

124 FERC ¶ 61,176
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Pepco Holdings, Inc.

Docket Nos. ER08-686-000
ER08-686-001

ORDER GRANTING TRANSMISSION RATE INCENTIVE

(Issued August 22, 2008)

1. On March 18, 2008, as supplemented on June 23, 2008, Pepco Holdings, Inc. (PHI), on behalf of its transmission-owning public utility affiliates,¹ filed revised tariff sheets to the PJM Interconnection, L.L.C. (PJM) Open Access Transmission Tariff (OATT) pursuant to section 205 of the Federal Power Act (FPA)² and Order Nos. 679 and 679-A³ to implement a transmission rate incentive for eight transmission projects (PHI Projects).⁴ These projects were identified in the PJM Regional Transmission Expansion Plan (RTEP) as baseline projects and have been approved by the PJM Board of Managers (PJM Board). PHI requests an effective date of June 1, 2008, for the tariff sheets submitted. For the reasons

¹ PHI's transmission-owning public utility affiliates are: Atlantic City Electric Company (ACE), Delmarva Power & Light Company (Delmarva), and Potomac Electric Power Company (Pepco) (collectively, the PHI Companies).

² 16 U.S.C. § 824d (2006).

³ *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 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

⁴ On June 23, 2008, PHI submitted a response (Supplemental Filing) to a deficiency letter issued by the Director, Division of Tariffs and Market Development – East, acting under delegated authority.

discussed below, we grant PHI's request for a transmission rate incentive for the PHI Projects, to be effective June 1, 2008.

I. Background

A. Description of the Company

2. Delmarva and ACE are wholly-owned subsidiaries of Conectiv which in turn is a wholly-owned subsidiary of PHI. Pepco is a wholly-owned subsidiary of PHI. The PHI Companies provide electric transmission, distribution and gas distribution services to several states along the Atlantic seaboard and are regulated by the Commission and various state commissions.⁵

B. Description of the PHI Projects and Project Specific Risks and Challenges

3. The PHI Projects are PJM RTEP approved baseline projects and have an aggregate projected construction cost of nearly \$290 million. The PHI Projects are scheduled to go into service between the summer of 2008 and 2012. The PHI Projects consist of various upgrades to existing substation equipment (such as replacement and/or addition of transformers and capacitors to existing substations), the addition of new substations, rebuilding and reconductoring existing lines, and adding discrete transmission lines throughout the Maryland, New Jersey, and Delmarva Peninsula area. The PHI Projects are discussed in more detail below. PHI requests Commission authorization of a 150-basis point return on equity (ROE) adder for the PHI Projects.

1. Pepco Baseline Projects

4. The PHI Projects in the Pepco transmission zone are Dickerson-Station H, Brighton, and Burches Hill.⁶ PHI states that these projects represent a significant expansion of the 500/230 kV import capability into the Southwest Mid-Atlantic area. The total cost of these projects is estimated to be \$156.75 million and all work must be completed by June 2012.

⁵ Transmittal Letter at 4.

⁶ Ex. No. PHI-13.

5. The Dickerson-Station H project⁷ involves a terminal equipment upgrade at the Dickerson-Station H 230 kV substation and the addition of a 300 MVAR capacitor at the same substation. PHI states that it will have to obtain approval of outage schedules and permits and that long manufacturing lead times will make the construction very challenging. Dickerson is one of the two main northern import paths into the Pepco/BG&E zones from Allegheny Power. Therefore, PHI states that the Dickerson upgrade will remediate NERC reliability violations at Dickerson and on the 500 kV system in Pennsylvania, which add to voltage and import restrictions at Dickerson. PHI states that in recognition of these the broad regional benefits that will be achieved by the Dickerson upgrade, PJM has determined that the cost of these below 500 kV upgrades should be allocated to the load in the ACE, BG&E, Delmarva, Jersey Central, MetEd, Neptune, PECO, Pepco, PSEG, and ECP zones. Further, PHI states the Dickerson project is significant because of its important reliability and economic contributions on a regionally critical portion of the PJM system. PHI claims that this significance is highlighted by PJM's cost allocation to many different pricing zones. PHI states that the Dickerson project is also significant because of its use of new conductor design, which facilitates a higher rating using existing right-of-ways. PHI claims additional reactive power support is critically needed at Dickerson. PHI asserts that this project will make it more feasible for new generators to interconnect at the Dickerson station. The timeline for this project calls for 2011 and 2012 in-service dates with the total cost of these projects estimated to be \$22.75 million.

6. The Brighton project⁸ involves the replacement of the existing 500/230 kV transformer and the installation of a second 500/230 kV transformer at the Brighton substation, two new 500 kV breakers, six new 230 kV breakers, and expansion of the substation bus, new control and protection equipment. PHI states that Brighton is one of the two main import paths into the Pepco/BG&E zones from the north. In addition, PHI asserts that based on the summer 2009 Southwest Mid-Atlantic Load Deliverability test, PJM concluded that an outage of the Brighton-to-Waugh Chapel 500/230 kV transmission line and transformer would cause the existing Brighton 500/230 kV transformer to experience a two percent overload in the summer of 2009. PHI also states that further analysis showed that with the installation of the new Kempton 500 kV transmission lines, the existing transformer will become overloaded and must be replaced with a new two percent impedance transformer. PHI asserts that the installation of new 500/230 kV transformers is a major (non-routine) undertaking involving significant manpower

⁷ PJM Project Nos. b0367 and b0561.

⁸ PJM Project Nos. b0288 and b0496.

needs, design work, system coordination, transportation issues, and manufacturer lead time. PHI states that Pepco has yet to obtain the transformers and that transformer costs continue to rise, which could impact the project's budget. In addition, PHI asserts that the outage and construction plan is complex. The ability to arrange voluntary outages to reconfigure the existing breakers and install the new breakers and transformers could negatively impact the schedule. PHI notes that the Brighton project, with an estimated cost of \$52 million, will independently and in conjunction with other system reconfigurations constructed with the Potomac-Appalachian Transmission Highline (PATH) project serve crucial and wide-reaching regional reliability needs as determined by PJM.⁹ It states this project will improve transfer capability into the Southwest Mid-Atlantic region, eliminate low impedance-induced overloads on the Brighton transformer, and ultimately improve transfer capability in conjunction with the Amos-Kempton 765/500 kV PATH Project. Finally, PHI states the Brighton upgrades were approved by the PJM Board and because of the strategic location and regional benefit, PJM has determined that the costs will be allocated to load in the BG&E, Dominion, and Pepco zones.

7. The Burches Hill project¹⁰ involves installation of two 500/230 kV transformers at Burches Hill, reconductoring three existing 230 kV circuits from Burches Hill to Palmers Corner, and new smart relay protection equipment. PHI states that Burches Hill is located on the main import and transfer path between Dominion Virginia Power and BG&E. Based on the 2006 Baseline RTEP Report, the Burches Hill 500/230 kV transformer has a base case overload of 101 percent. PHI asserts that PJM's 2007 Baseline Report identified overloads that would result during an outage of two of the three 230 kV transmission lines connecting Burches Hill and Palmers Corner, a major supply path into the District of Columbia. PHI states the project will (a) remedy the overloads and relieve future overload conditions in BG&E and Pepco zones as identified in the BG&E/Pepco Load Deliverability test for 2011; (b) eliminate the overloads for N-2 criteria and ensure compliance with NERC/RFC criteria; and (c) improve transfer capability into the Southwest Mid-Atlantic region of PJM. PHI states that Pepco has to obtain permits, materials, and schedule outages, which are significant risks to the project and could impact the construction schedule. PHI asserts that engineering resources are becoming more difficult to find. For example, one of the major equipment suppliers for the project has indicated that it has limited engineering resources, so its ability to provide timely equipment drawings will compress

⁹ Supplemental Filing, Response to Question 3.

¹⁰ PJM Project Nos. b0319, b0478 and b0499.

Pepco's own design schedule. PHI further asserts that the project is large and will require an outside consulting firm. PHI claims that there are a limited number of engineering firms with such resources currently available. In addition, PHI states there are limited internal construction mechanics and relay personnel, therefore, additional outside forces will be required to supplement Pepco's crew. PHI states that each phase of the Burches Hill project will entail major capital commitments, totaling \$82 million.¹¹ PHI further states that the Burches Hill project has been determined by PJM to meet necessary system reliability needs in more than one PJM zone and thus the cost of Burches Hill upgrades will be allocated to the load in the Pepco and BG&E zones. PHI notes that this project falls within the Mid-Atlantic National Interest Electric Transmission Corridor, as designated by the Secretary of the Department of Energy.

2. Delmarva Baseline Projects

8. Delmarva is located in the Eastern Mid-Atlantic PJM Area, which consists of the six transmission zones in New Jersey, southeastern Pennsylvania, and the Delmarva Peninsula. The PHI Projects in the Delmarva's transmission zone are Cool Springs, Red Lion, Oak Hall, and Indian River.¹² PHI claims the total cost estimate of the projects is \$64.3 million. According to PHI, the projects will increase load deliverability and reliability for the entire Delmarva Peninsula and portions of Maryland and Virginia, and all of Delaware. In addition, the projects will provide the ability to import additional energy to offset the retirement of generation located on the Peninsula. Finally, these projects will be in service by 2012 and will provide benefits to many municipalities and cooperatives in addition to Delmarva Power customers.

9. The Cool Springs project¹³ was identified by PJM to alleviate the 2010 Delmarva South Load Deliverability criterion violation. PHI claims that the Indian River to Millsboro 69 kV line experienced a 6 percent overload for the outage of the Indian River to Robinsonville 138 kV line along with numerous transmission voltage violations. PHI asserts that the Delmarva Peninsula continues to experience overload conditions due to substantial load growth and limited local generation. PHI states that the Cool Springs baseline RTEP project

¹¹ Supplemental Filing, Response to Question 3 at 14 (stating the individual breakdown is: \$37 million for Project b0319, \$14.5 million for Project b0478, and \$31 million for Project b0499).

¹² Ex. No. PHI-14.

¹³ PJM Project No. b0320.

will address immediate overload conditions by reducing thermal loading on the 69 kV facilities in Delaware and Maryland. The project also provides much needed reactive power support in the northern Delaware beach areas to address an N-1 contingency loss. The Cool Springs project involves construction of a new 230/69 kV substation at the Cool Springs site in Sussex County, Delaware, that will split an existing Indian River-to-Milford 230 kV transmission line, add a new 230/69 kV transformer, and extend a new 69 kV circuit to Harbeson, Delaware.

10. PHI states that the Cool Springs project will use aluminum conductor steel supported/trapezoidal wire (ACSS/TW) and aluminum conductor composite core (ACCC) technology instead of more conventional conductors for the new Cool Springs to Lank 69 kV line. PHI claims that this new technology will maximize use of existing rights-of-way, thereby reducing the need to acquire additional land. PHI asserts that installation of the new substation, coupled with the addition of a new transformer and transmission circuit are not routine or ordinary projects. PHI asserts that they require substantial commitments of manpower, resources and capital. PHI claims that this project, which has a 2010 scheduled in-service date, is competing for resources with a number of other important projects being conducted in the same timeframe. PHI further states that the Cool Springs project is also out of the ordinary in that it will utilize advanced conductor technology, and the use of such new technology will help to expedite the project because it enables Delmarva to make maximum use of existing rights-of-way. PHI estimates that the total cost of the Cool Springs project will be \$12.8 million.

11. The Red Lion project¹⁴ is located on one of the principal 500 kV paths from eastern Pennsylvania to New Jersey. PHI asserts that it is designed to address future overloads of the Keeney 500/230 kV transformer identified in the 2009 Delmarva Zone Load Deliverability Test. In addition to improving system reliability, PHI claims that the Red Lion project benefits the region by improving the import capability of the 500 kV transmission system. The project involves a reconfiguration of the Red Lion 230 kV substation to tie in the existing 500/230 kV transformer and creates a new 500/230 kV path into the Delmarva transmission system. The project also involves the construction of a new five position 230 kV Breaker and a Half substation adjacent to the existing Red Lion 500 kV switchyard. Delmarva will also replace breakers at the Keeney and Edge Moor 230 kV substations. The second part of the project entails installation of a second 230/138 kV transformer in parallel with the current transformer at the Red Lion substation located in New Castle County, Delaware.

¹⁴ PJM Project Nos. b0241 and b0260.

12. PHI claims that the Red Lion project will entail significant transmission line reconfiguration to make room for the new 230 kV substation. Several 230 kV lines will be rerouted around the perimeter of the new substation. Since a 500 kV line runs adjacent to the new substation, the 230 kV transmission line reconfiguration must be carefully planned such that the new line locations do not interfere with the new substation or the existing 500 kV line. PHI claims that reconfiguring the Red Lion substation, creating a new 500/230 kV transmission path and adding a new 230/138 kV transformer are neither routine nor ordinary ventures. PHI asserts that they require substantial commitment of resources at many different levels and ongoing coordination. PHI states that this project will require material transmission line reconfigurations and replacement of multiple breakers. In addition, detailed studies have identified the need for numerous structure and foundation changes. PHI states that major construction and outage coordination is necessary to ensure that all of this work can be completed prior to the required in-service date of June 2009.

13. PHI asserts that when completed, the Red Lion projects will improve system reliability (for example, by providing additional transformer redundancy) and also improve the import capability of the 500 kV transmission system, which broadly benefits the PJM region. PHI notes that the Delmarva Peninsula has long been cited as a congested area and PJM, together with Delmarva, has been aggressively addressing such congestion. Based on the regional benefit, a portion of the costs for this series of upgrades will be socialized, while the costs for the 230 kV portions will be shared between load in Delmarva and PECO. In total, PHI states that its total costs will be \$20.5 million.

14. The Oak Hall project¹⁵ was identified by PJM to resolve overloads and low voltage levels on the Delmarva Peninsula. The project involves construction of a new 138 kV line and a 69 kV feed from the Oak Hall substation to the Wattsville substation. In addition, the project includes installation of a new 138 kV substation at the existing Wattsville substation site, which includes a new 138 kV and 69 kV breakers and a new 138/69 kV transformer.

15. PHI states that significant wetland issues are present in the area of the Oak Hall substation and as a consequence, Delmarva will have to use temporary matting during all work; thus making the construction process more challenging, complex and time-consuming than normal. PHI also states that Delmarva is required to get a Certificate of Public Convenience and Necessity from the Virginia State Corporation Commission. In addition, PHI states that a joint permit

¹⁵ PJM Project No. b0483.

application has been filed as a pre-construction notice to the U.S. Army Corps of Engineers and the Virginia Department of Environmental Quality in order to verify that additional approvals are not required for the line. Additionally, PHI claims that a threatened and endangered species review consultation is currently underway, and the results are pending. PHI states that the results of the survey could have significant impact on the project. PHI further states that construction of the new Oak Hall transmission lines and associated breakers and transformer are not ordinary or routine activities. PHI asserts that PJM directed that these upgrades be made after consideration of alternatives, less aggressive solutions demonstrated that the new 138 kV line configuration was the most cost-effective solution to shortages of west-to-east transfer capability and reactive power supply in eastern PJM and on the Delmarva Peninsula. PHI claims that this project is expected to make a significant long-term contribution to load supply and voltage stability in the southern part of the Delmarva Peninsula. PHI estimates that the total cost of Oak Hall project will be \$8 million.

16. The Indian River project¹⁶ is designed to accommodate generator retirements in Eastern PJM, which will particularly impact the Delmarva Peninsula. The Indian River project will consist of rebuilding the Trappe Tap-Todd 69 kV line and the Mt. Pleasant to Townsend 138 kV line, and the addition of a third Indian River 230/138 kV transformer. PJM has determined that NRG's retirement of 180 MW of on-peninsula generation at the Indian River station will result in reliability overloads that need to be addressed by the three Indian River baseline upgrades. PHI asserts that these upgrades are not ordinary or customary. PHI states that Indian River project involves significant reconstruction of two transmission line circuits and the addition of a new 230/138 kV transformer. PHI claims that this is not the kind of work that is done as a routine matter.

17. PHI claims that coordination with multiple other utilities will also be necessary because of the nature of these projects. PHI notes that, in the vicinity of Indian River, the numerous wetlands pose significant siting and construction issues.¹⁷ PHI states that temporary matting will be required, which adds to the complexity and timing of all the work. In addition, Delmarva must coordinate and design outage planning with numerous utilities whose facilities tap into the Delmarva lines. PHI states that outage planning is especially challenging when multiple parties are affected. The Indian River Project is estimated to cost \$23 million.

¹⁶ PJM Project Nos. b0566, b0567, and b0568.

¹⁷ Supplemental Filing, Response to Question 3 at 28.

3. ACE Baseline Projects

18. PHI states that ACE is located in the Eastern Mid-Atlantic PJM Area. Generator retirements and increased load in the east have resulted in increasing transfers from the west, which is causing major load deliverability violations within Eastern PJM. The Eastern Mid-Atlantic Load Deliverability analysis for the summer of 2008 indicated a bus fault at the Chichester 230 kV bus causing a 35 percent overload, an outage of the Red Lion to Hope Creek 500 kV transmission line causing a 50 percent overload, and N-2 outages of the New Freedom to Salem 500 kV and the New Freedom to Hope Creek 500 kV transmission lines causing a greater than 50 percent overload. The PHI Projects in the ACE transmission zone that will address these reliability violations are the Mickleton Project and the Orchard Projects.¹⁸ The projects are estimated to cost \$69 million and to be in service by 2009. PHI states that approximately one third of the costs of the projects will be socialized across all load in PJM. The remainder of the costs will be allocated to the load in the Atlantic City, Jersey Central, PSEG, Rockland, and Neptune zones. Further, PHI states the cost allocation by PJM recognizes the regional benefits associated with the Orchard and Mickleton projects.

19. PHI states that the Orchard project¹⁹ will consist of construction of a new 500/230 kV substation at Orchard in Salem County, New Jersey. The project also involves constructing two new 230 kV lines from the Orchard substation to the existing 230 kV Churchtown-Cumberland line. The estimated cost of the Orchard project is \$63 million. PHI claims that this new substation will reduce the overloads on the Chichester to Mickleton 230 kV line and allow the line to be reconducted, thereby, upgrading it to a higher capacity, a result considerably less expensive than the cost to rebuild the 230 kV line. PHI asserts that the Orchard project has an aggressive schedule, recognizing that this is an entirely new site that required purchase of land and extensive environmental studies to ensure that the site selected would support the construction of a substation. Further, PHI states, this project will require close coordination with other transmission owners as well as with the owners of the Salem nuclear plant. PHI further asserts that the fact that an entirely new 500/230 kV substation will be sited, permitted, designed and constructed in two years is a remarkable undertaking for any utility. PHI states that after a potential site was selected for the Orchard project, the permitting necessary to construct the new substation while minimizing impacts to a nearby

¹⁸ Ex. No. PHI-15.

¹⁹ PJM Project No. b0210.

stream has been extremely challenging. PHI claims a significant amount of coordination and design modifications were necessary in order to ultimately gain approval to construct the new substation. Further, PHI claims that the project has to be reconfigured and redesigned several times in order to comply with state, county, and local permitting agency requirements.

20. PHI additionally states that the existing 500 kV Salem to East Windsor Line has to be cut into and out of the new 500 kV ring bus in order to tie the new Orchard substation. PHI claims that this involves significant coordination with two other utilities (PSE&G and FirstEnergy), as well as coordinating with a scheduled refueling outage of one nuclear generating unit. For example, the physical orientation of the new substation was designed to minimize the work necessary to cut the existing 500 kV line into the ring bus. PHI asserts that relay protection philosophy associated with the new Salem to Orchard and Orchard to East Windsor 500 kV lines also had to be coordinated with PSEG and FirstEnergy. This results in an extremely complex relay protection scheme for both lines.

21. PHI claims that the redesigns further impacted the material procurement and construction schedules. PHI asserts that the overall schedule (including engineering, material procurement and construction) of this project is extremely compressed. Also, PHI claims that construction elements had to be perfectly orchestrated in order to complete the work prior to the required in-service date.

22. The Mickleton project²⁰ will entail reconductoring of the Chichester-to-Mickleton 230 kV line over the Delaware River.²¹ The Chichester-to-Mickleton 230 kV line is jointly owned by ACE and Exelon Corporation's PECO subsidiary. The Mickleton project thus involves coordination with PECO in reconductoring the line. PHI claims that the project's reconductoring portion will be using two new technologies: ACSS/TW cable and new optical ground wire (OPGW) fiber optic design. PHI's share of the cost of the project will be \$6 million. PHI also notes that the siting and construction of the Chichester-to-Mickleton 230 kV line faces serious challenges due to the numerous permits that are required for the line as well as the sensitive habitat which is found in the area. PHI also notes that crossing the Delaware River will present significant siting challenges, unique permitting and safety issues, and multi-party coordination. For example, PHI states temporary matting will be used in order to traverse more than five acres of

²⁰ PJM Project No. b0265.

²¹ Reconductoring the Chichester-to-Mickleton 230 kV line with ACSS/TW cable allows for increased capacity.

wetlands during all work, making the construction more complex and time consuming. Further, PHI asserts that due to concerns that the project could impact archeological resources, matting installation must be monitored by a professional archeological monitor that meets National Park Service Professional Qualification Standards. Finally, PHI states the manufacturing time needed for the equipment to cross the Delaware River is approaching two years – a significant portion of the overall construction schedule.

C. Incentive Rate Proposal

23. PHI requests Commission authorization for a 150-basis point ROE adder for the PHI Projects. PHI requests that this adder be added, not to a midpoint return, but rather to its previously-accepted 11.3 percent ROE.²² PHI asserts that the projects ensure regional reliability by eliminating anticipated overloading of transmission facilities and preserve competition by improving import capability. The resultant ROE for the PHI Projects will be 12.8 percent, which will be implemented through PHI Companies' individual formula rates.

24. PHI states that these projects satisfy the Commission's requirements under Order No. 679 that "the facilities for which [a public utility] seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion consistent with the requirements of section 219 [of the Federal Power Act] . . .,"²³ and that "the total package of incentives is tailored to address the demonstrable risks and challenges faced by the applicant in undertaking the project. . . ."²⁴ PHI states that the requested ROE incentive also fulfills Order No. 679's requirement that the "resulting rates are just and reasonable,"²⁵ as discussed in more detail below.

²² *Baltimore Gas and Electric Company, et al.*, Docket No. ER05-515, *et al.*, a recent filing, established a stated base ROE of 10.8 percent for transmission facilities placed in-service by Baltimore Gas & Electric Co. and/or the PHI Companies prior to January 1, 2006 and a stated base ROE of 11.3 percent for transmission facilities placed in-service on or after that date. The Commission accepted these base ROEs in *Baltimore Gas & Electric Co.*, 115 FERC ¶ 61,066 (2006) (*Settlement Order*).

²³ Transmittal Letter at 8 (citing 18 C.F.R. § 35.35(d) (2008)).

²⁴ Transmittal Letter at 9 (citing Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 48).

²⁵ Transmittal Letter at 9 (citing 18 C.F.R. § 35.35(d) (2008)).

1. Combined Projects' Risks and Challenges

25. In addition to specific project's risks and challenges cited above, PHI asserts that the ROE incentive will address financial, regulatory, and construction risks. PHI claims that an ROE adder will help ensure that their credit metrics remain stable, allowing the companies to finance their aggressive, PJM-directed transmission investment program at reasonable cost.

a. Financial Risks

26. PHI states that one of the financial risks of the PHI Projects is that PHI will spend \$290 million to construct these upgrades, which represents almost one-third of its existing transmission rate base. PHI claims that the ROE incentive addresses the magnitude of the transmission capital budget for the PHI Projects and provides the correct signal for even larger budget requirements that are soon to follow.

27. PHI asserts that it is essential for it to maintain stable, investment credit ratings in order to prevent financing costs from increasing. PHI states that a downgrade of the PHI Companies' credit ratings would have an inevitable negative impact on the cost of capital of the utilities as well as the parent company, PHI. Since the PHI Projects will be partially financed with equity issued by PHI, a downgrading of PHI's debt would have a negative effect on their common stock. The proposed ROE incentive and the regulatory message sent by authorizing this incentive will help support the PHI Companies' credit ratings as they begin a period of even larger capital requirements.

28. PHI claims that the success of the financing plan rests on its ability to attract sufficient external investors. PHI explains investors expect a satisfactory return on their investment in transmission, commensurate with returns granted to similar projects and risks. PHI argues that an ROE adder granted to other PJM transmission owners but denied to PHI in analogous circumstances would jeopardize external funding not only for the PHI Projects but also for other important baseline projects.

29. PHI adds that it has limited internal funding resources and the PHI Companies will be competing for capital. PHI explains that the PHI Companies' construction expenditures for the period 2008 - 2012 are projected to be \$5 billion while the total corporate-wide construction expenditures are forecast to be \$5.7 billion. PHI states that the incentives to build the PHI Projects with their regional benefits are necessary and appropriate, since PHI will be competing for capital with many other construction projects.

b. Regulatory Risks

30. PHI states that there is significant regulatory uncertainty. For example, energy prices, market forces, increased market scrutiny, regulatory initiatives at the federal and state levels, and mandatory reliability standards all have contributed to the current atmosphere of uncertainty, and the financial implications for investors and ratepayers are cause for concern.

31. In addition, PHI asserts that cost recovery is not guaranteed. The ROE incentive adder helps to counter this risk and thereby send the correct message to transmission owners and constructors and the investors who supply the capital to build transmission.

32. PHI states that to date the transmission system has performed with remarkable reliability, however, it is now approaching the limits of its capacity and new bulk transmission facilities must be built to ensure the continued reliability of the system. PHI claims that the PHI Projects' critical locations on major import paths and west-east transfer locations should be acknowledged; PHI Projects will improve import capability, reduce congestion, and improve reliability in the mid-Atlantic region. PHI states it is willing to undertake this risk because they support the PJM process and the Commission's underlying goals - to make energy markets competitive by ensuring a reliable, robust grid. PHI asserts that the ROE adder will promote those goals by recognizing the importance of these new facilities and the risks inherent in bringing them to completion.

c. Construction and Siting Risks

33. PHI claims that there are significant construction risks associated with the PHI Projects. PHI states that it does not control the planning process or the timing of expected project in-service dates. In addition, PHI states a single stand-alone transmission entity does not face the risk that a transmission owning member of a highly interconnected Regional Transmission Organization (RTO) faces. PHI asserts that an upgrade in one area can be driven by multiple overloads. For example, Delmarva's Red Lion substation sits astride a major 500 kV transmission line that brings in power from Pennsylvania to New Jersey. The upgrades associated with the electrical reconfiguration at Red Lion will improve west-to-east transfers. As a result, lower cost energy will be delivered to New Jersey and the Delmarva Peninsula, reducing congestion costs. This upgrade mitigates one transformer overload, six 230 kV breaker overloads, and two 138 kV breaker overloads. The costs of the 500 kV upgrades at the Keeney substation will be socialized across all PJM load. The remainder of the costs will be shared by load in the Delmarva and PECO zones. Finally, PHI asserts that any transmission

project today faces growing materials and labor costs and the ROE adder will help recognize these additional risks.

34. PHI states that the PHI Projects entail complex designs, materials procurement, construction, and outage plans. PHI asserts that transmission substation reconfiguration can be extremely time consuming and requires substantial analysis of existing 500 kV and 230 kV circuits, ground grids, existing towers, structures, and busses, and relay protection schemes.

35. PHI also claims that there are also environmental issues associated with siting and permitting. For example, PHI states several of their jurisdictions require endangered species reviews, historic site review, archeological review, wetlands review, and review by the U.S. Army Corps of Engineers.

II. Notice of Filing and Responsive Pleadings

36. Notice of the PHI's filing, as amended, was published in the *Federal Register*, 73 Fed. Reg. 37,947 (2008), with interventions and protests due on or before July 14, 2008. Timely interventions were filed by the New Jersey Board of Public Utilities, North Carolina Electric Membership Corporation, Dominion Resources, Inc., Southern Maryland Electric Cooperative, Inc., Exelon Corporation, Office of the People's Counsel of the District of Columbia, Old Dominion Electric Cooperative, Public Service Electric and Gas Company, and PPL Electric Utilities Corporation.

37. A notice of intervention and protest was filed by the Public Service Commission of Maryland (Maryland Commission), and motions to intervene and protests were filed by the Delaware Municipal Electric Corporation, Inc. (DEMEC), and Maryland Office of People's Counsel (People's Counsel). On April 18, 2008, PHI filed a motion for leave to answer and answer to the protests. On May 5, 2008, DEMEC filed a motion for leave to answer and an answer.

38. On May 23, 2008, the Director, Division of Tariffs and Market Development – East, acting under delegated authority, issued a deficiency letter (Deficiency Letter) seeking additional information relating to PHI's filing.

39. The Deficiency Letter directed PHI to provide: (i) workpapers, schedules, and detailed explanations supporting the calculations of PHI's proposed ROE; (ii) a revenue increase disclosure inclusive of the requested ROE adders; (iii) an explanation of the nexus between the projects and the incentives sought; (iv) a more detailed explanation of the Technology Statement; (v) benefits of fiber optic cables employed as opposed to other technologies; and (vi) an explanation of how ROE incentives will address risks.

40. On June 23, 2008, PHI submitted the Supplemental Filing in response to the Deficiency Letter (Supplemental Filing). In this response, PHI provided workpapers and calculations supporting the resulting ROE of 12.8 and a further revenue increase disclosure,²⁶ illustrating the revenue impact by project.²⁷ On July 14, 2008, interventions and protests on the Supplemental Filing were filed by the Maryland Commission and DEMEC. On July 22, 2008, PHI filed an answer to DEMEC's comments.

III. Discussion

A. Procedural Matters

41. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), the notices 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) (2008), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the answers from PHI and DEMEC because they have provided information that assisted us in our decision-making process.

B. Incentives Request

1. Section 219 Demonstration

42. PHI states that its projects satisfy the rebuttable presumption and the requirements of section 219 by virtue of their approval in the PJM RTEP as baseline projects, consistent with Commission precedent.²⁸

a. Protests

43. The Maryland Commission protests PHI's request for an incentive ROE adder of 150-basis points on top of a base 11.3 percent.

²⁶ PHI reiterates that it has supplied a limited revenue increase disclosure in its original filing to show the rate effect of the ROE adder on first year's annual revenue requirement, but it did not demonstrate the impact by project.

²⁷ Supplemental Filing at Ex. PHI-1.

²⁸ Transmittal Letter at 9 (citing *Trans-Allegheny Interstate Line Co.*, 119 FERC ¶ 61,219, at P 69, *order on reh'g*, 121 FERC ¶ 61,009 (2007)).

44. People's Counsel argues that the PHI Projects are inconsistent with the Energy Policy Act of 2005 (EPAct 2005), which adds section 219 to the FPA.²⁹ Section 219(a) directs the Commission to promulgate a rule on transmission incentives.³⁰ People's Counsel claims that section 219(b) establishes four goals that the Commission must accomplish in this rulemaking,³¹ and that the

²⁹ Pub. L. No. 109-58, § 1241, 119 Stat. 594, 961 (2005) (codified at 16 U.S.C. § 824s).

³⁰ Section 219(a) states:

Not later than 1 year after the date of enactment of this section, the Commission shall establish, by rule, incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.

³¹ Section 219(b) states that the rule shall:

- (1) promote reliable and economically efficient transmission and generation of electricity by promoting capital investment in the enlargement, improvement, maintenance, and operation of all facilities for the transmission of electric energy in interstate commerce, regardless of the ownership of the facilities;
- (2) provide a [ROE] that attracts new investment in transmission facilities (including related transmission technologies);
- (3) encourage deployment of transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities and improve the operation of the facilities; and
- (4) allow recovery of—
 - (A) all prudently incurred costs necessary to comply with mandatory reliability standards issued pursuant to section 215 [of the FPA]; and
 - (B) all prudently incurred costs related to transmission infrastructure development pursuant to section 216 [of the FPA].

Commission's rule fails if, in its application, all four goals are not met: (1) promote capital investment in interstate transmission facilities; (2) provide an ROE "that attracts new investment in transmission facilities (including related transmission technologies);" (3) "encourage deployment of transmission technologies and other measures to increase the capacity and efficiency of existing transmission facilities" and improve their operations; and (4) "allow recovery of a company's prudently-incurred costs."

45. People's Counsel contends that the PHI Projects fail to meet two of section 219's goals. Specifically, People's Counsel claims that the PHI Projects do not encourage the deployment of new transmission technologies and will not attract new investment in transmission facilities.³²

46. In response to the Supplemental Filing, People's Counsel reiterates its concerns that most of the eight projects are not going to employ "new technologies"³³ and that the Orchard Project is not eligible for incentives because the construction began before PHI's filing and is estimated to be completed one and a half months after the filing date.

b. Commission Determination

47. In EPC Act 2005, Congress added section 219 to the FPA – directing the Commission to establish, by rule, incentive-based rate treatments to promote capital investment in transmission infrastructure. The Commission subsequently issued Order No. 679, which set forth processes by which a public utility could seek transmission rate incentives pursuant to section 219.

48. Order No. 679 provides that a public utility may file a petition for declaratory order or a section 205 filing to obtain incentive rate treatment for transmission infrastructure investment that satisfies the requirements of section 219, i.e., the applicant must demonstrate that the facilities for which it seeks incentives either ensure reliability or reduce the cost of delivered power by reducing transmission congestion.³⁴ Order No. 679 established a process for an applicant to follow to demonstrate that it meets this standard, including a

³² The People's Counsel details the extent of the technology that it believes is commonly used and that is not new, innovative, and risky technology in its protest of the Supplemental Filing at 18-19.

³³ People's Counsel Protest of the Supplemental Filing at 16.

³⁴ 18 C.F.R. § 35.35(i) (2008).

rebuttable presumption that the standard is met if: (i) the transmission project results from a fair and open regional planning process that considers and evaluates projects for reliability and/or congestion and is found to be acceptable to the Commission; or (ii) a project has received construction approval from an appropriate state commission or state siting authority.³⁵ Order No. 679-A clarifies the operation of this rebuttable presumption by noting that the authorities and/or processes on which it is based (i.e., a regional planning process, a state commission, or siting authority) must, in fact, consider whether the project ensures reliability or reduces the cost of delivered power by reducing congestion.³⁶

49. We find that the PHI Projects meet the requirements of section 219 as a result of the rebuttable presumption established in Order No. 679. All projects were included in the PJM RTEP as baseline projects, which means that PJM made a determination that the projects are regional in nature and mitigate congestion or ensure PJM's ability to continue to serve load reliably.

50. We reject People's Counsel's arguments, which proceed from the premise that section 219(b) establishes mandatory requirements with regard to new transmission technologies and attraction of capital that transmission projects must satisfy before the Commission may authorize incentives. This premise is inconsistent with the statute.³⁷

2. Nexus Demonstration

51. At the outset, PHI notes that it requests only one incentive: a 150-basis point ROE incentive adder that, it claims, is calculated to provide sufficient additional revenue to promote investment. It argues this additional revenue will serve the dual purpose of enabling PHI's utility affiliates to compete successfully

³⁵ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 58.

³⁶ *Id.* P 49.

³⁷ *Baltimore Gas & Electric Co.*, 123 FERC ¶ 61,262, at P 19-25 (2008) (*June 13 Order*) (denying rehearing of the order granting incentives to transmission owner-initiated projects at 121 FERC ¶ 61,167 (2007)); *accord Baltimore Gas & Electric Co.*, 120 FERC ¶ 61,084, at P 52 n.53 (2007) ("We are not proposing a new formulaic checklist that must be met by every applicant for every proposed incentive or project."), *reh'g denied*, 122 FERC ¶ 61,034 (2008) (*BG&E*); *see also* Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 41, 42 (where we have found that such an interpretation would be inconsistent with EPC Act 2005 as a whole, and would lead unreasonable results).

for funding resources while at the same time maintaining positive financial metrics and credit ratings to avoid increase borrowing costs.³⁸ PHI further asserts that the ROE incentive will address financial, regulatory, and construction risks. PHI claims that an ROE adder will help ensure that their credit metrics remain stable, allowing the companies to finance their aggressive transmission investment program at reasonable cost. In addition, an ROE adder will signal to corporate management that the PHI Projects merit heightened attention and commitment of internal resources.

52. PHI further notes that each of the PHI projects for which it requests incentives has been designated by PJM as a RTEP baseline project. As such, it argues that these projects, by definition, are non-routine under the Commission's nexus test. However, based on the above information, it argues the record also supports a finding that the projects are material in scope, are non-routine, face identifiable financing and completion risks, and will serve regionally-identified reliability and/or economic objectives as determined independently by the regional planning entity.³⁹

a. Protests

53. The Maryland Commission states the Commission must adhere to Order No. 679-A, which states "the incentive(s) sought must be tailored to address the demonstrable risks and challenges faced by the applicant in undertaking the project."⁴⁰ In addition, the Maryland Commission states the FPA required the Commission to ensure that the rate at issue is just and reasonable and to consider the following six characteristics of the project: (1) the public interest benefits of the project; (2) the cost of the project in absolute terms; (3) the cost of the project in proportion to the current transmission rate base of the applicant; (4) the difficulty of completing it due to the number of jurisdictions traversed and whether they are jurisdictions the applicant regularly deals with; (5) the difficulty of relying on normal rate recovery methods due to the length of time it will take to

³⁸ Ex. No. PHI-17 at 8.

³⁹ Supplemental Filing, Response to Question 3 at 2.

⁴⁰ Maryland Commission Protest at 11, (citing Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 21).

complete; and (6) whether the applicant would otherwise be required to build the project even without an incentive.⁴¹

54. The Maryland Commission states the PHI Projects are certainly important, but, based on Commission precedent,⁴² these projects are not entitled to the same level of incentives. The Maryland Commission states the total ROE of 12.8 percent requires careful scrutiny and must be considered in an evidentiary hearing where the proponent can be subject to cross-examination and answering testimony by experts of other parties. Several parties argue that the PHI Projects are routine investments.⁴³ The Maryland Commission asserts that rate incentives should only be awarded for regional transmission projects that otherwise would not be built.⁴⁴ The Maryland Commission claims that PHI has not demonstrated that the PHI Projects improve reliability or provide regional benefits.

55. The Maryland Commission protests that awarding a 150-basis point ROE adder in this case is excessive. The Maryland Commission protests that granting the full 150-basis point adder for all projects forces Maryland ratepayers to pay extraordinary incentives for ordinary projects. “It also encourages the continuing spiraling of incentives to transmission owners for even the most routine investments, and enhances the growing disparity in incentives being granted by FERC that appear to have no real nexus to any particular project.”⁴⁵

56. The Maryland Commission states the term “baseline project” does not carry the same connotation of regional benefit impacts as it once did because the Bulk Electric System definition was changed in PJM to extend to projects below 230 kV and PJM stopped distinguishing transmission owner-initiated projects.⁴⁶ Several parties state that much of the investment in the PHI Projects should be characterized as routine, particularly the portions that involve the replacement of

⁴¹ Maryland Commission Protest at 11, (citing *Baltimore Gas and Elec. Co.*, 121 FERC ¶ 61,167 (2007) (Kelly, dissenting, slip op. at 1)).

⁴² Maryland Commission Protest at 11, (citing *Baltimore Gas and Elec. Co.*, 121 FERC ¶ 61,167 (2007) (Kelly, dissenting, slip op. at 1)).

⁴³ People’s Counsel Protest at 21 (internal citations omitted).

⁴⁴ Maryland Commission Protest at 3.

⁴⁵ Maryland Commission Protest at 9.

⁴⁶ Maryland Commission Protest at 7.

aging infrastructure, such as the Brighton Project. People's Counsel rebuts PHI's assertion that the financial scope of the projects defines them as non-routine, pointing out that in fact, the estimated expenditures of these projects requesting ROE incentives represents only 4.32 percent of the total net plant for the regulated PHI Companies, and 5.48 percent of the expected capital expenditures for the 2008 - 2012 period for the PHI Companies.

57. Several parties argue that there is no support for PHI's arguments related to construction risk, risk of cost recovery, the scope of investments or risk of obsolescence, and that the PHI filing contains very little information about the particular projects themselves or any special risks and challenges associated therewith.⁴⁷ The Maryland Commission states that Standard and Poor's indicated that FERC-regulated transmission activities are less risky than generation.⁴⁸ In addition, the Maryland Commission states transmission faces less competition, little risk from transmission outages, and is not affected by rising costs of fuel and compliance with environmental laws that generation and is therefore less risky. Finally, the Maryland Commission claims that transmission charges approved by FERC do not face the risk of denial by state regulators.⁴⁹

58. On the purported risk of obsolescence, parties argue that there is little risk these projects will become obsolete, that they will be abandoned by regulators or that there will be any stranded costs.⁵⁰ People's Counsel states that with regards to the right-of-way issues, the PHI Companies have always dealt with narrow rights-of-way in the Delmarva Peninsula, and therefore, any risk associated with this construction is already reflected in the ROE using traditional DCF methodologies.⁵¹

59. On regulatory risks, People's Counsel states that in prior proceedings before the Maryland Commission, one company was able to achieve a Certificate

⁴⁷ See e.g., People's Counsel Protest at 8, Affidavit of Peter J. Lanzalotta (Lanzalotta Aff.) at 8-10.

⁴⁸ Maryland Commission Protest at 4.

⁴⁹ People's Counsel Protest at 8, Lanzalotta Aff. at 8-10.

⁵⁰ People's Counsel Protest at 25.

⁵¹ People's Counsel Protest, Lanzalotta Aff. at 13-14.

of Public Convenience and Necessity within 6 months after it was referred to the Hearing Examiner.⁵²

60. Regarding the risks associated with advanced technologies, People's Counsel states that the technology used by PHI is no longer considered new, innovative, and risky technology, and therefore presents a "risk" which is already reflected in the existing ROE. In terms of environmental factors presenting risk, People's Counsel also argues that this risk is not new, and is therefore already reflected in the existing ROE and therefore, does not merit additional ROE incentives.⁵³

61. People's Counsel states that the PHI erred in its conclusion that the Commission's prior approval of the PHI Companies' formula rates were financially insignificant and did not reduce the PHI Companies' risk, stating that a formula rate allows for timely recovery of transmission investment with minimal expenditure of effort and regulatory costs. People's Counsel states that formula rates reduce the risks that PHI purports to have. As an example, People's Counsel points to American Transmission Company, which received an "A" bond rating after receiving formula transmission rate approval from the Commission.⁵⁴

b. Commission Determination

62. In addition to satisfying the section 219 requirement of ensuring reliability or reducing the cost of delivered power by reducing congestion, an applicant must demonstrate that there is a nexus between the incentive sought and the investment being made. In Order No. 679-A, the Commission clarified that the nexus test is met when an applicant demonstrates that the total package of incentives requested is "tailored to address the demonstrable risks or challenges faced by the applicant."⁵⁵ As part of our evaluation of whether the incentives requested are tailored to address the demonstrable risks or challenges faced by the applicant, the Commission has found the question of whether a project is "routine" to be particularly probative. In *BG&E*,⁵⁶ the Commission clarified how it will evaluate

⁵² People's Counsel Protest, Lanzalotta Aff. at 9.

⁵³ People's Counsel Protest to Supplemental Filing at 24 (internal citations and emphasis omitted).

⁵⁴ People's Counsel Protest, Lanzalotta Aff. at 12.

⁵⁵ Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 40.

⁵⁶ *BG&E*, 120 FERC ¶ 61,084 at P 52-55.

projects to determine whether they are routine. Specifically, to determine whether a project is not routine, the Commission will consider all relevant factors presented by the applicant. For example, an applicant may present evidence on: (i) the scope of the project (e.g., dollar investment, increase in transfer capability, involvement of multiple entities or jurisdictions, size, effect on region); (ii) the effect of the project (e.g., improving reliability or reducing congestion costs); and (iii) the challenges or risks faced by the project (e.g., siting, internal competition for financing with other projects, long lead times, regulatory and political risks, specific financing challenges, other impediments).

63. We find that PHI has sufficiently demonstrated a nexus by demonstrating that the projects are not routine, based on the projects' scope, effects, challenges or risks, in addition to other factual information provided by PHI, as discussed below.

64. As to the scope of the projects, an applicant may, as in *Duquesne*,⁵⁷ compare the total investment in a range of projects to some other aggregate measure of investment, such as total rate base or recent annual investment levels, as delineated in *BG&E*.⁵⁸ Here, PHI has taken the approach delineated in *BG&E*, comparing its investment to recent annual investment levels. PHI indicates that the PHI Companies' projects will require significant capital investments, up to \$290 million,⁵⁹ which will increase the combined PHI Companies' transmission rate base by nearly a third.⁶⁰ Further, this level of capital spending accounts for nearly 50 percent of the PHI Companies' RTEP construction obligation over the 2008 - 2012 period, without factoring in the Mid-Atlantic Power Pathway.⁶¹

65. In *BG&E*, the Commission stated that "[t]he scope of a project involves factors such as size, dollar investment, increase in transfer capability, involvement of multiple entities or jurisdictions and effect on the region."⁶² As noted above,

⁵⁷ *Duquesne Light Co.*, 118 FERC ¶ 61,087, at P 52 (2007).

⁵⁸ See *BG&E*, 120 FERC ¶ 61,084 at P 53.

⁵⁹ Supplemental Filing, Response to Question 3 at 3.

⁶⁰ The estimated costs for each of the PHI Companies will be \$156.75 million for the PEPCO baseline projects, \$64.3 for the Delmarva baseline projects, and \$69 million for the ACE baseline projects. *Id.*

⁶¹ *Id.*

⁶² *BG&E*, 120 FERC ¶ 61,084 at P 52.

each set of projects being undertaken by PHI Companies involves substantial coordination with other utilities. In many cases, such as in the case for the Indian River projects discussed above, this high level of coordination is required to accommodate complex upgrades which require many utilities to synchronize line outages to minimize reliability and supply disturbances. Further, we find that these projects, individually and together, represent a significant financial outlay.

66. PHI states that while to date the transmission system has performed with remarkable reliability, it is now approaching the limits of its capacity and new bulk transmission facilities must be built to ensure the continued reliability of the system. PHI adds that the projects are at critical locations on major paths. We find that the PHI Projects will improve import capability, reduce congestion, and improve reliability in the mid-Atlantic region. We agree with PHI that the ROE adder will promote those goals by recognizing the importance of these new facilities and the risks inherent in bringing them to completion.

67. We reject the Maryland Commission's argument that six characteristics must be met before a project should be granted incentives. As we found in *Duquesne*:⁶³

Section 219 of the FPA cannot be so narrowly read as to allow incentive based rate treatment only if the cost of the project in absolute terms or in relation to the applicant's current transmission base is high, if the proposal crosses several jurisdictions, if the project takes a long time to complete, and if the applicant would otherwise be required to build the project without an incentive. Indeed, the Commission may find that incentive based rate treatment is appropriate even if these characteristics are not present, as long as the proposed project ensures reliability or reduces the cost of electric energy by reducing congestion, and a nexus is shown as required under section 219 of the FPA and Order Nos. 679 and 679-A.[⁶⁴]

⁶³ 118 FERC ¶ 61,087 at P 51, n.40.

⁶⁴ See also *Southern California Edison Co.*, 121 FERC ¶ 61,168, at P 46 (2007) (“Notably, [in Order No. 679,] the Commission chose not to adopt a list of criteria or characteristics that must be met by every applicant before an incentive would be approved. The Commission recognized that it would be impossible to identify every conceivable challenge or risk faced by an applicant, or to develop *a priori* a menu of incentives that would or would not be appropriate given a particular set of risks and challenges. Thus, we have held that we will address each request for incentives on its own merits and on a case-by-case basis.”), *reh'g denied*, 123 FERC ¶ 61,293 (2008).

68. We also reject the Maryland Commission's assertion that rate incentives should only be granted for projects that otherwise would not be built. The Commission expressly rejected such a "but for" test in Order No. 679 as inconsistent with Congressional intent in enacting section 219.⁶⁵

69. We disagree with the protestors that these projects do not address regionally significant reliability problems or provide regional benefits. As we noted above, each of these projects has been approved, both individually and collectively, by PJM in its RTEP. Further, with respect to the Pepco, Delmarva, and ACE baseline projects, we find that these projects will have regional benefits. PHI has demonstrated that these projects will increase deliverability and reliability for the Delmarva Peninsula including portions of Maryland and Virginia and all of Delaware. In addition, these projects will increase the ability to import additional energy to offset the retirement of generation located on the Delmarva Peninsula, which has long been cited as a congested area. These projects' status as PJM RTEP baseline projects is "significant in our analysis" because such projects provide benefits to "customers in one or more transmission owner zones."⁶⁶

70. In *BG&E*, we found that the challenges or risks faced by a project can include: siting, internal competition for financing with other projects, long lead times, regulatory risks, specific financing challenges and other similar impediments.⁶⁷ The ROE incentive adder helps to counter these risks and thereby send the correct message to transmission owners and the investors who supply the capital to build transmission. PHI has demonstrated similar challenges and risks here. We agree that PHI will face competition for financing of the projects while at the same time maintaining positive financial metrics and credit ratings to avoid increase borrowing costs.⁶⁸ We also agree that the ROE incentive will address financial, regulatory, and construction risks.

71. PHI also has demonstrated a range of construction risks and challenges for the PHI Projects.⁶⁹ As noted above, there will be construction in narrow rights-of-

⁶⁵ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 48; Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 25.

⁶⁶ *BG&E*, 120 FERC ¶ 61,084 at P 52.

⁶⁷ *Id.*

⁶⁸ Ex. No. PHI-17 at 8.

⁶⁹ Ex. No. PHI-6 at 19.

way and will involve river crossings. PHI states that one of the biggest risks is the ability to construct these lines without causing serious damage to the protected wetlands and threatened and endangered species of plants and animals that are found along the routes of these transmission lines.

72. We disagree with protestors' arguments regarding the regulatory risks, risks associated with advanced technologies, and risks associated with construction. Advanced transmission technologies are not required for a project to be eligible for transmission investment incentives.⁷⁰ PHI has made a sufficient demonstration that it will face multiple risks and challenges in constructing these projects, including these risks and challenges. Further, these risks and challenges are not the only factors we consider when analyzing a request for incentives. We examine such factors as the scope of the project, and its effect on the transmission system.⁷¹

73. We also disagree with the protestors on the financial risks of the PHI Projects. The largest source of funding will be from external sources and will include corporate debt or other similar securities of the individual utilities, as well as issuances of common equity of the parent company, PHI. In addition, the investment in the PHI Projects will add financial stress to the PHI Companies' credit ratings and may result in higher costs of capital and greater difficulty achieving financing.

74. In addition, several credit rating agencies have expressed concerns over the magnitude of capital expenditures the PHI is undertaking and the potential stress on current ratings. For example, Moody's Investors Service states, "While we note that [Delmarva] has been trying to improve its credit metrics over the past several years, the company's adjusted FFO [funds from operations] to interest and

⁷⁰ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 310 ("As previously stated, we expect that new development programs will include, or at least consider, advanced technologies, but we will not mandate it. We agree that improvements in the operation of the grid, perhaps through advanced technologies addressing time of day congestion, could result in efficiency benefits and encourage such proposals on a case-by-case basis.").

⁷¹ *BG&E*, 120 FERC ¶ 61,084 at P 52. In *BG&E*, we explained that the factors highlighted there were only examples of evidence that can help inform the Commission on the question of whether a project is routine, and that we were not proposing a formulaic checklist that must be met by every applicant for every proposed incentive or project.

adjusted FFO to debt coverage ratio continue to be weak for its rating.”⁷² And PHI explains that it has limited internal funding resources and its affiliates will be competing for capital; construction expenditures for PHI Companies for the period 2008-2012 are projected at \$5 billion while total corporate-wide construction expenditures are forecast to be \$5.7 billion. The ROE incentive is thus necessary and appropriate, since the PHI Projects are competing for capital with many other investment opportunities. In any event, purported lack of such financial risks, in and of itself, would not require the Commission to deny incentives under Order No. 679.⁷³ As noted above, we consider other factors in determining whether a project is or is non-routine.

75. For example, there are several non-financial factors in assessing the routine nature of projects. In this case, the Washington-Baltimore metro area is highly dependent upon power transfers from west of the Allegheny Mountains, relying on three main import paths for power – which are impacted by the baseline upgrades proposed herein. The baseline upgrades address severe overloading conditions on the three main power import paths into the Southwest Mid-Atlantic Area. Further, increased load in the east, particularly New York and Long Island, have exacerbated deliverability violations in Eastern PJM, and the baseline upgrades in the Atlantic City Transmission Zone will increase deliverability in the east.⁷⁴ All of the baseline upgrades will increase import capability, eliminate overloading, and improve transfer capability.⁷⁵

76. Based on the aforementioned factors, PHI has demonstrated the non-routine nature of these projects. All of these projects, individually and combined, address significant short-term reliability issues and represent a substantial capital undertaking. Accordingly, we reject protestors’ arguments that PHI’s requested

⁷² See Ex. No. PHI-17 at 7-8 (citing Moody’s Investors Service Global Research, Credit Opinion-DPL, May 25, 2007, at 2). These calculations are used by lenders to measure, in part, a company’s ability to pay its debt obligations, and if there is enough cash flow to maintain a company’s debt obligations.

⁷³ *BG&E*, 120 FERC ¶ 61,084 at P 52.

⁷⁴ Supplemental Filing, Response to Question 3 at 17.

⁷⁵ All of the projects also are located in the Mid-Atlantic National Interest Electric Transmission Corridor, one of the two DOE-designated corridors that face significant transmission congestion and limited transmission capability. Transmittal Letter at Ex. No. PHI-6, Supplemental Filing at 2.

ROE is excessive, in whole or in part, and grant the requested 150-basis point ROE adder for the PHI Projects as further discussed below.

3. Technology Statement

77. PHI asserts that it is engaged in two pilot programs installing real-time dynamic line ratings equipment. In addition, PHI is optimizing its transmission line configurations to minimize electric and magnetic fields and to minimize environmental impact. PHI is currently installing on-line monitors on its entire fleet of 500/230 kV transformers across all three utilities. PHI is expanding and applying digital technology to substations for monitoring, protection, and control. PHI states Aluminum Conductor Steel Supported/Trapezoidal Wire (ACSS/TW) will be used to reconductor ACE's, Chichester-to-Mickleton, 230 kV transmission line, which crosses the Delaware River. In addition, ACSS/TW will be used in the Delmarva Cool Springs project. Finally, PHI will use high temperature low sag aluminum conductors.

78. PHI asserts that its new fiber technology will prepare it to implement the mandate of the Energy Independence and Security Act of 2007.⁷⁶ For example, PHI states that a "Smart Grid" is a transmission network that "self-heals" and is compliant with NERC's Critical Infrastructure Protection Reliability Standards. In this vein, PHI plans to install network technology such as Synchronous Optical Networks, Power Delivery Wide Area Networks, and Substation Local Area Networks. PHI states that these systems will optimize the grid's "self-healing" capability by automatically detecting and responding to actual and emerging transmission problems.

79. Also, PHI plans to install a distributed substation architecture which it states will provide for distributed electric system intelligence. Further, PHI states it envisions a fully integrated communication system among its three operating companies, which it maintains will allow for redundancy and increased efficiency among key network operating systems. Finally, PHI states that a robust fiber optic communication system with redundant paths for reliability will enable its companies to manage emergencies or crises from multiple locations across PHI.

80. We find that PHI has satisfied Order No. 679's technology statement requirement in providing a description of the advanced technologies that were considered, and an explanation as to why these particular technologies were chosen over other alternatives.

⁷⁶ Pub. L. No. 110-140, § 1301, 121 Stat. 1492 (2007).

C. Section 205 Demonstration

81. PHI submitted testimony supporting a range of reasonable returns of 7.9 percent to 16.5 percent, relying on the Discounted Cash Flow (DCF) methodology applied to a proxy group of utilities.⁷⁷ PHI states that its requested 150-basis point ROE adder for the PHI Projects, when added to its settlement approved ROE of 11.3 percent applicable to new transmission facilities built after January 1, 2006, results in ROE of 12.8 percent for the PHI Projects – which is within this range of reasonable returns.

82. PHI adds that its DCF calculation does not include an adjustment for the cost of “floating” new equity securities. Nevertheless, PHI states that the fact that flotation costs will be incurred should be recognized as a legitimate consideration that supports the reasonableness of the ROE.⁷⁸

83. PHI explains that rather than developing annual estimates of cash flows into perpetuity, it has implemented the DCF model in its simplified “constant growth” form. PHI states that the constant growth form of the DCF model is based upon a number of strict assumptions, which in reality are not strictly met; assuming a constant growth rate for both dividends and earnings, a stable dividend payout ratio; the discount rate exceeds the growth rate; a constant growth rate for book value and price; a constant earned rate of return on book value; no sales of stock at a price above or below book value; a constant price-earnings ratio; a constant discount rate (i.e., no changes in risk or interest rate levels and a flat yield curve); and all of the above extend to infinity.⁷⁹

84. PHI states that the constant growth form of the DCF recognizes that the rate of return consists of two parts: dividend yield and growth. In other words, investors expect to receive a portion of their return on investment through dividends, and the remainder of their return on investment through price appreciation.

⁷⁷ Dr. William E. Avera Test. (Avera Test.) Ex. PHI-1.

⁷⁸ *Id.* at 62-64.

⁷⁹ *Id.* at 34.

85. In testimony, PHI explains in developing the proxy group, the DCF model analysis focused on a group of 15 transmission-owning utilities in the Northeast.⁸⁰ PHI states that this 15 company proxy group resulted by excluding companies based on the following screens: (1) companies who don't pay common dividends; (2) companies for whom no Institutional Brokers Estimation System (IBES) or Value Line data is available; (3) companies who were in the process of merger activity; and (4) companies whose business was comprised mainly of natural gas operations. PHI also states that it evaluated the proxy group based on three objective measures of investment risk: Standard and Poor's corporate credit rating, Value Line's Safety Rank, and Financial Strength Rating.⁸¹

86. PHI cautions that artificially restricting the proxy group to geographical boundaries balkanizes the process of proxy group selection, and can have the potentially undesirable effect of distorting price signals to investors - stimulating capital investment in one area of the country, while artificially stifling capital investment in another area of the country. PHI states that the Commission should apply its ROE policies in an equitable and even-handed manner, expanding the proxy group to include adjacent regions as well as including companies that face similar circumstances helps to avoid regional discrimination with no underlying economic justification.⁸²

1. Protests

87. The People's Counsel states that section 219(d) expressly retained the requirement that all rates approved under Order No. 679 are subject to the requirements of sections 205 and 206 that resulting rates "be just and reasonable and not unduly discriminatory or preferential." The People's Counsel cites to *Municipal Light Boards of Reading and Wakefield, Mass. v. Federal Power Commission*, 450 F.2d 1341 (1971), *cert. denied*, 405 U.S. 989 (1972), which found that the "primary aim" of this Federal Power Act provision is "the

⁸⁰ *Id.* at 37. The utilities are: American Electric Power Co., Central Vermont Public Service Corp., Consolidated Edison, Inc., Constellation Energy Group (Constellation), Dominion Resources Inc., Dayton Power Light Inc. (DPL Inc.), Exelon Corp. (Exelon), FirstEnergy Corp., Florida Power Light Group, Inc. (FPL Group), Northeast Utilities, NSTAR, Pepco Holdings, Inc., PPL Corp. (PPL), Public Service Enterprise Group (PS Energy Group), and UIL Holdings Corporation (UIL Holdings).

⁸¹ Avera Test. Ex. PHI-1 at 36, 43.

⁸² *Id.* at 40-42.

protection of consumers from excessive rates and charges.” The People’s Counsel states that, by retaining the just and reasonable standard in enacting section 219, Congress intended that the Commission’s primary focus remain on the protection of consumers from excessive rates and charges.

88. To this end, the People’s Counsel and DEMEC argue that PHI makes the following errors in justifying where in the zone of reasonableness that return should lie:⁸³ (1) improper inclusion of companies in the proxy group whose risks are not commensurate with other enterprises having corresponding risks;⁸⁴ (2) improper calculation of dividend yields; (3) improper calculation of stock prices; and (4) improper growth rate calculations and reliance upon an insufficient number of sources for growth rate estimates.

89. The Maryland Commission disagrees with PHI that its exclusion of a flotation cost adjustment should be viewed as additional support for granting a higher ROE. The Maryland Commission is unclear why there needs to be this additional consideration in granting a higher ROE. Further, the Maryland Commission questions why flotation costs are not already recovered in the year that they were incurred under PHI’s existing formula rates, rather than as a percentage increase in the requested ROE.

90. People’s Counsel states that PHI has inappropriately chosen to apply one-half of the growth rate to each of their proxy companies’ 2007 dividend yields. The People’s Counsel states that this approach ignores company-specific factors such as the possibility that the company at issue is seeking to increase its retained earnings, which is a high likelihood when there is an urgent need for additional capital.⁸⁵

91. People’s Counsel states that PHI inappropriately used the absolute highest and lowest stock prices during the previous 90 days to calculate the overall stock price used in its DCF calculation. People’s Counsel states that this practice gives undue weight to upward or downward blips in the market prices, and therefore fails to measure broad investor consensus on stock valuation. People’s Counsel

⁸³ People’s Counsel Protest at 27 (citing Order No. 679-A, FERC Stats. & Regs. ¶ 31,236).

⁸⁴ *Id.* at 33 (citing *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*)).

⁸⁵ *Id.* at 29 (citing Affidavit of Charles King at 14 (King Aff.)).

states that PHI should have used the average of all the closing prices in the past three months.

92. People's Counsel states that PHI's sources for growth rates are inappropriately too narrow, using only the IBES and the $(br + sv)$ formula in the DCF analysis.⁸⁶ People's Counsel states that PHI should have used a wider array of growth rate sources to ensure a more reliable result. In addition, the People's Counsel proposes that the composite use of three sources (IBES, Value Line, and Zachs) is a more reliable way to estimate the growth rate.⁸⁷

93. With respect to the use of $(br + sv)$, the People's Counsel states that this measure of growth must be disregarded as a measure of growth. People's Counsel states that this is because there is a one-for-one correspondence among the growth rates for dividends, earnings, and book value per share. People's Counsel states that this correspondence is not sufficiently reflected empirically in this growth rate formula. People's Counsel states that this growth rate does not reflect this relationship appropriately for several reasons.

94. First, this growth rate makes the assumption that the calculation is based on a fully-regulated utility, where the utility's earnings are determined by applying a rate of return to a rate base which supposedly reflects the *full* book value of the company. People's Counsel states that this is not the case here, where the utilities used in the proxy group have substantial unregulated activities which *do not* reflect the full book value of the company.

95. Second, People's Counsel states that the $(br+sv)$ growth rate assumes that investors use it in making investment decisions, relying on the assumption that investors set the stock price, thereby indicating what return is necessary to invest, i.e., attract capital, based on investors' perceptions of future earnings growth. People's Counsel states that under this assumption, the growth rate would only be valid to the extent that investors use it in calculating their expectations of future

⁸⁶ The People's Counsel refers to this formula as the "book value growth methodology." The formula is $G = (br + sv)$, where

G= sustainable growth rate

b= earnings retention rate, or 1 minus the payout ratio

r= return on equity

s = percentage increase in new stock raised from sale

v = fraction of sales of new stock that accrues to current stockholders

⁸⁷ People's Counsel Protest at 29 (citing King Aff. at 14).

earnings growth. People's Counsel states that this calculation has never been present in analysts' reports on public utilities.

96. Third, People's Counsel states that this growth rate is repetitive, because it is used to find out the expected return on book value, but one of its components in finding this out is expected return on book value.

97. Fourth, People's Counsel states that there is a structural weakness in the $(br+sv)$ growth rate because it relies on only one source: Value Line.⁸⁸

98. The Maryland Commission protests that PHI's ROE analysis is flawed and cannot be approved without being subjected to the review required by the FPA. The Maryland Commission states, in regards to the proxy group, it would make sense to use the same entities as in *PATH*.⁸⁹ People's Counsel states that the PHI improperly focused on utilities whose risks pertained to generation and distribution functions, not to transmission in developing its proxy group used in its discounted cash flow analysis. People's Counsel states that the transmission function has not experienced an increase in risk, and in fact, its risk has declined as a result of restructuring, because transmission rates are under the sole jurisdiction of the Commission, and the state commissions are obliged to pass Commission-approved rates and charges through to retail consumers.

99. People's Counsel states that, following the *Hope* and *Bluefield*⁹⁰ principles laid down by the Supreme Court, there are compelling reasons for departing from the Commission's stated preference for relying upon transmission-owning companies that operate in the same or an associated RTO. People's Counsel argues that a proxy group based on a Northeast regional distinction is probably the most inappropriate choice of proxy group because this proxy group does not accurately represent the risk profile of these transmission projects. People's Counsel and DEMEC state that this is because almost all of these proxy companies chosen by PHI are heavily engaged in unregulated activities, which are

⁸⁸ People's Counsel Protest at 32, King Aff. at 16.

⁸⁹ Citing *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188, at P 105 (2008) (*PATH*).

⁹⁰ *Hope*, *supra* note 85; *Bluefield Water Works and Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923) (*Bluefield*).

not comparable in risk to the applicant, a regulated transmission utility having guaranteed cost recovery.⁹¹

100. The Maryland Commission states that PHI used the midpoint instead of the median as the appropriate reference point to determine the propriety of the ROE sought in the PHI filing. The Maryland Commission claims that the Commission has ruled that the midpoint should be used to establish a ROE that will be applicable to all transmission owners in a RTO, but the Commission has never explained why the median would not be more appropriate in the case of single electric utilities. The Maryland Commission asserts that the median is more appropriate to determine ROEs in connection with single electric companies, consistent with the Commission's findings in *Midwest Independent Transmission System Operator, Inc.*⁹²

101. The Maryland Commission states that PHI excluded low-end ROEs considered to be below the average cost of debt, but included the high-end ROEs of these companies, which is contrary to Commission precedent.

102. People's Counsel submits a DCF analysis using eleven utilities, without the regional restriction, that it asserts have risk levels much closer to that of PHI's investment in the transmission facilities as issue in this case. People's Counsel contends that the proxy companies it chose are similar because they operate vertically integrated systems, have very little non-regulated business and thus, are more comparable in risk, consistent with *Hope* and *Bluefield* – producing a zone of reasonableness of 7.4 percent to 11.9 percent.

⁹¹ People's Counsel Protest at 29 (citing King Aff. at 8 and DEMEC Supplemental Protest at 2).

⁹² The Maryland Commission (at 14 & n.26) cites, *order on remand*, 106 FERC ¶ 61,302 (2004), *aff'd in pertinent part and rev'd in other parts sub nom. Pub. Serv. Comm'n. of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005) (where the Commission stated g that “[b]ecause the ROE in this case will apply to a diverse group of companies, the entire range of results yielded by the subset is relevant here. Thus, we find that using the midpoint is the most appropriate measure for determining a single ROE for all Midwest ISO [transmission operators], since it fully considers that range. Selecting the most refined measure of central tendency, as might be achieved with the use of the median, is not the Commission's goal in this case, given that we are not selecting a ROE for a single utility of average risk.”).

103. In addition, DEMEC states the proposed ROE is outside the zone of reasonableness thus resulting in excess of a just and reasonable ROE. DEMEC argues PHI's DCF analysis is flawed and does not support the requested ROE adder. DEMEC's analysis supports a zone of reasonableness of 7.9 percent to 11.6 percent. DEMEC's witness Jatinder Kumar excluded outliers from the analysis and the proxy group is limited to public utilities in PJM.

104. DEMEC states that consistent with the fundamental premise of investment, that higher returns are generally commensurate to higher risk, PHI's DCF calculation is flawed, because it does not take into account the reduced risk of its formula rate, making them essentially risk-free. Further, DEMEC states that PHI's reference to certain Standard Offer Service (SOS) contracts increasing PHI's riskiness is flawed, since those SOS contracts' risk is related to power supplies, and not transmission service.⁹³

105. DEMEC states that overall downward trends in returns suggest that using double-digit growth rates in calculating an ROE for a virtually risk-free regulated company such as PHI is unconscionable based on any standard. DEMEC states that the compounded total return for the ten years of 1998 - 2007 for the S&P 500 companies was 5.9 percent, and their total return in 2007 was 5.5 percent. DEMEC states that, compared to this, PHI's proposed ROE is too high.⁹⁴

106. DEMEC, therefore, protests the inclusion of all companies with double-digit growth rates in PHI's proxy group: Exelon, Constellation, PS Energy Group, DPL Inc., Northeast Utilities, UIL Holdings, and PPL.⁹⁵

107. DEMEC also states that there is a declining trend in ROEs in the industry, which does not comport with PHI's high ROE request. DEMEC states that in November 2007, Public Utilities Fortnightly published a survey of ROEs approved by regulatory agencies for 56 utilities in 2006, stating that out of those 57 utilities only six received ROEs of 11 percent, and only two received an ROE of over 12 percent. DEMEC states that this survey also clearly demonstrates a declining trend in cost of capital (ROE), because prior to 2006 the median ROE of these 57 companies was 10.93 percent, but a year later, in 2006, the median ROE went

⁹³ DEMEC Protest, Affidavit of Jatinder Kumar at 6-7(Kumar Aff.).

⁹⁴ DEMEC Protest, Kumar Aff. at 8.

⁹⁵ DEMEC Protest, Kumar Aff. at 9.

down to 10.23 percent. DEMEC observes a similar downward trend in the overall range of returns and overall midpoint of these 57 companies.⁹⁶

108. DEMEC states that PHI's filing is inconsistent with the Formula Rate Case Settlement approved by the Commission in Docket No. ER05-515-000.⁹⁷ Section 3.3 of the Formula Rate Case Settlement states, "during the three-year Base ROE moratorium period described in section 4.2(a) hereof, and thereafter until either or both of the Base ROEs is changed consistent with the applicable moratorium provisions, any ROE Adder(s) will be added to the 10.80 % Base ROE set forth in section 3.1(a) hereof and not the 11.30 % Base ROE set forth in section 3.1(b) hereof." The Base ROE set forth in section 3.1(a) is "10.80 % applicable to all transmission facilities placed in-service prior to January 1, 2006." The Base ROE set forth in section 3.1(b) is "11.30 % applicable to all transmission facilities placed in-service on or after January 1, 2006."

109. The Maryland Commission protests PJM's cost allocation for the Delmarva and Pepco projects. The Maryland Commission states that PJM allocated the costs of only one (Pepco) project between the two zones. In addition, PJM's tariff indicated that 100 percent of the costs of several DPL projects included in the PHI filing were assigned to DPL. The Maryland Commission protests that PJM is not filing cost allocations, leaving unclear the extent to which other projects included in the PHI Filing have benefits extending outside the PHI's affiliates' service territories.

110. In protests to the Supplemental Filing, the People's Counsel and DEMEC make the following arguments regarding the (br+sv) growth rate proffered by PHI witness Avera:⁹⁸ (1) The "Adjusted 'r' Value" is unexplained; (2) the "Change in BV"⁹⁹ column is unclear because it is not the basis for the final calculation presented in column m; and (3) the assumed return on book value of DPL's stock of 25.8 percent and Exelon's return on the book value common stock of 26.3 percent is unrealistic, since no regulated entity can expect to enjoy these levels of

⁹⁶ DEMEC Protest, Kumar Aff. at 11 and Att. 3.

⁹⁷ See *Baltimore Gas and Electric Co.*, Order Approving Uncontested Settlement, 115 FERC ¶ 61,066 (2006) (*Settlement Order*).

⁹⁸ Supplemental Filing, Ex. No. PHI-1, Att. 1 at 2.

⁹⁹ Referencing the change in book value that is calculated as part of the "Adjusted 'r' Value" calculation.

profitability and earnings. Such returns would immediately elicit show cause orders for rate reductions from state agencies.¹⁰⁰

111. Protestors state that if the Commission does not reject the filing, there are issues of material fact which can only be resolved through trial-type evidentiary hearing, and request that the ROE be set for hearing.

2. Commission Determination

112. We find that PHI has made a sufficient demonstration that its requested ROE incentive results in an ROE that is within the range of reasonable returns, as adjusted, and as discussed below.

113. First, PHI used the appropriate initial proxy group of entities within the interrelated RTO markets operated by PJM, ISO-New England, and New York ISO to begin its DCF analysis. Second, PHI applied the following screening criteria to exclude companies consistent with Commission precedent: (1) companies who don't pay common dividends; (2) companies for whom no IBES or Value Line data is available; (3) companies who were involved in merger activities; and (4) companies whose business was comprised mainly of natural gas operations.

114. However, we have previously found that it is reasonable to also use proxy companies' corporate credit ratings as a screen for risk,¹⁰¹ since corporate credit ratings generally consider both financial risk and business risk. PHI's corporate credit rating is BBB. Therefore, we eliminate the following companies from PHI's proxy group presented in Ex. No. PHI-1, whose corporate credit ratings are outside the band of BBB- to BBB+, consistent with Commission precedent: Central Vermont Public Service Company, Consolidated Edison Company, Dominion Resources, FPL Group, and NSTAR.

115. We also find that PHI has not sufficiently screened its proxy group for unsustainable growth rates. Commission policy has been to exclude companies whose growth rates are considered outliers – those that “fail the economic test of

¹⁰⁰ People's Counsel Protest at 17-18; DEMEC Protest at 3.

¹⁰¹ *Southern California Edison Company*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,264 (2000).

logic,” or whose implied cost of equity is “unsustainable.”¹⁰² Therefore, PPL Group is eliminated from the proxy group of companies because its growth rate is 13.7 percent.

116. Based on this analysis, we find that PHI’s proxy group should include: American Electric Power Company, DPL Inc., Exelon Corp., FirstEnergy Corp., Northeast Utilities, Pepco Holdings, and UIL Holdings, which establishes a range of reasonable returns of 7 percent to 15.9 percent. Based on this revised proxy group and the risks faced by the PHI Projects, we will grant PHI’s request for a 150-basis point adder to its currently-authorized ROE of 11.3 percent, resulting in an overall ROE of 12.8 percent for PHI’s investments in the PHI Projects, well within the range of reasonable returns established here. We will now address the specific arguments raised by the protestors.

117. In response to PHI’s request that we consider flotation costs in granting its requested ROE, we do not permit flotation cost adjustments to the ROE unless the utility demonstrates that a new stock issuance is imminent.¹⁰³ Further, if flotation costs are justified, there is a set formula to apply.¹⁰⁴ These conditions have not been sufficiently met in this case, and therefore, are not part of our consideration of PHI’s ROE.

118. We also reject protestors’ contentions that the proxy group be restricted to transmission-only companies. This is inconsistent with Commission precedent in which we have rejected proposals to restrict proxy groups based on narrow company attributes.¹⁰⁵

¹⁰² *Bangor Hydro-Electric Company*, Opinion No. 489, 117 FERC ¶ 61,129, at P 24-28, 53-60 (2006), *order on reh’g*, 122 FERC ¶ 61,265 (2008) (*Bangor Hydro Rehearing Order*).

¹⁰³ *Allegheny Generating Co.*, 65 FERC ¶ 63,026 at 65,179 (1993); Opinion No. 445, 92 FERC ¶ 61,070 at 61,264 (2000); *Bangor Hydro Electric Co.*, Opinion No. 489, 117 FERC ¶ 61,129 at P 82-87 (2006).

¹⁰⁴ *Boston Edison Co.*, 66 FERC ¶ 63,013, at 65,804 (1994), *aff’d*, Opinion No. 411, 77 FERC ¶ 61,272, at 62,172 (1996).

¹⁰⁵ *See Midwest Independent Transmission System Operator, Inc.*, Initial Decision, 99 FERC ¶ 63,011, at P 9, 15-16, *order approving initial decision*, 100 FERC ¶ 61,292, at P 12 (2002) (the Commission rejected a proposal to restrict a proxy group for transmission owners to the use of generation-divested utilities, permitting the inclusion of parent companies with some generation and

(continued...)

119. We disagree with People’s Counsel that it was inappropriate to apply one-half of the growth rate to each of their proxy companies’ dividend yields.¹⁰⁶ PHI’s approach is modeled after the adjustment factor detailed by the Commission in several proceedings,¹⁰⁷ is necessary to account for the company’s quarterly payment of dividends, and results in an “average” expected annual dividend yield that can be used in the DCF. Without it, there would be no average dividend yield that considers the fact that dividends are paid out on a quarterly basis during the course of a year. People’s Counsel’s assertion that the adjustment is not needed embeds an illogical assumption within the DCF model, that dividend yields are paid continuously throughout the year, and that investors require a lower return for the receipt of dividends on a continuous basis, because they are able to reinvest these dividends continuously, as opposed to the reality of quarterly dividends.

120. Protestors’ challenges to stock price calculations and dividend yields are impermissible collateral attacks on Commission policy. In any event, even if we agreed with the protests on this point, the upper end of the zone of reasonableness for PHI would not change. Ultimately, the challenges to the growth rate data would not affect PHI’s ROE, since, as we note below, the upper end of the zone of reasonableness in this case is established using IBES data, not sustainable growth rate data.

121. In its answer, PHI illustrates how its calculations are consistent with Commission precedent,¹⁰⁸ i.e., noting the adjustment factor used to inflate the value of “r” was approved in the *Bangor Hydro Rehearing Order*.¹⁰⁹

unregulated revenues in the proxy group); *order affirming initial decision with modification*, 100 FERC ¶ 61,292 (2002), *order on reh’g*, 102 FERC ¶ 61,143 (2003), *order on remand*, 106 FERC ¶ 61,302,(2004), *aff’d in pertinent part and rev’d in other parts sub nom. Publ. Serv. Comm’n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005), Opinion No. 489, 117 FERC ¶ 61,129 at P 38; *Bangor Hydro Rehearing Order*, 122 FERC ¶ 61,265 (2008).

¹⁰⁶ People’s Counsel references the adjustment factor for computing dividend yield $(1 + .5g)$, where “g” is the investors’ expected growth in the company’s dividends per share.

¹⁰⁷ *Generic Determination of Rate of Return on Common Equity for Public Utilities*, Order No. 420, FERC Stats. & Regs., ¶ 30,644 at 61,338-340.

¹⁰⁸ Also, PHI notes that the Commission has previously rejected substitute sources for growth rates in *Midwest Independent Transmission System Operator, Inc.*, Initial Decision, 99 FERC ¶ 63,011, at P 49-50 (2002), *order affirming initial*
(continued...)

122. Regarding protestors' contentions on the use of a regional proxy group distinction, we have previously found that a 15-company proxy group that includes utilities in PJM, ISO-NE and NYISO is a good starting point for a proxy that takes into account comparable risks.¹¹⁰ And in consideration of the record in totality, we find that the existing proxy group is sufficiently robust and comparable in risk, after applying the additional screens as discussed elsewhere in this order. We therefore reject protestors request to use proxy companies beyond the Northeast region.

123. We will not modify the existing base ROE of 11.3 percent in this case to reflect either a median or a midpoint return within the established range of reasonable returns here. This base ROE was a product of a prior Commission order,¹¹¹ and PHI has not filed to change this base ROE in this proceeding. Therefore, parties' contention that that base ROE should now be modified to reflect the median return established in this proceeding is not properly before us here.

124. Protestors' arguments against the use of the (br+sv) growth rate contravene Commission policy. Protestors do not explain why the Commission should depart from its existing reasoning for using the (br+sv) growth rate. In Opinion No. 445, we outlined several reasons why the (br+sv) growth rate should be used.¹¹² We have consistently held that this is a reasonable approach to determining growth rates and protestors have not justified a departure from precedent. In any event, since the base ROE of 11.3 in this case is a product of a settlement, and the high end of the range of reasonable returns is set by UIL Holdings, and is based upon

decision with modification, 100 FERC ¶ 61,292 (2002), *order on reh'g*, 102 FERC ¶ 61,143 (2003), *order on remand*, 106 FERC ¶ 61,302,(2004), *aff'd in pertinent part and rev'd in other parts sub nom. Publ. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005), and that the time period used in calculating dividend yields is consistent with Commission policy. PHI (Answer at 8) also cites *Orange and Rockland Utils., Inc.*, 44 FERC ¶ 61,253, at 61,956-57 (1988) (concurrence of Commissioner Trabandt).

¹⁰⁹ PHI's Answer at 11, citing *Bangor Hydro Rehearing Order*.

¹¹⁰ *PATH*, 122 FERC ¶ 61,188 at P 105.

¹¹¹ *Pepco Holdings Inc.*, 121 FERC ¶ 61,169 at P 15 (2007).

¹¹² See Opinion No. 445, 92 FERC ¶ 61,070 at 61,261.

IBES growth rate, and not the (br+sv) growth rate, PHI's overall ROE with the incentive ROE adder of 12.8 percent still falls within the high end of the range of reasonable returns.

125. Similarly, we reject protestors' contentions concerning Exelon's return on book value. The protestors' assertions on this issue have no bearing on PHI's return since, again, the high end of the range of reasonable returns of 15.9 percent results from reliance on UIL Holdings' IBES growth rate, and not Exelon's return on book value.

126. With the resulting range of reasonable returns, and the base ROE of 11.3 percent, it is unclear how the Maryland Commission is aggrieved by the exclusion of one low-end result of a single proxy company, but retaining the high end result of that same company, and how, in this case, that would result in a skewed ROE. While the circumstances may produce different results for other cases, in this particular case, we agree with PHI that "removing such companies would have no impact on the range of reasonableness ... produced by the Commission's DCF approach."¹¹³ Importantly and particular to this case, removal of only one component in this case has no impact on the base return to which a basis point adder is added, because the base return was a product of a prior settlement.

127. DEMEC's assertion that overall historical trends in ROEs suggest a lower ROE here is flawed. First, DEMEC relies on past, historical values, which are an entirely different time period than the DCF model, which is forward-looking. These past, historical values that DEMEC relies on may not be reflective of future returns and most importantly, *investors' expectations* of future returns. Second, there is no indication of how these returns were calculated or under what conditions they were applied by the individual regulators. For example, there is no indication whether a return may have been adopted as part of a packaged settlement, or whether the ROEs are "earned returns" as opposed to "required returns," or what model (e.g., the Capital Asset Pricing Model, or the DCF Model) was used in calculating these returns. DEMEC's submission only indicates that they were "authorized ROEs." For lack of context, they are not comparable and are irrelevant in determining a just and reasonable ROE here.

128. Contrary to DEMEC's interpretation, the base ROE to which the 150 basis point adder would be applied is 11.3 percent. While DEMEC is correct that sections 3.1, 3.3, and 4.2(a) of the settlement language originally required a base ROE of 10.8 percent on which any combination of ROE adders would be applied,

¹¹³ Transmittal Letter, Ex. No. PHI-1 at 55.

the Commission, in *Pepco Holdings Inc.*, 121 FERC ¶ 61,169, at P 15 (2007), subsequently approved an additional 50 basis points for RTO participation, effectively changing the base ROE to 11.3 percent.

129. Regarding the Maryland Commission's concern regarding cost allocation, for transmission projects built as a result of the PJM RTEP process, cost allocation is not part of the individual transmission owner's incentive request or its rate filing, but rather is filed by PJM. Therefore, the Maryland Commission's protest is outside the scope of this proceeding, and is more appropriately addressed at the time PJM files a cost allocation proposal.

130. Finally, we deny protestors' request for a trial-type evidentiary hearing. These challenges are contrary to well established case law. Federal courts have held repeatedly that "a formal trial-type hearing is unnecessary where there are no material facts in dispute."¹¹⁴ The courts have emphasized that "mere allegations of disputed fact are insufficient to mandate a hearing; petitioners must make an adequate proffer of evidence to support them."¹¹⁵ A broad allegation of factual issues "without proffer of specific foundation [] is simply not enough to meet the material issue of fact requirement."¹¹⁶ Moreover, even when there are factual disputes, the Commission needs not hold a hearing if the dispute can "be adequately resolved on the written record."¹¹⁷

¹¹⁴ *Pennsylvania Pub. Util. Comm'n v. FERC*, 881 F.2d 1123, 1126 (D.C. Cir. 1989) (citations omitted).

¹¹⁵ *Woolen Mill Assoc. v. FERC*, 917 F.2d 589, 592 (D.C. Cir. 1990) (citations omitted).

¹¹⁶ *Pennsylvania Pub. Util. Comm'n*, 881 F.2d at 1126-27.

¹¹⁷ *Moreau v. FERC*, 982 F.2d 556, 568 (D.C. Cir. 1993).

The Commission orders:

PHI's requested ROE incentive and proposed tariff sheets are hereby accepted for filing, effective June 1, 2008, as discussed in the body of this order.

By the Commission. Commissioners Kelly and Wellinghoff dissenting with separate statements to be issued at a later date.

(S E A L)

Kimberly D. Bose,
Secretary.