

116 FERC ¶ 61,282
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.

Calpine Oneta Power, L.P.

Docket No. ER03-765-001

ORDER ON INITIAL DECISION

(Issued September 26, 2006)

1. This case is before the Commission on the exceptions to the Initial Decision (ID), issued October 28, 2005,¹ by Administrative Law Judge Herbert Grossman (ALJ). At issue is whether Calpine Oneta Power, L.P.'s (Oneta) proposed rate schedule for the provision of Reactive Supply from Generation Sources Services (reactive power) to Southwest Power Pool, Inc. (SPP) meets the just and reasonable standard established by section 205 of the Federal Power Act (FPA).²

2. As discussed below, the Commission finds that Oneta's proposed rate schedule is just and reasonable. The Commission affirms the ALJ's finding that applying a "needs" test to Oneta's reactive power capability for Oneta to receive compensation that is not also applied to all other generating plants in its vicinity would deny Oneta comparable treatment, constitute undue discrimination, and is contrary to Commission precedent. The Commission finds that Oneta should receive compensation under Oneta's proposed rate schedule for providing reactive power on a comparable basis. To this end, the Commission finds SPP's Schedule 2 of its open access transmission tariff (OATT), which allows only generation sources from transmission owners to receive compensation for providing reactive power, to be unjust, unreasonable and unduly discriminatory under section 206 of the FPA and directs SPP to compensate all generators under Schedule 2, including independent power producers (IPPs), on a comparable basis. The Commission

¹ *Calpine Oneta Power, L.P.*, 113 FERC ¶ 63,015 (2005).

² 16 U.S.C. §824d(a) (2005).

also provides that SPP (and other parties) may develop criteria, applied comparably and prospectively, that would determine which generators would receive reactive power compensation. Any such proposal should be advanced in a separate section 205 proceeding.

3. The Commission, however, rejects the ALJ's finding that any and all fixed costs that may be attributed to reactive power capability should be classified as generation, rather than transmission, and none may be charged to transmission customers as beyond the scope of this proceeding.

Background

A. History of Reactive Power Pricing

4. The modern history of reactive power pricing begins with the Commission's Order No. 888 issued in April 1996.³ In that order, the Commission concluded that reactive power is one of six ancillary services that transmission providers must include in an open access transmission tariff.⁴ The Commission noted that there are two ways of supplying reactive power and controlling voltage: (1) installing facilities as part of the transmission system and (2) using generation facilities. The Commission concluded that the costs of the first would be recovered as part of the cost of basic transmission service and thus, would not be a separate ancillary service.⁵ The second (using generation facilities) would

³ *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. Regulations Preambles January 1991-June 1996 ¶ 31,036 at 31,705-06 and 31,716-17 (1996), Order No. 888-A, FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

⁴ Order No. 888 at 31,705. The *pro forma* open access transmission tariff (OATT) includes six schedules that set forth the details pertaining to each ancillary service. The details concerning reactive power are included in Schedule 2 of the pro forma OATT. *Id.* at 31,960.

⁵ Supplying reactive power and voltage control by installing facilities as part of the transmission system is not at issue in this proceeding.

be considered a separate ancillary service, and must be unbundled from basic transmission service. The Commission stated that, in the absence of proof that the generation seller lacks market power in providing reactive power, rates for this ancillary service should be cost-based and established as price caps, from which transmission providers may offer a discount.⁶

5. In Opinion No. 440,⁷ the Commission approved a method presented by American Electric Power Service Corp. (AEP) for generators to recover costs for reactive power. AEP identified three components of a generation plant related to the production of reactive power: (1) the generator and its exciter, (2) accessory electric equipment that supports the operation of the generator-exciter, and (3) the remaining total production investment required to provide real power and operate the exciter. Because these plant items produce both real and reactive power, AEP developed an allocation factor to sort the annual revenue requirements of these components between real and reactive power production.⁸ Subsequently, the Commission indicated that all generators that have actual cost data should use this AEP method in seeking reactive power recovery.⁹

6. After Opinion No. 440, the Commission accepted a proposal by PJM Interconnection, LLC (PJM),¹⁰ that revenue requirements of generation owners that are not also transmission owners be included in the charges for reactive power. Subsequently, the Commission concluded that a generator need not be compensated further for providing reactive power within its power factor range.¹¹ The Commission

⁶ Order No. 888 at 31,720-21.

⁷ *American Electric Power Service Corp.*, Opinion No. 440, 88 FERC ¶ 61,141 (1999) (AEP).

⁸ The factor for allocating to reactive power, developed by AEP, is $Mvar^2 / MVA^2$, where Mvar is megavolt amperes reactive capability and MVA is megavolt amperes capability at a power factor of 1.

⁹ *WPS Westwood Generation, LLC*, 101 FERC ¶ 61,290 at 62,167 (2002) (WPS Westwood).

¹⁰ *PJM Interconnection LLC*, Docket No. ER00-3327-000, September 25, 2000 (unpublished letter order).

¹¹ *Michigan Electric Transmission Co.*, 96 FERC ¶ 61,214 at 61,906 (2001) (citing *Consumers Energy Company*, 93 FERC ¶ 61,339 at 62,154 (2001), *order on reh'g*, 94 FERC ¶ 61,230 at 61,834 (2001)).

also concluded that a transmission owner need not provide compensation to generators for reactive power if the generator is not under the control of the control area operator.¹² However, the Commission explained that a transmission owner must compensate a non-affiliated generator for providing reactive power to the extent that the transmission owner compensates an affiliated generator for providing reactive power.¹³

7. In Order No. 2003,¹⁴ the Commission concluded that an interconnection customer should not be compensated for reactive power when operating within its established power factor range. Under Order No. 2003, the required power factor range is 0.95 leading (consuming) and 0.95 lagging (supplying), but the transmission provider may establish a different power factor range. However, the Commission determined that the transmission provider must compensate the interconnection customer for reactive power during an emergency where the interconnection customer provides reactive power outside the power factor range. In Order No. 2003-A, the Commission clarified that if a transmission provider pays its own or its affiliated generators for reactive power within the established range, it must also pay the interconnection customer.¹⁵

B. SPP's Schedule 2

8. Schedule 2 of SPP's OATT, which is similar to the Commission's *pro forma* OATT, indicates that reactive power service will be provided by the control area operator within SPP where the load is located. Under Schedule 2, SPP receives the revenues for reactive power and then passes through these revenues to the control area operator.

¹² *Otter Tail Power Co.*, 99 FERC ¶ 61,019 at 61,092 (2002).

¹³ *Michigan Electric Transmission Co.*, 97 FERC ¶ 61,187 at 61,853 (2001) (*METC*).

¹⁴ *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs., Regulations Preambles ¶ 31,146 at P 21 (2003) (Order No. 2003), *order on reh'g*, Order No. 2003-A, 69 Fed. Reg. 15,932 (March 26, 2004), FERC Stats. & Regs., Regulations Preambles ¶ 31,160 (2004) (Order No. 2003-A), *order on reh'g*, 109 FERC ¶ 61,287 (2004) (Order No. 2003-B), *order on reh'g*, Order No. 2003-C, 111 FERC ¶ 61,401 (2005) (Order No. 2003-C).

¹⁵ Order No. 2003-A at P 416.

9. SPP's Schedule 2 does not allow SPP to directly compensate non-transmission owners or independent power producers for providing reactive power; rather, all payments for Schedule 2 service are distributed to the control area operator.

C. Relationship Between Oneta, AEP and SPP

10. Oneta owns a gas-fired generating facility (Oneta Facility) with a total generating capacity of approximately 1150 MW located in the Tulsa, Oklahoma area. The Oneta Facility is interconnected with Public Service Company of Oklahoma's (PSO) 345 kV transmission system in the southeast corner of the 345 kV loop around Tulsa. PSO is one of the AEP utility operating subsidiaries located in the SPP area. SPP, the independent regional transmission operator (RTO), provides regional transmission under the rates, terms and conditions of the SPP OATT for its member control areas. Therefore, SPP is the transmission provider; AEP, a traditional utility, is the control area operator; and, Oneta is the IPP, utilizing the transmission system in the Tulsa area.

D. Procedural History

11. On April 22, 2003, Oneta filed a proposed rate schedule to charge SPP for reactive power from the Oneta Facility with a proposed cost-based revenue requirement of \$2,743,958 derived by using the *AEP* methodology. On June 20, 2003, the Commission accepted and suspended the rate schedule, subject to refund, and set for hearing the issue of whether the proposed rate schedule was just and reasonable, but held the hearing in abeyance pending settlement discussion which ultimately failed.¹⁶

12. During the hearing, Oneta asked for comparable treatment so as to recover in Schedule 2 of SPP's OATT the reactive power-related portion of the fixed costs of the Oneta Facility.¹⁷ AEP, SPP and Commission Staff opposed Oneta's recovery of those costs essentially on the grounds that Oneta's reactive power capability is not needed.

13. The ALJ made the following findings and conclusions, with respect to the merits of Oneta's proposal: (1) reactive power from a generator can be used to maintain voltage only at or near that generator and cannot be transmitted significant distances, and there is between three and ten times the reactive power capability as is needed in the Tulsa area where Oneta's generating plant is located, not taking into account Oneta's reactive power capability; (2) neither Oneta's, nor any other generator's reactive power capability is

¹⁶ *Calpine Oneta Power, L.P.*, 103 FERC ¶ 61,338 (2003) (June 20 Order).

¹⁷ During the hearing Calpine lowered its proposed revenue requirement to approximately \$2.455 million.

needed on the SPP system other than to support the voltage produced by that generator, and each generator on the SPP system is able to support its own voltage; (3) applying a “needs” test to Oneta’s reactive power capability that is not also applied to all other generating plants in its vicinity would deny Oneta comparable treatment and would constitute undue discrimination; and (4) applying a “needs” test to Oneta’s reactive power capability would be contrary to Commission precedent.

14. In addition to addressing the merits of Oneta’s proposal, the ALJ made a finding regarding the functionalization of generation-related reactive power costs stating that, “any and all fixed costs that may be attributed to reactive power capability are hereby classified as generation, rather than transmission, and none may be charged to transmission customers under the OATT, in Schedule 2 or otherwise.”¹⁸

15. Exceptions were filed by Oneta, AEP, and SPP. Briefs opposing exceptions were filed by all three and Trial Staff. We will address the issues raised below.

Discussion

16. As discussed more fully below, we find that Oneta’s proposed reactive power service rate service is just and reasonable because it compensates Oneta comparably, as other generators are compensated. Generally, opponents to Oneta’s proposed rate schedule argue, among other things, that Oneta’s rate schedule is not just and reasonable because the Oneta Facility is not needed to provide reactive power service. In other words, they subject the Oneta Facility to a “needs” test. In support of our just and reasonable determination, the Commission affirms the ALJ’s findings that requiring a needs test would be contrary to Commission precedent, would deny Oneta comparable treatment, and would constitute undue discrimination. Additionally, we find, among other things, that Oneta should have been receiving compensation for reactive power service since the effective date established by the Commission.

A. “Needs” Test & Commission Precedent

1. ALJ’s Findings

17. The ALJ found that applying a “needs” test to Oneta’s reactive power capability would be contrary to Commission precedent. The ALJ agreed with Staff, AEP and SPP that Oneta’s reactive power capability was not needed. Indeed, the ALJ also agreed that there was an excess of reactive power capability in the Tulsa area in the amount of either

¹⁸ ID at P 128.

three or ten times what was needed, depending on whether the excess was determined by comparing real power generation with peak load or total reactive power capability with peak load requirements for reactive power.¹⁹ However, the ALJ explained that such excess did not resolve the matter of whether Oneta should be subjected to a “needs” test. He stated that subsequent to *WPS Westwood*, where the Commission instructed all generators then seeking recovery for reactive power that they use the *AEP* methodology based on capability, the Commission issued a number of hearing orders²⁰ on rate schedules filed by merchant generators seeking compensation for reactive power support, in which it summarily denied requests that these IPPs be required to show a need for the reactive power service to become eligible for compensation. The ALJ stated that *WPS Westwood* and the cases that followed it had an underlying principle and policy that merchant generators should be accorded the same rate treatment for their reactive power as is given traditional utilities, in accordance with the Commission’s general policy of comparable treatment and non-discrimination.²¹ Based on this precedent, the ALJ concluded that a “needs” test should not be applied in this proceeding.

2. Exceptions

18. SPP disagrees with the ALJ’s conclusion that needs tests should not apply. SPP also faults the ALJ for not fully recognizing and addressing the issue of whether the Oneta Facility is used and useful in providing reactive power services within the SPP region. SPP argues that whether a facility is needed represents a key component of a used and useful analysis, in that if a facility is not needed, then it would obviously fail the used and useful test. SPP states that the needs test and used and useful issues address the

¹⁹ The ALJ bases his finding on the engineering studies that the combined reactive capability of the six major generating facilities in the Tulsa area, other than Oneta’s, is 4600 MVAR; there are an additional 300 MVAR of capacitors; and, only 459 MVAR are needed to ensure system reliability on a peak day. In addition, AEP’s power flow analysis simulating 2005 summer peak conditions in the Tulsa area, showed that its generators could have produced all the reactive power needed to maintain voltage at safe and reliable levels without the Oneta Facility or any other third-party generators. (AEP’s 2005 Model).

²⁰ *Rolling Hills Generating, L.L.C.*, 109 FERC ¶ 61,069 at P 12 (2004) (*Rolling Hills*); *FPL Energy Marcus Hook, L.P.*, 110 FERC ¶ 61,087 at P 16 (2005), *order on reh’g*, 111 FERC ¶ 61,168 at P 10-11 (2005); *Cottonwood Energy Company, L.P.*, 111 FERC ¶ 61,369 (2005).

²¹ ID at P 76.

question of whether a service provider should receive compensation for a service that is neither wanted nor used by ratepayers. SPP states that it did not want the Oneta Facility's reactive power and that the record is clear that the Oneta Facility was not needed for reactive power support.²²

19. SPP notes that elsewhere in the ID, the ALJ implicitly accepted that considerations of need and whether a facility is used and useful are valid concerns. For example, SPP states that the ALJ's determination that reactive power capability be classified to generation functions and not transmission functions would allow Oneta to be compensated for reactive power only when it actually produces reactive power that is needed and used for transmission support service. SPP argues that the ALJ has implicitly recognized that "used and useful" are appropriate criteria considerations in his discussion regarding AEP generators.²³

20. SPP states that consideration of needs issues and whether a facility is used and useful are fundamental aspects in deciding whether a proposed rate is just and reasonable, as required by section 205 of the FPA. SPP states that precedent supports the requirement of a used and useful test.²⁴ SPP states that if reactive power from the Oneta Facility is not needed, then that means that SPP will not call upon it to provide reactive power or capability and the Oneta Facility clearly would not be used or useful.²⁵

²² To support its claim that the Oneta Facility was not needed for reactive power, SPP states that the only reactive power the Oneta Facility produced involved amounts necessary to support its own sales; the Oneta Facility operates infrequently and it produces a significant amount of reactive power even more infrequently (*i.e.*, less than one percent of the time); the Oneta Facility is located in a area in which generation exceeds load by a factor of three and reactive power production capability far exceeds needs; and SPP's short-term and long-term studies show that reactive power from the Oneta Facility will not be needed. SPP's Brief on Exceptions at 9-10.

²³ ID at P 86, 88.

²⁴ *Citing Anaheim v. FERC*, 669 F.2d. 799, 808 (D.C. Cir. 1981); *Tenn. Gas Pipeline Co. v. FERC*, 606 F.2d 1094, 1109 (D.C. Cir 1979), *cert. denied*, 445 U.S. 920 (1980) (and the cases cited therein); *New England Power Co.*, 42 FERC ¶ 61,016 at 61,078 (1988).

²⁵ SPP also cites as support the Commission's Staff Report in Docket No. AD05-1-000 (Staff Report) which recommends that the level of compensation should depend on system need. Staff Report at 11.

21. AEP states that the needs test is not a standard that applies only to reactive power but to any service for which a utility is seeking compensation. Therefore, AEP states that its position that a needs test should be applied to determine the use and usefulness of Oneta's service is not a novel requirement.²⁶ Although not addressed in a specific exception, AEP also maintains that reactive power from the Oneta Facility is not useful based on AEP's 2005 Model simulating summer peak conditions.

3. Opposing Exceptions

22. Oneta argues that SPP and AEP fail to demonstrate that the ALJ is required to address needs; to the contrary, Oneta argues that Commission precedent with respect to reactive service compensation specifically precludes such an inquiry. In support, Oneta states that it must use the *AEP* methodology for determining reactive power compensation and the *AEP* methodology does not require a "needs" test.

23. In addition, Oneta argues that the record clearly supports that the reactive power the Oneta Facility provides is, in fact, wanted and used by ratepayers. It explains that it seeks to recover a capacity charge that covers Oneta's expenses for providing reactive power and that it is not putting all of its generation-related costs into this charge, but only those components of generator costs that are "used and useful" for providing reactive power. Oneta argues that the *AEP* Methodology includes a built-in "used and useful" test, and ensures that the reactive power revenue requirement only recovers the cost of equipment allocated to reactive power. To the extent that SPP is arguing that Oneta cannot recover a capacity charge for having the ability to provide reactive power services because it is not providing reactive power in all hours, Oneta states that SPP is incorrect. Oneta argues that the "used and useful" requirement does not mandate that a service be provided at all times. It states that such an argument would be a blanket attack against the use of capacity payments (and the *AEP* Methodology), which are widespread throughout the industry.

24. Also, Oneta argues that it produces and absorbs reactive power in response to the transmission system's real-time needs and that such a service should be compensable. Oneta states that AEP and SPP's assertion that they have never requested that the Oneta Facility produce reactive power for system reliability is disingenuous. Oneta explains that consistent with Schedule 2 of the SPP OATT, SPP requires control areas such as AEP to manage real-time reactive needs of the system. Oneta argues that since the Automatic Voltage Regulator causes the Oneta Facility to respond to the real-time

²⁶ Citing *Entergy Nuclear Operations, Inc., v. Consolidated Edison Co. of New York, Inc.*, 110 FERC ¶ 61,312, *reh'g denied*, 112 FERC ¶ 61,117 at P 11 (2005).

reactive needs of the system, it is no surprise that neither SPP nor AEP have ever requested the Oneta Facility to produce reactive power for system reliability. Further, Oneta notes that no studies were run specifically to assess reactive needs in the SPP footprint and that when asked whether SPP developed a “needs” test SPP’s response was that “SPP has had no reason to design a “needs” test for the provision of reactive power, and the SPP OATT does not require such a test.”²⁷

25. With regard to AEP’s 2005 Model to demonstrate that the reactive power from the Oneta Facility is not useful, Oneta states that the 2005 Model is not credible. Specifically, it states that the 2005 Model suffers from the following flaws: (1) it fails to account for contingency conditions, (2) it has not been benchmarked against actual operation, (3) it is a snapshot of only one hour in one year, (4) it fails to factor in purchases from AEP-designated network resources in the market and the displacement of its own generation, (5) it fails to factor in retirement of AEP generation, (6) it is designed to solve without identification of a need from non-AEP generation, and (7) AEP’s representations based on the 2005 Model are inconsistent with AEP’s studies that were not prepared in the context of this proceeding.

4. Commission determination

26. We affirm the ALJ’s finding that Commission precedent rules out the application of a “needs” test. The Commission’s analysis for reactive power compensation begins with whether the generator is providing reactive power within the dead band, *i.e.*, maintaining voltage levels for energy entering the grid during normal operations, or outside the established power factor range, *i.e.*, providing reactive power for transmitting power across the grid to serve load. The Commission has emphasized that an interconnecting generator should *not* be compensated for reactive power when operating *within* the established power factor range, since it is *only* meeting its obligation.²⁸ Generators interconnected to a transmission provider’s system need only be compensated where the transmission provider directs the generator to operate *outside* the established power factor range.²⁹ However, the Commission has held that compensation for reactive

²⁷ Exhibit No. KZ-20.

²⁸ See, e.g., *Consumers Energy Co.*, 93 FERC ¶ 61,339 at 62,154, *order on reh’g*, 94 FERC ¶ 61,230 at 61,834 (2001); Order No. 2003 at P 546 (emphasis added).

²⁹ See *METC*, 97 FERC at 61,852 (“[T]o the extent that reactive power is provided as an ancillary service, and thus outside reactive design limitation, Generators would be entitled to compensation.”); see also *Detroit Edison Co.*, 95 FERC ¶ 61,145 at 62,538 (2001) (“A generator is required to supply reactive power in order to operate the facility

(continued)

power within the established power factor range is based on comparability and thus, if the transmission provider compensates its own or its affiliated generators for reactive power *within* the established range, it *must* also pay the interconnecting generator.³⁰

27. Here, SPP's Schedule 2 allows AEP's generators to receive compensation for providing reactive power within the established power factor range, but not the Oneta Facility. Consistent with the Commission's reactive power comparability standard, Oneta must also receive compensation. No further inquiry is required.³¹

28. In addition, we agree with Oneta that the *AEP* methodology, which the Commission recommends generators use to calculate revenue requirements for reactive power, does not include a "needs" test. It measures a generator's maximum capability to produce reactive power. Also, the Commission has held that a generator is "used and useful" if the generator is *capable* of providing reactive power.³² Here, the record indicates that the Oneta Facility is capable of providing reactive power and thus, consistent with Commission precedent regarding the *AEP* methodology, is "used and useful." The fact that the reactive power which a generator is capable of producing is not used at some particular given time does not render the generator's filed rates based on reactive power capability unjust or unreasonable.³³ In fact, SPP, via Schedule 2, allows generators owned by control area operators to recover compensation for reactive power

in a safe and reliable manner and in accordance with good utility practice. If, however, a transmission provider requests a generator to increase or decrease reactive power output, the generator must be compensated by the transmission provider.").

³⁰ See, e.g., *METC.*, 97 FERC ¶ 61,187 at 61,852-53 (2001) ("the need to treat all generation interconnection customers comparably underlies the need for a *pro forma*. To that end, it is hardly consistent to allow an affiliate to have different and/or superior terms and conditions for interconnection than non-affiliates . . . we direct Michigan Electric to compensate Generators for providing reactive power to the same degree that it will compensate its affiliate, Consumers, for providing reactive power"). See also Order No. 2003-A at P 416 (comparability of compensation); *accord* Order No. 2003-B at P 113, 119; October 14, 2005 Order, 113 FERC ¶ 61,040 at P 22-24, 38-39.

³¹ See *Midwest Independent Transmission System Operator, Inc.*, 114 FERC ¶ 61,192 at P 17 (2006) (*Midwest ISO*).

³² *Id.* at P 19.

³³ *Id.*

based on their reactive power capability; not on whether such generators are needed or actually used. Further, the record indicates that no studies were run specifically to assess reactive needs in the SPP footprint and when asked whether SPP developed a “needs” test SPP’s response was that “SPP has had no reason to design a ‘needs’ test for the provision of reactive power, and the SPP OATT does not require such a test.”³⁴

B. Needs test and undue discrimination

1. ALJ’s Findings

29. The ALJ found that applying a “needs” test to Oneta’s reactive power capability that is not also applied to all other generating plants in its vicinity would deny Oneta comparable treatment and would constitute undue discrimination. Specifically, the ALJ stated that:

based on the factual and expert evidence adduced in this case, it is apparent that there is no difference between the reactive power capabilities of traditional utilities and those of merchant generators under the control of the same transmission provider or control area operator. To treat them differently is undue discrimination.³⁵

2. Exceptions

30. AEP argues that there has been no evidence that Oneta has been subject to disparate treatment that has harmed its ability to compete with AEP, as is necessary to constitute “undue discrimination” under the FPA.

31. AEP also argues that even assuming that Oneta would be subject to a different test than transmission providers subject to OATT Schedule 2 reactive power obligations, the Commission must inquire as to whether that difference can be justified based on the record to determine that the test constitutes undue discrimination.³⁶ AEP states that in addition to the basic undue discrimination analysis under the FPA of allowing different treatment for different customers if that difference is justified, differential rate treatment

³⁴ Exhibit No. KZ-20.

³⁵ ID at P 105.

³⁶ *Citing St. Michaels Utils. Comm’n v. FPC*, 377 F. 2d 912, 915 (4th Cir. 1967).

may be justified on cost or non-cost bases.³⁷ AEP contends that the FPA's ban on undue discrimination guarantees fairness, not equality. Additionally, AEP argues that discrimination caselaw has been established in which the central issue has been whether there was an undue preference that hindered customers' ability to compete.³⁸ AEP argues that a finding of undue discrimination cannot rest on the impact of competition because there is no evidence in the record that AEP and Oneta compete for reactive power service or that Oneta's ability to compete in the capacity and energy markets in any way has been or will be affected by Oneta's ability to collect a rate based on Oneta's reactive power capability. AEP also states that neither the Commission nor the courts have applied the "undue discrimination" principles to mandate that sellers recover comparable revenue streams. Finally, AEP states that Oneta cannot argue that it will be unable to recover the costs if its proposal is rejected because the cost-based revenue stream that Oneta seeks in this proceeding is on top of the unregulated and uncapped revenues that Oneta is permitted to earn in the marketplace.

3. Opposing Exceptions

32. Oneta argues that not only is it unnecessary for Oneta to have made a record on competitive harm, but AEP's position is a collateral attack on Order No. 2003-C, which found that interconnected customers such as Oneta, provide reactive power service;³⁹ the *Midwest ISO* Order which stated that "only a Schedule 2 that includes all generators, including IPPs, is just and reasonable and not unduly discriminatory or preferential;"⁴⁰ and all the reactive power rate schedules that the Commission has accepted for filing with or without hearing as "used and useful" was not a condition to receiving approval to be compensated for reactive power.

³⁷ Citing *City of Frankfort, Ind v. FERC*, 678 F.2d 699, 706 (7th Cir. 1982).

³⁸ Citing, e.g., *Federal Power Commission v. Conway Corp.*, 426 U.S. 271 (1976); *Cities of Batavia v. FPC*, 548 F. 2d 1056 (D.C. Cir. 1977); *Cities of Bethany v. FERC*, 670 F.2d 187 (D.C. Cir. 1981); *Towns of Alexandria, Minn. v. FERC* 555 F.2d 1020 (D.C. Cir. 1977); *Public Service Co. of Indiana, Inc., v. FERC*, 575 F.2d 1024 (7th Cir. 1978); *Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978); *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156, 1170-72 (D.C. Cir. 1979).

³⁹ Order No. 2003-C at P 42.

⁴⁰ *Midwest ISO*, 114 FERC ¶ 61,192 at P 40.

33. In addition, Oneta argues that the cases AEP cites involve rates to different wholesale customers as well as rate differences between wholesale and retail customers. Oneta states that this proceeding is factually different because it involves the rates different entities charge for reactive power. Further, the issue is not one of competition between AEP and the seven other SPP transmission-owning entities receiving reactive compensation and Oneta, but whether it is fair that certain parties receive compensation for Reactive Service while independent generators like Oneta do not.

34. Also, Oneta agrees that the FPA guarantees fairness, not equality, but that if the principle were applied in this proceeding, the record demonstrates that Oneta's and AEP's generation is similarly situated and that in the absence of differences, fairness dictates that it be compensated. Further, Oneta states that it is not proposing a difference in rate treatment and that, in fact, Oneta's and AEP's reactive power rates are based on the *AEP* methodology.

4. Commission determination

35. We agree with the ALJ's finding that applying a "needs" test to Oneta's reactive power capability that is not also applied to all other generating plants in its vicinity would deny Oneta comparable treatment and would constitute undue discrimination. Currently, in calculating its own reactive power rates, AEP determines the percentages of its generating plants that are allocable to reactive power capability under the *AEP* Methodology. SPP then charges its transmission customers those percentages of AEP's fixed costs of generation under Schedule 2 of SPP's OATT. It then pays those amounts over to AEP.⁴¹ Non-control area operators or IPPs do not receive compensation for providing reactive power. As we discussed above, reactive power compensation is based on comparability and, in fact, the imposition of a "needs" test would be contrary to this principle,⁴² and would be unduly discriminatory where others receive compensation based on capability. AEP effectively proposes a "needs" test that would be applied only to new generation, and not to their pre-existing generation. Such a proposal would be unduly discriminatory because existing generators, most of which are owned by or affiliated with the control area operators, would not be subject to the test; existing

⁴¹ ID at P 63.

⁴² In line with the Commission's comparability standard, the Commission has accepted a proposal to eliminate compensation for reactive power within the established range for all generators, regardless of whether the generator is independent or owned by or otherwise affiliated with a transmission owner. See *Entergy Services Inc.*, 113 FERC ¶ 61,040 at P 22-24, 38-39.

generators would be presumed to be needed and receive compensation for their capability, while new generators would be presumed not to be needed unless proven otherwise.

36. Further, we disagree with AEP's argument that competitive harm has to be proven in order for the Commission to find undue discrimination under the FPA. Discrimination is undue when there is a difference in rates or services among similarly situated entities.⁴³ As discussed above, the Oneta Facility and AEP's generators are similarly situated for reactive power compensation purposes because they all have the capability of providing reactive power within their respective dead bands. Because they are similarly situated, compensating AEP's generators for their capability of providing reactive power and denying Oneta's Facility for similar capability is unduly discriminatory.

C. Comparable Use of Reactive Power

1. ALJ's Findings

37. During the hearing Oneta's opponents argued that it would be unjust and unreasonable to burden transmission customers with the costs of a reactive power capability that is unneeded and, for a great percentage of the time, unusable. In response, the ALJ found that AEP's generators' reactive power capability is no more usable than Oneta's, and the reactive power costs allocated to all of these units are included in AEP's reactive power rates.⁴⁴ The ALJ pointed out that Oneta's generators are on-line only 8.4 percent of the time and that the need for generator supplied reactive power is instantaneous and can't be supplied by a generator that is shut down. However, he also pointed out that approximately half of AEP's generators operate even less frequently and the reactive power costs of these AEP generators are included in AEP's reactive power rates.⁴⁵ In addition, the ALJ found no justification for the position advanced by AEP, SPP and Staff that certain of AEP's generators are required to be available for supplying reactive power, while Oneta's units are not. The ALJ stated that no showing was made that any of AEP's units that are supposedly relied on for reactive power capability have any greater capability than units, such as Oneta's, that might displace it for reasons of economic dispatch or otherwise.⁴⁶ Also, the ALJ rejected the argument that AEP's

⁴³ See, e.g., *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 115 (2005).

⁴⁴ ID at 86.

⁴⁵ ID at P 86.

⁴⁶ ID at P 89.

generators are entitled to more favorable treatment than Oneta's because, unlike Oneta's, they were built in their locations based upon reactive power considerations.⁴⁷ The ALJ found no evidence that would suggest that a decision to build or locate a plant was ever based on the need for, or potential to sell, reactive power. Further, the ALJ rejected arguments that Oneta's Facility does not supply a reactive power "service" that would entitle it to compensation. The ALJ stated that AEP's generators supply no more of a reactive power "service" than Oneta's and that AEP conceded that the voltage schedules for its generating facilities mirror the voltage schedules for Oneta.⁴⁸ In fact, the ALJ noted that AEP's generators do not come close to operating near their design limits, whether 0.95 or 0.85 lagging, and 0.95 leading.

2. Exceptions

38. AEP argues that the ID erroneously found that the Oneta Facility and AEP generation are similarly situated, ignoring the differences in the reactive "service" each provides and focusing on operating characteristics, *i.e.*, capability of producing reactive power, that are not relevant to that question. AEP states that the service it provides under the *pro forma* OATT results from Order No. 888, which required transmission providers such as AEP to plan and operate their generators to meet the real-time voltage needs. AEP argues that this requirement means that AEP must commit and dispatch its generators regardless of market conditions. In other words, AEP states that it may have generation on-line and operating for no purpose other than to produce reactive power needed to meet local area voltage concerns.⁴⁹ For this reason, AEP argues that the ALJ was mistaken to believe that the Oneta Facility or other third-party could displace AEP generators for economic reasons.⁵⁰ AEP states that the Oneta Facility operates only when

⁴⁷ ID at P 93.

⁴⁸ ID at P 96.

⁴⁹ AEP states that the certain AEP gas-fired generators in the Tulsa area have been designated must run, meaning that at times they must be on-line and generating at least at a minimum leveling order to maintain voltage, even if less-expensive AEP or third-party resources are available to produce real power on another part of the system. Exhibit No. KZ-17.

⁵⁰ AEP states that it is possible for a third-party generator to displace AEP's generation for real power, but third-party generation has no bearing on the reactive power requirements, which are locational in nature.

there is a market for real power and Oneta has taken no obligation and believes it is under no obligation to run its generator to meet system voltage needs.⁵¹

39. AEP asserts the ALJ found that AEP's generators were not providing a service to distinguish them from the Oneta Facility because of the "excess" of reactive power capability in the Tulsa area. AEP states that the ALJ determined this excess reactive power capability by comparing reactive power capability, as determined by SPP and modeled on a broad description of the "Tulsa area" with reactive power needs, as determined by AEP and modeled only on the system in the immediate Tulsa area. AEP argues that even assuming there was an excess of reactive power capability, it is still providing a service. Specifically, AEP states that to maintain a stable system, AEP, as the control area operator, is responsible for ensuring that voltage levels are maintained to accommodate open access transmission.

40. In addition, AEP contests the ALJ's conclusion that AEP provides no more of a service than Oneta based on the Oneta Facility having a wider power factor range (.85 lagging) than AEP generation (.95 lagging) and on the fact that AEP generation typically does not operate at the lower end of the power factor range. AEP argues that the Oneta Facility's wider power factor range is irrelevant to the issue of whether Oneta is providing a comparable service or whether Oneta's obligations make it similarly situated to AEP. AEP states that Oneta did not incur any additional expenditures to meet the .85 lagging power factor requirement and the previous owner of the Oneta Facility never voiced concern about the power factor requirement. AEP asserts that the differences in power factor requirements reflect different specifications in different vintages of generating equipment. Additionally, AEP notes that there is no evidence that the Oneta Facility has ever operated near the .85 lagging power factor.

41. Further, AEP argues that the fact that AEP has never needed or requested its generation or the Oneta Facility to operate outside of the normal operating parameter means that AEP efficiently provides reactive service rather than AEP is not providing a service as posited by the ALJ. AEP notes that its operators monitor system conditions on a real-time basis and its generators may have to manually adjust their reactive power output to produce or absorb additional reactive power.

42. Finally, AEP asserts that the capacity factors of its generators do not determine whether AEP is providing any more of a service than Oneta. AEP states that it has a fleet

⁵¹ AEP also states that the capability argument has no logical end because the Oneta Facility has the capability to provide regulation or spinning reserve service but customers are not obligated to pay a capacity charge for that capability.

of generators (unlike Oneta) that is available to meet reactive power requirements and its peaking units are designed only to meet peak system requirements. AEP contends that the Commission has never suggested that peaking units should be excluded from cost-based rates due to their low capacity factors, as these resources purposely have been planned to be available and run only as necessary to meet peak loads. AEP states that the same holds true for reactive power. It explains that it runs some of the low-capacity peaking units on its lower voltage system for reactive power when needed to meet local needs close to the loads even though lower-cost real power is available. Accordingly, AEP states that it is reasonable for AEP to include its peaking units in the derivation of its reactive revenue requirement. However, AEP states that assuming that it was not reasonable, the answer would be to revise AEP rates because the impact on AEP's rates of including the cost of peaking facilities simply has no bearing on the question of whether Oneta is providing a comparable service.

43. SPP argues that the ALJ's conclusions on comparability were flawed because regardless of comparability, the key issue should be whether Oneta is providing a service and whether the proposed rate is just and reasonable. SPP states that the Commission may not approve a rate that is not just and reasonable simply to ensure what it views as comparability.

44. SPP states that the ALJ's conclusion regarding comparability is incorrect, given the substantial differences between the reactive power production from AEP's fleet of generators and the reactive power production from the Oneta Facility. SPP points out that unlike the control area operators who receive limited reactive power payments under Schedule 2 of SPP's OATT, Oneta seeks to recover its full reactive power revenue requirement regardless of whether it actually provides reactive power.⁵² SPP states that AEP generators compensated under Schedule 2 of the SPP OATT are baseload and intermediate load facilities⁵³ that provide reactive power services on a daily basis but the Oneta Facility rarely runs and SPP does not rely on the Oneta Facility to provide reactive power; therefore, Oneta is not providing the same type of reactive service as AEP.

45. SPP states that if the Commission believes that comparability must be addressed, then SPP recommends developing a rate for all generators that addresses the needs issue

⁵² SPP states that the record shows that Oneta is seeking to be paid more for its reactive power production than AEP is for its entire fleet of units. Exhibit No. SPP-1 at 10.

⁵³ SPP states that AEP does not recover any reactive power costs for its peaking units in the Tulsa area. Exhibit No. S-1 at 10.

and pays the generators a stated rate for each hour in which they provide reactive power support. SPP states that AEP provided such a methodology in its testimony and SPP claims the proposal would be just and reasonable because the proposal addresses the need or used and useful issue by paying generators only for the service provided, the comparability issue by paying all generators on the same basis, and prevents over charges to the customer.

3. Opposing Exceptions

46. Oneta opposes AEP's and SPP's contention that the ALJ erred in finding that the Oneta Facility and AEP's generation are similarly situated and comparable. It argues that Commission precedent requires reactive power compensation for Oneta. Oneta states that while AEP is correct that Order No. 888 places a service obligation on transmission providers, AEP is not a transmission provider. Thus, Oneta argues, AEP's reliance on Order No. 888 is misplaced. If anything, Oneta states, AEP and Oneta are similarly situated just as the generation is on the Midwest ISO transmission system, and consistent with Commission precedent, are to be treated the same for purposes of Reactive Service.⁵⁴ Likewise, Oneta argues that its generation cannot be compensated differently than AEP's generation, which is compensated under SPP's OATT Schedule 2 using the AEP Methodology. Oneta adds that in Order No. 2003-C, the Commission noted that affiliated and non-affiliated generating units were different in some respects, but that those differences were "not so significant as to eliminate the need to compensate other generators."⁵⁵

47. In addition, Oneta argues that engineering and operating characteristics support reactive power compensation for Oneta. Oneta lists 23 characteristics it claims demonstrate that the Oneta Facility is not significantly different from an AEP generating facility in the provision of reactive power. These include, for instance, Oneta's contractual obligation to operate at a power factor nameplate of .85 whereas AEP's units typically operate at .95; the same AEP voltage schedule applies to the Oneta Facility and certain AEP generation; and that for 2004 Oneta's capacity factor was 8.4 percent, with approximately 50 percent of AEP's PSO units having a lower capacity factor.

⁵⁴ *Citing Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,005 at P 40 (2004) (finding "only a Schedule 2 that includes all generators, including IPPs, is just and reasonable and not unduly discriminatory or preferential.").

⁵⁵ Order No. 2003-C at P 43.

4. Commission determination

48. We affirm the ALJ's finding that AEP's generators' reactive power capability is comparable to and no more usable than Oneta's. Among the evidence presented that supports the ALJ's finding were the facts that the Oneta Facility operates at a power factor nameplate of .85 whereas AEP's units typically operate at .95;⁵⁶ the same AEP voltage schedule applies to the Oneta Facility and certain AEP generation;⁵⁷ and that for 2004 Oneta's capacity factor was 8.4 percent, with approximately half of AEP's units having a lower capacity factor.⁵⁸

49. As to AEP's and SPP's argument that the ALJ should have focused on the differences in "service" the Oneta Facility and AEP's generators provide as opposed to the capability of producing reactive power, we reject it. As we stated above, the fact that the reactive power which a generator is capable of producing is not used at some particular given time does not render the generator's filed rates based on reactive power capability unjust or unreasonable. The *AEP* methodology, which Oneta used to determine its cost-based reactive power revenue requirement focuses on the capability of the generator. The issue before the ALJ was whether AEP's generators' reactive power capability, which AEP receives compensation for, is comparable to the Oneta Facility's capability, which is not compensated. The ALJ's focus on capability, therefore, was proper. The fact that AEP has more generators than Oneta or that AEP may have a generator on-line for no other purpose than to produce reactive power is irrelevant to whether AEP receives compensation for being capable of providing reactive power within its dead band, and whether Oneta is also capable of providing reactive power within its dead band and thus, also eligible to receive compensation under Commission precedent.

50. Also, SPP recommends that a rate be developed for all generators that addresses the needs issue and pays the generators a stated rate for each hour in which they provide reactive power support. The Commission has in the past found such an approach to be

⁵⁶ Exhibit AEP-2 at 17.

⁵⁷ AEP's Initial Brief at 19 n.23.

⁵⁸ Exhibits KZ-11 at 26, 26; KZ-30.

inconsistent with the *AEP* methodology because the *AEP* methodology focuses only on the capability of a generator.⁵⁹ Although we continue to find this precedent appropriate in circumstances where reactive power compensation is based on capability as established by an RTO/ISO for instance,⁶⁰ and that any change to the *AEP* methodology should be made on a generic basis,⁶¹ we recognize that the ALJ found that there is between three and ten times the reactive power capability as is needed in the Tulsa area where the Oneta Facility is located, not taking into account Oneta's reactive power capability. This evidence suggests that perhaps the Commission's reactive power compensation approach for generators providing reactive power within their established power factor range based on capability may not be appropriate in all circumstances.⁶² Going forward, parties may propose a rate for all generators that compensates them comparably for the level of reactive power actually needed and used, so as to avoid remuneration in excess of those levels. Therefore, SPP (and other parties) may develop criteria, including a needs test, to be applied comparably and prospectively, that would determine which generators would receive reactive power compensation. We would also expect that SPP factor reliability into any proposal that it might make. Any such proposal should be advanced in a separate section 205 proceeding.⁶³

⁵⁹ See, e.g., *Rolling Hills*, 109 FERC ¶ 61,069 at P 12 (finding that the embedded investment cost of reactive power “remains constant regardless of the hours of operation of the facility,” and that in the *AEP* methodology, “the Commission did not require *AEP* to demonstrate the hours of operation of its generation facilities providing reactive power, but rather, the allocation factors were based on the capability of the generator.”).

⁶⁰ See, e.g., PJM's Schedule 2.

⁶¹ *FPL Energy Marcus Hook, L.P.*, 111 FERC ¶ 61,168 at P 11.

⁶² We emphasize that a generator is only allowed to receive compensation for providing reactive power within its power factor range if another generator within the control area is already receiving compensation for it.

⁶³ We note that in the order being issued concurrently in *Midwest Independent Transmission System Operator, Inc.*, Docket No. ER06-1112-000, regarding the Midwest ISO's resource adequacy plan, we address the use of demand resources in providing ancillary services, such as reactive power.

D. Contractual Obligations

1. ALJ's Findings

51. The ALJ found that SPP's OATT, the SPP Membership Agreement, and the SPP Criteria established a sufficient contractual basis to require SPP to pay Oneta for reactive power, to the extent that any charge was deemed to be just and reasonable, stating that "while the language of the relevant SPP documents does not specifically authorize payments to merchant generators, it does not exclude them."⁶⁴ The ALJ also stated that:

It is obvious from the requirements imposed on Oneta by the various agreements and guidelines of SPP and AEP that it has the requisite contractual relationship with both the transmission provider and control area operator that would entitle it to the same compensation under Schedule 2 of SPP's OATT as accorded traditional utilities. If AEP as Control Area Operator does not presently charge SPP for Oneta's reactive power capability on the same basis as it does for the capabilities of its own generating facilities, it is remiss in not doing so. And SPP, fully cognizant of the situation, is able to charge its transmission customers and pay the amounts over to Oneta even without specific authorization from AEP.⁶⁵

52. The ALJ found that even if the existing language of Schedule 2 of SPP's OATT can be construed as not specifically authorizing reactive power compensation for Oneta, that is no bar to Oneta's claims. He states that it is clear that, if Schedule 2 does not presently contain language authorizing the payments, Oneta is willing to have that language inserted, and it is only SPP's refusal that prevents it from happening. Nor, he adds, is it even necessary to have any language authorizing payments *now*, as required by the June 20 Order. The ALJ states that the Commission's June 20 Order itself is sufficient authorization to collect those amounts from customers, subject to refund, and pay them over to Oneta. The ALJ further states that SPP's refusal to do so is in blatant defiance of the Commission Order. The ALJ concludes that if a final order is issued in this case determining that Oneta is entitled to reactive power payments, the language changes, if necessary, should be made at that time. He states that in *Tenaska*,⁶⁶ the Commission already held, in a similar situation, that the lack of current procedures or compatible rate design procedures in an OATT to recover from customers the

⁶⁴ ID at P 78.

⁶⁵ ID at P 80.

⁶⁶ *Tenaska Virginia Partners*, 107 FERC ¶ 61,207 (2004) (*Tenaska*).

compensation paid to generators for providing reactive power service was not an adequate basis on which to reject or suspend a proposed rate schedule.

2. Exceptions

53. SPP argues that Oneta, through its acquisition of the IA from Panda (former owner of the Oneta Facility), entered into a contract with reactive power obligations but no compensation and concludes that the ALJ should have found that Oneta was precluded from receiving compensation under the terms of the IA. Nonetheless, SPP argues that even if there were such provisions in the IA, Oneta should seek compensation from AEP, the control area operator, instead of SPP.

54. SPP states that the ALJ was mistaken to conclude that Oneta's reactive power charge is consistent (or at least is not inconsistent) with Schedule 2 of the SPP OATT. SPP states that Schedule 2 requires that reactive power services are to be provided by the control area operators.⁶⁷ Moreover, SPP states that Schedule 2 also provides for the charges for the services to be a pass-through of the amounts that the control area operators charge to SPP.⁶⁸ Further, there is nothing in the SPP OATT that indicates generators who are not control area operators are to be compensated by SPP. SPP asserts that Oneta's witness concurred with these facts.

55. SPP states that the ALJ's suggestion that Attachment L, Treatment of Revenues, may "authorize" the payment of reactive power charges to Oneta is also mistaken because SPP argues that Attachment L is part of the SPP OATT and merely provides a means for distribution of revenues received by SPP under the SPP OATT. SPP contends that there is nothing in Attachment L that obligates SPP to pay a generator a revenue requirement for reactive power and the SPP OATT does not provide for independent generators to receive revenues directly from SPP.

56. In addition, SPP faults the ALJ for finding that Oneta's proposed reactive revenue requirement is consistent with the SPP Membership Agreement or the SPP Criteria because the plain language of these documents states otherwise. SPP argues that the ALJ

⁶⁷ Schedule 2 states, in part, that "Reactive Supply and Voltage Control from Generation Sources Service is to be provided by the Transmission Provider by making arrangements with the Control Area operator(s) that perform(s) this service for the Transmission System."

⁶⁸ Schedule 2 states, in part, "The charge collected through this schedule shall represent a pass through of the costs charged by that Control Area operator."

misconstrued the nature and intent of the SPP Membership Agreement. SPP states that section 3.0 of the SPP Membership Agreement does not impose an obligation on Oneta to provide reactive power for which it should be compensated with the reservation charge it has proposed.⁶⁹ SPP argues that this provision addresses incremental reactive power needs as determined by SPP for which the entity will be compensated during the time it is actually providing the service as compared to Schedule 2 which provides a reservation charge which provides compensation for every hour of the year, not just during the time when reactive power is provided.⁷⁰ SPP states that the Membership Agreement was never intended to provide that a party which might be called upon infrequently or never should receive a year-around reservation charge.

57. With respect to the SPP Criteria, SPP states that while the SPP Criteria require Oneta to follow a reactive power voltage schedule,⁷¹ it does not create any sort of contractual arrangement between SPP and Oneta that entitles Oneta to payment for its reactive power revenue requirement.⁷² Further, SPP takes issue with the ALJ's statement that there is sufficient contractual relationship with both the transmission provider and control area operator that would entitle Oneta to the same compensation under Schedule 2 of the SPP OATT as accorded traditional utilities. SPP counters that Oneta's contractual relationship with AEP has nothing to do with whether SPP is contractually

⁶⁹ Section 3.0 of the SPP Membership Agreement states that “[w]here Member owns generators within the SPP Region which directly affect the capacity or reliability of the Electric Transmission Systems, it shall offer to provide the ancillary services required under the OATT at rates approved by regulatory authorities, where appropriate, to the extent such generators are able to provide such ancillary services.” Exhibit No. KZ-42 at 2.

⁷⁰ SPP notes that base reactive power needs are satisfied under Schedule 2, not the Membership Agreement.

⁷¹ SPP states that section 7.8.2.2a of the SPP Criteria appears to be the basis for the ALJ's decision. This section states, “[s]ynchronous generators shall maintain a network voltage or reactive power output as required by the control area operator.”

⁷² SPP notes that even Oneta's witness admitted that there is nothing in the SPP Criteria that addresses compensation in any way.

obligated to pay Oneta. SPP states that if Oneta thought it was inadequately compensated under the IA with AEP, Oneta should have sought to modify that IA.⁷³

58. SPP also contends that the ALJ incorrectly determined that it should have paid Oneta's proposed reactive requirement while the hearing was pending. SPP argues that this issue was not set for hearing since it was not related to the justness and reasonableness of the Oneta proposal. Accordingly, SPP concludes that the issue was not properly decided by the ALJ.⁷⁴

59. SPP again argues that an entity cannot be forced to take a service that it neither wants nor needs.⁷⁵ SPP states that there is no service agreement between SPP and Oneta obligating SPP to pay for the charges in Oneta's proposed tariff or any other tariff; therefore, SPP has never agreed to take reactive power service from Oneta. SPP argues that without a service agreement or some other agreement between SPP and Oneta by which SPP agreed to take reactive power, acceptance by the Commission of Oneta's proposal, subject to refund, is not enough to require SPP to pay Oneta's revenue requirement. In support of this argument, SPP notes Commission acceptance of Schedule 2 to Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) tariff

⁷³ SPP also contends that the SPP Membership Agreement and SPP Criteria must be read in the context of the SPP OATT so that all the documents are consistent with one another.

⁷⁴ *Citing Sierra Pac. Power Co.*, 104 FERC ¶ 61,223, at P 36 (2003) (vacating initial decision insofar as it addressed issues beyond the scope of those set for hearing), *reh'g denied*, 106 FERC ¶ 61,155 (2004); *City of Freeport, N.Y. v. Consol. Edison Co.*, 91 FERC ¶61,003 at 61,011-12 (2000), *reh'g denied*, *Village of Freeport, N.Y. v. Consolidated Edison Co.*, 101 FERC ¶ 61,225 (2002) (affirming decision of ALJ that he cannot consider issues that were not addressed in the hearing order).

⁷⁵ *Citing Entergy Nuclear Operations, Inc., v. Consol. Edison Co. of New York, Inc.*, 112 FERC ¶ 61,117 (2005); *AES Somerset, LLC v. Niagara Mohawk Power Co.*, 110 FERC ¶ 61,032 at P 56 (2005). Additionally, SPP states that in *Southwest Power Pool, Inc.*, 98 FERC ¶ 61,256 at 62,027, *reh'g granted*, 100 FERC ¶ 61,096 (2002), the Commission stated that it would not force the transmission customer to take service it does not want. SPP also states that Title II of the FPA also supports this as it shows that the Commission does not regulate customers and cannot force customers to take a service.

allowing for independent generators to be compensated.⁷⁶ Instead of entering into service agreements with independent generators, Midwest ISO filed a tariff provision that would provide payment to independent generators for reactive power service. SPP notes that its tariff has no such provision. SPP states that Commission precedent and practice is to require entities taking service under tariffs to execute contracts or request the filing of an unexecuted one before charges can be imposed.⁷⁷

60. Finally, SPP contests the ALJ's reference to *Tenaska* to conclude that SPP should pay the bills sent to it by Oneta. SPP argues that in *Tenaska* the independent generator and the utility were parties to an IA which provided for the generator to be compensated for reactive power. Given this provision, the Commission found that the absence of a mechanism in the utility's OATT to recover those reactive power payments from the utility's customers was not relevant. SPP states that, by contrast, there is no contractual relationship between Oneta and SPP that would entitle Oneta to compensation for reactive power.

61. AEP adds that since Oneta waited several years to seek compensation, this confirms that Oneta did not believe that it was providing a service.

3. Opposing exceptions

62. Oneta states that the fact that the Interconnection Agreement is silent on the matter of reactive power compensation does not preclude Oneta from recovering such charges. Oneta argues that consistent with Order No. 2003-A, if a transmission-owning entity receives compensation for reactive power, so should an interconnected independent generator.

63. Oneta argues that SPP erroneously interprets its agreements with Oneta as not imposing the requirement on Oneta that Oneta provide reactive power for the benefit of the SPP transmission system. To the extent that Oneta's Reactive Service Rate Schedule and SPP's OATT conflict (and Oneta is not sure that they do), Oneta argues that one could just as equally argue that SPP's OATT is flawed because it violates Oneta's Rate Schedule. Oneta states that the Commission has rejected similar arguments that a

⁷⁶ See *Midwest Indep. Transmission Sys. Operator, Inc.*, 109 FERC ¶ 61,005 (2004), 110 FERC ¶ 61,267 (2005), *order on reh'g*, 114 FERC ¶ 61,192 (2006), *order on reh'g*, 116 FERC ¶ 61,283 (2006) (Midwest ISO Schedule 2 Orders).

⁷⁷ Citing *MidAmerican Energy Co.*, 83 FERC ¶ 61,084, at 61,415-16 (1998); *Commonwealth Edison Co.*, 78 FERC ¶ 61,312 at 62,335 n.3 (1997).

transmission provider should not be required to compensate an independent power producer for providing Reactive Service because the transmission provider's tariff does not contain a mechanism to recover such costs.⁷⁸ Further, Oneta states that if SPP's position governed, transmission providers could withhold reactive power payments simply by refusing to amend their OATTs.

64. With regard to the SPP Membership Agreement, Oneta states that nothing in it limits compensation to incremental service, or even requested service. Oneta states that the Agreement simply states that the generator will be compensated at rates approved by the Commission.⁷⁹ Accordingly, Oneta argues that because the record demonstrates that Oneta is providing Reactive Service to SPP, and Oneta's rate has been accepted by the Commission, the SPP Membership Agreement requires SPP to compensate Oneta.⁸⁰

65. As to the SPP Criteria, Oneta states that it is subject to the criteria addressing operating standards for generation within the SPP region, and SPP requires Oneta to comply with the SPP Criteria. It argues that the fact that SPP has made a control area responsible for certain activities does not alleviate Oneta of its obligation to SPP under the SPP Criteria. And, as set forth in Oneta's Interconnection Agreement, Oneta argues that to the extent there is a conflict between AEP's Interconnection Guidelines and the SPP Criteria, the SPP Criteria control. Therefore, Oneta states that SPP is ultimately responsible for Oneta contributing to the reliable operation of the SPP transmission system.

66. In addition, Oneta argues that the SPP Membership Agreement provides for compensation to Oneta for reactive power and that the Commission's decision in *Tenaska* to deny VEPCO's argument that it should not be required to compensate Tenaska

⁷⁸ Citing *Tenaska*, 107 FERC ¶ 61,207.

⁷⁹ See *supra* note 69.

⁸⁰ In its brief opposing exceptions Oneta begins by distinguishing SPP's cited caselaw for the proposition that SPP is not required to pay Oneta's reactive power revenue requirement pending this proceeding from the circumstances here. Oneta points out these distinguishing factors here: there is a rate schedule accepted by the Commission for filing that specifically identifies SPP as the party responsible for compensating Oneta for the service, making a service agreement necessary; Oneta does have reactive power capability and is providing reactive power; Oneta was obligated to install reactive power equipment, and it has detailed the costs associated with its reactive supply capabilities.

because its OATT does not provide for “compatible rate design provisions” did not turn on any provision in Tenaska’s interconnection agreement. Further, Oneta argues that *Tenaska* stands for the proposition that where the Commission has accepted for filing an independent generator’s reactive power rate schedule, the absence of provisions in the transmission provider’s OATT does not suspend or otherwise stay the transmission provider’s obligation to compensate a party for the service.

67. Oneta concludes that the Commission should direct SPP to pay Oneta, within ten days of the date of its Order on Initial Decision, Oneta’s reactive power revenue requirement together with all past due amounts, plus interest, for Reactive Service from the effective date of Oneta’s reactive power rate schedule.

4. Commission Determination

68. We find Oneta’s rate schedule is just and reasonable, as modified below. As we have concluded above, Oneta provides reactive power capability that is in every way comparable to the reactive power capability provided by AEP and under Commission policy and precedent, should be comparably compensated.

69. Oneta’s Interconnection Agreement with AEP states in section 3.5 that the Oneta Facility will follow AEP’s reactive and voltage restrictions⁸¹ but the Interconnection Agreement is silent as to compensation for doing so. Historically AEP has provided no compensation to Oneta under the Interconnection Agreement for following AEP’s reactive and voltage restrictions. However, section 13.16 of the Interconnection Agreement states as follows:

Company shall not require Customer to comply with standards and procedures in excess of those applied to Company’s own interconnected generating facilities that are similarly situated.

We interpret this section of the Interconnection Agreement to mean that if AEP receives compensation from SPP for reactive power service then AEP must ensure that Oneta receives similar compensation for the reactive power service provided by the Oneta

⁸¹ Section 3.5 states, in part, that the Customer, will follow Company’s reactive and voltage restrictions, as provided in the Interconnection Guidelines, within the design tolerances of the Facility and as scheduled with the operators of the Facility.

Facility.⁸² Therefore, we require Oneta to file a compliance filing within 30 days containing a revised rate schedule with AEP as the customer. AEP is required to seek compensation from SPP for reactive power service provided by the Oneta Facility as though the Oneta Facility was part of the control area operator's generation. By treating the Oneta Facility in a manner similar to AEP's similarly situated generation, for the purpose of receiving reactive power compensation under Schedule 2 of the SPP OATT, AEP will be holding Oneta to procedures that are not in excess of the procedures to which it holds itself and would allow AEP to comply with section 13.16 of the Interconnection Agreement. AEP's failure to ensure Oneta is compensated in a manner comparable to the way AEP's generation is compensated is even more egregious given that, as the ALJ points out, Oneta was subject to section 2.7.5(f) of AEP's Guidelines for Generation, Transmission, and Transmission Electricity End-Users Interconnection Facilities; therefore, its power factor requirement was 0.95 lead and 0.85 lag, even exceeding requirements for AEP's generators, which were only 0.95 lead and 0.95 lag.⁸³

70. Moreover, we affirm the ALJ's conclusion that the SPP Criteria establish a sufficient contractual basis to require SPP to pay Oneta, albeit indirectly through the control area operator, for the reactive power capability provided by Oneta.⁸⁴ As a member of SPP, Oneta is subject to the SPP Criteria addressing operating standards for generation within the SPP region.⁸⁵ One criterion to which Oneta is subject requires synchronous generators to maintain reactive power output as required by the control area operator within the reactive capability of the units.⁸⁶ The fact that SPP has made a control area operator responsible for certain activities does not alleviate Oneta of its

⁸² We note that in *Calpine Construction*, 111 FERC ¶ 61,403 (2005), the Commission stated that the interconnection agreement at issue there could have “(1) committed Calpine to provide reactive power and voltage control services without compensation; (2) committed Western to pay for the services; or (3) not addressed the issue.” *Id.* at P 9. The Commission found that “[o]nly in the first instance would it be clear that Calpine is not entitled to charge for the service.” *Id.*

⁸³ *Id.* at 78.

⁸⁴ Given our finding that recovery of Oneta's revenue requirement from SPP through AEP is just and reasonable, we do not need to make a finding with respect to the SPP Membership Agreement.

⁸⁵ Exhibit KZ-41.

⁸⁶ *Id.* at 3.

obligation to SPP under the SPP Criteria. Furthermore, Oneta's Interconnection Agreement states that "[s]hould a conflict exist between the Interconnection Guidelines and SPP Criteria, then SPP Criteria shall control."⁸⁷

71. With respect to Schedule 2 and Attachment L of SPP's OATT, we affirm the ALJ that nothing explicitly addresses payment of reactive power costs directly to generators unaffiliated with control area operators. These provisions merely establish the rates and costs attributable to reactive power service provided by control area operators and do not preclude other entities in SPP from providing reactive power service and from recovering compensation for that service under separate rate schedules. Since we find in this proceeding that Oneta is also providing reactive power capability comparable to that provided by control area operators, SPP must reflect Oneta's revenue requirement for reactive power service as part of the total revenue requirement for reactive service in AEP's control area and assess those charges to load pursuant to Schedule 2.⁸⁸

72. For the past billings commencing June 20, 2003, the effective date of Oneta's rate schedule, SPP must recalculate the reactive power service rates for the AEP control area and flow through the new reactive power revenue requirement pertaining to the Oneta Facility to load. SPP must pass through the compensation received for the period beginning June 20, 2003 to AEP, consistent with Schedule 2, and AEP will forward such amounts to Oneta.

E. Schedule 2 and Section 206

73. SPP's existing Schedule 2 provides compensation for reactive power service from generation sources from control area operators. Schedule 2 has no mechanism to directly compensate non-control area operators or IPPs for providing this same reactive power service. Because Schedule 2 has no mechanism to compensate non-control area operators or IPPs, we find that SPP's Schedule 2 is unduly discriminatory under section 206 of the FPA.⁸⁹

⁸⁷ See section 3.14 of Interconnection Agreement (First Revised Service Agreement No. 208).

⁸⁸ Since we are finding that SPP must pay AEP, the control area operator, for Oneta's provision of reactive power service, and AEP must pass that compensation thru to Oneta, we find the issue of whether SPP was remiss in not compensating Oneta directly to be moot.

⁸⁹ 16 U.S.C. § 824e(a) (2000).

74. We find that Schedule 2 must be revised to provide compensation for reactive power service to both control area operators and non-control area operators or IPPs insofar as they both provide such service; in that fashion, Schedule 2 will be just and reasonable and not unduly discriminatory. That is, only a Schedule 2 that includes all generators, including IPPs, is just and reasonable and not unduly discriminatory or preferential. This is consistent with a similar ruling in the Midwest ISO Schedule 2 Orders.

75. Accordingly, pursuant to section 206 of FPA, we direct SPP to file to replace existing Schedule 2 with a revised Schedule 2 within 30 days of the date of this order; that revised Schedule 2 must provide compensation for all generators, including IPPs. Further, given that transmission owners under Schedule 2 receive compensation for reactive power based on cost-based revenue requirements that are filed with the Commission and that IPPs currently do not have cost-based revenue requirements on file with the Commission, we will direct SPP to include language in its Schedule 2 that provides for IPPs to file cost-based revenue requirements with the Commission prior to their being compensated.

76. Further by revising the provisions in Schedule 2 to include the reactive power service provided by other IPPs, SPP will be able to avoid unnecessary litigation that may occur from other IPPs filing their own reactive power rate schedules, as Oneta has done.⁹⁰

F. Functionalization of Reactive Power

77. The ALJ made a finding that reactive power supplied by any generating plant during its normal operations within its power factor design range does not constitute reactive power “service” within the meaning of Order Nos. 888 and 2003. He finds that the initial decision in *AEP*, which the Commission affirmed in Opinion No. 440, was in error to presume that Order No. 888 required functionalization to transmission of the portion of generating assets allocable to reactive power capability.

78. The ALJ concludes that taking into account cost causation, engineering, regulatory and economic principles, it is unjust and unreasonable, and against the public interest to permit any utility, including Oneta and AEP, to recover fixed costs attributable to reactive power capability from transmission customers. The ALJ states that all utilities should be required to attempt to recover their full fixed costs of generation assets from

⁹⁰ As discussed above, we remind SPP that if it has a proposal to compensate generators affiliated with control area operators and generators unaffiliated with control area operators on a comparable basis, it may file that proposal under section 205.

their sales of real power, the sole purpose for which the generation was built, including its reactive power capability.

79. AEP and Oneta excepted to the ALJ's findings and Commission Trial Staff filed opposing exceptions. We find the ALJ's findings regarding the refunctionalization of reactive power costs to be beyond the scope of this proceeding because the Commission only set for hearing whether Oneta's proposed rate schedule for reactive power is just and reasonable.⁹¹ Issues regarding AEP's or other utilities' rates are not relevant to this issue. Therefore, the Commission will neither consider the ALJ's findings regarding the refunctionalization of reactive power nor adopt them.

The Commission orders:

(A) The ALJ is hereby affirmed in part and reversed in part, as discussed in the body of this order.

(B) Oneta is hereby directed to file with the Commission, within 30 days of the date of this order, a revised rate schedule, as discussed in the body of this order.

(C) SPP is hereby directed to file with the Commission, within 30 days of the date of this order, a revised Schedule 2, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

⁹¹ See June 20 Order, Ordering Paragraph (C).