

ORAL ARGUMENT IS SCHEDULED FOR APRIL 16, 2004

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

Nos. 02-1121, *et al.*

**MIDWEST ISO TRANSMISSION OWNERS, *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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**FOR RESPONDENT
FED. ENERGY REGULATORY COMM'N
WASHINGTON, D.C. 20426**

DECEMBER 10, 2003

FINAL BRIEF: JANUARY 21, 2004

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

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 Petitioners' brief. There are no *amici*.

B. Rulings Under Review

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

1. *Midwest Independent Transmission System Operator, Inc., et al.*, Opinion No. 453, 97 FERC ¶ 61,033 (2001) (*Midwest ISO I*), J.A. 1;
2. *Midwest Independent Transmission System Operator, Inc., et al.*, Opinion No. 453-A, 98 FERC ¶ 61,141 (2002) (*Midwest ISO II*), J.A. 15;
3. *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,192 (2003) (*Midwest ISO III*), J.A. 24; and
4. *Midwest Independent Transmission System Operator*, 104 FERC ¶ 61,012 (2003) (*Midwest ISO IV*), J.A. 32.

C. Related Cases

On December 6, 2002, the Court granted the Commission's motion for voluntary remand of the first two of the petitions for review (Nos. 02-1121 and 02-1122) in this proceeding. The Commission agrees with Petitioners (Cert. at 8) that another pending case – *Midwest ISO Transmission Owners, et al. v. FERC*, D.C. Cir. No. 03-1163 – raises similar issues.

Robert H. Solomon
Deputy Solicitor

January 21, 2004

GLOSSARY

ALJ	Administrative Law Judge
<i>ALJ Decision</i>	<i>Midwest Independent Transmission System Operator, Inc., et al.</i> , 89 FERC ¶ 63,008 (1999), J.A. 674
Commission or FERC	Federal Energy Regulatory Commission
Cost Adder	Proposed adder in Schedule 10 of the Midwest ISO Tariff, to recover costs of administering and operating the Midwest ISO
FPA	Federal Power Act
ISO	Independent System Operator
J.A.	joint appendix page
LG&E/KU	Louisville Gas & Electric Company and Kentucky Utilities Company
Midwest ISO	Midwest Independent Transmission System Operator, Inc.
<i>Midwest ISO I</i>	<i>Midwest Independent Transmission System Operator, Inc., et al.</i> , Opinion No. 453, 97 FERC ¶ 61,033 (2001), J.A. 1
<i>Midwest ISO II</i>	<i>Midwest Independent Transmission System Operator, Inc., et al.</i> , Opinion No. 453-A, 98 FERC ¶ 61,141 (2002), J.A. 15
<i>Midwest ISO III</i>	<i>Midwest Independent Transmission System Operator, Inc.</i> , 102 FERC ¶ 61,192 (2003), J.A. 24
<i>Midwest ISO IV</i>	<i>Midwest Independent Transmission System Operator</i> , 104 FERC ¶ 61,012 (2003), J.A. 32
Midwest ISO Tariff	Open access transmission tariff administered by the Midwest ISO

MWh	megawatt/hour
RTO	Regional Transmission Organization
Transmission owners or TOs	Owners of the transmission facilities operated by the Midwest ISO

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STATEMENT OF THE ISSUES

1. Whether this Court has jurisdiction to review the challenged cost allocation orders, when Petitioners have failed to show that they have sustained any definitive injury as a result of the orders, or that any injury cannot be remedied through various cost recovery mechanisms, identified in the orders, that Petitioners have not yet exercised.

2. Assuming jurisdiction, whether the Federal Energy Regulatory Commission (“Commission”), in affirming the initial decision of its administrative

law judge after hearing, reasonably allocated the costs of administering the regional transmission grid in the Midwest among all users that benefit from the regional administration of the grid.

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.

COUNTER-STATEMENT OF JURISDICTION

Contrary to the argument of Petitioners (*see* Pet. Br. 1-2), this Court lacks jurisdiction to consider their appeal. Petitioners fail to allege a concrete and non-speculative injury resulting from the Commission’s cost allocation decision. Moreover, Petitioners’ appeal is not ripe for immediate review, as judicial review would benefit from Petitioners first exercising various cost recovery mechanisms identified in the challenged orders.

STATEMENT OF THE CASE

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

This case concerns one particular rate design issue – the allocation of costs incurred by the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”) in operating a regional transmission grid in the Midwest. As part of their initial filing to create the Midwest ISO, the owners of the transmission facilities operated by the Midwest ISO (“transmission owners” or “TOs”) proposed

to develop a cost adder by allocating all the ISO's operating expenses to the two smallest classes of customers. The Commission found that the proposed cost adder had not been shown to be just and reasonable and, accordingly, set the matter for hearing. *See Midwest Independent Transmission System Operator, Inc., et al.*, 84 FERC ¶ 61,231 (1998), J.A. 159.

After hearing, in five subsequent orders, the administrative law judge ("ALJ") and the Commission consistently found that the transmission owners' proposed allocation of the ISO's administrative costs was not just and reasonable to the extent it did not spread costs among all customers that benefit from the Midwest ISO's operation of the regional grid. *See Midwest Independent Transmission System Operator, Inc., et al.*, 89 FERC ¶ 63,008 (1999) (ALJ), J.A. 674; 97 FERC ¶ 61,033 (2001) (Opinion No. 453), J.A. 1; 98 FERC ¶ 61,141 (2002) (Opinion No. 453-A), J.A. 15; 102 FERC ¶ 61,192 (2003) (order on voluntary remand), J.A. 24; 104 FERC ¶ 61,012 (2003) (order on rehearing), J.A. 32. Specifically, the proposed cost adder failed to allocate any of the ISO's administrative costs to bundled retail and grandfathered wholesale loads, even though they, like other load served by the ISO, benefit from the ISO's operational, reliability, and planning responsibilities.

In response to objections, the Commission explained that its cost allocation decision is consistent with its initiatives in recent years to promote the reliable, competitive operation of regional transmission grids, and the efforts of market

participants in the Midwest to conform with those initiatives. The Commission also explained that the transmission owners had not demonstrated that they were unable to recoup the allocated costs of serving bundled retail and grandfathered loads through other identified means.

II. STATEMENT OF FACTS

A. Development of Regional Transmission Systems

“Historically, electric utilities were vertically integrated, owning generation, transmission, and distribution facilities and selling these services as a ‘bundled’ package to wholesale and retail customers in a limited geographical service area.” *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607, 610 (D.C. Cir. 2001). In recent years, however, driven by technological advances and legislative initiatives promoting increased entry into wholesale electricity markets, electric utilities increasingly have “unbundled” their service offerings to their customers. This has led to an increasingly competitive market for the sale of electric energy and power. *See New York v. FERC*, 535 U.S. 1, 5-14 (2002) (describing developments).

To foster these developments, so that the benefits of a competitive market are realized by customers, the Commission, in Order No. 888, directed utilities to offer non-discriminatory, open access transmission service.¹ To implement this

¹ *See Promoting Wholesale Competition Through Open Access Non-discriminatory*

directive, the Commission ordered the functional unbundling of wholesale generation and transmission services. 535 U.S. at 11. “Functional unbundling” requires each utility to state separate rates for its wholesale generation, transmission and ancillary services, and to take transmission of its own wholesale sales and purchases under a single general tariff applicable equally to itself and to others. *Id.*

To further the development of competitive markets, the Commission in Order No. 888 encouraged, but did not direct, the development of independent system operators of regional, multi-system grids. *See* FERC Stats. & Regs., Regs. Preambles at 31,730-32. The Commission announced various principles (e.g., ISO independence, control over grid operations, and responsibility for ensuring reliability of grid operations) that would guide its future assessment of ISO proposals.

After several years of experience reviewing initial ISO proposals, such as that presented by the Midwest ISO (*see infra* page 7), the Commission, in Order No. 2000, directed all transmission owning utilities to make filings to either

Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. & Regs., Regs. Preambles ¶ 31,036 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1997), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,048, *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*, *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).

participate in a regional transmission organization (“RTO”) or explain efforts to participate in a RTO.² The Commission explained that “better regional coordination in areas such as maintenance of transmission and generation systems and transmission planning and operation” was necessary to address regional reliability concerns and to foster competition over wider geographic areas. *Public Utility District No. 1 v. FERC*, 272 F.2d at 611 (quoting rulemaking).³

In relevant respect, Order No. 2000 directed the utility members of a Commission-approved ISO (such as the Midwest ISO) to show, by January 16, 2001, that the ISO meets the minimum characteristics and functions of an RTO. Those characteristics and functions (which require the RTO, among other things, to be independent from market participants, to have planning and expansion authority, and to be the only provider of transmission services over the facilities it controls) are codified at 18 C.F.R. §§ 35.34 (j)-(k).

B. Development of the Midwest ISO

² *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs., Regs. Preambles ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000), *dismissed sub nom. Public Utility District No. 1 v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

³ According to the Commission, RTOs would benefit users of the grid by: (1) improving efficiencies in transmission grid management; (2) imposing grid reliability; (3) removing remaining opportunities for discriminatory transmission practices; (4) improving market performance; and (5) facilitating lighter handed regulation. *Public Utility District No. 1 v. FERC*, 272 F.2d at 611 (quoting rulemaking).

In response to industry developments and Order No. 888, on January 15, 1998, several transmission owners in the Midwest applied for approval of: (1) the transfer of operational control of their transmission facilities to the Midwest ISO; and (2) an open access transmission tariff (Midwest ISO Tariff). Under the proposed tariff, all new wholesale and existing unbundled retail transmission services would take service immediately under the tariff rates, terms and conditions. All existing bundled retail loads would not take service under the tariff until they are released under retail access programs in the various states. Furthermore, under the Midwest ISO proposal, all bilateral agreements (grandfathered agreements) for wholesale loads would be placed under the tariff after a six-year transition period.⁴

The Commission conditionally authorized the establishment of the Midwest ISO, finding that the proposal generally satisfied the various principles for ISO formation announced in Order No. 888. *See Midwest Independent Transmission System Operator, Inc., et al.*, 84 FERC ¶ 61,231 (1998), J.A. 159, *order on reconsideration*, 85 FERC ¶ 61,250 (1998), *order on reh'g*, 85 FERC ¶61,372 (1998). In addition, the Commission conditionally accepted for filing the Midwest ISO Tariff, suspended it, and set it for hearing.

⁴ Central features of the six-year transition period were a zonal rate structure (rather than immediate imposition of a single Midwest ISO-wide rate) and preservation of the rates, terms and conditions of existing contracts. *See Midwest ISO IV*, 104 FERC at 61,029, J.A. 33.

In response to Order No. 2000, on January 16, 2001, the Midwest ISO submitted an explanation of how, under its current structure, it satisfied the required characteristics and functions for RTO status. The Commission agreed and thus granted RTO status to the Midwest ISO. *See Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001).⁵ As a result, the Midwest ISO began providing transmission services under its Tariff on February 1, 2002, Pet. Br. 46, thereby becoming the sole administrator of the Tariff, as required under Order No. 2000, with sole authority to receive, evaluate, and approve or deny all requests for transmission service. *See* 97 FERC at 62,511.

C. Proposed Cost Adder

The transmission owners proposed, as part of their 1998 filing to transfer operating control of their facilities to the Midwest ISO, a Cost Adder in Schedule 10 of the Midwest ISO Tariff. As proposed, the Cost Adder would recover the ISO's costs associated with investment and expenses related to running the ISO.⁶ The monthly Cost Adder unit rate would be based on the budgeted expenses to be recovered that month, divided by the amount (MWh) of transmission service

⁵ The ISO submitted its RTO filing before the Commission had addressed the ALJ's post-hearing findings and conclusions on the reasonableness of the provisions of the Midwest ISO Tariff, and the Commission did not address the contested tariff issues in its RTO order.

⁶ Specifically, under Schedule 10 ("Determination of the Monthly Charge"), the ISO costs recovered under the Cost Adder include the ISO's deferred pre-operating costs; the costs associated with building and operating the Security Center, including capital costs; and operating expenses and costs associated with administering the tariff. J.A. 47.

expected to be provided under the Midwest ISO Tariff during the same period, subject to a true-up.

The Cost Adder, although intended to recover the ISO's actual operating costs, was capped at 15 cents/MWh during the six-year transition period. *See supra* page 7 (discussing transition). Costs above the cap are deferred until after the six-year transition period, when they would be recovered, plus financing costs, as an additional adder. The deferred costs will be amortized monthly over five years and recovered from all customers taking service under the Midwest ISO Tariff.

The proposed Cost Adder, as well as other proposed terms and conditions of service under the Midwest ISO Tariff, was suspended and set for hearing. *See* 84 FERC at 62,167 (describing Cost Adder and explicitly setting it for hearing), J.A. 190. The parties subsequently filed testimony and evidence on the reasonableness of the proposed adder. Some supported the adder as proposed, while others urged that the costs should be spread over all classes of customers benefiting from operation of the ISO. *See* Pet. Br. 11-12, 54 (acknowledging different proposals presented at hearing).

D. The Commission's Orders Rejecting the Proposed Cost Adder

In a series of five orders, the ALJ, first, and the Commission, later, agreed that the Cost Adder, as proposed, was not just and reasonable and must be modified to allocate ISO costs among all users of the grid benefiting from the

ISO's operation and administration.

1. *ALJ Decision*. In an Initial Decision issued November 26, 1999, the ALJ, after a hearing and upon review of all testimony and evidence submitted on the subject, concluded that the proposed Cost Adder was unjust and unreasonable for three reasons. See *Midwest Independent Transmission System Operator, Inc., et al.*, 89 FERC ¶ 63,008 (1999) (*ALJ Decision*), J.A. 674. First, the ALJ found that while “[a]ll . . . customers will benefit from Midwest ISO’s operational and planning responsibilities for the Midwest ISO transmission system,” only some customers (taking load under the Midwest ISO Tariff) are responsible for the Cost Adder. *Id.* at 65,045, J.A. 678. The ALJ concluded that “to ensure that retail load will properly bear a fair share of the Midwest ISO’s costs, all long-term firm, bundled retail, and grandfathered load should be included in the divisor in developing the [unit rate for the] Cost Adder.” *Id.*

Second, the ALJ found that the proposed Cost Adder failed to specify precisely what charges will apply after the transition period ends. *Id.* Third, and related, the ALJ found that the proposed Cost Adder failed to specify precisely how deferred costs will be allocated among customers after the transition period. *Id.* To remedy these latter two deficiencies, the ALJ directed the Midwest ISO to make a filing under section 205 of the Federal Power Act (“FPA”), 16 U.S.C. § 824d, prior to the end of the transition period detailing the precise apportionment of costs and providing full cost support for the post-transition Cost Adder. *Id.*

2. *Midwest ISO I*. After reviewing briefs on exceptions to the *ALJ Decision*, the Commission affirmed the ALJ's findings and conclusions on the proposed Cost Adder. See *Midwest Independent Transmission System Operator, Inc., et al.*, Opinion No. 453, 97 FERC ¶ 61,033 (2001) (*Midwest ISO I*), J.A. 1. The Commission agreed that the Cost Adder "must include all existing bundled retail load and any grandfathered wholesale load," because "all users of the grid operated by the Midwest ISO will benefit from the Midwest ISO's operational and planning responsibilities for the Midwest ISO transmission system, as well as increased grid reliability of the transmission system." *Id.* at 61,169, J.A. 6. Accordingly, "to ensure that loads will properly bear a fair share of the Midwest ISO's costs, all long-term firm, bundled retail, and grandfathered load should be included in the divisor in developing the Cost Adder." *Id.*

In making this decision, the Commission recognized that it previously had approved, in 1998, the proposal to exclude bundled retail and grandfathered wholesale loads from service under the Midwest ISO Tariff during the transition period. *Id.* at 61,169-70, J.A. 6-7. The Commission approved limitations on tariff service in the context of reviewing the ISO's satisfaction of the Order No. 888 ISO principles. However, as the Commission explained, after issuance of Order No. 2000 and approval of the Midwest ISO's request for RTO status, Order No. 2000 principles now apply, including the requirement that an RTO must be the only provider of transmission service over the facilities under its control. See 18 C.F.R.

§ 35.34(k)(1)(i). This means that the RTO must provide transmission service for all customers, including bundled retail load and grandfathered load. For this reason, the Commission directed the Midwest ISO to allocate the Cost Adder to all load. *Id.* at 61,170, J.A. 7.

3. *Midwest ISO II*. Transmission owners sought rehearing of *Midwest ISO I*, which, on the topic of the Cost Adder, was denied. *See Midwest Independent Transmission System Operator, Inc., et al.*, Opinion No. 453-A, 98 FERC ¶ 61,141 (2002) (*Midwest ISO II*), J.A. 15.

Contrary to rehearing claims, the Commission was not asserting jurisdiction over bundled retail transmission service by its action.⁷ *Id.* at 61,411, J.A. 19. The rates, terms and conditions of bundled retail agreements and grandfathered agreements throughout the transition period would continue to be honored. *Id.* Customers to those agreements are properly allocated a portion of the Cost Adder, however, because they (like all users of the regional grid) benefit from grid operation and planning “by a single regional entity instead of multiple local entities whose goals may often conflict.” *Id.* at 61,412, J.A. 20. The benefits of regional operation of an integrated grid -- *e.g.*, more efficient siting of transmission

⁷ Whether the Commission could assert jurisdiction over bundled retail transmission service, if necessary to further its regulatory goals under the FPA, was left open by the Supreme Court. *See New York v. FERC*, 535 U.S. at 27 (noting, without deciding, that the Commission’s remedy upon a finding of undue discrimination under FPA § 206, 16 U.S.C. § 824e, “could very well involve FERC’s decision to regulate bundled retail transactions”).

facilities; more effective congestion management; and the ability to accommodate greater power flows -- ultimately enhance the reliability of service to all loads:

Thus, load served from generation located on an individual transmission owner's system (*i.e.*, located on low-voltage transmission facilities that have not been transferred to Midwest ISO) can not be served reliably without the facilities operated by Midwest ISO. If those Midwest ISO-operated facilities were to disappear, service to all loads, including bundled retail loads, would suffer greatly.

Id.

Responding to transmission owner allegations that the Cost Adder could not be flowed through to bundled load, the Commission noted that any "trapping" of costs at the retail level should be taken up with appropriate state commissions. *Id.* at 61,414, J.A. 22. The Commission also noted that the parties to existing, grandfathered contracts should consider renegotiation of their contracts to the extent, if any, necessary to allow for cost recovery. *Id.*

4. *Midwest ISO III*. Transmission owners sought judicial review of the Commission's cost allocation decision. The Commission subsequently moved for voluntary remand, which the Court granted.

In its order on remand, the Commission continued to find that all load (including bundled retail load and grandfathered wholesale agreements) must be included in the calculation of the Cost Adder. *See Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,192 (2003) (*Midwest ISO III*), J.A. 24. The allocation of ISO operating costs to all customers that benefit from

the coordinated operation of the regional grid, the Commission explained, is consistent with the earlier orders in this proceeding, as well as with Order Nos. 888 and 2000. *Id.* at 61,530-31, J.A. 27-28. The nature of the benefits of regional operation of the grid accruing to all customers was further developed based on record testimony. *Id.* at 61,531-32, J.A. 28-29. Based on the record, the Commission continued to find that it was unreasonable for the transmission owners to allocate all costs of administering the regional grid to only some beneficiaries of regional administration:

[T]he record shows that up to 75 percent of the ISO Cost Adder costs was expected to be recovered during the transition period and no mechanism was proposed to recover from bundled retail and grandfathered wholesale loads (the largest loads on the Midwest ISO grid) any of the ISO Cost Adder costs collected during that transition period. In essence, the Midwest TOs agreed among themselves to charge only the two smallest classes – wholesale customers (not parties to grandfathered agreements) and unbundled retail customers – for the bulk of the costs that Midwest ISO incurs to operate a grid that primarily serves bundled retail load.

Id. at 61,532, J.A. 29.

The record was unclear about whether any ISO operating costs allocated to bundled load could be recovered by means other than the proposed Cost Adder. *Id.* at 61,533, J.A. 30. If the transmission owners were unsuccessful in seeking to recover these costs from bundled load in current rates, the Commission left open the possibility that unrecovered costs could be treated as a regulatory asset under its accounting regulations. *Id.* at 61,534 (citing 18 C.F.R. Part 101, Account No.

182.3), J.A. 31.

5. *Midwest ISO IV*. Various transmission owners, joined by the Public Service Commission of the Commonwealth of Kentucky, filed for rehearing of *Midwest ISO III*. Again, the Commission affirmed the decision to allocate the ISO's operating costs to all users that benefit from coordinated operation of the regional grid and, accordingly, denied all requests for rehearing. *See Midwest Independent Transmission System Operator*, 104 FERC ¶ 61,012 (2003) (*Midwest ISO IV*), J.A. 32. Among the reasons for denial: all users of the Midwest ISO grid, including bundled load, benefit significantly from the ISO's operation of the grid; lack of support for the claim that allocated costs are currently unrecoverable; and no demonstration by transmission owners that other means of recovery were futile. *Id.* at 61,030-32, J.A. 34-36.

SUMMARY OF ARGUMENT

This Court lacks jurisdiction to consider Petitioners' appeal. Petitioners' claim of injury is too speculative to constitute an injury-in-fact. As the Commission explained, Petitioners offered no support for their claim that they will be unable to recover all or a portion of the costs of the ISO's administration of the regional grid that are allocated to bundled customers. Moreover, Petitioners' claim of injury, from the Commission's rejection of their proposal to allocate ISO operating costs only to some (but not all) of the customer classes that benefit from the Midwest ISO's operation of the regional grid, fails to take into account possible

reduced costs or increased benefits from ISO operation.

Similarly, Petitioners' appeal is not ripe for immediate review. Petitioners have not taken advantage of cost recovery mechanisms identified by the Commission. Nor have they explained why it would be futile for them to exercise the mechanisms. In any event, the Commission's identification of (untried) alternative cost recovery mechanisms demonstrates that the Commission reasonably confronted and remedied Petitioners' claim of injury.

Turning to the merits, the Commission, in affirming the decision of its ALJ after hearing, reasonably found, based on record evidence, that all users of the transmission grid benefit from the ISO's coordinated operation of the grid. Based on that finding, the Commission reasonably determined that it was unreasonable for Petitioners to propose to allocate the costs of the ISO's operation of the grid only to some of the customers that benefit from that operation. The Midwest ISO provides a critical and centralized role in ensuring the reliable, efficient and non-discriminatory operation of the regional grid; all users of the grid (even bundled users that cannot yet take full advantage of competitive markets) benefit significantly from that role. It is entirely consistent with Commission ratemaking principles, affirmed by the courts, to spread the costs of the ISO's operation of the regional, integrated grid to all users that benefit from that operation.

Similarly, the Commission acted consistently throughout the proceeding under FPA § 205 to investigate and later revise the proposed Cost Adder, and

properly took into account the efforts of the parties during the proceeding to comply with the RTO requirements of Order No. 2000. The Commission's conclusion that the Midwest ISO's operation of a multi-state grid produces benefits for all users of the grid is confirmed by the argument of LG&E/KU that their decision to join the Midwest ISO results in benefits (lower-cost power) to consumers throughout the region.

ARGUMENT

I. PETITIONERS' ALLEGED INJURY, AND THE CLAIMED INADEQUACY OF VARIOUS COST RECOVERY MECHANISMS, ARE TOO SPECULATIVE TO ESTABLISH JURISDICTION

Petitioners fail to articulate any cognizable injury that confers jurisdiction on this Court. If Petitioners are found to have sustained such an injury, a number of cost recovery mechanisms identified by the Commission, if actually tested by Petitioners in the future, likely would eliminate it.

Under FPA § 313(b), 16 U.S.C. § 825l(b), only a party that is "aggrieved" by a Commission order may obtain judicial review. *See, e.g., Public Utility District No. 1*, 272 F.2d at 613. An "aggrieved" petitioner must meet both constitutional and prudential standing requirements. *See, e.g., Louisiana Energy and Power Authority v. FERC*, 141 F.3d 364, 366 (D.C. Cir. 1998). Constitutional standing analysis focuses on three familiar requirements: (1) an "injury in fact" – an "invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical;" (2) a "causal

connection between the injury and the conduct complained of;” and (3) “it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.” *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (citations and quotations marks omitted); *see also Bennett v. Spear*, 520 U.S. 154, 162 (1997).

In addition, a claim of injury must be ripe for judicial review. An inquiry into ripeness, which “overlaps significantly” with the standing inquiry, *Alabama Municipal Distributors Group v. FERC*, 312 F.3d 470, 472 (D.C. Cir. 2002), requires an evaluation of the “fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration.” *Abbott Laboratories v. Gardner*, 387 U.S. 136, 149 (1967); *see also, e.g., Mississippi Valley Gas Co. v. FERC*, 68 F.3d 503, 509 (D.C. Cir. 1995).

Under either inquiry, Petitioners’ claim for immediate judicial redress must fail because: (1) Petitioners’ alleged injury is not concrete and actual; and (2) other cost recovery mechanisms identified by the Commission have not yet been tested by Petitioners.

A. Petitioners Fail to State an Injury That is Concrete and Non-Speculative

Petitioners’ alleged harm is based on the “risk of” an impermissible “trapping” of costs. Pet. Br. 43. They state that transmission owners will incur “millions of dollars of costs” if forced to bear all the costs expended by the ISO in

operating the regional grid. *Id.*

Petitioners, however, make no effort to quantify further their estimate of allegedly unrecovered costs, by demonstrating that they will have to bear any or all these costs, or explaining the actual operation of the Cost Adder, either during the transition period or after. Petitioners were equally vague before the Commission, which found that their “bald assertions” offered “no support” for their proposition that they would be unable to recover all or a portion of the allocated ISO administrative costs from bundled load. *Midwest ISO III*, 102 FERC at 61,533 and n.45, J.A. 30. The Commission explained that “it is unclear whether any costs will indeed be unrecovered as a result of our rulings,” and that “[t]he parties provide no concrete information concerning the existence of or the amount of the costs that the Midwest ISO TOs allegedly cannot recover.” *Id.* at 61,533, J.A. 30.

An example of the inadequacy of Petitioners’ showing can be seen in their claims regarding the retail rates of Louisville Gas & Electric Company and Kentucky Utilities Company (“LG&E/KU”), serving retail customers in Kentucky. According to LG&E/KU testimony, retail rates are “capped” through 2003. Because the Midwest ISO began billing its Cost Adder only after February 1, 2002, when it began providing transmission service under its Tariff, and because transmission owners failed to address on the record whether the retail rate “cap” allows for a rate increase in limited circumstances, there is no basis to the claim that any unrecovered amounts “will be in the ‘millions of dollars’ as LG&E/KU

claim.” *Id.* at 61,533 nn. 45-46 (citing LG&E/KU request for rehearing and LG&E rebuttal testimony), J.A. 30; *see also Midwest ISO IV*, 104 FERC at 61,031 (no party has “provided any evidence of bundled retail rate agreements that are ‘capped’ (or frozen), or evidence of how long the rates are ‘capped’ or whether these ‘capped’ rates nevertheless contain provisions that would allow a Midwest ISO TO to pass through the ISO Cost Adder to the retail customers”), J.A. 35.

In addition, the Commission found that the transmission owners’ reliance on state retail rate freezes, without consideration of the corresponding benefits they received, to be one-sided. LG&E/KU agreed to a retail rate freeze in Kentucky to gain state commission approval of their merger. *Midwest ISO III*, 102 FERC at 61,533 n.45, J.A. 30. Thus, any inability to recover costs from bundled retail load during the freeze results from LG&E/KU’s own “business decision” that the benefits of a merger outweighed the alleged detriment of a freeze, not directly from the Commission’s allocation of costs. *Id.* The Commission explained the narrowness of Petitioners’ focus as follows: “A utility’s costs inevitably will change over time, and an increase in certain cost categories may well be offset by decreases in other categories. A utility agreeing to a rate freeze or contractually waiving its unilateral right to seek a rate increase assumes the risk that its total costs will increase.” *Id.*

Similarly, even if the transmission owners were unable to recover from bundled load some of the costs associated with the Cost Adder, “no information

was provided in the record to establish that assessment of such additional costs would result in a net under recovery of total costs. . . .” *Id.* at 61,533, J.A. 30. Petitioners look at only one particular category of costs as increasing, without addressing whether other costs declined and thus offset imposition of the Cost Adder. *See Midwest ISO IV*, 104 FERC at 61,031 n.28 (parties have not “alleged that they would not be able to recover the cost of doing business, as opposed to being unable to recover the ISO Cost Adder (as an additional charge without addressing other rate issues)”), J.A. 35. With the Midwest ISO acting as the regional transmission provider, and encouraging the supply of greater quantities of power at lower, non-duplicative rates, the Commission projected that transmission owners should be able to lower overall costs to serve their bundled retail and grandfathered wholesale customers. *Midwest ISO III*, 102 FERC at 61,533, J.A. 30.

In these circumstances, when it has not been shown that Petitioners are unable to recover Cost Adder-allocated costs from bundled load, or that any unrecovered costs are not offset by reduced costs or increased benefits in other areas, Petitioners’ alleged injury is either non-existent or, at most, highly speculative. In either event, the alleged injury is inadequate to give rise to an injury in fact. *See North Carolina Utilities Commission v. FERC*, 653 F.2d 655, 664 (D.C. Cir. 1981); *see also Public Utility District No. 1*, 272 F.3d at 616-17 (finding absence of injury in fact from division of rate filing responsibilities).

B. Petitioners Fail to Explain the Inadequacy of Mechanisms Available to Recover Costs

Even if Petitioners are incurring additional costs as a result of the Commission's cost allocation, there is no basis for their claim (Pet. Br. 43) that the Commission "refuse[d] to take any action to allow a reasonable opportunity to recover those costs." To the contrary, the Commission explained that Petitioners have several alternative mechanisms for cost recovery. That Petitioners favor more direct billing mechanisms does not mean that the Commission-identified cost recovery mechanisms are ineffectual in remedying their alleged harm. Petitioners have not tried the Commission-identified mechanisms. Absent a demonstration that those mechanisms are futile, Petitioners' challenge is not yet ripe because other avenues of relief may resolve this dispute without immediate judicial involvement. If judicial review is appropriate now, however, the Commission's identification of (untried) alternative cost recovery mechanisms demonstrates that the Commission reasonably confronted and remedied Petitioners' claimed injury.

1. Negotiation With, and Cost Recovery Filing By, the Midwest ISO

As the "price that the Midwest ISO TOs pay to the RTO becomes their cost for the transmission used to deliver the energy they sell at retail," they can reduce their transmission costs by obtaining a discount from the ISO. *Midwest ISO III*, 102 FERC at 61,533, J.A. 30. Specifically, the transmission owners "are free to seek a rate from Midwest ISO for the transmission purchased to deliver energy to

bundled retail customers equal to the transmission component of the bundled retail rates set by their state commissions.” *Id.* Such a rate agreement would have to be reflected in a contract and filed with, and accepted by, the Commission. *Id.*

Petitioners denigrate the possibility of obtaining a price adjustment or cost deferral from the Midwest ISO as an “utterly futile exercise” (Pet. Br. 53). They argue that the ISO “would have no reason to accept payment of less than the costs assigned by FERC for recovery from the transmission owner” (Pet. Br. 52). But this argument rests on sheer speculation. As the Commission explained, “[n]o party has indicated that they have been unsuccessful in negotiating this type of discount with Midwest ISO.” *Midwest ISO IV*, 104 FERC at 61,031, J.A. 35.

Indeed, as the Commission recognized, the Midwest ISO has demonstrated a willingness to amend the Tariff and its Cost Adder as appropriate to address cost allocation concerns. *See Midwest ISO II*, 98 FERC at 61,413 n.25, J.A. 21; *Midwest ISO III*, 102 FERC at 61,534 n.49, J.A. 31, *Midwest ISO IV*, 104 FERC at 61,030, J.A. 34. Specifically, in FERC Docket No. ER02-111, the Midwest ISO filed proposed revisions to its Tariff, including revisions to the Schedule 10 Cost Adder (to unbundle services to certain “independent” transmission customers and to provide an “alternate” cost recovery adder for former ISO members). *See Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,268 (2001), *reh’g denied*, 98 FERC ¶ 61,267 (2002). While certain of the Midwest ISO transmission owners protested that filing, they later reached settlements on

disputed issues. *See Midwest ISO IV*, 104 FERC at 61,030, J.A. 34.⁸

Petitioners have offered no explanation why additional efforts to negotiate with the Midwest ISO on disputed Cost Adder issues would be any less successful.

2. Renegotiation of Existing Bundled Wholesale Agreements

If Petitioners continue to believe that existing bundled wholesale agreements (grandfathered agreements) prevent recovery of any of the costs of serving bundled load, “nothing prevents” them from seeking to renegotiate those agreements. *Midwest ISO II*, 98 FERC at 61,414 (also noting that RTO policy under Order No. 2000 provides for ongoing review “of the interaction between existing contracts and new RTO service” on a case-by-case basis), J.A. 22. Even if bilateral renegotiation is impossible, the Commission explained, “the Midwest ISO TOs may have the unilateral right to amend rates, terms and conditions of these agreements under Section 205 [of the FPA] if the TOs find that their rates actually turn out not to sufficiently recover their costs.” *Midwest ISO III*, 104 FERC at 61,533, J.A. 30. Because existing grandfathered agreements were not filed in this proceeding for Commission review, the Commission was unable to review “the overall rate and all cost components,” and thus unable to determine whether such review in fact “may reveal that a TO is over recovering costs.” *Id.* at 61,533 n.47,

⁸ The ISO and the settling parties have committed “to study the feasibility and desirability of unbundling its [Schedule] 10 adder” pursuant to a timetable that contemplate “good faith negotiations” and future filings with the Commission. *Midwest ISO IV*, 104 FERC at 61,030 n.20, J.A. 34.

J.A. 30.

Petitioners assert that they cannot be left to the “uncertain outcome of the negotiating table” (Pet. Br. 46) and that they “may well face” the argument of counter-parties that the agreements can be amended only upon satisfaction of the high “public interest” standard (Pet. Br. 47).

But this argument, based on the assumed futility of further negotiations, is just as speculative as the argument (*see supra* page 23) condemning the possibility of further negotiations with the ISO. Nothing in the record demonstrates the futility of further negotiations. To the contrary, “no party has submitted to the Commission evidence of grandfathered wholesale agreements that do not permit the Midwest ISO TOs to unilaterally change the rates pursuant to Section 205 of the FPA.” *Midwest ISO IV*, 104 FERC at 61,031, J.A. 35. “Nor have any of the parties alleged that they have tried but failed to renegotiate the grandfathered wholesale load agreements to allow for recovery of the ISO Cost Adder.” *Id.* Indeed, the Commission noted that in a recent LG&E/KU case, the Commission accepted proposed revisions modifying the rates under two grandfathered wholesale agreements. *Midwest ISO III*, 102 FERC at 61,533 n.48 (citing *Louisville Gas and Electric Co., et al.*, 101 FERC ¶ 61,182 (2002)), J.A. 30.

In light of Petitioners’ failure to back up their claims of futility or ineffectiveness for alternative recovery mechanisms, the Commission found that there was no need, at least “at this time,” *Midwest ISO IV*, 104 FERC at 61,031,

J.A. 35, to adopt a more intrusive direct billing mechanism. *See infra* page 41 (describing cases that uphold general Commission policy of rolling-in to all customers costs incurred for the benefit of all customers); *see also Midwest ISO II*, 98 FERC at 61,412 n.24 (noting that the Commission later may consider “future cost adder allocation methods that directly attribute specific administrative and start-up costs to those that take specific Midwest ISO services”), J.A. 20.

3. Retail Rate Recovery

Petitioners’ concerns about their asserted inability to recover their allocated portion of the ISO’s administrative costs from bundled retail customers are properly raised with the appropriate state commission. *See Midwest ISO II*, 98 FERC at 61,414, J.A. 22. The Commission recognized that it lacks jurisdiction over retail rates, and cannot impose a direct bill on retail customers. *Id.*

Petitioners prefer that the Commission take the affirmative step of “preempt[ing]” any effective retail rate freeze.⁹ Pet. Br. 50. Petitioners have not shown, however, that a retail rate freeze conflicts with the Commission’s goals. *See supra* page 20 (lack of record evidence as to effect of rate freeze).

⁹ Petitioners attempt to reverse the case law on the “trapping” of costs which, they claim, makes it “unlawful for FERC to take an action that imposes on public utilities costs that they have no reasonable opportunity to recover.” Pet. Br. 44. Actually, the case law prohibits the states from trapping at the retail level costs that already have been approved at the wholesale level by the Commission. *See, e.g., Entergy Louisiana Inc. v. Louisiana Public Service Commission*, 123 S. Ct. 2050, 2056-57 (2003). The effect of a retail rate freeze to which a utility has agreed on its “trapping” claims has not been squarely addressed by the courts.

Accordingly, there are no grounds to adopt such a dramatic remedy. Moreover, there is no basis for Petitioners' argument that the Commission failed to consider their cost "trapping" argument. Rather, the Commission reasonably chose to see whether less drastic means, short of preemption, were available and whether those means would be effective to satisfy any remaining cost recovery concerns. *See Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18, 35 (D.C. Cir. 2002) (explaining that the Commission is free to proceed "one step at a time," and that the court will upset the agency's "gradualism" only if "it truly yields unreasonable discrimination or some other kind of arbitrariness").

Indeed, the Commission explicitly noted that the possibility of retail rate recovery had not been tested: "Nothing in the record indicates that any TO has attempted but been denied such state relief. Similarly, certain retail rate freezes allow rates to be increased in limited circumstances, but the TOs have not addressed this possibility on the record." *Midwest ISO III*, 102 FERC at 61,533 n.46, J.A. 30. Lacking record evidence (or even credible allegations) that the states are unable to deal with the cost recovery issue, or that rate freezes conflict with federal objectives on this issue, the Commission reasonably found that it was not "necessary to preempt a specific rate freeze" and could thereby avoid "infring[ing] on states' retail rate authority." *Midwest ISO IV*, 104 FERC at 61,031, J.A. 35.

4. Favorable Accounting Treatment

In any event, should all other cost recovery alternatives fail, the Commission

indicated that it would consider treating any costs that can be demonstrated to be currently unrecoverable as a “regulatory asset” under its Uniform System of Accounts, *see* 18 C.F.R. Part 101, Account No. 182.3. *See Midwest ISO III*, 102 FERC at 61,534, J.A. 31. To obtain such an accounting treatment, the parties must “make a filing with the Commission clearly demonstrating and supporting that such costs are indeed currently unrecoverable.” *Id.*; *see also Midwest ISO IV*, 104 FERC 61,031-32, J.A. 35-36.

As with the other cost recovery mechanisms, Petitioners challenge this accounting proposal as too ineffectual. They prefer an assurance, at this time and in advance of any filing, that the Commission will allow, at the end of the transition period, the rate recovery of all ISO costs. *See* Pet. Br. 54-58. They argue that “there is no reasonable basis to believe that any regulatory asset filing would be granted” (Pet. Br. 58), but, again, they offer nothing but speculation. *See PJM Interconnection, L.L.C.*, 105 FERC ¶ 61,166 (2003) (granting another RTO’s request for deferral of costs and granting request to record deferred amounts as a regulatory asset).¹⁰ The Commission explained that “the record in this proceeding

¹⁰ While, as Petitioners recognize (Pet. Br. 56), the Commission in *American Electric Power Service Corp.*, 104 FERC ¶ 61,013 (2003), denied a request to record RTO start-up and integration costs as a regulatory asset, Petitioners fail to acknowledge that the Commission did so only because it viewed the request as premature – because the Commission granted a request to defer costs until they could be recovered in retail rates. Other cost recovery initiatives, if actually filed and justified by the transmission owners, may be appropriate. *See California Independent System Operator Corp., et al.*, 103 FERC ¶ 61,114 (2003) (approving

was not sufficient to support” an assurance of later recovery, but did not preclude an opportunity to make a case for recovery in the future. *Midwest ISO IV*, 104 FERC at 61,031-32, J.A. 35-36.

Indeed, the record lacks specificity as to whether, what, when, and how any post-transition period deferred recovery would be accomplished. The ALJ found that the transmission owners had failed to specify precisely what charges will apply to whom, and how deferred costs will be apportioned, after the transition period ends. *See ALJ Decision*, 89 FERC at 65,045, J.A. 678. Rather than deciding the matter now, the ALJ and the Commission directed the Midwest ISO to file, prior to the end of the transition period, a detailed apportionment of costs, with full cost support for the Cost Adder to be charged after the transition period. *See id.*; *see also Midwest ISO I*, 97 FERC at 61,177, J.A. 14. As Petitioners have not challenged this future filing requirement, they should not now be allowed to argue that a similar future filing requirement, affording an opportunity to obtain favorable accounting treatment upon a clear demonstration that current costs are not recoverable, is any less effective or appropriate.

The availability of untested cost recovery mechanisms makes this case unripe for judicial review at this juncture. The Court should dismiss the petitions to allow Petitioners the opportunity, in the first instance, to pursue recovery of

recovery by transmission owner of ISO administrative and operating costs on a dollar-for-dollar basis, on the ground that a new service is being provided, with new benefits to all consumers).

allocated costs through the available means identified by the Commission. Such pursuit may obviate the need for later judicial review of the Commission's allocation of the Cost Adder-related costs. *See Alabama Municipal Distributors Group v. FERC*, 312 F.3d 470, 473-74 (D.C. Cir. 2002) (finding challenge to discounted rate decision premature when the particular impact of that decision will not be established until after next rate filing); *New York State Electric & Gas Corp. v. FERC*, 177 F.3d 1037, 1040-41 (D.C. Cir. 1999) (finding rate-related claim unripe before completion of actual rate proceeding); *Mississippi Valley Gas Co. v. FERC*, 68 F.3d 503, 509 (D.C. Cir. 1995) (finding challenge to discount adjustment policy not fit for judicial review when impact of policy would become clearer after future filings).

II. ASSUMING JURISDICTION, THE COMMISSION REASONABLY ALLOCATED THE ISO'S OPERATING COSTS TO ALL CUSTOMERS THAT BENEFIT FROM THE ISO'S OPERATION OF THE GRID

A. 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 findings of the Commission as to facts, 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 subject 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) (citing *Time Warner Entertainment Co. v. FCC*, 56 F.3d 151, 163 (D.C. Cir. 1995)); *see also, e.g., Northern States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) (explaining same "highly deferential" standard for issues of rate design). As for ratemaking procedures, it is well established that the agency "has broad discretion in selecting methods for the exercise of its powers to make and oversee rates." *Aeronautical Radio, Inc. v. FCC*, 642 F.2d 1221, 1228 (D.C. Cir. 1980) (citing *FPC v. Texaco, Inc.*, 417 U.S. 380, 387-89 (1974)); *see also Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968) ("[T]he breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties.").

As explained below, the Commission's decision to allocate the costs of operating the Midwest ISO to all customers that benefit from the ISO's operation

of the regional grid was reasonable, well-explained, and supported by substantial evidence. Accordingly, that decision must be upheld.

B. The Commission Reasonably Found That All Users of the Grid Benefit Significantly From the Midwest ISO's Operation of the Grid

The ALJ found, after hearing, that all users of the transmission grid benefit from the Midwest ISO's operation of the grid. *See ALJ Decision*, 89 FERC at 65,045, J.A. 678. The Commission upheld that finding on four occasions. *See Midwest ISO I*, 97 FERC at 61,169, J.A. 6; *Midwest ISO II*, 98 FERC at 61,412, J.A. 20; *Midwest ISO III*, 102 FERC at 61,531-32, J.A. 28-29; *Midwest ISO IV*, 104 FERC at 61,030, J.A. 34. Based on that finding, both the ALJ and the Commission consistently held that the allocation of the Cost Adder to only a minority of users of the grid was not just and reasonable. Instead, as both the ALJ and the Commission consistently held, the Cost Adder would be reasonable only if it were spread out among all beneficiaries of the ISO's operations – including existing (grandfathered) bundled wholesale load and bundled retail load.

The ALJ considered the testimony of witnesses offering, as Petitioners acknowledge, *see* Pet. Br. 11-12, 54, differing accounts of whether the divisor of the Cost Adder should be increased to reflect bundled load customers. After conducting an evidentiary hearing, the ALJ concluded that the proposed Adder was unreasonable because it excluded existing bundled retail load and any grandfathered wholesale load:

All of the Midwest ISO Participants' transmission customers will benefit from Midwest ISO's operational and planning responsibilities for the Midwest ISO transmission system, as well as increased grid reliability of the transmission system. Therefore, to ensure that retail load will properly bear a fair share of the Midwest ISO's costs, all long-term firm, bundled retail, and grandfathered load should be included in the divisor in developing the Cost Adder.

ALJ Decision, 89 FERC at 65,045, J.A. 678.

All four Commission orders challenged by Petitioners confirmed the ALJ's judgment that all transmission customers, whether bundled or unbundled, benefit significantly from the Midwest ISO's operation of the grid and, accordingly, must bear a "fair share" of the ISO's operating costs. *Midwest ISO I*, 97 FERC at 61,169, J.A. 6; *Midwest ISO IV*, 104 FERC at 61,029-30, J.A. 33-34. In *Midwest ISO II*, the Commission identified several related benefits to all users of the regional grid from ISO operation: (1) "operat[ion] and plann[ing] by a single regional entity instead of multiple local entities whose goals may often conflict;" that will lead to (2) "more efficient siting of transmission facilities from the regional perspective; *i.e.*, siting that follows need rather than arbitrary boundaries such as individual local service territories;" that in turn will result in (3) "enhanced reliability." 98 FERC at 61,412, J.A. 20. Those reliability benefits will extend to "non-Midwest ISO-operated facilities, such as those connected to local generation," because such facilities in the region "are integrated with the facilities operated by the Midwest ISO." *Id.* (citing established policy that spreads the costs of operating an integrated grid to all users of the grid).

Because of grid integration, even load (including bundled retail load) served by non-Midwest ISO facilities “cannot be served reliably without the facilities operated by Midwest ISO.” *Id.* In addition, all users of the regional grid can be expected to benefit from increased supply of competing generation. The grid will be able to accommodate “greater power flows, and thus more transactions than otherwise possible,” through the ISO’s “more efficient operation of the regional grid, including an effective congestion management scheme.” *Id.*

In *Midwest ISO III*, the Commission presented another enumeration of benefits, based on the record compiled before the ALJ. Indeed, the Commission found that “[t]he record, contrary to parties’ assertions, is replete with evidence that justifies the inclusion of bundled retail and grandfathered wholesale load in the calculation of the ISO Cost Adder.” 102 FERC at 61,531-32, J.A. 28-29. The Commission’s findings were based on the following record evidence:

1. Testimony by TO witnesses, that the ISO control center must clear any operation of the transmission system, and that the ISO exercises functional control and ensures system security for all transmission customers, demonstrates that “Midwest ISO exercises operational control over the regional system that serves bundled retail load, as well as other types of load.”
2. The language of Schedule 10 of the ISO Tariff shows that “the ISO Cost Adder is designed to recover the costs of running Midwest ISO as it operates the grid from which bundled retail and grandfathered wholesale loads take power.”
3. Concessions by TO witnesses that bundled retail load uses, and is served by, the ISO-controlled facilities supports the finding that “bundled retail and

grandfathered wholesale loads will take power over the transmission system, relying on Midwest ISO's operation and planning of that system."

4. Testimony that up to 90% of load in an individual TO's system is bundled retail load shows that "the bulk of Midwest ISO TOs' load using the regional system is bundled retail load."

5. Testimony that all customers classes benefit from various ISO operations (regional security and reliability appraisals; calculation of available transmission capacity on the grid; availability of grid status information in accessible, electronic format; and transmission system planning) supports finding that "certain functions that Midwest ISO performs directly affect all retail load."

Id. at 61,532 & nn.35-39, J.A. 29.

The proposed Cost Adder failed to reflect these benefits to all load by failing to spread cost responsibility to all loads. Instead, the proposed Adder would have allocated all costs to only one-third of the load (unbundled retail and non-grandfathered wholesale customers) benefiting from the ISO's operation of the facilities under its control. *Id.* at 61,532 & n.40 (citing testimony of TO witness Heintz), J.A. 29. Such a mismatch between benefits and cost responsibilities, the Commission reasonably found, was not acceptable:

[N]o mechanism was proposed to recover from bundled retail and grandfathered wholesale loads (the largest loads on the Midwest ISO grid) any of the ISO Cost Adder costs collected during [the] transition period. In essence, the Midwest ISO TOs agreed among themselves to charge only the two smallest classes – wholesale customers (not parties to grandfathered agreements) and unbundled retail customers – for the bulk of costs that Midwest ISO incurs to operate a grid that primarily serves bundled retail load.

Id. at 61,532, J.A. 29.

In these circumstances, and on the basis of the record compiled in this lengthy proceeding, the Commission was justified in concluding that the transmission owners failed to meet their burden under section 205 of the FPA, 16 U.S.C. § 824d, to “show that the exclusion of bundled retail and grandfathered wholesale load from its calculation of the proposed ISO Cost Adder was just and reasonable.” 102 FERC at 61,532, J.A. 29.

C. The Midwest ISO’s Operating Role Is Not as Limited as Petitioners Now Presume

Petitioners concede that the Midwest ISO’s operation of the regional grid provides benefits to bundled users of the grid. *See* Pet. 33-34. They argue, however, that those benefits (mostly reliability-based) are limited because, they claim, the ISO performs only a limited role with respect to customers that have chosen (or are not yet allowed to choose) to unbundle and secure competitive supplies. In particular, they argue that the ISO “does not actually operate the transmission system,” but only directs its operation, and that “for the most part [bundled loads] would see no difference in their service if the [Midwest ISO] did not exist.” Pet. Br. 33-34.

This claim fails for several reasons. First, Petitioners’ disparagement of the ISO’s operation ignores record evidence, discussed above, that centralized operation and dispatch results in efficiencies for all customers. Both the ALJ and the Commission found that bundled customers would, in fact, see a significant

decline in the quality of the service they receive, both now and in the future, if the ISO were to disappear. *See Midwest ISO II*, 98 FERC at 61,412, J.A. 20. And while bundled customers might not be taking stand-alone transmission service under the ISO tariff at present, the Commission expected that coordinated ISO operation of the integrated grid will, by improving grid efficiency and promoting the supply of competitive generation, better enable customers to unbundle in the future. *Id.*

Second, Petitioners' reference to the fact that the Midwest ISO does not undertake "hands on" operations, Pet. Br. 33, does not diminish the ISO's operating authority over the integrated, regional grid. Record testimony established that the ISO has "functional control" over the grid, because "any operation of the transmission system would have to be cleared with the Midwest ISO control center." *See Midwest ISO III*, 102 FERC at 61,532 n.35 (citing record excerpts), J.A. 29. Testimony also established that the ISO's operating control is "done for the purpose of all transmission" customers, whether wholesale or retail, or bundled or unbundled, and that the ISO's operations affect the system as a whole. *Id.*

Third, Petitioners' attempt to downplay the centralized role of the Midwest ISO in directing the operation of the integrated grid cannot be squared with the RTO principles established in Order No. 2000 and the Midwest ISO's successful efforts to satisfy them. *See supra* pages 6-8 (discussing RTO formation

principles and the Midwest ISO's efforts). As the Commission explained in this proceeding, coordinated RTO operation of a regional grid, as opposed to individual TO operation of separate transmission facilities, "further eliminate[s] undue discrimination and anti-competitive practices and further improve[s] grid reliability within the electric industry." *Midwest ISO III*, 102 FERC at 61,530, J.A. 27.

The Commission found, in support of its decision to allocate ISO costs to all customers, that: (1) all transmission customers, "including those serving bundled load, will derive significant benefit from the operation of an RTO"; and (2) "[i]n order to determine fair allocation of RTO costs, an RTO must consider the existence of bundled load that utilizes facilities on the RTO's integrated grid when it performs its functions." *Id. See also id.* at 61,531 (noting that the Commission explained in Order No. 2000 that various RTO operating and planning activities benefit all users of the integrated grid, including retail load), J.A. 28; *Midwest ISO II*, 98 FERC at 61,411 (noting that "the Commission's objective was to simply work toward the goal set forth in Order No. 2000 that the RTO be the sole provider of transmission service over facilities under its control"), J.A. 19.

D. The Commission Followed Appropriate Cost Causation Principles

Petitioners respond that the Commission failed to meet basic "cost causation" principles which, they claim, require efforts to match, with precision based on record evidence, costs with benefits. They claim that bundled load

receives little of the benefits, but is allocated most of the costs, associated with the ISO's operation of the regional grid. *See* Pet. Br. 24-26.

Contrary to Petitioners' claim, however, the Commission did meet applicable cost causation principles. The ALJ's and the Commission's decision to allocate some of the costs of operating the grid to bundled load is premised on the benefits that bundled load receives from that operation. Petitioners ignored precisely the same cost causation principles they now cite by proposing that none of the ISO's operating costs be allocated to bundled load, even though bundled load benefits from the ISO's operation of the grid.

That bundled load may now be responsible for most of the ISO's administrative costs does not mean, as Petitioners submit (Pet. Br. 24), that the Commission's assignment of costs is "grossly disproportionate" to benefits received. While the ISO may have a different operational and billing relationship with bundled load than with unbundled load, both loads benefit from the ISO's operation of the grid. The division of cost responsibility among beneficiaries of ISO administration of the grid thus reflects the fact that most of the transmission owners' load using the regional system administered by the ISO is bundled retail load. *See Midwest ISO III*, 102 FERC at 61,532 (citing testimony of TO witnesses Heintz and Becher), J.A. 29. As the Commission found, Petitioners themselves proposed an allocation of administrative costs that was grossly disproportionate, and thus unjust and unreasonable, by "agree[ing] among themselves to charge only

the two smallest classes – wholesale customers (not parties to grandfathered agreements) and unbundled retail customers – for the bulk of costs that Midwest ISO incurs to operate a grid that primarily serves bundled retail load. *Id.*

The ALJ and the Commission reasonably acted to ensure that all – instead of only some -- users of the grid that benefit from the ISO’s grid operation pay a fair share of the operating costs. The decision to allocate costs among all users that benefit from their incurrence is entirely consistent with ratemaking precedent. As the Commission explained, “[i]t is established Commission policy that . . . all customers using [an integrated transmission] grid share in all costs of the grid, because they all benefit.” *Midwest ISO II*, 98 FERC at 61,412 (citing Commission policy that discourages direct assignment of costs to certain customers when all customers benefit), J.A. 20. That ratemaking policy has been affirmed by the courts. *See Entergy Services, Inc. v. FERC*, 319 F.3d 536, 542-45 (D.C. Cir. 2003) (affirming the Commission’s roll-in to all transmission customers of the costs of interconnecting the grid to additional generation, based on the agency’s judgment that all users of the grid benefit from short-circuit and stability upgrades enhancing grid reliability); *Western Massachusetts Electric Co. v. FERC*, 165 F.3d 922, 927-28 (D.C. Cir. 1999) (affirming Commission’s decision to roll-in costs to all transmission customers, based on presumption that “[w]hen a system is integrated, any system enhancements . . . benefit the entire system”) (citing cases). *Cf. Sithe/Independence Power Partners v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002)

(noting that Commission “is not bound to reject any rate mechanism that tracks the cost-causation principle less than perfectly,” as long as it explains its decision).

E. The Commission’s Allocation of Costs to All Users of the Grid Does Not Represent an Impermissible Reversal of Course

From the inception of this proceeding, the reasonableness of the proposed Cost Adder has been in doubt. In its 1998 order addressing the proposed rates, terms and conditions of the Midwest ISO Tariff, the Commission explicitly listed “the ISO Cost Adder” as one of the issues set for hearing. 84 FERC at 62,167, J.A. 190. The parties filed testimony and submitted evidence on the reasonableness of the proposed Adder, the ALJ issued findings on the proposed Adder (deeming it unreasonable), the parties filed briefs on the contested issue, and the Commission issued orders affirming the ALJ’s conclusion that the Adder (because it excluded bundled loads that benefit from ISO operations) was unreasonable. The initial filing was made under FPA § 205, the Commission suspended the proposed Adder and set it for hearing under FPA § 205, the ALJ issued findings under FPA § 205, and the Commission reached its ultimate decision (affirming the ALJ) under FPA § 205.

Years into the proceeding, Petitioners argue now that the Commission could not act on the proposed Cost Adder under FPA § 205. *See* Pet. Br. 40-43. They contend that the Commission was obligated to proceed under FPA § 206, 16 U.S.C. § 824e, and make findings that the “existing rate” was unjust and

unreasonable, because the Commission “effectively” approved the proposed Cost Adder in 1998. Pet. Br. 41-42.

The Commission correctly recognized that the proposed Adder was never effective and always subject to Commission examination under FPA § 205 as to its reasonableness. As the Commission explained, “[s]ince [*Midwest ISO I and II*] represent an appropriate exercise of the Commission’s authority under Section 205 of the FPA, there was no need for the Commission to examine the proposed ISO Cost Adder as if it had already been unconditionally accepted (i.e., examined under the Section 206 standard).” *Midwest ISO III*, 102 FERC at 61,530, J.A. 27; *see also Midwest ISO IV*, 104 FERC at 61,029 (explaining that the Commission “explicitly set for hearing the justness and reasonableness of the proposed ISO Cost Adder under Section 205 of the FPA” and that “it is not necessary to institute a Section 206 proceeding on this issue”), J.A. 33.

To be sure, in 1998 the Commission accepted the transmission owners’ proposal to not place existing bundled retail load and any grandfathered wholesale load under the Midwest ISO’s Tariff for at least a six year transition period. *Midwest ISO I*, 97 FERC at 61,169, J.A. 6; *see supra* page 7 (explaining transition period). However, that action could not have “effectively constituted approval of the proposal to exclude bundled load from the calculation of the ISO Cost Adder,” as Petitioners submit (Pet. Br. 41). Such a construction would effectively nullify the Commission’s decision to suspend the proposed Cost Adder and set it for

hearing under FPA § 205 and all resulting litigation as to its reasonableness. *See, e.g., Exxon Co., U.S.A. v. FERC*, 182 F.3d 30, 49 (D.C. Cir. 1999) (finding that “equity and predictability are not undermined when the Commission warns all parties involved that a change in rates is only tentative and might be disallowed”) (quoting *OXY USA, Inc. v. FERC*, 64 F.3d 679, 699 (D.C. Cir. 1995) (internal marks omitted)).

As the proposed Cost Adder has always been subject to reexamination and revision, Petitioners’ argument really concerns the reasonableness of the Commission’s decision to place all load, bundled or unbundled, under the Midwest ISO Tariff. This decision was not, as Petitioners submit (Pet. Br. 41), an unexpected “revers[al of] course,” but rather the result of ongoing developments throughout the course of this long proceeding. As the Commission explained, it initially reviewed the transmission owners’ proposal for compliance with the ISO principles of Order No. 888. *See Midwest ISO I*, 97 FERC at 61,169, J.A. 6. Before the Commission could act again on that proposal, however, the Commission issued Order No. 2000 and the Midwest ISO urged the Commission to grant it RTO status in light of its purported compliance with the principles for RTO formation established in Order No. 2000. *See supra* pages 6-8 (explaining development of Order No. 2000 and Midwest ISO’s efforts to obtain RTO status).

One of the requirements of RTO status, as the Commission explained, is that the RTO be the sole provider of transmission services over the facilities under its

control and have sole authority to receive, evaluate and approve or deny all requests for transmission service. *See Midwest ISO I*, 97 FERC at 61,170, J.A. 7. To comply with this requirement, the Commission directed the Midwest ISO to place all load under its Tariff. *Id. See also Midwest ISO III*, 102 FERC at 61,532 (explaining that because the Midwest ISO is now an RTO in compliance with Order No. 2000, the transmission owners “are no longer the transmission providers,” the “Midwest ISO provides all transmission service and must be compensated, as would any transmission provider,” and, as a result, “the rates, terms and conditions of transmission service purchased by the TOs from Midwest ISO in order to serve their bundled retail customers must be on file with the Commission”), J.A. 29. To the extent the transmission owners now complain about this requirement, they are challenging the ISO’s decision to apply for, and the Commission’s decision to grant, RTO status – not the Commission’s examination of the reasonableness of the Cost Adder.¹¹

F. The Commission’s Did Not Ignore the Benefits Provided by LG&E/KU to the Entire Midwest ISO System

Finally, Petitioners argue that the Commission “disregarded” the benefits provided by LG&E/KU in making low-cost power available throughout the

¹¹ Moreover, while the Commission did not make FPA § 206 findings in the instant proceeding on the issue of the Cost Adder (because it did not need to), it reasonably was able to rely on the findings in Order No. 2000, that satisfaction of the RTO principles would promote a more competitive, reliable, non-discriminatory market to the benefit of all market participants (including bundled load).

Midwest ISO region. If the Commission had considered those benefits, Petitioners submit, it would have acted to maintain the integrity of the parties' negotiations and resulting compromise by deferring the transmission owners' responsibility for the Cost Adder during the six-year transition period. *See* Pet. Br. 58-69.

The Commission did not disregard those benefits or the concerted efforts of the many parties. *See Midwest ISO I*, 97 FERC at 61,171 (recognizing that “a great amount of work and negotiation went into the voluntary attempt to organize the Midwest ISO”), J.A. 8. As explained above, the Commission believed that it could not honor the parties' “compromise” without allowing an unreasonable Cost Adder, that allocates costs only to some of the beneficiaries of the ISO's centralized operation of the grid, to go into effect. The Commission cannot allow a particular utility's reliance on the bargain it strikes, and then submits to the Commission for approval, to trump its fundamental concern for the reasonableness of rates charged consumers. As the Commission explained in *Midwest ISO IV*, in response to LG&E/KU's claim of reliance, it “cannot be bound by the unreasonable assumption that it will approve a proposed tariff provision as just and reasonable simply because an entity relied on that provision.” 104 FERC at 61,029, J.A. 33. *See also Midwest II*, 102 FERC at 61,531 (explaining that the Midwest ISO's filing for RTO status “carried the risk that it could be required to institute changes not negotiated among the participants”), J.A. 28.

Indeed, the LG&E/KU “benefits” argument, to the extent it is relevant, serves only to demonstrate the reasonableness of the Commission’s decision on the proposed Cost Adder. The benefits cited by Petitioners – *e.g.*, the availability of low-cost power to consumers throughout the Midwest ISO region, *see* Pet. Br. 60-61 – are more widely available precisely because of the existence of the multi-state Midwest ISO and its operation of an integrated multi-state grid in the Midwest. The LG&E/KU “benefits” argument thus confirms the fundamental predicate for the Commission’s cost allocation decision; namely, that operation of the Midwest ISO results in benefits to all users of the grid, whether bundled or unbundled, and that the costs of ISO operations should be spread among all load that benefits. *See Midwest ISO IV*, 104 FERC at 61,031 n.26 (explaining that “finding that all loads benefit from the use of Midwest ISO’s grid” responds to the argument that “customers in states that have chosen not to unbundle derive fewer benefits from RTO operation”), J.A. 35.

CONCLUSION

For the foregoing reasons stated, the Commission submits that the petitions for review should be dismissed for lack of aggrievement or ripeness. If the Court decides that it has jurisdiction, the challenged orders should be upheld as reasonable in all respects.

Respectfully submitted,

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