

102 FERC ¶ 61, 184

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Illinois Power Company
Illinois Electric Transmission Company, LLC
Trans-Elect, Inc.

Docket Nos. EC03-30-000
ER03-284-000

ORDER ON DISPOSITION OF JURISDICTIONAL FACILITIES, ACCEPTING
PROPOSED AGREEMENTS, SUSPENDING CERTAIN RATES AND
ESTABLISHING HEARING PROCEDURES

(Issued February 20, 2003)

1. In this order, the Commission addresses the transfer of certain jurisdictional facilities in order to facilitate the creation of an independent stand-alone transmission company. The Commission also sets the proposed Wholesale Distribution Service rates for hearing and accepts certain proposed agreements. Further, the Commission sets Applicants' other proposed rates for hearing, as discussed in the body of this order. Our actions encourage seamless Regional Transmission Organization (RTO) development in the Midwest, as the transmission assets of Illinois Power Company (Illinois Power) ultimately will be under the control of the Midwest ISO. Additionally, the order lessens the potential for the exercise of undue discrimination in the provision of transmission services and facilitates the development of competitive markets.

Background

2. On December 16, 2002, Illinois Power, Illinois Electric Transmission Company LLC (IETC), Illinois Transco Holdings, LP (Illinois Transco Holdings) and Trans-Elect, Inc. (Trans-Elect) (collectively, Applicants) filed a joint application under sections 203 and 205 of the Federal Power Act (FPA) requesting Commission approval for Illinois Power to (1) reclassify certain transmission and distribution assets of Illinois Power, (2) sell and transfer to IETC all of Illinois Power's right, title, and interest in its jurisdictional transmission facilities and related assets (Purchased Assets), (3) provide Wholesale Distribution Service over Illinois Power's distribution system, and (4) enter into certain

agreements with other Applicants prior to or at the time of closing. The application also proposes that IETC provide open access transmission service over the Purchased Assets through an RTO at certain rates, terms and conditions. IETC commits to making all the necessary filings with the Commission to facilitate the transfer of functional control of the transmission system to the Midwest ISO.¹

3. Illinois Power states that its decision to divest its transmission assets is consistent with state law and Commission policy.² Applicants believe that this transaction provides further evidence that a truly independent for-profit transmission company is a viable model for achieving the Commission's goal of developing independent transmission in the United States. IETC commits that with only the transmission business as its focus, it will build those necessary transmission facilities that can be sited and properly permitted by the appropriate regulatory authority and upon which a reasonable return on investment can be earned.

The Parties

4. Illinois Power, an indirect wholly-owned subsidiary of Dynegy Inc., is a public utility engaged in the transmission, distribution and sale of electric energy, and the distribution, transportation and sale of natural gas in the state of Illinois.

5. Trans-Elect is an independent, for-profit transmission company that focuses solely on the acquisition of transmission systems from investor-owned utilities and other transmission owners, with the goal of creating a network of independent transmission companies under the RTOs envisioned by the Commission. Trans-Elect owns and controls Trans-Elect Illinois, LLC, a limited liability company, which is the general partner of Illinois Transco Holdings.

6. Illinois Transco Holdings is a limited partnership with Trans-Elect Illinois, LLC as the general partner and AIG Highstar Capital, L.P. (Highstar), through its subsidiary AIG Highstar Transmission Systems, LLC, as the limited partner. Highstar will hold a preferred limited partnership equity interest in Illinois Transco Holdings and have consent rights to certain transactions that might materially affect its investment. Illinois Transco Holdings will own IETC, a newly formed limited liability company that will own the transmission assets acquired from Illinois Power.

¹Exhibit No. TE-1 at 35.

²Citing Order No. 2000 at 31,034 and 31,064 (2000); DTE Energy Co. and Int'l Transmission Co., 97 FERC ¶ 61,330 at 62,569 (2001).

Introduction

7. Applicants state that this transaction represents a continuation of Trans-Elect's business plan to create a network of truly independent transmission companies under RTO direction and in response to the Commission's regulatory initiatives. Applicants further state that the Commission, in the context of approving Trans-Elect's acquisition of the Michigan Electric Transmission Company (METC) from Consumers Energy Company (Consumers Energy), specifically recognized Trans-Elect's independence from market participants as a benefit associated with the creation of a stand-alone transmission business. Additionally, Applicants note that the Commission has indicated its expectation that Trans-Elect's business model would bring needed infrastructure investment and lead to a more efficient operation of transmission facilities.

8. Applicants claim that the instant transaction demonstrates that, under appropriate circumstances, utilities will sell their transmission assets to entities like Trans-Elect by utilizing appropriate Order No. 2000 principles, given appropriate incentives. In addition, Trans-Elect believes that this transaction will further the Commission's open access and RTO initiatives, accelerate the transition to competitive bulk power markets, and result in significant benefits. Furthermore, Applicants note that the application proves that equity capital and debt funding can be used to finance these transactions and support transmission investment.

9. Applicants further claim that their business model creates a more focused management of transmission assets than that of vertically integrated investor-owned utilities since Trans-Elect, without ties to generation or distribution, will be completely independent of competing business interests and will only have the transmission business as its focus. This, coupled with its commitment to invest in new facilities, according to Applicants, will lead to the building of necessary transmission infrastructure. In fact, Trans-Elect identifies certain infrastructure investments already being considered by Trans-Elect. The project under consideration is a 345 kV transmission line from Sidney to Rising in Illinois, which Applicants assert could benefit the market by relieving a potential constraint on the Illinois Power transmission system.

10. In order for these benefits to be forthcoming, Applicants state that certain rate treatments are necessary and appropriate. Specifically, Applicants seek approval of the following components for use in a formula to determine IETC's revenue requirement: (1) gross plant levelized return; (2) a 13 percent rate of Return on Equity (ROE); and (3) a capital structure of 50 percent long-term debt and 50 percent common equity to be used for rate purposes. Applicants assert that in order for the transaction to close, these rate

treatments must be approved as proposed without suspension, refund obligation or hearing.

Notices and Responsive Pleadings

11. Notice of the filing was published in the Federal Register,³ with comments, protests, and interventions due on or before January 6, 2003.⁴ The following entities filed timely motions to intervene: Consumers Energy; Dynegy Power Marketing, Inc. and Dynegy Midwest Generation, Inc. (together, Dynegy); Exelon Corporation (Exelon); Illinois Municipal Electric Agency (Illinois Municipal); ISG Hennepin Inc. (ISG Hennepin); and Wisconsin Electric Power Company (Wisconsin Electric). Additionally, Ameren Services Company (Ameren) and MidAmerican Energy Company (MidAmerican) filed out-of-time motions to intervene.

12. Timely motions to intervene and protests or comments were filed by: Archer-Daniels-Midland Company (Archer-Daniels); Illinois Industrial Energy Consumers (Illinois Industrial Energy);⁵ Southwestern Electric Cooperative, Inc. (Southwestern); Soyland Power Cooperative, Inc. (Soyland); and Wabash Valley Power Association, Inc. (Wabash Valley). Iowa Utilities Board (Iowa Board) filed a notice to intervene and protest. In addition, Southern Illinois Power Cooperative (SIPC) filed an out-of-time motion to intervene and protest, and the Illinois Commerce Commission (Illinois Commission) filed an out-of-time motion to intervene and comments.

13. On January 13, 2003, and January 23, 2003, the Commission staff requested additional information from Applicants. On January 15, 2003, and January 29, 2003, Applicants submitted supplemental information in response to the Commission staff's requests.

14. On January 21, 2003, Applicants filed an answer in response to various protesters. On January 29, 2003, Illinois Industrial Energy filed a motion to strike Applicants'

³67 Fed. Reg. 79,597 (2002).

⁴On January 2, 2003, the Commission rejected requests for an extension of time.

⁵Illinois Industrial Energy members intervening in this proceeding are: A.E. Staley Manufacturing Company; Air Products & Chemicals Company; Archer-Daniels-Midland Company; Cargill, Inc.; Caterpillar, Inc.; Granite City Steel Division of National Steel Corp.; Illinois Cement Company; International Steel Group; Olin Corporation; PPG Industries, Inc.; and U.S. Silicia Company.

answer and, in the alternative, a motion to respond to the answer and an answer. On January 30, 2003, Illinois Power filed a certified copy of the Illinois Commission's order approving the proposed reclassification. On February 3, 2003, Applicants filed an answer to Illinois Industrial Energy's motion to strike. On February 5, 2003, Archer-Daniels filed an answer to Applicants' answer. Applicants, on February 10, 2003, filed a response to Archer-Daniels' answer.

Discussion

A. Procedural

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2002), the timely, unopposed motions to intervene and the notice of intervention serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure,⁶ given their interest in this proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay, we find good cause to grant Ameren's, MidAmerican's, SIPC's and the Illinois Commission's untimely, unopposed motions to intervene.

16. While Rule 213(a)(2) of the Commission's Rules of Practice and Procedure⁷ generally prohibits answers to protests unless otherwise permitted by the decisional authority, we will permit Applicants' answer because it provides additional information that assists us in the decision-making process. We will also accept Illinois Industrial Energy's and Archer-Daniels' answer to Applicants' answer, as well as Applicants' answer to Illinois Industrial Energy's motion to strike. We will also accept Applicants' answer to Archer-Daniel's answer.

B. Transmission Rate Treatments

1. Applicants' Proposal

17. Applicants claim that in order for the benefits of its proposal to be realized, certain rate treatments must be approved by the Commission without suspension, refund obligation or hearing. Specifically, Applicants seek approval of a rate formula that will establish IETC's revenue requirement based upon a levelized gross plant original cost method, a 13 percent rate of return on equity, and a capital structure, for rate purposes, of

⁶18 C.F.R. § 385.214(d) (2002).

⁷18 C.F.R. § 385.213(a)(2) (2002).

50 percent long-term debt and 50 percent common equity. Applicants acknowledge that the proposal, particularly the levelized gross plant feature, will result in a rate increase at least for some customers. To mitigate the effects of the rate increase, Applicants state that they will place into effect certain measures that they state will protect customers.

18. In support of their rate treatment proposal, Applicants have filed testimony and exhibits that set forth and support what they refer to as illustrative first-year rates under the proposal.⁸ Applicants state that the rate formula IETC plans to use to establish its revenue requirement is based on the rate template approved for use by the Midwest ISO. For jurisdictional transmission owners, the Midwest ISO formula template uses data from the transmission owner's most current FERC Form No.1. Applicants will modify the Midwest ISO formula to some degree in order to accommodate, among other things, the claimed rate of return on equity and the levelization aspect of their proposal.

19. Under their levelization proposal, Applicants propose to use the gross transmission plant balance (undepreciated) at the time the underlying asset disposition transaction closes in order to calculate their initial rates pursuant to the formula. Applicants claim that the proposed levelized rate is necessary so that IETC can receive revenues sufficient to justify the price it will pay for the Illinois Power assets. IETC witnesses estimate the gross plant balance to be approximately \$280 million. According to Applicants, the actual plant costs will be determined at the time of closing.

20. Because the levelized rates will result in a rate increase, IETC and Illinois Power have proposed measures that they state will protect most retail ratepayers from being impacted by the rate increase. According to Applicants, the rate increase will immediately affect wholesale transmission customers and, except under very limited circumstances, retail ratepayers will be unaffected through December 31, 2006. Applicants state that IETC will establish a number of other mitigation measures, such as a commitment to file (in 2005) and implement performance based rates (PBR) and a rate cap that will begin on June 1, 2007, and continue through the end of 2010. In addition, Applicants argue that the rate increase proposed by the instant application is not significantly different from Illinois Power's planned rate increases for the next ten years, absent the sale of the assets. Applicants provide testimony and exhibits sponsored by Illinois Power witnesses outlining the planned rate increases. The final piece of

⁸IETC claims that its rates are illustrative in nature because its formula includes certain revenue credits that are not yet known. IETC states that it will make a compliance filing prior to the effective date of its rates to provide the actual rate levels once the revenue credits levels are better established.

Applicants' rate treatments package is a cost-benefit analysis purporting to show the benefits of the more focused transmission investment strategy that the new owners will provide. The study consists of an analysis of the net benefits expected to result from IETC's potential investment in a 345kV transmission line (the so-called Sydney-Rising line) that would provide increased access to a less expensive and broader array of generation options.

2. Protesters' Comments

21. Protesters generally object to Applicants' proposal to utilize a levelized gross plant rate methodology, a 13 percent ROE, and a hypothetical capital structure of 50 percent debt and 50 percent equity. They assert that the proposed switch to levelized rates, by failing to take into account prior recovery of depreciation associated with the facilities at issue under a different rate methodology, will result in a second recovery of past depreciation amounts and excessive rates in the future. Regarding the rate of return proposal, they argue that there is no support that actual financing will be in the proportions reflected in the proposed capital structure or that the proposed 13 percent ROE is reasonable if the equity portion of the actual financing is ultimately less than 50 percent.

22. Protesters also take issue with the proposed mitigation measures and the cost-benefit analysis. Iowa Board argues that the willingness of a transmission-owning utility to construct a needed expansion is not relevant to the costs and benefits of the sale of currently existing transmission facilities because, at some level, the construction of needed facilities is an obligation of the transmission owner, not a benefit resulting from a property transfer. Illinois Industrial Energy faults the cost-benefit study for not examining the likelihood of the line being built under an IETC versus Illinois Power scenario. Archer Daniels argues that the cumulative net benefits of \$16.9 million on a present value basis claimed in the Applicants' cost-benefits study does not consider rate impacts associated with the proposal.

3. Discussion

23. The Commission shares the concerns raised by protesters that the proposed rate treatments will result in significantly increased rates and that these rates may not be justified by the benefits associated with the transaction. The Commission has previously granted, on a case-by-case basis, certain rate treatments for transmission owners that exceeded the independence standard in Order No. 2000, in consideration for the benefits

produced by this additional level of independence.⁹ Given the rate treatments that IETC requests, a cost-benefit analysis, quantifying the impact of the proposed rates and the benefits that will ensue from the proposal, is required. Our preliminary analysis in this proceeding indicates that the proposed rate treatments may result in IETC's recovery of a premium above book value that significantly exceeds the amounts that we have approved in those instances and that significantly exceeds the benefits identified by IETC's cost-benefit analysis.

24. A number of issues of material fact exist that must be addressed at the trial-type evidentiary hearing ordered below in order to provide the Commission with a more complete factual record concerning the rate impacts and benefits associated with the proposal. For example, IETC's illustrative rates reflect an average life for depreciable transmission plant of roughly 100 years, while Illinois Power's 2001 FERC Form No. 1 shows an average life for depreciable transmission plant of approximately 60 years. In response to staff's data requests about this discrepancy, IETC simply stated that the depreciation rate in its illustrative rates is consistent with the application of the levelized rate methodology.¹⁰ It appears that while gross plant levelized cost-of-service analyses typically do express the depreciation and return factors differently from non-levelized cost-of-service analyses, to reflect the different manner in which each methodology recovers investment cost over the life of the asset, both types of analyses would reflect the same physical characteristics (average life) of depreciable plant. There are other significant and unexplained discrepancies between Illinois Power's 2001 FERC Form No. 1 and IETC's illustrative rate calculation that must be addressed at the hearing ordered below.

25. In addition, while we are encouraged by IETC's submission of a cost-benefit analysis, certain of the assumptions in that analysis raise concerns, such as the assumption that Illinois Power would never have built the Sydney-Rising line. At the hearing, participants should explore refinements to the cost-benefit analysis, as well as expansion of that analysis to consider all of the costs and benefits associated with the

⁹See *Trans-Elect, Inc., et al.*, 98 FERC ¶ 61,142 (2002) (February 13 Order). See also *ITC Holdings Corp., et al.*, ___ FERC ¶ _____ (2003) (Docket Nos. EC03-40-000 and ER03-343-000), being issued concurrently with this order.

¹⁰See January 23, 2003 response of IETC to FERC Staff Data Request No. 15.

formation of this new company. Accordingly, we will set the proposed rates for a trial-type evidentiary hearing.¹¹

26. Lastly, because of our decision with respect to Applicants' rate treatment proposals, there is no need, at this juncture, to decide whether Trans-Elect is independent of market participants. In this regard, we note that in response to a staff data request asking for the Illinois Transco Holdings, LP partnership agreement, Trans-Elect responded that the agreement had not yet been negotiated. In order to complete the evaluation of independence in this case, Trans-Elect is directed to file the agreement as soon as it is executed.¹²

B. Wholesale Distribution Service

1. Applicants' Proposal

27. Illinois Power proposes a Wholesale Distribution Service Agreement, Exhibit M to the Application, under which Illinois Power will provide wholesale distribution service through the OATT applicable to the IETC system.¹³ Customers will be liable for charges based on: (1) a share of the revenue requirement associated with distribution facilities used by multiple customers; and (2) the revenue requirement associated with

¹¹We note that Applicants did not submit tariff sheets setting forth the proposed rates for service to be provided by IETC. Following the hearing, we would expect that tariff sheets implementing its proposed rates would be filed pursuant to section 205 of the FPA.

¹² The Commission is continuing to explore the independence standard for incentive rate treatment in the context of independent transmission companies. See Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid (issued on January 15, 2003) (Docket No. PL03-1-000). The Commission recently proposed that an independent transmission company must be fully independent, *i.e.*, no active or passive ownership interests in the independent transmission company by market participants, in order to qualify for either the allowance tied to deferred taxes approved in Trans-Elect or an ROE-based lump sum payment incentive for independent ownership. We are currently informed, but not limited by, the proposed pricing policy as it is pending.

¹³IETC or Midwest ISO will collect the charges for Wholesale Distribution Service on Illinois Power's distribution system and pass such collections on to Illinois Power.

distribution facilities used solely by the customer. Illinois Power calculates the annual revenue requirement associated with particular facilities by either multiplying the gross plant balance by a fixed charge rate of 13.27 percent or by multiplying the net plant by a fixed charge rate of 20.87 percent.

2. Discussion

28. The Commission finds that Illinois Power has failed to adequately support the proposed rates for Wholesale Distribution Service and our preliminary review indicates that the proposed distribution rates may not be just and reasonable. Accordingly, we will accept the proposed rates for filing, suspend them for a nominal period, to become effective, subject to refund, as of the date of closing, as requested. Further, we will include Illinois Power's proposed Wholesale Distribution Service rates in the hearing established above.

C. Disposition of Jurisdictional Facilities

29. Applicants seek authorization under section 203 of the FPA for Illinois Power to sell its interests in the jurisdictional transmission assets and related tariffs, contracts, agreements, books and records (Purchased Assets) to IETC.¹⁴ The Asset Purchase Agreement among Illinois Power, IETC and Trans-Elect establishes the terms and conditions of the sale of the Purchased Assets. Illinois Power also requests authorization to either wholly or partially assign certain interconnection agreements, facilities use agreements, and transmission service agreements to IETC or the relevant RTO.¹⁵ In addition, Illinois Power requests approval to assign to IETC any other jurisdictional agreements that it enters into between the date of the Asset Purchase Agreement and the date of the closing. Section 1.2 of the Asset Purchase Agreement states that the purchase price is \$239 million, subject to certain adjustments.¹⁶

30. Section 203(a) of the FPA provides that the Commission must approve a disposition of jurisdictional facilities if it finds that it "will be consistent with the public

¹⁴Exhibit H to the application lists the transmission assets to be acquired by IETC.

¹⁵Exhibit N to the application identifies the agreements to be assigned.

¹⁶See Section 1.6 and Section 1.7 of the Asset Purchase Agreement for adjustments to purchase price.

interest."¹⁷ The Commission's Merger Policy Statement sets forth the criteria and considerations for evaluating applications under section 203 and provides that the Commission will generally take account of three factors in its analysis: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.¹⁸ As discussed below, we find that the proposed transaction will not adversely affect competition or regulation; we will defer making any determination regarding the effect on rates.

1. Effect on Competition

a. Applicants' Arguments

31. Applicants indicate that a competitive screen analysis is not required because the transaction only involves the acquisition of transmission assets. Applicants state that neither IETC, Trans-Elect nor any company owned by Trans-Elect owns any generation and that the proposed transaction will not change the ownership or control of any generation resources. Applicants claim that the proposed transaction will benefit competition by ensuring that transmission service is provided in a fair and non-discriminatory manner, without regard to corporate affiliation, by an entity that is within an RTO and is not affiliated with any market participant.

b. Protesters' Concerns

32. Southwestern argues that the Non-Competition Agreement between Illinois Power and Trans-Elect improperly excludes a long-time transmission service provider from the relevant market, thus eliminating a significant restraint on the exercise of market power. Illinois Industrial Energy argues that the benefits to competition are overstated and that the rate increase may deter retail customers from customer choice, thus undermining the development of retail competition.

¹⁷16 U.S.C. § 824(b) (1994).

¹⁸See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (December 30, 1996), FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000 ¶31,044 (1996), order on reconsideration, Order No. 592-A, 62 Fed. Reg. 33,341 (June 19, 1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); see also Revised Filing Requirements Under Part 33 of the Commission's regulations, Order No. 642, 65 Fed. Reg. 70,983 (November 28, 2000), FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,111 (2000), order on reh'g, Order No. 642-A, 66 Fed. Reg. 16,121 (March 23, 2001), 94 FERC ¶ 61,289 (2001).

c. Discussion

33. There will be no change in the ownership or control of any generation resources resulting from this transaction. In addition, after the transaction, the transmission system will be owned by a stand-alone transmission company and transmission service over the system will be provided by an approved RTO. Therefore, we conclude that the proposed transaction will have no adverse effect on competition. In fact, we expect that it will enhance competition.

34. The Non-Competition Agreement stipulates that Illinois Power shall not compete with the operation of the Purchased Assets for five years within the geographic area in which Illinois Power conducts business. In this case, a franchised utility is proposing to turn over its transmission grid to a stand-alone transmission company that will be part of an approved RTO. As we have said before, having transmission facilities operated independently from market participants will help ensure non-discrimination and thus encourage entry into wholesale markets. While non-competition agreements may be unacceptable in circumstances such as an agreement between two wholesale sellers, we find on balance that the proposed transaction, including the non-competition agreement will promote competition, in light of the current stage of competition in the industry.

35. While Illinois Industrial Energy contends that the proposed transaction will have a detrimental effect on retail competition, our policy statement indicates that it is outside the scope of the Commission to conduct such an analysis, unless requested by a state commission. In this case, no state has requested such action.

2. Effect on Regulation

a. Applicants' Arguments

36. Applicants state that Trans-Elect will become a registered holding company as a result of the proposed transaction. To allay the Commission's concern regarding the loss of jurisdiction over transactions within registered holding companies, Trans-Elect, Illinois Transco Holdings, and IETC commit to abide by the Commission's policies on the pricing of non-power goods and services with respect to intra-company and affiliate transactions. Applicants state that Illinois Power's wholesale sales will continue to be subject to the Commission's jurisdiction and that its bundled retail service and rates will continue to be subject to the Illinois Commission's jurisdiction. Thus, Applicants conclude that neither federal nor state regulation will be adversely affected as a result of the proposed transaction.

b. Protesters' Concerns

37. Illinois Industrial Energy argues that the Illinois Commission may be restricted in its ability to enforce its rules on reliability because IETC seeks to become a "public utility" and not an "electric utility." According to Illinois Industrial Energy, the Illinois Commission's rules addressing reliability apply only to "electric utilities" or "jurisdictional entities," not "public utilities."

c. Discussion

38. As explained in the Merger Policy Statement, the Commission's primary concern with the effect on regulation of a proposed disposition of jurisdictional facilities involves the possible changes in the Commission's jurisdiction when a registered holding company is formed, thus invoking the jurisdiction of the Securities and Exchange Commission. We are also concerned with the effect on state regulation where a state does not have authority to act on a merger and has raised concerns about the effect of the transaction on its regulation.¹⁹

39. Trans-Elect, Illinois Transco Holdings, and IETC have committed to abide by the Commission's policies with respect to intra-company and affiliate transactions. In light of this commitment, we find that the proposed transaction will not impair the Commission's regulation.

40. Regarding Illinois Industrial Energy's concern that the Illinois Commission's regulation may be impaired, we note that the Illinois Commission has authority to review the proposed transaction and has not asked this Commission to take any action.

41. Thus, we find that the proposed transaction will not adversely affect regulation.

3. Effect on Rates**a. Applicants' Arguments**

42. Applicants indicate that the proposed transaction would result in a rate increase to wholesale transmission customers and some unbundled retail transmission customers. Applicants performed a cost-benefit analysis which shows the net benefits that they say will result from increased investments in transmission infrastructure. Applicants argue

¹⁹Merger Policy Statement at 30,124-25.

that the benefits of independent transmission, such as increased transmission investments and focused transmission management, would offset any rate increase.

43. Furthermore, as discussed above, Applicants commit to several mitigation measures to reduce the effects of any rate increase. The mitigation measures include a retail rate freeze and other state law mechanisms that protect bundled retail customers and most unbundled retail transmission customers through December 31, 2006. For wholesale transmission customers and certain unbundled retail transmission customers, Applicants commit to (1) file to implement performance based rates beginning in 2005, and (2) institute a rate cap effective from June 2007 through December 2010.

b. Protesters' Concerns

44. Wabash Valley argues that there is inadequate mitigation in place to protect wholesale customers from a transmission rate increase. Wabash Valley argues that the proposed mitigation measure are meaningless and are of no real benefit to wholesale customers. Southwestern argues that customers would not be held harmless if the application is approved.

c. Discussion

45. We are unable to make a determination at this time regarding the effect on rates. As discussed above there is uncertainty regarding the rate treatments, and thus, we are setting the rates for hearing. Accordingly, we will defer issuing an order on the disposition of facilities pending the outcome of the hearing ordered above.

4. Other Issues

46. Soyland argues that the proposed transaction could result in degradations and/or interruptions in service and a less reliable system. We disagree. Soyland's arguments are speculative; it provides no evidence that such an effect is likely and we see no reason why the disposition proposed here should adversely affect service.

47. In addition, we note that Section 6.16 of the Asset Purchase Agreement purports to limit the Commission's review of IETC's rates, charges, terms and conditions for electric transmission service to the public interest standard. This proposed language conflicts with Commission precedent against binding the Commission, without its consent, to a public interest standard of review. As we have explained, we are not bound to employ a public interest standard of review when we undertake our initial review of an agreement or when we are acting sua sponte or at the request of non-parties to change

rates, terms and conditions in order to protect non-parties. While we have proposed to change this policy with regard to market-based power sales,²⁰ the rationale for that proposed policy change does not apply here, where we are dealing with transmission service (by its nature a monopoly service) and a contract that is essentially seeking to set not only the respective rights and obligations of the contractual parties, but also the rates that third parties will pay.

D. Related Contracts and Agreements

48. Applicants have included as Exhibits to the Asset Purchase Agreement various other agreements between Illinois Power and IETC that relate to and define their ongoing relationship with regard to open access transmission service, ancillary services, interconnection arrangements between Illinois Power and IETC, the joint use of real estate rights, operation and maintenance services and future competition among the parties. These agreements include: the Services Agreement; the Network Integration Transmission Service Agreement (NITSA); the Purchase and Sale Agreement for Ancillary Services-Related Resources (ASA); the Distribution-Transmission Interconnection Agreement (DTIA); the Easement Agreement and the Common-Use Right-of-Way and Pole Attachment Agreement (Use Agreements); and the Non-Competition Agreement. Applicants request approval of the NITSA, ASA, DTIA and Wholesale Distribution Service under section 205 of the FPA, without refund obligation or other conditions.

1. Services Agreement

49. The Services Agreement provides that Illinois Power, as the Contractor, will provide certain operational services to IETC for a minimum period of five years, with an option to extend. These services are broken down into three categories: (1) Field Services consisting of Operational, Maintenance and Inspection Work, Demand Work, Major Maintenance Work, Capital Work, and Spare Parts Inventory Management; (2) Transition Services; and (3) Control Center Support Services.

50. Transition Services, Operational, Maintenance and Inspection Work, Demand Work, and Major Maintenance Work services will be priced at cost plus a 5 percent management fee adder. Capital Work services are subject to a competitive bidding

²⁰Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 67 Fed. Reg. 51,516 (2002) (Docket No. PL02-7-000).

process by IETC, but Illinois Power is given an opportunity to bid. Spare Parts Inventory Management services are priced based upon Illinois Power's normal material loading charged by Illinois Power for analogous equipment maintained for use on Illinois Power's distribution system. Control Center Support Services are priced at the lump sum annual amount of \$2,775,000 payable in equal monthly installments (\$231,250). This lump sum will escalate at 4 percent per annum on each anniversary of the effective date. Finally, all of these services are subject to a \$292,000 monthly fee to cover general and administrative costs.²¹

51. All work and services under the Services Agreement are to be provided under the direction and control of, and at the discretion of IETC subject to Section 14 of the Services Agreement which details the independent contractor relationship between Illinois Power and IETC and reads: "In the performance of the Operational Services, [Illinois Power] shall be an independent contractor with the sole authority to control and direct the performance of the details of the Operational Services, including the means, methods, techniques, sequences and procedures, [IETC] being only interested in the results obtained, to the extent herein warranted."

a. 205 Filing

52. Illinois Power did not request approval of the Services Agreement under section 205 of the FPA and, in response to a Commission data request, asserts that the services it will provide do not comprise jurisdictional service under the Federal Power Act and do not require that a rate schedule be filed with the Commission. It claims that "these services are input costs to the provision of jurisdictional transmission service for which IETC, as the provider of jurisdictional service, has discretion to incur in its business judgment."²²

53. In Prior Notice and Filing Requirements Under Part II of the Federal Power Act, 64 FERC ¶ 61,139 (1993), the Commission set forth a two-part test to determine when

²¹Applicants' answer did not address the Services Agreement. However, Applicants did respond to questions in the January 23 data request regarding cost support for certain services under the Services Agreement. Applicants generally responded that the lump sum payment for control center support services as well as the 5 percent management fee was a result of arm's-length negotiations and are for services that do not comprise jurisdictional services that need to be filed under the FPA.

²²Illinois Power response to Data Request No. 1.

O&M-type agreements are subject to the Commission's jurisdiction under section 205 of the FPA. First, can the O&M service at issue be tied to wholesale sales or to transmission in interstate commerce (for instance, does the O&M agreement contain rates or charges for or in connection with transmission or sales for resale in interstate commerce, or does it in any manner affect or relate to jurisdictional rates or services). Second, does a public utility provide the O&M service? If the answer to both questions is yes, then the O&M agreement must be filed for Commission review.²³

54. The Commission concludes that the Services Agreement is subject to its jurisdiction and thus must be filed under section 205 of the FPA. The services provided by Illinois Power under the Services Agreement (for operational purposes Illinois Power will continue to manage the system much as it does now as the owner) will affect and/or relate to jurisdictional rates or services. Not only will the costs of these services be ultimately reflected in rates charged by IETC, but Illinois Power's provision of Transition Services (implementing schedules into or out of the control area), among other services, directly involves the provision of transmission services.²⁴ As to the second question, the Commission concludes that Illinois Power will continue to be a public utility. Illinois Power will continue to operate facilities used to provide transmission services in interstate commerce that are jurisdictional to the Commission under section 205 of the FPA.²⁵ Accordingly, we find that the Services Agreement must be filed under section 205 of the FPA.

²³We note that even if the entity providing the O&M service is not a public utility, if such O&M service is being provided to a public utility (such as an independent transmission company or RTO), the Commission has the authority to require that the agreement be filed by the public utility for whom the O&M service is being provided because it is a contract affecting that public utility's jurisdictional services.

²⁴Even if Illinois Power were not providing transmission services, the services provided by Illinois Power under the Services Agreement (for operational purposes Illinois Power will continue to manage the system much as it does now as the owner) will affect and/or relate to jurisdictional rates or services, and IETC would have to file the Services Agreement with the Commission.

²⁵See *Bechtel Power Corp.*, 60 FERC ¶ 61,156 (1992). We also note that Illinois Power will provide Wholesale Distribution Service that is subject to the Commission's jurisdiction under section 205 of the FPA.

b. Nature of Services Performed and Transition Period

55. We recognize that Illinois Power, as the Contractor, will provide IETC with assistance during this transition period and that its previous experience will be valuable. However, IETC must assume ultimate authority. While historically, independence of independent transmission companies was viewed primarily in terms of active or passive ownership interests in the independent transmission company by market participants, we believe that there are additional factors that have a bearing on whether the operational responsibilities of the transmission owner are performed independent of market participants. For instance, in our view, an independent transmission company that directly employs all of the people who work on the transmission system will operate with greater independence than if it were staffed by employees of transmission owners affiliated with market participants.

56. The Commission believes this is a situation which, due to the encompassing nature of the Services Agreement, warrants close attention to ensure that it does not undermine independence. Under the Services Agreement, Illinois Power essentially will be performing the same day-to-day functions necessary to operate the transmission assets in its capacity as a contractor to IETC as it does as the current owner of the assets.²⁶ While there could be valid reasons for some type of interim arrangement in order to ensure a smooth transition to new ownership, the Commission believes that the initial five-year term is too long. The mere existence of the Services Agreement leads to the perception that operation of the IETC system may not be completely independent.

57. Additionally, the amount and breadth of the services provided to IETC by Illinois Power raise the potential that Illinois Power's affiliates could unfairly benefit under the arrangement if Illinois Power were to operate the transmission facilities in a preferential manner. For instance, in the area of Control Center Support Services, Illinois Power

²⁶This is in contrast to the agreement (Secondment Agreement) for services submitted in Trans-Elect's proceeding to purchase METC's transmission assets. That agreement provided for services to Trans-Elect, after closing, by certain employees of Consumers Energy, for a period of up to two years. Under the agreement, Trans-Elect retained full control over the employees. Furthermore, those employees had no duty of loyalty to Consumers Energy and, rather, owed a duty of confidentiality to Trans-Elect. While the employees remained on Consumers Energy's payroll; Trans-Elect reimbursed Consumers Energy for their salaries, wages and employee benefits on an actual cost basis. Additionally, Trans-Elect had the option to hire any of these employees, during or after the service period, without the consent of Consumers Energy.

will, among other things, direct transmission system switching and tagging activities, evaluate requests for equipment outages and system configuration changes and reconfigure the system to maximize reliability and/or throughput. These functions could possibly be conducted in a manner that could favor Illinois Power affiliates.

58. Therefore, we will limit the period for IETC contracting with Illinois Power to one year from the service commencement date. After one year, we would expect IETC to have in place the staff and other resources necessary to operate as a transmission business entity. However, if IETC determines that it continues to need to contract for support services, it must issue a Request For Proposal (RFP) seeking competitive bids sufficiently in advance of the end of the first year of operations such that at the beginning of the second year of operations Illinois Power will no longer provide the required services. Any services agreement resulting from the RFP process must be with a non-market participant and must be filed with the Commission under section 205 of the FPA.

3. Network Integration Transmission Service Agreement

59. The Network Integration Transmission Service Agreement (NITSA) will govern the provision of network transmission service to Illinois Power as a transmission customer over IETC's transmission facilities.

60. IIEC is concerned that Illinois Power's obligation under the NITSA with IETC to collateralize its financial obligation to IETC for network transmission service may adversely affect Illinois Power's ability to provide reliable distribution service. More specifically, IIEC believes that the collateral requirement will impose significant costs that may limit Illinois Power's ability to fund necessary investment. IIEC claims that it is uncertain whether Illinois Power will be able to contract for transmission service needed to fulfill its obligation to provide safe and reliable service to its bundled retail customers.²⁷

61. Applicants respond by stating that Illinois Power has "carefully evaluated its obligations under the NITSA before agreeing to these [obligations] and concluded that those obligations will have no impact on Illinois Power's ability to continue to reliably satisfy the energy demands of its native load customers."²⁸ Applicants assert that the NITSA will have no adverse impact on Illinois Power's future infrastructure investments.

²⁷ Illinois Industrial Electric Protest at 9-10.

²⁸ Applicants' Answer at 17.

62. The Commission does not share IIEC's concern regarding the collateral obligation in the NITSA. We find that the collateral obligation is a just and reasonable instrument to help ensure the financial integrity of the transaction. Moreover, concerns regarding Illinois Power's ability to fund investment are speculative. However, Section 11 of the NITSA purports to limit the Commission's review of IETC's Rate Treatments, rates, charges, terms and conditions for electric transmission service to the public interest standard. As discussed in Section C.4, supra, this proposed language conflicts with Commission precedent against binding the Commission, without its consent, to a public interest standard of review. Accordingly, we will accept the NITSA for filing, as modified to remove the language purporting to bind the Commission to a public interest standard of review, and will waive the 120-day advance notice requirement, to the extent necessary, to allow the agreement to become effective as of the date of closing, as requested. Applicants must submit a compliance filing within 30 days of the date of this order to reflect the modifications required above.

4. Other Agreements

63. The ASA sets forth the terms and conditions under which Illinois Power will offer and provide the necessary resources for IETC to meet its ancillary service obligations. The ASA's initial term ends December 31, 2004, unless extended by the parties. Additionally, IETC has waived its rights under the FPA to protest or complain about the rates (i.e., subject to the public interest standard) through January 1, 2007, unless the rate methodology changes or new rates are added. The specific service schedules for these ancillary services are derived from, and in many cases identical to, existing schedules in the Illinois Power OATT. These services will be provided under rates, terms and conditions that replicate the service now provided by Illinois Power.²⁹ The DTIA establishes the rights, responsibilities and obligations regarding the interconnection and use of Illinois Power's distribution system and IETC's transmission facilities. The Use Agreements between IETC and Illinois Power, among other things, provides IETC an easement to property owned by Illinois Power on which both parties own facilities and provides that the parties coordinate the operation and maintenance of their respective facilities on the IETC rights-of-way.³⁰ Applicants state that unlike the METC

²⁹To the extent IETC purchases ancillary services from Illinois Power under the ASA, IETC will pass through all charges collected from transmission customers to Illinois Power.

³⁰This is in contrast to the Easement Agreement in the METC proceeding which,
(continued...)

acquisition, where the sale did not include the land on which the transmission facilities were located, IETC is purchasing the transmission facilities and acquiring land rights underneath those facilities.

64. Article 10 of the ASA purports to limit the Commission's review of Illinois Power's rates, charges, terms and conditions for service under this Agreement prior to January 1, 2007, to the public interest standard. As discussed in Section C.4, supra, this proposed language conflicts with Commission precedent against binding the Commission, without its consent, to a public interest standard of review. Accordingly, we will accept the ASA for filing, as modified to removed the language purporting to bind the Commission to a public interest standard of review, and will waive the 120-day advance notice requirement, to the extent necessary, to allow the ASA to become effective as of the date of closing, as requested. Applicants must submit a compliance filing within 30 days of the date of this order to reflect the modification required above. In addition, we will accept the DTIA for filing and will waive the 120-day advance notice requirement, to the extent necessary, to allow the DTIA to become effective as of the date of closing, as requested.

E. Reclassification of Local Distribution and Transmission Facilities

65. Applicants state that Illinois Power recently conducted an analysis of its transmission and local distribution systems under the Commission's "seven-factor test" set forth in Order No. 888 and concluded that (1) certain electric lines currently classified as "transmission" should be classified as "local distribution;"³¹ and (2) certain substations should be reclassified as "transmission." Applicants state that Illinois Power will sell to IETC those assets classified as transmission facilities as a result of the seven-factor test analysis. On January 23, 2003, Illinois Power submitted to the Commission, the Illinois

³⁰(...continued)

as proposed, did not allow Trans-Elect to have the same rights to use the land for transmission additions or expansions as Consumers Energy could have exercised before the transfer of facilities. We indicated in that proceeding that our fundamental problem with the proposed easement arrangement was that use of the land for transmission additions or expansions would be subordinate to the use of the land by Consumers Energy for non-transmission purposes. 98 FERC ¶ 61,142 at 61,422 (2002).

³¹Illinois Power proposes to reclassify three 69 kV lines as local distribution.

Commission's order approving the proposed reclassification. Illinois Power requests that the Commission accept the reclassification as approved by the Illinois Commission.³²

66. Southwestern is concerned that the Applicants' proposed reclassification may lead to less RTO control of facilities that have been reclassified as local distribution. Southwestern also questions whether it is necessary for these facilities to be reclassified in conjunction with the sale of transmission assets when Illinois Power has already gained the approval of the Illinois Commission for its reclassification in 1999.

67. Soyland argues that as a result of the proposed reclassification rate increases on both the transmission and local distribution side could result. In addition, Soyland argues, Illinois Power is likely to request an increase in its revenue requirement for the remaining local distribution facilities, and that the resulting rate increase is unjust and unreasonable.

68. Applicants respond that the Protesters' arguments are without merit. Applicants maintain that the reclassification is consistent with state law and Commission precedent. In response to Soyland, Applicants explain that a recent analysis demonstrated the need for a limited reclassification to permit the distribution system and transmission system to be operated separately. Further, Applicants explain that the limited reclassification would result in a net increase of \$616,000 in the net book cost of transmission plant and a net decrease of \$616,000 in the net book cost of distribution plant. They state that the reclassification is necessary to ensure that Illinois Power continues to be able to provide reliable distribution service and ensures that all facilities necessary for transmission are included in IETC's rate base.

69. Consistent with Order No. 888 and prior Commission orders, we are persuaded to defer to the Illinois Commission and adopt the Illinois Commission's determination concerning the reclassification of facilities.³³ However, we reiterate our finding in Order No. 888 that to the extent that any facilities, regardless of their original nominal classification, in fact, prove to be used by public utilities to provide transmission service in interstate commerce in order to deliver power and energy to wholesale purchasers, such facilities become subject to this Commission's jurisdiction and review.³⁴ In addition, the rates, terms and conditions of all wholesale and unbundled retail

³²Application at 67-68.

³³See Order No. 888 at 311,783-84; Order No. 888-A at 30,336; see also MidAmerican Energy Co., et al., 90 FERC ¶ 61,105 (2000).

³⁴See Order No. 888 at 31,969.

transmission service provided by public utilities in interstate commerce are subject to this Commission's jurisdiction and review.

The Commission orders:

(A) The Commission hereby accepts the NITSA, as modified, the ASA, as modified, and the DTIA for filing, as discussed in the body of this order.

(B) Applicants' proposed rates for Wholesale Distribution Service are hereby accepted for filing and suspended for a nominal period, to become effective as of the date of closing, as requested, subject to refund, and set for hearing, as discussed in the body of this order.

(C) Applicants' other proposed rates are hereby set for hearing, as discussed in the body of this order.

(D) Applicants are hereby directed to submit a compliance filing modifying the NITSA and the ASA within 30 days of the date of this order, as discussed in the body of this order.

(E) Trans-Elect is hereby directed to file the Illinois Transco Holdings, LP partnership agreement as soon as it is executed, as discussed in the body of this order.

(F) The request for reclassification is hereby granted, as discussed in the body of this order.

(G) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly Sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held concerning Applicants' proposed rates.

(H) A presiding administrative law judge, to be designated by the Chief Administrative Law Judge, shall convene a prehearing conference in this proceeding, to be held within approximately fifteen days of the date of this order in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C., 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on

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all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.