market participants and provided that no market participant controls the Alliance Transco.[39] The Commission required the Alliance Companies to "decide which of the alternative business plans proposed they intend to implement" and to inform the Commission within 45 days.[40] The Commission further directed that "from the date of this Order an independent board be established to make all business decisions for the RTO."[41]

On August 10, 2001, the Alliance Companies sought clarification of the requirement in *Alliance V* that "from the date of this Order an independent board be established to make all business decisions for the RTO." Specifically, the Alliance Companies requested the Commission to clarify that: (1) establishment of an independent managing member for the Alliance Transco would satisfy the Order's requirement for an independent board; (2) the Order does not set a specific date by which an independent board or an independent managing member must be established; and (3) the Alliance Companies may look to *GridFlorida* for guidance during the interim period before independence for Alliance Transco is established. To the extent the Commission declined to grant the requested clarification, the Alliance Companies sought

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strategic investor -- *i.e.*, a non-market participant that has experience and expertise in transmission or a related business -- to make an equity investment and to become the managing member of the Alliance Transco. The strategic investor would have to satisfy the Commission's requirements for non-market participant status and would abide by a governance structure that conforms with Commission guidance and requirements for independence. The Alliance Companies' envision that the strategic investor/managing member would both own and operate transmission facilities within the Alliance Transco. Alternatively, the Alliance Companies proposed to identify financial-only investors, *i.e.*, investors who do not possess operational experience in the electric transmission or related business. The Alliance Companies proposed that the board of directors elected by such investors and independent of market participants would control and manage the Alliance Transco. To ensure that the board consists of persons having the appropriate skills and background to direct the professional management of this business, the Alliance Companies proposed a governance structure and board of director selection process that the Order finds is "similar to those previously approved by the Commission." *Alliance V*, 96 FERC at 61,134.

[39] In fact, the proposals specify that both of these conditions will be satisfied.

[40] On August 27, 2001, the Alliance Companies filed their Business Plan, in which they informed the Commission that a wholly-owned subsidiary of National Grid USA ("National Grid") an independent transmission owner and operator, would serve as the managing member of Alliance Transco, subject to the Commission granting National Grid's petition for declaratory order that it is a non-market participant. On December 20, 2001, the Commission granted National Grid's petition, finding that National Grid is not a "market participant," thus establishing the independence of Alliance Transco. *National Grid USA, et al.*, 97 FERC ¶ 61,389 (2001).

rehearing of the Commission's directive in *Alliance V* that "from the date of this Order an independent board be established to make all business decisions for the RTO." In Alliance VI, the Commission denied the Alliance Companies' request for rehearing."[42]

C. The Commission Approved a Settlement Between the Alliance Companies and the Midwest ISO that Would Accommodate the Development of Two RTOs in the Super-Region

In compliance with the Commission's directive in *Alliance III*, the Alliance Companies participated in settlement proceedings before Chief Administrative Law Judge Curtis Wagner (the "Chief Judge"). Also participating in the settlement proceedings were most of the state commissions that are parties to the Alliance Companies' RTO proceedings. As described by the Chief Judge, "[w]hen settlement negotiations began . . . the parties supporting the [Midwest ISO] and the parties supporting Alliance, as well as the state agencies and consumers, were as far apart as day and night."[43] Nonetheless, "there was much give and take on the part of all parties in order to arrive at a solution to the long-standing problems involved – some dating back three or more years –"[44] and, after two months of negotiations, the parties reached a "unanimous comprehensive settlement that disposes of all issues in the proceeding, as well as issues in other proceedings pending before the Commission."[45]

On March 21, 2001, the "Settlement Agreement Involving the Midwest Independent Transmission System Operator, Inc., Certain Transmission Owners in the Midwest ISO, the Alliance Companies and Other Parties" (the "Settlement") was filed with the Commission. The Settlement resolved a number of significant issues that previously had beset the efforts of both

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41 *Alliance V*, 96 FERC at 61,135 (citing *GridFlorida LLC, et al.*, 94 FERC ¶ 61,363 at 62,325 (2001)).

42 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 15.

43 *Illinois Power Company*, "Report of the Chief Judge," 94 FERC ¶ 63,012, 65,036 (2001).

44 *Illinois Power Company*, 94 FERC at 65,036.

45 *Illinois Power Company*, 94 FERC at 65,035.

the Alliance Companies and the Midwest ISO to obtain timely regulatory approval of their respective proposals and to become operational. Among other things, the Settlement (1) allowed Ameren, ComEd and Illinois Power to withdraw from the Midwest ISO and join the Alliance RTO in exchange for a payment to the Midwest ISO of $60 million, (2) established the basis for two RTOs – the Alliance RTO and the Midwest ISO – to be formed, and (3) established single (i.e., non-pancaked) transmission access charges within the Alliance-Midwest ISO Super-Region ("Super-Region"). In sum, the Settlement "permits the entire Midwest region to operate as a seamless market, and at the same time, carry forward the ISO-features critical to some members of MISO and permit other parties to enjoy the different business model developed by Alliance."[46] The state commissions either did not contest the Settlement or did not oppose certification of the Settlement.[47]

The Commission unanimously accepted the Settlement, with minor modifications, in an order issued on May 8, 2001 ("Settlement Order").[48] In that order, the Commission found the Settlement to be "the basis for an expanded market and a sounder, seamless and a more reliable electric grid in the Midwest,"[49] and rejected an argument that it should require a single RTO in the Super-Region.[50] On July 6, 2001, the Commission denied rehearing of the Settlement

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46 *Illinois Power Company*, 94 FERC at 65,036.

47 *Illinois Power Company*, "Chief Judge's Certification of Settlement," 95 FERC ¶ 63,003, 65,022 (2001).

48 *Illinois Power Co., et al.*, "Order on Settlement Agreement," 95 FERC ¶ 61,183 (2001) ("Settlement Order").

49 Settlement Order, 95 FERC at 61,646 (emphasis added).

50 Settlement Order, 95 FERC at 61,648. The Commission stated that the Alliance Companies' final compliance with the scope and configuration requirements of Order No. 2000 would be determined in Docket No. RT01-88, and that the Midwest ISO's final compliance with the scope and configuration requirements of Order No. 2000 would be made in Docket No. RT01-87. 95 FERC at 61,646.

Order.[51] No party appealed the Commission's decision approving the Settlement. Consequently, the Settlement is final and binding on all parties and on the Commission.

1. The purpose and effect of the Settlement is to permit and to facilitate both the Alliance RTO and the Midwest ISO becoming operational

The Settlement clearly establishes that both the Alliance RTO and the Midwest ISO will operate as separate RTOs. Indeed, the Preamble to the Settlement states that the very purpose of the Settlement is to allow both the Alliance RTO and the Midwest ISO to become operational, to wit:

> The intended purposes of this Settlement Agreement are to afford an opportunity, without the need to issue new debt financing, for the Midwest ISO to remain financially viable and for it to proceed to operations in accordance with Order No. 2000; to preserve the Alliance Companies' business model by providing the regulatory certainty deemed by the Alliance Companies and others to be necessary for Alliance Transco to be formed, financed and become operational in accordance with Order No. 2000; and to create the basis for an arrangement that will preserve the separate organizations and features of the Alliance Regional Transmission Organization ("Alliance RTO") and the Midwest ISO, while allowing the regions served by the Alliance RTO and the Midwest ISO to operate as a seamless market.[52]

In addition, Article III of the Settlement, pertaining to the IRCA, provides that "in accordance with the IRCA, the Midwest ISO and the Alliance Companies (and the Alliance RTO, upon its creation) agree to provide the basis for the development of a seamless market throughout the regions served by the Midwest ISO and the Alliance RTO."[53]

Furthermore, Article V of the Settlement provides that "[a]ny person qualifying as an eligible customer under the Alliance RTO OATT or the Midwest ISO OATT will be able to

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51 *Illinois Power Co., et al.*, "Order Denying Rehearing," 96 FERC ¶ 61,026 (2001).

52 Settlement, Article I, Preamble (emphasis added).

53 Settlement, Article III.

obtain transmission service within the Alliance-Midwest ISO Super-Region during the Transition Period . . . ."[54]

2. The IRCA Commits the Parties to Develop Procedures and Protocols to Implement the Agreement

The Settlement also included the Inter-RTO Cooperation Agreement ("IRCA"), an agreement between the Alliance Companies and the Midwest ISO that sets forth the framework for eliminating or reducing "seams" between the Alliance RTO and the Midwest ISO with the goal of promoting the development of a seamless market within the Super-Region. The IRCA provides the basis for the development of reliable and coordinated operations between the Alliance RTO and the Midwest ISO. The IRCA requires the parties to develop and implement procedures and protocols that will enable the two RTOs to provide transmission users seamless access to markets throughout the Super-Region. The IRCA was intended to be a flexible and living document that will allow the RTOs to work together to satisfy the needs of transmission users and to promote a seamless market. The Preamble to the Settlement provides that:

> In addition, the Inter-RTO Cooperation Agreement ("IRCA") between the Midwest ISO and the Alliance Companies, included as Attachment A to this Settlement Agreement, commits the Midwest ISO and the Alliance Companies to coordinate activities for transmission and transmission related serves so that the regions will be able to operate as a seamless market. The Midwest ISO and the Alliance Companies or, upon its creation, the Alliance RTO, will develop procedures and protocols through the processes set forth in the IRCA that will coordinate transmission services for a seamless power market in the regions served by the Alliance RTO and the Midwest ISO. In addition, this Settlement Agreement establishes explicitly deadlines and a process for resolving implementation disputes consistent with the Order No. 2000 requirement of achieving operational status no later than December 15, 2001.[55]

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54 Settlement, Article V.

55 Settlement, Article I, Preamble.

The IRCA requires the Alliance Companies and the Midwest ISO to develop procedures and protocols to address: coordinated transmission planning across the two regions, security coordination and ATC determination and coordination, Day One congestion management, independent market monitoring, accommodation of one-stop shopping, and compatible real-time balancing markets, and compatible business practices.

The IRCA is assignable to the Alliance RTO upon its creation and the Settlement requires the Midwest ISO and the Alliance RTO to file the IRCA with the Commission pursuant to Section 205 of the FPA within ten (10) days of its assignment to the Alliance RTO.

3. The Alliance Companies and the Midwest ISO are implementing the Settlement

On October 9, 2001, the Alliance Companies and the Midwest ISO submitted to the Commission reports and updates on their efforts to implement the IRCA.[56] Both reports demonstrate that the parties have successfully completed and gone beyond the requirements of the IRCA in many areas. In their IRCA Report, the Alliance Companies reminded the Commission that "full implementation of the IRCA cannot be achieved until both RTOs are operational."[57]

At the Commission's October 24, 2001 meeting, the Commission staff briefed the Commission on the Alliance Companies and Midwest ISO IRCA Reports, informing the Commission that the Alliance Companies and the Midwest ISO "are moving along consistent

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[56] "Alliance Companies' Report and Update on IRCA Implementation: Building A Strong Foundation For A Seamless Market ("Alliance Companies' IRCA Report"), and "Status Report of the Midwest Independent Transmission System Operator Inc." ("Midwest ISO IRCA Report").

[57] Alliance Companies' IRCA Report at 9.

with what was approved . . . They are on schedule . . . . They are doing what they said they would do and what we approved."[58]

D. Late in 2001, the Commission Engaged in Ex Parte Communications with State Commissions that are Parties to These Proceedings

In summary, as the end of 2001 approached, the Alliance RTO had been substantially approved and was awaiting a final order on rehearing of *Alliance V* and approval of National Grid as the independent Managing Member of Alliance Transco in order to become operational. In other words, the Alliance RTO was "poised for operations."[59] The Alliance Companies and the Midwest ISO also were working to implement the IRCA, so that the two RTOs could eliminate or reduce seams. Making every attempt to meet the Order No. 2000 goal of a December 15, 2001 operational date for RTOs, and in reliance on the Commission's orders approving the Alliance RTO and directing the Alliance Companies to implement their proposal, the Alliance Companies incurred, or are committed to incur, approximately $90 million in start-up costs for formation of the Alliance RTO.[60]

However, shortly before rendering a decision on rehearing of *Alliance V*, the Commission, on November 27, 2001, engaged in impermissible ex parte communications in order to obtain the views of state commissions that are parties to these proceedings as to how the Commission should rule on the pending requests for rehearing of *Alliance V*. As the Commission's order in *Alliance VI* demonstrates, the Commission's rulings made on rehearing

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58 FEDERAL ENERGY REGULATORY COMMISSION, 777th Regular Meeting (October 24, 2001), Transcript at 101 (emphasis added).

59 Comments of Alliance Companies, December 7, 2001 at 7.

60 Comments of Alliance Companies, December 7, 2001, Affidavit of Stanley F. Szwed at 6. Mr. Szwed identifies approximately $75 million in start-up expenses for the Alliance RTO, exclusive of legal/regulatory expenses. With the addition of legal/regulatory expenses, the total start-up budget for the Alliance RTO is approximately $90 million.

of *Alliance V*, were crafted around the views imparted by state commissions during these ex parte communications.

1. To facilitate the ex parte communications, the Commission issued an order "modifying the application of" its ex parte regulations

In an order issued on November 9, 2001, in certain RTO proceedings, including those of the Alliance Companies, the Commission modified the application of its regulations governing off-the-record communications to "treat, as exempt, communications between the Commission or its staff and state agencies which are parties in the captioned proceedings."[61] The Commission also announced its plans to "organize State-Federal regional panels to reflect the state interests affected by RTO developments since the issuance of Order No. 2000,"[62] and to "address issues of mutual concern on a generic basis as well as in specific cases."[63] On December 10, 2001, the Alliance Companies requested rehearing of this order. By its "Order Granting Rehearing for Further Consideration," issued January 9, 2002, the Commission "tolled" this request for rehearing, but indicated that it would reach a decision on the merits of the proceeding by February 15, 2002.

On November 20, 2001, the Commission issued a notice stating simply that, "on November 27, 2001, a State-Federal Midwest Regional Panel discussion will be held, pursuant to the Commission's order issued November 9, 2001, in Docket No. RT02-2-000, *et al.* A transcript of the panel discussion will be placed in the above listed dockets."[64] The Notice was not published in the Federal Register. The Notice did not provide for public participation in this

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61 *State-Federal Regional RTO Panels, et al.*, "Order Announcing the Establishment of State-Federal Regional Panels to Address RTO Issues, Modifying the Application of Rule 2201 in the Captioned Dockets, and Clarifying Order No. 607," 97 FERC ¶ 61,182, 61,837 (2001) ("November 9 Order").

62 November 9 Order, 97 FERC at 61,837.

63 November 9 Order, 97 FERC at 61,836 (emphasis added).

64 *Notice of State-Federal Regional RTO Panels*, Docket Nos. RT02-2-000, *et al.* (Nov. 20, 2001) ("Notice").

panel discussion, and therefore, did not provide for participation by the Alliance Companies. The Notice did not provide other parties an opportunity to respond to any statements made during the course of such discussion. The Notice did not reasonably inform the Alliance Companies that the merits of pending requests for rehearing of *Alliance V* would be discussed during the panel discussion. The Notice did not reasonably inform the Alliance Companies that the state commissions would be given an opportunity to persuade the Commission to repudiate the Settlement without affording the Alliance Companies an opportunity to respond.

2. On November 27, 2001, the Commission engaged in ex parte communications between the Commission and state commissions that are parties to these proceedings

On November 27, via conference call, the Commission convened ex parte communications with state commissions that are parties to these contested proceedings involving the proposed Alliance RTO.[65] Press reports of Commission staff accounts of the conference call indicated that some state regulatory commissions urged the Commission not to approve the Alliance RTO.[66] Such press reports are borne out by the transcript of the discussions,[67] which clearly indicate that the Commission held a discussion with state commissions that are parties to the Alliance Companies RTO proceedings for the purpose of learning how the majority of the state commissions wanted the Commission to rule on the pending requests for rehearing of *Alliance V*.

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65 Unlike other entities that must file a motion to intervene in a proceeding, the Commission's Rules of Practice and Procedure provide that "[a]ny State Commission is a party to any proceeding upon filing a notice of intervention in that proceeding, if the notice is filed within the period established under Rule 210(b)." 18 C.F.R. § 385.214(a)(2) (2001).

66 *See*, Energy Power Daily, November 29, 2001, page 3.

67 The transcript of the communication not filed in the proceedings in Docket No. RT02-2-000 until December 13, 2001. The transcript of the communication was not served on the parties to these proceedings, and was not filed in the proceedings or posted on RIMS in Docket No. RT01-88-000 or in any of the other Alliance RTO proceedings.

Participating in the conference call were Commission Chairman Pat Wood, III, Commissioner Nora Mead Brownell, a representative from Commissioner Massey's office,[68] representatives of the Commission's Office of the General Counsel and Office of Markets, Tariffs and Rates, and representatives of 20 state public utility regulatory commissions,[69] 14 of which are parties to the Alliance Companies' RTO proceedings.

The transcript of the ex parte communications makes clear that the Alliance Companies were not permitted to participate in the discussion.[70] Furthermore, the transcript leaves no doubt that the specific purpose of the ex parte communication was to learn how the state commissions, including those that were parties to the proceedings, wanted the Commission to rule on the pending requests for rehearing in *Alliance V*.[71] Indeed, one exchange makes this point explicitly:

> MR. WALKER: I guess it's an awkward situation, in that there have already been orders approving the Alliance RTO configuration, and I guess in our view, you didn't really adequately address many of the concerns that the Virginia Commission raised in those proceedings. And I recognize that this new initiative represents a way of addressing those, and we appreciate that. I guess I'm at a loss as to an immediate fix.
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> CHAIRMAN WOOD: . . . I think we've got the seams issues really front and center on a number of dockets here. And I

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68 See Transcript at 38 (CHAIRMAN WOOD: "and Bud from Bill's office is in this meeting as well right now. . . ."

69 The Arkansas Public Service Commission, the Illinois Commerce Commission, the Indiana Utility Regulatory Commission, the Iowa Utilities Board, the Kansas Corporation Commission, the Kentucky Public Service Commission, the Michigan Public Service Commission, the Minnesota Public Utilities Commission, the Missouri Public Service Commission, the Nebraska Power Review Board, the North Carolina Utilities Commission, the North Dakota Utilities Commission, the Public Utilities Commission of Ohio, the Oklahoma Corporation Commission, the Pennsylvania Public Utility Commission, the Tennessee Regulatory Authority, the Public Utility Commission of Texas, the Virginia State Corporation Commission, the Public Service Commission of West Virginia, the Public Service Commission of Wisconsin. Transcript at 1-6.

70 Chairman Wood opened the discussion by stating: "Today's discussions are pursuant to the Commission's order that we issued on November 9, 2001, in docket number RT02-2. The discussions are not open to the public." Transcript at p. 7.

71 Chairman Wood stated that the purpose of the conference call was "to get as much helpful feedback from you all as possible before we went in and made the cuts on these final orders [in Alliance and Midwest ISO RTO proceedings], which we anticipate doing at our December 19 open meeting, in a couple weeks' time." Transcript at p. 13.

> should add that the docket you referred to as well as all these are still pending rehearing, so we're not really done with all of this yet. And we would like to get them all fixed, quite frankly, so that's why we're doing this. It ain't over until it's over, order denying rehearing, and I don't believe we've issued any of those yet.[72]

The transcript also makes clear that: many state commissions participating in the conference call, including those that are parties to these proceedings, urged the Commission to (1) require one RTO for the Super-Region,[73] (2) approve the Midwest ISO model,[74] and (3) repudiate the bargain struck in the Settlement that both the Alliance RTO and the Midwest ISO should both become operational as RTOs.[75] As the Commission's rulings in *Alliance VI* demonstrate, the Commission acceded to all of these requests.

E. The Commission's Order in *Alliance VI* Departs from Order No. 2000, its Earlier Orders in *Alliance I-V* and the Settlement

On December 20, 2001, the Commission issued *Alliance VI*, based on the views of state commissions, in which it departed abruptly from Order No. 2000, its RTO regulations, its prior rulings in proceedings *Alliance I-V* and its orders approving the Settlement.

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[72] Transcript at 33-34 (emphasis added).

[73] *See e.g.* Transcript at 18 (MR. NELSON: "But I think the fundamental question of going to a single RTO at this time is whether we can continue along the path we started last spring with the virtual RTO that was approved by the Commission. And I think that a number of us have reached the conclusion that that is not working and that there's a number of changed circumstances that warrant us giving much further thought to a single RTO in the Midwest.") *See also*, Transcript at 22-23 (MS. MUNNS: ". . . there's a consensus that a Midwestern RTO is what we would like."), and Transcript at 30 (MR. GARVIN: "The one message from our state is we support a single RTO, and the sooner the better, in our view.") *See also* Transcript at 36 (MR. ELLIS: "[W]e're willing to participate in the Alliance [Midwest ISO] debate, and our view is that a single RTO would be preferable.")

[74] *See e.g.*, Transcript at 29 (MS BODE: "And so anyway, we really like the concept of moving more to what the MISO is, which has an independent board.") *See also* Transcript at 31 (MR. WALKER: "The Virginia Commission certainly is not opposed to an expanded vision of the Midwest ISO and possible consolidation of the Alliance in the Midwest.") This view, however, was not unanimous.

[75] *See e.g.*, Transcript at 22 (MR. SVANDA: "When that settlement was reached, it was in an environment where we didn't have the same level of confidence and certainty. So it was a settlement in the true sense of the word. We really didn't accomplish all that we might have, if we had been playing from a little stronger position.") *See also*, Transcript at 22 (MR. HARVILL: "I think we all went into the settlement, hoping that it would move the ball down the field, so to speak. And I think we're all feeling as though we're not really in the driver's seat here. . . .")

1. *Alliance VI* findings and rulings

In its December 20, 2001 order, the Commission stated that it was making "difficult decisions" with respect to the "competing proposals" of the Alliance Companies and the Midwest ISO.[76] The Commission also indicated that it was making these decisions "taking into account the views of the majority of the Midwestern State commissions."[77] The Commission stated it "can no longer conclude that the proposed Alliance RTO has sufficient scope consistent with . . . Order No. 2000."[78] The Commission concluded that the public interest would best be served if the Alliance Companies were to join the Midwest ISO, directed the Alliance Companies to explore joining the Midwest ISO, denied the Alliance Companies' request for rehearing of *Alliance V*, and terminated the Alliance Companies' RTO dockets.

2. Commissioner Breathitt's dissent in *Alliance VI*

Commissioner Breathitt dissented from the Commission's order, stating that she "cannot participate in this sudden departure from the road map I believe we drew in our prior Alliance orders."[79] In her dissent, Commissioner Breathitt observed that: (1) "[b]ased on the Commission's guidance and encouragement, the Alliance member companies have extended significant energy, time and expense in developing and implementing the proposal;" (2) "Alliance has worked in good faith to satisfy the characteristics and functions established in Order No. 2000;" (3) "Alliance tells us it could be operational in the first quarter of 2002 pending the necessary FERC approvals," and (4) "[t]he rehearing order relies heavily on the comments of state commissions, which generally favor one RTO for the Midwest."[80]

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76 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 3-4.

77 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 4.

78 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 14.

79 *Alliance VI*, 97 FERC ¶ 61,327 Commissioner Breathitt, dissenting, slip op. at 2.

80 *Alliance VI*, 97 FERC ¶ 61,327 Commissioner Breathitt, dissenting, slip op at 1.

III. THE COMMISSION'S RULING IN *ALLIANCE VI* THAT THERE SHOULD BE ONE RTO IN THE MIDWEST FAILS TO GIVE EFFECT TO THE SETTLEMENT IT APPROVED BETWEEN THE ALLIANCE COMPANIES AND THE MIDWEST ISO

The Commission's rejection of the Alliance Companies' RTO proposal depends, in part, upon its findings that "various state commissions in the Midwest . . . overwhelmingly prefer a single Midwest RTO. . . ."[81] and "the views of many of the state commissions have persuaded us that allowing two RTOs in the Midwest would be a second-best solution that would not serve the best interest of customers throughout the Midwest."[82] The "preferences" and "views" of many state commissions notwithstanding, because the Settlement provides for both the Alliance RTO and the Midwest ISO becoming operational as RTOs, this ruling by the Commission fails to give effect to the Settlement that the Commission approved and to which, consequently, the Commission is bound. The Commission's failure to give effect to the Settlement in *Alliance VI* is arbitrary and capricious and an abuse of discretion.

A. The Commission Cannot Ignore that the Settlement as Approved by the Commission Accommodates Both the Midwest ISO and the Alliance RTO Becoming Operational

As set forth above, the unequivocal purpose and effect of the Settlement was to permit both the Alliance RTO and the Midwest ISO to move forward and become operational as RTOs, consistent with the requirements of Order No. 2000. Specifically, the Settlement "provides two financially and operationally viable RTOs with a single Super-Regional rate that removes all seams and pancakes between the two RTOs, and preserves the different business practices of the participants."[83]

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81 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 14.

82 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 15.

83 *Illinois Power Company*, "Chief Judge's Certification of Settlement," 95 FERC ¶ 63,003, 65,025 (2001) (emphasis added).

The Commission acknowledged this fact in approving the Settlement, first of all, by observing that "[t]he Super Region rate contemplates that the Midwest ISO and the Alliance will each become an RTO"[84] and, second, by specifically rejecting an argument that "the Midwest transmission grid must be under the control of a single operator to provide for a seamless market."[85] While the Commission did, indeed, "encourage further efforts . . . to build upon the framework of this Settlement to develop common processes," the Commission also found consideration of a single RTO "premature" because, in establishing settlement proceedings, it had "directed parties to attempt to resolve their differences in a way that would respect their business model preferences . . . ."[86] The parties to the Settlement complied with the Commission's direction, and entered into a Settlement that preserved both the Alliance RTO and the Midwest ISO business models and established the structure of two RTOs in the Super-Region.

Contrary to the Settlement, however, the Commission in *Alliance VI*, ruled that there would be one RTO in the "Midwest." For the Commission simply to ignore the fact that the Settlement it approved "provides two financially and operationally viable RTOs"[87] is arbitrary, capricious and an abuse of its discretion. The courts have held that "[t]he Commission is not justified . . . in cavalierly disregarding private [settlements],"[88] and that "[t]he Commission's failure to take the existence of . . . negotiated [settlement] agreements into account is a material

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84 Settlement Order, 95 FERC at 61,644 n.32.

85 Settlement Order, 95 FERC at 61,648.

86 Settlement Order, 95 FERC at 61,648.

87 As the Chief Judge stated: "[a] merger between the Alliance RTO and the Midwest ISO was not the goal of the settlement negotiations nor were the parties directed to consider that issue by the Commission." 95 FERC at 65,025 (emphasis added).

88 *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 519 (D.C. Cir. 1985).

deficiency in its reasoning."[89] On rehearing, the Commission should give effect to the Settlement it approved and reverse its ruling that there will be only one RTO in the Midwest.

B. The Commission is Bound by the Settlement it Approved

The Midwest ISO acknowledged in its IRCA Report that it is "contractually obligated to support the Midwest structure established in the *Illinois Power* Settlement Agreement."[90] Because it approved the Settlement, the Commission is similarly obligated. It is black-letter law that "[o]nce approved . . . a settlement binds the Commission as well as the regulated entity."[91] Indeed, "[t]he Commission also acknowledges that it is bound by approved settlement agreements."[92] Furthermore, "such approval [of a settlement] binds the Commission . . . to all constituent parts of the agreement."[93] There has been no claim that the Settlement was reached by any means other than good faith and proper conduct between the parties. Additionally, by directing Ameren, ComEd and Illinois Power, as Alliance Companies, to pursue participation in the Midwest ISO, the Commission in *Alliance VI* fails to acknowledge the effect of such a directive on the provisions of the Settlement permitting those companies to withdraw from the Midwest ISO in exchange for their payment to the Midwest ISO of $60 million. Consequently, in approving the Settlement, the Commission bound itself to the Settlement structure that

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89 771 F.2d at 520.

90 Midwest ISO IRCA status report at 32.

91 *Kentucky West Virginia Gas Co. v. FERC*, 780 F.2d 1231, 1237 (5th Cir. 1986). *See also, Mobil Oil Corp. v. FPC*, 570 F.2d 1021, 1026 (D.C. Cir. 1978), *Texas Gas Transmission*, 441 F.2d 1392, 1394 (6th Cir. 1971) ("Settlement agreements are one of the means by which the Commission exercises its authority to regulate the power industry. Such agreements bind both parties – the Commission and the regulated entity – and thus allow both to avoid the delays and uncertainties of litigation."), and *Chicago v. FPC*, 385 F.2d 629, 638-41 (D.C. Cir. 1967), *cert. denied*, 390 U.S. 945 (1968).

92 *Tennessee Gas Pipeline Co. v. F.P.C.*, 504 F.2d 199, 202 (D.C. Cir. 1974). *See also, Sea Robin Pipeline Company*, Opinion No. 227-A, "Order Granting Rehearing in Part, Terminating Investigation, Ordering Refund, and Ordering Filing of Revised Tariff Sheets," 31 FERC ¶ 61,188 at 61,380 (1985) ("Upon reflection, we are of the opinion that Sea Robin and Gulf are correct. The Commission is indeed bound by the terms of a settlement, just as the parties to it are.")

93 *Williston Basin Interstate Pipeline Co. v. FERC*, 874 F.2d 834, 837 (D.C. Cir. 1989).

accommodates two RTOs in the Super-Region and to the withdrawal of Ameren, ComEd and Illinois Power from the Midwest ISO as provided for by the Settlement. The Commission's ruling in *Alliance VI* that there will be one RTO in the Midwest is inconsistent with the Settlement it approved and to which it, consequently, is bound. On rehearing, therefore, the Commission should reverse its ruling that there will be one RTO for the "Midwest," and give effect to all of the provisions of the Settlement.

C. The Commission Has Failed to Provide a Reasoned Explanation for Failing to Give Effect to the Settlement it Approved

"Agencies are under an obligation to follow their own . . . precedents, or provide a rational explanation for their departures."[94] In *Alliance VI*, the Commission's reliance on the "preference" of "various state commissions in the Midwest" for "a single Midwest RTO"[95] does not constitute a "rational explanation" for failing to give effect to the two-RTO structure to which the parties agreed in the Settlement, and that the Commission approved. Therefore, the Commission's ruling that there will be one RTO in the "Midwest" is arbitrary, capricious and an abuse of its discretion.

D. The Commission's Preference for One RTO in the "Midwest" is Unsupported by Substantial Evidence.

The Commission's mere assertion that "allowing two RTOs in the Midwest would be a second-best solution that would not serve the best interests of customers throughout the Midwest,"[96] does not justify its failure to give effect to the Settlement. Factual determinations by the Commission must be supported by "substantial evidence" in the record.[97] "Substantial

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94 *National Conservative Political Action Committee v. FERC*, 626 F.2d 953, 959 (D.C. Cir. 1980).

95 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 14.

96 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 14.

97 16 U.S.C. § 825l (2001) and *see e.g.*, *City of Charlottesville v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981) ("What is basic is the requirement that there be support in the public record for what was done.")

evidence is more than a mere scintilla, and must do more than create a suspicion of the evidence of the fact to be established."[98]

In *Alliance VI*, however, the Commission has not presented one shred of evidence to support its conclusion that allowing both the Alliance RTO and the Midwest RTO to become operational, as RTO would not be in the interest of consumers. Rather, the Commission has merely asserted that the two RTO structures established in the Settlement would not serve the best interests of customers. As the courts have held, "[s]ubstantial evidence is not adduced by mere agency assertion."[99] Therefore, because it is unsupported by substantial evidence in the record, the Commission's ruling that there will be one RTO in the Midwest does not justify its failure to give effect to the Settlement is arbitrary and capricious.

IV. IN *ALLIANCE VI*, THE COMMISSION FAILS TO PROVIDE A REASONED EXPLANATION OF ITS DEPARTURE FROM ITS RULINGS IN *ALLIANCE I-V*

As set forth above, its earlier rulings in these proceedings, the Commission substantially approved the Alliance RTO. It is well-established that "an agency must provide a reasoned explanation for any failure to adhere to its own precedent."[100] "If the Commission departs from one of its own precedents it is obligated to articulate a reasoned justification for doing so."[101] In concluding that it "cannot approve the Alliance RTO as a stand-alone RTO,"[102] the Commission turns 180 degrees away from its earlier rulings in these proceedings that the Alliance RTO

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98 *NLRB v Columbian Enameling & Stamping Co.*, 306 U.S. 292, 300 (1939).

99 *Nat'l Ass'n of Recycling Indus. v. FMC*, 658 F. 2d 816, 824 (D.C. Cir. 1980). *See also, Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305, 1313 (D.C. Cir. 1991) ("An agency's unsupported assertion does not amount to 'substantial evidence.'")

100 *Hatch v. FERC*, 654 F.2d 825, 834 (D.C. Cir. 1981).

101 *Wisconsin Central Ltd. v. Surface Transportation Board, et al.*, 112 F.3d 881, 887 (7th Cir. 1997).

102 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 16.

substantially satisfies the requirements of Order No. 2000,[103] but fails to provide a reasoned explanation and justification for doing so. Reasoned decision making is "a process demonstrating the connection between the facts found and the choice made."[104] The Commission's reliance in *Alliance VI* on the "preference" of "various state commissions in the Midwest" for the Midwest ISO does not constitute a reasoned explanation, much less a reasoned justification, for departing from its prior orders in these proceedings. "For the agency to reverse its position in the fact of a precedent it has not persuasively distinguished is quintessentially arbitrary and capricious." [105] Therefore, the Commission's 180-degree turn away from its prior rulings in these proceedings is arbitrary, capricious and an abuse of its discretion.

V. THE COMMISSION'S RULING THAT THE ALLIANCE RTO LACKS ADEQUATE SCOPE IS UNSUPPORTED BY SUBSTANTIAL EVIDENCE IN THE RECORD, IS BASED ON A MISINTERPRETATION OF THE IRCA, IS UNDULY DISCRIMINATORY AND DENIES THE ALLIANCE COMPANIES EQUAL PROTECTION UNDER THE LAW

The Commission bases its determination that the Alliance RTO lacks adequate scope on three grounds: first, its claim that "the confidence of the Commission and participating state commissions in the IRCA's ability to resolve seams issues has eroded;"[106] second, its own assertion that "the IRCA implementation has not progressed as expected;"[107] and third, the

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[103] In *Alliance III, IV* and *V*, the Commission found that the Alliance RTO scope and configuration fully satisfies the requirements of Order No. 2000. In *Alliance III, IV* and *V*, the Commission found that the Alliance RTO satisfies the Order No. 2000 requirements for operational control. In *Alliance III, IV* and *V*, the Commission found that the Alliance RTO satisfies the Order No. 2000 requirements for short-term reliability.

[104] *ANR Pipeline Co. v. FERC*, 771 F.2d 507 at 516, *citing Burlington Truck Lines, Inc. v. U.S.*, 371 U.S. 156 167-68 (1962) and *Electricity Consumers Resources Council v. FERC*, 742 F.2d 1511, 1513-14 (D.C. Cir. 1984).

[105] *See Louisiana Public Service Comm'n v. FERC*, 184 F. 3d 892, 897 (D.C. Cir. 1999) (holding that the Commission's 180 degree turn away from a previous decision without adequate explanation was arbitrary and capricious) (*citing Motor Vehicle Mfrs. Ass'n. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 57 (1988).

[106] *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 13.

[107] *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 13.

withdraw of International Transmission Company ("ITC") from the Alliance.[108] These grounds, however, do not provide a basis for finding that the Alliance RTO lacks adequate scope. The Commission's eroded confidence in the IRCA's ability to resolve seams issues is unsupported by substantial evidence in the record, its assertion that the IRCA implementation has not progressed as expected is based on a misinterpretation of the IRCA, and the ITC's withdrawal from the Alliance is insufficient for the Commission to reverse its earlier findings that the Alliance RTO satisfies the scope requirement of Order No. 2000.

A. The Commission's Claims Regarding the Ability of the IRCA to Resolve Seams Issues are Unsupported by Substantial Evidence in the Record

1. The Commission has not provided a reasoned explanation for its repudiation of the IRCA

In approving the Settlement, which included the IRCA, the Commission took no issue with the Chief Judge's finding that the IRCA "provide[s] the basis for the development of a seamless market throughout Alliance and the Midwest ISO,"[109] and concluded that the Settlement "is the basis for an expanded market and a sounder, seamless and a more reliable electric grid in the Midwest."[110] In *Alliance VI*, the Commission fails to provide a reasoned explanation for its repudiation of the IRCA, which it approved as part of the Settlement. Therefore, its repudiation of the IRCA is arbitrary and capricious.[111]

2. The Commission has failed to support its claims regarding IRCA with substantial evidence in the record

In *Alliance VI*, the Commission has not provided substantial evidence supporting its claimed "eroded" confidence in the ability of the IRCA to resolve seams issues. As explained

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108 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 14.

109 Settlement Order, 95 FERC at 61,640 (emphasis added).

110 Settlement Order, 95 FERC at 61,646 (emphasis added).

111 *See Louisiana Public Service Comm'n v. FERC*, 184 F.3d at 897.

above, the FPA requires that factual determinations by the Commission be supported by "substantial evidence in the record,"[112] and "substantial evidence "is more than a 'mere scintilla.'"[113] It is equally well-established, however, that "an agency's unsupported assertion does not amount to 'substantial evidence.'"[114] Thus, the unsupported assertions of state commissions and, subsequently, of the Commission in *Alliance* VI do not constitute "substantial evidence," and the Commission's repudiation of the IRCA is arbitrary, capricious and an abuse of its discretion.

B. The Commission's Conclusion that the IRCA Implementation Has Not Progressed as Expected is Unfounded

In *Alliance VI*, the Commission states that its previous finding that the Alliance RTO had adequate scope "relied in part, on implementation of the IRCA,"[115] but that the Alliance Companies and the Midwest ISO filed status reports "which indicate that the IRCA implementation has not progressed as expected."[116] These claims by the Commission are based on a misinterpretation of the IRCA and, in fact, are contradicted by the IRCA Reports of the Alliance Companies and the Midwest ISO.

1. The Commission's order misinterprets the IRCA

The Commission claims that the IRCA has not been implemented because: (1) the Alliance Companies and the Midwest ISO each state that they will calculate ATC and TTC using similar, but not identical methods; (2) detailed operating protocols and procedures necessary to

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112 16 U.S.C. 825l(b) (2001) and *see e.g.*, *City of Charlottesville v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981) ("What is basic is the requirement that there be support on the public record for what was done.")

113 *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938) (*citing Appalachian Power Co. v. NLRB*, 93 F.2d 985, 989 (4th Cir. 1938).

114 *See Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305, 1313 (D.C. Cir. 1991).

115 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 13.

116 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 13.

accomplish one-stop shopping have not yet been developed and agreed upon; (3) the Midwest ISO and the Alliance Companies have only developed compatible, and not common energy imbalance markets; and (4) the Midwest ISO and the Alliance RTO will have separate security coordinators.[117] These purported grounds for concluding that the IRCA has not been implemented and, consequently, for ruling that the Alliance RTO lacks adequate scope, represents a fundamental misinterpretation of the provisions of the IRCA. Contrary to the Commission's assertions, (1) the IRCA does not require "identical" ATC and TTC calculations, (2) the mechanisms necessary to accomplish one-stop shopping have been developed, (3) the IRCA does not require common energy imbalance markets, and (4) the IRCA does not require one security coordinator for the Midwest ISO and the Alliance RTO.

In many cases, the parties to the Settlement deliberately adopted requirements for compatible, rather than common or identical, systems because both the Alliance Companies and the Midwest ISO already made investments and had developed system for their respective RTOs, and in many instances development of common systems was not practical in light of a December 15, 2001 start date.

a. The IRCA does not require "identical" ATC and TTC calculations.

Contrary to the Commission's ruling, the Settlement does not require that the Alliance Companies and the Midwest ISO develop "identical" methods for calculating ATC and TTC. Rather, the Settlement only requires that the methods be "compatible." Section 3.2 of the IRCA provides, in relevant part, that; "The Cooperating RTOs agree to develop necessary protocols to determine and coordinate the posting of compatible ATCs with any regional seam. A joint working group has been meeting, and will continue to meet to finalize a compatible methodology

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[117] *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 13-14.

for protocols for determining, coordinating, and posting ATC values impacting the Cooperating RTOs." Furthermore, as the Alliance Companies explain in their status report, this requirement of the IRCA has been implemented.[118] In its IRCA Report, the Midwest ISO indicated that the Midwest ISO and the Alliance Companies adopted CPP-9 in response to the IRCA's requirement, stating that it "does not expect that the differences in ATC models will compromise reliability. . . ."[119]

b. The Midwest ISO and the Alliance Companies have complied with the requirements of the IRCA with respect to one-stop shopping.

As the Commission acknowledged in its order approving the Settlement, Section 3.4 of the IRCA requires the Alliance RTO and the Midwest ISO to facilitate one-stop shopping directly by the transmission customer or indirectly through a one-stop shopping service provider.[120] In approving the Settlement, the Commission found that "the commitments made in Article X, once properly implemented, should meet or exceed the requirements of Order No. 2000."[121] This requirement of the IRCA has been satisfied. As the Alliance Companies stated in their IRCA Report: "The Alliance Companies and the Midwest ISO have successfully completed and gone beyond the IRCA requirements for accommodating one-stop shopping."[122] In addition, the Midwest ISO reported that:

> The OSS Group has held twelve face-to-face meetings, three conference calls and two separate scheduling meetings with the PJM since its formation in December 2000. It has been successful in identifying RTO scheduling information that must appear on a tag, agreeing to a common scheduling approach

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118 Alliance Companies' IRCA Report at 10-12.

119 Midwest ISO IRCA Report at 19.

120 Settlement Order, 95 FERC at 61,651.

121 Settlement Order 95 FERC at 61,651.

122 Alliance Companies' IRCA Report at 12.

between RTOs, seeking a NERC waiver on the RTO scheduling process and defining a common system that will be used by RTOs to electronically coordinate schedules between RTOs. The participating entities in the OSS Group are the Midwest ISO, ARTO, GridSouth, PJM, SPP, and TVA. All six have agreed to a common approach to electronically coordinate schedules between RTOs. The six participating entities sought bids from several vendors on the use of a common system that will coordinate schedules between RTOs. A vendor has been selected and a statement of work is being finalized that will provide a common system ready for use by the RTOs when they go operation on December 15, 2001. Having all of these RTOs agree to a common process that can be ready by December 15, 2001 is a significant improvement to scheduling practices that are being followed today. There is still a significant amount of work required before all electronic scheduling issues are resolved, but the work being done under CPP-3 and CPP-12 provides a solid foundation for perfecting OSS over a region that is far larger than even that envisioned under the IRCA.[123]

c. The IRCA does not require "common energy imbalance markets."

Contrary to the Commission's ruling, the IRCA does not require "common" energy imbalance markets. Rather, the IRCA requires that the Alliance and the Midwest ISO adopt "compatible" energy imbalance services. Section 3.6.2 specifically provides that "Each Cooperating RTO shall be responsible for implementing its own imbalance market."[124] Section 3.6.3 of the IRCA also requires that "The Cooperating RTOs shall cooperate in the development of their individual imbalance markets to ensure their compatibility in their application of Multi-RTO Transmission Transactions."[125]

Furthermore, in the Settlement Order the Commission specifically rejected requests that it require the development of common or joint energy imbalance mechanisms, stating: "While joint arrangements would appear desirable in the long run, we have no basis to find, at this time,

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123 Midwest ISO IRCA Report at 22 (emphasis added).

124 IRCA § 3.6.2.

that multiple, truly compatible energy imbalance . . . mechanisms are not consistent with Order No. 2000."[126]

As the Alliance Companies stated in their IRCA Report, this requirement was being implemented:

> CPP-7 satisfies the IRCA requirement that the Alliance and the Midwest ISO adopt compatible energy imbalance services. The Alliance Companies and the Midwest ISO did not find it necessary or appropriate to develop a common energy imbalance market for initial operation. The long-lead time for development of an imbalance market when compared to the short-lead time until initial operation of the RTOs made development of a single energy imbalance market infeasible. Moreover, both the Alliance and the Midwest ISO white papers on long-term congestion management envision that the Day 2 congestion management market will incorporate imbalance markets. Thus, it seems appropriate to concentrate on Day 2 congestion management and imbalance markets for future operations.[127]

In its IRCA Report, the Midwest ISO stated that "[e]ven though the [Alliance RTO] Energy Imbalance Process is different from the Midwest ISO's process, the two processes can work together and are compatible in the treatment of multi-RTO transactions."[128]

The unreasonableness of the Commission's reliance on a misinterpretation of the IRCA's requirements for energy imbalance markets is demonstrated further by its finding in *Midwest ISO* that the Midwest ISO satisfies Order No. 2000's requirements for providing ancillary services even through the Midwest ISO will not be providing an energy imbalance market on Day 1.[129] Since the Midwest ISO will not even provide an energy imbalance market when it becomes operational it is arbitrary and capricious for the Commission to conclude in *Alliance VI* that the

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125 IRCA § 3.6.3.

126 Settlement Order, 95 FERC at 61,650.

127 Alliance IRCA Report at 17-18.

128 Midwest ISO IRCA report at 26.

129 *Midwest ISO*, 97 FERC ¶ 61,326, slip op. at 33.

Alliance RTO should not be approved due to the absence of a common energy imbalance market with the Midwest ISO. The unequal treatment afforded the Alliance Companies in the evaluation of their RTO proposal is unduly discriminatory and denies the Alliance Companies the equal protection of the laws.

d. The IRCA does not require a "common security coordinator."

With respect to security coordination, Section 3.3.1 of the IRCA provides that "The Cooperating RTOs agree to share security information among themselves and with neighboring RTOs to coordinate and improve the security coordination function."[130] Section 3.3.2 also provides that "The Cooperating RTOs agree to adopt, as applicable, the results of initiatives NERC currently has underway to improve coordination between security coordinators, potentially resulting in a broader approach that may align security coordinators on an RTO basis."[131]

Thus, contrary to the Commission's ruling, nothing in the IRCA or in the Commission's order approving the Settlement requires the Alliance RTO and the Midwest ISO to have a common security coordinator. Furthermore, the Alliance Companies and the Midwest ISO have satisfied the IRCA's requirement for coordination of the security function. As the Alliance Companies stated in their status report:

> CPP-8 (Security Data and Information Sharing) satisfies the IRCA requirements of the Alliance and the Midwest ISO for coordinating and improving security coordination. CPP-8 defines Day 1 security coordination, including data and information sharing between the two RTOs. This data exchange will be done over existing infrastructures including the: Interregional Security Network ("ISN"), Security Coordinator Information System ("SCIS"), Interchange Distribution Calculator ("IDC"), and System Data Exchange ("SDX"). Additional security information,

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130 IRCA § 3.3.1.

131 IRCA § 3.3.2.

> including next-day security analyses and operating studies, will also be shared by the two RTOs. The Alliance Security Coordinator and the Midwest ISO Security Coordinator will communicate directly to immediately resolve security issues as they might arise and will utilize the NERC hotline to coordinate any security issue with all NERC Security Coordinators.[132]

Additionally, in its status report, the Midwest ISO stated that in response to the requirement of Section 3.3 of the IRCA, "the Midwest ISO and Alliance have adopted CPP-8 which establishes the framework for the sharing of [security] information."[133]

2. The IRCA has been implemented consistent with its terms and consistent with the Commission's orders approving the Settlement

The Commission's claim that the IRCA has not been implemented as expected are directly contradicted by the record in these proceedings. In fact, the record demonstrates that implementation of the IRCA has progressed precisely as any party had the right to expect; that is, it has been implemented consistent with its terms and consistent with the Commission's orders approving the Settlement.

Contrary to the Commission's characterization of the Alliance Companies' IRCA Report, the Alliance Companies told the Commission that "[t]he Alliance Companies and the Midwest ISO have worked together to develop a Cooperative Procedure and Protocol ("CPP") for each element of the Settlement and the IRCA requiring a procedure and protocol on or before the date required therein."[134] Contrary to the Commission's characterization of the Midwest ISO's IRCA Report, the Midwest ISO told the Commission that "the Midwest ISO and the [Alliance RTO] have developed procedures and protocols in accordance with the IRCA."[135]

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132 Alliance Companies' IRCA Report at 17.

133 Midwest ISO IRCA report at 20.

134 Alliance Companies' IRCA Report at 10.

135 Midwest ISO IRCA Report at 16.

The Commission's conclusion that the IRCA has not been implemented as expected also is unreasonable because the Commission has failed to give the parties an opportunity to demonstrate the IRCA's effectiveness. In their IRCA Reports, both the Alliance Companies and the Midwest ISO told the Commission that the IRCA cannot be fully implemented until the two RTOs become operational.[136]

Finally, following its review of the Alliance Companies and Midwest ISO status reports, the Commission staff itself informed the Commission that the Alliance Companies and the Midwest ISO "are moving along consistent with what was approved . . . They are on schedule. . . . They are doing what they said they would do and what we approved."[137] Thus, there is no basis whatsoever for the Commission's conclusion that implementation of the IRCA has not progressed as expected. On the contrary, the record demonstrates that implementation of the IRCA has progressed consistent with its terms and consistent with the Commission's orders approving the Settlement.

C. ITC's Withdrawal from the Alliance is Insufficient to Reverse the Commission's Prior Rulings with Respect to Scope

The Commission also attempts to justify its finding that the Alliance RTO lacks adequate scope on the withdrawal of International Transmission Company ("ITC") from the Alliance. Contrary to the Commission's ruling, ITC's withdrawal from the Alliance does not support a finding that the Alliance RTO lacks adequate scope. Without ITC, the Alliance RTO satisfies

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[136] Alliance IRCA Report at 9, and Midwest ISO IRCA Report at 16-17. The Settlement, including the IRCA, took over two months to negotiate. It was filed with the Commission on March 21, 2001, and approved by the Commission on May 21, 2001. For the Commission to despair of the IRCA only 7 months after approving it is unreasonable, particularly, as the Alliance Companies have said, full implementation of the IRCA can come only after the two RTOs became operational.

[137] FEDERAL ENERGY REGULATORY COMMISSION, 777th Regular Meeting (October 24, 2001), Transcript at 101 (emphasis added).

the scope and configuration requirements of Order No. 2000 and the Commission's RTO regulations.

1. The Commission previously found a smaller Alliance RTO satisfied the scope and configuration requirement of Order No. 2000

In *Alliance VI*, the Commission claims that ITC's withdrawal "shrinks" the Alliance RTO, "concomitantly diminishing its scope."[138] However, in *Alliance III* and *IV*, the Commission found that a smaller Alliance RTO satisfied the scope and configuration requirements of Order No. 2000. In *Alliance III*, the Commission held that "Alliance Companies' proposed scope and configuration are consistent with Order No. 2000."[139] In *Alliance IV*, the Commission held that:

> Alliance in scope is consistent with Order No. 2000. Alliance has approximately 40,000 miles of transmission lines covering 132,000 square miles with a population of 30 million people in nine states and a load of nearly 71 gigawatts. * * * The sheer size of Alliance, coupled with a revised rate proposal that eliminates rate pancaking, are significant factors that underlie our finding in the Alliance III Order."[140]

Since *Alliance III*, the "sheer size" of the Alliance RTO has, in fact, increased. Five new companies joined the Alliance, greatly enhancing its scope and configuration. As currently configured, without ITC, the region covered by the Alliance RTO encompasses 54,100 miles of transmission lines covering 181,900 square miles with a population of 34.8 million people in nine states and a peak load of nearly 100,800 MW. Having found that the RTO presented in *Alliance III* satisfied the scope requirements of Order No. 2000, there is no basis for the Commission to conclude now that a larger RTO fails to do so. Consequently, the withdrawal of ITC from the Alliance does not support a finding that the Alliance RTO lacks adequate scope.

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138 *Alliance VI*, 97 FERC ¶ 61,327 slip op. at 14.

139 *Alliance III*, 94 FERC at 61,307.

2. Without ITC, the Alliance RTO satisfies the scope and configuration requirements of Order No. 2000

As the Commission explained in *Alliance IV*, the Commission's finding that the Alliance RTO satisfied the scope requirement of Order No. 2000 "was based on a totality of circumstances and not solely on any one rationale."[141] Consequently, the Commission cannot now base a determination that the Alliance RTO lacks sufficient scope on the single fact of ITC's withdrawal from the Alliance. The Commission's regulations with respect to "scope and regional configuration" provide that an "appropriate region" must be of sufficient scope and configuration to permit the [RTO] to maintain reliability, effectively perform its required functions, and support efficient and non-discriminatory power markets."[142] The Commission has failed to provide substantial evidence in the record that the withdrawal of ITC from the Alliance renders the Alliance RTO unable to (1) maintain reliability, (2) effectively perform its required functions, or (3) support sufficient and non-discriminatory power markets. Contrary to the Commission's finding, the record in these proceeding establishes that the Alliance Companies satisfy the scope and configuration requirements set out in the Commission's RTO regulations.[143]

Moreover, in Order No. 2000, the Commission emphasized that "regions should be configured so as to recognize trading patterns."[144] The record in these proceedings demonstrates that the region encompassed by the proposed RTO recognizes trading patterns.[145] The

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140 *Alliance IV*, 95 FERC at 61,628.

141 *Alliance V*, 96 FERC at 61,629.

142 18 C.F.R. §35.34(j)(2) (2001).

143 *See* Affidavit of David B. Patton and Affidavit of Ronald F. Szymczak, filed on January 16, 2001.

144 Order No. 2000 at 31,084.

145 *See e.g.*, Affidavit of David B. Patton, Affidavit of Ronald F. Szymczak, and Affidavit of Steven T. Naumann, P.E., filed on January 16, 2001.

Commission has provided no rational basis, supported by substantial evidence, to justify its departure in these proceedings from the "trading pattern" standard established in Order No. 2000.

3. The Settlement establishes the largest area ever proposed for the development of a seamless market

The Settlement approved by the Commission establishes the largest area ever proposed – the Super-Region – for the elimination of transmission rate pancaking and the development of a seamless market. The Super-Region includes more than 153,800 miles of transmission lines, and encompasses approximately 167,100 MW of generating capacity and 116,100 MW of peak load.[146] As such, the Super-Region provided by the Settlement is far larger than any RTO approved by the Commission or under consideration. Indeed, the proposed Alliance RTO, by itself is as large or larger than any RTO approved by the Commission, including the Midwest ISO. Given these facts, there is no basis for the Commission to conclude that the Alliance RTO is too small or otherwise in adequate in scope and configuration to co-exist as an RTO with the Midwest ISO.

D. The Commission's Ruling that the Alliance RTO Lacks Sufficient Scope is Unduly Discriminatory

In its order approving the Midwest ISO's RTO proposal, the Commission found that "Midwest ISO has adequate scope and configuration to meet the requirements of Order No. 2000."[147] An examination of the basis for the Commission's ruling with respect to the Midwest ISO, demonstrates that the Commission's ruling that the Alliance RTO lacks adequate scope

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146 These statistics assume that TRANSLink becomes an ITC under the Midwest ISO.

147 *Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001), slip op. at 17. ("*Midwest ISO*").

creates a preference for the Midwest ISO without a reasonable basis and, therefore, is unduly discriminatory.[148]

1. The Commission approved an RTO which, in several respects, is smaller than the Alliance RTO

According to the Commission, the Midwest ISO . . . as currently configured, would serve a region with a peak load of 53,000 MW, generating capacity of approximately 59,000 MW, and over 62,000 miles of transmission lines."[149] In comparison, the Alliance RTO, as currently configured, would serve a region with a peak load of 100,800 MW, generating capacity of approximately 108,100 MW and over 54,100 miles of transmission lines. In *Alliance VI*, the Commission provides no reasonable basis for finding that an RTO that is larger in many respects than the current configuration of the Midwest ISO lacks sufficient scope. If the Midwest ISO, as currently configured, satisfies Order No. 2000's requirements as to scope and configuration, then so does the Alliance RTO, and the Commission has provided no reasonable basis for treating the two RTO proposals differently. This is unduly discriminatory.

2. The Commission approved an RTO that presented a "less than ideal" configuration while rejecting an RTO whose scope and configuration it previously had approved

In its order approving the Midwest ISO's RTO proposal, the Commission concludes that its decision in *Alliance VI*, that "the public interest is best served by a single Midwest RTO (i.e., Midwest ISO), creates problems with Midwest ISO's eastern seam."[150] Specifically, it "creates a hole in the Midwest ISO and isolates Southern Illinois Power Cooperative, International Transmission Company, and Central Illinois Light Company from the other Midwest ISO

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148 "Undue discrimination" is defined as a "preference without a reasonable basis." *Sebring Utility Commission v. FERC*, 591 F.2d 1003, 1010 n. 28 (5th Cir. 1979), *cert. denied*, 444 U.S. 879 (1979).

149 *Midwest ISO*, slip op. at 16.

150 *Midwest ISO*, slip op. at 17

members."[151] "By Midwest ISO's own admission, this configuration is not ideal."[152] Nevertheless, the Commission explains that it has taken steps to correct this "less than ideal" configuration presented by the Midwest ISO by directing the Alliance Companies to "explore membership in the Midwest ISO."[153]

In sum, in its *Alliance VI* and *Midwest ISO* orders, the Commission has: (1) rejected the RTO proposal of the Alliance Companies – a proposal without a "hole" – which the Commission previously held to satisfy the scope and configuration requirements of Order No. 2000; (2) approved an RTO proposal with a "hole," and which the Commission acknowledges to present a "less than ideal" configuration; and (3) relied on its directive in *Alliance VI* that the Alliance Companies explore joining the Midwest ISO to cure the deficiencies in the Midwest ISO configuration. In making these rulings, the Commission clearly has created a preference for the Midwest ISO without a reasonable basis. In making these rulings, the Commission has acted in an unduly discriminatory manner and, furthermore, has denied the Alliance Companies equal protection of the laws.

VI. THE COMMISSION'S FINDING THAT "THE PUBLIC INTEREST WOULD BEST BE SERVED IF THE ALLIANCE COMPANIES WERE TO JOIN THE MIDWEST ISO" IS INCONSISTENT WITH ORDER NO. 2000 AND THE COMMISSION'S RTO REGULATIONS

As demonstrated above, the Commission's ruling that there will be one RTO serving the Midwest violates the terms of the Settlement it approved. In addition, the Commission's ruling that the public interest would best be served if the Alliance Companies were to join the Midwest ISO is inconsistent with the terms of Order No. 2000, a rule promulgated by the Commission after notice-and-comment rulemaking. This is because, under the framework established in

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151 *Midwest ISO*, slip op. at 17.

152 *Midwest ISO*, slip op. at 17.

Order No. 2000, the Alliance RTO and the Midwest ISO are not, contrary to the Commission's characterization, "competing proposals." Furthermore, requiring the Alliance Companies to explore joining the Midwest ISO is inconsistent with the voluntary formation of RTOs, which is the bedrock of Order No. 2000.

A. The Alliance RTO and the Midwest ISO Are Not "Competing Proposals"

As is made clear in Order No. 2000 and in the Commission's previous *Alliance* orders, the Alliance RTO and the Midwest ISO are not – and never have been – "competing proposals." This is because (1) the Alliance RTO and the Midwest ISO are not mutually exclusive proposals, (2) Order No. 2000 and the Commission's RTO regulations do not require a single RTO for the Midwest, and (3) the Commission's stated preference for one RTO in the Midwest does not change the terms of Order No. 2000 or the Commission's RTO regulations.

1. The Alliance RTO and Midwest ISO proposals are not mutually exclusive

The Alliance RTO and the Midwest ISO are not "competing proposals" because the Alliance Companies have never proposed that their RTO would encompass the transmission facilities of the transmission owners participating in the Midwest ISO. Similarly, the Midwest ISO has never proposed that its RTO proposal would encompass the transmission facilities of the Alliance Companies. Consistent with Order No. 2000, each of these RTO proposals is a voluntary RTO filing, and each is intended to apply to separate regional transmission facilities that happen to have some points of common interface, as do the facilities of all neighboring regional transmission organizations.[154] Because the two RTO proposals are not mutually

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153 *Midwest ISO*, slip op. at 18.

154 The proposed Alliance RTO also interfaces with the transmission facilities of the proposed PJM RTO and the proposed GridSouth RTO.

exclusive, and approving one RTO proposal does not preclude approving the other proposal, the Alliance RTO and the Midwest ISO are not "competing" RTO proposals.

2. Order No. 2000 does not require a single RTO for the "Midwest"

Furthermore, the Alliance RTO and the Midwest ISO are not competing proposals because, as explained above, the Commission declined to set specific boundaries for the formation of RTOs in Order No. 2000. In other words, Order No. 2000 did not establish a single "Midwest" region for which numerous RTOs would submit "competing" proposals. Instead, under Order No. 2000, the proponents of an RTO are free to define a "region" to be served, which "region" would be evaluated by the Commission under the criteria set out in Order No. 2000 and in the Commission's RTO regulations. The Commission's RTO regulations provide that "an appropriate region" is one of "sufficient scope and configuration to permit the [RTO] to maintain reliability, effectively perform its required functions, and support efficient and non-discriminatory power markets."[155] Nothing in the Commission's regulations defines an "appropriate region" as a specific geographic region of the United States, such as the "Midwest," or the "Southeast."

In their RTO proposal, the Alliance Companies have proposed a region to be served, and the Commission has, in three prior orders, found that region to satisfy the requirements of Order No. 2000.[156] For the Commission to now simply declare that there will be one RTO for the "Midwest" is at odds with the policies established in Order No. 2000 and with the Commission's RTO regulations. The Commission cannot depart from its established policies without providing a reasoned explanation for doing so,[157] and "is not free to ignore or violate its regulations while

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155 18 C.F.R. §35.34 (j)(2) (2001).

156 *Alliance III*, 94 FERC at 61, 307, *Alliance IV*, 95 FERC at 61,627, and *Alliance V*, 96 FERC at 61,135.

157 *Hall v. Baker*, 867 F.2d 693, 696 (D.C. Cir. 1989).

they remain in effect."[158] Order No. 2000 and the Commission's RTO regulations remain in effect, but the Commission ignored them in *Alliance VI*. Consequently, the Commission's ruling that there will be one RTO in the "Midwest" is arbitrary and capricious and an abuse of its discretion.

3. The Commission's ruling in *Alliance VI* that there will be one RTO in the Midwest does not modify Order No. 2000 or the Commission's RTO regulations

Order No. 2000, which does not establish or require one RTO in the "Midwest," was promulgated after notice-and-comment rulemaking. The Commission's ruling in *Alliance VI* that there will be one RTO in the Midwest is insufficient to repeal or modify Order No. 2000 or the Commission's RTO regulations.[159]

Changing Order No. 2000 to require one RTO in a predetermined geographic region – the "Midwest" – requires formal notice-and-comment rulemaking. The APA requires federal administrative agencies to follow notice and comment procedures when seeking to amend or

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[158] *United States Lines, Inc. v. Federal Maritime Comm'n*, 584 F.2d 519, 527 n. 20 (D.C. Cir. 1978). *See also Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120, 1135 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980).

[159] Neither is the Commission's announcement in July 2001 in unrelated RTO orders that it "favors the development of one RTO for the Northeast, one RTO for the Midwest, one RTO for the Southeast, and one RTO for the Midwest" (*see e.g., New York Independent System Operator, Inc., et al.*, 96 FERC ¶ 61,059 at 61,185 (2001)) sufficient to alter Order No. 2000 and the Commission's RTO regulations. As Commissioner Breathitt pointed out in dissent, "If the majority believes that the Commission should depart from the basic philosophies embodied in Order No. 2000, then I believe that it would be only appropriate to initiate a formal notice-and-comment rulemaking proceeding so that we could make a reasoned decision. . . ." 96 FERC at 61,207. In any event, since July 12, 2001, the Commission has departed from this announced preference, indicating that it would approve three RTOs for the West. *See* Inside FERC, "After Feeling The Heat, FERC Backs Away From Strict RTO Policy," November 12, 2001 ("Commissioner William Massey told *Inside FERC* early last week: 'We're just facing more or less the political realities of very lukewarm support for a West-wide RTO from the Pacific Northwest congressional delegation, Massey said.") (emphasis added).

repeal a rule.[160] Similarly, an agency cannot "make a fundamental change in its interpretation of a substantive regulation without notice and comment."[161]

Moreover, establishing one RTO in the Midwest alters the right of utilities, as established in Order No. 2000, to define a "region" in their RTO proposals. Such a change in Order No. 2000 could only be accomplished through notice-and-comment rulemaking. If an agency alters or enlarges obligations imposed by a preexisting regulation, the agency's action is substantive and notice and comment is required.[162] Failure to allow notice and comment, where required, is grounds for invalidating the rule.[163]

Until it changes Order No. 2000 by notice-and-comment rulemaking, the Commission "is not free to ignore or violate its regulations while they remain in effect."[164] Therefore, the Commission must follow Order No. 2000 and its RTO regulations in evaluating the Alliance Companies' RTO proposal. Because Order No. 2000 and the RTO regulations do not establish or require one RTO for the Midwest, the Commission, on rehearing, should reverse its ruling in *Alliance VI* that there will be one RTO in the Midwest.

B. The Commission's Requirement that the Alliance Companies Explore Joining the Midwest ISO is Inconsistent with Voluntary Formation of RTOs Provided in Order No. 2000, as Recognized by the Court

In *Alliance VI*, the Commission also fails to apply Order No. 2000 in its directive that the Alliance Companies explore joining the Midwest ISO. This requirement clearly is inconsistent

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160 *Paralyzed Veterans of America, et al. v. D.C. Arena L.P., et al.*, 117 F.3d 579, 586 (D.C. Cir. 1997); *Montgomery Ward & Co., Inc. v. F.T.C.*, 691 F.2d 1322 (9th Cir. 1982).

161 *Paralyzed Veterans of America*, at 586.

162 *Aviators for Safe and Fairer Regulation, Inc. v. F.A.A.*, 221 F.3d 222, 226-27 (1st Cir. 2000).

163 *Auer v. Robbins*, 519 U.S. 452, 459 (1997). *See also, Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979) and *National Org. of Veterans' Advocates, Inc. v. Secretary of Veterans Affairs*, 260 F.3d 1365, 1375 (Fed. Cir. 2001).

with the voluntary formation of RTOs, as established by Order No. 2000 and as recognized by the Court.

In Order No. 2000, the Commission recognized that: "the voluntary creation of RTOs requires that current owners of transmission assets must be willing to transfer operational control of these assets to RTOs or to divest their interests in their entirety."[165] Furthermore, in dismissing petitions for review of Order No. 2000, the Court observed that "the validity of the Commission's jurisdictional argument turns on whether Order No. 2000 requires the Utilities to participate in an RTO, or rather merely encourages them to join or form an RTO voluntarily."[166] The Court also observed that the voluntariness of Order No. 2000 lies in the existence of the ability of "any public utility to opt not to participate in an RTO."[167]

In *Alliance VI*, however, the Commission requires the Alliance Companies to "explore joining" an RTO which the Alliance Companies had indicated they were not willing to join. In their December 7, 2001 comments, the Alliance Companies told the Commission that the suggestion that the Alliance should be an independent transmission company under the Midwest ISO's Appendix I was "very disturbing" and "is not an acceptable option to the Alliance Companies."[168] This is because the Midwest ISO embodies an entirely different business model from that proposed by the Alliance Companies. Moreover, as evidenced by the Settlement, three of the Alliance Companies paid, in settlement, $60 million to leave the Midwest ISO! Thus, to require the Alliance Companies to "explore" doing the very thing that the Alliance Companies

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164 *United States Lines, Inc. v. Federal Maritime Comm'n*, 584 F.2d 519, 527 n. 20 (D.C. Cir. 1978). *See also Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120, 1135 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980).

165 Order No. 2000 at 31,064.

166 272 F.3d at 613 (emphasis added).

167 272 F.3d at 614.

previously indicated was "unacceptable" flies in the face of the voluntary formation of RTOs that is the foundation of Order No. 2000.

By directing the Alliance Companies to explore joining the Midwest ISO, the Commission has acted contrary to Order No. 2000 by denying the Alliance Companies their right to "join or form an RTO voluntarily" or to "opt not to participate in an RTO." On rehearing, the Commission should reverse its directive that the Alliance Companies explore joining the Midwest ISO.

VII. THE COMMISSION'S DECISION IN *ALLIANCE VI* IS INVALID BECAUSE IT IS BASED ON EX PARTE COMMUNICATIONS

As set forth above, on November 27, 2001, the Commission engaged in impermissible ex parte communications with state commissions that are parties to this proceeding for the express purpose of determining how those parties wanted the Commission to rule on the pending rehearing of *Alliance V*. The Alliance Companies were not given the opportunity to respond to characterizations of the progress of implementation of the IRCA made during these ex parte communications. The Commission's order in *Alliance VI*, and the transcript of the ex parte communications between the state commissions and the Commission demonstrate that the Commission's rulings in *Alliance VI* were based on those ex parte communications. Because the ex parte communications are not permitted by the Commission's regulations or by the APA, the Commission's order in *Alliance VI*, which was based on these ex parte communications, is invalid.

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[168] Comments of Alliance Companies, December 7, 2001, at 6 and Affidavit of Elizabeth Anne ("Betsy") Moler at 10.

A. The Commission's Regulations Do Not Permit the Commission's Ex Parte Communications with State Commissions that are Parties to these Proceedings

The Commission's November 27, 2001, ex parte communications with state commissions were not permitted by the Commission's regulations governing off-the-record communications. These regulations do not exempt communications with state regulatory commissions that are parties to a contested proceeding, including the contested proceedings involving the Alliance Companies' proposal to form the Alliance RTO.

First, the plain language of the Commission's regulations restricts the exemption to "an off-the-record communication to or from a Federal, state, local or Tribal agency that is not a party in the Commission proceeding, subject to disclosure. . . ."[169]

Second, the history of Order No. 607, which promulgated the Commission's ex parte regulations, indicates that the Commission specifically considered - and decided not to adopt - a regulation that would exempt off-the-record communications between state agencies that are parties to a contested proceeding. In Order No. 607-A, the Commission denied the request of the Department of the Interior that the Commission "expand the exemption for off-the-record communications to include agencies that are parties to contested proceedings." In doing so, the Commission stated:

> [w]e believe that such an approach conflicts with fundamental fairness contemplated by the restrictions on ex parte communications established by the APA. Moreover, we find that such an approach adds little to the free flow of information that can occur on the record, while threatening to prejudice, or to appear to prejudice, the due process rights of other parties to a contested proceeding.[170]

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169 18 C.F.R. § 385.2201(e) (2001) (emphasis added).

170 Order No. 607-A at 61,931-2.

Because the Commission's regulations do not exempt off-the-record communications with state agencies that are parties to a proceeding, the Commission's receipt of ex parte communications on November 27, 2001 was unlawful. The Commission cannot "modify the application" of regulations to permit an action that is not permitted by those very regulations.[171]

"It is axiomatic that an agency is legally to respect its own regulations and commits procedural error it if fails to abide them."[172] The mere assertion that a modification of the application of its regulations "is appropriate"[173] does not constitute a "principled explanation"[174] by the Commission for the abandonment, in the Alliance Companies' RTO proceedings, of the Commission's conscious, principled decision in Order No. 607-A not to treat as exempt off-the-record communications from state agencies that are parties to a contested proceeding. The courts have made clear that the Commission may not ignore its own regulations to suit its convenience.[175]

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171 Of course, as explained above, if the Commission intends to reinterpret or revise its regulations to exempt off-the-record communications with state agencies that are parties to a contested proceeding, it can do so only through notice-and-comment rulemaking procedures. The APA requires federal administrative agencies to follow notice and comment procedures when seeking to amend or repeal a rule. *Paralyzed Veterans of America, et al. v. D.C. Arena L.P., et al.*, 117 F.3d 579, 586 (D.C. Cir. 1997); *Montgomery Ward & Co., Inc. v. F.T.C.*, 691 F.2d 1322 (9th Cir. 1982). If an agency alters or enlarges obligations imposed by a preexisting regulation, the agency's action is substantive and notice and comment is required. *Aviators for Safe and Fairer Regulation, Inc. v. F.A.A.*, 221 F.3d 222, 226-27 (1st Cir. 2000). Similarly, an agency cannot "make a fundamental change in its interpretation of a substantive regulation without notice and comment." *Paralyzed Veterans of America*, at 586. Failure to allow notice and comment, where required, is grounds for invalidating the rule. *Auer v. Robbins*, 519 U.S. 452, 459 (1997). *See also, Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979) and *National Org. of Veterans' Advocates, Inc. v. Secretary of Veterans Affairs*, 260 F.3d 1365, 1375 (Fed. Cir. 2001).

172 *Esch v. Yeutter*, 876 F.2d 976, 991 (D.C. Cir.1989).

173 November 9 Order, 97 FERC at 61,837.

174 *See Nat'l Black Media Coalition v. FCC*, 775 F.2d 342, 355 (D.C. Cir. 1985).

175 *Servia v. Dulles*, 354 U.S. 365 (1957). *See also, Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120, 1135 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980) (FERC cannot "play fast and loose with its own regulations; the fact that a regulation as written does not provide FERC a quick way to reach a desired result does not authorize it to ignore the regulation . . .").

B. The APA Does Not Permit the Commission's Ex Parte Communications with State Commissions that are Parties to these Proceedings

The Commission attempted to justify engaging in ex parte communications with state commissions that are parties to proceedings by stating that its rules allow the Commission to "modify any provision of Rule 2201, as it applies to all or part of a proceeding, to the extent permitted by law."[176] This statement, of course, begs the question whether the Commission's modification of the application of its regulations is "permitted by law." In fact, ex parte communications with state commissions that are parties to proceedings are not permitted by law.

Except as otherwise authorized by law, the APA prohibits ex parte communications relevant to the merits of a proceeding between employees involved in the decisional process of a proceeding and interested persons outside the agency.[177] The purpose of the APA's prohibition of ex parte communications is to "ensure that 'agency decisions required to be made on a public record are not influenced by private, off-the-record communications from those personally interested in the outcome.'"[178] The APA's prohibition of ex parte communications is consequently broad and generally prohibits "any ex parte communications relevant to the merits of an agency proceeding."[179] The Alliance Companies' contested RTO proceedings are adjudications, determined on-the-record, and subject to an opportunity for hearing under the

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176 November 9 Order, 97 FERC at 61,837, *citing* 18 C.F.R. § 385.2201(a) (2001).

177 The APA provides, in relevant part: "In any agency proceeding which is subject to subsection (a) of this section, except to the extent required for the disposition of ex parte matters as authorized by law -- (A) no interested person outside the agency shall make or knowingly cause to be made to any member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be expected to be involved in the decisional process of the proceeding, an ex parte communication relevant to the merits of the proceeding; and (B) no member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be expected to be involved in the decisional process of the proceeding, shall make or knowingly cause to be made to any interested person outside the agency an ex parte communication relevant to the merits of the proceeding. . ." 5 U.S.C. 557(d).

178 *Portland Audubon Society v. Endangered Species Comm.*, 984 F.2d 1534, 1539 (9th Cir. 1993) (*quoting Raz Inland Navigation Co. v. I.C.C.*, 625 F.2d 258, 260 (9th Cir. 1980)); H.R. Rep. No. 94-880, 94th Cong., 2d Sess. 3, 1976 U.S.C.C.A.N. 2183, 2184).

FPA. Therefore, the ex parte rules of the APA apply to those proceedings and do not permit the Commission to modify the application of its regulations in those proceedings to treat, as exempt, off-the-record communications between the Commission and state commissions that are parties in those proceedings.

Modifying "the application of its regulations" to treat, as exempt, communications from state commissions that are parties to a contested proceeding clearly is contrary to the essential purpose of the APA's ban on ex parte communications, which is to "require that all communications that might improperly influence an agency be encompassed within the ex parte contacts prohibition or else the public and the parties will be denied indirectly their guaranteed right to a meaningful participation in agency decisional processes."[180] By definition, ex parte contacts cannot be addressed and rebutted through the adversarial discussion among the parties.[181] Consequently, the Commission's November 27, 2001 ex parte communications with state commissions that are parties to these proceedings are not permitted, either by the letter or the spirit of the APA.

C. By its Ex Parte Communications with State Commissions that are Parties to these Proceedings, the Commission Prejudiced the Due Process Rights of the Alliance Companies

1. The Alliance Companies had no opportunity to rebut the views expressed in the November 27, 2001 ex parte communications

In Order No. 607, the Commission stated that its regulations governing off-the-record communications are "based on the fundamental APA principles that are the foundation for the ex

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179 *Portland Audubon Society*, 984 F.2d at 1539.

180 *Portland Audubon Society*, 984 F.2d at 1544.

181 *Portland Audubon Society*, 984 F.2d at 1543; *State of North Carolina, Envtl. Policy Inst., and Conservation Council of North Carolina v. E.P.A.*, 881 F.2d 1250, 1258 (4th Cir. 1989).

parte prohibition, and furthers the basic tenets of fairness."[182] The Commission explained that: "a hearing is not fair when one party has private access to the decision maker and can present evidence or argument that other parties have no opportunity to rebut . . . ."[183] With respect to the Alliance Companies' contested proceedings, the Commission has called into question the basic fairness of those proceedings by modifying the application of its regulations to permit state commissions private access to decisionmakers where they may present arguments that the Alliance Companies had no opportunity to rebut.

The transcript of the ex parte communications was not served on the parties to the Alliance Companies proceedings, and was filed in the Alliance Companies' RTO proceedings. Furthermore, the transcript was not filed in the proceeding in Docket No. RT02-2-000 (a non-Alliance proceeding) until December 13, 2001 – only six days before the Commission rendered its decision in *Alliance VI*. Under these circumstances, it is clear that the Alliance Companies were not given the opportunity to rebut the arguments made to the Commission by the state commissions on November 27, 2001.

2. The Commission's ex parte communications with state commissions rendered the decision-making process leading to *Alliance VI* fundamentally unfair, depriving the Alliance Companies of a reasoned decision with respect to its RTO proposal

Only one year ago, the Commission denied the U.S. Department of Agriculture's motion for late intervention in a relicensing proceeding because, among other things:

> The Forest Service was involved in off-the-record communications with the Commission staff for nearly three years before filing its comments on the draft [Environmental Assessment], and has continued to have an opportunity to engage in off-the-record communications with Commission staff since then because of its

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182 Order No. 607 at 30,878.

183 Order No. 607 at 30,878, *citing WKAT, Inc. v. FCC*, 296 F.2d 375 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 841 (1961).

> status as a cooperating agency. No party has been afforded notice or an opportunity to comment on the substance of these communications. To allow Agriculture to intervene as a party after having had such private access to the decisional processes of the Commission staff strikes us as fundamentally unfair.[184]

During the past three years, state regulatory commissions have had party status in the Alliance Companies' proceedings. At the end of the process, for the Commission to afford these same state commissions "private access to the decisional processes of the Commission" is fundamentally unfair. Basic fairness requires that ex parte communications "play no part" in agency adjudications that involve "high stakes for all the competing interests and concern issues of supreme national importance."[185]

These proceedings involving the Commission's evaluation of the Alliance Companies' RTO proposal certainly involved "high stakes" for the Alliance Companies. The ex parte communications with state commissions resulted in the "views" and "preferences" of state overriding the Commission's earlier orders in these proceedings. By introducing such ex parte communications into the Alliance Companies' proceedings, the Commission has compromised the basic fairness of its decision making in these proceedings, prejudiced the due process rights of the Alliance Companies and, ultimately, deprived the Alliance Companies of a reasoned decision with respect to their application to form the Alliance RTO.

VIII. IN DEFERRING TO THE VIEWS OF THE MIDWEST COMMISSIONS, THE COMMISSION HAS ABDICATED ITS RESPONSIBILITY UNDER THE FPA TO ENGAGE IN REASONED DECISION-MAKING

As set forth above, in *Alliance VI*, the Commission affirms repeatedly that is rulings are made to comply with the preferences of a majority of state commissions in the Midwest. By

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184 *Arizona Public Service Company*, "Order Denying Rehearing," 94 FERC ¶ 61,076 at 61,351 n.10 (2001) (emphasis added).

185 *Portland Audubon Society*, 984 F.2d at 1543.

deferring to the views of state commissions, the Commission has failed to engage in reasoned decision-making. The Commission's approach in *Alliance VI* represents the view, as expressed at the ex parte communications that the state commissions "are not parties before" the Commission, but rather, "are partners" with the Commission.[186] This approach by the Commission is incorrect.

The Commission has an independent obligation under the FPA to regulate in the public interest, and it cannot abdicate that responsibility or share with or delegate it to the states.[187] Furthermore, in the well-known *Scenic Hudson* case,[188] the Second Circuit reversed the Commission for "blandly calling balls and strikes," instead of providing reasoned decision-making. In *Alliance VI*, the Commission plainly has abdicated its decision-making responsibilities by asking for a "show of hands" from state commissions and then deferring to the majority opinion of the state commissions in acting on the requests for rehearing of *Alliance V*. The Court previously has warned the Commission of the perils of decision-making by "mere 'head count.'"[189] Furthermore, as explained above, in this proceeding, the Commission did not even count all of the heads – only those of the state commissions. In *Alliance VI*, the Commission has failed to engage in reasoned decision-making and, by this failure, effectively has abdicated its decision-making responsibilities to the state commissions.

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186 *See* Transcript at 44-45.

187 *See, e.g., Pub. Serv. Co. of New Hampshire*, 56 FERC ¶ 61,105 at 61,404 & n.25 (1991) ("We are obliged under the Federal Power Act to undertake an independent review of all issues under our exclusive jurisdiction." *citing Florida Power & Light Co.*, 40 FERC ¶ 61,045 at 61,120-21 (1987), *reh'g denied*, 41 FERC ¶ 61,153 at 61,381-82 (1987)); accord, e.g., *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 371-77 (1988); *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 377-80, 381 (1983); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982).

188 *Scenic Hudson Preservation Conference v. FPC*, 354 F.2d 608, 620 (2nd Cir. 1965), *cert. denied sub nom., Consolidated Edison of New York, Inc. v. Scenic Hudson Preservation Conference*, 384 U.S. 941 (1966).

189 *See Laclede Gas Co. v. FERC*, 997 F.2d 936, 946 (D.C. Cir. 1993) ("Even when customer support is unanimous . . . FERC retains the responsibility of making an 'independent judgment' as to whether the settlement amount constitutes a reasonable remedy.")

IX. THE COMMISSION'S DIRECTIVE THAT THE ALLIANCE COMPANIES EXPLORE JOINING THE MIDWEST ISO CONSTITUTES A "TAKING" PROHIBITED BY THE U.S. CONSTITUTION

As explained above, by requiring the Alliance Companies to explore joining the Midwest ISO, the Commission has deprived the Alliance Companies of their right to "join or form an RTO voluntarily." In order for the Alliance Companies to join the Midwest ISO, they must transfer ownership and or function control of their transmission facilities; that is, their private property -- again, involuntarily. Such an involuntary transfer resulting from the Commission's order in *Alliance VI* constitutes a "taking" prohibited by the U.S. Constitution.

The Fifth Amendment to the Constitution provides that the government shall not deprive any person of private property without just compensation.[190] It is generally accepted that, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking."[191] The Supreme Court has established that economic regulation can result in a taking, even though the Government does not formally condemn property.[192] A regulation that "denies all economically beneficial or productive use" of property constitutes a per se taking, requiring just compensation "without case-specific inquiry into the public interest advanced in support of the restraint."[193] The Court also has acknowledged that a regulation that results in less than a

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190 U.S. CONST. amend. V.

191 *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922).

192 *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (*quoting General Motors Corp.*, 323 U.S. at 378); *see also*, *Buchanan v. Warley*, 245 U.S. 60 (1917) ("Property is more than the mere thing . . . . It includes the right to acquire, use and dispose of it.").

193 *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992) (*citing Nollan v. California Coastal Comm'n*, 483 U.S. 825, 834 (1987); *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470, 495 (1987); *Hodel v. Virginia Surface Mining & Reclamation Assn., Inc.*, 452 U.S. 264, 295-96 (1981); and *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980)).

total deprivation of a property's economic use may nonetheless, after a case-specific inquiry, be shown to be a taking.[194]

In *Alliance VI*, by requiring the Alliance Companies to explore joining the Midwest ISO, the Commission, deprives the Alliance Companies of their right under Order No. 2000 to "join or form an RTO voluntarily." As a result, the Alliance Companies are, in effect, required to involuntarily transfer functional control and/or ownership of their jurisdictional transmission facilities, depriving them of their property rights to possess, use and dispose of such transmission facilities. Requiring the Alliance Companies to explore joining the Midwest ISO instead of allowing them to form a stand-alone RTO has very real business and economic effects on the Alliance Companies. The Alliance Companies proposed establishing a for-profit Transco. This is fundamentally different than the Midwest ISO's non-profit business model.

When a regulation requires an owner of real property "to sacrifice all economically beneficial uses in the name of the common good, that is to leave his property economically idle, he has suffered a taking."[195] The Alliance Companies sought and succeeded in developing "an attractive business enterprise for investors and divesting transmission owners."[196] The Alliance Companies based their business model for the Alliance RTO on the premise that a for-profit Transco would "provide better service and generate greater profit then businesses which operate in a cost plus framework . . . ."[197] The Commission's order, in *Alliance VI*, that the Alliance Companies explore joining the Midwest ISO deprives the Alliance Companies of all economically beneficial use of their transmission facilities by unjustifiably prohibiting the

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194 *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1019 n.8 (1992). *See also, Connolly, et al., v. Pension Benefit Guaranty Corp., et al.*, 475 U.S. 211 (1986).

195 *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 at 1019.

196 Comments of Alliance Companies, December 7, 2001, Affidavit of Charles M. Davis, Jr. at 3.

197 Affidavit of Charles M. Davis, Jr. at 8.

Alliance Companies from using their facilities as part of a for-profit Transco. Consequently, the Commission's directive in *Alliance VI* constitutes a "taking" prohibited by the U.S. Constitution and, on rehearing, the Commission should reverse its directive that the Alliance Companies explore joining the Midwest ISO.

X. THE COMMISSION SHOULD REVERSE ITS RULINGS IN *ALLIANCE VI*

As demonstrated above, (1) the Commission's ruling that there should be only one RTO in the Midwest violates the terms of the Settlement approved by the Commission; (2) the Commission's ruling that the Alliance RTO lacks adequate scope is unsupported by substantial evidence in the record, is based on a misinterpretation of the settlement approved by the Commission, and is unduly discriminatory, (3) the Commission's finding that the public interest would best be served if the Alliance Companies were to join the Midwest ISO is inconsistent with Order No. 2000, (4) the Commission's decision in *Alliance VI* is invalid because it is based on ex parte communications not permitted by its regulations or by the APA, (5) the Commission has abdicated its responsibility under the FPA to engage in reasoned decision making by deferring to the views of state commissions, and (6) the Commission's requirement that the Alliance Companies' explore joining the Midwest ISO constitutes a taking prohibited by the U.S. Constitution.

Wherefore, for the foregoing reasons, the Commission should reverse its rulings in *Alliance VI*. On rehearing, the Commission should reinstate the Alliance Companies' RTO proceedings, and find that the Alliance RTO satisfies the requirements of Order No. 2000.

Respectfully submitted,

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Attorneys for the Alliance Companies

January 22, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service lists compiled by the Secretary in these proceedings.

Dated at Washington, D.C., this 22nd day of January, 2002.

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Attachment 7

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January 22, 2002

VIA MESSENGER

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Re: The Alliance Companies, Docket Nos. RT01-87-000, RT01-97-001, ER02-106-000 and ER02-108-000, Not consolidated

Dear Ms. Salas:

Enclosed for filing please find an original and fourteen copies of the Alliance Companies' Application for Rehearing in the above-mentioned proceedings. Please time and date stamp the 3 receipt copies enclosed and return it to our messenger.

Thank you for your attention to this matter. Please direct any questions regarding this filing to the undersigned.

Respectfully submitted,

Becky Bruner

Enclosures

cc: service list

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission System Operator, Inc.	)	Docket Nos. RT01-87-000
	)	RT01-97-001
	)	ER02-106-000
	)	ER02-108-000
	)	Not consolidated

APPLICATION FOR REHEARING OF THE ALLIANCE COMPANIES

Pursuant to Section 313 of the Federal Power Act, 16 U.S.C. § 825l (2001) and Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2001), the Alliance Companies[1] request rehearing of the Commission's "Order Granting RTO Status And Accepting Supplemental Filings," issued December 20, 2001 ("December 20th Order")[2], in the proceedings referenced above.

Specifically, the Alliance Companies seek rehearing of: (1) the Commission's treatment of the RTO proposals filed by the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") and the Alliance Companies as "competing proposals;" and (2) the Commission's conclusion that the public interest requires that only one RTO should be permitted to exist in the regions applicable to the proposed Midwest ISO and Alliance RTO.

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[1] For purposes of this request for rehearing, the Alliance Companies are Ameren Services Company (on behalf of Union Electric Company and Central Illinois Public Service Company) ("Ameren"), American Electric Power Service Corporation (on behalf of Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, and Wheeling Power Company) ("AEP"), The Dayton Power and Light Company ("DP&L"), Exelon Corporation (on behalf of Commonwealth Edison Company and Commonwealth Edison Company of Indiana, Inc.) ("ComEd"), FirstEnergy Corp. (on behalf of American Transmission Systems, Inc., The Cleveland Electric Illuminating Company, Ohio Edison Company, Pennsylvania Power Company, and The Toledo Edison Company) ("FirstEnergy"), Illinois Power Company ("IP"), Northern Indiana Public Service Company ("NIPSCO"), and Virginia Electric and Power Company ("VP"). Consumers Energy Company and its affiliate, Michigan Electric Transmission Company, do not join in this request for rehearing.

[2] *Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001) ("December 20th Order").

I. STATEMENT OF ERROR

The Commission erred, both as a matter of fact and of law, in treating the RTO proposals of the Alliance Companies and the Midwest ISO as "competing proposals" and concluding that the public interest would be served if there were only one RTO in the "Midwest." The Commission's actions are arbitrary and capricious, unduly discriminatory, and an abuse of the Commission's discretion for the following reasons:

1. The Commission's order misinterprets the RTO proposals of the Alliance Companies and the Midwest ISO.

2. The Commission's order fails to give effect to the "Settlement Agreement Involving the Midwest Independent Transmission System Operator, Inc., Certain Transmission Owners in the Midwest ISO, the Alliance Companies and Other Parties" (the "Settlement") approved by the Commission.

3. The Commission's order is inconsistent with Order No. 2000.

II. STATEMENT OF THE CASE

In its December 20th Order, the Commission characterizes the RTO proposals of the Midwest ISO and the Alliance Companies as "competing proposals" and concludes that "the Midwest ISO's proposal most fully complies with the vision and requirements of Order No. 2000."[3] The Commission's characterization of the RTO proposals of the Midwest ISO and the Alliance Companies as "competing proposals" is erroneous. The Commission's treatment of the Alliance Companies and Midwest ISO RTO proposals as "competing proposals" is also inconsistent with the Settlement. By choosing between the two RTO proposals, the Commission fails to give effect to the Settlement approved by the Commission and to which it is bound. The

[3] *Id.*, mimeo at 2.

presumption of a "Midwest" region to be served by one RTO is also contrary to Order No. 2000. Order No. 2000 provides for the voluntary formation of RTOs and does not establish fixed or specific regional boundaries for RTOs, but rather provides flexibility for industry participants to structure RTOs and define appropriate regions, subject to Commission review under Order No. 2000 criteria.[4]

A. The Alliance RTO and the Midwest ISO Are Not "Competing Proposals"

As is made clear in Order No. 2000 and in the Commission's previous *Alliance* orders,[5] the Alliance RTO and the Midwest ISO are not – and never have been – "competing proposals." This is because (1) the Alliance RTO and the Midwest ISO are not mutually exclusive proposals, (2) Order No. 2000 and the Commission's RTO regulations do not require a single RTO for the Midwest, and (3) the Commission's stated preference for one RTO in "the Midwest" does not change the terms of Order No. 2000 or the Commission's RTO regulations.

1. The Alliance RTO and Midwest ISO proposals are not mutually exclusive

First of all, the Alliance RTO and the Midwest ISO are not "competing proposals" because the Alliance Companies have never proposed that their RTO would encompass the transmission facilities of the transmission owners participating in the Midwest ISO. Similarly, the Midwest ISO has never proposed that its RTO proposal would encompass the transmission facilities of the Alliance Companies. Consistent with Order No. 2000, each of these RTO proposals is a voluntary RTO filing, and each is intended to apply to separate regional

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[4] *Regional Transmission Organizations*, Order No. 2000, FERC Statutes and Regulations, Regulations Preambles ¶ 31,089 at 30,994 (1999), *order on reh'g*, Order No. 2000-A, FERC Statutes and Regulations, Regulations Preambles ¶ 31,092 (2000), *petitions for review dismissed, Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001) ("Order No. 2000").

[5] *Alliance Companies, et al.*, 89 FERC ¶ 61,298 (1999), *order on compliance filings and reh'g*, 91 FERC ¶ 61,152 (2000), *order on compliance filings and reh'g*, 94 FERC ¶ 61,070 (2001). *reh'g denied*, 95 FERC ¶ 61,182 (2001) and *Alliance Companies*, 96 FERC ¶ 61,052 (2001).

transmission facilities that happen to have some points of common interface, as do the facilities of all neighboring regional transmission organizations.[6] Because the two RTO proposals are not mutually exclusive, and approving one RTO proposal does not preclude approving the other proposal, the Midwest ISO and the Alliance RTO are not "competing proposals."

2. Order No. 2000 does not establish specific regions for RTO formation

The December 20th Order presupposes a region – "the Midwest" – and concludes that only one RTO should be permitted within this region. This approach is inconsistent with Order No. 2000 wherein the Commission's requirements for voluntary RTO formation were promulgated. In Order No. 2000, the Commission declined to set specific boundaries for the formation of RTOs. Significantly, the Commission concluded that, "as a matter of policy," it "is not proposing . . . the establishment of fixed or specific regional boundaries" for RTOs.[7] Rather, the Commission emphasized that "regions should be configured so as to recognize trading patterns."[8]

In their RTO proposal, the Alliance Companies have proposed a region to be served and have supported the proposed region under the criteria established in Order No. 2000.[9] In three prior orders,[10] the Commission has concurred with the appropriateness of the proposed Alliance region. In its December 20th Order, the Commission provides no rationale basis, supported by substantial evidence, to support a departure from the Order No. 2000 criteria for establishing

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[6] The proposed Alliance RTO also interfaces with the transmission facilities of the proposed PJM RTO and the proposed GridSouth RTO.

[7] Order No. 2000 at 30,994.

[8] *Id.*, at 31,084.

[9] See. e.g., Docket No. RT01-88-000, Affidavits of David B. Patton, Ronald F. Szymczak and Steven T. Naumann, filed on January 16, 2001.

[10] *Alliance Companies, et al.*, 94 FERC ¶ 61,070 at 61,307 (2001), *reh'g denied, Alliance Companies, et al.*, 95 FERC ¶ 61,182 at 61,627 (2001), and *Alliance Companies, et al.*, 96 FERC ¶ 61,052 at 61,135 (2001).

appropriate regions or otherwise supported the conclusion that "the Midwest" is the only appropriate region.

For the Commission to now simply declare that there will be one RTO for the "Midwest" is at odds with the policies established in Order No. 2000 and with the Commission's RTO regulations. The Commission "is not free to ignore or violate its regulations while they remain in effect."[11] Consequently, the Commission's ruling that there will be one RTO in the "Midwest" is arbitrary and capricious and an abuse of its discretion.

3. The Commission's determination that there will be one RTO in the Midwest does not modify Order No. 2000 or the Commission's RTO regulations

Order No. 2000, which does not establish or require one RTO in the Midwest, was promulgated after notice-and-comment rulemaking. The Commission's ruling in the December 20th Order that there will be one RTO in the Midwest is insufficient to repeal or modify Order No. 2000 or the Commission's RTO regulations.[12]

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[11] *United States Lines, Inc. v. Federal Maritime Commission*, 584 F.2d 519, 527 n. 20 (D.C. Cir. 1978). See also *Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120, 1135 (D.C. Cir. 1979), cert. denied, 449 U.S. 889 (1980).

[12] Neither is the Commission's announcement in July 2001 in unrelated RTO orders that it "favors the development of one RTO for the Northeast, one RTO for the Midwest, one RTO for the Southeast, and one RTO for the Midwest" (*see e.g., New York Independent System Operator, Inc.*, et al., 96 FERC ¶ 61,059 at 61,185 (2001)) sufficient to alter Order No. 2000 and the Commission's regulations. As Commissioner Breathitt pointed out in dissent, "If the majority believes that the Commission should depart from the basic philosophies embodied in Order No. 2000, then I believe that it would be only appropriate to initiate a formal notice-and-comment rulemaking proceeding so that we could make a reasoned decision. . . ." 96 FERC at 61,207. In any event, since July 12, 2001, the Commission has departed from this announced preference, indicating that it would approve three RTOs for the West. *See Inside FERC*, "After Feeling The Heat, FERC Backs Away From Strict RTO Policy," November 12, 2001 ("Commissioner William Massey told *Inside FERC* early last week. 'We're just facing more or less the political realities of very lukewarm support for a West-wide RTO from the Pacific Northwest congressional delegation,' Massey said.") (emphasis added)

In Order No. 2000, the Commission emphasized that "regions should be configured so as to recognize trading patterns."[13] The Commission fails to provide a reasoned explanation for departing from the trading pattern standard established in Order No. 2000.

Changing Order No. 2000 to establish one RTO in a predetermined geographic region – the "Midwest" – requires formal notice-and-comment rulemaking. The APA requires federal administrative agencies to follow notice and comment procedures when seeking to amend or repeal a rule.[14] Similarly, an agency cannot "make a fundamental change in its interpretation of a substantive regulation without notice and comment."[15]

Moreover, establishing one RTO in the Midwest alters the right of utilities to define, in the first instance, a "region" in their RTO proposals. Such a change could only be accomplished through notice-and-comment rulemaking. If an agency alters or enlarges obligations imposed by a preexisting regulation, the agency's action is substantive and notice and comment is required.[16] Failure to allow notice and comment, where required, is grounds for invalidating the rule.[17]

Consequently, until it changes Order No. 2000 by notice-and-comment rulemaking, the Commission must follow Order No. 2000 and the regulations promulgated thereunder in evaluating RTO proposals. Because Order No. 2000 does not establish or require one RTO for the Midwest, the Commission, on rehearing, should reverse its ruling in the December 29th Order that there will be one RTO in the Midwest.

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13 Order No. 2000 at 31,084.

14 *Paralyzed Veterans of America, et al. v. D.C. Arena L.P., et al.*, 117 F.3d 579, 586 (D.C. Cir. 1997); *Montgomery Ward & Co., Inc. v. F.T.C.*, 691 F.2d 1322 (9th Cir. 1982).

15 *Paralyzed Veterans of America*, at 586.

16 *Aviators for Safe and Fairer Regulation, Inc. v. F.A.A.*, 221 F.3d 222, 226-27 (1st Cir. 2000).

17 *Auer v. Robbins*, 519 U.S. 452, 459 (1997). *See also, Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979) and *National Org. of Veterans' Advocates, Inc. v. Secretary of Veterans Affairs*, 260 F.3d 1365, 1375 (Fed. Cir. 2001).

B. The Commission's Ruling That There Should Be One RTO In The Midwest Fails To Give Effect To The Settlement It Approved

The Commission's determination that there should be only one RTO in the "Midwest" fails to give effect to the Settlement that the Commission approved and to which, consequently, the Commission is bound. The Commission's failure to give effect to the Settlement is arbitrary and capricious and an abuse of discretion.

1. The Commission Cannot Ignore that the Settlement as Approved by the Commission Accommodates Both the Midwest ISO and the Alliance RTO Becoming Operational

On March 21, 2001, the Settlement reached in *Illinois Power*[18] was filed with the Commission. The Settlement resolved a number of significant issues that previously had beset the efforts of both the Alliance Companies and the Midwest ISO to obtain timely regulatory approval of their respective proposals and to become operational. Among other things, the Settlement (1) allowed the Illinois Companies to withdraw from the Midwest ISO and join the Alliance RTO in exchange for a payment to the Midwest ISO of $60 million, (2) established the basis for two RTOs – the Alliance RTO and the Midwest ISO – to be formed, and (3) established single (i.e., non-pancaked) transmission access charges within the Alliance-Midwest ISO Super-Region ("Super-Region"). In sum, the Settlement "permits the entire Midwest region to operate as a seamless market, and at the same time, carry forward the ISO features critical to some members of MISO and permit other parties to enjoy the different business model developed by Alliance."[19]

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[18] *Illinois Power Co., et al.*, 95 FERC ¶ 61,183 (2001) ("Settlement Order").

[19] *Illinois Power Company*, "Report of the Chief Judge," 94 FERC ¶ 63,012 at 65,036 (2001) ("Chief Judge's Report").

The Commission unanimously accepted the Settlement, with minor modifications, in an order issued on May 8, 2001 ("Settlement Order").[20] In that order, the Commission found that the Settlement formed the "basis for an expanded market and a sounder, seamless and a more reliable electric grid in the Midwest,"[21] and rejected an argument that it should require a single RTO in the Super-Region.[22] On July 6, 2001, the Commission denied rehearing of the Settlement Order.[23] No party appealed the Commission's decision approving the Settlement. Consequently, the Settlement is final and binding on all parties and on the Commission.

The Settlement clearly establishes that both the Alliance RTO and the Midwest ISO should develop operational RTOs.[24] Indeed, the Preamble to the Settlement states that the very purpose of the Settlement is to allow both the Alliance RTO and the Midwest ISO to become operational, to wit:

> The intended purposes of this Settlement Agreement are to afford an opportunity, without the need to issue new debt financing, for the Midwest ISO to remain financially viable and for it to proceed to operations in accordance with Order No. 2000; to preserve the Alliance Companies' business model by providing the regulatory certainty deemed by the Alliance Companies and others to be necessary for Alliance Transco to be formed, financed and become operational in accordance with Order No. 2000; and to create the basis for an arrangement that will preserve the separate organizations and features of the Alliance Regional Transmission Organization ("Alliance RTO") and the Midwest ISO, while allowing the regions served by the Alliance RTO and the Midwest ISO to operate as a seamless market.[25]The unequivocal purpose and effect of the Settlement, and the Inter-Regional Cooperation Agreement ("IRCA") approved as part of the Settlement, was to permit both the Alliance RTO and the Midwest ISO to move forward and become operational as RTOs, consistent with the requirements of Order No. 2000. Specifically, the Settlement "provides two

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20 Settlement Order.

21 *Id.* at 61,646.

22 Settlement Order at 61,648.

23 *Illinois Power Co., et al.*, "Order Denying Rehearing," 96 FERC ¶ 61,026 (2001).

24 The Commission, however, reserved a final determination on scope and configuration the Midwest ISO and the Alliance RTO in their respective Order No. 2000 compliance filings. Settlement Order at 61,646-47.

25 Settlement Agreement, Article I, Preamble (emphasis added).

financially and operationally viable RTOs with a single Super-Regional rate that removes all seams and pancakes between the two RTOs, and preserves the different business practices of the participants."[26]

The Commission acknowledged this fact in approving the Settlement, first of all, by observing that "[t]he Super Region rate contemplates that the Midwest ISO and the Alliance will each become an RTO"[27] and, second, by specifically rejecting an argument that "the Midwest transmission grid must be under the control of a single operator to provide for a seamless market."[28] While the Commission did, indeed, "encourage further efforts . . . to build upon the framework of this Settlement to develop common processes," the Commission also found consideration of a single RTO "premature" because, in establishing settlement proceedings, it had "directed parties to attempt to resolve their differences in a way that would respect their business model preferences . . . ."[29] The parties to the Settlement complied with the Commission's direction, and entered into a Settlement that preserved both the Alliance RTO and the Midwest ISO business models and established the structure of two RTOs in the Super-Region.

Contrary to the Settlement, however, the Commission in the December 20th Order ruled that there will be one RTO in the "Midwest." For the Commission simply to ignore the fact that the Settlement it approved "provides two financially and operationally viable RTOs"[30] is arbitrary, capricious and an abuse of its discretion. The courts have held that "[t]he Commission

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26 *Illinois Power Company*, "Chief Judge's Certification of Settlement," 95 FERC ¶ 63,003 at 65,025 (2001) (emphasis added).

27 Settlement Order at 61,644 n.32.

28 Settlement Order at 61,648.

29 Settlement Order at 61,648.

30 As the Chief Judge stated: "[a] merger between the Alliance RTO and the Midwest ISO was not the goal of the settlement negotiations nor were the parties directed to consider that issue by the Commission." 95 FERC at 65,025 (emphasis added).

is not justified . . . in cavalierly disregarding private [settlements],"[31] and that "[t]he Commission's failure to take the existence of . . . negotiated [settlement] agreements into account is a material deficiency in its reasoning."[32] On rehearing, the Commission should give effect to the Settlement it approved and reverse its ruling that there will be only one RTO in the Midwest.

2. The Commission is Bound by the Settlement it Approved

As the Midwest ISO acknowledged in its IRCA implementation status report, it is "contractually obligated to support the Midwest structure established in the *Illinois Power* Settlement Agreement."[33] Because it approved the Settlement, the Commission is similarly obligated. It is black-letter law that "[o]nce approved . . . a settlement binds the Commission as well as the regulated entity."[34] Indeed, "[t]he Commission also acknowledges that it is bound by approved settlement agreements."[35] Furthermore, "such approval [of a settlement] binds the Commission . . . to all constituent parts of the agreement."[36] There has been no claim that the Settlement was reached by other than good faith and proper conduct between the parties. Consequently, in approving the Settlement, the Commission bound itself to the Settlement that

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31 *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 519 (D.C. Cir. 1985).

32 771 F.2d at 520.

33 Midwest ISO IRCA status report at p. 32.

34 *Kentucky West Virginia Gas Co. v. FERC*, 780 F.2d 1231, 1237 (5th Cir. 1986). *See also, Mobil Oil Corp. v. FPC*, 570 F.2d 1021, 1026 (D.C. Cir. 1978), *Texas Gas Transmission*, 441 F.2d 1392, 1394 (6th Cir. 1971) ("Settlement agreements are one of the means by which the Commission exercises its authority to regulate the power industry. Such agreements bind both parties – the Commission and the regulated entity – and thus allow both to avoid the delays and uncertainties of litigation."), and *Chicago v. FPC*, 385 F.2d 629, 638-41 (1967), cert. denied, 390 U.S. 945 (1968).

35 *Tennessee Gas Pipeline Co. v. F.P.C.*, 504 F.2d 199, 202 (D.C. Cir. 1974). See also, *Sea Robin Pipeline Company*, Opinion No. 227-A, "Order Granting Rehearing in Part, Terminating Investigation, Ordering Refund, and Ordering Filing of Revised Tariff Sheets," 31 FERC ¶ 61,188 at 61,380 (1985) ("Upon reflection, we are of the opinion that Sea Robin and Gulf are correct. The Commission is indeed bound by the terms of a settlement, just as the parties to it are.")

36 *Williston Basin Interstate Pipeline Co. v. FERC*, 874 F.2d 834, 837 (D.C. Cir. 1989).

accommodates two RTOs in the Super-Region. The Commission's ruling in the December 20th Order that there will be one RTO in the Midwest plainly violates the Settlement it approved and to which it is bound. On rehearing, therefore, the Commission should reverse its ruling that there will be one RTO for "the Midwest."

3. The Settlement establishes the largest area ever proposed for the development of a seamless market

The Settlement approved by the Commission establishes the largest area ever proposed – the Super-Region – for the elimination of transmission rate pancaking and the development of a seamless market. The Super-Region includes more than 153,800 miles of transmission lines, and encompasses approximately 167,100 MW of generating capacity and 116,100 MW of peak load.[37] As such, the Super-Region provided by the Settlement is far larger than any RTO approved by the Commission or under consideration. Indeed, the proposed Alliance RTO, by itself is as large or larger than any RTO approved by the Commission, including the Midwest ISO. Given these facts, there is no basis for the Commission to conclude that the Alliance RTO is too small or otherwise inadequate in scope and configuration to co-exist with the Midwest ISO as an RTO.

[37] These statistics assume that TRANSLink becomes an ITC under the Midwest ISO.

II. CONCLUSION

For the foregoing reasons, the Commission should reverse its finding that there should be only one RTO within the regions to be served by the proposed Alliance RTO and the Midwest ISO.

Respectfully submitted,

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Attorneys for the Alliance Companies

January 22, 2002

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

The Alliance Companies	)	
	)	
Ameren Services Company	)	
	)	
American Electric Power Service Corporation	)	
	)	
Exelon Corporation	)	
	)	
FirstEnergy Corp.	)	
	)	
Virginia Electric and Power Company	)	
	)	
Illinois Power Company	)	
	)	
Northern Indiana Public Service Company	)	
	)	
The Dayton Power and Light Company	)	
	)	
Petitioners,	)	
	)	
v.	)	Case No. _____
	)	
Federal Energy Regulatory Commission,	)	
	)	
Respondent	)	

PETITION FOR REVIEW

Pursuant to Section 313(b) of the Federal Power Act, 16 U.S.C. § 825*l*(b) and Rule 15 of the Federal Rules of Appellate Procedure, the Alliance Companies[1] hereby respectfully petition

[1] The Alliance Companies are: Ameren Services Company (on behalf of Union Electric Company and Central Illinois Public Service Company), American Electric Power Service Corporation (on behalf of Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, and Wheeling Power Company), Consumers Energy Company and Michigan Electric Transmission Company; The Dayton Power and Light Company, Exelon Corporation (on behalf of Commonwealth Edison Company and Commonwealth Edison Company of Indiana, Inc.), FirstEnergy Corp. (on behalf of American Transmission Systems, Inc., The Cleveland Electric Illuminating Company, Ohio Edison Company, Pennsylvania Power Company, and The Toledo Edison Company), Illinois Power Company, Northern Indiana Public Service Company, and Virginia Electric and Power Company. However,

for review of the following orders issued by the Federal Energy Regulatory Commission, copies of which are attached hereto as Appendix A:

1. *Alliance Companies, et al.*, "Order on RTO Filing," 96 FERC ¶ 61,052 (July 12, 2001), and

2. *Alliance Companies, et al.*, "Order on Requests for Rehearing," 97 FERC ¶ 61,327 (December 20, 2001).

In accordance with Rule 15(c) of the Federal Rules of Appellate Procedure, a list of the parties served with a copy of this Petition is attached hereto as Appendix B. The Disclosure Statement required by Rule 26.1 is attached hereto as Appendix C.

The Alliance Companies would not object to a motion by Respondent to hold this proceeding in abeyance pending action by the Federal Energy Regulatory Commission on the requests for rehearing of the order issued on December 20, 2001.

Respectfully submitted,

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Attorneys for
The Alliance Companies

February __, 2002

Consumers Energy Company and its affiliate, Michigan Electric Transmission Company, do not join in this Petition for Review.

CERTIFICATE OF SERVICE

I hereby certify that I have, this __ day of February, 2002, mailed copies of the foregoing by first class mail, postage prepaid, to the Solicitor of the Federal Energy Regulatory Commission, 888 First Street, N.E.,. Washington, D.C. 20426, and to each of the parties listed on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in the case below, a copy of which is appended as Appendix B.

Donna J. Bobbish

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Disclosure Statement Required By Rule 26.1

The Alliance Companies are:

1. Ameren Services Company, a Missouri corporation with its principal place of business in Jefferson City, Missouri (on behalf of Union Electric Company, a Missouri corporation with its principal place of business in St. Louis, Missouri and a subsidiary of Ameren Corporation, a Missouri corporation with its principal place of business in St. Louis, Missouri; and Central Illinois Public Service Company, an Illinois corporation with its principal place of business in Springfield, Illinois and a subsidiary of Ameren Corporation).

2. American Electric Power Service Corporation, a New York corporation with its principal place of business in Columbus, Ohio and a subsidiary of American Electric Power Company, Inc., a New York corporation and a registered public utility holding company with its principal place of business in Columbus, Ohio (on behalf of Appalachian Power Company, a Virginia corporation with its principal place of business in Roanoke, Virginia and a subsidiary of American Electric Power Company, Inc.; Columbus Southern Power Company, an Ohio corporation with its principal place of business in Columbus, Ohio and a subsidiary of American Electric Power Company, Inc.; Indiana Michigan Power Company, an Indiana corporation with its principal place of business in Fort Wayne, Indiana and a subsidiary of American Electric Power Company, Inc.; Kentucky Power Company, a Kentucky corporation with its principal place of business in Ashland, Kentucky and a subsidiary of American Electric Power Company, Inc.; Kingsport Power Company, a Tennessee corporation with its principal place of business in Kingsport, Tennessee and a subsidiary of American Electric Power Company, Inc.; Ohio Power Company, an Ohio corporation with its principal place of business in Canton, Ohio and a subsidiary of American Electric Power Company, Inc.; and Wheeling Power Company, a West Virginia corporation with its principal place of business in Wheeling, West Virginia and a subsidiary of American Electric Power Company, Inc.).

3. Consumers Energy Company, a Michigan corporation with its principal place of business in Jackson, Michigan and a subsidiary of CMS Energy Corporation, a Michigan corporation with its principal place of business in Dearborn, Michigan; and Michigan Electric Transmission Company, a Michigan corporation with its principal place of business in Jackson, Michigan and a subsidiary of Consumers Energy Company

4. The Dayton Power and Light Company, an Ohio corporation, with its principal place of business in Dayton, Ohio and a subsidiary of DPL Inc., an Ohio corporation with its principal place of business in Dayton, Ohio.

5. Exelon Corporation, a Pennsylvania corporation and a registered public utility holding company with its principal place of business in Chicago, Illinois (on behalf of Commonwealth Edison Company an Illinois corporation with its principal place of business in Chicago, Illinois and a subsidiary of Exelon Corporation, and Commonwealth Edison Company of Indiana, Inc., an Indiana corporation with its principal place of business in Dowers Grove, Indiana and a subsidiary of Exelon Corporation).

6. FirstEnergy Corp., an Ohio corporation and a public utility holding company, with its principal place of business in Akron, Ohio (on behalf of American Transmission Systems, Inc., an Ohio corporation with its principal place of business in Akron, Ohio and a subsidiary of FirstEnergy Corp.; The Cleveland Electric Illuminating Company, an Ohio corporation with its principal place of business in Akron, Ohio and a subsidiary of FirstEnergy Corp.; Ohio Edison Company, an Ohio corporation with its principal place of business in Akron, Ohio and a subsidiary of FirstEnergy Corp.; Pennsylvania Power Company, a Pennsylvania corporation with its principal place of business in New Castle, Pennsylvania and a subsidiary of FirstEnergy Corp.; and The Toledo Edison Company, an Ohio Corporation with its principal place of business in Akron, Ohio and a subsidiary of FirstEnergy Corp.).

7. Illinois Power Company, an Illinois corporation with its principal place of business in Decatur Illinois and a subsidiary of Illinova Corporation, which is a subsidiary of Dynegy, Inc., a publicly traded Illinois corporation, with its principal place of business in Houston, Texas. Dynegy Inc.'s principal shareholder is Chevron Corporation (through its subsidiary Chevron U.S.A. Inc), which owns approximately 28 percent of the issued and outstanding common stock of Dynegy Inc.

8. Northern Indiana Public Service Company, an Indiana corporation with its principal place of business in Merrillville, Indiana, and a subsidiary of NiSource Inc., an Indiana corporation with its principal place of business in Merrillville, Indiana.

9. Virginia Electric and Power Company, a Virginia corporation with its principal place of business in Richmond, Virginia and a subsidiary of Dominion Resources, Inc., a Virginia corporation with its principal place of business in Richmond, Virginia.