

119 FERC ¶ 61,219  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
Philip D. Moeller, and Jon Wellinghoff.

Trans-Allegheny Interstate Line Company

Docket Nos. ER07-562-000  
ER07-562-001

ORDER ACCEPTING AND SUSPENDING PROPOSED FORMULA RATES,  
SUBJECT TO CONDITIONS, AND ESTABLISHING HEARING AND  
SETTLEMENT JUDGE PROCEDURES

(Issued May 31, 2007)

1. On February 21, 2007, as amended on March 30, 2007, Trans-Allegheny Interstate Line Company (TrAILCo) filed with the Commission, pursuant to section 205 of the Federal Power Act (FPA)<sup>1</sup> tariff sheets for inclusion within the Open Access Transmission Tariff (OATT) administered by PJM Interconnection, L.L.C. (PJM) to implement a transmission cost of service formula rate for TrAILCo. The proposed tariff sheets establish the rate for all jurisdictional facilities to be held by TrAILCo and also implement incentive rate authorization for a previously-qualified facility, the Trans-Allegheny Interstate Line Project (TrAIL Project).<sup>2</sup> TrAILCo requests a proposed

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<sup>1</sup> 16 U.S.C. § 824d (2000).

<sup>2</sup> The TrAIL Project is a proposed 500 kilovolt (kV) transmission line that is to be constructed from southwestern Pennsylvania to West Virginia to Northern Virginia, within the PJM region. A petition for declaratory order on transmission rate incentives for an early version of the TrAIL Project was granted in *Allegheny Energy, Inc.*, 116 FERC ¶ 61,058 (2006) (July 20 Order), *order on reh'g*, 118 FERC ¶ 61,042 (2007). In that proceeding, the Commission approved several incentives for a multi-state 500 kV line: (1) a return on equity (ROE) be set at the high end of the zone of reasonableness; (2) the ability to recover construction work in progress (CWIP) prior to the in-service date of the proposed project; (3) the option to expense and recover on a current basis the costs that the companies incur during the pre-construction/pre-operating (pre-commercial) period; and (4) the ability to recover all development and construction costs if the proposed project is abandoned as a result of factors beyond applicant's control.

effective date of June 1, 2007. TrAILCo also seeks approval for an incentive ROE for a static VAR compensator (SVC) to be installed at the existing Black Oak Substation (Black Oak SVC), in accordance with Order Nos. 679 and 679-A.<sup>3</sup>

2. For the reasons discussed below, we will accept TrAILCo's proposed formula rate, subject to conditions, and suspend it for a nominal period, to become effective on June 1, 2007, as requested, subject to refund. Moreover, we will grant TrAILCo's request for incentive rate treatment for the Black Oak SVC. In addition, we will establish hearing and settlement judge procedures.

## **I. Background**

### **A. Description of TrAILCo**

3. TrAILCo is a newly-formed, indirect subsidiary of Allegheny Energy, Inc.<sup>4</sup> TrAILCo was organized to finance, construct, own, operate and maintain the TrAIL Project and other transmission facilities that have been approved by the PJM Board of Managers under PJM's Regional Transmission Expansion Plan (RTEP) for construction under the provisions of the PJM Amended and Restated Operating Agreement (PJM Operating Agreement). TrAILCo states that it will own and operate other transmission

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<sup>3</sup> *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

<sup>4</sup> The petition for declaratory order addressed in the July 20 Order was filed by Allegheny Energy, Inc. and its subsidiaries, Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company, all doing business as Allegheny Power (collectively, Allegheny). The Allegheny Power companies are public utilities that deliver and supply electric energy at retail in parts of Maryland, Pennsylvania, Virginia, and West Virginia. They own an extensive network of transmission facilities, rated up to 500 kV, subject to the functional control of PJM, and located in the Allegheny Power transmission zone (APS Zone). The Allegheny Power companies are owned and controlled by, and are direct subsidiaries of, Allegheny Energy, Inc., a holding company under the Public Utility Holding Company Act of 2005. Allegheny Energy, Inc. also owns Allegheny Energy Supply Company, LLC that is engaged in the business of marketing and trading energy related products and commodities in the PJM markets. July 20 Order, 116 FERC ¶ 61,058 at P 1 and n.1. When Allegheny filed the original petition for declaratory order, it specifically requested authority for a newly-formed subsidiary to implement the requested incentive rate authority. *See Id.* P 6.

enhancements in addition to the TrAIL Project and the Black Oak SVC, including two additional transformers at the Wylie Ridge Substation to be in service by the end of 2007, as well as other more conventional upgrades.<sup>5</sup>

4. TrAILCo is a Transmission Owner within the meaning of the PJM Operating Agreement, the OATT and the Consolidated Transmission Owners Agreement (TO Agreement) because it is the owner of the transmission facilities that PJM has directed to be built pursuant to the regional transmission planning authority exercised under the PJM Operating Agreement and PJM OATT.<sup>6</sup> TrAILCo states that it has the exclusive right to submit this rate filing in order to collect its charges for transmission service through PJM.

## **B. The Filing**

5. The February 21, 2007 filing (February 21 Filing), as amended by the March 30, 2007 supplemental filing (March 30 Supplemental Filing), includes two requests: (1) approval of a formula rate design to recover all of TrAILCo's annual transmission revenue requirement as well as implement the transmission rate incentives that were approved in the July 20 Order; and (2) approval of an incentive ROE for the Black Oak SVC.

### **1. Proposed Formula Rate Filing**

6. TrAILCo proposes to implement a cost-of-service formula rate under which it will collect its annual transmission revenue requirement. The proposed formula rate would be populated using TrAILCo's FERC Form No. 1 accounts from the prior year. The formula rate will be applicable for all transmission service over TrAILCo's facilities from June 1 of a given year, through May 31 of the subsequent year. On or before May 15 of each year, TrAILCo will recalculate its annual transmission revenue requirement, producing an "annual update" for the next rate year, and will post the update on the PJM website. However, TrAILCo states that, because it is a newly-formed entity, its first FERC Form No. 1 will not be filed until late April 2008. Therefore, TrAILCo's initial annual transmission revenue requirement, effective June 1, 2007, will be calculated by populating the formula with estimated 2007 investment and expenses for the 2007 rate year, rather than its FERC Form No. 1. In May 2008, TrAILCo will use its 2007 FERC

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<sup>5</sup> The incentive treatment sought by TrAILCo, discussed below, applies only to the TrAIL Project and the Black Oak SVC.

<sup>6</sup> TrAILCo was accepted as a member of PJM as of March 28, 2007. March 30 Supplemental Filing, Transmittal Letter at 1.

Form No. 1 actual data to recalculate the annual transmission revenue requirement, and the difference between the 2007 estimated and actual revenue requirements will be the true-up component of the 2008 annual transmission revenue requirement (for the rate year from June 1, 2008 through May 30, 2009).<sup>7</sup> From the 2008 rate year on, the costs will be largely historical,<sup>8</sup> based upon data reported on TrAILCo's prior calendar year FERC Form No. 1. Any data that is estimated will be trued-up in the following year's annual update.

7. TrAILCo states that its proposed methodology is consistent with prior cost-of-service formulas recently approved by the Commission for other PJM transmission owners<sup>9</sup> with a few exceptions.<sup>10</sup>

8. First, TrAILCo requests a base ROE of 12.2 percent for non-incentive transmission projects, and an ROE of 13.9 percent for incentive projects.<sup>11</sup> TrAILCo asserts that, based on a discounted cash flow (DCF) analysis using a fifteen-company proxy group,<sup>12</sup> its zone of reasonable returns ranges from a low-end ROE of 7.8 percent to a high-end ROE of 15.6 percent. Working from the midpoint of that range (11.7 percent) with an additional 50 basis point adder to reward TrAILCo's continued

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<sup>7</sup> February 21 Filing, Exh. No. TRC-200 at 20-22.

<sup>8</sup> All costs are historical except for forecasted costs based on CWIP. For projects that are estimated to go into service in a rate year, the associated CWIP costs are calculated based upon the months in-service for that rate year, and the months that the projects are classified as CWIP.

<sup>9</sup> February 21 Filing at 9 (*citing Baltimore Gas and Electric Company*, 115 FERC ¶ 61,066 (2006) (*BG&E*); *Duquesne Light Company*, 118 FERC ¶ 61,087 (2007), *reh'g pending* (*Duquesne*)).

<sup>10</sup> *Id.*, Exh. No. TRC-200 at 23-24.

<sup>11</sup> The July 20 Order permitted Allegheny to adopt an ROE in the high end of the zone of reasonableness.

<sup>12</sup> The proxy group includes: American Electric Power; Consolidated Edison, Inc.; Constellation Energy Group; Dominion Resources; DPL, Inc.; Energy East Corp.; Exelon Corp.; FirstEnergy Corp.; FPL Group, Inc.; Northeast Utilities; NSTAR; Pepco Holdings, Inc.; PPL Corp.; Public Service Enterprise Group; and UIL Holdings. February 21 Filing, Exh. No. TRC-300 at 32.

participation in a Regional Transmission Organization (RTO),<sup>13</sup> TrAILCo asserts its base ROE should be 12.2 percent. Calculating the high end of the zone of reasonableness to then be between 12.2 and 15.6 percent, TrAILCo submits that the midpoint of that range, 13.9 percent, should be accepted by the Commission as an appropriate incentive ROE.<sup>14</sup>

9. Second, TrAILCo proposes implementation of the Commission-approved pre-commercial cost recovery for the TrAIL Project. The formula rate provides for the current recovery of pre-construction expenses prior to the in-service date of the TrAIL Project, which would be trued-up in subsequent annual submissions using data from FERC Form No. 1. In addition, the formula rate proposes to collect the actual pre-construction expenses that have been incurred prior to the instant FPA section 205 filing. TrAILCo's formula rate also provides for the inclusion of 100 percent of CWIP in rate base.

10. Third, TrAILCo proposes to use a hypothetical capital structure of 50 percent debt/50 percent equity. TrAILCo does not request the use of the hypothetical capital structure as a formal incentive but rather, proposes the capital structure as a pragmatic resolution of a fluctuating capital structure during the construction phase and as a cost-saving approach for ratepayers. TrAILCo argues that, during construction, its capital structure will be fluid, with financing through the issuance of stock or borrowing. The percentages of each of these financing vehicles will vary during construction depending on the costs, efficiencies, and difficulty in securing financing associated with each.

11. Fourth, TrAILCo does not propose to file its annual update with the Commission. TrAILCo states that the revenues under its formula rate are comprised of an annual revenue requirement forecast. TrAILCo explains that it is unable to subdivide this cost by customer, as the Commission's regulations require, because information regarding the load of load-serving entities and that of their customers in each zone is maintained by PJM. TrAILCo states that PJM classifies this information as confidential business information and does not make it publicly available.

12. TrAILCo also states that it is not able to provide rate design information pursuant to section 35.13(h)(37) of the Commission's regulations because the cost allocation to

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<sup>13</sup> TrAILCo states that this proposed incentive is consistent with Commission precedent. February 21 Filing, Exh. No. TRC-300 at 60-62.

<sup>14</sup> In support thereof, TrAILCo submits the testimony of Dr. Mark A. Joensen, Mr. Alan C. Heintz and Dr. William E. Avera. See February 21 Filing, Exh. Nos. TRC-100, TRC-200 and TRC-300, respectively.

zones and within zones is not within control of TrAILCo but, rather, is determined by PJM in the RTEP process and in PJM's rate design of zonal rates. TrAILCo further states that its "costs" are being submitted as the "rate." TrAILCo states that there is no rate for unit of service proposed, as the rate filed is simply an annual revenue requirement. TrAILCo states that, therefore, it is not comparable to other rates. TrAILCo further provides that the cost allocation responsibilities were set by PJM in the RTEP, as accepted by the Commission, suspended subject to refund, and subject to the outcome of hearing proceedings.<sup>15</sup>

## 2. Proposed Rate Incentive Treatment

13. In addition to previously-granted incentives as to the TrAIL Project, TrAILCo requests approval to recover an incentive ROE of 13.9 percent for the Black Oak SVC. TrAILCo states that the Black Oak SVC meets the requirements of Order No. 679 and its progeny and qualifies for the incentive ROE.

14. TrAILCo states that the Black Oak SVC is necessary to enhance the ability to transmit energy on the Black Oak-Bedington 500 kV transmission line and alleviate the effects of the loss of the Pruntytown-Mt. Storm 500 kV line. TrAILCo states that the Black Oak SVC is classified as a baseline project (PJM Upgrade No. b0216) under the RTEP.<sup>16</sup> TrAILCo also states that PJM's RTEP creates a rebuttable presumption that the Black Oak SVC is the product of a fair and open regional planning process intended to ensure reliability and/or reduce the cost of delivered power by reducing congestion.<sup>17</sup>

15. TrAILCo also asserts that its proposed incentives satisfy the Commission's requirement that a nexus exist between the incentive being requested and the investment that will be made; in this case, the Black Oak SVC.<sup>18</sup> In establishing the nexus between the incentive sought and the investment made, TrAILCo states that the size of the investment, the use of state-of-the-art technology, the substantial funding risk, and the

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<sup>15</sup> March 30 Supplemental Filing at 2 (*citing PJM Interconnection L.L.C.*, 117 FERC ¶ 61,058 (2006); *PJM Interconnection, L.L.C.*, 118 FERC ¶ 61,154 (2007)).

<sup>16</sup> *Id.* at 7. As explained in the March 30 Supplemental Filing, the Black Oak SVC was erroneously listed a Transmission Owner initiated project on the PJM website.

<sup>17</sup> February 21 Filing at 3-4 (*citing* Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 58).

<sup>18</sup> *Id.* (*citing* Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 48).

accelerated in-service deadline, establish the nexus for the requested rate incentive.<sup>19</sup> TrAILCo states that the Black Oak SVC is a state-of-the-art, solid-state SVC that will be the largest ever installed in the United States, as well as one of the largest in the world, at a capital cost of \$50 million.<sup>20</sup> The proposed in-service date for the Black Oak SVC is December 2007.

16. To demonstrate a financial nexus for the ROE incentive for the TrAIL Project and the Black Oak SVC, TrAILCo submits a detailed cash flow analysis for all of its transmission projects demonstrating that, notwithstanding the previously-granted incentives, an incentive ROE is essential to maintain financial integrity and investment-grade credit ratings. In its cash flow analysis, TrAILCo states that it uses a calculation that lenders typically use in determining the risk of a prospective borrower and the cost of borrowing. TrAILCo performs the cash flow study first, with a non-incentive ROE, then with the incentive ROE of 13.9 percent, and finally, with an ROE of 15.6 percent, and applies the effective bond rating for each scenario as more fully described in testimony submitted by TrAILCo witness Dr. Joensen.<sup>21</sup> TrAILCo asserts, through its cash flow analysis, that an ROE of less than 13.9 percent will result in below-investment grade credit rating, or “junk bond” rating, and therefore, an ROE of 13.9 is essential to maintaining financial integrity.<sup>22</sup>

17. In addition to the financial risks of the project, TrAILCo states that the project involves significant technological risks that merit the incentive ROE. For example, TrAILCo states that there is only one manufacturer that would commit to manufacturing and installing the SVC in the accelerated timeframe as requested by PJM. TrAILCo notes that pre-operation testing of the Black Oak SVC may present challenges beyond a typical installation because of the accelerated installation. TrAILCo states that the use of new technologies will increase the risks of the Black Oak SVC as procurement, installation, operations and maintenance of the new facilities will require new business processes and systems.<sup>23</sup>

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<sup>19</sup> *Id.* at 5; *See also Id.*, Exh. No. TRC-100 at 16-18.

<sup>20</sup> *Id.* at 11.

<sup>21</sup> *Id.*, Exh. No. TRC-101.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*, Exh. No. TRC-100 at 26-27.

18. TrAILCo also states that there remain significant regulatory risks to merit the higher ROE as well, such as acquiring siting approvals, traversing multiple states, and the difficulty in acquiring the necessary rights-of-way for the TrAIL Project.<sup>24</sup>

19. TrAILCo also filed a technology statement as required by Order No. 679.<sup>25</sup> TrAILCo proposes to use several advanced technologies in connection with the TrAIL Project, and identifies numerous incremental benefits associated with the use of these advanced technologies for the TrAIL Project.<sup>26</sup> Regarding the Black Oak SVC, TrAILCo states that while SVC technology itself is not new, “what makes this installation particularly challenging is that the SVC will be one of the largest in the world, based upon its total capacity of 675 MVar [(reactive and capacitive)], and the largest unit installed in the United States to date.”<sup>27</sup> TrAILCo states that the Black Oak SVC is state-of-the-art in that it is entirely thyristor-controlled.<sup>28</sup> TrAILCo states that the Black Oak SVC will limit congestion on one of the most limiting facilities for west-to-east transfer in PJM – the Black Oak-Bedington 500 kV line.<sup>29</sup>

## **II. Procedural History, Notice of Filing and Responsive Pleadings**

20. TrAILCo filed its proposed tariff sheets as part of the February 21 Filing. On March 21, 2007, the Director, Division of Tariffs and Market Development – East, acting

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<sup>24</sup> *Id.*, Exh. No. TRC-100 at 26-31.

<sup>25</sup> Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 302 (“In as much as EPAct 2005 requires the Commission to encourage the deployment of transmission technologies, we will require applicants for incentive rate-treatment to provide a technology statement that describes what advanced technologies have been considered and, if those technologies are not to be employed or have not been employed, an explanation of why they were not deployed.”).

<sup>26</sup> February 21 Filing at 12-14.

<sup>27</sup> *Id.* at 14.

<sup>28</sup> *Id.* A thyristor is a solid-state power electronic valve, utilized in an SVC device, to control current through shunts (capacitor banks and inductor banks) and output the required Mvars in order to achieve bus voltage criteria.

<sup>29</sup> While construction of the Black Oak SVC and the TrAIL Project were both directed as part of the PJM RTEP, construction of the Black Oak SVC is not contingent upon construction of the TrAIL Project.

under delegated authority, issued a deficiency letter (Deficiency Letter) seeking additional information relating to TrAILCo's February 21 Filing. In response to the Deficiency Letter, TrAILCo submitted the March 30 Supplemental Filing.

21. Notice of TrAILCo's February 21 Filing was published in the *Federal Register*, 72 Fed. Reg. 9,519-20 (2007), with interventions and protests due on or before March 14, 2007. Timely motions to intervene and notices of intervention were timely filed by: Pepco Holdings, Inc. and certain of its jurisdictional affiliates, Potomac Electric Power Company, Atlantic City Electric Company and Delmarva Power & Light Company; PJM; PPL Electric Utilities Corporation; and the Public Service Commission of Maryland. Timely comments and protests were filed by: Exelon Corporation (Exelon); H-P Energy Resources LLC (H-P); Public Service Electric and Gas Company, PSEG Power LLC, and PSEG Energy Resources & Trade LLC (the PSEG Companies); and the Maryland Office of People's Counsel (MPC). Motions to intervene out of time were filed by: Dominion Resources Services, Inc. (Dominion); FirstEnergy Service Company (FirstEnergy); the Pennsylvania Office of Consumer Advocate (PA OCA); the Pennsylvania Public Utility Commission (Pennsylvania Commission); and the Virginia State Corporation Commission (Virginia Commission).

22. Notice of the March 30 Supplemental Filing was published in the *Federal Register*, 72 Fed. Reg. 17,890 (2007), with interventions and protests due on or before April 20, 2007. A timely motion to intervene was filed by the PJM Industrial Customer Coalition and the West Virginia Energy Users Group (jointly).

23. On April 30, 2007, TrAILCo filed an answer to the comments and protests.

### **III. Comments and Protests**

24. Commenters raised several concerns about TrAILCo's proposed formula rate including: (1) whether TrAILCo has standing to make a formula rate filing; (2) whether, and if so, how customers will be provided refunds in light of changes in cost allocation in the PJM region; (3) the potential implications of an incentive rate filing for future transmission facilities for non-affiliated market participants; (4) TrAILCo's calculation of its proposed ROE; (5) whether the PJM RTEP process satisfies the Commission's standard of review for transmission rate incentives.

#### **A. Standing**

25. The PSEG Companies argue that TrAILCo is not a signatory to the PJM TO Agreement, and therefore, lacks standing to make a section 205 filing to include tariff pages in the PJM OATT to establish and collect its revenue requirements. Accordingly,

the PSEG Companies argue that the Commission should reject the filing outright or, in the alternative, hold it in abeyance until such time that TrAILCo executes the PJM TO Agreement.

**B. Potential for Refunds**

26. Exelon and the PSEG Companies raised concerns about whether customers will be provided refunds in light of changes in cost allocation in the PJM region. Exelon notes that the payments allocated to customers for the proposed projects are subject to refund in accordance with the Commission's orders in Docket Nos. ER06-456 and ER06-1271.<sup>30</sup> Exelon asks that the Commission confirm that "if after a final determination in those dockets, the Commission finds that [PECO Energy Company's (PECO)] percentage allocation of these projects should be decreased from the percentages filed by PJM, that PECO will be made whole, *i.e.*, receive the appropriate refunds with interest."<sup>31</sup>

27. Similarly, the PSEG Companies argue that "[i]f TrAILCo's proposed rates go into effect prior to the final resolution of the consolidated cost allocation cases, they must be subject to refund; otherwise impacted transmission customers will have no recourse to implement the results of the cost allocation dockets vis-à-vis the TrAIL Project."<sup>32</sup> The PSEG Companies also argue that the June 1, 2007 proposed effective date sought by TrAILCo is premature given that PJM's cost allocation for the RTEP projects are being challenged in Docket No. ER06-456, *et al.*

**C. Potential for Discrimination**

28. H-P raises concerns about the potential implications of an incentive rate filing for future transmission facilities for non-affiliated market participants. First, H-P argues that "it is not clear that TrAILCo will be subject to the Commission's Standards of Conduct

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<sup>30</sup> Exelon Comments at 3 (*citing PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,261, at P 56 (2006); *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,058, at P 49 (2006)).

<sup>31</sup> *Id.* at 3.

<sup>32</sup> The PSEG Companies Comments at 6-7.

and other rules governing transmission providers under the [FPA] during the period of development and construction.”<sup>33</sup> H-P maintains that while TrAILCo states that it will be a jurisdictional facility, TrAILCo fails to clarify the extent of this jurisdiction.<sup>34</sup>

29. Second, H-P argues that the “creation of a new entity complicates protection of non-affiliates from discrimination by existing transmission providers” arguing that “[b]ecause PJM relies on transmission owners to conduct interconnection studies and because transmission owners have a number of other roles in the interconnection process, non-affiliates can be disadvantaged by a transmission owner that does not undertake interconnection responsibilities as diligently as it advances its own projects.”<sup>35</sup> H-P asks that the Commission “consider the ways in which it will monitor for discrimination and remedy discrimination when it occurs, perhaps by conditioning acceptance of the proposed incentives subject to elimination if an affiliate of TrAILCo treats TrAILCo better than a non-affiliate or does not meet other regulatory obligations vis-à-vis non-affiliates.”<sup>36</sup>

#### **D. Calculation of ROE**

30. MPC argues that TrAILCo has failed to justify its proposed base and incentive ROEs. MPC asks the Commission to set for hearing the issues of “the proper proxy group for establishing a zone of reasonableness for the base and incentive ROE, the additional incentives derived from the proposed capital structure, and the additional incentives received by TrAILCo’s owners . . .”<sup>37</sup>

31. MPC argues that TrAILCo fails to justify the ROE rate incentive for the Black Oak SVC. MPC argues that Dr. Joensen’s testimony fails to provide any justification for treating the Black Oak SVC upgrade different from conventional transmission upgrades other than its size. MPC also argues that TrAILCo does not sufficiently identify which other investments justify, or fail to justify, incentive ROE treatment. MPC also argues

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<sup>33</sup> H-P Comments at 2-3.

<sup>34</sup> *Id.* at 3.

<sup>35</sup> *Id.* (internal citations omitted).

<sup>36</sup> *Id.* at 5.

<sup>37</sup> MPC Comments at 5.

that Dr. Joensen's testimony refers to several projects but does not specify whether they would qualify for incentive treatment. In support of its arguments, MPC submits an affidavit of Dr. John R. Morris.

32. Dr. Morris argues TrAILCo's proposed ROE is above a proper zone of reasonableness, which should be 7.8 to 10.5 percent, with a midpoint of 9.2 percent. MPC also argues that TrAILCo fails to meet the burdens of the July 20 Order and Order No. 679-A, which requires each applicant for incentive rate treatment to support a particular ROE in its FPA section 205 filing. In his affidavit, Dr. Morris asserts that Allegheny, as TrAILCo's equity owner, will receive additional incentives not presented in the application. Dr. Morris argues that the incentive ROE cannot be justified in light of already granted non-ROE incentives that will serve to lower TrAILCo's risk.

#### **E. Sufficiency of the PJM RTEP Process**

33. The PSEG Companies argue that TrAILCo has not established that the proposed project is prudent or the most-effective solution to the reliability concerns identified by PJM. The PSEG Companies note that when the PJM's decision to include the TrAIL Project in the RTEP was challenged in Docket No. ER06-1271, the Commission stated that issue was outside the scope of that proceeding and "suggested that parties that wish to challenge particular transmission projects must do so in the context of the PJM stakeholder process . . ."<sup>38</sup> The PSEG Companies assert, as was argued in Docket No. ER06-1271, that the stakeholder process lacked sufficient PJM analysis to provide a viable forum for parties to challenge the outcome. The PSEG Companies argue that "[p]arties must have the ability to challenge specific transmission projects on prudence and cost-effectiveness grounds before the Commission."<sup>39</sup> The PSEG Companies ask that the Commission suspend the proposed rates and set them for a trial-type evidentiary hearing, in order to allow entities to file testimony on various issues "including the prudence and cost-effectiveness of constructing the TrAIL Project and whether TrAILCo's proposed revenue requirements are just and reasonable."<sup>40</sup>

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<sup>38</sup> The PSEG Companies Comments at 8 (*citing PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,058, at P 42 (2006)).

<sup>39</sup> *Id.* at 9.

<sup>40</sup> *Id.* at 10.

#### IV. Discussion

##### A. Procedural Matters

34. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

35. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2007), the Commission will grant the late-filed motions to intervene of Dominion, FirstEnergy, the PA OCA, the Pennsylvania Commission and the Virginia Commission given their interests in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

36. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept TrAILCo's answer and will, therefore, reject it.

##### B. Proposed Formula Rate Filing

37. For the reasons discussed below, we will accept TrAILCo's proposed formula rate, effective June 1, 2007, as requested, subject to conditions and nominal suspension, and hearing and settlement judge procedures. Our preliminary analysis of the components of TrAILCo's proposed formula rate, including its proposed ROE and certain other elements of TrAILCo's filing, indicate that these components of the proposed formula have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Accordingly, we will set these issues for hearing, as identified below.

38. In *West Texas Utilities Company*,<sup>41</sup> the Commission explained that when its preliminary examination indicates that the proposed rates may be unjust and unreasonable, and may be substantially excessive, as defined in *West Texas*, the Commission would generally impose a five-month suspension. It is recognized, however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results.<sup>42</sup> Such circumstances

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<sup>41</sup> 18 FERC ¶ 61,189, at 61,374-75 (1982) (*West Texas*).

<sup>42</sup> *California Independent System Operator Corporation*, 105 FERC ¶ 61,406, at P 22 (2003).

exist here where the Commission has, in fact, urged transmission owners to move from stated rates to formula rates, and where customers would also benefit from the incentive provided by these rate changes to TrAILCo to commence construction of RTEP upgrades. Accordingly, the Commission will exercise its discretion to suspend the revisions to the TrAILCo's rates for a nominal period and permit the rates to become effective June 1, 2007, subject to refund and the outcome of the hearing established in this order.

39. As noted, protesters raise numerous issues regarding the reasonableness of the proposed rates that are best addressed in the hearing we order below.

### 1. ROE

40. We set for hearing TrAILCo's proposed ROE, including the composition of its proxy group. In *Midwest Independent Transmission System Operator, Inc.*,<sup>43</sup> the Commission accepted a proxy group of Midwest ISO transmission owners in setting an ROE applicable to the participating transmission owners in the Midwest ISO.<sup>44</sup> Applying this reasoning here, TrAILCo has not shown that its proposal to include in its proxy group companies that have no direct link to PJM to be just and reasonable. We will permit, however, participants to the hearing to consider the appropriateness of including or excluding particular PJM Transmission Owners from the proxy group. We will also permit TrAILCo and other participants to demonstrate that companies with no direct link to PJM should be included in TrAILCo's proxy group. However, we do not expect such companies to be included in TrAILCo's proxy group unless there is compelling evidence to support a deviation from our general policy of requiring a proxy group to be comprised of transmission owners with a direct link to the same RTO or Independent System Operator in which the applicant is located. Finally, in the July 20 Order the Commission approved an ROE to be set in the high end of the zone of reasonableness. Therefore, the hearing will establish the overall range of reasonableness as well as where in the upper end the ROE would fall – whether at the top end or at a different point in the upper end of the range.<sup>45</sup>

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<sup>43</sup> 100 FERC ¶ 61,292 (2002) (*Midwest ISO ROE Order*), *order on reh'g*, 102 FERC ¶ 61,143 (2003), *order on remand*, 106 FERC ¶ 61,302 (2004), *aff'd in part and reversed in part sub nom., Public Service Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005).

<sup>44</sup> *See Midwest ISO ROE Order*, 100 FERC ¶ 61,292 at P 30.

<sup>45</sup> Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 68.

## 2. CWIP and Pre-Commercial Costs

41. The July 20 Order authorized TrAILCo to include 100 percent of CWIP in rate base, provided that TrAILCo fulfills the Commission's requirements for CWIP inclusion.<sup>46</sup> TrAILCo was also authorized to defer pre-commercial costs incurred in 2006 and amortize those deferred costs over a defined period. Further, the Commission authorized TrAILCo to expense pre-commercial costs incurred in 2007.<sup>47</sup> The July 20 Order directed TrAILCo to follow a specific accounting treatment to recognize the economic effects of the CWIP inclusion and the expensing of pre-commercial costs and to maintain comparability between entities. Additionally, the July 20 Order required TrAILCo to propose a method of tracking all of the prudently-incurred pre-commercial costs that are expensed to ensure that these items are not capitalized in subsequent section 205 filings.

42. TrAILCo's proposed formula rate provides for the inclusion of 100 percent of CWIP in rate base, the expense and current recovery of pre-commercial costs incurred in 2007, and the recovery of deferred pre-commercial costs incurred in 2006 through a four-year amortization. TrAILCo also requests authorization to use footnote disclosures, in its FERC Form No. 1 and FERC Form No. 3-Q, in lieu of the specific accounting treatment required in the July 20 Order, to account for the economic effects of its rate incentives. TrAILCo argues that its proposed footnote disclosures are consistent with the Commission's order in *ATC II*, in which the Commission clarified that certain footnote disclosures were an adequate replacement for the same specialized accounting required in the July 20 Order.<sup>48</sup>

43. Additionally, to satisfy the Commission's requirements for the inclusion of CWIP in rate base and the Commission's requirement to propose a method of tracking prudently incurred pre-commercial costs, TrAILCo provided Attachment 5a of Attachment H-18A, page 18 of Exhibit No. TRC-203.<sup>49</sup>

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<sup>46</sup> July 20 Order, 116 FERC ¶ 61,058 at P 74.

<sup>47</sup> *Id.* P 99-113.

<sup>48</sup> TrAILCo Filing at 16-17 (citing *American Transmission Company, LLC*, 105 FERC ¶ 61,388 (2003) (*ATC*), order providing clarification, 107 FERC ¶ 61,117, at P 16-17 (2004) (*ATC II*)).

<sup>49</sup> February 21 Filing, Exh. No. TRC-200 at 24; March 30 Supplemental Filing at 4-5. Although referenced at times as part of Exhibit No. TRC-202, Attachment 5a is labeled as part of Exhibit No. TRC-203.

44. The transmission rate incentives that provide for the current recovery of a return on CWIP and pre-commercial costs related to the TrAIL Project result in TrAILCo recovering costs in a different period than when they would ordinarily be charged to expense under the general requirements of the Commission's Uniform System of Accounts (USofA). The USofA requires an Allowance for Funds Used During Construction (AFUDC) to be capitalized as a cost of a construction project and depreciated over the service life of the asset. The USofA also requires pre-commercial costs to be accumulated in Account 183, Preliminary Survey and Investigation Charges, before being transferred to CWIP and capitalized as a cost of the construction project. To promote comparability in accounting between entities, the July 20 Order required a specific accounting treatment to capitalize AFUDC and pre-commercial costs and recognize the economic effects of the rate plan.<sup>50</sup>

45. However, as TrAILCo notes, in *ATC II* the Commission authorized certain footnote disclosures to be provided in the FERC Form No. 1 and FERC Form No. 3-Q in lieu of the same specific accounting required in the July 20 Order. In *ATC II*, the Commission found that the proposed footnote disclosures provided the financial information needed for comparability and simplified compliance. Likewise, the Commission believes that similar footnote disclosures by TrAILCo will provide the relevant financial information needed for comparability. Therefore, TrAILCo is authorized to provide footnote disclosures in the Notes to the Financial Statements of its annual FERC Form No. 1 and its quarterly FERC Form No. 3-Q which: (1) fully explain the impact of the transmission rate incentives it receives insofar as the incentives provide for a deviation from the general requirements of the USofA; (2) include details of amounts not capitalized because of the transmission rate incentives for the current year, the previous two years, and the sum of all years beginning June 1, 2007; and (3) include a partial balance sheet consisting of the Assets and Other Debits section of the balance sheet to include the amounts not capitalized because of the transmission rate incentives.

46. With regard to TrAILCo's Attachment 5a of Exhibit No. TRC-203, the Commission finds that this attachment does not fully satisfy the objectives of the Commission's requirements for including CWIP in rate base and expensing pre-commercial costs. To include CWIP in rate base, the Commission requires a utility to propose accounting procedures in a rate filing that ensure that wholesale customers will not be charged for both capitalized AFUDC and corresponding amounts of CWIP

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<sup>50</sup> This specific accounting treatment would require TrAILCo to debit through FERC Account 407.3, Regulatory Debits, and credit through FERC Account 254, Other Regulatory Liabilities, in accordance with the objectives of those accounts.

proposed to be included in rate base.<sup>51</sup> Also, to satisfy accounting concerns, the July 20 Order required TrAILCo to propose a method of tracking all of the prudently-incurred pre-commercial costs that are expensed to ensure that these items are not capitalized in subsequent section 205 filings. Attachment 5a fails to meet these Commission requirements, because it does not propose the actual accounting procedures to be used to ensure AFUDC related to CWIP in rate base and expensed pre-operational costs will not be included in future rates.

47. Accounting procedures that have satisfied this burden have provided internal procedures, processes, and/or journal entries intended to prevent costs recovered in current rates from being included in future rates.<sup>52</sup> For example, entities have provided detailed narratives and illustrations showing modifications to the accounting system to identify and segregate work orders associated with projects that include CWIP in rate base and to exclude expensed pre-commercial costs from work orders that do not. These accounting procedures have also explained the manner in which the costs of a work order will be traced to specific FERC accounts based on the appropriate accounting treatment. Other entities have provided accounting procedures showing and explaining specific accounting journal entries that ensure that no improper capitalization occurs. There may also be other accounting procedures and methodologies that satisfactorily achieve the objectives described above.

48. For reasons discussed above, TrAILCo is hereby ordered to submit, in the compliance filing to be made within 30 days of this order, a narrative describing the preventative internal accounting procedures and controls that TrAILCo will implement to ensure that no improper capitalization occurs in a later section 205 filing.<sup>53</sup> TrAILCo should also indicate whether there will be an ongoing verification by an independent auditor attesting to the proposed accounting treatment as part of annual FERC Form No. 1 audits.

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<sup>51</sup> 18 C.F.R. § 35.25(f) (2007).

<sup>52</sup> *See, e.g.*, The United Illuminating Company, Docket No. ER07-653-000, Exh. Nos. UI-13, UI-14 and UI-15 (filed Mar. 23, 2007); Boston Edison Company, Docket No. ER05-69-000, Exh. Nos. BE-2 (at 4-5) and BE-6 (filed Oct. 25, 2004); American Transmission Company LLC, Docket No. ER04-108-000, Exh. Nos. ATC-9 and ATC-10 (filed Oct. 30, 2003).

<sup>53</sup> This method should be implemented prior to the time when costs would be passed on to consumers and should act as an internal mechanism to prevent inappropriate capitalization from taking place.

49. Furthermore, while Step 3 in Attachment 5a does state that reconciliation will be summarized “by project,” a project-defined reconciliation is insufficient to determine what types of costs are included as “pre-commercial” costs. As an example, for a \$1.7 million pre-commercial cost recovery, TrAILCo provides a single description: “Prexy-502 Junction.” There is no further indication as to what types of costs were included in this amount. For the duration of its pre-commercial cost recovery, TrAILCo is required to include an updated comprehensive list of its pre-commercial costs as part of its required annual filing to ensure that these costs are in fact legitimate pre-commercial costs. The comprehensive list provided in TrAILCo’s March 30 Supplemental Filing would act as an appropriate model for this requirement.

50. We also note that TrAILCo’s filing, including its proposed formula rate and supporting schedules, does not indicate which FERC account will be used to expense or amortize pre-commercial costs. As a result, TrAILCo’s formula rate lacks transparency and makes it difficult to determine whether the pre-commercial costs are appropriately included in TrAILCo’s formula rate. The Commission’s USofA does not address accounting for pre-commercial costs which are expensed as incurred and subsequently recovered in rates. These costs are normally deferred in Account 183, as discussed above. In the Commission’s view, however, these costs appear to be appropriately recognized as a transmission operating expense. Account 566, Miscellaneous Transmission Expense, includes transmission expenses not included elsewhere. Accordingly, we will require TrAILCo to expense and amortize all pre-commercial costs related to the TrAIL Project in Account 566.<sup>54</sup> Additionally, in the hearing procedures set forth below, TrAILCo shall propose all necessary modifications to its formula rate to include pre-commercial costs using Account 566.

### **3. Additional Matters Set For Hearing**

51. We also set for hearing the appropriateness of TrAILCo’s inclusion of CWIP balances in both the Gross and Net Plant Allocators, their impact on costs which are assigned to the transmission function, and the relationship to plant under construction.<sup>55</sup>

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<sup>54</sup> This accounting is also consistent with the accounting treatment permitted by the Commission in *ATC*.

<sup>55</sup> In Exhibit No. TRC-203, line 29 of the formula incorporates CWIP in the numerator for the Gross Plant Allocator on line 16 of the formula, but not in the denominator. Line 39 of the formula incorporates CWIP in the numerator for the Net Plant Allocator on line 18 of the formula, but not in the denominator.

Particularly, TrAILCo's proposed formula includes CWIP in the numerator of these allocators, but not in the denominator, thus inflating the overall allocation factors.

52. We also set for hearing the use of the Gross Revenue Requirement in developing the Net Plant Carrying Charge<sup>56</sup> which over-recovers costs by including, *e.g.*, revenue credits from Attachment 3 of the formula and direct-assignment interconnection costs that have already been paid for by interconnection customers through other rate schedules consistent with Order No. 2003-A.<sup>57</sup>

53. Further, we will require TrAILCo to file, as part of the hearing procedures, proposed depreciation rates to be applied to its transmission plant, consistent with 18 C.F.R. § 35.13(h)(1)(iv) (2007).

#### **4. Additional Aspects of the Formula Rate**

54. TrAILCo seeks a waiver of certain filing requirements relating to its recovery of Post-Employment Benefits Other Than Pension (PBOP) costs.<sup>58</sup> Specifically, TrAILCo proposes that any PBOP-related changes to its formula rate falling below a stated threshold (*i.e.*, that do not exceed an impact on the formula output of its Net Zonal Revenue Requirement of 2.5 percent, as compared to the immediately preceding annual update), be included in its annual update without the need to make a FPA section 205 or

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<sup>56</sup> February 21 Filing, Exh. No. TRC-202 at proposed Original Sheet No. 314I.04, line 162.

<sup>57</sup> *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003-A, FERC Stats. & Regs. ¶ 31,160 at P 657 (2004), *order on reh'g*, Order No. 2003-B, FERC Stats. & Regs. ¶ 31,171, *order on reh'g*, Order No. 2003-C, FERC Stats. & Regs. ¶ 31,190 (2005), *aff'd sub nom. Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, 475 F.3d 1277 (D.C. Cir. 2007).

<sup>58</sup> *See Statement of Financial Accounting Standards No. 106*, Employers' Accounting for Postretirement Benefits Other Than Pensions. PBOP accounts are typically amounts that are amortized over a set period of time (in accordance with Statement of Financial Accounting Standards No. 106) much like depreciation or decommissioning expenses. A modification in the amortization without Commission scrutiny can result in over-recovery or intergenerational inequities. Commission policy requires the utility to file PBOP even if the utility operates under a formula rate.

206 filing.<sup>59</sup> PBOP costs are typically amounts that are amortized over a set period of time,<sup>60</sup> much like depreciation or decommissioning expenses. A modification in the amortization without Commission scrutiny can result in over-recovery or intergenerational inequities. We reject this provision of TrAILCo's proposal, as inconsistent with Commission policy on PBOPs.<sup>61</sup> TrAILCo is directed to submit revised tariff sheets reflecting this revision as part of the compliance filing to be made within 30 days of the date of this order.

55. Moreover, consistent with Commission precedent, TrAILCo is directed to remove its provisions for modifying extraordinary property losses without a section 205 filing with the Commission.<sup>62</sup> Extraordinary property losses are one-time expenses, not traditionally reoccurring expenses, and are not permitted to be passed through without initial Commission review. TrAILCo is directed to submit revised tariff sheets reflecting this revision as part of the compliance filing to be made within 30 days of the date of this order.

56. We will also accept in part and reject in part TrAILCo's hypothetical capital structure, consistent with Commission precedent, as explained further.<sup>63</sup>

57. Further, TrAILCo requests several waivers of the requirements of section 35.13 of the Commission's regulations (Filing of Changes in Rate Schedules). These include: (i) waiver of the full Period I/Period II data requirements;<sup>64</sup> (ii) waiver of the attestation concerning Period II submissions;<sup>65</sup> (iii) waiver of the requirement to determine if, and

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<sup>59</sup> February 21 Filing, Exh. No. TRC-202 at proposed Original Sheet No. 314I.26, § 1(g).

<sup>60</sup> This is in accordance with Statement of Financial Accounting Standards No. 106.

<sup>61</sup> See *Maine Yankee Atomic Power Company*, 66 FERC ¶ 61,375, *clarified*, 68 FERC ¶ 61,190 (1994).

<sup>62</sup> *South Carolina Generating Company, Inc.*, 32 FERC ¶ 61,224 (1985).

<sup>63</sup> Because TrAILCo seeks this incentive rate treatment for the first time in the February 21 Filing, the request is addressed as part of the discussion of new incentives in section IV.C.2.a, *infra*.

<sup>64</sup> 18 C.F.R. § 35.13(d)(1) and (2) (2007).

<sup>65</sup> *Id.* § 35.13(d)(6).

the extent to which, a proposed change constitutes a rate increase based on Period I/Period II rates and billing determinants;<sup>66</sup> and (iv) waiver of the cost of service statements. In support of its requested waivers, TrAILCo states that the cost support matrix and supporting worksheets with testimony accompanying its filing provide ample support for the reasonableness of its proposed formula rate. We reject TrAILCo's request for waiver of filing an attestation as required in 18 C.F.R. 35.13(d)(6) (2007). TrAILCo has provided no justification for the requested waiver. We will require TrAILCo to provide this attestation as part of its compliance filing to be made within 30 days of the date of this order. However, we will grant the remaining waivers consistent with our prior approval of formula rates.<sup>67</sup>

58. Additionally, the Commission has identified several typographical errors that should be corrected in order to make TrAILCo's formula rate consistent with previously-accepted formula rates: (1) on Original Sheet No. 314I.25 at footnote 1, line 2, replace the period with a comma between the words "therein" and "that"; (2) on Original Sheet No. 314I.26, section 1(g), at line 5, replace "he" with "be"; (3) on Original Sheet No. 314I.29, section 4, at line 8, remove the words ". . . for the then current year . . . ."; and (4) at the bottom of each of the proposed tariff sheets, replace the name "Craig Glaser" with "Craig Glazer." In addition, we direct TrAILCo to correct the references to the Commission's interest calculations on its proposed Original Sheet No. 314I.29 from ". . . in accordance with 18 C.F.R. §38.19a . . ." to ". . . in accordance with 18 C.F.R. §35.19a . . ." TrAILCo should make these corrections in revised tariff sheets submitted as part of the compliance filing to be made within 30 days of the date of this order.

59. Finally, we direct TrAILCo to make an informational filing with the Commission when it recalculates its annual transmission revenue requirement and when it posts such data on the PJM website. This informational filing must include the information TrAILCo is required to post on its web site regarding updates to its formula rate. TrAILCo must also provide a detailed accounting of transfers between CWIP and Plant in Service, by work order identifier and date in service and reconcile any changes. TrAILCo must also provide a detailed accounting of all costs based upon "company records," with references to the source FERC Accounts. True-ups of estimated costs and actual costs also should be itemized.

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<sup>66</sup> *Id.* § 35.13(a)(2)(iv).

<sup>67</sup> *Allegheny Power System Operating Companies*, 111 FERC ¶ 61,308, at P 55-56 (2005), *order on reh'g*, 115 FERC ¶ 61,156 (2006).

### 5. Responses to Comments on the Proposed Formula Rates

60. We find that the PSEG Companies' concern regarding standing to be moot. As stated in the March 30 Supplemental Filing, TrAILCo was accepted as a PJM member as of March 28, 2007.

61. We agree with Exelon and the PSEG Companies that TrAILCo's rates should be subject to refund in accordance with the pending proceedings regarding cost allocation in the PJM region.<sup>68</sup> To the extent it is determined that they, or any other entities, are deemed not to be the responsible customers, they will be refunded the costs associated with the TrAILCo's facilities. This is also consistent with Commission precedent regarding allocation of costs associated with CWIP.<sup>69</sup> Accordingly, the PSEG Companies' concern about the prematurity of TrAILCo's rates is without effect – the PSEG Companies will be made whole regardless of the effective date of TrAILCo's tariff sheets.

62. Finally, we find that H-P's concerns about discrimination are unsupported and speculative. No evidence has been presented for us to suspect that affiliates within the Allegheny holding company system would favor one another based on TrAILCo's proposed formula rate filing. Moreover, we note that TrAILCo is now a Transmission Owner subject to the same code of conduct as every other Transmission Owner participating in the PJM markets. This does not mean, however, that the Commission will not consider such allegations in an adequately supported complaint. As stated in the July 20 Order, “[a]fter the justness and reasonableness of the proposed rate incentives is determined under the appropriate section 205 proceeding, an entity that believes that rate incentives for transmission owner projects adversely affect the access of merchants, or any other market participant, to the transmission grid, can raise such allegations in a complaint pursuant to section 206 of the FPA.”<sup>70</sup>

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<sup>68</sup> Exelon Comments at 3; The PSEG Companies Comments at 6-7.

<sup>69</sup> *Boston Edison Company*, 109 FERC ¶ 61,200, at P 38 (2004), *order on reh'g*, 111 FERC ¶ 61,266 (2005) (“Any return revenues based on a misstated CWIP are subject to annual true-up and refund with interest pursuant to the Commission's provisions in 18 C.F.R. § 35.19(iii)(A) . . .”); *Northeast Utilities Service Company*, 114 FERC ¶ 61,089, at P 21 (2006) (“[W]e will require NU to ensure that customers who have paid for CWIP through its inclusion in rate base and who are not ultimately responsible for these facility costs will receive appropriate refunds, with interest.”).

<sup>70</sup> July 20 Order, 116 FERC ¶ 61,058 at P 39 (emphasis added).

### C. Proposed Incentive Rate Treatments

63. In light of the additional incentives requested in the February 21 Filing, the Commission has looked at the total package of incentives approved in the July 20 Order and proposed for the first time herein and finds that, based on the reasons discussed below, they are consistent with the principles articulated in Order No. 679 and its progeny. That is, not only are each of the additional incentives justified individually, but they are justified when weighed against the incentives already granted.

#### 1. Proposed Incentive Rate Treatments for the TrAIL Project

64. In the Energy Policy Act of 2005 (EPAAct 2005), Congress addressed the allowance of incentive-based rate treatments for new transmission construction.<sup>71</sup> Specifically, section 1241 of EPAAct 2005 added a new section 219 to the FPA directing the Commission to establish, by rule, incentive-based (including performance-based) rate treatments. The Commission issued Order No. 679, which sets forth processes by which a public utility could seek transmission rate incentives pursuant to section 219.

65. Order No. 679 provides that a public utility may file under the FPA a petition for declaratory order or section 205 filing to obtain incentive rate treatment for transmission infrastructure investment that satisfies the requirements of FPA section 219, *i.e.*, the applicant must demonstrate that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion.<sup>72</sup> Order No. 679 also establishes a rebuttable presumption (as modified by Order No. 679-A) for: (i) “[a] transmission project that results from a fair and open regional planning process that considers and evaluates projects for reliability and/or congestion and is found to be acceptable to the Commission;” or (ii) “[a] project that has received construction approval from an appropriate state commission or state siting authority.”<sup>73</sup>

66. Order No. 679-A also clarifies the operation of this rebuttable presumption by noting that the authorities and/or processes on which it is based (*i.e.*, a regional planning

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<sup>71</sup> Pub L. No. 109-58, § 1241, 119 Stat 594, 961 (2005).

<sup>72</sup> 18 C.F.R. § 35.35(i) (2006).

<sup>73</sup> *Id.*; Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 41.

process, a state commission, or siting authority) must, in fact, consider whether the project ensures reliability or reduces the cost of delivered power by reducing congestion.<sup>74</sup>

67. Accordingly, we will deny the PSEG Companies' argument that TrAILCo has not established that the TrAIL Project is prudent or the most cost-effective alternative. We have already found that the TrAIL Project is needed for reliability and/or to reduce congestion.<sup>75</sup> The PSEG Companies' arguments about the sufficiency of TrAILCo's demonstration is as an impermissible collateral attack on the Commission's findings in Order Nos. 679 and 679-A and prior orders regarding the sufficiency of PJM's RTEP procedures and the July 20 Order.

68. Moreover, the Commission generally does not require that utilities seeking to recover costs through their rates demonstrate initially that all expenditures for which they seek recovery were prudent.<sup>76</sup> Rather, participants in rate proceedings seeking to challenge the expenditures must first create a serious doubt as to the prudence of the expenditures before the burden shifts to the filing utility.<sup>77</sup> As stated in Order No. 679, "[t]he Commission is making no change in the long-standing regulatory presumption in a section 205 proceeding that costs are prudently incurred, but parties are free to provide evidence to the contrary . . . ."<sup>78</sup> We do not find that the PSEG Companies have

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<sup>74</sup> Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 49.

<sup>75</sup> July 20 Order, 116 FERC ¶ 61,058 at P 21-23.

<sup>76</sup> See, e.g., *Southern Company Services, Inc.*, 116 FERC ¶ 61,231, at P 32 (2006); *Midwest Independent Transmission System Operator, Inc.*, 115 FERC ¶ 61,224, at P 28, *order on reh'g*, 117 FERC ¶ 61,108, at P 14-16 (2006) (internal citations omitted).

<sup>77</sup> *Midwest Independent Transmission System Operator, Inc.*, 115 FERC ¶ 61,224, at P 28 (citing *Minnesota Power and Light Co.*, Opinion No. 86, 11 FERC ¶ 61,312 at 61,644-45 & n.45, *reh'g denied*, Opinion No. 86-A, 12 FERC ¶ 61,264 (1980) (generally, the party seeking to call the prudence of an expenditure into question must do so by adducing evidence or citing to material of which the Commission may take official notice); *Indiana Municipal Power Agency v. FERC*, 56 F.3d 247, 253 (1995) (complainant urging that utility's rate is unjust must present evidence)).

<sup>78</sup> Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 347. This being said, "ultimately, the burden is on the applicant to demonstrate that its proposal is just and reasonable." *Id.* Under the procedures established by the Order No. 679 rulemaking proceeding, TrAILCo, as a Transmission Owner, is required to make the instant section

(continued...)

presented evidence to support their assertion. The Commission and the courts have long recognized that a protestor has a burden to do more than make mere unsubstantiated allegations.<sup>79</sup> Yet that is all that the PSEG Companies did; the PSEG Companies have not made a showing sufficient to call into question, *i.e.*, to warrant a trial-type hearing into whether costs associated with TrAILCo's proposed TrAIL Project are imprudently incurred. Further, PJM's market efficiency analysis for the TrAIL Project shows that the project will result in savings across PJM and has been found to be cost effective.<sup>80</sup>

69. Moreover, to the extent that the PSEG Companies challenge the rebuttable presumption that the TrAIL Project is needed to ensure reliability, we deny this as well. As stated in the July 20 Order, the reliability need for the TrAIL Project has been sufficiently demonstrated. PJM's RTEP protocols require PJM to "consolidate the transmission needs of the region into a single plan which is assessed on the bases of maintaining the reliability of the PJM Region in an economic and environmentally acceptable . . . manner and in a manner that supports competition in the PJM region."<sup>81</sup>

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205 filing to submit its specific rates, terms and conditions for use of its facilities by PJM in providing transmission service and to establish its revenue requirement. Accordingly, in the instant proceeding, we address whether TrAILCo's revenue requirement is just and reasonable.

<sup>79</sup> *E.g.*, *Midwest Independent Transmission System Operator, Inc.*, 117 FERC ¶ 61,108 at P 14 n.16; *PJM Interconnection, LLC*, 115 FERC ¶ 61,052, at P 12 n.10 (2006); *Duke Energy Corporation*, 87 FERC ¶ 61,249, at 61,966 n.4 (1999); *Central Maine Power Company*, 60 FERC ¶ 61,285, at 61,965 n.17 (1992); *Philadelphia Electric Company*, 58 FERC ¶ 61,060, at 61,132 n.2 (1992); *Georgia Power Company*, 52 FERC ¶ 61,321, at 62,278 n.5 (1990).

<sup>80</sup> PJM has performed several market efficiency analyses on the 502 Junction-Loudoun line and determined that this line will result in an overall cost savings of \$766 million in combined zonal load payments, FTR credits, and production costs. *See* PJM Transmission Expansion Advisory Committee, Market Efficiency Analysis Progress Report (Apr. 5, 2007), at 9, *available at* <http://www.pjm.com/committees/teac/downloads/20070405-market-efficiency-analysis-progress-report.pdf> (as measured against the 2011 RTEP system). This amount is calculated by reconciling the total increases in cost with the total decreases in cost for each of the following categories: zonal load payments, FTR credits, and production costs.

<sup>81</sup> PJM Operating Agreement, Schedule 6 (Regional Transmission Expansion Planning Protocol) § 1.4(a) at Substitute Sixth Rev. Sheet No. 183; *see also* PJM Manual (continued...)

With respect to upgrades defined as “baseline,” PJM has made the required reliability determination, finding that these upgrades will directly benefit one or more transmission owner zones for the purpose of maintaining reliability.<sup>82</sup> As we more recently stated in *Duquesne*, PJM’s RTEP determinations on baseline projects can be relied upon by TrAILCo as a rebuttable presumption supporting its section 219 showing.<sup>83</sup>

70. The PSEG Companies bear the burden of demonstrating that we should not rely on PJM’s finding that the project should be considered as a baseline reliability project. The PSEG Companies have not provided sufficient evidence to refute the rebuttable presumption that these projects are needed for reliability.

71. In addition to satisfying the section 219 requirement, a proposed incentive rate must also be shown to have a nexus between the incentive sought and the investment being made. Order No. 679 requires that an applicant must “show some nexus between the incentives being requested and investment being made, *i.e.*, to demonstrate that the incentives are rationally related to the investments being proposed.”<sup>84</sup> The Commission stated that in evaluating whether an applicant has satisfied the required nexus test, the Commission will examine the total package of incentives being sought, the inter-relationship between any incentives, and how any requested incentives address the risks and challenges faced by the project.<sup>85</sup> Applicants must provide sufficient explanation and

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14-B (Generation and Transmission Interconnection Planning) (Mar. 1, 2007), at 53, *available at* <http://www.pjm.com/contributions/pjm-manuals/pdf/m14b.pdf> (“The purpose of the [RTEP] is to develop plans which will assure reliability and meet the demands for firm transmission service in the PJM Region as described in Schedule 6 of the Operating Agreement.”).

<sup>82</sup> RTEP-identified baseline upgrades also include upgrades that will ensure PJM’s ability to continue to serve load reliably. PJM Manual 14-C (Generation and Transmission Interconnection Facility Construction) (Mar. 3, 2006), at 36, *available at* <http://www.pjm.com/contributions/pjm-manuals/pdf/m14b.pdf> (“Baseline upgrades [are] . . . required transmission system upgrades which are a *direct result of a study finding from PJM* and become part of the RTEP . . .”) (emphasis added).

<sup>83</sup> *Duquesne*, 118 FERC ¶ 61,087 at P 62-68; *see also* Order No 679, FERC Stats. & Regs. ¶ 31,222 at P 58; Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 46-50.

<sup>84</sup> Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 48.

<sup>85</sup> 18 C.F.R. § 35.35(d) (2007); Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 26; Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 21 (“By this we mean that the  
(continued...)”) (continued...)

support to allow the Commission to evaluate the incentives. In addition, the Commission has clarified that it retains the discretion to grant incentives that promote particular policy objectives, unrelated to whether or not a project presents specific economic risks or challenges.<sup>86</sup>

72. As stated in the July 20 Order, TrAILCo has satisfied its nexus requirement as to the incentives requested for the TrAIL Project. “Allegheny has shown a nexus between each of its proposed incentive rates and the proposed Project, thus establishing that the particular proposed incentive rates are appropriate for the particular investments being made.”<sup>87</sup> The actual ROE incentive and overall ROE for TrAILCo will be determined in the hearing and settlement judge procedures ordered below.

## 2. Newly-Proposed Incentive Rate Treatments

73. In addition to requesting approval of its formula rate, TrAILCo requests, for the first time, certain incentive rate treatments under FPA section 219, consistent with Order No. 679 and its progeny. To qualify for incentive rate treatment under section 219, TrAILCo must demonstrate that the proposed investment is consistent with FPA section 219 and that there is a nexus between proposed incentive rate treatment and proposed investment. TrAILCo must also show that it is eligible for the total package of incentives sought. For the reasons stated below, we find that TrAILCo has made these showings as to its proposed hypothetical capital structure and its proposed ROE incentive for the Black Oak SVC.

### a. Hypothetical Capital Structure

74. As stated in the Order No. 679 rulemaking proceeding, use of hypothetical capital structures “can be an appropriate ratemaking tool for fostering new transmission in certain relatively narrow circumstances.”<sup>88</sup> The Commission found, however, that

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incentive(s) sought must be tailored to address the demonstrable risks and challenges faced by the applicant in undertaking the project.”).

<sup>86</sup> Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at n.37.

<sup>87</sup> July 20 Order, 116 FERC ¶ 61,058 at P 3; *See also Id.* P 64 (ROE at the high end of the zone of reasonableness), P 81 (CWIP), P 112 (pre-commercial costs) and P 127 (abandonment).

<sup>88</sup> Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 93.

adoption of such a hypothetical capital structure would require a demonstration of the required nexus between the need for a hypothetical capital structure and the proposed investment project.<sup>89</sup> While TrAILCo does not request the use of the hypothetical capital structure as a formal incentive, the Commission believes that the finding of a nexus is appropriate under these circumstances. During construction, TrAILCo's capital structure will be fluid, with financing available through the issuance of stock or borrowing. The percentages of each of these financing vehicles will vary during construction depending on the costs and efficiencies, and difficulty in securing financings associated with each.

75. We find that TrAILCo has demonstrated a sufficient nexus for the hypothetical capital structure during construction in the following ways. First, TrAILCo will enjoy lower debt costs through use of a hypothetical capital structure. Such an approach will permit TrAILCo to vary its financing vehicles to the needs of construction, such as timing of expenditures, regulatory developments, and changes in financial market conditions, enabling TrAILCo to achieve the most workable outcomes during construction. Moreover, use of a hypothetical capital structure during the construction phase of the projects is consistent with Commission precedent.<sup>90</sup> Accordingly, the Commission finds that a sufficient nexus has been shown to support the use of a hypothetical capital structure during the construction period.

76. However, we direct TrAILCo to adopt a capital structure based upon its actual financing upon completion of its projects. TrAILCo does not provide a sufficient nexus for the use of a hypothetical capital structure once the project financing is completed, or the need for flexibility when construction is complete. TrAILCo currently anticipates a 50 percent debt/50 percent equity capital structure upon completion of construction.<sup>91</sup> Moreover, this approach using the company's FERC Form No. 1 data is consistent with Commission precedent for PJM Transmission Owners with this type of formula rate, and will closely follow TrAILCo's actual capital structure.<sup>92</sup>

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<sup>89</sup> *Id.*

<sup>90</sup> *Michigan Electric Transmission Co., LLC*, 105 FERC ¶ 61,214 (2003); *ITC Holdings Corp.*, 102 FERC ¶ 61,182, *reh'g denied*, 104 FERC ¶ 61,033 (2003).

<sup>91</sup> *See Trans-Allegheny Interstate Line Company*, 119 FERC ¶ 62,052 (2007).

<sup>92</sup> All of the PJM transmission owners with this type of formula rate calculate their capital structures based upon actual data in their FERC Form No. 1. *See Atlantic City Electric Company, Baltimore Gas & Electric Company, Delmarva Power & Light Company, Potomac Electric Power Company, Commonwealth Edison Company*

**b. Incentive ROE For Black Oak SVC**

77. TrAILCo requests approval for an incentive ROE for the Black Oak SVC in accordance with the Order No. 679 rulemaking proceeding. TrAILCo requests an incentive ROE of 13.9 percent for the Black Oak SVC consistent with the calculations discussed above. Because neither TrAILCo nor Allegheny previously sought a declaratory order requesting approval of incentive rate treatment for ROE for the Black Oak SVC, we review TrAILCo's request for incentive rate treatment for the Black Oak SVC for the first time.

78. First, TrAILCo must demonstrate that the proposed investment is consistent with FPA section 219. TrAILCo states that PJM's RTEP creates a rebuttable presumption that the Black Oak SVC is a product of a fair and open regional planning process intended to ensure reliability and/or reduce the cost of delivered power by reducing congestion.<sup>93</sup> For the reasons discussed above, the Commission believes that PJM's designation of the Black Oak SVC as a baseline reliability upgrade in the RTEP process satisfies the rebuttable presumption.

79. As discussed above, the Black Oak SVC has been designated by the PJM RTEP process as a baseline reliability upgrade needed to provide voltage support at the Black Oak 500 kV substation. The existing system experiences voltage problems during critical contingencies and heavy west-to-east transfers in PJM. TrAILCo states that this upgrade was initiated by PJM to benefit the Baltimore/Washington area as a result of expected transfers and generation retirements.<sup>94</sup>

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(pending in Docket No. ER07-583-000, *et al.*), and UGI Utilities, as filed in their formula rates under the PJM OATT, FERC Electric Tariff, Sixth Rev. Vol. No. 1, Att. H-1, H-2, H-3, H-9, H-13 and H-8C, respectively.

<sup>93</sup> February 21 Filing at 4 (*citing* Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 58 and Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 5).

<sup>94</sup> Section 3.2.3 (Generation Deactivations Impact Southwestern PJM Reliability) of PJM's 2006 RTEP found that "[d]eactivation of generation in the Baltimore/Washington D.C. area between 2003 and 2005 has totaled 585 MW, the result of plant retirements, unit environmental restrictions and other deactivations. Events in August 2005 suggesting the shut-down of the Potomac River generating plant account for 482 MW tagged for deactivation . . . [triggering] immediate transmission expansion upgrades needs, including: 1) the installation of two new 230 kV circuits between Palmers Corners and Blue Plains; and, 2) *an increase in the size of the dynamic reactive*

(continued...)

80. The Bedington-Black Oak 500 kV line is a limiting facility for summer transfers going into the mid-Atlantic region and the Black Oak SVC will help support the 500 kV line during critical contingency scenarios. High historical imports into the Mid-Atlantic region of PJM have caused both pre-contingency and post-contingency voltage problems in the BG&E and PEPCO areas. The Black Oak SVC will be helpful in providing voltage stability in the Mid-Atlantic region considering the reduction in reactive capability.<sup>95</sup> The Black Oak SVC will also be helpful if the Mid-Atlantic experiences extreme weather scenarios.

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*device at the Black Oak substation.*” PJM Regional Transmission Expansion Plan 2006, Version 2.0 (Feb. 22, 2006), at 36 (emphasis added), *available at* <http://www.pjm.com/planning/downloads/20060410-rtep-report.pdf> (PJM 2006 RTEP). These reliability findings were made in the PJM 2006 RTEP and not superseded by (although not copied to) the RTEP dated February 27, 2007, which reflects planned system upgrades announced by PJM through December 31, 2006, *available at* <http://www.pjm.com/planning/reg-trans-exp-plan.html>.

<sup>95</sup> In its 2006 RTEP, PJM states:

PJM experienced voltage-based operational performance issues on July 27, 2005: low pre-contingency voltages at Doubs 500 kV substation and low post-contingency voltages in BG&E and PEPCO. Several area 500/230 kV transformers were also at their thermal capabilities. PJM’s investigation concluded that factors driving this issue included the following: 1) several generators had reduced reactive capability for the summer of 2005; 2) differences in PEPCO’s planning load model versus actual peak load system conditions; 3) differences in Dominion’s planning load versus actual peak load system conditions; and 4) the combined effect of the high imports serving the PJM Mid-Atlantic Region and Dominion. PJM’s RTEP Process identified system upgrades to be completed prior to June 2006 to provide additional voltage support and 500/230 kV transformation to help mitigate these reactive issues and other local thermal limits identified during 2005 peak load operations. With these upgrades completed, southwestern PJM, eastern PJM and Dominion will pass load deliverability tests for 2006. Upgrades identified to be complete by June 2006 included: .

..

- *increase size of Black Oak dynamic reactive device by June 2008*

PJM 2006 RTEP, *supra* note 94, at 43 (emphasis added).

81. Further, the benefits of this project will accrue predominately to customers in PJM transmission zones other than the Allegheny Power zone. This is confirmed by the fact that PJM has allocated 99 percent of the cost of the Black Oak SVC to transmission zones other than the Allegheny Power transmission zone.

82. Moreover, the Black Oak SVC is one of the largest dynamic reactive devices in the world at 675 MVAR total capacity, and is the largest SVC in the United States. The proposed SVC has a dynamic/continuous capability ranging from -100 MVAR (reactive) to +575 (capacitative) on the 500 kV bus at the Black Oak Substation.

83. In addition, although TrAILCo does not seek incentive rate treatment for the Black Oak SVC on the basis of the use of “advanced technology” within meaning of section 1223 of EAct 2005,<sup>96</sup> the Commission finds that TrAILCo’s use of such technologies for the Black Oak SVC further supports a finding, as discussed below, that TrAILCo demonstrated the appropriateness of an ROE in the high end of the zone of reasonableness for the Black Oak SVC. In section 1223 of EAct 2005, Congress directed the Commission to encourage the deployment of advanced transmission technologies that increase the capacity, efficiency and reliability of an existing or new transmission facility. The Black Oak SVC represents three of the 18 technologies cited by Congress in FPA section 1223(a). First, the Black Oak SVC represents optimized transmission line configurations by increasing the efficiency and magnitude of power flow capability. Second, the operation of the Black Oak SVC indicates that voltage is being monitored and that the SVC is supplying reactive power continuously, through thyristor control, to maintain minimum and maximum voltage limits on the constrained path. Although not mentioned by TrAILCo, this indicates that the SVC and associated control represents a flexible AC transmission device. The Black Oak SVC uses a control technology making its operation “dynamic,” enabling higher power transfers through PJM’s western interface with minimum impact on the environment, shorter project implementation times, and lower investment costs, as compared to the alternatives to accommodate the specified reliability need. Third, the Black Oak SVC exemplifies

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<sup>96</sup> Section 1223(b) states, “[i]n carrying out the Federal Power Act (16 U.S.C. 791a et seq.) and the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. 2601 et seq.), the Commission shall encourage, as appropriate, the deployment of advanced transmission technologies.” Section 1223(a) defines an advanced transmission technology as “a technology that increases the capacity, efficiency, or reliability of an existing or new transmission facility . . .” Pub. L. No. 109-58, § 1223, 119 Stat. 594, 953-54 (2005).

power electronics through the device use of thyristor-control. In particular, the Black Oak SVC is able to provide a defined range of reactive supply dynamically at precise increments to maintain minimum voltage levels.

84. Further, because of the solid state nature of the device as a thyristor-controlled device, the Black Oak SVC can increase power transfer capability and reduce transmission losses almost instantaneously, increasing system efficiency through continuous supply of reactive power. Traditional large capacitor bank modules cannot provide the kind of flexibility, efficiency or speed that the Black Oak SVC power electronic technology can provide. The Black Oak SVC allows lines to be loaded closer to the transmission lines' thermal rating, thereby enabling more efficient use of transmission capacity. The Black Oak SVC has continuous monitoring of voltages along the constrained PJM path and maintains predefined voltage targets. In part, the Black Oak SVC is needed by PJM to resolve voltage problems and a reactive supply deficiency created by several recently retired mid-Atlantic generating units. This type of technology is particularly important in light of the increase in west-to-east transfer of bulk power flows, due to several generation retirements in the mid-Atlantic region, the generation scarcity during summer peaks, and the mid-Atlantic region's heavy reliance upon imports during summer peaks.

85. The Black Oak SVC will mitigate losses of the Pruntytown-Mt. Storm 500 kV line, which has been identified as one of the most limiting facilities in PJM for west-to-east transfers, within a fraction of a second.<sup>97</sup> Traditional capacitor banks initiated by breaker closure are not nearly as fast, flexible, or reliable as those proposed in the Black Oak SVC design. We thus find that the construction of the Black Oak SVC is necessary to meet reliability concerns and to reduce congestion costs.

86. TrAILCo must also demonstrate that there is a nexus between proposed incentive rate treatment and the proposed investment.<sup>98</sup> As discussed above, in Order No. 679-A,

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<sup>97</sup> February 21 Filing, Exh. No. TRC-100 at 16 ("The SVC will alleviate the effects of the loss of the Pruntytown-Mt. Storm 500 kV line by providing dynamic and steady-state voltage support at the Black Oak 500 kV Bus. When it is installed, the SVC will ensure that the voltage remains above the violation limit at the Bus.").

<sup>98</sup> As stated above, TrAILCo does not seek authorization for the incentive rate treatment for the Black Oak SVC as an "advanced technology incentive" under section 1223 of EAct 2005. Accordingly, the Commission's standard of review under section 219, including the requirement of a nexus showing, is used herein. *Compare The United Illuminating Company*, 119 FERC ¶ 61,182 at P 71 (2007) (noting that the standard of review for an advanced technology incentive under EAct 2005 section 1223 is whether

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the Commission clarified that its nexus test is met when an applicant demonstrates that the total package of incentives requested is “tailored to address the demonstrable risks or challenges faced by the applicant.”<sup>99</sup> By its terms, this nexus test is fact-specific and requires the Commission to review each application on a case-by-case basis. Notably, the Commission chose not to adopt a list of criteria or characteristics that must be met by every applicant before an incentive would be approved.<sup>100</sup> The Commission recognized that it would be impossible to identify every conceivable challenge or risk faced by an applicant, or to develop, an *a priori* menu of incentives that would or would not be appropriate given a particular set of risks and challenges.<sup>101</sup> Consistent with our exercise of ratemaking authority under section 205, our evaluation of incentive rate proposals will be fact-specific and will rely on the requirements established in the enabling statute and our regulations promulgated thereunder.

87. The Commission finds that there is a nexus between the incentive ROE and the investment in the Black Oak SVC for several reasons. First, we recognize that the rating of TrAILCo’s affiliates (in light of TrAILCo’s new company formation) presents a risk of default that necessitates a commensurate ROE to encourage investment. While TrAILCo does not yet have a corporate credit rating, the three Allegheny Power companies have a corporate credit rating of BB+, *i.e.*, below investment grade,

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the technology “mitigate[s] congestion and enhance[s] grid reliability by increasing the capacity, efficiency or reliability of an existing or new transmission facility”).

<sup>99</sup> Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 40.

<sup>100</sup> Adoption of a static list of characteristics for use in evaluating all requests for incentive-based rate treatment also could unreasonably chill the creativity of the industry in developing and proposing advanced and worthwhile technologies or products that otherwise meet the criteria set forth in FPA section 219 and the Order No. 679 rulemaking proceeding. We do not want to discourage an applicant that develops a worthwhile product or proposal from submitting its proposal for our consideration simply because the product or proposal did not meet a predetermined list of characteristics.

<sup>101</sup> In addition, the Commission chose not to be so bounded to a limited and arbitrary set of criteria or characteristics because doing so would have impaired our ability to fulfill Congress’ mandate that we “promote reliable and economically efficient transmission and generation of electricity by promoting capital *investment* in the enlargement, improvement, maintenance, and operation of *all facilities for the transmission of electric energy in interstate commerce . . .*” 16 U.S.C. § 824s(b)(1) (emphasis added).

speculative or “junk bond” for an electric utility. The ratings of TrAILCo’s affiliates affect its financial risk. Moreover, TrAILCo’s new company formation presents a risk of default that necessitates a commensurate ROE to encourage investment. TrAILCo presents a compelling cash flow analysis, the same as would be undertaken by lenders, to demonstrate that its bond rating will be negatively affected by a lower ROE.<sup>102</sup>

88. We also agree that TrAILCo’s project entails significant regulatory and technological risks in terms of its location, the need for siting and rights of way, its size and its use of thyristor technology.

89. Order No. 679 provides that “routine investments made to comply with existing reliability standards may not always qualify for an incentive based-ROE.”<sup>103</sup> TrAILCo has demonstrated that the Black Oak SVC upgrade is not a routine investment, but rather a significant investment not present in the ordinary course of business, in terms of the amount of investment required for this technology, and in terms of size. We acknowledge that these factors alone will require new business processes and systems, and entail new challenges not present in the ordinary course of business.

90. We find that the Black Oak SVC can increase power transfer capability and reduce transmission losses, increasing the efficiency of the system through continuous supply of reactive power at precise increments. Accordingly, the Commission believes that TrAILCo has adequately demonstrated a nexus between the proposed ROE rate incentive and its investment in the Black Oak SVC.

91. We agree with TrAILCo that an ROE incentive will assist TrAILCo in managing the risks outlined above (with benefits that will inure to ratepayers). Moreover, as discussed below, we agree that the Black Oak SVC entails significant technological and regulatory risks that are not attendant in routine transmission projects. Subject to TrAILCo’s compliance filing requirement, as discussed above, we will grant TrAILCo an ROE in the high end of the zone of reasonableness for the Black Oak SVC. However, as stated above, the Commission’s preliminary analysis indicates that TrAILCo’s proposed ROE calculations may produce rates that have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful and we are setting for hearing TrAILCo’s proposed ROE. The appropriate ROE to be adopted for the Black Oak SVC will be established in those hearing procedures.

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<sup>102</sup> February 21 Filing, Exh. No. TRC-101.

<sup>103</sup> Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 94.

92. TrAILCo has shown that its total package of incentives is tailored to address the demonstrable risks or challenges that it faces in the construction of the TrAIL Project and Black Oak SVC. As discussed above, TrAILCo has made a compelling case for the incentives because its proposed projects are new and presents special risks or challenges and, thus, is not a routine investment made in the ordinary course of business.<sup>104</sup>

#### **D. Hearing and Settlement Judge Procedures**

93. TrAILCo's proposed formula rates raise issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

94. Our preliminary analysis indicates that TrAILCo's proposed formula rates have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will accept TrAILCo's proposed formula rates for filing, suspend it for a nominal period, make it effective June 1, 2007, subject to refund, and set it for hearing and settlement judge procedures.

95. While we are setting these matters for a trial-type evidentiary hearing, we encourage the participants to make every effort to settle their dispute before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.<sup>105</sup> If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.<sup>106</sup> The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, concerning the status of settlement discussions.

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<sup>104</sup> See Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 27, 60.

<sup>105</sup> 18 C.F.R. § 385.603 (2006).

<sup>106</sup> If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience ([www.ferc.gov](http://www.ferc.gov) – click on Office of Administrative Law Judges).

Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) TrAILCo's proposed formula rates are hereby accepted for filing and suspended for a nominal period, to become effective June 1, 2007, as requested, subject to refund, as discussed in the body of this order.

(B) TrAILCo is hereby directed to submit a compliance filing, within 30 days of the date of this order, as discussed in the body of this order.

(C) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning TrAILCo's proposed formula rates. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Paragraphs (D) and (E) below.

(D) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2007), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(E) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

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(F) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in this proceeding in a hearing room of the Commission, 888 First Street, N.E., Washington, D.C. 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission. Commissioner Wellinghoff concurring in part and dissenting in part with a separate statement attached.

( S E A L )

Kimberly D. Bose,  
Secretary.

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Trans-Allegheny Interstate Line Company

Docket Nos. ER07-562-000  
ER07-562-001

(Issued May 31, 2007)

WELLINGHOFF, Commissioner, concurring in part and dissenting in part:

The TrAIL Project is a proposed 500 kV transmission line to be constructed from southwestern Pennsylvania to West Virginia to Northern Virginia within the PJM region. The Commission previously granted a petition for declaratory order that sought transmission rate incentives for an early version of the TrAIL Project.<sup>107</sup> In that proceeding, the Commission approved several incentives for the 500 kV line, including an ROE to be set in the upper end of the zone of reasonableness. Trans-Allegheny now seeks approval for a specific ROE that reflects that previously approved incentive adder. Trans-Allegheny proposes a base ROE of 12.2 percent for non-incentive projects and an ROE of 13.9 percent for incentive projects.

The Commission today establishes a hearing to determine the appropriate ROE, including an incentive adder, for Trans-Allegheny's incentive projects. For the reasons set forth in my separate statement in *Allegheny*, I do not believe that an incentive ROE adder for the TrAIL Project had been justified.<sup>108</sup> Therefore, a hearing to determine where to place an incentive ROE adder within the zone of reasonableness is unwarranted.

In addition, Trans-Allegheny seeks incentive rate treatment for the static VAR compensator to be installed at the existing Black Oak Substation (Black Oak SVC). Specifically, Trans-Allegheny requests that an ROE of 13.9 percent, including an incentive adder, apply to the Black Oak SVC. In today's order, the Commission grants that request.

I have previously stated that in providing an incentive adder over the base ROE, the Commission should focus on encouraging investment decisions beyond the upgrades simply required to meet a utility's service obligations or the minimum standard of good

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<sup>107</sup> *Allegheny Energy, Inc.*, 116 FERC ¶ 61,058 (2006), order on reh'g, 118 FERC 61,042 (2007) (*Allegheny*).

<sup>108</sup> See *Allegheny*, 118 FERC ¶ 61,042 (2007) (statement of Commissioner Wellinghoff, concurring in part and dissenting in part).

utility practice. An incentive adder should be more narrowly targeted to transmission investments that provide incremental benefits, such as benefits that result from the deployment of “best available technologies” that increase operational and energy efficiency, enhance grid operations, and result in greater grid flexibility.<sup>109</sup> Such investments recognize that efficient transmission facilities and state-of-the-art transmission technologies are essential to solving our serious energy delivery problems. Promoting such investments is also consistent with the Congressional directive set forth in section 1223 of EAct 2005 that the Commission shall encourage the use of advanced transmission technologies in infrastructure improvements of both existing and new transmission facilities.<sup>110</sup>

Trans-Allegheny does not seek incentive rate treatment for the Black Oak SVC on the basis of using “advanced transmission technologies” within the meaning of section 1223 of EAct 2005. However, as discussed in today’s order, Trans-Allegheny’s use of the Black Oak SVC is consistent in many respects with these goals of that statutory provision.<sup>111</sup> In addition, although construction of the Black Oak SVC and the TrAIL Project were both directed as part of the PJM RTEP process, construction of the Black Oak SVC is not contingent upon construction of the TrAIL Project.

I believe that it is appropriate to grant Trans-Allegheny some incentive adder over its base ROE for the Black Oak SVC, to recognize its deployment of advanced technologies. I would have set the amount of that incentive adder for hearing.

For these reasons, I respectfully concur in part and dissent in part with today’s order.

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Jon Wellinghoff  
Commissioner

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<sup>109</sup> Id. See also American Elec. Power Serv. Corp., 118 FERC ¶ 61,041 (2007) (concurring statement of Commissioner Wellinghoff).

<sup>110</sup> See Pub. L. No. 109-58, § 1223, 119 Stat. 594, 953-54 (2005).

<sup>111</sup> 119 FERC ¶ 61,219, at PP 83-85 (2007).