

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
and Jon Wellingshoff.

American Electric Power Service Corporation

Docket No. EL06-50-001

ORDER ON REHEARING

(Issued January 19, 2007)

1. This order addresses requests for rehearing of an order issued by the Commission on July 20, 2006 (July 20 Order).<sup>1</sup> The July 20 Order granted the petition for declaratory order approving the incentive rate treatment proposed by American Electric Power Service Corporation (AEP), filed on behalf of its subsidiary, AEP Transmission Company LLC (AEP Transco), for a new 765 kilovolt (kV) transmission line that AEP Transco is proposing to build (proposed Project). Our approval was predicated on the proposed Project being included as part of the PJM Interconnection, L.L.C.'s (PJM) Regional Transmission Expansion Plan (RTEP) because AEP relied on that process in its petition.<sup>2</sup> We deny rehearing, as set forth below.

**I. Background**

2. On January 31, 2006, as supplemented on February 1, 2006, AEP filed a petition for a declaratory order requesting that the Commission approve its proposed incentive rate treatments for its proposed Project. AEP sought incentive rate treatments including: (1) a return on equity (ROE) that is set at the high end of the zone of reasonableness or, alternatively, a 200 basis point adder above the ROE established pursuant to the Commission's conventional methodology; (2) the option to recover the cost of capital associated with construction work in progress (CWIP) on a timely basis; and (3) the option to expense and recover on a current basis the costs that AEP Transco incurs during the pre-construction/pre-operating period. Further, AEP sought certain accounting authority for the deferral for future recovery of the pre-construction/pre-operating costs

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<sup>1</sup> American Electric Power Service Corporation, 116 FERC ¶ 61,059 (2006).

<sup>2</sup> Under the RTEP process, PJM coordinates the planning of facilities with regional impact on system operations and, where warranted, allocates the costs of those facilities to the PJM zones that benefit from those facilities.

not yet being recovered plus related carrying costs. AEP sought to reserve the right to request additional incentive rate treatments authorized by a final rule resulting from the rulemaking on Promoting Transmission Investment through Pricing Reform.<sup>3</sup> AEP also stated that contemporaneously with its filing, it had submitted a request to PJM for the proposed Project's inclusion in PJM RTEP.

3. The July 20 Order granted the petition for declaratory order, approving the incentive rate treatments proposed by AEP for the proposed Project pursuant to the Commission's existing authority under section 205 of the Federal Power Act (FPA),<sup>4</sup> consistent with Congress' direction in new FPA section 219,<sup>5</sup> and, generally, the regulations promulgated pursuant to FPA section 219 in Order No. 679, on condition that the proposed Project be included as part of the PJM RTEP, *inter alia*. The July 20 Order noted that although AEP's petition need not comply with Order No. 679 because the final rule would not become effective until 60 days after publication in the *Federal Register*, the Commission reviewed AEP's proposed incentives for general consistency with the Order No. 679 and Congress' direction in FPA section 219. The July 20 Order also found that AEP demonstrated a nexus between each of its proposed incentive rate treatments and the proposed Project, thus establishing that the particular proposed incentive rate treatments are appropriate for the particular investments being made.

4. In addition, the Commission's approval of AEP's proposed incentives was predicated on AEP making a subsequent filing with the Commission pursuant to section

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<sup>3</sup> *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 71 Fed. Reg. 43,294 (July 31, 2006), FERC Stats. & Regs. ¶ 31,222 (2006) (Order No. 679), *order on reh'g*, Order No. 679-A, 72 Fed. Reg. 1152 (January 10, 2007), 117 FERC ¶ 61,345 (2006) (Order No. 679-A); *see also Promoting Transmission Investment through Pricing Reform*, Notice of Proposed Rulemaking, 70 Fed. Reg. 71,409 (November 29, 2005), FERC Stats. & Regs. ¶ 32,593 (2005) (Pricing Reform NOPR).

<sup>4</sup> 16 U.S.C. § 824d (2000) (section 205).

<sup>5</sup> This section was established by section 1241 of the Energy Policy Act of 2005 (EPAct 2005). *See* Pub. L. No. 109-58, § 1241, 119 Stat. 594, 961-62 (2005) (to be codified at section 219 of the FPA, 16 U.S.C. § 824s) (section 219). The Commission found that FPA section 219 is a directive to the Commission to use its existing authority to allow incentive-based rates and, further, to provide some of the parameters of the incentives to be allowed in the particular rulemaking ordered under FPA section 219 (*i.e.* Order No. 679).

205 of the FPA, proposing the rates associated with the incentive rate treatment, in part.<sup>6</sup> The Commission clarified that its approval in the July 20 Order was declaratory in nature, was confined to the particular incentives being approved in that proceeding, and did not constitute approval of any particular rate. The July 20 Order found that AEP must demonstrate the justness and reasonableness of AEP Transco's overall rates in a subsequent FPA section 205 filing.

5. Old Dominion Electric Cooperative (ODEC) and Ohio Consumers' Counsel (Ohio Consumer) filed timely requests for rehearing of the July 20 Order.

## II. Discussion

### A. Reliance on Order No. 679

#### 1. Request for Rehearing

6. ODEC claims that the Commission erred by approving AEP's proposed incentive rate treatments in reliance on Order No. 679, which, according to ODEC, is a final rule that did not have legal force or effect and that will almost surely be subject to further litigation.<sup>7</sup> ODEC asks that "the Commission require AEP to re-file a more complete application for ROE incentives" that complies with the applicable principles in the existing precedent at the time prior to the effective date of Order No. 679.<sup>8</sup>

#### 2. Commission Determination

7. We disagree with ODEC's assertions on this point. The July 20 Order conditionally granted AEP's petition pursuant to our *existing* authority under FPA section 205 and held that it was *consistent with* Congressional directives in FPA section 219. The July 20 Order noted generally that AEP's petition was also consistent with the regulations implemented pursuant to FPA section 219, (which were being issued concurrently with the July 20 Order).<sup>9</sup>

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<sup>6</sup> The Commission also stipulated reporting requirements associated with the future FPA section 205 filing. AEP committed to making this FPA section 205 filing after the proposed Project has been accepted for inclusion in the RTEP.

<sup>7</sup> Although Order No. 679 was issued concurrently with the July 20 Order, the regulations promulgated therein became effective on September 29, 2006.

<sup>8</sup> ODEC Request for Rehearing at 8.

<sup>9</sup> July 20 Order, 116 FERC ¶ 61,059 at P 3, 18-21.

8. As stated in the July 20 Order, the Commission's authority to encourage investment in infrastructure through the application of incentive pricing is not new. The Commission, exercising its existing authority under FPA section 205, has done so for the purpose of encouraging new investment to meet demonstrated needs.<sup>10</sup> Indeed, the courts have recognized that a primary purpose of the FPA and the Natural Gas Act is to encourage plentiful supplies of energy at reasonable prices, through, among other means, the development of needed infrastructure.<sup>11</sup> As recently as June 2006, the U.S. Court of Appeals for the D.C. Circuit affirmed that the Commission has significant discretion within its ratemaking authority to consider both cost-related factors and policy-related factors (*e.g.*, the need for new transmission investment). In *Maine Public Utilities Commission v. FERC*, the court reviewed the Commission's authority to approve incentive rates, holding that the Commission's determinations "involve matters of rate design, which are technical and involve policy judgments at the core of [the Commission's] regulatory responsibilities."<sup>12</sup> The court further stated that, "the court's review of whether a particular rate design is just and reasonable is highly deferential."<sup>13</sup> The court also rejected the argument that the Commission was required to calibrate the level of benefits that an incentive is designed to produce beyond a finding that the incentive at issue is within the zone of reasonableness.<sup>14</sup>

9. While the regulations promulgated under FPA section 219 were not in effect at the time of the July 20 Order, we appropriately acknowledged the explicit directive from Congress to allow certain incentive-based rate treatments for the purpose of ensuring reliability or reducing congestion. As indicated in the July 20 Order, FPA section 219 is

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<sup>10</sup> See, *e.g.*, *Western Area Power Administration*, 99 FERC ¶ 61,306, reh'g denied, 100 FERC ¶ 61,331 (2002), aff'd sub nom. *Public Utilities Commission of the State of California v. FERC*, 367 F.3d 925 (D.C. Cir. 2004) (*CPUC v. FERC*); *Michigan Electric Transmission Co., LLC*, 105 FERC ¶ 61,214 (2003); *American Transmission Company, L.L.C.*, 105 FERC ¶ 61,388 (2003), order approving settlement, 107 FERC ¶ 61,117 (2004) (*ATC*); *ITC Holdings Corp.*, 102 FERC ¶ 61,182, reh'g denied, 104 FERC ¶ 61,033 (2003); *TransBay Cable LLC*, 112 FERC ¶ 61,095 (2005), order granting clarification, 114 FERC ¶ 61,104 (2006).

<sup>11</sup> See, *e.g.*, *CPUC v. FERC*, 367 F.3d at 929, citing *NAACP v. FPC*, 425 U.S. 662, 670 (1976).

<sup>12</sup> 454 F.3d 278, 287 (D.C. Cir. 2006) (*Maine PUC v. FERC*). See also *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) (*Permian*).

<sup>13</sup> *Maine PUC v. FERC*, 454 F.3d at 287.

<sup>14</sup> *Id.* at 287-89.

a directive to the Commission to use its existing authority under FPA section 205 to allow incentive-based rate treatments and, *further*, provides some of the parameters of the incentives to be allowed in the particular rulemaking ordered under FPA section 219.<sup>15</sup> In the July 20 Order we found that permitting the requested incentives would further the goals of FPA section 219 by providing, among other things, up-front regulatory certainty, rate stability and improved cash flow for applicants.<sup>16</sup>

10. Contrary to ODEC's contention,<sup>17</sup> the Commission did not use the Pricing Reform NOPR as the basis upon which to evaluate AEP's proposal. We disagree with the implication that the Commission would have found that "the mere issuance of the proposed rulemaking was enough to effectuate the change in this case."<sup>18</sup> As the courts have made clear, "[a] notice of proposed rulemaking [has] no effect upon the existing regulations."<sup>19</sup> Under our existing authority at the time of the July 20 Order, we determined that AEP had shown that its proposed incentive rate treatments were just and reasonable. However, we believe that the July 20 Order correctly pointed out that AEP's proposed incentive rate treatments also met the requirements of the concurrently issued Order No. 679. Meeting those requirements simply provided further indication as to why we should have found that AEP proposed incentives are just and reasonable. Moreover, complying with the requirements proposed in the Pricing Reform NOPR or ultimately adopted in Order No. 679 was neither mandatory for AEP nor dispositive of the Commission's decision in the July 20 Order.

## **B. Sufficiency of Evidence**

### **1. Request for Rehearing**

11. ODEC argues that the Commission erroneously approved AEP's proposed incentives when AEP's application was patently deficient under the FPA and requests that the Commission require AEP to re-file a more complete application. ODEC contends that AEP must demonstrate that, *inter alia*: (1) the requested rate increase is needed and is no more than necessary for the stated purpose; (2) the cost of its non-cost

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<sup>15</sup> July 20 Order, 116 FERC ¶ 61,059 at P 2.

<sup>16</sup> *Id.* P 56.

<sup>17</sup> ODEC Request for Rehearing at 7.

<sup>18</sup> *Public Service Company of Indiana, Inc. v. FERC*, 584 F.2d 1084, 1088 n.6 (D.C. Cir. 1978).

<sup>19</sup> *Id.* at 1087.

incentives is outweighed by the benefits customers will receive; and (3) the proposed incentive rate mechanism will directly result in the desired outcome. Ohio Consumer similarly argues that AEP's petition should have shown that other measures than AEP's proposed incentives will not suffice, the expenditure of dollars will result in concomitant benefits for consumers, and that the proposed incentive rates are narrowly tailored. Finally, ODEC argues that the Commission erred by approving AEP's proposed ROE incentive because it did not comply with the requirements of the FPA since AEP did not demonstrate: (1) which specific ROE should be approved; (2) that but for an enhanced ROE, AEP would not proceed with the proposed Project; and (3) why the specified ROE is appropriate to encourage new investment in the proposed Project.

12. Ohio Consumer argues that the Commission failed to apply the commonly-understood meaning of incentive in determining that AEP Transco is eligible for incentive rate treatment. Ohio Consumer states that an incentive provides the motive for a particular course of action and counts as a reason for preferring one choice to its alternatives. Here, according to Ohio Consumer, AEP's proposed Project was in process before any incentives were approved by the Commission and, moreover, the Commission had no record to find that AEP Transco needed a motive to proceed and complete the proposed Project. In particular, Ohio Consumer, along with ODEC, contend that AEP made no showing that incentives were necessary to attract capital for the proposed Project. Ohio Consumer also points out that, given the support and resources of AEP Transco's parent company, AEP, access to capital is likely readily available. Further, ODEC and Ohio Consumer argue that the Commission erred by not setting a trial-type evidentiary hearing to determine whether others may be willing to undertake or participate in the project without the requested incentives. Ohio Consumer states that until the Commission provides an opportunity for publicly-owned systems and other interested entities to express their willingness to participate with or without incentives, the Commission cannot say whether AEP's requested rate incentives are needed. Thus, ODEC and Ohio Consumer request a trial-type evidentiary hearing to determine whether incentive rate treatment is necessary for the proposed Project, and if so, whether AEP's requested incentive rates are no higher than necessary, as well as to determine whether the proposed incentives are unjust and unreasonable.

13. ODEC also argues that the Commission erroneously approved AEP's proposed incentives because AEP's application was patently deficient under the Commission's then-current regulations.<sup>20</sup> According to ODEC, section 35.34(e) of the Commission's regulations can only be used by Commission-approved Regional Transmission Organizations (RTO). Since AEP is not an approved RTO, and it is not requesting an

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<sup>20</sup> At the time of issuance of the July 20 Order, the Commission's regulations related to requests for innovative rate treatments for transmission was set forth in 18 C.F.R. § 35.34(e) (2005). Order No. 679 replaces this section with a new section, 18 C.F.R. § 35.35 (2006).

ROE incentive for joining an RTO, ODEC argues that AEP is not eligible to request an ROE incentive under this section. ODEC claims that AEP's petition does not comply with the requirements of section 35.34(e), including submission of a detailed cost-benefit analysis.

14. Finally, ODEC seeks rehearing of the Commission's approval of AEP's proposed rate incentives in advance of the proposed Project's inclusion in PJM's RTEP and the filing of a full FPA section 205 rate case by AEP. ODEC requests that the Commission defer approval of the rate incentives until AEP makes its full FPA section 205 filing, when "a thorough review" of the costs and benefits of the rates, including the rate incentives, is accomplished and it shows that both the rates and incentives are just and reasonable.

## 2. Commission Determination

15. We will deny ODEC and Ohio Consumer's requests for rehearing. We find that AEP has provided sufficient information to permit the Commission to approve its proposed rate incentives under FPA section 205 and existing precedent, subject to AEP's demonstration of the justness and reasonableness of AEP's overall rates in a subsequent FPA section 205 filing. That our conditional approval was consistent with the directives set forth by FPA section 219 does not change this.<sup>21</sup> We disagree that additional demonstrations, such as whether the incentive rate mechanism will directly result in the desired outcome, whether "but-for" an enhanced ROE, AEP would not proceed with the proposed Project, or whether the cost of the incentives outweighs the benefits to be received by customers, are necessary.<sup>22</sup> The Commission has broad authority to provide incentive rate treatments; and the requirement that the resulting rates be just and reasonable does not require "but for" tests, as the courts have recognized.<sup>23</sup> Indeed, Congress did not direct such a requirement in FPA section 219.

16. In response to petitioners' arguments that AEP has not demonstrated that the proposed incentives are necessary to attract capital, we note that AEP is under no

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<sup>21</sup> Section 219 does not simply "codify" our legal authority; it requires us to take affirmative action to promote new investment. The Commission's actions on the AEP petition are consistent with FPA sections 205 and 219.

<sup>22</sup> See Order No. 679-A, 117 FERC ¶ 61,345 at P 25-26 (reaffirming Order No. 679's rejection of a "but for" test as inconsistent with Congressional intent in enacting section 219).

<sup>23</sup> See *Permian*, 390 U.S. at 791-92; *CPUC v. FERC*, 367 F.3d at 929; see also Order No. 679-A, 117 FERC ¶ 61,345 at P 39 (stating that courts have held that the Commission may consider non-cost factors in setting rates).

obligation under either FPA section 205 or FPA section 219 to establish that the incentives requested are necessary. Indeed, to require an applicant to demonstrate that a proposed incentive is necessary to ensure an investment is made is the equivalent of a “but for” test that we have previously rejected.<sup>24</sup> Nonetheless, AEP has adequately established a nexus between the incentives requested and proposed Project.<sup>25</sup> For example, AEP explained that the proposed Project is not the ordinary transmission investment but rather presents special risks that merit an ROE at the high end of the zone of reasonableness. AEP offered that the length, scope, and multi-state nature of the proposed Project present substantial risks and challenges in siting and obtaining the required permits, and that in addition to the risk associated with the proposed Project, it will require an enormous investment (estimated by AEP to be \$3 billion) and thereby presents financing challenges not faced by the ordinary transmission investment. Further, unlike the ordinary transmission project, AEP is under no state obligation to construct the line. AEP has provided adequate justification for its requested incentives.

17. To the extent that ODEC or Ohio Consumer seek rehearing of the Commission’s approval of AEP’s proposed *rates*, they misinterpret the July 20 Order. As noted above, while the July 20 Order granted AEP its proposed *rate incentive treatment*, it did not make a decision regarding any specific rates.<sup>26</sup> The July 20 Order clearly stated that AEP must propose and support a particular ROE in its FPA section 205 filing.<sup>27</sup> Accordingly, the Commission reserved its determination regarding the justness and reasonableness of AEP Transco’s specific ROE for a FPA section 205 filing, which AEP has stated it will make in the future. In that FPA section 205 proceeding, AEP’s overall range of reasonableness will be established, as well as a determination of where within that range its ROE should be set.<sup>28</sup> This is consistent with the Commission’s recent clarification that it “do[es] not intend to grant incentive returns ‘routinely’ or that, when granted, they will always be at the ‘top’ of the zone of reasonableness. Rather, each applicant will,

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<sup>24</sup> See *supra* note 22.

<sup>25</sup> We note that the July 20 Order did find that AEP demonstrated a nexus between each incentive sought and its proposed Project (*i.e.* that each incentive was rationally related to the proposed investment). July 20 Order, 116 FERC ¶ 61,059 at P 3. As the Commission determined in Order No. 679-A, applicants must demonstrate that the total package of incentives is tailored to the demonstrable risks or challenges faced by the applicant in undertaking the project. Order No. 679-A, 117 FERC ¶ 61,345 at P 6, 21, 27.

<sup>26</sup> July 20 Order, 116 FERC ¶ 61,059 at P 21.

<sup>27</sup> *Id.* P 45.

<sup>28</sup> Order No. 679-A, 117 FERC ¶ 61,345 at P 68.

first, be required to justify a higher ROE under the [required] nexus test and, second, to justify where in the zone of reasonableness that return should lie.”<sup>29</sup> Because the Commission granted AEP’s request for an incentive ROE at the upper end of the range of reasonableness in the July 20 Order,<sup>30</sup> the FPA section 205 proceeding would establish 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>31</sup>

18. ODEC’s assertion that AEP’s application was patently deficient under the Commission’s then-current regulations, namely section 35.34(e) of the Commission’s regulations, is misplaced. The July 20 Order did not review AEP’s proposal pursuant to this provision because this provision only applies to RTO incentive proposals. Instead, the Commission reviewed AEP’s petition under FPA section 205 and with consideration of section 219. We did not require that AEP submit a detailed cost-benefit analysis before approving its proposal. A cost-benefit analysis is not required under FPA sections 205 or 219, and the regulation in question, since replaced, did not apply outside of RTO incentive proposals. The courts have long recognized that a primary purpose of the FPA is to encourage the orderly development of plentiful supplies of electricity at reasonable prices.<sup>32</sup> To carry out this purpose, the Commission has broad authority to provide incentive rate treatments and may consider non-cost factors as well as cost factors.<sup>33</sup> Here, we are persuaded that the demonstrations provided by AEP indicate that the proposed Project will further the goals of this Commission and as envisioned by Congress.

19. Moreover, as discussed in the July 20 Order, any person who seeks a binding Commission determination concerning a proposed transaction may file a petition for declaratory order under Rule 207 of the Commission’s regulations.<sup>34</sup> The fact that the approach taken by AEP was consistent with the Commission’s proposal in the Pricing

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<sup>29</sup> *Id.* P 67.

<sup>30</sup> July 20 Order, 116 FERC ¶ 61,059 at P 40.

<sup>31</sup> *See* Order No. 679-A, 117 FERC ¶ 61,345 at P 68.

<sup>32</sup> *See supra* note 11.

<sup>33</sup> *See* Order No. 679-A, 117 FERC ¶ 61,345 at P 39, citing *Permian*, 390 U.S. at 791-92; *CPUC v. FERC*, 367 F.3d at 929; *Maine PUC v. FERC*, 454 F.3d 278, slip op. at 19.

<sup>34</sup> July 20 Order, 116 FERC ¶ 61,059 at P 28.

Reform NOPR and ultimate determination in Order No. 679 did not affect AEP's ability to file a petition for declaratory order nor influence the Commission's determination as to whether the proposed rate incentives are just and reasonable.

20. We disagree with ODEC's assertion that the Commission should not have approved AEP's proposed incentives until after AEP submits its full FPA section 205 filing. Petitions for declaratory orders allow an applicant to receive upfront guidance from the Commission and can be an especially valuable tool for an entity undertaking a significant transmission project. An applicant can obtain an order from the Commission indicating which incentives its project qualifies for before making a FPA section 205 filing and prior to commencing siting, permitting, and investing in new facilities. AEP must file with the Commission under section 205 of the FPA to put rates into effect and must demonstrate that its overall rate, including incentives, is just and reasonable in its FPA section 205 filing. This provides all interested parties with an opportunity to comment, and the Commission will evaluate whether the rates are just and reasonable and not unduly discriminatory or preferential.

21. Finally, we also disagree that the Commission should have set a trial-type evidentiary hearing in this proceeding. Interested parties have been afforded an opportunity to present their positions, and AEP provided sufficient evidence for the Commission to conditionally approve AEP's proposed incentive rate treatments.

### **C. Showing for CWIP and Pre-Operating Cost Incentives**

#### **1. Request for Rehearing**

22. ODEC seeks rehearing of the Commission's approval of AEP's proposed CWIP and pre-construction/pre-operating costs incentives, arguing that the Commission's approval was cursory. ODEC argues that AEP's petition did not contain sufficient information to support the Commission finding these proposed rate incentives as just and reasonable. ODEC submits that further information is needed regarding the level and types of costs that AEP seeks to recover, as AEP appears to believe that all pre-operation costs are eligible for inclusion. For example, AEP seeks to recover the start-up costs associated with forming AEP Transco as a corporate entity, but its petition fails to explain why ratepayers and not shareholders should bear the costs associated with its corporate decision.

23. Ohio Consumer argues that the Commission erred by approving the CWIP incentive without a demonstration that the costs are prudently incurred as part of a plan approved through the PJM RTEP process. Ohio Consumer states that only prudent investment costs should be included in rates; expensed capital costs should be amortized over a reasonable period of years and not a discrete, short period that does not relate to the life of a plant. Ohio Consumer also contends that the Commission failed to consider

the intergenerational cost allocation issues of expensing long-lived assets, and it maintains that traditional long-term costs associated with land, towers, substations, etc should be exempt from expensing through the CWIP.

24. Finally, ODEC argues that the Commission erred by failing to require AEP to refund any CWIP and pre-operating costs that have been expensed, if the proposed Project is cancelled due to factors within AEP's control. Thus, both ODEC and Ohio Consumer request that the Commission direct AEP to adopt the condition that if the proposed Project is cancelled for reasons within AEP's control, CWIP and pre-operating costs must be refunded.

## 2. Commission Determination

25. ODEC essentially raises no new arguments on rehearing. ODEC again asserts that the Commission's approval was cursory. This ignores the substance of the Commission's ruling addressing the proposal on its merits. It also ignores our existing policy on CWIP; a policy that has undergone judicial review. ODEC does not explain how the Commission's existing policy creates an unjust or unreasonable rate for AEP Transco.<sup>35</sup> ODEC also does not address how the Commission erred in requiring that AEP demonstrate the overall justness and reasonableness of any future rate recovery in its future FPA section 205 filing.<sup>36</sup> In fact, ODEC does not explain how the Commission's adherence to existing policy is arbitrary or capricious.

26. The concept of earning a return on CWIP in rate base is not new to this Commission,<sup>37</sup> and in fact, has posed a strong stimulus for investment in much needed infrastructure. We have consistently upheld the need for CWIP in rate base as in the public interest, to mitigate rate shock to consumers.<sup>38</sup>

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<sup>35</sup> For example, ODEC does not address how the Commission's requiring an annual report on the status of the project is unjust and unreasonable.

<sup>36</sup> July 20 Order, 116 FERC ¶ 61,059 at P 27, 55.

<sup>37</sup> See *Construction Work In Progress for Public Utilities; Inclusion of Costs in Rate Base*, Order No. 298, 48 Fed. Reg. 24,323 (June 1, 1983), FERC Stats. & Regs. ¶ 30,455, *order on reh'g*, Order No. 298-A, 48 Fed. Reg. 46,012 (Oct. 11, 1983), FERC Stats. & Regs., P 30,500 (1983), *order on reh'g*, Order No. 298-B, 48 Fed. Reg. 55,281 (Dec. 12, 1983), FERC Stats. & Regs. ¶ 30,524 (1983). See also *Boston Edison Company*, 109 FERC ¶ 61,300 (2004), *order on reh'g*, 111 FERC ¶ 61,266 (2005) (*Boston Edison*); *ATC*, *supra* note 10; *Northeast Utilities Service Company*, 114 FERC ¶ 61,089 (2006).

<sup>38</sup> See *supra* note 37.

27. As we stated in the July 20 Order, without CWIP in rate base, a new plant has no direct effect on consumer prices until it begins to provide service.<sup>39</sup> Without recovery of CWIP, when the project goes into service, consumers' rates reflect the costs and return associated with the plant, as well as an Allowance for Funds Used During Construction. AEP's investment is estimated to cost \$3 billion and take over eight years to complete. If the Commission did not permit AEP to recover CWIP in rate base, all of AEP's cost of borrowing this estimated \$3 billion in investment would be accrued over eight years and then capitalized once the project goes into service, along with a return of the investment cost through depreciation. Therefore, as Order No. 298 explains, a large project such as the proposed Project has the potential to produce a rate shock for consumers that is both extraordinarily large and sudden.<sup>40</sup> By permitting AEP to recover CWIP, the Commission is mitigating this rate shock to consumers.

28. Regarding the concerns of the Ohio Consumer, we note that the Commission's approval of incentives for the proposed Project is based on the assumption that the proposed Project will result from the PJM regional planning process, and therefore we have no basis to conclude that costs will not be prudently incurred. We clarify that the CWIP costs recovered through rates only represent the return on rate base for facilities under construction. Therefore, CWIP does not recover depreciation costs associated with transmission facilities. Also, the costs of the facilities are not recovered over a short period time. Rather, depreciation costs of the new facilities are recovered when the facilities go into service, and are depreciated over the life of the facilities or a shorter period if requested and granted by the Commission.

29. Finally, we reject ODEC and Ohio Consumer's request that the Commission direct AEP to adopt the condition that, if the proposed Project is cancelled due to factors *within* AEP's control, CWIP and pre-operating costs must be refunded.<sup>41</sup> First and foremost, AEP has not requested approval to recover abandoned plant. Moreover, we find that this request for refunds in the event of AEP's abandonment is premature. ODEC and Ohio Consumer have not shown that this issue is ripe for a resolution sufficient to require AEP to include conditions relating to a non-existent circumstance.

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<sup>39</sup> July 20 Order, 116 FERC ¶ 61,059 at P 59 (citing Order No. 298, FERC Stats. & Regs. ¶ 30,455 at 30,499). ODEC does not dispute this finding.

<sup>40</sup> July 20 Order, 116 FERC ¶ 61,059 at P 59 (citing Order No. 298, FERC Stats. & Regs. ¶ 30,455 at 30,499).

<sup>41</sup> We note, however, that Order No. 679-A provides that if an applicant has been granted authority to recover CWIP or abandoned plant, and subsequently the applicant's project is abandoned, the applicant will not be required to refund the prudently-incurred costs. Order No. 679-A, 117 FERC ¶ 61,345 at P 115-16.

## **D. Duplicative Incentives**

### **1. Request for Rehearing**

30. ODEC argues that the Commission erred by failing to address ODEC's argument regarding the possibility of duplicative incentives. ODEC states that it had raised the concern that the three rate incentives requested by AEP may be duplicative and noted that AEP did not address this possibility in its petition. ODEC claims that, in particular, to the extent that a prospective investor perceives an investment in the proposed Project to be more secure as a result of recovery of CWIP and pre-operating costs, an ROE rate incentive may be unjustified.

### **2. Commission Determination**

31. As stated in the July 20 Order, the incentive rate treatments proposed by AEP are not mutually exclusive.<sup>42</sup> This finding is consistent with precedent that has upheld use of multiple incentives,<sup>43</sup> Congress' directive to the Commission in FPA section 219 to establish incentive-based rate treatments to construct new transmission, and with Order No. 679. The Commission has, in prior cases approved multiple rate incentives for particular projects.<sup>44</sup> This is consistent with our interpretation of FPA section 219 as authorizing the Commission to approve more than one incentive rate treatment to an applicant proposing a new transmission project, as long as each incentive is justified by a showing that it satisfies the requirements of FPA section 219 and that there is a nexus between the incentives being proposed and the investment being made. Here, AEP explained why it sought each incentive and how it was relevant to its proposed Project and conditioned the recovery of the incentives on the proposed Project's inclusion in PJM's RTEP. Thus, the incentives approved by the Commission were shown to have a nexus between the incentives sought and the proposed Project and was made contingent on a presumption that the proposed Project provided either enhanced reliability or reduced congestion benefits (*i.e.* subject to the proposed Project's inclusion in PJM's RTEP).

32. That being said, however, we recognize ODEC's concern that the assurance of rate incentive treatments such as the recovery of CWIP and pre-construction/pre-operating

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<sup>42</sup> July 20 Order, 116 FERC ¶ 61,059 at P 47.

<sup>43</sup> See Boston Edison, *supra* note 37.

<sup>44</sup> *Trans-Elect, Inc.*, 98 FERC ¶ 61,142, *reh'g denied*, 98 FERC ¶ 61,368 (2002), *appeal dismissed*, *Transmission Agency of Northern California v. FERC*, No. 05-1400 (D.C. Cir., Mar. 13, 2006) (unpublished); *ATC, supra* note 10; *CPUC v. FERC, supra* note 10.

costs may result in a lowered risk assessment that would affect the need for an ROE rate incentive to compensate for that risk.<sup>45</sup> We do not believe that is the case here. AEP has demonstrated that the ROE rate incentive is appropriate. The Commission's approval of AEP's incentive ROE is based on the Commission's finding that an ROE on the upper end of the zone of reasonableness is appropriate to attract investment, based on all the relevant project characteristics in AEP's application.<sup>46</sup> As we found in the July 20 Order, the length, scope, and multi-state nature of the proposed Project will present substantial risks and challenges in siting and obtaining the required permits. We also think it is important to recognize that instead of investing capital in another venture, AEP has voluntarily chosen to invest a large amount of capital to build backbone high voltage transmission facilities that it believes will increase reliability and/or reduce the cost of delivered power to customers by reducing transmission congestion. This, coupled with the time for completion – eight years – all support the need for an ROE incentive set at the high end of the zone of reasonableness.<sup>47</sup> Although the Commission has determined here that AEP will receive an ROE in the upper end of the zone of reasonableness, the Commission, in setting the ROE within the upper end of the zone of reasonableness in a FPA section 205 proceeding, will take into account all risk factors including whether the non-ROE incentives granted here serve to lower risk.

33. In the July 20 Order, the Commission conditioned its approval of the rate incentives on AEP making a subsequent filing with the Commission pursuant to section 205 of the FPA. This requirement was codified in Order No. 679-A wherein the Commission stated that while an applicant's total package of incentives must satisfy the nexus requirement, the Commission will still evaluate the justness and reasonableness of the rates associated with the incentives that make up that package at the FPA section 205 proceeding. Indeed, the Commission makes clear that it will conduct a case-by-case review of applications for incentives and will examine the unique factors in each case in making such determinations. AEP has sufficiently demonstrated that a higher ROE, in conjunction with the other rate incentive treatments, is justified.

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<sup>45</sup> Order No. 679-A, 117 FERC ¶ 61,345 at P 6 (“If some of the incentives in the package reduce the risks of the project, that fact will be taken into account in any request for an enhanced ROE.”).

<sup>46</sup> See July 20 Order, 116 FERC ¶ 61,059 at P 6, 40.

<sup>47</sup> *Id.* P 64.

## **E. Piecemeal Ratemaking**

### **1. Request for Rehearing**

34. ODEC and Ohio Consumer argue that the Commission erred by engaging in impermissible piecemeal rate-making by allowing AEP the right to propose additional incentives at a later time. ODEC and Ohio Consumer state that without knowing which additional incentives AEP seeks, it is not possible to conduct a full analysis of AEP's rate and cost recovery proposals, including evaluation of the whole package of rate incentives, to determine that resulting rates will be just and reasonable. ODEC states that the Commission should have, at a minimum, foreclosed the possibility of further rate incentives for the proposed Project.

### **2. Commission Determination**

35. We disagree with ODEC's assertion. The Commission will conduct review sufficient to determine the justness and reasonableness of any additional incentives, based upon the fact that: (1) the applicant must successfully satisfy the prescriptions set forth in Order No. 679 and Order No. 679-A;<sup>48</sup> (2) the Commission will evaluate applications for additional incentives with the record of the previous incentives; and (3) continuing evaluations of incentive metrics, the Commission has the ability to re-evaluate incentives, and, if appropriate, to discontinue them pursuant to FPA section 206.<sup>49</sup>

36. Further, we may not prohibit utilities from exercising their FPA section 205 filing rights, as ODEC recommends here.<sup>50</sup> ODEC's assertion that the Commission should foreclose the possibility for AEP to make a filing for further rate incentive inappropriately challenges, in this proceeding, an existing rate (*i.e.* or term or condition that affects rates) on file. In particular, PJM's Open Access Transmission Tariff (OATT) states that

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<sup>48</sup> As noted in Order 679-A, applicants for incentive rate treatment must demonstrate that the total package of incentives is tailored to the demonstrable risks or challenges faced by the applicant undertaking the project. For instance, if some of the incentives in the package reduce the risks of the project, that fact will be taken into account in any request for an enhanced ROE. *See* Order No. 679-A, 117 FERC ¶ 61,345 at P 6, 21, 27.

<sup>49</sup> 16 U.S.C. § 824e (2000).

<sup>50</sup> *See Atlantic City Electric Company, et al. v. FERC*, 295 F.3d 1, 9-10 (D.C. Cir. 2002) (finding that the Commission cannot deny a utility its right under FPA section 205 to file changes to rates, charges, classification, or service at any time upon 60 days notice).

transmission owners in PJM “shall have the exclusive and unilateral right to make FPA section 205 filings regarding: (i) the establishment and recovery of the PJM [Transmission Owners’] revenue requirements under the PJM OATT; (ii) the transmission rate design under the PJM OATT; and (iii) *incentive and performance-based rates* [emphasis added].”<sup>51</sup> All utilities are free to file for a change in rates under section 205 of the FPA.

The Commission orders:

ODEC and Ohio Consumer’s requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission. Commissioner Kelly concurring with a separate statement attached.  
Commissioner Wellinghoff concurring with a separate statement attached.  
Commissioner Moeller not participating.

( S E A L )

Magalie R. Salas,  
Secretary.

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<sup>51</sup> PJM Interconnection, LLC, FERC Electric Tariff, Sixth Revised Vol. No. 1, Fourth Revised Sheet No. 52, Article 9.1.

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

American Electric Power Service Corporation

Docket No. EL06-50-001

(Issued January 19, 2007)

KELLY, Commissioner, *concurring*:

This order addresses rehearing requests regarding AEP's proposal to include certain incentive rate treatments in its to-be-filed transmission rates for a new 550 mile long, 765 kV transmission line from West Virginia to New Jersey that will add 5,000 MWs of new transfer capability. I voted for the underlying order and continue to support the grant of certain incentives for this excellent transmission project, which will benefit a large proportion of the American public by greatly enhancing reliability and by improving the competitive markets for generation on which the public depends. That said, I concur in order to expand upon my reasoning for supporting this order.

Framework for Judging Incentive Proposals

I deem it important to identify and assess the following six characteristics of any transmission project in order to make reasoned and consistent decisions on requests for incentives for the project: (1) the public interest benefits of the project; (2) the cost of the project in absolute terms; (3) the cost of the project in proportion to the current transmission ratebase of the applicant; (4) the difficulty of completing it due to the number of jurisdictions traversed and whether they are jurisdictions the applicant regularly deals with; (5) the difficulty of relying on normal rate recovery methods due to the length of time it will take to complete; and (6) whether the applicant would otherwise be required to build the project even without an incentive. The comments submitted in connection with Order Nos. 679 and 679-A, and the experience gained in working on individual incentive cases over the past year lead me to conclude that these particular characteristics are most relevant to deciding whether to award incentives.

I support incentives for this project based on my assessment of these characteristics of the project and I believe this assessment is consistent with Order No. 679 and Congressional intent as embodied in section 1241 of EPCAct 2005.

Turning to specifics, I agree with the majority that the "length, scope, and multi-state nature" of the proposed project and the "enormous" \$3 billion cost estimate are all important aspects of a comprehensive analysis of why incentives

are appropriate for this project. However, as noted above they are not the only characteristics that are important and I believe the Commission should weigh all relevant characteristics in all cases. In this case, I believe that the following facts are also pivotal in supporting incentives in this case.

Threshold Question: Should Incentives Be Considered At All?

First and foremost in my analysis are the broad regional benefits of this project to the public interest and the question of whether AEP would otherwise be required to build this project. If, for example, AEP were merely proposing to make the bare minimum of transmission improvements to existing facilities necessary to maintain its own service reliably, I would be less inclined to consider incentives because such minimum facilities must be built in any event and may not bring broad-ranging benefits to the public interest deserving of special treatment.

Here, AEP will create 5,000 MW of new highly efficient transfer capability linking Midwest generation with markets in the East, thus greatly improving upon the status quo for both reliability and competition in generation. Furthermore, the line is to be constructed almost wholly outside of the states within which AEP currently operates, and where its native load is located. Thus it appears highly unlikely that AEP could be compelled to build this line in order to serve its native load. To me it is a bedrock principle that incentives are meant to encourage behavior that is in the public interest but that is not otherwise required. AEP's project clearly meets both tests and, accordingly, I believe that incentives can be considered for this project. Next, I will discuss the specific incentives proposed.

The ROE Incentive

The ROE incentive is, perhaps, the incentive of most interest to the industry and the one for which the highest hurdle should be erected because it raises customer transmission cost. I believe the characteristics of this project raise it over that high hurdle and support an ROE incentive; in particular, setting the ROE somewhere in the upper half of the range as discussed in Order No. 679-A (*see e.g.*, Order No. 679-A at P 67-8). In addition to the broad public interest in the project described above, the fact that AEP is under no known obligation to build it, and the great size of the investment in absolute terms (\$3 billion), I also believe the fact that this project will greatly increase AEP's total transmission plant in service (by roughly 74%), will take a long time to complete (at least 8 years), and will require AEP to deal with multiple state and local authorities it has likely never had to deal with before, support an ROE somewhere in the upper half of the range. The absence of any of these characteristics would have weighed against an ROE guaranteed to be in the upper half of the range, but they are all present for AEP's project.

Non-ROE Incentives

Regarding, the other proposed incentives, the facts here also support them. Both the proposal to include 100% of CWIP in ratebase and to expense and recover pre-construction/pre-operating costs on a current basis, are supported by the long construction period and large cost, both in absolute terms and as a percentage of current rate base; the longer the period of spending large sums without cost recovery, the more challenging the project. If the cost and time to completion were both less, I would see far less support for granting these incentives.

Summary and Conclusion

In summary, I concur with this order because it grants incentives that I agree should be granted in this case, and write separately in order to provide the full analysis that I believe is required to support this outcome. Accordingly, I respectfully concur as discussed above.

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Sudeen G. Kelly

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

American Electric Power Service Corporation

Docket No. EL06-50-001

(Issued January 19, 2007)

WELLINGHOFF, Commissioner, concurring:

The Commission recently observed that the need for capital investment in energy infrastructure is a national problem that requires a national solution.<sup>1</sup> That problem stems from both a decades-long decline in transmission investment and a precipitous decline, primarily in the last decade, in demand-side resource investment that now threatens to impair the reliability of the electric system, cause billions of dollars in congestion costs, and generally frustrate the development of efficient competitive wholesale markets. We must promote investment in efficient transmission infrastructure, as well as facilitate the rapid expansion of demand response resources, energy efficiency, and distributed generation, to begin to solve these serious energy problems.

The Congress directed the Commission, among other things, to provide incentives for transmission investment that promotes “reliable and economically efficient transmission” and a return on equity that “attracts new investment in transmission facilities (including related transmission technologies); encourage deployment of transmission technologies and other measures to increase capacity and efficiency of existing transmission facilities and improve the operation of the facilities.”<sup>2</sup> The Congress also provided guidance to the Commission as to the types of advanced transmission technologies that should be encouraged in infrastructure improvements of both existing and new transmission facilities. Those technologies include high-temperature lines (including superconducting cables), optimized transmission line configurations (including multiple phased transmission lines), high-voltage DC technology, flexible AC transmission systems, controllable load, distributed generation (including PV, fuel cells, and microturbines), and enhanced power device monitoring.<sup>3</sup> I agree that incentives should be authorized by this Commission in those instances that I have fully described below. It should be recognized, however, that such incentives for

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<sup>1</sup> Order No. 679-A at P 9.

<sup>2</sup> See Pub. L. No. 109-58, § 1241, 119 Stat. 594, 961-62 (2005) (EPAAct)(to be codified at section 219 of the FPA).

<sup>3</sup> See Pub. L. No. 109-58, § 1223, 119 Stat. 594, 961-62 (2005) (EPAAct)(to be codified at section 216 of the FPA).

long lead time projects such as transmission are benefits not enjoyed by shorter lead time demand-side resource investments. Thus, it should be recognized that such subsidies may encourage the financial community to favor one type of investment over the other.

AEP in this proceeding seeks three incentive rate treatments in connection with its planned construction of a new 765 kV transmission line: (1) the option to recover 100 percent of the cost of capital associated with CWIP on a timely basis, (2) the option to expense and recover on a current basis the costs incurred during the pre-construction/pre-operating period, and (3) an ROE to be set at the high end of the zone of reasonableness. AEP also seeks certain accounting authority for the deferral for future recovery of the pre-construction/pre-operating costs not yet recovered plus carrying costs. In its original order, which issued prior to my becoming a Commissioner, the Commission conditionally granted AEP's petition for declaratory order approving the proposed incentives. In today's order, the Commission denies requests for rehearing. I agree with that result, but I disagree with the Commission as to the appropriate evidentiary basis for the decision. Therefore, I respectfully concur with today's order.

With regard to the first requested incentive rate treatment, it is important to recognize that allowing the inclusion of CWIP in rate base is not a new ratemaking technique. In 1983, the Commission issued Opinion No. 298, which amended the Commission's regulations to allow utilities to include no more than 50 percent of CWIP in rate base.<sup>4</sup> As the Commission explained at that time, one policy goal advanced by allowing rate base treatment for CWIP is mitigating the rate shock to consumers.<sup>5</sup> More recently, the Commission has recognized that allowing 100 percent inclusion of CWIP in rate base is a departure from the status quo, but found that such treatment may be appropriate for some projects because it provides up-front regulatory certainty, rate stability, and improved cash flow for applicants, thereby easing pressures on their finances caused by transmission development programs.<sup>6</sup>

In this proceeding, the Commission has found that allowing 100 percent inclusion of CWIP in rate base is appropriate, among other reasons, because AEP's cost of borrowing an estimated \$3 billion in investment (that otherwise would be accrued over

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<sup>4</sup> See *Construction Work in Progress for Public Utilities; Inclusion of Costs in Rate Base*, Order No. 298, 48 Fed. Reg. 24,323 (June 1, 1983), FERC Stats. & Regs. ¶30,455, *order on reh'g*, Order No. 298-A, 48 Fed. Reg. 46,012 (Oct. 11, 1983), FERC Stats. & Regs. ¶30,500 (1983), *order on reh'g*, Order No. 298-B, 48 Fed. Reg. 55,281 (Dec. 12, 1983), FERC Stats. & Regs. ¶30,524 (1983).

<sup>5</sup> Order No. 298, FERC Stats. & Regs. ¶30,455 at 30,499.

<sup>6</sup> Order No. 679 at P103, 115.

eight years and capitalized once the project goes into service), along with a return of the investment cost through depreciation, could produce an extraordinary and sudden rate shock for consumers. Thus, the Commission has found that the size of the financial investment in this “backbone” transmission facility, coupled with the length of the construction period, justifies special treatment in the form of incentives that may well be unavailable for potential alternatives that involve shorter lead times, such as distributed generation or demand response investments. In addition, the Commission relies on AEP’s assertion that the CWIP will assist the company in raising debt and equity capital from investors.

Similarly, the Commission recognizes that AEP’s requested pre-construction/pre-operating cost rate incentive and accounting treatment are departures from traditional practices. Again, the Commission relies on AEP’s assertions that current recovery of pre-construction/pre-operating costs will facilitate raising debt and equity capital.

I agree that where the construction cycle is so extended, eight years in this case, and the level of investment significant, consumers may be best served by allowing 100 percent of CWIP in rate base. With all CWIP in rate base, the impact of new plant is spread over the entire construction period, and, thus, consumers will face less of a rate shock at the in-service date. Similarly, the proposal to expense pre-construction/pre-operating costs prior to the in-service date, rather than capitalizing those costs as cost of construction and depreciated over the service life of the asset, can be justified. On this basis, I support granting these incentive rate treatments to AEP. By contrast, while increasing the percentage of CWIP in rate base will increase cash flow, I do not believe that AEP has made a sufficient showing as to why such an increase is needed to ease pressures on the company’s finances caused by its transmission development proposal. For example, AEP fails to provide any statistical analysis that shows the impact of 100 percent of CWIP on its financial indicators.<sup>7</sup> In the absence of such support, I do not base my decision to support AEP’s request for this incentive rate treatments on mere conclusory statements.

With regard to requests for ROE incentives, I note that the Commission recently stated (and I agree) that if an applicant desires up-front certainty of the ROE it will receive, then it may seek a particular ROE in a petition for declaratory order and include the appropriate support for that request, such as a DCF analysis.<sup>8</sup> In such a proceeding, the Commission may have a sufficient record to evaluate the risks associated with a

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<sup>7</sup> In Order No. 298, the utility impacts of including CWIP in rate base were presented in five statistical studies. FERC Stats. & Regs. ¶30,455 at 30,512-14.

<sup>8</sup> Order No. 679-A at P 70.

project and determine a specific ROE. The Commission also stated (and I agree) that an applicant may request in a petition for declaratory order an ROE that is at the upper end of the zone of reasonableness.<sup>9</sup> In that event, the Commission must still provide adequate support for a decision to grant the requested ROE incentive, even if the specific ROE for the project will not be determined until a later hearing process.

AEP's application for an ROE incentive presents the latter type of request.<sup>10</sup> In support of its decision to grant an ROE incentive, the Commission states that we have broad discretion within our ratemaking authority to approve incentive adders.<sup>11</sup> While I do not disagree with that statement, I do not believe that it, in and of itself, justifies the granting of any particular incentive. The key issue is not whether the Commission has the authority to approve incentive adders, but how we exercise our discretion to do so.

The Commission also finds that the length, scope, and multi-state nature of the proposed facility present substantial risks and challenges in siting and obtaining the required permits and, therefore, warrant an enhanced ROE. In further support of its position, the Commission states that AEP's large financial investment in the proposed facility presents financial challenges not faced by ordinary transmission investment, and that because AEP is under no state obligation to build the facility, it is important to note that the capital could have been invested in another venture.

Those statements, however, do not provide adequate support for the Commission's decision to grant AEP an ROE in the upper end of the zone of reasonableness. Where the Commission is relying on a factual record to support its decision, it must demonstrate that the record actually contains facts that support the result.<sup>12</sup> The Commission here does not cite sufficient record evidence to demonstrate that the stated problems are likely to arise

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

<sup>10</sup> AEP's petition for declaratory order need not comply with Order Nos. 679 and 679-A because those rules were not effective at the time of its submission. Instead, the Commission evaluated the petition pursuant to its existing authority under FPA section 205. Nonetheless, the Commission in this proceeding has reviewed AEP's proposed incentives for general consistency with Order Nos. 679 and 679-A.

<sup>11</sup> In support of this statement, the Commission cites *Maine Public Utilities Commission v. FERC*, 454 F.3d 278 (D.C. Cir. 2006).

<sup>12</sup> See *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 843-44 (D.C. Cir. 2006) ("Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decision-making."), citing *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 42-43 (1983).

in this case, or adequately explain why an enhanced ROE in the upper end of the zone of reasonableness is appropriate to address those problems.

Despite my concerns regarding the appropriate evidentiary basis in this record for an incentive ROE, I support the Commission's decision to grant an ROE incentive to AEP. My decision is based on the following rationale.

It is necessary to start first with the base ROE. In setting the base ROE, the Commission must balance the interests of shareholders and consumers, recognizing that the base ROE must be sufficiently high to attract capital and compensate the utility for its risks, including regulatory risk. That review may be conducted in response to an applicant's filing pursuant to FPA section 205 or, as noted above, in a declaratory order proceeding if the applicant submits sufficient evidentiary support for its request, such as a DCF analysis. I have not foreclosed considering variations on the DCF methodology or other methods to determine the cost of equity. I also agree with AEP that the appropriate ROE is not established by simply setting a base ROE at the midpoint of the zone of reasonableness.

In providing an incentive or enhanced ROE 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 simply meeting the minimum standard of good utility practice. An incentive adder should be more narrowly targeted to transmission investments that provide incremental benefits. Those benefits should result from the deployment of "best available technologies" that increase operation and energy efficiency, enhance grid operations, and result in greater grid flexibility. In addition, the Commission should ensure that there has been an open, fair, and robust consideration of all the alternatives to the specific transmission investment being proposed. That consideration should include local resource alternatives such as demand response and distributed generation, alternative line configurations such as direct current, and other advanced technologies that may effectively complement, or in some cases supplant, a proposed new transmission line.

Applying these considerations to the facts of this case, I believe that AEP has made a minimally adequate demonstration that an ROE in the upper end of the zone of reasonableness is appropriate. AEP states that it is committed to deploy state-of-the-art technologies to maximize the performance and benefits of the proposed project.<sup>13</sup> In particular, AEP indicated that it may utilize:

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<sup>13</sup> Attachment A, The AEP Interstate Project Proposal at 15.

- Single-phase switching – to enhance the availability and stability of the line by only interrupting one phase to clear temporary single line-to-ground faults;
- Single-phase static VAR compensators – permitting phase voltage balancing, boost line loadability and voltage performance;
- Fiber-optic wire(s) – facilitating the use of differential line protection;
- Open ground wire to reduce line losses; and
- Switchable shunt reactors to improve voltage control.

I commend AEP for taking a first step toward introducing the concept of energy efficiency as support for its requested ROE rate incentive. In any future petition for declaratory order by a utility seeking incentive rates, I expect to see a more thorough and complete evaluation of the feasibility of using state-of-the-art technologies.<sup>14</sup> I would also condition approval of an enhanced ROE on actual deployment of such technologies.

In addition, AEP assessed its proposed project against other methods of power delivery, including HVDC, adding generation in eastern PJM, and lower voltage transmission.<sup>15</sup> AEP concluded that the beneficial attributes of its proposed 765 kV transmission line included the ability to maximize economies of scale for the required capacity and leverage the existing 765 kV transmission infrastructure to facilitate future expansion. Again, I commend AEP for considering at least some alternatives to its proposal. I would require future applicants seeking an enhanced ROE to demonstrate more thoroughly that they have considered other alternatives to their proposal. To the extent that an applicant can demonstrate that a relevant regional planning process included an open, fair, and rigorous consideration of alternatives, then the applicant could rely on that process in its petition for declaratory order.

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<sup>14</sup> Order No. 679 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>15</sup> Attachment A, The AEP Interstate Project Proposal at 5-6.

For these reasons, I respectfully concur with the Commission's order.

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Jon Wellinghoff  
Commissioner