UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission System Operator, Inc. — Docket Nos. ER02-2595-006, ER02-2595-007

ORDER CONDITIONALLY ACCEPTING COMPLIANCE FILINGS

(Issued April 15, 2005)

1. In this order, we conditionally accept the compliance filing submitted by the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) pursuant to the order issued on September 16, 2004 in this proceeding.[1] We also conditionally accept the compliance filing submitted by Midwest ISO on January 19, 2005 (January 2005 Compliance Filing), which proposes revisions to Schedules 16 and 17 of Midwest ISO's Transmission and Energy Markets Tariff (TEMT). We direct Midwest ISO to file another compliance filing to address certain issues, as discussed below. Our action here benefits customers by ensuring that the rates charged under Schedules 16 and 17 of the Midwest ISO tariff are just and reasonable.

Background

2. On September 24, 2002, the Midwest ISO filed Schedules 16 and 17 to its tariff which proposed cost recovery mechanisms for the provision of Financial Transmission Rights Administrative Service (FTR Service) and Energy Market Support Administrative Service (Energy Market Service), respectively. In the Commission's order issued November 22, 2002, the Commission accepted the proposed schedules for filing, suspended them, and made them effective November 25, 2002, subject to refund.[2]

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[1] *See Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,235 (2004) (Schedule 16/17 Order).

[2] *Midwest Independent Transmission System Operator, Inc.*, 101 FERC ¶ 61,221 (2002) (November 2002 Order), *reh'g denied*, 103 FERC ¶ 61,035 (2003).

3. In the November 2002 Order, the Commission found that the record did not contain sufficient information to resolve the issues concerning the proposed billing determinants for the Schedule 16 and 17 charges and ordered a "paper hearing" to address the billing determinants for the charges, including issues of cost causation, among other things. The Commission also found that the proposed allocation of exit fees associated with the development of Energy and FTR Markets to be unsupported. Accordingly, the Commission included the issue regarding the allocation of the exit fee in the "paper hearing." Additionally, the Commission required a compliance filing that, among other things, would add specificity to the proposed formula rate.

4. On January 6, 2003, the Midwest ISO submitted the compliance filing (January 2003 Compliance Filing) required by the Commission's November 2002 Order. To address the Commission's concerns, the Midwest ISO proposed, as part of its formula rates for FTR service and Energy Market service, to charge a rate, each month, based on the estimated costs of providing the service for that month, plus a true-up of actual revenues and expenses for the prior month, divided by the total proposed billing determinants. The January 2003 Compliance Filing also proposed to calculate the cost of providing service in five components, exclusive of the true-up mechanism.[3]

5. In the Schedule 16/17 Order, we found, among other things, that the formulas in the January 2003 Compliance Filing were still not specific enough to operate as formula rates because, among other reasons, the Midwest ISO would continue to have discretion with respect to calculating the charges in Schedules 16 and 17. We directed the Midwest ISO to make specific changes to the formulas to provide more detail about how certain calculations would be made. Among other required changes, we directed the Midwest ISO to reflect the accounts used in the Uniform System of Accounts throughout the formula, define capitalized terms, explain the treatment of deferred pre-operating costs, and fix the percentage of depreciation expense and interest and financing costs amongst Schedules 10, 16 and 17. The Midwest ISO was also directed to use sub-accounts by schedule (Schedules 10, 16 and 17) so that market participants can check the formulas' fixed percentage allocations included in the rates with the percentage allocations included in the Midwest ISO's books. We also required the Midwest ISO to clarify that it will not

[3] The five components are: (1) the cost of the Market Operations Department less adjustments for depreciation expense, finance costs and amortization costs allocated between Schedules 16 and 17; (2) the labor-related costs of divisions other than the Market Operations Department to the extent they provide support (*e.g.*, engineering) for services associated with each schedule; (3) the costs of certain departments that provide administrative and general services; (4) depreciation of non-General Plant assets based on a study of the use of the assets; and (5) the Midwest ISO's interest, finance costs and amortization costs associated with each schedule and assigned the costs to each schedule based on the use of the proceeds of the financing activity.

seek recovery of any loan principle associated with any asset for which it is recovering depreciation expense and to provide to stakeholders the inputs and cost allocations of the formulas.

6. Since the Midwest ISO did not support its exit fee allocation in the paper hearing, we rejected the proposed allocation of the exit fees without prejudice. We directed the Midwest ISO to remove the exit fee allocation from the tariff and to state in the tariff that exit fees must be negotiated and filed with the Commission.

7. On November 1, 2004, as amended on November 4, 2004, the Midwest ISO submitted revised tariff pages to comply with our Schedule 16/17 Order, that, among other things, reformat the formulary rates in Schedules 16 and 17. Subsequently, on January 19, 2005, Midwest ISO submitted an additional compliance filing (January 2005 Compliance Filing), which supplements the revisions filed in the November 1, 2004 Compliance Filing.

Notices of Filing and Protest

8. Notice of the November 1, 2004 Filing, as amended on November 4, 2004, was published in the *Federal Register*, 69 Fed. Reg. 67,338 (2004), with comments, protests and interventions due on or before November 22, 2004. The Wisconsin Electric Power Company (Wisconsin Electric) filed timely comments. On December 7, 2004, the Midwest ISO filed an answer responding to Wisconsin Electric's comments.

9. Notice of the January 2005 Compliance Filing was published in the *Federal Register*, 70 Fed. Reg. 6434 (2005), with comments, protests and interventions due on or before February 9, 2005. Alcoa Power Generating Inc. (Alcoa) filed a motion to intervene raising no substantive issues.

Discussion

A. Procedural Matters

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), Alcoa's timely, unopposed motion to intervene serves to make it a party to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Midwest ISO's answer filed in Docket No. ER02-2595-006 because it has provided information that assisted us in our decision-making process.

B. November Compliance Filing

11. To comply with our Schedule 16/17 Order, the Midwest ISO proposed revisions that reformat the formulary rates in Schedules 16 and 17.[4] The proposed formulas still provide charges, each month, based on the estimated costs of providing service for the month, plus a true-up of revenues and expenses for the prior month, divided by the billing determinants. However, the formulas calculating the estimated costs for the month have been reformatted from five components to eight components.

12. The first formulary component (A1) recovers the total operating costs (excluding depreciation, interest, financing and amortization costs) recorded directly to either Schedule 16 or 17 sub-accounts. The Midwest ISO states that the first and second formulary components in the January 2003 Compliance Filing have been combined into A1 in the instant submittal.

13. The second formulary component (A2) recovers the remaining total operating costs (excluding depreciation, interest, financing and amortization costs) not recorded directly to a particular sub-account multiplied by a salary and wages-based allocation factor. The Midwest ISO states that the third formulary component in the January 2003 Compliance Filing is A2 in the instant submittal.

14. The third formulary component (A3) recovers the depreciation expense recorded to either the Schedule 16 or 17 sub-accounts. The fourth formulary component (A4) recovers the remaining depreciation expense not recorded directly to a particular sub-account multiplied by a salary and wages-based allocation factor. The Midwest ISO states that the fourth formulary component in the January 2003 Compliance Filing has been broken up into components A3 and A4 in the instant submittal. The Midwest ISO made the change to clarify how depreciation associated with assets not recorded to a Schedule 10, 16 or 17 sub-account is allocated among the three cost recovery schedules. The Midwest ISO also states that it is still conducting use studies of its assets to determine if the assets are properly assigned to Schedules 10, 16 or 17, and will fix the allocation percentages in component A4 when the studies are completed.

15. The fifth formulary component (A5) recovers interest and financing costs recorded directly to either Schedule 16 or 17 sub-accounts. The sixth formulary component (A6) recovers the remaining interest and financing costs not recorded directly to particular sub-accounts multiplied by a salary and wages-based allocation factor. The Midwest ISO states that the fifth formulary component in the January 2003 Compliance Filing equals the sum of A5 and A6 in the instant submittal, and the change was made to provide

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[4] Among other things, the Midwest ISO also replaced the language concerning the allocation of the exit fee with a requirement that the exit fee be negotiated.

further clarification on how assets not recorded to a Schedule 10, 16 or 17 sub-account are to be allocated among the three cost recovery schedules. The Midwest ISO also states that loan principle will not be recovered as it is recovered through depreciation in A4.

16. The Midwest ISO states that it added formulary components A7 and A8 to provide greater clarity regarding the amortization of the pre-operating expenses as required by the Schedule 16/17 Order. The Midwest ISO also revised the language in the schedules to explain that the pre-operating expenses are directly assigned to the appropriate schedule and the amortization of such deferred expenses is included as a regulatory debit in Account 407.3.

Comments and Response

17. Wisconsin Electric states that the proposed formulas for calculating Schedule 16 and 17 charges inappropriately allocate wages to the various schedules. For example, Wisconsin Electric notes that the Operation Expense Allocation Factor in Schedule 16 is the base wages directly charged to Schedule 16 divided by the base wages assigned to Schedule 10 and 17. Wisconsin Electric states that the apparent failure to include Schedule 1 base wages in the divisor may result in a double collection of costs. Wisconsin Electric states that its concern about double recovery of Schedule 1 costs is heightened by the language contained in Schedule 10 that "the costs recovered pursuant to the terms of this Schedule 10 are exclusive of those costs recovered pursuant to Schedules 1, 16 and 17 of this Tariff."

18. The Midwest ISO responds that there are no costs allocated to or recovered under Schedule 1, nor does Midwest ISO foresee allocating costs to Schedule 1 in the future. Nonetheless, the Midwest ISO states that it would be willing to reflect Schedule 1 in the divisor of the Operation Expense Allocation Factor to address Wisconsin Electric's concerns.

Commission Determination

19. We will accept the Midwest ISO's compliance filing, subject to the Midwest ISO submitting a compliance filing to make the modifications discussed below. We direct the Midwest ISO to modify, within 30 days from the date of this order, the Operation Expense Allocation Factor in Schedules 16 and 17 to reflect Schedule 1 base wages in the divisor, as it agrees to do in its answer to Wisconsin Electric's protest.

20. In addition, there are other issues discussed in the Schedule 16/17 Order that the Midwest ISO needs to address. For formulary components applicable to depreciation expense, the Midwest ISO must file the applicable fixed percentage allocations as soon as it has completed the use studies, as it has stated it would do.[5]

21. Additionally, with respect to interest and financing costs, while the Midwest ISO has satisfied our requirement to include a fixed percentage allocation for component A6 by using the Operating Expense Allocation Factor, they have not addressed our concerns with respect to component A5. In the Schedule 16/17 Order, we explained our concern with the amount of discretion the Midwest ISO would have in this area. In the transmittal letter to the January 2003 Compliance Filing, the Midwest ISO states that interest and finance costs will be allocated to Schedules 16 and 17 based on the use of the proceeds and that currently the split of the financing monies is approximately 33 percent to Schedule 16 and 67 percent to Schedule 17. We find that allocating these costs based on the use of the proceeds is reasonable, but Midwest ISO will still have discretion in deciding what the use of the proceeds is. Therefore, we direct the Midwest ISO to file within 30 days from the date of this order a compliance filing incorporating its statement in the January 2003 Compliance Filing, discussed above, into the tariff sheets for component A5. If Midwest ISO has percentage allocations that are more recent than the 33 percent for Schedule 16 and 67 percent for Schedule 17, it should use the more recent data and include appropriate support for the new percentage allocations. We note that changes to these percentage allocations will require a section 205 filing for a change in rate, and this filing requirement will ensure that Midwest ISO will not be able to change the allocation of interest and financing costs amongst the schedules at its discretion.[6]

22. Finally, the Midwest ISO's reformatting of the formula rates from five components to eight components obviates the need for some of the changes required by our Schedule 16/17 Order, but the reformatting also causes a new issue that must be addressed on compliance. For components A1 and A2 of the formula rates, the Midwest ISO must clarify, within 30 days from the date of this order, when expenses will be directly billed to a particular schedule (component A1) or allocated among the various schedules (component A2) by defining direct costs and indirect costs.[7]

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[5] *See* Midwest ISO transmittal Letter at p. 8. *See also* Schedule 16/17 Order at P 74.

[6] Schedule 16/17 Order at P 75.

[7] Presumably, direct costs are operating costs, which the Midwest ISO states in the January 2003 Compliance Filing were in the first and second formulary components, and these costs consisted of the Market Operations Department and other divisions in the Midwest ISO that performed support functions for services associated with each schedule

(continued….)

C. **January 2005 Compliance Filing**

23. The Midwest ISO filed the January 2005 Compliance Filing to change the amortization period for certain Schedule 16 and 17 pre-operating expenses from five years to seven years to better match the recovery period for the software costs associated with the development and start-up of the FTR and energy markets. The Midwest ISO states that this filing is made in compliance with the Schedule 16/17 Order which required, among other things, the Midwest ISO to clarify the treatment of deferred Schedule 16 and 17 pre-operating costs to avoid the possibility of over-recovery.[8] The Midwest ISO explains that the filing will have no impact on the asset lives and depreciation rates for capital costs associated with the development and start-up of the Midwest ISO's FTR energy markets.[9] The Midwest ISO also states that the proposed change will have no impact on the total amount of pre-operating expenses to be recovered from Market Participants, but that it will benefit market participants by reducing the charges in the first five years and collecting any remaining costs over an additional two years. Midwest ISO notes that the proposed changes have been discussed with stakeholders and has received no indication of opposition to the proposed change.

Commission Determination

24. We conditionally accept the proposed filing to change the amortization period from five years to seven years. Our analysis indicates that that the proposed change will better match software costs and will benefit market participants by reducing the charges in Schedules 16 and 17 for the first five years as they obtain experience with the new markets.

25. The Midwest ISO has proposed implementing the change in amortization from five years to seven years by changing Sheet Nos. 999 (Schedule 16) and 1008A (Schedule 17) of the TEMT. However, our review of Schedules 16 and 17 of the TEMT indicates that Sheet Nos. 993 (Schedule 16) and 1001 (Schedule 17) also need to be modified. For example, Schedule 16 under section B titled "Determination of Costs to be Recovered," states:

(such as engineering) but did not perform administrative and general activities. Also, according to the January 2003 Compliance Filing, indirect costs are the costs of only those divisions in the Midwest ISO that perform administrative and general activities (*e.g.*, executive management and human resources).

[8] Midwest ISO cites the Schedule 16/17 Order at P 69.

[9] Midwest ISO filing, Holstein Affidavit, P 7.

> Included in Deferred Schedule 16 Costs shall be all costs associated with the development and implementation of the Service prior to the provision of the Service and all costs associated with financing the Deferred Schedule 16 Costs. The Deferred Schedule 16 Costs shall be recovered over a five-year transition period (the "Transition Period") beginning on the operational date of this Schedule 16.[[10]]

26. We direct the Midwest ISO to file a compliance filing, within 30 days from the date of this order, to either modify section B of both Schedule 16 and 17 to change the Transition Period, as it is defined in the schedules, from five to seven years to conform to the proposed change or to explain the reason that such changes to section B need not be made.

The Commission orders:

(A) Midwest ISO's November compliance filing is hereby conditionally accepted, as discussed in the body of this order, subject to ordering paragraph C.

(B) Midwest ISO's January 2005 Compliance Filing is hereby conditionally accepted, as discussed in the body of this order, subject to ordering paragraph C.

(C) Midwest ISO is hereby directed to submit a compliance filing, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

[10] *See* Original Sheet No. 993 of Midwest ISO's TEMT. Schedule 17 contains similar language.