

ORAL ARGUMENT IS NOT YET SCHEDULED

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

**Nos. 05-1001 and 05-1002
(consolidated)**

**MAINE PUBLIC UTILITIES COMMISSION, ET AL.,
PETITIONERS,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

**ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

**BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY
COMMISSION**

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CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties are as stated in the Petitioners' briefs.

B. Rulings Under Review

The rulings under review are as follows:

1. *ISO New England Inc., et al.*, "Order Granting RTO Status Subject to Fulfillment of Requirements and Establishing Hearing and Settlement Judge Procedures," 106 FERC ¶ 61,280 (March 24, 2004); and
2. *ISO New England Inc., et al.*, "Order Accepting Partial Settlement, Subject to Conditions; Accepting, in Part, Compliance Filings; and Granting, in Part, and Denying, in Part, Requests for Rehearing," 109 FERC ¶ 61,147 (November 3, 2004).

C. Related Cases

This case has not previously been before this Court. The Connecticut Department of Public Utility Control (D.C. Cir. No. 05-1297) and Connecticut Municipal Electric Cooperative, *et al.* (D.C. Cir. No. 05-1308) have filed petitions for review of the orders at issue here. The Commission filed motions to dismiss on October 17, 2005 (No. 05-1297) and on November 9, 2005 (No. 05-1308). An earlier petition for review filed by Connecticut Municipal Electric Energy Cooperative, *et al.* (D.C. Cir. No. 05-1119) was dismissed for prematurity.

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February 23, 2006

TABLE OF CONTENTS

| | PAGE |
|---|-------------|
| STATEMENT OF THE ISSUES..... | 1 |
| STATUTES AND REGULATIONS..... | 2 |
| STATEMENT OF THE CASE..... | 2 |
| I. Nature of the Case, Course of Proceedings, and Disposition Below..... | 2 |
| II. Statement of Facts..... | 3 |
| A. Statutory and Regulatory Background..... | 3 |
| B. Events In New England Leading To The Challenged Orders..... | 6 |
| C. The Approval Order..... | 9 |
| D. The Rehearing Order..... | 12 |
| E. Subsequent Events..... | 14 |
| SUMMARY OF ARGUMENT..... | 14 |
| ARGUMENT..... | 16 |
| I. Standard of Review..... | 16 |
| II. The Commission Properly Determined That A Just And Reasonable Standard Would Apply To Its Review Of Any FPA § 205 Filing Pertaining To A Transmission Owner’s Withdrawal From RTO New England..... | 16 |
| III. The Commission Properly Determined That A 50 Basis Point Incentive Adder For RTO Participation Is Just And Reasonable... | 26 |

TABLE OF CONTENTS

| | PAGE |
|--|-------------|
| A. It Is Undisputed That RTOs Provide Significant Public Benefits..... | 26 |
| B. The Commission Reasonably Inferred That RTO New England Will Provide Significant Benefits to New England..... | 31 |
| C. The Commission Properly Exercised Its Broad Ratemaking Authority In Determining That The Adder Would Result In Just and Reasonable Rates..... | 36 |
| D. Application of the Adder Is Consistent With Commission Precedent..... | 40 |
| IV. The Commission Properly Determined That Adders Are Not Warranted For Local Service That Is Not Under Control Of An RTO..... | 42 |
| CONCLUSION..... | 46 |

TABLE OF AUTHORITIES

| COURT CASES: | PAGE |
|---|-----------------|
| * <i>Atlantic City Electric Co. v. FERC</i> , 295 F.3d 1 (D.C. Cir. 2002)..... | 3,4,17,18,19,23 |
| <i>City of San Antonio v. ICC</i> , 631 F.2d 831 (D.C. Cir. 1980)..... | 38 |
| <i>Consumers Union of United States, Inc. v. FERC</i> , 510 F.2d 656 (D.C. Cir. 1975)..... | 35 |
| <i>Farmers Union Central Exch. v. FERC</i> , 734 F.2d 1486 (D.C. Cir. 1984)..... | 36 |
| <i>Florida Mun. Power Agency v. FERC</i> , 315 F.3d 362 (D.C. Cir. 2003)..... | 45 |
| <i>FPC v. Natural Gas Pipeline Co.</i> , 315 U.S. 575 (1942)..... | 36 |
| <i>FPC v. Sierra Pacific Power Co.</i> , 350 U.S. 348 (1956)..... | 4,23 |
| <i>Groton v. FERC</i> , 587 F.2d 1296 (D.C. Cir. 1978)..... | 42 |
| <i>Interstate Natural Gas Ass’n of America v. FERC</i> , 285 F.3d 18 (D.C. Cir. 2002)..... | 39,40 |
| <i>Midwest ISO Transmission Owners v. FERC</i> , 373 F.3d 1361 (D.C. Cir. 2004)..... | 40 |

* Cases chiefly relied upon are marked with an asterisk.

TABLE OF AUTHORITIES

| COURT CASES: | PAGE |
|---|-------------|
| <i>Mobil Oil Corp. v. FPC</i> , 417 U.S. 283 (1974)..... | 37 |
| <i>Motor Vehicle Manufacturer’s Ass’n v. State Farm Mutual Automobile Ins. Co.</i> , 463 U.S. 26 (1983)..... | 16 |
| <i>NAACP v. FPC</i> , 425 U.S. 662 (1976)..... | 16 |
| <i>Nat’l Cable Television Ass’n v. Copyright Royalty Tribunal</i> , 724 F.2d 176 (D.C. Cir. 1983)..... | 16 |
| <i>New York v. FERC</i> , 535 U.S. 1 (2002)..... | 5 |
| <i>Northeast Utilities Service Co. v. FERC</i> , 993 F.2d 937 (1st Cir. 1993)..... | 22 |
| * <i>Northern States Power Co. v. FERC</i> , 30 F.3d 177 (D.C. Cir. 1994)..... | 16 |
| <i>Permian Basin Area Rate Cases</i> , 390 U.S. 747 (1968)..... | 36,39 |
| <i>Potomac Electric Power Co. v. FERC</i> , 210 F.3d 403 (D.C. Cir. 2000)..... | 4,22,23 |
| <i>Public Service Comm’n of Kentucky</i> , 397 F.3d 1004 (D.C. Cir. 2005)..... | 37,40 |
| <i>Public Util. Comm’n of California v. FERC</i> , 367 F.3d 925 (D.C. Cir. 2004)..... | 38,39 |
| <i>Public Util. Dist. No. 1 of Snohomish County v. FERC</i> , 272 F.3d 607 (D.C. Cir. 2001)..... | 6,27,28 |

TABLE OF AUTHORITIES

| COURT CASES: | PAGE |
|--|-------------|
| <i>Schurz Communications, Inc. v. FCC</i> , 982 F.2d 1043 (7 th Cir. 1992)..... | 38 |
| <i>Sithe/Independence Power Partners v. FERC</i> , 165 F.3d 944 (D.C. Cir. 1999)..... | 16 |
| <i>System Fuels, Inc. v. ICC</i> , 642 F.2d 112 (5th Cir. 1981)..... | 38 |
| <i>Texaco Inc. v. FERC</i> , 148 F.3d 1091 (D.C. Cir. 1998)..... | 4 |
| <i>Town of Norwood v. FERC</i> , 587 F.2d 1306 (D.C. Cir. 1978)..... | 4 |
| <i>Transmission Access Policy Study Group v. FERC</i> , 225 F.3d 667 (D.C. Cir. 2000)..... | 5 |
| <i>United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.</i> , 350 U.S. 332 (1956)..... | 4 |
| ADMINISTRATIVE CASES: | |
| <i>Allegheny System Operating Companies, et al.</i> , 111 FERC ¶ 61,308 (2005)..... | 36,41 |
| <i>Bangor Hydro-Electric Company, et al.</i> , 96 FERC ¶ 61,063 (2001)..... | 7 |
| <i>Bangor Hydro-Electric Company, et al.</i> , 111 FERC ¶ 63,048 (2005)..... | 14 |
| <i>Guidance on Regional Transmission Organization and Independent System Operator Filing Requirements under the Federal Power Act</i> , 104 FERC ¶ 61,248 (2003)..... | 10,18,19 |

TABLE OF AUTHORITIES

| ADMINISTRATIVE CASES: | PAGE |
|---|---------------------|
| <i>ISO New England, et al.</i> , 106 FERC ¶ 61,280 (2004)..... | passim |
| <i>ISO New England, et al.</i> , 109 FERC ¶ 61,147 (2004)..... | 2,12,13,21,22,24,43 |
| <i>Midwest Independent Transmission System</i> , 100 FERC ¶ 61,292 (2002)..... | 40 |
| <i>Midwest Independent Transmission System</i> , 102 FERC ¶ 61,143 (2003)..... | 28 |
| <i>NEPOOL Power Pool Agreement</i> , 48 FPC 538 (1972)..... | 42 |
| <i>New England Power Pool Agreement</i> , 56 FPC 1562 (1976)..... | 42 |
| <i>New England Power Pool</i> , 79 FERC ¶ 61,374 (1997)..... | 7,32 |
| <i>New England Power Pool</i> , 83 FERC ¶ 61,045 (1998)..... | 11,42 |
| <i>New England Power Pool</i> , 97 FERC ¶ 61,093 (2001)..... | 36 |
| <i>PJM Interconnection, LLC</i> , 101 FERC ¶ 61,345 (2002)..... | 41 |
| <i>PJM Interconnection, LLC</i> , 104 FERC ¶ 61,124 (2003)..... | 41 |

TABLE OF AUTHORITIES

| ADMINISTRATIVE CASES: | PAGE |
|--|------------------------|
| <p><i>Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities</i>, Order No. 888, FERC Stats. & Regs., Regs. Preambles [Jan. 1991-June 1996] ¶ 31,036 (1966) (“Order No. 888”), <i>clarified</i>, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1997), <i>order on reh’g</i>, Order No. 888-A, FERC Stats. & Regs., Regs. Preambles [July 1996-Dec. 2000] ¶ 31,048 (“Order No. 888-A”), <i>order on reh’g</i>, Order No. 888-B, 81 FERC ¶ 61,248, <i>order on reh’g</i>, Order No. 888-C, 82 FERC ¶ 61,046 (1998).....</p> | 5 |
| <p><i>Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid</i>, 102 FERC ¶ 61.032 (2003).....</p> | 6,29,30,31,34,35,37,39 |
| <p><i>*Regional Transmission Organizations</i>, Order No. 2000, FERC Stats. & Regs., Regs. Pmbls. ¶ 31,089 (1999), <i>order on reh’g</i>, Order No. 2000-A, FERC Stats. & Regs., Regs. Pmbls. ¶ 31,092 (2000).....</p> | 5,27-30,34 |
| <p><i>Standardization of Generator Interconnection Agreements and Procedures</i>, Order No. 2003, FERC Stats. & Regs., Regs. Pmbls. ¶ 31,146 at P 26 [July 24, 2003].....</p> | 26 |

TABLE OF AUTHORITIES

| STATUTES: | PAGE |
|---|-------------|
| Federal Power Act | |
| Section 201(b), 16 U.S.C. § 824(b)..... | 3 |
| Section 203, 16 U.S.C. § 824b..... | 18 |
| Section 205, 16 U.S.C. § 824d(a)-(b)..... | 18 |
| Section 205(e), 16 U.S.C. § 824(e)..... | 2,3,17,18 |
| Section 313(b), 16 U.S.C § 825l(b)..... | 25 |
| REGULATIONS: | |
| 18 C.F.R. § 35.34(j)..... | 6 |
| 18 C.F.R. § 35.34(k)..... | 6 |
| 18 C.F.R. § 35.34(l)..... | 6 |

GLOSSARY

| | |
|--------|--------------------------------------|
| FERC | Federal Energy Regulatory Commission |
| ISO | Independent System Operator |
| NEPOOL | New England Power Pool |
| OATT | open access transmission tariff |
| RTO | regional transmission organization |

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**ON PETITIONS FOR REVIEW OF ORDERS OF THE
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**BRIEF FOR RESPONDENT FEDERAL ENERGY
REGULATORY COMMISSION**

STATEMENT OF THE ISSUES

1. Whether the Federal Energy Regulatory Commission (“FERC” or “Commission”), in approving a comprehensive filing by New England transmission owners to create a regional transmission organization (“RTO”), reasonably rejected a proposal to limit the Commission’s review of later filings by transmission owners to withdraw from that RTO.

2. Whether the Commission, in approving the New England RTO, reasonably afforded the transmission owners a 50 basis point adder to their

return on equity for regional service, but not local service, for turning over control of their transmission systems.

STATUTES AND REGULATIONS

The applicable statutes and regulations are contained in the addendum to this brief.

STATEMENT OF THE CASE

I. Nature of the Case, Course of Proceedings, and Disposition Below

The orders under review are *ISO New England, et al.*, “Order Granting RTO Status Subject to Fulfillment of Requirements and Establishing Hearing and Settlement Judge Procedures,” 106 FERC ¶ 61,280 (March 24, 2004) (“Approval Order”) (R 133, JA 392); and “Order Accepting Partial Settlement, Subject to Conditions; Accepting in Part, Compliance Filings; and Granting, in Part, and Denying, in Part, Requests for Rehearing,” 109 FERC ¶ 61,147 (November 3, 2004) (“Rehearing Order”) (R 252, JA 640).

The orders approved an agreement establishing an RTO in New England and made numerous findings, of which only three are at issue here. To avoid possible adverse impact on the public from transmission owner withdrawal from the RTO, the orders required the agreement to provide for exit from the RTO only after the Commission has reviewed the requisite tariff filings under the “just and reasonable” standard of § 205 of the Federal Power Act (“FPA”), 16 U.S.C. §

824(e). The Commission also found that New England transmission owners are entitled to a 50 basis point incentive adder to their return on equity for regional service in light of their voluntary formation of the RTO and the ensuing benefits to the public. The Commission rejected application of the adder to local service because the adder was to encourage ceding control of regional facilities, and because, in any case, the owners retained significant control of local service.

II. Statement of Facts

A. Statutory and Regulatory Background

Section § 201(b) of the FPA, 16 U.S.C. § 824(b), affords the Commission jurisdiction “over all rates, terms, and conditions of electric transmission service provided by public utilities in interstate commerce, as well as the sale of electric energy at wholesale.” *Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 4 (D.C. Cir. 2002). Under section 205(e) of the FPA, 16 U.S.C. § 824(e), utilities must file tariff schedules with the Commission showing their rates and service terms, along with related contracts, for jurisdictional service. Upon receipt of such a filing, the Commission is “obliged to assure that the rates and charges demanded or received by any public utility in connection with the interstate transmission or sale of electric energy are just and reasonable, and that no public utility’s rates will unduly discriminate against any consumers.” *Id.* (citing 16 U.S.C. §§ 824d(a)-(b)).

Under the *Mobile-Sierra* doctrine, named after two leading Supreme Court cases on the subject, see *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), “utilities may choose to voluntarily give up, by contract, some of their rate-filing freedom under section 205.” *Atlantic City*, 295 F.3d at 10. Specifically, “parties may negotiate a fixed-rate contract with a provision relinquishing their right to file for a unilateral change in rates.” *Id.* at 11. In that case, the Commission may abrogate or modify fixed rates or fixed rate-setting methods “only if required by the public interest.” *Id.* at 14 (citing *Texaco Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998)). The “public interest” standard of review, while evading precise definition, is “much more restrictive than the just and reasonable standard of” FPA section 205. *Id.* (citing *Potomac Electric Power Co. v. FERC*, 210 F.3d 403, 407 (D.C. Cir. 2000)).

The underlying purpose of the *Mobile-Sierra* doctrine is “to preserve the benefits of the parties’ bargain as reflected in the contract, assuming that there was no reason to question what transpired at the contract formation stage.” *Id.* (citing *Town of Norwood v. FERC*, 587 F.2d 1306, 1312 (D.C. Cir. 1978)).

Historically, vertically integrated public utilities sold generation, transmission, and electric distribution services as part of a bundled package. Eventually, significant technological advances and changes in the law led to Order

No. 888,¹ which required all jurisdictional public utilities to unbundle wholesale electric power services, and to take transmission on a non-discriminatory basis under filed open access transmission tariffs (“OATTs”). Order No. 888 also encouraged the formation of independent system operators (“ISOs”) to operate regional, multi-system transmission grids.

Open access and other factors placed new demands on the transmission grid. Ultimately, FERC Order No. 2000² concluded that transmission-related impediments were hindering a fully competitive, non-discriminatory wholesale electric market. By combining various utilities’ segmented transmission facilities into a regional transmission grid under control of one entity, the RTO, the Commission expected RTOs to eliminate certain transmission inefficiencies and opportunities for discrimination that prevented the formation of competitive wholesale electric energy markets, and to result in significant benefits to the

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs., Regs. Preambles [Jan. 1991-June 1996] ¶ 31,036 (1966) (“Order No. 888”), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1997), *order on reh’g*, Order No. 888-A, FERC Stats. & Regs., Regs. Preambles [July 1996-Dec. 2000] ¶ 31,048 (“Order No. 888-A”), *order on reh’g*, Order No. 888-B, 81 FERC ¶ 61,248, *order on reh’g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff’d sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff’d sub nom. New York v. FERC*, 535 U.S. 1 (2002).

² *See Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs., Regs. Pmbles. ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, FERC Stats. & Regs., Regs. Pmbles. ¶ 31,092 (2000), *petitions for review dismissed Public Util. Dist. No. 1 of Snohomish County v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

public. *See Pub. Util. Dist. No. 1 of Snohomish County v. FERC*, 272 F.3d 607, 610-12 (D.C. Cir. 2001) (recounting history of RTO development) (“*Snohomish County*”). The RTO rule also “specifies both the minimum characteristics and functions that a regional entity must satisfy, in order to be considered an RTO under the rule.” *Id.* at 611, citing 18 C.F.R. §§ 35.34(j), (k) and (l).

By 2003, however, only two RTOs had been fully approved. To encourage timely formation of RTOs, FERC issued a policy statement that proposed a 50 basis point incentive adder to return on equity for transmission owners participating in a Commission-approved RTO. *See Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid*, 102 FERC ¶ 61,032 (2003) (“Pricing Policy”).

B. Events In New England Leading To The Challenged Orders

In 1971, New England transmission and generation owners, suppliers, publicly-owned entities, and end-users formed the New England Power Pool (“NEPOOL”). NEPOOL operated as a tight power pool, a unified regional network which coordinated bulk power transmission and generation facilities, including central dispatch services. *See Approval Order* at P 5, JA 394. In 1997, in response to Order No. 888, NEPOOL obtained FERC approval for the creation of ISO New England, Inc., a non-profit company that manages New England’s power grid and wholesale electricity market pursuant to a contract with NEPOOL.

Id. at P 6, JA 394; *see New England Power Pool*, 79 FERC ¶ 61,374 (1997). NEPOOL maintained primary responsibility for amending the New England open access transmission tariff and for amending the market rules that apply to the operation of the wholesale power exchange. Approval Order at P 8, JA 395.

After Order No. 2000 issued, interested New England parties began negotiations to form an RTO. On January 16, 2001, ISO New England and a group of transmission owners jointly filed a petition seeking a declaratory order, *inter alia*, “that the existing arrangements between [ISO New England], the New England [transmission owners], and [NEPOOL] fail to satisfy the requirements of Order 2000” *Bangor Hydro-Electric Company, et al.*, 96 FERC ¶ 61,063 at 61,254 (2001) (“2001 Declaratory Order”). Following notice and comment, the Commission found the existing arrangements “to be inconsistent with the requirements of Order No. 2000,” *id.* at 61,275, because, *inter alia*, ISO New England “[does] not operate with sufficient independence of market participants, given its ongoing ties to NEPOOL and the market participant interests represented within NEPOOL,” *id.* at 61,259.³

³ A second RTO proposal was filed jointly by the New England ISO and the New York ISO on August 23, 2002, subject to negotiation of key elements of the proposal with stakeholders. Approval Order at P 9 n. 8, JA 395. The negotiations failed and the proposal was withdrawn on November 22, 2002.

On October 31, 2003 in Docket Nos. RT04-2-000, *et al.*, ISO New England and the New England transmission owners jointly submitted for Commission approval, pursuant to FPA § 205, a proposal to establish RTO New England. Approval Order at P 1, JA 392. The respective rights and responsibilities of RTO New England and the transmission owners are addressed in the Transmission Operating Agreement (“Operating Agreement”). *Id.* at P 11, JA 396. Under section 10.01(a), JA 196, the Operating Agreement has an initial term of five years, which may be extended automatically for additional two-year periods.

A transmission owner may terminate its participation in RTO New England at the end of any term by giving 180 days written notice, Operating Agreement § 10.01(a)(i) (JA 197), or unilaterally withdraw from RTO New England at any time upon the occurrence of certain conditions.⁴ To effectuate withdrawal, a transmission owner must file a replacement tariff pursuant to FPA § 205. Operating Agreement § 10.01(g), JA 199. A withdrawal may also require an RTO New England tariff filing to address issues that might arise from the withdrawal.

⁴ These include: (i) a default by RTO New England; (ii) a change in federal policy concerning RTO formation; (iii) a Commission order revising the parties’ division of their respective rights and duties; (iv) membership in an independent transmission company; and (v) membership in another RTO following a merger or acquisition. Approval Order at P 43, JA 407; Operating Agreement § 10.01(b), JA 197.

Operating Agreement § 10.01(e), JA 199. The transmission owners intended that the *Mobile-Sierra* “public interest” standard apply to the Commission’s review of withdrawals from RTO New England:

[A]ny termination or withdrawal permitted by this Section 10.01 shall be effective unless the FERC finds that such termination or withdrawal is contrary to the public interest under the public interest standard of review set forth in [*Mobile-Sierra*].

Operating Agreement § 10.01(f), JA 199 (as proposed) .

In addition, on November 4, 2003, the New England transmission owners submitted a related FPA § 205 filing in Docket No. ER04-157-000, seeking approval for a single return on equity recoverable under the regional and local transmission rates charged by RTO New England. The proposed return on equity would consist of a base return on equity of 12.8 percent plus incentive adders of 50 basis points to reward RTO participation and 100 basis points to reward future transmission expansions, for a combined return on equity of 13.3 percent for existing transmission facilities and 14.3 percent for new transmission facilities. Approval Order at P 2, JA 393.

C. The Approval Order

The Commission issued a lengthy order addressing numerous issues and finding that the proposal to establish RTO New England will comply with the minimum characteristics and functions applicable to RTO operations as set forth in Order No. 2000, subject to certain conditions. Approval Order at P 3, JA 393. In

addition, the Commission also set for hearing, subject to suspension and refund, a request for a 100 basis point adder to return on equity to reward future transmission expansions and a proposal for a single base return on equity of 12.8 percent applicable to all regional and local transmission rates. *Id.*

As relevant here, the Commission rejected the proposed application of *Mobile-Sierra* “public interest” review to withdrawals from the RTO. *Id.* at P 59, JA 412. Application of the higher *Mobile-Sierra* standard to an election to withdraw from the RTO would prohibit meaningful review by the Commission under FPA § 205, even in those instances where revisions to RTO New England’s operating agreements may be necessary or appropriate as a result. *Id.* Moreover, the proposal in this regard is inconsistent with the Commission’s previously-issued policy statement on transmission owner withdrawal from an ISO or RTO.⁵ *Id.* Meaningful review is necessary, prior to RTO withdrawal, “to determine whether all of the elements contained in the filed arrangements meet the principles of Order No. 2000 and are just and reasonable” under FPA § 205. *Id.*

⁵ *Guidance on Regional Transmission Organization and Independent System Operator Filing Requirements under the Federal Power Act*, 104 FERC ¶ 61,248 (2003) (“RTO Withdrawal Policy”). The Commission stated that, in light of *Atlantic City*, 295 F.3d 1, any transfer of operational control of jurisdictional transmission facilities to or from an RTO or ISO, which does *not* involve a transfer of ownership or other proprietary interest in transmission facilities, would not require an FPA § 203 filing. Instead, arrangements to join or exit an RTO or ISO will be reviewed in the context of FPA § 205 filings such as agreements establishing the roles and responsibilities of the participants.

FERC's findings on certain return on equity issues are also at issue here. The Commission found a 50 basis point incentive adder for regional network service ⁶ warranted because of the transmission owners' "voluntary proposal to establish [RTO New England] and their commitment to transfer the day-to-day operational control authority over their transmission facilities to [RTO New England]." *Id.* at P 245, JA 468. Approval of the adder was consistent with FERC rulings in other cases involving RTO formation in other regions. Moreover, the adder is appropriate in light of the establishment of RTO New England resulting in region-wide benefits. *Id.*

Objections to the 50 basis point adder, on grounds that transmission owners had already been rewarded for participation in NEPOOL and ISO markets, missed the mark because these earlier arrangements did not meet the Order No. 2000 independence requirements. *Id.* at 246, JA 468. Moreover, the incentive adder will result in rates falling within the zone of reasonableness. *Id.*

The Commission agreed with objections to a 50 basis point adder for application to RTO New England's local service.⁷ Approval Order at P 247, JA

⁶ Regional service refers to the transmission facilities that are essentially the main highways for electricity in the New England market and does not include lines that serve only local loads. *See, e.g., New England Power Pool*, 83 FERC ¶ 61,045 at 61,232 (1998).

⁷ Local service charges generally recover the costs of facilities that do not

469. The adder was intended as an incentive for turning over control of regional, not local service; local facility charges reflect local environmental decisions and benefits; and the transmission owners retained significant control over local service tariffs including the right to file for changes in terms and conditions of service. *Id.* at PP 247-48, JA 469.

D. The Rehearing Order

On September 14, 2004, the parties submitted for approval a settlement seeking to resolve, in part, pending issues related to the RTO proposal. In addition, numerous intervenors sought rehearing and/or clarification of the Approval Order. The Rehearing Order accepted the settlement, and granted in part and denied in part the requests for rehearing/clarification not resolved by the settlement.

As relevant here, the Commission affirmed that it will review a transmission owner's withdrawal from RTO New England under the statutory just and reasonable standard. Rehearing Order at P 39, JA 653. A full, meaningful review by the Commission of a requested withdrawal from, or termination of, the RTO would not be possible if the standard of review is limited by application of the stringent *Mobile-Sierra* "public interest" standard. Rehearing Order at P 40, JA

provide regional service, *e.g.*, lower voltage lines and radial lines. Approval Order at P 247, JA 469.

653. Moreover, review of a requested withdrawal must consider the Order No. 2000 RTO formation policies because withdrawal can have a substantial impact on other market participants and the markets themselves. *Id.* at P 41, JA 654.

The Commission rejected arguments that the 50 basis point adder for return on equity for regional service would be an unjustified above-cost return. *Id.* at P 207, JA 706. A return on equity is “not susceptible to a precise calculation. It is based, rather, on a range of reasonable returns, which take into account a number of factors that may be both cost-related and policy-related, including business risk factors.” *Id.* The Commission found it appropriate “to adjust the allowed return for Transmission Owners that undertake commitments designed to enhance the overall competitiveness and efficiency of the wholesale markets, so long as the resulting rate of return is within the range of reasonable returns.” *Id.*

The Commission also affirmed its denial of a 50 basis point return on equity adder for facilities providing local service. *Id.* at P 201, JA 703. The adder was intended to be an incentive for independent control of regional service, not for local service under individual local tariffs. Rehearing Order at P 201-202, JA 703-04.

E. Subsequent Events

Petitions for review from the State Commission (Docket No. 05-1001) and the Transmission Owners (Docket No. 05-1002) followed. On February 28, 2005,

the Commission filed a motion explaining that certain issues were ripe for review and moving for an order setting a briefing schedule for review of those issues. The instant proceeding followed. On May 27, 2005, an initial decision issued addressing those return on equity issues which had been set for hearing. *See Bangor Hydro-Electric Company, et al.*, 111 FERC ¶ 63,048 (2005). Exceptions to the initial decision are pending.

Subsequently, the Connecticut Department of Public Utility Control (D.C. Cir. No. 05-1297) and Connecticut Municipal Electric Cooperative, *et al.* (D.C. Cir. No. 05-1308) filed petitions for review of the orders at issue here. The Commission filed motions to dismiss on October 17, 2005 (No. 05-1297) and on November 9, 2005 (No. 05-1308). The motions are pending.

SUMMARY OF ARGUMENT

The Commission's rejection of stringent *Mobile-Sierra* "public interest" restrictions on its review of filings to permit withdrawals from RTO New England was lawful and well-supported. While formation of an RTO is voluntary, agreements to form or exit an RTO are filed with the Commission pursuant to FPA § 205 and are subject to the Commission's review under the FPA § 205 "just and reasonable" standard. Here, the Commission found that the proposal to restrict the Commission's review of any future transmission owner withdrawal from the RTO to a public interest standard was unjust and unreasonable. Given the potentially

broad public impact of a withdrawal, FERC's determination was well-supported and reasonable.

The Commission's acceptance of a 50 basis point incentive adder to return on equity for regional service was reasonable and consistent with Commission policy and precedent. The adder provided incentive to the transmission owners to surrender control over their transmission facilities beyond that previously surrendered to ISO New England, and the resulting RTO would provide additional benefits to electric energy consumers. The adder, moreover, was small and the total return on equity would still fall within the zone of reasonableness.

In contrast, as the Commission explained, there was no basis for a 50 basis point adder for local service. The adder is intended to encourage transfer of control of regional transmission service facilities, and the local service charges generally cover the costs of facilities that do not provide such service. Moreover, the transmission owners have retained significant control over local service.

ARGUMENT

I. Standard of Review.

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See e.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). The relevant inquiry for a court under that standard is whether the agency has “examine[d] the relevant data and articulate[d] a rational connection between the facts found and the choice made.” *Motor Vehicle Manufacturer’s Ass’n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 26, 43 (1983). The level of a court’s “surveillance of the rationality of agency decisionmaking, however, depends upon the nature of the task assigned to the agency.” *Nat’l Cable Television Ass’n v. Copyright Royalty Tribunal*, 724 F.2d 176, 181 (D.C. Cir. 1983). “Because [i]ssues of rate design are fairly technical, and, insofar as they are not technical, involve policy judgments that lie at the core of the regulatory mission, our review of whether a particular rate design is just and reasonable is highly deferential.” *Northern States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) (internal quotation marks and citations omitted).

II. The Commission Properly Determined That A Just And Reasonable Standard Would Apply To Its Review Of Any FPA § 205 Filing Pertaining To A Transmission Owner’s Withdrawal From RTO New England.

Transmission Owners argue (Br. at 19-24) that the Commission, in modifying the termination provision (Section 10.01) of the Operating Agreement, *see* JA 196, as part of its overall approval of the creation of RTO New England, stripped them of their statutory filing rights under FPA § 205, 16 U.S.C. § 824d.

The Commission did no such thing. Rather, the Commission acted to ensure that, once it receives a public utility filing, it retains full review rights under FPA § 205. The Transmission Owners' proposal, to limit the Commission's review authority only to the high "public interest" standard, rather than the statutory "just and reasonable" standard, if unchecked, would have undermined the Commission's exercise of its own statutory obligation to protect New England customers.

Transmission Owners argue (Br. at 19) that the Commission's decision is inconsistent with the Court's *Atlantic City* decision. In *Atlantic City*, the Court examined the statutory text of FPA § 205, which gives to the public utility "the right to file rates and terms for services rendered with its assets." 295 F.3d at 9; *see also id.* at 10 ("the power to initiate rate changes rests with the utility"). For this reason, the Commission cannot eliminate or encumber the statutory filing rights of public utilities such as the Transmission Owners. Upon receipt of a public utility filing, however, the Commission is not obliged to accept the proposal, no matter how voluntarily it is made. Rather, the Commission is "obliged to assure that the rates and charges demanded or received by any public utility in connection with the interstate transmission or sale of electric energy are just and reasonable, and that no public utility's rates will unduly discriminate against any consumers." *Id.* at 4 (citing 16 U.S.C. §§ 824d(a)-(b)).

Specifically, as to a public utility's withdrawal from an ISO (or RTO), the Court determined in *Atlantic City* that the Commission cannot insist upon its approval under the "public interest" standard of FPA § 203, 16 U.S.C. 824b. 295 F.3d at 11-13. The Court explicitly stated, however, that the Commission can insist upon its approval under its "just and reasonable" review authority under FPA § 205 prior to withdrawal from an ISO (or RTO):

This does not mean that FERC is prohibited from reviewing entry to or exit from an ISO. The petitioners are not disputing FERC's authority to review their agreements at the outset and to decide, based on the evidence in the record, whether the entrance and exit rights specified therein are just and reasonable within the meaning of section 205. Nor do petitioners contest FERC's authority to review a specific withdrawal under section 205.

Id. at 12. Here, all the Commission was doing was exercising the statutory authority recognized in *Atlantic City*, by reviewing the proposed "agreements at the outset" and deciding whether the proposed "entrance and exit rights . . . are just and reasonable within the meaning of section 205."

After *Atlantic City*, the Commission issued guidance to utilities seeking to form or withdraw from an ISO or RTO. *See* RTO Withdrawal Policy at P 1 ("In light of the recent court decision in [*Atlantic City*], a number of entities have informally sought Commission clarification with respect to whether public utilities that seek to join" an RTO or ISO, "or to exit an RTO or ISO," must first file with the Commission). The Commission clarified that, consistent with *Atlantic City*,

“arrangements to join or exit an RTO or ISO will be reviewed in the context of filings made under Section 205 of the FPA.” *Id.* at P 2. Moreover, in reviewing such filings, the Commission will consider “whether, at the outset of an RTO or ISO, member entrance and exit rights are just, reasonable and not unduly discriminatory as well as whether a specific proposed withdrawal of a participant is consistent with the FPA” and the requirements of Order No. 2000. *Id.* at P 3.

Here, in reviewing the proposed termination provision, limiting the Commission’s review of future filings to withdraw from the RTO, the Commission acted entirely in accord with relevant authority on the subject. *See* Approval Order at P 59 and n. 41 (noting filing’s inconsistency with RTO Withdrawal Policy and order approving settlement on remand from *Atlantic City*), JA 412. The Transmission Owners do not dispute that RTO formation (or RTO withdrawal) requires filings pursuant to FPA § 205, but contend that the Commission may not modify a section in the proposed Operating Agreement intended to establish *Mobile-Sierra* public interest review of RTO withdrawals, unless its review in the first instance also satisfies *Mobile-Sierra*. The Transmission Owners sought *Mobile-Sierra* protection for numerous other provisions of the Operating Agreement as well. Approval Order at PP 129-131, JA 433.

The Commission gave thoughtful consideration to the *Mobile-Sierra* requests, recognizing that the Transmission Owners had surrendered substantial authority in the Operating Agreement:

We begin our analysis with the recognition that the [Operating Agreement] sets forth the terms and conditions pursuant to which the Transmission Owners participating in [RTO New England] will voluntarily transfer the operational authority over their transmission facilities to [RTO New England]. Under these circumstances, we generally think it reasonable, subject to the conditions discussed below, that the Filing Parties be permitted in return for their commitment to rely on the terms of their agreement with the contractual protection afforded by the *Mobile-Sierra* public interest standard of review.

Approval Order at P 127, JA 432. Accordingly, the Commission approved *Mobile-Sierra* inclusion in seventeen sections of the Operating Agreement, addressing a wide array of rights and responsibilities. *Id.* at P 129, JA 433. “These provisions generally address the division of responsibility as between [RTO New England] and the Transmission Owners . . . , or interests that affect, predominantly, the contracting parties alone.” *Id.* at P 130, JA 433.

On the other hand, the Commission also recognized that some terms of the Operating Agreement may also affect the rights of non-parties to the Agreement. Under those circumstances, these other interests had to be considered and protected as well:

Our review of the [Operating Agreement], however, should not and cannot be limited to a consideration of the rights and interests of the contracting parties alone where the [Operating Agreement], by its

terms, may also affect the rights and interests of [RTO New England's] customers, other non-party market participants, or the performance and operation of the market as a whole. Under these circumstances (and as the Filing Parties themselves acknowledge), we are required to balance the needs of the Transmission Owners for contractual certainty with the interests properly represented by an RTO.

Approval Order at P 128, JA 432. The Commission disagreed with the transmission owners' argument that it "is precluded from reviewing, in any substantive way, a request for *Mobile-Sierra* protection at the time that the underlying agreement at issue (in this case, the [Operating Agreement]) is initially filed for acceptance under Section 205." Rehearing Order at P 72, JA 664. Rather, "where the interests of third-party market participants, or the effects on the market as a whole, are significant, we cannot find that a two-party agreement that would have the effect of limiting our ability to protect these broader interests is just and reasonable." *Id.* at P 73, JA 665.

With regard specifically to withdrawal rights, the Commission noted that "a transmission owner's withdrawal can have a substantial impact on the other market participants and the markets themselves." *Id.* at P 41, JA 654. This conclusion was reasonable given that the purpose of RTO formation is to eliminate opportunities for undue discrimination, thereby encouraging new entrants, more efficient plant operations, and more sophisticated forms of transacting. *See infra* page 29 (discussing benefits of RTOs). The Commission struck the proper balance

by recognizing the Transmission Owners' rights to file to withdraw from the RTO, but insisting upon "meaningful review" under the FPA § 205 "just and reasonable" standard of any withdrawal filings to ensure that the interests of the public are protected. *See* Approval Order at P 59, JA 412; Rehearing Order at P 40, JA 653; *see also* Approval Order at P 47, JA 408 (argument of intervenors that the proposed withdrawal provision could undermine the independence of the RTO and allow one group of market participants – transmission owners – "too much leverage over the day-to-day operations" of the RTO).

The Transmission Owners contend (Br. at 26) that the Commission's ruling is inconsistent with *Mobile-Sierra* because the public interest standard applies even to initial Commission reviews of proposals to limit future changes to a contract. However, they cite no similar decision of this Court addressing the issue of *Mobile-Sierra* limits on initial Commission review of a contract. *See Potomac Electric Power Co. v. FERC*, 210 F.3d 403, 409 & n. 2 (D.C. Cir. 2000) (noting that the Court "has not had occasion to address, and need not do so here, whether FERC has authority to apply a *Mobile-Sierra* standard," or apply a "more flexible standard, "when reviewing a contract for the first time").⁸

⁸ In *Potomac Electric*, the Court recognized that the Commission, on occasion, has stated that it is not bound by the "practically insurmountable" public interest standard, and may apply a more flexible standard, in "first review cases," when acting to protect non-parties to the agreement. 210 F.3d at 408-09 (citing *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686, 692 (1st Cir. 1995)).

Rather, the Court has confined its analysis of the *Mobile-Sierra* public interest standard to pre-existing, Commission-approved contracts. *See, e.g., Atlantic City*, 295 F.3d at 11-13. This limitation on application of the *Mobile-Sierra* public interest standard, to pre-existing contracts rather than those submitted to the Commission in the first instance for approval, makes sense in light of the Court's repeated emphasis on the "importance of contractual stability" in its *Mobile-Sierra* cases. *Potomac Electric*, 210 F.3d at 409 (citing cases). There is no expectation of contract stability when a contract is submitted for the first time and has not yet been approved by the Commission and has not yet gone into effect. This is especially true of complex agreements, like the Operating Agreement, filed with the Commission under FPA § 205 to establish brand new regional structures with an impact on all market participants, not just those making the filing.⁹

Here, the Commission has had no previous opportunity to consider the lawfulness or effectiveness of the Operating Agreement. As the Commission explained, "although participation is voluntary, a transmission owner's withdrawal can have a substantial impact on other market participants and the markets

⁹ Indeed, in the original *Mobile* and *Sierra* cases, *see, e.g.*, 350 U.S. at 352, the utilities sought a rate increase, without the customer's consent, from a fixed-rate contract already on file with the Commission. In other words, the seller was seeking relief from contractual terms which the Commission had already reviewed and accepted, and which affected only the parties to the contract.

themselves.” Rehearing Order at P 41, JA 654. For example, the Commission anticipates that formation of RTOs will encourage new generation and other entrants into the market. Having made business decisions in reliance upon a transmission grid controlled by an independent entity, entrants should be able to rely upon meaningful Commission review of changes in control of the grid. The Commission’s finding, upon initial review, that the parties to the Operating Agreement may bind themselves to a *Mobile-Sierra* standard (as they requested) for any future transmission owner withdrawal, but that they may not so limit the Commission, is a reasonable accommodation of the Commission’s responsibility to protect the public and the utilities’ right to arrange their affairs by contract. *See id.* at P 73, JA 665.

The Transmission Owners also contend (Br. at 28-31) that the Commission failed to present a reasoned basis for rejecting the termination provision because it did not analyze all of the requirements that a transmission owner would have to meet before withdrawing from the RTO. In the first place, their comparatively extensive discussion of Operating Agreement § 10.01 was absent from the Transmission Owners’ rehearing request, which stated simply that “[b]efore a transmission owner may terminate its participation under the [Operating Agreement], it must develop and file alternative arrangements for the operation of the transmission and/or markets with the Commission under FPA Section 205.”

Rehearing Request at p. 46, JA 556. To the extent that the rehearing request failed to raise with specificity the objections now presented, the Court lacks jurisdiction to consider them. FPA § 313(b), 16 U.S.C. § 825l(b). In any case, the Transmission Owners' rehearing request stated that they "take no position at this time as to whether the 'just and reasonable' standard is the appropriate standard of review for evaluating replacement arrangements" Rehearing Request at p. 44, JA 554. As the Transmission Owners could take the position in the future that replacement arrangements are subject to a public interest test, these later filings would not necessarily improve the Commission's ability to protect the public.

The Transmission Owners also argue (Br. at 30) that since RTO participation is voluntary, Order No. 2000 is not relevant to withdrawal, so that the Commission erred in stating that a just and reasonable review "was necessary in order to determine whether all of the elements contained in the filed arrangements meet the principles of Order No. 2000."¹⁰ Petitioners overstate their case. The Commission agrees that RTO participation is voluntary, *see* Rehearing Order at P 41, JA 654. However, withdrawal from RTO New England could result in "instances where revisions to [RTO New England's] operating agreements may be necessary or appropriate as a result," *see* Approval Order at P 59 (JA 412). In

¹⁰ The cited language appears in the Approval Order at P 59, JA 412.

those instances, consistent with the Commission's RTO Withdrawal Policy, the revisions must be submitted for the Commission's FPA § 205 review and to determine their consistency with Order No. 2000. Approval Order at P 59, JA 412. Consequently, although participation in an RTO is voluntary, "the policies enunciated in Order No. 2000 would be relevant and must be considered." *Id.*

Additionally, RTO status, once approved, confers certain benefits on the Transmission Owners, such as the 50 basis point adder and additional pricing flexibility under Order No. 2003.¹¹ Since the Transmission Owners have received these benefits, it would be unreasonable to permit them to dissolve their participation without the Commission first considering the impact of such withdrawal on the criteria set forth in Order No. 2000.

III. The Commission Properly Determined That A 50 Basis Point Incentive Adder For RTO Participation Is Just And Reasonable.

A. It Is Undisputed That RTOs Provide Significant Public Benefits.

The New England transmission owners made their filing under FPA § 205 for approval of New England RTO as consistent with the requirements of Order No. 2000. In approving the formation of the RTO, the Commission agreed that the

¹¹ See *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, FERC Stats. & Regs., Regs. Preambles [July 24, 2003] ¶ 31,146 at P 26 (2003).

proposal, as modified in certain respects, satisfied all the requirements of Order No. 2000. Approval Order at P 3, JA 393.

In Order No. 2000, the Commission explained how formation of RTOs, beyond simple ISO development, would further benefit energy users by enhancing competition in electric generation and fostering transmission system improvements. In brief, the availability of open access transmission after Order No. 888 resulted in an increase in the total volume of trade in the wholesale electricity market and more intensive (and different) uses of the transmission grid. *Snohomish County*, 272 F.3d at 610-11.¹² New stresses on regional transmission systems resulted. *Id.*¹³ After investigation, the Commission, finding existing market institutions inadequate to deal with these new stresses, concluded that more sophisticated regional solutions were necessary. *Id.*

More particularly, Order No. 2000 found two overarching impediments to a competitive wholesale electric market that RTO formation would remedy: (1) the engineering and economic inefficiencies inherent in the current operation and expansion of the transmission grid; and (2) continuing opportunities for transmission owners to unduly discriminate in the operation of their transmission

¹² See also, e.g., Order No. 2000 at 30,997-99; Regional Transmission Organizations, Notice of Proposed Rulemaking, FERC Stats and Regs., Prop. Regs. ¶ 32,541 at 33,689-92 (1999) (“Order No. 2000 Proposed Rule”).

¹³ See also, e.g., Order No. 2000 at 30,997-98; Order No. 2000 Proposed Rule at 33,685 and 33,689-92.

systems so as to favor their own or their affiliates' power marketing activities. *Snohomish County*, 272 F.3d at 610.¹⁴ The engineering and economic inefficiencies included, *inter alia*, difficulties in planning and investing in new transmission facilities. Order No. 2000 at 31,014. Moreover, market participants complained that companies that own both transmission and generation facilities under-invest in transmission because new transmission encourages competition that often decreases the value of their generation assets. *See, e.g., Midwest Independent Transmission System*, 102 FERC ¶ 61,143 at P 14 (2003). Regarding discrimination, the Commission concluded that “opportunities for undue discrimination continue to exist that may not be remedied adequately by functional unbundling [through open access transmission tariffs].” Order No. 2000 at 31,015. The Commission found, moreover, that even “perceptions of discrimination are significant impediments to competitive markets.” *Id.* at 31,017.

RTOs “can reduce opportunities for unduly discriminatory conduct by cleanly separating the control of transmission from power market participants.” Order No. 2000 at 31,024. Transmission owners will be unable to discriminate against other energy market participants because the terms governing market access are controlled by an independent entity that is also responsible for the day-to-day operations of the market.

¹⁴ *See also* Order No. 2000 at 31,003.

By eliminating mistrust of grid management, “entry by new generation into the market will become more likely as new entrants will perceive the market as more fair and attractive for investment.” *Id.* at 31,025. Moreover, more players in the market will allow “for more sophisticated forms of transacting and better matching of buyers and sellers.” *Id.* In addition, the “evidence is clear that market incentives can lead to highly efficient [generating] plant operations.” *Id.* In fact, among the many commenters on the Order No. 2000 rulemaking, “no one seriously dispute[d] the benefits of a marketplace where service quality and availability are uniform, where users of the network are treated equally, and where commercially important data are readily available.” *Id.* at 31,024.

The Commission’s Pricing Policy, which announced a return on equity adder to stimulate RTO formation (*see supra* page 6), reiterated the benefits accruing from RTO formation: “Because they are independent of market participants, RTOs . . . make competitive wholesale electric markets more efficient, fair, trustworthy, and cost-effective.” Pricing Policy at P 1. Transmission facilities can be operated more reliably and efficiently when coordinated over large geographic areas, and RTOs would also “help eliminate the opportunity for unduly discriminatory practices by transmission providers, reduce the need for overly intrusive regulatory oversight, and instill trust among competitors that all are playing by the same rules.” Pricing Policy at P 3.

Order No. 2000 had also explained that transmission pricing reforms might be needed to facilitate RTO formation, and had identified innovative rate treatments that entities joining RTOs could request. *Id.* at P 4. FERC had approved incentive rates for RTO participation and additional levels of independence on a case-by-case basis. *Id.* at P 6. Despite the advantages to the wholesale markets and FERC's offer to consider incentives on a case-by-case basis, however, only two RTOs had become fully operational before the Pricing Policy issued. *Id.* at P 5. The Pricing Policy provided regulatory certainty with regard to incentives, *id.* at P 20, which FERC expected would encourage RTO formation:

While significant benefits from competition are expected to result from RTOs . . . , these benefits will be shared among end-use customers and generators, among others. To assure that transmission owners receive benefits from RTO formation, we believe that it is reasonable to allow an adjustment to be applied to the rates of transmission owners participating in an RTO.

Id. at P 21. The participation adder also encourages transmission owners to stay in RTOs, because recovery of the adder is contingent upon continued participation in the RTO. *Id.* at P 28.

To encourage timely RTO participation, a deadline of December 31, 2004 to qualify for the incentives was proposed. *Id.* at P 28. FERC stated further that:

We believe that these incentives will encourage RTO participation and independent ownership in a timely fashion and that customers will benefit from an independent and regional approach to the provision of

electric transmission service. The additional incentives proposed for new investment in transmission facilities, in combination with RTO system expansion planning, should encourage long-overdue investment in new transmission, increase the number of generators who can compete in the market place, improve efficiency and reliability, and ultimately lower the costs paid by customers for electricity.

Pricing Policy at P 37.

B. The Commission Reasonably Inferred That RTO New England Will Provide Significant Public Benefits to New England.

The orders challenged here found, among their many findings, that a 50 basis point participation adder was warranted for RTO New England because (like other RTOs) “of the region-wide benefits that will be set in place by the establishment of [RTO New England].” Approval Order at P 245, JA 468. A primary underpinning of this finding is RTO New England’s independence. ISO New England lacked the independence (and the ensuring benefits) that the transmission owners conceded to RTO New England.

Under the preexisting ISO New England arrangement, the ISO was essentially the hired contractor that operated the unified transmission system pursuant to NEPOOL’s instructions. NEPOOL’s participants, transmission owners in particular, not ISO New England, had the primary authority to “establish and revise the rates, terms and conditions governing the operation of the New England wholesale electricity market.” Approval Order at P 52, JA 409; Request for Approval of RTO New England at 17, JA 52. New or changed market rules were

generally developed through NEPOOL committees. *New England Power Pool*, 79 FERC at 62,579. Under these arrangements, “control over changes to the NEPOOL [transmission tariff] [was] largely given to NEPOOL participants. . . .” Protest and Motion of the New England Conference of Public Utilities at 3 (filed Dec. 8, 2003), JA 235 (“New England Conference Protest”).

The 2001 Declaratory Order (*see supra* at 7) found that these arrangements did not satisfy the Order No. 2000 requirements because NEPOOL’s control over ISO New England was inconsistent with the objectives of Order No. 2000:

In order for ISO-NE to be truly independent of market participants, it must have the sole authority to make changes to Market Rules and any other changes it deems necessary without being required to seek approval from NEPOOL. Under a restructured RTO environment, market participant committees such as NEPOOL should serve a purely advisory role.

2001 Declaratory Order, 96 FERC at 61,259; *see also id.* at 61,275-76.

In contrast, RTO New England, unlike ISO New England, has sole authority to submit filings to establish and revise “the terms and conditions of the [New England open access transmission tariff], any separate tariffs relating to regional transmission service, all market rules, and its own administrative tariff.” Approval Order at P 73, JA 416. Moreover, although the transmission owners have retained

FPA § 205 filing rights,¹⁵ they have agreed to include with their filings a written statement provided by RTO New England whenever RTO New England concludes that a transmission owner filing would be inconsistent with the regional New England market design or would otherwise be harmful to the market. Approval Order at P 62, JA 413; *see also* Request for Approval of RTO New England at 7-8, JA 42-43. The transmission owner filing would not become effective until approved by the Commission. Approval Order at P 62, JA 413. In addition, pursuant to emergency filing procedures, RTO New England may make certain FPA § 205 filings to address issues such as efficiency, competitiveness, and reliability of the New England markets. *Id.* at P 64, JA 413.

The independence of RTO New England is also enhanced by the five-year term with automatic renewal of the Operating Agreement. ISO New England previously provided day-to-day operation of the transmission facilities under a series of interim contracts, and the uncertainties in this arrangement had a negative

¹⁵ The transmission owners, acting individually, have the authority to submit FPA § 205 filings to establish and revise: their own revenue requirements; the rates, terms, and conditions for each owner's local transmission service; the rates or charges for recovery of investment in new transmission facilities; and the terms and conditions applicable to interconnection agreements. Acting jointly, the transmission owners have the authority to submit § 205 filings to establish and revise the rates and charges for transmission service under the RTO New England open access transmission tariff and the rates, terms, and conditions relating to incentive or performance-based rates. Approval Order at P 60, JA 412.

impact on ISO New England's independence. Request for Approval of RTO New England at 16, JA 51; *see also* Approval Order at P 47, JA 408 (intervenors contended that Operating Agreement provisions giving transmission owners the unilateral right to withdraw give the transmission owners too much leverage over the day-to-day operations of RTO New England); New England Conference Protest at 5-6, JA 237-38 (same).

The Commission reasonably inferred that New England will receive the same benefits from RTO independence as would other regions. For the first time, an independent entity will control the open access transmission tariff and other terms governing the market. Transmission owners will be unable to discriminate against other energy market participants, and the public should benefit from the new players, new generation, more sophisticated transactions, efficiency improvements in older generation, and more light-handed regulation that a more competitive market will bring.

The formation of an independent RTO New England should also improve transmission planning and encourage investment in new transmission facilities. Order No. 2000 at 31,024; Pricing Policy at P 37. RTO New England has a broader regional planning function than did ISO New England. *See* Approval Order at P 194, JA 451; Request for Approval of RTO New England at 10, JA 45. RTO New England has authority to: (1) determine whether a particular

transmission project should be built; (2) assess regional needs; (3) identify alternative solutions to problems where a market solution is not forthcoming; and (4) coordinate planning activities on an inter-regional basis. Approval Order at P 211, JA 456. Thus, although transmission owners had certain obligations to build under the ISO arrangement as they do now under RTO New England, decisions regarding the need for construction are now made by an independent entity. *Id.* at PP 195, 214, JA 451-52, 457.

For their part, the State Commissions argue (Br. at 21-22) that FERC has improperly rewarded the transmission owners for past actions. As demonstrated above, however, the transmission owners have, in fact, surrendered significant control over their transmission facilities in replacing the ISO with an RTO. Moreover, recovery of the adder is contingent upon continued participation in RTO New England. Pricing Policy at P 28. Thus, the adder rewards the transmission owners for their future participation, as well as for their initial surrender of control over their facilities.

The cases the State Commissions cite (Br. at 23-24), moreover, do not support a different result. For example, they cite *Consumers Union of United States, Inc. v. FERC*, 510 F.2d 656, 660 (D.C. Cir. 1975), for the proposition that it is not possible to incent conduct that has already occurred. However, as demonstrated above, the conduct here had not already occurred, and *Consumer*

Union simply affirms the Commission’s authority to rely, as it did here, on non-cost ratemaking factors. Similarly, Petitioners cite *Allegheny System Operating Companies, et al.*, 111 FERC ¶ 61,308 (2005), for the proposition that an incentive adder was not awarded because PJM’s transmission owners became PJM members many years ago. That case, however, was discussing the 50 basis point adder in the context of recovery of the costs of reliability expansions, not, as here, a filing directed at RTO formation.¹⁶

C. The Commission Properly Exercised Its Broad Ratemaking Authority In Determining That The Adder Would Result In Just And Reasonable Rates.

The Commission is not required to adopt as just and reasonable any particular rate level or methodology; “rather, courts are without authority to set aside any rate selected by the Commission which is within a ‘zone of reasonableness.’” *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (citing *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942)). Rate orders fall within a “zone of reasonableness” when rates are neither “less than compensatory” nor “excessive.” *Farmers Union Central Exch. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984). Moreover, the Commission “may, within this zone,

¹⁶ *New England Power Pool*, 97 FERC ¶ 61,093 (2001), also cited, stands only for the general proposition that incentives are not awarded for past actions.

employ price . . . to achieve relevant regulatory purposes” *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 317 (1974).

The 50 basis point incentive adder results in a rate within the zone of reasonableness. Approval Order at P 246, JA 468; Rehearing Order at P 207, JA 706. The Commission calculates a return on equity by selecting a proxy group of public companies, establishing the array of returns on equity experienced by these companies, and extracting a single return on equity as representative. *See Public Service Comm’n of Kentucky v. FERC*, 397 F.3d 1004, 1007 (D.C. Cir. 2005). The return on equity adders will result in reasonable rates because they are capped by the returns on equity in the array developed for the particular RTO:

The [return on equity-based] incentives would be subject to a cap on the overall [return on equity], including incentive adders, equal to the top of the range of reasonable [returns on equity] for a proxy group consisting of the investor-owned transmission owners participating in the relevant RTO whose shares are publicly traded.

Pricing Policy at P 37. The Pricing Policy noted that in the Midwest ISO case, for example, the resulting ROE would be reasonable even if the RTO received all of the possible adders to ROE:

We note that the sum of these incentives, totaling 300 basis points, would have resulted in an overall ROE within the zone of reasonableness established for the Midwest ISO Transmission Owners in Docket No. ER02-485-000.

Id.

The State Commissions' argument (Br. at 31-33) that the Commission has set a "meaningless standard" is simply wrong and the cases they cite are unpersuasive. In *City of San Antonio v. ICC*, 631 F.2d 831, 853 (D.C. Cir. 1980), the Interstate Commerce Commission set the rates at seven percent above fully allocated costs, which already included a 10.6 percent rate of return on capital. Unlike the instant case, the rationale provided by the ICC included no cap and, as the Court found, could justify any additive. *See also System Fuels, Inc. v. ICC*, 642 F.2d 112, 116 (5th Cir. 1981) (same, except rate exceeded fully allocated costs by only 3.7 percent).¹⁷

The adder here not only results in a return on equity that is reasonable, but also encourages the formation of an RTO with resulting improved markets and supplies of energy. A primary purpose of the statutes governing Commission authority is to assure adequate service at reasonable rates. *Public Utilities Comm'n of California v. FERC*, 367 F.3d 925, 929 (D.C. Cir. 2004) (quoting *NAACP v. FPC*, 425 U.S. 662, 669-70 (1976)) ("the principal purpose of those Acts was to encourage the orderly development of plentiful supplies of electricity and natural gas at reasonable prices"). To carry out this purpose, the Commission may

¹⁷ Another case cited by the State Commissions, *Schurz Communications, Inc. v. FCC*, 982 F.2d 1043, 1050 (7th Cir. 1992), is not a rate case. It stands for the unremarkable proposition that there must be a rational connection between the facts found and the choice made.

consider non-cost factors as well as cost factors in setting rates. *Permian Basin Area Rate Cases*, 390 U.S. at 791, 815; *Public Utilities Comm'n of California*, 367 F.3d at 929 (affirming 200 basis point incentive adder to encourage facilities construction). The assessment of how to balance cost and non-cost factors must be justified by a showing that “the goals and purposes of the statute will be accomplished through the proposed changes.” *Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18, 31 (D.C. Cir. 2002) (citation omitted).

The 50 basis point participation adder here was reasonably calibrated to encourage RTO formation. No party seriously questions the potential benefits of RTOs generally. The Commission, moreover, did extensive computer modeling which estimated a subset of the potential cost savings from RTOs to be at least \$2.4 billion annually. Order No. 2000 at 31,025-28. By the January 2003 issuance of the Pricing Policy, however, only two RTOs had been fully approved. The Commission reasonably determined that a clear policy of ensuring that a portion of the RTO cost savings goes to transmission owners would encourage the timely formation of additional RTOs with the resulting public benefits. Pricing Policy at P 21-23.

The State Commissions nevertheless argue (Br. at 25-26, 32-33) that the Commission failed to provide a “reasoned explanation” for a non-cost ROE adder, “including a demonstration that the specific level of the approved adder has been

‘calibrated’ to the resulting customer benefit.” This argument expects too much. “The full value of the benefits of RTOs to improve market performance cannot be known with precision before their development, and we do not yet have a sufficiently long track record with existing institutions with which to measure.” Order No. 2000 at 31,025. The Commission has explained how “the goals and purposes of the statute will be accomplished through the proposed changes,” *see Interstate Natural Gas Ass’n of America v. FERC*, 285 F.3d at 31, and that is sufficient. *Cf. Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1371 (D.C. Cir. 2004) (“the cost causation principle does not require exacting precision in a ratemaking agency’s allocation decisions”).

D. Application Of The Adder Is Consistent With Commission Precedent.

The State Commissions contend (Br. at 26-29) that the cases cited in the Approval Order in support of the adder are “inapposite.” Their analysis of the cases is unpersuasive, however. For example, with regard to *Midwest Independent Transmission System*, 100 FERC ¶ 61,292 (2002), the State Commissions state that the case was remanded by this Court¹⁸ and contend (Br. at 27) that on remand, FERC “chose not to defend its ruling . . . and MISO transmission owners received no adder” This misconstrues FERC’s actions. The Court remanded FERC’s

¹⁸ *Public Service Comm’n of Kentucky v. FERC*, 397 F.3d at 1012.

award of a 50 basis point adder on lack of notice due process grounds, and on remand the Commission declined to defend the appropriateness of the notice, but invited the MISO transmission owners to make a § 205 filing requesting the adder.

In *PJM Interconnection, LLC*, 104 FERC ¶ 61,124 at P 74 (July 25, 2003), the Commission stated that it had accepted a 50 basis point participation adder in the Midwest case, that the adder was based on a policy justification for rewarding RTO participation, and a similar adjustment would be allowed for PJM. The Approval Order, which issued a few months later, properly relied upon this statement of Commission policy. The State Commission reference to *Allegheny Power System Operating Cos.*, 111 FERC ¶ 61,308 (2005), is inapposite. That order was about recovery of costs for reliability expansion, not RTO. In fact, FERC had approved formation of the PJM RTO three years earlier. See *PJM Interconnection, LLC*, 101 FERC ¶ 61,345 (December 20, 2002). Even so, *Allegheny* referred the adder issue for consideration at an evidentiary hearing. 111 FERC ¶ 61,308 at P. 54.

The State Commissions' complaint (Br. at 28-29) that FERC's reference to its "RTO formation policies" is insufficient ignores the discussion of incentives in both Order No. 2000 and the Pricing Policy. Their criticism, moreover, of the Pricing Policy as not providing "independent support" for the actions taken here is

inapposite given that the Pricing Policy does, in fact, lay out the Commission's reasoning in providing RTO participation adders.

IV. The Commission Properly Determined That Adders Are Not Warranted For Local Service That Is Not Under Control Of An RTO.

The long-standing practice in New England has been to distinguish between regional rates and services and local rates and services. *See* Approval Order at P 12, n.11, JA 396; *see also, e.g., New England Power Pool*, 83 FERC ¶ 61,045 at 61,232 (1998).¹⁹ Under ISO New England, the NEPOOL open access transmission tariff governed regional service, and local service was provided under individual transmission owner tariffs. *See* Approval Order at P 12, n.11, JA 396-97.

The challenged orders approving RTO New England rejected a 50 basis point adder for the local service. Approval Order at P 247, JA 469; Rehearing Order at P 201, JA 703. “The adder was intended as an incentive for transmission owners to turn over the operational control of their transmission facilities to an entity responsible for providing regional transmission service under the terms and conditions of a regional tariff. The Local Service charges generally recover the

¹⁹ *Accord Groton v. FERC*, 587 F.2d 1296, 1300 (D.C. Cir. 1978) (distinguishing between those transmission lines “necessary for power from significant sources to move unobstructed over the New England network” and those “lines that serve only local loads and are unnecessary for the flow of power over the regional grid”); *NEPOOL Power Pool Agreement*, 48 FPC 538, 540 (1972) (same); and *New England Power Pool Agreement*, 56 FPC 1562, 1583 (1976) (same).

costs of facilities that do not provide regional service, *e.g.*, lower voltage lines and radial lines.” Approval Order at P 247, JA 469; Rehearing Order at P 201, JA 703. Moreover, rates for local service may include the cost of facilities upgrades that are higher because of local environmental decisions in the siting process. Local customers, rather than regional customers, would receive the primary benefit of these higher costs. Approval Order at P 247, JA 469.

The Commission also found that RTO New England has less control over facilities that are used to provide local service than it has over regional service facilities. Approval Order at P 248, JA 469. For example, regional service facilities are subject to one tariff and one set of terms and conditions. In contrast, local service facilities are subject to the separate tariffs and terms and conditions of service for each transmission owner. *Id.* Moreover, individual transmission owners have reserved the right to file for changes in terms and conditions for local service, while RTO New England has the right to make such changes for regional service. *Id.*

In addition, local service facilities are not under the day-to-day operational authority of an independent entity. Rehearing Order at P 202, JA 704. Rather, the transmission owners remain responsible for the day-to-day operation of the local service facilities. *Id.* at n.103, JA 704.

For their part, the Transmission Owners contend (Br. at 35) that the Commission has failed to explain how differences in voltage and other operational factors between local service and regional service facilities justify the difference in rate treatment. This focus on operational factors is beside the point. The adder is intended to be an incentive for the transmission owners to turn over operational control of their facilities to an independent operator for regional service, and the facilities at issue perform local, not regional, service. Rehearing Order at PP 201-02, JA 703-04. Moreover, as discussed above, the transmission owners, rather than RTO New England, are still responsible for the day-to-day operation of local service facilities.

The Transmission Owners also contend (Br. at 35-36) that the Commission drew no such distinction between regional and local service in the cases approving RTOs in other regions. However, as demonstrated above, New England is unique in its long history of splitting transmission into local and regional functions. The Commission's treatment of the facilities at issue here is entirely reasonable, given these circumstances.

The Transmission Owners' contention (Br. at 37), that their reservation of filing rights for local rates simply recognizes their *Atlantic City* filing rights, misses the point. The Commission's objective in offering the 50 basis point adder is to encourage formation of RTOs, and the perpetuation of separate tariffs and

terms of service for each transmission owner for local service is antithetical to this objective. Moreover, as discussed above, the transmission owners, not RTO New England, continue to control these facilities.

The Transmission Owners' citation (Br. at 37-38) of FERC orders for the proposition that the integrated transmission grid benefits all customers overstates the case. Whether a facility provides a primarily local function depends upon the particular facts. *See, e.g., Florida Mun. Power Agency v. FERC*, 315 F.3d 362, 364 (D.C. Cir. 2003) (fact that a facility is connected to a transmission system does not demonstrate that the facility benefits the transmission system). Here, the distinction between local and regional facilities is decades-old. The transmission owners have maintained that distinction by retaining control over the terms and conditions of local service, rather than relinquish that control to the RTO.

CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

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CERTIFICATE OF COMPLIANCE

In accordance with Circuit Rule 28(d)(1), I hereby certify that this brief contains 10,547 words, not including the tables of contents and authorities, the certificate of counsel, this certificate, and the addendum.

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