

ORDER NO. 77262

In the Matter of The Potomac Edison	*	
Company's Proposed (A) Stranded Cost	*	
Quantification Mechanism; (B) Price	*	Case No. 8797
Protection Mechanism; and (C)	*	
Unbundled Rates.	*	
	* * * * *	

To All Parties of Record and Interested Persons:

I. INTRODUCTION

On March 12, 2001 the Maryland Office of People's Counsel (OPC) filed a letter claiming that upon final review of The Potomac Edison Company's (PE) calculation of its Warrior Run (WR) Surcharge "an important discrepancy is apparent and needs to be heard by the Commission." According to OPC, the WR Surcharge is overstated by \$5.1 million for the period ending December 31, 2001.¹ OPC asserts that the Company's restructuring Settlement,² particularly paragraph 10 thereof, requires PE to credit transmission and ancillary services revenues associated with Warrior Run as part of the surcharge mechanism. PE disputes this claim and argues that transmission of the Warrior Run "output" is a separate independent transaction that is not a part of the WR Surcharge calculation. Consequently, PE says that it has properly calculated the WR Surcharge. Staff supports OPC's position and asserts that the WR Surcharge is intended to be

¹ The Commission had previously approved the Warrior Run Surcharges for the periods, July 1, 2000 – December 31, 2000 and January 1, 2001 – December 31, 2001 based upon the recommendations of PE, the Public Service Commission Staff (Staff), and OPC, subject to further review pending data from PE. As part of the surcharge mechanism, costs and revenues are subject to true-up in the following calendar year.

² Approved in Commission Orders 75851 and 76009 in Case No. 8797. See Docket No. 86.

revenue neutral, which it claims will not result if the associated transmission and ancillary services revenues are not credited to the surcharge. The parties note that determination of this issue may have long lasting implications.

The Commission determines that based upon the record, and for the reasons set forth herein, OPC's request will be denied. Furthermore, the WR Surcharge will not be subject to a credit for transmission or ancillary services revenues through 2004. However, effective January 1, 2005, the amount of transmission revenues and application of transmission revenues to customer rates is subject to further review and adjustment as set forth in this Order.

II. PARTIES' POSITIONS

According to OPC's March 12 letter, PE's Warrior Run Surcharge is not calculated according to the terms of the restructuring Settlement in Case No. 8797. Specifically, OPC says that the Surcharge does not comply with Paragraph 10. Paragraph 10 of the 8797 Settlement states:

10. Starting July 1, 2000, the Warrior Run surcharge will be set equal to Warrior Run contract payments less revenues received from the sale of the Warrior Run output, including, but not limited to, all energy, capacity and any ancillary services, into the wholesale market through a competitive bidding process. The Warrior Run Surcharge will be revised annually to true-up revenues and expenses from the previous period including interest on any over or under recovery and to reflect the best estimates of the next year's charge. Starting July 1, 2000, any over or under recoveries of Warrior Run revenues and expenses will accrue interest at the current prime rate as published in the Wall Street Journal, adjusted for taxes. The new surcharge calculation shall be filed 30 days prior to its effective date to allow all parties ample time to review and comment on the filing before the Commission.

According to OPC, this language requires PE to offset Warrior Run costs with transmission and ancillary service revenues from wheeling Warrior Run output from the delivery point at the Ridgeley substation to the border of the Allegheny Power System

(APS) control area. PE did not do this in computing the WR Surcharge. OPC emphasizes the phrase “including but not limited to” in support of its position. Furthermore, OPC states in its letter that in the 8797 Settlement “all parties agreed that the Company would be assured dollar-for-dollar recovery of the Warrior Run PURPA Contract.” “The agreement was not to provide the Company a profit when the AES Warrior Run power was sold into the wholesale market.” Consequently, OPC requested that PE be required to true-up the WR Surcharge to reflect transmission and ancillary service revenues with appropriate interest. According to OPC this amounts to approximately \$5.1 million.

PE filed a letter in response on March 30, 2001 opposing OPC’s position. According to PE the credit to the WR Surcharge is to be the revenue received from the sale of Warrior Run output into the wholesale market. According to PE this does not include transmission. It is PE’s emphasis on “output” that is at odds with OPC’s position.

PE argues that OPC’s position would significantly change the language of the 8797 Settlement. PE notes that the Settlement clearly does not mention transmission revenue as a part of the credit. While OPC argues that the phrase “including but not limited to” includes transmission, PE just as strenuously argues that this phrase merely attempts to define Warrior Run “output.” PE says output and transmission are distinctly separate items. Output includes energy and capacity and in this case also includes ancillary services if they are generated by Warrior Run. However, transmission is the delivery of this output. As for the ancillary services at issue, PE claims that these are

transmission related and result from APS's own generation, not Warrior Run. Therefore, PE says they are also not part of the credit.

PE asserts that its position is supported by several additional facts. First, transmission revenues are potentially substantial. Had the parties intended credits (\$3.2 million for 2001) of this magnitude, the Settlement would have specifically provided for it. Second, the Company's currently capped rates include as a credit the July 1999 level of transmission revenues. PE says that transmission revenue produced by the sale of Warrior Run output is no different from any other sale of transmission. PE emphasizes that it is presently at risk for maintaining the same level of transmission revenues that are included in the capped rates. PE also notes that OPC's interpretation of the Settlement would amount to a re-bundling of the current unbundled rates. Furthermore, even if the Commission accepts OPC's position, PE says the amount of the credit is not correct. This is because OPC omits transmission costs as an offset and does not apply the appropriate jurisdictional allocation of the revenue. PE concludes that risks and benefits were part of the considerations in reaching the Settlement. OPC's position on transmission revenues would open up frozen rates for one item but ignore others such as future increases in generation costs.

At the Commission's Administrative Meeting of May 16, 2001 the Commission heard arguments from the parties on this issue. This issue was item number 9 on the agenda. The Staff supported OPC's position. The Commission concluded that it would be appropriate to permit the parties to file briefs on this important subject. PE, OPC and Staff filed briefs on May 23, 2001.

In its brief OPC offers several additional arguments to support its contention that transmission revenues should be included in the calculation of the WR Surcharge. OPC says that the transmission revenues attributable to Warrior Run are an incremental source of revenue because the associated transmission costs are already being recovered in PE's cost of service. OPC states that this is also an issue of fairness. Since PE is entitled to dollar for dollar recovery of the capacity and energy payments associated with the project Maryland ratepayers are entitled to "equitable crediting." OPC argues that if PE is permitted to retain the transmission and ancillary services revenues then PE will be unjustly enriched.

According to OPC, the phrase "including but not limited to" in Paragraph 10 of the 8797 Settlement was included in the document to expand the definition of the revenues to be received from the sale of the Warrior Run output. Warrior Run output has no value without transmission because there would be no revenues from the sale of the output without transmission. Furthermore, according to OPC the central purpose of the Settlement of the WR Surcharge was to keep the status quo regarding what customers are required to pay and PE is entitled to receive. However, PE would have the Commission reach a contrary conclusion. OPC also notes that nowhere in the 8797 Settlement is there a definition for Warrior Run output.

OPC also addresses the credit to PE's presently capped rates for the July 1999 level of transmission revenues. OPC points out that the credit for transmission in the capped rates does not include Warrior Run, which did not begin commercial operation until 2000. All aspects of Warrior Run have been treated separately. This treatment applies not only to capacity and energy costs but also transmission and ancillary services.

OPC notes that if Warrior Run energy and capacity costs had not been treated separately and were still recovered through bundled rates then Warrior Run transmission and ancillary services revenues would have been credited to ratepayers through the fuel surcharge.

As for the bidding process, OPC notes that PE is required to maximize Warrior Run revenues. The contract for the Warrior Run energy and capacity is separate from the contract for transmission and ancillary services. OPC argues that if these components were bundled together the price for the “output” would be higher to reflect the transmission component. Together, these components maximize Warrior Run proceeds. OPC concludes that PE is to be reimbursed for Warrior Run contract costs, but OPC did not agree that PE should make a profit on the transaction.

Finally OPC states that it has properly calculated the amount of the credit. OPC notes that the predictability of transmission revenues is irrelevant; OPC only seeks credit for revenues actually received. Further, since Maryland is assigned 100% of the cost of the Warrior Run project all associated revenues should be credited 100% to Maryland. OPC says that any transmission constraints are irrelevant because PE must have been aware that when it agreed to the sale of Warrior Run output into the wholesale market that transmission would necessarily be required. For all of these reasons OPC concludes that \$5.1 million should be credited to the WR Surcharge for the period ending December 31, 2001.

Staff says that Paragraph 10 of the 8797 Settlement clearly requires that the WR Surcharge reflect all revenues received as a result of the sale of Warrior Run output.

Staff argues that this is the only interpretation consistent with the goal, stated in the cases, testimony and oral argument, that the Company is to receive revenue-neutral, dollar-for-dollar recovery regarding Warrior Run. Staff says that any other reading grants PE an unearned inequitable profit that contravenes the intent of the 8797 Settlement, the expectations of the parties, and the explicit requirements of the restructuring legislation.

Staff also addresses the issue of the “including but not limited to” language of Paragraph 10 of the Settlement. Staff says that the reference to “energy, capacity and any ancillary services” is simply a short list of possible examples of what is included in Warrior Run output. The phrase “including but not limited to” demonstrates that the list is not intended to be a complete and exclusive list. PE, in effect, argues that the list is exclusive and since transmission is not specifically listed it is not part of the credit. Staff argues that the fundamental error of PE’s position is that this exclusive interpretation is not possible unless the words “including but not limited to” are completely ignored. Furthermore, transmission is an essential component of any sale; without it, no sale is possible. Staff says that it is only in this sense that transmission revenues are “ancillary” to generation. Finally, ancillary service revenues are expressly included in the list of examples and therefore must be included in the credit to the Surcharge.

Staff emphasizes that throughout various proceedings involving the Warrior Run project that the fundamental underlying principle is financial neutrality to the Company. Importantly Steve L. Klick, Director, Regulation and Rates for the Company testified in Case No. 8797 that a “dollar per dollar recovery mechanism is necessary to assure that the effect of the purchase contract does not over charge customers and **is neutral to AP’s**

earnings.”³ (Emphasis Added by Staff). Further, in his oral testimony on October 14, 1999 Mr. Klick testified that the “Company is requesting only recovery of our **net** Warrior Run cost.”⁴ (Emphasis Added by Staff). Staff concludes that the parties never intended for PE to realize a profit from Warrior Run while Maryland ratepayers bear the full liability for Warrior Run costs.

Staff also notes that absent restructuring and its resultant rate caps, there would be no new transmission revenues from Warrior Run. This is because the Company received the full cost of its transmission facilities in base rates and power plants did not pay for transmission service. PE is attempting to enrich itself in the restructured environment. Maryland ratepayers continue to be liable for all Warrior Run costs but the new benefit associated with transmission revenues flows entirely to PE under its proposal, even though PE is insulated from all Warrior Run costs. Staff says that for PE to comply with Paragraph 11 of the 8797 Settlement to “maximize the proceeds from the sale of the Warrior Run output” requires that the transmission and ancillary services revenues be used to offset Warrior Run costs. According to Staff, PE’s current WR Surcharge is overstated by \$5,119,906 for the period ending December 31, 2001.

Staff also argues that permitting PE to retain windfall revenues is contrary to the Electric Customer Choice and Competition Act of 1999 (Act). Section 7-505 (a) requires that the transition to competition be “fair to customers.” Section 7-513(a) provides that an electric company should have a “fair opportunity to recover all of its prudently incurred and verifiable net transition costs, subject to full mitigation.” The parties testified that the 8797 Settlement was consistent with the Act and the Commission

³ Testimony of Steve L. Klick at 11 in Case No. 8797. Docket No. 99.

⁴ Case No. 8797, Transcript of October 14, 1999 hearing at 76. Docket No. 104.

concluded in its orders approving the Settlement. Staff concludes that if transmission and ancillary services revenues are not included in the credit for Warrior Run costs that PE will receive a profit above net transition costs and recovery will not be subject to full mitigation and not be fair to customers.

PE filed its Final Comments on May 23, 2001. PE reiterates its position that the sale of Warrior Run output and the transmission of that output are separate transactions.

PE emphasizes the competitive bidding process in support of its position. According to the Company, successful wholesale purchasers take title to the Warrior Run energy at the point of interconnection. Thereafter, the purchaser must arrange for transmission services. Transmission revenues depend upon where the power is ultimately sold and what type of transmission service is purchased. PE says that when considered in the context of the sales transaction, the terms of the 8797 Settlement are clear. Furthermore, there is no mention in the Settlement that revenues from the separate sale of transmission to the wholesale purchaser should be part of the credit to the surcharge. PE emphasizes the fact that the revenues to be credited to the Surcharge under Paragraph 10 of the Settlement are to come from sales “through a competitive bidding process.” PE says that the sale of transmission service does not occur through a competitive bidding process. Instead, transmission rates are negotiated between PE and the wholesale purchaser. Because transmission revenues result from a separate sale that is not part of the competitive bidding process, these revenues are not part of the credit for sales of Warrior Run output.

PE argues that excluding transmission revenues from the credit is consistent with its capped rates. These rates include as a credit the July 1999 level of transmission

revenues. PE notes that the transmission credit did not and could not have included the transmission of Warrior Run output because Warrior Run was not on-line at that time. PE says that the transmission credit in the capped rates was included as a representative level of transmission revenues. According to PE, it bears the financial risk to maintain the same level of transmission revenues as are reflected in the transmission credit in the capped rates.⁵ PE concludes that pulling out transmission revenues associated with Warrior Run would amount to a partial dismembering of the Company's capped generation rate, would change the terms of the 8797 Settlement, and is improper.

According to PE, Staff seems to suggest that transmission services are "ancillary" to Warrior Run output and are therefore included as a part of the credit. PE notes that "ancillary services" is a term of art in the utility business. It includes such things as reactive supply and voltage control. It is a defined term and does not include transmission. PE states that the ancillary services reported in its response to data requests were generated by APS's own generation, not Warrior Run output, and therefore are not a credit to the WR Surcharge. Ancillary services are necessary for transporting the Warrior Run output.

Finally, PE says that Staff and OPC have incorrectly calculated the credit. If the Commission adopts a transmission credit, PE says that it must include transmission costs and the appropriate jurisdictional allocation of revenue. PE concludes that the credit through December 31, 2001 would then be approximately \$234,000, not \$5.1 million.⁶

III. COMMISSION ANALYSIS AND DECISION

⁵ PE notes that it is also at risk for higher fuel costs. Final Comments of PE at 5. Docket No. 205.

⁶ See Attachment No. 2 of PE's Final Comments. Docket No. 205.

This matter requires the Commission to interpret the language of the 8797 Settlement, specifically Paragraphs 10 and 22. Each of the parties provided a background on the Warrior Run issues and their interpretations of them. The Parties are bound by the terms of the 8797 Settlement Agreement that was approved in Order Nos. 75851 and 76009, including the plain meaning of words contained therein. Testimony before the Commission is equally relevant when it provides guidance to the meaning of terms in the Settlement.

Initially, the Commission observes that the word transmission is not included in Paragraph 10 of the Settlement, which describes what is to be included in the WR Surcharge calculation. Traditionally, generation (energy and capacity), transmission and distribution are treated as distinctly separate items. While OPC emphasizes the phrase “including but not limited to”, PE just as vehemently emphasizes the word “output.” Importantly, Paragraph 10 specifically requires that the revenue offset be from sales “into the wholesale market through a competitive bidding process.” Transmission sales to deliver the Warrior Run output are, undisputedly, not made through a competitive bidding process. This is a separately negotiated charge between PE and the successful bidder of the Warrior Run output. In addition, PE’s interpretation of Paragraph 10 is supported by the fact that in Paragraph 22 specific reference to transmission is made to clearly indicate its inclusion, whereas transmission is not mentioned in Paragraph 10 and as such should not be included as an offset to the surcharge.

In contrast to the Company’s position, Staff and OPC have emphasized the testimony in the hearing conducted on the Settlement. Likewise, the Commission agrees that sworn testimony is very relevant. Company witness Klick stated that the WR

Surcharge was designed as a dollar for dollar recovery mechanism and that the effect was to be neutral on PE's earnings. (Revenue neutrality, absent other directives, has been the guiding principal in resolving Warrior Run issues.) The Company attempts to explain its interpretation regarding transmission, by asserting that this reference was only to Warrior Run "output".

It is important for the Commission to be able to rely upon the veracity of statements made by witnesses in proceedings before the Commission, particularly when done so under oath. Attempts to mislead or obfuscate answers so as to mislead parties and the Commission will not be tolerated. However, in this instance, since the word transmission was not included in Paragraph 10, while being included elsewhere in the Settlement, the Commission determines that the Settlement has not conclusively included transmission in the Warrior Run Surcharge.

The Commission will not read into Paragraph 10 a substantial transmission revenue credit in the absence of a clear indication that this was intended. PE's currently capped generation rates include a transmission credit, at 1999 levels. Where possible, it is prudent to avoid adjusting individual items in the Settlement. PE is at risk for maintaining its 1999 level of transmission revenues just as it is at risk for future increases in fuel costs. It would not be appropriate to transfer these risks to ratepayers.

None of the parties has discussed other Settlement provisions in detail. The Commission notes that pursuant to Paragraph 22 transmission rates are capped for all PE customers through 2004. After this time transmission rates are subject to adjustment. The Commission agrees that adjusting transmission rates prior to this date is inappropriate, not only because of the provisions of Paragraph 22 but because current

rates reflect a credit for transmission revenues at the 1999 rate. How transmission revenues should be treated January 1, 2005 and beyond is an open question. It is also an open question how transmission and ancillary services revenues associated specifically with Warrior Run should be treated.

The Commission also notes that many changes relative to transmission issues are taking place at the federal and regional level. In particular, PE is expected to become a member of PJM West, part of a regional transmission organization (RTO). As the Company noted at the May 16, 2001 Administrative Meeting, “[a]fter that, any power sold, any output from Warrior Run sold in PJM will not generate transmission revenues.”⁷ Implications of this new scenario as well as other issues regarding RTOs are under consideration and are likely to affect future transmission rates. Consequently, the Commission intends to re-examine all transmission issues in a future proceeding.

The 8797 Settlement reflects risks and benefits for the Company and ratepayers; each party must accept these risks and benefits as approved by the Commission. While reasonable minds can and do differ on this matter, the Commission is persuaded that the WR Surcharge should not be adjusted for transmission and ancillary service revenues during the transmission rate cap period. Transmission and ancillary service revenues will be reviewed as part of the Commission’s investigation into transmission and distribution rate changes effective January 1, 2005. This, of course, may impact the WR Surcharge or be dealt with independently. Therefore, the Commission will not approve OPC’s request to reduce the WR Surcharge by \$5.1 million through 2001. Barring unforeseen events at

⁷ Administrative Meeting of May 16, 2001, transcript at 25.

the federal level, the Commission will not make any similar adjustment to the WR Surcharge for transmission or ancillary services for rates effective through 2004, the transmission rate cap period.

The Commission specifically declares that its determination herein does not establish any precedent for the WR Surcharge after 2004. The Commission will determine appropriate transmission issues generally, and specifically whether a transmission and ancillary services revenue credit should be reflected in the WR Surcharge thereafter. This decision of the Commission is limited to a determination of the appropriate Warrior Run Surcharge for the period ending December 31, 2004.

IT IS THEREFORE, this 26th day of September in the year Two Thousand and One, by the Public Service Commission of Maryland.

ORDERED: The Office of People’s Counsel’s request that the Potomac Edison Company be ordered to reflect transmission and ancillary services revenues in the Warrior Run Surcharge for the period ending December 31, 2001 is denied.

Commissioners