

ORAL ARGUMENT IS SCHEDULED FOR MARCH 15, 2005

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

No. 04-1111

**MICHIGAN PUBLIC POWER AGENCY, et al.,
PETITIONERS,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

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

**BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY
COMMISSION**

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**NOVEMBER 24, 2004
FINAL BRIEF: JANUARY 14, 2005**

CIRCUIT RULE 28(a)(1) CERTIFICATE

Pursuant to Circuit Rule 28(a)(1), Respondent Federal Energy Regulatory Commission hereby certifies as follows:

A. Parties and Amici

All parties and intervenors appearing before the Commission and this Court are listed in Petitioner's brief. There are no *amici*.

B. Rulings Under Review

The following orders of the Federal Energy Regulatory Commission are under review here:

1. *Michigan Electric Transmission Company, LLC*, 104 FERC ¶ 61,236 (2003), R. 20, J.A. 10; and
2. *Michigan Electric Transmission Company, LLC*, 106 FERC ¶ 61,064 (2004), R. 27, J.A. 14.

C. Related Cases

Two recent decisions of this Court address issues similar to those raised in the instant appeal: (1) *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004) ("*Midwest ISO I*") (concerning the allocation of costs among customers taking service over the Midwest ISO system); and (2) *Midwest Independent Transmission System Operator, Inc. v. FERC*, No. 03-1238 (D.C. Cir.

Nov. 12, 2004) (“*Midwest ISO II*”) (concerning the calculation and recovery of FERC annual charges).

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November 24, 2004
Final Brief: January 14, 2005

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GLOSSARY

Commission or FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
Grandfathered agreements	Existing agreements that predate operation of the Midwest ISO
Initial Order	<i>Michigan Electric Transmission Company, LLC</i> , 104 FERC ¶ 61,236 (2003), R. 20, J.A. 10
ISO	Independent System Operator
J.A.	joint appendix page
METC	Michigan Electric Transmission Company, LLC
Michigan Agencies	Petitioners Michigan Public Power Agency and Michigan South Central Power Agency
Midwest ISO	Midwest Independent Transmission System Operator, Inc.
<i>Midwest ISO I</i>	<i>Midwest ISO Transmission Owners v. FERC</i> , 373 F.3d 1361 (D.C. Cir. 2004)
<i>Midwest ISO II</i>	<i>Midwest Independent Transmission System Operator, Inc. v. FERC</i> , No. 03-1238 (D.C. Cir. Nov. 12, 2004)
Operating Agreements	Transmission Ownership and Operating Agreements between METC (and its predecessor, Consumers Power Company) and the Michigan Agencies
R.	record page

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Michigan Electric Transmission Company, LLC,
106 FERC ¶ 61,064 (2004), R. 27, J.A. 14

RTO

Regional Transmission Organization

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

No. 04-1111

**MICHIGAN PUBLIC POWER AGENCY and
MICHIGAN SOUTH CENTRAL POWER AGENCY,
Petitioners,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.**

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

**BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission (“Commission” or “FERC”) reasonably permitted an electric utility to recover from municipal customers certain costs – including FERC-imposed annual charges – related to service to those customers.

STATUTES AND REGULATIONS

Pertinent sections of the Federal Power Act (“FPA”) and the Commission’s

implementing regulations are set out in the Addendum to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

This case concerns the allocation of costs incurred by Michigan Electric Transmission Company, LLC (“METC”). METC serves a group of municipal customers under agreements that are at least 20 years old. METC filed with the Commission proposed amendments to those agreements, to allow for the recovery of a proportionate share of costs it pays to the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO” or “ISO”) based on the amount of service the municipal customers take over the Midwest ISO transmission system.

The challenged orders approved the proposed amendments over the objections METC’s municipal customers. *See Michigan Electric Transmission Company, LLC*, 104 FERC ¶ 61,236 (2003), R. 20, J.A. ___, *order denying rehearing*, 106 FERC ¶ 61,064 (2004), R. 27, J.A. ___. In relevant part, the Commission rejected the argument that METC should not be allowed to recover the municipal customers’ share of FERC annual charges incurred by the Midwest ISO and flowed through to METC. The Commission found that annual charges are no different than other costs incurred by METC in providing service and that METC should be able to recover those costs from customers who are responsible for the incurrence of those costs. In making this finding, the Commission rejected

arguments that METC should not be permitted to recover those costs from municipal customers that: (1) are exempt from direct FERC jurisdiction; and (2) hold ownership interests in some of the transmission facilities over which they receive service.

II. STATEMENT OF FACTS

This case involves two familiar concepts. The first concerns the allocation of costs among customers taking service over the Midwest ISO system, which the Court recently addressed in *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004) (“*Midwest ISO I*”). The second concerns the calculation and recovery of FERC annual charges, which the Court recently addressed (again, in the context of the Midwest ISO) in *Midwest Independent Transmission System Operator, Inc. v. FERC*, No. 03-1238 (D.C. Cir. Nov. 12, 2004) (“*Midwest ISO II*”).

A. Operation of the Midwest ISO and Allocation of its Costs

The Midwest ISO is a non-profit corporation that “link[s] up the transmission lines of the member transmission-owning utilities . . . into a single interconnected grid stretching across the northern border of the U.S. from Michigan to eastern Montana, and reaching as far south as Kansas City, Missouri and Louisville, Kentucky.” *Midwest ISO I*, 373 F.3d at 1365. Individual transmission owners (like METC) physically operate and maintain their

transmission facilities, subject to the instructions and functional control of the ISO. *Id.* The ISO also administers an open access transmission tariff, under which all customers “pay a single rate to use the entire MISO transmission system, based on the volume of power the customer carried on the system.” *Id.*

In *Midwest ISO I*, the Court affirmed the Commission’s decision to allow the recovery of the ISO’s administrative costs from all ISO users. In particular, the Court affirmed the Commission’s judgment that all users of the integrated, multi-state transmission grid benefit from the ISO’s functional operation and control of the grid. *Id.* at 1368-72. The Court agreed that it is reasonable for each customer-beneficiary of ISO operation to pay some portion of the ISO’s administrative costs – even bundled retail customers that are not subject to the Commission’s direct regulation and customers under “grandfathered agreements” that predate operation of the ISO.

B. Calculation and Recovery of FERC Annual Charges

“Obligated by statute to recoup its costs from industries it regulates, the [Commission] funds its electricity-related programs through annual charges to public utilities based on the volume of electricity they transmit.” *Midwest ISO II*, slip op. at 2. The Commission’s regulations specify the precise calculation of annual charges. *See* 18 C.F.R. § 382.201 (recovery of the Commission’s “costs of administration of [its] electric regulatory program” in annual charges based on the

amount of transmission service provided in the preceding year by each public utility).

The Commission adopted the most recent version of its annual charges regulation in 2000. *See Revision of Annual Charges Assessed to Public Utilities*, Order No. 641, FERC Stats. & Regs. ¶ 31,109 (2000), *order on reh'g*, Order No. 641-A, 94 FERC ¶ 61,290 (2001). In that rulemaking, the Commission explained that, based on changes in the industries it regulates and in its regulatory priorities, it would no longer assess annual charges on the basis of both transmission volumes and wholesale power sales. *See Midwest ISO II*, slip op. at 3-6 (explaining historic and current calculation of annual charges). Despite those changes, the Commission continued to exempt municipal utility systems and other governmental and cooperative entities, *see* 16 U.S.C. § 824(f), from the direct obligation to pay annual charges. *See* Order No. 641, FERC Stats. & Regs. at 31,845.

Several years later, the Commission denied a petition for rulemaking filed by the Midwest ISO and others which sought to compel the Commission to return to the methodology existing prior to 2000 – i.e., to again base annual charges on both transmission service and power sales. *See Midwest Independent Transmission System Operator, Inc.*, 103 FERC ¶ 61,048 (2003), *reh'g denied*, 104 FERC ¶ 61,060 (2003). The Commission determined that it would continue to recover its

electric regulatory program costs from those entities – transmission providers – that, it believes, are primarily responsible for the Commission’s current and future electric workload. The Court affirmed those orders in *Midwest ISO II*.

In sticking with its methodology for calculating annual charges – i.e., based solely on volumes of transmission service – the Commission determined that it would continue to recover annual charges directly only from jurisdictional public utilities. It clarified, however, that annual charges differ little from other transmission-related costs incurred by public utilities, all of which can be recovered in their rates, even from their customers that are not FERC-jurisdictional. Regional transmission organizations (RTOs) such as the Midwest ISO, like other jurisdictional public utilities, enjoy flexibility in how they collect annual charges from their ratepayers. 103 FERC ¶ 61,048 at P15 & n.25; 104 FERC ¶ 61,060 at P19 & n.35.

C. METC’s Relationship With the Midwest ISO and Its Municipal Customers

METC owns and operates electric transmission facilities located in the lower peninsula of Michigan. As a member of the Midwest ISO, METC provides transmission service under the rates, terms and conditions of the Midwest ISO open access transmission tariff to transmission customers located within the METC pricing zone.

Petitioners Michigan Public Power Agency and Michigan South Central

Power Agency (collectively, “Michigan Agencies”) are municipal power agencies, organized under the laws of the state of Michigan, that purchase transmission service for their members located within the METC pricing zone. For over two decades – i.e., long before the organization and operation of the Midwest ISO – METC (and its predecessor, Consumers Power Company) have served the Michigan Agencies under three Transmission Ownership and Operating Agreements (“Operating Agreements”). The Operating Agreements are, because of their vintage, “grandfathered agreements” that are not subject to the rates, terms and conditions of the Midwest ISO open access transmission tariff.

Under the Operating Agreements, the Michigan Agencies hold a joint ownership interest in some of the METC transmission lines and a right to use the entire METC transmission system. The Operating Agreements define the rates, terms and conditions applicable to the Michigan Agencies’ use of the METC system, which is now part of the Midwest ISO system, to serve the load of their member municipal customers.

D. METC’s Amendment of the Operating Agreements to Allow for the Recovery of Annual Charges

On June 30, 2003, METC filed proposed amendments to the Operating Agreements. In relevant part, the proposed amendments added a new or revised Article 20 (“RTO Charges”), to allow for the recovery of a share of the annual charges assessed to the Midwest ISO and passed through to METC:

If the Capacity Entitlement of [the particular Michigan Agency] served hereunder is treated under the [Midwest ISO] Open Access Transmission Tariff . . . as [Agency] load served by the METC system such that the MISO imposes charges on METC in connection with such entitlement, [the Agency] shall reimburse METC for the full amount of its share of any charges paid by METC for [various MISO charges, including] annual charges assessed to public utilities pursuant to 18 C.F.R. § 382.201 imposed on METC in connection with the [Agency] Capacity Entitlement.

R. 10 at Exhibits A, C, D, J.A. __. In other words, METC proposed to recover from the Michigan Agencies a proportionate share of FERC annual charges based on the amount of capacity the Agencies transfer over the Midwest ISO system.

In support, METC explained that the Commission, under its regulations, *see supra* pages 4-5, now assesses annual charges to the Midwest ISO based on its proportionate share of all FERC-jurisdictional transmission. The Midwest ISO, in turn, passes through to METC its share of the ISO's annual charges based on METC's capacity entitlements on the Midwest ISO system. METC proposed to pass a proportionate share of its annual charges through to the Michigan Agencies, based on their capacity transferred over the Midwest ISO system within the METC pricing zone. R. 10 at 3-6, J.A. __. METC argued that the proposed recovery of annual charges from the Michigan Agencies is not only equitable, but also entirely consistent with cost causation and recovery principles. R. 10 at 6, J.A. __; R. 16 at 6-10, J.A. __.

E. Commission Orders Approving the Proposed Amendments to the Operating Agreements, Allowing Annual Charges Recovery

On August 29, 2003, the Commission approved the proposed amendments to the Operating Agreements, thereby allowing the recovery of a portion of METC's share of Midwest ISO-assessed annual charges from the Michigan Agencies. *Michigan Electric Transmission Co., LLC*, 104 FERC ¶ 61,236 (2003), R. 20, J.A. ___ (“Initial Order”).¹

The Commission explained that METC is entitled to recover all the costs of providing service over its transmission system, including its share of annual charges attributable to service to the Michigan Agencies. *Id.* at ¶¶ 14-16, J.A. ___. The Commission recognized that the Michigan Agencies are not FERC-jurisdictional public utilities and thus may not be directly assessed for FERC annual charges. Nevertheless, as explained in earlier Commission orders (including those affirmed in *Midwest ISO II*), there is no jurisdictional bar to flowing through to non-jurisdictional customers their legitimate share of the costs of providing service to them, including annual charges, as “a matter of the public utility’s ratemaking.” *Id.* at ¶ 17, J.A. ___.

Moreover, the Commission recognized that the Michigan Agencies are joint owners of certain METC transmission facilities and not simply transmission

¹ The approved amendments also permitted the recovery of various cost recovery adders assessed to METC by the Midwest ISO, which the Michigan Agencies did not challenge. In addition, the Commission accepted similar cost-recovery amendments to METC Operating Agreements with Wolverine Power Supply Cooperative, Inc.

customers. Whether the Michigan Agencies are treated as “customers or co-owners of the METC system” is, however, of no significance. *Id.* at ¶ 18, J.A. ___. What is significant is that they indisputably are responsible for “capacity entitlement being transmitted by the Midwest ISO over the Midwest ISO transmission system . . . within the METC pricing zone.” *Id.* As the Commission concluded, “METC is merely recovering those costs [including annual charges] it is being allocated by the Midwest ISO in connection with the transmission capacity entitlements” of the Michigan Agencies. *Id.*

The Michigan Agencies filed for rehearing, *see* R. 22, J.A. ___, which the Commission denied in an order issued January 28, 2004. *Michigan Electric Transmission Co., LLC*, 106 FERC ¶ 61,064 (2004), R. 27, J.A. ___ (“Rehearing Order”). The Commission again found that METC, like any public utility, is entitled to recover all the costs – including annual charges – associated with its provision of transmission service under the Operating Agreements. *Id.* at ¶¶ 7-8, J.A. ___. Moreover, the Commission again found that the Michigan Agencies’ status as transmission-owning, exempt (municipal) entities did not negate METC’s ability to charge them rates that reflect annual charges in direct proportion to their entitlement to service over the Midwest ISO system. *Id.* at ¶ 18, J.A. ___ (citing Order No. 641 and subsequent orders affirmed in *Midwest ISO II*).

SUMMARY OF ARGUMENT

The Commission reasonably permitted METC to recover from the Michigan Agencies annual charges assessed initially to the Midwest ISO, and in turn passed through to METC, in proportion to the Michigan Agencies' entitlement under the Operating Agreements. The Commission's decision follows a basic ratemaking principle, that cost recovery follows cost causation. As the Michigan Agencies are responsible for a portion of the annual charges assessed to the Midwest ISO and passed along to METC, their payment to METC under the Operating Agreements should reflect that responsibility.

The fact that the Michigan Agencies are municipal entities does not relieve them of their cost responsibility. The Commission explained that it imposes annual charges only on FERC-jurisdictional public utilities (such as the Midwest ISO and METC). How those utilities seek to recover their costs from non-jurisdictional customers (such as the Michigan Agencies) is a matter of ratemaking policy, not statutory construction. Similarly, the fact that the Michigan Agencies have joint ownership and use rights under the Operating Agreements is not determinative. What does matter is the fact that their exercise of those rights imposes costs on the Midwest ISO and METC that properly are recoverable from them.

ARGUMENT

I. STANDARD OF REVIEW

Judicial review of Commission ratemaking decisions falls under the arbitrary and capricious standard of 5 U.S.C. § 706(2)(A). The relevant inquiry for the reviewing 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. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). Moreover, the Commission's factual findings, if supported by substantial evidence, are conclusive. FPA § 313(b), 16 U.S.C. § 825l(b); *see, e.g., Consolidated Hydro, Inc. v. FERC*, 968 F.2d 1258, 1261 (D.C. Cir. 1992).

Where the orders under review involves ratemaking **B**"and thus an agency decision involving complex industry analyses and difficult policy choices **B**the court will be particularly deferential to the Commission's expertise." *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996); *see also, e.g., Entergy Services, Inc. v. FERC*, 319 F.3d 536, 541 (D.C. Cir. 2003) (explaining same "highly deferential" standard for issues of rate design); *Northern States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) (same). The Court in *Midwest ISO I* applied this same deferential standard in approving the challenged

allocation of Midwest ISO administrative costs to both customers that are not FERC-jurisdictional (bundled retail load) and customers under “grandfathered agreements” that predate operation of the Midwest ISO. *Midwest ISO I*, 373 F.3d at 1368.

Similarly, here, the Commission’s approval of METC’s allocation of Midwest ISO costs (including FERC annual charges) to the Michigan Agencies, that take service from METC under grandfathered agreements and that themselves are not subject to direct FERC regulation, fully “comports with reasoned decisionmaking.” *Id.*

II. THE COMMISSION REASONABLY APPROVED THE ALLOCATION OF COSTS TO METC CUSTOMERS THAT ARE RESPONSIBLE FOR THOSE COSTS

The Commission followed a basic cost causation principle in approving METC’s cost allocation proposal. The Commission agreed with METC that the Michigan Agencies are entitled to capacity over the Midwest ISO system and are thus responsible for a portion of the FERC annual charges assessed to the Midwest ISO and passed through to METC. Accordingly, METC is entitled to pass through to the Michigan Agencies that share of the annual charges.

Cost allocation follows cost responsibility. This basic principle “requires that all approved rates reflect to some degree the costs actually caused by the customer who must pay them.” *KN Energy, Inc. v. FERC*, 968 F.2d 1295, 1300

(D.C. Cir. 1992). As explained in *Midwest ISO I*, compliance with this “unremarkable principle” is determined by “comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party.” 373 F.3d at 1368-69. The cost causation principle does not require exacting precision. *Id.* at 1371 (as all users of the transmission grid operated by the Midwest ISO benefit from that operation, all should bear a portion of the ISO’s administrative costs, even those that do not directly take service under the ISO tariff); *see also Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002) (“FERC is not bound to reject any rate mechanism that tracks the cost-causation principle less than perfectly”).

As explained above, *see supra* page 5, assignment of FERC annual charges is based on the amount of jurisdictional transmission capacity transfer in the preceding year. The Michigan Agency’s entitlement to capacity on the Midwest ISO transmission system, in METC’s pricing zone, is reflected in the calculation of annual charges that are assessed to the ISO and passed along to METC. The Commission explained how the Michigan Agencies’ capacity demand is converted to a share of METC’s assigned portion of FERC annual charges as follows:

METC reports the Michigan Agencies capacity entitlements to the Midwest ISO as megawatts. The Midwest ISO then converts those megawatts to megawatt hours and includes those megawatts hours in assessing annual charges to METC.

Initial Order at ¶ 18 n. 9, J.A. __.

In other words, the amount of FERC annual fees that the Midwest ISO charges METC is based, in part, on the Michigan Agencies' entitlement to capacity delivered over the Midwest ISO transmission system within the METC pricing zone. *Id.* at ¶ 18, J.A. ___. As the Commission explained, "METC is merely recovering those costs it is being allocated by the Midwest ISO in connection with the [Michigan Agencies'] transmission capacity entitlements." *Id.*; *see also* Rehearing Order at ¶ 8, J.A. ___ (noting that "if the Midwest ISO imposes its RTO charges on METC in connection with the capacity entitlements shown under the Operating Agreements, the charges are rightly passed through to the involved parties consistent with the agreements"). If the Commission did not permit the proposed amendment to the Operating Agreements, those costs "could not be recovered otherwise." Initial Order at ¶ 2, J.A. ___; Rehearing Order at ¶ 1, J.A. ___.

The link between cost recovery and cost responsibility is demonstrated in the specific language of the approved amendment to the Operating Agreements. *See supra* page 8 (quoting relevant language of new or revised Article 20). The Michigan Agencies are responsible only for their "share of any charges paid by METC" for annual charges or other Midwest ISO costs actually "imposed on METC in connection with the [Michigan Agencies'] Capacity Entitlement." R. 10 at Exhibits A, C, D, J.A. ___. The Michigan Agencies are thus on the hook for FERC annual charges recovery only to the extent "MISO imposes charges on

METC in connection with” the Agencies’ entitlement to transmission capacity that is served over the Midwest ISO system. *Id.* In short, the cost responsibility of the Michigan Agencies is directly proportional to the demand they place on the Midwest ISO system. *See* Rehearing Order at ¶ 16, J.A. ___ (charges recovered under amended Operating Agreements “reflect the cost of providing service over the METC transmission system”).

Annual charges do not differ from other costs, incurred initially by the Midwest ISO and then passed through to METC, that are entitled to cost recovery from METC’s customers. *See* Initial Order at ¶ 17, J.A. ___ (explaining that “[j]ust as a public utility recovers its other transmission-related costs in its rates, so a public utility’s annual charges may be recovered in rates”). Indeed, the Michigan Agencies did not object to the amendment of their Operating Agreements to allow for the recovery of other cost recovery adders assessed to METC under the Midwest ISO’s open access transmission tariff (including the Schedule 10 cost adder upheld in *Midwest ISO I*). *See* Initial Order at ¶¶ 10, 15 J.A. ___.

Moreover, in approving the pass-through of costs (here, FERC annual charges) to those entities responsible for those charges, the Commission acted entirely in accord with other Midwest ISO cost allocation orders. Specifically, as referenced in the challenged orders, *see id.* at ¶¶ 4-5, J.A. ___, the Commission approved a similar amendment to an Operating Agreement with one of the

Michigan Agencies to allow for the reimbursement of ISO cost recovery adders. *See Michigan Electric Transmission Co., LLC*, 103 FERC ¶ 61,195 (2003), R. 6, J.A. __ (also directing METC to provide language in Article 20 specifically identifying categories of costs for recovery). *See also Louisville Gas and Electric Co.*, 101 FERC ¶ 61,182 (2002) (approving similar pass-through of Midwest ISO costs under grandfathered agreements). The Commission thus followed, in approving the proposed amendments, both general ratemaking principles and specific Commission ratemaking treatment of Midwest ISO costs.

III. MICHIGAN AGENCIES' STATUS AS MUNICIPAL, TRANSMISSION-OWNING ENTITIES DOES NOT JUSTIFY DEPARTURE FROM COST CAUSATION PRINCIPLES

The Michigan Agencies submit that their circumstances warrant a departure from general cost causation principles and from the Commission's specific and consistent allocation of Midwest ISO costs. They assert that they should not be responsible for any portion of the FERC annual charges incurred by METC because: (1) they are exempt, as municipal entities, from direct Commission regulation (Brief at 14-17, 20-22); and (2) they have an ownership interest in certain METC transmission facilities (Brief at 17-20, 23-26). As the Commission explained, however, neither factor overrides the basic rate principle that costs attributable to service for the Michigan Agencies should be paid by them.

A. METC is Entitled to Recover the Costs Related to the Demands of Both Jurisdictional and Non-Jurisdictional Customers

The Michigan Agencies (Brief at 22) present their objection to paying their share of Midwest ISO-assessed annual charges as based on “express statutory law,” rather than on Commission policy. There is, however, no issue of statutory law; all parties recognize that the Michigan Agencies, as municipal entities, are exempt from direct Commission jurisdiction under FPA section 201(f), 16 U.S.C. § 824(f), as well as from the direct assessment of annual charges under the Commission’s regulations, *see* 18 C.F.R. § 382.201. Rather, the only issue presented is indeed one of policy, specifically Commission ratemaking policy. There is no statutory bar to reflecting in the rates charged to exempt or non-jurisdictional entities their share of the costs of serving them. As the Commission explained, Michigan Agencies’ claim “reflects a fundamental misunderstanding of our annual charges regulations” which “assess annual charges to public utilities, which are jurisdictional. How the cost is recovered is a matter of the public utility’s ratemaking.” Initial Order at ¶ 17, J.A. ___ (citations omitted).

In responding to the Michigan Agencies’ statutory objections, the Commission recognized correctly that it had “previously addressed this issue,” in Order No. 641 and in the follow up orders affirmed by this Court in *Midwest ISO II*. Rehearing Order at ¶ 18, J.A. ___. In Order No. 641, the Commission explicitly refrained from assessing FERC annual charges directly to entities – municipal and

rural electric cooperative systems – that are not public utilities subject to direct Commission regulation. *See* FERC Stats. & Regs. ¶ 31,109 at 31,845. In the same rulemaking, however, the Commission further indicated that, as a matter of ratemaking policy, these same entities may be subject to rates that reflect their share of the annual charges assessed to their transmission provider. *Id.* at 31,845 nn. 32, 34.

Similarly, in the later orders upheld in *Midwest ISO II*, the Commission confirmed that municipal and other non-jurisdictional entities may be responsible for rates reflecting annual charges assessed to jurisdictional entities:

How the [annual charge] cost is recovered is a matter of the public utility's ratemaking. Just as a public utility recovers its other transmission-related costs in its rates, so a public utility's annual charges may be recovered in its rates. That the entity paying these rates may not itself be jurisdictional does not mean it should not have to pay these rates.

Midwest Independent Transmission System Operator, Inc., 103 FERC at 61,180 n.25; *see also Midwest Independent Transmission System Operator, Inc.*, 104 FERC at 61,120 n.35 (annual charges are assessed directly only to public utilities, which in turn may seek to recover such charges in their rates for service to jurisdictional and non-jurisdictional customers).

Indeed, in *Midwest ISO I*, the Court affirmed the Midwest ISO's assignment of its administrative costs among both jurisdictional and non-jurisdictional (there, bundled retail) customers. *See* 373 F.3d at 1369-72. The Commission's decision

here to allow for the rate recovery of METC's share of FERC annual charges – another category of costs – is no less reasonable simply because certain of METC's customers are otherwise exempt, non-jurisdictional municipal entities. *See Intermountain Municipal Gas Agency v. FERC*, 326 F.3d 1281, 1286 (D.C. Cir. 2003) (fact that Commission's direct regulation "may affect" non-jurisdictional municipal systems "does not defeat the agency's jurisdiction").

B. The Michigan Agencies' Joint Ownership of Facilities Does Not Relieve Them of Cost Responsibility

The Michigan Agencies also argue (Brief at 23-25) that the Commission failed to confront their status as transmission owners under the Operating Agreements. In fact, the Commission did understand that the Michigan Agencies have certain ownership and use rights over the METC system. *See* Initial Order at ¶¶ 3, 10, J.A. ___. The Commission simply found this fact was not determinative of the ratemaking question: "[W]hether Michigan Agencies are considered customers or co-owners of the METC transmission system, the Commission's annual charges may be allocated to them by METC for service provided by METC." *Id.* at ¶ 18, J.A. ___. What does matter, for ratemaking purposes, is that METC is incurring costs (a share of the annual charges assessed to the Midwest ISO and passed along to METC) that are based on the Michigan Agencies' entitlement to capacity on the Midwest ISO system under the Operating Agreements. *Id.*

The Michigan Agencies respond (Brief at 15) that they receive no

transmission service at all from METC under the Operating Agreements. They claim (Brief at 18, 22) that they are obligated as transmission owners to pay only their “own costs” in using METC’s transmission capacity to move their own power to their members. The Michigan Agencies are not, however, responsive to the cost causation principle applied by the Commission (and upheld in *Midwest ISO I*). Their rights and obligations under the Operating Agreements, however they are characterized, operate to affect the megawatt hours of service reported by the Midwest ISO and used to calculate its share of FERC annual charges, which in turn is passed along to METC. Initial Order at ¶ 18 & n.9, J.A. ___.

In any event, the Commission found that, in fact, METC does provide transmission service to the Michigan Agencies under the Operating Agreements. *Id.* at ¶¶ 2, 16, J.A. ___. Specifically, the Commission found that under the proposed amendment (Article 20) “the capacity entitlements of the Michigan Agencies” may be “treated under the Midwest ISO [open access transmission tariff] as load served by the METC system.” *Id.* at ¶ 16, J.A. ___. In that case, charges imposed by the Midwest ISO on METC “in connection with such entitlements . . . may be passed through to the involved parties.” *Id.* Moreover, in response to an argument of another party, the Commission examined other sections of the Operating Agreements and found that they contemplate use of the entire METC system to transmit energy, even though ownership interests are confined to

designated portions of the system. Rehearing Order at ¶¶ 7-8, J.A. ___ (finding that the terms of the Operating Agreements contemplate the provision of transmission service over the entire METC system). The Michigan Agencies acknowledge in their brief (at 15) that their use rights under the Operating Agreements confer “use rights to the system at large,” not just over the specific facilities it co-owns.

In these circumstances, the Commission was amply justified in concluding that the Michigan Agencies’ ownership interest does not relieve them from responsibility for paying for their share of FERC annual charges directly attributable to their rights under the Operating Agreements. *See Midwest ISO I*, 373 F.3d at 1369-72 (affirming the Commission’s judgment that the costs of administering the ISO grid can be recovered from customers, like the Michigan Agencies, that take service under pre-ISO grandfathered agreements, like the Operating Agreements, rather than directly under the ISO open access transmission tariff).

CONCLUSION

For the foregoing reasons stated, the challenged orders should be upheld as reasonable in all respects.

Respectfully submitted,

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November 24, 2004