UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Allegheny Energy, Inc. Monongahela Power Company Allegheny Energy Supply Company, LLC	Docket Nos. ER07-121-000 ER07-121-001

ORDER CONDITIONALLY GRANTING WAIVER OF CERTAIN CODE OF CONDUCT PROVISIONS

(Issued April 6, 2007)

1. In this order, the Commission grants, as conditioned herein, a request filed by Applicants, the Allegheny Companies,[1] for waivers of certain provisions of AE Supply's market-based rate code of conduct, effective January 1, 2007, (a) to the extent necessary to continue combined physical operations at two conjoined generation facilities, and (b) for the limited additional purpose of maintaining shared pools of bulk spare parts and refurbished capital parts between Mon Power and AE Supply.

I. Background

2. On October 31, 2006, Allegheny Companies requested waivers of certain provisions of AE Supply's market-based rate code of conduct so that they can continue combined physical operations at two contiguous coal-fired plants after an internal restructuring of generation asset ownership within the Allegheny Companies' system.

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[1] The Allegheny Companies include Allegheny Energy, Inc. (Allegheny Energy), Monongahela Power Company (Mon Power), and Allegheny Energy Supply Company, LLC (AE Supply). Mon Power, a franchised public utility, and AE Supply, a generation and marketing affiliate, are subsidiaries of Allegheny Energy.

This internal restructuring was approved by the Commission[2] and the Public Service Commission of West Virginia.[3] On December 20, 2006, as amended December 21, 2006, Commission Staff issued a data request. The Allegheny Companies responded on February 7, 2007.

3. The Allegheny Companies explain that, as more fully detailed in their application that led to the Commission's Restructuring Order, prior to 1999 each of the Allegheny Operating Companies[4] owned its own generation. Typically, each company would take an ownership interest in each new generation facility to the extent it needed capacity at the time the facility was constructed; thus, each facility could be owned by one or more of the Allegheny Operating Companies. In response to certain states' requirements that generation be unbundled, AE Supply was formed to own the generation facilities previously owned by the Allegheny Operating Companies. The Allegheny Operating Companies transferred most of their interests in their generation facilities to AE Supply and entered into agreements with AE Supply to purchase power through the state-mandated transition periods.[5] The exception is the load-related fractional ownership interests of Mon Power in various Allegheny Energy generation assets in West Virginia, which Mon Power was required to retain by the Public Service Commission of West Virginia. With respect to the units for which Mon Power retained ownership interests, Applicants explain that AE Supply and Mon Power were joint owners, with AE Supply conducting all plant operations and dispatch functions of these jointly owned facilities (aside from one facility not at issue in this proceeding).

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[2] *Allegheny Energy, Inc.*, 113 FERC ¶ 61,077 (2005), *order on clarification*, 114 FERC ¶ 61,247 (2006) (Restructuring Order).

[3] Public Service Commission of West Virginia, Case Nos. 00-0801-E-PC, 00-1246-E-PC, 00-1616-E-PC, and 03-0695-E-PC, Order dated April 7, 2006.

[4] The Allegheny Operating Companies are the Potomac Edison Company, Mon Power, and West Penn Power Company.

[5] West Penn transferred its generation to AE Supply and entered into a power sales agreement in 1999, Potomac Edison did so in 2000, and Mon Power followed with respect to its former Ohio operations in 2001. The Commission approved these transfers and power sales agreements.

II. Notice Of Filing And Responsive Pleadings

4. Notice of the Applicants' October 31, 2006 filing was published in the *Federal Register,* 71 Fed. Reg. 66,323 (2006), with interventions and protests due on or before November 21, 2006. None was filed.

5. Notice of the Applicants' February 5, 2007 filing was published in the *Federal Register,* 72 Fed. Reg. 11,855 (2007), with interventions and protests due on or before March 26, 2007. None was filed.

III. Discussion

6. The Commission requires affiliates of franchised public utilities that request market-based rate authority to submit a market-based rate code of conduct to govern the relationship between the franchised public utility and its affiliates. The purpose of the market-based rate code of conduct requirement is to safeguard customers against affiliate abuse in order to protect against the possible diversion of benefits or profits from franchised public utilities (i.e., traditional public utilities with captive ratepayers) to an affiliated entity for the benefit of shareholders.[6] Just as the Commission has expressed concern about the potential for affiliate abuse in connection with power sales between affiliates, it also has recognized a potential for affiliate abuse through other means, such as the pricing of non-power goods and services or the sharing of market information between affiliates.[7] For example, a franchised public utility may refrain from competing for a power sale to enable its power marketing affiliate to make that sale instead. This would reduce the revenue credits (benefit) that would otherwise be used to lower the rates of captive customers.

7. The Commission has waived the market-based rate code of conduct requirement in cases where there are no captive customers, and thus no potential for affiliate abuse, or where the Commission finds that such customers are adequately protected against

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[6] *See Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, Notice of Proposed Rulemaking,* 71 Fed. Reg. 33,102 (June 7, 2006), FERC Stats. & Regs. ¶ 32,602 (2006).

[7] *See, e.g., Potomac Electric Power Company,* 93 FERC ¶ 61,240 at 61,782 (2000); *Heartland Energy Services Inc.*, 68 FERC ¶ 61,223 at 62,062-63 (1994).

affiliate abuse.[8] Here, we will grant limited waiver of the market-based rate code of conduct for post-restructuring operations, as specifically discussed and conditioned below.

A. Paragraphs 1 and 2 of the Code of Conduct

8. Applicants seek any waivers of Paragraph 1 and 2 of the AE Supply market-based rate code of conduct necessary to continue, after the internal restructuring, combined physical operations at the Pleasants and Willow Island plants, two contiguous coal-fired generation facilities that the Allegheny Companies assert already effectively function as a single, conjoined facility. Applicants explain that prior to the restructuring, the Pleasants and Willow Island plants were both jointly owned by AE Supply and Mon Power but AE Supply operated and dispatched them. After the restructuring,[9] AE Supply's ownership interest in the 1300 MW Pleasants plant increased from approximately 77 percent to 92 percent, while Mon Power became the sole, 100 percent owner in the conjoined 243 MW Willow Island plant.[10]

9. The Allegheny Companies indicate that, given that Willow Island now is wholly owned by Mon Power while Pleasants remains jointly owned by Mon Power and AE Supply, certain provisions of AE Supply's market-based rate code of conduct will be implicated by continued shared operations at these conjoined facilities. Specifically, Paragraph 1 of the AE Supply market-based rate code of conduct, dealing with separation of functions, provides:

> To the maximum extent practical, the employees of AE Supply performing wholesale power sales activities will operate separately

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[8] *See, e.g., CMS Marketing, Services and Trading Co.*, 95 FERC ¶ 61,308 at 62,051 (2001) (granting request for cancellation of code of conduct where wholesale contracts, as amended, "cannot be used as a vehicle for cross-subsidization of affiliate power sales or sales of non-power goods and services"); *Alcoa, Inc.*, 88 FERC ¶ 61,045 at 61,119 (1999) (waiving code of conduct requirement where there were no captive customers); *Green Power Partners 1 LLC*, 88 FERC ¶ 61,005 at 61,010-11 (1999) (waiving code of conduct requirement where there are no captive wholesale customers and retail customers may choose alternative power suppliers under retail access program).

[9] The restructuring was scheduled to be implemented on January 1, 2007.

[10] Prior to restructuring, Mon Power held an approximately 85 percent interest in the Willow Island plant.

> from the employees of AE Supply's Regulated Affiliates performing wholesale power sales activities or transmission system operations.

Paragraph 2 of the AE Supply market-based rate code of conduct, dealing with information sharing, provides:

> No employee of any Regulated Affiliate will share market information with any employee of AE Supply unless all such information is simultaneously made available to the public. This policy will not apply to market information disclosed to employees of AE Supply who are engaged in support roles, including human resources, information resources, data processing, finance, legal accounting, and other support personnel who do not participate in directing, organizing and executing the business decisions of the wholesale merchant or generation functions of AE Supply, provided that such employees are prohibited from acting as an improper conduit to pass market information obtained from any Regulated Affiliate to non-support personnel of AE Supply.

10. The Allegheny Companies explain that, after the restructuring, generation dispatch decisions for the jointly-owned Pleasants plant will be the responsibility of AE Supply's Market Optimization and Dispatch group, while Allegheny Power's Load Management/Market Optimization and Dispatch group will dispatch Willow Island on behalf of Mon Power.[11] Applicants assert that these two groups will operate separately, with no joint decision-making or sharing of nonpublic market information.[12] They emphasize that groups making generation dispatch decisions for Pleasants and Willow Island are located in separate physical locations, both of which are themselves separate from the physical location of Pleasants and Willow Island.[13]

11. The Allegheny Companies assert that given the conjoined status of Pleasants and Willow Island, coordination between the two plants must continue, including coordination with respect to maintenance and outage scheduling. Applicants request waiver of Paragraph 1 of their market-based rate code of conduct "to allow AE Supply employees that manage and operate the Pleasants power station [fractionally owned by AE Supply] to manage the operation of the Willow Island station [wholly owned by Mon Power]. The eight AE Supply management employees at the Pleasants station (described

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[11] Allegheny Companies' October 31, 2006 Filing at 10, 12-13.

[12] *Id.* at 17.

[13] *Id.*

at p. 12 of the October 31, 2006 filing)[footnote omitted] would be the only AE Supply employees that would be permitted to perform work on Willow Island."[14]

12. Because all generation facilities owned by Mon Power before the generation asset swap were jointly owned with AE Supply, Allegheny Companies state that they did not restrict the sharing of information relating to the status or operations of Pleasants or Willow Island, as they believed each owner was eligible to receive this information as a co-owner of these facilities.[15] Further, Applicants state that, because Willow Island after the restructuring will be wholly owned by Mon Power, that plant could no longer be operated by AE Supply employees and information related to it could no longer be shared with such employees without implicating the AE Supply market-based rate code of conduct. In addition to their waiver request, the Allegheny Companies add that they have adopted additional policies and procedures that restrict the sharing of market information with AE Supply, and have engaged in an extensive training program for employees.

13. Applicants state that the great majority of employees at the conjoined Pleasants and Willow Island site are either: (a) field and maintenance employees; (b) support employees engaged in purely administrative or ministerial roles; or (c) employees who perform purely mechanical, technical, or engineering functions. With respect to that last employee class, they explain that such employees, while they may "operate" generation in a mechanical and engineering sense, do not "operate" generation in the economic sense. They do not buy or sell energy or related financial products. The Allegheny Companies state that in certain circumstances, these employees may carry out the directives of their respective market optimization and dispatch groups and/or provide technical input to those groups but they are not otherwise participants in the dispatch or market decision making process.

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[14] Allegheny Companies' February 5, 2007 Data Request Response at 15. In their initial filing, Applicants indicated that Allegheny Power would be conducting plant operations and dispatch at all plants (except Bath County) that are wholly owned by Mon Power (this would include Willow Island). Allegheny Companies' October 31, 2006 Filing at 6.

[15] We note that this order is limited to issues relating to: (1) post-restructuring operations and dispatch at Willow Island and Pleasants, and (2) post-restructuring shared pools of bulk spare parts and refurbished capital parts between Mon Power and AE Supply.

14. Further, there is also a Regional Director with overall responsibility for physical operations at the conjoined Pleasants and Willow Island site and a Business Manager responsible for budgeting, cost tracking and controls for the entire conjoined site. As their filings explain, the Allegheny Companies are proposing to share eight AE Supply management employees at the conjoined facilities, including the Regional Director, Business Manager, Maintenance Manager, Manager, Production (of Willow Island), Manager, Operations (of Pleasants), Engineering Manager, Administration Manager, and Manager of Bulk Materials.[16]

15. The Manager, Production (of Willow Island) has responsibility for physical operations at the Willow Island plant while the Manager, Operations (of Pleasants) has responsibility for physical operations at the Pleasants plant. Allegheny Companies state that, typically, each of these managers provides information or support such as: station fuel demand, projected generation, system availability/impact, fuel inventory, pending performance testing, fuel blending requirements, unit equipment condition, input on work scope, and the development of risk assessments for work scope. Such information is shared between these managers in a team effort to deal with any type of situation efficiently and effectively. Where maintenance scheduling is necessary, the Regional Director will lead the discussions. Further, the managers of Pleasants and Willow Island review outage needs, urgency, duration, system impact, and projected market pricing with their respective dispatch groups, provide information and scheduling options to staff, input on work scope, and developing risk assessments for work scope. This is typical of what was shared before the restructuring and what they request to be allowed to continue.

16. Applicants add that the remaining managers have site-wide responsibilities such as overall maintenance, plant engineering and technical support, overall administration (e.g., human resources, employee-relations, organizational development, performance management, etc.), and bulk materials handling (receive, store and transport fuel to the stations and waste from the facilities). They emphasize that none of these managers (including the Regional Director, the Manager, Production (of Willow Island), and the Manager, Operations (of Pleasants)) makes dispatch decisions.

17. The Allegheny Companies also explain that the conjoined facilities use commonly maintained equipment, shared services, and many common employees. This includes barge unloading and coal handing equipment, a common coal pile run-off trench, truck

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[16] Allegheny Companies' October 31, 2006 Filing at 12, figure 3; Allegheny Companies' February 5, 2007 Data Request Response at 15 and n.5.

scales, ash disposal, water treatment, security, and maintenance. Additionally, there are common telephone, radio, and loud speaker/page systems. Applicants state that there are common emergency and spill response drills, safety programs, and technical training. Also, while some personnel typically work at one plant or the other, personnel are shifted between plants for work, particularly for outages, and to accommodate vacations.

18. With respect to the simultaneous disclosure provision of the market-based rate code of conduct, the Allegheny Companies maintain that it would be virtually impossible to post all the information shared in managing the physical operations of the Willow Island station. They state that this information could vary from minute to minute and could be based on physical observations, oral communications, real-time monitoring and electronic systems. They add that due to the extensive nature of the shared equipment, posting information about Willow Island would also reveal information about the status of Pleasants. Even if they hired duplicate employees to perform the management functions at Willow Island that are now performed by the shared employees, the sharing of information between Willow Island and Pleasants would still be required in order to operate both plants. Additionally, because of the extremely close proximity of each plant to the other, Applicants state that status of each plant is known to people at the other simply because of visual and physical observation, sound and vibrations.

19. Based on the facts presented, we find that waiver of Paragraph 1 of AE Supply's market-based rate code of conduct is unnecessary. Paragraph 1 requires the employees of AE Supply performing wholesale power sales activities to operate separately from the employees of AE Supply's Regulated Affiliates performing wholesale power sales activities. Applicants represent that the eight AE Supply management employees responsible for physical operations at the conjoined Willow Island and Pleasants facilities do not perform wholesale power sales activities.[17] Applicants therefore do not need a waiver of Paragraph 1 to share these employees.

20. Applicants also seek a waiver of the market-based rate code of conduct's information sharing provision (Paragraph 2) "to allow the sharing of information about Willow Island with the eight AE Supply employees located at Pleasants."[18] Applicants insist that, given their duties and the conjoined nature of operations[19] at the adjacent

[17] Allegheny Companies' February 5, 2007 Data Request Response at 15.

[18] *Id.* at 16.

[19] The conjoined facilities use commonly maintained equipment, including barge unloading and coal handing equipment and water treatment, and some amount of coordinated operation is necessary to safely and efficiently operate both plants.

Pleasants Willow Island facilities, "these employees need access to Willow Island information concerning operations and maintenance to manage the physical operations at Willow Island."[20] Given the size disparity between Pleasants and Willow Island, Applicants reason that continuing conjoined operations of these facilities would ensure efficient, cost-effective operations at Willow Island through access to greater economies of scale and would avoid unnecessary duplication of efforts or resources. Allegheny Companies represent that this can only benefit Mon Power's ratepayers. Again, based on the representations in the Applicants' filings, we grant waiver of Paragraph 2 of AE Supply's market-based rate code of conduct for the limited purpose of allowing the continued sharing of information to the extent necessary to manage the physical operations at Willow Island. These limited waivers are granted based on the conjoined nature of the facilities in order to allow their practical and efficient operation.[21]

21. As Applicants have pledged, actual dispatch decisions must be made separately by the AE Supply and Allegheny Power optimization and dispatch groups for Pleasants and Willow Island, respectively. We emphasize that any employee responsible for, or engaging in, marketing activities or decisions that would affect marketing activities, cannot be shared, nor does the waiver granted here make such conduct permissible.

22. Further, regarding AE Supply employees who will be responsible for dispatching the jointly-owned Pleasants facility, we grant waiver of Paragraph 2 of AE Supply's market-based rate code of conduct to the extent necessary to dispatch the Pleasants facility to meet Mon Power's load.[22] The Allegheny Companies are required to maintain sufficient records to enable the Commission to audit their compliance.

B. <u>Paragraph 4 of the Code of Conduct</u>

23. Applicants seek waiver of the market-based rate code of conduct to the extent necessary to continue maintaining shared pools of bulk spare parts and refurbished capital

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[20] *Id.*

[21] We note that a franchised public utility or a power sales affiliate is prohibited from using an individual or entity as a conduit for improperly disclosing market information.

[22] We note that, when marketing Pleasants' excess capacity, Paragraph 6 of AE Supply's code of conduct requires AE Supply to offer Mon Power's portion of such excess supply first. *See,* Allegheny Energy Supply Company, LLC, FERC Electric Tariff, First Revised Electric Rate Schedule FERC No. 1, Second Revised Sheet No. 6.

parts between Mon Power and AE Supply. Paragraph 4 of the AE Supply code of conduct includes the following requirement for "asymmetrical pricing:"

> All non-power goods and all non-power services provided by any Regulated Affiliate to AE Supply shall be priced at the higher of cost or market price and all non-power goods and all non-power services provided by AE Supply to any Regulated Affiliate shall not be priced higher than market price.

The Allegheny Companies state that because bulk spare parts are billed to the respective plants at weighted average cost and the capital parts are billed at book value for all plants, continuation of these pools may not be consistent with Paragraph 4's requirements.

24. Applicants explain that the service company for Allegheny Energy purchases bulk parts on behalf of the Allegheny Companies. These parts are owned and held in inventory in store rooms at each plant, and are available to all plants at weighted average cost. Similarly, spare capital parts are held in inventory at each plant, and are made available to all plants. Capital parts that need to be replaced are repaired, salvaged, or reclaimed, retaining their original book value, while refurbishment costs are expensed by the company using them. As the capital parts are made available to a plant, they are charged out at book value. The Allegheny Companies maintain that both the bulk and capital spare parts are reflected in inventory on each company's books based on the percentage ownership of each plant. They contend that thus there is no potential for cross-subsidization and harm to ratepayers. The Allegheny Companies state that in the case of bulk parts, significant and frequent fluctuations in market price generally do not occur. They add that while there may be some lag, the weighted average cost will generally be roughly equivalent to current market price. Because the AE Supply generation fleet is much larger than the Mon Power fleet, Applicants reason that Mon Power's participation in the bulk spare parts pool gives its ratepayers the benefits of economies of scale that would not exist if Mon Power were forced to buy parts itself. With respect to the pool of spare capital parts, the Allegheny Companies maintain that benefits to Mon Power's ratepayers are at least as great. Participation in the pool gives Mon Power and its ratepayers the benefits of greater economies of scale, allowing Mon Power to keep fewer large capital parts in its own inventory. They add that there is not really a market price for spare refurbished capital parts. Applicants conclude that continuation of these shared pools creates no real risk of cross-subsidization, improper transfer of benefits, or harm to ratepayers.

25. With respect to the sharing of parts, we are persuaded by the Allegheny Companies' statement that Mon Power's participation in the shared parts pool "gives its

ratepayers the benefits of economies of scale that would not exist if Mon Power were forced to create a smaller parts pool based on its smaller operations."[23] We find that the parts sharing programs will not harm captive customers. We therefore grant a limited waiver of paragraph 4 of the AE Supply market-based rate code of conduct regarding asymmetrical pricing to the extent that maintaining the shared pools of bulk spare parts and refurbished capital parts does not harm Mon Power's captive customers. The Allegheny Companies must maintain sufficient records to enable the Commission to audit their compliance.

The Commission orders:

(A) The Allegheny Companies' request for waiver of certain provisions in the AE Supply market-based rate code of conduct is hereby granted to the extent necessary, with conditions, as discussed in the body of this order, effective January 1, 2007.

(B) The Allegheny Companies are required to maintain records to enable the Commission to audit its compliance, as discussed in the body of this order.

By the Commission.

(S E A L)

Philis J. Posey,
Acting Secretary.

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[23] Allegheny Companies' October 31, 2006 Filing at 9.