

160 FERC ¶ 61,102  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;  
Cheryl A. LaFleur, and Robert F. Powelson.

Delmarva Power & Light Company

Docket No. ER09-1158-000

ORDER DENYING FORMAL CHALLENGE

(Issued September 20, 2017)

1. On May 16, 2016, Delmarva Power & Light Company (Delmarva) submitted its annual informational formula rate update, as required by the formula rate protocols set forth in Delmarva's formula rate filed as Attachment H-3E of the PJM Interconnection, L.L.C. (PJM) Open Access Transmission Tariff (Tariff).<sup>1</sup> On January 18, 2017, Delaware Municipal Electric Corporation, Inc. (DEMEC) submitted a formal challenge pursuant to Rule 206 of the Commission's Rules of Practice and Procedure and section 4.a of Attachment H-3E of the PJM Tariff (Formal Challenge), challenging certain inputs of Delmarva's formula rate. As discussed below, we deny the Formal Challenge.

**I. The Formula Rate and Protocols**

2. Attachments H-3D and H-3E of the PJM Tariff set forth Delmarva's formula rate template and protocols under which Delmarva recovers its annual transmission revenue requirement, and through which Delmarva establishes charges for transmission service for facilities it owns that are under PJM's functional control.

3. Delmarva's protocols detail how Delmarva's formula rate is to be updated annually and how it can be challenged. Section 2 of the formula rate protocols requires Delmarva to update its transmission rates annually by May 15 (Annual Update),<sup>2</sup> post the

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<sup>1</sup> See Docket No. ER09-1158-000, Delmarva Informational Filing of Annual Formula Rate Update, Transmittal Letter, at 1 (2016).

<sup>2</sup> Section 2.c of Delmarva's protocols specifies that, "if the date for making the Annual Update posting/filing should fall on a weekend or a holiday recognized by the FERC, then the posting/filing shall be due on the next business day."

Annual Update on the PJM website, cause notice of such posting to be provided to PJM's membership, and file the Annual Update with the Commission as an informational filing. Section 3 of the protocols states that any interested party shall have up to 150 days after the Annual Update is published to review the calculations (Review Period) and to notify Delmarva in writing of any specific challenges, including challenges related to accounting changes, to the application of the formula rate (Preliminary Challenge). Section 4 of the protocols states that if Delmarva and any interested parties have not resolved any Preliminary Challenge to the Annual Update within sixty days after the Review Period, an interested party shall have an additional thirty days to make a Formal Challenge with the Commission. Section 4.b of the formula rate protocols requires that any response by Delmarva to a Formal Challenge must be submitted to the Commission within 30 days of the filing of the Formal Challenge.

4. Preliminary and formal challenges are limited to six issues as listed in section 3.d of Delmarva's formula rate protocols: (1) whether Delmarva has properly calculated the Annual Update under review; (2) whether the costs included in the Annual Update are properly recordable and recorded, and otherwise consistent with Delmarva's accounting policies, practices and procedures consistent with the FERC Uniform System of Accounts; (3) whether Delmarva's actual costs and expenditures were reasonable and prudent (including whether such costs were incurred according to cost control methodologies); (4) whether the input data used in the Annual Update are accurate and correctly used in the formula rate; (5) whether the formula rate has been applied according to its terms, including the procedures in Delmarva's protocols; and (6) whether Delmarva's accounting changes are reasonable and consistent with the Uniform System of Accounts.

## **II. Background**

5. DEMEC is a joint action agency<sup>3</sup> formed under Delaware law consisting of the following members: Delaware Cities and Towns of Newark, Milford, New Castle, Seaford, Lewes, Smyrna, Clayton, Middletown, and Dover. In total, DEMEC members have a peak load of about 500 MW. DEMEC is a member of PJM and a transmission

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<sup>3</sup> According to DEMEC, "Joint Action Agencies are a tool that municipal distribution utilities can use to accomplish their goals of reliable, safe and low-cost electric supply and services to their communities in an efficient and effective manner," through "[s]hared costs and mutual support...." *About DEMEC, Joint Action Agency Values*, <http://www.demecinc.net/The-Values-of-Joint-Action-Agencies> (last visited May 30, 2017).

customer taking service under the PJM Tariff administered by PJM at the Delmarva Power & Light zone rate.<sup>4</sup>

6. Pursuant to Section 2 of the protocols, DEMEC submitted three sets of data requests to Delmarva regarding its 2016 Annual Update. Delmarva and DEMEC discussed various issues raised by DEMEC, and on November 11, 2016, DEMEC submitted a timely Preliminary Challenge pursuant to Section 3.a of the formula rate protocols. On November 18, 2016, Delmarva and DEMEC representatives had a meeting in order to attempt to resolve the issues raised in DEMEC's Preliminary Challenge. On December 13, 2016, Delmarva filed its response to the Preliminary Challenge.<sup>5</sup>

### **III. Formal Challenge**

7. On January 18, 2017, DEMEC submitted the Formal Challenge to Delmarva's 2016 Annual Update. DEMEC raises three issues with Delmarva's 2016 Annual Update, which DEMEC argues have a significant impact on the annual transmission revenue requirement (ATTR): (1) Delmarva's inclusion of discretionary Prepaid Pension Assets in rate base;<sup>6</sup> (2) Delmarva's change to directly assign Account No. 454 (Rent from Electric Property) revenue credits to Transmission, instead of using a plant allocator;<sup>7</sup> and (3) Delmarva's use of the Commission-approved return on equity (ROE) inclusive of ROE adders in calculating its Allowance for Funds Used During Construction (AFUDC).<sup>8</sup>

8. DEMEC requests that the Commission direct Delmarva to revise its 2016 Annual Update consistent with DEMEC's demonstrations. Alternatively, DEMEC requests that the Commission set the issues raised in the Formal Challenge for hearing and settlement judge procedures for additional discovery and resolution.<sup>9</sup>

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<sup>4</sup> Formal Challenge at 1-2.

<sup>5</sup> *Id.* at 5.

<sup>6</sup> *Id.* at 6-7.

<sup>7</sup> *Id.* at 7-9.

<sup>8</sup> *Id.* at 9-13.

<sup>9</sup> *Id.* at 14.

#### **IV. Filings and Responsive Pleadings**

9. On February 17, 2017, Delmarva filed an answer to DEMEC's Formal Challenge. On March 6, 2017, DEMEC filed a motion for leave to respond and a response to Delmarva's February 17, 2017 answer. On March 21, 2017, Delmarva filed a motion for leave to answer and an answer to DEMEC's March 6, 2017 answer.

#### **V. Discussion**

##### **A. Procedural Matters**

10. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2017), prohibits an answer to a protest or answer unless otherwise ordered by the decisional authority. We accept the answers filed by DEMEC on March 6, 2017 and Delmarva on March 21, 2017 as they have provided information that assisted us in our decision-making process.

##### **B. Substantive Matters**

###### **1. Prepaid Pension Assets**

###### **a. Delmarva's Treatment**

11. In its 2016 Annual Update, Delmarva records Prepaid Pension Assets in Account No. 186 (Miscellaneous Deferred Debits) and includes this amount in rate base. A joint settlement agreement filed in August 2014 provided for Delmarva to book Prepaid Pension Assets in Account No. 186 rather than in Account No. 165 (Prepayments).<sup>10</sup>

###### **b. DEMEC's Formal Challenge**

12. DEMEC objects to Delmarva's inclusion of any discretionary Prepaid Pension Assets in rate base. DEMEC argues that, lacking an express formula rate or settlement provision providing Delmarva such authority, the Commission should require Delmarva to remove Prepaid Pension Assets from rate base. DEMEC states that, in its 2016 Annual Update, Delmarva included \$14.04 million of Prepaid Pension Assets in its transmission

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<sup>10</sup> On August 25, 2014, DEMEC, Delmarva and Delaware Public Service Commission filed a joint settlement agreement with the Commission (2014 Settlement Agreement). The 2014 Settlement Agreement was a black-box settlement of Formal Challenges to the transmission revenue requirements set forth in Delmarva's 2011, 2012, and 2013 Annual Updates. The Commission accepted the 2014 Settlement Agreement on January 9, 2015. *Delmarva Power & Light Company*, 150 FERC ¶ 61,009 (2015).

rate base which resulted in increasing the ATRR by approximately \$1.5 million. DEMEC explains that, per the 2014 Settlement Agreement, Delmarva was required to record Prepaid Pension Assets in Account No. 186 rather than Account No. 165. DEMEC states that it does not object to Delmarva's booking of Prepaid Pension Assets in Account No. 186, but rather the inclusion of the prepaid pension amounts in rate base.<sup>11</sup> According to DEMEC, Delmarva is inappropriately attempting to characterize Account No. 186 as a prepayment and trying to include it in the ATRR even though neither Delmarva's formula rate protocols nor formula rate itself include an express provision providing Delmarva authority to include Prepaid Pension Assets in rate base.<sup>12</sup> DEMEC contends that, beyond the provisions of the formula rate, ratepayers should not be required to pay a return on voluntary contributions (in excess of legal requirements), which Prepaid Pension Assets constitute.<sup>13</sup>

**c. Delmarva's First Answer, February 17, 2017**

13. In its First Answer, Delmarva argues DEMEC's claims are without merit as the formula rate does in fact include a provision that explicitly allows it to include Prepaid Pension Assets in rate base and earn a return on that asset.<sup>14</sup> Delmarva explains that prepaid pensions are amounts that Delmarva's shareholders contribute to Delmarva's pension fund in excess of the amount charged to expense and borne by ratepayers.<sup>15</sup> In its First Answer, Delmarva illustrates that the Formula Rate, Attachment 5, Line 45 explicitly provides for the inclusion of prepayments and, separately, "Prepaid Pensions if not included in Prepayments."<sup>16</sup> Delmarva argues that DEMEC's failure to highlight this language in its Formal Challenge is grounds alone to deny DEMEC's challenge.<sup>17</sup>

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<sup>11</sup> *Id.* at 6.

<sup>12</sup> *Id.* at 6-7.

<sup>13</sup> *Id.* at 7.

<sup>14</sup> Delmarva First Answer at 6.

<sup>15</sup> *Id.* at 8.

<sup>16</sup> *Id.* at 7.

<sup>17</sup> *Id.* at 8.

14. Delmarva states that DEMEC has never argued that the formula rate did not include this cost in its previous formal challenges.<sup>18</sup> Delmarva asserts that the 2014 Settlement Agreement provided for Delmarva to book prepaid pensions in Account No. 186 rather than in Account No. 165, but made no changes to Delmarva's inclusion of 100 percent of prepaid pensions in rate base.<sup>19</sup> Delmarva argues that it is disingenuous for DEMEC to argue that this agreed upon accounting change had the effect of removing the item from rate base.<sup>20</sup>

15. In response to DEMEC's argument that ratepayers should not be required to pay a return on "discretionary" pension contributions, Delmarva states that DEMEC's argument fails to recognize the difference between Generally Accepted Accounting Principles (GAAP) accounting standards and the requirements of the Employee Retirement Income Security Act (ERISA) and the Pension Protection Act of 2006, which impose higher pension funding obligations than Delmarva's GAAP-based pension costs, in order to protect employees' pensions.<sup>21</sup> Delmarva explains that the additional amounts contributed to the pension fund by Delmarva's shareholders as a result of ERISA and Pension Protection Act of 2006 requirements, also represent prepaid pensions and thus are a reasonable and necessary cost of doing business.<sup>22</sup> Delmarva contends that its payments into the pension fund in excess of the current pension expense borne by ratepayers are necessary to assure the security of the company's pension obligations. Delmarva argues that DEMEC's arguments ignore the fact that these prepayments earn a return that remains in the pension fund, which ultimately benefits ratepayers by reducing the annual pension expense that the company would otherwise experience.<sup>23</sup>

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<sup>18</sup> *Id.* at 9 (citing DEMEC 2012 Formal Challenge, Docket Nos. ER05-515-000, ER09-1158-000, and EL13-48-000, at 17-19 (filed December 17, 2012); DEMEC 2013 Formal Challenge, Docket Nos. ER05-515-000, ER09-1158-000, and EL13-48-000, at 14-18 (filed December 12, 2013); and Delmarva Answer to DEMEC 2013 Formal Challenge, Docket Nos. ER05-515-000, ER09-1158-000, and EL13-48-000, at 43 (filed January 13, 2014)).

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

<sup>20</sup> *Id.* at 10.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 11.

<sup>23</sup> *Id.* at 12 and fn.27.

**d. DEMEC's March 6, 2017 Response**

16. DEMEC reiterates that there is no explicit provision in the 2014 Settlement Agreement or the formula rate that permits inclusion of amounts recorded in Account No. 186 in rate base. DEMEC explains that its failure to lodge a Formal Challenge to Delmarva's 2014 and 2015 Annual Updates is irrelevant because Delmarva's formula rate protocols do not bar pursuit of issues in subsequent Annual Updates.<sup>24</sup> DEMEC states that, despite Delmarva's assertions otherwise, Delmarva's letter shows that Prepaid Pension Assets are above the minimum funding level and are thereby voluntary in nature.<sup>25</sup> Further, DEMEC contends that Delmarva has failed to provide support for its claim that ratepayers are capturing benefits corresponding to the return Delmarva is collecting for the Prepaid Pension Assets recorded in Account No. 186.<sup>26</sup>

**e. Delmarva's Second Answer, March 21, 2017**

17. Delmarva states that the formula rate allows, and has always allowed, the inclusion of prepaid pensions as an adjustment to rate base.<sup>27</sup> Delmarva argues that, contrary to DEMEC's claims, Delmarva's inclusion of prepaid pensions in rate base is permitted regardless of the FERC account used to record the prepaid pensions.<sup>28</sup>

18. According to Delmarva, DEMEC asserts that prepaid pension amounts should not be included in rate base because they represent "voluntary" contributions to the pension fund. Delmarva, asserts that its payments into the pension fund are only "voluntary" in the sense that they are not required by GAAP. However, Delmarva states that its management has determined that the payments are necessary to comply with federal pension laws and to ensure the security of Delmarva's employees' pensions. Delmarva

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<sup>24</sup> DEMEC Response at 2.

<sup>25</sup> DEMEC Response at 3 (citing Formal Challenge at Attachment B). Attachment B of DEMEC's Formal Challenge contains Delmarva's written letter response dated December 13, 2016 which responds to DEMEC's Preliminary Challenge.

<sup>26</sup> *Id.* (citing *S. Co. Servs., Inc.*, 122 FERC ¶ 61,218, at P 22 (2008), *reh'g denied* 131 FERC ¶ 61,120 (2010)).

<sup>27</sup> *Id.* at 2.

<sup>28</sup> *Id.* (citing *Baltimore Gas and Elec. Co.*, Settlement Offer and Offer of Settlement, Docket No. ER05-515-000, page 102 of 374 (Mar. 20, 2006); *Baltimore Gas and Elec. Co.*, Order Approving Uncontested Settlement, 115 FERC ¶ 61,066 (2006)).

argues that these prepaid pension costs are included in rates, provided utility management has acted prudently, which DEMEC has not challenged.<sup>29</sup>

**f. Commission Determination**

19. The Commission rejects DEMEC's challenge on this issue as inconsistent with the formula rate and outside the scope of a Formal Challenge as defined in the formula rate protocols. The formula rate protocols specify that Formal Challenges are limited to whether costs are reasonable, prudent, and properly recorded, and whether the formula rate has been applied according to its terms.<sup>30</sup> Indeed, attacks on the formula rate itself, where a party asserts that expenses should be treated differently from how the formula prescribes, are outside the scope of a formal challenge.<sup>31</sup>

20. DEMEC's primary argument is that Prepaid Pension Assets recorded in Account No. 186, under the terms of the 2014 Settlement Agreement and the formula rate, cannot be included in rate base. Contrary to DEMEC's assertion that nothing in the formula rate permits Delmarva to include these costs in the rate base, the formula rate has always contained a provision that explicitly allows these Prepaid Pension Assets as an adjustment to rate base.<sup>32</sup> Since DEMEC asserts that prepaid pension expenses should be excluded from rate base, a treatment different from what the formula rate prescribes, DEMEC's challenge amounts to an impermissible attack on the formula rate itself, rather than the inputs and other issues that may be subject to formal challenge as outlined in the formula rate protocols.

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<sup>29</sup> *Id.* at 3.

<sup>30</sup> PJM Tariff, Attachment H-3E, Protocols, Section 3(d).

<sup>31</sup> *See Ameren Illinois Co.*, 156 FERC ¶ 61,209, at P 71 (2016) (denying a formal challenge to costs included in rates in a manner consistent the formula as outside the scope of challenge procedures).

<sup>32</sup> Attachment 5, line 45 of the Formula Rate includes in rate base Account 165, Prepayments, plus "Prepaid Pensions if not included in Prepayments"; *see also Baltimore Gas and Elec. Co.*, Settlement Offer and Offer of Settlement, Docket No. ER05-515-000, page 102 of 374 (Mar. 20, 2006); *Baltimore Gas and Elec. Co.*, Order Approving Uncontested Settlement, 115 FERC ¶ 61,066 (2006).

21. However, parties can challenge the inputs to the formula rate by raising prudence issues.<sup>33</sup> Here, DEMEC argues that the prepaid pension amounts themselves are “voluntary” and therefore should be treated as imprudent expenditures that should be excluded from the rate base.

22. The Commission has found that “a prudent expenditure is one ‘reasonable utility management [] would have made, in good faith, under the same circumstances, and at the relevant point in time.’”<sup>34</sup> We find that Delmarva has met its burden to justify these expenses as prudent. We agree with Delmarva that ERISA and the Pension Protection Act of 2006 impose higher funding obligations than Delmarva’s GAAP-based pension costs.<sup>35</sup> We also agree that pre-paying pension costs to ensure the security of employees’ pensions is a reasonable and prudent business decision.

## 2. Account No. 454 and Material Accounting Change

### a. Delmarva’s Treatment

23. In its 2016 Annual Update, Delmarva specifically identifies items in Account No. 454 (Rent from Electric Property) which are transmission related, directly assigns these costs to Transmission and deducts them in calculating the ATRR. Delmarva previously allocated Account No. 454 based on a net plant allocation factor.

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<sup>33</sup> *Delmarva Power & Light Co.*, 145 FERC ¶ 61,055, at 61,404 (2013) (citing *Appalachian Power Co.*, 23 FERC ¶ 61,032, at 61,088 (1983); *Golden Spread Elec. Coop., Inc. v. Sw. Pub. Serv. Co.*, 72 FERC ¶ 61,142, at 61,727 n.9; *Pub. Serv. Co. of N.H.*, 6 FERC ¶ 61,299, at 61,710 (1979)).

<sup>34</sup> *Potomac-Appalachian Transmission Highline, LLC*, 158 FERC ¶ 61,050 (2017) (citing *New England Power Co.*, 31 FERC ¶ 61,047, at 61,084 (1985)). The regulated entity has the burden of proof under section FPA 205 to establish prudence. However, in order to ensure that rate cases are manageable, the Commission presumes that all expenditures are prudent so the utility need not justify in its case-in-chief the prudence of all of its costs. Parties challenging the prudence of an expenditure have to raise “serious doubt” as to the prudence of an expenditure.

<sup>35</sup> The determination of pension expense under GAAP and the minimum funding requirement of a pension plan under ERISA are two separate calculations resulting in differing amounts.

**b. DEMEC's Formal Challenge**

24. DEMEC argues that Delmarva's change in approach in the 2016 Annual Update for allocating the Account No. 454 revenue credit to Transmission inappropriately inflates ATRR and constitutes a material accounting change for which Delmarva has not sought the Commission's approval.<sup>36</sup> DEMEC explains that Delmarva has acknowledged it used specific identification for Account No. 454 for the 2016 Annual Update, where it had previously allocated Account No. 454 based on a net plant allocation factor.<sup>37</sup> DEMEC notes that if Delmarva had used the net plant allocation factor for the 2016 Annual Update the Account No. 454 revenue credit to Transmission Service would increase by \$287,174.

25. DEMEC disputes Delmarva's arguments that such a change "was not deemed a change in accounting... as using the general ledger business area to capture transmission rental agreement transactions results in a precise calculation," and that it "has refined its identification of rents from electric property in FERC Account 454 such that it is specifically Transmission...."<sup>38</sup> DEMEC contends that allowing such a change in allocation methodology results in transmission customers unduly subsidizing non-transmission expenses while not receiving adequate revenue credit for transmission facilities.<sup>39</sup> In light of the foregoing, DEMEC asserts that the ATRR should be revised to reflect the increased Account No. 454 credit by \$287,174.

**c. Delmarva's First Answer, Feb. 17, 2017**

26. In its First Answer, Delmarva states it determined which Account No. 454 revenue credits to include in the formula rate calculations by specifically identifying which items were transmission related and directly assigning these costs to Transmission. Delmarva states that its change in allocation methodology is not an accounting change.<sup>40</sup> Delmarva argues that Account No. 454 explicitly provides for inclusion of items that are

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<sup>36</sup> Formal Challenge at 8-9. DEMEC states that Section.f.iii(d) of Delmarva's formula rate protocols require Delmarva to provide notice of any changes in accounting from its previous Annual Update that affect inputs to the formula rate or the resulting charges under the formula rate.

<sup>37</sup> Formal Challenge at 8 and Attachment D.

<sup>38</sup> Formal Challenge at 8 and Attachment D.

<sup>39</sup> *Id.* at 9.

<sup>40</sup> Delmarva First Answer at 13-15.

“transmission related,” but does not prescribe a method to identify such items.<sup>41</sup> Delmarva states that it previously explained to DEMEC that, in the instance of the 2016 Annual Update, it was feasible to identify specific revenue credit items as transmission related which is a more precise way of determining the amount of revenue credits that are “transmission related” than using a plant allocator. Delmarva asserts that its practice in this regard is consistent with the filed rate and the customary manner in which formula rates are implemented.<sup>42</sup>

27. Further, Delmarva explains that its accounting did not change in any way due to direct assignment of transmission and non-transmission related costs, nor would its accounting have been any different using the prior plant allocation method.<sup>43</sup> Delmarva contends that DEMEC is confusing cost accounting with cost allocation reflected in its accounts for ratemaking.<sup>44</sup> Delmarva asserts DEMEC has provided no rationale for continuing to use the net plant allocator to determine transmission related costs aside from the fact that that it provides more revenue credits to transmission customers. Delmarva avers that the change to using a specific assignment method in the 2016 Annual Update results in DEMEC losing a benefit that it should not have received in the first place.

28. Delmarva notes that DEMEC makes no assertion that Delmarva misidentified any items as transmission or non-transmission related when it made its calculations, determinations which it asserts are disciplined by customer review and challenge, as well as arbitration by the Commission.<sup>45</sup>

**d. DEMEC’s March 6, 2017 Response**

29. DEMEC states that the Commission has defined “accounting changes” as “any accounting change during the rate period that affects inputs to the formula rate or the

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<sup>41</sup> *Id.* at 12. Delmarva points to the relevant formula rate section pertaining to Account No. 454 (Formula Rate Attachment 3 “Revenue Credit Workpaper,” Line 1 “Rent from Electric Property – Transmission Related”).

<sup>42</sup> *Id.* at 14.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at 15.

<sup>45</sup> *Id.* at 13-15.

resulting charges billed under the formula rate.”<sup>46</sup> Under this definition, DEMEC continues, use of either direct assignment or plant allocators are accounting methods and it follows that any changes to these methods in determining costs from one year to another do constitute accounting changes for ratemaking purposes.<sup>47</sup> In support of its argument, DEMEC cites precedent where the Commission has described use of plant allocators as an “accounting method.”

**e. Delmarva’s Second Answer, March 21, 2017**

30. Delmarva sets forth three responses to DEMEC’s claim that Delmarva’s direct assignment of Account No. 454 amounts for ratemaking purposes represents a change in accounting. First, Delmarva states that the dispositive issue in a Formal Challenge is whether Delmarva has complied with the formula rate and followed proper accounting, and that DEMEC makes no assertion that Delmarva has failed to do so.<sup>48</sup> Second, Delmarva argues, how costs that are booked to the utility’s books and records are allocated among the utility’s functions for ratemaking purposes is not an accounting matter.<sup>49</sup> Delmarva asserts that directly assigning Account No. 454 transmission related revenues to the transmission function for ratemaking purposes is a ratemaking matter, and is consistent with the formula rate. Finally, Delmarva points out that the *Transco* case on which DEMEC relies does not equate cost allocation with accounting.<sup>50</sup> Delmarva asserts that in *Transco*, the Commission ruled that although it preferred the

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<sup>46</sup> DEMEC Response at 4 (citing *Louisville Gas & Elec. Co. & Kentucky Utilities Co.*, 150 FERC ¶ 61,202, at P 35 (2015); *Midwest Indep. Transmission Sys. Operator, Inc.*, 143 FERC ¶ 61,149, at P 87 (2013); and *Transcon. Gas Pipe Line Corp.*, 106 FERC ¶ 61,299, at PP 190-192 and 203 (2004) (DEMEC notes the Commission’s order in *Transcon. Gas Pipe Line Corp.* describes direct assignment versus use of plant ratios to allocate operations and maintenance costs as a “manner of accounting for these costs” and directing the utility to utilize direct assignment as the “accounting method” and notes that due to the fact that “there are no direct labor ratios available due to Transco’s current accounting practices,” use of plant ratios was an acceptable surrogate for allocation of administrative and general costs and required the utility to “utilize that accounting method” in its next rate case)).

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

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.* (citing *Transcon. Gas Pipe Line Corp.*, 106 FERC ¶ 61,299, at PP 190-192 (2004), *reh’g denied*, 112 FERC ¶ 61,170, at PP 143-149 (2005) (Transco)).

direct assignment method of cost allocation, it found that the manner in which the Company maintained its books and records did not permit such an allocation, but the Commission did not describe the cost allocation decision as a manner of accounting.<sup>51</sup>

**f. Commission Determination**

31. The Commission rejects DEMEC's challenge to Delmarva's use of a direct assignment method, instead of a net plant allocation method, to identify transmission related items in Account No. 454 for ratemaking purposes and its claim that Delmarva's direct assignment method for ratemaking purposes constitutes an accounting change requiring Commission approval. We find that Delmarva's use of the direct assignment method to determine transmission related items in Account No. 454 is not an accounting change, but a change in the method used to functionalize revenues.

32. For such a functionalization change, Delmarva's formula rate does not obligate Delmarva to submit a tariff filing for Commission approval.<sup>52</sup> Rather, Delmarva must demonstrate that it followed its formula rate and that the functionalization allocator it chose is just and reasonable. Here, Delmarva posted the information required under the formula rate and met the requirements set forth in its protocols by responding in full to DEMEC's data requests identifying the change in functionalization methodology.<sup>53</sup>

33. In addition, Delmarva's identification of "transmission related" revenues and direct assignment of those revenues to Transmission within Account No. 454 was just and reasonable. Delmarva's direct assignment of transmission related revenues recorded in Account No. 454 provides a more precise method of assigning transmission revenues and is permissible under its formula rate. Direct assignment of costs and revenues, as opposed to using an allocator, is generally preferred when the costs and revenues can be accurately assigned to a particular function.<sup>54</sup>

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<sup>51</sup> *Id.*

<sup>52</sup> Delmarva's formula rate provides only that Delmarva will include revenues recorded in Account No. 454 that are "transmission related". PJM Tariff, Attachment H-3D. Attachment 3 "Revenue Credit Workpaper," Line 1.

<sup>53</sup> See *PPL Electric Utilities Corporation*, 136 FERC ¶ 61,101, at P 18 (2011) (recognizing PPL's methodology for functionalizing transmission costs must be within the bounds of its formula rate language).

<sup>54</sup> *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299, at PP 190-192 (2004).

### **3. ROE for Calculating AFUDC Rate**

#### **a. Delmarva's Treatment**

34. The AFUDC accounts record a utility's financing costs of constructing facilities before those facilities are placed into service.<sup>55</sup> This account is then recovered by the utility once those facilities go into service. One component of AFUDC represents the return on equity investment in plant and equipment. Delmarva uses the ROE accepted by the Commission as the carrying charge for this component.

#### **b. DEMEC's Formal Challenge**

35. DEMEC contends that Delmarva's use of its Commission-approved ROE in calculating its AFUDC rate is inconsistent with the Uniform System of Accounts and Commission precedent. DEMEC asserts that, per Order No. 561, Order No. 561-A and Electric Plant Instruction No. 3(A)(17)(b),<sup>56</sup> the cost of equity used to calculate AFUDC should be the one which is allowed by the regulatory commission having primary rate jurisdiction over the utility, which, according to DEMEC, is the Delaware Public Service Commission (Delaware PSC). DEMEC asserts that the Delaware PSC most recently approved an ROE of 9.70 percent for Delmarva. DEMEC argues that Order No. 561-A clearly endorsed using a single AFUDC rate using the ROE allowed by the regulatory authority which has jurisdiction over the utility, not the company's facilities.

#### **c. Delmarva's First Answer, Feb. 17, 2017**

36. In its First Answer, Delmarva argues the Commission-approved ROE of 11.30 percent is the correct input for calculating the AFUDC rate for Delmarva's transmission assets, stating that the Commission has primary rate jurisdiction over Delmarva's

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<sup>55</sup> These accounts therefore represent the debt and equity used to construct utility assets before it can start recovering those costs.

<sup>56</sup> Formal Challenge at 9-11 (citing *Amendments to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, Order No. 561, 57 FPC 608 (1977); order denying reh'g and on clarification, Order No. 561- A, 59 F.P.C. 1340 (1977), order on clarification, 2 FERC ¶ 61,050 (1978) (Order No. 561-A)); and 18 C.F.R. § 101 (2017).

transmission assets.<sup>57</sup> Delmarva states that the intent of Electric Plant Instruction No. 3(A)(17)(b), which does not explicitly state whether the primary rate jurisdiction should be determined on a company-wide or functional basis, is to recognize the interrelationship between the cost of capital established in a rate case and that used for AFUDC purposes. Delmarva reasons that, since the ROE it earns on its transmission and distribution assets are determined on a functional basis, it is consistent with the intent of Electric Plant Instruction No. 3(A)(17)(b) to determine the ROE for AFUDC purposes on a functional basis as well.<sup>58</sup> Further, Delmarva asserts that since Order No. 561-A was issued prior to the functional unbundling of utilities, the determinations made in Order No. 561 and Order No. 561-A are inapplicable and no longer serve as useful precedent.<sup>59</sup> Delmarva states that Order No. 561 recognized that an ROE determination may need to be modified in certain circumstances, including where utilities are subject to multiple rate jurisdictions.<sup>60</sup>

37. Delmarva asserts that DEMEC's argument for using a state regulator approach is inconsistent with Order No. 561 and subsequent Commission orders. Delmarva highlights three specific instances where Commission orders recognized that the AFUDC rate appropriately accounts for the circumstances in which the AFUDC rate is being used.<sup>61</sup> First, in *Alabama Power Co.*, the Commission determined it would calculate the company's AFUDC using the Commission-approved ROE rather than the ROE

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<sup>57</sup> Delmarva First Answer at 17 (citing *Promoting Wholesale Competition through Open Access Non-discriminatory Transmission Service by Public Utilities and Transmitting Utilities*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, at 30,226 (1997) (Order No. 888)). Delmarva states that in Order No. 888-A the Commission expressly clarified that it has exclusive jurisdiction over 'transmission in interstate commerce' including "the unbundled interstate transmission component of a previously bundled retail transaction."

<sup>58</sup> *Id.* at 17-18.

<sup>59</sup> *Id.* at 18 (citing Order No. 561-A at 1343: "the facilities constructed by an electric utility cannot be segregated as between those which will be employed solely for retail service and those which will be employed solely for wholesale service.").

<sup>60</sup> *Id.* at 19 (citing Order No. 561 at 610). Delmarva states that FPC recognized that the use of primary jurisdiction ROE "may require some modification in situations where ratemaking bodies use other than an 'original cost' rate base or where utilities are subject to multiple rate jurisdictions."

<sup>61</sup> *Id.* at 19-20.

determined by the state agency with primary rate jurisdiction.<sup>62</sup> Second, in *Carolina Power & Light Co.*, the Commission used the ROE determined in the last rate proceeding before the beginning of each calendar year, rather than the ROE determined in the last rate proceeding at the time AFUDC was calculated as Order No. 561 provides.<sup>63</sup> Third, Delmarva explains, in *Public Service Company of Indiana*, the court elected to use the company's three-year average earned ROE even though the state had computed an ROE for the company, finding that "in effect, State-approved rates are 'unavailable' where the State rates were calculated on the basis of costs which bear no relationship to the package of investments and costs upon which the Commission is attempting to devise a fair return."<sup>64</sup> Delmarva concludes that, here too, the state-approved rate is not appropriate for the transmission investments and costs at issue, which are explicitly and exclusively subject to the Commission's jurisdiction.

**d. DEMEC's March 6, 2017 Response**

38. DEMEC notes that Delmarva, in its First Answer, concedes that Electric Plant Instruction 3(A)(17)(b) does not explicitly state whether primary rate jurisdiction for AFUDC should be determined on a company-wide or functional basis. DEMEC counters Delmarva's interpretation of the regulation's intent to allow it to use the Commission-approved ROE by noting that the Commission has not changed the Instruction, despite the issuance of Order No. 888 in 1996.<sup>65</sup> Additionally, DEMEC states that Electric Plant Instruction 3(A)(17)(b) has not been modified to distinguish a separate common equity rate based on the function of facilities under construction.

39. DEMEC also challenges Delmarva's reliance on *Alabama Power Co.*, *Carolina Power & Light Co.* and *Public Service Co. of Indiana*. First, DEMEC contends the Commission's finding in *Alabama Power Co.* is unavailing because, in this case, the Commission authorized use of the Commission-approved rate as opposed to the state rate on the grounds that the state-authorized return was in excess of the Commission-

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<sup>62</sup> *Id.* at 19 (citing *Alabama Power Co.*, 8 FERC ¶ 61,083, at 61,324 (1979), *rev'd on other grounds*, *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20 (D.C. Cir. 1982)).

<sup>63</sup> *Id.* at 19-20 (citing *Carolina Power & Light Co.*, 4 FERC ¶ 61,203, at 61,470-61,471 (1978)).

<sup>64</sup> *Id.* at 20 (citing *Public Service Company of Indiana*, 3 FERC ¶ 63,038, at 65,275 (1978)).

<sup>65</sup> DEMEC Response at 4 (citing Order No. 888).

approved ROE.<sup>66</sup> DEMEC asserts that these circumstances do not apply here. Next, DEMEC argues that *Carolina Power & Light Co.* is not appropriate precedent because the Commission allowed a deviation from Order No. 561 because the deviation resulted in only minor changes in the equity allowance over the short term.<sup>67</sup> Here, DEMEC asserts that Delmarva's reliance of this precedent is inapposite absent a showing that use of the Commission-approved ROE in lieu of the state-approved ROE would also result in "relatively minor changes."<sup>68</sup> Regarding *Public Service Co. of Indiana*, DEMEC contends that, where Delmarva relies on the Administrative Law Judge's initial decision<sup>69</sup> to support its use of the Commission-approved ROE, the subsequent Commission order recognizes that Order No. 561 "should and does govern the present proceeding."<sup>70</sup> DEMEC states that the Commission found that use of the average rate earned during the preceding three years to compute the cost equity factor instead of the state-approved rate (where the state is the ratemaking body having primary jurisdiction) was appropriate because the Public Service Commission of Indiana "does not expressly grant a cost rate for common equity, but rather grants an overall fair value rate of return on fair value rate base."<sup>71</sup>

**e. Commission Determination**

40. We reject DEMEC's challenge regarding the proper ROE. We do not find that Delmarva's use of the Commission ROE is improper in this case since the Commission has jurisdiction over Delmarva's transmission facilities and these facilities are separately identifiable from its distribution facilities. In the current environment in which distribution and transmission assets are unbundled under Order No. 888, the ROE accepted by the Commission applies to all Delmarva's transmission assets, and we find no reason to apply a different equity rate to transmission facilities during the construction period. Our interpretation accords with Electric Plant Instruction No. 3(A)(17)(B) because the Commission is "the ratemaking body having primary rate jurisdiction" over

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<sup>66</sup> *Id.* at 5 (citing *Alabama Power Co.* at fn.14).

<sup>67</sup> *Id.* (citing *Carolina Power & Light Co.* at 61,470-61,471).

<sup>68</sup> *Id.* (citing *Carolina Power & Light Co.* at 61,470-61,471).

<sup>69</sup> *Id.* at 6 (citing *Public Service Co. of Indiana*, 3 FERC ¶ 63,038, at 65,275 (1978)).

<sup>70</sup> *Id.* (citing *Public Service Co. of Indiana*, 7 FERC ¶ 61,319 (1979)).

<sup>71</sup> *Id.* (citing *Public Service Co. of Indiana*, 7 FERC ¶ 61,319 (1979) at 61,704-61,705).

Delmarva's transmission assets. Therefore, the Commission-approved ROE should be used to determine the AFUDC rate used in Delmarva's formula rate.

41. We find DEMEC's reliance on Order No. 561 unavailing, because as relevant here, Order No. 561 acknowledged that the single-rate approach it established "may require some modification in situations ... where utilities are subject to multiple rate jurisdiction."<sup>72</sup> Further, the Commission recognized in Order No. 561 that the need to choose a single ROE was based on the inability (at that time) to separately identify retail and wholesale facilities.<sup>73</sup> In this case, however, Delmarva separately identifies transmission and distribution facilities so the Commission-approved ROE can be applied to the transmission facilities. Therefore, we find that the use of the Commission-accepted ROE is appropriate for establishing rates for Commission jurisdictional transmission facilities.

42. Using the state approved ROE also would be inconsistent with the Commission's treatment afforded to Construction Work in Progress (CWIP). The Commission uses the Commission accepted ROE for determining the financing costs for CWIP included in rate base. Including CWIP in rate base permits the utility to recover its financing costs as they are incurred, while AFUDC reflects those same financing costs with recovery deferred until the plant goes into service. Since the financing costs of constructing assets to be used in utility service are the same, a consistent ROE should be applied to both AFUDC and CWIP.

#### **4. 50 Basis Point Adder for RTO Participation**

##### **a. Delmarva's Treatment**

43. In calculating AFUDC, Delmarva includes in its ROE the Commission-approved 50 basis point adder for participating in an RTO.

##### **b. DEMEC's Formal Challenge**

44. DEMEC contends that, if the Commission-approved ROE is to be used in the AFUDC calculation, Delmarva is incorrectly including the 50 basis point adder for participation in PJM. DEMEC argues that, in accordance with the plain language of Electric Plant Instruction No. 3(A)(17), the 50 basis point adder should not apply for a project that is under construction which has not been turned over to PJM, and thus should not be used to calculate the AFUDC rate. Further, according to DEMEC, the

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<sup>72</sup> Order No. 561 at 610.

<sup>73</sup> Order No. 561-A at 1343.

Commission found in *Northeast Transmission Development* that the RTO participation adder is not recoverable until the date the project is placed into service.<sup>74</sup>

**c. Delmarva's First Answer, Feb. 17, 2017**

45. Delmarva asserts that Commission precedent clearly shows that the AFUDC rate should include the 50 basis point adder for RTO participation. Delmarva explains that in *Northern Pass Transmission LLC*, the Commission approved Northern Pass's Transmission Service Agreement inclusive of the 50 basis point adder for RTO membership reflected in the requested ROE prior to and during construction.<sup>75</sup> Additionally, Delmarva argues, the language of Electric Plant Instruction No. 3(A)(17) does not distinguish between the cost of capital used during construction and whether the 50 basis point adder pertains to construction.<sup>76</sup> Delmarva points out that the regulation simply provides for the use of the "rate granted common equity in the last rate proceeding before the ratemaking body having primary jurisdiction."<sup>77</sup> Delmarva argues that the facilities subject to the 50 basis point adder inevitably will be turned over to PJM and, thus, the adder should apply to the entire capital cost of the project, including capital costs incurred during construction.<sup>78</sup> Delmarva argues that exclusion of the 50 basis point adder from the ROE used to calculate its AFUDC rate is inconsistent with the Commission's RTO incentive policy, as it dilutes the value of the incentive.

46. Additionally, Delmarva also contends that DEMEC inaccurately characterized the Commission's ruling in *Northeast Transmission Development* that the 50 basis point adder is not recoverable until the project is placed into service.<sup>79</sup> Rather, Delmarva

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<sup>74</sup> Formal Challenge at 10 (citing *PJM Interconnection, L.L.C. and Northeast Transmission Development, LLC*, 155 FERC ¶ 61,097, at P 94 (2016) (*Northeast Transmission Development*) and *FERC Uniform System of Accounts*, Electric Plant Instruction No. 3(A)(17)(b)).

<sup>75</sup> Delmarva First Answer at 20-21 (citing *Northern Pass Transmission LLC*, 136 FERC ¶ 61,090 at P 5 and P 1). Delmarva notes that the Commission then also denied New Hampshire Public Utilities Commission's request for rehearing of the Commission's decision to grant a 50 basis point adder for RTO participation.

<sup>76</sup> Delmarva First Answer at 21.

<sup>77</sup> *Id.* (citing Electric Plant Instruction 3(a)(17)(b), 18 C.F.R. §101 (2017)).

<sup>78</sup> Delmarva First Answer at 21.

<sup>79</sup> *Id.* at 22.

explains, the Commission found in that case that “DEMEC’s request that any RTO participation adder not be awarded until the Project is placed in service should be dismissed as moot since [Northeast Transmission Development] will not begin to recover its ROE and applicable incentives until the date new facilities are placed in service.”<sup>80</sup>

**d. DEMEC’s March 6, 2017 Response**

47. DEMEC contends that the language of Electric Plant Instruction No. 3(A)(17) contradicts Delmarva’s argument regarding inclusion of a 50 basis point adder for PJM membership in determining the common equity rate. Specifically, DEMEC states that the Note to Electric Plant Instruction No. 3(A)(17)(b) focuses on the fact that AFUDC shall cease when a plant is placed in operation or ready for service.<sup>81</sup> DEMEC asserts that Delmarva’s contention that it is irrelevant whether a facility has been turned over to PJM is belied by the fact that a facility cannot be turned over to PJM’s operational control until it is in service.<sup>82</sup> DEMEC also asserts that the Commission’s finding in *Northern Pass Transmission LLC* to permit incentive ROE adders during pre-commercial operation is not applicable here, as Delmarva has not demonstrated that it has sought or received the Commission’s approval to include the indicated 50 basis point adder on a pre-commercial basis for purposes of computing AFUDC in its 2016 Annual Update.<sup>83</sup> DEMEC notes that in that case the Commission explicitly recognized the unique nature of the project and commercial arrangements facilitating its construction, particularly the \$1.1 billion capital commitment involved therein.<sup>84</sup>

48. Likewise, DEMEC asserts that Order No. 679 clearly states that the RTO participation incentive is different than specific incentives for transmission

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<sup>80</sup> *Id.* (citing *Northeast Transmission Development* at P 97).

<sup>81</sup> DEMEC Response at 6.

<sup>82</sup> *Id.* at 6-7 (citing *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222, *order on reh’g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236, at P 21 (2006), *order on reh’g*, 119 FERC ¶ 61,062 (2007) DEMEC states that the language of Order No. 679 specifies that the RTO participation adder is available to a public utility member of an RTO “as to all of its jurisdictional transmission facilities that have been turned over to the operational control of the Transmission Organization.”)

<sup>83</sup> *Id.* at 7.

<sup>84</sup> *Id.* (citing *Northern Pass Transmission LLC*, 134 FERC ¶ 61,095 (2011), *reh’g denied*, 136 FERC ¶ 61,090 at P 11).

construction.<sup>85</sup> DEMEC contends that Order No. 679 expressly states that the RTO participation adder is available only for facilities that have been turned over to the operational control of the system operator.<sup>86</sup> DEMEC states that this language directly undermines Delmarva's argument that the RTO participation adder should apply prior to a project going into service because otherwise it "dilutes the value of the RTO incentive."<sup>87</sup> Additionally, DEMEC contends that in *Northeast Transmission Development*, the Commission found that approval of an RTO participation adder was contingent on Northeast Transmission Development's commitment to become a member of PJM and transfer operational control to PJM once the project has been placed in service.<sup>88</sup>

49. Lastly, DEMEC reiterates that Delmarva should not be allowed to include project-specific incentive adders in calculating the AFUDC rate. DEMEC argues that Delmarva, in its First Answer, fails to address DEMEC's concerns, noting that Delmarva bears the burden of proof to establish the justness and reasonableness of the rates in its 2016 Annual Update. DEMEC contends Delmarva fails to confirm whether or not the AFUDC rate it applied does or does not include project-specific incentive adders, or whether the Commission has granted an express approval to do so.<sup>89</sup>

e. **Commission Determination**

50. We find just and reasonable Delmarva's inclusion of its approved 50 basis point adder for RTO participation in its Commission-approved ROE used to calculate AFUDC. The RTO adder applies to membership in an RTO, not to specific projects or to the timing of cost incurrence. For example, the RTO incentive applies to all project investment recovered by the utility in rates after joining an RTO, including the remaining undepreciated costs of facilities built before the utility joined the RTO. We see no reason to exclude the RTO adder to calculate AFUDC related to facilities under construction when the utility is part of the RTO. As noted above, the RTO adder is included in the

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<sup>85</sup> *Id.* at 8 (citing Order No. 679-A at P 21).

<sup>86</sup> *Id.* at 7.

<sup>87</sup> *Id.* at 7-8 (citing Delmarva First Answer at 21).

<sup>88</sup> *Id.* at 8 (citing *Northeast Transmission Development*, 155 FERC ¶ 61,097 (2016) at P 94).

<sup>89</sup> *Id.*

ROE for calculating a return on CWIP included in rate base and it similarly should be included in calculating AFUDC on CWIP not included in rate base.

51. DEMEC maintains that the RTO adder should not be applied to AFUDC because Electric Plant Instruction No. 3(A)(17) provides that AFUDC ceases when a project is placed in service. It argues that the facilities cannot be turned over to the RTO's control until the facilities are in service, so the RTO adder should not apply. As discussed above, the Commission consistently allows the RTO adder to apply to the equity component of carrying charges that are applied to CWIP balances directly related to investment that occurs prior to the project going into service.<sup>90</sup> As support for its argument that carrying charges incurred for investment prior to the in-service date should be excluded from AFUDC, DEMEC references *Northeast Transmission Development* in which the Commission stated, "NTD will not begin to recover its ROE and applicable incentives until the date the new facilities are placed in service."<sup>91</sup> However, we note that including the RTO incentive in AFUDC is consistent with that statement from *Northeast Transmission Development* because AFUDC is not recovered until facilities are placed in service.<sup>92</sup> Moreover, unlike Northeast Transmission, which was a new transmission developer that had not yet joined an RTO and had not proposed a project, Delmarva is a long-standing member of PJM with numerous projects to which the RTO adder applies.<sup>93</sup>

52. Lastly, we find DEMEC's contention regarding inclusion of project-specific adders in the AFUDC rate to be speculative and premature as DEMEC does not cite to any such adders being included in Delmarva's AFUDC rate.

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<sup>90</sup> DEMEC offers no compelling reason why the equity carrying charges for the investment prior to the in-service date should differ from the carrying charges on the depreciated cost of the same investment after the project is in service.

<sup>91</sup> *Northeast Transmission Development*, 155 FERC ¶ 61,097 (2016).

<sup>92</sup> AFUDC is recorded on the utility's accounts as the investment in plant is made.

<sup>93</sup> In *Northern Pass Transmission LLC*, cited by Delmarva, the Commission's determination provides support for including the RTO adder in AFUDC for costs incurred prior to the in-service date of the facilities. The Commission also approved inclusion of the 50 basis point adder for RTO participation for pre-commercial costs incurred prior to operation.

The Commission orders:

The Formal Challenge is hereby denied, as discussed in the body of this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.