

109 FERC ¶ 61,069
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Rolling Hills Generating, L.L.C.

Docket Nos. ER04-1098-000
and ER04-1098-001

ORDER ACCEPTING FOR FILING PROPOSED TARIFF REVISIONS,
SUBJECT TO REFUND, AND ESTABLISHING HEARING
AND SETTLEMENT JUDGE PROCEDURES

(Issued October 22, 2004)

1. On August 4, 2004, as amended August 24, 2004, Rolling Hills Generating, L.L.C. (Rolling Hills) filed a rate schedule under which it specified its revenue requirement for reactive power service under Schedule 2 of the PJM Open Access Transmission Tariff (OATT).¹ In this order, we accept for filing and suspend the revenue requirement, subject to refund, and institute hearing and settlement judge procedures. This action benefits customers because it provides an opportunity for the parties to develop a more complete factual record upon which the Commission may evaluate the justness and reasonableness of the proposed rate.

I. Background

2. Rolling Hills is an 800 MW natural-gas fired peaking generating facility located in Wilkesville, Ohio, and is interconnected to the Ohio Power Company transmission system, which is an operating company of American Electric Power Service Corporation (AEP). AEP filed a Generator Interconnection and Operating Agreement with Rolling Hills on behalf of Ohio Power on June 11, 2001, indicating compensation for reactive support as follows:

¹ The rate schedule is designated as Rate Schedule FERC No. 2.

In the event that the FERC, or any other applicable regulatory authority, issues an order or approves a tariff establishing a specific compensation to be paid to Generating Company [Rolling Hills] for reactive support service, Company [Ohio Power] shall pay Generating Company [Rolling Hills] pursuant to such order or tariff.²

3. Upon AEP joining PJM, which is scheduled for October 1, 2004, the Ohio Power Company control area will be administered by PJM under the PJM OATT. Schedule 2 of PJM's OATT³ governs charges and payments through its application of a formula rate for reactive supply and voltage control from generation sources in the PJM region.

Essentially, PJM consolidates the Commission-approved revenue requirements of all of the generators within the PJM region, breaks the total revenue requirement down into a monthly expense, and then allocates a percentage of this monthly expense to network and point to point transmission customers directly in proportion to their share of the total monthly transmission use based on zonal and non-zonal determinants.

4. Each month, PJM then distributes the reactive power revenues to each generation owner in an amount equal to the generation owner's monthly revenue requirement that has been approved by the Commission. In this proceeding, Rolling Hills submits cost support required to be eligible for compensation as a reactive power provider under Schedule 2 of the PJM Tariff and requests an effective date of October 1, 2004 or the date that control of the AEP transmission system is transferred to PJM, whichever is later.

5. Rolling Hills submits a revenue requirement comprised of two components; a fixed capability component of \$1,489,521.07 annually, and a heating losses component of \$2,483.88 annually. Rolling Hills also submits a provision for any lost opportunity costs that may occur as provided for recovery under 3.2.3B of the Appendix to Attachment K of the PJM OATT. Rolling Hills requests waiver of Part 35, much of which is not applicable to a charge for reactive power service, and, to the extent necessary, any other regulations under Part 35, so that Rolling Hills' revenue requirement may become effective as requested.

² Generation Interconnection Operating Agreement, section 4.12(c)(i), accepted in an unpublished delegated letter order.

³ FERC Electric Tariff, Sixth Revised Volume No. 1.

II. Notice, Interventions, and Protests

6. Notice of Rolling Hills' filings were published in the *Federal Register*.⁴ AEP filed a timely, unopposed motion to intervene and protest. PJM and Duke Energy Washington, L.L.C. filed timely notices of intervention.

III. Discussion

A. Procedural Matters

7. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

B. Revenue Requirement and Rate Design

i. Rolling Hills' Filing

8. Rolling Hills requests approval of its reactive power service revenue requirement utilizing the AEP Methodology in determining the fixed capability component of the revenue requirement.⁵ Rolling Hills first determined the total portion of investment cost of the generator/excitor, step-up transformer, and accessory electrical equipment that was attributable to reactive power production as \$10,670,196, in accordance with the AEP Methodology.

9. Rolling Hills then applied a fixed charge rate of 13.95 percent, which incorporates depreciation expense, income tax expense, and a return on common equity of 13.5 percent, to derive the annual levelized cost (the fixed capability component) of \$1,489,521. Rolling Hills explains that it used the proxy return on common equity of

⁴ 69 Fed. Reg. 51,076 (2004) and 69 Fed. Reg. 53,911 (2004), with comments, protests, and interventions due on or before August 25, 2004 and September 3, 2004, respectively.

⁵ See, *American Electric Power Service Corp., initial decision*, 80 FERC ¶ 63,006 at 65,071 (1997), *Opinion No. 440*, 88 FERC 61,141 at 61,456 (1999), *on reh'g*, 92 FERC ¶ 61,001 (2000), *WPS Westwood Generation, L.L.C.*, 101 FERC ¶ 61,290 at 14 (2002), in which the Commission provided guidance for future generation reactive power cost recoveries; "... the Commission recommends that all generators seeking reactive recovery that have actual cost data and support use the method employed in American Electric Power Service Corporation." (Hereinafter, AEP Methodology)

AEP (13.5 percent) as approved in Docket No. ER03-242-000, *American Electric Power Service Corporation*, 103 FERC ¶ 61,008 (2003), because it is interconnected to AEP, and is a non-utility generator not subject to traditional ratemaking. Rolling Hills describes this rate of return as conservative in light of its generation-only status.⁶

ii. Intervenors' Comments

10. AEP requests investigation and suspension of the filing, stating that Rolling Hills' proposal appears to be unjust and unreasonable in several respects. First, AEP states that Rolling Hills is a peaking plant, designed to run only during limited periods. AEP requests that the Commission investigate whether it is just and reasonable for Rolling Hills to receive a steady payment for providing service under Schedule 2 regardless of when or how often the service is provided. AEP states that the Rolling Hills facility has operated very infrequently in 2003, with only 181 hours of operation in a four month time frame, and states that customers should not have to pay for a service that is seldom provided. AEP points out that Rolling Hills currently charges AEP a per unit charge for reactive power support, and not a capacity charge, such as Rolling Hills submits in this instant proceeding.

11. Further, AEP states that the Rolling Hills facility was not designed on an integrated basis to provide reactive power support for transmission transactions, nor was it built to supply for any identified need for real or reactive power on the AEP transmission system. AEP states that customers should not be required to pay for the potential to provide a service that they did not request and do not need. AEP also states that Rolling Hills' resulting monthly charge, at \$113 per megawatt,⁷ seems inordinately high, in light of AEP's present monthly rate for reactive power service at \$73 per megawatt.

iii. Commission's Response

12. AEP misrepresents the nature of Rolling Hills' revenue requirement, which is intended to recover the embedded, investment cost of reactive power. This embedded cost remains constant regardless of the hours of operation of the facility. In the AEP

⁶ Rolling Hills states that the Commission has previously approved the use of a proxy transmission owner rate of return as a conservative alternative to extensive return on equity submissions for merchant generators in *New England Power Pool, et al.*, 92 FERC ¶ 61,020 at 61,041(2000).

⁷ AEP calculates this rate by dividing the annual revenue requirement of \$1,492,004.95 by 977.95 MW (the total real power capability).

Methodology, the Commission did not require AEP to demonstrate the hours of operation of its generation facilities providing reactive power, but rather, the allocation factors were based on the capability of the generator.⁸ Additionally, Rolling Hills' reactive power proposal is consistent with Schedule 2 of the PJM Tariff, which provides that generators are compensated based on capital investment in reactive power facilities, not actual operations. Therefore, AEP's protest that a single generator be required to be compensated based on actual operations is inconsistent with the PJM Tariff on file.

13. We also deny AEP's request that Rolling Hills be required to show a need for this reactive power service. We find this request to be contrary to Order No. 2003⁹ and PJM standards,¹⁰ which require all generators to maintain reactive power capability and do not require a "needs" test for a generator to be an eligible supplier of reactive power. Further, PJM, as the reliability coordinator for the region, calculates the system need for reactive power and each generator's reactive power design criteria.¹¹

14. However, AEP raises issues of material fact concerning the cost components of the fixed capability revenue requirement that are best resolved in hearing procedures. In addition, we find that the proxy rate of return that Rolling Hills proposes to use, which is based on AEP's rate of return, was withdrawn in various proceedings under Docket Nos. ER03-262-000 and ER03-242-000¹² and may not be a reasonable proxy for rate of return

⁸ See *American Electric Power Service Corporation*, 88 FERC ¶61,141 at 61,457 (1999) ("[T]he allocation factor should be based on the *capability* [emphasis added] of the generators to produce VARs and that this capability should be measured at the generator terminals . . . [and] a generating plant must be capable of producing reactive power in excess of that which ultimately reaches the transmission system in order to have enough reactive power remaining to provide adequate voltage support on the transmission system.").

⁹ Standardization of Generator Interconnection Agreements and Procedures, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs. ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, 106 FERC ¶ 61,220 (2004), *reh'g pending* (Order No. 2003).

¹⁰ NERC Planning Standard I.D., System Adequacy and Security--Voltage Support and Reactive Power (September 16, 1997).

¹¹ See, section 54.7 of the PJM OATT.

¹² See *New PJM Companies*, Opinion No. 472 at 129-130, 107 FERC ¶ 61,271 (2004) and *American Electric Power Service Corporation, order granting request for withdrawal of rates*, 103 FERC ¶ 61,369 (2003).

consistent with proxies we have found permissible in prior proceedings. Because our preliminary analysis of Rolling Hills' proposed reactive power revenue requirement indicates that it has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful, we accept for filing and suspend the revenue requirement for a nominal period,¹³ make it subject to refund, and institute hearing and settlement judge procedures.

15. Rolling Hills requested in its filing that the Commission waive the requirement of filing certain cost support for the proposed charges for reactive supply service as set forth in Part 35. AEP objects to this request in its protest, requesting a full cost-of-service investigation through hearing proceedings. Moreover, Rolling Hills has not filed sufficient cost-of-service data to evaluate the revenue requirement. The Commission directs Rolling Hills to file its cost of service data as part of its case-in-chief according to the hearing procedures as established by the Administrative Law Judge.

16. In order to provide the parties an opportunity to resolve these matters among themselves, we will hold the hearing in abeyance and direct settlement judge procedures, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.¹⁴ If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in this proceeding; otherwise, the Chief Judge will select a judge for this purpose.¹⁵ The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

¹³ In *West Texas Utilities Company*, we explained that where our preliminary examination indicates that proposed rates may be unjust and unreasonable and may be substantially excessive, as defined in that case, we would generally impose a five-month suspension. 18 FERC ¶ 61,189 at 61,375 (1982) (explaining the Commission's electric rate suspension policy). However, in this proceeding, our examination indicates that the proposed rate does not yield substantially excessive revenues.

¹⁴ 18 C.F.R. § 385.603 (2004).

¹⁵ *Id.*

The Commission orders:

(A) Rolling Hills' proposed reactive power revenue requirement is hereby accepted for filing, suspended for a nominal period, to become effective October 4, 2004, subject to refund, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning the justness and reasonableness of Rolling Hills' proposed tariff revisions. As discussed in the body of this order, the hearing will be held in abeyance to give the parties time to conduct settlement judge negotiations.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2004), the Chief Administrative Law Judge is hereby authorized to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge in writing or by telephone within five (5) days of the date of this order.

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

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

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.