

Docket No. ER98-1438-015, et al.

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Commission's Uniform System of Accounts properly classified in Account No. 182.3, Other Regulatory Assets. (Footnote omitted).

February 24 Order, 102 FERC at P 30.

2. Louisville Gas and Electric Company and Kentucky Utilities Company (LG&E/KU) filed a joint request for rehearing of the February 24 Order.
3. The Public Service Commission of the Commonwealth of Kentucky (Kentucky Commission) and the Midwest ISO Transmission Owners (Midwest ISO TOs)³ filed separate requests for rehearing and clarification of the February 24 Order.
4. We will discuss these requests below.

Discussion

5. The requests for rehearing and/or clarification raise three major issues on which the parties assert that the Commission erred in the February 24 Order. First, the parties essentially renew their arguments raised in the underlying proceedings that bundled retail and grandfathered wholesale load should not be included in the calculation of the ISO Cost Adder. Second, they argue that bundled retail load should not be included in the calculation of the ISO Cost Adder because this load does not cause Midwest ISO to incur administrative costs. Third, the parties assert that ISO Cost Adder charges that are attributed to bundled retail load in states with rate freezes or grandfathered wholesale load will produce costs that cannot be recovered (i.e., trapped costs). Below we will address these issues and the specific concerns that stem from them.

6. As we discuss below, we again deny the requests to revise our decision that requires Midwest ISO to include bundled retail and grandfathered wholesale load in the calculation of the ISO Cost Adder.

³LG&E/KU also join the rehearing request filed by the Midwest ISO TOs.

A. What is the effect of the transition period on including bundled retail and grandfathered wholesale load in the calculation of the ISO Cost Adder?

1. Objections to the February 24 Order

7. The Kentucky Commission asserts that if the Commission wishes to mandate treatment for bundled retail load different than originally proposed by the Midwest ISO TOs, it must make the two-part finding required under Section 206 of the Federal Power Act (FPA)⁴ that: (I) the proposal to exclude bundled retail load from the calculation of the ISO Cost Adder is unjust and unreasonable; and (ii) inclusion of bundled retail load in the ISO Cost Adder is just and reasonable.⁵ The Kentucky Commission argues that Section 206 must be applied here because the Commission accepted the proposal to exclude these loads during the six-year transition period in the September 16 order.⁶

8. LG&E/KU assert that the transition period, during which Midwest ISO originally proposed to defer the bundled retail loads' responsibility for the ISO Cost Adder and capital charges was essential in persuading them to join Midwest ISO. LG&E/KU also contend that the transition period compromise did not unduly burden other Midwest ISO customers because the ISO Cost Adder was capped during the transition period and costs not recovered through the capped charge were deferred for recovery by Midwest ISO after the transition period.

2. Commission Determination

9. We disagree with the parties' interpretation of the September 16 Order. In that order, we approved Midwest ISO's proposed six-year transition period. The central features of the transition period agreed to by the Midwest ISO TOs provided for a zonal rate structure (rather than immediate imposition of a single Midwest ISO-wide rate) and

⁴16 U.S.C. § 824e (2000).

⁵Kentucky Commission Rehearing Request at 2-3.

⁶Midwest Independent Transmission System Operator, Inc., et al., 84 FERC ¶ 61,231 (September 16 Order), order on reconsideration, 85 FERC ¶ 61,250, order on reh'g, 85 FERC ¶ 61,372 (1998).

preservation of the rates, terms and conditions of existing contracts.⁷ However, we explicitly set for hearing the justness and reasonableness of the proposed ISO Cost Adder under Section 205 of the FPA.⁸ We have repeatedly explained to the parties that the six-year transition period is still operational.⁹ In light of the fact that we suspended the ISO Cost Adder and set that issue for hearing pursuant to Section 205; accordingly, we find that it is not necessary to institute a Section 206 proceeding on this issue.¹⁰

10. Furthermore, we will not change our decision because LG&E/KU relied on the proposed deferral of bundled retail loads' responsibility for the ISO Cost Adder and capital charges when making their decision to join Midwest ISO. The Commission cannot be bound by the unreasonable assumption that it will approve a proposed tariff provision as just and reasonable simply because an entity relied on that provision. Moreover, in the underlying orders, the Commission has found that existing bundled retail and grandfathered wholesale loads benefit from the regional grid, and, although the ISO Cost Adder is capped, that charge covers the costs that Midwest ISO incurs to operate the grid for all users. In Opinion No. 453, the Commission said: "to ensure that all loads will properly bear a fair share of the Midwest ISO's costs, all long-term firm, bundled retail, and grandfathered load should be included in the divisor in developing the Cost Adder." Opinion No. 453, 97 FERC ¶ 61,033 at 61,169.

B. Should ISO Cost Adder charges be applied to bundled retail load?

1. Objections to the February 24 Order

11. The Midwest ISO TOs assert that the Commission erred when it adhered to the decision that bundled retail and grandfathered wholesale load must bear a portion of the

⁷84 FERC ¶ 61,250 at 62,167.

⁸16 U.S.C. § 824d (2000).

⁹See, Opinion No. 453, 97 FERC ¶ 61,033 at 61,171; Opinion No. 453-A, 98 FERC ¶ 61,141 at 61,410; 102 FERC at 61,530, 61,532.

¹⁰See Opinion No. 453-A, 102 FERC at P 15. "Since Opinion Nos. 453 and 453-A represent an appropriate exercise of the Commission's authority under Section 205 of the FPA, there was no need for the Commission to examine the proposed ISO Cost Adder as if it had already been unconditionally accepted (i.e., examined under the Section 206 standard)."

ISO Cost Adder costs. They argue that the Commission failed to follow its precedent and apply the cost causation principle to this adder.¹¹

12. The Midwest ISO TOs argue that the Commission must conduct an inquiry into whether the allocation of costs to bundled retail and grandfathered wholesale load is commensurate with the benefits those loads receive. They argue that Midwest ISO does not actually operate the transmission system and that the Midwest ISO TOs continue to perform all of the hands-on operation of the system. They also argue that bundled retail loads do not rely on Midwest ISO as unbundled loads do because bundled loads do not directly use the open access services administered by Midwest ISO.¹²

13. LG&E/KU assert that service to their bundled load has not materially changed in the wake of Midwest ISO's "control" and no change is expected in the future, primarily because they are already low-cost providers. LG&E/KU argue, assuming arguendo, that the Commission finds that they actually cause Midwest ISO to incur administrative costs, the Commission should permit the original proposal of deferring the charge of the ISO Cost Adder until the end of the six-year transition period because of the benefits that they provide to the Midwest ISO participants (i.e., availability of excess low-cost power beyond that needed to satisfy native load and significant connection to other transmission systems in the south).¹³

14. The Kentucky Commission also argues that the Commission violated its cost causation policy because the record does not support a finding that bundled retail customers derive significant benefits from Midwest ISO's activities. The Kentucky Commission points out that there is little need for utilities in Kentucky, let alone their retail customers, to access the bulk power markets in search of lower cost power. It argues that, Kentucky and other states' bundled retail customers are unlikely to utilize Midwest ISO's services as compared to unbundled customers or derive significant benefits from Midwest ISO Operation. The Kentucky Commission asserts that bundled

¹¹See Midwest ISO TOs Rehearing Request at 2. The Midwest ISO TOs assert that the Commission has consistently applied the cost causation principle to ISO and RTO cost recovery adders, citing: ISO New England, Inc., 85 FERC ¶ 61,453 at 62,279 (1998); Central Hudson Gas & Electric Corp. et al., 86 FERC ¶ 61,062 at 61,215, Opinion No. 457, 100 FERC ¶ 61,023 (2000); and PJM Interconnection, L.L.C., 92 FERC ¶ 61,114 (2002)

¹²Midwest ISO TOs Rehearing Request at 15.

¹³See LG&E/KU Rehearing Request at 2-3.

retail load may shoulder most of Midwest ISO's administrative costs under the Commission's approach.¹⁴ The Kentucky Commission argues that the Commission should institute further procedures to determine the just and reasonable allocation of the ISO Cost Adder to bundled retail load ISO.¹⁵

2. Commission Determination

15. The parties have presented no new arguments or evidence to establish that Midwest ISO's administration of the grid does not provide significant benefits to all users of the grid, including bundled retail load. We reiterate that bundled retail and grandfathered wholesale loads, including LG&E/KU's, benefit from the services provided by Midwest ISO,¹⁶ and, therefore, that in order for the ISO Cost Adder to be just and reasonable, bundled retail and grandfathered wholesale load must be included in the calculation of the ISO Cost Adder.

16. The issue of benefits related to Midwest ISO's services is implicated in another pending proceeding. In Midwest Independent Transmission System Operator, Inc.,¹⁷ the Commission accepted and suspended proposed tariff revisions and established hearing and settlement judge procedures related to the applicability of the ISO Cost Adder.¹⁸

17. We note that LG&E and the Midwest ISO TOs protested the filing in Docket No. ER02-111-000 in part because Midwest ISO proposed to unbundle the services for ITCs

¹⁴See Kentucky Commission Rehearing Request at 13. See also LG&E/KU Rehearing Request where they allege that approximately 90% of their load is bundled retail load.

¹⁵See Kentucky Commission Rehearing Request at 11.

¹⁶See Opinion No. 453-A, 98 FERC ¶ 61,141 at 61,412.

¹⁷97 FERC ¶ 61,268 (2001), order denying reh'g, 98 FERC ¶ 61,267, certification of contested settlement, 99 FERC ¶ 63,040, supplement to settlement certification, 100 FERC ¶ 63,002 (2002), order on compliance filing, 101 FERC ¶ 61,113 (2002), order on contested settlement 102 FERC ¶ 61,193 (2003) (MISO - ER02-111).

¹⁸The proposed revisions included Midwest ISO's proposal to modify Schedule 10 of its OATT to provide Independent Transmission Companies (ITC) that join Midwest ISO under Appendix I of the Midwest ISO Transmission Owners' Agreement the option of electing bundled or unbundled Regional Transmission Operator (RTO) services.

but not any others. They argued that such a provision "will permit the Midwest ISO to discriminate against classes of customer that do not fully utilize its services. [They] argue[d] that unbundled Schedule 10 charges should be available to all customers on a non-discriminatory basis."¹⁹ Subsequently, a settlement agreement was filed resolving a number of issues and a partial settlement was approved by the Commission.²⁰ In addition, we note that, in a letter dated May 30, 2003, filed in Docket No. ER02-111-000, et al., Midwest ISO filed a status report with the settlement judge which indicates that the parties have reached a settlement in principle on the remaining issues and anticipate a filing no later than June 20, 2003. To the extent LG&E/KU's concern with respect to unbundling of the ISO Cost Adder is not resolved by the settlement, we will address their concern in that proceeding.

C. Does the February 24 Order cause the TOs to incur trapped costs from bundled retail load and grandfathered wholesale load?

1. Objections to the February 24 Order

18. The Midwest ISO TOs argue that the Commission, by casting aside the six-year transition period, an important compromise that led to the formation of Midwest ISO,

¹⁹MISO-ER02-111, 97 FERC ¶ 61,228 at 62,151.

²⁰See MISO-ER02-111, 102 FERC ¶ 61,193 (2003). The partial settlement provides:

Section 2.5 of Article II reflects the commitment of the Midwest ISO to study the feasibility and desirability of unbundling its Section 10 adder. Section 2.5 provides that, by no later than March 1, 2003, the Midwest ISO shall initiate a stakeholder process to seek input on whether Midwest ISO's Schedule 10 should be revised to develop a menu of services or unbundling of services applicable to all customers or loads paying the Schedule 10 charges. By June 1, 2003, the Midwest ISO will engage in good faith negotiations with the parties to this proceeding on developing a filing regarding such revisions. If after such negotiations, no filing is made or a filing is made which any party does not fully support, then that party shall have the right to submit any proposal regarding a menu or unbundling of services to the Commission it desires, and no party shall object to the right to make such a filing.

imposes on them a large amount of new costs that were not contemplated in their current retail rates and that may currently be difficult or impossible to recover at the state level.

19. The Midwest ISO TOs argue that the Commission has and should exercise its authority to preempt retail rate freezes that are the reason that the ISO Cost Adder charges will be unrecoverable from retail customers.²¹

20. The Midwest ISO TOs argue that they will be unable to recover ISO Cost Adder charges at the transmission-owner level with respect to grandfathered wholesale load as well. As part of that problem, the Midwest ISO TOs point to the Commission's refusal to establish a mechanism for direct recovery of these costs from these customers. They argue that the Commission's suggestion that transmission owners can seek to amend these grandfathered agreements pursuant to Section 206 of the FPA,²² is an insufficient remedy. They note that if the contracts can only be amended pursuant to Section 206, then the transmission owners may well face the argument that a party to the agreement can only amend such a contract if it satisfies the "public interest" standard.

21. Finally, the Midwest ISO TOs question the efficacy of treating the trapped costs as regulatory assets. They assert that the Commission's regulations permit regulatory assets only when it is probable that costs that are not recoverable in a current period will be permitted by regulators to be included in rates later. The Midwest ISO TOs argue this raises the question whether the Commission intends that the probability of later rate recovery is to be determined by state action or by the Commission's actions.²³

22. The Kentucky Commission objects to the Commission's decision to include bundled retail load in the calculation of the ISO Cost Adder because, it argues, that this decision does not accommodate the policy choices that the state of Kentucky has made concerning electric service in the Commonwealth. According to the Kentucky Commission, "states that have chosen to unbundle have made a policy choice that customers will benefit from access to a broader supply market. States that have maintained bundled retail markets, on the other hand, have made a choice that retail customers are better served by [the] continuance of the vertically integrated utility

²¹See Midwest ISO TOs Rehearing Request at 22.

²²16 U.S.C. § 824e (2000).

²³See Midwest ISO TOs Rehearing Request at 25.

framework."²⁴ The Kentucky Commission argues that the Commission's decision to assess the ISO Cost Adder on bundled retail load fails to consider the fact that customers in states that have chosen not to unbundle derive less benefit from RTO operation.²⁵

23. The Kentucky Commission requests clarification that the Commission's invitation for parties to make filings for regulatory asset treatment does not include treatment of costs subject to recovery in bundled retail rates. The Kentucky Commission also seeks clarification that the Commission has not established a new standard by which regulatory asset treatment will be authorized by replacing the existing requirement of a showing that it is probable that costs will be recoverable in future rates, with a standard that merely requires a showing that costs are unrecoverable in existing rates.

2. Commission Determination

24. The parties have not raised any new arguments or introduced any new evidence to establish that bundled retail and grandfathered wholesale loads should not be included in the calculation of the ISO Cost Adder.²⁶ As we explained above, the proposed ISO Cost Adder was not approved in the September 16 Order as part of the six-year transition period, but was suspended and set for hearing to determine whether it was just and reasonable under FPA § 205.

25. While the February 24 Order allowed the parties to make a filing with the Commission demonstrating and supporting their assertion that such costs are indeed currently unrecoverable and should be treated as a regulatory asset, at this juncture, no party has submitted to the Commission evidence of grandfathered wholesale agreements that do not permit the Midwest ISO TOs to unilaterally change the rates pursuant to Section 205 of the FPA.²⁷ Nor has any party provided any evidence of bundled retail rate

²⁴See Kentucky Commission Rehearing Request at 16.

²⁵Id. at 16.

²⁶We believe our finding that all loads benefit from the use of Midwest ISO's grid in the underlying proceeding addresses the Kentucky Commission's argument that by assigning the ISO Cost Adder to customers in states that have chosen not to unbundle derive fewer benefits from RTO operation.

²⁷Indeed, LG&E/KU recently filed under Section 205 to modify rates under two grandfathered agreements. The revised agreements were accepted for filing with a

(continued...)

agreements that are "capped" (or frozen), or evidence of how long the rates are "capped" or whether these "capped" rates nevertheless contain provisions that would allow a Midwest ISO TO to pass through the ISO Cost Adder to the retail customers. Nor have any of the parties alleged that they have tried but failed to renegotiate the grandfathered wholesale load agreements to allow for recovery of the ISO Cost Adder. Consequently, we are not persuaded that a Section 206 finding addressing the assessment of the Cost Adder to bundled retail load is necessary at this time. Nor are we persuaded that it is necessary to preempt a specific rate freeze.

26. Furthermore, the parties' argument denigrating the potential for obtaining a discounted ISO Cost Adder charge from Midwest ISO is unpersuasive and premature. No party has indicated that they have been unsuccessful in negotiating this type of discount with Midwest ISO.

27. We disagree with the parties' assertions that our decision to include bundled retail load in the ISO Cost Adder infringes on states' authority. Our decision here, and in the underlying proceedings, permits the retail rate contracts to remain effective, as approved by the relevant state commission, therefore we find that we have not infringed on states' retail rate authority.²⁸

28. As to the Midwest ISO TOs comments regarding regulatory assets, the Commission notes that it did not approve or direct any transmission owner to recognize a regulatory asset for the ISO Cost Adder costs. To the contrary, we found that the record in this proceeding was not sufficient to support that result.²⁹ However, we provided the parties an opportunity to make an additional filing with the Commission that clearly demonstrates that the costs are not recoverable through existing rates and that recovery in

²⁷(...continued)

nominal suspension, subject to refund. See Louisville Gas & Electric Co., et al., 101 FERC ¶ 61,182 (2002).

²⁸See February 24 Order, 102 FERC ¶ 61,192 at P 23-25. Furthermore, as we pointed out before parties have not shown that these rate freezes were imposed on them without them receiving a corresponding benefit from the state, or that they did not voluntarily accept a rate freeze, nor have they alleged that they would not be able to recover the cost of doing business, as opposed to being unable to recover the ISO Cost Adder (as an additional charge without addressing other rate issues).

²⁹See, MISO-ER02-111, 102 FERC ¶ 61,193 and Midwest Independent Transmission System Operator, Inc., et al., 103 FERC ¶ 61,205 (May 20, 2003).

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future rates is probable. Until and unless the Midwest ISO TOs make such a showing, the ISO Cost Adder costs, like all other operating costs, must be accounted for as current expenses and, as such, are presumed to be recovered in current rates.

29. With respect to the Kentucky Commission concern as to the standard to review rate filings for regulatory asset treatment, we clarify that we will continue to apply the existing standard as set forth in 18 C.F.R. Part 101, Account No. 182.3 (2002). Accordingly, any parties requesting regulatory asset treatment will be required to demonstrate that the costs at issue are both unrecoverable in existing rates and that it is probable that such costs will be recoverable in future rates.

The Commission orders:

- (A) The rehearing requests are hereby denied for the reasons stated herein.
- (B) The requests for clarification are granted to the extent discussed herein.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.