

Nos. 08-1306, 08-1780, 08-2071, 08-2124 and 08-2239 (consolidated)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

ILLINOIS COMMERCE COMMISSION, *ET AL.*,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

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

BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

CYNTHIA A. MARLETTE
General Counsel

ROBERT H. SOLOMON
Solicitor

JENNIFER S. AMERKHAIL
Attorney
888 First St., N.E.
Washington, D.C. 20426
202/502-8650

For Respondent
Federal Energy Regulatory Commission

FINAL: March 24, 2009

TABLE OF CONTENTS

	PAGE
COUNTER-STATEMENT OF JURISDICTION	1
STATEMENT OF ISSUES	4
STATUTORY AND REGULATORY PROVISIONS.....	4
STATEMENT OF THE CASE	5
STATEMENT OF FACTS	7
I. Regulatory Background	7
II. Development of PJM Regional Electricity Market.....	9
A. History and Development of Rates for Existing Facilities	11
B. History and Development of Rates for New Facilities ..	13
III. Underlying FERC Proceedings	17
A. Proposed Replacement Rates and Initial Orders	17
B. ALJ Decision.....	18
IV. Intervening Rulemaking on Transmission Issues	20
V. Challenged FERC Orders	21
A. Orders Setting Rate Design	21
B. Implementation Order.....	24

TABLE OF CONTENTS

	PAGE
SUMMARY OF ARGUMENT	25
ARGUMENT	26
I. Standard of Review	26
II. The Commission’s Decision Regarding the Reasonableness of Existing Facilities Rates Should Be Sustained.....	29
A. The Commission Reasonably Determined that the Zonal Rates Properly Allocate Costs to Those that Caused the Facilities To Be Built	29
1. The Commission Decision Is Consistent with Cost Causation Principles.....	29
2. The Commission Examined Evidence of Benefits	33
3. The Commission Drew the Correct Distinction Between Old and New Transmission.....	35
B. The Commission Reasonably Considered the Relevant Cost Shifts In Retaining the Zonal Rates	37
C. The Commission Reasonably Considered the Views of the Majority of PJM Transmission Owners	43
III. The Commission’s Decision To Replace the Unreasonable New Facilities Cost Allocation Should Be Sustained.....	46
A. The Replacement Rates Promote New Transmission Infrastructure and Are Just and Reasonable.....	47
B. The Commission Properly Determined that the Prior Rate for New Facilities Was Unjust and Unreasonable.....	51

TABLE OF CONTENTS

	PAGE
C. There Were No Cost Shifts for the Commission To Consider	54
D. The Other Issues Raised by the New Facilities Petitioners Lack Merit as Well	58
CONCLUSION	62

TABLE OF AUTHORITIES

COURT CASES:	PAGE
<i>Alabama Mun. Distribs. Group v. FERC</i> , 300 F.3d 877 (D.C. Cir. 2002).....	59
<i>Algonquin Gas Transmission Co. v. FERC</i> , 948 F.2d 1305 (D.C. Cir. 1991).....	35, 39, 54
<i>Arkansas La. Gas Co. v. Hall</i> , 453 U.S. 571 (1980).....	39
<i>Atlantic City Elec. Co. v. FERC</i> , 295 F.3d 1 (D.C. Cir. 2002).....	9, 11
<i>East Ky. Power Cooperative, Inc. v. FERC</i> , 489 F.3d 1299 (D.C. Cir. 2007).....	5
<i>ExxonMobil Oil Corp. v. FERC</i> , 487 F.3d 945 (D.C. Cir. 2007).....	51
<i>FPC v. Hope Natural Gas Co.</i> , 320 U.S. 591 (1944).....	41
<i>Illinois v. United States</i> , 666 F.2d 1066 (7th Cir. 1981)	27
<i>Jancik v. HUD</i> , 44 F.3d 553 (7th Cir. 1995)	27
<i>Jupiter Corp. v. FERC</i> , 943 F.2d 704 (7th Cir. 1991)	28
<i>Louisiana Pub. Serv. Comm'n v. FERC</i> , 522 F.3d 378 (D.C. Cir. 2008).....	28
<i>Maine Pub. Utils. Comm'n v. FERC</i> , 520 F.3d 464 (D.C. Cir. 2008).....	44
<i>Midwest ISO Transmission Owners v. FERC</i> , 373 F.3d 1361 (D.C. Cir. 2004).....	5, 7, 8, 31, 46

TABLE OF AUTHORITIES

COURT CASES:	PAGE
<i>Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.</i> , 463 U.S. 29 (1983)	27
<i>New York v. FERC</i> , 535 U.S. 1 (2002)	1
<i>Northern Ind. Pub. Serv. Co. v. FERC</i> , 782 F.2d 730 (7th Cir. 1986)	27, 28, 31, 32, 35, 36, 61
<i>Northern States Power Co. (Minn.) v. FERC</i> , 30 F.3d 177 (D.C. Cir. 1994).....	28
<i>Permian Basin Area Rate Cases</i> , 390 U.S. 747 (1968).....	28
<i>Perot v. FEC</i> , 97 F.3d 553 (D.C. Cir 1996).....	54
<i>Petal Gas Storage, L.L.C. v. FERC</i> , 496 F.3d 695 (D.C. Cir. 2007).....	51
<i>Platte River Whooping Crane Critical Habitat Maint. Trust v. FERC</i> , 962 F.2d 27 (D.C. Cir. 1992).....	59
<i>Process Gas Consumers Group v. FERC</i> , 912 F.2d 511 (D.C. Cir. 1990).....	59
<i>Public Serv. Comm’n of Wis. v. FERC</i> , 545 F.3d 1058 (D.C. Cir. 2008).....	5, 6, 29, 31, 32, 36, 44
<i>United States Telecom Ass’n v. FCC</i> , 359 F.3d 554 (D.C. Cir. 2004).....	53

TABLE OF AUTHORITIES

COURT CASES:	PAGE
<i>Schneider Nat'l, Inc. v. ICC</i> , 948 F.2d 338 (7th Cir. 1991)	27
<i>Sithe/Independence Power Partners, L.P. v. FERC</i> , 285 F.3d 1, 5 (D.C. Cir. 2002).....	34
<i>Western Area Power Admin. v. FERC</i> , 525 F.3d 40 (D.C. Cir. 2008).....	5
<i>Wisconsin Pub. Power, Inc. v. FERC</i> , 493 F.3d 239 (D.C. Cir. 2007).....	5, 7, 45, 51
 ADMINISTRATIVE CASES:	
<i>Alliance Cos.</i> , 100 FERC ¶ 61,137 (2002)	12
<i>Allegheny Power Sys. Operating Cos.</i> , 111 FERC ¶ 61,308 (2005)	11,14,17
<i>Allegheny Power Sys. Operating Cos.</i> , 115 FERC ¶ 61,156 (2006)	17, 18, 41
<i>American Elec. Power Service Corp.</i> , 103 FERC ¶ 61,008 (2003)	12
<i>American Elec. Power Service Corp.</i> , 103 FERC ¶ 61,009 (2003)	42
<i>American Elec. Power Service Corp.</i> , 110 FERC ¶ 61,392 (2005)	12
<i>California Indep. Sys. Operator Corp.</i> , 103 FERC ¶ 61,114 (2003)	33

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES:	PAGE
<i>California Indep. Sys. Operator Corp.</i> , 111 FERC ¶ 61,337 (2005)	39
<i>California Power Exchange</i> , 106 FERC ¶ 61,196 (2004)	33
<i>ISO New England v. New England Power Pool</i> , 91 FERC ¶ 61,311 (2000)	32
<i>New PJM Cos.</i> , 110 FERC ¶ 61,392 (2005)	10
<i>Midwest Indep. Transmission Sys. Operator, Inc.</i> , 104 FERC ¶ 61,105, <i>order on reh'g</i> , 105 FERC ¶ 61,212 (2003)	12, 41
<i>Midwest Indep. Transmission Sys. Operator, Inc.</i> , 108 FERC ¶ 61,163 (2004)	33
<i>Midwest Indep. Transmission Sys. Operator, Inc.</i> , 109 FERC ¶ 61,168 (2004)	13, 41
<i>Midwest Indep. Transmission Sys. Operator, Inc.</i> , 114 FERC ¶ 61,106, <i>order on reh'g</i> , 117 FERC ¶ 61,241 (2006)	32, 44
<i>Pennsylvania-New Jersey-Maryland Interconnection</i> , 92 FERC ¶ 61,282 (2000)	11
<i>PJM Interconnection, L.L.C.</i> , 104 FERC ¶ 61,124 (2003)	13
<i>PJM Interconnection, L.L.C.</i> , 105 FERC ¶ 61,123 (2003), <i>order on reh'g & compliance</i> , 109 FERC ¶ 61,067 (2004)	13, 14

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES:	PAGE
<i>PJM Interconnection, L.L.C.</i> , 111 FERC ¶ 61,308 (2005)	14
<i>PJM Interconnection, L.L.C.</i> , 115 FERC ¶ 61,261 (2006)	15, 16
<i>PJM Interconnection, L.L.C.</i> , 116 FERC ¶ 61,118 (2006)	15, 16
<i>PJM Interconnection, L.L.C.</i> , 116 FERC ¶ 63,007 (2007)	18, 19, 34, 49
<i>PJM Interconnection, L.L.C.</i> , 117 FERC ¶ 61,058 (2006)	15, 16
<i>PJM Interconnection, L.L.C.</i> , 117 FERC ¶ 61,218 (2006)	16
<i>PJM Interconnection, L.L.C.</i> , 118 FERC ¶ 61,154 (2007)	17
<i>PJM Interconnection, L.L.C.</i> , 119 FERC ¶ 61,033 (2007)	15, 16
<i>PJM Interconnection, L.L.C.</i> , 119 FERC ¶ 61,063 (2007) (“Rate Design Order”).....	1, 9, 10, 13, 20, 21, 22, 23, 29, 30, 31, 34, 36, 37, 38, 41, 43, 44, 45, 46, 48, 49, 50, 52, 53, 57, 59, 60, 61
<i>PJM Interconnection, L.L.C.</i> , 119 FERC ¶ 61,067 (2007)(“Formula Development Order”) ..	3, 24, 53, 59

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES:	PAGE
<i>PJM Interconnection, L.L.C.</i> , 122 FERC ¶ 61,082 (2008) (“Rehearing Order”).....	1, 15, 16, 23, 30, 33, 34, 35, 36, 38, 39, 40, 41, 42, 43, 44, 45, 46, 48, 49, 52, 60, 61
<i>PJM Interconnection, L.L.C.</i> , 122 FERC ¶ 61,217 (2008) (“Implementation Order”)	3, 24, 57
<i>Preventing Undue Discrimination and Preference in Transmission Service</i> , Order No. 890, FERC Stats. & Regs., Regs. Preambles ¶ 31,241, <i>order on reh’g</i> , Order No. 890-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,261 (2007), <i>order on reh’g</i> , Order No. 890-B, FERC Stats. & Regs., Regs. Preambles ¶ 61,299 (2008).....	20, 21, 46
<i>Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design</i> , Order Terminating Proceedings, 112 FERC ¶ 61,073 (2005).....	43
<i>Regional Transmission Organizations</i> , Order No. 2000, FERC Stats.& Regs., Regs. Preambles ¶ 31,089 (1999), <i>order on reh’g</i> , Order No. 2000-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2002), <i>appeals dismissed sub nom. Public Util. Dist. No. 1 of Snohomish County v. FERC</i> , 272 F.3d 607 (D.C. Cir. 2001)	8, 9, 40, 42, 46
STATUTES:	
28 U.S.C. § 2112(a)(3).....	2
Administrative Procedure Act	
5 U.S.C. § 706(2)(A)	26

TABLE OF AUTHORITIES

STATUTES:	PAGE
Federal Power Act	
Section 201(b), 16 U.S.C. § 824(b)	1
Section 205(a)-(c), 16 U.S.C. § 824d(a)-(c)	3
Section 206(a)-(b), 16 U.S.C. § 824e(a)-(b)	1, 3, 17, 39, 54
Section 219, 16 U.S.C. § 824s	36, 48
Section 313(b), 16 U.S.C. § 825l(b)	2, 3, 27, 58, 59, 60
 OTHER:	
Operating Agreement of the PJM Interconnection, L.L.C., Schedule 6, § 1.5.6(g)	52

GLOSSARY

ALJ	Administrative Law Judge
ALJ Decision	<i>PJM Interconnection, L.L.C.</i> , 116 FERC ¶ 63,007 (July 13, 2007), R.243, JA 0001
Allegheny	Allegheny Power Company, a transmission-owning member of the PJM Interconnection
American Electric Power	Petitioner American Electric Power Service Corporation
Beneficiary Pays Formula	A formula, using metrics and a stated methodology, to be developed that will allocate the cost of transmission facilities in PJM to those that benefit from the facilities
Commission or FERC	Respondent Federal Energy Regulatory Commission
Commonwealth Edison	Commonwealth Edison Company, a transmission-owning subsidiary of Exelon Corporation
Dayton	Petitioner Dayton Power and Light Company
Dominion	Virginia Electric and Power Company, a subsidiary of Dominion Resources, Inc. and a transmission-owning member of PJM
Exelon	Intervenor Exelon Corporation
Existing Facilities Petitioners	Petitioners American Electric Power Service Corporation and the Public Utilities Commission of Ohio
FPA	Federal Power Act
Formula Development Order	<i>PJM Interconnection, L.L.C.</i> , 119 FERC ¶ 61,067 (Apr. 19, 2007)

Illinois	Petitioner Illinois Commerce Commission
Implementation Order	<i>PJM Interconnection, L.L.C.</i> , 122 FERC ¶ 61,217 (Mar. 7, 2008), R.355, JA 0174
Initial Order	<i>Allegheny Power Sys. Operating Cos.</i> , 111 FERC ¶ 61,308 (May 31, 2005), R.1, JA0181
JA	Joint Appendix
kV	Kilovolts
New Facilities Petitioners	Petitioners Illinois Commerce Commission, Dayton Power and Light Company and the Public Utilities Commission of Ohio
Ohio	Petitioner Public Utilities Commission of Ohio
Order No. 890	<i>Preventing Undue Discrimination and Preference in Transmission Serv.</i> , Order No. 890, FERC Stats. & Regs., Regs. Preambles ¶ 31,241, <i>order on reh'g</i> , Order No. 890-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,261 (2007), <i>order on reh'g</i> , Order No. 890-B, FERC Stats. & Regs., Regs. Preambles ¶ 61,299 (2008)
Order No. 2000	<i>Regional Transmission Organizations</i> , Order No. 2000, FERC Stats. & Regs., Regs. Preambles ¶ 31,089 (1999), <i>order on reh'g</i> , FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000), <i>dismissed sub nom. Public Utility District No. 1 of Snohomish County v. FERC</i> , 272 F.3d 607 (D.C. Cir. 2001).
P	Paragraph number in a FERC order
PJM	PJM Interconnection, L.L.C., the entity responsible for administering the tariff for access to transmission in 13 states in the mid-Atlantic and surrounding areas

R.	Record citation
Rate Design Order	<i>PJM Interconnection, L.L.C.</i> , 119 FERC ¶ 61,063 (Apr. 19, 2007), R.283, JA 0095
Regional Facilities	Centrally-planned transmission facilities operating at or above 500 kilovolts
Rehearing Order	<i>PJM Interconnection, L.L.C.</i> , 122 FERC ¶ 61,082 (Jan. 31, 2008), R.345, JA 0142
RTO	Regional Transmission Organization

COUNTER-STATEMENT OF JURISDICTION

The jurisdictional statements in the joint briefs of petitioners are not complete and correct. *See* Cir. R. 28(b).

This is a consolidated appeal of three final orders of the Federal Energy Regulatory Commission (“Commission” or “FERC”) generally involving transmission rate design. Section 201(b) of the Federal Power Act (“FPA”), 16 U.S.C. § 824(b)(1), grants the Commission exclusive jurisdiction over the transmission of electricity in interstate commerce. *See, e.g., New York v. FERC*, 535 U.S. 1 (2002).

The first set of orders concerns the Commission’s review, pursuant to authority under Section 206(a)-(b) of the FPA, 16 U.S.C. § 824e(a)-(b), of existing rates. On April 19, 2007, the Commission issued an Opinion and Order on Initial Decision, *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,063 (2007) (“Rate Design Order”), R.283, JA 0095. On January 31, 2008, the Commission addressed the issues raised in requests for rehearing of that order in *PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,082 (2008) (“Rehearing Order”), R.345, JA 0142.

Within 60 days of the issuance of the Rehearing Order and based on their four independent requests for rehearing of the Rate Design Order, Petitioners Illinois Commerce Commission (“Illinois”), American Electric Power Service Corporation (“American Electric Power”), Dayton

Power and Light Company (“Dayton”) and the Public Utilities Commission of Ohio (“Ohio”) appealed these final orders. Illinois, No. 08-1306 (filed Feb. 8, 2008); American Electric Power, No. 08-1780 (filed Feb. 11, 2008); Dayton, No. 08-2071 (filed Mar. 18, 2008); Ohio, No. 08-2239 (filed Mar. 27, 2008); *see also* 16 U.S.C. § 825l(b). Although three of these petitions for review were first filed in the United States Court of Appeals for the District of Columbia Circuit, this Court has jurisdiction because the United States Judicial Panel for Multidistrict Litigation randomly selected the Seventh Circuit. 28 U.S.C. § 2112(a)(3).

Exelon Corporation (“Exelon”), designated by this Court as an Intervenor-Petitioner, sought rehearing of the Rate Design Order and intervened in support of FERC in three of the petitions for review, Case Nos. 08-1780, 08-2071 and 08-2239. It did not intervene in Case No. 08-1306 or file a petition for review of any of the orders in this consolidated appeal.

Petitioners Illinois, Dayton and Ohio (“New Facilities Petitioners”) raise two issues on appeal that they failed to individually preserve on rehearing before the Commission; these issues are jurisdictionally barred pursuant to Section 313(b) of the FPA, 16 U.S.C. § 825l(b). *See infra* pp. 58-59, 60. Further, this Court is without jurisdiction to address issues raised solely by Intervenor Exelon because it did not file with a court of

appeals a “petition praying that the order of the Commission be modified or set aside in whole or in part.” 16 U.S.C. § 825(l)(b); *see infra* pp. 59, 60.

In a parallel proceeding, under Section 206(a)-(b) of the FPA, 16 U.S.C. § 824e(a)-(b), the Commission directed PJM Interconnection, L.L.C. (“PJM”) to revise its tariff to implement the Rate Design Order with regard to existing cost allocations for planned high voltage facilities operating at 500 kV or above (“Regional Facilities”). *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,067 at P 1 (2007) (“Formula Development Order”). In that same order, acting pursuant to Sections 205(a)-(c) and 206(a)-(b) of the FPA, 16 U.S.C. § 824d(a)-(c), 824e(a)-(b), the Commission broadened the scope of an existing administrative hearing to require the development of a formula (“Beneficiary Pays Formula”) for the assignment of new transmission costs for facilities with a voltage level below 500 kilovolts (“kV”). This latter proceeding is continuing before the agency.

On March 7, 2008, the Commission denied the request for rehearing of Illinois pertaining solely to the directive that PJM modify its tariff to reallocate the costs of planned transmission projects and approved PJM’s implementation filing. *PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,217 (2008) (“Implementation Order”), R.355, JA 0174. Illinois timely petitioned for review of the Implementation Order (Case No. 08-

2124 (filed May 6, 2008)) and sought consolidation with its appeal in Case No. 08-1306. The Court granted Illinois' motion to consolidate on June 11, 2008.

STATEMENT OF ISSUES

The issues presented for review are:

1. Whether the Commission reasonably determined that existing transmission costs, all of which are sunk costs incurred by individual transmission owners, should continue to be allocated to customers in each transmission owner's zone for whom the costs were incurred, rather than paid by all customers in a 13-state region;
2. Whether the Commission reasonably found the rates for new, centrally-planned transmission facilities were unreasonable because the tariff failed to explicitly provide a cost allocation formula; and
3. Whether the Commission reasonably held that the costs of high-voltage transmission facilities to be centrally-planned and constructed in the future had regional benefits and, accordingly, should be allocated to all customers in the region.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutory provisions and relevant tariff sheets are contained in the Addendum to this Brief.

STATEMENT OF THE CASE

This case is the latest in a long list of cases to come before the courts of appeals on the development of rates in electricity markets operated by independent regional entities and regulated by the Commission. See, e.g., *Public Serv. Comm'n of Wis. v. FERC*, 545 F.3d 1058 (D.C. Cir. 2008) (upholding rate design that distinguishes between vintages of transmission facilities); *Western Area Power Admin. v. FERC*, 525 F.3d 40 (D.C. Cir. 2008) (upholding the assessment and pass-through of administrative fees in California); *Wisconsin Pub. Power, Inc. v. FERC*, 493 F.3d 239 (D.C. Cir. 2007) (upholding, *inter alia*, the integration, after a transition period, of pre-existing electricity contracts into the rate design of the Midwest regional market operator); *East Ky. Power Cooperative, Inc. v. FERC*, 489 F.3d 1299 (D.C. Cir. 2007) (upholding pass-through of costs to customers included, but not expressly participating, in regional electricity markets based on benefits received); and *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004) (upholding assignment of administrative costs to all customers in the region that benefit from the operation of the regional market). The most recent of these cases involves the exact subject matter at issue in this case: the assignment, after a prolonged period of stakeholder discussion and administrative litigation, of the costs of

transmission facilities that are included in a regional market. *Public Serv. Comm'n of Wis.*, 545 F.3d at 1059-60.

Similarly, in this case extensive stakeholder negotiations carried out over a prolonged period led to litigation before the Commission. After a hearing and a decision by a FERC administrative law judge (“ALJ”), the Commission determined that the rate design for the PJM region remained reasonable with respect to existing transmission facilities but required changes to the assignment of the costs of transmission facilities to be constructed in the future.

The Commission determined that the cost of existing facilities should continue to be assigned to the customers in each of PJM’s 17 zones, each roughly representing the service territory of a transmission owner. American Electric Power remains the sole transmission owner challenging the cost assignment for these facilities. Petitioners American Electric Power and Ohio (“Existing Facilities Petitioners”) prefer a regional allocation of some existing transmission facilities so that American Electric Power’s costs can be shared with customers throughout the PJM region.

For new transmission facilities, the Commission determined that the existing rates were unreasonable and should be replaced with a rate that spreads the costs of Regional Facilities, those operating at 500 kV

and above, across the region. Petitioners Illinois, Dayton and Ohio (“New Facilities Petitioners”) prefer the line be drawn differently so that their ratepayers incur none of the costs of these new Regional Facilities planned for the next 15 years. As an alternative, these petitioners seek to relitigate the definition of Regional Facilities so that some of their lower-voltage facilities would be eligible for regional allocation. By contrast, in the proceeding below, Petitioner American Electric Power supported the Commission’s decision to allocate high-voltage facilities across the region.

Petitioner Ohio is unique in its challenge to both decisions. It seeks cost sharing of existing facilities and opposes cost sharing of new Regional Facilities. This is at odds with Ohio’s position in the proceeding below in which it argued that the Commission erred in not treating new and existing facilities equally.

STATEMENT OF FACTS

I. Regulatory Background

In recent years, the Commission, through a series of rulemakings and initiatives, has encouraged competition and reliability improvements in the wholesale market for electric power through provision of non-discriminatory, efficient access to transmission. *See Midwest ISO*, 373 F.3d at 1363-65; *Wisconsin Pub. Power*, 493 F.3d at 247. One of these

significant rulemakings, Order No. 2000, encouraged the formation of Regional Transmission Organizations (“RTOs”) and directed utilities to either voluntarily transfer operational control of their transmission facilities to an RTO or explain any efforts to participate in a market operated by such entity.¹ *See Midwest ISO*, 373 F.3d at 1365 (discussing transmission control requirements).

A central goal of the Commission’s Order No. 2000 policy is the elimination of multiple transmission charges for a single transaction crossing multiple utility systems within a region. Order No. 2000 at 31,174. Over the objection of Petitioner American Electric Power and one other transmission owner, the Commission “affirm[ed] that the RTO tariff must not result in transmission customers paying multiple access charges to recover capital costs.” *Id.*

In setting this policy, the Commission noted that all previously-approved independent system operators (of which PJM was one) had zonal transmission rates (also called license plate rates). *Id.* at 31,176. Zonal rates require that a transmission user pays based on the transmission costs of the member system in which the user is located,

¹ *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 Util. Dist. No. 1 of Snohomish County v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

whether or not its transactions cross multiple member systems within the region. *Id.* (noting that zonal rates are not generally uniform across a region). As an initial matter, the Commission approved of zonal rates, as opposed to uniform region-wide rates (also called postage stamp rates), during RTO formation. Order No. 2000 at 31,177. In making this finding, the Commission gave great weight to the fact that zonal rates limit the cost shifting consequences of RTO formation. *Id.* The Commission, however, required that after a transition period, each RTO must “justify its choice to continue or discontinue using [zonal] rates” *Id.* (“not requiring that the RTO continue or abandon the use of [zonal] rates”).

II. Development of PJM Regional Electricity Market

PJM, as “the oldest . . . power pool in the nation” (*Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 5-6 (D.C. Cir. 2002)), has expanded its control of transmission and electricity market responsibilities over the last decade at the same time that its geographic scope has significantly increased. In 1997, the member transmission owners of PJM, located in six mid-Atlantic states, transferred operational control of their eight transmission systems to PJM. Rate Design Order at P 5, JA 0101. At that time, PJM established zonal transmission rates and an auction-based wholesale electricity market with congestion pricing. *Id.* In 2001,

PJM assumed responsibility for planning new construction to expand the existing transmission system. *Id.* at P 6, JA 0102.

Between 2002 and 2005, the PJM-controlled transmission grid significantly expanded, principally through the addition of new member transmission owners to the South and West of the then-existing PJM boundary, rather than the construction of new transmission facilities. *Id.* at P 7, JA 0102; *see also* Ex. AP-900 at 5, R.405, JA 0404 (Allegheny Power Company (“Allegheny”) was the first addition on April 1, 2002). As relevant here, Commonwealth Edison Company (“Commonwealth Edison”), a subsidiary of Exelon, joined on May 1, 2004, followed close in time by Petitioners American Electric Power and Dayton. *New PJM Cos.*, 110 FERC ¶ 61,392 at P 4 n.2 (2005). Virginia Electric and Power Company (“Dominion”), a subsidiary of Dominion Resources, Inc., joined in 2005. The transmission owners within the PJM boundary are divided into 17 transmission zones representing roughly each of their historical service territories, with some zones containing more than one transmission owner. Rate Design Order at P 54, JA 0122. The PJM zones are located in Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia. *Id.* at P 7, JA 0102.

As the transmission owners joined PJM, they adopted the PJM transmission rate design for the use of their facilities. Transmission owners no longer collected revenues for uses of their system by other PJM members; rather, service was “sold for a single rate, even when a transaction uses the transmission lines of more than one utility.”

Atlantic City, 295 F.3d at 14.

Although the rate design for new and existing facilities is combined in the proceeding below, each was originally developed along separate tracks.

A. History and Development of Rates for Existing Facilities

As part of RTO formation, PJM members committed to negotiate and file some sort of “uniform system-wide rate” and the Commission ordered PJM to file this rate by a date certain. *Pennsylvania-New Jersey-Maryland Interconnection*, 92 FERC ¶ 61,282, 61,951 (2000), *vacated in part sub nom. Atlantic City*, 295 F.3d at 15 (FERC may not require members to relinquish rights “to file changes in rate designs”). After remand and in a different proceeding, the Commission accepted a settlement on August 9, 2004, that required certain PJM transmission owners to address “whether the existing zonal rate design should be changed after May 31, 2005” *Allegheny Power Sys. Operating Cos.*, 111 FERC ¶ 61,308 at P 3 & n.4 (2005), R.1, JA 0183 (“Initial Order”).

During this time, there were many proceedings to address integration of the new transmission owners, including American Electric Power, into PJM. Given that it would lose a source of revenues when it could no longer charge for transactions that flowed between its system and neighboring systems in PJM, American Electric Power proposed a transitional means of reclaiming this revenue stream once it joined PJM. *See American Elec. Power Serv. Corp.*, 103 FERC ¶ 61,008 at PP 4, 32-33 (2003); Br. at 14. The Commission set these proposed transitional rates for hearing, finding American Electric Power’s proposal “may be unjust and unreasonable,” or “otherwise unlawful.” 103 FERC ¶ 61,008 at PP 32-33; *see also American Elec. Power Serv. Corp.*, 110 FERC ¶ 61,392 (2005) (order terminating proceeding as moot).

Contemporaneous with American Electric Power’s decision to join PJM, the Commission opened a proceeding to determine the reasonableness of rates for transactions that flow between PJM and its neighboring RTO, Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”). *Alliance Cos.*, 100 FERC ¶ 61,137 at P 50 (2002). On July 23, 2003, the Commission directed the RTOs to eliminate the rates for such transactions. *Midwest Indep. Transmission Sys. Operator, Inc.*, 104 FERC ¶ 61,105 (2003). In an order issued on November 19, 2004, the Commission also adopted a 16-month transitional mechanism

(to expire on March 31, 2006) to allow recovery of revenue lost due to the elimination of these inter-RTO rates. *Midwest Indep. Transmission Sys. Operator, Inc.*, 109 FERC ¶ 61,168 at PP 54-62 (2004).

B. History and Development of Rates for New Facilities

By 2002, with FERC approval as an RTO, PJM had assumed responsibility for planning the expansion of the transmission system in its region to achieve reliable electricity supply at the lowest reasonable costs. Rate Design Order at P 6, JA 0102. As part of the RTO approval, the Commission required PJM to plan for projects that would address congestion (so-called “economic projects”) as well as reliability problems on its system.

In response to this FERC order and after a lengthy stakeholder process, PJM proposed a rate design for newly constructed transmission facilities that allowed for the allocation of costs to beneficiaries outside of the zone in which the transmission was built. *See PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,124 (2003). The Commission preliminarily approved PJM’s proposal but required six more months of stakeholder process to further develop the procedures for identifying economic projects. *PJM Interconnection, L.L.C.*, 105 FERC ¶ 61,123 at P 55 (2003), *order on reh’g & compliance*, 109 FERC ¶ 61,067 (2004) (accepting Schedule 6 to the PJM Operating Agreement).

The new Commission-approved tariff allowed for cost assignment based on PJM’s “assessment of the contributions to the need for, and benefits expected to be derived from, the pertinent enhancement or expansion” of transmission facilities. 109 FERC ¶ 61,067 at P 64 (citing PJM Operating Agreement, Schedule 6, § 1.5.6(g), attached in Addendum to this brief).

In the same proceeding, PJM proposed, and the Commission approved, a new rate recovery conduit (PJM Tariff Schedule 12) to allow PJM to charge and credit back the costs of transmission projects after (1) the Commission approved rates for the projects and (2) PJM designated the parties responsible for the costs of each project. Subsequently, in an order issued on May 31, 2005, the Commission required PJM to modify Schedule 12 of its tariff every time PJM designated a beneficiary (and determined a beneficiary’s proportional allocation) of a new transmission project to allow for Commission review of the allocations. *PJM Interconnection, L.L.C.*, 111 FERC ¶ 61,308 at P 49 (2005); see Initial Order at PP 25, 49, JA 0192- 0193, 0200.

Between January 5, 2006 and April 10, 2007, pursuant to these new tariff provisions and after extensive opportunity for stakeholder input, PJM submitted four sets of cost allocations for new transmission projects added pursuant to its 2005 and 2006 Regional Transmission

Expansion Plans. *See PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,261 at PP 1, 23 (2006); *PJM Interconnection, L.L.C.*, 116 FERC ¶ 61,118 (2006); *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,058 at PP 1, 3 (2006) (first Expansion Plan with 15-year planning horizon); *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,033 (2007). These filings showed that “PJM need[ed] over \$9 billion of transmission infrastructure investment to address identified reliability concerns.” Rehearing Order at P 55, JA 0161.

In each filing, PJM described its Beneficiary Pays Formula, the methodology for applying the allocation principle in its tariff: (1) it allocated costs for reliability projects based on the extent to which load in each zone contributed to the violation of reliability criteria as shown through a power flow analysis (*see, e.g., PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,261 at PP 7, 52 (describing Distribution Factor analysis that was not part of the filed rate)); and (2) it allocated costs for economic projects based on the electricity cost savings of each zone relative to the total projected electricity costs savings. *See id.* at P 9 (noting that one project of the 35 planned was an economic upgrade of relatively low voltage allocated to one transmission owner). In each proceeding, there were objections to the methodology for allocating reliability project cost (*e.g., id.* at PP 32-34), requests for inclusion of the Beneficiary Pays

Formula in the tariff (*e.g.*, *id.* at P 35), and many objections to specific project cost allocations. *E.g.*, *id.* at P 47 (listing 28 of 35 projects as contested).

Between May 26, 2006 and April 10, 2007, the Commission issued orders addressing each of the four Expansion Plan filings. *See PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,033 at P 4 n.2 (summarizing prior proceedings). In each order, the Commission set the specific project cost allocations for administrative hearing procedures, but, finding that PJM had complied with the allocation formula in its tariff, it did not set for hearing general objections to the allocation methodology. *See id.* at P 56; *PJM Interconnection, L.L.C.*, 116 FERC ¶ 61,118 at P 38; *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,058 at P 49. Instead, the Commission noted that modifications to the Beneficiary Pays Formula should be raised in the ongoing stakeholder process to revise PJM's expansion planning process. *E.g.*, *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,261 at P 52; *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,058 at P 44. On November 21, 2006, the Commission directed PJM to file status reports on the progress of this stakeholder process. *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,218 at P 31 (2006). On February 27, 2007, the Commission held the consolidated hearings in abeyance pending its decision in the Rate Design proceeding on appeal here. *PJM*

Interconnection, L.L.C., 118 FERC ¶ 61,154 at P 9 (2007) (noting overlap on the issue of proper allocation methodology between the proceedings).

III. Underlying FERC Proceedings

A. Proposed Replacement Rates and Initial Orders

The specific Rate Design proceedings on review here began when, pursuant to a settlement (*see supra* pp. 11-12), many of the PJM transmission owners filed a proposal to continue the rate design within PJM. Initial Order at P 5, JA 0184. Only American Electric Power filed a protest challenging continuation of PJM’s existing rates. *See id.* at PP 18-19, JA 0190. Pursuant to Section 206(a)-(b) of the FPA, 16 U.S.C. § 825e(a)-(b), the Commission set the zonal rates for existing facilities and the rates for new facilities designed through PJM’s Expansion Plan process (collectively referred to as Modified Zonal Rates) for administrative hearing. *Id.* at P 1 & n.2, JA 0182. Addressing requests for rehearing of the Initial Order, the Commission clarified that the issue set for hearing in the Initial Order was “the proper rate design for facilities of [transmission owners] within PJM” and did not include the issue of how costs were allocated among PJM and Midwest ISO, which was the subject of a different ongoing proceeding. *Allegheny Power Sys. Operating Cos.*, 115 FERC ¶ 61,156 at PP 16-17 & n.14 (2006), R.209, JA 0248 (rejecting request to consolidate proceedings).

B. ALJ Decision

On July 13, 2006, the Presiding ALJ issued his initial decision preserving the current rate design for new facilities and recommending replacement rates for existing facilities. *See PJM Interconnection, L.L.C.*, 116 FERC ¶ 63,007 (2007), R.243, JA 0001 (“ALJ Decision”).

With regard to existing transmission facilities, the judge found that the rates were unreasonable and should be replaced with a uniform regional rate. *Id.* at P 327, JA 0093. He reasoned that the rate design does not comport with cost causation principles because it does not reflect the benefits that customers derive from the PJM grid as a whole. *Id.* at P 244, JA 0072. While the judge recommended a uniform regional rate as a replacement, he found two other voltage-based allocation proposals would also serve as reasonable replacements.

With regard to new transmission facilities rates, the judge determined that proponents of change had not met their burden to show that the rates were unjust and unreasonable. ALJ Decision at P 267, JA 0079. The ALJ based this decision on an understanding that PJM’s tariff (Schedule 12) contained provisions allocating costs for reliability projects on a Distribution Factor analysis, i.e., that the tariff contained a Beneficiary Pays Formula. *Id.* at P 262, JA 0078. Finding that “[t]he current rate design makes a reasonable attempt to link cost recovery to

those who are causing” and benefiting from the projects, and finding that the rate design was relatively new and untested, the ALJ concluded that the new facility rates should remain unchanged. *Id.* at P 267, JA 0079. Finally, the ALJ urged PJM to convene a stakeholder process to develop a means of more widely distributing the costs of new projects with regional benefits. *Id.* at PP 264, 268, JA 0078, 0079.

In evaluating the rate design proposals advocating the sharing of costs for transmission projects above certain voltages, the judge found that a voltage-based rate design can “accurately reflect[] the way the PJM regional transmission facilities are operated” and “align cost responsibility more closely to the customers receiving [regional] benefits.” *Id.* at P 276, JA 0081. Although the judge took note of the considerable disagreement on where to draw the line (*id.* at P 293, JA 0085), he found that “the designation of . . . [a] regional facilities boundary accurately reflects the role of these extra-high voltage facilities as the backbone of the transmission system” *Id.* at P 276, JA 0081; *see also id.* at 281, 294, JA 0083, 0085-0086 (finding 345 kV the most well-supported split between regional and local facilities, but also accepting 230 kV or 500 kV as proper delineations).

Many parties filed exceptions to the ALJ Decision. Several member transmission owners (including Petitioner Dayton and Intervenor Exelon)

and Petitioner Illinois expressed significant opposition to the conclusions that existing facilities rates are unreasonable or that the rates should be immediately replaced. See Rate Design Order at PP 22-23, 35, JA 0109-0110, 0114. Regarding new facilities, two member transmission owners, a coalition of public power providers and PJM opposed the decision's treatment of new facilities rates, arguing that the *status quo* rates were unreasonable and that the ALJ wrongly rejected their proposals for adding a regional cost allocation component to the rates. See *id.* at PP 31, 33, 36, JA 0113, 0114; see also "Transmission Owner Proponents" Br. on Exceptions at 1, 46, R.262, JA 0613, 0639; "Participants for Purposeful Pricing" Br. Opposing Exceptions at 48, R.273, JA 0670.

IV. Intervening Rulemaking on Transmission Issues

About seven months after the issuance of the ALJ Decision, the Commission issued Order No. 890, a rulemaking to promote competition by reducing barriers to entry in the provision of transmission service.² Citing a decline over the last decade in transmission investment relative

² *Preventing Undue Discrimination and Preference in Transmission Serv.*, Order No. 890, FERC Stats. & Regs., Regs. Preambles ¶ 31,241, *order on reh'g*, Order No. 890-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,261 (2007), *order on reh'g*, Order No. 890-B, FERC Stats. & Regs., Regs. Preambles ¶ 61,299 (2008), *appeal pending sub nom. National Rural Elec. Cooperative Ass'n v. FERC*, D.C. Cir. No. 08-1278 (filed Aug. 22, 2008) (in abeyance pending continuing FERC consideration).

to electricity demand, the Commission required all transmission operators to engage in a coordinated, open and transparent transmission planning process. Order No. 890 at PP 421-425, 435.

As relevant here, in Order No. 890, the Commission clarified the three factors it would consider in resolving transmission cost allocation disputes before the agency. *Id.* at P 559. In judging the reasonableness of a rate design for new transmission facilities, the Commission weighs whether the design: (1) “fairly assigns costs among participants, including those who cause them to be incurred and those who otherwise benefit from them[;]” (2) “provides adequate incentives to construct new transmission[;]” and (3) “is generally supported by state authorities and participants across the region.” *Id.*

V. Challenged FERC Orders

A. Orders Setting Rate Design

In the Orders on review, the Commission applied the three-factor test of Order No. 890, and reversed the ALJ Decision in part with regard to new transmission facilities. Rate Design Order at PP 3-4, JA 0100-0101. The Commission also held that the existing zonal rates were just and reasonable and the transmission expansion rates were unreasonable. *Id.*

The Commission agreed with the judge's finding that the transmission grid was operated on an integrated basis, but determined that the existing facilities at issue were not regionally-planned and were constructed for the benefit of the customers of the individual transmission owners. *Id.* at P 3, JA 0100; *see also id.* at P 50, JA 0120. The Commission also determined that the considerable cost shifts that would result from the rate design proposals could destabilize RTO membership. *Id.* at P 3, JA 0100. To reach this conclusion the Commission analyzed record evidence of expected cost shifts under the various rate design proposals. *Id.* at P 59, JA 0124-0125. For these reasons, the Commission reversed the judge's determination and approved the continuation of zonal rates for existing facilities.

The Commission also agreed generally with the judge that PJM's beneficiary pays principle for assigning transmission expansion costs was the correct approach. *Id.* at P 4, JA 0100-0101. The Commission, however, reversed the judge's finding that PJM's expansion rate was just and reasonable, finding, instead, that the tariff lacked a Beneficiary Pays Formula, i.e., any methodology or metrics for determining which transmission owner zones benefit from new transmission. *Id.* Adopting the same backbone transmission theory supported by the judge, the Commission determined that new transmission facilities at 500 kV and

above (“Regional Facilities”) provide benefits across PJM as a whole. *Id.* at PP 77-80, JA 0132-0134. In order to provide cost certainty and other incentives to build Regional Facilities, the Commission directed PJM to allocate these costs on a uniform regional basis, among all customers in PJM. *Id.* at PP 61, 68, 80, JA 0126, 0128, 0134. For facilities below 500 kV, the Commission determined that further hearing and settlement procedures were necessary to modify the PJM tariff to include a Beneficiary Pays Formula. *Id.* at P 72, JA 0130.

The Commission denied requests for rehearing of the Rate Design Order. Rehearing Order at PP 17-18, JA 0147-0148 (describing factors considered), PP 24-40, JA 0149-0156 (addressing allegation that FERC ignored benefits of existing facilities), PP 41-49, JA 0156-0158 (addressing alleged cost-recovery expectations for existing facilities), PP 63-69, JA 0164-0167 (affirming cost allocation for Regional Facilities), PP 70-71, JA 0168 (citing more record evidence supporting 500 kV division). In the same order, the Commission also approved PJM’s filing to implement the Commission’s directive with regard to new Regional Facilities. *Id.* at PP 72-92, JA 0168-0173.

B. Implementation Order

As described above, in the Formula Development Order, not on appeal here, the Commission directed further proceedings consistent with the Rate Design Order. *See supra* p. 3. As relevant here, the Commission directed the resumption of hearings on PJM's four Expansion Plan filings, expansion of the hearing's scope to include the development of a Beneficiary Pays Formula and revision of the specific cost allocations for all planned Regional Facilities contained in PJM's tariff. Formula Development Order at P 1.

Three parties, including Petitioner Illinois, filed requests for rehearing of the Formula Development Order, raising the same concerns as were raised on rehearing of the Rate Design Order. *See* Implementation Order at P 8, JA 0176; *also see id.* at P 9, JA 0176 (noting that Illinois simply included both dockets in a single request for rehearing and noting that FERC had not consolidated the two proceedings). Referencing the issuance of the Rehearing Order, the Commission denied the requests for rehearing without further discussion. *Id.* at P 17, JA 0178-0179.

.

SUMMARY OF ARGUMENT

After disagreements about cost allocation in PJM that have spanned the last decade and spawned numerous contentious proceedings before FERC, the Commission issued the challenged orders to set the transmission rate design in PJM.

The issues on appeal concern regional cost sharing of transmission projects and the appropriateness of lines drawn to differentiate between projects for cost sharing purposes. Petitioners American Electric Power and Ohio (“Existing Facilities Petitioners”) seek to have cost sharing apply to the sunk costs of American Electric Power’s facilities that were constructed primarily to serve its customers and built before it joined PJM. They challenge the distinction between old and new facilities.

Except with regard to Petitioner Ohio (as a participant in both briefs in this case), New Facilities Petitioners (Petitioners Illinois and Dayton with Petitioner Ohio) do not challenge a different treatment between sunk costs and the costs of future transmission facilities. Rather, they challenge the distinction between Regional Facilities and lower voltage facilities in assigning costs for new transmission. New Facilities Petitioners argue that they do not benefit from Regional Facilities and should not have to share in the costs of these facilities.

The views of the two petitioner transmission owners (American Electric Power and Dayton), as well as Intervenor Exelon, are contrary to the views of the other transmission owners in the 17 zones in PJM. Those other transmission owners support the rate design in full. Additionally, none of the 14 state regulatory commissions involved in the proceedings below have come forward to challenge the FERC's decision except Ohio and Illinois, and several have intervened in support of the decision.

The Commission, relying on substantial evidence in a voluminous record and its significant discretion to address rate design issues, established a just and reasonable rate that balances these and other competing interests as required by the Federal Power Act. Under the respectful standard of review, that balance should not be upset by this Court, just as other courts have refrained from upsetting similar rate design judgments affecting regional cost allocations.

ARGUMENT

I. Standard of Review

The Commission's determination of a reasonable PJM transmission rate design is subject to the arbitrary and capricious standard of the Administrative Procedure Act. 5 U.S.C. § 706(2)(A). "Under this standard, the court's review is narrow; a court may not set aside an

agency decision that articulates grounds indicating a rational connection between the facts and the agency's action." *Schneider Nat'l, Inc. v. ICC*, 948 F.2d 338, 343 (7th Cir. 1991) (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

In conducting this review, the Court considers "whether each essential element of the Commission's order is supported by substantial evidence, and . . . whether the Commission has given reasoned consideration to . . . balancing the needs of the industry with the relevant public interests." *Northern Ind. Pub. Serv. Co. v. FERC*, 782 F.2d 730, 739-40 (7th Cir. 1986) (citations omitted); *see also* 16 U.S.C. § 825l(b) (factual findings are "conclusive" if supported by substantial evidence). "Substantial evidence is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Jancik v. HUD*, 44 F.3d 553, 555 (7th Cir. 1995) (quotation omitted).

In making its determination, the Court is not permitted to "decide the facts anew, reweigh the evidence, or to substitute [its] own judgment" for that of the administrative agency. *Id.* at 556. When an agency reviews the decision of an Administrative Law Judge, as FERC has done here, "it has all the powers that it would have if it were making the decision in the first instance." *Illinois v. United States*, 666 F.2d 1066, 1074 (7th Cir. 1981). The Commission may reject an ALJ's findings,

even though not clearly erroneous, as long as the Commission explains its conclusions. *Id.*; see also *Louisiana Pub. Serv. Comm'n v. FERC*, 522 F.3d 378, 370 (D.C. Cir. 2008) (ALJ's findings are "treated as 'part of the record'" and "not entitled to any special deference" by the FERC).

Under the Federal Power Act, "Congress has entrusted the regulation of the . . . industry to the informed judgment of the Commission, and therefore a presumption of validity attaches to each exercise of the Commission's expertise." *Northern Ind.*, 782 F.2d at 739 (citing to parallel provisions of the Natural Gas Act). Moreover, deference to FERC's decisions regarding rate issues is particularly appropriate, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); see also *Jupiter Corp. v. FERC*, 943 F.2d 704, 706 (7th Cir. 1991) ("We afford deference to the FERC, given that they are an 'expert body'"); *Northern States Power Co. (Minn.) v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) ("our review of whether a particular rate design is 'just and reasonable' is highly deferential").

II. The Commission’s Decision Regarding the Reasonableness of Existing Facilities Rates Should Be Sustained

A. The Commission Reasonably Determined that the Zonal Rates Properly Allocate Costs to Those that Caused the Facilities To Be Built

1. The Commission Decision Is Consistent with Cost Causation Principles

As one of several factors, the Commission properly considered the original basis for making a transmission investment and the purpose originally served by the facilities in determining the reasonableness of any sunk cost reallocation. Rate Design Order at P 3, JA 0100. The Commission found that the existing transmission facilities “were not planned . . . to maximize benefits on a region-wide basis” (*id.* at P 54, JA 0122), “were not part of a system-wide planning process” and “were constructed to serve the needs of individual transmission systems,” i.e., the demands of each transmission owner’s customers. *Id.* at P 50, JA 0120; *cf. Public Serv. Comm’n of Wis.*, 545 F.3d at 1065 (holding that “it is not unfair to require [a Transmission Owner] to shoulder the costs of projects which were ‘planned’ before any cost sharing policy was in effect”).

This finding by the Commission was supported by specific record evidence such as the testimony of American Electric Power witness Mr. Pasternack that the addition of new high voltage transmission “would be

required to meet the needs of the [American Electric Power] system by 1990.” Rate Design Order at P 50 & n.64, JA 0120 (citing Ex. AEP-300 at 9, R.382, JA 0364); *see also id.* at P 50 & nn.62-63, JA 0120 (citing Ex. AP-900 at 5, R.405, JA 0404) (testimony of Allegheny witness that it built lines to ensure reliable operation of its own system); *id.* at P 50 & n.60, JA 0120 (citing, for example, Ex. AEP-104 at 6, R.368, JA 0316) (testimony of American Electric Power witness Baker: “Do you dispute that the [American Electric Power] transmission system was designed and built primarily to serve the needs of [American Electric Power]’s native load customers? No, I do not.”). The Commission concluded that because the existing facilities “were not built as part of the RTO or as a result of its joint planning,” their costs should not be automatically reallocated across the RTO region. Rehearing Order at P 30, JA 0151.

Existing Facilities Petitioners do not dispute that American Electric Power’s transmission facilities were not planned by PJM for the benefit of that entire region. *See Br.* at 43 (American Electric Power “naturally planned the system to meet the needs of its own customers”). Instead, they argue that there is contradictory evidence that its facilities were not “planned . . . in a vacuum.” *Br.* at 42-43. This is inconsistent with the position taken by American Electric Power below. As American Electric Power stated in its rehearing request, “[t]he fact is that no party disputes

that the facilities that make up the backbone of the PJM regional grid originally were built to meet local needs.” American Electric Power Rehearing Request at 19, R.295, JA 0776; *see also id.* at 20, JA 0777 (“[American Electric Power]’s (and other entities’) facilities were not designed through a regional planning process”). Moreover, the Court has acknowledged that in “particularly complicated rate design proceedings” such as these, evidence is bound to be contradictory. *Northern Ind.*, 782 F.2d at 743. The Commission’s job is “to reach a result that is consistent with the evidence on which it relies,” as the Commission has done here. *Id.*

Given its findings based on record evidence, the Commission reasonably concluded that “[t]he current zonal rate design is consistent with cost causation principles because it allocates costs to the customers for whom those facilities were constructed.” Rate Design Order at P 51, JA 0121. This cost causation standard is consistent with FERC and court precedent.

Cost causation “precedent requires only that ‘all approved rates reflect *to some degree* the costs actually caused by the customer who must pay them.’” *Public Serv. Comm’n of Wis.*, 545 F.3d at 1067 (citing *Midwest ISO*, 373 F.3d at 1368). With regard to FERC precedent, the D.C. Circuit found that this cost causation standard was “consistent

with the ‘Cost Causation Rate Principles’ FERC has embraced in previous decisions,” noting that transmission costs are assigned to beneficiaries if they can be identified. *Id.* (citing *ISO New England v. New England Power Pool*, 91 FERC ¶ 61,311 at 62,076 (2000)); see *Northern Ind.*, 782 F.2d at 737 n.15, 738 (FERC accepted Staff proposal that was based on belief that “the primary goal of rate design was to assign cost to those customers who are responsible for causing them”).

The underlying orders recently upheld by the court in *Public Service Commission of Wisconsin* support the Commission’s action here. In a set of orders issued prior to the Rate Design Order in this appeal, the Commission addressed regional cost sharing for transmission expansion projects in an RTO. *Midwest Indep. Transmission Sys. Operator, Inc.*, 114 FERC ¶ 61,106, *order on reh’g*, 117 FERC ¶ 61,241 (2006), *aff’d sub nom. Public Serv. Comm’n of Wis.*, 545 F.3d 1058. Finding that the Commission’s decision did not violate cost causation principles, the court upheld the Commission’s denial of regional cost sharing for projects even though those projects “improve[d] regional reliability” and were planned after the transmission owners became members of the RTO. *Public Serv. Comm’n of Wis.*, 545 F.3d at 1065 & n.16, 1067.

On appeal, here, Existing Facilities Petitioners assert that the Commission did not “discuss its long-standing body of cost-causation

cases.” Br. at 39. To the contrary, the Commission explained the FERC precedent cited again here by Existing Facilities Petitioners. Rehearing Order at P 39, JA 0155 (discussing, e.g., *California Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,114 (2003), *California Power Exchange*, 106 FERC ¶ 61,196 (2004), and *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 FERC ¶ 61,163 (2004)). The Commission found that these cases, on their facts, were distinguishable from the situation it now faced in determining the reasonableness of assigning existing transmission facility costs. *Id.*

2. The Commission Examined Evidence of Benefits

Existing Facilities Petitioners contend that “FERC ignored the evidence” of the benefits provided by existing high voltage facilities in determining whether zonal rates remain just and reasonable. Br. at 23. In so doing, Existing Facilities Petitioners allege that the Commission imposed an incorrect burden on the proponents of regional cost sharing. *Id.* at 34. Neither of these arguments has merit.

While the Commission agreed with the judge that all of the transmission facilities in PJM are integrated, after examination of the evidence, it found that not all transmission is “equally available or valuable to all users of the system.” Rehearing Order at P 40, JA 0156. The Commission found scant support for the judge’s finding that “all

transmission facilities in PJM provide access to all generation in PJM, which provides generation market benefits and enhanced reliability to all PJM transmission zones.” Rate Design Order at P 52, JA 0121 (referencing ALJ Decision at P 244, JA 0073). Specifically, the Commission found that the presence of significant congestion on the system means that the claimed market benefits cannot reach all zones. *Id.* (citing \$2 billion in annual congestion costs, Tr. at 346, R.203, JA 0270); *see also* Ex. RPA-6 at 11, R.460, JA 0506 (testimony of “Responsible Pricing Alliance” witness Smatlak that significant physical constraints on the PJM system exist). The Commission also determined that power needed for reliability is not equally available to all customers. Rehearing Order at P 32, JA 0152 (citing FERC finding in an earlier proceeding).

The Commission acknowledged that there were general regional benefits from American Electric Power’s high voltage system, but determined that these benefits were not as great as claimed and, when balanced against other factors, including the cost shifts to others in PJM, did not justify a change in rate design. Rate Design Order at P 52, JA 0121; *cf. Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002) (“FERC is not bound to reject any rate mechanism that tracks the cost-causation principle less than perfectly.”). Following

Algonquin Gas Transmission Co. v. FERC, 948 F.2d 1305 (D.C. Cir. 1991), the Commission determined that the showing of integration (and related general benefits) was insufficient in the context of a FPA 206 proceeding on review of an existing approved rate to overturn that rate. Rehearing Order at P 31 & n.32, JA 0151; *see Algonquin*, 948 F.2d at 1313 (“Absent evidence of specific system-wide benefits, the Commission’s declaration that the pipeline is ‘integrated’ provides no basis for” reallocating costs to all customers). The benefits shown here, that “in some way improve[] the quality of service to all customers” are the same type the court found unpersuasive in *Algonquin*. 948 F.2d at 1313.

3. The Commission Drew the Correct Distinction Between Old and New Transmission

Because both existing and new high voltage facilities bring general regional benefits, Existing Facilities Petitioners argue that the cost allocation for the different types of facilities should be the same. Br. at 35. But this ignores that the Commission balances different goals in designing the rates for these different types of facilities. *See* Rehearing Order at PP 52-55, JA 0159-0162. This Court has held that the goals served by a rate design and their respective weights are “left to the Commission’s informed judgment” for balancing. *Northern Ind.*, 782 F.2d at 742 n.25 (finding FERC has authority to make “pragmatic adjustments” to meet those goals).

One of the Commission's (and, per FPA § 219, 16 U.S.C. § 824s, Congress') rate design goals for new facilities is to provide incentives for transmission expansion to serve growing needs. Rehearing Order at P 55, JA 0161-0162; *see Northern Ind.*, 782 F.2d at 742 (incentive goals are proper). The cost allocation differs for the two types of facilities because of this goal, and because there is specific evidence in this proceeding that reallocating sunk costs cannot provide incentives for new transmission construction. *See* Rate Design Order at P 53 n.68, JA 0121 (citing Exs. RPA-20 at 7, R.474, JA 0536, Tr. at 454, R.204, JA 0277 and S-2 at 16, R.357, JA 0291) (e.g., testimony of Staff witness Savitski that "[t]he incentive to invest depends on the treatment of new investment, not existing investment (since that is sunk)").

The Commission reasonably concluded that a valid distinction exists between existing facilities' sunk costs and the costs of new facilities that are part of a regional planning process. Rehearing Order at P 52, JA 0159; *see Public Serv. Comm'n of Wis.*, 545 F.3d at 1066-67 (upholding FERC decision providing for cost allocation based on the vintage of facilities). This is especially true when American Electric Power and other PJM transmission owners understood PJM's existing rate design, and accepted that rate design, when they decided to join PJM. *See* Rehearing Order at PP 47-48, JA 0157-0158; *id.* at P 53, JA

0160 (“the distinction between rate design for old and new facilities existed prior to this proceeding”).

Although Petitioner Ohio’s position here is consistent with its rehearing request below (Ohio Rehearing Request at 10, R.293, JA 0741 (“[t]he rate design for the existing system should not be different than the rate design for the new system”)), there is a conflict between this argument and the positions Ohio holds in the Existing Facilities Petitioners’ brief and the New Facilities Petitioners’ brief. In Existing Facilities Petitioners’ brief, Ohio seeks cost sharing of existing high-voltage transmission facilities and argues for a consistent rate design between new and existing facilities. Existing Facilities Petitioners Br. at 35. In New Facilities Petitioners’ brief, Ohio opposes cost sharing of new high-voltage transmission facilities. New Facilities Petitioners Br. at 13. It is unclear what remedy would meet all of Ohio’s requested relief.

B. The Commission Reasonably Considered the Relevant Cost Shifts In Retaining the Zonal Rates

In addition to considering the original basis for transmission investment, the Commission also analyzed the cost shifts that would occur if it reallocated the sunk costs across PJM on a region-wide basis. Rate Design Order at PP 57-60, JA 0123-0126. The Commission reasonably determined that the benefits brought by the integration of American Electric Powers’ facilities did not justify the significant cost

shifts that would occur under any reallocation proposal, especially given the incentive effects of reallocation on RTO membership. Rehearing Order at P 39, JA 0155. The agency elaborated:

[W]e cannot find that those advocating some form of rolled-in rates have shown that imposing significant cost shifts is somehow fairer to everyone than continuing the existing [zonal] rate design under which each utility contributes its facilities to the joint effort, where no attempt is made to impose different valuations on such contributions.

Id. at P 36, JA 0154. The Commission concluded that cost shifts of the magnitude shown in record evidence supported its determination that the existing zonal rates were just and reasonable. Rate Design Order at P 59, JA 0124-0125.

The Commission's finding of significant costs shifts affecting a range of parties is well-supported by record evidence. For example, the evidence shows that the reallocation of the costs of all transmission facilities across the region, as favored by Existing Facilities Petitioners, would result in one zone's annual rates increasing by \$113 million, a 73 percent increase. *Id.* at P 59 & n.81, JA 0125. The same proposal would have shifted \$37 million a year to the Commonwealth Edison zone. *Id.* at P 59 & n.82, JA 0125. The evidence shows that any one zone might incur additional costs or shift costs to its neighbors depending on the proposal. *Id.* (costs for the Commonwealth Edison zone decrease under the American Electric Power proposal and increase under the two other

proposals) (citing Ex. AEP-203 at 1, R.372, JA 0333, and TOP-5, R.414, JA 0421).

Existing Facilities Petitioners assert that the Commission improperly departed from its standard analysis in FPA § 206 cases when it considered the significant cost shifts inherent in the proposed replacement rates. Br. at 47 (citing *California Indep. Sys. Operator Corp.*, 111 FERC ¶ 61,337 (2005)). In fact, the Commission’s approach in analyzing the cost shifting effects of the replacement rates finds firm legal support in *Algonquin*, 948 F.2d 1305. In examining provisions of the Natural Gas Act that parallel the provisions of FPA § 206 (see *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1980)), the D.C. Circuit remanded a FERC decision in which the Commission found the existing rates unreasonable and mandated a replacement rate. *Algonquin*, 948 F.2d at 1310-11. The court found that “[b]ecause the FERC . . . did not explicitly consider the cost shifting that its order might effect, we hold that it has failed to ascertain that the mandated rates are just and reasonable.” *Id.* at 1315. Despite the Commission’s repeated references to *Algonquin* (e.g., Rehearing Order at P 35 nn.39, 45, P 48 n. 58, JA 0153, 0154, 0158) and its determination that *Algonquin* “emphasiz[ed] the need to consider cost shifts in determining whether to change rate designs” (*Id.* at P 35 n.39, JA 0153), Existing Facilities

Petitioners do not attempt to distinguish the case and, in fact, simply fail to mention it.

Furthermore, Existing Facilities Petitioners' claim that the Commission must act in this proceeding to replace American Electric Power's lost revenues (Br. at 12, 22-23, 49-51) is irrelevant and without merit. Because the Commission found that Order No. 2000 eliminated certain revenue sources without guaranteeing uniform system-wide rates for RTOs (Rehearing Order at P 47, JA 0157) and that concerns about other potential lost sources of revenue are outside the scope of the proceeding on appeal here (Rate Design Order at P 60 & n.85, JA 0125), Existing Facilities Petitioners also have no valid claim that "the analysis relied upon by FERC . . . begins from an arbitrarily selected starting point that masks the reality of the costs shifted to [American Electric Power]" Br. at 51.

To be clear, this issue is not about a loss of revenue that could harm American Electric Power and its shareholders. As Order No. 2000 (*see supra* pp. 8-9) required, American Electric Power is made whole for the costs of its transmission system through zonal rates. *See* Order No. 2000 at 31,172 ("transmission prices must reflect the costs of providing the service") (citing *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 606

(1944) (through “basing annual depreciation on costs . . . the utility is made whole”).

The main source of revenue to pay for American Electric Power’s transmission facilities has always been the retail customers in American Electric Power’s service territory. Br. at 7. There are two other historical sources of revenues, those for transactions flowing between PJM transmission owners and those for transactions between PJM and Midwest ISO. See Rehearing Order at P 41, JA 0156 (describing through and out revenues). The Commission determined that the former is the subject of the proceeding on appeal here and the latter is excluded from the hearing below as it is the subject of another ongoing proceeding before the Commission. *Allegheny Power Sys. Operating Cos.*, 115 FERC ¶ 61,156 at P 17, JA 0248; see Rate Design Order at P 60 n.85, JA 0125 (citing *Midwest Indep. Transmission Sys. Operator, Inc.*, 109 FERC ¶ 61,168); Rehearing Order at P 48 n.59, JA 0158; see also *Midwest Indep. Transmission Sys. Operator, Inc.*, 104 FERC ¶ 61,105 at P 35, *order on reh’g*, 105 FERC ¶ 61,212 (2003) (eliminating through and out charges for transactions flowing between RTOs). Existing Facilities Petitioners overstate the level of through and out revenues that are properly the subject of this appeal because their loss figures combine both sources of

through and out revenues. *See, e.g.*, Ex. AEP-207, R.376, 1-2, JA 0339-0340.

As to the loss of revenues for transactions within PJM, the Commission reasonably determined that Order No. 2000 required the elimination of through and out revenues. Rehearing Order at P 47, JA 0157 (citing Order No. 2000 at 31,173); *see also American Elec. Power Serv. Corp.*, 103 FERC ¶ 61,009 at P 1, 12 (2003) (American Electric Power proposed a zonal revenue requirement with rates that “are high enough to compensate for the reduced through and out revenues which may result . . . because [it] ha[s] joined PJM”). The Commission also reasonably found that American Electric Power had no guarantee that zonal rates would be changed to uniform system-wide rates that American Electric Power favors. Rehearing Order at P 45, JA 0157.

Additionally, Existing Facilities Petitioners rely on non-final Commission orders in alleging that the Commission “promised [a] long-term rate solution to replace [through and out] charges” for transactions between PJM transmission owners. Br. at 61; *see* Br. at 38-39. For example, Existing Facilities Petitioners cite a Notice of Proposed Rulemaking (Br. at 9-10, 38) that was stalled at the time the underlying proceeding at issue here was established and that was explicitly terminated less than two months later. *See* Order Terminating

Proceeding, 112 FERC ¶ 61,073, PP 6-7 (2005) (noting FERC interest in rulemaking that became Order No. 890). Existing Facilities Petitioners' contentions, that Order No. 2000's goal was to establish region-wide cost-sharing or that zonal rates were somehow limited by Order No. 2000 (Br. at 12), are not only without citation, they are contrary to the express language of that order. See Rehearing Order at PP 43-44, JA 0156 (citing Order No. 2000 and explaining that it "did not mandate the elimination of [zonal] rates").

C. The Commission Reasonably Considered the Views of the Majority of PJM Transmission Owners

Existing Facilities Petitioners contend that the Commission engaged in "ratemaking by head-count" in affirming the rates for existing facilities based on the views of the majority of the PJM transmission owners. Br. at 57; *see id.* at 58-59 (arguing that FERC should follow its precedent and protect the minority from cost shifts). To the contrary, the weight given to the consensus in this contentious case was appropriately limited and consistent with the Commission's practice in other RTO cases.

While the Commission found that the majority view among member transmission owners in PJM was relevant (Rate Design Order at P 56, JA 0123), this was one of multiple factors, and one "not uniquely critical" to the Commission's ultimate decision that the existing rates were just and

reasonable. Rehearing Order at P 38, JA 0154. The D.C. Circuit recently noted with approval that “the Commission often gives weight to a proposal that may not represent complete stakeholder consensus but is the position of the majority of the transmission owning members of the RTO.” *Public Serv. Comm’n of Wis.*, 545 F.3d at 1062 (citing Rate Design Order at P 56, JA 0123) (punctuation omitted); *see also Midwest Indep. Transmission Sys. Operator, Inc.*, 114 FERC ¶ 61,106 at P 24 (approving cost allocation resulting from stakeholder task force over concerns that the task force did not represent all RTO members); *Maine Pub. Utils. Comm’n v. FERC*, 520 F.3d 464, 469 (D.C. Cir. 2008) (FERC reasonably approved settlement over objections of a few). Further, the consideration of transmission owner preferences is consistent “with [FERC’s] established practice to give deference to regional choices on how to allocate the costs of transmission expansions.” *Public Serv. Comm’n of Wis.*, 545 F.3d at 1062 (citations and punctuation omitted).

Moreover, when the process of developing a cost allocation is “open” and allows for “extensive participation,” as was the administrative hearing here, the D.C. Circuit has rejected the belief that the majority is able to vitiate all minority rights and views by exerting its influence before the Commission. *Public Serv. Comm’n of Wis.*, 545 F.3d at 1062-63 (FERC must exercise independent judgment in determining the

reasonableness of rates). Here, the majority of transmission owners is not “foist[ing] cost responsibility upon the minority.” Br. at 26. The majority simply let American Electric Power, and by extension Ohio, continue to pay costs it would reasonably have expected to pay as a consequence of joining PJM for facilities American Electric Power built before joining PJM. See Rate Design Order at P 50, JA 0120; Rehearing Order at PP 47-48, JA 0157-0158 (“the Commission made clear . . . that the basis upon which a utility joins an RTO is the elimination of through-and-out . . . rates”).

In the orders on appeal, the Commission assessed whether the reallocation of sunk costs could destabilize PJM in evaluating the reasonableness of the existing rates. The Commission determined that, in its predictive judgment, that reallocation could provide disincentives to staying in or joining an RTO. Rehearing Order at P 38, JA 0154; see *Wisconsin Pub. Power*, 493 F.3d at 260-261 (FERC may rely on its predictive judgments as long as it reasonably addresses conflicting record evidence).

Existing Facilities Petitioners argue that the Commission improperly considered the effect on RTO membership in assessing the reasonableness of the rate, asserting that “the burden imposed by a rate is [not] pertinent to the justness and reasonableness of that rate.” Br. at

59-60. In fact, American Electric Power argued the opposite below – that the impact on RTO membership was relevant and failing to adopt its rate proposal would limit further expansion of RTOs. AEP Rehearing Request at 56-59, R.295, JA 0813-0816.

In any case, because “RTOs are voluntary agreements of transmission owners,” incentives to join or remain in an RTO are properly considered in evaluating the reasonableness of an existing RTO rate design. Rehearing Order at P 38, JA 0154; *accord* Order No. 2000 at 31,171. Although the Commission need not “allocate costs with exacting precision” (*Midwest ISO*, 373 F.3d at 1369), it cannot discard one rate that may not perfectly reflect all of the current uses of the system for another rate design that is, at best, no better and, at worst, would cause significant cost shifts and harm to RTO membership.

III. The Commission’s Decision To Replace the Unreasonable New Facilities Cost Allocation Should Be Sustained

In evaluating rate designs for newly-constructed transmission facilities, the Commission takes into account whether there is consensus for a particular design, whether a rate design fairly assigns costs to those that cause the need for the transmission or benefit from the transmission, and whether a design provides adequate incentives for new construction where it is needed. Rate Design Order at PP 61-63, JA 0126-0127 (citing Order No. 890 at PP 559-561). The Commission

examined PJM's prior rates for new facilities using these factors and determined that, because the PJM tariff lacked a formula for allocating the costs of new transmission projects, resulting in uncertainty and delay of needed transmission projects, the rates were unreasonable. *Id.* at P 65, JA 0127.

The Commission then evaluated replacement rates and determined that two approaches were just and reasonable: (1) a formulaic approach that allocates costs to those that, for example, contribute to a specific reliability violation in the future (i.e., a Beneficiary Pays Formula); or (2) cost sharing of high-voltage facilities among everyone in an RTO. *Id.* at P 66, JA 0128; *see id.* at P 67, JA 0128 (describing reasonable rate designs in other RTOs). Because no consensus on the issue had developed during the protracted litigation on the rate design in this proceeding, the Commission reasonably found it must select a rate design based on the record in the proceeding. *Id.* at P 68, JA 0128. The selection, by the Commission, of the cost sharing approach for Regional Facilities is the focus of New Facilities Petitioners' challenge here.

A. The Replacement Rates Promote New Transmission Infrastructure and Are Just and Reasonable

The core of New Facilities Petitioners' complaint is that the Commission selected an arbitrary delineation of 500 kV to define Regional Facilities that are subject to cost sharing. Br. at 42-48. To the

contrary, the Commission weighed the evidence for different treatment of different sized transmission facilities and found that there was support in the record showing 500 kV and above facilities served regional needs and that, historically, these costs were shared across the region. Rate Design Order at PP 78-79, JA 0133-0134; Rehearing Order at PP 65-66, JA 0165-0166. Furthermore, the Commission reasonably determined that cost sharing for these facilities would provide transmission incentives, consistent with the goals of Section 219 of the FPA, 16 U.S.C. § 824s, to address the growing problem of insufficient infrastructure in PJM. Rate Design Order at P 80, JA 0134; Rehearing Order at P 63, JA 0164.

In selecting 500 kV as the point above which the region as a whole would pay for new transmission facilities, the Commission chose a conservative breakpoint – one that would be underinclusive of facilities that served regional needs. Rehearing Order at P 67, JA 0166. This is appropriate as a properly-designed Beneficiary Pays Formula should identify those lower voltage facilities that serve regional needs and spread the costs of such facilities broadly.

FERC relied in part on the independent judgment of the operator of the system, PJM, in determining that voltages below 500 kV more often support local rather than regional needs. Rate Design Order at P 78, JA

0133; Rehearing Order at P 64, JA 0165. Further evidence showed that two of the four rate design proposals before the ALJ advocated treating 500 kV and above facilities as “backbone” facilities, the costs of which should be shared across the region. Rate Design Order at PP 76-77 & n.104, JA 0132-0133 (noting “Participants for Purposeful Pricing” proposal to cost share 500 kV and above facilities and citing Ex. TOP-1, R.410, JA 0418) (testimony of “Transmission Owner Proponents” witness Bourquin that “[t]he network of PJM transmission facilities has as its backbone the 500 kV system Thus, setting a highway rate to recover the costs associated with facilities of 500 kV and above from all network transmission customers is the logical first step”); *see also* ALJ Decision at P 281, JA 0083 (“[Transmission Owner Proponents] suggest[] that the boundary could be set to include only the 500 kV and above facilities, or to include the facilities down to 220 kV, in recognition that they play a regional role in PJM East”). Relying on specific evidence in the record, the Commission also determined that facilities with voltages at 500 kV and above provide more reliability and greater power transfer capability than lower voltage facilities. Rate Design Order at P 78 & nn.105-106, JA 0133 (“The reliability of 500 kV and above circuits . . . is 70% more reliable than 138 kV circuits and 60% more than 230 kV circuits on a per mile basis”).

While PJM expressed optimism about its Expansion Plan process and its construction capabilities in June 2006 (*see* Br. at 49), it provided the Commission with a different picture in February 2007. After most of the planned projects in four Expansion Plan filings had been set for administrative hearing (*see supra* pp. 14-16), and its stakeholder process for reforming the Expansion Plan process had stalled, PJM reported to the Commission that “[r]esolving the cost allocation issues as soon as possible is of particular importance given the immediate need for major new transmission investment” Rate Design Order at P 68, JA 0128 (citing PJM Status Report (filed Feb. 20, 2007)). The Commission reasonably acted on this information in not delaying the rate design decision and acting to spread the costs of Regional Facilities across the PJM region to ensure greater certainty regarding transmission investments.

At bottom, New Facilities Petitioners are arguing that it would be reasonable to allocate costs for all new facilities using the Beneficiary Pays Formula. Br. at 20-21, 25. However, even if such a course might have been reasonable from a cost causation standpoint, this would not in any way invalidate the Commission’s reasonable and record-supported determination. As the D.C. Circuit recently explained, for the purposes of appellate review, “FERC is not required to choose the best solution” in

this context, “only a reasonable one.” *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 703 (D.C. Cir. 2007) (citation omitted); see *Wisconsin Pub. Power*, 493 F.3d at 266 (the burden “is on the petitioners to show that the Commission’s choices are unreasonable and its chosen line of demarcation is not within a zone of reasonableness as distinct from the question of whether the line drawn by the Commission is precisely right”); *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 955 (D.C. Cir. 2007) (Commission need not adopt the best possible policy as long as the agency has acted within the scope of its discretion and reasonably explained its actions).

B. The Commission Properly Determined that the Prior Rate for New Facilities Was Unjust and Unreasonable

New Facilities Petitioners also challenge FERC’s determination that the prior rate design for new transmission was unreasonable. Br. at 18-32. New Facilities Petitioners’ arguments are premised on an assumption that PJM’s tariff, at the time of these proceedings, contained a Beneficiary Pays Formula used by PJM to allocate the costs of planned facilities. See Br. at 6 (“each component of the . . . Formula . . . was accepted by FERC”). New Facilities Petitioners’ premise is incorrect and their related arguments (*see, e.g.*, Br. at 20) are without merit.

The PJM rate on file contains a simple principle, that new facility costs will be allocated based on PJM’s “assessment of the contributions

to the need for, and benefits expected to be derived from” the planned facilities. Operating Agreement of the PJM Interconnection, L.L.C., Schedule 6, § 1.5.6(g) at Sheet No. 185A; see Addendum attached to this brief. This is the only provision relating to cost allocation in the tariff and the only provision approved by FERC. (Schedule 12 merely references this part of the filed rate and is updated periodically to list allocations determined by PJM for specific projects.) See Rate Design Order at P 70, JA 0129.

In the orders on review, the Commission found that the Beneficiary Pays principle was not in dispute. *Id.* at P 64, JA 0127. It concluded, however, that this simple principle stated in PJM’s tariff was not a cost allocation methodology and that without a methodology the rate was not just and reasonable. *Id.* at PP 4, 65-66, JA 0100, 0127-0128; Rehearing Order at P 9, JA 0145 (because the “methodology” was not in the tariff, the “existing method” was not just and reasonable). The Commission recognized that, over time and through ad hoc stakeholder processes, PJM had developed a Beneficiary Pays Formula to supplement this principle for allocating cost to beneficiaries. Rate Design Order at P 71, JA 0130. Importantly, the Commission found that the Beneficiary Pays Formula “is found in its manuals, not in its Tariff” and that many elements of the formula were missing altogether. *Id.* at P 72 n.99, JA

0130. The Commission concluded that further administrative process was required to fully develop the formula for facilities below 500 kV prior to its insertion in the tariff. *Id.* at PP 69-75, JA 0129-0132; *see also* Formula Development Order at PP 16-18, 21-23 (broadening scope of existing hearing proceedings).

FERC reasonably determined that the principle stated in the existing rates was insufficient to give certainty about how cost assignments would be made. Rate Design Order at P 72, JA 0130 (“Tariff does not provide the details”). Further, the Commission reasonably found that this lack of certainty, and the extensive litigation engendered by this uncertainty, had caused a delay in needed transmission projects. *Id.* at P 65, JA 0127 (citing PJM’s comment that “the continuous cycle of litigation . . . must be stopped . . . to see that needed transmission is in fact developed”); *see also supra* p. 16 (28 planned projects in litigation). Requiring provisions in the tariff that spell out the cost allocation methodology rather than state a simple principle, the Commission acted reasonably to lessen PJM’s discretion and allow customers to better predict their cost responsibilities. *See United States Telecom Ass’n v. FCC*, 359 F.3d 554, 567 (D.C. Cir. 2004) (agency may not “delegate[] to another actor almost the entire determination of whether a specific statutory requirement . . . has been

satisfied”); *Perot v. FEC*, 97 F.3d 553, 559-560 (D.C. Cir 1996) (agency acted reasonably in requiring that a regulated entity establish “objective criteria” and seek agency approval of that criteria prior to criteria application).

C. There Were No Cost Shifts for the Commission To Consider

New Facilities Petitioners calculate a shift in costs that they allege the Commission failed to examine prior to determining the just and reasonable replacement rate. Br. at 34-36 (citing PJM Tariff Filing, Attachment, R.301). New Facilities Petitioners’ argument is without merit.

In the FPA § 206 context, the Commission is required to examine any shift in costs that occur in changing from a previously-approved rate to a new Commission-mandated rate. *Algonquin*, 948 F.2d at 1315; see *supra* p. 39. For example, in *Algonquin*, the Commission should have examined the shift in costs between the existing rates, approved by the Commission in the 1980s, that allowed for direct assignment of certain costs and the new rates mandated by the Commission that would have rolled in all of the costs for certain classes of customers. 948 F.2d at 1308-09. Here, the Commission cannot examine cost shifts between the Expansion Plan allocations and the cost sharing for Regional Facilities directed in challenged orders because there is no previously-approved

rate for which a comparison may be made. Most of the cost allocations in PJM's Expansion Plan filings were set for hearing, consolidated by the Commission and held in abeyance pending the outcome of the challenged orders. *See supra* pp. 14-16. Because those allocations were subject to change, there was no previously-approved rate to serve as a starting point for a cost shift analysis.

An examination of Dayton's cost shifting claim explains this point. Dayton argues on appeal (and before the Commission below) that it was not allocated any of the costs of the Regional Facilities prior to the challenged orders. Br. at 34. Based on this, Dayton argues that it will experience a 50 percent increase in its annual revenue requirement as a result of the challenged orders. Br. at 34 n.8. But this ignores the fact that the allocations were not final. In fact, the alleged 50 percent increase is based on a shift of about \$120 million in total project costs (Dayton Rehearing Request at 25, R.290, JA 0727(2.6 percent of \$4.6 billion)), not the \$31 million claimed here (Br. at 34), that included a proposed high-voltage project not yet part of the Expansion Plan. Dayton Rehearing Request at 1, JA 0703. On review of specific allocations for the planned projects set for hearing, the Commission could have found that Dayton benefited from projects and should share in their costs. Given that there were no pre-approved rates for comparison, the

Commission could not analyze any cost-shifting effect of its challenged orders on new transmission facility costs.

If the Court finds that there were costs shift for the Commission to analyze here, it should be aware of the many problems with New Facilities Petitioners' summary of Record Item 301 and the conclusions drawn from the summary. Record Item 301 is PJM's filing to implement the Rate Design Order's mandate that the costs of all Regional Facilities are shared across the region. R.301 at 2-3, JA 0882-0883. It contains an attachment showing in redline the changes from previously-filed versions of the Expansion Plan cost allocations. R.301, Attachment A, JA 0927-0965. New Facilities Petitioners collected this information in a spreadsheet to sum the total changes in costs shown in the document. See Br. Attachment 1-3.

The costs shifts alleged by New Facilities Petitioners are inaccurate. New Facilities Petitioners purport that their attachment "consolidates the information contained in [record item 301]" (Motion to Include Attachment at 2 (filed Oct. 31, 2008)) but, in fact, admit that "data was obtained from the previously effective tariff sheets" in a docket that is not part of the record before the court. New Facilities Petitioners' Reply, Ex. B at PP 2-3 (filed Nov. 24, 2008). If New Facilities Petitioners' attachment is not a summary of record item 301, it should reasonably include

information pertaining to each planned project that is in the record. Yet, New Facilities Petitioners' attachment includes cost allocations for two projects that PJM determined were improperly included in regional cost sharing. See Implementation Order at P 7, JA 0176 ("B0223 and B0224, were erroneously included").

New Facilities Petitioners have also failed to provide context to this court regarding the level of alleged cost shifts. In the Rate Design Order, the Commission examined record evidence of costs shifts in determining whether the rates for existing facilities should be retained. See Rate Design Order at P 59, JA 0124. The figures cited by the Commission represent the projected changes to the annual revenue requirements of different transmission owners. See, e.g., *id.* at P 59 n.82 (citing Ex. S-4, R.359, JA 0125) (tables of costs shifts with stated revenue requirements); Here, however, New Facilities Petitioners express the costs shifts in total dollars, failing to account for the spreading of these costs over the useful life of the facilities, periods that can be 40 years or longer. See Rate Design Order at P 82, JA 0135. With the exception of figures for Petitioner Dayton, New Facilities Petitioners have also failed to provide this court with the relative increase that the alleged cost shifts would cause in their annual revenue requirements. See, e.g., *id.* at P 59,

JA 0125 (cost shifts for existing facilities would cause a 73 percent increase in Commonwealth Edison’s revenue requirement).

Finally, New Facilities Petitioners also grossly overstate the alleged \$231 million cost increase that Ohio might incur (Br. at 11), given that costs allegedly shifted to American Electric Power, a transmission owner with a service territory that covers parts of seven states, are assumed to flow to Ohio in their entirety. They also misrepresent the geographic nature of the alleged costs shifts, arguing that “customers in western PJM [will] subsidize rates for energy service in eastern PJM.” Br. at 36 (capitalization removed). By their own calculations, cost increases are spread throughout the region, as are cost decreases. For example, costs for Dominion, a transmission owner with service territory along the East Coast in Virginia and North Carolina, will increase by \$24 million, and costs for Allegheny, a transmission owner with service territory mostly in West Virginia and western Pennsylvania, will decrease by \$20 million. Br. Attachment at 3.

D. The Other Issues Raised by the New Facilities Petitioners Lack Merit as Well

New Facilities Petitioners argue that the Commission has failed to follow cost causation principles in requiring that the costs of economic (as opposed to reliability) projects be shared regionally. Br. at 20-22. New Facilities Petitioners did not raise this argument on rehearing,

however, so may not raise it now. 16 U.S.C. § 825l(b); see *Platte River Whooping Crane Critical Habitat Maint. Trust v. FERC*, 962 F.2d 27, 34-35 (D.C. Cir. 1992) (“Under the FPA's judicial review provision, . . . parties seeking review of FERC orders . . . must themselves raise in [the rehearing] petition all of the objections urged on appeal”). Although Intervenor Exelon raised the issue on rehearing before the Commission, Exelon, and by extension New Facilities Petitioners, may not raise the issue here because Exelon has not petitioned the courts of appeals for review of the challenged orders. 16 U.S.C. § 825l(b); cf. *Alabama Mun. Distribs. Group v. FERC*, 300 F.3d 877, 879-80 (D.C. Cir. 2002) (intervenors are limited in the issues they may raise before the court) (citing *Process Gas Consumers Group v. FERC*, 912 F.2d 511, 512-16 (D.C. Cir. 1990)).

In any case, the Commission has recognized that “a clear distinction does not exist between reliability and economic projects” because the use of a project can change over the 40-year life of a transmission facility. Rate Design Order at P 86, JA 0136. Moreover, the Commission has not encountered planned Regional Facilities that are judged, according to PJM’s Beneficiary Pays Formula, to have no reliability benefits. See Formula Development Order at P 23 (“PJM has only filed a cost allocation for one economic upgrade”); see *supra* p. 15

(the economic upgrade had a much lower voltage than 500 kV and was not a Regional Facility). Given that Regional Facilities built solely for economic purposes are unlikely, the Commission reasonably selected an allocation method that takes account of the “region-wide reliability of high voltage lines.” Rehearing Order at P 63, JA 0164. Should Regional Facilities with solely economic benefits develop, the Commission stated that it would entertain a consensus proposal for a different allocation. Rate Design Order at P 88, JA 0137.

New Facilities Petitioners also assert that the Commission erred in accepting PJM’s proposal that was not submitted in time to allow discovery or responsive witness testimony. Br. at 49-51. New Facilities Petitioners did not raise that specific issue in their rehearing requests, nor did they argue on rehearing that the Commission’s action violated the notice provisions of the APA. Br. at 51. Thus, these arguments are jurisdictionally barred. 16 U.S.C. § 825l(b). Intervenor Exelon raised the arguments before the Commission, but because it did not file a petition for review with this or any other court of appeals, it may not raise the issue here. *Id.*; *see supra* p. 59.

In any event, the Commission only used PJM’s proposal as a starting point. The Commission, in deciding cost sharing was appropriate for Regional Facilities, looked to the several proposals in the

record that advocated cost sharing for high-voltage facilities, including one that specifically advocated cost sharing for facilities with voltages at or above 500 kV. Rehearing Order at P 71 & n.90, JA 0168 (citing Ex. PPP-1, R.430, JA 0447) (testimony of “Participants for Purposeful Pricing” witness that all 500 kV and above facilities should be presumed to serve regional functions). To be sure, the Commission took notice of PJM’s proposal and evaluated its position as a neutral party in this proceeding with no self interest in where the line was drawn between regional and local facilities. Rate Design Order at P 80, JA 0134. But, in the end, the Commission made an independent decision based on evidence in the record and balanced its several goals for the rate design. Rehearing Order at P 71, JA 0168; *see Northern Ind.*, 782 F.2d at 742 n.25 (upholding FERC’s choice of goals in designing rates).

CONCLUSION

For the foregoing reasons, the petitions for review should be denied, and the Commission's orders should be upheld in all respects.

Respectfully submitted,

Cynthia A. Marlette
General Counsel

Robert H. Solomon
Solicitor

Jennifer S. Amerkhail
Attorney

Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C. 20426
Phone: 202-502-8650
Fax: 202-273-0901
E-mail: jennifer.amerkhail@ferc.gov

January 21, 2009
Final Brief: March 24, 2009

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION,
TYPEFACE REQUIREMENTS, and TYPE STYLE REQUIREMENTS

I hereby certify that this brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because the brief has been prepared in a proportionally spaced typeface using Microsoft Word, in 13-point Bookman Old Style font, and complies with Federal Rule of Appellate Procedure Rule 32(a)(7)(B) in that the brief, including the glossary, contains 13,782 words, excluding the parts of the brief, exempted by Fed. R. App. P. 32 (a)(7)(B)(iii).

Jennifer S. Amerkhail
Attorney

Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C. 20426
Phone: 202-502-8650
Fax: 202-273-0901
E-mail: jennifer.amerkhail@ferc.gov

March 24, 2009

CIRCUIT RULE 31(e)(1) CERTIFICATION

I hereby certify that the Addendum to the brief is not included in the digital version of this brief because it is not available electronically in non-scanned Portable Document Format.

Jennifer S. Amerkhail
Attorney

Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C. 20426
Phone: 202-502-8650
Fax: 202-273-0901
E-mail: jennifer.amerkhail@ferc.gov

March 24, 2009

Illinois Commerce Commission, et al. v.
FERC
7th Cir. Nos. 08-1306, et al.

Docket Nos. EL05-121, et al.

CERTIFICATE OF SERVICE

I hereby certify that I have, this 24th day of March, 2009, served the foregoing by causing copies to be mailed to the counsel listed below.

**ILLINOIS COMMERCE
COMMISSION**

John P. Kelliher
Office of the Attorney General
Illinois Commerce Commission
Suite C-800
160 N. LaSalle Street
Chicago, IL 60601-000

Paul Berks
Office of the Attorney General
Civil Appeals Division
12th Floor
100 W. Randolph Street
State of Illinois Center
Chicago, IL 60601

**AMERICAN ELECTRIC POWER
SERVICE CORP.**

Steven J. Ross
Steptoe & Johnson, LLP
1330 Connecticut Avenue, NW
Washington, DC 20036-1796

**AMERICAN MUNICIPAL
POWER-OHIO, INC.**

Gary J. Newell
Thompson Coburn LLP
1909 K Street, NW
Suite 600
Washington, DC 20006

**BALTIMORE GAS & ELECTRIC
COMPANY**

Gary E. Guy
Baltimore Gas & Electric Co.
110 West Fayette Street
2 Center Plaza
Suite 1301
Baltimore, MD 21201-0000

**PJM INDUSTRIAL CUSTOMER
COALITION**

Robert A. Weishaar, Jr.
McNees, Wallace & Nurick
777 North Capitol Street, NE
Suite 401
Washington, DC 200002-0000

**FIRSTENERGY SERVICE
COMPANY**

Kenneth G. Jaffe
Alston & Bird LLP
950 F Street, NW
The Atlantic Building
Washington, DC 20004-1404

**NEW JERSEY BOARD OF PUBLIC
UTILITIES**

Rachel J. Lehr
Hughes Justice Complex
25 W. Market Street
P.O. Box 093
Trenton, NJ 08625

Margaret E. Comes
Office of The Attorney General
Fifth Floor
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

NEW YORK POWER AUTHORITY

Michael R. Engleman
Kenneth M. Simon
Dickstein Shapiro LLP
1825 Eye Street, NW
Washington, DC 20006-5403

**OLD DOMINION ELECTRIC
COOPERATIVE, INC.**

Glen L. Ortman
John E. McCaffrey
Stinson Morrison Hecker, LLP
1150 18th Street, NW
Suite 800
Washington, DC 20036-3816

**PEPCO HOLDINGS, INC.
POTOMAC ELECTRIC POWER
COMPANY
DELMARVA POWER & LIGHT
COMPANY
ATLANTIC CITY ELECTRIC CO.**

Peter K. Matt
David Goroff
Bruder, Gentile & Marcoux
1701 Pennsylvania Ave., NW
Suite 900
Washington, DC 20006-5806

PJM INTERCONNECTION, LLC

Barry S. Spector
Wright & Talisman
1200 G Street, NW, Suite 600
Washington, DC 20005-3802

**PPL ELECTRIC UTILITIES
CORP.**

Donald A. Kaplan
John L. Longstret
K&L Gates LLP
1601 K Street, NW
Washington, DC 20006-1600

**PUBLIC SERVICE ELECTRIC
& GAS COMPANY
PSEG ENERGY RESOURCES &
TRADE LLC**

Tamara L. Linde
PSEG Services Corp.
80 Park Plaza – Rm. T5G
Newark, NJ 07102-0570

STRATEGIC ENERGY, LLC

Jodi R. Wine
Nixon Peabody LLP
161 N. Clark Street
48th Floor
Chicago, IL 60601-3213

Elizabeth Ward Whittle
Nixon Peabody LLP
Suite 900
401 Ninth Street NW
Washington, DC 20004

**VIRGINIA ELECTRIC & POWER
COMPANY**

Catherine E. Stetson
Hogan & Hartson LLP
555 Thirteenth Street NW
Washington, DC 20004

**PUBLIC SERVICE ELECTRIC &
POWER CO.**

David M. Connelly
Dominion Resources Services
Suite 729
400 N. Capitol Street, NW
Washington, DC 20001

EXELON CORPORATION

A. Karen Hill
Exelon Corporation
Suite 400 east
101 Constitution Ave. NW
Washington, DC 20001

**MARYLAND OFFICE OF PEOPLES
COUNSEL**

William F. Fields
Maryland Office of People's
Counsel
Suite 2102
Six St. Paul Street
Baltimore, MD 21202

**PUBLIC SERVICE COMMISSION
OF MARYLAND**

Miles H. Mitchell
Office of The People's Counsel
Suite 500
1133 15th Street NW
Washington, DC 20001

**NORTH CAROLINA ELECTRIC
MEMBERSHIP CORP.**

Denise C. Goulet
Miller, Balis & O'Neil, P.C.
Suite 1200
1015 15th Street NW
Washington, DC 20005

**DAYTON POWER AND LIGHT
COMPANY**

Steven A. Weiler
Leonard, Street & Deinard
Suite 800
1350 I Street, NW
Washington, DC 20005

Randall Verne Griffin
Dayton Power and Light Co.
1065 Woodman Drive
Dayton, OH 45432

**PUBLIC UTILITIES COMMISSION
OF OHIO**

Duane W. Luckey
Office of the Attorney General
Seventh Floor
180 E. Broad Street
Columbus, OH 43266

Jennifer S. Amerkhail
Attorney

Federal Energy Regulatory
Commission
Washington, DC 20426
Tel: (202) 502-8650
Fax: (202) 273-0901