STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

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| IN RE:<br><br>INTERSTATE POWER AND LIGHT COMPANY AND MIDAMERICAN ENERGY COMPANY | DOCKET NOS. SPU-02-21<br>SPU-02-23 |

**ORDER DISAPPROVING, WITHOUT PREJUDICE, APPLICATIONS FOR REORGANIZATION AND RECOMMENDING DELINEATION OF TRANSMISSION AND LOCAL DISTRIBUTION FACILITIES**

(Issued June 13, 2003)

## PROCEDURAL HISTORY

On November 26, 2002, Interstate Power and Light Company (IPL) filed with the Utilities Board (Board) an application for reorganization, pursuant to Iowa Code §§ 476.76 and 476.77, to transfer ownership of IPL's electric transmission facilities to TRANSLink Transmission Company, L.L.C. (TRANSLink), a proposed independent transmission company (ITC). As part of the filing and pursuant to the Board's May 28, 2002, order in Docket No. M-150, IPL submitted its delineation of transmission and distribution facilities using the seven-factor test developed by the Federal Energy Regulatory Commission (FERC).

On December 18, 2002, MidAmerican Energy Company (MidAmerican) filed an application for reorganization. MidAmerican plans to transfer functional control of its transmission facilities to TRANSLink, although MidAmerican also asks for the

Attachment 1

authority to transfer ownership of its electric transmission facilities to TRANSLink at some later, unspecified date. The Board has previously addressed the delineation of MidAmerican's transmission and distribution facilities. MidAmerican Energy Company, "Order Recommending Delineation of Transmission and Local Distribution Facilities," Docket No. SPU-98-12 (4/30/99).

Because much of the testimony in the IPL and MidAmerican filings was duplicative, IPL and MidAmerican asked that the dockets be consolidated for hearing purposes. To facilitate consolidation, IPL filed a motion to withdraw and reinstate its application for reorganization on December 23, 2002. IPL asked that it be allowed to withdraw its application and have it reinstated as of December 18, 2002, the same date MidAmerican filed its application. The Board granted the motion by order issued December 23, 2002, so that the statutory review period and other time limitations contained in Iowa Code § 476.77 and 199 IAC chapter 32 would be identical for both proceedings. The Board granted the motion to consolidate for purposes of hearing and the procedural schedule in the notice of hearing issued February 6, 2003. In that order, the Board also extended, for good cause, the 90-day statutory deadline for decision by an additional 90 days, to June 16, 2003. Iowa Code § 476.77(2).

In addition to the Consumer Advocate Division of the Department of Justice (Consumer Advocate), the Iowa Consumers Coalition (ICC), TRANSLink Development Company, LLC, Central Iowa Power Cooperative, Corn Belt Power Cooperative, Deere & Company, the Resale Power Group of Iowa (RPGI), and the

Midwest Municipal Transmission Group intervened in the proceeding. A hearing was held beginning April 22, 2003, and all parties had the opportunity to file initial and reply briefs.

With respect to the delineation of IPL's transmission and distribution facilities, the Board issued an order on December 19, 2002, stating that it had hired KEMA Consulting, Inc. (KEMA), to assist in the evaluation of IPL's proposed delineation. KEMA submitted a report that was available to all parties and some parties conducted discovery. Because of ex parte concerns, KEMA personnel were not available to directly advise the Board and the Board did not have any conversations with KEMA personnel on any substantive matters during the process. A KEMA representative was made available at hearing for cross-examination by the parties. The Board took official notice of the KEMA report.

## DESCRIPTION OF PROPOSED REORGANIZATION

IPL and MidAmerican propose to transfer control of their electric transmission assets to TRANSLink. MidAmerican proposes to do this initially by entering into a lease agreement. IPL proposes to enter into an asset contribution agreement. (Ex. 203). TRANSLink is an ITC that has been authorized by the FERC. (Exs. 202 and 207). TRANSLink will participate in several regional transmission organizations (RTOs). RTO functions will be shared by TRANSLink and the Midwest Independent System Operator (MISO).

In order to comply with the FERC's independence requirements affecting market participants, TRANSLink will consist of two separate entities. TRANSLink Management Corporation will be responsible for the management of the ITC. The transmission assets themselves will be held in TRANSLink Transmission Company, LLC. (Tr. 25-26). TRANSLink Development Company, LLC, has been established as a bridge company to perform start-up activities prior to TRANSLink's commencement of commercial operations. If the reorganizations are completed, there will be a transfer of control of the transmission assets from individual vertically-integrated electric utilities, MidAmerican and IPL, to a transmission-only company.

The TRANSLink transfer agreements have three options for investor-owned utilities—lease, asset contribution, and private power operating agreements. IPL has selected the contribution option and MidAmerican the lease option. Though it currently plans to utilize the lease agreement participation method, MidAmerican is asking the Board to authorize MidAmerican to employ any one of the three forms of transfer agreements.

## STATUTORY FACTORS

Iowa Code § 476.77(3) lists the following factors that the Board may consider in its review of a proposal for reorganization:

a. Whether the board will have reasonable access to books, records, documents, and other information relating to the public utility or any of its affiliates.

b. Whether the public utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is impaired.

c. Whether the ability of the public utility to provide safe, reasonable, and adequate service is impaired.

d. Whether ratepayers are detrimentally affected.

e. Whether the public interest is detrimentally affected.

The standards for review in section 476.77 indicate the important questions are the impacts of the reorganization on the utility's ability to attract capital, the utility's ratepayers, and the public interest generally. The Board will discuss each of the five statutory factors. Ratepayer impact and the public interest will be discussed in a separate section following discussion of the other three factors.

In reviewing these reorganizations, the Board finds that it will continue to have reasonable access to books and records of both IPL and MidAmerican. The Board also understands that it will have access to any records it deems necessary from TRANSLink through IPL and MidAmerican as TRANSLink members. Based on this understanding, the proposed reorganizations will result in no changes to the Board's access to these records and no party contested this issue.

IPL's and MidAmerican's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, will not be impaired. Because MidAmerican is proposing only to enter into a lease agreement with TRANSLink at this time, there is no direct impact on its capital structure. Also, its ability to attract capital may be enhanced if TRANSLink invests in new transmission assets, freeing MidAmerican's capital for other utility projects.

IPL's ability to attract capital may also be enhanced. If TRANSLink proceeds to fruition under the current plan, IPL will receive over $100 million in proceeds from TRANSLink's debt issuance because it plans to contribute assets to TRANSLink. IPL states it will use the proceeds to finance its Power Iowa generation project. However, as discussed later in this order, the Board has other concerns with IPL's plan to transfer ownership of its transmission assets to TRANSLink.

IPL and MidAmerican both argue that TRANSLink has the potential to enhance the reliability and operations of the electric transmission system in Iowa. However, ITCs in general and TRANSLink in particular represent a new way of conducting the transmission business, and Consumer Advocate argues that the Board should condition any approval on the understanding that transmission facilities shall not be contributed to TRANSLink without assurances that the proposed reorganization does not affect IPL's and MidAmerican's obligations to provide reasonably adequate bundled retail electric service within their respective service territories consistent with the requirements of Iowa Code chapter 476.

If the reorganizations are allowed to proceed, there is nothing to indicate that FERC will not adequately perform its regulatory responsibilities with respect to TRANSLink's operation. In addition, with or without TRANSLink, IPL and MidAmerican remain subject to Iowa Code chapter 476 and retain the obligation to provide retail electric service within their respective service territories. Based on the evidence and these understandings, there is no evidence to indicate IPL's and

MidAmerican's ability to provide safe, reasonable, and adequate service would be impaired by the reorganization.

## RATEPAYER IMPACT AND PUBLIC INTEREST

It is difficult to evaluate the impact of the proposed reorganizations on ratepayers and the public interest because of uncertainty at the federal level. FERC's proposed rule making regarding Standard Market Design (SMD), Docket No. RM01-12-000, is one of the drivers of much of the RTO and ITC activity and testimony at hearing indicated that is was unclear what form any final rules would take. Subsequent to the hearing, FERC, in the SMD docket, released a White Paper on April 28, 2003, which stated an intent to change some of the basic assumptions of the SMD rule making.

The transmission regulatory landscape was impacted in at least three major ways by the FERC White Paper. First, and perhaps most significant, FERC said it would not seek to exercise jurisdiction over the transmission rate component of bundled retail sales. Second, divestiture is not required to achieve independent operation of the transmission system, meaning that utilities may remain vertically integrated under an RTO or ISO (Independent System Operator). Third, FERC will recognize regional differences and regional timing constraints and look to state regulatory partners, like the Board, to frame the way an RTO or ISO should work in a particular region. For example, FERC now says it will look to regional state

committees to determine how financial transmission rights shall be allocated to current customers based on current uses of the grid.

MidAmerican and IPL enumerate numerous purported benefits of TRANSLink. (IPL Initial Brief, pp. 15-21; MidAmerican Initial Brief, pp. 13-25). However, even though FERC through its orders and rule makings is encouraging utilities to participate in an RTO directly or indirectly through an ITC such as TRANSLink, the record does not show that the TRANSLink proposal is the least-cost or most beneficial means of participating in an RTO or an ITC. In fact, based on the changes FERC has announced it intends to make through its White Paper, the Board does not believe there is substantial evidence in the record to support a finding that TRANSLink is a reasonable alternative. Many of the benefits claimed are benefits associated with RTO participation and are not TRANSLink specific. IPL and MidAmerican concede there is likely to be an increase in transmission costs in the initial years, but economic studies were not presented to support their belief that benefits would exceed costs over the long term. (Tr. 271; 369; 387).

Approving the reorganizations would also result in jurisdictional shifts between FERC and state regulatory authority. Prior to the issuance of the White Paper, it appeared FERC would take jurisdictional authority over the bundled element of transmission in retail rates regardless of how a utility's TRANSLink participation was structured. Subsequent to the White Paper, it is not clear that this shift necessarily occurs under the lease or operating agreement options. Under the TRANSLink model, the Board's authority to review transmission costs may be quite limited and

the Board may relinquish its current authority to review the reasonableness of transmission costs that are passed along to Iowa retail customers. Beyond the jurisdictional issue, the Board is not certain that voluntary relinquishment of this authority at this time is in the "public interest." The Board requires assurances that Iowa ratepayer interests will not be detrimentally affected after any reorganization. For example, the Board is especially concerned that Iowa's views on regional transmission issues will be ignored if the Board no longer has the authority to protect Iowa ratepayers on at least some aspects of transmission.

The Board is particularly concerned with allowing IPL or MidAmerican to contribute assets to TRANSLink. While the Board accepts the arguments that TRANSLink is more likely to be successful if it has an asset base with which to obtain financing, IPL's sole contribution of assets to the organization could be detrimental to its Iowa ratepayers, particularly given the current uncertainty regarding the final SMD rules. The Board questions why other utilities are not contributing assets, perhaps on a pro rata basis based on the size of their transmission systems. It should not be on the shoulders of IPL's ratepayers alone to make sure that TRANSLink begins operations on a strong financial footing. Also, the Board questions whether other participants will have the same level of commitment to TRANSLink when they have not contributed any portion of their assets and assumed IPL's level of risk.

The Board acknowledges that maintenance of existing transmission and construction of new transmission is vital to system reliability and dispatch of least-

cost generation resources. However, the Board believes, based on the record in this proceeding, that transfer of ownership of existing transmission assets may be premature and expose IPL's ratepayers to unforeseen risks and consequences. Transfer of assets by a single utility will likely present fewer risks to its ratepayers after TRANSLink has an operational record for the Board to evaluate.

The Board recognizes the difficult planning task faced by IPL and MidAmerican in attempting to comply with federal mandates that continue to change and evolve. The Board understands that if the reorganization proposals are disapproved, MidAmerican still has an obligation to join an RTO directly or through an ITC. IPL is currently a member of MISO, a FERC-approved RTO. However, based primarily on the current uncertainty and the resulting unanswered questions at the federal level, the Board cannot find today that the proposed reorganizations will not be detrimental to ratepayer interests or the public interest. Accordingly, the Board must disapprove the applications for reorganization.

As some of the unanswered questions begin to be answered, the Board's finding could change and the Board invites IPL and MidAmerican to refile their applications at a later date. The Board's disapproval is without prejudice. If the applications are refiled, IPL and MidAmerican can request that the Board take official notice of the record in these dockets so that duplicative material will not have to be filed, to the extent the information in this record is still correct.

If IPL and MidAmerican refile their proposals, they should address the following questions:

1. Does participation in TRANSLink through a lease or operating agreement have the effect of unbundling the transmission element of what are now fully bundled Iowa-jurisdictional retail sales, thereby ending the Board's primary ratemaking jurisdiction over that element?

2. Is there a way to structure TRANSLink participation by IPL and MidAmerican such that the Board retains state jurisdiction over the bundled component of transmission in retail rates?

3. What are the costs and benefits to Iowa ratepayers of having the transmission component of bundled retail sales subject to primary Board price jurisdiction? What are the costs and benefits to Iowa ratepayers of having the transmission component of bundled retail sales subject to primary FERC price jurisdiction?

4. What are the costs and benefits to Iowa ratepayers of each of the different forms of participation in TRANSLink—operating, lease, or contribution?

5. What are the additional risks, if any, of participation in TRANSLink via asset contribution? If there are additional risks, is it appropriate that only IPL undertake such risks?

6. What are the costs of participation in TRANSLink, with TRANSLink being a member of MISO and MISO performing some of the RTO functions, as opposed to the costs of IPL and MidAmerican directly joining MISO and MISO performing all the RTO functions?

7. What options, in addition to TRANSLink, are available to MidAmerican to satisfy FERC directives regarding RTO participation?

The Board continues to believe that participation in an RTO is likely to provide benefits to customers of IPL and MidAmerican through reduced wholesale electricity costs. Participation in an RTO, either independently or through an ITC, may also provide benefits with respect to transmission service, either through lower rates or substantial intangible benefits. However, given the current uncertainty in the transmission marketplace, the Board cannot conclude at this time that the proposed reorganizations will not be detrimental to ratepayer or the public interest.

The Board reaches this result reluctantly. The Board would have preferred to delay its decision in these dockets, request additional information from IPL and MidAmerican, and reconvene the hearing. This option, however, was not available to the Board because of the statutory mandate regarding the time in which the Board must issue a decision in a reorganization proceeding. Iowa Code § 476.77(2).

## IPL DELINEATION

Pursuant to FERC Order 888, FERC will give deference to states' determinations as to which facilities are transmission and which are local distribution, provided the states apply the seven-factor test outlined in the FERC order. FERC clarified that there is no bright line test that distinguishes transmission from distribution, but instead promulgated a functional test based on the seven factors. The seven factors are:

1. Local distribution facilities are normally in close proximity to retail customers.

2. Local distribution facilities are primarily radial in character.

3. Power flows into local distribution systems; it rarely, if ever, flows out.

4. When power enters a local distribution system, it is not reconsigned or transported on to some other market.

5. Power entering a local distribution system is consumed in a comparatively restricted geographical area.

6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

7. Local distribution systems will be of reduced voltage.

IPL proposes to classify all facilities 69 kV and above as transmission. In applying the seven FERC factors, the Board recognizes that some lines or facilities classified as distribution may not meet all the indicators of distribution lines. The Board believes no one factor in the test is determinative and that the Board must evaluate and balance all the factors in determining whether a line or facility is transmission or distribution. The Board recognizes that no delineation of IPL facilities is required at this time because the Board will disapprove the proposed transfer to TRANSLink. However, the issue was addressed by the intervenors and deciding the issue now should facilitate IPL's planning in determining whether and when to file a subsequent reorganization proposal.

IPL did not apply the FERC seven-factor test on a circuit-by-circuit basis but instead used a voltage class approach across the entire IPL system. Using this approach, IPL concluded that facilities 69 kV and above were transmission and facilities below 69 kV were distribution. Consumer Advocate argued that there were flaws in IPL's method because the circuit-by-circuit approach was not used. The RPGI contended that because IPL's 34.5 kV and 69 kV facilities in Iowa typically serve the same function, they should all be classified the same. The ICC supported IPL's proposed delineation.

The Board understands that there were differences in how MidAmerican and IPL applied the seven-factor test. This is because each utility's transmission system has unique characteristics and is used and operated based on different criteria. While the Board ordered IPL to use a "similar" methodology in its delineation to that used by MidAmerican, the Board did not expect IPL to necessarily use the same methodology because of the differences between IPL's and MidAmerican's systems. Interstate Power and Light Company, "Order Requiring Delineation," Docket No. M-150 (5/28/02).

The primary issue revolves around the classification of the 69 kV facilities. While IPL has operated its 34.5 kV and 69 kV systems from two separate control centers for the last five years, such separation requires cooperation and coordination between the two control centers. There is no indication that reliability or safety has been sacrificed during this time. IPL points out there are differences in the configuration of their 69 kV and 34.5 kV systems. There are separate operating

centers for the transmission (69 kV) and distribution (34.5 kV) systems. IPL's open, radial 34.5 kV facilities do not serve the same function as its closed loop, networked 69 kV facilities.

No analysis was introduced by the parties showing that a circuit-by-circuit analysis would have resulted in a substantially different delineation. In addition, the KEMA report, using a circuit-by-circuit approach, reached substantially the same result as the IPL study. On balance, IPL's application of the seven-factor test for delineation of transmission and distribution facilities is reasonable and will be adopted. However, if changes in Iowa's electric industry result in substantive changes to the way IPL's system is used and operated, it may be appropriate to recommend different delineations to FERC. What is transmission today may be distribution tomorrow, and what is distribution today may be transmission tomorrow. The Board's recommendations to FERC are based on the evidence presented in this docket, and the Board reserves the right to recommend new delineations if the facts and circumstances warrant.

## CONCLUSION

Based upon the testimony and evidence filed pursuant to Iowa Code § 476.77 (2003) and 199 IAC chapter 32, the Board finds IPL and MidAmerican have not established that their respective reorganizations are not contrary to the interests of ratepayers and the public interest. Therefore, the applications for reorganization will be denied without prejudice.

## ORDERING CLAUSES

**IT IS THEREFORE ORDERED:**

1. The applications for reorganization filed by Interstate Power and Light Company and MidAmerican Energy Company on December 18, 2002, are disapproved without prejudice.

2. Interstate Power and Light Company's delineation of transmission and distribution facilities is recommended by the Board to FERC at this time pursuant to Order 888, but the Board specifically reserves the right to recommend different delineations if changes in facts and circumstances so warrant.

3. Motions and objections not previously granted or sustained are denied or overruled. Any argument not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comment.

**UTILITIES BOARD**

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, the 13th day of June, 2003.