

123 FERC ¶ 61,098  
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.

Virginia Electric and Power Company

Docket Nos. ER08-92-000  
ER08-92-001  
ER08-92-002  
ER08-92-003

ORDER ON FORMULA RATE PROPOSAL

(Issued April 29, 2008)

1. On October 25, 2007, Virginia Electric and Power Company (VEPCO) filed revised tariff sheets to Attachment H-16 and Schedules 7, 8, and 12 of PJM Interconnection, L.L.C.'s (PJM) Open Access Transmission Tariff (OATT) to substitute a formula rate for its stated rates for Network Integration Transmission Service (NITS) and Point-to-Point transmission service (October 25 Filing). VEPCO also requested a 50 basis point adder to the return on equity (ROE) reflected in its formula rate as an incentive for continued membership in a regional transmission organization (RTO), pursuant to Order Nos. 679 and 679-A.<sup>1</sup> In this order, the Commission accepts the formula rate proposed by VEPCO, with certain modifications, rejects its proposed ROE and requires a compliance filing as discussed herein, effective January 1, 2008.

**I. Background**

2. VEPCO states that it is in the early stages of a major expansion of its transmission system due to continued peak load growth. VEPCO expects to participate in the construction of transmission projects included in PJM's Regional Transmission Expansion Plan (RTEP).

3. On October 25, 2007, in Docket No. ER08-92-000, VEPCO filed revised tariff sheets to PJM's OATT which would substitute a forward-looking formula rate for its currently-effective stated rates for transmission service within the VEPCO zone of PJM.

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<sup>1</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).

VEPCO states that a forward-looking formula rate will (1) provide for the timely and administratively efficient recovery of the costs associated with the expansion, (2) eliminate the need for multiple filings under section 205 of the Federal Power Act,<sup>2</sup> and (3) allow for the systematic adjustment of its rates to reflect changes in transmission costs and loads over time. VEPCO states that its proposed formula rate is consistent with other Commission-approved formula rates. Specifically, VEPCO states that the foundation for its proposal is the formula rate from an uncontested settlement approved by the Commission in *PHI/BGE*<sup>3</sup> and incorporates the forward-looking features adopted by the Commission in *ITC*.<sup>4</sup> According to VEPCO, formulas that are updated after FERC Form No. 1 data becomes available, inherently build 5 to 17 months of lag in between the end of the cost year and the beginning of the rate year, thus detrimentally impacting the utility's ability to recover its prudently-incurred costs in a timely manner.

4. On December 19, 2007, the Commission staff issued a deficiency letter requesting additional information to be filed by January 18, 2008 (Deficiency Letter). The additional information requested dealt with, *inter alia*, cost and revenue data required by section 35.13 of the Commission's regulations and detailed explanations of the formula rate and the True-Up Adjustment.

5. On January 10, 2008 (January 10 Filing), as amended on January 11, 2008 (January 11 Filing), VEPCO filed in Docket No. ER08-92-001, its response to the majority of staff's questions and noted that it would be filing several more responses by the January 18, 2008 due date. In addition, VEPCO requested that the Commission staff "modify the [Deficiency L]etter to not require [VEPCO]" to answer the questions on actual cost-of-service data for the 2006 calendar year (Period 1) and for projected cost-of-service data for the 2008 calendar year (Period 2). In the alternative, VEPCO requested a one-month extension of time, to February 19, 2008, to answer the Deficiency Letter. On January 18, 2008, VEPCO filed in Docket No. ER08-92-002 its responses to several outstanding questions from staff in the Deficiency Letter. On February 12, 2008, VEPCO requested an additional 10-day extension of its already extended due date of February 19, 2008 to respond to certain questions regarding cost-of-service data. On February 29, 2008, in Docket No. ER08-92-003, VEPCO filed its responses to staff's remaining questions.

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<sup>2</sup> 16 U.S.C. § 824d (2000).

<sup>3</sup> *Baltimore Gas and Electric Co.*, 115 FERC ¶ 61,066 (*PHI/BGE*) (2006).

<sup>4</sup> *International Transmission Co.*, 116 FERC ¶ 61,036 at P19 (*ITC*) (2006).

## II. Proposal

6. VEPCO proposes to utilize a forward-looking formula rate in calculating its annual transmission rates, instead of the current stated cost-of-service rate it uses. VEPCO proposes a forward-looking formula which will be used to calculate its Annual Transmission Revenue Requirement (ATRR). The annual rate for transmission service will then be calculated by dividing the ATRR by the annual single-day coincidental peak for the 12-month period ending October 31 of the previous year. As described in greater detail herein, the proposed forward-looking formula is adjusted annually through an Annual Update which is based on projected costs, and subsequently reconciled to actual costs in the following year using the True-Up Adjustment process set forth in VEPCO's tariff sheets.

7. To effectuate its formula rate, VEPCO proposes to make the following changes to PJM's OATT:

- Revise Attachment H-16, *Annual Transmission Rates for Network Integration Transmission Service*, to: (1) eliminate VEPCO's "stated" ATRR of \$155,000,000 and the rate for NITS of \$10,971.35 per MW per year and replace these amounts with amounts to be determined according to the formula contained in the new Attachment H-16A, *Formula Rate – Appendix A*, and the protocols contained in the new Attachment H-16B, *Formula Rate Implementation Protocols* and (2) specify the calculation of revenue credits.
- Add new Attachment H-16A, *Formula Rate – Appendix A*, which is a spreadsheet containing formulas to calculate VEPCO's ATRR and the rate for transmission service in the VEPCO zone of PJM.
- Add new Attachment H-16B, *Formula Rate Implementation Protocols*, which will set out the implementation protocols for the formula rate. Attachment H-16B specifies: (1) the projected and actual costs which will be used in determining the ATRR and the rate for transmission service in the VEPCO zone of PJM, (2) how the True-Up Adjustment will be implemented, and (3) the procedures for reviewing and challenging the inputs to the spreadsheet.
- Revise Schedules 7 and 8 to replace VEPCO's existing stated rates for transmission service to delivery points within the VEPCO Zone with rates that are derived from the VEPCO formula.
- Make non-substantive changes to effectuate the formula rate by: (1) revising Schedule 12 to reference the derivation of VEPCO's annual revenue requirements for its RTEP projects for which it seeks recovery, (2) moving from Attachment H-16A to Attachment H-16C the Virginia Retail

Administrative Fee Credit for Virginia Load Serving Entities in the VEPCO Zone, and (3) moving from Attachment H-16B to Attachment H-16D the proposed rates for wholesale distribution service.

8. VEPCO requests an effective date of January 1, 2008 for its proposed revisions to the PJM OATT.

### **III. Notice, Interventions, and Protests**

9. Notice of VEPCO's October 25 Filing in Docket No. ER08-92-000 was published in the *Federal Register*, 72 Fed. Reg. 62,842 (2007), with interventions and protests due on or before November 15, 2007. Timely motions to intervene were filed by American Electric Power Service Corporation, Exelon Corporation (Exelon), PJM, PJM Industrial Customer Coalition, and PPL Electric Utilities Corporation. Timely motions to intervene or notices of intervention and comments were filed by PHI Companies,<sup>5</sup> the Public Service Commission of Maryland (Maryland Commission), the Staff of the Virginia State Corporation Commission (VSCC Staff), and Public Service Electric and Gas Company (PSE&G). A timely motion to intervene and protest was filed by the Office of the Attorney General of Virginia, Division of Consumer Counsel (Virginia Consumer Counsel).

10. Baltimore Gas and Electric Company (BG&E) filed a motion to intervene, comments, and a request for maximum suspension period. Indicated Customers<sup>6</sup> filed a motion to intervene, protest, request for a hearing, and opposition to waivers. North Carolina Agencies<sup>7</sup> and the Virginia Municipal Electric Association No. 1 (VMEA)<sup>8</sup> filed

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<sup>5</sup> The PHI Companies are Pepco Holdings, Inc., Potomac Electric Power Company (Pepco), Atlantic City Electric Company and Delmarva Power & Light Company.

<sup>6</sup> Indicated Customers are Central Virginia Electric Cooperative, Craig-Botetourt Electric Cooperative, North Carolina Electric Membership Corporation and Old Dominion Electric Cooperative.

<sup>7</sup> North Carolina Agencies are the North Carolina Utilities Commission, the Public Staff – North Carolina Utilities Commission, and the Attorney General of the State of North Carolina.

<sup>8</sup> The members of VMEA – Blackstone, Culpeper, Elkton, Franklin, Manassas and Wakefield, Virginia, and the Harrisonburg Electric Commission – state that the issues of significance to VMEA have been raised in the protest filed on November 15 by Indicated Customers.

a motion to intervene or notice of intervention, protests, and requests for a hearing. On November 30, 2007, VEPCO filed an answer to the comments and protests. On December 17, 2007, Indicated Customers filed an answer to VEPCO's answer.

11. Notice of VEPCO's January 10 Filing, as amended on January 11, in Docket No. ER08-92-001 was published in the *Federal Register*, 73 Fed. Reg. 4,202 (2008), with interventions and protests due on or before January 30, 2008. On January 18, 2008, Indicated Customers filed an answer opposing or commenting on certain procedural requests of VEPCO's January 10 Filing. Notice of VEPCO's January 18 Filing in Docket No. ER08-92-002 was published in the *Federal Register*, 73 Fed. Reg. 6,174 (2008), with interventions and protests due on or before January 31, 2008. On January 31, 2008, Indicated Customers filed a protest to VEPCO's filings of January 10 and 11, 2008 and January 18, 2008, which provided responses to the Deficiency Letter.

12. Notice of VEPCO's February 29 Filing was published in the *Federal Register*, 73 Fed. Reg. 13,877 (2008), with interventions and protests due on or before March 21, 2008. On March 21, 2008, Indicated Customers filed a protest to VEPCO's February 29, 2008 filing (Indicated Customers March 21 Supplemental Protest). Also on March 21, 2008, Virginia Consumer Counsel filed comments. On April 2, 2008, VEPCO filed an answer to the March 21 protests by Indicated Customers and Virginia Consumer Counsel (VEPCO April 2 Answer). On April 15, 2008, Indicated Customers filed an answer to VEPCO's April 2 Answer.

#### IV. Discussion

##### A. Procedural Matters

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,<sup>9</sup> the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

14. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure<sup>10</sup> prohibits an answer to an answer or protest unless otherwise permitted by the decisional authority. In this case, we find that VEPCO's November 30 and April 2 answers and Indicated Customers' December 17 and April 15 answers have assisted the Commission in its decision-making process.<sup>11</sup> Therefore, we will accept them.

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<sup>9</sup> 18 C.F.R. § 385.214 (2007).

<sup>10</sup> 18 C.F.R. § 385.213(a)(2) (2007).

<sup>11</sup> See, e.g., *Midwest Independent System Operator Corp.*, 121 FERC ¶ 61,132, at P 12 (2007); *Westar Energy, Inc.*, 121 FERC ¶ 61,108, at P 18 (2007).

**B. Formula Rate Proposal**

15. We approve VEPCO's proposal to implement a transmission cost of service formula rate. The Commission has found that the use of formula rates encourages the construction and timely placement into service of needed transmission infrastructure.<sup>12</sup>

16. The Commission has approved the use of formula rates by a number of transmission-owning utilities in the PJM region, both those utilizing prior-year FERC Form No. 1 data to calculate rates for the upcoming year,<sup>13</sup> as well as those utilizing projected costs, as VEPCO proposes to do.<sup>14</sup> In each case, the fundamental process for the formula rates remains the same: rates are estimated for the following year, either through prior-year FERC Form No. 1 data or through projections, and data regarding such rates is provided to customers with sufficient time for them to review the rates before they are implemented and challenge them before the Commission if necessary. Once the actual costs are known from that year's FERC Form No. 1, those costs are trued-up to the rates that have been charged over the past year and any over-collections are returned to customers with interest at the FERC interest rate. These mechanisms allow the utility to recover its costs in a more timely manner while also protecting customers from inflated rates through the true-up process. Since over-collections are returned to customers with interest at the FERC interest rate, customers are made whole from any excessive projections or over-collections.<sup>15</sup> As discussed herein, VEPCO's proposal is consistent with this structure.

**1. Formula Rate Proposal****a. Use Of Projected Costs****i. VEPCO's Proposal**

17. VEPCO's proposed formula rate is contained in Attachment H-16A, Appendix A to PJM's OATT, which consists of a spreadsheet and supporting documents. VEPCO's

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<sup>12</sup> See *Northeast Utilities Service Co.*, 105 FERC ¶ 61,089, at P 23 (2003).

<sup>13</sup> *PHI/BGE*, 115 FERC ¶ 61,066; *Duquesne Light Co.*, 118 FERC ¶ 61,087 (2007).

<sup>14</sup> *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 ¶ FERC 61,188 (2008) (*PATH*).

<sup>15</sup> *International Transmission Co.*, 116 FERC ¶ 61,036, at P 20 (2006) (*ITC*).

ATRR will be calculated by entering data into the spreadsheet. The annual rate for transmission service will then be calculated by dividing the ATRR by the annual single-day coincidental peak for the 12-month period ending October 31 of the previous year.<sup>16</sup>

18. VEPCO states that its utilization of projected costs parallels the traditional reliance on Period II cost of service data for establishing rates.<sup>17</sup> In addition, VEPCO states that the key modification to its proposed formula, as compared to the PHI/BGE formula, is its accommodation of projected calendar year cost-of-service data to determine an ATRR and rates. VEPCO also states that the majority of the projected cost-of-service data is derived from VEPCO's budgets. VEPCO states that, as with the ITC formula, the ATRR and the rates are ultimately trued-up with interest using actual calendar year cost-of-service data. VEPCO also states that the actual data is taken from FERC Form No. 1 or from accounting data that are consistent with the FERC Form No. 1 data.<sup>18</sup>

19. VEPCO also proposes to modify the PHI/BGE formula by using average balances for inclusion in rate base rather than end-of-year balances. An average of the 13 months' balances for the calendar year will be used for each balance for plant in service and depreciation. Further, for every other type of balance in rate base, VEPCO proposes to use the average of the balance for the beginning and end of the calendar year.

20. VEPCO proposes that its rate be effective January 1, 2008 for a calendar year – the same year for which it uses projected cost-of service data. VEPCO notes that this is another feature of its proposal that differs from the PHI/BGE formula, which uses the twelve months beginning June 1. For calendar year 2008, VEPCO's ATRR is contained in the instant filing and supported by testimony.<sup>19</sup> For each year thereafter, VEPCO will post on PJM's website by September 15 its proposed Annual Update, which will reflect the projected costs to be used to determine the rates for the subsequent calendar year. VEPCO will file with the Commission, in an informational filing, its proposed Annual Update by December 15.

21. VEPCO requests an ROE of 11.73 percent, plus a 50 basis point adder to its proposed ROE for continued membership in PJM, for a total ROE of 12.23 percent.

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<sup>16</sup> See October 25 Filing, Exhibit No. DVP-2, Direct Testimony Mr. James Daniel Jackson, Jr. (Jackson Testimony).

<sup>17</sup> *Id.* at 7.

<sup>18</sup> *Id.* at 8.

<sup>19</sup> See October 25 Filing, Exhibit Nos. DVP-8, Attachment H-16A, *Formula Rate – Appendix A*; DVP-9, Direct Testimony of Mr. Alexander N. Bailey (Bailey Testimony); and DVP-10, Direct Testimony of Mr. Leo R. Meyer.

VEPCO states that the range of implied cost of equity is from 7.85 percent to 15.61 percent, with the midpoint of the range produced by the adjusted proxy group being 11.73 percent. VEPCO states that the requested 50 basis point adder is appropriate because the Commission has consistently authorized a 50 basis point ROE adder in order to encourage RTO membership, specifically for RTO participants that continue such participation.<sup>20</sup>

22. VEPCO states that it is not seeking an ROE transmission rate incentive in this proceeding. However, VEPCO notes that it has included placeholders for ROE incentives in its formula in order to accommodate projects which may receive incentives at varying ROE levels in the future.<sup>21</sup> VEPCO states that the placeholders will only be changed pursuant to a Commission ruling in a section 205 filing.

23. VEPCO states that its proposed rates reflect a \$66,500,000 increase in revenues when compared to its currently-effective ATRR of \$155,000,000.<sup>22</sup> This is an increase of 42.9 percent. VEPCO states that its requested rate increase does not include the recovery of any RTO start-up costs or administrative fees.

## ii. Comments and Protests

24. The Virginia Consumer Counsel and Indicated Customers raise concerns with VEPCO's proposal to use projected costs. They are concerned that parties will not be able to meaningfully analyze the projected costs which will be derived from VEPCO's internal budgets. They are also concerned with the accuracy and reasonableness of the projections.

25. Indicated Customers take exception to VEPCO's reliance on the ITC formula. For example, they note that unlike ITC, which is a single-purpose new transmission project, VEPCO is a vertically-integrated plant. They add that VEPCO's estimated cost of new transmission investment is \$2 billion, which is only a small portion of VEPCO's electric plant-in-service of \$23 billion (for the year ending December 2008). In addition, Indicated Customers take exception to VEPCO's contention that its forward-looking proposal is not a departure from "traditional" ratemaking.<sup>23</sup> Rather, Indicated Customers note that under "traditional" ratemaking when projected costs are used: (1) the utility

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<sup>20</sup> *Citing Duquesne Light Co.*, 118 FERC 61,087, at P 50 (2007); *Commonwealth Edison Co.*, 119 FERC 61,238, at P 72, 77 (2007) (*ComEd*).

<sup>21</sup> Jackson Testimony at 13.

<sup>22</sup> October 25 Filing at 9.

<sup>23</sup> *Citing ITC*, 116 FERC ¶ 61,036 at P 19.

makes a FPA section 205 filing, (2) the filing is noticed and customers have an opportunity to challenge the filing, and (3) the Commission reviews the projections to determine that the resulting rates are just and reasonable. However, Indicated Customers contend that under VEPCO's proposal: (1) VEPCO proposes that only the revised Annual Update be submitted as an "informational" filing, but not the initial Annual Update or the True-Up Adjustment, and (2) such informational filings do not give customers an opportunity to challenge the projections or resulting rates before they take effect.

26. Indicated Customers recommend that the Commission require VEPCO to annually file its proposed changes in charges produced under the formula rates pursuant to FPA section 205. Indicated Customers state that under this approach, the Commission would retain its authority to provide maximum protection against abuse of formula rates while not depriving VEPCO of the legitimate benefits of a formulary approach to ratemaking. Indicated Customers further state that formula would still be the "filed rate," and that investigations would not "open up" the formula. Indicated Customers argue that with an annual filing, there should be little or no controversy triggering the Commission's exercise of its section 205 remedial powers.

27. In response to VEPCO's February 29 Filing, Indicated Customers contend that VEPCO's filing still lacks cost support, workpapers, budgets, underlying assumptions or other data to support its projected Period II revenue requirements, which result in a 42.9 percent increase in its ATRR. Indicated Customers request that the Commission reject VEPCO's formula rate filing as deficient. In the alternative, Indicated Customers request that an evidentiary hearing be established to examine the justness and reasonableness of VEPCO's formula rate proposal.

### **iii. Commission Determination**

28. The Commission will approve the forward-looking aspect of VEPCO's proposed formula rate. As VEPCO notes, the use of estimated costs in determining rates is not a change in Commission policy. In fact, the Commission has recently approved formula rate proposals very similar to the instant proposal.<sup>24</sup>

29. Indicated Customers and the VSCC Staff express concern that they will not be able to "meaningfully analyze" the projections provided by VEPCO and express concern over the accuracy of such projections. VEPCO has proposed an annual update process that will provide its customers with sufficient opportunity to evaluate its projected rates.

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<sup>24</sup> *Xcel Energy Service, Inc.*, 121 FERC ¶ 61,284 (2007) (*Xcel*); *Michigan Electric Transmission Co.*, 117 FERC ¶ 61,314 (2006), *order on reh'g*, 118 FERC ¶ 61,139 (2007) (*Michigan Electric*).

30. For the forward-looking ATRR, which reflects projected costs, VEPCO will post on the PJM website, by September 15 of each year, its Annual Update which contains: (1) its projected costs, including the ATRR and NITS rate, (2) its estimated peak load, and (3) any Material Accounting Changes. VEPCO also will provide a spreadsheet containing its projected rates. By September 30 of each year, VEPCO will hold a public meeting to explain the projected costs and respond to questions from its customers.<sup>25</sup> During this process, VEPCO must make available sufficient information for parties to evaluate the accuracy of its forward-looking ATRR.<sup>26</sup> This process provides sufficient opportunity for customers to review VEPCO's projected costs, discuss those costs with VEPCO, and challenge them before the Commission if the explanations offered by VEPCO are not sufficient.

31. We deny Indicated Customers' request that VEPCO be required to file a limited section 205 filing each year, containing its Annual Update and True-Up Adjustment. When the Commission approves a company's request for a formula rate, it approves the formula itself, which becomes the filed rate. There is no need to file each Annual Update or True-Up Adjustment under section 205 because the data contained in these processes is not the rate; it is merely an input into the formula, which is the rate. Any excess costs charged as a result of inaccurate projections will be returned to customers, with interest at the FERC interest rate, during the True-Up Adjustment process.

32. We also deny Indicated Customers' request to reject the filing as deficient or to set the proceeding for hearing. Although VEPCO did not submit as much information as is required for Period II costs, the true-up mechanism contained in VEPCO's proposal obviates the need for the filing of all of the data specified in our regulations for Period II costs.<sup>27</sup>

**b. True-Up Adjustment**

**i. VEPCO's Proposal**

33. VEPCO's proposed protocols, setting forth the procedures by which VEPCO will implement its formula rate, are contained in Attachment H-16B of Appendix A to PJM's OATT.

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<sup>25</sup> Attachment H-16B § 2, Proposed Original Sheet No. 314F.26.

<sup>26</sup> *Michigan Electric*, 117 FERC ¶ 61,314 at P 18, *order on reh'g*, 118 FERC ¶ 61,139 at P 13.

<sup>27</sup> Unlike rate cases in which cost projections are used to establish fixed rates, VEPCO's true-up mechanism will protect customers against unjust and unreasonable rates based on the projections.

34. VEPCO's projected costs will be trued-up to actual costs once such data becomes available. To calculate the True-Up Adjustment, VEPCO proposes to use actual cost-of-service data, which will either come from FERC Form No. 1 or from accounting data that is consistent with FERC Form No. 1 data.<sup>28</sup> VEPCO will compare the actual ATRR with the adjusted ATRR. The difference in these amounts, plus interest, equals the True-Up Adjustment. VEPCO proposes to post on PJM's website, by June 15, the adjusted ATRR for the previous year, along with the True-Up Adjustment. Parties will have until October 1 of each year to submit information requests to VEPCO concerning the adjusted ATRR and the True-Up Adjustment. VEPCO states that it will make a good faith effort to respond to such requests within 15 business days.

35. The protocols also provide for challenges to the True-Up Adjustment. Under VEPCO's proposed "Preliminary Challenge" provision, parties have until November 1 to notify VEPCO of any challenges to: (1) the True-Up Adjustment for the previous calendar year or (2) any Material Accounting Changes identified in the Annual Update. If changes are agreed upon, such changes will be posted on the PJM website by November 30 and incorporated into the ATRR for the following calendar year. If the differences among the parties are not resolved, parties may file a section 206 complaint with the Commission no later than December 16. The protocols limit the subject of the complaint to issues which were raised during the Preliminary Challenge stage of the proceeding.

36. The protocols specify that in any complaint proceeding or any proceeding initiated *sua sponte* by the Commission, VEPCO shall bear the burden of proving that it has reasonably calculated the True-Up Adjustment or reasonably made the Material Accounting Change. In addition, the protocols specify that the True-Up Adjustment and any Material Accounting Change, as well as the resulting ATRR, shall become final and no longer subject to challenge by the later of: (1) December 16 of the year in which they are posted if no complaint is filed and no proceeding is initiated *sua sponte* by the Commission, or (2) a final Commission order issued in response to a complaint or Commission-initiated proceeding to consider the True-Up Adjustment.

## **ii. Comments and Protests**

37. The Virginia Consumer Counsel, VSCC Staff and Indicated Customers argue that VEPCO's proposal improperly attempts to create a new burden for customers by requiring them to file a complaint in order to trigger Commission scrutiny of changes in

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<sup>28</sup> VEPCO explains that it needs to use data other than that contained in FERC Form No. 1 because it relies on plant costs which use an average of 13 monthly balances. The balances for the first and last months will come from FERC Form No. 1, while the balances for the remaining 11 months will come from VEPCO's general ledger.

charges under the formula rates, which would then require the customers to bear the burden, as the complainant, of demonstrating that the existing rate or charge is unjust and unreasonable and what the change(s) to be made to the rate or charge should be and why. They contend that the utility, and not the ratepayer, has the burden of justifying its rates. Further, Indicated Customers object to a formal challenge being limited to issues raised in a preliminary challenge, even though issues may be discovered after the artificial cut-off date established by VEPCO's proposed timeline.

38. Protestors note that the amount of information to be provided by VEPCO under its proposal will be limited, and therefore will make it difficult to establish a factual basis to support a section 206 complaint. They also note that VEPCO's proposal limits parties' rights to challenge whether: (1) costs are prudent, (2) costs were properly recorded in the Uniform System of Accounts, or (3) the implementation of the formula rate is consistent with any changes in the requirements and contents of FERC Form No. 1 implemented since the adoption of the formula rate. Further, the protestors contend that VEPCO's proposed protocols limit the time allowed for analysis of changes in charges, which would artificially and unreasonably limit the right of an interested party to challenge the projected ATRR, adjusted ATRR, and True-Up Adjustment.

39. Protestors also raise a number of procedural issues. For example, Indicated Customers note that PJM cannot provide notice under the FPA to customers of a rate change; only the Commission can discharge this responsibility.<sup>29</sup> Protestors also state that the protocols do not provide procedures if VEPCO does not respond to requests for information or withholds relevant information. They also note that if VEPCO is not required, under section 205, to file its forward-looking ATRR or its true-up procedures, then VEPCO is not subject to the Deficiency Letter or suspension of its rates. Without such protections, protestors contend that the Commission will be deprived of the tools it needs to ensure that VEPCO's charges are not unjust, unreasonable, or unduly discriminatory.

40. Indicated Customers state that the timeline must be adequate to afford interested parties the opportunity to conduct the necessary review of the underpinning data, including time for discovery. Indicated Customers propose that in order to afford customers a meaningful opportunity for review of the projected ATRR and the True-Up Adjustment: (1) customer meetings should be scheduled at least 30 days after the posting, (2) customers should have at least 90 days after the customer meeting to submit information request to VEPCO, with 15 business days for VEPCO to respond; and (3) customers should have at least 30 days after the last response to submit a preliminary challenge.

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<sup>29</sup> Indicated Customers Protest at 18, *citing* 18 C.F.R. § 35.1(a), (c).

41. Indicated Customers note that VEPCO's protocols would require VEPCO to identify and customers to challenge Material Accounting Changes, which are changes in VEPCO's accounting policies and practices "that took effect in the preceding twelve months ending August 31"<sup>30</sup> that are reported in Notes 3 and 4 of VEPCO's Securities and Exchange Commission Form 10-Q. Indicated Customers note that this fails to take into account any changes VEPCO makes to conform to changes in FERC accounting policies. Indicated Customers note that changes to the formula rate are needed if there are changes to: (1) the reporting requirements in FERC Form No. 1; (2) the Uniform System of Accounts; (3) accounting policies, practices and procedures of the formula rate; and (4) the Commission's current policies with regard to cost allocation and rate designs. Indicated Customers contend that since the protocols do not address these fundamental predicates, VEPCO will be left with discretion as to when and how changes in the formula rate will reflect these predicates.

42. VSCC Staff notes that VEPCO's proposed True-Up Adjustment does not examine actual revenues collected by VEPCO under the formula rate. Rather, VSCC Staff contends that VEPCO proposes to compare projected costs with actual costs, not actual revenues. VSCC Staff argues that the Commission should require VEPCO to use actual revenues collected from customers in calculating the True-Up Adjustment.

43. VSCC Staff also notes that the True-Up Adjustment could serve to allow VEPCO to circumvent Virginia law regarding retail rates. Under the law, retail rates are capped until 2009. Because VEPCO will true-up its 2008 revenue requirement in 2010, retail ratepayers in Virginia could end up paying costs which were incurred during a period in which the retail rates were capped.

### **iii. Commission Determination**

44. VEPCO's proposed True-Up Adjustment is consistent with the true-up mechanisms approved by the Commission for other companies.<sup>31</sup> To the extent that there is a disparity between actual revenues and actual costs which is not resolved through the True-Up Adjustment process set forth in VEPCO's protocols, parties may file a challenge with the Commission requesting that the inputs into the rate be reviewed. Between the information available from VEPCO's FERC Form No. 1 and that provided by VEPCO to its customers through the Annual Update and True-Up Adjustment, parties should have the information necessary to make such a challenge.

45. Several parties are concerned that VEPCO's proposed tariff language limits parties' and the Commission's rights to initiate a section 206 proceeding. The

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<sup>30</sup> Indicated Customers Protest at 33-34.

<sup>31</sup> See, e.g., *PHI/BGE*, 115 FERC ¶ 61,066; *Xcel*, 121 FERC ¶ 61,284.

Commission does not object to a utility's efforts to resolve matters with its customers before resorting to a section 206 complaint. That process, however, may not impact the rights of any party which has standing to bring a complaint. VEPCO must revise its tariff to expand the definition of the term "Interested Party" to include all parties having standing under section 206, pursuant to its commitment in its April 2 Answer.<sup>32</sup>

46. VEPCO also proposes that there be a cut-off date for challenges to its rates but has not adequately justified why such a cut-off date is needed. In order for formula rates to work properly, they must allow for after-the-fact corrections and updates.<sup>33</sup> Parties should use due diligence to ensure that correct data is used; however, should an error be discovered, the inputs to the formula must be corrected and the formula re-calculated to prevent parties from being overcharged or undercharged. The Commission therefore requires VEPCO to remove the provision prohibiting parties from raising in a section 206 complaint any issues that it did not raise in its Preliminary Challenge; and remove the December 16 cut-off date for filing challenges.

47. We note that any challenge to the projected costs, True-Up Adjustment or Material Accounting Change would not require the complainant to meet the section 206 burden of proof. VEPCO continues to bear the burden of demonstrating the justness and reasonableness of the rate resulting from its application of the formula the Commission approves today, and specifically recognizes this burden in the applicable tariff sheets:

In any Complaint proceeding or proceeding initiated *sua sponte* by the FERC challenging a True-Up Adjustment or a Material Accounting Change, VEPCO shall bear the burden of proving that it has reasonably calculated the True-Up Adjustment and/or reasonably adopted and applied the Material Accounting Change.<sup>34</sup>

48. We will not require VEPCO to file its True-Up Adjustment in an informational filing, as requested by various parties. VEPCO has committed, in its protocols, to provide information to its customers and to respond to information requests by such

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<sup>32</sup> VEPCO April 2 Answer at 14.

<sup>33</sup> See, e.g., *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 96 FERC ¶ 61,120, at 61,508 n.42 (2001); *Kern River Gas Transmission Co.*, 116 FERC ¶ 61,217 (2006).

<sup>34</sup> Attachment H-16B § 3(b), Proposed Original Sheet No. 314F.27.

customers.<sup>35</sup> We expect VEPCO to provide data to its customers relating to both the Annual Update and True-Up Adjustment in a timely manner, hold a customer meeting to explain the data, and respond to requests for further information.

49. We agree with Indicated Customers, however, that one day after a customer meeting is not sufficient time for parties to prepare comments, though we disagree that parties need 90 days. Within 30 days of the date of this order, VEPCO is required to make a compliance filing proposing a reasonable time period for parties to submit comments.

50. Indicated Shippers argue that only the Commission can provide notice that a rate has been changed. Indicated Shippers are correct that the formula can only be changed with proper notice. As noted above, the formula is the rate and the inputs that are applied as part of the formula are not part of the rate.<sup>36</sup> Therefore, Indicated Shippers' concerns are misplaced.

51. VSCC Staff did not explain how approving a wholesale formula rate would impact capped retail rates. The Commission is not making a predetermination of VEPCO's ability to collect retail rates under Virginia law. We find that VSCC Staff's concerns regarding the retail rate freeze in Virginia is beyond the scope of this proceeding.

## **2. Issues Related to Formula Inputs**

### **a. RTO Membership Adder**

#### **i. VEPCO's Proposal**

52. VEPCO requests Commission approval of a 50 basis point adder to its proposed ROE for its continued participation in the PJM RTO. VEPCO notes that the Commission has consistently authorized a 50 basis point adder in order to encourage RTO membership and has specifically authorized the adder for RTO participants that continue their participation. VEPCO contends that its requested base ROE of 11.73 percent plus the RTO incentive adder results in an ROE of 12.23 percent, which falls within the zone of reasonableness.

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<sup>35</sup> Attachment H-16B § 2, Proposed Original Sheet No. 314F.26.

<sup>36</sup> *PJM Interconnection, LLC*, 110 FERC ¶ 61,053, at P 120 (2005), *Appalachian Power Co.*, 23 FERC ¶ 61,032, at 61,088 (1983).

**ii. Comments and Protests**

53. The North Carolina Agencies and VSCC Staff oppose the 50 basis point adder for VEPCO's continued participation in PJM. They note that that Order No. 679 specifies that the 50 basis point incentive adder is to reward utilities for voluntary membership in an RTO.<sup>37</sup> However, they note that VEPCO's membership in PJM is not voluntary; rather it was required by the Virginia Electric Utility Restructuring Act<sup>38</sup> and the VSCC order approving VEPCO's integration into PJM.<sup>39</sup> Therefore, they contend, that to reward VEPCO for its obligatory participation in PJM rewards VEPCO's shareholders at the expense of Virginia's ratepayers.

**iii. Commission Determination**

54. We find that VEPCO's proposal to increase its ROE by 50 basis points for continued participation in PJM is just and reasonable and not unduly discriminatory. Section 219 of the FPA specifically provides that the Commission shall provide for incentives to each transmitting utility that joins an RTO. The consumer benefits, including reliable grid operation, provided by such organizations are consistent with the purpose of section 219. As we stated in Order No. 679-A, we will authorize incentive-based rate treatment for public utilities that continue to be a member of an RTO.<sup>40</sup> This decision to provide incentives for RTO participation is based on the policy of encouraging utilities to join and remain in an RTO.<sup>41</sup> Accordingly, we reject requests that VEPCO not be rewarded for its continued membership in PJM. In addition, we also deny the relief requested by the parties as this argument is a collateral attack on Order No. 679-A.<sup>42</sup> Finally, we note that the level of the requested incentive, 50 basis points, is the same as that approved for similar utilities, including BG&E.<sup>43</sup>

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<sup>37</sup> *Citing* Order No. 679 at P 83 and Order No. 679-A at P 331.

<sup>38</sup> VSCC Protest at 5, *citing* Va. Code § 56-577.

<sup>39</sup> VSCC Protest at 5, *citing* VSCC Case No. PUE-2000-0055 (November 10, 2004).

<sup>40</sup> Order No. 679-A at P 86.

<sup>41</sup> *AEP*, 121 FERC ¶ 61,245 at P 10 (denying rehearing of objections to 50 basis point ROE adder when participation in the RTO was a merger condition, not voluntary).

<sup>42</sup> Order No. 679-A at P 79.

<sup>43</sup> *Baltimore Gas and Electric Co.*, 120 FERC ¶ 61,084, at P 31 (2007), *reh'g pending*.

**b. Return on Equity****i. VEPCO's Proposal**

55. VEPCO's formula rate incorporates a base ROE of 11.73 percent, which is the midpoint of its proposed range of reasonableness of 7.5 percent to 15.61 percent. VEPCO states that this range of reasonableness was determined using the one-step DCF methodology with benchmarks for sustainable growth rate estimated from Value Line information and security analysts' long-term earnings growth forecasts. VEPCO used a proxy group of transmission owners within PJM,<sup>44</sup> excluding: (1) those utilities that are not currently paying cash dividends; (2) utilities that have announced a merger during the six-month period used to calculate the dividend yields; (3) utilities primarily operating as natural gas companies; (4) utilities that do not have both an IBES (International Brokers Estimation System) growth rate and *Value Line* data; and (5) one utility whose high-end cost of equity was more than 100 basis points above the cost of equity of any other utility in its proposed proxy group.

**ii. Comments and Protests**

56. VSCC Staff contends that VEPCO's proposed ROE of 11.73 percent is too high because (1) a formula rate reduces financial risk by allowing for more timely recovery of costs; (2) the true-up mechanism permits ratepayer funds to be used as a source of financing; and (3) Virginia law requires that all of VEPCO's costs for transmission service provided by PJM must be deemed prudent. VSCC Staff notes that the VSCC has determined that the ROE for Virginia jurisdictional utilities is approximately 10 percent. VSCC Staff recommend that the issue of the appropriate ROE be set for hearing.

57. Indicated Customers also contend that the proposed ROE does not reflect the appropriate level of risk for VEPCO because (1) electric transmission utilities, like VEPCO, are less risky than electric generating utilities, such as many of the companies in VEPCO's proxy group; (2) the conversion from stated rates to formula rates eliminates uncertainty regarding the collection of prudently incurred actual costs, including equity costs; and (3) VEPCO's parent carries a lower risk than VEPCO's proposed proxy group. Indicated Customers further argue that Constellation and Exelon should be excluded from the proxy group because they provide an upward bias. In addition, Indicated Customers contend that VEPCO incorrectly relies on the midpoint of the low and high results of the

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<sup>44</sup> VEPCO's proposed proxy group consists of American Electric Power Company, Inc. (AEP), Consolidated Edison, Inc. (ConEd), Constellation Energy Group, Inc. (Constellation), VEPCO's parent – Dominion Resources, Inc., DPL, Inc. (DPL), Exelon Corp. (Exelon), First Energy Corp. (FirstEnergy), PHI, PPL Corp. (PPL), and Public Service Enterprise Group, Inc. (Public Service).

range of reasonableness. They recommend that the median be used,<sup>45</sup> and recommend a base ROE of 10.06 percent. Finally, in their response to VEPCO's February 29 Filing, Indicated Customers request that the Commission set the issue of ROE for hearing and not summarily address the issues.

### iii. Commission Determination

58. We deny VEPCO's request for an ROE of 12.23 percent (a base ROE of 11.73 percent as discussed below plus a 50 basis point ROE adder for continued RTO membership) and find that, consistent with our precedent, the appropriate ROE to be applied is 10.9 percent, plus the 50 basis point ROE adder for continued RTO membership. This yields a combined ROE of 11.4 percent. As discussed below, first, we find that VEPCO's proxy group does not reflect our current proxy group policies as set forth in *PATH*.<sup>46</sup> Second, the Commission's precedent on ROE for individual companies requires the use of the median of the calculated ROE of companies in the proxy group, rather than the midpoint used by VEPCO.

59. The Supreme Court has provided guidance in two often-cited decisions regarding the range of allowed returns that may be permitted in a particular case. In *Bluefield*, the court stated that the approved return should be "reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit, and enable it to raise the money necessary for the proper discharge of its public duties."<sup>47</sup> In *Hope*, the court stated that the return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risks.<sup>48</sup>

60. The Commission has found that a 15-company proxy group that includes utilities in PJM, ISO-NE and NYISO is a good starting point for companies in PJM to develop an individual proxy that takes into account comparable risks.<sup>49</sup> VEPCO limited its proposed proxy group to utilities within PJM. However, VEPCO did not provide any evidence as to why comparable utilities should be limited to PJM as opposed to utilities in the

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<sup>45</sup> *Citing Northwest Pipeline Corp.*, 99 FERC ¶ 61,305, at 62,276 (2002).

<sup>46</sup> *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188 at P 93-103 (2008) (*PATH*).

<sup>47</sup> *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 693 (1923).

<sup>48</sup> *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

<sup>49</sup> *PATH*, 122 FERC ¶ 61,188.

northeastern United States. Consistent with our holdings in *PATH* and other cases, we find that the broader region more accurately reflects the energy markets in which VEPCO competes. Therefore, the proxy group should be expanded to include entities within the interrelated RTO markets operated by PJM, ISO-NE and the New York ISO whose risk is comparable to VEPCO.<sup>50</sup>

61. In order to ensure that the entities in its proxy group are of comparable risk, VEPCO applied the following screening criteria as part of its analysis and excluded: (1) those utilities that are not currently paying cash dividends; (2) utilities that have announced a merger during the six-month period used to calculate the dividend yields; (3) utilities primarily operating as natural gas companies; (4) utilities that do not have both an IBES growth rate and Value Line data, and (5) one utility whose high-end cost of equity was more than 100 basis points above the cost of equity of any other utility in its proposed proxy group. However, while VEPCO states that it applied a screen for risk, VEPCO's proxy group does not sufficiently screen for risk, because as discussed below it includes various companies whose corporate credit ratings are not comparable. Further, VEPCO has not sufficiently screened its proxy group for unsustainable growth rates.

62. We agree with protesters that, consistent with *Hope*, we must consider whether the proxy group is composed of companies with comparable risk to that of VEPCO. It is reasonable to use the proxy companies' corporate credit rating as a good measure of investment risk, since this rating considers both financial and business risk. At the time of its filing, VEPCO's parent company's Standard and Poor's (S&P) corporate credit rating was BBB.<sup>51</sup> Indicated Customers state that, since VEPCO's filing, S&P has upgraded the crediting rating of VEPCO's parent company to A-.<sup>52</sup> They accordingly argue that the proxy group should be limited to utilities with credit ratings within one step above and below the current credit rating of VEPCO's parent. This would limit the proxy group to utilities with credit ratings of BBB+, A-, and A. However, VEPCO responds that although S&P upgraded the credit rating, the other two major credit rating agencies, Fitch Ratings (Fitch) and Moody's Investor Services (Moody's), have not altered their credit ratings for VEPCO's parent company. Fitch's most recent rating is BBB+, which is the equivalent of an S&P rating of BBB+. Moody's most recent rating is Baa2, which is the equivalent of an S&P rating of BBB.

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<sup>50</sup> *PATH*, 122 FERC ¶ 61,188 at P 95.

<sup>51</sup> See October 25 Filing, Exhibit No. DVP-12 at 10 (Direct Testimony of Dr. Michael J. Vilbert).

<sup>52</sup> Indicated Customers March 21 Supplemental Protest, Attachment B at 8 (Affidavit of J. Bertram Solomon); see also VEPCO April 2 Answer at 7-8.

63. In these circumstances, we find that the appropriate credit rating screening criterion to use in this case is to require that each utility included in the proxy group have corporate credit ratings from BBB to A-, or the equivalent Moody's rating. Consistent with our holdings in other cases, this limits the proxy companies to one of three possible credit ratings,<sup>53</sup> and in this case each of those credit ratings is currently applied to VEPCO's parent by a major credit rating agency. We accordingly exclude ConEd, FPL and NSTAR from the proxy group, because their credit ratings are all higher than A-. We also exclude UIL Holdings and Central Vermont Public Service because their credit ratings are below BBB or the Moody's equivalent.

64. We also agree with Indicated Customers that the inclusion of Constellation, Exelon, and Public Service in the proxy group is inappropriate because, as we found in *PATH*,<sup>54</sup> their current growth rates are too high to be sustainable over time and therefore do not meet threshold tests of economic logic. In addition, we find that VEPCO's parent company should be excluded from the proxy group, because its cost of equity is below its cost of debt.<sup>55</sup>

65. Based on these findings, we find that VEPCO's proxy group should include the following six utilities: AEP, DPL, FirstEnergy, Northeast Utilities, Pepco Holdings, and PPL. We find that, with these revisions to VEPCO's proposed proxy group, the resulting proxy group is of comparable risk to VEPCO.

66. In the instant proceeding, we are determining the appropriate ROE for an individual utility of average risk, rather than a group of utilities. We agree with Indicated Customers that, in this circumstance, use of the median rather than the midpoint is appropriate because the median "best represents the central tendency in a proxy group with a skewed distribution of returns."<sup>56</sup> As we found in Opinion No. 501, "using the median also has the advantage of taking into account more of the companies in a proxy group rather than only those at the top and bottom."<sup>57</sup>

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<sup>53</sup> *PATH*, 122 FERC ¶ 61,188 at P 98.

<sup>54</sup> *Id.* at P 100.

<sup>55</sup> See *Southern California Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,266 (2000); *PATH*, 122 FERC ¶ 61,188 at P 101.

<sup>56</sup> *Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Co.*, 123 FERC ¶ 61,047, at P 63 (2008), citing *Northwest Pipeline Corp.*, 99 FERC ¶ 61,305, at 62,276 (2002); see also *Midwest Independent Transmission System Operator Corp.*, 106 FERC ¶ 61,302, at P 10 (2004).

<sup>57</sup> *Golden Spread*, 123 FERC ¶ 61,047 at P 64.

67. Using the data prepared by Dr. Solomon and revising the proxy group to reflect the companies selected as appropriate for VEPCO yields a range of ROE from 7.9 percent to 14.9 percent, with a median of 10.9 percent.<sup>58</sup> As noted above, consistent with our finding in *Golden Spread*, we find that use of the median ROE of 10.9 percent is appropriate for VEPCO, resulting in an 11.4 percent ROE once the 50 basis point incentive adder for continued RTO membership is included.

68. Finally, the fact the VSCC may have found that the appropriate ROE for the retail services of utilities subject to its jurisdiction is about 10 percent is not relevant to our determination of the appropriate ROE to include in VEPCO's rates for the interstate services subject to our jurisdiction. The Commission has conducted an ROE analysis utilizing comparable companies consistent with our precedent which supports the rate of return we are accepting.

**c. Capital Structure**

**i. VEPCO's Proposal**

69. VEPCO proposes to use a projected capital structure of 41.2 percent debt and 58.8 percent common equity.<sup>59</sup> This is comprised of the average balance for the 2008 calendar year, using VEPCO's projected beginning and year-end debt and equity balances.<sup>60</sup> VEPCO proposes to true-up the debt-equity ratio based on actual costs as reflected in the previous year's FERC Form No. 1, except that ROE will remain at 12.23 percent.

**ii. Comments and Protests**

70. Indicated Customers and North Carolina Agencies contend that VEPCO's proposed capital structure is based on unsubstantiated projections and that the proposed 58.8 percent equity ratio is high compared to the equity ratios of other electric utilities and given current economic conditions. Indicated Customers note VEPCO's 2006

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<sup>58</sup> Supplemental Protest, Exhibit No. INC-1. The median is determined utilizing the methodology accepted by the Commission in *Golden Spread*. First, the average of the high and low ROEs for each of the six proxy companies is calculated. Second, the averaged ROEs for the two utilities which fall within the middle of the range of the high-low average is then averaged. This results in a median of 10.9 percent. *See Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Co.*, 63 FERC ¶ 63,043 at P 100 and Exhibit No. S-1, Schedule No. 10.

<sup>59</sup> Exhibit No. DVP-8, at 3, lines 120-122.

<sup>60</sup> Bailey Testimony at 9.

average common equity ratio was 53 percent while the equity ratio for VEPCO's proxy group utilities was 46 percent for the year ending December 31, 2007. They further note that VEPCO's parent had an equity ratio of 42 percent as of December 31, 2007.

71. North Carolina Agencies contend that VEPCO's formula rate allows VEPCO a return on equity on an "ever-changing" equity ratio. North Carolina Agencies object to the "floating" equity ratio and recommend that the issue be set for hearing.

72. Indicated Customers are concerned that the proposed true-up would provide VEPCO's parent company an opportunity to potentially manipulate VEPCO's regulated capital structure to its overall corporate benefit and subsidize unregulated subsidiaries at the expense of the regulated formula rate customers. Indicated Customers therefore recommend that VEPCO's formula rate contain a 50 percent cap on its common equity ratio so that a "manipulated, excessive, actual common equity ratio" cannot be used just because it was the actual reported in the company's FERC Form No 1.

### **iii. Commission Determination**

73. We agree with protestors that VEPCO has not supported its proposed capital structure. In fact, VEPCO has provided no explanation as to why it proposes a hypothetical debt/equity ratio of 41.2/58.8. The Commission has a strong preference for using the actual capital structure of the company in developing its rate of return, unless there is an overriding reason not to do so.<sup>61</sup> Further, using FERC Form No. 1 data is consistent with Commission precedent for PJM transmission owners with formula rates. Because VEPCO did not provide an overriding reason to use a hypothetical capital structure, we will require VEPCO to file revised tariff sheets within 30 days of the date of this order to reflect the capital structure for 2006, as shown in its FERC Form No. 1 data.<sup>62</sup>

### **3. Cost of Service Issues**

74. The Commission reviews certain issues related to VEPCO's inputs into the formula rate for 2008 rates because customers have not had the opportunity to review this data and challenge it through the Annual Update process contained in VEPCO's tariff. We note that in the future, we expect that issues related to the cost-of-service inputs into

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<sup>61</sup> *Transcontinental Gas Pipeline Corp.*, 84 FERC ¶ 61,084 (1998); *Allegheny Power*, Opinion No. 469, 106 FERC ¶ 61,251, at P 27 (2004) *citing* 103 FERC ¶ 63,001, at P 28 (2003).

<sup>62</sup> *See, e.g.*, PJM OATT, FERC Electric Tariff, Sixth Rev. Vol. No. 1, Attachment H-1 or H-2.

the formula rate will be resolved through VEPCO's Annual Update and True-Up Adjustment process, with recourse to the Commission only when the parties cannot resolve the issues themselves.

75. In response to VEPCO's October 25 Filing, the Commission issued a Deficiency Letter requesting additional information on certain inputs to the 2008 rate. We find that VEPCO's responses to the following issues are adequate: (1) balances of Account 283, *Accumulated Deferred Income Taxes – Other*; <sup>63</sup> (2) property insurance; (3) inclusion of revenue credits in VEPCO's ATRR; (4) increase in transmission operations and maintenance costs; (5) expenses for wages and salaries; (6) amount to be included in Account No. 165, Prepayments; and (7) amortization of software as part of intangible plant amortization. We also accept VEPCO's proposal for cash working capital as just and reasonable because it conforms to our policy which allows for 45 days or one-eighth of a year's operations and maintenance expenses, less purchased power costs and is consistent with our finding on cash working capital in *PATH*.<sup>64</sup>

#### **4. Request for Waivers**

##### **a. VEPCO's Proposal**

76. VEPCO requests waiver of section 35.13 of the Commission's regulations, including waiver of the full Period I and Period II data requirements and waiver of the requirement in section 35.13(a)(2)(iv), to determine if and the extent to which a proposed change constitutes a rate increase based on Period I-Period II rates and billing determinants. VEPCO contends that waiver is appropriate because of its use of filed FERC Form No. 1 data and the fact that VEPCO is proposing a formula rate rather than a stated rate. VEPCO also requests that the Commission grant any other necessary waivers.

##### **b. Comments & Protests**

77. Indicated Customers argue that VEPCO's justification for the waiver of section 35.13 of the Commission's regulations does not apply here. Indicated Customers explain that in *PHI/BGE*, the Commission reasoned that such Period I and Period II data may not be necessary where the transmission owner is establishing a formula rate using FERC Form No. 1 data. However, Indicated Customers contend that VEPCO's witness, Mr. Bailey, in his supporting testimony, explains that some of the formula input data is not

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<sup>63</sup> October 25 Filing at Exhibit No. DVP-8, page 7.

<sup>64</sup> *Trans-Elect NTD PATH 15, LLC*, 117 ¶ 61,214, at P 32, 39-43 (2006); *see also PATH*, 122 FERC ¶ 61,188 at P 158.

available from FERC Form No. 1.<sup>65</sup> Indicated Customers state that VEPCO has provided Attachment 5 to its filing in order to compensate for the missing data which Mr. Bailey describes as “similar to” statements that would be submitted per section 35.13.<sup>66</sup> Indicated Customers argue that the purpose of requiring detailed cost of service data is to allow the Commission and interested parties the opportunity to verify the rates to be charged. Rather than rely on a blend of FERC Form No. 1 data and attachments that are “similar to” what would be required in the absence of detailed cost information, Indicated Customers urge the Commission to direct VEPCO to comply with the requirements of section 35.13.

**c. Commission Determination**

78. We will grant VEPCO’s requests for waiver to the extent such requests have not been made moot by its responses to the Deficiency Letter. In its responses to the Deficiency Letter,<sup>67</sup> VEPCO provided Statements AA through AY for Period I based on calendar year 2006 that correlates to FERC Form No. 1 data and for Period II that correlates with Exhibit No. DVP-8. VEPCO also provided revenue data as required in Statement BG and Statement BH of section 35.13 of the Commission’s regulations. While we find that the provision of these statements (or the data required by these statements) moots VEPCO’s requests for waivers as they relate to those statements in section 35.13 of the Commission’s regulations, the requests for waivers are still relevant to those provisions of section 35.13 with which VEPCO has not complied. In this instance, we will grant waivers of those remaining provisions of section 35.13 as VEPCO has provided sufficient information to allow the Commission and interested parties the opportunity to verify the rates to be charged for 2008, which we find adequately addresses the concern raised by Indicated Customers.

**5. Coordination with Schedule 12 Proceeding**

**a. VEPCO’s Proposal**

79. VEPCO requests an effective date of January 1, 2008 for its formula rate.

**b. Comments and Protests**

80. BG&E, along with PSE&G and PHI Companies, urge the Commission to approve an uncontested settlement containing revised Schedule 12 cost allocations (Schedule 12

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<sup>65</sup> *Citing* Bailey Testimony at 13.

<sup>66</sup> *Id.*

<sup>67</sup> *See* February 29 Filing and January 18 Filing.

Costs Settlement) before VEPCO's formula rate proposal is allowed to go into effect.<sup>68</sup> BG&E explains that all of the Schedule 12 cost allocations that VEPCO is currently reflecting in its formula are from PJM filings that were protested by numerous parties and are to be superseded by the Schedule 12 Costs Settlement filed on September 14, 2007. BG&E states that if the proposal takes effect prior to the Commission's approval and implementation of the Schedule 12 Costs Settlement, then PJM will have to invoice its various rate zones the allocations reflected in the October 25 Filing, only to have to subsequently re-bill these amounts with refunds and retroactive surcharges, as appropriate, once the Schedule 12 Costs Settlement is approved. BG&E argues that this allocation/reallocation scenario is contrary to the public interest, will result in unjust and unreasonable rates, and is administratively inefficient and burdensome. BG&E argues that should this scenario occur, the BG&E rate zone load would be forced to subsidize, through a virtual loan, the agreed-upon Responsible Customers in the interim period between the effective date of the formula rate and the effective date of the Schedule 12 Costs Settlement. BG&E suggests that the most rational approach is for the Schedule 12 Costs Settlement to be approved and effectuated and then to allow the formula rates to go into effect, subject to refund and based on the outcome of a final Commission determination.

81. The Maryland Commission states that recovery of costs for VEPCO transmission projects through Schedule 12 may result in Maryland sharing in a portion of the costs for certain projects through the formula rates in the present proceeding. The Maryland Commission requests that the Commission clarify that the allocation of costs for VEPCO transmission projects to the VEPCO Zone and to other participants in the PJM market through the VEPCO formula rate are (1) subject to any revisions to the PJM Schedule 12 allocations as determined by the Commission and (2) just and reasonable.

**c. Commission Determination**

82. Protestors request that the tariff sheets associated with the Schedule 12 Costs Settlement be accepted for filing before the tariff sheets establishing VEPCO's formula rate. Alternatively, BG&E requests that the tariff sheets in this proceeding be conditioned upon the acceptance of the tariff sheets in the RTEP proceeding. We deny both requests and accept the tariff sheets submitted by VEPCO in this proceeding, subject to conditions, effective January 1, 2008. We are required by statute to act on VEPCO's filing by April 29, 2008, 60 days after VEPCO filed its last response to the Deficiency

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<sup>68</sup> Alternatively, BG&E opposes VEPCO's request to have its formula rate become effective on January 1, 2008 unless the Schedule 12 Costs Settlement is allowed to go into effect prior to January 1, 2008, and VEPCO and PJM concur that no invoices will be rendered for Schedule 12 costs until VEPCO updates its formula rate filing to reflect the approved Schedule 12 Costs Settlement.

Letter. The Schedule 12 Costs Settlement is pending, but does not require action by a specific date. Although the proceedings may have overlapping issues, we are considering each proceeding on its own merits. Our regulations recognize that the acceptance of tariff sheets in one proceeding may require that tariff sheets accepted in another proceeding be re-filed. In Order No. 614, we referred to such tariff sheets as “retroactive” sheets.<sup>69</sup> Should PJM be required to surcharge or refund ratepayers on VEPCO’s behalf, as a result of re-filing tariff sheets, it will apply interest in accordance with our regulations.<sup>70</sup>

The Commission orders:

(A) VEPCO’s revised tariff sheets to the PJM OATT are accepted for filing effective January 1, 2008, subject to revision based on the compliance filing.

(B) VEPCO is ordered to file revised tariff sheets to PJM’s OATT within 30 days of this order, as discussed more fully above.

By the Commission. Commissioner Kelly dissenting in part with a separate statement to be issued at a later date.

( S E A L )

Kimberly D. Bose,  
Secretary.

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<sup>69</sup> *Designation of Electric Rate Schedule Sheets*, (Order No. 614), 65 Fed. Reg. 18,221 (March 21, 2000) FERC Stats. & Regs. ¶ 31,096, at 31,520 (2000).

<sup>70</sup> 18 C.F.R. § 35.19a (2007).

Document Content(s)

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