historical expectations of state regulators should not serve as a basis to continue the current subsidies, because many of the existing transmission facilities were constructed years or decades before RTOs existed. State regulators should have modified their expectations at the time the state authorized a TO to join PJM. Further, if Staff's proposal is found to be just and reasonable, state regulators will have no substantive basis to complain about cost shifts, which are an inevitable result of a rate design change.

161. Staff refutes RPA's argument that its rate design will yield the most severe cost shifts, indicating that continuing the current rate design would produce egregious cost shifts. Further Staff argues that cost shifts should be considered in light of other circumstances, and the amount of costs shifted by moving to the postage stamp rate design is related to the degree to which the current rate design is out of line with cost causation. Cost shifts are in fact necessary due to current subsidies in PJM's system, therefore, the issue of cost shifts should not be determinative of the justness and reasonableness of Staff's proposal.

162. Staff counters RPA's argument that Staff has failed to support its analogy that the transmission system is a public good and that the benefits of the PJM network are evenly distributed, explaining that RPA cannot criticize Staff for its failure to perform an impossible analysis. Staff points out that RPA witness Shanker has specifically argued that a benefits analysis cannot be performed, and TOP witness Scarpignato also reached this conclusion. Despite the inability to perform the analysis however, Staff argues that various parties agree that the existing transmission facilities do provide widespread benefits. Staff avers that the cumulative weight of the evidence provided supports the conclusion that the existing PJM facilities provide region wide benefits.

163. Staff acknowledges, as indicated by RPA, that its proposal would not result in a single uniform rate. Staff indicates that while its rate design proposal would not result in a uniform rate design for PJM, the implementation of a postage stamp rate for existing transmission facilities would allow the recognition of regional transmission benefits in PJM and allocate costs accordingly. Staff refutes RPA's argument that the postage stamp rate will create controversy, because customers will object to paying for costs of transmission facilities located in other transmission zones that should be classified as distribution facilities. Staff avers that in its use of the PJM definition of transmission facilities it assumed that PJM used due diligence when assessing how to classify particular facilities. Further, the controversy would not result directly from the implementation of Staff's proposal, but rather it would occur regardless of whether not the postage stamp rate design is implemented.

164. Staff also argues that TOP's reliance on two cases, *Tennessee Gas Pipeline Co.*, 50 FERC ¶ 61,286 (1990) and *Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305 (D.C. Cir. 1991) is unfounded. First, it contends that the facts in *Tennessee Gas* are not consistent with the facts in proceeding, as it dealt with a settlement which established interim rates pending the results of the hearing. Second, *Algonquin* concerned a review of a Commission order in which the Commission modified the settlement and the court found that the Commission had to support its view that facilities' benefits flowed to the customers who bore the financial burden with more than just a statement that the existence of system wide benefits renders it unjust to allocate facilities to costs incrementally. However, Staff observes in this proceeding there is much evidence and support to demonstrate that existing transmission facilities within PJM provide widespread benefits.

165. Staff maintains that its congestion free assumption is reasonable despite RPA criticisms. Staff explains that upgrades designed to alleviate congestion should be contemplated and approved after due consideration of costs and benefits rather than constructed at any expense, and by using the congestion free RTO assumption Staff is not actually saying that such an RTO will ever exist. However, the assumption was used in order to strictly limit its analysis to rate design issues, as congestion sheds little light on determining an appropriate rate design to recover fixed capital costs under cost of service rates. Staff contends that small amounts of congestion, in the long run, will not meaningfully reduce the broad regional benefits from PJM's transmission grid and the rationale for spreading such costs through postage stamp rates.

166. Staff argues that its phase-in plan is just and reasonable, although it acknowledges the predicament of some customers who will pay increased rates. Staff believes, however, that a scheduled phase-in is the most appropriate and fair way to implement the postage stamp rate design and believes its proposal would mitigate the effects of any cost shift caused by a change in rate design. Exh. S-3 at 19-20. Staff also refutes PPP's argument that Staff's phase-in proposal is ambiguous, pointing out that its intent in proposing the phase-in was to mitigate the impact of cost shifts. Staff argues that the fact that its proposal is not detailed is not sufficient reason to reject it. Staff indicates that a compliance filing would be needed before the postage stamp rate design could be made effective and PPP's questions could be addressed in that context. Tr. at 753.

### **3. Other Parties' proposals**

167. Staff asserts that the TOP, AEP/AP, and PPP rate proposals do have advantages over the current license plate rate design, but objects to their arbitrarily selected voltage levels to determine what facilities constitute regional transmission facilities. Staff points out that TOP, AEP/AP, and PPP have arrived at different voltage levels based on differing criteria, while each claims to have technical justification for the selection of the

cut-off. Staff argues that this indicates that there is not a strong engineering based justification for a specific voltage. Exh. S-1 at 4. Arbitrary voltage cut-offs could result in discriminatory treatment for functionally similar facilities and it could create a bias regarding what new facilities are proposed, Staff maintains. While there are safeguards to prevent such distortions in the RTEP process, Staff contends that the process can not guarantee that abuses will not occur.

168. Staff objects to AEP/AP's proposal because of it uses an arbitrarily selected voltage level, a concern that is bolstered by the fact that AEP/AP provides no industry documentation to support the recommended voltage cut-offs. Exh. RPA-59. Further, Staff suggests that AEP/AP's proposal could also result in discriminatory treatment of existing facilities costs, if a lower voltage facility provides regional benefits, but does not qualify as an RTF. Staff believes that this defeats the purpose of the regional rate design, which is to allocate regionally the costs of facilities that provide regional benefits. Also, a bias to build an RTF would be created, according to Staff, due to the use of the voltage level cut-offs, since the entity would only be responsible for a smaller share of the costs. S-1 at 9. Additionally, Staff argues that the customer could ignore costs in its location, which would result in inefficient investment decisions. S-2 at 13.

169. Staff objects to the TOP proposal because of the arbitrarily selected voltage level used to determine which facilities constitute a highway transmission facility. TOP witness Scarpignato, while supporting the 200 kV cut-off was not able to perform an incremental analysis to determine which facilities provide regional benefits, nor was he able to determine on a temporal basis the benefits of each added facility. Exh. TOP-3 at 20. Staff believes TOP's proposal suffers from the same problems regarding discriminatory treatment as discussed above in regards to AEP's proposal.

170. Staff also argues that TOP's proposal for allocating the costs of its facilities is too undeveloped and undefined, and may result in a lengthy and burdensome procedure. Staff contends that it would be speculation to presume that as a result of a stakeholder process resolution of the issue would occur. Staff indicates that this proceeding demonstrates the type of prolonged litigation that could occur from the use of a stakeholder process. Staff also argues that TOP's proposed five year freeze is not reasonable, as it would eliminate cost recovery of newly constructed transmission facilities for five years, and would undermine a TO's ability to seek recovery from other zones for the costs of highway facilities.

171. Staff has the same concerns with PPP's proposal that it has regarding the proposals of AEP and TOP. Additionally, Staff argues that the PPP proposal adds too many presumptions and details, which increase its complexity and potential for controversy. Staff's has similar concerns regarding PPP's ability to justify its voltage cut-offs of 500 kV and 200 kV. Staff argues that PPP has not shown how its proposal would better adhere to the principle of cost causation, in light of the fact that an

incremental assessment of benefits can be, and is performed, by PJM for all new transmission facilities.

172. Staff argues that AEP/AP, TOP, and PPP have failed to meet their burden regarding changing PJM's rate design for new transmission facilities. Staff argues that the AEP/AP, TOP, and PPP have the burden, under Section 206 to prove that the existing rate design for new transmission facilities is unjust and unreasonable. Staff believes that the PJM rate design for new transmission facilities allocates costs based on benefits, a fact that has been acknowledged by various parties and the Commission. Staff indicates that costs of some new RTEP process transmission projects have been allocated to beneficiaries that are outside of the zones in which the facilities are located. Staff contends that socializing the costs of new transmission investment would weaken the rate design's potential to send efficient locational signals to customers. Staff asserts that the Schedule 12 methodology would lead to more efficient investment decisions. Exhs. S-3 at 17, S-2 at 16. Staff argues that since the rate design for new transmission facilities has only recently been approved, it is reluctant to recommend that it be changed. Exh. S-3 at 17. Staff explains that RPA has shown that the PJM rate design for new facilities is properly allocating costs to those who benefit from them, and therefore the current rate design should be continued. Staff believes that the rate design should be allowed more time to operate before the Commission considers modifying it.

#### **4. It is not necessary to consider ARRs/FTRs in this proceeding**

173. Staff also argues that RPA's contention that the role of private transmission rights is the major equitable driver in the overall PJM rate design, fails for two reasons. First the implementation of a postage stamp rate design and the resulting reallocation of transmission costs will not alter the current ARRs/FTRs allocation process. Second, the Commission can consider ARRs/FTRs allocation changes in a separate proceeding, if necessary.

174. Staff argues that AEP witness Mr. Reeping explained that ARRs and FTRs do not have anything to do with the cost allocation for the physical flow of power across the transmission system. AEP-700 at 3. This was affirmed by RPA's own witness, Mr. Naumann when under cross examination he stated that "the ability to get the ARRs is not dependent on the ... flow over the transmission system." Tr. at 553. Staff indicates that Mr. Reeping explained that ARRs are a financial entitlement to protect zonal loads, during constrained transmission conditions, against the differences in locational marginal pricing across a zone. AEP-700 at 3. Further there is a pending proceeding in which RPA could voice its ARRs/FTRs allocation concerns.<sup>31</sup>

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<sup>31</sup> *Long-Term Firm Transmission Rights in Organized Electricity Markets, Long-Term Transmission Rights in Markets Operated by Regional Transmission Organizations and Independent System Operators*, "Notice of Proposed Rulemaking," 114 FERC ¶

## **G. Ormet Primary Aluminum Corporation**

175. Ormet explains that the license plate rate design assigns existing transmission investment costs to the zone where those facilities are located based on a historic delineation of the zones. Ormet indicates that this means that all embedded costs of existing facilities would be charged on this basis until full depreciation, and no revenues are collected by TOs for transactions involving non-zonal customers inside PJM's and MISO's footprint. Zonal customers bear the entire costs of the transmission facilities within their zone. The cost of new transmission investment for upgrades or new facilities is allocated to customers or zones based on who receives the benefit from using those facilities.

### **1. License plate rates are unjust and unreasonable**

176. Ormet argues that license plate rates are unjust and unreasonable because of the failure to account for the regionalization that has occurred in this industry over the past decade. Ormet believes that such a rate design does not comply with the Commission's call for regionalization of transmission rates, fails to account for cost causation principles, and imposes unjust and unreasonable costs on customers. Ormet does indicate, however, that the current new facilities rate design, based on Schedule 12, is just and reasonable because it accounts for the PJM transmission system's regional nature, matches benefits and costs, and provides for incentives for transmission investment.

177. Ormet argues that license plate rates have been made unjust and unreasonable due to:

(i) changes in the use of PJM member transmission systems by third parties under open access requirements implemented by the Commission; (ii) the resulting growth of the regional wholesale electricity market; (iii) the elimination of rates for through-and-out service for TOs which have joined PJM between MISO and PJM, and the recent discontinuation of the SECA mechanism and the resulting loss of revenues to transmission owners; and (iv) the benefits of transmission regionalization flowing to areas with higher electricity prices. Ormet I.B. at 15.

178. Ormet asserts that the use of AEP's system has changed significantly. Now, AEP's system is frequently used to deliver low cost coal-fired power from the Midwest

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61,097 at 61,331 ("these guidelines will give transmission organizations in consultation with market participants, the flexibility to propose alternative designs that reflect regional preferences and accommodate the regional market design, while also ensuring that the objectives of Congress expressed in new section 217(b)(4) of the FPA are met.")

for use by the Classic PJM Companies, Dominion Virginia's zonal customers and other regional transactions. Exh. AEP-104 at 10-13, 29. Ormet contends that the development of PJM wholesale markets in the Midwest and MidAtlantic states have been fostered by AEP's integration in PJM, and all PJM customers have benefited from these market efficiencies. *New PJM Cos., et al.*, 106 FERC ¶ 63,029 at 65,316 (2004). Ormet indicates that the increased efficiencies and economies of the PJM wholesale market provide support for the regionalization of transmission costs for the facilities that are allowing the PJM market to perform at such a level.

179. Ormet explains that through-and-out service was eliminated by the Commission in order to encourage open access and competition, and eliminate seams between regions. The Commission recognizing that this would result in a loss of revenues to the TOs also established SECA as a temporary recovery mechanism, but SECA expired March 31, 2006. Exh. AEP-104 at 14. Ormet argues that the Commission must address the elimination of rates for through-and-out service, and further contends that RPA's arguments that state rate freezes may prevent the passing of regional rate mechanism benefits to zonal customers does not support the continuation of unjust and unreasonable rates. Exh. RPA-42 at 4. Ormet believes that, under the filed rate doctrine, the Commission can ensure just and reasonable rates, and state commissions must then decide how to allocate transmission costs within FERC mandated bounds. Further, Ormet contends that "[m]arket participants in PJM, including market participants in DVP as part of PJM, would benefit as a result of increased imports of lower cost power from AEP and the rest of the Midwest." Exh. AEP-100 at 28.

180. Ormet believes that although Commission policy does not require that license plate rates be abandoned at the end of the initial fixed term, the RTO and its transmission owners must justify their choice to continue or discontinue using license plate rates which the TOs have not done.<sup>32</sup> Ormet points out that the Commission has approved the use of license plate rates only in situations where it has also implemented mechanisms to mitigate cost shifts through lost revenue recovery adders or some other load-based surcharge. Ormet argues that the Commission's reason for allowing zonal rates was to avoid cost shifting, but in this instance there has been huge cost shifting associated with the post SECA license plate rates. Exh. S-6 at 6.

181. Ormet points out that PJM TOs, including companies which comprise RPA, had committed to file for a uniform rate at the expiration of the transitional period, but instead have prolonged the license plate rate and continue to argue against a replacement. RPA's argument that license plate rates are just and reasonable because the Commission did not

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<sup>32</sup> Order No. 2000, FERC Stats. & Regs. ¶ 31,089 at 31,177-178; *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168; *Allegheny Power System Operating Cos.*, 115 FERC ¶ 61,156 at 61,543.

order changes in MISO's rate design until January 31, 2008 is flawed because in the May 2005 Order the Commission found that PJM's rates may be unjust and unreasonable, and the Commission has differentiated PJM from MISO in its November 18, 2004 Order. RPA's argument that it is inappropriate to impose regional rates when the use of regional facilities by MISO are not addressed is also flawed, according to Ormet, because the Commission ordered only examination of PJM's rates and with seams elimination, loads in PJM are entitled to use MISO transmission facilities without paying an RTOR charge. The Commission rejected linking transmission rates in PJM to MISO's transmission rates and it should not be considered at this time. The Commission has required the PJM TOs and MISO TOs to submit a filing for the proper allocation of inter PJM-MISO service, effective February 1, 2008. Ormet asserts that PJM customers should not have to continue paying unjust and unreasonable rates until that is decided.

182. RPA argues that in the November 18, 2004 Order the Commission indicated that zonal rates without RTORs can be just and reasonable. Ormet, however, argues that RPA is contradicting the Commission's explicit caveat that the license plate rates constitute an appropriate transitional mechanism and require reevaluation after a fixed period, in order to be just and reasonable. RPA is ignoring the fact that the November 18, 2004 Order was issued before the May 2005 Order finding license plate rates may be unjust and unreasonable, Ormet contends. Ormet argues that the November 18, 2004 Order involves inter-RTO rates as opposed to intra-RTO rates as in this proceeding, and PJM is past the transition period and the reevaluation should have already occurred. Ormet concludes that Commission precedent does not support license plate rates as a recovery mechanism for RTOR lost revenues.

183. Ormet contends that RPA ignores: (1) the fact that some facilities were built to serve regional needs, (2) the current use of the system is based on regional use in addition to serving zonal customers, and (3) the Commission's future looking cost causation policy. Ormet argues that historically, some of the facilities were built with an expectation that they would increase the effectiveness of the AEP system for regional transactions and the interconnections among systems. Exh. PPP-10 at 7-8. Some of the facilities located within a TO's zone were even constructed for non zonal customers' benefit and are still used by non zonal customers, Ormet contends. Tr. at 579-580, 583. Ormet argues that the transmission system has also dramatically changed with many facilities being used extensively to provide economic benefits to non zonal customers and continues to regionalize. Further, Ormet argues that Commission policy is forward looking and allocates the existing system's embedded costs on a regional basis, focusing on the type of transmission service at issue and whether it causes a need to plan for future capacity. Exh. PPP-10 at 10-11, *Louisiana Public Service Commission v FERC*, 184 F.3d 892, at 896.

184. Ormet also asserts that the Commission looks both at who originally caused the costs to be incurred and who currently benefits from the facilities. *California Independent*

*System Operator Corp.*, 113 FERC ¶ 63,017. Ormet argues that if the benefits are substantial, as they are in this proceeding, there is strong support for a cost allocation based on benefits. Ormet contends that the policy is consistent with the Commission's policy allowing the allocation of system upgrades associated with generator interconnection, where the Commission has recognized that system wide benefits should be allocated to all customers even if the upgrade was triggered by the request to interconnect. *Pacific Gas and Electric Co.*, 100 FERC ¶ 61,160 at 61,586 (2002).

185. Ormet argues that while all of the proposals involve cost shifting, license plate rates produce the highest and most unjustified cost shifts. The cost shift under license plate rates is a subsidization of non-native users by AEP's zonal transmission load. Ormet is one of the customers adversely affected because of the post SECA license plate rate design. Ormet counters RPA's argument that the loss of RTOR and SECA revenues is not unjust and unreasonable because it causes the reversion of AEP's transmission rates to a level equivalent to those prior to Order No. 888. RPA indicates that AEP's 1995 rates were slightly higher than the post SECA rates, but ignores the fact that AEP system use has dramatically increased since Order No. 888 has been issued and regional use of AEP's system has also expanded. Exh. AEP-104 at 10-13. Further, Ormet points out that this proceeding involves PJM's rates, not AEP's, and transmission customers in AEP's zone take service directly from PJM. Ormet maintains that Commission precedent does not support the disparate treatment of similarly situated customers, as this is undue discrimination. *Cities of Newark v. FERC*, 763 F.2d 533 at 547 (3<sup>rd</sup> Cir. 1985); *Cities of Bethany v. FERC*, 727 F.2d 1131 at 1139 (D.C. Cir. 1984).

186. Ormet refutes JCA's argument that a rate design must be economically efficient, arguing that JCA distorts what economically efficient price signals are by focusing on the physical use of transmission rather than the economic use of transmission. Exh. JCA-1 at 6-7. Ormet argues that JCA witness Mr. Galigan's theory is flawed because it fails to account for the fact that economic decisions are made regardless of the closest available generation since PJM is centrally dispatched. *New PJM Cos., et al.*, 107 FERC ¶ 61,271 at 61,212-213 (2004). Further, Ormet believes that the argument is irrelevant because of competitively neutral proposals. Tr. at 676-677.

187. Ormet indicates that RPA witnesses Evans and Shmalense are also incorrect, when they attempt to justify license plates rates by indicating that the electric industry is made of two sided platforms which link generators and load serving entities, with the transmission system allowing both of these participants to obtain value they could not on their own. Exh. RPA-20 at 9-13. Ormet argues that this is not a justification for license plate rates, as the two platforms require each other to make the system work, which is an argument for regionalization of related costs. Exh. PPP-10 at 4-6.

188. Ormet contends that license plate rates without recovery for lost revenues are not justified through the linking of ARRs and FTRs to the rate design. Ormet argues that

FTRs do not represent a right to physical delivery of power, but only give market participants price certainty when delivering energy across the PJM system and provide a hedging mechanism that can be separately traded from transmission system.

189. Ormet argues that RPA's claims that ARR/FTRs allocate rights to congestion free use of the transmission system to those who have been historically paying for the cost of building the system is irrelevant for three reasons: (1) when the Commission adopted the ARR/FTRs mechanism in PJM, it recognized the changing nature of the market and the fallacy of using past constraints as the basis for awarding congestion rights;<sup>33</sup> (2) this hearing was not set to consider congestion related rights allocation, but instead to determine the just and reasonableness of the current zonal design; (3) even if ARR/FTRs could be linked to transmission costs, they are ancillary to the license plate rates as they do not form the main costs and credits of that rate.

190. PJM argues that any changes in the rate design should be synchronized with the ARR/FTRs that customers receive, but Ormet argues that PJM does not propose how to change that allocation, merely suggesting a compliance filing or other stakeholder process. Ormet argues that no change may be needed because the Commission found that a change in rate design was not inconsistent with historic and continuing allocation of ARR/FTRs when it approved PJM's change in rate design in becoming an independent system operator. *Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 81 FERC ¶ 61,257 at 62,241. Even PJM explains that the initial allocation of ARR/FTRs are tied to not to transmission allocation, but to a customer's historic use of the transmission system.<sup>34</sup> Ormet argues that ARR/FTRs are not reallocated every time a TO or PJM itself reallocates the PJM revenue requirement, files a new rate case, or changes its transmission rates. Further, Ormet notes that neither PJM nor RPA proposed or insisted on ARR/FTRs reallocation when SECA was effected or expired, despite SECA's substantial alteration of the allocation of PJM's transmission revenue requirement among transmission customers. Even when AEP obtained an increase in its transmission rates, no change in ARR/FTRs allocation was proposed and these ARR/FTRs allocation are evaluated annually so they can be addressed in that process, Ormet observes.

191. Ormet argues that there is a double penalty to customers of AEP as Ormet would be paying unjust and unreasonable transmission rates, and would be at a disadvantage because Ormet would not be able to purchase the less expensive power supply that is produced in its region, having instead to import more expensive power. Under the

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<sup>33</sup> *Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 81 FERC ¶ 61,257 at 62,256s.

<sup>34</sup> See *Workshop on PJM ARR and FTR Market* available at <http://www.pjm.com/markets/ptr/downloads/ptr-annual-allocation-course.pdf>

license plate rate design, power produced in AEP's zone that is less expensive in PJM is shipped to customers outside AEP's zone that do not pay for the AEP transmission facilities used to deliver the power, Ormet argues. Some of AEP's customers may get the advantage of AEP's lower cost generation, but not AEP's wholesale customers, such as Ormet.

192. JCA and RPA argue that license plate rates are justified because AEP generation is making money, but Ormet argues that whether AEP generators are making money is irrelevant in this proceeding since it is setting transmission rates charged to load. Ormet contends that the Commission deliberately separates generation and transmission functions<sup>35</sup> and has a historic antipathy to cross subsidization.<sup>36</sup> Ormet asserts that the RPA/JCA argument ignores the fact that in the AEP zone, some transmission customers such as Ormet, neither own nor sell generation. Also, Ormet says that RPA/JCA appear to be arguing that AEP should not increase its transmission rates since its generation is making more money now that seams are eliminated, however AEP has already filed to increase its transmission rates, a settlement has been reached, and the Commission has approved the increase. Exh. ORM-1 at 6-7. Settlement rates will be adjusted if a regional rate is adopted in this proceeding. *See* Section 3.2 of the Settlement Agreement filed in Docket No. ER05-751 on November 7, 2005.

193. Ormet also addresses JCA's claims that only an additional 1.4 percent of power flowed from AEP to PJM after its integration into PJM. Ormet argues that JCA misses the point because it makes the wrong comparison on power flows from AEP to PJM out of a total energy load. Instead the increase in the flows over the AEP system should be examined, which indicates that there has been a 25 percent increase in power flows over the AEP system into PJM. Exh. AEP-402, AEP-201. The 25 percent increase is additional to substantial amounts of power which flow from AEP to PJM, for which AEP is no longer being compensated due to seams elimination.

194. JCA also contends that license plate rates are economically efficient, because they are neutral in pricing due to the ability of any entity in the footprint to procure power at the same transmission delivery cost. However, Ormet refutes this claim indicating that every proposal in this proceeding allows customer access to any generation within PJM by paying a single rate. According to Ormet, the relevant questions are whether there should be a regional or zonal rate, and if regional, what proposal should be implemented. Further, from the transmission customer's point of view, license plate rates differ greatly depending on which zone the customer is located in. Ormet argues that the cost of local service can be higher in some zones than others, based on the need for higher cost

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<sup>35</sup> *See* Order No. 2000, FERC Stats. & Regs. ¶ 31,089.

<sup>36</sup> *See Transactions Subject to FPA Section 203*, 113 FERC ¶ 61,315 (2005); *Pacific Gas and Electric Co., et al.*, 88 FERC ¶ 63,007 at 65,651 (1999).

transmission systems within zones serving urban areas. However, it continues, there is no justification for the current design which allows all customers equal access to EHV highway transmission facilities which are only paid for by some customers.

195. JCA's assertion that the physical flow of electrons within the PJM footprint has not changed, similarly misses the point, Ormet asserts, as the real issue is the economic right to obtain generation from distant suppliers. Ormet explains that while the elimination of seams has not altered the laws of physics it has substantially altered trading patterns and the economic bargain among the parties. Further, Ormet sees as highly doubtful the proposition that the flow of electrons has not changed as power flows and trading patterns over PJM's and MISO's wires have changed substantially<sup>37</sup> and customers can now purchase power through the PJM/MISO footprint and make deals that were once not economically feasible.<sup>38</sup>

196. Ormet also counters JCA's argument that when facilities were originally built there were certain trade-offs considered among generation and transmission and so it would be unreasonable to allow utilities with high transmission costs to export those high costs, while retaining less expensive generation for their native load. Ormet asserts that this argument is not based on the current situation as native load, transmission, and generation customers can no longer be solely identified with the transmission assets of a single vertically integrated utility. Ormet explains that some utilities do own generation and transmission, but others do not, and even those that are vertically integrated must have separate generation and transmission functions. Order No. 888, FERC Stats. & Regs. ¶ 31,048 at 31,653-656. Ormet continues, arguing that customers not owning either transmission or generation enjoy no trade-offs, and eliminating the cross-subsidies between the generation and transmission functions of vertically integrated utilities was one of the primary objectives of restructuring and introducing competition and open access.

197. Finally, Ormet explains that it objected to paying for AEP's newly proposed 765 kV line, not because it objected to incentive rate treatment for the proposed line, but because Ormet did not want to pay disproportionately for it. Ormet would not object if a portion of the 765 kV line were allocated to AEP's zone as long as Schedule 12 properly identified those benefits or AEP's share would be proportional to its proposal for allocating all future facilities across PJM.

## **2. Staff's rate design proposal should be adopted, without the phase-in**

198. Ormet indicates that all four of the regional rate design proposals are preferable to

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<sup>37</sup> Exh. AEP-300 at 20-22.

<sup>38</sup> *Allegheny Power System Operating Cos.*, 115 FERC ¶ 61,156 at 61,543.

the license plate rates. Ormet believes that in order to develop an efficient PJM and ensure non-discrimination among customers in PJM, regionalization of costs is essential. Ormet however, believes that Staff's proposal is the most just and reasonable because it:

(1) ensures uniform, non discriminatory, rates for all customers in PJM; (2) places all customers receiving transmission service from PJM on an equal footing that is not based on the customer's location in PJM; (3) accounts for the use of the regional system and PJM's operational dispatch decisions; (4) ensures certainty of rates by avoiding a determination based on voltage that may lead to controversy; and (5) is the simplest and most efficient to implement. Ormet I.B. at 38-39.

199. Ormet supports Staff's proposal, without the phase-in, and explains that the proceeding is complicated because it involves cost shifts. Ormet believes that while Staff's proposal is not perfect, it best distributes costs of the regional services that PJM provides to all customers that are benefiting from the integrated regional system. Further Ormet suggests that Staff's proposal is consistent with the Commission's goal of introducing a system wide rate throughout the RTO.

200. Ormet explains that Staff's proposal allows for cost recovery of all PJM operated facilities through a uniform rate, which best accounts for the PJM system's regional nature, and the system-wide benefits of those facilities. Further, Staff's proposal acknowledges that it is sometimes impossible to determine the benefits to the system of a particular piece of a transmission facility, which is consistent with the Commission's traditional methodology of rolling in transmission facilities based on the fact that they serve a system wide function. *Northeast Texas Electric Cooperative, Inc., et al.*, 108 FERC ¶ 61,084 at 61,433 (2004). Ormet asserts that Staff's proposal is simple, because it includes the costs of all PJM controlled facilities which are easily identifiable and would be comprised of those facilities that provide regional benefits.

201. Staff's definition of regional transmission facilities is in accordance with the PJM Operating Agreement's definition of "Transmission Facilities" in Section 1.44.<sup>39</sup> Ormet believes that this is an objective test and reasonable because it accounts for all of those facilities that form the integrated PJM transmission system. Ormet claims that these facilities meet FERC's transmission definition and have been demonstrated to provide integrated service that serves all of the transmission and power customers before the PJM Office of Interconnection. Facilities excluded under Staff's definition are controlled by TOs and so their costs should not be recovered through a PJM regional rate, Ormet maintains. Further, if the Commission decides it is necessary, Ormet suggests that the

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<sup>39</sup> See Amended and Restated Operating Agreement of PJM Interconnection, LLC ("Operating Agreement"), available at <http://www.pjm.com/documents/downloads/agreements/oa.pdf>

non-PJM facilities' costs could be recovered through a localized TO rate. *ISO New England, Inc.*, 106 FERC ¶ 61,280 at 62,031 *order on reh'g*, 109 FERC ¶ 61,147 (2004). Further, in the event that the Commission would want to apply the seven factor test, Ormet argues that it can order each TO that has not done so, to do so.

202. Ormet asserts that Staff's proposal is also consistent with Commission policy setting transmission rates on a postage stamp basis. *Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act*, FERC Stats. & Regs., ¶35,024 at 35,163 (1993). Ormet contends that postage stamp rates were ordered by the Commission, and are overdue through the PJM control area since the Commission ordered a regional rate design on July 1, 2002. *Allegheny Power System Operating Co.*, 115 FERC ¶ 61,156 at 61,544 n.15. Ormet contends that postage stamp rates are required to ensure the just and reasonable allocation of costs and benefits to transmission customers.

203. However, Ormet opposes Staff's phase-in plan because it would continue to unduly burden customers entitled to a reduction of transmission charges and suggests the Staff proposal become effective on April 1, 2006. As to new facilities, Ormet agrees that PJM should continue using Schedule 12 to allocate the costs of new facilities. Finally, Ormet explains that the current RTEP process under Schedule 12 provides proper incentives for new transmission investment making it just and reasonable. Ormet argues however, that after a period of time determined through the PJM stakeholder process, the costs of the new facilities should be rolled into the Staff proposed uniform postage stamp rate.

### **3. Other Parties' proposals are flawed**

204. Ormet indicates that the other three proposals advocate a highway byway rate design which would regionalize the costs of some facilities while localizing others based on voltage determinations. Ormet believes that while this design may be an advanced method of determining the regional nature and related benefits of the facilities, it would be difficult to implement based on the fact that the methods may prove controversial because of the decision making process involved in the needed determinations. Of these highway byway proposals, Ormet prefers AEP/AP's proposal as it regionalizes only the extra high voltage facilities that provide clear regional benefits.

205. Ormet believes that AEP/AP's proposal is just and reasonable, but Staff's proposal is superior. Ormet explains that the AEP/AP proposal is easy to implement and is supported by adequate engineering principles, sustainable economic theory and reasonable cost shifting based on the current use and benefits of PJM's system. Ormet asserts that allocating the costs of extra high voltage facilities is justified from an engineering perspective. Ormet states that, economically, these high voltage facilities are the backbone of PJM's regional system, as they provide broad regional benefits by

enabling long distance transmission between various PJM members and enhance PJM's system reliability. Ormet notes that the AEP/AP proposal also produces the least cost shifts and would limit Ormet's exposure to significant transmission rate increases. Exh. AEP-207.

206. Ormet argues that opponents of the AEP/AP proposal are in error when they argue that it is not just and reasonable because of its failure to comply with cost causation principles, it ignores ARR/FTRs allocation, and fails to apply to the MISO transmission customers. Ormet argues that the AEP proposal is consistent with cost causation and reasonable expectations of the users of PJM's system, as those who benefit from using PJM's regional system should pay for the system. Ormet maintains that the AEP/AP proposal does not address ARR/FTRs allocation because that should be addressed in another proceeding. Ormet further argues that the AEP/AP proposal also does not include the costs associated with or facilities of MISO transmission owners because this proceeding was limited to PJM. Although Ormet believes that Staff's proposal is the best option in the alternative Ormet would support AEP/AP's proposal.

207. Ormet also would not object to AEP/AP's proposed revision to Schedule 12 which would differentiate between new projects that support PJM system reliability and which would be allocated to the entire PJM footprint and new projects that support economic benefits and would be allocated only to those who benefit from the projects. Ormet however, does not support PJM's suggestion of a bright line regionalization of only all newly constructed 500 kV and above facilities regardless on an analysis of the benefits provided and whether the facilities were built for reliability or economic efficiency. Ormet does not agree that 500 kV facilities are considered backbone facilities but 350 kV facilities only support local needs.

208. Ormet argues that of the three highway byway proposals, TOP's is the least desirable. Ormet asserts that the TOP proposal does recognize the regional nature of the PJM system and correctly assigns the costs of some regional facilities to all PJM customers but feels it overreaches because it allocates many facilities under 345kV that may not be regional in nature, while excluding others that are below 200 kV. Ormet argues that facilities with voltages below 345kV are not extra high voltage facilities and as such do not provide the same type of regional benefits of 345 kV and above facilities. Ormet explains that facilities of 345kV and higher almost always serve predominately regional functions, while facilities below 345 kV only do so sometimes. Exh. AEP-300 at 23, AEP-309 at 15. As for new facilities, Ormet states that the TOP proposal will result in a lengthy and burdensome procedure that may lead to additional litigation and is therefore unjust and unreasonable.

209. Ormet argues that the PPP proposal does recognize the regional nature of the PJM system and correctly assigns the costs of some regional facilities to all PJM customers. However, Ormet does not favor the proposal because it is burdensome and complex and

the 1996 cut off period for middle tier facilities may not be determinative of the regional benefits provided for those facilities. Finally, the proposal fails to presume that facilities of 345 kV are regional, when these facilities provide regional benefits and are classified as extra high voltage facilities. As to the new facilities proposal, Ormet also believes that the rebuttable presumption complicates the process of assigning costs and would unjustly hurt customers who would have to litigate in order to rebut such a presumption.

#### **4. Applicable effective date for the new rate design**

210. Ormet asserts that April 1, 2006 should be the effective date of any new PJM rate design change. Ormet argues that a phase-in, as Staff has proposed, would prolong the current unjust and unreasonable rates and so an earlier effective date is appropriate. Ormet also disagrees with TOP's February 1, 2008 effective date because there is no justifiable reason to wait almost two years to replace license plate rates.

#### **H. FirstEnergy Companies**

211. A sub-set of the members of the Responsible Pricing Alliance, designated the FirstEnergy Companies (Jersey Central Power & Light Company, Metropolitan Edison Company and Pennsylvania Electric Company), support retention of the existing license plate rate design; however, they argue that, if a new rate design is accepted, any such rate design should be conditioned on the termination of the payment obligations under certain EHV Agreements. These agreements contain terms and conditions under which the parties to each of them have agreed to construct and share in the cost of certain high voltage 500 kV transmission facilities in PJM known as the "EHV Facilities." Most of these facilities are 345 kV and above; however, there are some 230 kV investments included. Exh. FE-100 at 8. Under the terms of these agreements individual transmission owners in PJM make payments to other transmission owners for their share of the costs of the EHV Facilities.

212. The FirstEnergy Companies are concerned that, under all of the various proposals to regionalize cost responsibility for existing transmission facilities, the costs of the EHV Facilities would be excluded from regional sharing. The costs of these facilities would not be included in any of the highway/byway proposals or in Staff's postage stamp rate proposal, but would continue to be collected on a license plate basis. This is unreasonable and unjust, according to the FirstEnergy Companies, because they contend that the EHV Facilities are no different from any other transmission facilities for which regionalization is proposed. Failure to regionalize the costs of similarly situated facilities would discriminate against the transmission owners and their zonal customers who pay the cost of the EHV Facilities under the agreements listed above. There is no basis upon which one could treat these regional facilities differently, the FirstEnergy Companies contend, since they serve the same network function as other facilities that would be regionalized. They propose to roll the costs of the EHV Facilities into the

regional rate, to be recovered from all customers in PJM.

213. The FirstEnergy Companies contend that the Commission's 1997 PJM order, which rejected a proposal to terminate the EHV Agreements, provides no support for similar treatment here because it did not involve a complete change in rate design from license plate rates to regionalization. They further suggest that a concern of the Commission expressed previously, i.e., that termination would increase costs of the owners, does not exist here. The Companies argue that, here, the proposal is to change cost responsibility for transmission facilities that perform a regional function, and once a decision is made to do that, it would be illogical to exclude the EHV Facilities on the ground that termination would cause cost reallocations and cost shifts. Those impacts will occur in any case, the FirstEnergy Companies maintain.

214. The FirstEnergy Companies also reject the argument that the EHV Agreements entered into by the transmission owners cannot be terminated, arguing that rates and rate designs are subject to modification if findings are made that rates previously found to be reasonable becomes unjust and unreasonable. They contend that the issue is not whether the companies agreed to these arrangements in the past, but whether they continue to be just and reasonable in the context of a new rate design. If there is a significant and fundamental shift in the way that transmission costs are allocated and recovered, a change is warranted in the way the costs of the EHV Facilities are allocated and recovered, according to the FirstEnergy Companies.

### **I. EHV Participants.**

215. Another sub-group of entities, all members of the RPA, have submitted briefs under the designation "EHV Participants".<sup>40</sup> They agree with RPA on the question whether the existing PJM transmission rate design has been found unjust or unreasonable and whether any other design has been shown to be just and reasonable, concluding that neither has been demonstrated. They argue, however, that, if this decision were to find otherwise and recommend a new rate design, the existing EHV Agreements, which, as noted above, are investment-sharing contractual agreements among multiple entities, should not be disturbed.

216. The EHV Participants oppose the position of FirstEnergy, which advocates termination of the EHV agreements if the AEP/AP or TOP rate design proposals are adopted. The EHV Participants argue, in addition, that FirstEnergy did not make a case

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<sup>40</sup> These entities include: Exelon Corporation on behalf of PECO Energy Company; the Pepco Holdings, Inc. transmission-owning affiliates Potomac Electric Power Company, Delmarva Power & Light Company and Atlantic City Electric Company; PPL Electric Utilities Corporation; Public Service Electric and Gas Company; and UGI Utilities, Inc.

for termination of the EHV agreements if the rate design proposals of PPP or Staff are adopted. The Participants argue that the standard of review for abrogation of voluntarily negotiated and executed contracts has not been met here. They contend that the Commission has no authority to change a contract rate without first making a determination that the existing rate is unjust, unreasonable, unduly discriminatory, or preferential. 16 U.S.C. § 824e(a). Moreover, the EHV Participants argue that the strict “public interest” standard<sup>41</sup> should apply here where no standard of review has been designated. They contend that FirstEnergy has failed to demonstrate that the rigorous public interest standard required for the extraordinary remedy of contract modification or abrogation has been met.

217. The EHV agreements, according to the EHV Participants, stand alone from the PJM transmission rate design. The rate design cannot change the contractual obligations of the signatories to the agreements, the EHV group asserts. Neither is it unduly discriminatory, the EHV group maintains, to enforce existing contractual bargains. Preserving the integrity of contracts is in the public interest and consistent with the underlying principles of the Federal Power Act, the EHV Participants assert. The Commission has long recognized that integrity of contracts is a critical element of an orderly bulk power market, citing *Pub. Serv. Co. of New Mexico*, 43 FERC ¶ 61,469 at 62,153, *reh’g denied*, 45 FERC ¶ 61,034 (1988).

218. The EHV group argues that termination of the existing payment obligations would reallocate the respective EHV cost shares that each party to the agreements agreed to bear and would harm the EHV Participants by exposing them to larger cost shares. The EHV Participants further maintain that the Commission has found the EHV agreements to be correct cost-sharing agreements that should be preserved.<sup>42</sup>

219. EHV Participants further contend that the EHV Agreements are not consistent with regionalization, as had been argued by TOP. It points out that regionalization would allocate costs to and prescribe recovery from all customers in PJM, whereas the current agreements allocate costs to and recovery of such costs from only certain transmission owners and their zonal customers

## **J. Illinois Commerce Commission**

220. The Illinois Commerce Commission (ICC) takes the position that there is no real need to modify the current zonal license plate rate design approach for allocating costs of

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<sup>41</sup> *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

<sup>42</sup> PPP Reply Brief at 4, FN 6, citing to *PJM Interconnection, L.L.C.*, 108 FERC ¶ 61,264 (2004). See also *Jersey Central Power & Light Co. v. Atlantic City Elec. Co.*, 111 FERC ¶ 61,179, *order on reh’g*, 113 FERC ¶ 61,237 (2005).

existing PJM transmission facilities. The agency points out that the Commission is publicly committed to re-examine the rate design for the combined PJM/MISO region in a proceeding to be commenced by August 1, 2007. It further believes that the PJM/MISO stakeholder forum is the proper place for that re-examination to take place.

221. The ICC further contends that the resources of all interested parties would be better devoted to the development of proper transmission rate design for the combined PJM/MISO region. Modifying the PJM rate design before that effort has begun would, ICC argues, unnecessarily complicate the combined proceeding to be undertaken in 2007. The ICC sees record deficiencies here also that would operate to complicate matters. For example, it suggests that the record as to modification of the current FTR/ARR allocation process does not adequately address the subject or disclose how it might be accomplished.

222. Nevertheless, should the Commission proceed to modify the current license plate rate design for allocating costs of existing intra-PJM transmission facilities in favor of a highway/byway design, ICC would prefer that the voltage demarcation point be set at 345 kV. ICC points to testimony of AEP witness Mr. Pasternack to the effect that voltage lines of 345 kV and above possess all of the characteristics of a regional transmission highway, namely, the ability to transfer large amounts of power overlong distances, high capacity, and interconnection with other high capacity systems. Exh. AEP-300 at 15. ICC contends that the 345 kV demarcation point could work well in the highway/byway rate context as a logical point of differentiation between those facilities that provide regional benefits and those that do not. ICC notes, as well, that it had accepted 345 kV as a cut-off level in a MISO proposal to allocate the costs of new baseline transmission projects between local and regional use.<sup>43</sup> It further suggests that 20 to 50 percent of the costs of existing 345 kV and above transmission facilities be allocated on a regional basis.

223. The ICC also urges the Commission not to upset or disrupt the cost allocation process for new transmission facilities that is currently contained in PJM's Operating Agreement Schedule 6 and Open Access Transmission Tariff Schedule 12. This will ensure that only beneficiaries of these new facilities share in the cost, consistent with cost causation ratemaking principles.

224. ICC would also not favor the use of a load-ratio share, in the form of 1 CP for allocating the highway portion of the allocated costs, preferring instead, use of some measure of imports. ICC refers to testimony of RPA witnesses Mr. Shanker and Mr. Naumann, who testified that the load ratio share methodology is not linked rationally to cost causation principles nor does it match well the benefits to cost allocation. Exhs.

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<sup>43</sup> Comments of the Organization of MISO States, October 28, 2005, at 2., Docket No. ER06-18-000.

RPA-26 at 20-21; RPA-10 at 28.

### **K. Public Service Commission of Maryland**

225. The Public Service Commission of Maryland (MDPSC) contends that the existing license plate rate design fails to recognize adequately the regional nature of transmission in a large RTO, the benefits obtained by exporting zones and the changing energy flows. MDPSC further is concerned that allocation of new transmission costs to specific zones will engender opposition, possibly preventing the construction of new needed capacity. The agency points out that changes in electricity flows occur through time, making it unjust and unreasonable to make a permanent assignment of the costs of new facilities only to those zones currently expected to benefit from the construction. This approach also ignores the benefits derived by exporting zones, according to MDPSC, as well as reliability improvements that redound to the benefit of the entire region. MDPSC does not have a preference for a new rate design among those offered in this proceeding, but notes that postage stamp treatment of new transmission facilities will avoid the problems which concern it.

### **L. PJM Interconnection, L.L.C.**

226. PJM submitted observations on the record that were designed to protect the viability of its market design. PJM took no position on the merits of the alternative rate designs for existing transmission investment, which it sees as a matter of equity among the various market participants. However, PJM does express a warning that certain of the proposals, including those to freeze the methodology for allocation of ARR and to change the allocation of costs of new facilities at voltage levels below 500 kV, would have negative impacts on the PJM marketplace. PJM offers its view that any change in the existing license plate design would have significant implications for the manner in which ARR are allocated. Since this is a fundamental feature of the PJM market design, it advocates a synchronization of any change in the existing license plate design with a concurrent change in the methodology for allocating ARR in the PJM region. This is important, according to PJM, because customers should not receive a greater percentage of ARR than their share of transmission costs. The Commission should not, PJM asserts, freeze the current allocation methodology if there is a fundamental change in the rate design that produced the allocation method.

227. The necessary synchronization of a change in ARR allocation with the change in the license plate rate design could be accomplished by requiring PJM to make a compliance filing realigning the allocations, or by directing a stakeholder meeting to develop a new ARR allocation methodology to conform to the new rate design.

228. For new facilities, PJM observes that a bright line demarcation at 500 kV and above for regional allocation of the cost of EHV facilities would be consistent with the

PJM market design. Such facilities, PJM notes, are properly characterized as backbone facilities that benefit the entire region. It contends that the Commission could reasonably adopt this test as a matter of policy, since it would encourage development of backbone facilities benefiting the entire PJM region, eliminate controversy over future cost allocations, and be consistent with goals of the Energy Policy Act of 2005<sup>44</sup>, which support development of critical new transmission infrastructure.

229. PJM would extend the regional treatment of 500+ kV investment to those facilities constructed to support the new EHV plant. PJM does not believe the demarcation line can be set lower, because it contends that facilities at 345 kV and below are frequently required to support local needs, and cannot be deemed to be regional backbone facilities.

#### IV. ISSUES

##### A. Preliminary Issue re: Burden of Proof

230. As noted above, RPA has argued that the advocates of a rate design change bear a two part burden of proof in that they must demonstrate that the existing rate structure is unjust, unreasonable, unduly discriminatory or preferential, and that the proposed alternate rate structure is just and reasonable. It argues that because the Commission has not found the existing rate design to be unjust and unreasonable, advocates of a new design bear “the heavy burden of first demonstrating that the existing rate design is unjust and unreasonable before any alternative proposal may be considered.” RPA I.B. at 23. RPA goes on to argue that the advocates of an alternate rate design have not carried the first burden of showing that the existing rate structure is unjust and unreasonable.

231. TOP and other allied parties have challenged RPA’s premise as to the appropriate burden here. They say that this is not the typical kind of case where the Commission has approved a rate design as just and reasonable without condition, and a challenger would be required to satisfy the two burden test required by Section 206 of the Federal Power Act, 16 U.S.C. § 824e. Here, TOP argues that the Commission has conditioned authorization of the current license plate rate design, deeming it strictly temporary, envisioning that it would be in effect only through a transition period, to be followed by a uniform, system-wide rate that would apply to transmission services throughout PJM. Indeed, the Commission has also questioned whether the rate design now in effect is just and reasonable, and has set up this proceeding for the express purpose of gathering evidence on that very question. So, those parties opposing RPA’s view of the burden here believe that it is not necessary for the parties advocating an alternate design to prove that existing rates are unjust and unreasonable in order to design a new charge. The TOP proposal here can be seen as an amendment to the license plate design, it argues, because it retains elements of the existing rate design, citing *Louisiana Public Service*

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<sup>44</sup> FPA § 216, 16 U.S.C. § 824o (2006).

*Commission v. FERC*, 184 F.3d 892, in support of its contention.

232. Staff also argues that there is no additional burden in this proceeding associated with the Commission's stated goal of establishing a joint rate design for the PJM/MISO Combined Region in 2008. Staff argues that the Commission dismissed the option of continuing the current rate design for PJM when it found that it may not be just and reasonable and set this proceeding up to investigate the justness and reasonableness of the current PJM transmission rate design.

233. TOP further argues that Section 206 should not be invoked to make the Commission go back to square one, since it has already passed the hurdle of finding the existing rate design temporary and needing to be replaced. The parties opposed to RPA on this point, however, assert that both tests have in fact been satisfied, and the Commission has a record upon which it can act either to affirm the propriety of the existing rate design, or to find it unjust and unreasonable and adopt an alternate in its stead.

234. I agree with the latter point. The Commission established this proceeding for the very purpose of examining the justness and reasonableness of the existing license plate rate design. Whether or not one views that charge as identical to the burden set up by invocation of Section 206, the RPA point here would take us on a metaphysical exercise that, reduced to its foundation, simply elevates form over substance. The record here is more than adequate to make a determination on the open question whether the existing PJM transmission rate design is or is not just and reasonable, and if it is found to be unjust or unreasonable, to select an alternate among those presented here that can be determined on this record to be just and reasonable. In other words, the RPA argument confuses the matter before us and further consideration of it in all of its metaphysical grandeur will not contribute to a proper determination of the issues set for hearing by the Commission.

235. The parties advocating the position that the existing rates are unjust and unreasonable and should be replaced by an alternate rate design must demonstrate those points with sufficient and persuasive evidence in order to carry the day. That may be viewed as a burden of proof; however, these parties carry no special or additional burden.

**B. Is PJM's current modified zonal license plate rate design unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful?**

236. To begin, it is worthwhile to review the rate design principles that the Commission has followed in making decisions as to the reasonableness of a particular rate structure. A rate is just and reasonable when it is based "on the costs of providing service to the utility's customers, plus a just and fair return on equity." *Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1 (2002) (citing *Alabama Electric Cooperative v.*

*FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982)).

237. The Commission has identified five transmission pricing principles that adhere to the FPA requirements that rates must be just and reasonable and not unduly discriminatory or preferential. *Transmission Pricing Policy Statement*, ¶ 31,005 at 31,140. In the *Transmission Pricing Policy Statement* the Commission found that transmission pricing: (1) must meet the traditional revenue requirement, (2) must reflect comparability; (3) should promote economic efficiency; (4) should promote fairness; and (5) should be practical. *Id.* at 31,141-31,144. The first two principles are previously established Commission requirements and the last three principles are goals that an applicant with a non-conforming proposal should try to meet, but which may have to be ultimately balanced against one another in determining whether the proposed rates are just and reasonable. *Id.* at 31,141.

238. The first principle requires that transmission prices be based on the costs of the transmission service provided. Costs should be allocated to customers in a way that reflects the costs of providing transmission services to those customers. *Id.* at 31,141. The Commission indicated that customers must pay different rates if they use the system in different ways, but rates must be designed so that a TO meets, but does not exceed its revenue requirement. *Id.* While the Commission prefers proposals that conform to the traditional revenue requirement, the Commission will consider alternative pricing proposals which conform to the comparability principle and take into account the other three pricing principles. *Id.* at 31,147-31,148.

239. Cost causation first requires that rates reflect and recover costs. *Public Service Co. of NH v FERC*, 600 F.2d 944, 959 (D.C. Cir. 1979). Rates should allocate costs for each customer that match the costs to serve that customer. *Alabama Electric Cooperative Inc., v. FERC*, 684 F.2d 20, 27(citations omitted). Rates must track the costs for which customers are responsible. *Pennsylvania Electric Co v. FERC*, 11 F.3d 207, 211 (D.C. Cir. 1993),(citing *Town of Norwood v FERC*, 962 F.2d 20, 25 (D.C. Cir. 1992); *Union Elec. Co. v FERC*, 890 F.2d 1193, 1198 (D.C. Cir. 1989)). Received benefits cost allocation requires that those who benefit should also bear the costs. *See City of New Orleans v. FERC*, 875 F.2d 903, 905 (D.C. Cir. 1989); *Tennessee Gas Pipeline Co., 55 FERC ¶ 61,484, at 62,633* (1991).

240. Commission precedent indicates that “cost causation and received benefits are two methods of expressing the same concept.” *California Independent System Operator, Corp.*, 103 FERC ¶ 61,114 at 61,357 (2003), *reh’g denied*, 106 FERC ¶ 61,037 (2004). In *KN Energy, Inc. v. FERC.*, the Court of Appeals stated that the received benefits cost allocation was another method of cost causation, and simply an extension of the chain of cost causation. *KN Energy*, 968 F.2d 1295, at 1302. In *Midwest ISO Transmission Owners v FERC*, 373 F.3d 1361, at 1368, the Court of Appeals also found that cost causation principles compare the costs assessed to benefits drawn or burdens imposed.

Commission precedent holds that in order for benefits based cost allocation to occur the benefits must not be “insubstantial, limited or purely speculative.” *California Independent System Operator Corporation*, 113 F.E.R.C. ¶ 63,017 at 65,125 (2005), (citations omitted).

241. The second principle requires that a new transmission pricing proposal must “offer third parties access on the same or comparable basis, and under the same or comparable terms and conditions, as the transmission provider’s uses of its system.” *Transmission Pricing Policy Statement*, FERC Stats. & Regs. ¶ 31,005 at 31,142, (quoting *American Electric Power Service Corporation*, 67 FERC ¶ 61,168 (1994)). This principle involves a “golden rule of pricing” that provides that a TO should “charge itself on the same or comparable basis that it charges others for the same service.” *Id.* Additionally, the comparability principle requires that a utility must pay the same price that third-party customers pay for transmission service when it makes off-system sales using its own transmission system. *Id.* at 31,142-31,143.

242. The third principle provides that transmission pricing should promote good decision making and allow for

“efficient expansion of transmission capacity; efficient location of new generators and new load; efficient use of existing transmission facilities, including the efficient allocation of constrained capacity through market clearing mechanisms; and efficient dispatch of existing generating resources. *Id.* at 31,143.

243. The fourth principle provides that transmission pricing should be fair and equitable, which requires that existing wholesale, retail and transmission customers, to the extent practicable, should not pay for costs incurred in providing wholesale transmission services ordered under Section 211. *Id.* Additionally, the economic harm created when transitioning from one pricing approach to another should be mitigated to the extent practicable. *Id.* at 31,144. The fifth principle provides that transmission pricing should be practical and easy to administer allowing a user to be able to calculate how much it will be charged for transmission service. *Id.*

## **1. Existing Facilities**

244. The record amply demonstrates that the current PJM license plate rate design for existing transmission facilities fails to properly align rates with cost causation and benefit derivation, and requires replacement. The first and most compelling reason for this conclusion is the record evidence from a number of witnesses who point out persuasively that the current license plate rates, which assign existing facilities’ costs only to customers in the zone where the transmission facilities are located, fail to allocate any of the costs to beneficiaries of the transmission facilities that might be located in other zones. Exh. TOP-1 at 8-9; Exh. PPP-10 at 4-6. As these witnesses have demonstrated,

the PJM footprint has expanded, and transmission facilities in the footprint are now integrated so that they are available to serve all customers in the footprint, and are not dedicated exclusively to serving local customers, other than those lower voltage facilities that are directly connected to distribution facilities and end use customers. *Id.* All transmission facilities in PJM provide access to all generation in PJM, which provides generation market benefits and enhanced reliability to all PJM transmission zones. Exh. S-3 at 15-16.

245. To support this conclusion there is evidence in the record that AEP's interfaces with neighboring utilities have experienced greater power flows, indicating greater uses of the system by customers throughout the region, especially its higher voltage facilities rated over 345 kV. Exhs. AEP- 300 at 20; AEP-304 and 305; AP- 902 at 4-6; Tr. at 107. Inclusion of AEP in PJM was anticipated to have this effect on the patterns of delivery of power across the PJM footprint, and studies have confirmed this to be the case. It is only just that the beneficiaries of the newly expanded and integrated transmission system bear an appropriate share of the costs of the existing system through a rate design that is more properly aligned with cost causation and benefit derivation.

246. Moreover, the evidence suggests that the existence of larger deliveries across zonal borders within PJM are sustainable and not only a transient phenomenon. Exh. AEP- 211; Exh. AEP-403 at 21. As such, they simply cannot be ignored for ratemaking purposes. As TOP witness Bourquin stated, combined region services are being treated under the license plate rates as if they did not exist. Exh. TOP-1 at 8-9. With all of the costs of the existing transmission facilities being recovered from local native load, the beneficiaries of the regional usage of the existing transmission rate base are receiving a free ride at the expense of the native load customers. There can be no clearer demonstration of an unjust and unreasonable rate design.<sup>45</sup>

247. RPA, JCA and ICC have raised several arguments in an attempt to retain the current rate design for existing facilities. RPA advances some equitable considerations that it contends should operate to justify the continued use of license plate rates. It first argues that most of the transmission owners favor the zonal rate design for existing facilities, which it believes warrants continuation of the current rate design until a new

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<sup>45</sup> The suggestion that rates should be based solely on the reasons the transmission lines were originally built without reflecting current and future use reflects a strained interpretation of cost causation that ignores benefit derivation. I subscribe to the view expressed by the Commission in *California Independent System Operator*, 103 FERC ¶ 61,114 at 61,357, that "cost causation and received benefits are alternate means of expressing the same concept." The point being that rate design cannot be static and ignore a changing pattern of benefit derivation caused by changed circumstances, of which there have been many since the original decision to build the existing transmission plant was made.

design is adopted for the Combined Region in February, 2008. While the Commission has taken a regional or stakeholder consensus into account in determining an appropriate rate design<sup>46</sup>, this is not an example of such a stakeholder consensus. This is a hotly contested issue, with transmission owners on both sides of the question. In other words, this is one matter that does not lend itself to majority rule, especially where the transmission owners who are benefiting from the existing rate design outnumber those who are not. It is also not the kind of issue that a stakeholder process would be likely to resolve, given the disparity of viewpoints and the cost shifts attendant to any new design.

248. RPA also would give great weight to the initial cost allocation decision, given that the zonal rates allocate costs to those for whom the facilities were initially planned, designed and built, because they had notice and a chance to review the cost and design of the facilities. They argue that retaining the original cost allocation would strike a blow for efficiency-based need determinations and the assignment of costs to those who originally supported the facilities. Here again, it is not as simple as RPA would have it. Their preference would totally ignore changed usage patterns and the expanded integrated system that now exists for the benefit of existing customers and a whole new group of customers. It fails to account for new uses and fails to consider fairness and conformance of the rate design to cost causation/benefit allocation principles. Moreover, while reallocating sunk costs may not create economic efficiency, that argument ignores the need to have an equitable rate design. It also ignores the considerable additional investment that is added to the existing transmission plant on a regular basis for upgrades and refurbishment. Tr. at 372-373. At least as to that part of the rate base, there will be proper price signals and economic efficiency if the rate design is modified to take account of the regional use of the existing system.

249. Perhaps the strongest equitable point that RPA has made in defense of the current license plate rate design is the contention that current cost allocations are reasonable because existing facilities were constructed for the purpose of providing in-zone customers with the property rights necessary for congestion-free usage of those facilities. This is a suggestion that there is a hierarchy of entitlement to use, and the highest continues to be serving local loads from traditional generation resources. However, the Commission established a regime of open access in Order 888 from any network load to any network load that is difficult to reconcile with the RPA argument here. Indeed, RPA members receive congestion-free rights to use the high-voltage transmission system owned by other PJM members to import power from non-local generators as part of this new regime.<sup>47</sup> Property rights associated with original use decisions of the classic PJM companies reflect an historic fact that has little relevance in the changed market structure of today's PJM. It does not provide a sufficient basis for maintaining a rate design that

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<sup>46</sup> See *California Indep. Sys. Operator*, 109 FERC ¶ 61,301 at 62,479 (2004), *reh'g denied*, 111 F.E.R.C. ¶61, 337 (2005).

<sup>47</sup> See, e.g., *PJM Interconnection, LLC*, 108 FERC ¶ 61,264 (2004).

fails to properly account for current and future uses of the PJM transmission system.

250. RPA also contends that administrative efficiency considerations argue in favor of retention of the existing rate design, at least until the Commission considers a rate design for the Combined Region in February, 2008. Staff responds that this factor should give way to more material considerations, such as alignment of the rate design to cost causation principles and avoidance of subsidies. Other parties point out that RPA's members have been attempting to forestall a rate design change for several years and that this argument is one more delaying tactic. I conclude that administrative efficiency is a worthwhile factor that ought to be considered as an interim measure where there is no real need to correct inequities, or there is a need for further study to ascertain the proper direction to follow. Neither of these caveats is relevant here. There is a compelling need to align the rate design with cost causation and benefit allocation principles and the record contains more than enough well-supported alternate rate design options for the Commission to consider. There is no need to wait and no need to retain an unjust rate design for the sake of administrative efficiency.

251. I am also not persuaded by the criticisms offered by RPA as to the substantive basis for the conclusion that the current rate design is unjust and unreasonable. RPA attacked what it described as "generalized assertions" regarding uses and benefits of the integrated PJM transmission system, decrying a lack of quantification of the uses and benefits. Without such a quantification, RPA suggests, there is no principled way for the Commission to determine if rates are misaligned and therefore unjust. RPA I.B. at 37. The generalized assertions that the parties urging a change in rate design are making are pretty fundamental concepts underlying the design of rates. That precise measurement of uses and benefits is not available provides no justification for the utter failure to allocate costs to beneficiaries on the basis of purpose, function and usage. While exhibiting some rhetorical relish, the following point made by TOP is fundamentally correct:

License plate rate defenders cannot demand such exactitude as the price for letting go of a methodology that is totally bereft of even a loose connection between cost burdens and benefits. TOP R.B. at 34.

252. RPA argues further that it is irrational to reallocate the costs of transmission systems in a two-sided platform,<sup>48</sup> such as PJM, on the basis of voltage. In such an arrangement, RPA contends, all facilities are interrelated and essential in performing the delivery function, and it is not possible to differentiate any facilities as being used more or providing more benefits than any others. Of course, this argument seems to bolster Staff's view of the matter, discussed below, rather than suggest a basis for a design that

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<sup>48</sup> The PJM network is said to be a classic network, or "two-sided platform", where both generation and load are necessary for the network to have value. Exh. RPA-20 at 13-14.

ignores the fact that some facilities are supporting a regional function. In any event, I am not persuaded that this is a basis for concluding that the existing design should be retained.

253. RPA additionally maintains that customers in a host zone primarily use and benefit from the existing transmission facilities in that zone. Since these in-zone customers receive the primary benefit from the facilities in their zone, a rate design that allocates to such customers the in-zone costs of the existing facilities is appropriate, according to RPA. However, this does not change the fact that some zones have little or no high voltage lines and, under license plate rates, these customers escape responsibility for the cost of network grid services at the expense of those in zones with a great number of such facilities. It is clear the charging solely on the basis of proximity to transmission fails to properly charge beneficiaries and results in cost subsidies. Exh. TOP-1 at 3-6.

254. JCA indicates that cost shifts would be created if any of the proposals were adopted, noting that there were trade-offs between more or less transmission investment, and transmission and generation costs, which were considered by utilities and their state regulators when they planned their existing transmission facilities. JCA argues that the costs of the facilities were to be borne by the native load customers for whose benefit the transmission company built the facilities. JCA argues that it is unreasonable to allow high cost transmission utilities to export these costs to other areas though a system-wide rate component while allowing the utility to retain the less expensive generation for its native load customers. As indicated above, in response to RPA's similar initial cost allocation/sunk costs argument, an equitable rate design is needed. While cost shifts will be created with the implementation of any new rate design, a new rate design is necessary to create the proper price signals and economic efficiency. The rate design must be changed in order to take into account the additional investment added for upgrades and refurbishment which benefits customers outside of the zones that are currently paying for those upgrades.

255. JCA also contends that the current system is operating in an economically efficient manner, since an entity in the footprint can procure power at the same transmission delivery cost. Exh. JCA-1 at 14-19. JCA also argues that the physical operations of the electric grid have not changed, so power that is used locally continues to be dispatched over locally used and paid for lines. JCA argues that there is no evidence that indicates that the current system is inequitable or results in cross-subsidization, and since the physical flow of the transmission system has not changed, it is being paid for by the parties who benefit from it.

256. Ormet argues that JCA's assertions, while true, fail to take into account the issue that current license plate rates can greatly differ depending on which zone the customer is located. Ormet argues that the current system provides equal access to extra high voltage transmission facilities, which are paid only by customers in some zones. AEP argues that

while it is true that the PJM expansion did not change the law of physics, large amounts of west-to-east power transfers, which cannot take place without the underlying regional transmission grid, are occurring. The fact that an electron generated in the Midwest cannot be traced directly to a New Jersey customer is irrelevant.

257. TOP argues that JCA's assertions are irrelevant because customers are only charged for power that was dispatched due to their demand. *PJM Interconnection, LLC*, 109 FERC ¶ 61,067 at 61,260. TOP argues that the fact that some transactions are made possible through displacement, which allows for the electricity to not have to travel the full distance, does not negate the benefits of lower cost supply charged based on a remote location's competitive electric supply. TOP further argues that the ability to contract on an unbundled basis for generation which is located at long distances provides load with economic choices unavailable prior to open access and RTO formation. Similarly, Ormet argues that while seams elimination did not alter the laws of physics, it did change the trading patterns and altered the economic bargain among the parties as parties in the PJM/MISO footprint can now make deals that were not economically feasible within the original PJM footprint.

258. As discussed above, the evidence indicates that some customers that are benefiting from high voltage lines are not paying for network grid services at the expense of the zones in which those facilities are located. JCA's arguments do not change the reality that license plate rates fail to allocate costs based on cost causation and benefits received. Further, the argument that the laws of physics have not been altered is unpersuasive, as clearly there is a subsidization issue with the current license plate rate design. *See* Exh. TOP-1 at 8-9; Exh. PPP-10 at 4-6.

259. Finally, the ICC maintains that modification of the existing rate design would only unnecessarily complicate the combined proceeding to be filed in less than 15 months. The ICC contends that since the seam between PJM and MISO is so interwoven, the attention and resources of stakeholders should be focused on development of a combined PJM/MISO region rate design. The ICC also indicates that the Commission's policy envisioned Regional State Committees being involved in the decision of whether the license plate rates should be retained, but neither the Organization of PJM States Inc., nor the Organization of MISO States has been able to address the issue as envisioned by the Commission. ICC argues that the record does not provide a basis on which to resolve issues associated with modifying the current rate, and it would be premature for the Commission to adopt and implement any of the proposals presented in this proceeding.

260. As explained in response to RPA's administrative efficiency argument, while it is a factor to be considered, in this case there are inequities that need to be corrected. The rate design must be properly aligned with cost causation and benefit allocation. As to ICC's concerns that Regional State Committees have been unable to address these issues, these organization may become involved in the MISO proceeding and choose to address

the issues there. Their inability to address the issues in time to weigh-in in this proceeding is not a reason to wait and retain an unjust rate design.

## 2. New facilities

261. As for new facilities, it will be recalled that the zonal rate design has been modified for investment in new facilities. Specifically, new facilities are planned centrally by PJM for the integrated needs of the region as a whole. Under Schedule 6 and Schedule 12, PJM determines when and where transmission facilities should be expanded or enhanced both for reliability reasons and for economic purposes, *i.e.* to relieve congestion. PJM also determines independently who causes and thereby benefits from the upgrades and hence who should pay the associated costs. Thus, significant portions of the costs of new facilities may be assigned outside of the zones in which the facilities are built.

262. Under Schedule 12, Reliability RTE are allocated to zones based upon an OTDF that is calculated as a projection of flows at a single point in time in the future when a reliability violation or operational performance issue is projected to occur. This requires a prediction of future operating conditions. AEP/AP argues that such predictions are required for planning purposes, but constitute a poor basis upon which to allocate costs. Exh. AEP-802 at 4. It is contended that use of the transmission enhancement will continue to evolve over time. AEP/AP contends that the costs of these enhancements should be allocated on a system-wide basis, because reliability improvements cannot be isolated and determined to have been required by specific geographic locations or local zones. Allocation of costs only to those customers within the zones identified in the snapshot projection would be unjust and unreasonable, according to AEP/AP, because that allocation may bear no relationship to the actual use of the facilities as that evolves over time. AEP/AP would allocate all Reliability RTE at 345 kV and above to zones on the basis of each zone's contribution to PJM's 1 CP load, which it contends would reflect the grid-wide reliability and market benefits resulting from the new facilities.

263. As for economic RTE, *i.e.*, that which is not approved for reliability purposes, but to improve LMP for specific zones, AEP/AP would continue to allocate that investment to the specific zones.

264. TOP argues that there is no fully fleshed-out set of criteria for PJM to follow in determining whether other beneficiaries exist in other zones that would warrant a regional allocation. It favors the convening of a stakeholder process to develop criteria which PJM can use to assess what would constitute a regional benefit that would justify regional rate treatment of at least some of the revenue requirements associated with the new facilities. It recommends that all of the revenue requirements associated with new facilities determined to provide regional benefits using the new criteria be allocated to what they have styled as highway rates.

265. PPP proposes that the Commission establish a rebuttable presumption that new facilities operated at “interstate highway” voltage and approved through PJM’s regional planning process benefit the entire region, so that the costs can be allocated on a postage stamp basis.

266. Staff argues that the existing PJM rate design for new facilities has not been shown to be unjust or unreasonable, and that it should be allowed to continue in effect. Staff points out that the current structure for new facilities: (1) adheres to the principle of cost causation; (2) provides a proper incentive for new transmission investment; and (3) has only recently been approved by the Commission and should be given a chance to mature.

267. I agree with Staff that the existing PJM rate structure for new facilities has not been shown to be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. There is a burden to overcome here, and the participants urging a change in the basic design for new facilities have not met that burden. Staff is correct that the record will not support a finding that the new facilities design is unjust or unreasonable. The current rate design makes a reasonable attempt to link cost recovery to those who are causing the costs to be incurred and to those benefiting from the enhancements, something that cannot be said for the rate design for the existing transmission plant. Incentives for new construction appear to be properly in place. Moreover, as Staff argues, the rate structure for new facilities, under which PJM determines when and where transmission facilities should be expanded or enhanced both for reliability reasons and for economic purposes, *i.e.* to relieve congestion, has been in place only a short time and should be given a chance to operate before being tossed onto the scrap heap.

268. While there is not a sufficient basis from which one may conclude that the rate design is unjust or unreasonable, that does not mean that it cannot be enhanced. The TOP suggestion that a stakeholder process be convened for the development of criteria under which PJM would make the determinations required by this rate design strikes me as a reasonable and desirable improvement that can be undertaken voluntarily within the construct of the current rate design. I would urge PJM to give that suggestion serious consideration, but its adoption is not compelled by the record.

### **3. ARR/FTRs**

269. As discussed above, RPA has argued that current cost allocations are reasonable because existing facilities were constructed for the purpose of providing in-zone customers with the property rights necessary for congestion-free usage of those facilities. It further notes that the linkage between cost responsibility and congestion-free use was preserved when PJM became an ISO in part through the allocation of congestion-free rights in the form of FTRs and ARRs. Both RPA and PJM argue here that ARRs are an

important part of the PJM market design, and suggest that any modification of the existing license plate rate design without consideration of its impact on FTRs and ARR would undermine the PJM market structure and require its systematic redesign. Exh. RPA-26 at 11-12; see also Tr. 403-407.

270. Staff argued, however, that the allocation of ARRs and FTRs is premised upon a recipient's status as a load serving entity, and is not based upon an entity's position as a transmission owner. Exh. AP-700 at 5; Tr. at 553. Staff argues that a change to its proposed postage stamp rate design will not affect distribution of FTRs and ARRs. TOP also takes the position that the issues in this proceeding should not impact the distribution of FTRs and ARRs. AEP/AP also argues that customers will continue to pay an allocated share of the system transmission costs under its proposed new rate design, and the Commission has never linked a specific rate design to allocation of FTRs and ARRs. Nothing in its proposal alters the entitlement to existing uses or the ARRs/FTRs allocated to hedge the congestion costs associated with such uses, AEP/AP argues. Several of the parties opposed to the RPA and PJM linkage arguments point out that the Commission has approved changes in PJM's rate design without altering the existing allocation of ARRs, and AEP/AP notes that the PJM manuals do not require a reallocation of ARRs after a change in rate design. Tr.at 74-75.

271. Several of those parties opposed to the RPA and PJM position here also point out that the Commission has an ongoing ARR/FTR proceeding where the matter can be examined and changes made to the allocation scheme as necessary.

272. For the reasons suggested by Staff, TOP, AEP/AP and others similarly aligned, I agree that a new rate design may be adopted here to replace the one found to be unjust and unreasonable without consideration of or changes to the existing allocation of ARRs/FTRs. PJM may be correct that it would be desirable to evaluate a new rate design in the context of impacts on its market structure, including allocation of ARRs and FTRs. However, major changes in rate impacts within PJM have taken place without such an inquiry, such as the elimination of RTORs and SECA charges, which suggests that the current ARR/FTR structure may be continued under a new rate design without serious problems arising with the PJM markets. Moreover, the Commission has established a generic rulemaking with respect to ARRs and FTRs.<sup>49</sup> The matter can be explored and resolved in the context of that broader inquiry, where greater attention can be focused on the ARR/FTR mechanism than was possible on this record. In any event, I am not persuaded that a change from an unjust and unreasonable rate design need await an examination of the question of allocation of ARRs/FTRs. The existing allocation

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<sup>49</sup> *Long-term Firm Transmission Rights in Organized Electricity Markets. Long-term Transmission Rights in Markets Operated by Regional Transmission Organizations and Independent System Operators*, "Notice of Proposed Rulemaking." 114 FERC ¶ 61,097 at 61,331.

scheme may be continued as part of the new rate design.

**C. If the answer to IV.B. is yes, are there any proposals as to rate design advanced by the participants in this proceeding that are just and reasonable and not unduly discriminatory or preferential or otherwise unlawful?**

273. As discussed in the Positions of the Parties above, numerous alternate rate design proposals have been suggested in this record. These need to be evaluated as to their strengths and weaknesses to determine which, if any among them, can be found to be a just and reasonable replacement for the modified zonal postage stamp design now in place. The choices include three variations of the “highway/byway” style rate design which use various voltage level boundaries for treatment of regional facilities. There is also the “postage stamp” proposal offered by Staff, and favored as well by Ormet, to consider.

**1. Are the proposals as to rate design advanced by AEP/AP just and reasonable and not unduly discriminatory or preferential or otherwise unlawful?**

274. As discussed above in the positions of the parties, AEP/AP has proposed a regional rate to collect the cost of transmission facilities with a voltage level of 345 kV and above. The rate would be derived by dividing the revenue requirements for these higher voltage facilities by the 1 CP for each zone. The actual rate derivation requires use of FERC Form 1 data and the adoption of certain informed assumptions. The balance of the revenue requirements for existing facilities of lower voltage would continue to be collected via the zonal rate design. Exh. AEP 200.

275. The voltage-based regional rate design offered by AEP and AP would effectively reallocate the revenue requirement associated with existing higher voltage facilities and would also assign the revenue requirement associated with new RTE to the regional component to better align usage of and benefits provided by these facilities with the cost responsibility. AEP I.B. at 32.

276. According to AEP/AP, its proposed voltage-based regional rate design accurately reflects the way the PJM regional transmission facilities are operated and correctly allocates costs to those customers who benefit from those facilities. There is little doubt that the expansion of the PJM region and other related changes have created benefits which include greater reliability, lower reserve costs and greater access to markets throughout the region, as has been amply demonstrated on this record. Exhs. AEP-212; ORM-1 at 5-6, 7-13; AEP- 100 at 2, 13, 18, 19, 21 and 27; AP-800 at 10. The AEP regional rate design proposal is well constructed to reflect these regional benefits and align cost responsibility more closely to the customers receiving these benefits. This is because the designation of 345 kV as the regional facilities boundary accurately reflects the role of these extra-high voltage facilities as the backbone of the transmission system

supporting the expanded PJM markets and the role of lower voltage facilities that support a more local delivery function. Exhs. AEP-100 at 32; AEP-802 at 3; AEP-300 at 4, AEP-403 at 19-20; AP-900 at 3-4, 7,9-12, 15. In short, the record contains a wealth of analysis and engineering studies that confirm the wisdom of a regional rate and the selection of 345 kV as the appropriate boundary.

277. Parties opposed to the AEP/AP rate design proposal raise several lines of argument. In addition to the point discussed previously that AARs and FTRs need to be readjusted if a plan like the AEP/AP rate design is adopted, RPA argues that the AEP/AP rate design proposal is based upon generalized and unquantified notions of usage and benefits. It says that there is no connection between the AEP/AP proposal for allocation of costs and the notion of use of the transmission system. RPA contends that the PJM system is a “two-sided platform” or network, in which benefits cannot be specifically attributed in the manner suggested by the AEP/AP rate design. The suggestion is that all participants are necessary to the success of a network:

In general, each participant in the platform is important to every other participant for generating the usage and scale-economy externalities, and the economic benefits that flow from those externalities... Therefore, it makes no economic sense for either one to assert that it should bear less of the cost or derive more of the benefits of the network because it brought a valuable asset to the platform. Exh. RPA-20 at 12-13.

278. Further, RPA decries the lack of any causal link between the use of the system and its cost allocation proposal, finding the 1 CP based allocation proposal inherent in the design an inadequate basis upon which to align cost responsibility with usage. RPA additionally notes that much of the benefit of the AEP transmission system is enjoyed by MISO. Tr. at 164-73. Failure to allocate any cost to MISO customers is a fatal flaw in the AEP/AP plan, according to RPA.

279. RPA joins other parties in arguing that the AEP/AP proposal is based upon an arbitrary and unsupported voltage cut-off. It contends that the actual function of the facilities whose costs are being allocated must be part of any design basis. RPA notes the Commission’s concerns in the *November 18, 2004 Order* at 109 FERC ¶ 61,168 at 61,821 that proposed voltage-based elements of a regional rate design were insufficiently supported by engineering analyses. RPA sees the same fault here, observing that AEP’s studies introduced here were limited to AEP facilities. Tr. at 138. Similarly, AP looked only at AP’s higher voltage facilities when conducting its analyses. Tr. at 153. RPA also found the analogy to a highway system flawed, noting that some 345 kV facilities were responsible for a significant number of congestion hours in 2005. See Exh. RPA-58. RPA further questions the number of different voltage-based proposals introduced here, suggesting that the motivation was less to come up with a good rate design as to find one that served the self-interest of the proponent. RPA sees problems with implementation as

well, since records are not maintained that would permit determination of revenue requirements by voltage, without detailed and burdensome studies. Exh. RPA- 23 at 3-4.

280. RPA sees the same defects with AEP/AP's rate design proposal for new facilities, since it would allocate new facilities on the same basis as existing facilities. In addition, RPA believes that the AEP/AP design for new high voltage lines would create problems for the construction of such facilities, in that it would introduce controversy beyond the area where the facility is planned.

281. TOP argues that the AEP/AP plan would discriminate against PJM tariff ratepayers in the eastern portion of the PJM region (PJM East) because that territory does not have facilities rated at 765 kV. It is argued that comparable facilities in PJM East to the 765/345 kV plant in the western portion of the PJM region (PJM West) are rated at 500 kV and 220 kV respectively. Drawing a boundary at 345 kV would exclude transmission facilities (220 kV) performing a regional function in PJM East, much like the 345 kV plant in PJM West, TOP contends. TOP suggests that the boundary could be set to include only the 500 kV and above facilities, or to include the facilities down to 220 kV, in recognition that they play a regional role in PJM East. TOP states that AEP/AP "chose to be piggy" in rejecting these options. TOP I.B. at 76.

282. PPP takes the view that the AEP/AP rate design proposal would be a significant improvement over the unreasonable rate design now in effect. However, PPP sees the AEP/AP proposal as suboptimal, preferring its own design idea, which it claims has significant advantages over the AEP/AP rate design plan.

283. Staff also argues that the voltage cut-off adopted in the AEP/AP proposal is arbitrary, pointing out that the 345 kV level is not based on industry sources, suggesting that facilities below 345 kV provide only local benefits. Exh. RPA- 59. Staff worries as well that facilities below 345 kV may be providing regional benefits but the cost of this plant would not be regionalized, resulting in discriminatory treatment. Staff is also concerned that selection of such an arbitrary voltage cut-off would encourage the construction of facilities at or above this cut-off, where another lower voltage might have been more rational.

284. Ormet finds that the AEP/AP proposal is just and reasonable, but it prefers Staff's proposed postage stamp rate design.

285. The arguments of the opponents to the AEP/AP proposed rate design fail to persuade me that the design is not just and reasonable. As I mentioned above, the studies and analyses submitted in support of the rate design are sufficient to overcome the Commission's concerns in the November 18, 2004 Order that the voltage cut-off proposed there was not well supported. There is a general industry recognition, in addition to the studies sponsored by AEP and AP that facilities as large as 345 kV and

above are constructed to serve regional needs.<sup>50</sup> But to be sure, this record contains substantial evidence to confirm this view.<sup>51</sup> I conclude that there is a reasonable and well-supported basis for the voltage cut-off selected as part of the AEP/AP rate design.

286. Neither is the argument directed toward the network or “two platform” nature of PJM persuasive in questioning the efficacy of the AEP/AP rate design. The purpose of this proceeding is to identify an alternate design that would be just and reasonable to replace one that has been found to be unjust and unreasonable. The assignment of some cost responsibility to those who enjoy the benefits of a regional network is a significant improvement over the existing structure, although, admittedly, it may not provide the optimum solution. As is discussed in more detail below, I found the Evans/Schmalensee argument persuasive in the context of support for the Staff postage stamp rate design, which I believe is superior to the AEP/AP design. But it does not preclude adoption of a rate design like that sponsored by AEP/AP which attempts to assign some cost responsibility to regional usage. The argument, in any case, provides an insufficient basis upon which to conclude that the AEP/AP proposed alternate rate design fails to meet the just and reasonable standard.

287. The criticism of RPA directed to the selection of the 1 CP method for allocating costs of the regional facilities under the AEP/AP proposal is also unpersuasive. I agree with AEP/AP that this is a well accepted method for allocations in PJM, and that greater specificity is simply not required. The record establishes that the 1 CP method is “...verifiable, easily understood and administered, and represents a sound measure of usage of utility facilities, as indicated by its wide acceptance and use.” Exh. AEP-206 at 22.

288. TOP’s discrimination concerns are unfounded. There is little in this record by way of engineering analysis or usage studies to confirm TOP witness Matassa’s conclusion that 230 kV facilities perform in PJM East a function similar to that of 345 kV lines in PJM West. Exh. AEP-309 at 16. I conclude that the evidence in the totality of the record confirms the fact that the backbone regional transmission facilities operate at 345 kV and above.

289. As to the fact that benefits of the PJM integrated transmission system extend to MISO, the Commission has decided, in its wisdom, to separately consider the issue of a rate design for the combined PJM/MISO region. Since we are here foreclosed from inquiring into the impacts of PJM transmission service on MISO, I am constrained to

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<sup>50</sup> The fact that 345 kV facilities may at times be congested does not make them any less a highway than Interstate I-95, which also becomes congested from time to time, as I can personally confirm. Tr. at 148-149

<sup>51</sup> See, e.g., Exhs. AEP- 212 at 5; AEP-300 at 20; AP-900 at 16-17; AEP-204; AEP-400 at 5-6; RPA-58 at 303-07.

look only at an appropriate rate design for PJM. So, while the AEP/AP alternate design may be sub-optimal compared to one for the combined region, it cannot be said to be unjust and unreasonable on this account. Standing alone, the record supports a finding that the proposed AEP/AP rate design is just and reasonable.

290. I conclude that rates for existing transmission facilities in PJM would be just and reasonable if they were designed with a regionally applicable component for facilities at 345 kV and above. As discussed above, I have found that the existing rate design for new facilities remains just and reasonable and does not require revision. So, AEP/AP's proposal for new facilities is rejected as unnecessary.

**2. Are the proposals as to rate design advanced by TOP just and reasonable and not unduly discriminatory or preferential or otherwise unlawful?**

291. It will be recalled that TOP advanced a "highway/byway" rate design for existing facilities that is similar to the AEP/AP design discussed above, but would allocate facilities with a voltage level of 200 kV and above to the regional, or highway, rate because it believes that such facilities serve a regional function in PJM East and West. The arguments in favor of the voltage cut-off recommended by TOP were discussed briefly above, but require further evaluation.

292. TOP claims that there is a distinction in the voltage levels of facilities in the two PJM regions. It says that, in PJM East, facilities rated at 500 kV and 230 kV perform a function similar to facilities in PJM West rated at 765 kV and 345 kV. AEP/AP suggests that the premise of the demarcation line between highway and byway portions of the TOP rate design is poorly justified, in that TOP has offered what it considers to be unsupported conclusions and poorly articulated reasoning.

293. The debate as to where to set the bottom limit for designation of regional or highway transmission facilities has devolved into differing opinions among those witnesses testifying on this subject. TOP witness Matassa contends that in any geographic area, the top two voltage tiers carry the majority of interregional transfers. In PJM East, those go down to 230 kV. Exh. TOP-10 at 6. AEP witness Pasternack testified that most of the 230 kV lines are not part of PJM's network in that they limit transfers across PJM and are not regional facilities. Exh. AEP-309 at 14-15. Mr. Matassa responded that the Mid-Atlantic Area Reliability Council (MAAC) referred to 230 kV facilities in its definition of highway facilities. Exh. TOP-3 at 17; TOP-1 at 6; TOP-17 at 8. AEP questions the source of that claim. TOP also asserts that its demarcation point will offer administrative simplicity.

294. AEP contends that TOP has failed to offer substantial evidence that its choice of 230 kV is superior to the 345 kV level adopted in the AEP proposal. I agree that the preponderance of the evidence supports the AEP position. The 345 kV demarcation point

is well documented and supported in this record, as previously indicated. The TOP analysis comes up second best at this juncture. I do conclude however, that a rate design based upon the TOP highway/byway proposal would be just and reasonable. It is simply not as well supported or justified as the proposal of AEP/AP. The record confirms the current wisdom of setting the highway demarcation level at 345 kV in a highway/byway rate design.

295. As to new facilities, it will be recalled that TOP proposed that the Commission convene a stakeholder process to develop definitions of “regional benefits” necessary to warrant the designation of highway for new facilities. Exh. TOP-3 at 25. AEP/AP questions the wisdom of this process recommendation, noting that the existing Schedule 6 and Schedule 12 process was the result of a stakeholder process.

296. I have determined that the existing rate design and process for new facilities has not been shown to be unjust and unreasonable. I suggested above that it may be desirable to consider the TOP suggestion for a stakeholder committee at this point to shed more light on the development of the regional component of new facilities; however, that process suggestion is not compelled by the record of this proceeding.

**3. Are the proposals as to rate design advanced by PPP just and reasonable and not unduly discriminatory or preferential or otherwise unlawful?**

297. PPP proposed a more complex version of the highway/byway concept. Under its plan, the costs of all transmission facilities with voltages over 500 kV and above would be allocated regionally, and the costs of facilities below 200 kV would be allocated locally. The cost of the middle tier facilities falling below these voltage levels would be split between regional and local based upon a percentage equal to the percentage of facilities in that tier that were constructed after 1996, the year that Order No. 888 was issued. Exh. PPP-1 at 21-22. PPP would also permit a case-by-case alteration of the allocation of a particular facility based upon a showing that regional treatment of the particular facility may not be appropriate. PPP contends that its proposed regionalization concept would promote construction of necessary and efficient transmission facilities. It believes that its middle voltage tier recognizes that, with open access under Order No. 888, deliveries across zonal boundaries increased, and transmission owners took on an explicit obligation to plan their systems to accommodate requests for firm service to or from loads outside of their local zone. *Id.*

298. AEP/AP argues that the PPP plan rests on an arbitrary line of demarcation that has no bearing on how the facilities are used or the benefits they convey. AEP/AP contends that the suggested “compromise” proposal of PPP is inconsistent with the Commission’s cost causation principles. Moreover, according to AEP/AP, there is no engineering or other support in the record for including in the highway portion of the rate the costs of transmission at voltages between 200 kV and 345 kV. AEP/AP sees problems with the

middle tier allocation methodology, which it contends will operate to allocate more 345 kV to local usage than should be the case. Noting that Exh. PPP-4 shows that only \$68.7 million (2.3 percent) of the total \$2.946 billion middle tier investment would be allocated to regional use, with the remaining 97.7 percent allocated to local use, AEP/AP concludes that this “lopsided result” is not justified. AEP/AP I.B. at 55.

299. AEP/AP further argues that there is no precedent for the concept of cost allocation by vintage, and emphasizes its record contributions that demonstrate the regional benefits provided by all 345 kV facilities, as well as noting that significant non-zonal use of utility transmission systems for third party transmission service before 1997. Exh. AEP-104 at 18-19; AEP-206 at 22; AEP-211. AEP/AP additionally contends that the PPP proposal would be unduly cumbersome to administer and is unnecessarily complicated.

300. RPA also finds no precedent for the cost allocation by vintage proposal suggested by PPP for the middle tier facilities. RPA further claims that no studies were submitted by PPP to demonstrate that the suggested cost allocation will align with the function of the facilities in the middle tier. RPA also objects to the PPP plan as overly complex and rife with potential errors, noting the complexity of the calculations in Exhs. PPP-4, PPP-5, PPP-6 and PPP-7. Also problematical, according to RPA, is the feature of the PPP proposal that would allow a challenge to a regional determination requiring a case-specific examination of particular facilities. RPA sees this proposal as poorly developed and one that creates additional complexity and uncertainty.

301. TOP sees no problem with the PPP proposal, contending that the design is squarely within the zone of reasonableness. Staff sees potential discrimination issues with the PPP plan, (as it does with the AEP/AP and TOP proposals) in that it might fail to recognize and allocate costs appropriately to lower voltage transmission that actually provides regional benefits.

302. I cannot endorse the PPP plan as a just and reasonable replacement for the existing rate design. I agree with AEP/AP and RPA that the plan is unduly complex and has little justification for the novel and untested idea of creating a middle tier of transmission facilities whose costs would be allocated on the basis of vintage. There is little record support to confirm the wisdom of this approach, and the parties objecting to it have raised serious concerns. I am troubled by the allocation of most of the middle tier facilities to local use, given the record evidence to support a finding that the 345 kV facilities that would fall in this range generally provide regional benefits. Moreover, given the development of clearly superior highway/byway alternatives offered by AEP/AP and TOP, I see little need to explore further the wisdom of a complex and uncertain methodology. While innovation may be a desirable pursuit and much good can come from such experimentation, this is not the place to engage in that exercise. We are concerned primarily here with righting a wrong, and we have several alternatives that will do that in a manner well-supported by the record.

**4. Are the proposals as to rate design advanced by FERC Trial Staff just and reasonable and not unduly discriminatory, preferential or otherwise unlawful?**

303. Departing from the highway/byway approach of attempting to identify and assign cost responsibility to those facilities that provide regional benefits, Staff has proposed a “postage stamp” rate design for PJM that is based on the fact that existing transmission facilities provide widespread benefits throughout the PJM region which fall outside of the zone of their location, and those benefits cannot be partitioned. Exh. S-5 at 8-9. The simplest and most common type of transmission pricing is postage stamp pricing. A postage stamp rate is a fixed charge per unit of energy transmitted within a particular zone, regardless of the distance that the energy travels. “A postage stamp rate design ... would allocate all of the revenue requirements throughout the RTO footprint so that everyone pays the same charge for transmission regardless of whether they call upon transmission service from a nearby generator or call upon service from a far-away generator.” TOP-3 at 19.

304. Staff would effectively assign a system-wide average rate to all existing facilities, which attempts to align cost responsibility with the region-wide benefits that all transmission facilities can be said to provide as part of the PJM network.

305. Staff would employ the PJM definition of transmission facilities to determine what facilities should be regionalized, contending that this definition has the Commission’s imprimatur, and presumably, PJM’s as well. Since a postage stamp rate design treats all transmission costs equally, a non-discriminatory rate design for PJM can be adopted. For new facilities, Staff would continue the current PJM rate design process, which it argues would carry no risk of creating a bias leading to inefficient investment.

306. Staff contends that the postage stamp rate design would satisfy cost causation principles. Staff sees cost causation as extending beyond a simple determination of who caused the facilities to be built, arguing that it should reflect as well those who benefit from the incurrence of the costs, a concept that is dynamic, as uses of the system change over the years. Staff suggests that a postage stamp rate reflects the widespread benefits provided by an integrated system like PJM’s and allocates costs on a socialized basis to all beneficiaries.

307. Staff further claims that the equal assignment of cost responsibility to all users/beneficiaries will alleviate the discriminatory nature of the existing license plate design, where some customers receive benefits without having any cost responsibility.

308. Because a shift to postage stamp rates will entail some significant cost shifts, Staff is proposing to phase-in the new rate design, by limiting the impact on the zonal revenue requirement paid by customers to no more than 10 percent annually. Staff also suggests

that the Commission may want to consider allowing TO's subject to retail rate freezes or caps to defer any trapped costs for later recovery. Exhs. S- 3 at 20; S- 6 at 6.

309. RPA objects to the Staff postage stamp rate design, arguing first that there is no Commission directive, goal or preference for such a rate structure. RPA again raises the failure of the Staff plan to account properly for the property rights in PJM represented by ARRs and FTRs, an argument considered and rejected above. RPA also disputes Staff's characterization of the PJM transmission system as a "public good", which formed the basis for the Staff plan. RPA maintains that Staff has not demonstrated that any results from interconnectivity of the system are evenly distributed.

310. RPA also objects to the severe cost shifts that are associated with the Staff postage stamp rate design, noting that one utility, Dominion, would incur a 72 percent cost increase. The proposed phase-in would only result in short-term mitigation, according to RPA.

311. PPP argues that Staff's rate design would memorialize functional boundaries between transmission and distribution that are inconsistent across the region. It suggests the need for application of the Commission's seven factor test, described above, which would delay implementation of the Staff plan. PPP also sees the Staff rate design proposal as ambiguous and ill-defined, and one that will require greater refinement.

312. TOP agrees with PPP that there is no uniformity in the classification of facilities as between transmission and distribution, which will encourage gamesmanship of utilities as they can be expected to attempt to shift costs. The classification problem will also open the floodgates of litigation, TOP suggests, as the companies squabble about the correct classification for low voltage facilities. TOP argues that it is just as wrong to charge 100 percent of the costs of transmission facilities to all load through a uniform regional charge as it is to collect 100 percent of the costs from native load customers, as is done under license plate rates. TOP contends that the rate design should be based on some analysis of primary purpose and function. Otherwise, one is treating unlike facilities the same for rate purposes, which it is suggested itself constitutes discrimination. Exh. TOP-15 at 25.

313. The acceptability of the Staff rate design proposal is dependent upon the extent to which one believes, as has been testified to by RPA witnesses Schmalensee and Evans, that no participant in a regional transmission organization can obtain the benefits of being a part of a wide-scale electricity market without the other participants. The RPA argument, offered in opposition to the AEP/AP rate design proposal which attempts to assign cost responsibility for facilities used to conduct regional transactions to those who benefit from them, cuts the other way when looking at the Staff proposal, which is predicated upon the very idea that transmission facilities in the context of a network are equally valuable.

314. I am persuaded that the PJM transmission system is an integrated network, and whether or not it can be described as a public good, it does, as a whole, operate to provide region-wide benefits. I agree with witnesses Schmalensee and Evans that it is fundamentally inappropriate in the case of a network like PJM to attempt to assign cost responsibility on the basis of some relative notion of which assets are more valuable than others for certain purposes. The Staff rate design instead assigns cost responsibility broadly and evenly across the network to all participants who benefit from membership or participation in the network. Those who argue that a postage stamp rate design fails to reflect the purpose for which the lines were built, or their original intended function, or even their current function, misunderstand the dynamic nature of the integrated PJM system, a system that has evolved into a network providing widespread benefits across a large geographic region. It would be inappropriate and counter to cost causation principles to design a rate structure predicated upon the original intended uses of the existing transmission lines in PJM when the uses have evolved, and will continue to evolve, encompassing more users and providing benefits to customers in a way the original planners could never have conceived. In such an integrated network, where no participant can obtain the benefits of being a part of a wide-scale electricity market without the other participants, Staff's rate design proposal is fundamentally right on the money. It assigns cost responsibility broadly and evenly to all participants. It is the correct rate design for a regional transmission organization such as PJM.

315. Conceptually, this approach is quite unlike the AEP/AP or TOP rate design proposals which attempt to make a finer distinction based on an analysis of primary purpose and function of specific facilities. I have been persuaded on this record that the better approach, recognizing the integrated nature of the network, is not to engage in that exercise, which is problematic, even if one accepts the premise that drawing this distinction is proper. Much of the evidence in this record concerns where to draw the line between facilities that perform primarily a regional function and those that perform a local function. The truth is, as Evans and Schmalensee testified, such an exercise is not appropriate in the context of a network where benefits are created jointly by network participants and cannot really be specifically attributed to certain facilities. Exh. RPA-20 at 7.<sup>52</sup>

316. The parties opposing the Staff plan are right to raise objections as to the cost impacts and possible practical implementation problems. The record confirms that a flash-cut transition to postage stamp rates from the diametrically opposed license plate

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<sup>52</sup> Nevertheless, I believe the proposals of AEP/AP and TOP can reasonably be adopted as just and reasonable, viewing that legal concept as capable of satisfaction by various means. It is clear to me, however, that the economically correct rate design is the one proffered by the Staff.

rate design would create unacceptable rate shock to customers. The transition will have to be moderated. Staff's proposal to phase-in the new rate design so that no zone would bear greater than a 10 percent rate increase annually is an acceptable means of transitioning to the new rate design. If the Commission proceeds in this fashion it should also consider allowing any trapped costs due to rate freezes or caps at the retail level to be deferred for later recovery.

317. As for classification issues, Staff seems to have a good point of departure, using Commission-approved definitions for the classification of transmission plant. There is no reason to expect that the horror stories feared by the opposing parties to develop. If there is any attempt to abuse the classification structure or if there are inconsistent applications among the PJM users, the Commission has procedural mechanisms available to deal with them. In short, I do not believe that these allegations present a serious impediment to implementation of the Staff postage stamp rate design.

318. In sum, I find that the Staff sponsored postage stamp rate design, with the added feature of a phase-in limitation on the extent of rate increases, is a just and reasonable rate design, that is not discriminatory, preferential or otherwise unlawful.

**D. If the answer is yes to more than one sub-part in IV.C., which of such rate designs should be adopted in this proceeding?**

319. The record here suggests the possibility of two approaches that can remedy the unfairness of the existing license plate rate design: the highway/byway design and the postage stamp design. As just discussed, they proceed from fundamentally different premises. The former is based upon a determination about which facilities are used primarily for regional purposes and would allocate the costs of such facilities to the regional market beneficiaries. As discussed, there are some disputes as to where to draw the line, but they do require that a line be drawn. This approach has some appeal, but I believe that Staff has the better idea.

320. The record confirms that the postage stamp rate concept is the correct one for the existing transmission facilities in a regional transmission organization like PJM, provided that the rate impacts can be successfully moderated, as I believe they can. I consider the highway/byway proposals of AEP/AP and TOP to be just and reasonable alternatives to the existing design, which is not just and reasonable, but as the record demonstrates, the following factors lead me to conclude that it is an inferior choice, when compared with the Staff proposal:

- a. The highway/byway rate design necessarily involves creating a distinction between regional and local facilities, when all facilities can be said to contribute to the benefits of the network that is PJM;

b. The highway/byway rate design requires a determination of the voltage levels of facilities that support regional use, which has been hotly contested here and in fact may not accurately assign regional cost responsibility in the context of an integrated network like PJM;

c. The highway/byway design fails to reflect adequately the dynamic nature of the PJM grid, where all facilities contribute to the success of and the benefits derived from the markets administered by PJM

d. The highway/byway design is capable of causing discrimination if the voltage determinations are incorrect or inaccurate, whereas the postage stamp rate is evenly and broadly applied to all participants.

321. As for new facilities, as discussed above, the existing rate design may be continued because it has not been demonstrated to be unjust or unreasonable . This is consistent with what Staff has proposed.

**E. If the Commission accepts any of the rate design proposals advanced in this proceeding, whether acceptance should be conditioned on the termination of the payment obligations under the EHV Agreements and the regionalization of the costs of EHV Facilities?**

322. I agree with the arguments of the so-called EHV Participants that the new rate design should not be conditioned on the termination of the payment obligations under the EHV Agreements. I do not believe that the First Energy Companies, which argued for such a condition, have met the rather difficult standard for overturning contracts willingly entered into by participants in the electric markets.

323. The Commission has long recognized that integrity of contracts is a critical element of an orderly bulk power market. *Pub. Serv. Co. of New Mexico*, 43 FERC ¶ 61,469 at 62,153, *reh'g denied*, 45 FERC ¶ 61,034 (1988). Moreover, there is no contract language in the EHV Agreements that suggests a standard different than the Mobile-Sierra public interest standard of review, which holds that the terms of an agreement can be changed only if doing so is proven to be in the public interest.<sup>53</sup> Such a demonstration has not been made here as to the two highway/byway proposals found to be just and reasonable, and has not even been attempted in the context of the preferred Staff postage stamp rate design proposal.

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<sup>53</sup> The “Mobile-Sierra” standard developed as a result of two Supreme Court decisions: *United Gas Pipe Line Co. v. Mobile Gas Service. Co.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). This standard is more difficult to meet than the “just and reasonable” standard. See *Northeast Utilities Service Co. v. FERC*, 993 F.2d 937, 960 (1<sup>st</sup> Cir. 1993).

**F. If a new rate design is adopted in this proceeding, what should be the applicable effective date?**

324. TOP, RPA and AP believe that the implementation of a new rate design should be deferred until February 1, 2008, when a design can be adopted for the Combined PJM-MISO region. TOP takes this view, notwithstanding that its members would fare better if a highway/byway rate design was implemented for PJM alone. TOP claims to take this position in fairness to all the PJM rate zones.

325. PPP prefers the implementation of a new design at April 1, 2006, with the refund effective date of August 13, 2005.<sup>54</sup> PPP argues that there is insufficient reason to delay implementation of a new rate design, given that existing rates are unjust and unreasonable. AEP/AP argues for implementation of its proposed design either on August 13, 2005 or April 1, 2006, finding no credible argument for another effective date. Staff takes no position on this issue, deferring to the Commission's judgment.

326. I conclude that the effective date for any rate design change which is meant to replace unjust and unreasonable rates should be as early as feasible. Here, that date is April 1, 2006. Prior to then, the SECA charges were in effect, which would be inconsistent with the adoption of the proposed new rate design. I do not believe the record would support deferral of the rate design change until 2008.

**V. CONCLUSION**

327. It is therefore concluded, for the reasons set forth in detail above, that the existing PJM modified zonal rate design for existing transmission facilities has been shown on this record to be unjust and unreasonable, and should be replaced with a postage stamp rate design, as recommended by Staff, to be effective April 1, 2006. The rate design should be phased in, as recommended by Staff, to avoid undue rate impacts, so that no customer receives greater than a 10 percent annual rate increase. Other rate designs considered on this record, specifically, those offered by AEP/AP and TOP also would produce just and reasonable rates, and may be considered by the Commission as alternatives to the Staff's postage stamp proposal. The current rate design for new facilities in PJM has not been shown to be unjust, unreasonable, unduly discriminatory, preferential, or otherwise unlawful and need not be changed.

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<sup>54</sup> *Order Accepting Filing, Requiring Compliance Filing, Accepting and Suspending Proposed Tariff Sheets, and Establishing Hearing Procedures*, 70 Fed. Reg. 34,458-67 (June 14, 2005).

It is so **ORDERED**.

William J. Cowan  
Presiding Administrative law Judge