

131 FERC ¶ 61,143
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

Pinnacle West Capital Corporation

Docket No. TX02-1-002

ORDER ACCEPTING IN PART, AND REJECTING IN PART,
PROPOSED FORMULA RATE

(Issued May 17, 2010)

1. On July 15, 2008, Electrical District No. 3 of the County of Pinal, State of Arizona (ED3) submitted an application, pursuant to sections 211 and 212 of the Federal Power Act (FPA),¹ to change the rate contained in its transmission service agreement with Arizona Public Service Company (APS) from a stated rate to a formula rate. In this order, the Commission accepts, subject to modification, ED3's proposed formula rate. We find that the proposed ED3 formula rate, as modified by this order, strikes an equitable balance between ED3's need to recover the costs of providing transmission service to APS, on one hand, and APS's actual use of the ED3 system, on the other.

I. Background

2. ED3 states that it is an electrical district organized and existing under the laws of the State of Arizona and engaged in providing retail electrical service as authorized by law within Pinal County, Arizona. Prior to October 8, 2001, ED3 leased its electric transmission and distribution system to APS. The Commission determined that, upon expiration of the lease, control of ED3's system returned to ED3.² At that time, APS became a transmission customer of ED3.

¹ 16 U.S.C. §§ 824j, 824k (2006).

² See *Arizona Pub. Serv. Co.*, 98 FERC ¶ 61,172 (2002) (APS).

3. Subsequent to expiration of the lease, APS³ filed an application with the Commission requesting an order under sections 211 and 212 of the FPA directing ED3 to provide transmission service of the same character and nature as the service that APS previously received under the lease. In January 2002, the Commission issued a Proposed Order directing ED3 to provide the requested transmission service and providing the parties 45 days in which to negotiate the rates, terms, and conditions for carrying out the Proposed Order.⁴ After negotiation, ED3 filed a proposed Transmission Service Agreement with the Commission. On August 2, 2002, the Commission issued a Final Order directing ED3 to provide transmission service to APS at the rates, terms, and conditions provided for in the Transmission Service Agreement.⁵

A. Original Filing

4. In its July 15, 2008 filing, ED3 requests a change in the rate for the transmission service it provides to APS from a stated rate to a formula rate.⁶ In support, ED3 asserts that the stated rate of 15 mills per kWh no longer recovers ED3's cost of service. ED3 asserts that the Transmission Service Agreement provides for changes in rate and avers that all preconditions to a change in the rate established by the Transmission Service Agreement have been fulfilled.⁷

5. ED3 proposes to incorporate both the transmission and distribution facilities of ED3 in the system average formula rate. ED3 proposes to use actual calendar year audited cost and plant-in-service data to develop its system-wide annual revenue requirement. ED3 states that the formula produces a net annual transmission revenue requirement that is the sum of the return on rate base, operation and maintenance expense, depreciation expense, and revenue credits. ED3 notes that its proposed formula is modeled on the formula used by APS.⁸ However, ED3 explains that its proposed

³ APS filed the application through its parent corporation, Pinnacle West Capital Corporation.

⁴ *Pinnacle West Capital Corp.*, 98 FERC ¶ 61,039, at 61,115 (2002).

⁵ *Pinnacle West Capital Corp.*, 100 FERC ¶ 61,146 (2002).

⁶ ED3 July 15, 2008 Application in Docket No. TX02-1-002 (ED3 Filing).

⁷ *Id.* at 3-4.

⁸ The APS formula was approved by the Commission in *Arizona Pub. Serv. Corp.* 124 FERC ¶ 61,088 (2008).

formula includes two significant modifications to account for ED3's status as a non-public utility.⁹

6. First, regarding the return component of its proposed formula, ED3 states that, as a political subdivision, it does not have stockholders and no literal "equity" on which to seek a return. Therefore, ED3 proposes a cost of capital developed utilizing ED3's actual cost of debt for each historical period, grossed-up by a margin requirement of 25 basis points.¹⁰ ED3 does not propose to incorporate a return on equity component in its cost of capital, but notes that the bond covenants provided by the lending institutions require ED3 to maintain a TIER level that ensures that rate levels will collect sufficient revenues to cover annual operating expenses.¹¹

7. Second, ED3 proposes to incorporate 100 percent of construction work in progress (CWIP) into the development of rate base. In support, ED3 argues: (1) 100 percent of CWIP is necessary to fund ED3's infrastructure program at the pace required by its consumer-owners; (2) ED3 includes 100 percent of CWIP in rate base for its own customers; and (3) 100 percent CWIP promotes the efficient use of the transmission system because it provides APS with the appropriate price signal for APS to invest in its own transmission facilities. ED3 also points out that consumer-owned utilities are not subject to the same conflicts between stockholder and customer interests that exist for public utilities, and which led to the implementation of the Commission's 50 percent CWIP limitation. Therefore, ED3 contends that the Commission's rationale for limiting CWIP in rate base to 50 percent does not apply with the same force to consumer-owned utilities as to public utilities, and its proposal is appropriate.¹²

8. ED3 further proposes that the rate developed through the formula will be applicable to service from June 1 through May 31 of the subsequent year (Rate Year). ED3 states that it will calculate the revenue requirement for each upcoming Rate Year and make the results available to all customers receiving transmission service by no later than May 15 of that year. ED3's formula rate proposal also includes protocols regarding the timeframes for disputes to the formula inputs and the process by which those disputes will be handled. ED3 states that, to the extent that the revenue requirement resulting

⁹ ED3 Filing at 6.

¹⁰ The margin requirement is known as a times interest earned ratio (TIER).

¹¹ Exhibit No. ED3-1 (Testimony of Jeffrey Woner) at 17.

¹² ED3 Filing at 8, *citing* Order No. 298, FERC Stats. & Regs. ¶ 30,455 at 30,494-30,497 (1983).

from its proposed formula is either over-collected or under-collected due to variations between forecast and actual conditions, the difference will be added to or subtracted from the following year's revenue requirement in an annual true-up.¹³

9. ED3 requests an effective date of July 16, 2008 (i.e., one day after the date ED3 submitted its application) for the implementation of the proposed formula. ED3 requests waiver of the Commission's regulations to the extent necessary to allow ED3's proposed formula rate to go into effect on that date. ED3 notes that it voluntarily commits to the refund with interest of any amounts collected from APS that the Commission determines to exceed rates that are just and reasonable.¹⁴

10. Notice of the proposed rate change was published in the *Federal Register*, 73 Fed. Reg. 44,248 (2008) with motions to intervene, comments, and protests due on or before August 5, 2008.

11. On August 5, 2008, APS filed a protest.¹⁵ APS argues that a system average formula transmission rate is not appropriate for a transmission service agreement involving mostly distribution service over distribution-level facilities. APS claims that the APS load, and the corresponding need for additional ED3 facilities to continue serving the APS load, is not growing. In fact, APS contends that the APS load is likely to decrease. Therefore, APS asserts that, rather than using a system average formula, it may be more appropriate for ED3 to identify the specific facilities used to serve APS load and directly assign a proportion of the cost of those facilities to APS.¹⁶

¹³ *Id.* at 6.

¹⁴ *Id.* at 10.

¹⁵ We note that, although APS styled its submission as a motion to intervene and protest, it was not necessary for APS to file a motion to intervene to be a party to this proceeding. When an entity will be directly affected by a Commission order in a section 211 proceeding, the Commission deems that entity to be a party to the proceeding. *See Duquesne Light Co.*, 71 FERC ¶ 61,156, at 61,514, n.6 (1995); *Minnesota Municipal Power Agency v. Southern Minnesota Municipal Power Agency*, 66 FERC ¶ 61,223, at 61,508, n.9 (1994). Moreover, because APS was a party to the earlier proceedings in this docket, it is automatically a party to any subsequent proceedings in any subsequent subdockets.

¹⁶ APS Protest at 3-4.

12. APS also contends that ED3's requested return is not adequately supported. APS states that ED3 has not sufficiently demonstrated that the 1.25 TIER is appropriate for service to APS. Moreover, APS contends that ED3's proposed formula rate contains no mechanism to adjust the return component if the ED3 coverage ratio is lowered.¹⁷

13. In addition, APS objects to ED3's request to recover 100 percent of CWIP in rate base. APS contends that ED3 has failed to meet the Commission's basic requirements for supporting this request. Moreover, APS argues that ED3 has failed to distinguish between transmission and distribution facilities in its application. APS claims that the significant portion of ED3's distribution construction is necessary to serve solely ED3's load. Additionally, APS argues that 100 percent CWIP recovery of distribution facilities from APS may not be appropriate. Finally, APS asserts that ED3's proposed CWIP charges are for facilities that "may become used and useful at some point in the future, when APS's loads in the ED3 area are significantly reduced or absent entirely."¹⁸ APS concludes that it is not appropriate to shift those future costs to APS's current loads.¹⁹

14. APS also opposes ED3's requested effective date. APS points out that the effective date requested by ED3 is one day after the date of its application to the Commission. APS acknowledges that the Transmission Service Agreement permits a rate change upon "application to FERC with a *proposed* effective date after the date of application."²⁰ However, APS contends that this provision does not give ED3 the right to a one-day notice for imposing a rate increase. APS also observes that, although the Transmission Service Agreement gives ED3 the right to propose an effective date, it does not require the Commission to grant the requested effective date. APS adds that ED3 agreed in a February 2008 power sale agreement with APS that any rate increase proposed for the Transmission Service Agreement would not take effect until at least 30 days after the date of the filing, with the proposed rate increase subject to refund.²¹

15. On August 20, 2008, ED3 filed a response, stating that APS is not entitled to a direct assignment rate, and arguing that Commission policy favors the roll-in of the costs

¹⁷ *Id.* at 4.

¹⁸ *Id.* at 5.

¹⁹ *Id.*

²⁰ APS Protest at 4 (quoting section 7.1 of the Transmission Service Agreement).

²¹ *Id.* at 4-5 (referencing the Power Sale Agreement, included as Attachment 1 to the APS Protest).

of transmission facilities where “any degree of integration can be shown.”²² ED3 contends that in order to justify a direct assignment rate, APS has the burden of showing that the facilities over which it is served satisfy each of the five factors of non-integration set forth in *Mansfield Municipal Electric Department*.²³ ED3 maintains that APS has not made the required showing. Specifically, according to ED3, APS’s arguments fail because ED3 uses the same facilities to serve its own customers as it uses to serve APS’s transmission customers, thereby indicating system integration sufficient to preclude direct assignment. In addition, ED3 argues that APS customers benefit from the integrated ED3 system and system improvements and, therefore, should pay for the system.²⁴

16. Further, ED3 asserts that the cost of capital component of its proposed formula rate is reasonable and is fully consistent with the requirements of FPA section 212(a).²⁵ Similarly, ED3 argues that its proposal to include 100 percent of CWIP in rate base is appropriate, due to the benefits of system expansion to APS customers, and also necessary to comply with requirements of section 212(a) of the FPA. ED3 contends that the 50 percent limitation of CWIP in rate base is not applicable in this case due to ED3’s status as a consumer-owned utility.²⁶ Finally, ED3 argues that it should be entitled to its requested effective date of July 16, 2008 and insists that APS’s claim that the effective

²² ED3 August 20, 2008 Response in Docket No. TX02-1-002 at 3 (ED3 Answer) (citing *Northeast Texas Electric Cooperative, Inc.*, 108 FERC ¶ 61,084, at P 47-51 (2004) (*Northeast Texas Electric*)).

²³ *Mansfield Municipal Electric Dept. v. New England Power Co.*, 97 FERC ¶ 61,134 (2001) (*Mansfield*). In *Mansfield*, the Commission established a five-factor test for determining whether facilities are integrated into a utility’s transmission network. Facilities are considered to be integrated, thereby justifying rolled-in pricing, unless all five of the following factors are satisfied: (1) the facilities are radial, not looped; (2) energy flows in just one direction over the facilities at issue; (3) the applicant is able to serve only its own customers over these facilities; (4) the radial configuration prevents the applicant from providing support and added reliability to the other looped lines; and (5) an outage on any one of these facilities would not affect the power flows on the remainder of the system. Thus, a negative showing on even one of the factors is sufficient to demonstrate some degree of integration.

²⁴ ED3 Answer at 5-6.

²⁵ *Id.* at 6-8.

²⁶ *Id.* at 9-11.

date must be at least 30 days after the date of the ED3 Filing is “simply unfounded.”²⁷ ED3 contends that section 4 of the Power Sale Agreement “addresses what APS is willing to do” (pay the proposed rate starting 30 days after ED3 files a rate increase), but does not obligate ED3 to do anything.²⁸

B. Supplemental Filing

17. On March 2, 2009, the Director, Division of Tariffs and Market Development-West, acting pursuant to delegated authority, issued a letter to ED3 requesting additional information for the purpose of evaluating ED3’s proposed rate change. More specifically, ED3 was asked to provide: (1) evidence supporting ED-3’s proposed 1.25 TIER; (2) the 13 monthly balances for each of the rate base items utilized in the proposed formula; (3) support for the proposed inclusion of 100 percent of CWIP; (4) ED-3’s total peak system capacity, in MW, for each month of the 2007 test period; and (5) an annual report or similar publicly-available audited financial records.

18. On March 27, 2009, ED3 filed supplemental information. Regarding ED3’s proposal to implement a system average formula rate, ED3 states that there is no discrete and identifiable set of facilities that is used to serve APS loads. Thus, according to ED3, direct assignment of the costs of any particular facilities to APS is neither feasible nor appropriate.²⁹

19. With respect to the return component of the proposed formula, ED3 provides a copy of the credit agreement governing ED3’s outstanding debt to verify its claimed 1.25 TIER requirement.³⁰ In support of its request to include 100 percent of CWIP, ED3 generally argues that, due to its non-jurisdictional status, section 35.25 of the Commission’s regulations,³¹ which normally allows only 50 percent of CWIP, does not apply to ED3. Additionally, ED3 argues that, even if the CWIP regulation applies, inclusion of 100 percent of CWIP is necessary to satisfy the requirements of section 212(a) of the FPA. ED3 reiterates that, because the rate it charges its own retail customers includes 100 percent of CWIP in rate base, excluding 100 percent of CWIP from the rates charged to APS would be unduly discriminatory. ED3 further contends

²⁷ *Id.* at 8-9 (referencing section 7.1 of the Transmission Service Agreement).

²⁸ *Id.* at 9.

²⁹ *See* ED3 Supplemental Filing at Exhibit ED3-6 at 4.

³⁰ *Id.* at Exhibit ED3-7.

³¹ 18 C.F.R. § 35.25 (2009) (CWIP regulation).

that the 100 percent of CWIP component of its proposed formula rate is necessary to comply with the section 212(a) requirements by: (1) permitting recovery by ED3 of all the costs incurred in connection with the transmission services provided; and (2) ensuring that the costs incurred in providing the service are properly allocated to and recovered from APS, rather than from ED3's regular customer base.³²

20. Notice of the ED3 Supplemental Filing was published in the *Federal Register*, 74 Fed. Reg. 17,474 (2009), with interventions and protests due on or before April 17, 2009. APS submitted a timely response to the ED3 Supplemental Filing.

21. APS states that it is generally supportive of formula transmission rates but finds that use of a formula rate for service under the Transmission Service Agreement is neither appropriate nor justified. APS asserts that ED3 has not provided adequate information to show that the system facilities included in the proposed formula rate are integrated. Specifically, APS claims that ED3's proposed formula rate inappropriately incorporates all of ED3's non-network distribution level lines. APS asserts that Commission precedent on this issue requires direct assignment of costs to distribution level facilities and prohibits the type of system-wide average cost pricing proposed by ED3.³³

22. APS also reaffirms its objection to ED3's proposal to include an imputed rate of return to the service provided under the Transmission Service Agreement. APS asserts that the use of an imputed rate of return on equity for a municipal entity with little risk under a long-term bond agreement is inappropriate.³⁴

23. In addition, APS continues to argue that ED3 has not met the Commission's requirements to include 100 percent of CWIP in rate base. Moreover, APS alleges that, since a significant amount of ED3's distribution construction is necessary to exclusively serve ED3 load, APS should not have to pay CWIP for facilities that it will not use. APS requests that the Commission either: (1) require ED3 to provide the necessary support for its request; or (2) deny ED3 recovery of 100 percent CWIP and revert to the standard 50 percent recovery for this item. APS also requests that the Commission set this matter

³² ED3 Supplemental Filing, Exhibit ED3-6 at 7-9.

³³ *Id.* at 2-3.

³⁴ APS Response at 3.

for hearing and settlement judge procedures to fully evaluate the calculation and impact of ED3's proposed formula rate.³⁵

II. Technical Conference and Related Submissions

24. On October 29, 2009, the Commission issued a Technical Conference Notice that requested ED3 to address a number of issues that would enable the Commission to determine which facilities within the ED3 transmission and distribution system are used to serve APS customers, along with supporting documentation. Specifically, the Commission stated that “[s]upport for the issues identified above [in the Notice] should include color-coded system-wide and voltage level specific one-line diagrams, power flow and other completed system studies, long-term transmission plans, load forecast studies and any additional information that will assist Commission staff.”³⁶

25. On November 9, 2009, ED3 submitted additional materials. In the Technical Conference Submittal, ED3 provides a series of diagrams and other relevant information in order to illustrate the relationship between its transmission and distribution system and APS load served under the Transmission Service Agreement. ED3 explains that, for purposes of the Transmission Service Agreement, ED3 does not delineate between transmission and distribution facilities. Rather, ED3 states that it receives the power for delivery to APS customers at a single substation (Santa Rosa 230 kV substation) and delivers the power to APS customers at “split end” 12 kV lines owned by APS or, in some cases, directly to APS retail customers.³⁷ ED3 states that the APS points of delivery are updated periodically by APS because, to date, no primary metering system has been installed to automatically manage these delivery points.³⁸ ED3 notes further that all other relevant studies and plans have already been filed in this proceeding, except for ED3's most current load forecast, which was included with the Technical Conference Submittal.³⁹

³⁵ *Id.* at 3-4.

³⁶ Technical Conference Notice at 2.

³⁷ Technical Conference Submittal at 7. For simplicity, in this order we refer to ED3's 12.47 kV facilities as 12 kV.

³⁸ *Id.* at 6.

³⁹ *Id.* at 9.

26. On November 19, 2009, Commission Staff held a technical conference for the limited purpose of obtaining additional information about the degree of integration of ED3's transmission and distribution system.

27. In its initial post-technical conference comments, ED3 asserts that it has demonstrated that its proposed formula rate satisfies the requirements of section 212 of the FPA, and that APS has established no basis for modifying ED3's proposal.⁴⁰ First, regarding the degree of system integration, ED3 contends that the 69 kV and 12 kV facilities satisfy the *Mansfield* factors for integration, making the use of a rolled-in rate appropriate. ED3 refutes the assertion by APS that distribution-level facilities must be directly assigned and reiterates its position that Commission policy favors the roll-in of costs where "any degree of integration can be shown."⁴¹ ED3 claims that at least two of the five *Mansfield* integration factors are present in its system. Specifically, ED3 states that it provides transmission service to itself over the facilities in question on the same basis as it provides service to APS. In addition, ED3 states that both its 69 kV and 12 kV systems provide reliability benefits to the system. Thus, ED3 argues that "there can be no serious contention that ED3's system is not integrated."⁴²

28. Second, ED3 argues that its proposed rate is consistent with cost causation principles despite the fact that much of the APS load is clustered in the far southwest of the ED3 system, while most of the load growth is occurring in other areas. ED3 asserts that it need only show that the benefits of system improvements are roughly commensurate with the costs to satisfy cost causation principles. ED3 claims that, because of the integrated nature of its system, APS load will enjoy reliability benefits from any improvements to the system. ED3 concludes, therefore, that the type of rate segmentation advocated by APS is unwarranted and antithetical to the basic tenets of cost causation.⁴³

29. Finally, ED3 states that the account balances for accounts 369 (services), 370 (meters), and 373 (street lighting and traffic signals) are properly included in rate base

⁴⁰ ED3 Initial Comments at 1-4.

⁴¹ *Id.* at 4-5 (citing *Northeast Texas Electric Cooperative, Inc.*, 108 FERC ¶ 61,084, at P 47-51 (2004) (*Northeast Texas Electric*); *Allegheny Power*, 108 FERC ¶ 61,151, at P 21-22 (2004) (*Allegheny*); *Entergy Gulf States, Inc.*, 99 FERC ¶ 61,095, at P 13 (2002)).

⁴² *Id.* at 8.

⁴³ *Id.* at 8-9.

because costs in all three accounts were “undoubtedly” recovered in the fixed rate charged by APS to its customers for delivery service over the ED3 system.⁴⁴ Thus, according to ED3, the fact that the nature of the service has not changed fully justifies the inclusion of these costs in the proposed formula rate. However, ED3 acknowledges that the rate impact from removing these items from the formula rate is negligible.⁴⁵

30. In its initial post-technical conference comments, APS continues to argue that a system average rate is not appropriate for the service provided under the Transmission Service Agreement. APS urges the Commission to reject the formula rate proposed by ED3 and to establish transmission rates based only on facilities comprising the integrated transmission grid, along with a direct assignment charge to allocate the costs of the distribution level facilities actually used by ED3 to serve APS load. APS refutes ED3’s claim that the prior fixed rate under the Transmission Service Agreement was based on average cost pricing, as the fixed rate was the result of a “black box” settlement between APS and ED3. Thus, APS contends that, in order to switch to a system average rate, ED3 must satisfy its burden to demonstrate that each of its facilities is integrated with the rest of its system. APS contends that ED3 has not satisfied this burden.⁴⁶

31. APS asserts that system average pricing is based on the assumption that all customers receive the benefits inherent in an integrated system. APS contends that this is not the case here. Rather, APS argues that certain facilities provide no benefit to APS and should be eliminated from rate base. In particular, APS objects to ED3’s proposal to include street light signals, installations on specific customer premises, and facilities associated with the Rancho El Dorado subdivision, a subdivision which APS claims is separate and distinct from virtually all APS loads served by ED3. APS expresses concern that, in general, the majority of the improvements to the ED3 system have no relation to facilities needed to serve APS load.⁴⁷

32. APS asserts that Commission policy permits the roll-in of sub-transmission facilities and transmission facilities into a single rate only when the sub-transmission facilities have been shown to perform a transmission function, rather than a distribution

⁴⁴ *Id.* at 10.

⁴⁵ *Id.* at 10-11 (noting that the impact of removing these costs is approximately \$18,772.94 from July 15, 2008 – the date ED3 implemented its formula rate – through December 31, 2009).

⁴⁶ APS Initial Comments at 1-3.

⁴⁷ *Id.* at 3-5.

function. APS argues that ED3 has not made this showing. In addition, APS claims that, even under the *Mansfield* test, ED3 has failed to show that all of its facilities are integrated. APS acknowledges that the diagrams provided by ED3 illustrate at least minimal looping of the 69 kV and 12 kV lines, but points out the absence of load flow studies for the lines. APS contends that the bulk of ED3's system is radial, with energy flowing in only one direction, indicating that the facilities are not integrated network facilities for purposes of the system average rate methodology. Further, according to APS, Commission precedent requires that the question of system integration turns, in part, on how the system is normally operated, not how it could theoretically be operated. Finally, APS claims that there is no evidence in the record showing that any of ED3's lines can be considered "back up" lines, and contends that, without power flow studies, it is impossible to determine how ED3 actually handles contingencies.⁴⁸

33. APS argues that, because ED3 has not demonstrated the necessary integration of its distribution and transmission facilities, system average cost pricing must be rejected in favor of direct assignment for the distribution level facilities.⁴⁹ Further, APS argues that Commission precedent supports the apportionment of the cost of those distribution facilities that are used to serve both a section 211 customer and the utility's own customers on the basis of the load served from such facilities.⁵⁰ APS acknowledges that it has been unable to estimate the proportion of the ED3 system that is used to provide service to APS. However, APS asserts that ED3 should be required to perform a direct assignment study and develop the charges for the distribution level facilities accordingly. APS notes that it has previously performed such studies to compute the appropriate rate for customers taking service over non-open access distribution facilities. APS suggests that, although there are no integrated demand metering facilities in place on the ED3 system, ED3 could reasonably approximate the relative uses of the system by using profiled load data in order to determine relative loads on its facilities and assign charges accordingly.⁵¹

⁴⁸ *Id.* at 5-10.

⁴⁹ *Id.* at 10 (citing *Tex-La Electric Cooperative of Texas, Inc.*, 69 FERC ¶ 61,269 (1994) (rejecting inclusion of distribution facilities in system average rate because such facilities were not operated in an integrated manner) (*Tex-La*); *Borough of Zelmanople, Pennsylvania*, 70 FERC ¶ 61,073 (1995) (finding that the appropriate basis for developing a distribution facilities rate is direct assignment because these facilities were not integrated with the rest of the system)).

⁵⁰ *Id.* at 12 (citing *Tex-La*, 69 FERC ¶ 61,269 at 62,036).

⁵¹ *Id.* at 12-15.

34. Finally, APS claims that ED3's proposal to include 100 percent CWIP in its rate base, in conjunction with ED3's proposed 21-day limitation on APS's right to challenge updates to the formula rate, could result in APS cross-subsidizing ED3's construction of distribution facilities for other customers. Thus, APS requests the Commission to require ED3 to eliminate both of these elements of its proposed formula rate.⁵²

35. In its post-technical conference reply comments, ED3 asserts that APS is attempting to place an undue burden on ED3 to demonstrate that all of the facilities that ED3 has proposed to include in its formula rate are integrated network facilities. ED3 argues that the Commission has previously treated both the transmission and distribution components of ED3's system as one system. Therefore, ED3 argues that the Commission has already determined that ED3 uses all of its transmission and distribution facilities to serve APS load under the Transmission Service Agreement, making further demonstration of its system configuration unwarranted.⁵³

36. ED3 also refutes APS's characterization of the Commission's policy regarding rates for distribution facilities. ED3 asserts that APS's reliance on *Tex-La* and *Borough of Zeligople* for the proposition that the Commission requires the direct assignment of the cost of distribution facilities is misplaced because the findings in both of those cases were too fact-specific to lead to a general rule. ED3 further rejects APS's claim that ED3 has not demonstrated system integration under the *Mansfield* factors, essentially reiterating its arguments from its Initial Comments.⁵⁴

37. ED3 argues specifically that the inclusion of facilities associated with the Rancho El Dorado subdivision in rate base is appropriate because APS has two transmission loads that are served through the Rancho El Dorado underground distribution system. ED3 claims that the combined load of these two customers is significant and belies APS's argument that the Rancho El Dorado facilities are separate and distinct from the rest of the ED3 system.⁵⁵

38. In addition, ED3 contends that APS's request that the Commission require ED3 to perform direct assignment studies is without merit. First, ED3 maintains that it has demonstrated the fully integrated nature of its system, making rolled-in pricing

⁵² *Id.* at 16.

⁵³ ED3 January Comments at 2-3.

⁵⁴ *Id.* at 3-6.

⁵⁵ *Id.* at 7-8.

appropriate. Next, ED3 claims that APS's descriptions of the locations of its loads and the areas of system growth are factually inaccurate. Moreover, ED3 submits that Commission policy does not require a rate to be "sliced as finely" as APS requests.⁵⁶ ED3 also argues that requiring a direct assignment study would improperly alter ED3's evidentiary burden in this case, noting that the Commission's review of section 212 rate changes should not extend to a determination of whether a proposed rate is more or less reasonable than alternative rate designs.⁵⁷ Finally, ED3 contends that the direct assignment arrangement cited by APS is factually distinguishable from this case, and that it is not relevant to the question of whether ED3's proposed system average rate is just and reasonable.⁵⁸

39. In its reply comments, APS maintains that ED3 has still failed to demonstrate that all of ED3's distribution facilities act as an integrated whole. Moreover, APS argues that the precedent cited by ED3, including the *Mansfield* factors, is not on point because those cases focus solely on whether a utility's transmission facilities are integrated and do not consider the question of whether the roll-in of distribution facilities is permitted. Thus, APS states that it "does not oppose the payment of a just and reasonable average system rate for service over ED-3's transmission facilities,"⁵⁹ but continues to insist that "service over distribution facilities must be priced on a direct assignment basis, separately from the rates for transmission service."⁶⁰ Accordingly, APS asserts that ED3 should be required to perform a direct assignment study to develop a proper direct assignment charge.⁶¹

III. Discussion

A. Procedural Matters

40. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2009), prohibits an answer to a protest unless otherwise ordered by the

⁵⁶ *Id.* at 9.

⁵⁷ *Id.* at 9 (citing *ISO New England Inc.*, 114 FERC ¶ 61,315, at P 33, n.35 (2006)).

⁵⁸ *Id.* at 9-10.

⁵⁹ APS January Comments at 2.

⁶⁰ *Id.*

⁶¹ *Id.*

decisional authority. We will accept ED3's answer because it has provided information that assisted us in our decision-making process.

B. Rolled-in Treatment of Transmission and Distribution Facilities

41. The Commission will accept ED3's proposed formula rate, subject to modification, as discussed below. We find that the information provided by ED3 demonstrates that its 12 kV (and lower voltage) distribution facilities are not appropriate for rolled-in treatment. Despite repeated requests for additional information and multiple opportunities to bolster its case, ED3 has not provided evidence sufficient to support a finding that every 12 kV (and lower voltage) facility is appropriate for rolled-in treatment in the rate.

42. Under Commission precedent regarding the allocation of the cost of transmission facilities among customers, when facilities are integrated and thus provide system-wide benefits, facilities' costs are generally rolled-in and charged to all customers served.⁶² The Commission has also allowed the roll-in of sub-transmission facilities with high voltage facilities "when the system is an integrated one and the low voltage facilities provide, or have the capacity to provide, a benefit to the system as a whole."⁶³ However, when facilities are not integrated and thus do not provide system-wide benefits, direct assignment typically is used to allocate costs to those customers who use the facilities.⁶⁴

43. As the applicant requesting a change from a stated rate to a formula rate that rolls in the costs of both transmission and distribution facilities, the burden rests on ED3 to demonstrate that its proposed formula rate is just and reasonable and otherwise satisfies the requirements of section 212 the FPA.⁶⁵ To justify its proposal to roll-in the cost of all the proposed facilities, ED3 must demonstrate that all of its facilities function as a single, integrated transmission system that is used to serve APS customers. We find that ED3 has met this burden only with respect to the 69 kV and higher voltage facilities. ED3 has

⁶² *Allegheny Power*, 122 FERC ¶ 61,160, at P 23 (2008) (Allegheny Remand Order).

⁶³ *Utah Power & Light Co.*, 24 FERC ¶ 63,108, at 65,176 (1983) (*Utah Power*); *see also Niagara Mohawk Corp.*, 42 FERC ¶ 61,143, at 61,532 (1988) (explaining that the roll-in of sub-transmission facilities was required because the lines served a transmission function and were integrated with higher voltages) (*Niagara Mohawk*).

⁶⁴ Allegheny Remand Order, 122 FERC ¶ 61,160 at P 23.

⁶⁵ 16 U.S.C. § 824k(a) (2006).

persuaded us that, given the configuration of the ED3 transmission system, the 69 kV and higher voltage facilities serve a system-wide transmission function. Therefore, we find that ED3 may include the costs associated with these facilities in its formula rate.

44. In contrast, we find that ED3 has not met its burden with respect to its 12 kV and lower voltage facilities. We find as a preliminary matter that the *Mansfield* factors are not dispositive as to the question of integration here due to the unique factual circumstances presented in this case. To begin with, the Commission has historically defined a transmission network as a “cohesive network moving energy in bulk.”⁶⁶ The *Mansfield* factors, which have been used by the Commission to determine whether specific facilities are part of an integrated transmission network, arose in a case concerning the integrity of a large bulk power system. In *Mansfield*, what was at issue were 115 kV lines that carried power from the New England Power Company’s pool transmission facilities to two municipal electric departments.⁶⁷ In several more recent cases, the Commission has similarly stated that *Mansfield* is the appropriate test to use to assess whether new 115 kV lines were network upgrades.⁶⁸

45. In the limited number of cases where the Commission has applied the *Mansfield* factors to lower voltage, sub-transmission facilities, the factors were applied to specific facilities, not to an entire distribution system. In *Allegheny*, for example, the Commission applied the Mansfield factors to 25 kV and 46 kV facilities associated with 18 specific delivery points in three geographically isolated service zones. Although the Commission found that roll-in was suitable for most of the facilities at issue in *Allegheny*, we find that the physical characteristics of the ED3 system and the nature of the proposal distinguish the current situation from the circumstances presented in *Allegheny*. Specifically, ED3 does not limit its proposal to a discrete set of facilities or delivery points. Rather, the ED3 proposal requires the Commission to consider *en masse* the entirety of ED3’s low-voltage distribution facilities, spread throughout the ED3 transmission and distribution system, including delivery points down to the level of individual households. Given the topology of the ED3 system and our understanding of its normal use, the *Mansfield* factors are inappropriate as a test for integration. Therefore, under the specific set of facts presented in this case, the 12 kV and lower voltage

⁶⁶ *Northeast Texas Electric*, 108 FERC ¶ 61,084 at P 50; *see also Alabama Power Co.*, 8 FERC ¶ 61,083, at 61,329 (1979); *Florida Power & Light Co.*, 99 FERC ¶ 61,197, at P 12, n.9 (2002).

⁶⁷ *Mansfield*, 97 FERC ¶ 61,134 at 61,612.

⁶⁸ *See Central Maine Power Co.*, 129 FERC ¶ 61,302, at P 1, 13 (2009); *Southern California Edison Co.*, 117 FERC ¶ 61,103, at P 72-73 (2006).

facilities cannot be wedged neatly into the *Mansfield* framework. Accordingly, we find that the *Mansfield* factors alone are not sufficient to justify average cost pricing for the entire ED3 distribution system.

46. As noted above, the burden is on ED3 in this proceeding to fully support its claims of system integration. ED3 has not done so. First, we are not persuaded by ED3 that the 12 kV facilities function as part of the integrated, higher voltage transmission network. Rather, we find that ED3's own description of its system belies such a characterization. For example, in its 2007 Transmission Plan of Service Report, ED3 describes its transmission system being comprised of only the 69 kV facilities: "The ED3 transmission system is primarily comprised of a 69 kV system emanating from the Maricopa and Santa Rosa 69 kV bulk receiving station.... In 2007, ED3 had approximately 80 miles of 69 kV transmission system serving eleven (11) electrical distribution substations."⁶⁹ ED3 appears, therefore, to consider its 12 kV facilities to be distinct from its transmission system, and to draw the line between the two sets of facilities at the 69 kV level.⁷⁰

47. In addition, ED3 has not persuaded us that all of the 12 kV facilities provide a system-wide reliability benefit by supporting the higher-voltage transmission system. Indeed, ED3 has failed to provide the requested power flow studies to support its claim that the lower voltage facilities are integrated with the rest of the transmission system. Moreover, the system maps that ED3 did provide indicate that a number of 12 kV lines are radial, are not looped within the 12 kV distribution system, and do not otherwise serve identified APS load points.⁷¹ For example, based on the information provided by ED3, it appears that power flows in one direction only on these facilities, which indicates that they are not integrated. In addition, ED3 has expressly acknowledged the radial nature of certain components of its current system in its transmission plan and states that "[a]dditional activity has also been to rebuild older facilities that are being integrated from a radial system to a 'looped' system as the opportunities occur."⁷² We conclude, therefore, that these radial facilities provide no parallel capability to either the 69 kV system or the rest of the 12 kV system and are unlikely to support system-wide contingencies. As a result, we find that ED3 has not demonstrated that all of the 12 kV (and lower voltage) facilities are used, either directly or indirectly, to serve APS

⁶⁹ Exhibit ED3-9 at page 4.

⁷⁰ See, e.g., ED3 Initial Comments at 8.

⁷¹ See Exhibits ED3-21 through ED3-47.

⁷² Exhibit ED3-9 at 4.

customers. APS customers should not bear the burden of paying for distribution lines that serve only ED3 customers and provide no system-wide benefit.

48. Further, given the concentration of APS load in the far southwest of the ED3 system, in comparison to the growth and expansion occurring primarily in the northeast, we disagree with ED3's claim that its proposed formula rate satisfies the cost causation principle. In essence, ED3's argument that APS customers will benefit greatly from all system upgrades fails because ED3 has not demonstrated that its 12 kV (and lower voltage) facilities function as part of an integrated transmission network. Thus, we are not persuaded that upgrades to the low voltage facilities around the city of Maricopa and other northeastern regions of the ED3 footprint will result in improved reliability and coordination of the transmission service provided to APS. Due to the lopsided distribution between APS customers and the bulk of the ED3 expansion, we find that it would be inequitable to pass the cost of the entire ED3 distribution system through to APS customers. In reaching this conclusion, we are not requiring ED3 to allocate its costs with "exacting precision," or to "calculate benefits to the last penny," in contravention of applicable precedent.⁷³ Rather, we are ensuring that the rate charged by ED3 to APS adheres to the fundamental principle of cost causation "that costs should be recovered in the rates of those customers who utilize the facilities and thus cause the cost to be incurred."⁷⁴

49. Finally, ED3's reliance on the Commission's prior treatment of the ED3 "system" is misplaced. The language cited by ED3 regarding the Commission's supposed treatment of the ED3 transmission and distribution facilities as a single, integrated system appears in a footnote of the relevant order as a definitional convenience only.⁷⁵ The issue before the Commission in *APS* was the legal effect of the termination of the lease between APS and ED3, not the degree of integration of various components of the ED3 transmission and distribution systems; the Commission made no findings on the question of integration.

⁷³ See *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1369 (D.C. Cir. 2004) ("we have never required a ratemaking agency to allocate costs with exacting precision"); *Illinois Commerce Commission v. FERC*, 576 F.3d 470, 477 (7th Cir. 2009) ("We do not suggest that the Commission has to calculate benefits to the last penny ...").

⁷⁴ *Northern States Power Co.*, 64 FERC ¶ 61,324, at 63,379 (1993), *reh'g denied*, 74 FERC ¶ 61,106 (1996).

⁷⁵ See *APS*, 98 FERC ¶ 61,172 at 61,634 n.1.

50. Because ED3 has not satisfied its burden of showing that all of its 12 kV (and lower voltage) facilities are integrated network facilities, we will reject ED3's proposal to include the costs of these facilities in the system average rate it charges APS for transmission service. We find that rolling in the costs of these lower voltage distribution facilities would inappropriately force APS customers to subsidize the cost of facilities that benefit only other users. Based upon our review of the substation maps provided by ED3, we can conclude that only certain facilities appear to be used and useful in providing service to APS.⁷⁶ An assessment of eligible ED3 distribution facilities is included as Appendix A. The costs associated with these lower voltage facilities would be more appropriately recovered through a direct assignment charge.

51. Accordingly, we will direct ED3 to modify its proposed formula rate to include only the costs of 69 kV and higher voltage facilities, as discussed above. We will also permit ED3 to separately develop and submit a secondary distribution charge for jurisdictional distribution service, in which ED3 may recover the costs associated with those eligible 12 kV (and lower voltage) facilities specified in Appendix A, which lists those facilities that we find directly serve APS customers.⁷⁷ Such a pricing methodology should address APS's concerns about paying for facilities that provide no benefit to APS customers, while allowing ED3 the opportunity to recover the cost of providing the required transmission service to APS. We will direct ED3 to submit a compliance filing incorporating this modification (i.e., removal of the 12 kV (and lower voltage) facilities from its formula rate) along with the submission of its final formula rate, within 60 days of the date of this order.

⁷⁶ For example, a review of the ED3 maps was performed to determine: (1) whether each individual circuit was attached to an APS load point; and (2) whether there were substantial radial terminus points on each circuit. Based on this review, the Commission finds that only certain 12 kV facilities, with the exception of radial lines that do not connect to APS load, are eligible for cost recover for service to APS.

⁷⁷ To develop the secondary distribution charge, ED3 may only include the 12 kV facilities identified in Appendix A as eligible for recovery. Furthermore, ED3 must identify the plant cost, depreciation, operation and maintenance cost, depreciation expense, and return component in developing this charge. The charge must be developed using APS pro rata load on the identified facilities. In addition, ED3 must address the issue of account balances for Accounts 369 (Services), 370 (Meters), and 373 (street lighting and traffic signals) in the context of the secondary distribution charge, consistent with the facilities listed in Appendix A.

C. Cost of Capital

52. The Commission finds ED3's proposed return component of the formula to be reasonable. The Commission has previously determined that it is appropriate for a non-public utility to include a return component in the rate charged for section 211 transmission services, so long as the return is reasonable.⁷⁸ In *AES Power*, the Commission approved a 10 percent margin in a rate charged by the Tennessee Valley Authority (TVA) for section 211 transmission service provided to AES Power. Like ED3's requested margin, TVA's requested margin was based, in part, on its bond requirements. In approving the margin, the Commission explained, "TVA, like any other similar business, must provide internal funding for a portion of its expenses. The fact that the financing is funded internally rather than through the sale of common stock makes it no less of a cost."⁷⁹ In the instant submittal, ED3 likewise proposes to recover its cost of debt plus a margin, as required by its bond financiers' covenants. We find that the proposed formula allows ED3 to recover its debt service costs, as verified by the documentation provided in ED3's Supplemental Filing, while allowing ED3 to earn a margin on its debt service in order to provide adequate cash flow for maintaining its financial viability. Accordingly, we find ED3's return calculation to be reasonable.

53. The Commission also finds APS's concerns over an imputed return on equity to be unfounded. ED3 has made a showing that its proposal is just and reasonable based on the requirements of its bond covenants." In addition, although ED3 will not be able to make changes to the return component of its formula absent Commission approval, APS always retains the right to file a complaint, citing section 212 of the FPA, if it believes that the 1.25 TIER has become unjust and unreasonable in light of a change in bond coverage requirements.

D. Inclusion of CWIP

54. As discussed below, we will deny ED3's request to include 100 percent of CWIP in rate base in its proposed formula rate. We do not agree that inclusion of 100 percent of CWIP in rate base is necessary to fulfill the requirement of section 212(a). We will permit, however, inclusion of 50 percent of ED3's demonstrated CWIP in the proposed formula for facilities rated 69 kV or higher, and for those eligible 12 kV (and lower voltage) facilities described in Appendix A that are directly connected to APS customers.

⁷⁸ *AES Power, Inc.*, 74 FERC ¶ 61,220, at 61,745 (1996) (*AES Power*).

⁷⁹ *Id.*

1. CWIP in Rates Developed under Section 212(a) of the FPA

55. We reject ED3's argument that inclusion of 100 percent of CWIP is necessary to fulfill the requirement of section 212(a) of the FPA. First, we disagree that exclusion of the 100 percent of CWIP from the rates charged to APS would be unduly discriminatory because that is the rate ED3 charges its retail customers. The protection against undue discrimination prohibits utilities from treating similarly situated customers or groups of customers differently; however, price differences can be justified due to customer or product differences.⁸⁰ Unlike the service provided by ED3 to its retail customers, which is under the regulatory authority of the Arizona Corporation Commission, the section 211 transmission service provided to APS is a Commission-jurisdictional transmission service, with rates subject to this Commission's approval. The service provided to APS is a wholesale service and different than the retail service provided to ED3's retail customers, thereby justifying different treatment for APS. Moreover, as discussed above, the Commission has set forth specific requirements that must be met before we will approve the inclusion of 100 percent of CWIP and we find that ED3 has not satisfied these requirements, as explained above. The fact that ED3's non-jurisdictional rates include this component does not overcome the Commission's pre-existing standards for permitting the inclusion of 100 percent of CWIP. Second, we are not persuaded by ED3's arguments regarding the allocation and recovery of costs. ED3 has not demonstrated that all of the costs of its planned system expansion are attributable to or necessary for the service it provides to APS. Thus, we do not find that section 212(a) of the FPA requires the inclusion of 100 percent of CWIP in the formula rate charged to APS.

2. Inclusion of 100 Percent of CWIP

56. Order No. 679⁸¹ allows applicants to request recovery of 100 percent of CWIP for transmission projects. Although the Commission stated in Order No. 679 that ratemaking incentives are generally not directly available to non-jurisdictional entities, such as ED3, because they do not file their rates with the Commission,⁸² we explained in Order

⁸⁰ See, e.g., *Cities of Bethany v. FERC*, 727 F.2d 1131, 1139 (D.C. Cir. 1984) (upholding Commission order allowing utility to charge different rates pursuant to settlement agreement, negotiated in good faith, or based on differences in general characteristics such as load profile).

⁸¹ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222 (2006), *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236, *order on reh'g*, 119 FERC ¶ 61,062 (2007).

⁸² Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 354.

No. 679-A that that non-public utilities may be permitted incentive-based rate treatments under section 211(a) of the FPA.⁸³ However, because the Commission has not set forth a formal framework for evaluating requests for transmission incentives under sections 211 and 212, we will review ED3's request under the requirements of Order No. 679 to determine whether granting such an incentive achieves the policy objectives of Order No. 679, notwithstanding that ED3 did not make an explicit request for incentive treatment under Order No. 679. In doing so, we find that ED3 has not demonstrated that inclusion of 100 percent of CWIP is appropriate in this case.

57. Order No. 679 provides that a utility may request incentive rate treatment for transmission infrastructure investment that satisfies the requirements of section 219 of the FPA,⁸⁴ i.e., the applicant must demonstrate that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion.⁸⁵ In addition to satisfying the section 219 requirement, an applicant must demonstrate a nexus between the incentive sought and the investment being made. In evaluating whether an applicant has satisfied the required nexus test, the Commission will examine the total package of incentives being sought, the interrelationship between any incentives, and how any requested incentives address the risks and challenges faced by the project. The applicant bears the burden of providing sufficient explanation and support to allow the Commission to evaluate the incentives.⁸⁶

58. We find that ED3 has not demonstrated that it faces any particular risks or challenges that require incentive treatment. ED3 has not alleged that without the incentives, its financial condition will weaken. Nor has ED3 shown that including 100 percent of CWIP in the rates charged to APS is necessary to maintain adequate cash flow. Moreover, ED3 cites no regulatory risks that would justify its request. Rather, the information provided suggests that ED3's expansion projects would go forward regardless of whether 100 percent of CWIP is included in the rates charged to APS. ED3 has given the Commission no reason to find that a special incentive is necessary to encourage the continued expansion of its transmission and distribution systems. Accordingly, we find that the inclusion of 100 percent of CWIP in ED3's formula would not further the policy objectives underlying Order No. 679, and will deny ED3's request to include 100 percent of CWIP in its proposed formula rate.

⁸³ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 89.

⁸⁴ 16 U.S.C. § 824s (2006).

⁸⁵ See 18 C.F.R. § 35.35(i) (2009).

⁸⁶ *Commonwealth Edison Co.*, 119 FERC ¶ 61,238, at P 53 (2007).

3. Applicability of CWIP Regulation

59. Finally, we are not persuaded by ED3's contention that the limitation of CWIP recovery to 50 percent for non-pollution control/non-fuel conversion facilities in the CWIP regulation should not apply to ED3. The Commission has previously explained that, in the interest of developing a uniform transmission pricing policy, it will apply the same transmission pricing principles to the pricing of transmission service whether that service is provided under section 205, 206, or 211 of the FPA.⁸⁷ Accordingly, we properly evaluate this request to change the rate for section 211 transmission service using standards similar those applied in a traditional section 205 rate case. The CWIP regulation is one of the standards applied to requests to recover CWIP in section 205 rate cases.⁸⁸ Thus, given the absence of specific standards regarding CWIP in sections 211 and 212, and despite ED3's status as a non-public utility, we find that the CWIP Regulation may be applied as a general framework for evaluating ED3's request.

60. The Commission finds that ED3 has satisfied the conditions for the inclusion of 50 percent of CWIP under the CWIP regulation. First, the Commission has explained that, to support a request for the inclusion of CWIP in rate base, an applicant must provide information sufficient to enable Commission staff and intervenors to review the prudence of the construction and related costs that may be included in the rate base.⁸⁹ We find the transmission plan submitted by ED3 with its Supplemental Filing is sufficient to facilitate such a review. We note, however, that we will permit 50 percent CWIP recovery only for those facilities providing a system-wide benefit, i.e., those network transmission facilities at 69 kV or higher, or those eligible facilities that are directly connected to APS customers, as specified in Appendix A. We will further

⁸⁷ *Northern States Power Company (Minnesota) and Northern States Power Company (Wisconsin)*, 74 FERC ¶ 61,106, at 61,345 (1996) (quoting *Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act*, FERC Stats. & Regs. ¶ 31,005, at 31,140-41 (1994), *clarified*, 71 FERC ¶ 61,195 (1995)).

⁸⁸ As discussed *supra*, ED3 has failed to make the demonstration necessary to satisfy the requirements of Order No. 679, the applicable standard for evaluating requests for the inclusion of 100 percent of CWIP.

⁸⁹ *Boston Edison Company*, 109 FERC ¶ 61,300, at P 33 (2004) (*Boston Edison*).

require ED3 to make available to APS, at the time of the annual true-up, an update of the facilities and associated CWIP that are related to the service for APS.⁹⁰

61. In addition, an applicant filing for 50 percent CWIP recovery must generally demonstrate that it has discontinued Allowance for Funds Used During Construction (AFUDC) on the date that it proposes to include CWIP in rate base, must adopt certain accounting procedures, and must address certain anticompetitive consequences of its CWIP proposal. However, as a municipal utility, ED3 does not use AFUDC as an accounting method. Accordingly, we find that this requirement is not applicable to ED3.

62. Finally, the CWIP regulation requires the utility to develop forward looking allocators for CWIP expenses. The applicant must provide supporting documentation in sufficient detail to permit examination and verification by the parties.⁹¹ We agree with ED3 that forward-looking allocators are not necessary in this case, because ED3's proposed formula allocates on the basis of actual wholesale customer usage.⁹² Further, as discussed below, ED3's formula rate is subject to a true-up mechanism that would apply over-collections or under-collections of revenue from the current year to the following year's revenue requirement. We will direct ED3 to incorporate the CWIP modifications, as discussed above, when it submits its compliance filing setting forth the final rate methodology within 60 days of the date of this order. In the compliance filing, ED3 must delineate between CWIP associated with the rolled-in pricing and CWIP that will be included in the secondary distribution charge.

4. True-Up Mechanism

63. Although ED3 states that its formula includes a true-up mechanism, our review of ED3's proposal indicates that neither the proposed formula nor the formula rate implementation protocols⁹³ include a mechanism or methodology for: (1) determining

⁹⁰ This requirement is consistent with precedent where the Commission has required annual filings to ensure that CWIP standards are met. *See, e.g., Maine Yankee Atomic Power Company*, 66 FERC ¶ 61,375 (1994), *order on reh'g*, 68 FERC ¶ 61,190 (1994).

⁹¹ *Boston Edison*, 109 FERC ¶ 61,300 at P 33.

⁹² *See id.* P 37-38 (finding that the requirement on forward-looking allocators did not apply because the utility used an allocation method based on actual wholesale customer usage and made all return revenues subject to an annual true up).

⁹³ ED3 Filing at Exhibit ED3-3.

the level of the over-collection or under-collection; or (2) implementing an over-collection or under-collection of the revenue requirement into the formula. As a result, we will require ED3 to amend its formula rate to include a true-up mechanism. We will direct ED3 to submit a compliance filing incorporating this modification along with the submission of its final formula rate, within 60 days of the date of this order.

5. Other Issues

a. Effective Date

64. We will deny ED3's request for an effective date of July 16, 2008 for the formula rate. We find, pursuant to the Power Sales Agreement between ED3 and APS, that the effective date for ED3's proposed rate change may be no earlier than 30 days following ED3's application with the Commission. While the Transmission Service Agreement permits ED3 to request an effective date for a rate change "after the date of the application,"⁹⁴ as APS observes, it does not require the Commission to grant ED3's requested effective date.⁹⁵ In the Power Sale Agreement, ED3 and APS agreed that APS would be "willing to pay the proposed rate [increase] starting thirty (30) days after ED-3 has made such a filing with such rates being subject to refund based on the final FERC Order."⁹⁶ APS did not protest an effective date, consistent with the Power Sale Agreement, of 30 days after filing, and ED3 filed its application in the instant proceeding on July 15, 2008. Accordingly, we find that the effective date for the formula rate, as modified by this order, as well as the secondary distribution charge, is August 13, 2008.

b. "Repose" Provision

65. We will deny APS's request to eliminate the 21-day limit on formal protests to the ED3 annual update to the formula rate. The 21-day limitation applies only if parties are unable to resolve disputes through the procedures provided during the review period.⁹⁷

⁹⁴ Transmission Service Agreement, section 7.1.

⁹⁵ APS Protest at 4. Indeed, the Commission generally requires 60 days' prior notice before a change in rates may become effective. 16 U.S.C. § 824(d) (2006). However, because ED3 is not a public utility, the prior notice requirements of section 205 do not strictly apply, even though we are evaluating ED3's request using standards similar to a section 205 proceeding.

⁹⁶ Section 4 of Power Sale Agreement.

⁹⁷ ED3 Filing, Exhibit ED3-3 at 3-6.

Given the numerous opportunities to informally resolve disputes prior to filing a preliminary or formal challenge, and the fact that nothing in the proposed annual update procedures forecloses a party's right to file a complaint with the Commission, we find that the 21-day limitation on formal challenges does not unduly restrict APS's right to challenge inputs to the formula rate during the annual update process. Accordingly, we will accept ED3's proposed formula rate implementation protocols.

c. Refunds

66. In its application, ED3 committed to "the refund with interest as provided in 18 C.F.R. § 35.19a of such amounts collected from APS under ED3's proposed formula rate as may subsequently be determined by the Commission to have exceeded levels that are just and reasonable."⁹⁸ In light of the modifications to ED3's proposed formula rate required by this order, we will accept ED3's commitment to refund to APS any amounts charged in excess of the rate inputs approved in this order, plus interest, pursuant to 18 C.F.R. § 35.19a.⁹⁹ For the period from July 16, 2008 and August 12, 2008, the refund should be based on the prior stated rate of 15 mills per kWh. For the period beginning on August 13, 2008, the refund should be calculated using the final formula rate, plus the secondary distribution charge, if applicable, that are ultimately accepted by the Commission. We will further address the issue of appropriate refunds upon acceptance of ED3's final formula rate.

The Commission orders:

(A) ED3's proposed formula rate is hereby accepted, as modified, as discussed in the body of this order.

(B) ED3 is hereby directed to submit a compliance filing within 60 days of the date of this order, consistent with the modifications discussed in the body of this order.

⁹⁸ ED3 Filing at 10.

⁹⁹ 18 C.F.R. § 35.19a (2009).

(C) ED3 is hereby directed to submit annual updates regarding its CWIP usage, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Appendix A

Circuits Eligible for Direct Assignment to APS

Caywood 142 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Caywood 542 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Sexton 142 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Sexton 242 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Sexton 842 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Wingfield 142 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Wingfield 542 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Farrell 242 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Peters & Nall 113 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Peters & Nall 114 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Hidden Valley 242 Circuit – All

Hidden Valley 442 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Maricopa 1222 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Maricopa 1322 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Maricopa West 132 Circuit - Overhead conductors only; radial feeds ending in ED3 transformers not eligible.

Maricopa West 134 Circuit - Overhead conductors only; radial feeds ending in ED3 transformers not eligible.

Sonny Dunn 942 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Sonny Dunn 1142 Circuit – With the exception of radial feeds on this circuit ending in ED3 transformers.

Sonny Dunn 1542 Circuit - Overhead conductors only; radial feeds ending in ED3 transformers not eligible.

Kelly 122 Circuit - With the exception of radial feeds on this circuit ending in ED3 transformers.

Talla 132 – With the exception of radial underground feeds ending in ED3 transformers.

Circuits Not Eligible for Direct Assignment to APS

Farrell 642 Circuit - No APS load identified.

Maricopa West 133 Circuit - No APS load identified.

Maricopa West 135 Circuit - No APS load identified.

Sonny Dunn 742 Circuit - No map provided. No APS load identified.

Sonny Dunn 1742 Circuit - No map provided. No APS load identified.

Sonny Dunn 1342 Circuit - No APS load identified.

Kelly 123 Circuit - No APS load identified.

Kelly 124 Circuit - No APS load identified.

Kelly 125 Circuit - No APS load identified.

Talla 112 Circuit - No APS load identified

Talla 124 Circuit - No APS load identified

Talla 125 Circuit - No APS load identified

Talla 133 Circuit - No APS load identified