102 FERC ¶ 61,143
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission System Operator, Inc. — Docket No. ER02-485-002

ORDER DENYING REQUESTS FOR REHEARING

(Issued February 5, 2003)

1. In this order, we deny the requests for rehearing filed by American Municipal Power-Ohio, Inc. (AMP-Ohio), the Intervenor Group,[1] and jointly by the Public Service Commission of the Commonwealth of Kentucky, Minnesota Department of Commerce, Iowa Office of Consumer Advocate, Indiana Office of Utility Consumer Counselor and Iowa Utilities Board (collectively, state commissions and advocates)[2] of the Commission's order issued in this proceeding on September 23, 2002[3] (September 23 Order). In the September 23 Order, the Commission affirmed with modification the Initial Decision issued in this case on April 25, 2002[4] (Initial Decision), regarding the return on common equity (ROE) component for the formula calculation of the transmission service rates for the Midwest Independent Transmission System Operator,

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[1]The Intervenor Group includes: the Coalition of Midwest Transmission Customers; Dairyland Power Cooperative; Industrial Energy Users-Ohio; and the Midwest TDUs.

[2]Except where indicated, AMP-Ohio, the Intervenor Group, and the state commissions and advocates shall be collectively referred to as "Petitioners."

[3]Midwest Independent Transmission System Operator, Inc., 100 FERC 61,292 (2002).

[4]Midwest Independent Transmission System Operator, Inc., 99 FERC ¶ 63,011 (2002).

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Inc. (Midwest ISO) transmission owners (Midwest ISO TOs).[5] The September 23 Order made an upward adjustment within the zone of reasonableness to the ROE set forth in the Initial Decision and thus, set the ROE at 12.88 percent. Our actions herein advance the public interest by encouraging the expansion of the Midwest ISO which will thereby allow more customers to receive the benefits of a regional transmission organization (RTO).

I. Background

2. On December 3, 2001, pursuant to section 205 of the Federal Power Act[6] (FPA) the Midwest ISO filed proposed revisions to its Open Access Transmission Tariff (OATT), in order to, among other things, increase the ROE from 10.5 to 13 percent for all Midwest ISO pricing zones, except one.[7] The Commission found that the parties raised issues of material fact regarding the 13 percent ROE proposal and therefore, by order issued January 30, 2002[8] (January 30 Order), the Commission accepted and suspended for a nominal period the proposed ROE to become effective, subject to refund, on February 1, 2002, and established expedited hearing procedures. The hearing was held on March 21 and 22, 2002, and, as stated above, the Initial Decision was issued on April 25, 2002.

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[5]The Midwest ISO TOs who participated in the filing include: Alliant Energy Corporate Services, Inc., as agent for IES Utilities, Inc. and Interstate Power Co.; Central Illinois Light Co.; Cinergy Services, Inc. (for Cincinnati Gas & Electric Co., PSI Energy, Inc. and Union Light Heat & Power Co.); City Water, Light & Power (Springfield, IL); Hoosier Energy Rural Electric Cooperative, Inc.; Indianapolis Power & Light Company; International Transmission Co.; LG&E Corporation (for Louisville Gas and Electric Co. and Kentucky Utilities Co.); Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.); Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northwestern Wisconsin Electric Company; Otter Tail Power Co.; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Co.; UtiliCorp United, Inc.; and Northern States Power Co. and Northern States Power Co. (Wisconsin), subsidiaries of Xcel Energy, Inc.

[6]16 U.S.C. § 824(d) (2000).

[7]American Transmission Company, LLC did not join in the filing.

[8]Midwest Independent Transmission System Operator, Inc., 98 FERC ¶ 61,064 (2002); reh'g denied, 98 FERC ¶ 61,356 (2002) (Rehearing Order).

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3. For reasons detailed in the Initial Decision, the judge found that the ROE should be set at 12.38 percent. Briefly summarized, the judge accepted a discounted cash flow (DCF) analysis of a proxy group consisting of nine Midwest ISO TOs; calculated a zone of reasonable returns for that group,[9] which ranged from 8.79 to 15.96 percent; and relied upon the midpoint of that zone of reasonableness to identify the 12.38 percent ROE. The judge found this approach to be consistent with Commission precedent in Consumers Energy,[10] SoCal,[11] and Systems Energy,[12] in which the Commission found that using the midpoint of the zone of reasonableness resulted in a reasonable ROE for the electric utility involved in those cases.

4. In the September 23 Order, the Commission affirmed the methodology used by the judge in determining the ROE. With particular regard to the judge's reliance upon the midpoint, the Commission stated:

> Our review of the presiding judge's reasoning and the underlying record, as well as the parties' arguments on and opposing exceptions, leads us to summarily affirm the presiding judge's finding that the midpoint of the zone of reasonableness represents the appropriate ROE in this case. The Commission has consistently used the midpoint in setting the ROE for electric utilities,[13] and we see no reason to depart from our precedent here. We are unpersuaded by appeals to use the methodology utilized in setting the ROE for gas

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[9]As part of the DCF analysis, the judge calculated sustainable growth rates for the proxy group members, using three Value Line estimates over a five-year period. The judge also estimated the low ROE for each proxy group member by adding the adjusted average low dividend yield to the lower of the two growth rates already derived (one derived from Value Line data and one from the Institutional Brokers Estimate Service), and calculated the high ROE for each company by adding the adjusted high dividend yield to the higher of the two growth rates.

[10]Consumers Energy Co., 98 FERC ¶ 61,333 (2002) (Consumers Energy).

[11]Southern California Edison, 92 FERC ¶ 61,070 (2000); reh'g pending (SoCal).

[12]Systems Energy Resources, Inc., 92 FERC ¶ 61,119 (2000), reh'g denied, 96 FERC ¶ 61,165 (2002) (Systems Energy).

[13]See Consumers Energy, 98 FERC at 62,416; SoCal, 92 FERC at 61,266.

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> pipelines, for we have also consistently emphasized that significant differences exist between the electric and gas industries.[14] Furthermore, we reject the Intervenor Group's argument that UtiliCorp's inclusion in the Midwest ISO TO proxy group improperly skews the midpoint upward. As we previously stated, we find that the Midwest ISO TO proxy companies properly represent the Midwest ISO TOs, for the reasons set forth in the Initial Decision.

September 23 Order at 62,315.

5. The September 23 Order also implemented an upward adjustment to the ROE for the turning over of operational control of transmission facilities. The Commission stated:

> There are, however, policy reasons to make upward adjustments– particularly with regard to the level of operational independence that the Midwest ISO provides. In this case, we will make an upward adjustment of 50 basis points [(50 point premium)] from the proxy group midpoint for the turning over of operational control of transmission facilities. We will consider providing additional upward adjustments for greater levels of independence. The Commission will be clarifying its incentive rate policy in the near future with concrete statements of the behavior and performance we wish to incentivize.

II. The Instant Filing

6. On rehearing, for substantially the same reasons set forth at earlier stages in this proceeding, Petitioners argue that the median, not the midpoint, should be used in determining the appropriate ROE for Midwest ISO TOs.[15]

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[14]See Consumers Energy, 98 FERC at 61,261-62; Systems Energy, 92 FERC at 61,443-45.

[15]Petitioners maintain that the Commission consistently has relied upon the median in determining the appropriate ROE for gas pipelines, and that the Commission failed to articulate an adequate reason for taking a different approach in this proceeding. In addition, Petitioners contend that utilizing the midpoint in this case leads to

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7. Petitioners further argue that the Commission erred in establishing the 50 point premium to increase the ROE from 12.38 percent to 12.88 percent. As an initial matter, Petitioners contend that the Commission's decision, sua sponte, to implement the 50 point premium deprived them of notice and opportunity to be heard on the issue, in violation of the Administrative Procedure Act.[16]

8. In addition, Petitioners state that the 50 point premium is an arbitrary number that the Commission failed to support in the September 23 Order. Petitioners argue that the Commission also failed to provide a detailed explanation of how the 50 point premium would help achieve the goals of an RTO, including efficient use of and investment in the transmission system and reliability benefits to customers, in accordance with Commission regulations.[17] The Intervenor Group adds that, also pursuant to Commission regulations,[18] the Commission should have restricted the duration of the 50 point premium to the December 31, 2004 termination date for innovative RTO pricing.

9. Petitioners further contend that the 50 point premium constitutes an innovative rate designed to encourage membership in the Midwest ISO, and that therefore, the Commission's decision to implement the 50 point premium is inconsistent with the January 30 Order requiring that all innovative rate proposals be submitted to the stakeholder process. Likewise, Petitioners argue that the September 23 Order is self-contradicting, because it at once implemented the 50 point premium and affirmed the judge's refusal to upwardly adjust the ROE, which was based in part upon the finding that innovative rate proposals are outside of the scope of this proceeding.[19]

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[15](...continued)
particularly skewed results, because, according to Petitioners, certain companies should not have been included in the Midwest ISO TO proxy group.

[16]5 U.S.C. § 554(b)(3).

[17]Petitioners cite 18 C.F.R. § 35.34(e)(1)(I) (2001).

[18]The Intervenor Group cites 18 C.F.R. § 35.34(e)(4).

[19]The state commissions and advocates further note that the judge rejected arguments that the ROE should be upwardly adjusted, because transmission owners faced increased risks by transferring to the Midwest ISO operational control of their facilities.

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10. Finally, Petitioners state that although any decision to allow an incentive-based return must be prospective,[20] the 50 point premium rewards transmission owners for past performance, i.e., relinquishing to the Midwest ISO operational control of their transmission facilities. Petitioners state that the 50 point premium therefore raises customers' costs without providing a corresponding benefit.

III. Discussion

11. As an initial matter, we will deny Petitioners' requests for rehearing, relating to use of the midpoint. Petitioners raise no new arguments on rehearing that have not been addressed at an earlier stage in this proceeding. Accordingly, we will not address those arguments here.

12. Furthermore, we will deny Petitioners' requests for rehearing to the extent they seek a retraction of the 50 point premium. We reject Petitioners' argument that implementing the 50 point premium in this case required prior Commission notice. As stated above, this proceeding arises from the Midwest ISO's request, noticed and filed pursuant to section 205 of the FPA, to increase the ROE from 10.5 to 13 percent. It is well-established that the FPA grants the Commission broad authority to determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and fix the same by order.[21] Pursuant to that authority, the Commission determined that the 50 point premium is appropriate in this case. We further note that the 50 point premium sets the ROE at 12.88 percent, which is less than the 13 percent ROE originally sought by the Midwest ISO.

13. Although we deny Petitioners' requests for rehearing, we will elaborate on our policy reasons for providing the 50 point premium. The Commission has long recognized the benefits of RTOs. As we stated in Order No. 2000,[22] transmission

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[20]Petitioners cite Policy Statement for Incentive Regulation, 61 FERC ¶ 61,168 at 61,589 (1992).

[21]16 U.S.C. § 824e(a) (2000). See, e.g., Central Louisiana Electric Company, Inc.; Louisiana Energy and Power Authority v. Central Louisiana Electric Company, Inc., 70 FERC ¶ 63,015 (1995), aff'd, 83 FERC ¶ 61,125 (1998).

[22]Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), order on reh'g, Order No. 2000-A, 65

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facilities can be operated more reliably and efficiently when coordinated over large geographic areas. RTOs would achieve this result by establishing: regional transmission pricing and the elimination of rate pancaking; improved congestion management; more accurate estimates of available transmission capacity; more effective management of parallel path flows; and improved grid reliability. We also found in Order No. 2000 that RTOs would help eliminate the opportunity for unduly discriminatory practices by transmission providers, reduce the need for overly intrusive regulatory oversight, and instill trust among competitors that all are playing by the same rules.

14. In addition, as we recently stated in the Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid[23] (Proposed Pricing Policy), market participants have complained about the difficulties they have experienced in gaining equal access to the transmission grid to compete with vertically integrated utilities. Market participants also have complained that companies that own both transmission and generation under-invest in transmission because the resulting competitive entry often decreases the value of their generation assets. Much of this problem is directly attributable to the remaining incentives and ability of vertically integrated utilities to exercise transmission market power to protect their own generation market share. Independent transmission providers and owners, such as RTOs and independent transmission companies (ITCs), would solve these problems. In short, because they operate independently from the activities of other market participants, and operate the transmission system on a regional basis, RTOs and ITCs make competitive wholesale electric markets more efficient, fair, trustworthy, and cost-effective.

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[22](...continued)
Fed. Reg. 12,088 (Mar. 8, 2000), FERC Stats. & Regs. ¶ 30,092 (2000), aff'd sub nom. Public Utility District. No. 1 of Snohomish County, Washington v. FERC, 272 F.3d 607 (D.C. Cir. 2001).

[23]102 FERC ¶ 61,032 (2003). The Proposed Pricing Policy would, among other things, reward transmission owners for joining RTOs and turning their assets over for RTO operation, or taking other measures which make their transmission facilities operationally independent from the activities of other market participants, and pursuing additional measures to operate and expand the transmission grid efficiently in ways that solve RTO-identified system needs using either classic transmission investments or innovative technologies. More specifically, under the Proposed Pricing Policy, any entity that transfers operational control of transmission facilities to a Commission-approved RTO would qualify for an incentive adder of 50 basis points on its ROE for all such facilities transferred.

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15. Given the many benefits to customers that result from the Midwest ISO's independent and regional approach to the provision of electric transmission service, we believe that the 50 point premium is appropriate at this time. As we explained in the Proposed Pricing Policy:

> While significant benefits from competition are expected to result from RTOs and ITCs, these benefits will be shared among end-use customers and generators, among others. To assure that transmission owners receive benefits from RTO formation, we believe that it is reasonable to allow an adjustment to be applied to the rates of transmission owners participating in an RTO. . . .

Proposed Pricing Policy, 102 FERC at ¶61,032 at___(2003).

16. The Commission believes that the 50 point premium will encourage timely participation in the Midwest ISO and encourage current and potential Midwest ISO TOs to maintain and achieve an independent and regional approach to transmission, thereby improving the performance of the transmission grid. Customers in the midwestern United States have benefitted from the early efforts of current Midwest ISO TOs, which allowed the Midwest ISO to become operational in early 2002. We believe that the 50 point premium must be available to public utilities that have already turned over operational control of their facilities to the Midwest ISO, but have not yet received the incentive of 50 basis points.

17. Petitioners' argue that the Commission's decision to implement the 50 point premium contradicts prior orders in which we stated that the Midwest ISO must first vet proposed innovative rates through the stakeholder process before submitting them to the Commission. We disagree. The Midwest ISO did not propose the 50 point premium; we implemented the rate pursuant to the Commission's authority under the FPA, as discussed earlier.

18. Finally, with regard to Petitioners' argument that the Commission should have made the 50 point premium subject to the December 31, 2004 sunset provision for innovative rates, set forth at 18 C.F.R. 35.34(e)(4), that section applies only to innovative rate proposals involving: (1) rate moratoria or (2) rates of returns that do not vary with capital structure. The 50 point premium falls into neither category.

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The Commission orders:

Petitioners' request for rehearing is hereby denied.

By the Commission.

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Magalie R. Salas,
Secretary.