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October 29, 2001

Hand Delivered

The Honorable Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102-0360

FILED³

OCT 29 2001

**Missouri Public
Service Commission**

Re: AmerenUE Case No. EO-2001-684

Dear Judge Roberts:

Enclosed for filing in the above-referenced case are an original and eight (8) copies of the Missouri Industrial Energy Consumers' Post-Hearing Brief. Also enclosed is an additional copy to be file-stamped and returned to me.

Thank you for your assistance in bringing this filing to the attention of the Commission

Very truly yours,

Diana M. Vuylsteke

Diana M. Vuylsteke

DMV:dv

cc: All Parties of Record

Enclosures

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED³
OCT 29 2001

Missouri Public
Service Commission

In the matter of the Application of Union Electric)
Company d/b/a AmerenUE for an Order Authorizing)
It to Withdraw from the Midwest ISO to Participate)
in the Alliance RTO.)

Case No. EO-2001-684

MISSOURI INDUSTRIAL ENERGY CONSUMERS' POST-HEARING BRIEF

Comes now Adam's Mark Hotel, Alcoa Foil Products, Anheuser-Busch Companies, Inc., The Boeing Company, Ford Motor Company, General Motors Corporation, Holnam, Hussmann Refrigeration, ISP Minerals, Mallinckrodt, Inc., MEMC Electronic Materials, Monsanto Company, Precoat Metals, Procter & Gamble Manufacturing, Ralston Purina and Solutia, hereafter referred to as the Missouri Industrial Energy Consumers ("MIEC"), and pursuant to Judge Mills' October 10 directive in this case, files its post-hearing brief.

I. Background

In Case No. EM-96-149, Union Electric Company d/b/a AmerenUE (hereafter "AmerenUE") agreed in a Commission-approved stipulation and agreement to file or join in the filing of a Regional Independent System Operator (ISO) at the Federal Energy Regulatory Commission ("FERC"). The stipulation provided that the ISO would eliminate pancaked transmission rates and be consistent with the guidelines set out in FERC Order No. 888.

The Commission authorized AmerenUE to join the Midwest ISO ("MISO") in Case No. EO-98-413. In that case, the Commission approved a stipulation and agreement which placed conditions on Ameren's participation in the MISO. (A copy of this stipulation and agreement is attached as Attachment 1). One of these conditions was that AmerenUE would provide this Commission with notice if it sought to withdraw from participation from the MISO. The

stipulation provided that AmerenUE's withdrawal from the MISO would not be effective until the Commission accepted or approved such notice.

On November 9, 2000, AmerenUE notified the MISO that it intended to withdraw as a transmission owning member from the MISO effective November 1, 2001. This Commission was not notified of this withdrawal as required by the Commission in Case No. EO-918-413. T. 66, 82-83. AmerenUE's decision to withdraw from the MISO was voluntary and not required by the FERC. T. 105.

On May 8, 2001 in Docket No. ER-01-123-000 et al., the FERC accepted a settlement to permit AmerenUE, Commonwealth Edison Company and Illinois Power Company to withdraw from the MISO and join the Alliance Regional Transmission Organization ("ARTO"). *Alliance Companies, et al.*, 95 FERC 61,183 (2001). The MIEC, the Commission Staff and the Office of Public Counsel were not parties to this Settlement. *Id.*; T. 78-79.

Critical components of the settlement agreement included:

- Provision of the basis for a seamless market throughout the ARTO and MISO
- Establishment of a process for stakeholder involvement in the ARTO.
- Authorization for AmerenUE, Illinois Power and Commonwealth Edison Company to withdraw from the MISO and to participate in the ARTO by collectively paying an exit fee of \$60 million, of which AmerenUE's share is \$12.5 million

On May 15, 2001, AmerenUE paid the MISO an exit fee of \$12.5 million. In a May 16 letter from Mr. James P. Torgerson, President and CEO of the MISO, the MISO indicated that Ameren's membership application with the MISO was deemed withdrawn concurrent with the FERC's order in Docket No. ER-01-123-000 dated May 8, 2001. (Exhibit 6HC, Schedule 1).

On June 8, 2001, AmerenUE filed its application with the MoPSC initiating this proceeding.

II. The Commission should not grant AmerenUE's application at this time because granting AmerenUE's application would be against the public interest.

AmerenUE's application is against the public interest, and the evidence in this case shows that AmerenUE should not be permitted to transfer control of its transmission assets to the ARTO at this time.

A. The ARTO has not met the FERC's requirements.

The ARTO companies are not in compliance with the FERC's requirements in a number of respects. The most significant violation is the ARTO's failure to establish an independent board to manage the ARTO's business. Exhibit 6HC at p. 7-8. Several stakeholders have filed a protest with the FERC calling for an immediate stay of further startup operations by the Companies. (JRD Schedule 3). Not only does the ARTO lack an independent board, it lacks independence from its members. For example, the ARTO is planning to use a security center currently associated with ARTO member American Electric Power Service Corporation (AEP). T. 111. At least one ARTO member has sought to withdraw from the ARTO due to concerns over the independence of the National Grid Company as managing member of the ARTO. T. 111.

Another glaring example of the ARTO's compliance deficiencies is the ARTO's failure to meet its obligation to provide for seamless congestion management systems as required by the FERC-approved settlement. The ARTO companies continue to pursue development of a long-term congestion management system through their own Market Develop Advisory Group, rather than jointly with the MISO Congestion Management Working Group. Long-term seamless

congestion management cannot occur in the MISO and ARTO regions unless it is developed on a joint basis. T. 221-222; Exhibit 6HC at p. 8.

AmerenUE's witness David A. Whitely, Senior Vice President of Ameren Services, admitted that it would make "total sense" for this Commission to refuse to permit AmerenUE to join the ARTO until it is approved by the FERC. T. 136.

The failure to comply with the FERC's requirements demonstrates that it is against the public interest at this time for the Commission to grant AmerenUE's application to transfer control over transmission assets to the ARTO until the FERC approves the ARTO.

B. AmerenUE has not demonstrated that the ARTO is better than the MISO for AmerenUE's retail customer in Missouri.

AmerenUE has already withdrawn from the MISO in violation of the Commission's order approving the settlement in EO-98-413. However, the FERC has recently noted that the MISO can perform the necessary RTO functions in the Midwest. In its Order issued on October 11, 2001 in Docket Nos. ER-98-1438-000 et al., the FERC stated that

To date, no regional entity exists that performs the functions to be performed by the Midwest ISO in its region. The Commission believes that an operational Midwest ISO, as currently configured, will bring public interest benefits to its region that should not be delayed. These benefits include, among other things, reduced transmission rates, increased transmission system reliability, and increase competition in generation sales.

Midwest Independent System Operator Inc., 97 FERC Paragraph 61,033 (October 11, 2001). (A copy of this Order is attached hereto as Attachment 2). The FERC has never made any similar statement in regard to the ARTO.

AmerenUE voluntarily chose to withdraw from the MISO and join the ARTO in order to preserve transmission revenues for shareholders. Exhibit 6HC at pages 9 through 12; T. 223-

224. AmerenUE made this decision and effectuated its withdrawal even though the MISO has met all FERC requirements while the ARTO has failed to meet those requirements.

The ARTO will provide comparable benefits to the MISO provided that the Alliance Companies fully comply with all FERC RTO requirements and all of the requirements of the settlement agreement in FERC Docket No. ER01-123-000, et al. Exhibit 6HC at page 7; T. 218. However, as discussed above, the ARTO is presently not in compliance. If AmerenUE had remained in the MISO; the public interest would have been served. The MISO currently is the only entity able to perform ISO functions in the regions, it is the only entity in compliance with FERC requirements, T. 224-226. Moreover, AmerenUE's payment of \$12.5 million as an exit fee to the MISO renders ratepayers worse off with AmerenUE in the ARTO than if it had remained in the MISO. T. 217-218.

III. AmerenUE should be required to abide by the terms of the Commission's Order approving the stipulation and agreement in EO-98-413 as a condition to approval of its application.

In the event that AmerenUE is permitted to transfer control of its assets to the ARTO, the Commission should require AmerenUE to abide by the terms and conditions of the Commission-approved stipulation and agreement in EO-98-413 as if the ARTO was the MISO. Exhibit 6HC, p. 3; T. 215-217.

The provisions of the stipulation and agreement in Case No. EO-98-413 resolved the proceeding that permitted AmerenUE to join the MISO. T. 21. The Commission should order that those substantive provisions and conditions contained in that stipulation be applied in their entirety if AmerenUE transfers control of its assets to the ARTO. The paragraphs of the stipulation containing these substantive provisions are: (1) Paragraph 10, relating to the independence of control area functions; T. 215; (2) Paragraph 11, requiring AmerenUE to

provide notice and seek approval of withdrawal from the ARTO from the Commission or other applicable regulatory agencies if it seeks to withdraw from the ARTO; T. 215-216; (3) Paragraphs 6 through 9, relating to the transition period for transmission pricing (to be applied to the ARTO, these provisions would need to be modified to reflect the ARTO's shorter transition period). T. 217.

Certain non-substantive modifications to the stipulation and agreement would be required to make it applicable to the ARTO. Specific references to the MISO and MISO proceedings and agreements should be deleted, and replaced with appropriate references to the ARTO and ARTO proceedings and agreements as suggested by Mr. Dauphinais, including the period defining the transition period contained in Paragraph 6 of the stipulation and agreement. T. 216-217.

It is important to ensure that the ratepayer protections contained in this important stipulation and agreement be preserved in any Commission order which permits AmerenUE to transfer control of transmission assets to the ARTO.

IV. The Commission's Order in this case should determine that the Commission will consider in Case No. EC-2002-1 the issue of whether AmerenUE is earning excess transmission revenues that should be shared with Missouri retail customers.

The evidence shows that AmerenUE's withdrawal from the MISO and subsequent application in this case was motivated primarily by AmerenUE's desire to preserve transmission revenues for its shareholders. Exhibit 6HC at pages 2, 9-12; T. 222. Based on the record in this case, the Commission should ensure that the issue of whether AmerenUE is earning excess transmission revenues that should be shared with Missouri ratepayers is addressed in the pending excess earnings complaint case against AmerenUE, *Staff of the Missouri Public Service Commission v. Union Electric Company d/b/a AmerenUE*, Case No. EC-2002-1.

V. Conclusion and MIEC Recommendation

The MIEC's recommendations to the Commission are contained on page 3 of the Rebuttal Testimony of James Dauphinais. Exhibit 6HC; T. 223-224. These recommendations are as follows:

- The Commission should not approve AmerenUE's proposed transfer of control over its transmission facilities to the ARTO at this time.
- The Commission should not permit AmerenUE to effectuate transfer of control over its transmission assets until the FERC has declared the ARTO as meeting all of FERC's requirements that are applicable on the startup date of the ARTO.
- If and when AmerenUE transfers control of its assets to the ARTO, the Commission should require AmerenUE to abide by the substantive terms and conditions of the Commission-approved stipulation and agreement in Case No. EO-98-413 as if the ARTO was the MISO.
- If the FERC does not declare the ARTO as meeting all of the startup requirements of Order No. 2000 by December 31, 2002, AmerenUE must immediately withdraw from the ARTO and return to the MISO.
- The Commission should not permit AmerenUE to recover any portion of the \$12.5 million exit payment it made to the MISO unless AmerenUE demonstrates that Missouri retail customers obtained comparable savings by AmerenUE's switch from the MISO to the ARTO.
- The Commission should address in Case No. EC-2002-1 whether AmerenUE has any excess transmission revenues that should be shared with Missouri retail customers.

For all of the above reasons, the MIEC requests that the Commission issue an Order denying AmerenUE's application and adopting the MIEC's recommendations.

Respectfully submitted,

BRYAN CAVE, LLP

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed to all counsel of record as shown on the attached service list this 29th day of October, 2001.

Diana M. Vuylsteke

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BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Union)
Electric Company for an Order Authorizing)
It to Participate in the Midwest ISO)

Case No. EO-98-413

FILED
APR 22 1999
Missouri Public
Service Commission

STIPULATION AND AGREEMENT

Comes now the undersigned parties, Union Electric Company ^{and} AmerenUE (AmerenUE or the Company), the Staff of the Missouri Public Service Commission (Staff), the Office of the Public Counsel (Public Counsel), and the Missouri Industrial Energy Consumers (the MIEC) ^{and} ¹, and submit to the Missouri Public Service Commission (Commission) for its consideration and approval the following Stipulation and Agreement (Stipulation) in settlement of the above-styled case.

Background

1. On January 15, 1998, AmerenUE and several other transmission owners filed applications with the Federal Energy Regulatory Commission (FERC) requesting permission to transfer control of their transmission facilities to the Midwest Independent Transmission System Operator, Inc. (Midwest ISO). These transmission owners requested approval of the Midwest ISO's Transmission Tariff (Tariff) and Operating Agreement (Agreement).
2. On March 30, 1998, AmerenUE filed with the Commission an Application for an order authorizing the Company to participate in the Midwest ISO. AmerenUE's filing was designed to comply with the Commission's Report and Order of February 21, 1997 in Case No. EM-96-149 approving the merger of Union Electric and CIPSCO, Inc.

¹ Adam's Mark Hotel, Alumax Foils, Inc., Anheuser-Busch Companies, Inc., The Boeing Company, Ford Motor Company, Holnam, Inc., Hussman Corporation, Mallinckrodt Inc., MEMC Electronic Materials, Inc., Monsanto Company and Precoat Metals.

3. In its Report and Order of February 21, 1997, the Commission approved the merger on the condition that AmerenUE "participate in a regional ISO that eliminates pancaked transmission rates and that is consistent with the ISO guidelines set out in FERC Order 888". (at page 16)

4. On September 16, 1998, the FERC issued its order conditionally approving the establishment of the Midwest ISO. The FERC also conditionally approved the transfer of control of transmission facilities to the Midwest ISO. It also conditionally accepted the Midwest ISO Tariff and Agreement. AmerenUE filed a copy of the FERC order in this proceeding on October 15, 1998. In its Order, the FERC concluded that the Midwest ISO would eliminate pancaked transmission rates. (at page 33) The FERC also concluded that the Midwest ISO was consistent with FERC's ISO principles set forth in its Order 888, either as proposed by the Midwest ISO or as modified by the FERC. (at pages 19-60)

Items Specific to this Settlement

5. The undersigned parties agree that the Commission should grant AmerenUE's Application, and should allow the Company to participate in the Midwest ISO, subject to the conditions set forth in this Stipulation.

6. The undersigned parties agree that the Commission should grant the Company permission to join the Midwest ISO for the six year transition period. The transition period is defined in the Midwest ISO's Tariff as "The period from the first day the ISO begins providing transmission service to the last day of the sixth year after the ISO begins providing transmission service". (Section 1.44a)

7. AmerenUE shall request that the Midwest ISO file its position on the following issues with the FERC at least one year before the end of the transition period:

- a. Implementation of congestion pricing that allows the Midwest ISO to measure the most valued use of scarce transmission capacity;
- b. An equitable resolution of the post-transition application of the Midwest ISO Tariff to bundled retail load; and
- c. A proposal for addressing incentives for the efficient location of generation and construction of transmission facilities within the Midwest ISO.

Additionally, AmerenUE and the other undersigned parties, at their option, may file their positions on these issues with the FERC at or before the same time.

8. No later than six months prior to the end of the six year transition period, AmerenUE shall file with the Commission a request to join on a permanent basis the Midwest ISO, another ISO, or some appropriate regional transmission entity. In this filing, AmerenUE shall address the issues in paragraph no. 7 a) through c).

9. If by six months prior to the end of the transition period, the issues set forth in paragraph no. 7 a) through c) have not been addressed in a FERC Order concerning the Midwest ISO, the undersigned parties agree that AmerenUE may file a petition with the Commission requesting an extension of its membership in the Midwest ISO, and an extension of the Company's requirement to file with the Commission as set forth in paragraph no. 8 .

10. - AmerenUE shall also address the need, if any, for independence in the control area functions not being performed by the Midwest ISO. The Company shall address this issue when the earlier of the following two events occurs: 1) the filing required by paragraph no. 8 above; or 2) the time the Commission considers market power issues subsequent to a legislative mandate to allow retail customers in Missouri to choose their suppliers of electricity other than on a pilot basis.

11. In the event that AmerenUE seeks to withdraw from its participation in the

Midwest ISO pursuant to Article Five or Article Seven of the Midwest ISO Agreement, the Company shall file a Notice of Withdrawal with the Commission, and with any other applicable regulatory agency, and such Withdrawal shall become effective when the Commission, and such other agencies, approve or accept such Notice or have otherwise allowed it to become effective.

12. AmerenUE states that to the best of its knowledge, information, and belief all of its transmission facilities—that is, facilities accounted for as transmission under the FERC Uniform System of Accounts—will be transferred to the control of the Midwest ISO, except for the following transmission facilities: Generator Step-Up Transformers, generator lead lines, and their breaker positions. These non-transferred transmission facilities serve to connect the Company's power plants to Ameren's transmission system. They are not networked facilities. Pursuant to the Midwest ISO Agency Agreement, all of the transmission owners will make such non-transferred transmission facilities available to the Midwest ISO so that it may provide "one stop shopping" under the ISO's Tariff over all transmission facilities in the Midwest ISO region. (Agreement, Appendix G to the ISO Operating Agreement)

General Items for Settlement

13. If requested by the Commission, the Staff shall have the right to submit to the Commission a memorandum explaining its rationale for entering into this Stipulation. Each party of record shall be served with a copy of any memorandum and shall be entitled to submit to the Commission, within five (5) days of receipt of the Staff's memorandum, a responsive memorandum which shall also be served on all parties. All memoranda submitted by the parties shall be considered privileged in the same manner as are settlement discussions under the Commission rules, shall be maintained on a confidential basis by all parties, and shall not become a part of the record of this proceeding, or bind or prejudice the party submitting such memorandum in any future proceeding or in

this proceeding whether or not the Commission approves this Stipulation. The contents of any memorandum provided by any party are its own and are not acquiesced in or otherwise adopted by the other signatories to this Stipulation, whether or not the Commission approves and adopts this Stipulation.

14. The Staff also shall have the right to provide, at any agenda meeting at which this Stipulation is noticed to be considered by the Commission, whatever oral explanation the Commission requests, provided that the Staff shall, to the extent reasonably practicable, provide the other parties with advance notice of when the Staff shall respond to the Commission's request for such explanation once such explanation is requested from the Staff. The Staff's oral explanation shall be subject to public disclosure, except to the extent it refers to matters that are privileged or protected from disclosure pursuant to any Protective Order issued in this case.

15. None of the parties to this Stipulation shall be deemed to have approved or acquiesced in any question of Commission authority, accounting authority order principle, decommissioning methodology, ratemaking principle, valuation methodology, cost of service methodology or determination, cost of capital methodology, capital structure, depreciation principle or method, rate design methodology, cost allocation, cost recovery, or prudence that may underlie this Stipulation, or for which provision is made in this Stipulation.

16. The Stipulation represents a negotiated settlement. Except as specified herein, the parties to this Stipulation shall not be prejudiced, bound by, or in any way affected by the terms of this Stipulation (a) in any future proceeding; (b) in any proceeding currently pending under a separate docket; and/or (c) in this proceeding should the Commission decide not to approve the Stipulation in the instant proceeding, or in any way condition its approval of same.

17. The provisions of this Stipulation have resulted from extensive negotiations among the signatories and are interdependent. In the event that the Commission does not approve and adopt the terms of this Stipulation in total, it shall be void and no party hereto shall be bound by, prejudiced, or in any way affected by any of the agreements or provisions hereof unless otherwise provided herein.

18. The prepared testimonies and schedules of the following witnesses shall be received into evidence without the necessity of these witnesses taking the witness stand:

R. Alan Kelley, AmerenUE (Direct and Surrebuttal)

James R. Dauphinais, MIEC (Rebuttal)

Ryan Kind, OPC (Rebuttal and Cross-Surrebuttal)


Michael S. Proctor, Staff (Rebuttal and Cross-Surrebuttal)

19. In the event the Commission accepts the specific terms of this Stipulation, the signatories waive their respective rights to cross-examine witnesses, their respective rights to present oral argument and written briefs pursuant to Section 536.080.1 RSMo 1994; their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2 RSMo 1994; and their respective rights to judicial review pursuant to Section 386.510 RSMo 1994. This waiver applies to a Commission Report And Order respecting this Stipulation issued in these proceedings, and does not apply to any matters raised in any subsequent Commission proceeding, or any matters not explicitly addressed by this Stipulation.

WHEREFORE, the undersigned parties request that the Commission approve this Stipulation and Agreement.


COMMISSION STAFF

DANA K. JOYCE
General Counsel

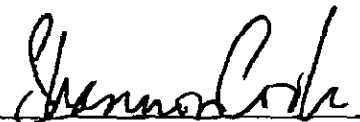

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Respectfully submitted,

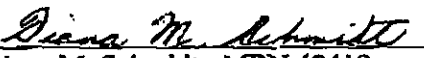
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d/b/a AmerenUE

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ADAM'S MARK HOTEL, ALUMAX FOILS,
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THE BOEING COMPANY, FORD MOTOR
COMPANY, HOLNAM, INC., HUSSMAN
CORPORATION, MALLINCKRODT, INC.,
MEMC ELECTRONIC MATERIALS, INC.,
MONSANTO COMPANY and
PRECOAT METALS

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, postage prepaid, or hand-delivered to all counsel of record as shown on the attached service list this 22nd day of April, 1999.



Docket No. ER98-1438-000, et al.

97 FERC ¶ 61,033
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 453

Midwest Independent Transmission
System Operator, Inc.

Docket Nos. ER98-1438-000
ER98-1438-006
ER98-1438-007
ER01-479-000 and
ER01-479-001

The Cincinnati Gas & Electric
Company,
Commonwealth Edison Company,
Commonwealth Edison Company
of Indiana,
Illinois Power Company,
PSI Energy, Inc.,
Wisconsin Electric Power Company,
Union Electric Company,
Central Illinois Public Service
Company,
Louisville Gas & Electric Company,
Kentucky Utilities Company

Docket No. EC98-24-000

OPINION AND ORDER AFFIRMING IN PART AND CLARIFYING
IN PART INITIAL DECISION,
ADDRESSING SEPARATELY BRIEFED ISSUE,
AND ADDRESSING SUPPLEMENTAL FILINGS

Issued: October 11, 2001

Docket No. ER98-1438-000, et al.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 453

Midwest Independent Transmission
System Operator, Inc.

Docket Nos. ER98-1438-000
ER98-1438-006
ER98-1438-007
ER01-479-000 and
ER01-479-001

The Cincinnati Gas & Electric
Company,
Commonwealth Edison Company,
Commonwealth Edison Company
of Indiana,
Illinois Power Company,
PSI Energy, Inc.,
Wisconsin Electric Power Company,
Union Electric Company,
Central Illinois Public Service
Company,
Louisville Gas & Electric Company,
Kentucky Utilities Company

Docket No. EC98-24-000

APPEARANCES

Karl Zobrist for Midwest Independent Transmission System Operator, Inc.

David S. Ferman, Paul M. Flynn, Michael E. Small, and Barry S. Spector for Midwest
ISO Participants

Kevin F. Tuffy for American Electric Power Service Corporation

Bonnie S. Blair, Mary Nagelhout, and David R. Straus for American Municipal Power -
Ohio

Docket No. ER98-1438-000, et al.

Peter J. T. Brickfield, Christopher C. O'Hara, and Frederick H. Ritts for **Blue Ridge Power Agency and Steel Dynamics, Inc.**

Wayne A. Kirkby, William M. Lange, Deborah A. Moss, and Robert M. Neustifter for **Consumers Energy Company**

William D. DeGrandis and Jennifer Han for **Central Iowa Power Cooperative, Corn Belt Power Cooperative, and Soyland Power Cooperative**

John Wan for **Central Iowa Power Cooperative and Corn Belt Cooperative**

Michael P. May for **Cities of Batavia and St. Charles, Illinois, and Municipal Electric Utilities of Wisconsin**

James N. Horwood, David Lieb, and David E. Pomper for **City of Detroit, Michigan**

Jeffrey L. Landsman for **Dairyland Power Cooperative**

Gregory W. Camet, Jon P. Christinidis, Mary Ann Huntington, and John D. McGrane for **The Detroit Edison Company**

Douglas F. John, Shelby L. Provencher, and Gordon J. Smith for **Duke Energy Trading and Marketing, L.L.C., and NYMEX**

Daniel A. King and Kathryn L. Patton for **Electric Clearinghouse, Inc.**

Terry R. Black and Susan Hedman for **Environmental Coalition**

Howard A. Benowitz and Alan I. Robbins for **Hamilton, Ohio, and Illinois Municipal Electric Agency**

Paul G. Foran and Eric Robertson for **Illinois Industrial Energy Consumers**

Robert A. Jablon for **Index Energy Services, Inc.**

Thomas C. Trauger for **Indiana Municipal Power Authority, Michigan Central Power Agency, Michigan Public Power Agency, and Wolverine Power Supply Cooperative**

Eric Eisen for **Indiana Utility Regulatory Commission**

Samuel C. Randazzo for **Industrial Energy Users - Ohio and Midwest Coalition for Effective Competition**

Lee Cullen and Curt F. Pawlisch for Madison Gas and Electric Company

Walter R. Hall II and Bryan G. Moorhouse for Maryland Public Service Commission

David D'Alessandro, Kelly A. Daly, Gregory O. Olaniran, and David A. Voyes for State of Michigan and Michigan Public Service Commission

Robert A. Jablon and Sarah C. Weinberg for Michigan Central Power Agency, Michigan Public Power Agency, and Wolverine Power Supply Cooperative

Edward J. Finn for Northern Indiana Public Service Company

Peter J. Mattheis for Nucor Steel

J. Cathy Fogel and Sang Y. Paek for Ormet Primary Aluminum Corporation

Denise R. Foster and Denise Goulet for Pennsylvania Office of Consumer Advocate

Neil L. Levy and Steven M. Sherman for ProLiance Energy, LLC

Thomas V. McNamee for Public Utilities Commission of Ohio

Michael B. Jiggs, Randolph O. McManus, and Wendy B. Warren for Reliant Energy Power Generation, Inc.

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

Midwest Independent Transmission
System Operator, Inc.

Docket Nos. ER98-1438-000
ER98-1438-006
ER98-1438-007
ER01-479-000 and
ER01-479-001

The Cincinnati Gas & Electric
Company,
Commonwealth Edison Company,
Commonwealth Edison Company
of Indiana,
Illinois Power Company,
PSI Energy, Inc.,
Wisconsin Electric Power Company,
Union Electric Company,
Central Illinois Public Service
Company,
Louisville Gas & Electric Company,
Kentucky Utilities Company

Docket No. EC98-24-000

OPINION NO. 453

OPINION AND ORDER AFFIRMING IN PART AND
CLARIFYING IN PART INITIAL DECISION,
ADDRESSING SEPARATELY BRIEFED ISSUE,
AND ADDRESSING SUPPLEMENTAL FILINGS

(Issued October 11, 2001)

I. Introduction

This proceeding is before the Commission on exceptions to an Initial Decision (Midwest Independent Transmission System Operator, Inc., 89 FERC ¶ 63,008 (1999)). The proceeding concerns the initial application to form the Midwest Independent Transmission System Operator (Midwest ISO).

In addition to addressing the litigated issues from this proceeding, this opinion addresses a separately briefed issue and supplemental filings, all of which are components of the same proceeding, as discussed further below.

The Commission intends for this order to provide the Midwest ISO with the authority it needs to become operational as soon as possible. To date, no regional entity exists that performs the functions to be performed by the Midwest ISO in its region. The Commission believes that an operational Midwest ISO, as currently configured, will bring public interest benefits to its region that should not be delayed. These benefits include, *among other things, reduced transmission rates, increased transmission system reliability, and increased competition in generation sales.*

We note that during the pendency of this proceeding, much has changed. The Commission continues to examine developments in the Midwest,¹ and other regions of the country,² and may take further action on the matters addressed herein, as necessary, to assure appropriate structure and operations of proposed regional transmission organizations (RTOs).³

II. Procedural Background

¹ See Illinois Power Company, 95 FERC ¶ 61,183 (2001), reh'g denied, 95 FERC ¶ 61,026 (2001); see also, Southwest Power Pool, Inc. et al., 96 FERC ¶ 61,062 (2001).

² See GridSouth Transco, LLC, et al., 96 FERC ¶ 61,067 (2001) and related orders; see also PJM Interconnection, L.L.C., 96 FERC ¶ 61,061 (2001) and related orders.

³ Midwest ISO's updated filing in Docket No. RT01-87-001 and other related filings are pending. The Commission is encouraged by developments related to the Midwest ISO, e.g., Midwest ISO's expanded membership and its settlement with the Alliance Companies addressing interregional coordination, and by Midwest ISO's efforts to be operational on or by December 15, 2001.

On January 15, 1998, ten transmission-owning public utilities⁴ (Applicants) filed an application under section 203 of the Federal Power Act (FPA), 16 U.S.C. § 824b (1994), for Commission approval of the transfer of operational control over their jurisdictional facilities to the Midwest ISO. Concurrently, in Docket No. ER98-1438-000, the entities establishing the Midwest ISO (Midwest ISO Participants)⁵ filed under section 203 of the FPA for Commission approval of the Midwest ISO Tariff and the Midwest ISO Agreement.

By order issued September 16, 1998, the Commission conditionally authorized the establishment of the Midwest ISO and established hearing procedures.⁶

By order issued May 17, 1999, the Commission waived the issuance of an initial decision on the issue of return on equity.⁷ The order approved a stipulated rate of return on equity floor of 10.5 percent and allowed the parties to directly brief the Commission on the issue of whether an upward adjustment to equity return should be provided as an incentive for membership in the Midwest ISO.

Following a public hearing on the remaining issues, the Presiding Judge issued an Initial Decision on November 26, 1999.⁸

III. Summary Affirmance Issues

⁴ The Cincinnati Gas & Electric Company; Commonwealth Edison Company and Commonwealth Edison Company of Indiana (Collectively, Commonwealth Edison); Illinois Power Company; PSI Energy, Inc.; Wisconsin Electric Power Company; Union Electric Company; Central Illinois Public Service Company; Louisville Gas & Electric Company; and Kentucky Utilities Company.

⁵ These participating are listed in the filing as Cinergy Corp. (for Cincinnati Gas & Electric Company; PSI Energy, Inc.; and Union Light, Heat & Power Company), Commonwealth Edison, Wisconsin Electric Power Company, Hoosier Energy Rural Electric Cooperative, Inc. (Hoosier), Wabash Valley Power Association, Inc. (Wabash), Ameren (for Central Illinois Public Service Company and Union Electric Company), Kentucky Utilities Company, Louisville Gas & Electric Company, and Illinois Power Company. Hoosier and Wabash did not file under FPA section 203 because they are not public utilities.

⁶ 84 FERC ¶ 61,231 (1998)(September 16 Order). The Commission analyzed Midwest ISO's proposal pursuant to the ISO principles laid out in Order No. 888. See 84 FERC at 61,142. See also Order on Motion for Reconsideration and Request for Clarification, 85 FERC ¶ 61,250 (1998), and Order on Rehearing, 85 FERC ¶ 61,372 (1998).

⁷ 87 FERC ¶ 61,189 (1999).

⁸ 89 FERC ¶ 63,008 (1999)(Initial Decision).

The Initial Decision identified and resolved ten issues, identified therein as issues A through J.⁹ We will adopt the Initial Decision's sequential identification of issues. In this opinion, we summarily affirm the Initial Decision, without discussion, on all issues except issues B and F which are addressed below. We find that the Initial Decision properly decided the issues that we are summarily affirming and the arguments on exceptions, to the extent there were any, have failed to convince us that the Initial Decision erred or that additional discussion is necessary.

Midwest ISO Participants also request that the Commission specifically approve two trial stipulations entered into prior to the hearing.¹⁰ Specifically, Midwest ISO Participants seek clarification by the Commission that the rates, terms and conditions it is approving are those set forth in the original filing, as modified by Joint Stipulation and the Loss Stipulation and any other changes deemed necessary by the Commission in its opinion.¹¹ The Commission will so clarify.

IV. Issues for Discussion

Issue B Whether the ISO cost adder proposed by the Midwest ISO Participants is just and reasonable and what, if any, changes should be made to such ISO cost adder?

Schedule 10 of the Midwest ISO Tariff proposes to charge transmission customers a rate adder that will recover the Midwest ISO's costs associated with investment and

⁹ The issues are: (Issue A) Loss recovery methodology; (Issue B) ISO Cost Adder; (Issue C) rate divisor for the Midwest ISO's network and point-to-point transmission services; (Issue D) whether to use distance-based transmission pricing; (Issue E) whether to use locational marginal pricing for congestion management; (Issue F) conditions under which bundled retail loads can be served under the Midwest ISO tariff; (Issue G) deadline for transmission owners to file for a determination of transmission/distribution classification of their facilities; (Issue H) levelized vs. non-levelized ratemaking methodology; (Issue I) penalty provisions; and (Issue J) Ancillary Service Schedule.

¹⁰ See Joint Stipulation of the Midwest ISO Participants, the Commission Trial Staff, and other Undersigned Parties Regarding Certain Issues Set for Hearing (Joint Stipulation), Ex. S-20; see also Additional Joint Stipulation Between Midwest ISO Participants and the Commission Trial Staff Concerning Recovery of Losses (Loss Stipulation), Ex. S-21.

¹¹ Midwest ISO Participants Brief on Exceptions at 27-28.

expenses to run the ISO. The ISO Cost Adder is based on the budgeted expenses to be recovered that month divided by the MWh of transmission service expected to be provided under the Midwest ISO Tariff during the same period, subject to a true-up.

During the six year transition period,¹² the ISO Cost Adder is capped at fifteen cents per MWh. Any costs in excess of the cap will be deferred and amortized monthly over the first five years following the transition period, and recovered from customers taking service under the tariff.

Initial Decision

The Initial Decision concluded that the ISO Cost Adder is unjust and unreasonable because: (1) the calculation of the ISO Cost Adder during the transition period fails to include existing bundled retail load and any grandfathered wholesale load not served under the tariff;¹³ (2) the Midwest ISO fails to propose either a rate cap, with related cost support, or a formula rate to be implemented in the ISO Cost Adder after the transition period; therefore, it is unclear what charges will apply; and (3) the Midwest ISO failed to explain how the Midwest ISO will apportion the deferred costs among the customers served under the Midwest ISO Tariff after the transition period ends.¹⁴

The Initial Decision further stated that the imposition of additional charges to recover the deferred costs from the transition period would result in a rate change and, therefore, at the end of the transition period, the Midwest ISO must make a section 205 filing detailing the apportionment of deferred cost and providing full cost support for any additional cost adder to be charged.

Exceptions

Midwest ISO Participants argue that bundled load should not be assessed the ISO Cost Adder during the transition period because during this period (1) bundled load will

¹² Initially, all new wholesale and unbundled retail transmission service is placed under the Midwest ISO Tariff. Existing wholesale loads, bundled retail load and grandfathered agreements that are not released under state retail access programs will be placed under the Midwest ISO Tariff in six years.

¹³ The Initial Decision stated that because all of the Midwest ISO Participants' transmission customers will benefit from the Midwest ISO's operational and planning responsibilities for the transmission system as well as increased grid reliability, these loads should be included in the divisor to develop the ISO Cost Adder.

¹⁴ The Initial Decision also stated that the Midwest ISO has not provided a means to amortize and collect deferred costs for formerly bundled customers who become unbundled within the transition period.

not take service under the Midwest ISO Tariff and (2) bundled load will not receive direct benefits from the ISO. According to Midwest ISO Participants, with the exception of the reliability function, most of the ISO's assigned functions do not apply to bundled customers and, in fact, only benefit transmission customers under the tariff.¹⁵

Midwest ISO Participants state that by assigning cost responsibility equal to the proportion of bundled loads in the ISO Cost Adder rate divisor, transmission owners will face a trapping of costs and thus bear a large part of the ISO's administrative costs during the transition period. Midwest ISO Participants claim that these additional ISO costs cannot be recovered absent contract modification to grandfathered agreements and transmission owners may have difficulty in some states recovering additional ISO costs in retail rates.¹⁶

Midwest ISO Participants state that if the Commission concludes that bundled loads and grandfathered contracts should be included in the divisor for recovery of the ISO's administrative costs, then the Commission should clarify: (1) that ISO costs assigned to grandfathered wholesale load will not be collected from customers taking service under those contracts until the Commission approves the pass through of those costs to those customers; and (2) that any ISO costs assigned to bundled retail load not taking service under the tariff should be accounted for but deferred and collected after the transition period.¹⁷

Consumers Energy Company (Consumers) argues that it is inconsistent to impose the ISO cost adder on bundled retail load while restricting the transmission owners from taking network service from the Midwest ISO for power purchased on behalf of their bundled retail load during the transition period. Consumers states that the only way to make all bundled load responsible for the cost adder is to allow all such load to take network service from the ISO on a non-discriminatory basis.¹⁸

IMHA states that because retail bundled load benefits from the creation of the Midwest ISO, they should be assessed a portion of its start-up costs.

Trial staff disagrees that the formation of the Midwest ISO only provides limited benefits to bundled retail and grandfathered loads as Midwest ISO Participants suggest.

¹⁵ These functions include transmission service to eligible customers, implementing and administering OASIS, offering ancillary services, serving as regional security coordinator, and engaging in a collaborative planning process.

¹⁶ Midwest ISO Participants Brief on Exceptions at 18-19.

¹⁷ Midwest ISO Participants Brief on Exceptions at 24-26.

¹⁸ Consumers' Brief on Exceptions at 20.

Trial staff argues that transmission customers taking service under the Midwest ISO tariff should not subsidize the bundled retail and grandfathered loads that are part of the network load of each transmission customer. As an option, trial staff suggests that costs attributable to these loads be deferred until the end of the transition period, at which time an additional cost adder component under the tariff would apply to these loads.¹⁹

Discussion

The Commission will affirm the presiding judge's finding that the Midwest ISO Cost Adder must include all existing bundled retail load and any grandfathered wholesale load. We agree with the presiding judge that all users of the grid operated by the Midwest ISO will benefit from the Midwest ISO's operational and planning responsibilities for the Midwest ISO transmission system, as well as increased grid reliability of the transmission system. Therefore, to ensure that loads will properly bear a fair share of the Midwest ISO's cost, all long-term firm, bundled retail, and grandfathered load should be included in the divisor in developing the Cost Adder.

The above discussion, moreover, highlights a more fundamental problem in the proposed design and operation of the Midwest ISO. The Midwest ISO's origin dates back to January 15, 1998, when it filed with the Commission in Docket Nos. EC98-24-000 and ER98-1438-000 for Commission approval of the Midwest ISO Tariff and Midwest ISO Agreement. In that Agreement, the Midwest ISO proposed to not place existing bundled retail load and any grandfathered wholesale load under the Midwest ISO's Tariff for at least a six year transition period. In the context of an ISO, the Commission accepted the Midwest ISO's proposal in its September 16 Order.²⁰ Now, however, the Commission must review its proposal in the context of Order No. 2000.²¹

As we explained in Southern,²² Order No. 2000 and section 35.34(k) of the Commission regulations require that an RTO be the only provider of transmission services over the facilities under its control. Section 35.34(k)(1)(i) provides that:

The Regional Transmission Organization must be the only provider of transmission service over the facilities under its control, and must be the sole administrator of its own Commission-approved open access transmission tariff. The Regional Transmission Organization must have the sole authority to receive,

¹⁹ Trial staff Brief On Exceptions at 15.

²⁰ 84 FERC ¶ 61,231 at 62,167-68 (1998).

²¹ Midwest ISO's compliance with Order No. 2000 will be more fully addressed in Docket Nos. RT01-87-000 and RT01-87-001.

²² See Southern Company Services, Inc., 94 FERC ¶ 61,271 (2001).

evaluate, and approve or deny all requests for transmission service. The Regional Transmission Organization must have the authority to review and approve requests for new interconnects.²³

The Commission therefore directs Midwest ISO to revise its Midwest ISO Agreement and Tariff, as necessary, to place and provide all load under the Midwest ISO's Tariff. Further, the Commission intends to initiate a rulemaking proceeding on market design and market structure to translate the RTO functions into concrete protocols that RTOs will follow in providing transmission services and administering or monitoring certain energy markets and the decisions we make here will be subject to that rulemaking.

Issue F Whether the Provisions of the Midwest ISO Agreement and the Midwest ISO Participants' Proposed Tariff, Which Prescribe Conditions Under Which Bundled Retail Loads Can Be Served Under the Midwest ISO Tariff, Are Just And Reasonable?

Section 37 of the Midwest ISO Tariff provides that during the transition period transmission owners may elect to take network service to serve bundled retail load only if they meet one of two conditions. They must either be transmission dependent utilities within a particular rate zone (i.e., their transmission facilities within a zone are insufficient to serve their load in that same zone) or they must operate in a state that requires them to take transmission service from Midwest ISO to serve bundled retail load. If they do not satisfy either of these conditions, they must take point-to-point service to serve these loads.²⁴

Initial Decision

The presiding judge found that the conditions under which bundled retail loads can be served under the Midwest ISO Tariff (not including the MAPP member exemption which was filed later) are just and reasonable because allowing all transmission owners to elect network transmission service for their bundled load would disrupt the negotiated revenue distribution that was key to the formation of the Midwest ISO.²⁵ The presiding

²³ 18 C.F.R. § 35.34(k)(1)(i) (2000).

²⁴ After the issuance of the Initial Decision, in Docket No. ER01-479-000, Midwest ISO proposed to add Section 37.5 which provides a special exemption from these restrictions to certain members of Mid-Continent Area Power Pool (MAPP). This will be discussed further below.

²⁵ Appendix C to the Owners Agreement requires that revenue from network service be distributed to the transmission owners based on what zone a load is located in while revenue from point-to-point service is distributed based 50 percent on transmission

judge also found that it would be unjust to upset the consensus reached by the Midwest ISO Participants on this point in order to appease the two parties (Consumers and Detroit Edison) who objected to these provisions, because they were not participants of the Midwest ISO.

Briefs on and Opposing Exceptions

On exceptions, Consumers argues that the Initial Decision erred by failing to require the Midwest ISO to allow bundled retail load to be served under its Tariff. Consumers asserts that allowing some transmission owners to have this option and not others is discriminatory. This, Consumers argues, derives from the fact that using network service to serve bundled retail load will remove a "virtual" rate pancake that otherwise applies when the point-to-point service rate is combined with the transmission costs included in the bundled retail rate. Consumers argues that allowing this type of disparate treatment will lead to improper price signals and the encouragement of inefficient power decisions. Consumers also asserts that this proposal contravenes the requirements of ISO Principle No. 3 which calls for non-discriminatory open access to an ISO's systems and all services under its control at non-pancaked rates. Finally, Consumers rejects the presiding judge's rationale that preserving the negotiated revenue distribution is sufficient reason to allow some transmission owners to take network service to serve bundled retail load while denying the same benefit to other transmission owners.

In their Brief Opposing Exceptions, Midwest ISO Participants answer that there is no rate pancake in the filed proposal, the presiding judge's attempt to preserve the negotiated revenue distribution is appropriate, and the Commission has already approved this revenue distribution method. Accordingly, the Midwest ISO Participants argue that the Commission should affirm the presiding judge and reject Consumers' proposal to upset that revenue distribution method.

Commission trial staff, in its brief opposing exceptions, states that the Commission already addressed this issue in the September 16 Order and accepted the proposed transition period restrictions on using network service to serve bundled retail load.

Discussion

investment and 50 percent on power flows. Accordingly, a relaxation of the transition conditions on who can take network service to serve bundled retail load would alter the overall revenue distribution to transmission owners.

The Commission will affirm the presiding judge's finding on this issue. The Commission recognizes that a great amount of work and negotiation went into the voluntary attempt to organize the Midwest ISO. We recognize that efforts to mitigate cost shifts including the negotiated revenue distribution, were essential to the process of reaching a voluntary consensus among the great number of participants in those negotiations, and that rejecting the proposed conditions on use of network service to serve bundled retail load will upset that negotiated revenue distribution. Finally, we recognize that the conditions that Consumers opposes only exist during the transition period. On this basis, we hereby approve the transition conditions on use of network service to serve bundled retail load. These conditions are temporary, they are consistent with the wishes of the Midwest ISO Participants, and we believe that the public interest benefits of Midwest ISO operation will far outweigh any temporary drawback attributable to these transition conditions.

V. Separately Briefed Issue (Return On Equity Adjustment)

Background

On April 16, 1999, the Midwest ISO Participants, Wisconsin Public Service Corporation, Wisconsin Public Power, Inc., the Illinois Municipal Electric Agency, the City of Hamilton, Ohio and the Commission trial staff filed a joint motion to waive an initial decision on the issue of rate of return on common equity. The motion was filed as a result of a joint stipulation dated April 6, 1999 among the parties. The Joint Stipulation states in pertinent part:

The Midwest ISO Participants, Staff and any other signatories agree to the following procedure for the purposes of avoiding or minimizing the burdens and risks of litigation with respect to the issue of rate of return on equity. First, a rate of return on equity floor of 10.50 % shall be established. Second, the Midwest ISO Participants as well as others will be allowed to argue to the Commission for an increase in the rate of return on equity from 10.5% to up to 11.50% to reflect their participation in the Midwest ISO. . . . The parties shall not be permitted to address in their briefs any other issues as to the return on equity. Thus, all issues pertaining to return on equity are resolved except the issue of whether an upward adjustment to equity return should be provided as an incentive for membership in the Midwest ISO. Nothing herein shall preclude the Midwest ISO Participants from supporting the request for an 11.50% return by arguing that the facts and circumstances would warrant an even higher return; provided that no such return higher than 11.50% shall be requested to be approved in this proceeding.

By order issued May 17, 1999,²⁶ the Commission granted the motion to waive the Initial Decision on the issue of return on equity. In doing so, the Commission also approved the rate of return on equity floor, stating that the 10.50 percent agreed to in the joint stipulation is fair and reasonable and in the public interest and is, therefore, approved. The Commission further stated that the sole issue to be briefed is "whether an upward adjustment to equity return should be provided as an incentive for membership in the Midwest ISO."

Pleadings

On August 2, 1999, Blue Ridge Power Agency (Blue Ridge), Wisconsin Public Service Corporation (WPSC), Midwest ISO Participants, Consumers and Joint Consumer Advocates²⁷ (Joint Consumers), respectively, filed initial briefs on the establishment of the return on equity for the Midwest ISO. On September 16, 1999, Blue Ridge, WPSC, Midwest ISO Participants and Consumers, respectively, filed reply briefs. On September 16, 1999, trial staff filed a reply brief and motion to disregard allegedly improper arguments made by Midwest ISO Participants, Consumers, and WPSC, and extra-record testimony filed by Midwest ISO Participants. On the same date, Blue Ridge filed a motion to strike the same arguments and extra-record testimony of Midwest ISO Participants. On October 1, 1999, Midwest ISO Participants filed an answer in opposition to motions to strike or disregard portions of its initial brief.

Initial Briefs

Midwest ISO Participants state that a return on equity of at least 11.50 percent is necessary to encourage continued and expanded ISO participation. Because the Midwest ISO will provide substantial benefits such as lower transmission rates, more reliable service, and independent administration of a region-wide transmission tariff, the Midwest ISO Participants state that the Commission should affirmatively reward the participating transmission owners. According to the Midwest ISO Participants, an increase in the return on equity will counter the reduction in revenues that Participants will experience, and may facilitate the construction of transmission facilities needed to maximize ISO benefits.

Midwest ISO Participants argue that increased risks and cost under-recovery associated with participation also justify a higher return on equity. Midwest ISO

²⁶ 871 ERC ¶ 61,189 (1999).

²⁷ Joint Consumer Advocates consist of the Pennsylvania Office of Consumer Advocate, the Ohio Consumers' Counsel, the Missouri Office of Public Counsel, the Indiana Office of Utility Consumer Counselor, and The Citizens Utility Board.

Participants argue that transmission owners will face increased financial risk because transmission owners will be required to incur costs at the direction of the ISO, some of which may not be fully recovered in rates. Transmission owners will also face increased operational risks because they will bear the obligations of ownership such as debt costs while the Midwest ISO will direct operation of the transmission facilities. Moreover, according to Midwest ISO Participants, the transmission owners may face liability which extends beyond their existing service territories to include the territory served by the ISO.

WPSC and Consumers also agree that an upward adjustment to the equity return should be provided. They contend that a higher return is needed to (1) encourage the participation by a large number of transmission owners throughout the region, (2) reflect a return more in line with existing state commission allowed returns, and (3) provide sufficient return to encourage and fund needed construction. WPSC states that by joining the Midwest ISO, a transmission owner accepts considerable risk including loss of control over assets and reduced transmission revenues associated with the elimination of rate pancaking.²⁸ Consumers argues that a true incentive for voluntary Regional Transmission Organization (RTO) formation is a positive adjustment to an existing authorized return. Consumers states that a RTO's initial return on equity should be no lower than one percent above the highest currently authorized return on equity of the individual RTO transmission owners.²⁹

Blue Ridge and Joint Consumers oppose an unconditioned increase to the return on equity as an incentive to join the Midwest ISO. According to Blue Ridge, because the Midwest ISO is a transmission-only utility, it is a low-risk regulated monopoly that cannot be bypassed by its transmission dependent utilities or customers. Therefore, Blue Ridge argues that the return on equity should be lower than a return on equity for a vertically integrated utility to reflect this decreased risk. Blue Ridge asserts that, since no downward adjustment was made, the proposed return on equity already contains an incentive.³⁰

Joint Consumers also opposes the use of a rate of return on equity adjustment to encourage or reward participation in the Midwest ISO. Joint Consumers states that the incentive mechanism is unnecessary and would result in rates that are unjust and unreasonable, particularly for those Midwest ISO Participants who have already

²⁸ WPSC also states that it faces an immediate reduction in revenues if it follows the Wisconsin requirement that all transmission service including that for bundled retail load be taken from the ISO.

²⁹ According to Consumers, the Commission should grant the Midwest ISO a return on equity between 15.23 percent and 17.23 percent. Consumers' Initial Brief at 7.

³⁰ Blue Ridge Initial Brief at 9-10.

voluntarily committed to participate. An upward adjustment increases transmission rates without providing any other benefit to consumers. In addition, Joint Consumers argues that a rate of return adder will increase transmission rates and serves to move regulated transmission rates further from marginal cost and economic efficiency. According to Joint Consumers, with an excessive rate of return, a utility has the incentive to overinvest in transmission utility plant in order to maximize excess profits.³¹

Trial staff differentiates between payment for the acceptance of risk and payment in the form of an incentive for the purpose of encouraging companies to participate in the ISO. Trial staff states that Midwest ISO Participants, Consumers, and WPSC violated the Joint Stipulation by failing to restrict their arguments to reasons why an adder should be allowed in order to encourage transmission owners to join the Midwest ISO.³²

Midwest ISO Participants' Response

Midwest ISO Participants state that the majority of Midwest ISO customers recognize that any increase in rates resulting from an 11.50 percent return on equity is offset by the elimination of rate pancaking and the larger the Midwest ISO becomes, the greater the transmission cost savings and other benefits will be to consumers.³³ They state that Elue Ridge and Joint Consumers ignore substantial disincentives to Midwest ISO participation, including reduced revenues and increased risks which are somewhat mitigated by the 11.50 percent return. They also fail to recognize that a return of at least 11.50 percent is the minimum return required as a starting point to encourage needed investment in transmission facilities.

Midwest ISO states that the joint stipulation is a compromise which establishes a 10.50 percent "floor" or lower limit on the equity return for the Midwest ISO. The fact that the parties agreed to support the 10.50 percent floor return on equity as just and

³¹ Joint Consumers favors a generic policy proceeding to address how to set an appropriate rate of return for an RTO.

³² Trial staff requests that the Commission disregard certain inappropriately made arguments, such as the extra-record testimony attached to the Midwest ISO Participants' Brief on Exceptions. In the alternative, trial staff requests that the Commission set for hearing the issue of what the Midwest ISO's market-required return on equity would be. Trial staff Reply Brief at 5.

³³ According to Midwest ISO Participants, the issue before the Commission is whether the compromise 11.50 percent equity return should be adopted as an incentive for membership in the Midwest ISO or to lessen the disincentives of joining, which is separate from the issue of whether or not some form of performance-based regulation should apply after the ISO is formed and operational.

reasonable (and the Commission found that return "fair and reasonable and in the public interest) does not mean that a higher return cannot be justified under the Commission's established rate of return standards. In fact, the joint stipulation specifically provides that the Midwest ISO Participants may argue that the "facts and circumstances" warrant a higher return.³⁴ Midwest ISO Participants also point out that an 11.50 percent return cannot serve as an incentive for overinvestment because the Midwest ISO, not the transmission owners, will decide on the planning and construction of transmission facilities.

In addition, Midwest ISO Participants argue that Blue Ridge offers no evidence to support its assertions that as a transmission-only utility, Midwest ISO faces less risk than a vertically integrated utility. To the contrary, Midwest ISO Participants state that those entities like the Midwest ISO will be subject to increased risks that warrant higher returns on equity. In addition to the loss of transmission revenues from the elimination of rate pancaking, transmission owners may need to collect from retail ratepayers substantial monies that are incurred by the ISO actions.³⁵

Discussion

The Commission finds that the proposed adjustment to ROE to incent membership in the Midwest ISO constitutes an innovative rate proposal as defined in Order No. 2000.³⁶ Under the innovative rate requirements of Order No. 2000 and the Commission's regulation promulgated thereunder,³⁷ the Midwest ISO must first qualify as an RTO in order to receive approval of an innovative rate proposal. The determination of whether or not the Midwest ISO qualifies as an RTO will be made in a subsequent order.³⁸ While we are hereby rejecting the proposed 100 basis point adjustment to ROE, our rejection is without prejudice to Midwest ISO making a new rate filing supporting an innovative rate proposal consistent with the Commission's requirements for innovative rates. We endorse

³⁴ Midwest ISO Participants Reply Brief at 29.

³⁵ For example, the transmission owner may need to recover costs from bundled retail load of constructing facilities required by the Midwest ISO which the owner would not have constructed as a non-participant.

³⁶ Regional Transmission Organizations, Order No. 2000, 65 FR 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), order on reh'g, Order No. 2000-A, 65 FR 12,088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), petitions for review pending sub nom, Public Utility District No. 1 of Snohomish County, Washington v. FERC, No. 00-1174, et al. (D.C. Cir.).

³⁷ See 18 CFR § 35.34(e) (2000).

³⁸ See Docket Nos. RT01-87-000, et al.

the concept of innovative rates where supported and will give our prompt consideration to an innovative rate proposal by Midwest ISO.³⁹

VI. Supplemental Filing in Docket No. ER98-1438-006 (Loss Factors)

Background

The proposed loss recovery methodology was Issue A from the Initial Decision. As noted earlier, prior to the hearing, Midwest ISO Participants and Commission staff entered into a Loss Stipulation pursuant to which the parties agreed that the proposed loss recovery methodology is appropriate but also agreed that one of the originally filed inputs to the methodology required recalculation. The parties agreed that the transmission owner loss factors, as originally filed, were not consistent with the assumptions of the proposed loss recovery methodology and agreed that the Applicants would submit revised loss factors in a subsequent filing. The presiding judge accepted the proposed loss recovery methodology in light of the Loss Stipulation, and we have summarily affirmed that action above. In Docket No. ER98-1438-006, the Midwest ISO Participants filed their revised loss factors.

Applicants' Representations

Applicants state that the revised loss factors were calculated using a uniform methodology that was applied to all of the companies. This methodology included a thorough evaluation of all of the different components of losses and took into consideration parallel flows on the Midwest ISO system.

Intervention and Answer

WPPI submitted a motion to intervene and limited protest. WPPI does not challenge the underlying methodology used to calculate the loss factors, but instead challenges the output of that methodology for two of the twelve transmission owners involved: Northern States Power (NSP) and Alliant Energy Operating Companies (Alliant). WPPI suggests that the calculation, in these two instances, may have been flawed in two ways. First, WPPI argues that a double-recovery of losses could occur because NSP and Alliant receive loss compensation for certain MAPP-related

³⁹ At that time the Midwest ISO may also wish to revisit the issue of whether its base ROE of 10.5 percent properly reflects its financial requirements in light of the many changes that have transpired since the issue was stipulated. However, we emphasize that we are not requiring Midwest ISO to revisit that issue and we see no reason why it may not begin operating under the base ROE of 10.5 percent.

transactions. Second, WPPI asserts that an over-recovery of losses could occur as a result of NSP's and Alliant's reciprocity or dynamic scheduling arrangements. WPPI maintains that these errors should be corrected.

In their answer, Applicants state that there can be no MAPP-Midwest ISO double-recovery of losses because once NSP and Alliant transfer control of their transmission facilities to Midwest ISO, all transmission service over those facilities will be provided under the Midwest ISO Tariff. Thus, the MAPP loss recovery procedure will no longer apply to NSP and Alliant and there will be no MAPP-related double recovery. Next, Applicants state that all control area loads and losses will be properly matched, including those under dynamic scheduling and reciprocity arrangements. Accordingly, there will be no over-recovery on this account either.

Discussion

The Commission will approve the proposed loss factors. No party challenges the methodology used to calculate these loss factors and Applicants' response to WPPI sufficiently addresses WPPI's concerns regarding the output of the methodology.

VII. Supplemental Filings in Docket Nos. ER98-1438-007 and ER01-479-000

Background

In Docket No. ER01-479-000, the Midwest ISO filed amendments to the Midwest ISO Tariff and Owners Agreement to: (1) modify the membership of the Midwest ISO Advisory Committee, and (2) to allow some additional Transmission Owners, who are members of MAPP, to take Midwest ISO network service for their bundled retail customers.⁴⁰ Simultaneously, in Docket No. ER98-1438-007, the Midwest ISO filed a reformatted Midwest ISO tariff and Owners Agreement to conform with the requirements of Order No. 614. Midwest ISO proposed an effective date of November 20, 2000, for both filings.

Interventions and Answer

Motions to intervene in Docket No. ER01-479-000 were filed by Western Area Power Administration (WAPA), Midwest ISO Transmission Owners, Commonwealth Edison, MAPP COR, and the Illinois Commerce Commission. Motions to intervene in Docket No. ER98-1438-007 were filed by Commonwealth Edison, GEN-SYS Energy,

⁴⁰ By letter dated June 4, 2001, designated Docket No. ER01-479-001, the Midwest ISO requested expedited action on the filing in Docket No. ER01-479-000.

and Dairyland. In addition, Consumers filed a protest⁴¹ and WAPA, Midwest ISO Transmission Owners, and Commonwealth Edison filed comments.

Midwest ISO filed a Motion for Leave to Answer and Answer.

Discussion

With respect to Docket No. ER01-479-000, WAPA's comments included a request that Midwest ISO add certain additional language to the Midwest ISO Tariff in order to allow federal entities to participate in the Midwest ISO. In its answer, Midwest ISO committed to make the requested changes, with minor modifications, in a later filing. Similarly, Midwest ISO agreed with the comments of Midwest ISO Transmission Owners that the proposed changes to the Midwest ISO Tariff are not effective until the transfer date. Regarding Consumers' Protest,⁴² Midwest ISO noted that the proposed modification was made to accommodate MAPP members that contemplated joining the Midwest ISO and if the option to take network service to serve bundled retail load during the transition period is a necessary condition for Consumers to join the Midwest ISO as a transmission owning member, the Midwest ISO would consider the same flexibility for Consumers.

We find that the proposed modifications to the Midwest ISO Tariff and Owners Agreement are acceptable in light of our affirmance of the presiding judge's findings on the issue of network service for bundled retail load during the transition period. The proposed change to the membership of the Midwest ISO Advisory Committee is unopposed and appears reasonable as well.⁴³ Accordingly, we will grant an effective date of November 20, 2000, for the reformatted and revised Owners Agreement, and make the reformatted and revised Midwest ISO Tariff effective on the transfer date, as requested.

The only comments that dealt with the Order No. 614 compliance filing were from Commonwealth Edison. Commonwealth Edison argued that the reformatted Midwest ISO Tariff should be made effective on the date that the Midwest ISO takes operational control of member transmission systems. In its answer, Midwest ISO agreed. We will accept the filing in Docket No. ER98-1438-007. In light of our approval of the proposed changes in Docket No. ER01-479-000 which are incorporated in this filing, our review

⁴¹ Because the subject matter of that protest actually applies to one of the changes submitted in Docket No. ER01-479-000, we will deal with it as though it were filed in Docket No. ER01-479-000.

⁴² In its protest, Consumers basically cited the same arguments it made on Exceptions to the Initial Decision.

⁴³ We will deal with Midwest ISO's filing to incorporate the proposed WAPA language once it is filed.

Docket No. ER98-1438-000, et al.

indicates that the proposed modifications in Docket No. ER98-1438-007 comply with the requirements of Order No. 614.

The Commission orders:

(A) The Initial Decision is hereby affirmed in part and clarified in part, as discussed in the body of this order.

(B) Prior to the end of the transition period, the Midwest ISO/Midwest ISO Participants shall make a section 205 filing with the Commission detailing and supporting a post-transition period ISO Cost Adder and detailing how deferred costs from the transition period will be apportioned among all customers under the Midwest ISO Tariff following the end of the transition period.

(C) The rates, terms and conditions hereby approved are set forth in the Midwest ISO Participants original filing as modified by the Joint Stipulation and the Loss Stipulation, and further modified by this Order.

(D) The proposed adjustment to the stipulated return on equity floor is hereby rejected as discussed above.

(E) The proposed loss factors filed in Docket No. ER98-1438-006 are hereby approved, however, as the proposed tariff sheets associated with the revised loss factors do not conform to the requirements of Order No. 614, they must be refiled consistent with the Order No. 614 requirements.

(F) The proposed modifications, and associated designations, filed in Docket Nos. ER98-1438-007 and ER01-479-000 are hereby approved as filed and Docket No. ER01-479-001 is hereby terminated.

By the Commission.

(SEAL)