1. On July 18, 2006, the Edison Electric Institute (EEI), on behalf of 41 jurisdictional signatories\(^1\) (collectively, Applicants) to a Spare Transformer Sharing Agreement

(Agreement) filed with the Commission an application for blanket authorization under section 203 of the Federal Power Act (FPA)\(^2\) for any jurisdictional public utility party to the Agreement to engage in future transfers of transformers pursuant to the Agreement, including transfers of transformers by public utilities to their affiliates. Applicants also request that the Commission issue a declaratory order granting certain assurances with respect to the recovery in transmission rates of the costs that Applicants will incur in connection with participation in the Agreement. As discussed in greater detail below, we find that the industry’s efforts to voluntarily coordinate the sharing of spare transformers will enhance the reliability of the transmission system and security of our energy supply infrastructure in the event of an act of deliberate destruction. Accordingly, the Commission conditionally grants the Application in part.


Applicants state that Center Point Energy Houston Electric LLC, and TXU Electric Delivery Company have executed the Agreement and share in the benefits and responsibilities of the Agreement, but do not join in the Application because they are not “public utilities” under the Federal Power Act, “but instead are subject to limited [Commission] jurisdiction and do not require section 203 authorization or rate approvals from the Commission with respect to their actions under the Spare Transformer Agreement.” Application at 1, n.1.

I. **Background**

2. As part of EEI initiatives, a group of transmission owners has established the Spare Transformer Equipment Program (STEP). STEP is a “coordinated, industry-wide program [designed] to increase the electric industry’s inventory of spare transformers in order to ensure that the electric industry has sufficient capability to restore service in the event of coordinated, deliberate destruction of utility substations.” Applicants state that any electric utility that owns transformers in the United States or Canada, including an investor-owned utility, a government-owned utility or a rural electric utility, is eligible to participate in the program.

3. The Agreement is “a binding contract that was negotiated through a six-month open and collaborative process by representatives of more than 50 utilities, including EEI member companies and representatives from the American Public Power Association, the National Rural Electric Cooperative Association, the North American Electric Reliability Council, the Electric Power Research Institute, and Federal Power Marketing Administrations.” Forty-three entities have executed the Agreement so far (hereinafter referred to as Participating Utilities). Applicants state that these Participating Utilities own more than 60 percent of the jurisdictional bulk-power transmission system.

4. Applicants maintain that STEP and the Agreement can enhance the reliability of the nation’s transmission system. They state that the Agreement “is a prudent approach to making efficient use of the industry’s existing spare transformers and fairly allocating the responsibility to acquire a limited number of additional spares, while minimizing duplicative purchases of these costly assets.”

5. The Agreement provides for: (a) an overall Equipment Committee, (b) an Equipment Subcommittee for each voltage class; and (c) an Executive Committee. The Equipment Committee and Equipment Subcommittees are responsible for making various technical decisions under the Agreement. The Executive Committee is responsible for addressing appeals of decisions of the Equipment Committee and Equipment

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3 Application at 3-4.

4 Id. at 4-5.

5 Id. at Attachment A.

6 Transmittal Letter at 2.
Subcommittees, resolving disputes relating to call rights under the Agreement, and
developing an annual budget and dues assessment.\(^7\)

6. Under the Agreement, each Participating Utility is required to maintain, and if
necessary, acquire, a specific number of transformers in various voltage classes. The
Agreement requires each Participating Utility to sell its spare transformers to any other
Participating Utility in its voltage class if there is a Triggering Event.\(^8\) Each Participating
Utility is required to maintain a share of the required number of transformers in each
voltage class in which it participates. That share is based on the participant’s share of the
megavolt-amperes (MVA) of all transformers in use in that class and its share of the
transformer MVA that is needed to restore the systems of all participants.

7. As described in the Application, the number of spare transformers needed in each
of nine voltage classes will be determined by a formula measuring the number needed “to
restore the most vulnerable system to an ‘N-0’ status, in the event that its five most
critical substations in any voltage class in which it chooses to participate are inoperable.”\(^9\)
N-0 status describes a transmission system configuration where the loss of any single
element, at peak load conditions, may result in system instability. Applicants state that,
with unanimous consent, Participating Utilities may adjust the methodology that
establishes each entity’s equipment obligation.

8. According to the Agreement, the Equipment Subcommittee for each voltage class
will determine the number of spare transformers required for that class, referred to as the
“Required Obligations.” Then, from the class Required Obligations, the Subcommittee
will derive the required obligation of each Participating Utility. Applicants state that the
precise total number of transformers needed in each voltage class has not yet been
established, but that based on present projections, the current Participating Utilities
collectively will need to acquire between 21 and 31 transformers to meet their Agreement
obligations. Applicants state that the costs of transformers range from approximately
$500,000 for 200 MVA 138 kV transformers to approximately $11,000,000 for
2,000 MVA 500 kV transformers; therefore, compliance with STEP will require an
expenditure of $50 million to $75 million, spread among the program participants.

\(^7\) Agreement at Art. V (Equipment Committee) and Art. VI (Executive
Committee).

\(^8\) A Triggering Event is defined as an act of terrorism that destroys or disables one
or more substations and results in a declaration of a state of emergency by the President
of the United States. Agreement at§ 1.1 (Definitions).

\(^9\) Application at 6.
Applicants state that the number of spare transformers each Participating Utility is required to maintain will be recalculated each year to account for changes in load, changes in the transmission system, the addition of new participants, and the withdrawal of existing participants. Applicants maintain that because some utilities that join may already maintain more spare transformers than are required under the agreement, the addition of Participating Utilities will not always increase the obligation to purchase transformers, and in some cases it may reduce the group’s purchase obligation.

9. The Agreement also permits Participating Utilities to voluntarily transfer spare transformers to other utilities that have lost transformers and with whom they have formal or informal sharing or mutual assistance agreements, regardless of whether the transferee is a Participating Utility or the loss was caused by a Triggering Event. Each

10 The Agreement contemplates a broader category of transfers beyond just those prompted by a Triggering Event. The Agreement defines a “Permitted Disposition” as:

(1) the sale of a Qualified Spare Transformer [spare transformers that meet the minimum technical standards required by the Agreement] pursuant to the terms of this Agreement,

(2) the placement in service or similar disposition of a Qualified Spare Transformer not already in service by a Participating Utility for its own use in accordance with Good Utility Practice,

(3) the replacement of a Qualified Spare Transformer, due to its age, obsolescence, damage or any similar reason, in the ordinary course of business consistent with Good Utility Practice,

(4) the disposition of a Qualified Spare Transformer pursuant to any rule, regulation or order issued by any governmental authority requiring such dispositions that is applicable to such Qualified Spare Transformer and/or the Participating Utility that Committed it hereunder,

(5) the disposition of a Qualified Spare Transformer to another utility that has suffered a casualty or loss of one of its transformers pursuant to any voluntary sharing arrangement or similar arrangement or program, including any informal arrangements, in which the Participating Utility that Committed such Qualified Spare Transformer is participating,
Participating Utility that disposes of a spare transformer through such a voluntary “Permitted Disposition” is obligated to replace the transformer as soon as practicable, but no later than 18 months after the disposition.

10. The Agreement establishes June 30, 2008 as the initial measurement date, with annual recalculations to account for changes in load or to the transmission system or the addition or withdrawal of Participating Utilities. A utility wishing to withdraw from the Agreement must provide two years’ notice to give the remaining participants time to replace any spare transformers that no longer would be available due to the withdrawal.

11. Applicants state that “[i]n order to cost-effectively improve reliability, utilities with transformers of the same voltage class sometimes agree to share the cost of acquiring and maintaining spare transformers.” The Participating Utilities have decided to extend and formalize this practice by developing a more formal joint acquisition program for spare transformers. Applicants state that the Pooled Inventory Management program (PIM), a program currently managing joint equipment acquisitions for the nuclear power industry, has agreed to extend the scope of its spare parts program to include transformers. Applicants state that “[t]hrough PIM, a utility can join with a group of other utilities to acquire a spare transformer. Each participant in the joint acquisition would pay for a portion of the acquisition costs and would pay PIM a fee for maintenance and administrative costs.” Applicants state that PIM participants can use the transformers they jointly own under the PIM program to meet their obligations under the Agreement.

12. As discussed in greater detail below, Applicants seek blanket authorization under section 203 to engage in certain future transfers of jurisdictional facilities under the Agreement and a declaratory order concerning the rate treatment of costs that Applicants incur to implement the Agreement. Applicants state that this “is necessary to give the Applicants the regulatory certainty they need to begin undertaking the financial

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(6) the loss of a Qualified Spare Transformer in connection with a Triggering Event or other casualty.

Agreement at § 1.1 (Definitions).

11 Application at 8-9.

12 Id. at 9.
commitments and to seek the state and local regulatory approvals needed to implement the Agreement.”

II. Notice of Filing and Responsive Pleadings

13. Notice of Applicants’ filing was published in the Federal Register, 71 Fed. Reg. 43,145 (2006), with interventions, comments, and protests due on or before August 8, 2006. Motions to intervene were filed by: the City of Santa Clara, California and the City of Redding, California; Modesto Irrigation District; and the Northeast Utilities Companies. Exelon Corporation (Exelon) filed a timely intervention and comments. An untimely motion to intervene was filed by CenterPoint Energy Houston Electric, LLC (CenterPoint).

14. Exelon filed comments in support of the Application. Exelon states that “[t]he advance approval of transfers, cost recovery assurances, clarification and other relief requested in the Filing are important to provide regulatory certainty to utilities with respect to the implementation of the program and Agreement.” Exelon argues that “[a] Declaratory Order providing the cost recovery assurances and other relief requested in the Filing will provide the requested certainty and enable the program and Agreement to build broad support across the industry.”

III. Commission Determinations

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission’s Rules of Practice and Procedure, 18 C.F.R.§385.214 (2006), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will grant the motion for late intervention of CenterPoint, given the early stage of this proceeding and the absence of any undue delay, prejudice, or burden to the parties.

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13 Id. at 16.


15 Exelon Comments at 3.
B. Discussion

16. We applaud the industry’s efforts to voluntarily coordinate the sharing of spare transformers in the event of an act of deliberate destruction, and appreciate the thoughtful approach in the Agreement. The integrity of the transmission system is an issue of critical importance; we agree with Applicants that STEP and the Agreement can enhance the reliability of the transmission system. While we find this program to be a good first step, we think that it is vitally important for EEI and Participating Utilities to continue working to improve the program, including the method of calculating spare transformer requirements. We also encourage other entities owning high-voltage transformers to participate in STEP so that the benefits may be spread to more of the bulk power system. Accordingly, as discussed in greater detail below, the Commission conditionally grants the Application in part.

17. The Agreement only requires a Participating Utility to transfer transformers upon receipt of a call notice from another Participating Utility who suffers a Triggering Event.\(^\text{16}\) However, it is not clear if the Applicants are requesting to have the Commission extend its authorizations and approvals to other transfers permitted by the Agreement, i.e., all categories of “Permitted Dispositions.”\(^\text{17}\) The authorizations contained in this order apply only to required transfers. If Applicants seek broader authorizations, they must file a supplemental application with justification for such authorizations. We note, however, that there are other emergency circumstances under which the quick transfer of spare transformers might be beneficial. We encourage Applicants to expand the emergency situations under which the transfer of spare transformers will be required under the Agreement. The Commission is willing to consider whether additional blanket authorizations may be appropriate under such circumstances.

1. Section 203 Authorization

   a. Request for Blanket Section 203 Authorization for Transfers of Jurisdictional Facilities

      i. Application

18. Section 203 approval is required for public utility dispositions of jurisdictional transmission facilities of a value in excess of $10 million. Jurisdictional transmission

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\(^{16}\) See Agreement at §4.1 (Exercise of Call Right).

\(^{17}\) See supra note 10.
facilities include transformers used for transmission of electric energy in interstate commerce. Applicants state that jurisdictional Participating Utilities will not be able to quickly transfer transformers at prices that exceed the $10 million jurisdictional minimum without prior authorization under section 203. They also argue that section 203 does not apply to all transfers of transformers contemplated by the Agreement because the cost of most transformers does not exceed the $10 million jurisdictional minimum. Applicants are concerned, however, that the $10 million jurisdictional minimum may be met when a public utility disposes of a large transformer or disposes of several smaller transformers that together cost more than $10 million.

19. Applicants argue that the time required for a Participating Utility to prepare and file a section 203 application and receive authorization could significantly delay its ability to place its transmission system back in operation after a Triggering Event occurs. Applicants maintain that “preauthorization of the transfer of spare transformers will . . . ensure that a disabled utility can restore its system operation as quickly as possible.”\(^{18}\) Applicants also argue that granting advance approval of jurisdictional transfers of transformers “will provide regulatory certainty that will encourage additional utilities to join the program.”\(^{19}\)

20. Applicants commit to making informational filings to provide the information required by Part 33 of the Commission’s regulations within 30 days of closing of any jurisdictional transfer under the Agreement, and further informational filings within six months after the closing of such transactions, when the final terms of the sales have been established consistent with the terms of the Agreement.\(^{20}\)

ii. Commission Determination

21. Section 203(a) of the FPA provides that the Commission must approve a disposition of facilities if it finds that the disposition “will be consistent with the public interest.”\(^{21}\) The Commission’s analysis of whether a disposition is consistent with the public interest generally involves consideration of three factors: (1) the effect on

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\(^{18}\) Application at 11.

\(^{19}\) Id. at 12.

\(^{20}\) Id. at 12-13.

competition; (2) the effect on rates; and (3) the effect on regulation. In addition, EPAct 2005 amended section 203 to specifically require that the Commission also determine that the disposition will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest. As discussed below, we find that the proposed transactions meets these statutory standards, and therefore approve the request for blanket authorizations.

22. We condition this authorization upon public utility participants in the program filing within 30 days of closing of any transfer involving the public utility, and within six months after the closing of such transactions (when the final terms of the sales have been established), the information identified in Part 33. This reporting requirement is being imposed on each public utility participant with respect to all transfers of transformers committed to the program that involve the public utility participant, including transfers from the public utility to a non-public utility participant and vice versa. Such information is required for the Commission to ensure that public utility participation in STEP pursuant to the Agreement is consistent with the public interest.


24 This information is also necessary for the Commission’s determination that the sharing arrangement pursuant to the Agreement is prudent. See discussion infra section III.B.2.a.
(a) **Effect on Competition**

23. Applicants state that the requested authorizations will have no adverse effect on competition. They assert that the transactions have neither horizontal nor vertical competitive effects. Applicants state that the Agreement does not involve the sale of generation facilities and therefore will not increase the market share of generation facilities for any Participating Utility. Applicants also assert that because all Applicants provide transmission service pursuant to their own Open Access Transmission Tariffs (OATTs) or pursuant to RTO/ISO tariffs, the transfer of transformers will not affect transmission service. Applicants also state that transfers will simply restore the status quo by allowing the purchasers to expedite the process of placing their transmission systems back in service.²⁵

24. We find that the proposed transactions will have no adverse effect on competition. Applicants have shown that the transfers do not raise market power concerns, as the transactions do not affect generation assets. The transfers do not increase Applicants’ ability or incentive to use control over their transmission facilities to harm competition in the wholesale markets because Participating Utilities provide transmission service pursuant to open access transmission tariffs. We note further that no party in this proceeding claims that the requested authorizations will have an adverse effect on competition.

(b) **Effect on Rates**

25. Applicants state that although they seek a Commission order declaring that the costs incurred under the Agreement are prudently incurred and recoverable in rates,²⁶ the requested section 203 authorizations will not have an adverse effect on rates. The recovery of the costs associated with the Agreement will be addressed in separate rate filings under section 205 of the FPA. Applicants further argue that these expenditures are in the public interest because they enhance system reliability. Finally, Applicants assert that any rate impacts under the Agreement are “more than offset by the value of the reliability gains provided” because Participating Utilities “share the burden of acquiring and making available transformers” thus achieving greater reliability at a lower cost.²⁷

²⁵ Application at 13-14.

²⁶ See discussion infra section III.B.2.

²⁷ Application at 14.
26. As noted in the Commission’s *Merger Policy Statement*, the Commission primarily examines a transaction’s effect on rates in order to protect wholesale power and transmission service customers. Applicants have stated that the Agreement will allow Participating Utilities the benefits of acquiring spare transformers more quickly and at a lower cost than if they were to purchase the equipment without the Agreement. Thus, we are satisfied that the proposed transactions will not adversely affect rates.

(c) **Effect on Regulation**

27. Applicants state that the requested authorization will have no adverse effect on regulation because the transfer of transformers does not affect any Participating Utility’s jurisdictional status and all jurisdictional Applicants will continue to be subject to the Commission’s regulation after the proposed transactions. Applicants state that the proposed transactions also do not affect state regulatory authorities’ regulation of Applicants and their affiliates.

28. We find that the proposed transactions will not impair federal or state regulation. We note that no party has requested that the Commission address the effect of the transactions on state regulation.

(d) **Cross-subsidization**

29. Applicants state that the proposed transactions present no opportunity for affiliate abuse because the Agreement establishes that the sales price is, at the seller’s election, either the net book value of the spare transformer or its replacement cost, plus the seller’s loadout and transportation costs and tax liability attributable to the sale. Applicants state that it is reasonable for purchasers to pay the replacement cost of the transformer, if elected by the seller, because, as beneficiaries of the transaction, the purchaser’s ratepayers should bear the costs of replacing the transformer. Applicants also state that the Agreement does not place any encumbrance on utility assets because utilities are free to use their transformers themselves or to voluntarily transfer them to another utility with which they have a formal or informal sharing or mutual assistance agreement as needed, subject to the obligation to replace the transformers consistent with each Participating Utility’s Required Obligation under the Agreement. Applicants thus argue that the

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29 Application at 14-15.

30 *Id.* at 15.
transactions do not raise affiliate issues or present opportunities for cross-subsidization or pledges or encumbrance of assets for the benefit of an associate company. Moreover, Applicants state that Exhibit M\textsuperscript{31} information concerning jurisdictional transactions will be included in their post-closing informational filings.\textsuperscript{32}

\begin{quote}
\textsuperscript{31} Exhibit M requires an explanation, with appropriate evidentiary support:

(1) Of how applicants are providing assurance, based on facts and circumstances known to them or that are reasonably foreseeable, that the proposed transaction will not result in, at the time of the transaction or in the future, cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company, including:

(i) Disclosure of existing pledges and/or encumbrances of utility assets; and

(ii) A detailed showing that the transaction will not result in:

(A) Any transfer of facilities between a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, and an associate company;

(B) Any new issuance of securities by a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company;

(C) Any new pledge or encumbrance of assets of a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; or

(continued)
30. EPAct 2005 amended section 203 of the FPA to provide that the Commission is not to approve a proposed disposition of jurisdictional facilities absent the finding that the proposed transaction will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company unless the Commission determines that the cross-subsidization, pledge or encumbrance will be consistent with the public interest.33 In Order Nos. 669, 669-A, and 669-B,34 the Commission established specific filing requirements requiring applicants to demonstrate whether or not the prohibited activities will occur, which are to be in Exhibit M to the application.35 As noted above, Applicants indicate that this information will be filed after the transactions are completed.

31. The concern about cross-subsidization is principally a concern over the effect of the transaction on rates of captive customers. The concern is preventing a transfer of benefits from a traditional public utility’s cost-based customers to shareholders of the public utility holding company due to an intrasystem transaction that involves power or

(D) Any new affiliate contract between a non-utility associate company and a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review under sections 205 and 206 of the Federal Power Act; or

(2) If no such assurance can be provided, an explanation of how such cross-subsidization, pledge, or encumbrance will be consistent with the public interest.

Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, at P 144-46, amended by Order No. 669-B, FERC Stats. & Regs. ¶ 31,225, at P 49 (to be codified at 18 C.F.R§ 33.2(j)).

32 Application at 21.


34 See supra note 22.

35 See supra note 31.
energy, generation facilities, or non-power goods and services.\textsuperscript{36} Here, the proposed transactions are unlikely to provide the opportunity for cross-subsidization of a non-utility affiliate of the Participating Utilities. The Agreement establishes specific conditions under which transfers are to occur (the Triggering Event) and sets the price at which transformers are to be sold (at either net book value or replacement cost, by choice of the seller). Moreover, Participating Utilities must submit requests for recovery of costs related to the transactions in separate rate filings under section 205.\textsuperscript{37}

32. Given the unique nature of the proposed transactions, we find that Applicants have provided adequate assurance that the transactions will not result in cross-subsidization of a non-utility associate company in the same holding company as the Participating Utility or an encumbrance or pledge of utility assets. Our decision on this matter applies only to the facts in this case and in no way implies that future 203 applications may defer filing the required Exhibit M information.

**b. Additional Clarifications Sought as to Section 203 Authorization**

**i. Application**

33. As part of their petition for declaratory order, Applicants seek clarifications regarding the scope of the Commission’s jurisdiction under section 203. First, Applicants seek confirmation that transfers by jurisdictional public utilities of transformers that have not been energized do not require section 203 authorization. They argue that such transformers are not subject to the Commission’s jurisdiction because they do not provide transmission service in interstate commerce. Applicants specifically state that “[s]ince the Commission’s jurisdiction is defined by the flow of energy through electric transmission facilities, it follows that the Commission’s jurisdiction does not extend to facilities through which no electric energy flows.”\textsuperscript{38} Applicants state that because the Commission routinely approves transfers of transformers as part of larger transactions and has explicitly approved the transfer of spare transformers (noting, however, that such

\textsuperscript{36 Order No. 669, FERC Stats. & Regs. ¶ 31,200, at P 147.}

\textsuperscript{37 See discussion infra section III.B.2.}

\textsuperscript{38 Application at 33.}
orders did not address whether the spare transformers had been energized, Applicants seek this clarification from the Commission.

34. Applicants also seek confirmation that jurisdictional public utilities do not need section 203 authorization to acquire transformers from non-jurisdictional utilities under the Agreement because such transfers do not merge or consolidate the public utility’s facilities with those of the selling utility. Applicants argue that FPA section 203(a)(1)(A) does not apply to this scenario because it only applies to dispositions by public utilities. As to FPA section 203(a)(1)(B), Applicants argue that the acquisitions anticipated by the Agreement “would not consolidate or integrate the operation of transmission facilities since the transformers will be moved from the non-public utility’s system and installed in new locations on the systems of public utilities.”

ii. Commission Determination

35. As indicated above, we are conditionally granting Applicants’ request for blanket authorization for the transfer of facilities under section 203. Because we are granting the blanket authorization for all required transactions under Agreement, we need not address the specific requests for clarification on these points. Even if the transactions Applicants ask about are jurisdictional, they are pre-approved. Accordingly, we decline to rule on the points for which Applicants seek clarification.

2. Petition for Declaratory Order Regarding Rate Treatments

36. Applicants request that the Commission issue a declaratory order granting certain assurances with respect to the recovery in transmission rates of the costs that Participating Utilities will incur in connection with participation in the Agreement. The requests are discussed in greater detail below.

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40 Id. at 35.
a. **Whether the sharing arrangement under the Agreement is prudent**

i. **Application**

37. Applicants request that the Commission find that the sharing arrangement of the Participating Utilities under the Agreement and their participation in the PIM is a prudent approach to enhancing the reliability of the electric grid. Applicants argue that the program improves the recovery capability of all Participating Utilities while reducing the burden on any single utility to acquire spare transformers. Applicants also argue that the Agreement makes efficient use of the industry’s existing spare transformers and allocates fairly the responsibility to acquire a limited number of additional spares, while minimizing duplicative purchases of the costly assets. Applicants claim that the Agreement provides considerable flexibility for utilities to operate and to use assets as they would normally do during the course of business, while at the same time binding utilities to share their committed transformers if a Triggering Event should occur. Applicants argue that the Agreement and the PIM program provide substantial cost savings over alternative methods of achieving similar system restoration capability.

38. Applicants also ask the Commission to make a finding of prudence in the case where the transfer of transformers occurs between affiliates because the Agreement does not provide any opportunity for affiliate abuse. Applicants note that the Agreement imposes obligations to sell spare transformers in the case of a Triggering Event, and therefore, does not give a Participating Utility the option to refuse to sell to an affiliate. Applicants further argue that, in the absence of the Agreement, a Purchasing Utility would have to purchase a new transformer at market price, and therefore, under the

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We note that the Application is not consistent in its description of the requested authorization regarding prudence. In two locations, Applicants request a declaratory order holding that “[t]he decisions by each FERC-jurisdictional public utility to the Spare Transformer Agreement to enter into the Agreement, to purchase or sell transformers to meet its obligations under the Agreement, and to purchase or sell transformers in response to a Triggering Event, including decisions to make transfers between affiliates, all are prudent.” Application at 22, 37. At other times, however, Applicants describe their petition as a request that the Commission finds “the costs that Applicants incur in implementing the Spare Transformer Agreement and in participating in the PIM program are prudently incurred.” Id. at 25 (emphasis added). We are granting herein only Applicants’ explicit request as stated in the list of specific relief sought, that the decision to participate in the Agreement and PIM is prudent. The costs will be reviewed in a subsequent section 205 filing as discussed in P52 below.
Agreement, the purchaser will not benefit unduly from purchasing a transformer from an affiliate instead of from an unaffiliated utility.

ii. **Commission Determination**

39. We agree that the Agreement makes efficient use of both the industry’s existing spare transformers and additional spares by minimizing duplicative spare transformer replacements. We also agree that the Agreement improves Participating Utilities’ recovery capability if there is a Triggering Event, with a reduced burden on any single utility to acquire spare transformers. We applaud the efforts of Participating Utilities to use the existing PIM program and to extend its spare parts program to include transformers. Through PIM, a small utility can join with a group of other utilities to acquire a spare transformer, thus making the Agreement practical for a larger number of Participating Utilities. Without the Agreement, utilities would have to purchase substantially more transformers to achieve the same recovery capability, incurring substantially higher costs, or experience the inherent time delay associated with finding, negotiating for, ordering, transporting, and testing a replacement transformer. Furthermore, the Agreement establishes the obligation to share spare transformers with Participating Utilities if there is a Triggering Event. Accordingly, we find that the sharing arrangement in the Agreement is prudent.

40. We also agree that the transfer of transformers between affiliates when there is a Triggering Event is prudent because it makes efficient use of the industry’s existing spare transformers in order to ensure the reliability of the transmission grid. We find that these transfers will be prudent because the Agreement requires that the transfers occur after a Triggering Event and sets the price at which transformers are to be sold (at either net book value or replacement cost, by choice of the seller). In addition, as discussed above, the transactions will not result in cross-subsidization or encumbrance or pledging of utility assets.

41. Finally, if a jurisdictional Participating Utility wishes to recover the costs related to a transfer, the Commission will require it to seek recovery in a new section 205 filing. We encourage Participating Utilities to purchase energy efficient transformers for STEP.  

42 In its review of future section 205 filings, the Commission will consider incentive-based rate treatments (in addition to single-issue rate treatment, as discussed in section III.B.2.b of this order) that parties may propose in connection with the use of advanced transmission technologies that increase efficiency. Such consideration is consistent with section 219(b)(3) of the FPA, 16 U.S.C. §824s(b)(3) (2005), which

(continued)
b. **Whether the recovery of Agreement costs through single-issue ratemaking should be permitted**

i. **Application**

42. Applicants request that the costs that each jurisdictional Participating Utility incurs to comply with its obligations under the Agreement be recoverable through single-issue filings. Such costs include the initial costs to purchase transformers to meet obligations under the Agreement and the costs incurred to purchase transformers if there is a Triggering Event, including the costs of transfers between affiliates. Applicants argue that this approach is consistent with Commission policy.\(^{43}\)

ii. **Commission Determination**

43. We find that recovery of Agreement costs through single-issue ratemaking should be permitted. In a Policy Statement issued on September 14, 2001,\(^{44}\) the Commission stated that a company may propose a separate rate recovery mechanism in order to recover the expenses necessary to safeguard our energy infrastructure. The Application is designed to assist transmission systems to restore electric service if there is an act of deliberate destruction. Further, in our *Pricing Reform Order*,\(^{45}\) the Commission stated requires the Commission to “encourage deployment of transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities and improve the operation of the facilities,” and with the Commission’s implementation of that provision. *See Promoting Transmission Investment through Pricing Reform*, 71 Fed. Reg. 43,294, at 43,305, 43,326-27 (July 31, 2006), FERC Stats. & Regs. ¶ 31,222, at P 80-82, 288-92 (2006), *reh’g pending* (Pricing Reform Order).


\(^{45}\) *Pricing Reform Order*, FERC Stats. & Regs. ¶ 31,222, at P 191.
that single-issue ratemaking can provide a significant incentive for achieving infrastructure goals because it assures that the decision to construct new infrastructure is evaluated on the basis of the risks and returns of that decision. It removes from that decision the uncertainty associated with re-opening the applicant’s entire rate. Therefore, consistent with these prior Commission decisions, we find that each jurisdictional Participating Utility may seek to recover its costs through a single-issue ratemaking proceeding. An Applicant’s filing for single-issue ratemaking is only required to address cost and rate issues associated with the Agreement in a section 205 proceeding to approve those rates. Such Applicant will be required to fully develop and support any rate designed to recover those costs, including cost allocation and rate design. However, the Commission will not, in any such subsequent section 205 proceeding, revisit its decision that STEP costs qualify for single-issue ratemaking.

c. **Whether the recovery of an acquisition premium for transformers purchased in response to a Triggering Event is just and reasonable**

i. **Application**

Applicants ask the Commission to find that jurisdictional Participating Utilities may recover in their rates the costs they incur to buy transformers in response to a Triggering Event, including costs in excess of the net book value of the purchased transformers.

Applicants argue that, without the Agreement, a purchaser would have to pay the market price to acquire a new transformer, accept the long lead time associated with ordering a new transformer, and experience degraded system reliability in the meantime. Applicants assert that the Commission permits a purchaser of utility assets to recover in rates purchase costs in excess of the net book value of the assets where the purchase price provides benefits to customers.\(^{46}\) Accordingly, Applicants maintain that the Agreement enables the purchaser “to avoid the delay in replacing its damaged transformers while paying no more than the same price – the cost of a new transformer – that it would have to pay if the Agreement were not in place.”\(^{47}\) Applicants further assert that if the


\(^{47}\) *Id.* at 30.
Agreement set the purchase price at the transformer’s net book value even though the replacement cost is higher, the purchaser will receive a windfall. According to Applicants, permitting recovery of this acquisition premium appropriately allocates the costs to the utility that receives the benefits from the transfer.

46. Applicants also argue that payment for a spare transformer in excess of net book value is reasonable because the selling utility does not receive any undue benefit from the sales price. The selling utility typically must buy a new transformer to replace the one it sold to maintain its share of the inventory of spare transformers. Applicants assert that it will be a major disincentive to participation in the Agreement if the selling utility’s customers were required to incur additional costs to buy a new transformer to replace the one being sold. Applicants further argue that the selling utility’s customers should not have to do this because they do not receive any benefit from the sale.

ii. **Commission Determination**

47. We agree with Applicants that what would be most important after a Triggering Event is replacing destroyed transformers and quickly restoring the transmission system. We also agree that in this situation it is reasonable for a purchaser to pay and a seller to charge the replacement cost of the spare transformer, since this is the price that the purchaser would otherwise have had to pay and the price the seller would have to pay in the marketplace. Therefore, we find that, subject to the Commission’s review of the section 205 filing, Applicants may recover in their rates the costs they incur to purchase spare transformers in response to a Triggering Event, including costs in excess of net book value of the purchased transformers.

48. We also agree with Applicants that the selling utility’s customers should not be required to incur any additional costs to buy a new transformer to replace the one being sold. Therefore, we will require that any acquisition premium paid by the purchaser (that is, the difference between the actual sales price and net depreciated original cost) be credited against the seller’s cost of the replacement transformer. This will ensure that the selling utilities’ customers are not burdened by additional costs of a new transformer. Similarly, if, for a Permitted Disposition other than a Triggering Event, a Participating Utility sells a transformer that it has committed to meet its obligations under the Agreement, then the Participating Utility should credit against the cost of a replacement transformer the difference between the revenue received for the sale and the transformer’s net book value.
d. Whether jurisdictional public utilities that are subject to retail rate freezes should be able to defer recovery of the costs of complying with the Agreement

i. Application

49. Applicants argue that each jurisdictional Participating Utility that is under a retail rate moratorium should be permitted to use a deferred cost recovery mechanism that allows it to begin recovering the costs associated with the Agreement in jurisdictional rates at the end of the retail rate moratorium. Applicants maintain that this is consistent with the Commission’s policy.48

ii. Commission Determination

50. In the Pricing Reform Order, the Commission found that permitting public utilities under retail rate freezes to defer recovery of new transmission costs will help facilitate investment.49 The Commission also stated that deferred cost recovery mechanisms should be available to all public utilities when such initiatives reduce congestion and increase reliability, and recognized the importance of ensuring that federal and state ratemaking policies align to not only reduce regulatory lag, but facilitate transmission development. We find that Applicants have sufficiently demonstrated a nexus between the proposal for deferred cost recovery and the goals of STEP. Therefore, we find that each jurisdictional Participating Utility may seek to defer until after a retail rate moratorium the recovery of the costs of complying with the Agreement in its rates. To do so, a utility should submit a section 205 filing. We expect that in most cases, we will approve as just and reasonable deferred rate recovery of the costs of complying with the Agreement until the end of any retail rate freeze. If a state regulator believes that this conflicts with a state goal or undermines a state settlement with an applicant, the Commission will consider objections by state regulators on a case-by-case basis and will seek to avoid inconsistencies between state and federal regulation.

48 Id. at 31 (citing Promoting Transmission Investment through Pricing Reform, Notice of Proposed Rulemaking, 113 FERC ¶ 61,182, FERC Stats. & Regs. ¶ 32,593, at P 35 (2005)).

49 Pricing Reform Order, FERC Stats. & Regs. ¶ 31,222, at P 175.
e. Whether the Commission’s review of the inclusion in rates of costs incurred under the Agreement should be limited to whether public utility incurred the costs and whether the rates are properly designed to recover those costs

i. Application

51. Applicants seek a declaratory order establishing that the Commission’s review of any section 205 rate filing to recover costs associated with the Agreement will be limited to review of: (1) whether the public utility has actually incurred the costs claimed and (2) whether the filing is properly designed to recover the revenue requirement. Applicants argue that if the Commission determines now that costs incurred under the Agreement will be prudently incurred, that the recovery of the purchase cost (i.e., the acquisition premium) will be just and reasonable, and that the recovery of the costs through single-issue rate making is reasonable, then intervenors should not be permitted to raise these issues again in subsequent section 205 proceedings in which the Participating Utilities seek to recover these costs in their rates.

ii. Commission Determination

52. We have found that: (1) the decisions to participate in STEP and acquire and sell transformers as required are prudent; (2) subject to the Commission’s review of the section 205 filing, a Participating Utility may recover in its rates the cost to purchase a spare transformer from another Participating Utility at replacement cost; and (3) the costs that a Participating Utility incurs to meet its obligations under the Agreement qualify for single-issue rate treatment. We have not, however, made any predetermination regarding the costs incurred pursuant to the Agreement. Therefore, we will not limit the Commission’s review of any future section 205 filing as requested by the Applicants. In the prudence review process, it is well-settled that “the initial burden of proof as to whether a utility’s costs are excessive rests with the party making the allegation. Only when an opposing party raises ‘serious doubts’ does the burden shift to the utility to dispel those doubts.”50 Consistent with the process outlined in the Pricing Reform Order, we will not revisit the decisions already made in this proceeding and listed above.

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50 Indiana and Michigan Municipal Distributors Association and City of Auburn, Indiana v. Indiana Michigan Power Company, 62 FERC ¶ 61,189, at 62,239, order on reh’g, 65 FERC ¶ 61,087 (1993), aff’d sub nom. Indiana Municipal Power Agency v. FERC, 56 F.3d 247 (D.C. Cir. 1995); Public Service Company of Colorado, 90 FERC ¶ 61,285, at 61,960 (2000) (finding “our historical prudence standards” are that “costs are presumed prudent unless someone raises a reasonable doubt about them”); New England (continued)
3. **Whether the Commission’s Findings Should Apply To Future Signatories**

a. **Application**

53. Applicants seek to have future signatories to the Agreement granted the same blanket section 203 authorization and rate treatment as granted to the Applicants. Applicants state that any public utility that signs the Agreement in the future will provide the Commission with notice of such event and pledge to abide by the commitments made by the Applicants in this proceeding. Applicants request that the Commission hold that, upon receiving such notice, the new utility participant will be authorized under section 203 to transfer transformers pursuant to the Agreement and will be entitled to the same rate treatment as the Applicants. Applicants argue that the extension of the Commission’s order to future participants is in the public interest because it will encourage additional utilities to execute the Agreement but avoid the time and expense required to file duplicate pleadings.

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*Power Company*, Opinion No. 231, 31 FERC ¶ 61,047, at 61,084, *reh’g denied*, Opinion No. 231-A, 32 FERC ¶ 61,112 (1985), aff’d sub nom. *Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986) (“[M]anagers of a utility have broad discretion in conducting their business affairs and incurring costs necessary to provide service to their customers. In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that the management decision was wrong, our task is to review the prudence of the utility’s actions and the costs resulting therefrom based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.”); *Minnesota Power & Light Company*, Opinion No. 86, 11 FERC ¶ 61,312, at 61,645, *order on reh’g*, Opinion Nos. 86-A and 87-A, 12 FERC ¶ 61,264 (1980) (“As a matter of practice, utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent unless the Commission’s filing requirements, policy or precedent otherwise require. However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.”).
b. **Commission Determination**

54. We find that expansion of STEP to include additional participants is in the public interest. Expansion of the program will extend the reliability benefits of spare transformers to a greater portion of the bulk power system, and will do so in a cost-efficient manner. Therefore, we agree to Applicants’ request and declare that, upon receiving notice from a new participant that it has signed the Agreement and will comply with the commitments made by Applicants in this proceeding, the Commission will consider such participant authorized to transfer transformers under section 203 under the Agreement and entitled to the same rate treatment as Applicants are granted herein.

The Commission orders:

(A) Applicants’ request for blanket authorizations under section 203 is hereby conditionally granted, as discussed in the body of this order.

(B) Applicants’ petition for a declaratory order is hereby granted in part, as discussed in the body of this order.

(C) The proposed transactions are authorized upon the terms and conditions and for the purposes set forth in the Application, as discussed in the body of this order.

(D) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates, or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(E) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(F) Applicants shall make any appropriate filings under section 205 of the FPA as necessary to implement the proposed transactions.

By the Commission. Commissioner Moeller not participating.

( S E A L )

Magalie R. Salas,
Secretary.