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Administrative Law News

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Piecing Together a Regulatory Puzzle: American Electric Power Company's Proposed Corporate Reorganization

By C. Mitchell Burton, Jr.

Introduction

One of the more controversial – and complicated – utility matters to arise in 2013 involved American Electric Power Company's ("AEP") plan for a corporate reorganization that included a proposal to transfer certain coal-fired generating units among several of its affiliated subsidiaries. This corporate reorganization required AEP to navigate the regulatory process in multiple jurisdictions. This article intends to provide a procedural background to this process as well as an update on where things currently stand.

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Uneasy Seams: PJM and MISO Try to Work Out Kinks in Inter-RTO Capacity Market

By Kenneth A. Barry

Introduction

Resource adequacy – something not much talked about when competitive generation market restructuring first got rolling in the 1990s – has become a focal point of RTO and ISO market design in the last decade. And something of a sore spot too, as sellers (resource owners) or buyers (load-serving entities or "LSEs") don't hesitate to complain about prices for capacity being too low or too high, depending on one's vantage point.

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ABOUT THE EDITOR James G. Ritter is an associate in the Energy and Sustainability practice groups at Christian & Barton, LLP in Richmond. He focuses on regulatory matters before state and federal administrative entities involving electric, natural gas, and water utilities and cable companies. He also has experience working on behalf of telecommunications providers and local governments in Virginia. He earned his law degree from Washington & Lee University School of Law and his undergraduate degree from the University of Virginia.

Message from the Chair

Welcome to Spring 2014!

As usual, this year has been an active one for the Administrative Law Section. It has been my honor to work with so many talented lawyers in planning a variety of educational and networking opportunities for our Section's members. We have some wonderful programs scheduled for the coming months, and I'd like to encourage members and non-members alike to attend as many of them as possible.

The Thirty-Second Annual National Regulatory Conference will take place on May 15 and 16 at the Marshall-Wythe School of Law at the College of William & Mary in Williamsburg. This year's program will consider the changing regulatory landscape of the industry we serve, with particular focus on the ten-year anniversary of Virginia electric utilities' membership in PJM. Another emphasis will be cybersecurity, with remarks by a top expert on this dynamic and complex subject.

Planning also is underway for our annual Brown Bag CLE luncheon at the offices of Troutman Sanders LLP in Richmond. The CLE will focus on e-discovery and other electronic content management protocols in regulatory matters, and will feature comments by a range of panelists. The exact date of the program will be determined soon, so please lookout for more information.

As the year moves on, please consider how we can assist you in your practice as well as any contributions you might like to make to the work of the Section. Whether it is by writing an article for our newsletter or submitting an idea for future CLE programs or the next NRC, we are always eager to hear how we can provide better educational, networking, and professional development opportunities for our membership. Please feel free to contact me or any other member of the Board with your thoughts and ideas.

Finally, I would like to recognize Ashley Macko in the State Corporation Commission's Office of General Counsel, who recently stepped down as newsletter editor after seven years of service. Ashley deserves special thanks for her hard work.

Here's to warmer weather, and an excellent remainder of 2014!

~ Sam Brumberg

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32nd Annual National Regulatory Conference Will Be Held May 15-16, 2014 (Mark Your Calendar!)

Again this spring, we will gather in Williamsburg, Virginia for the 32nd annual National Regulatory Conference. As in the past, the conference will feature an array of panel discussions and speakers as well as a two-hour ethics CLE session. The day-and-a-half long conference will be held at the Marshall-Wythe School of Law at the College of William & Mary on May 15-16.

Our panels will cover diverse topics of particular interest to practitioners in administrative, energy, telecommunications, regulatory and utility law alike. They will address emerging energy technologies, the structure and changing role of electric cooperatives, the operation and regulation of wholesale electricity markets, and regional transmission planning. The conference will also feature a talk by a former top-level National Security Agency insider on the topical subject of digital security. He will address how our lack of cyber savvy is exposing us to extraordinary risks, including viruses that could destroy the power grid, simple hacks that harvest millions of credit card numbers from retailers, and security breaches with the potential for releasing vast amounts of classified information and intelligence through the Internet. The two-hour ethics session held on May 16th will be an entertaining exploration of the poignant topic of "The Ethics of Email and Social Media." As always, our panels will present topical information in a fresh format that encourages "give and take" between expert panelists and speakers.

So, be on the lookout for further information and make plans to join many of your fellow Administrative Law Section members in Williamsburg May 15-16.

CLE Alert: 2014 Virginia State Bar Annual Meeting June 14, 2014

The Administrative Law, Construction Law & Public Contracts, Local Government, and Real Property Sections will jointly sponsor a CLE program at the 2014 Annual Meeting of the Virginia State Bar in Virginia Beach on June 14, 2014. The title of the program is "Public-Private Partnerships: Smooth Sailing or Choppy Waters in the Wake of *Elizabeth River Crossings and VDOT v. Meeks?"*

A blue ribbon panel will discuss the law and policy of public-private partnerships (P3s) in the Commonwealth, with particular focus on the recent Portsmouth tunnels case and special purpose authorities such as the Fort Monroe Authority and the failed regional taxing authorities. While the P3 procurement model may accelerate project delivery and engage previously untapped resources, some projects may involve inherent tensions between the executive and legislative branches and state and local governments. Issues such as how P3s are procured, what can be administratively delegated, whether public assets should be privatized, how private property is affected, and impacts on local taxation, zoning, and land use will be explored.

The anticipated panelists include: Hon. Thomas K. Norment, Jr., Senator for the Third Senatorial District of Virginia; Cynthia E. Hudson, Chief Deputy, Office of the Attorney General; Patrick M. McSweeney, lead attorney for the plaintiffs in the *Elizabeth River Crossings* case; and Charles E. Wall, Partner, Williams Mullen.

We hope that members of the Administrative Law Section will plan to attend what promises to be an engaging and informative program.

Soaring Gas Prices Prompt FERC to Lift Cap on Offers in PJM Energy Markets

By James G. Ritter

This winter, after extreme cold weather conditions caused fuel prices to jump to unprecedented levels, the Federal Energy Regulatory Commission allowed PJM Interconnection, LLC to lift the $1,000/MWh cap on offers in the PJM energy markets. Issued on January 24 and February 11, as forecasters were predicting more frigid temperatures in significant parts of the PJM Region, the Commission's orders are intended to ensure that certain generators can recover their costs of generating power this winter.[1]

PJM explained in its filings that extraordinary market conditions in late January had placed generators in "an untenable situation." A provision of the PJM Operating Agreement obligates generators to offer the available capacity of their resources into PJM's Day-Ahead Energy Market, but another provision prohibits them from submitting offers above the $1,000/MWh price cap. These "must-offer" and "offer-cap" provisions had not previously come into conflict, until the recent cold weather events. Record-setting natural gas prices, combined with the cap, meant that generators were required to offer their resources into the market but could not recover their costs.

PJM noted that the average gas prices at two key citygates in the PJM Region had recently climbed to over $120/MMbtu, with some as high as $140/MMbtu. For a simple-cycle combustion turbine, these prices would equate to a marginal energy cost of about $1,200/MWh. PJM also pointed out that on one day in late January, close to 5,000 MW of generation was offered into the day-ahead market at a price of $999/MWh. The implication was that these resources had no choice but to buy fuel at significant cost in order to generate energy that would be sold at a loss.

According to PJM, this "patently unfair" result was contrary to the marginal cost pricing principle that is essential to the PJM energy market. For the market to function properly, PJM said, it is critical that offers for generation reflect the seller's marginal costs, and that sellers' primary reason for responding to PJM's dispatch instructions is that doing so will be economic. Otherwise, confidence in the market could be undermined and resources might not be available when they are most needed. PJM also noted that denying generators an opportunity to recover their costs could result in unlawful rates forbidden by Section 205 of the Federal Power Act.

PJM sought relief from FERC in two parts. In one filing, it asked for a waiver of the offer-cap provision to allow generators to submit cost-based offers above $1,000/MWh. PJM anticipated that this request would not be granted right away, because it would change how PJM clears the market. For that reason, the second filing proposed a more immediate answer—a separate tariff waiver allowing generators that submit cost-based offers and whose costs exceed the cap to receive make-whole payments covering the difference between their costs and the clearing price.

The second request was granted on an expedited basis, one day after the filing, but was superseded weeks later when FERC found that the first requested waiver was the better solution. Allowing marginal costs to be recovered in make-whole payments, the Commission said, fails to reflect those costs in transparent market prices. Removing the offer cap, on the other hand, would result in efficient market signals by "ensur[ing] that marginal prices paid by consumers appropriately equal the incremental cost of servicing them."

FERC emphasized that the short-term waiver, which expired March 31, would be subject to oversight. PJM's Independent Market Monitor would need to review sellers' offers to verify their documented costs, as it does with all cost-based offers. In addition, FERC directed the IMM to submit an informational filing within thirty days detailing the number of hours when clearing prices exceeded $1,000/MWh, the associated prices by PJM zone, and total energy costs. ❇

About the Author: see About the Editor p. 1

(Endnotes)

1. PJM sought relief in two dockets, ER14-1144 and ER14-1145.

FERC Opens the Door for Energy Storage Devices to Interconnect with the Grid

By James G. Ritter

The energy storage industry claimed an important victory after the Federal Energy Regulatory Commission issued Order No. 792 last November.[1] In the order, FERC adopted revisions to its *pro forma* Small Generator Interconnection Procedures and Small Generator Interconnection Agreement, the rules governing the interconnection of small generating facilities to the grid. One of these reforms makes clear that the SGIP and SGIA apply to energy storage devices.

Originally adopted in 2005, the SGIP and SGIA standardize the terms and conditions under which public utilities must provide transmission service to generators with capacity of no more than 20 MW.[2] The SGIP sets forth the technical procedures that must be followed when a small generator makes a request to interconnect with a transmission provider. The provider may use three alternative processes, including a "fast-track" process, to evaluate whether the interconnection can be safely and reliably accomplished. After this evaluation is complete, the SGIA is executed by the parties. It lays out the applicable contract terms, such as provisions addressing payment for any modifications to the transmission provider's system that are needed to accommodate the interconnection.

In Order No. 792, FERC concluded that the SGIP and SGIA should apply explicitly to storage devices. It therefore revised the definition of "Small Generating Facility," so that the term now means "[t]he Interconnection Customer's device for the production *and/or storage for later injection* of electricity identified in the Interconnection Request." FERC also enacted new provisions that address how to calculate a storage device's capacity. That information is used to determine whether a device is eligible for the SGIP and whether it can take advantage of the fast-track interconnection procedure.

The Commission found that these reforms were needed to respond to changes in the electric industry that have taken place since the SGIP and SGIA were first enacted. "The time is ripe," FERC said, "to promulgate such changes in light of the increased penetration of small generation resources, the continued focus by states and others on the development of distributed resources, and the need for this Commission to have its regulations and policies ensure just and reasonable rates, terms and conditions of service."

A welcome development for energy storage providers, Order No. 792 is expected to pave the way for more storage devices to connect to the grid. Like other small generators, storage projects must receive just and reasonable transmission service going forward. ❇

About the Author: see About the Editor p. 1

(Endnotes)

1. *Small Generator Interconnection Agreements and Procedures,* Order No. 792, 145 FERC ¶ 61,159 (Nov. 22, 2013).

2. *Standardization of Small Generator Interconnection Agreements and Procedures,* Order No. 2006, FERC Stats. & Regs. ¶ 31,180 (May 12, 2005).

SCC Approves Dominion Virginia Power's Brunswick County Power Station

By James G. Ritter

Last August, the State Corporation Commission approved Dominion Virginia Power's request to build and operate the Brunswick County Power Station, a 1,358 MW natural gas-fired combined-cycle electric generating facility near Lawrenceville, Virginia.[1] The Commission's order also allows Dominion to construct new 500 kV transmission lines, new switching stations, and other transmission infrastructure needed to interconnect the new generation to the grid. Dominion estimated that the project would cost approximately $1.27 billion, plus financing costs.

Many aspects of Dominion's application were not disputed, but the case did present two noteworthy issues: the utility's evaluation of third-party alternatives and its proposed recovery of transmission-related costs. Both issues were the subject of petitions for reconsideration, and the latter is the basis of an appeal to the Supreme Court of Virginia.

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Power Station *(continued)*

Third-Party Alternatives

The respondents in the case opposed the project, arguing that Dominion should have done more to consider third-party options for meeting its future generation needs. Before filing its application, Dominion compared the project with a forecast of wholesale market prices for capacity and energy, and it also solicited quotes from three independent power producers whose existing agreements with the utility were set to expire in the next several years. The respondents claimed that these actions were not enough, because neither involved an evaluation of genuine alternatives to building the Brunswick County plant. In their view, Dominion should have conducted a broader capacity solicitation, such as a request for proposals.

For support, the respondents pointed to the Commission's final order from Dominion's 2011 Integrated Resource Plan ("IRP") proceeding.[2] Some parties in that case argued that the utility should be required to evaluate actual market offers to support the self-build options included in its IRP, instead of relying on modeling alone. The Commission disagreed, emphasizing that an IRP is used for planning only, without binding a utility to any particular resource. But the Commission also said in its order that "Dominion should adequately consider third-party market alternatives as capacity resources," and that this type of evidence would be appropriate in cases where the utility asks for approval to move forward with a specific investment.[3]

The Brunswick County respondents construed these statements to mean that Dominion had to show it considered actual third-party alternatives to the project. So did the hearing examiner, who found that the utility needed to "fully investigate" market alternatives in order to establish that the project is necessary and prudent.[4] She recommended that the application be denied without prejudice, so that Dominion could re-file with additional information at a later date.

The Commission chose not to adopt that recommendation, finding instead that Dominion had presented enough evidence to satisfy the statutory requirements needed for approval. "While more evidence on market alternatives would have improved the record," the Commission stated, "we do not view the record as legally deficient without a capacity solicitation based upon the overall evidence presented."[5] The Commission explained that the relevant statutes do not require that utilities issue third-party solicitations, and that the Commission's filing requirements for new generating facilities likewise have never mandated competitive bidding. And contrary to the respondents' suggestions, the 2011 IRP order did not create some kind of new legal standard in generation certificate cases. Rather, whether a utility has presented adequate evidence to meet the applicable statutory requirements continues to be a question that depends upon the unique facts of each case. Here, the Commission said, a variety of facts supported approval of the project, including the chosen technology, fuel source, cost, fixed-price contracts, location, natural gas pipeline expansion, economic development, tax revenues, and fuel diversity.[6]

Two respondents, an independent power producer and a trade association representing competitive suppliers, filed petitions for reconsideration on this issue. The Commission granted the petitions, but reaffirmed its earlier conclusion. It also declined the two respondents' requests for a rulemaking on the scope of a new statutory provision that will require future applicants to show that they "considered and weighed alternative options, including third-party market alternatives."[7] That new requirement, the Commission said, will entail a "fact-based review" that will have to be made in each case.[8]

Recovery of Transmission Costs

The other notable issue in the case related to the utility's plan for recovering the costs of the transmission infrastructure that will move power from the new plant to the grid. Dominion proposed to recover all of the Brunswick County costs using the framework created by § 56-585.1 A 6 of the Code of Virginia ("Subsection A 6"), just as it has done with other recent projects.

Subsection A 6 allows a utility, with Commission approval, to use a special rate tracker called a "rate adjustment clause" to collect the costs of certain types of generation facilities. To incentivize these projects, the statute also awards the utility an enhanced rate of return on the common equity portion of its capital investment (known as "return on equity" or "ROE"). The amount of the incentive depends upon the type of generating facility. For a combined-cycle combustion turbine unit such as Brunswick County, the amount was 100 basis points, or 1.00%.[9]

About a month before hearing, the Commission Staff filed a motion asking for a ruling that the enhanced ROE does not apply to the transmission that a utility installs when it builds new generation. It relied for the

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Power Station *(continued)*

most part on the following provisions of Subsection A 6 (with emphasis supplied to aid the reader):

> A utility that constructs any such facility shall have the right to recover the *costs of the facility*, as accrued against income, through its rates, including projected construction work in progress, and any associated allowance for funds used during construction, planning, development, and construction costs, life-cycle costs, and *costs of infrastructure associated therewith*, plus, as an incentive to undertake such projects, an enhanced [ROE] calculated as specified below. . . . Such enhanced [ROE] shall be applied to allowance for funds used during construction and to construction work in progress during the construction phase of the facility and shall thereafter be applied to the entire facility during the first portion of the service life of the facility. . . . Such enhanced [ROE] shall apply *only to the facility* that is the subject of [the rate adjustment clause].

The Staff's basic argument was that this language creates two distinct categories of costs: the costs of the generating facility and the costs of associated infrastructure. And because the enhanced ROE applies "only to the facility," it cannot apply to costs that fall within the second category, including transmission costs. Two respondents representing consumer interests, the Office of the Attorney General's Division of Consumer Counsel and the Virginia Committee for Fair Utility Rates, supported the Staff's position.

Like the hearing examiner, a majority of the Commission was not persuaded by this interpretation. The majority reasoned that "costs of infrastructure" is not a distinct category, but rather is expressly included as part of the "costs of the facility." Moreover, the statute provides that the enhanced ROE must be applied to the "entire" facility. The majority concluded, then, that the "plain language" of the statute requires the Commission to apply the enhanced ROE to infrastructure—including transmission infrastructure that, as in this case, must be built before a new power plant can function.[10] And this decision was indeed consistent with several earlier Dominion cases, the majority noted. "Any other result," it said, "would be a clear departure from the Commission's consistent implementation of the plain language of the statute."[11]

In a dissenting opinion, Commissioner Dimitri sided with the Staff, Consumer Counsel, and the Virginia Committee. "The entire statutory framework regarding enhanced return," he observed, "is specific to the construction of a generation facility, and nothing more."[12] The word "facility," the dissent explained, is used throughout Subsection A 6 to refer to a generation facility, and the statute "unequivocally" states that the enhanced return shall apply "only to the facility."[13] The dissent also pointed out that while the enhanced return had been applied to transmission in earlier cases, until now the issue had never been contested. This case was different for another reason, because the level of transmission investment was "much broader in scope" than in the other cases.[14]

Consumer Counsel filed a petition asking the Commission to reconsider the question, but the Commission again was divided 2-1. Consumer Counsel noted an appeal to the Supreme Court of Virginia on December 2, 2013. The appeal is now pending, with the Commission and Dominion participating as appellees.[15] ❋

About the Author: see About the Editor p. 1

(Endnotes)

1. *Application of Virginia Electric and Power Company, For approval and certification of the proposed Brunswick County Power Station and related transmission facilities pursuant to §§ 56-580 D, 56-265.2, and 56-46.1 of the Code of Virginia, and for approval of a rate adjustment clause, designated Rider BW, pursuant to § 56-585.1 A 6 of the Code of Virginia,* Case No. PUE-2012-00128, Final Order (Aug. 2, 2013).
2. *Commonwealth of Virginia, ex rel. State Corporation Commission, In re: Virginia Electric and Power Company's Integrated Resource Plan filing pursuant to Va. Code § 56-597 et seq.*, Case No. PUE-2011-00092, Final Order (Oct. 5, 2012).
3. *Id.* at 4-5.
4. Report of A. Ann Berkebile, Hearing Examiner at 80 (June 13, 2013).
5. Final Order at 13-14.
6. *Id.* at 16-17.
7. Va. Code § 56-585.1 A 6.
8. Order on Reconsideration and Opinion at 6 (Nov. 18, 2013).
9. After the case was filed, the General Assembly amended Subsection A 6 so that utilities no longer will receive an enhanced ROE for most types of generation facilities. The exceptions are nuclear and offshore wind facilities.
10. Final Order at 18.
11. *Id.*
12. *Id.* at 26.
13. *Id.*
14. *Id.* at 22.
15. The appeal is docketed as Record Nos. 131872 and 131873.

Regulatory Puzzle *(continued)*

Background & Filings

For nearly 60 years, AEP's eastern utilities owning electric generating resources – most recently Ohio Power Company ("OPCo"), Appalachian Power Company ("APCo"), Indiana Michigan Power Company ("I&M"), and Kentucky Power Company ("KPCo") – operated in coordination pursuant to the terms of the AEP-East Interconnection Agreement. Pursuant to this Interconnection Agreement, generation was planned and operated on a system-wide basis in order to meet the needs of all customers, regardless of which particular operating company served a particular customer. In December 2010, each member of the Interconnection Agreement provided notice of intent to terminate participation effective January 1, 2014. Such termination requires that certain operating companies of the Interconnection Agreement plan and operate on a single-system basis, which requires each operating company to provide sufficient generation to meet its own load and reserve obligations.

Against this backdrop, in October 2012, AEP filed numerous applications with the Federal Energy Regulatory Commission (the "FERC") related to the corporate reorganization of AEP. Of focus here, AEP sought approval for (1) a new Power Coordination Agreement for operating companies APCo, I&M, and KPCo and an associated Bridge Agreement intended to replace the AEP-East Interconnection Agreement; (2) the transfer of OPCo's interest in two coal-fired generation assets to affiliates APCo and KPCo; and (3) the merger of affiliate Wheeling Power Company ("WPCo") with and into APCo ("Merger"). AEP's subsidiary operating companies thereafter made a series of filings in Virginia, West Virginia, and Kentucky to obtain necessary approvals to implement this corporate reorganization.

In December 2012, APCo filed its application with the Virginia State Corporation Commission ("SCC"). This application sought the SCC's approval for APCo to enter into a series of transactions by which APCo would secure a two-thirds interest in Amos Unit 3 and an undivided one-half interest in the Mitchell Plant. At the time, OPCo owned the Mitchell Plant and the two-thirds interest in Amos Unit 3. APCo already owned Amos Units 1 & 2, and the remainder one-third interest in Amos Unit 3. The remaining undivided one-half interest in the Mitchell Plant was to be transferred to KPCo. Together, the two-thirds interest in Amos Unit 3 and the one-half interest in the Mitchell Plant represent 1,647 MW of coal-fired generation capacity.

APCo's application to the SCC also requested the necessary approvals for the Merger. WPCo's service territory is in northwest West Virginia and is non-contiguous with APCo's service territory in West Virginia. WPCo serves approximately 41,000 retail customers and owns only distribution and transmission facilities.

APCo submitted a similar application to the West Virginia Public Service Commission ("WV PSC") for approvals to acquire the respective interests in the generating assets and the Merger. KPCo submitted an application to the Kentucky Public Service Commission ("Kentucky PSC") requesting approval for the transfer of the one-half undivided interest in the Mitchell Plant to KPCo.

Standards Applied Before Each Commission

At the FERC, AEP's various applications were subject to different standards of approval, as established by the Federal Power Act ("FPA"). Approvals of the transfer of the generating assets and the Merger were subject to Section 203 of the FPA. Specifically, Section 203(a)(4) provides that the FERC shall approve a transaction if it finds that the transaction "will be consistent with the public interest."[1] A public interest finding turns on three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.[2] In addition, the FERC determines whether the transaction will result in cross-subsidization.[3] AEP's application requesting approval of the new Power Coordination Agreement and Bridge Agreement, in contrast, was filed pursuant to Section 205 of the FPA and subject to a just and reasonable standard.[4] The FERC has clarified that the decision to terminate an operating arrangement is not subject to the just and reasonable standard; this standard is applied only to the successive arrangement.[5] The FERC also reviews such affiliate transactions for issues related to cross-subsidization.[6]

In Virginia, APCo's application was subject to approvals pursuant to both the Transfers Act[7] and the Affiliates Act.[8] The Transfers Act authorizes the SCC to oversee the transfer of assets or securities involving public service companies located in the Commonwealth.[9] For an application to be approved pursuant to the Transfers Act, the SCC must "be satisfied that adequate service to the public at just and reasonable rates will

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Regulatory Puzzle *(continued)*

not be impaired or jeopardized by granting the prayer of the petition."[10] The Affiliates Act requires SCC approval for any contract or arrangement "for the purchase, sale, lease or exchange of any property, right or thing . . . made or entered into between a public service company and any affiliated interest."[11] Unlike the Transfers Act, "the Affiliates Act imposes upon a public service company a burden . . . to demonstrate that the proposed transactions with affiliated companies will serve the public interest."[12] The Supreme Court of Virginia has directed that "an important aspect of public interest is assurance 'that an affiliated company of a regulated utility does not receive unjust benefits, to the detriment of the utility's customers.'"[13]

In Kentucky, a utility must obtain a Certificate of Public Convenience and Necessity from the Kentucky PSC before it may acquire any facility to be used in providing utility service to the public.[14] This requires a showing that there exists both a need for such facilities and that there is no wasteful duplication.[15] The Kentucky PSC applies a least-cost resource principle as one of the fundamental considerations when applying this standard.[16]

In West Virginia, the WV PSC may grant its consent for a transaction, such as the transfer of the interests in Amos Unit 3 and the Mitchell Plant, "if the terms and conditions of the transaction are reasonable, do not give an undue advantage to either party to the transaction, and do not adversely affect the public in the state."[17] The WV PSC has clarified that this standard does not include an "undue influence" nor an "arms' length" test.[18] Nevertheless, if the terms of an affiliate transaction provide a counterparty with an undue advantage, the WV PSC may consider this to be an adverse affect on the public.[19]

Orders

For APCo to acquire the two-thirds interest in Amos Unit 3 and the one-half interest in the Mitchell Plant, approvals were required from the FERC, the SCC, and the WV PSC. For WPCo and APCo to merge, approvals were also necessary from the FERC, the SCC, and the WV PSC. For KPCo to acquire the undivided one-half interest in the Mitchell Plant, approvals were required from the Kentucky PSC and the FERC, regardless of decisions made by the SCC and the WV PSC on the Mitchell Plant. Accordingly, the proceedings before each of the respective commissions were inextricably linked in many regards. That is, denial of an approval in one jurisdiction could, in effect, serve to do the same in another jurisdiction.

The FERC approved the transfer of the respective interests in the generating assets to APCo and KPCo on April 29, 2013.[20] The FERC reviewed the transfers pursuant to the FERC's Merger Policy Statement and authorized the transfers as being consistent with the public interest.[21] In making this finding, the FERC determined that the transfers (1) would have no adverse effect on competition;[22] (2) would not have an adverse effect on (wholesale) rates;[23] and (3) would not impair regulation at either the state or federal level.[24] The FERC also found that the transfers would "not result in cross-subsidization or the pledge or encumbrance of utility assets for the benefit of an associate company."[25] Accordingly, the FERC approved the transfer of the generating assets, but importantly did so "without prejudice to the authority of the Commission or any other regulatory body with respect to . . . any . . . matter whatsoever. . . ."[26] Similarly, in a separate order, the FERC found the Merger to be consistent with the public interest and authorized that transaction.[27] In addition, in December 2013, the FERC approved a revised version of the Power Coordination Agreement and Bridge Agreement.[28]

On July, 31, 2013, the SCC was the first state commission to enter an order addressing the proposed transfer of the respective interests in Amos Unit 3 and the Mitchell Plant and the Merger.[29] The SCC found that APCo had demonstrated a capacity need; however, pursuant to the Transfers Act, it found that APCo had not shown that such need should be fulfilled by acquiring both Amos Unit 3 *and* the Mitchell Plant.[30] Accordingly, the SCC ruled that it was "satisfied that adequate service to the public at just and reasonable rates [would] not be impaired or jeopardized," and that the public interest would be served, only if APCo acquired the two-thirds interest in Amos Unit 3 and not the one-half interest in the Mitchell Plant.[31] In making this determination, the SCC considered that APCo already owned Amos Units 1 & 2, as well as the remaining one-third interest in Amos Unit 3. The SCC also noted concerns regarding fuel diversity in support of its decision to authorize the transfer of only the interest in Amos Unit 3.[32] The Commission approved the Merger, subject to the implementation of a \$3.3 million surcredit, as consistent with the public interest.[33]

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Regulatory Puzzle *(continued)*

On July 2, 2013, KPCo filed a non-unanimous stipulation and settlement agreement at the Kentucky PSC. The stipulation and settlement agreement, subject to certain conditions, allowed for the transfer of the one-half interest in the Mitchell Plant to KPCo. The Kentucky Office of the Attorney General was the only party not to join the settlement and the Kentucky PSC proceeded to a full evidentiary hearing. The Kentucky PSC issued an order on October 7, 2013 and found that the transfer of the one-half undivided interest in the Mitchell Plant to KPCo was "needed" and represented the least-cost option alternative.[34] The Kentucky PSC accepted the stipulation as reasonable and approved it subject to several modifications.[35]

Finally, on December 13, 2013, the WV PSC entered its order addressing both the transfer of the generating assets and the Merger.[36] As did the SCC, the WV PSC found that APCo required additional generation capacity to offset projected capacity shortfalls.[37] The WV PSC further concluded that the transfer of the two-thirds interest in Amos Unit 3 represented the least-cost option as compared to market alternatives.[38] In recognition of these facts, the WV PSC approved the transfer of the two-thirds interest in Amos Unit 3 to APCo.[39] As to the one-half interest in the Mitchell Plant, the WV PSC noted in its order that there was "very little difference in the quality of the Mitchell plant and the Amos plant"[40] and that the record was "replete with the operational benefits to APCo of its acquiring ownership of Mitchell."[41] Thus, in the WV PSC's own words, the SCC's denial of the interest in the Mitchell Plant put the WV PSC in a "regulatory quandary."[42] The WV PSC denied the transfer of the Mitchell Plant and noted that this "non-approval is based on the [SCC's] denial."[43] The WV PSC commented that such a denial is typically based on a finding that the transaction is not in the public interest; but that, "[w]e do not make that finding with regard to the Mitchell acquisition at this time."[44]

The WV PSC declined to issue a final order on the Merger. This is despite the fact that the WV PSC had in the past "consistently directed APCo to proceed to obtain necessary approvals as soon as possible so that the merger can proceed."[45] The WV PSC again cited the SCC's decision on the Mitchell Plant as the reason it could not then approve the Merger. The WV PSC found that the Merger would result in APCo having a capacity deficiency of 424 MW in 2015,[46] and that it was not in the public interest to permit "the merger and create a capacity shortfall for APCo without a defined, economical, and achievable plan in place to cover that capacity shortfall."[47] The WV PSC has directed APCo to make a filing before March 3, 2014 addressing an updated plan to service WPCo's load after merger.[48]

Current Status

AEP filed status updates in relevant FERC dockets addressing its corporate reorganization. As those updates indicate, APCo acquired the two-thirds interest in Amos Unit 3 on December 31, 2013. KPCo acquired an undivided one-half interest in the Mitchell Plant on December 31, 2013.[49] The remaining undivided one-half interest in the Mitchell Plant that had been intended for APCo is now owned by AEP's unregulated generation subsidiary, AEP Generation Resources. WPCo has not merged with APCo. WPCo continues to receive generation service via a FERC-approved agreement with AEP Generation Resources. The new Power Coordination Agreement and Bridge Agreement took effect on January 1, 2014. Finally, AEP recently announced plans to make filings in the first quarter of 2014 to address the WV PSC's deferred decision on the Merger, and on the acquisition of the remaining undivided one-half interest in the Mitchell Plant to APCo. ❇

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(Endnotes)

1. 16 U.S.C. § 824b(a)(4).
2. *See Merger Policy Statement*, F.E.R.C. Stats. & Regs. ¶ 31,044, at 30,111 (1996).
3. 16 U.S.C § 824b(a)(4).
4. *Id.* § 824.
5. *Entergy Services, Inc.*, 129 F.E.R.C. ¶ 61,143 at P. 63 (2009).
6. *Cross-Subsidization Restrictions on Affiliate Transactions*, 124 F.E.R.C. ¶ 61,047, Order No. 707-A at P. 42 n.24 (July 17, 2008).
7. Va. Code Ann. § 56-88 *et seq*.
8. *Id.* § 56-76 *et seq*.

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Regulatory Puzzle *(continued)*

9. *Id.* § 56-89 ("It shall be unlawful for any public utility, directly or indirectly, to acquire or dispose of any utility assets situated within the Commonwealth or any utility securities of any other company unless such acquisition or disposition shall have been authorized by the Commission.").
10. *Id.* § 56-90.
11. *Id.* § 56-77(A).
12. *Roanoke Gas Co. v. State Corp. Comm'n*, 217 Va. 850, 853, 234 S.E.2d 302, 304 (1977).
13. *Id.* at 854, 234 S.E.2d at 304 (quoting Evans B. Brasfield, *Regulation of Electric Utilities by the State Corporation Commission*, 14 WM. & MARY L.REV. 589, 599 (1973)).
14. Ky. Rev. Stat. Ann. § 278.020(1).
15. *See Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 252 S.W.2d 885, 890 (Ky. 1952).
16. *Application of Kentucky Power Company for Approval of Renewable Energy Purchase Agreement for Wind Energy Resources Between Kentucky Power Company and FPL Illinois Wind, LLC*, Kentucky PSC Case No. 2009-00545, Order at 5 (June 28, 2010).
17. *Appalachian Power Company, dba American Electric Power, Petition for consent and approval of Appalachian Power Company consummating an arrangement for the transfer to it of 1647 MW of generating capacity presently owned by Ohio Power Company, an affiliate, pursuant to W.Va. Code 524-2-12, and associated agreements*, WV PSC Case No. 12-1655-E-PC, Commission Order at 23 (Dec. 13, 2013).
18. *Id.*
19. *Id.*
20. *Appalachian Power Company, Kentucky Power Company, AEP Generation Resources Inc.,* 143 F.E.R.C. ¶ 61,074 at P. 1 (Apr. 29, 2013).
21. *Id.* at P. 1.
22. *Id.* at P. 21.
23. *Id.* at PP. 34-36. In making this determination, the FERC also accepted the Applicants' commitment to hold harmless wholesale customers from transfer-related costs for a period of five years. *Id.* at P. 37.
24. *Id.* at P. 46.
25. *Id.* at P. 65.
26. *Id.* at Ordering Paragraph C.
27. *Appalachian Power Company & Wheeling Power Company,* 143 F.E.R.C. ¶ 62,072 (Apr. 29, 2013) (Action taken pursuant to the authority delegated to the Director, Division of Electric Power Regulation - West, under 18 C.F.R. § 375.307 (2012)).
28. *Appalachian Power Company,* 145 FERC ¶ 61,267 at P. 2 (Dec. 23, 2013).
29. *Application of Appalachian Power Company, For approval of transactions to acquire interests in the Amos and Mitchell generation plants and to merge with Wheeling Power Company*, SCC Case No. PUE-2012-00141, Order (July 31, 2013).
30. *Id.* at 6.
31. *Id.*
32. *Id.* at 8-9.
33. *Id.* at 12.
34. *In the matter of: Application of Kentucky Power Company for (1) a Certificate of Public Convenience and Necessity authorizing the transfer of an undivided fifty percent interest in the Mitchell Generating Station and associated assets; (2) approval of the assumption by Kentucky Power Company of certain liabilities in connection with the transfer of the Mitchell generating station; (3) declaratory rulings; (4) deferral of costs incurred in connection with the Company's efforts to meet Federal Clean Air Act and related requirements; and (5) all other required approvals and relief*, Kentucky PSC Case No. 2012-00578, Order at 35 (Nov. 5, 2013).
35. *Id.*
36. *Appalachian Power Company, dba American Electric Power, Petition for consent and approval of Appalachian Power Company consummating an arrangement for the transfer to it of 1647 MW of generating capacity presently owned by Ohio Power Company, an affiliate, pursuant to W.Va. Code 524-2-12, and associated agreements*, WV PSC Case No. 12-1655-E-PC, Commission Order (Dec. 13, 2013).
37. Id. at 41.
38. *Id.*
39. *Id.*
40. *Id.* at 29.
41. *Id.* at 30.
42. *Id.*
43. *Id.*
44. *Id.* at 31.
45. *Id.* at 33.
46. *Id.* at 40.
47. *Id.* at 33.
48. *Id.* at 35.
49. The Kentucky Office of the Attorney General has filed an appeal from the Kentucky PSC's Order approving the transfer of the one-half interest in the Mitchell Plant to KPCo.

Uneasy Seams *(continued)*

The RPM (short for "Reliability Pricing Model") is the foundation of PJM's resource adequacy requirement applicable to LSEs; and at the center of that is a three-year forward capacity auction.[1] Although resource sellers within PJM's footprint would appreciate higher market clearing prices in the annual capacity auctions, their counterparts in MISO – where the market value of capacity is lower – cast an envious eye towards PJM. And therein lies the crux: MISO-based resource owners who would like to increase their revenues by selling more capacity into the "lucrative" PJM market feel that unreasonable barriers stand in their way.

Serious attention to the problem at the Federal Energy Regulatory Commission ("FERC" or "Commission") goes back to June 2012, when the Commission issued a request for comments in Docket No. AD12-16. The comments from the MISO side transmitted the concern that PJM's exacting "deliverability" requirements for "external" resources were impeding efficient, desirable cross-border trade in capacity. Deliverability analysis for external resources was complicated by two separate evaluations conducted by each RTO (using different methodologies); for internal resources, rather than a point-to-point analysis, PJM assessed deliverability based on a "network" analysis, subject to any locational constraints in PJM's subregional markets. MISO hoped FERC would spur the RTOs and their stakeholders to coordinate reforms in the market rules causing these inter-RTO seams or barriers.

From PJM's side of the fence, the anxiety level was appreciably lower. The RTO's comments advised FERC that progress was being made in "seams coordination" between PJM and MISO under their Joint Operating Agreement (JOA) and what is called the "joint and common market" (JCM) process. PJM urged FERC only to monitor, not to proactively shape, the market rules development process while this joint stakeholder process was in its early stages.

MISO petitions FERC to lean on PJM

MISO raised the temperature when it filed a motion on January 3, 2013 requesting FERC to *direct* it and PJM to remove barriers facing capacity deliverability. The barriers are "real and substantial," intoned MISO, and are adversely impacting markets and consumers. MISO did not want to go so far as to jettison the JCM process, but it urged FERC to take a firmer hand by imposing deadlines for submission of tariff modifications to lower the market barriers.

PJM hastened to protest that MISO's proposal was overkill. The existing stakeholder processes under the JCM initiative were equal to the task, it said, and FERC staff oversight – rather than formal Commission intervention – was a far superior tool for ensuring meaningful progress. Interestingly enough, stakeholders on both sides of the RTO divide lined up behind PJM on this process question, suggesting the RTO/stakeholder JCM collaborative should be given ample room to work. This stage crescendoed with presentations by both RTOs at FERC's June 20 meeting, whereupon the RTOs committed to submit to the Commission a joint work plan for addressing a whole spectrum of JCM-related issues, of which delivery of capacity across the seam was a prime topic.

Joint work plan arrives in September 2013

Following through on their commitment, the two RTOs submitted a comprehensive work plan on September 26, 2013. The remarkably thorough filing included attachments providing (1) an overview of all 14 current JCM initiatives; (2) a zoom-in on the capacity deliverability issue; and (3) a narrative version of the work plan process charts found in the other attachments. FERC was evidently pleased, because it issued a new order and press release hailing the effort, directing its staff to participate in upcoming meetings, and establishing a new docket number, AD14-3, to reflect the broadened scope and new impetus for the original AD12-16 enquiry.

PJM stirs the pot with a new tariff filing to impose aggregate restrictions on "imports" of external resources

The submission and implementation of the joint work plan might have pacified the seams coordination front, were it not for a unilateral filing by PJM on November 29. PJM claimed necessity as the mother of this filing to amend its Reliability Assurance Agreement (RAA) with LSEs and its open access transmission tariff to erect specific, quantitative boundaries on external resource imports.[2] The filing proposed a new construct, the "Capacity Import Limit" (CIL), to be determined annually. The total MWs of the CIL would reflect what PJM's engineers conclude is the aggregate amount of external capacity that can be safely and

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Uneasy Seams *(continued)*

reliably imported into PJM, given existing transmission constraints, adjusted to reflect high load assumptions and the reservation of sufficient spare transmission capacity (called the "Capacity Benefit Margin," or CBM) to manage emergencies. PJM provided some general information on the methodology it would use to calculate the CIL and indicated further details would be spelled out in operating manuals developed with stakeholder input.

What drove the filing, said PJM, was a recurrent problem where external capacity resource owners may bid into the three-year forward RPM auction without necessarily having firm transmission rights from source to sink (PJM loads). This is by design – three-year ahead auctions are intended to encompass "new entry" bids from resource developers that, if cleared in the auction, will be followed up with construction of generation and any incrementally required interconnection and transmission upgrades. But the problem PJM discovered was that owners with cleared bids may not, in fact, obtain the transmission rights once they find out how costly they will be. So, if they bail out on their auction commitment, the losers are PJM loads (whose resource adequacy requirement is shortchanged).[3]

The collateral damage is troublesome too, elaborated PJM. Resource owners whose assets *might* have been chosen in the RPM auction (if the external bidders who later discovered they couldn't afford transmission had included a realistic amount of such costs in their bids) may lose out on critical steady revenues; and that could make the difference between continuing operation and premature retirement. Thus, "efficient" capacity may be irrevocably lost to the PJM region due to distortions in the competitive auction market.

PJM's recommended approach, imposing the CIL, would not actually require external resource bidders to obtain firm transmission rights on the front end, because that would defeat the purpose of encouraging new entrants to compete with existing resources in the auction.[4] Nonetheless, it believes that clamping down on the aggregate amount of external resources that can clear in the RPM auction, based on a calculation of aggregate capacity at PJM's interfaces with surrounding areas, would provide an enhanced level of reliability over the status quo. As to that, PJM noted the problem of more imported capacity being offered in the RPM auction than its system can handle is growing more acute, as owners of MISO-based capacity resources seek out better prices than their own region can provide.

Resistance from the MISO market guardian

In its November 29 filing, PJM requested FERC's approval of the CIL construct as quickly as possible to enable the new tariff and RAA rules to reshape its May 2014 capacity auction. It is unclear, so far, how quickly FERC will act, but PJM's filing did provoke a welter of comments from many stakeholders. MISO acknowledged the CIL touched on legitimate PJM reliability concerns; but it also underscored that a collaborative is under way to address seams issues across a broad front; and besides, PJM would do well to consider how to *expand* its import capability – not just focus on its current limitations. MISO's independent market monitor (IMM) submitted a more extensive – and critically edged – set of concerns. Among the lengthy list were:

- The CIL mechanism needs to be placed in a wider context of issues on "inefficient barriers" to the PJM market; these include: understating PJM's Available Transfer Capacity; the use of the CBM; and the requirement of unit-specific deliverability testing (among others).
- The PJM proposal will have a "profound impact" on capacity prices in both the PJM and MISO markets.
- While the proposal in broad strokes may be supportable as a way of addressing inter-RTO deliverability limitations, the CIL construct as filed offers "very little technical information" on the implementing methodology and leaves too much discretion to the RTO.
- PJM's "unilateral filing" makes it unclear how the ongoing, FERC staff-supervised collaborative process and work plan (AD14-3) will continue.
- PJM continues to apply unit-specific deliverability testing to external resources, which does not (in the MISO IMM's view) reflect how energy is actually delivered from the MISO region in the operating timeframe. The CIL proposal, believes the IMM, should *supersede* the individual unit testing, not come in as an overlay atop it. Moreover, the CILs themselves should be determined through an "accurate representation" of how energy is delivered from MISO to PJM.[5]

Before going ahead, counseled the MISO IMM,

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Uneasy Seams *(continued)*

FERC should convene a technical conference to more fully understand how the CILs would be calculated as well as how this PJM-proposed process fits within the broader context of the JCM stakeholder proceedings.

FERC deficiency letter bores in on issues raised

The most recent developments in this saga are (1) FERC's issuance of a "deficiency letter" on January 28 directing PJM to elaborate on some aspects FERC or commenting stakeholders found questionable; and (2) PJM's response to the letter, filed on February 20. As might be anticipated, PJM did not cede any ground in its claim of urgency to establish the CIL, or in its compatibility with the ongoing MISO-PJM collaborative on seams in the capacity markets (as part of the broader JCM) or its disagreement with MISO on the appropriate rigor for testing deliverability of external units participating in PJM capacity auctions. The Commission may feel the need to convene a technical conference, as the MISO IMM urged, to hash the differences in technical viewpoints and the potential impact on the collaborative.

As to the latter, PJM attempted to allay concern by insisting, in response to FERC's deficiency letter, that the CIL initiative is complementary to the joint work plan under AD14-3 and, to the extent the RTOs' engagement in the latter process leads to alternative, superior approaches to balancing system reliability with openness of the capacity market, PJM would be "amenable" to addressing changes in its CIL methodology.

Conclusion

Stakeholders will have an opportunity to comment on PJM's responses to the deficiency letter (comments are due by March 7), and FERC will then have to decide whether to move forward expeditiously (consistent with PJM's sense of urgency), or declare a pause (such as would be required for a technical conference and further submission of comments by stakeholders). Certainly, the rumblings from across the border – where PJM asserts it must act swiftly to arrest reliability-threatening anomalies and false price signals in its markets, while MISO's IMM points to no less serious distortions caused by PJM's layering of the CIL on top of other practices needing examination – make for some complex issues FERC needs to sort out, sooner rather than later. ❇

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(Endnotes)

1. The capacity requirement can also be met by self-supply where LSEs own their own generation or have long-term bilateral contracts that are the equivalent.

2. PJM's construct subdivided the areas surrounding its over 2000-mile perimeter into five "resource zones," each of which would be allocated a portion of the aggregate available import capacity based on specific interface factors.

3. PJM explained there are penalties for not following through on an auction commitment; but apparently they're not a sufficient deterrent.

4. PJM explained it may be impractical for a developer to obtain transmission rights until its project is in a more advanced state and it has the assurance of capacity payments to bolster its ability to finance the project. In addition, it may be waiting on construction of transmission enhancements in order to nail down firm transmission. It is a kind of "chicken and egg" problem, remarked PJM, but one that is best solved by not mandating upfront transmission.

5. This is but a sampling of the technical market efficiency issues the IMM raised in its extensive commentary.

Web Site News

The Section's home page on the Virginia State Bar's web site now provides a helpful bit of history, reflecting past developments in state regulatory law and the Section's efforts to keep its membership apprised of those developments. A comprehensive collection of Administrative Law News dating back to 1988 can now be accessed on-line. In addition, the programs of every National Regulatory Conference can be downloaded.

The Administrative Section home page can be found at http://www.vsb.org/sections/ad/index.htm Or, if it's easier, just go to the State Bar's web site (www.vsb.org), click on "Sections," then "Administrative Law."

Administrative Law News

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