

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

FirstEnergy Service Company

Docket No. AC05-7-000

ORDER ADDRESSING ACCOUNTING FOR EXTRAORDINARY VEGETATION
MANAGEMENT COSTS

(Issued March 4, 2005)

1. On November 1, 2004, FirstEnergy Service Company (FirstEnergy), a wholly owned subsidiary of FirstEnergy Corp., on behalf of American Transmission Systems, Inc. (ATSI), submitted a request for authorization to defer \$54 million of extraordinary vegetation management (VM) costs as a regulatory asset and to amortize the costs over a five year period. We grant FirstEnergy's request in part and deny it in part, as discussed in the body of this order.

Background

2. On September 1, 2000, the utility operating companies of FirstEnergy Corp. transferred their jurisdictional transmission facilities located in Ohio and western Pennsylvania to ATSI, a transmission company affiliate and wholly owned subsidiary of FirstEnergy Corp.¹ Effective October 1, 2003, ATSI transferred operational control of its transmission facilities to the Midwest Independent Transmission System Operator Inc. (Midwest ISO). As part of integration into the Midwest ISO, ATSI's zonal rates were established based on its existing revenue requirements. On December 2, 2004, the Midwest ISO and FirstEnergy submitted a rate filing to the Commission to convert ATSI's current rates to a formula rate under Attachment O to the Midwest ISO open access transmission tariff (OATT). This filing was accepted for filing and suspended for a nominal period, to become effective on February 1, 2005, subject to refund².

¹ The three operating utility companies of FirstEnergy Corp. are The Cleveland Electric Illuminating Company, Ohio Edison Company, and The Toledo Edison Company. Ohio Edison Company in turn owns Pennsylvania Power Company, another operating utility company.

² *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,080 (2005).

3. In its November 1, 2004 filing, FirstEnergy states that ATSI began a comprehensive VM enhancement project (VM Project) to supplement its existing VM maintenance program (Ordinary VM) in 2004. FirstEnergy states that the VM Project will continue through 2007 and will cost \$54 million to complete. FirstEnergy claims that the VM Project was commenced to comply with recent directives and recommendations by the Commission and the North American Electric Reliability Council (NERC) designed to enhance bulk electric system reliability.³

4. FirstEnergy proposes to defer all of the VM Project costs in Account 182.3, Other Regulatory Assets, and amortize the deferred VM costs over a five year period beginning June 1, 2006. FirstEnergy states that under ATSI's existing rate, and under the formula rate that will be effective for ATSI in 2005, the VM Project costs incurred from 2004 through 2007 will not be recoverable during the same years in which they are incurred. FirstEnergy asserts that the VM Project costs are entirely incremental to its Ordinary VM costs and immediate recognition of such extraordinary expenditures as expenses would distort FirstEnergy's net income. Accordingly, FirstEnergy claims that the purpose of its proposed accounting is to avoid a mismatch between the expensing and rate recovery of the VM Project costs and to provide for a fair and reasonable amortization of such costs in a future period.

5. FirstEnergy states that it expects to request at a future time, recovery of the deferred costs through a separate transmission surcharge. FirstEnergy also states that it is probable that such costs will be specifically recovered in future rates based upon the Commission's Policy Statement on Bulk Power System Reliability (*Reliability Policy Statement*).⁴ In the instant filing, it is only seeking authorization for the proposed accounting treatment, not approval for ratemaking purposes. Additionally, FirstEnergy acknowledges that the Commission, separate from its review of this accounting request, has authority to review such costs under the just and reasonable standard of the Federal Power Act.

³ See Application at page 3.

⁴ Application at page 4, n. 10. *Policy Statement on Matters Related to Bulk Power System Reliability*, 107 FERC ¶ 61,052 (*Reliability Policy Statement*), clarified, 108 FERC ¶ 61,288 (2004).

Protests and Comments

6. Notice of FirstEnergy's filing was published in the *Federal Register*, 69 Fed. Reg. 70,138 (2004), with motions to intervene and protests due on or before December 13, 2004. A timely notice of intervention and comment was filed by the Public Utilities Commission of Ohio (Ohio PUC). Timely motions to intervene and protest were filed by the Ohio Consumers' Counsel and the Pennsylvania Office of Consumer Advocate (Pennsylvania Consumer Advocate) (collectively, the protesters). On December 30, 2004, FirstEnergy filed an answer on behalf of ATSI.

7. The Ohio PUC supports the efforts ATSI has taken to enhance its VM program and recommend that the Commission accept the deferral requested by ATSI. The Ohio PUC notes that the U.S.-Canada Power System Outage Task Force Report,⁵ issued in April 2004, concluded that FirstEnergy's VM practices are within common or average industry practices which need significant improvement to assure greater transmission system reliability. The Ohio PUC states that the need to upgrade prior standards justify an extraordinary remedy such as the deferral proposed by ATSI. The Ohio PUC also requests that the Commission examine the reasonableness of the actual expenditures when it passes on the ultimate recovery of these deferrals.

8. The Ohio Consumers' Counsel protests that FirstEnergy's application is designed to focus on accounting in hopes that questions will not arise concerning the rate, tax and other implications of its proposal. It asserts that FirstEnergy's distribution utilities operating in Ohio have retail rate caps until the end of 2005 and the proposed deferral is an attempt to circumvent the rate caps. Accordingly, the Ohio Consumers' Counsel requests that the Commission reject the proposal to defer expenses in 2004 and 2005.

9. Additionally, the Ohio Consumers' Counsel argues that the Commission should reject FirstEnergy's characterization of its increased VM costs in the years immediately after the 2003 blackout as merely the generic response of a transmission entity to the Commission's desire for enhanced reliability. The Ohio Consumers' Counsel claims that FirstEnergy's VM expenditures after the blackout were made to address a legacy of neglect and were not improvements that would lower VM costs in the future.

10. The Pennsylvania Consumer Advocate argues that the VM expenses which FirstEnergy is seeking to defer do not qualify for regulatory asset treatment in

⁵ U.S.-Canada Power System Outage Task Force, Final Report on the August 14th Blackout in the United States and Canada: Causes and Recommendations (April 2004) (Final Blackout Report).

Account 182.3, Other Regulatory Assets. Specifically, it claims that FirstEnergy fails to provide evidence that the VM expenses cannot be booked as routine operation and maintenance expense in other accounts. Secondly, the Pennsylvania Consumer Advocate states that FirstEnergy provides no evidence that these expenses stem from the “ratemaking actions” of a regulatory agency. Third, it contends that FirstEnergy has not provided evidence showing that a net income loss will occur for accounting purposes. Consequently, the Pennsylvania Consumer Advocate states that if ATSI’s earnings are sufficient to cover the VM Project costs, there should be no need for regulatory asset treatment.

11. The Pennsylvania Consumer Advocate also argues that FirstEnergy’s proposed deferral is not necessary to receive recovery of the VM Project costs because ATSI’s filing under Attachment O of the Midwest ISO OATT may allow for recovery of the VM Project costs. It claims that FirstEnergy has failed to demonstrate that these expenses are any different, extraordinary or unusual as compared to other routine expenses recovered through Attachment O. Additionally, the Pennsylvania Consumer Advocate contends that the proposed deferral will not correct the perceived mismatch since ATSI does not propose to recover the cost in rates until after they are incurred.

12. The Pennsylvania Consumer Advocate states that, for the deferred accounting to be approved, FirstEnergy must demonstrate that the expenses are properly recoverable in rates to ensure that rates are just and reasonable. It claims that FirstEnergy’s prior vegetation management practices may not have been adequate, thus necessitating expenditures to correct problems arising from these inadequacies. Accordingly, the Pennsylvania Consumer Advocate contends that it is incumbent upon the Commission to conduct a full review of FirstEnergy’s vegetation management expenditures when considering the request for deferral, to determine the probability that these expenditures would be includible in rates.

Discussion

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept FirstEnergy’s answer and will, therefore, reject it.

14. FirstEnergy seeks authorization to defer ATSI’s VM Project costs as a regulatory asset in Account 182.3 and to amortize the costs over a five year period beginning June 1, 2006. FirstEnergy states that it will request recovery of the deferred VM Project costs through a surcharge in a separate rate filing.

15. The Pennsylvania Consumer Advocate claims that FirstEnergy fails to provide evidence that the VM expenses cannot be booked as routine operation and maintenance expense in other accounts, that it provides no evidence that these expenses stem from the “ratemaking actions” of a regulatory agency, and that no evidence shows that a net income loss will occur for accounting purposes. However, this is not the Commission’s standard for deferring costs as a regulatory asset. For ATSI to defer the VM Project costs as a regulatory asset, it must be probable that these costs will be recovered in rates in a different period than the period in which they would otherwise be charged to expense under the general requirements of the Commission’s Uniform System of Accounts.⁶ In our *Reliability Policy Statement*, we “assure[d] public utilities that we will approve applications to recover prudently incurred costs necessary to ensure bulk electric system reliability, including prudent expenditures for vegetation management...”⁷ Our statements in the *Reliability Policy Statement* provide a logical basis to conclude that the VM Project costs are probable of future recovery. Furthermore, the expected rate recovery mechanism, a surcharge, is consistent with the rate mechanism that we indicated would be available to entities in our *Reliability Policy Statement*.⁸

16. The arguments cited by the protesters which are intended to cast doubts as to the prudence and the ultimate recovery of these costs are not relevant in this proceeding because they are speculative and are not supported by a determination made by the Commission. These arguments are better raised in ATSI’s future rate case for the ultimate recovery of the deferred costs in rates. Additionally, the protester’s arguments that the deferral will not solve the matching problem are incorrect. As previously discussed, ATSI intends to recover the deferred costs through a separate surcharge rather than through the Attachment O. Thus, by using both the deferral and the surcharge the deferred costs will be amortized to expense concurrent with their recovery in rates.

⁶ The term “probable,” as used in the definition of regulatory assets, refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved. Revisions to Uniform System of Accounts to Account for Allowances under the Clean Air Amendments of 1990 and Regulatory-Created Assets and Liabilities and to Form Nos. 1, 1-F, 2 and 2-A, FERC Stats. & Regs., Regulations Preambles (January 1991 - June 1996) ¶ 30,967 (1993) (Order No. 552).

⁷ *Reliability Policy Statement*, 107 FERC ¶ 61,052 at P 27.

⁸ *Id.* at P 28.

17. For the foregoing reasons we will approve FirstEnergy's request to defer ATSI's VM Project costs in Account 182.3.⁹ If the Commission later determines that some or all of the VM Project costs are not recoverable in rates; those amounts are to be immediately removed from Account 182.3. However, we deny the proposed five year amortization proposal. This request is premature and is more appropriately addressed in the future rate case for the ultimate recovery of the deferred costs in rates. However, if the Commission allows recovery of these costs, the deferred costs shall be amortized over a period that is consistent with the recovery in rates.

The Commission orders:

FirstEnergy's proposed accounting treatment is hereby accepted in part and denied in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

⁹ This determination is for accounting purposes only and does not guarantee the ultimate rate recovery of the VM Project costs.