

ORAL ARGUMENT IS SCHEDULED FOR MAY 7, 2004

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

No. 03-1163

**MIDWEST ISO TRANSMISSION OWNERS,
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**

**CYNTHIA A. MARLETTE
GENERAL COUNSEL**

**DENNIS LANE
SOLICITOR**

**BETH G. PACELLA
ATTORNEY**

**FOR RESPONDENT
FEDERAL ENERGY REGULATORY
COMMISSION
WASHINGTON, DC 20426**

MARCH 11, 2004

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties:

All parties appearing before the Commission and this Court are listed in Petitioner's Rule 28(a)(1) certificate.

B. Rulings Under Review:

The rulings under review appear in the following orders issued by the Federal Energy Regulatory Commission:

1. *Midwest Independent Transmission System Operator, Inc.*, 101 FERC ¶61,113 (2002); and
2. *Midwest Independent Transmission System Operator, Inc.*, 103 FERC ¶61,038 (2003).

C. Related Cases:

This case has not previously been before this Court or any other court. This case is related to that in *Midwest Independent Transmission System Owners v. FERC*, D.C. Circuit Docket Nos. 02-1121, *et al.*, currently pending judicial review.

Beth G. Pacella
Attorney

March 11, 2004

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GLOSSARY

FPA	Federal Power Act
ISO	Independent system operator
Midwest ISO	Midwest Independent Transmission System Operator, Inc.
October Order	<i>Midwest Independent Transmission System Operator, Inc.</i> , 101 FERC ¶61,113 (2002)
RTO	Regional transmission organization
Rehearing Order	<i>Midwest Independent Transmission System Operator, Inc.</i> , 103 FERC ¶61,038 (2003)
TOs	owners of the transmission facilities operated by the Midwest ISO

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STATEMENT OF THE ISSUES

1. Whether this Court lacks jurisdiction because Petitioners are not aggrieved by the challenged orders.
2. Assuming jurisdiction, whether the Commission reasonably interpreted its precedent as requiring that the costs to administer the Midwest ISO be allocated to all loads that benefit from Midwest ISO's 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 Petitioners’ claim, Brief at 1-2, this Court lacks jurisdiction to consider their appeal. Petitioners fail to allege a concrete injury resulting from the challenged orders.

STATEMENT OF THE CASE

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

This case addresses the determination of the Cost Adder unit rates that will apply to recover the costs the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”) incurs to administer its regional transmission grid. In 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 the Cost Adder unit rate by allocating Midwest ISO’s administrative costs only to the two smallest classes of load served by transmission on the Midwest ISO system. The Commission found that the proposed allocation methodology had not been shown to be just and reasonable and, accordingly, set

the matter for hearing. *See Midwest Independent Transmission System Operator, Inc.*, 84 FERC ¶ 61,231 (1998).

After hearing, first the administrative law judge (ALJ) and then the Commission found that the transmission owners' proposed methodology to allocate Midwest ISO's administrative costs was not just and reasonable as it did not spread those costs among all loads that benefit from the Midwest ISO's administration of the regional grid. *See Midwest Independent Transmission System Operator, Inc.*, 89 FERC ¶ 63,008 (1999) (ALJ); 97 FERC ¶ 61,033 (2001) (*Midwest ISO I*); 98 FERC ¶ 61,141 (2002) (*Midwest ISO II*); 102 FERC ¶ 61,192 (2003) (*Midwest ISO III*); 104 FERC ¶ 61,012 (2003) (*Midwest ISO IV*). Specifically, the proposed methodology failed to allocate any of Midwest ISO's administrative costs to bundled retail and grandfathered wholesale loads, even though those loads, like all loads served by the Midwest ISO grid, benefit from Midwest ISO's administration of the regional grid.

The filing made in response to the Commission's determination that the Cost Adder must be allocated to all load served by transmission on the Midwest ISO system, including bundled retail load and grandfathered wholesale load, nevertheless included proposals to exempt grandfathered wholesale load from Cost Adder allocation. In the challenged orders, the Commission rejected those

proposals as inconsistent with its prior determination that all load served under the Midwest ISO Tariff be allocated a share of the Midwest ISO's administrative costs. *Midwest Independent Transmission System Operator, Inc.*, 101 FERC ¶ 61,113 (2002) ("October Order"); 103 FERC ¶61,038 (2003) ("Rehearing Order").

II. STATEMENT OF FACTS

A. Events Leading to the Challenged Orders

1. Development of Regional Transmission Organizations

"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, technological advances and legislative and regulatory initiatives have promoted increased entry into wholesale electricity markets and the unbundling of services by electric utilities. 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 assure that the benefits of a competitive market are realized by customers, the Commission's Order No. 888¹ directed each utility to offer non-discriminatory, open access transmission service, to have 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. *New York*, 535 U.S. at 11. Order No. 888 also encouraged the development of independent system operation of regional, multi-system grids. See FERC Stats. & Regs., Regs. Preambles at 31,730-32.

After several years of experience reviewing initial independent system operator ("ISO") proposals, including Midwest ISO's, the Commission, in Order No. 2000,² directed all transmission owning utilities either to participate in a

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs., Regs. Preambles ¶ 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).

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), *pet. dismissed sub nom. Public Utility District No. 1 v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

regional transmission organization (“RTO”) or to explain their efforts to participate in an RTO. The Commission determined 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*, 272 F.2d at 611 (quoting rulemaking). RTOs would benefit users of the grid by: (1) improving efficiencies in transmission grid management; (2) improving grid reliability; (3) removing remaining opportunities for discriminatory transmission practices; (4) improving market performance; and (5) facilitating lighter handed regulation. *Id.*

Under Order No. 2000, utility members of a Commission-approved ISO (such as the Midwest ISO) were required 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 the only provider of transmission services over the facilities it controls) are codified at 18 C.F.R. §§ 35.34 (j)-(k).

2. Development of the Midwest ISO

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 ISO-wide open access transmission tariff (Midwest ISO Tariff). Under the proposal, all new wholesale and existing unbundled retail transmission services would take service immediately under the Midwest ISO Tariff's rates, terms and conditions. Existing bundled retail loads would not take service under the tariff until released under retail access programs in the various states, while all existing bilateral agreements for wholesale loads (grandfathered agreements) would be placed under the tariff after a six-year transition period.³

The Commission conditionally authorized 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), *order on reconsideration*, 85 FERC ¶ 61,250 (1998), *order on reh'g*, 85 FERC ¶61,372 (1998). In addition, the Commission conditionally accepted the Midwest ISO Tariff for filing, suspended it, and set it for hearing.

When, in response to Order No. 2000, the Midwest ISO submitted a filing on January 16, 2001, asserting that its current structure satisfied the required RTO

³ The six-year transition period included 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.

characteristics and functions, the Commission agreed and granted the Midwest ISO RTO status. *See Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001).⁴ The Midwest ISO began providing transmission services under its Tariff on February 1, 2002, 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 on its regional grid. *See* 97 FERC at 62,511.

3. Proposed Cost Adder

As part of their 1998 filing to transfer operating control of their facilities to the Midwest ISO, the transmission owners proposed a Cost Adder in Section 10 of the Midwest ISO Tariff to recover the ISO's costs associated with investment and expenses related to administering the ISO. Those costs include the ISO's deferred pre-operating costs, the costs associated with building and operating the Security Center, including capital costs, and costs associated with administering the tariff.⁵

⁴ 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 this RTO order.

⁵ Although intended to recover the ISO's actual administrative costs, the Cost Adder was capped at 15 cents/MWh during the six-year transition period. 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

The monthly Cost Adder unit rate would be derived by dividing the month's administrative expenses by the amount (megawatt hours) of transmission service expected to be provided under the Midwest ISO Tariff during the month, subject to a true-up.

The proposed Cost Adder methodology and other proposed terms and conditions of service under the Midwest ISO Tariff were suspended and set for hearing. *See* 84 FERC at 62,167. The parties subsequently filed testimony and evidence on the reasonableness of the proposed Cost Adder methodology. Some supported the methodology as proposed, while others urged that the costs should be spread over all classes of customers benefiting from operation of the ISO.

4. The Orders Requiring That The Cost Adder Be Allocated To All Load Served Under the Midwest ISO Tariff

After hearing and upon review of all testimony and evidence submitted, the ALJ found that the proposed Cost Adder methodology was not just and reasonable because it did not allocate ISO costs among all users of the grid benefiting from the ISO's operation and administration. ALJ Decision, 89 FERC ¶ 63,008. While “[a]ll . . . customers will benefit from Midwest ISO's operational and planning responsibilities for the Midwest ISO transmission system,” only some load on the

amortized monthly over five years and recovered from all customers taking service under the Midwest ISO Tariff.

system is included in allocating the Cost Adder. *Id.* at 65,045. The ALJ concluded that, to assure that all load on the system will properly bear a fair share of these costs, all long-term firm, bundled retail, and grandfathered load should be included in the divisor used to develop the unit rate for the Cost Adder. *Id.*

After reviewing the record and briefs on exceptions to the ALJ Decision, the Commission affirmed the ALJ's findings and conclusions on the proposed Cost Adder. *Midwest ISO I*, 97 FERC ¶ 61,033. The Commission explained that, since Order No. 2000, an RTO must provide all transmission service to load using the facilities under its control and that all service must be provided under the RTO's Tariff. *Id.* at 61,170 (citing 18 C.F.R. § 35.34(k)(1)(i)); *Midwest ISO II*, 98 FERC at 61,413. As the Midwest ISO exercises operational control over its transmission grid and Midwest ISO TOs use that grid to serve their bundled retail and grandfathered wholesale load, it is equitable to include those two segments of load in calculating the unit rate. *Midwest ISO III*, 102 FERC at ¶22 and n.35.

The Commission reiterated, as support, its Order No. 2000 finding that all users of a regional transmission system benefit from the operation of and planning regarding that system as well as from the increased reliability that results from the regional operation of an integrated grid -- *e.g.*, more efficient siting of transmission facilities, more effective congestion management, and the ability to accommodate

greater power flows. *Midwest ISO I* at 61,169-70; *Midwest ISO II*, 98 FERC at 61,412; *Midwest ISO III*, 102 FERC at 61,531-32. As a result, all load served using the Midwest ISO transmission system, including bundled retail and grandfathered wholesale load, should be included in calculating the unit rate for the Midwest ISO Cost Adder. *Midwest ISO I* at 61,169-70; *Midwest ISO II*, 98 FERC at 61,412; *Midwest ISO III*, 102 FERC at 61,531-32.

Not including that load in the unit rate calculation would have serious effects. While “the record show[ed] that up to 75 percent of the ISO Cost Adder costs was expected to be recovered during the transition period . . . 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.” *Midwest ISO III*, 102 FERC at 61,532. *See also Midwest ISO IV*, 104 FERC at 61,530-32. Thus, the proposed Cost Adder methodology would have allocated all of Midwest ISO’s administrative costs to only the two smallest segments of load served on the Midwest ISO system – wholesale load not parties to grandfathered agreements and unbundled retail load. *Midwest ISO III*, 102 FERC at 61,532; *see also Midwest ISO IV*, 104 FERC at 61,530-32.

The ALJ, therefore, “correctly found that Midwest ISO did not meet its [FPA] Section 205 burden because it failed 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.” *Midwest ISO III*, 102 FERC at 61,532. To assure that all loads that benefit from Midwest ISO’s operation of the grid equitably share the Midwest ISO’s costs for that operation, the Cost Adder must be allocated to all load served by the Midwest ISO system, including bundled retail load and grandfathered wholesale load. *Midwest ISO I*, 97 FERC at 61,169-70; *Midwest ISO II*, 98 FERC at 61,412; *Midwest ISO III*, 102 FERC at 61,532. Moreover, the TOs are responsible for paying the Midwest ISO for the Cost Adder charges associated with the load they serve by transmission on Midwest ISO’s system. *Midwest ISO II*, 98 FERC at 61,413.

5. Midwest ISO's Proposal To Exclude From Cost Adder Allocation Some Grandfathered Wholesale Load Served By Midwest ISO Facilities Under The Midwest ISO Tariff

In response to, and purportedly in compliance with, *Midwest ISO I*, on December 31, 2001, Midwest ISO submitted proposed FPA §205 Tariff revisions. R. 541. Sections 37.1 and 37.2 of the Midwest ISO Tariff were revised to comply with the Commission's requirement that transmission related to all bundled retail load and grandfathered wholesale load be served under the Midwest ISO Tariff. R. 541 at 2, JA 2, First Revised Sheet No. 109, JA 7. Other proposed revisions, however, sought to exempt TOs from having to pay the Cost Adder for grandfathered loads the TOs serve using Midwest ISO facilities. R. 541 at §37.3(b) (regarding grandfathered load inside Midwest ISO) (First Revised Sheet No. 110), JA 8; §37.3(c) (regarding grandfathered load outside Midwest ISO); and §37.3 (e) (regarding direct billing to grandfathered load customers) (Second Revised Sheet No. 110a), JA 9.

B. The Challenged Orders And Intervening Events

1. The October Order

The Commission rejected the proposals to exempt TOs from having to pay the Cost Adder allocated to grandfathered loads as inconsistent with the Commission's prior determination that all load served under the Midwest ISO

Tariff be allocated a share of the Cost Adder costs. October Order at ¶¶19-21, JA

13-14. As the Commission had held in the *Midwest ISO* Orders:

Transmission-owning members [of Midwest ISO] will have to take transmission service under the Midwest ISO Tariff for their use of the Midwest ISO transmission system to serve bundled load and grandfathered agreement customers. . . . [T]hese transmission owning members will be exempt, during the transition period, from rates under the Midwest ISO Tariff for services provided pursuant to the existing agreements, *except the Cost Adder which . . . will reimburse the Midwest ISO for the services it performs that benefit all users of the grid*

October Order at ¶20, JA 13 (quoting *Midwest ISO II*, 98 FERC at 61,413) (emphasis added in October Order).

Accordingly, the Commission “direct[ed] Midwest ISO to revise [§37.3(b), regarding the proposed exception for grandfathered load inside Midwest ISO], to make clear that the Midwest ISO TO is responsible for payment of Schedule 10 [Cost Adder] charges for grandfathered agreement loads that are under the Midwest ISO [Tariff], consistent with [*Midwest ISO II*].” October Order at ¶19, JA 13. Moreover, because “Midwest ISO ha[d] not shown why grandfathered loads outside of Midwest ISO, that nevertheless utilize facilities under Midwest ISO’s control, for through or out service, should be exempt from the Schedule 10

Cost Adder,”⁶ the Commission directed the Midwest ISO “to revise proposed Section 37.3(c) by deleting the Midwest ISO TO’s exemption from responsibility to pay Schedule 10 charges for ‘transmission service provided as a result of or pursuant to Grandfathered Agreements for load outside of’ Midwest ISO.” October Order at ¶20, JA 13.

After reviewing Midwest ISO’s proposal, in §37.3(e), to directly bill grandfathered load customers for the Cost Adder allocated to their load rather than billing the TO “[o]nce a Service Agreement . . . between the Midwest ISO and the customer which is a party to the grandfathered Agreement is effective,” R. 541 at Second Revised Sheet No. 110a, JA 9, the Commission directed Midwest ISO to explain “how a customer can be a party to a grandfathered agreement (to which Midwest ISO is not a party) and also a party to an executed or unexecuted service agreement with Midwest ISO.” October Order at ¶21, JA 14. Moreover, “to the extent that Section 37.3(e) is intended to exempt the Midwest ISO TOs from responsibility for payment of Schedule 10 Cost Adder charges during the transition period, while the grandfathered agreement is still in effect,” the Commission

⁶ “Through and out service” is point-to-point transmission service used to export power from one transmission system to another. *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, 100 FERC ¶61,138 at ¶167 (2002). “Through” service begins outside Midwest ISO’s grid, moves over Midwest ISO’s grid, and ends outside Midwest ISO’s grid. “Out” service begins inside Midwest ISO’s grid and ends outside Midwest ISO’s grid.

ordered that "Midwest ISO must revise that language to provide otherwise, as discussed above." *Id.*

2. The Compliance Filing And Rehearing Requests

In light of the Commission's holding in *Midwest ISO II*, 98 FERC at 61,413-14, that TOs are directly responsible for Schedule 10 charges, Midwest ISO eliminated Tariff §37.3(e) in its November 15, 2002, compliance filing. *See* Rehearing Order at ¶¶3, 22, JA 44, 46. Midwest ISO also revised Tariff §37.3(b) to hold TOs responsible for payment of Cost Adder charges for grandfathered wholesale loads located inside Midwest ISO. *See* Rehearing Order at ¶3, JA 44.

Midwest ISO's filing, however, did not comply with the October Order's directive to revise §37.3 in light of the Commission's holdings in *Midwest ISO I-IV* and the October Order. *See* Rehearing Order at ¶4, JA 44. Rather, Midwest ISO, along with Petitioners, sought reconsideration or rehearing of that directive. R. 735, JA 25-29; R. 737, JA 30-37.

While purporting to agree with "the Commission's desire to ensure that all users of the system pay the Midwest ISO for the services the Midwest ISO performs on their behalf," Petitioners and Midwest ISO asserted that:

[I]t is inequitable to allocate administrative costs to grandfathered Transmission Owner load located outside the Midwest ISO's footprint where that Cost Adder is not comparably allocated to a similarly situated non-transmission owner. For example, if the Midwest ISO

were to follow this directive, a Transmission Owner with a grandfathered load outside the Midwest ISO's footprint would be required to pay the Schedule 10 Cost Adder for the portion of the Midwest ISO's resources used to serve load outside the Midwest ISO's footprint. However, a similarly situated non-transmission owner with load located outside the Midwest ISO's footprint using resources located inside the Midwest ISO would not pay the Cost Adder if the provision of transmission services was made under a contractual arrangement prior to open access.

R. 735 at 3-4; JA 27-28. *See also* Wabash Valley's rehearing request, R. 737 at 2-3, JA 31-32 (asserting that "It is inequitable to allocate administrative costs to loads being served under grandfathered contracts when the load is located outside the Midwest ISO when transmission owners similarly situated but not participating in an RTO do not incur such a charge.")

Petitioners and Midwest ISO also asserted that "[e]xemption of load outside the Midwest ISO's footprint is further justified by administrative efficiency," as, allegedly, the "revenue involved in this small subset of the Midwest ISO's transactions is *de minimis*." R. 735 at 4, JA 28. Furthermore, Petitioners and Midwest ISO raised potential "pancaking" issues, asserting that if "load outside the Midwest ISO's footprint will participate in the Commission's RTO vision for Standard Market Design ("SMD") under another Independent Transmission Provider ("ITP"), that grandfathered load outside the Midwest ISO's footprint is

likely to be subject to a similar cost adder once that load is included in the other ITP's footprint." *Id.*; see also R. 737 at 5-6; JA 34-35.

Consumers Energy Company opposed Petitioners and Midwest ISO's request for reconsideration or rehearing. R. 738.

3. The Rehearing Order

The Commission found that the requests for reconsideration or rehearing lacked merit. "[S]ince grandfathered loads served by through and out transactions utilize Midwest ISO's grid, they benefit from Midwest ISO's operational and planning responsibilities and should share in Midwest ISO's costs." Rehearing Order at ¶29, JA 47. This was consistent with the *Midwest ISO I-IV* holding "that the Schedule 10 Cost Adder should include in its calculation all loads using the regional grid that Midwest ISO operates." *Id.* And, because the TOs use Midwest ISO facilities to provide through and out service, "imposing an obligation on the TOs to pay the Schedule 10 Cost Adder for grandfathered loads outside of Midwest ISO's footprint is a reasonable allocation of costs." *Id.*

As "Midwest ISO ha[d] provided no evidence to substantiate its claim that the revenue involved in this subset of load transactions is *de minimis* when compared to the higher costs of accounting and collection," the Commission rejected that claim as well. *Id.* at ¶30, JA 47. Because the Commission wanted to

assure that TOs moving electricity in another RTO would not be liable for pancaked RTO cost adder charges, however, the Commission referred the potential pancaked rates issue to the ongoing the inter-RTO rate proceeding in Docket No. EL02-111-000. *Id.* at ¶30, JA 47.

Having found that the parties had not presented any new arguments that would justify granting the requests for rehearing or reconsideration, the Commission denied those requests. *Id.* at ¶31, JA 47. This petition for review followed.

SUMMARY OF ARGUMENT

I

The Petition for review should be dismissed for lack of subject matter jurisdiction as Petitioners cannot demonstrate injury-in-fact regarding the challenged orders. The administrative costs formerly incurred by the TOs to provide service to their grandfathered wholesale load have shifted to Midwest ISO since the grandfathered agreements were executed. The Midwest ISO, as an RTO, has taken over administration of the integrated regional grid (composed of the TOs facilities), and all service on Midwest ISO's system is now provided under Midwest ISO's Tariff. While the Midwest ISO Tariff holds the TOs responsible for payment of the Cost Adder allocated to the grandfathered wholesale load they

serve using the Midwest ISO system, the TOs continue to be paid under the grandfathered agreements for administrative costs they no longer incur.

II

Assuming jurisdiction, the petition should be denied for lack of merit. In the challenged orders, the Commission reasonably interpreted and applied its precedent requiring that the costs to administer the Midwest ISO be allocated to all load served by transmission on the Midwest ISO grid.

There is no jurisdiction to consider Petitioners' contention on appeal that the challenged orders disregarded cost-causation principles because Petitioners did not raise that contention on rehearing as required under FPA §313(b). In any event, the challenged orders assure that *all* loads that benefit from Midwest ISO's administration of the grid, including grandfathered wholesale load, are included in the methodology used to determine the Cost Adder unit rate. In that way, the Commission assured that all load would share equitably in the Midwest ISO's costs for grid administration.

As Petitioners did not seek rehearing of Petitioners' myriad challenges on appeal to FERC's referral of the potential pancaked rate issue to the EL02-111-000 proceeding, there is no subject matter jurisdiction to consider those challenges. None of those challenges, in any event, have merit.

It was well within FERC's discretion to refer the potential future Cost Adder rate pancaking for through and out service to a proceeding already addressing Midwest ISO through and out service rate issues. Furthermore, Petitioners took none of the readily available and necessary means to alert the Commission to their concerns about the referral. Moreover, Petitioners' complaint that the Commission did not, in the EL02-111-000 proceeding, appropriately address the referred cost adder issue may be made, if at all, only on challenge to the orders in EL02-111-000.

Finally, contrary to Petitioners' claim, the record establishes that the Commission appropriately responded to all of their claims. The Commission consistently required that the Cost Adder be allocated to *100 percent* of the load served by transmission on the Midwest ISO system. Despite Petitioners' attempts to confuse the issue, FERC's orders make clear that there is no exception to the requirement that *all* load served using the Midwest ISO system be factored into the Cost Adder methodology so that all load is allocated a fair share of the costs Midwest ISO incurs to administer the system used to service that load.

ARGUMENT

I. THE PETITION FOR REVIEW SHOULD BE DISMISSED FOR LACK OF JURISDICTION AS PETITIONERS DO NOT MEET THE NECESSARY PREREQUISITES TO OBTAIN JUDICIAL REVIEW

Under FPA § 313(b), 16 U.S.C. § 825l(b), only parties aggrieved by FERC orders may obtain judicial review. *See Public Utility Dist. Snohomish Cty. v. FERC*, 272 F.3d 607, 613 (D.C. Cir. 2001). To be aggrieved, a party must establish Article III constitutional standing by showing: (1) that it has suffered 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) that there is a causal connection between the injury and the conduct complained of; and (3) that it is likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision. *Id.*; *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992).

Petitioners cannot demonstrate injury-in-fact regarding the challenged orders. Those orders rejected a proposal that, inconsistent with Commission precedent, would have excluded from the Midwest ISO Cost Adder methodology grandfathered wholesale load TOs serve by transmission on the Midwest ISO grid. No injury-in-fact occurs because, while the TOs are responsible for the Cost Adder allocated to the grandfathered wholesale load they serve using the Midwest ISO system, the TOs are paid under the grandfathered agreements for those administrative costs. Brief at 10 (quoting R. 541 at 3, JA 3) (“the expenses which

the Administrative Cost Adder would recover ‘are . . . charged under the grandfathered agreement[s].’”).

When the grandfathered agreements were executed, the TOs incurred administrative costs related to their individual systems and tariffs. Now that the Midwest ISO, as an RTO, has taken over administration of the integrated regional grid (composed of the TOs facilities), and all service on Midwest ISO’s system is provided under Midwest ISO’s Tariff, however, the administrative costs formerly incurred by the TOs have shifted to Midwest ISO.

Petitioners concede that grandfathered wholesale loads are still charged for administrative costs under the grandfathered agreements. Br. at 10. As the Commission has directed, those charges continue to be paid directly to the TOs. *Midwest ISO II*, 98 FERC at 61,414. Petitioners have not shown that the grandfathered agreement administrative charges do not fully compensate them for their Midwest ISO Cost Adder responsibility, and, therefore, they have not established that they have suffered any concrete and particularized injury due to the challenged orders.

Furthermore, as pointed out in *Midwest ISO III*, 102 FERC at 61,533 ¶¶26-30, even assuming Petitioners had shown that the administrative cost charges in some grandfathered agreements do not fully compensate Petitioners for the Cost

Adder charges allocated to those particular loads, that alone would not establish a concrete injury causally connected to the challenged orders. Petitioners also would have to show that any additional costs would result in a net under recovery of their total costs. *Id.* Even that showing, however, would not establish aggrievement because Petitioners could seek to amend the grandfathered agreements under FPA §206 (or under FPA §205 if a grandfathered agreement preserved the TO's unilateral right to amend the rates) to recover for any uncompensated costs. *Id.* And, finally, as determined in *Midwest ISO III*, Petitioners can file to recover otherwise currently unrecoverable costs as regulatory assets. *Id.*

As Petitioners have failed to establish that they have suffered a concrete and particularized injury resulting from the challenged orders, the petition should be dismissed for lack of jurisdiction.

II. THE COMMISSION REASONABLY INTERPRETED ITS PRECEDENT AS REQUIRING THAT THE COSTS TO ADMINISTER THE MIDWEST ISO BE ALLOCATED TO ALL LOAD SERVED BY TRANSMISSION ON THE MIDWEST ISO GRID

A. Standard of Review

Assuming jurisdiction, the Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *E.g.*, *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999).

Under that standard, the Commission's decision must be reasoned and based upon substantial evidence in the record. For this purpose, the Commission's factual findings are conclusive if supported by substantial evidence. FPA § 313(b). Moreover, the Commission's reasonable interpretation of its own orders will be upheld. *Texaco Inc. v. FERC*, 148 F.3d 1091, 1099 (D.C. Cir. 1998); *Natural Gas Clearinghouse v. FERC*, 108 F.3d 397, 399 (D.C. Cir. 1997).

Where the subject under review involves ratemaking – "and thus an agency decision involving complex industry analyses and difficult policy choices – 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., 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). Moreover, it is well established that an 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 reasonably interpreted its precedent as requiring that the costs to administer the Midwest ISO be allocated to all load served by transmission on Midwest ISO's regional grid. Accordingly, that decision must be upheld.

B. Commission Precedent Requires That The Costs To Administer The Midwest ISO Be Allocated To All Load Served By Transmission On Midwest ISO's Grid And That Midwest ISO TOs Are Responsible For Payment Of The Cost Adder Allocated To The Grandfathered Wholesale Load They Serve Using Midwest ISO's Grid

Midwest ISO I-IV determined that **all** loads served by transmission on Midwest ISO's grid, including grandfathered wholesale loads, benefit from Midwest ISO's administration of the transmission grid. *Midwest ISO I*, 97 FERC at 61,169; *Midwest ISO II*, 98 FERC at 61,412; *Midwest ISO III*, 102 FERC at 61,531-32; *Midwest ISO IV*, 104 FERC at 61,030. The Commission explained that, because Midwest ISO exercises operational control over the regional system on which grandfathered wholesale load is transmitted, that load relies on Midwest ISO's operation and planning of the system. *Midwest ISO III*, 102 FERC at 61,531-32. Midwest ISO's administration of its regional system will necessarily lead to benefits for all loads served by that system:

[a]s a result of . . . unified planning and operation of the regional grid, [the Commission] expect[s] to see 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. This will result in enhanced reliability which will benefit all loads. This is because the non-Midwest ISO-operated facilities, such as those connected to local generation, in this region are integrated with facilities operated by Midwest ISO. It is established Commission policy that an integrated transmission grid is a cohesive network moving electricity in bulk. Thus, all customers using that grid share in all costs of the grid because they all benefit. This policy has been affirmed in court.⁷ 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) cannot be served reliably without the facilities operated by Midwest ISO. If those Midwest ISO-operated facilities were to disappear, service to all loads . . . would suffer greatly. Similarly, more efficient operation of the regional grid, including an effective congestion management scheme, should result in the ability of the regional grid to accommodate greater power flows, and thus more transactions than otherwise possible.

Midwest ISO II, 98 FERC at 61,412 (internal quotes and footnotes omitted); *see also Midwest ISO III*, 102 FERC at 61,531 ¶21 (noting that the Commission, in Order No. 2000, determined that all users of an integrated grid benefit from operation of that grid).

Because all load served, in whole or part, by transmission on Midwest ISO's grid benefits from Midwest ISO's operation of the grid, the Commission, in

⁷ Citing, *e.g.*, *Western Massachusetts Electric Co. v. FERC*, 165 F.3d 922, 927 (D.C. Cir. 1999) (approving the Commission's consistent policy of allocating the costs of system-wide benefits to all customers on an integrated transmission grid).

Midwest ISO I-IV, rejected the proposal to exclude grandfathered wholesale load from the divisor used to calculate the Midwest ISO Cost Adder unit rate. *E.g.*, *Midwest ISO III*, 102 FERC at 61,532. The Cost Adder unit rate would be just and reasonable only if it were spread out among all load benefiting from Midwest ISO's operations, including grandfathered wholesale load transmitted on that system. *Midwest ISO I*, 97 FERC at 61,169; *Midwest ISO II*, 98 FERC at 61,412; *Midwest ISO III*, 102 FERC at 61,531-32; *Midwest ISO IV*, 104 FERC at 61,030.

Furthermore, the Commission determined, because Midwest ISO TOs must take transmission service under the Midwest ISO Tariff for their use of the Midwest ISO grid to serve grandfathered wholesale load, the TOs are responsible to pay the Cost Adder associated with that load. *Midwest ISO II*, 98 FERC at 61,413.

C. The Challenged Orders Reasonably Interpreted and Applied Commission Precedent

The challenged orders addressed the compliance filings made in response to *Midwest ISO I-IV*. Citing to and applying its determinations in those *Midwest ISO* Orders, the Commission rejected the proposals to exempt TOs from responsibility for Cost Adder charges allocated to the grandfathered wholesale load they serve by transmission on the Midwest ISO grid. October Order at ¶¶12, 19-20, JA 12, 13; Rehearing Order at ¶29, JA 47. *Midwest ISO II* made clear “that the Midwest ISO

TO is responsible for payment of Schedule 10 [Cost Adder] charges for grandfathered agreement loads that are under the Midwest ISO [Tariff]” October Order at ¶19, JA 13. Furthermore, “Midwest ISO ha[d] not shown why grandfathered loads outside of Midwest ISO, that nevertheless utilize facilities under Midwest ISO’s control, for through and out service, should be exempt from the Schedule 10 Cost Adder.” *Id.* at ¶20, JA 13.

On appeal, Petitioners contend that the Commission disregarded cost-causation principles when it held, in accordance with *Midwest ISO I-IV*, that grandfathered wholesale load transmitted on, but located outside Midwest ISO’s grid, must be allocated a fair share of the Midwest ISO administrative costs. Brief at 27-32. That contention is not properly before the Court, as Petitioners did not raise it on rehearing as required under FPA §313(b), 16 U.S.C. §825l(b). *Entergy Services, Inc. v. FERC*, 319 F.3d 536, 545 (D.C. Cir 2003); *United Distrib. Cos. v. FERC*, 88 F.3d 1105, 1170 (D.C. Cir 1996).

Even if there were subject matter jurisdiction to address Petitioners’ contention, it has no merit. The Midwest ISO recovers its costs to administer the transmission grid and its Tariff through the Schedule 10 Cost Adder. As the detailed findings in *Midwest ISO I-IV*, as well as in Order No. 2000, establish, *all* loads served by transmission on the Midwest ISO grid benefit from the Midwest

ISO's administration of the grid. In *Midwest ISO I-IV*, the Commission applied its consistent policy of allocating costs that result in system-wide benefits to all load that uses all or part of an integrated grid, *Western Massachusetts*, 165 F.3d at 927; *Midwest ISO II*, 98 FERC at 61,412. Thus, having found that *all* loads served by transmission on Midwest ISO's grid benefit from Midwest ISO's administration of the grid, the Commission required *all* loads, including grandfathered wholesale loads, to be included in the methodology used to determine the Cost Adder unit rate. In that way, the Commission assured that all loads would share equitably in the Midwest ISO's costs for grid administration.

The Commission's interpretation of *Midwest ISO I-IV* as requiring that *all* grandfathered wholesale load, whether outside or inside the grid, that is served by transmission on the Midwest ISO grid be included in determining the Cost Adder unit rate, October Order at ¶¶12, 19-20, JA 12, 13; Rehearing Order at ¶29, JA 47, fully comports with cost-causation principles. This interpretation equitably spreads the Midwest ISO's administrative costs among all load that uses, and thus benefits from, Midwest ISO's administration of the grid. *Western Massachusetts*, 165 F.3d at 927 (approving the Commission's consistent policy of allocating costs of system-wide benefits to all load on an integrated grid).

If, as Petitioners proposed, the Commission excluded from the Cost Adder divisor grandfathered wholesale load served by transmission on, but located outside Midwest ISO's grid, the remaining load served by transmission on the Midwest ISO grid would be allocated a higher Cost Adder unit rate. While Midwest ISO would continue to fully recover its administrative costs in either case, under Petitioners' proposal Midwest ISO's administrative costs would not be equitably shared among all load benefiting from Midwest ISO's administration of the grid, a result the Commission found would be unjust and unreasonable as inconsistent with cost causation principles.

Furthermore, the Commission did not, as Petitioners claim, Brief at 10 n.9, expand the scope of *Midwest ISO I – II* in the challenged orders. Rather, the challenged orders simply applied a reasonable interpretation of the *Midwest ISO* Orders to compliance filings made in response to those orders. As the challenged orders reasonably interpreted the Commission's own orders, they should be upheld. *Texaco*, 148 F.3d at 1099; *Natural Gas Clearinghouse*, 108 F.3d at 399.

Petitioners' argument that FERC's determination "would nullify FERC's general policy against rate pancaking," Brief at 31, fails as well. Concerned that allocating the Cost Adder to grandfathered wholesale load outside the Midwest ISO grid potentially could cause Midwest ISO Cost Adder charges to be pancaked

with similar charges from another RTO, the Commission determined in the Rehearing Order that the matter would be considered “as part of the ongoing proceeding in Docket No. EL02-111-000.” Rehearing Order at ¶30, JA 47. ⁸

D. The Commission Properly Exercised Its Discretion In Referring The Potential Pancaked Cost Adder Issue to An Ongoing Proceeding

On appeal, Petitioners raise myriad challenges to the referral of the potential pancaked rate issue to the EL02-111-000 proceeding. As Petitioners did not seek rehearing of that referral, however, there is no subject matter jurisdiction to consider Petitioners’ challenges. FPA §313(b); *Entergy Services*, 319 F.3d at 545; *United Distrib. Cos.*, 88 F.3d at 1170.

None of those challenges, in any event, have merit. “An agency enjoys broad discretion in determining how best to handle related, yet discrete, issues in terms of procedures” *Mobil Oil Exploration & Prod. Southeast, Inv. v. United Distrib Cos.*, 498 U.S. 211, 230 (1991). Accordingly, it was well within FERC’s discretion to refer the potential future Cost Adder rate pancaking for

⁸ The Commission was responding to Petitioners’ professed concern about *potential* future cost adder pancaking, not to existing circumstances. Petitioners’ rehearing requests asserted that, *if* another RTO were formed, and *if* grandfathered wholesale load transported on Midwest ISO’s system also was transported on the new RTO, that load *might* be subject to allocation of a cost adder on both systems. R. 735 at 4, JA 28; R. 737 at 5-6, JA 34-35; *see also* Br. at 12 (“the rehearing request . . . explained that the likely result of the October Order will be to subject the Midwest ISO Transmission Owners to duplicative administrative cost adders for grandfathered-agreement load outside the [Midwest ISO] footprint . . .”).

through and out service to a proceeding already addressing Midwest ISO through and out service rate issues. *See Alliance Cos.*, 100 FERC 61,137 at 61,528 and ¶50, 61,530 at Ordering ¶D (2002) (“Pursuant to section 206 of the FPA, the Commission will initiate an investigation and hearing before a presiding administrative law judge [in Docket No. EL02-111-000] with regard to the rates for through and out service under the Midwest ISO and PJM tariffs . . .”).

Petitioners’ complaint that it was too late, at the time of the Rehearing Order (April 11, 2003), to refer the potential pancaked cost adder issue to the EL02-111-000 proceeding because the hearing record there already had been closed (Brief at 21-22), cannot stand. Even if the record were closed, Commission Rule 716, 18 C.F.R. §385.716, permits reopening of the evidentiary record upon motion by any participant or *sua sponte* by the ALJ or Commission. In fact, the record and hearing in EL02-111-000 had been reopened twice prior to the challenged referral. First, in response to a Commission order granting an interlocutory appeal and requiring that additional testimony be permitted, the ALJ reconvened the hearing that had taken place December 16-20, 2002, for an additional two days in January 2003. *Midwest Independent System Operator, Inc.*, 102 FERC ¶63,049 at ¶¶4-6 (2003). Later, to allow testimony by a Midwest ISO TO witness, the record was reopened again and further hearing held on March 18, 2003. *Id.* at ¶6.

Nor is there merit to Petitioners' claims that EL02-111-000 purportedly "was not intended to address administrative cost adder pancaking," Br. at 22, and was limited to considering rate issues between Midwest ISO and PJM, Br. at 23. EL02-111-000 was instituted to address the rates for through and out service under the Midwest ISO Tariff, *Alliance Cos.*, 100 FERC at ¶50, the very service Petitioners claim might cause rate pancaking. In any event, even if EL02-111-000 did not originally include within its literal purview consideration of the potential for pancaked cost adder liability, the challenged Rehearing Order expanded the proceeding to include consideration of that issue. Rehearing Order at ¶30, JA 47.

Further, Petitioners had a full opportunity to raise their concerns regarding referral by petitioning for clarification or rehearing of the Rehearing Order directing the referral. The stated factual bases for their concerns -- that the record and hearing in EL02-111-000 already had been closed; that EL02-111-000 was not intended to address administrative cost adder pancaking; and that EL02-111-000 was limited to consideration of rate issues only between Midwest ISO and PJM -- already existed when the Rehearing Order issued. In addition, Petitioners, who were parties to the EL02-111-000 proceeding, could have moved to reopen the record there to present additional evidence and argument regarding the referred

issue. Petitioners, however, took none of the readily available and necessary means to alert the Commission to their concerns.

Petitioners' complaint, Brief at 20, 23-24, that the Commission did not, in the EL02-111-000 proceeding, appropriately address the referred cost adder issue does not belong here. That complaint involves error alleged to have occurred in the EL02-111-000 proceeding, not the one here, and may be made, if at all, only on challenge to the orders in EL02-111-000.

E. The Commission Appropriately Addressed All Of Petitioners' Claims That The Cost Adder Should Not Be Allocated To All Load Served By Transmission On The Midwest ISO System

The *Midwest ISO* Orders and the orders challenged here appropriately responded to and consistently rejected Petitioners' persistent attempts to have the Cost Adder allocated to less than 100 percent of the load served by transmission on Midwest ISO's system. Petitioners argue on appeal, however, that the Commission did not respond to their claim that "FERC's action would leave otherwise similarly situated non-transmission owner load exempt from the cost adder (that is, non-transmission owner grandfathered load outside the footprint that 'utilizes' the [Midwest ISO]-administered grid in the same manner as a similarly situated Transmission Owner)" Brief at 32. The record establishes otherwise.

After noting Petitioners' assertion on rehearing, the Commission, in accordance with its precedent, continued to require that the Cost Adder be allocated to *100 percent* of the load served by transmission on the Midwest ISO system. Once again, the Commission explained that grandfathered wholesale loads served by through and out service on Midwest ISO's grid, like all load transmitted on the grid, benefit from Midwest ISO administration of the grid, and, therefore, must be factored into the calculation of the Cost Adder unit rate. Rehearing Order at ¶¶26, 29, JA 46, 47. Furthermore, the Commission found, it is reasonable for Midwest ISO TOs to be responsible for payment of the Cost Adder for grandfathered loads outside of Midwest ISO's footprint that they serve using the Midwest ISO system. Rehearing Order at ¶ 29, JA 47.

Petitioners' claim that FERC's orders exempt from Cost Adder allocation certain loads outside the Midwest ISO grid that are served by transmission on that grid, Br. at 32, is plainly erroneous. The Rehearing Order, consistent with *Midwest ISO I-IV* and the October Order, held that *100 percent* of the load transmitted on Midwest ISO's system, including all grandfathered wholesale load outside Midwest ISO but served by transmission on the Midwest ISO grid, must be included in the Cost Adder allocation methodology. Rehearing Order at ¶¶26, 29, JA 46, 47. Despite Petitioners' attempts to confuse the issue, FERC's orders make

clear that there is no exception to the requirement that *all* load served using the Midwest ISO system be factored into the Cost Adder methodology so that all load is allocated a fair share of the costs Midwest ISO incurs to administer the system used to service that load.

CONCLUSION

For the foregoing reasons stated, the petition for review should be dismissed for lack of aggrievement. If the Court decides that it has jurisdiction, the petition should be denied for lack of merit.

Respectfully submitted,

Cynthia A. Marlette
General Counsel

Dennis Lane
Solicitor

Beth G. Pacella
Attorney

Federal Energy Regulatory
Commission
Washington, D.C. 20426
TEL: (202) 502-6048
FAX: (202) 273-0901
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