

February 2, 2004

Magalie R. Salas, Secretary
Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: PJM Interconnection, L.L.C., *et al.*
Docket No. ER04-156-000, *et al.*

Dear Secretary Salas:

Please find for electronic filing, the Joint Consumer Advocates' Request for Rehearing in the above-referenced proceeding.

A copy has been served on each person on the designated official service list.

Very truly yours,

Filed electronically

Denise C. Goulet
Senior Assistant Consumer Advocate

Enclosure

cc: All parties of record

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

The Allegheny Power System Operating	:	Docket Nos. ER04-156-000
Companies: Monongahela Power	:	and ER04-156-001
Company, The Potomac Edison	:	
Company and West Penn Power	:	
Company, all doing business as	:	
Allegheny Power;	:	
The PHI Operating Companies: Potomac	:	
Electric Power Company, Delmarva	:	
Power & Light Company, and	:	
Atlantic City Electric Company;	:	
Baltimore Gas & Electric Company;	:	
Jersey Central Power & Light Company;	:	
Metropolitan Edison Company;	:	
Pennsylvania Electric Company;	:	
PECO Energy Company;	:	
PPL Electric Utilities Corporation;	:	
Public Service Electric & Gas Company;	:	
Rockland Electric Company; and	:	
UGI Utilities, Inc.	:	

JOINT CONSUMER ADVOCATES' REQUEST FOR REHEARING

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713, the Pennsylvania Office of Consumer Advocate ("Pa. OCA"), the Maryland Office of People's Counsel ("MPC"), the Ohio Office of Consumers' Counsel ("OCC"), the Consumer Advocate Division of the Public Service Commission of West Virginia ("WV CAD"), the Office of the People's Counsel for the District of Columbia ("DC OPC") and the Delaware Public Advocate ("DPA") (collectively referred to as "Joint Consumer Advocates") respectfully seek rehearing of the Commission's January 2, 2004 "Order Accepting and Suspending Proposed Tariff Sheets, Instituting Section 206

Investigation, Consolidating Proceedings, and Establishing Hearing Procedures” in the above captioned-docket. *Allegheny Power Systems Operating Companies, et al.*, 106 FERC ¶ 61,003 (2004) (hereinafter “January 2 Order”). Joint Consumer Advocates applaud the Commission’s decision to set the rate issues raised in this docket for hearing. However, in that the order, the Commission appears to have summarily decided two issues related to incentive Return on Equity (“ROE”) adders that Joint Consumer Advocates submit should have been set for hearing or should have been rejected outright. Joint Consumer Advocates request rehearing of the following issues: a) the Commission’s decision to grant the PJM Transmission Owners a 50 basis point ROE adder for being members of an RTO is arbitrary and capricious and does not comport with reasoned decision-making; and b) the Commission’s decision to allow a 100 basis point ROE adder once the Commission issues a Final Order in the Proposed Policy Statement proceeding relating to incentives for new investment in electric transmission facilities at Docket No. PL03-1-000, *Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid*, 102 FERC ¶ 61,032 at ¶¶ 24, 30 (2003) (hereinafter “Proposed Policy Statement”) is premature, arbitrary and capricious and does not comport with reasoned decision-making.

Specification of Errors

The Commission should reconsider the following errors in the January 2 Order in this docket:

- a) The Commission’s decision to grant the PJM Transmission Owners a 50 basis point adder to ROE for membership in an RTO and a 100 basis point adder to ROE for new investment is arbitrary and capricious and does not comport with reasoned decision-making because there is no benefit for consumers to be gained from the provision of such incentives to these transmission owners;

- b) The Commission's decision to grant the PJM Transmission Owners a 100 basis point adder to ROE for new investment does not comport with procedural due process or reasoned decision-making because the Commission's decision is based in part on testimony that interveners in this proceeding have not been given an opportunity to investigate and challenge, and in part on a Proposed Policy Statement that has been heavily challenged and is not yet final; and
- c) The Commission's decision to grant the 50 basis point and the 100 basis point ROE adders is premature and does not comport with reasoned decision-making because the Commission has not analyzed whether the end result of this decision produces a return which remains within the zone of reasonableness.

Summary of Argument

The 50 basis point and 100 basis ROE adders are incentive rates, and as such must comport with Commission policy and judicial mandates relating to incentive rates. The existing 1992 Policy Statement on Incentive Rates, *Re Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities*, 61 FERC ¶ 61,168 (1992) (hereinafter "1992 Policy Statement") and Order No. 2000 require that before the Commission can grant incentive rates, it must first find that the incentive rate program produces prospective benefits for consumers. The District of Columbia Circuit Court of Appeals has required that incentive rates provide consumer benefits at the lowest reasonable cost. The Commission's summary disposition of the ROE adder issues in this proceeding do not comport with these required findings.

The 50 basis point ROE adder is not justified by the evidence in this proceeding. There are no prospective benefits to be gained by consumers. The Commission granted the 50 basis point ROE adder because these transmission utilities have turned over operational control of their transmission facilities to a Commission approved Regional

Transmission Organization (RTO”) or Independent System Operator (“ISO”). However, that action occurred many years ago in 1996 when these Transmission Owners (“TOs”) first transformed PJM into an ISO. In fact, all but one of these TOs has participated in PJM’s joint operation of their facilities since at least the mid-1960s. There are no new benefits to be gained from the 50 basis point ROE adder since there is no action to be encouraged.

The 100 basis point ROE adder likewise fails the test of providing prospective benefits for consumers. The questionable evidence submitted by the PJM TOs in support of the adder has been challenged by interveners. These TOs have invested millions in recent years in new transmission facilities under PJM’s Regional Transmission Expansion Plan process without the need for the encouragement of the 100 basis point ROE adder. Additionally, The PJM Board of Managers has recently approved \$220 million more in new transmission facilities over the next few years, all without the encouragement of the 100 basis point ROE adder. Providing this incentive rate would not result in any new benefits that consumers aren’t already receiving under the current process. Furthermore, the formula surcharge mechanism itself is a type of incentive rate mechanism adopted to ensure that the PJM TOs can timely recover the costs of new investments in transmission infrastructure approved under the PJM RTEP process and there is no evidence that additional incentives are warranted.

Nor can the Commission point to the Proposed Policy Statement as justification for the adders here. First, that Proposed Policy Statement is not final. Therefore, the only existing policy is the 1992 Policy Statement on Incentive Rates and Order No. 2000. Additionally, if the Proposed Policy Statement is adopted without the required showing

of consumer benefits, stakeholders in that docket will likely appeal that ruling. Second, a policy statement is not a rule of required applicability, but rather a statement of general policy. The Commission must look at the circumstances of each case and determine whether those circumstances warrant application of the policy. That review requires a factual determination. Thus summary disposition of these issues is inappropriate. Where factual disputes exist, as here, an evidentiary hearing is required.

Finally, Commission approval of the 50 basis point ROE adder and the 100 basis point ROE adder is premature at this time. Any final ROE granted in this proceeding must remain within a zone of reasonableness. The Commission has yet to determine what that zone of reasonableness is, and whether the 150 additional basis points approved here as incentives will result in a final ROE that remains within that zone. That determination cannot be made until a final order is issued in this proceeding. Consequently, the Commission should reconsider its January 2 Order in this proceeding and either summarily reject the 50 basis point ROE adder and the 100 basis point ROE adder, or set those issues for hearing.

Argument

The PJM Transmission Owners (“PJM TOs”) initially filed in Docket No. ER03-738-000 a proposal to implement a formula surcharge to recover the cost of new investments approved under the PJM Regional Transmission Expansion Plan (“RTEP”). Joint Consumer Advocates challenged numerous aspects of that filing, including the 50 basis point and 100 basis point ROE adders. On July 24, 2003, the Commission rejected that filing. However, it approved the proposed 50 basis point ROE adder for the TOs’ membership in the PJM Interconnection L.L.C., a Commission approved Regional

Transmission Organization (“RTO”) under Order No. 2000, on the basis that the Commission had approved a similar adjustment for the Midwest Independent Transmission System Operator (“MISO”) transmission owners. *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 at ¶ 74 (2003). The Commission also in that order ruled that additional information would be required to support the need for the requested 100 basis point ROE adder for new investment in transmission facilities, including analysis of whether such an incentive should be limited to innovative technologies that result in lower costs than traditional technologies. *Id.* at ¶ 75.

Joint Consumer Advocates sought rehearing of the July 24 Order with respect to the issue of the 50 basis point ROE adder. On October 24, 2003, the Commission on rehearing rejected the argument challenging the 50 basis point adder, noting that the PJM TOs were free to include such an adder in a future filing, but further noting that “parties seeking to challenge that provision can do so in that proceeding.” *PJM Interconnection, L.L.C.*, 105 FERC ¶ 61,123 at ¶ 28 (2003).

On November 4, 2003, the PJM Transmission Owners refiled a formula surcharge tariff, once again seeking a 50 basis point ROE adder for membership in PJM and a 100 basis point ROE adder for investment in new transmission facilities. The PJM TOs included with the filing the testimony of a witness purporting to show that the magnitude of new investment required to sustain a competitive market, changes in investor perceptions of the risks associated with the industry, the dangers of inadequate returns, the August 14, 2003 Northeast blackout and the benefits of the adder all justified the 100 basis point ROE adder. The PJM TOs provided no new justifications for the 50 basis point ROE adder. Joint Consumer Advocates protested both ROE adder incentives.

In the January 2 Order in this docket, the Commission rejected these protests. The January 2 Order appears to provide for summary disposition of the 50 basis point ROE adder issue. *Allegheny Power Systems Operating Companies, et al.*, 106 FERC ¶ 27. That Order also states that the PJM TOs provided the required additional information with respect to the 100 basis point ROE adder. However, the Commission did not accept that adder at this time in light of the protests filed. *Id.* The Commission then required the Administrative Law Judge presiding over this proceeding to “apply” the final Policy Statement in Docket No. PL03-1-000 when it is issued to this proceeding and “incorporate” the policy in any ROE recommendation. *Id.*

A. **The Commission Erred In Approving The 50 Basis Point And The 100 Basis Point ROE Incentive Adders Because Those Incentives Fail To Provide Any Prospective Benefits To Consumers.**

The Commission justified granting the PJM TOs the 50 basis point ROE adder on the fact that the Commission granted the same 50 basis point ROE adder to the transmission owners in the Midwest Independent Transmission System Operator, Inc., an ISO operating in the Midwestern region of the United States. *Allegheny Power Systems Operating Companies, et al.*, 106 FERC at ¶ 27. In the MISO Orders, the Commission granted the MISO TOs a 50 basis point ROE adder because these entities had turned over control of their transmission facilities to an ISO. *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2002), *reh’g denied* 102 FERC ¶ 61,143 at ¶ 16 (2003) (hereinafter “the MISO Orders”). The Commission noted in the MISO Orders that the 50 basis point adder would encourage timely participation in MISO and provide consumer benefits thereby. 102 FERC at ¶ 16.

The ROE adders sought by the PJM TOs and granted by the Commission in the January 2 Order in this proceeding and in the MISO docket are a type of incentive rate. As such, these incentive rates should comply with existing Commission policy for granting incentive rates, *i.e.* that the incentive rates provide clear, quantifiable benefits to consumers, maintain quality of service, be applied prospectively, be voluntary and be understood by all parties. 1992 Policy Statement, 61 FERC ¶ 61,168 at 61,589 – 61,590. In Order No. 2000, the Commission once again endorsed the use of incentive rates, including ROE adders, under conditions that are consistent with the 1992 Policy Statement standards. *Regional Transmission Organizations*, Order No. 2000, FERC Stats. and Regs. [Regulations Preambles July 1996 – December 2000] ¶ 31,089 (1999), *Order on Reh'g*, Order No. 2000-A, [Regulations Preambles July 1996 – December 2000] ¶ 31,092 (2000), *Petitions for Review dismissed, Public Utility District No.1 of Snohomish County, Washington, et al. v. FERC*, 272 F.3rd 607 (D.C. Circuit 2001). Order No. 2000 expressly discusses new approaches to return on equity as part of incentive ratemaking, and provided such incentives in order to ensure that customers have access to non-discriminatory service, *i.e.* the same goal espoused in the MISO order. Order No. 2000 at 31,193. Order No. 2000 also establishes certain standards necessary to support incentive rates, including a requirement to demonstrate consumer benefits. *Id.*

While Commission policy clearly provides precedent for ROE adders as incentives, those adders cannot be approved in the absence of evidence showing the prospective benefits to be derived thereby. The PJM TOs have not justified the 50 basis point ROE adder incentive rate as providing any prospective benefits to consumers. Further, they have submitted questionable evidence of consumer benefits with respect to

the 100 basis point ROE adder. The Commission erred in summarily approving these incentive adders and should reconsider its decision in the January 2 Order.

1. **There Is No Evidence That The 50 Basis Point Adder Provides Any Prospective, Or New, Benefits To Consumers.**

The Commission justified its decision to extend the 50 basis point ROE adder to the PJM TOs on the basis that it provided a similar adjustment to the MISO TOs at the time the MISO TOs formed MISO. *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 at ¶ 74 (2003). The Commission characterized its decision in the MISO proceeding as based on a policy justification for recognizing the value of independent operation of transmission facilities. The MISO Orders are currently pending before the District of Columbia Circuit Court of Appeals on appeal. One issue pending on appeal is the issue of the reasonableness of the 50 basis point ROE adder. Petitioners challenge the grant of the 50 basis point ROE adder on grounds that the incentive has been provided for past action as opposed to prospective action, i.e. that the MISO TOs benefiting from the RO adder had already joined MISO. Here, as there, to the extent the action sought to be encouraged has already occurred, providing the incentive is inappropriate.

The concept of providing an incentive is to encourage someone to do something in the future. Providing a 50 basis point ROE adder for joining an RTO may be justified in order to encourage recalcitrant utilities to comply with Order No. 2000. The Commission posits that RTO membership will result in substantial consumer benefits. Thus encouraging utilities to join an RTO would provide new, prospective benefits to consumers.

However, providing an ROE adjustment to utilities that have been RTO or ISO members for some years will not result in any prospective or new benefits for consumers

on those utility systems. PJM formed as an ISO in 1996 and transformed into an RTO in 2001. However, the history of joint cooperation and system control by the TO members in PJM long predates the Commission's ISO and RTO policies. The PJM TOs, with the exception of Allegheny Power, have jointly dispatched their generation and controlled their transmission systems for 30 years or more. These utilities voluntarily formed an ISO and an RTO because of the substantial economic benefits they had to gain thereby. Obviously they needed no incentive to do so. Providing an ROE adder at this point would merely reward these utilities for doing exactly what was in their best economic interest to do rather than encourage them to undertake an action that would provide prospective benefits for consumers. As such, the PJM TOs' actions in joining PJM do not fall within the realm of action that is appropriate for incentive rates.

Furthermore, the Commission need not be concerned that the PJM TOs will disband their RTO because of the substantial economic benefits they would forego by so doing. Additionally, any such action would require prior Commission approval under Section 205 of the Federal Power Act, 16 U.S.C. § 824e. *PJM Interconnection, et al.*, 105 FERC ¶ 61,294 (2003). The Commission in that docket approved with modifications a settlement submitted by the PJM TOs in response to the D.C. Circuit Court's decision in *Atlantic City Electric Co. et al. v. FERC*, 295 F.3rd 1 (D.C. Cir. 2002) and *Atlantic City Electric Co. et al. v. FERC*, 329 F.3rd 856,859 (D.C. Cir. 2003). Thus there is no need for an incentive to restrain these utilities from disbanding PJM as this Commission will have final authority to rule on any such action.

The Commission's existing 1992 Policy Statement and indeed Order No. 2000 would require a showing of prospective, or new, benefits to be received by consumers in

exchange for the 50 basis point ROE adder. Otherwise, the provision of the adder would be arbitrary and would merely reward the PJM TOs for undertaking an action that they clearly undertook many years ago because they found that action to be in their best financial interest.

Finally, any attempt to justify the 50 basis point adder under the Proposed Policy Statement would nonetheless require either a hearing to determine whether the “policy statement” should be applied to these TOs, or a finding of prospective benefits to consumers. A Policy Statement is just that, an expression of policy. It is not a final rule to be applied in every case. Rather, the Commission must analyze the facts of each case and determine whether the policy should be applied. Consequently, a hearing would be required into the factual issue of whether these TOs require an incentive to join an RTO. Additionally, many stakeholders have submitted comments in the Proposed Policy Statement proceeding that the Commission must abide by its existing incentive rate standards and existing judicial mandates requiring a finding of prospective consumer benefits before providing such incentives. The judicial mandates issue is discussed in greater detail in subsection (2) below. The Proposed Policy Statement is not yet final and will likely be appealed unless such conditions are attached to any incentives approved. Even assuming the Proposed Policy Statement could pass judicial muster without requirements for a demonstration of consumer benefits, unlike the requirement in the Proposed Policy Statement for a sunset date to the 50 basis point ROE adder incentive of December 31, 2012, the Commission’s grant of a 50 basis point ROE adder in the January 2 Order contains no such termination date. Consequently, the Commission cannot rely on the Proposed Policy Statement to justify its action in the instant docket.

The Commission should reconsider its decision to grant a 50 basis point ROE adder and reject that request or set that issue for hearing.

2. **The Commission Erred In Awarding The 100 Basis Point ROE Adder Because The Grant Of Such An Incentive Will Provide No Prospective, or New, Benefits To Consumers.**

The 100 basis point ROE adder is likewise an incentive rate that must provide prospective, or new, benefits for consumers under existing Commission incentive rate policy and judicial mandates. The Commission in the July 24 Order in Docket No. ER03-738 recognized this and required the PJM TOs to justify the request in any future filing with an analysis of the need for such an incentive and the benefits to be gained thereby. *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 at ¶ 75 (2003). While the PJM TOs did submit evidence in this proceeding purporting to show that the 100 basis point ROE adder produced consumer benefits, Joint Consumer Advocates and others have challenged that evidence. In our Protest in this docket, we noted that:

“the evidence presented by the TOs through the testimony of Dr. Avera does not justify the incorporation of a 100 basis point adder for new investment ordered through PJM's RTEP in this instance. The general arguments made by the TOs in favor of ROE adders are more in line with general comments filed by some parties in the Proposed Policy Statement proceeding, which comments have not yet been ruled upon. The question that has not been answered in this specific instance is why PJM's Transmission Owners, at this time, warrant receiving an additional 100 basis points incentive for investment made pursuant to the RTEP process. The Transmission Owners made no showing demonstrating a lack of investment in PJM transmission facilities without such an adder, nor did they demonstrate that without the 100 basis point adder transmission investments ordered by PJM will not be built.”

Additionally, we noted in our Protest that the existing PJM RTEP process already allows PJM to order upgrades for reliability reasons. Transmission owners have been able to comply with the RTEP for some years without the benefit of the 100 basis point adder for new transmission. Hundreds of millions of dollars in new transmission

investment have been made over the past five years since PJM became an ISO, and the PJM Board of Managers recently approved an RTEP Plan that includes proposals for over \$220 million in addition transmission system investments over the next several years. The past investment has been made without the benefit of any incentive ROE adders, and the future plans have been approved also without the benefit of, or guarantee of, incentive ROE adders. The proposed adder will not help bring PJM's transmission owners into compliance with the RTEP process. They are already required to comply. The RTEP process includes a cost benefit analysis that must be passed before investment plans are approved. Allowing transmission owners to simply add 100 basis points to the return on equity received for transmission upgrades will bring windfall profits to the upgrading entity, while reducing the cost savings that the Commission expects consumers to enjoy through RTO membership. Giving transmission owners return on equity adders to perform functions they are already required to perform in order to comply with the rules of an organization they voluntarily joined is not sound incentive ratemaking policy and could very well skew the results of any cost benefit analysis.

The Commission in the January 2 Order recognized that these protests existed, but did not set this issue for hearing. The procedural aspect of that argument is discussed below. Here, we only note that the Commission's decision to award the 100 basis point ROE adder cannot be based on the evidence of benefits as would be required by 1992 Policy Statement and judicial mandates since evidence to the contrary exists and no hearing has been held to explore the factual disputes.

Thus the Commission's decision to award the 100 basis point ROE adder can only be based on the Proposed Policy Statement. Yet as noted above, the Commission has not

inquired into whether that policy is appropriate for the PJM TOs in this docket through an evidentiary hearing. More importantly, that proceeding is not yet final, and numerous parties, including Joint Consumer Advocates via their membership in the National Association of State Utility Consumer Advocates (“NASUCA”) have raised the issue of the need to ensure prospective benefits stemming from an incentive policy. As noted above, the likelihood that any prospective benefits will be derived in PJM from the provision of a 100 basis point ROE adder is unlikely considering the RTEP process. If the Commission should issue the Proposed Policy Statement as proposed, appeals are likely. There is no assurance that the Final Policy Statement will resemble the Proposed Policy Statement. Thus, the Commission’s reluctance to set the matter for hearing could result in even greater delays if appeals of any final order in that docket are successful.

The likelihood of success on any appeal of the issue relating to a required showing of prospective, or new, consumer benefits should not be understated. The D.C. Circuit Court of Appeals has required evidence of consumer benefits for incentive rate programs. The Court has stated that the Commission is allowed to adopt new methods of establishing rates, however in so doing it “must also, and always, relate its action to the primary aim of the Act to guard the consumer against excessive rates.” *City of Detroit v. Federal Power Commission*, 230 F.2d. 810, 817 (D.C. Cir. 1955). In that case, the D.C. Circuit Court noted that a Commission change in the method of assessing rate base for a natural gas pipeline might produce the end result sought by the Commission of encouraging pipelines to own producing properties and might encourage development of new sources of production “as an even greater increase also might do.” *Id.* However, the Court noted that the essential question is “whether a lesser amount [of rate increase as an

incentive] would suffice.” *Id.* at 818. The Court required substantial evidence that the goal sought could be accomplished by the change in policy at the lowest amount “reasonably necessary”. *Id.*

Even though the cited case is a natural gas proceeding under the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, rather than an electric proceeding under the Federal Power Act, 16 U.S.C. § 824 *et seq.*, both Acts exist for the same reason, protection of consumers from exploitation at the hand of monopolist utilities, and both Acts have similar paradigms for regulation of utilities. More importantly, the analogy to *City of Detroit* is particularly appropriate here where the Commission is undertaking an approach identical to that followed in *City of Detroit*, i.e. changing traditional rate policy, here calculation of rate of return, to foster incentive goals affecting ownership of utility facilities and investment in new facilities. As the D.C. Circuit Court noted, the Commission must ensure that the increase is needed, and is not greater than the amount needed to incent the required action. *Id.* at 818; *City of Charlottesville, Virginia v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981). Joint Consumer Advocates submit that the Commission’s action here does not meet this rigorous standard of showing that concrete benefits could result from the ROE adders for these Transmission Owners or that these adders are the lowest reasonable cost means of achieving such benefits..

The Commission also cannot rely on its orders in 2001 in the California and Western energy markets proceedings where it provided ROE incentive adders to spur development of new transmission infrastructure as support for its decision in this proceeding. In 2001, the Commission approved several incentive proposals, including a 200 basis point ROE adder for upgrades at existing constrained facilities if those

upgrades were placed in service by a July 1 of that year, and a 150 basis point ROE adder for facilities placed in service by November 1 of that year to transmission owners in those markets. *Removing Obstacles to Increased Electric Generation and Natural Gas Supply In The Western United States*, 96 FERC ¶ 61,155 (2001) (“Western Orders”). A second incentive would have allowed a 100 basis point adder for new facilities not already in use that would add significant transfer capability and could be in service by November 2, 2002, and a third incentive allowed a 150 basis point adder for facilities needed to interconnect new supply to the grid if it could be in service by November 1, 2001, or 150 basis point if it could be in service by November 1, 2002. In each situation, evidence existed that a specific consumer need for new investment existed and that supported the assumption that consumers would benefit from increased infrastructure given the crisis that existed in those markets at that time. Additionally, time limits were placed on the availability of the incentive ROE adders to encourage timely needed investment.

There is no evidence of either set of circumstances in the instant proceeding. First, there is no market crisis in PJM akin to that which existed in the California and Western markets in 2001, *i.e.* “the extraordinary circumstances surrounding the ongoing imbalances in California’s electricity power supply system, as reflected by the severity of the power shortages in the WSCC in general and in California, specifically.” *Id.* at 61,670. Second, the formula surcharge mechanism itself is a type of incentive rate mechanism adopted to ensure that the PJM TOs can timely recover the costs of new investments in transmission infrastructure approved under the PJM RTEP process and there is no evidence that additional incentives are warranted. Third, the Commission has imposed no time limits here on the availability of the incentive to spur timely

infrastructure investment. The Commission should either reject the 100 basis point adder outright, or set the issue of the need for such adders for hearing.

B. The Commission Denied Interveners A Right To Be Heard With Respect To The 100 Basis Point ROE Adder Issue By Failing To Set That Issue For Hearing Considering The Factual Challenges Made By Interveners To The PJM Transmission Owners' Evidence Related To The Alleged Need For And Benefits Of Such An Incentive.

Due process requires an opportunity to be heard in an evidentiary, trial type hearing where material facts are in dispute. *Union Electric Company*, 26 FERC ¶ 61,184 (1984); *United Gas Pipeline v. Federal Power Commission*, 551 F.2d 460, 463 (D.C. Cir. 1977). The Commission acknowledged that interveners in this proceeding challenged factual claims made by the PJM TOs in the testimony they submitted with their filing in this proceeding with respect to the purported benefits to be derived from a 100 basis point ROE adder. While the Commission attempted to circumvent this requirement by reliance on the Proposed Policy Statement, as Joint Consumer Advocates discussed above, it is likely that the Commission will ultimately have to comply with existing standards for incentive rates and judicial mandates requiring a showing of prospective consumer benefits in any final policy adopted in that proceeding. More importantly, a policy statement is not a rule of required applicability, but rather a generic statement of policy that must be reviewed in each proceeding to determine whether the circumstances warrant application of the policy to that case. That showing necessarily entails factual disputes. The Commission's failure to set this issue for hearing constitutes legal error and should be corrected.

C. **The Commission Erred In Granting The 50 Basis Point And The 100 Basis Point ROE Adders Before Considering Whether The Resulting Rate Of Return On Equity Would Remain Within The Zone of Reasonableness.**

The ultimate goal in this proceeding is to establish a rate of return for these utilities for new investment that provides for just and reasonable rates to consumers. The United States Supreme Court has required that the return established be commensurate with returns on investments in other enterprises having corresponding risks, be sufficient to ensure investor confidence in the financial integrity of the enterprises so as to attract capital and maintain credit, and balance investor and consumer interests. *Bluefield Waterworks & Improvements Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 692 (1923); and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944). The Commission has historically employed a range of reasonableness in determining an appropriate return on equity to satisfy these criteria. *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 at ¶ 30. The Commission must ensure that the return on equity finally authorized, including the incentive ROE adder basis points, nonetheless produces a final equity return that remains within the zone of reasonableness.

The Commission implicitly acknowledged the need to establish an upper limit on return on equity in the MISO rehearing order. *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,143 at ¶ 12-13. More importantly, the Commission explicitly recognized the need to stay within the range of reasonableness for equity returns in the Proposed Policy Statement, stating that a cap would be imposed on any returns increased by ROE adders, set at the top of the range for reasonable ROEs for a proxy group of publicly traded, investor owned transmission owners participating in the

relevant RTO. *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid*, 68 Fed. Reg. 3842 at ¶ 37 (2003). The Commission here will not know whether the 50 basis point adder or the 100 basis point adder will produce a final return on equity that remains within the zone of reasonableness until the Commission establishes that zone after full litigation of these issues. Consequently, the Commission's decision to approve the 50 basis point and 100 basis point adders is premature at best. The Commission should reconsider its decision to grant these adders at this time and either reject the adders outright, or set these issues for hearing as part of the inquiry into equity return issues in this case.

D. Conclusion

The Commission should reconsider its decision to grant the 50 basis point and 100 basis point ROE adders at this phase of the proceedings. There is no evidence that such incentives will produce any prospective, or new, benefits for consumers; that the facts in this proceeding warrant application of a future policy to the circumstances faced by the PJM TOs; that incentives in addition to the surcharge itself is necessary to encourage participation in RTOs or investment in new facilities; or that the adders will result in a final equity return that remains within a zone of reasonableness.

WHEREFORE, Joint Consumer Advocates respectfully request that the Commission reconsider its decision to grant the 50 basis point and 100 basis point ROE adders at this time and either reject those adders outright, or set these matters for hearing.

Respectfully submitted,

Filed Electronically

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CERTIFICATE OF SERVICE

The Allegheny Power System Operating : Docket Nos. ER04-156-000
Companies: Monongahela Power : and ER04-156-001
Company, The Potomac Edison :
Company, and West Penn Power :
Company, all doing business as :
Allegheny Power; :
The PHI Operating Companies: Potomac :
Electric Power Company, Delmarva :
Power & Light Company, and :
Atlantic City Electric Company; :
Baltimore Gas & Electric Company; :
Jersey Central Power & Light Company; :
Metropolitan Edison Company; :
Pennsylvania Electric Company; :
PECO Energy Company; :
PPL Electric Utilities Corporation; :
Public Service Electric & Gas Company; :
Rockland Electric Company; and :
UGI Utilities, Inc. :

I hereby certify that I have this date served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-referenced proceeding. Copies of this document have been served upon all parties designated on the Commission's official service list, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Harrisburg, PA this 2nd day of February, 2004.

Respectfully submitted,

--Filed electronically --

Denise C. Goulet
Senior Assistant Consumer Advocate

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