

UNITED STATES OF AMERICA 105 FERC ¶ 61,212
FEDERAL ENERGY REGULATORY COMMISSION

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

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| Midwest Independent Transmission System Operator | Docket Nos. EL02-111-004 EL02-111-005 EL02-111-006 EL02-111-007 EL02-111-008 |
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PJM Interconnection, L.L.C.

and all Transmission Owners
(including the entities identified below)

Union Electric Company

Central Illinois Public Service Company

Appalachian Power Company

Columbus Southern Power Company

Indiana Michigan Power Company

Kentucky Power Company

Kingsport Power Company

Ohio Power Company

Wheeling Power Company

Michigan Electric Transmission Company

Dayton Power and Light Company

Docket No. EL02-111-004, et al.

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Commonwealth Edison Company

Commonwealth Edison Company
of Indiana, Inc.

American Transmission Systems, Inc.

Illinois Power Company
Northern Indiana Public Service Company

Virginia Electric and Power Company

IES Utilities, Inc.

Interstate Power Company

Aquila, Inc. (formerly UtiliCorp United, Inc.)

PSI Energy, Inc.

Union Light Heat & Power Company

Dairyland Power Cooperative

Great River Energy

Hoosier Energy Rural Electric Cooperative

Indiana Municipal Power Agency

Indianapolis Power & Light Company

Louisville Gas & Electric Company

Kentucky Utilities Company

Lincoln Electric (Neb.) System

Minnesota Power, Inc. and its subsidiary
Superior Water, Light & Power Company

Montana-Dakota Utilities

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Northwestern Wisconsin Electric Company

Otter Tail Power Company

Southern Illinois Power Cooperative

Southern Indiana Gas & Electric Cooperative

Southern Minnesota Municipal Power Agency

Sunflower Electric Power Corporation

Wabash Valley Power Association, Inc.

Wolverine Power Supply Cooperative

International Transmission Company

Alliant Energy West

Xcel Energy Services, Inc.

MidAmerican Energy Company

Corn Belt Power Corporation

Allegheny Electric Cooperative, Inc.

Atlantic City Electric Company

Baltimore Gas & Electric Company

Delmarva Power & Light Company

Jersey Central Power & Light Company

Metropolitan Edison Company

PECO Energy Company

Pennsylvania Electric Company

PPL Electric Utilities Corporation

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Potomac Electric Power Company

UGI Utilities, Inc.

Allegheny Power

Carolina Power & Light Company

Central Power & Light Company

Conectiv

Detroit Edison Company

Duke Power Company

GPU Energy

Northeast Utilities Service Company

Old Dominion Electric Cooperative

Public Service Company of Colorado

Public Service Electric & Gas Company

Public Service Company of Oklahoma

Rockland Electric Company

South Carolina Electric & Gas Company

Southwestern Electric Power Company

Cincinnati Gas & Electric Company

Missouri Public Service

WestPlains Energy

Cleco Corporation

Kansas Power & Light Company

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OG+E Electric Services

Southwestern Public Service Company

Empire District Electric Company

Western Resources

Kansas Gas & Electric Co.

Ameren Services Company

on behalf of:

Union Electric Company

Central Illinois Public Service Company

Docket No. EL03-212-002

American Electric Power Service Corporation

On behalf of:

Appalachian Power Company

Columbus Southern Power Company

Indiana Michigan Power Company

Kentucky Power Company

Kingsport Power Company

Ohio Power Company

Wheeling Power Company

Dayton Power and Light Company

Exelon Corporation

On behalf of:

Commonwealth Edison Company

Commonwealth Edison Company
of Indiana, Inc.

FirstEnergy Corporation

On behalf of:

American Transmission Systems, Inc.

Illinois Power Company

Northern Indiana Public Service Company

Docket No. EL02-111-004, et al.

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American Electric Power Service Corporation

Docket No. EL04-4-000

On behalf of:

Appalachian Power Company
Columbus Southern Power Company
Indiana Michigan Power Company
Kentucky Power Company
Kingsport Power Company
Ohio Power Company
Wheeling Power Company

Commonwealth Edison Company
Commonwealth Edison Company of Indiana, Inc.
The Dayton Power and Light Company

v.

Midwest Independent Transmission System Operator, Inc.

American Electric Power Service Corp., et al.

Docket No. EL04-5-000

Commonwealth Edison Co.
Commonwealth Edison Company of Indiana, Inc.
Dayton Power and Light, Co.

v.

PJM Interconnection, LLC

American Electric Power Service Corp., et al.

Docket No. EL04-6-000

Commonwealth Edison Co.
Commonwealth Edison Company of Indiana, Inc.
Dayton Power and Light, Co.

v.

Ameren Services Co.

American Electric Power Service Corp., et al.

Docket No. EL04-7-000

Commonwealth Edison Co.
Commonwealth Edison Company of Indiana, Inc.
Dayton Power and Light, Co.

v.

Illinois Power Co.

American Electric Power Service Corp., et al.

Docket No. EL04-8-000

Commonwealth Edison Co.
Commonwealth Edison Company of Indiana, Inc.

v.

Dayton Power and Light, Co.

Docket No. EL02-111-004, et al.

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American Electric Power Service Corp., et al.
Dayton Power and Light, Co.

Docket No. EL04-9-000

v.

Commonwealth Edison Co.
Commonwealth Edison Company of Indiana, Inc.Commonwealth Edison Co.
Commonwealth Edison Company of Indiana, Inc.
Dayton Power and Light, Co.

Docket No. EL04-10-000

v.

American Electric Power Service Corp., et al

ORDER DENYING REHEARING IN PART AND GRANTING REHEARING IN
PART, DIRECTING COMPLIANCE FILINGS, AND DISMISSING COMPLIANCE
FILINGS AND COMPLAINTS

(Issued November 17, 2003)

1. In this order, we grant in part, and deny in part, requests for rehearing of the July 23 Order¹ that pertain to Docket No. EL02-111. We also make findings with respect to a new rate design for regional through and out service and direct compliance filings to implement that rate design effective April 1, 2004. This order benefits customers by ensuring that the design of rates of regional transmission organizations (RTOs) promotes efficient and competitive electricity markets in accordance with the requirements of Order No. 2000.²

¹ Midwest Independent Transmission System Operator, et al., 104 FERC ¶ 61,105 (2003) (July 23 Order).

² Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 & 31,089 at 31,086 (1999), order on reh-g, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 & 31,092 (2000), aff'd sub nom. Public Utility District No. 1 of Snohomish County Washington, et al. v. FERC, 272 F.3d 607 (D.C. Cir. 2001).

I. Background

2. In the Initial Decision in Docket No. EL02-111-000,³ the Presiding Judge determined that there was a lack of precedential authority that would permit him to eliminate the Regional Through and Out Rates (RTORs)⁴ for transactions between the expanded Midwest Independent Transmission System Operator, Inc. (Midwest ISO) and expanded PJM Interconnection, L.L.C. (PJM) under the circumstances of that proceeding. The Presiding Judge added that if, in a change of policy, the Commission was to order it, he would recommend that the Commission adopt, without requiring the filing of new rate cases, a transitional lost revenue recovery mechanism such as one of the Seams Elimination Charge/Cost Adjustment/Assignment (SECA) proposals submitted by the parties to prevent cost shifting.

3. In the July 23 Order, the Commission disagreed with the Presiding Judge's finding that there was a lack of precedential authority to eliminate the RTORs between the expanded Midwest ISO and expanded PJM under the circumstances of the case, and concluded that the Midwest ISO and PJM RTORs, when applied to transactions sinking within the proposed Midwest ISO/PJM footprint, are unjust and unreasonable. The Commission directed PJM and Midwest ISO to make a compliance filing within 30 days eliminating the RTORs for such transactions, effective November 1, 2003.⁵ The Commission declined to fix a transitional lost revenue recovery mechanism to replace the eliminated rates, but provided guidance regarding such mechanisms and invited parties to

³ Midwest Independent Transmission System Operator, Inc., et al., 102 FERC ¶ 63,049 (2003) (Initial Decision).

⁴ We define the Midwest ISO RTOR as the single, system-wide transmission rate in Schedules 7 and 8, and the Schedule 14 Regional Through and Out Rate. For PJM, the RTOR is the single, system-wide transmission rate for delivery to the PJM Border in Schedules 7 and 8 and the Transitional Revenue Neutrality Charge (TRNC).

⁵ On August 22, 2003, PJM and Midwest ISO filed compliance filings in Docket Nos. EL02-111-005 and EL02-111-006 containing revisions to their respective Open Access Transmission Tariffs (OATTs) that provide for the elimination of their RTORs, in accordance with the July 23 Order. On October 17, 2003, in Docket No. EL02-111-008, Midwest ISO submitted an additional compliance filing. As we are granting rehearing and directing further compliance filings in the instant order, these compliance filings are now moot. Therefore, we will dismiss these filings in this proceeding. For the same reason, we will also dismiss the regional SECA proposal and complaints filed by New PJM Cos. (AEP, ComEd and DP&L) in Docket Nos. EL02-111-007, EL03-212-002, and EL03-4-000, et al.

file such mechanisms under Section 205 of the Federal Power Act (FPA).⁶ The Commission also stated that, even with the elimination of the Midwest ISO and PJM RTORs, in the near term the region will still be riddled with seams, with the through and out (T&O) rates under the individual tariffs of certain former Alliances Companies⁷ (“former Alliance Companies” or “Companies”) acting as toll gates that impede the realization of more efficient and competitive electricity markets in the region and that preserve a competitive advantage for the non-RTO members’ generation. Accordingly, the Commission established an investigation under Section 206 of the FPA⁸ in Docket No. EL03-212-000 to determine whether the Companies’ T&O rates should be eliminated.

II. Filings

4. American Municipal Power-Ohio, Inc. (AMP-Ohio), Cinergy Services, Inc. (Cinergy), Detroit Edison Company (Detroit Edison), GridAmerica Companies⁹ (GridAmerica), the Michigan Agencies,¹⁰ Multiple TDUs,¹¹ and Pennsylvania Public Utility Commission (Pennsylvania Commission) filed timely requests for rehearing. Midwest ISO filed a timely motion for clarification and New PJM Cos. and Midwest ISO Transmission Owners (Midwest ISO TOs) filed timely requests for rehearing and motions for clarification. Cinergy filed an answer to Midwest ISO’s motion for clarification. The State of Michigan and the Michigan Public Service Commission

⁶ 16 U.S.C. § 824d (2000).

⁷ American Electric Power Service Corp. on behalf of Appalachian Power Co., Columbus Southern Power Co., Indiana Michigan Power Co., Kentucky Power Co., Kingsport Power Co., Ohio Power Co., and Wheeling Power Co. (collectively, AEP), Ameren Services Co. on behalf of Union Electric Co. and Central Illinois Public Service Co. (collectively, Ameren), Commonwealth Edison Co. on behalf of itself and Commonwealth Edison Co. of Indiana (collectively, ComEd), FirstEnergy Corp. on behalf of American Transmission Systems, Inc. (ATSI) (collectively, FirstEnergy), Illinois Power Co. (Illinois Power), Northern Indiana Public Service Co. (NIPSCO) and Dayton Power and Light Co. (DP&L).

⁸ 16 U.S.C. § 824e (2000).

⁹ The GridAmerica Companies are: Ameren, FirstEnergy, and NIPSCO.

¹⁰ Michigan Public Power Agency and Michigan South Central Power Agency.

¹¹ Coalition of Municipal and Cooperative Users of New PJM Cos.’ Transmission, Indiana Municipal Power Agency and Southeast Michigan Systems.

(collectively, Michigan Commission) filed a timely motion for clarification and alternatively, a request for rehearing to which GridAmerica filed an answer.

5. A number of parties contend that the Commission's elimination of Midwest ISO and PJM's RTORs violates the requirements of FPA Section 206. They claim that the Commission found the RTORs not just and reasonable based on such general policy grounds as economic efficiency and adequate RTO scope and configuration, but did not provide substantial evidence or make the required particularized findings to support eliminating the RTORs.¹² According to New PJM Cos., the Commission's evidence and findings, at best, might support a generic elimination of all rate pancaking, but such evidence cannot be relied upon to support the selective elimination of only Midwest ISO and PJM's RTORs, and then only for certain transactions. Some parties further argue that the Commission's finding is also contrary to Commission precedent and policy with some parties suggesting that the Commission's elimination of the RTORs departs from its prior approval of Midwest ISO and PJM as RTOs.¹³ New PJM Cos. argue that the finding that their choices to join PJM result in unjust and unreasonable rates for transactions between Midwest ISO and PJM is at odds with the policy guidance regarding rate design and delegation of functions provided in the Commission's Order on Petition for a Declaratory Order, in which the Commission indicated that its policy guidance would apply whether the Alliance Companies joined PJM or Midwest ISO.¹⁴ In addition, Certain Classic PJM TOs state that the Commission eliminated the RTORs in an attempt to remedy its prior approval of the expanded PJM and expanded Midwest ISO. They assert that the Commission should not have approved the scope of the expanded PJM unless the Companies had simultaneously submitted an acceptable plan to eliminate the seam between the expanded PJM and expanded Midwest ISO.¹⁵

¹² See, e.g., Pennsylvania Commission Rehearing at 6-7; New PJM Cos. Rehearing at 9-12; Certain Classic PJM TOs at 10.

¹³ See, e.g., New PJM Cos. Rehearing at 24-28 (citing Midwest Independent Transmission System Operator, et al., 97 FERC ¶ 61,326 (2001); PJM Interconnection, LLC, et al., 101 FERC ¶ 61,345 (2002)).

¹⁴ See New PJM Cos. Rehearing at 22-23 (citing Alliance Cos., et al., 99 FERC ¶ 61, 105 (2002) (Order on Petition)).

¹⁵ See Certain Classic PJM TOs Rehearing at 15-19. They also assert that the July 23 Order conflicts with Order No. 2000 and the SMD White Paper, which they argue do not require the elimination of border rates between RTOs. Id. at 16-21; see also New PJM Cos. Rehearing at 28.

6. Some parties also argue that the Commission failed to consider the impacts of eliminating the RTORs. Certain Classic PJM TOs state that cost shifts from Midwest ISO's native load to PJM's native load would result, thereby creating a discriminatory rate structure.¹⁶ They also argue that eliminating the Midwest ISO and PJM RTORs discriminates against transmission-owning members of existing PJM and Midwest ISO because it would allow non-RTO participants to continue charging export fees.¹⁷ They and New PJM Cos. support retaining the RTORs until the Midwest ISO and PJM joint and common market is formed, which New PJM Cos. assert would lead to the elimination of the RTORs.¹⁸ Multiple TDUs recommend maintaining the RTORs for transactions to serve the bundled retail load of RTO non-participants, even while the Commission otherwise eliminates the RTORs and the non-participants' T&O rates.¹⁹

7. Certain parties also object to the November 1, 2003 date set by the July 23 Order as the effective date for the elimination of the RTORs without simultaneously replacing them with a lost revenue recovery mechanism.²⁰ Certain Classic PJM TOs add that the Commission has arbitrarily established this date for eliminating the RTORs because it has not conditioned the date on any of the New PJM Cos. actually joining PJM. It asserts that the Commission has moved prematurely to address alleged potential seams that may not arise due to the uncertainty as to whether any of the New PJM Cos. will be in an RTO by that time. However, Consumers Energy supports eliminating the RTORs on the earliest possible date, i.e., January 18, 2003.²¹

¹⁶ See Certain Classic PJM TOs Rehearing at 11 (citing Initial Decision at P 68-75).

¹⁷ See Certain Classic PJM TOs Rehearing at 21-22.

¹⁸ See New PJM Cos. Rehearing at 30; Certain Classic PJM TOs Rehearing at 14-15.

¹⁹ Multiple TDUs state that unlike AEP, the RTOs and their non-former-Alliance-Company stakeholders are not late in meeting a merger commitment to join an RTO, and the transmission owners that are participating in one of the RTOs have not been enjoying the benefits of "market-independent and broadly [sic] regional planning, development, and operation of the former Alliance Companies' facilities." They suggest that if the RTORs are eliminated for transactions to serve the bundled load of RTO non-participants, this benefit should be credited against any non-participant's claim for recovery of lost revenues. See Multiple TDU's Conditional Request for Rehearing at 9.

²⁰ See, e.g., New PJM Cos. Rehearing at 33-34; Certain Classic PJM TOs at 12-13.

²¹ See Consumers Energy Rehearing at 5-8.

III. Commission Response

A. Justness and Reasonableness of RTORs

8. We will deny rehearing of our finding that the Midwest ISO and PJM RTORs are not just and reasonable. Our finding in the July 23 Order that the RTORs are unjust and unreasonable for transactions sinking in the RTOs was based on reasonable factual determinations and policy considerations and was consistent with Commission precedent, and the parties have not convinced us otherwise. The July 23 Order is one of a series of Commission orders that document the problems of RTO scope and configuration in this region.²² The July 23 Order explained how the RTO choices of certain of the former Alliance Companies would perpetuate these problems. Specifically, the July 23 Order cited evidence that these choices would divide a highly interconnected portion of the grid, leaving in place an elongated and irregular seam across which significant trading activity takes place, and would leave portions of Midwest ISO (Wisconsin and Michigan) only partially contiguous with the rest of Midwest ISO. These facts indicated that the proposed RTO configuration would divide a natural market, subjecting a significant number of transactions in the region to continued rate pancaking, and require companies in Wisconsin and Michigan to pay pancaked rates in order to wheel power through PJM from elsewhere in Midwest ISO.

9. On this basis, the Commission found that the RTORs, when applied to transactions sinking in the RTOs, would: (1) violate the fundamental requirement of Order No. 2000 that RTOs eliminate rate pancaking over a region of appropriate scope and configuration; (2) obstruct the realization of more efficient and competitive electricity markets in the region; and (3) result in unjust, unreasonable, and unduly discriminatory or preferential RTO rates. Accordingly, it concluded that a new rate design must be established for such service. The new rate design would be established in two steps. Initially, as discussed below, a transitional rate design would be implemented and remain in effect for a two-year period.²³ The transitional rate design is based on the existing just and reasonable rates and revenues for regional through and out service, but will recover these revenues from customers, in proportion to the benefits that such customers will receive from the

²² See, e.g., Alliance Companies, et al., 103 FERC ¶ 61,274 at P 26-28 (2003) (June 4 Order); Alliance Companies, et al., 100 FERC ¶ 61,137 (2002); PJM Interconnection, L.L.C., et al., 96 FERC ¶ 61,061 (2001), order on reh'g, 101 FERC ¶ 61,345 (2002); Midwest Independent Transmission System Operator, Inc., 97 FERC ¶ 61,326 at 62,507-08, order on reh'g, 103 FERC ¶ 61,169 (2001).

²³ As we explain below, we set a new effective date of April 1, 2004 to implement the new rate design for such services.

elimination of the unjust and unreasonable rate design in the region, through a non-bypassable surcharge for delivery to load. Further, as we discuss below, the transitional rate design will only apply to new transactions commencing on or after the effective date; for existing transactions, we will allow the existing RTOR rate design to remain in effect during the transition period. The transitional rate design will eliminate the injurious effects on efficient use of the grid associated with rate pancaking, while maintaining the cost responsibility and revenue flows under the existing RTORs, thus mitigating cost shifting among customers and revenue losses that would otherwise occur if rate pancaking were eliminated without a transitional rate mechanism. This will allow time for the parties to develop a long-term rate design solution that efficiently prices transmission service between the two RTOs to take effect at the end of the transition period.

10. Further, we disagree with Certain Classic PJM TOs that the July 23 Order departed from our orders approving Midwest ISO and PJM as RTOs. In those orders, we conditioned our approval of these RTOs based on their attaining sufficient scope to satisfy Order No. 2000. The Commission granted Midwest ISO RTO status based on its finding that Midwest ISO was best positioned to meet the requirements of Order No. 2000; however, it specifically noted that Midwest ISO's configuration problems on its eastern border were inconsistent with Order No. 2000's scope and configuration requirements, and found that these problems could be solved by successful integration of some or all of the Alliance Companies into Midwest ISO.²⁴

11. Similarly, in the Commission's initial order on PJM's RTO proposal, the Commission found that PJM exhibited insufficient scope to meet the requirements of Order No. 2000 and encouraged PJM to continue its efforts to expand in the region. On rehearing, the Commission found that PJM's planned expansion to incorporate some of the former Alliance Companies alleviated concerns regarding the possible insufficient scope of PJM as an RTO.²⁵ These actions are consistent with Order No. 2000, which specifically provided that the Commission would not categorically deny RTO status or delay RTO start-up where transmission owners representing a large majority of the facilities in a region are ready to move forward, even though agreement by a few transmission owners in the region has yet to be determined.²⁶

²⁴ Midwest Independent Transmission System Operator, Inc., 97 FERC ¶ 61,326 at 62,507-508, order on reh'g, 103 FERC ¶ 61,169 (2001).

²⁵ See PJM Interconnection, L.L.C., et al., 96 FERC ¶ 61,061 (2001), order on reh'g, 101 FERC ¶ 61,345 (2002).

²⁶ See Order No. 2000 at 31, 086.

12. We also disagree with New PJM Cos. that the July 23 Order is inconsistent with the Order on Petition. While the Commission indicated that the guidance it gave in the Order on Petition would apply whether the Alliance Companies joined PJM or Midwest ISO, the Commission intended that the resulting choices would continue to be evaluated against the scope and configuration requirements of Order No. 2000. In this regard, the Commission was acting consistent with Order No. 2000's receptivity to flexible and innovative ways to achieve appropriate RTO scope and configuration, such as the use of inter-RTO coordination to eliminate seams.²⁷ The Commission exercised this flexibility in establishing the conditions for New PJM Cos.' participation in PJM, including the requirement for a solution to inter-RTO rate pancaking.²⁸

13. Here, our actions continue to be consistent with Order No. 2000 as our finding that the Midwest ISO and PJM RTORs are unjust and unreasonable is another step towards ensuring that Midwest ISO and PJM achieve appropriate scope and configuration. Our actions are also consistent with the SMD NOPR and White Paper, as discussed in the July 23 Order.²⁹

14. As to the scope of the elimination of the RTORs, we will eliminate the RTORs for new transactions sinking in the combined region (i.e., Midwest ISO, PJM and the Companies' footprints).³⁰ The July 23 Order eliminated the RTORs with respect to transactions serving load in PJM and Midwest ISO. We clarify our intent in the July 23 Order to eliminate the RTORs for transactions sinking in the RTO non-participants' systems if the T&O rates under their individual-company Open Access Transmission Tariffs (OATTs) were eliminated in the July 23 Order's new Section 206 investigation into the justness and reasonableness of certain former Alliance Companies' T&O rates. As our companion order in Docket No. EL03-212-000, being issued concurrently with this order, directs the elimination of the T&O rates under the individual-company tariffs for transactions sinking in the region, we clarify that the RTORs are also eliminated for transactions sinking in the Companies' systems. In that order, we are not eliminating the T&O rates with respect to existing transactions (i.e., those existing as of the effective date) during the two-year transition period since

²⁷ Id. at 31,083.

²⁸ See June 4 Order, 103 FERC at P 31.

²⁹ See July 23 Order, 104 FERC at P 36.

³⁰ As also clarified in our Companion Order, the proposed Midwest ISO/PJM footprint as discussed in the July 23 Order constitutes the combined footprints of Midwest ISO, PJM, and the Companies and shall henceforth be referred to as the "combined region".

efficiencies could only be produced after rate pancaking is eliminated, and thus, no new gains in efficiency would be realized for existing transactions.³¹ Eliminating the RTORs only for new transactions during the transition period will minimize the lost revenues to be recovered through the lost revenue recovery mechanism. Therefore, consistent with our action in Docket No. EL03-212, we will not eliminate the RTORs for existing transactions that sink in the combined region, i.e., those existing prior to April 1, 2004, during the transition period.³² In addition, we will deny Multiple TDUs' request to retain the RTORs for transactions serving the bundled load of the RTO non-participants, as this would perpetuate significant market inefficiencies.³³

15. Further, we will change the effective date for the elimination of the RTORs for transactions sinking in the combined region from November 1, 2003 to April 1, 2004, to occur simultaneously with our elimination of the T&O rates of certain of the former Alliance Companies in our companion order in Docket No. EL03-212-000.³⁴ This new date will allow time to implement the replacement lost revenue recovery rates adopted here and in Docket No. EL03-212-000, to take effect simultaneously with the elimination of the RTORs. The details of the lost revenue recovery mechanism are explained in the next section. In addition, in order to quickly realize more efficient and competitive electricity markets in the combined region, we will not wait until the formation of the PJM/Midwest ISO common market to eliminate these rates since we can address the inter-RTO rate issue sooner than the planned October 2004 formation of the common market.

³¹ See July 23 Order at P 55 (Affirming the Presiding Judge's explanation that "efficiencies could only be produced by eliminating rate pancaking after the Commission issues a final order since past behavior cannot be changed.) For the same reason, we affirm our decision to not order refunds here as Consumers Energy requests. The July 23 Order also affirmed the Presiding Judge's ruling that no refunds should be ordered because the SECA replaces the RTORs with charges of a different form, a non-bypassable surcharge to be added to existing license plate zonal transmission rates but in approximately the same magnitude and imposed on the same groups of ratepayers; customers are not entitled to refunds because they have not overpaid.

³² The RTORs are eliminated once the transition period ends.

³³ See Multiple TDUs' Conditional Request for Rehearing at 9.

³⁴ This addresses Certain Classic PJM TOs' concern that such elimination will discriminate against transmission owners of the existing PJM and Midwest ISO by allowing RTO non-participants to continue charging export fees. See Certain Classic PJM TOs Rehearing at 21-22.

16. We base our decision, in part, on the benefits of establishing a more efficient and competitive electricity market that would directly result from the elimination of the seams in the combined region, and, in part, on enforcing the requirements of Order No. 2000. Our action here brings the combined region closer towards eliminating the obstacles to the formation of efficient and competitive electricity markets and fulfilling the goals of Order No. 2000.

B. SECA Issue

Proposed SECAs

17. Two SECA proposals were sponsored by parties to the proceeding, one by GridAmerica and one by the Midwest ISO TOs, to prevent cost shifting between customers.³⁵ The SECAs are generally designed as non-bypassable surcharges to license plate zonal rates for delivery to load within the RTOs. The SECA proposals would charge the load in the importing RTO for transmission service taken over the transmission facilities of the exporting RTO in proportion to the benefits that load within the importing RTO will realize when it no longer pays pancaked rates for transmission service over the transmission facilities in the exporting RTO. The SECA revenues would be distributed to the exporting RTO to offset the exporting RTO's cost of providing such through and out service. The load in the importing RTO would pay approximately the same amount in the aggregate through the SECA surcharge as it had previously paid through the RTORs. However, the surcharges would be assessed on all deliveries by customers within the importing RTO, not only the through and out transactions, thereby avoiding the harmful effects on economic choices caused by customers having to pay multiple charges under the existing rate design. Transactions under grandfathered agreements and transactions that sink outside the combined region are not included in these calculations. North American Electric Reliability Council (NERC) tag data would be used to identify the loads benefiting from particular through and out transactions, and lost through and out service revenues would be assigned to loads on the basis of such analysis.

18. In the July 23 Order, the Commission found that it need not establish a mechanism for recovery of lost RTOR revenues in this proceeding and did not make any further findings regarding the Presiding Judge's recommendations or parties' concerns with the SECA. Rather, it required parties to make filings under Section 205 of the FPA to propose SECAs to recover lost RTOR revenues and to address the specific attributes of

³⁵ The Grid America and the Midwest ISO TOs' proposals are generally the same. However, Midwest ISO TOs propose to use 2001 NERC tag data instead of 2002 data, phase-out the SECA over three years, and allow Michigan and Wisconsin entities to opt-out of the SECA and continue paying the RTOR.

the SECA. As discussed below, we will grant rehearing on this issue and make findings with respect to appropriate transitional lost revenue recovery mechanisms that result in a change in rate design but not a change in the level of revenues. Instead of requiring Section 205 filings, we will direct compliance filings that will change rate design from the existing transaction-based charge to include transitional surcharges to take effect on April 1, 2004. In order to put their positions in proper perspective, we will discuss the Presiding Judge's decision, the parties positions in their briefs, the Commission's decision in the July 23 Order and the parties' requests for rehearing, before we discuss our decision here.

a. Presiding Judge's Ruling

19. In the Initial Decision, the Presiding Judge stated that if the Commission eliminates the RTORs of PJM and Midwest ISO, he would recommend that the Commission adopt a transitional rate mechanism like one of the proposed SECAs to prevent cost shifting between customers of the two RTOs. He reasoned that absent a SECA, the exporting RTO's native load would have to pay increased transmission rates because the revenue credits for through and out service would cease³⁶ and the importing RTO's native load would save money by not paying the RTORs for imports, resulting in a cost shift from the exporting RTO to the importing RTO.

20. The Presiding Judge stated that an updated cost-of-service is unnecessary to adopt a SECA because the SECA is designed to recover the same amount of revenues lost from the elimination of through and out charges from the same group of customers that had previously paid them, instead of from native load to whom that obligation would otherwise shift. The Presiding Judge also noted that the Midwest ISO TOs utilize a formula rate that would automatically adjust charges to native load upon the elimination of the RTORs unless a SECA mechanism is adopted to prevent such cost shifts.

21. The Presiding Judge also dismissed claims that the SECA violates the rule against retroactive rate making, reasoning that the SECA surcharges are not designed to recoup past losses but to recover future ones.³⁷ Nor, he found, would transmission owners

³⁶ Through and out revenues are credited against the transmission owners' revenue requirements and relieve native load customers of responsibility for a portion of the transmission owners' cost-of-service in the basic transmission rates charged them by the transmission owners.

³⁷ The Presiding Judge added that the SECA revenues would take the place of lawful revenues that would otherwise be expected in the future if through and out charges were not eliminated. The Presiding Judge explained that it was only their calculation that
(continued...)

recover more than they would have received had they continued to charge through and out rates. The Presiding Judge stated that it was only the form of revenue recovery that would change to insure that, in the event the through and out charges were eliminated, there would not be any cost shifting between the native loads of the two RTOs. He concluded that there would be no increase in rates, but only a change in their form.³⁸

b. Briefs on Exceptions

22. Several parties opposed the Presiding Judge's recommendation that a SECA should replace the existing RTORs in the event that the Commission finds the RTORs unjust and unreasonable.³⁹ Generally, these parties raise concerns with respect to cost-shifting, consistency with traditional ratemaking principles, potential over-recovery of transmission owners' cost-of-service, and problems with implementation of the SECA in the Classic PJM territory.

23. Several parties argued that the Presiding Judge failed to recognize the cost shifting that will occur between generators and load as a result of implementing a SECA.⁴⁰ According to these parties, suppliers often paid charges for through and out service while the SECAs would recover all lost revenues only from load. They argued that the Commission specifically recognized this possibility when it set a similar transition rate

(...continued)

was based on a past test period, as was almost every rate sanctioned by the Commission and the courts. He further explained that even their magnitude would not be set on the basis of past lost revenues, although the rates would be; rather, their magnitude would be determined based on the level of future transactions, to which those rates would be applied, no differently than is the case with other lawful rates and charges. Initial Decision at P 90.

³⁸ See Initial Decision at P 89.

³⁹ The following parties all oppose any type of SECA or other revenue recovery mechanism: JCA, Consumers, Michigan Agencies, Michigan Commission, Wisconsin Commission, Maryland Public Service Commission and Pennsylvania Public Utility Commission (Maryland and Pennsylvania Commissions), WEPCO, WPSC/UPPC, TRRG.

⁴⁰ See Initial Decision at P 75-77.

mechanism for hearing in Docket No. ER03-262-000.⁴¹ They argued that there is no guarantee that these generators will pass on any cost savings to customers and that, therefore, cost shifting may result from the implementation of the SECA. TRRG stated that a cost-based approach to mitigating cost-shifts and eliminating rate pancaking, namely license plate rates with no lost revenue adders, has been used previously by other RTOs, including PJM.⁴² It suggested that, given the intertwined nature of PJM and Midwest ISO, the Commission should view elimination of the RTORs as involving the elimination of intra-regional rate pancaking, and follow those cases.⁴³

24. TRRG stated that any new load that appears in a zone will pay a SECA regardless of whether it was an importer of power during the test year, which, it argues, is in clear violation of cost causation principles.⁴⁴ Additionally, parties contended that the lost revenue recovery proposals will lead to retroactive rate increases when implemented because customers were not given notice before the test period that their transactions in the test period would form the basis for charges in subsequent years.⁴⁵

25. Some parties argued that revenues related to through and out transactions are not fixed or obligatory and the loss of that revenue, whether through changes in market conditions or through a regulatory mandate, is not an inappropriate cost shift.⁴⁶ They believed that transmission owners are entitled to receive their expenses and a fair rate of return but are not entitled to a specific amount of such revenue.

⁴¹ See American Electric Power Service Corporation, 103 FERC & 61,008 (2003). This case involved a proposal to address lost revenue recovery and potential cost shifting due to the elimination of rate pancaking within the expanded PJM, when the New PJM Companies are integrated into PJM.

⁴² TRRG also claims that lost revenue recovery mechanisms are unnecessary as incentives to participate in a RTO because of all the other incentive at the Commission's disposal and that such mechanisms could actually be an incentive to others that have yet to join a RTO to join an improperly configured one in order to collect the SECA.

⁴³ See TRRG Brief on Exceptions at 46.

⁴⁴ See TRRG Brief on Exceptions at 21-22.

⁴⁵ See, e.g., WI Commission Brief on Exceptions at 7-8. WEPCO Brief on Exceptions at 7 citing *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979), and *Columbia Gas Transmission Co. v. FERC*, 831 F.2d 1135, 1140 (D.C. Cir. 1987); TRRG Brief on Exceptions at 34.

⁴⁶ See, e.g., Michigan Agencies Brief on Exceptions at 15; Michigan Commission Brief on Exceptions at 14; TRRG Brief on Exceptions at 11.

26. Several parties raised the concern that a SECA will present an opportunity for transmission owners to over-recover their lost revenue amounts.⁴⁷ They objected to the Initial Decision's finding that the proposed SECAs would not collect from ratepayers amounts greater than the existing RTORs. They asserted that shareholder interests should be balanced against ratepayer interests. For example, Consumers noted that the proposed SECAs are fixed rates based on a historical test year, and, as load growth occurs, the SECA would over collect the test-year through and out revenues.⁴⁸ Some parties suggested that in adopting a lost revenue recovery mechanism, the Commission should look at the level of through and out revenues reflected in each transmission owner's most recent rate case to determine the level of through and out revenues it should be allowed to collect through the SECA, rather than basing it on revenues subsequently received through those rates.⁴⁹

27. Other parties argued that the Commission must require the filing of a full rate case for each company to ensure that there is no over-recovery of its cost-of-service.⁵⁰ Some parties also expressed concern about the effect of a SECA in light of existing retail rate caps. For example, Classic PJM Companies and Midwest ISO TOs objected to the Presiding Judge's suggestion that the issue of potential inappropriate cost shifting to transmission owners as a result of retail rate caps is a problem that should be addressed only at the state level.⁵¹ Midwest ISO TOs supported the inclusion of an opportunity for the creation of a regulatory asset account for portions of the SECA charges that are trapped because of retail rate freezes and caps. Conversely, WPSC/UPPC argued that the Commission should not allow the existence of retail rate caps or their potential impact on transmission owners throughout the combined PJM/MISO footprint to impact the design of a SECA.

⁴⁷ See, e.g., Maryland and Pennsylvania Commissions Brief on Exceptions at 18, Consumers Brief on Exceptions at 38, JCA Brief on Exceptions at 18 and TRRG Brief on Exceptions at 40-42.

⁴⁸ See, e.g., Consumers Brief on Exceptions at 38.

⁴⁹ See JCA Brief on Exceptions at 21.

⁵⁰ For example, TRRG contends that other costs may have offset the loss in revenues due to the elimination of rate pancaking. TRRG Brief on Exceptions at 19. See also WEPCO Brief on Exceptions at 27.

⁵¹ See Classic PJM Companies Brief on Exceptions at 17-18, Midwest ISO TOs Brief on Exceptions at 29.

28. With respect to the implementation of the SECA, some parties asserted that it is impossible to appropriately implement a SECA within the Classic PJM region.⁵² They noted that, because the Classic PJM region operates as a single control area, the NERC tag data used to identify the loads benefiting from particular through and out transactions will simply indicate the entire PJM control area as the sink but will not reveal the location of the load within PJM served through that transaction. Therefore, they argued, there is no way to accurately trace the benefits of eliminating through and out rates to those who historically imported power.

29. Finally, the Ohio Commission and TRRG argued that customers should receive financial transmission rights in exchange for any lost revenues for which they are made responsible through implementation of a SECA.⁵³ TRRG argued that such treatment would accord with the fact that customers received firm rights associated with the through and out service that they paid for prior to the elimination of rate pancaking. Otherwise, they asserted, customers would be denied the benefits of RTO formation as envisioned by the Commission.

c. Briefs Opposing Exceptions

30. A number of parties supported the Presiding Judge's ruling that a lost revenue recovery mechanism should be put in place simultaneously with the elimination of rate pancaking.⁵⁴ While the parties who supported the Presiding Judge's adoption of the SECA had differing opinions concerning certain attributes of the SECA, as discussed more fully below, they generally agreed that the Commission should approve the SECA.⁵⁵

⁵² See, e.g., JCA Brief on Exceptions at 15, Classic PJM Companies Brief on Exceptions at 12, TRRG Brief on Exceptions at 62.

⁵³ See Ohio Commission Brief on Exceptions at 9, TRRG Brief on Exceptions at 70-71.

⁵⁴ See, e.g., Briefs Opposing Exceptions filed by New PJM Companies, GridAmerica, Ormet, Trial Staff, Illinois Power, and Midwest ISO TOs.

⁵⁵ Trial Staff believes the evaluation of the SECA proposal requires that the nature and principles underlying the computation of the SECA be clear, and that there be a reasonable approximation of the impacts on both the transmission owners and LSEs from the complete elimination of through and out rates for transactions between the RTOs, as the Midwest ISO TOs provided. Trial Staff Brief on Exceptions at 13.

31. The parties supported adopting the SECA because it allows for lost revenue recovery and thereby mitigates cost shifting associated with the elimination of rate pancaking.⁵⁶ They claimed that a SECA-type mechanism is a just and reasonable replacement for the RTORs.⁵⁷ Trial Staff noted that a SECA mechanism will not protect against all cost shifting, but argued that it is administratively feasible and a good method of maintaining revenue neutrality and controlling cost-shifting due to the elimination of rate pancaking.⁵⁸ Further, GridAmerica contested the arguments that the SECA would shift costs from generators to load, stating that there is no record evidence demonstrating that there are a substantial number of transactions in the combined region where generators pay the RTOR. GridAmerica argued, where generators do pay the RTOR, removing the RTOR lowers the generator' cost which should be reflected in lower prices for power to load.⁵⁹ Moreover, Ormet, a transmission customer of AEP, noted that AEP receives a significant amount of revenue from through and out transactions, and elimination of these pancaked charges without a replacement SECA-type mechanism would result in considerable zonal rate increases, thus resulting in inequitable cost shifting. Ormet states that, although it ultimately believes that a single system rate should be adopted as a long term solution, it is in support of a SECA-type mechanism as a transitional solution to address the cost shifting problem from eliminating pancaking.⁶⁰

32. Several parties⁶¹ argued that the SECA is just and reasonable and consistent with Commission precedent because it is calculated in a manner similar to the rate design that the Commission previously accepted.⁶² For example, GridAmerica cited to precedent where the Commission has found surcharges which assign lost revenue responsibility proportional to the benefits received from the elimination of rate pancaking to be

⁵⁶ See, e.g., Illinois Power Brief Opposing Exceptions at 6-11.

⁵⁷ See, e.g., New PJM Cos. Brief Opposing Exceptions at 26, GridAmerica Brief Opposing Exceptions at 16, Illinois Power Brief Opposing Exceptions at 5, Trial Staff Brief Opposing Exceptions at 17.

⁵⁸ See Trial Staff Brief Opposing Exceptions at 17-18; See also GridAmerica Brief Opposing Exceptions at 16-17.

⁵⁹ GridAmerica Brief Opposing Exceptions at 14-15.

⁶⁰ See Ormet Brief Opposing Exceptions at 4-6.

⁶¹ See e.g., New PJM Cos. Brief Opposing Exception at 35; GridAmerica Brief Opposing Exceptions at 11, 17; Midwest ISO TOs Brief Opposing Exceptions at 8; Illinois Power Brief Opposing Exceptions at 6, 11.

⁶² See, e.g., Alliance Companies, 94 FERC & 61,070 (2001).

reasonable.⁶³ Additionally, Illinois Power cited to several other cases in which the Commission has approved a revenue neutrality charge.⁶⁴ Further, Illinois Power stated that Commission policy provides for non-native load transmission customers to have equal rights to use the transmission system and thus, an equal obligation to pay for the costs of such system.⁶⁵

33. GridAmerica also argued that the SECA mechanism is not a form of retroactive ratemaking because it does not allow for recovery of past losses for past services but, rather, is based on the well-accepted practice of using a test period for determining rates for future service.⁶⁶ Trial Staff stated that SECA proposals must be based on a historical period because what is being preserved is the amount of revenues that the utility would have collected without the elimination of the seams charge.⁶⁷ Trial Staff argued that once the RTORs are eliminated, trading patterns could change, and basing the SECA charges on those trading patterns will not preserve the prior revenues.

34. New PJM Cos. objected to the argument that a SECA will lead to excessive recovery of transmission owners' revenue requirements. They noted that the rate analysis sponsored by TRRG, which was the core basis for its argument, was discredited at hearing.⁶⁸ In addition, New PJM Cos. and others asserted that transmission owners need

⁶³ See GridAmerica Brief Opposing Exceptions at 11-12 citing Midwest Independent Transmission System Operator, Inc. 103 FERC ¶ 61,090 at P 15 (2003).

⁶⁴ See Illinois Power Brief Opposing Exceptions at 7 citing Avista Corp., et al., 100 FERC ¶ 61,274 (2002) (RTO West); Cleco Power LLC et al., 101 FERC ¶ 61,008 (2002) (SeTrans); Midwest Independent Transmission System Operator, Inc., 101 FERC ¶ 61,319 (2002). Illinois Power states that even though the lost revenues were recovered through a RTOR in the RTO West and SeTrans cases, the charges conform to the principles of revenue neutrality in that they are based on test period revenue collections, are collected as an addition to the otherwise applicable rate for a defined period of time, and are intended to be eliminated once a superseding rate design is implemented.

⁶⁵ See Illinois Power Brief Opposing Exceptions at 10.

⁶⁶ See GridAmerica Brief Opposing Exceptions at 17.

⁶⁷ See Trial Staff Brief Opposing Exceptions at 15.

⁶⁸ See New PJM Cos. Brief Opposing Exceptions at 38-41. For example, TRRG's witness used Attachment O to the Midwest ISO OATT even though that attachment is not used by PJM and has not been determined to be just and reasonable for companies in PJM. Further, after initial claims that most of the Companies had high earned rates of return, TRRG's witness adjusted his exhibits to show that many of the companies had

(continued...)

not submit full cost and revenue analysis prior to recovering lost revenues,⁶⁹ arguing that requiring such filings would be inconsistent with established Commission precedent.⁷⁰ New PJM Cos. believe that this proceeding should be viewed in the proper context of a major industry restructuring. They argued that, because the creation of RTOs requires the elimination of some rates, and the restatement of others, the Commission has not required full rate cases for each change in rates engendered by the restructuring.

35. GridAmerica also responded to the arguments raised that a SECA mechanism is impractical to implement in the Classic PJM region, stating that this hurdle should not necessitate the denial of a SECA.⁷¹ Rather, GridAmerica argued, PJM and the transmission owners in the Classic PJM region will have to make a more involved search or appropriate data or should be required to set forth an alternate allocation method in a compliance filing to the Commission.⁷²

36. Some state commissions objected to the creation of regulatory asset accounts as a means to circumvent state retail rate caps. The Maryland Commission asserted that recovery of SECA costs should be resolved at the state level because of the complexity of

(...continued)

earned returns of below 13 percent. TRRG's witness stated that other changes could be incorporated into his analysis that may reduce the earned rate of return even more. Another TRRG witness did not reflect the impact of several factors in his analysis and acknowledged that he made assumptions "that on closer scrutiny may not be absolutely valid."

⁶⁹ See, e.g., GridAmerica Brief Opposing Exceptions at 17-18; Commission Trial Staff Brief Opposing Exceptions at 21; Illinois Power Brief Opposing Exceptions at 14.

⁷⁰ New PJM Cos. cite Alliance Companies et al., 95 FERC ¶ 61,182 at 61,631 (2001) (clarifying that the Commission will not limit the lost revenue quantification to those revenues associated with cost levels last authorized in a federal or state rate case because doing so would be inconsistent with the concept of revenue neutrality); PJM Interconnection, LLC and Allegheny Power, 96 FERC ¶ 61,060 at 61,220 (2001) (denying requests that Allegheny be required to file an updated cost-of-service as inconsistent with the revenue neutrality concept).

⁷¹ Illinois Power also addressed this issue, stating that the "problem is akin to a group of diners in a Chinese restaurant who, having shared plates delivered to the table, inform the waiter that since they do not have a record of who ate how much of what, they will be unable to pay the bill. No waiter worth his salt would accept such a glib response. Neither should the Commission." See Illinois Power Brief Opposing Exceptions at 16.

⁷² GridAmerica Brief Opposing Exceptions at 14.

retail rate freezes. JCA asked the Commission to reject any argument or remedy that would circumvent state rate freezes.

37. Trial Staff stated that TRRG is incorrect for calling the SECA an incentive rate. Trial Staff believes that incentive rates are designed to provide efficiency incentives, whereas the SECA is a charge in substitution for existing rates and is intended to mitigate the adverse effects of joining a RTO. Illinois Power stated that to deny lost revenue recovery in this proceeding would act as a disincentive to other transmission owners joining RTOs.⁷³

d. July 23 Order

38. The Commission stated that it is not obligated to establish a transitional rate mechanism to recover lost revenues due to the elimination of rate pancaking since it previously approved the elimination of rate pancaking without such mechanisms in cases where parties did not propose them or adequately support them. The Commission also stated that mechanisms such as the proposed SECAs, if properly structured, can serve as a reasonable transition mechanism to address revenue losses arising from the elimination of rate pancaking due to RTO formation. However, since the Commission found that it was not obligated to establish such mechanisms, it decided that, if the parties wanted a transitional rate mechanism, they would need to file under Section 205 of the FPA to establish it.

39. Consistent with our prior orders, the July 23 Order determined that it was not necessary for RTO members to file an updated cost-of-service to adopt a transitional rate mechanism, such as the SECA, as that may create an unnecessary impediment to RTO formation.⁷⁴ The Commission also affirmed the Presiding Judge that the evidence presented by parties in an attempt to demonstrate that the level of certain transmission owners' existing rates is excessive was faulty and did not convincingly show that the existing rates are unjust and unreasonable. The Commission reminded the parties that if they feel that the existing rates and revenues, upon which the transitional surcharges are based, are no longer just and reasonable, the complaint process under Section 206 of the FPA is available for them to seek a change in those rates and the corresponding surcharges.

⁷³ Illinois Power Brief Opposing Exceptions at 10.

⁷⁴ The Commission did not address this issue for companies that are not RTO members.

e. **Rehearing Requests**

40. A number of parties contend that the Commission violated FPA Section 206 by finding the RTORs unjust and unreasonable without simultaneously establishing a replacement lost revenue recovery mechanism,⁷⁵ and that the Commission placed its burden of fixing a just and reasonable rate upon the utilities to make new rate filings under FPA Section 205. New PJM Cos. state that Commission policy requires consideration of the impact of lost revenues and cost shifting, and that the Commission should apply its policy favoring transitional rate mechanisms to mitigate potential revenue losses and cost shifts due to the elimination of rate pancaking. Midwest ISO TOs also state that the Commission's actions would deprive utilities of a reasonable opportunity to recover the costs of their facilities and would amount to an unlawful taking of this property without just compensation.⁷⁶ Some parties request that the Commission consider lost revenue recovery proposals in a second phase to the instant investigation if it does not reverse this finding and establish a lost revenue recovery mechanism based on the existing record.⁷⁷

41. In addition, several parties argue that the FPA Section 205 filing option is inadequate, with Midwest ISO TOs and Cinergy expressing concern regarding how FPA Section 205 filings can be used to implement a typical lost revenue recovery mechanism.⁷⁸ Certain parties cite to the record in Docket No. EL02-111 as the basis for

⁷⁵ See, e.g., Midwest ISO TOs Rehearing at 9-10; GridAmerica Rehearing at 9-12; Certain Classic PJM TOs at 10-11; New PJM Cos. Rehearing at 32-33. These parties support adoption of an effective date for elimination of the RTORs that is concurrent with the date that a replacement lost revenue recovery mechanism takes effect.

⁷⁶ See Midwest ISO TOs Rehearing at 11-15. They also contend that the Commission violated the previously accepted Midwest ISO Agreement by causing a major departure from revenue allocations assumed therein and requires Midwest ISO to violate its duty to maximize revenues associated with transmission service. Id. at 14-17.

⁷⁷ See, e.g., New PJM Cos. Rehearing at 32-33; Midwest ISO TOs Rehearing and Clarification at 9-10.

⁷⁸ They state that the lost revenue recovery mechanisms are designed to recover revenues lost from the elimination of the RTORs from the customers of another RTO, under whose tariff the entity seeking lost revenue recovery does not have FPA Section 205 filing rights. Midwest ISO TOs Rehearing at 27-30; Cinergy Rehearing at 6.

their support or opposition to the SECA mechanisms.⁷⁹ Certain parties also assert that, contrary to the July 23 Order's finding, there is sufficient record evidence to evaluate the SECA mechanisms introduced in Docket No. EL02-111-000.⁸⁰ Multiple TDUs assert that a specific rate proposal is needed before the Commission can make any final determinations regarding an appropriate methodology.⁸¹ Some parties also claim that the Commission failed to address their reasons for objecting to the SECA mechanism, as stated in their briefs.⁸² Detroit Edison requests that the Commission clarify whether companies not currently participating in a RTO are precluded from seeking recovery of lost revenues.⁸³ It and other parties seek rehearing of the Commission's determination that an updated cost-of-service would not be necessary to recover lost revenues for transmission owners that are already RTO members.⁸⁴ Detroit Edison asserts that the Commission has neither supported its decision not to require cost support for a transitional rate mechanism nor balanced investor and consumer interests.⁸⁵ Detroit Edison argues that it would be arbitrary to require an updated cost-of-service for non-participants, but not require an updated cost-of-service for RTO members.⁸⁶

⁷⁹New PJM Cos. supports adoption of the SECA mechanism, with the exception of the "opt-out." New PJM Cos. Rehearing at 35; See also Cinergy rehearing at 3-4 and GridAmerica rehearing at 13-15. However, Detroit Edison opposes the SECA and asks why the Commission did not reject the SECA based on the record in Docket No. EL02-111. See Detroit Edison Rehearing at 16-19.

⁸⁰See, e.g., Cinergy Rehearing at 3-4; GridAmerica Rehearing at 13-15; Detroit Edison Rehearing at 16-19.

⁸¹See Multiple TDUs Rehearing at 12.

⁸²See Detroit Edison Rehearing at 20-26; Certain Classic PJM TOs Rehearing at 28.

⁸³See Detroit Edison Rehearing at 8-9.

⁸⁴See; e.g., Detroit Edison Rehearing at 5-6, New PJM Cos. Rehearing at 6; Illinois Power at 3-4; MI Agencies at 7-8; WEPCO Answer to New PJM Cos.' Motion for Clarification at 10-11.

⁸⁵In support, Detroit Edison cites Missouri Pub. Serv. Comm'n. v. FERC, 337 F.3d 1066 (2003) (Missouri PSC).

⁸⁶Detroit Edison also states that the Commission mischaracterized the testimony it co-sponsored as part of TRRG. Detroit Edison states that its testimony was not meant to show that the existing rates are excessive; rather the testimony included cost and revenue analysis to demonstrate that the reasonableness of a lost revenue recovery proposal cannot be evaluated without considering both costs and revenues.

f. Commission Determination

42. In the July 23 Order, we stated that we are not obligated to establish a lost revenue recovery mechanism noting that, in earlier orders, the Commission approved the elimination of rate pancaking without transitional mechanisms to recover lost revenues.⁸⁷ However, on reconsideration, we recognize that, in those cases, the transmission owners voluntarily agreed to eliminate rate pancaking without a lost revenue recovery mechanism. Here, however, the parties do not agree to eliminate rate pancaking without a lost revenue recovery mechanism. Their concerns include the recovery of lost revenues and resulting cost shifts⁸⁸ that would occur upon the elimination of RTORs without simultaneously replacing them with a lost revenue recovery mechanism.⁸⁹

43. As discussed below, we find that these parties have raised valid concerns, grant rehearing and make findings with respect to an appropriate transitional lost revenue recovery mechanism to be established in this proceeding. As we stated in the July 23 Order, the record does not give the Commission a sufficient basis to establish the proposed SECA as a superseding rate. Even the Midwest ISO TOs, who filed testimony that included SECAs calculated for the region, stated that their calculated rates were not proposed at this time for Commission approval.⁹⁰ Instead of requiring that any filings seeking to recover lost revenues be made under FPA Section 205, we will direct Section 206 compliance filings that will contain a transitional surcharge to recover lost RTOR revenues, consistent with our findings herein, which can be implemented simultaneously with the elimination of the Midwest ISO and PJM RTORs on April 1, 2004.

⁸⁷ See PJM Interconnection, L.L.C., 81 FERC ¶ 61,257 (1997); see also Midwest Independent Transmission System Operator, Inc., et al., Opinion No. 453, 97 FERC ¶ 61,033 (2001), order on reh'g, Opinion No. 453-A, 98 FERC ¶ 61,141 (2002).

⁸⁸ See, e.g., New PJM Cos. Rehearing at 32-22; Midwest ISO TOs Rehearing at 9-10; GridAmerica Rehearing at 9-12.

⁸⁹ For example, Certain Classic PJM TOs state that eliminating RTORs without a lost revenue recovery mechanism would shift costs from Midwest ISO's native load to PJM's native load and there may be other costs shifts such as from generators in Midwest ISO to load in PJM. Certain Classic PJM TOs Rehearing at 11.

⁹⁰ See Exhibit No. MISO TOs-1, p. 25: 13-9. Mr. Heintz states that the data is not confirmed and checked and would need to be done so in a compliance filing.

44. As the Presiding Judge pointed out, without a SECA-like mechanism, there would be a significant cost-shift between the native loads of the two RTOs.⁹¹ Transitional lost revenue recovery mechanisms such as the proposed SECAs can serve as reasonable transitional mechanisms to address revenue losses and potential cost shifts arising from the elimination of rate pancaking.⁹² By recovering lost revenues from each zone proportionate to the benefit that each zone receives from the elimination of rate pancaking, and recovering such costs through a non-bypassable surcharge for delivery within the zone, such transitional lost revenue recovery mechanisms better control cost-shifting than conventional license plate rates without transitional surcharges while simultaneously avoiding the injurious effects on efficient use of the grid associated with rate pancaking.⁹³ By fixing the superseding rate in this Section 206 proceeding, the Commission will mitigate cost shifting during the transition period to ensure just and reasonable rates upon the elimination of the RTORs.

45. We recognize the concern of some parties that generators may benefit to some extent from the elimination of the RTORs, and that those savings may not all be passed on to load serving entities (LSEs). However, we believe that the remedies provided by this order contain features that adequately mitigate any such impact. First, as discussed above, we require that any transmission customer that currently has a long-term firm transmission reservation effective before April 1, 2004, including those that are not load-serving entities, will continue to pay the RTOR, thus limiting the amount of lost revenues to be recovered from load. Second, customers serving load in the combined region will be able to reserve service from the point where power is injected into the combined region to the ultimate delivery point from which load is served, for a single non-pancaked

⁹¹ As the Presiding Judge noted, native load customers are ultimately responsible for the costs of the utility's transmission system. Therefore, these mechanisms offset part of the cost of the transmission system that otherwise would be paid by the native load. These mechanisms prevent the transmission rates of native load from increasing as a result of the elimination of rate pancaking. For example, the Midwest ISO Tos are under a formula rate, which absent these mechanisms, would automatically the transmission rate to the rest of the customers (e.g., native load).

⁹² We note that proposals for lost revenue recovery mechanisms to address the elimination of intra-RTO rate pancaking when GridAmerica joins Midwest ISO and when the New PJM Cos. join PJM in Docket Nos. ER03-580 and ER03-262, respectively, are currently the subject of hearing and settlement procedures. We believe that the transitional rate mechanisms associated with the elimination of intra-RTO rate pancaking within the combined region should be the same as the mechanism prescribed here for the elimination of inter-RTO rate pancaking.

⁹³ See April 25 Order.

charge, thus enabling load-serving entities to negotiate power supply contracts based on the market price where the resource is located, rather than where the load is located, without incurring additional access charges. Third, the elimination of the RTORs will result in more remote generation becoming economic for import, which will put downward pressure on market prices where load is located, resulting in lower costs for purchases from local generation as well as imports. Fourth, as part of the compliance filing process, we will allow LSEs under existing contracts for delivered power that continue into the transition period to demonstrate that the supplier is the shipper for such transactions and to propose that the supplier be required to pay the SECA for that portion of the LSE's load served by the contract.⁹⁴

46. Detroit Edison characterizes the SECA as an incentive for RTO participation which requires a cost-benefit analysis under the provisions for incentive rates under the Policy Statement on Incentive Regulation.⁹⁵ Detroit Edison argues that the rates are incentive rates based on its claim that they are not cost-based because the Commission is not requiring an updated cost-of-service analysis. As an initial matter, we are not providing positive incentives, rather we are eliminating an unjust and unreasonable rate design and establishing a lost revenue recovery mechanism to mitigate cost-shifting and to hold transmission owners revenue neutral during a transition period to a new rate design.

47. We also disagree with Detroit Edison's characterization of the SECA as not cost-based. As explained below, we have previously accepted the existing cost-of-service and revenue levels of these companies as just and reasonable and our actions in this proceeding will maintain, not change, the level of these revenues. As we are only changing the design of existing rates, we are not departing from cost-based factors as Detroit Edison argues. Therefore, Detroit Edison's argument that the Commission is

⁹⁴ Similarly, we recognize that a LSE with existing T&O service reservations that will continue into the transition period will continue to pay the RTORs. If such an LSE does not have its own sub-zonal SECA, the SECA may assess such LSE a disproportionate share of lost RTOR revenues. Therefore, we will allow such LSEs with existing transmission arrangements that continue into the transition period to demonstrate to the Commission the extent of disproportionate impact of paying both the RTOR and the SECA and propose an adjustment to its SECA obligation proportional to the RTOR charges it will continue to incur under the existing transmission arrangements.

⁹⁵ See Detroit Edison Rehearing at 8 (citing Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities, 61 FERC ¶ 61,168 at 61,593-94 (1992)).

departing from cost-based factors is misplaced.⁹⁶ For these reasons, contrary to Detroit Edison's assertion, we are acting within our statutory responsibility to ensure that these rates remain just and reasonable.

48. In addition, the SECA prescribed by this order does not violate ratemaking principles as claimed by the parties.⁹⁷ Consistent with the principle of cost causation, the load of an importing utility should pay a fair share of the costs of the exporting utility's transmission facilities for its use of those facilities. Historically, such payments were made via transactional-based charges which have been determined by the Commission to no longer be just and reasonable for the combined region. Therefore, the Commission is developing the transitional rate mechanisms to ensure that the parties continue to pay the costs of facilities that they use and from which they benefit. The lost revenue recovery mechanisms are calculated based on the revenue recovered through the just and reasonable rate charged in a historical period for through and out service and will approximate the exporting utility's cost of providing such service to the importing utility's load. The new transition rate mechanism would allocate such costs in proportion to the benefits received while holding transmission owners revenue neutral. The transitional rate mechanism is designed to approximate the expected use of the exporting utility's transmission system during the two year transition period. Therefore, these lost revenue recovery mechanisms are consistent with the principle of cost causation during the transition period.

49. We also agree with the Presiding Judge that it is not necessary to require the filing of updated cost-of-service studies. We have previously accepted the existing rates of these companies as just and reasonable and our actions in this proceeding will maintain the revenues produced by those rates during the two-year transition period. In addition, some argue that the Commission indicated that an updated cost-of-service analysis was relevant to consideration of the transitional rate mechanism when it granted the interlocutory appeal of TRRG to admit testimony which suggested the transmission owners would vastly over earn their authorized rates of return. For example, TRRG's testimony suggested that transmission owners would receive an earned return on equity

⁹⁶ Even if the lost revenue recovery mechanism was an incentive rate, the Commission may relax requirement of a cost-benefit analysis under certain conditions as it proposed in the Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid. See Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid, 102 FERC ¶ 61,032 (2003). Likewise, its reliance on Missouri PSC and other cases involving the Commission's departure from cost-based ratemaking is misplaced.

⁹⁷ We summarily affirm the Presiding Judge regarding his finding that the SECA does not result in retroactive ratemaking and does not violate the filed rate doctrine.

as high as 63 percent, prior to the elimination of wheeling revenues,⁹⁸ indicating that the existing rates may no longer be just and reasonable and thereby necessitating further inquiry. However, as the Presiding Judge correctly found, TRRG's analysis as well as the cost analyses provided by other parties were discredited, and at the conclusion of the hearing, these parties were unable to bear the burden of proof that the transmission owners' existing rates were unjust and unreasonable.⁹⁹ Therefore, based on the record in this proceeding, we have no reason to believe the transmission owners' existing rates or revenues are unjust and unreasonable or that transitional surcharges based on those rates and revenues are unjust and unreasonable.¹⁰⁰ Accordingly, Midwest ISO and PJM are not required to submit updated cost-of-service studies in their compliance filings.

50. Additionally, some parties claim that with the load-based design of the SECA, companies will overearn due to load growth. However, these parties fail to realize that the elimination of this unjust and unreasonable rate design can cause the expected load growth to be supplied by increased imports from the other side of the seam. Therefore, even though companies may have increased revenues from load growth, they can incur increased transmission costs to support the additional trading in the region. This effect of load growth on the SECA is typical for stated rates that are routinely accepted by the Commission in that the amount actually collected under the rates is determined by the difference between the actual load and the test period load used as the divisor of the rate.

51. As for the Certain Classic PJM TOs, we recognize that they may be in a position similar to sub-zones elsewhere in the footprint concerning their ability to determine where transactions sink within the control area. Consistent with our findings below concerning sub-zones, we direct the Midwest ISO to consult with the customers in PJM

⁹⁸ See Exhibit No. DE/ITC-13 at 5:15-23.

⁹⁹ See GridAmerica Brief Opposing Exceptions at 21-22; New PJM Cos. Brief Opposing Exceptions at 38. We believe that we accurately reflected the essence of TRRG's testimony filed in the hearing containing the costs and revenues of other companies in the region.

¹⁰⁰ The Commission continues to monitor and review cost-based rates to ensure that they continue to be just and reasonable. To that end, the Commission recently proposed to revise its regulations by establishing new quarterly financial reporting requirements and making changes to its annual reporting requirements to provide the Commission with more timely, relevant, reliable and understandable financial information. This additional financial reporting will aid the Commission in, among other things, evaluating the adequacy of traditional cost-based rates, a task that would be made easier if utilities used formulaic rates. When we find reason to believe that the level of a rate on file may no longer be just and reasonable, we will take appropriate action.

regarding calculating the SECAs on a zonal or PJM-wide basis. If the PJM customers agree that they want their SECA calculated on a PJM-wide basis, then we order Midwest ISO and PJM to work together so that Midwest ISO may file a SECA on a PJM-wide basis. Otherwise, Midwest ISO and PJM should work together so that Midwest ISO can provide the data on a sub-zonal basis.

52. The opportunity to recover the transitional surcharges due to retail rate freezes should not present a problem. Because the surcharges are designed to reflect the historical costs of transmission service purchased to serve native load, they do not reflect new costs. However, consistent with our earlier orders concerning other RTO charges,¹⁰¹ if any transmission owner is not provided adequate opportunity to recover these costs in retail rates, it may make a filing with the Commission demonstrating that it does not have adequate opportunity to currently recover those costs and seeking treatment of such costs as a regulatory asset under the Commission's Uniform System of Accounts properly classified in Account No. 182.3, Other Regulatory Assets.¹⁰²

53. Finally, parties have not shown why the change in rate design from a transactional-based charge to a load-based charge would affect the allocation of physical or financial transmission rights set forth in the RTOs' OATTs. Therefore, load in Midwest ISO that makes a contribution towards the cost of the transmission facilities of PJM through payment of a SECA and that makes a firm reservation on the transmission system of PJM is entitled to financial transmission rights per PJM's OATT. Similarly, load in PJM that takes the same actions with respect to Midwest ISO would be entitled to firm physical transmission rights under the Midwest ISO OATT.¹⁰³

C. Specific Attributes of the SECA

54. In the July 23 Order, we gave guidance on specific attributes of the SECA to facilitate the filing of lost revenue recovery mechanisms under Section 205 of the FPA. Since that portion of the order merely provided guidance and did not adopt a SECA mechanism, we will not address the rehearing requests related to our prior guidance. In our discussion below we rely on the record in the hearing in this proceeding to make a determination on the specific attributes of the SECA that we are establishing herein.

¹⁰¹ See Midwest Independent Transmission System Operator, Inc., 102 FERC & 61,279 (2003) and Midwest Independent Transmission System Operator, Inc., order on remand, 102 FERC & 61,192, order on reh-g, 104 FERC & 61,012 (2003).

¹⁰² See 18 C.F.R. § Part 101, Account No. 182.3 (2003).

¹⁰³ We do not address the allocation of financial transmission rights under the Midwest ISO OATT as Midwest ISO is still formulating its Day 2 energy market rules.

1. **NERC Tag Data**

a. **Presiding Judge's Ruling**

55. The Presiding Judge stated that the proposed SECAs should be modified to reflect the most current circumstances, and, specifically, the Presiding Judge recommended that the year 2002 should be the test period. The Presiding Judge reasoned that Midwest ISO was not in existence until February of 2002. Thus, if the lost revenues were calculated for the year 2001, the lost revenues for Midwest ISO would consist of the through and out charges under Midwest ISO transmission owners' individual company OATTs which have already been eliminated.¹⁰⁴

56. The Presiding Judge stressed that the concern was with only eliminating the RTORs that currently exist and adopting a suitable replacement. The Presiding Judge added that evidence indicating that the RTORs were heavily discounted in 2002 was all the more reason to use that year as the test period to more realistically reflect in the SECA the rates and revenues that are actually going to be eliminated. The Judge stated that "the main purpose for using the year 2001 data as the test period, now that the figures for the year 2002 should be available, appears to be a desire to shelter a greater amount [of lost revenues] from the state rate caps. . ." and "if the lost revenues are calculated for the year 2001, as under the MISO TOs' proposal, the lost revenues in MISO would consist, for the most part, of the through and out charges between the transmission owners now in MISO that have already been eliminated."¹⁰⁵

¹⁰⁴ The Presiding Judge noted that apparently individual Midwest ISO transmission owners recovered \$115 million in through and out revenues in the year 2000, and with the formation of the Midwest ISO and the elimination of internal pancaking in the year 2002, it was anticipated that revenues from the RTOR, if not discounted, would amount to \$36 million. Initial Decision at n.25. The Presiding Judge added that how much more they were actually reduced by discounting was undisclosed by the record.

¹⁰⁵ See Initial Decision at P 91-92.

b. Briefs on Exceptions

57. Many parties excepted to the Presiding Judge's recommendation that 2002 be used as the test year for calculating a SECA.¹⁰⁶ For example, GridAmerica objected to the basis on which the Presiding Judge made his decision, claiming that the Presiding Judge erred because there is no connection between the issue of using 2001 as a test year and the retail rate caps. GridAmerica submitted that using a 2001 test year would not allow Midwest ISO members to collect revenues lost from eliminating pancaking solely within Midwest ISO.¹⁰⁷ In addition, it argued that since 2001 data were the only figures presented at hearing, the record does not support a finding that another year would be more representative of transaction behavior by participants. GridAmerica claimed that there are also other reasons that it is appropriate to use 2001 as the test year, including the fact that 2001 data is already part of the formal record and is "cleaner data" because 2002 data would reflect significant changes in market conditions due to the start-up of Midwest ISO and PJM West.¹⁰⁸ However, in the event that the Commission decides that a single test year is inappropriate, GridAmerica supported the averaging of calendar-year 2000, 2001, and 2002 data.¹⁰⁹

58. Several parties supported averaging data for multiple years to establish the test period data.¹¹⁰ They contended that averaging the test years will ameliorate anomalies in

¹⁰⁶ See, e.g., GridAmerica Brief on Exceptions at 9; Midwest ISO TOs Brief on Exceptions at 11; Madison Brief on Exceptions at 9; Maryland and Pennsylvania Commissions Brief on Exceptions at 16-17; Ohio Commission Brief on Exceptions at 4; Wisconsin Brief on Exceptions at 22; WEPCO Brief on Exceptions at 31; and WPSC/UPPCo Brief on Exceptions at 9.

¹⁰⁷ See GridAmerica Brief on Exceptions at 17-18.

¹⁰⁸ The Midwest ISO TOs also urged the Commission to accept 2001 as the test year, at least for the Midwest ISO TOs, arguing that 2002 data is aberrational with respect to themselves as it was the year of the Midwest ISO start-up and transactions through and out of the Midwest ISO footprint were initially suppressed due to problems with discounting and posting Available Transmission Capacity. See also Madison Brief on Exceptions at 9.

¹⁰⁹ See GridAmerica Brief on Exceptions at 21.

¹¹⁰ See, e.g., Ohio Commission Brief on Exceptions at 4; Wisconsin Commission Brief on Exceptions at 9; WEPCO Brief on Exceptions at 32; WPSC/UPPCo Brief on Exceptions at 25.

any single year. TRRG did not except to the Judge's rejection of 2001 as a test year; however, TRRG did not support use of 2002 either. TRRG recommended that, if the Commission insists on a method of lost revenue recovery, it use the most recent 12 months of data available and that the surcharge be trued-up annually to actual transmission usage.¹¹¹

c. Briefs Opposing Exceptions

59. MPSC agreed with the Presiding Judge's finding that 2002 be used as the test year for the SECA charge. It stated that 2002 is more representative of future imports to some Michigan and Wisconsin customers due to the addition of considerable new generation in Michigan. Consumers Energy concurred in this argument.

60. Dairyland stated that use of 2002 as a test year is adequately supported by the record. Commission Staff argued that 2002, or an average of multiple years, should be used because 2001 data is likely to lead to an over collection of lost revenues. Illinois Power also supported the use of a 2002 test period.

d. July 23 Order

61. In the July 23 Order, the Commission stated that as a general matter, in the context of a Section 205 filing, any such filing should use NERC tag data and develop lost through and out revenues for the most recent twelve months, with adjustments for known and measurable differences, to most closely reflect future trading patterns.¹¹²

e. Request for Rehearing

62. Most parties filing requests for rehearing recommend using calendar year 2002 data instead of the most recent 12 months.¹¹³ However, the Midwest ISO TOs repeat the arguments raised in their briefs in favor of calendar year 2001. Alternatively, the Midwest ISO TOs believe that the calendar year 2002 should be used because it will allow parties to synchronize with the reporting period of the FERC Form No. 1 and the data is already available. Additionally, Certain Classic PJM TOs believe that the Commission's willingness to entertain adjustments to the test period for known and

¹¹¹ See TRRG Brief on Exceptions at 70.

¹¹² See July 23 Order at P 54.

¹¹³ See New PJM Cos. Rehearing at 36.

measurable differences in trading is subject to potentially significant factual disputes which would be best resolved based on evidence presented at a hearing.¹¹⁴

63. Further, the Michigan Commission believes that NERC tag data can be manipulated to create significant inaccuracies; therefore, it states that the Commission should adopt a “fail safe” mechanism to protect Michigan consumers.¹¹⁵ Multiple TDUs believe that actual invoices should be used to determine any lost revenues.¹¹⁶

f. Commission Decision

64. We agree with the Presiding Judge’s recommendation to use the most recent data to calculate the transitional rate mechanisms, which, at the close of the hearing, was the 2002 test period.¹¹⁷ In addition to the reasons stated in the Initial Decision, Commission trial staff noted that changes in generation throughout the region in 2001 and 2002 make 2001 less representative of expected future trade patterns.¹¹⁸ However, since the Presiding Judge issued his Initial Decision, additional NERC tag data became available. We believed that the use of the most recent NERC tag data would be even more reflective of future trading patterns; therefore, in the July 23 Order the Commission recommended the use of the most recent twelve months of data.

65. However, since the issuance of the July 23 Order, the Commission has received feedback suggesting that while more recent data are available, significant work would be necessary to prepare that data, making it infeasible to utilize for filings by November 1, 2003, as contemplated in the July 23 Order. Several parties suggest using calendar year

¹¹⁴ See Certain Classic PJM TOs. Rehearing at 32-33.

¹¹⁵ See Michigan Commission Rehearing at 7.

¹¹⁶ See Multiple TDUs Rehearing at 12.

¹¹⁷ During the hearing, TRRG proposed that the SECA be trued up based on actual usage of through and out service. We reject this proposal because a true-up, as TRRG proposes, would essentially convert the SECA back into a transactional charge for through and out service, thus recreating the impacts of rate pancaking which we are eliminating.

¹¹⁸ Several large nuclear plants were out of service for extended periods of time in 2001. Additionally, the record indicates that Michigan and Certain Classic PJM TOs have increased generation capacity in locations that would avoid the RTOR subsequent to 2001. Trial Staff Brief Opposing Exceptions at 33-34.

2002 data for administrative convenience.¹¹⁹ Even the Midwest ISO TOs, who would prefer 2001 calendar year data, alternatively recommend using calendar year 2002 data.

66. On October 14, 2003, the New PJM Cos. filed in Docket No. EL02-111-007, et al., a regional SECA proposal to replace the through and out rates for transactions sinking in the Midwest ISO/PJM footprint. New PJM Cos. recommend in the proposal to use 2002 NERC tag data for the first year of the transition period and the most recent twelve months of data for the second year of the transition period. New PJM Cos. state that the purpose for redetermining the SECA in this manner is an attempt to comply with the Commission's requirement to use the most recent data, while also using data that make filings by November 1, 2003 feasible. The Commission believes that New PJM Cos.' proposal addresses the concerns of the parties and our original concerns. We will, therefore, require that the SECA be based on a calendar year 2002 test year period in the first year of the transition period and a calendar year 2003 test year for the second year of the transition period.

67. We reject the suggestion of some parties to base SECA charges on actual invoices, instead of NERC tag data, to ensure that the SECA does not charge parties more than the actual RTOR charges paid in the test period. Using actual invoices as the basis for the SECA charges could lead to under recovery of lost revenues and produce unfair results as many of the transmission customers are marketers that can change their level of trading activity from year to year. Further, as we explained above, since load ultimately benefits from the through and out service, assessing the lost revenues to load is just and reasonable.

2. Transition Period

a. Presiding Judge's Ruling

68. The Presiding Judge stated that the SECA should remain in place until a long-term solution could be established. Otherwise, the Presiding Judge believes that cost shifts will occur between the native loads of the two RTOs.

69. The Presiding Judge also rejected Midwest ISO TOs' proposal that the SECA be phased-out over a three-year period, and, instead, found that it should remain in effect until another methodology is devised to insure that there is no cost shifting to PJM's native load customers. The Presiding Judge explained that if the RTORs were eliminated

¹¹⁹ See, e.g., New PJM Cos. Motion for Clarification at 5; GridAmerica Motion for Clarification at 11; Midwest ISO TOs rehearing request at 7-8 (supporting use of the most recent calendar year if the Commission fails to grant rehearing and allow the use of 2001 year data).

without being replaced by a SECA, costs would be shifted from the Midwest ISO's native load to PJM's native load because PJM does more exporting to the Midwest ISO than vice versa. The Presiding Judge added that phasing out the SECA after the first year would be objectionable because it would result in PJM's native load subsidizing use of the PJM transmission system to serve the Midwest ISO's native load.¹²⁰

b. Briefs on Exceptions

70. Multiple parties objected to the Presiding Judge's failure to adopt a finite transition period.¹²¹ Edison Mission contended that a SECA should be established strictly as a transitional mechanism, consistent with previous Commission direction.¹²² The Michigan Agencies contended that adopting a SECA without a definite end to the transition period could be more harmful than the existing rate pancaking. WPSC and UPPC noted that a three-year transition period is consistent with the transition period reached in the Illinois Power Settlement, which they noted, the Commission pointed to as useful guidance in the July 31 Order.¹²³

71. Several parties argued that a SECA should be phased out over a three-year transition period as proposed by the Midwest ISO TOs.¹²⁴ They contended that a phase out is necessary in order to mitigate the potential for over recovery of lost revenues and to

¹²⁰ See Initial Decision at P 93.

¹²¹ See, e.g., Edison Mission Brief on Exceptions at 11, Trial Staff Brief on Exceptions at 10, Consumers Brief on Exceptions at 43-44, Dairyland Power Brief on Exceptions at 4-5, Madison Brief on Exceptions at 8, Maryland and Pennsylvania Commissions Brief on Exceptions at 6, Michigan Agencies Brief on Exceptions at 24, Wisconsin Commission Brief on Exceptions at 8, WPSC/UPPCo Brief on Exceptions at 22, Michigan Commission Brief on Exceptions at 17, TRRG Brief on Exceptions at 66.

¹²² See Edison Mission Brief on Exceptions at 11(citing Illinois Power Co., 95 ¶ FERC at 63,004).

¹²³ See WPSC/ UPPCo Brief on Exceptions at 26.

¹²⁴ See, e.g., Edison Mission Brief on Exceptions at 12, Trial Staff Brief on Exceptions at 16, Consumers Brief on Exceptions at 43, Dairyland Power Brief on Exceptions at 4-5, Madison Brief on Exceptions at 8, Maryland and Pennsylvania Commissions Brief on Exceptions at 6, Michigan Agencies Brief on Exceptions at 24-25, Wisconsin Commission Brief on Exceptions at 8, WPSC and UPPC Brief on Exceptions at 26, Michigan Commission Brief on Exceptions at 17-18, TRRG Brief on Exceptions at 67.

ameliorate some of the problems resulting from anomalous test year data. Trial Staff also supported a phase out because it strikes a balance between those supporting a full SECA without phase out and those opposed to any lost revenue recovery.¹²⁵

c. Briefs Opposing Exceptions

72. Several parties stated that the SECA charge is not a long-term remedy. Ormet Primary Aluminum Corp. believed that the appropriate long-term transmission rate for the common Midwest ISOPJM market is a single system rate.¹²⁶ WEPCO agreed that the Commission should focus on developing a permanent solution with the formation of the Midwest ISO/PJM common market.¹²⁷ WPSC also cautioned that the transition period should be as short as possible to minimize any opportunity for gaming.¹²⁸

d. July 23 Order

73. The July 23 Order stated the transitional period for a SECA should be as short as possible, while allowing enough time for parties to develop a permanent rate design to efficiently price transmission service between the regions. The Commission found that a two-year transition period for a transitional cost recovery mechanism will provide sufficient time for the parties to establish a permanent rate design that efficiently prices transmission service between regions in the Midwest ISO and PJM footprint.

e. Request for Rehearing

74. Detroit Edison believes that the Commission was wrong to indicate that the concept of inter-regional payments may be applicable to the proposed Midwest ISO/PJM footprint. Detroit Edison argues that the Midwest ISO and PJM are so poorly configured that transactions crossing the seam between Midwest ISO and PJM should be considered intra-regional transactions that would not be subject to inter-regional payments over the long term. Michigan Agencies request the Commission to clarify that its silence on the phase-out provision does not constitute rejection of the proposal; otherwise, a rejection of the phase-out provision will create unjust results for several parties.¹²⁹

¹²⁵ See Trial Staff Brief on Exceptions at 17.

¹²⁶ See Ormet Brief Opposing Exceptions at 6.

¹²⁷ See WEPCO Brief Opposing Exceptions at 3.

¹²⁸ See WPSC Brief Opposing Exceptions at 13.

¹²⁹ See Michigan Agencies Rehearing at 12-14.

f. Commission Decision

75. We conclude that a two-year transition period is sufficient time for the parties to establish a permanent rate design that efficiently prices transactions for inter-RTO pricing in the PJM/Midwest ISO footprint.¹³⁰

76. We agree with the Presiding Judge that no phase-out of the SECA is warranted. The Midwest ISO TOs state that 2001 test year data are not representative of the trading patterns that would occur in the RTOs and could lead to over-recovery and that phasing-out the SECA will mitigate any such potential for over-recovery. However, our decision to use data for the twelve-month period for calendar years 2002 and 2003 and a two-year transition period will mitigate the over-recovery suggested by the Midwest ISO TOs. We note that with a two year transition period, the result will be two years of recovery of the SECA which provides the same result as the Midwest ISO TOs' proposal with a phase-out over three years.¹³¹

3. Adjustments for "Hubbing" Transactions

a. Presiding Judge's Ruling

77. The Presiding Judge ruled that the SECA should replace only charges for through and out service for transactions that sink in either the expanded PJM or the Midwest ISO and source in or wheel through the other RTO. The Presiding Judge noted that, if power is transmitted through or out of one RTO and delivered to load in the other RTO, the exporting RTO's system is used to transmit that power for the benefit of the load to which

¹³⁰ With respect to Detroit Edison's concerns about the long-term solution to pricing transmission service between regions in the July 23 Order, we did not intend to prejudge the appropriate solution to pricing transmission service between RTOs in this region as that issue is not yet ripe. However, we are encouraged that Detroit Edison is thinking about issues associated with a fair and efficient long-term solution to pricing transmission between the RTOs. We encourage the parties to begin negotiations on the long-term solution to pricing transmission service and encourage Detroit Edison to participate in those negotiations.

¹³¹ In the first year of the transition period under the Midwest ISO's phase-out proposal, the SECA would be 100% of the transmission owner's SECA, in the second year, the SECA would be reduced to 66% of the first year amount and in the third year the SECA would be reduced to 33% of the first year amount. Overall, the Midwest ISO TOs proposal is equivalent to two years of full lost revenue recovery, spread out over three years.

the power is delivered and which would have to pay an RTOR if it was not eliminated. However, the Presiding Judge noted that, in "hubbing transactions", in which power is transmitted through or out of either PJM or Midwest ISO to the other RTO, but ultimate delivery is outside of the importing RTO, the load receiving the ultimate delivery is currently responsible for all charges. The Presiding Judge found that reflecting such transactions in the SECA charged to load in the RTO through which the power is transmitted, but does not sink, would improperly charge that load with the costs not incurred for its benefit and for transactions for which it would not previously have been charged an RTOR.¹³²

b. Brief on Exceptions

78. Illinois Power agreed with the Initial Decision that a SECA should reflect adjustments for hubbing transactions; however, it asserted that the Commission should clarify that transmission owners should make these adjustments in consultation with LSEs, prior to submitting SECA calculations in a compliance filing.¹³³

c. July 23 Order

79. The July 23 Order did not address hubbing transactions.

d. Commission Decision

80. This issue arises because NERC tag data shows certain transactions sinking in a particular control area, whereas the underlying transactions actually served load in another control area, either in the same RTO or outside of the RTO. We agree with the Presiding Judge and order the parties to make adjustments to the NERC tag data submitted in the compliance filings ordered herein to remove such "hubbing" transactions. Furthermore, to reduce the number of contested transactions, we encourage transmission owners and providers to consult with the interested parties prior to filing their compliance filings. And, as discussed later in this order, we will provide the parties 45 days in which to make their compliance filings.¹³⁴

¹³² See Initial Decision at P 96.

¹³³ See Illinois Power Brief on Exceptions at 23.

¹³⁴ We normally require compliance filings to be made within 30 days of the Commission's order.

4. Sub-Zones

a. Presiding Judge's Ruling

81. The Presiding Judge stated that the Commission must decide as a matter of policy whether the SECAs should be developed for the sink RTO as a whole or whether separate SECAs should be developed for individual license plate pricing zones or sub-zones. The Presiding Judge noted that, under the Midwest ISO's TOs' SECA proposal, each cooperative, municipal, or retail LSE could elect to have its own SECA calculated on the basis of its own transactions during the test period. This sub-zonal option does not affect the total lost revenue responsibility for load in an RTO or zone. However, the Presiding Judge noted that choosing the sub-zone SECA affects the payments made by the remainder of the zone, which will pay the balance of the zonal revenue responsibility.¹³⁵

b. Briefs on Exceptions

82. Several parties argued that the Presiding Judge erred in failing to specifically adopt a sub-zonal SECA.¹³⁶ They claimed that such an option would minimize cost shifting and more closely assign costs of eliminating the RTORs to those who benefit.

c. Briefs Opposing Exceptions

83. The Maryland and Pennsylvania Commissions objected to a sub-zonal SECA stating that SECA revenue responsibility cannot be rationally assigned to PJM LSEs. JCA also objected to sub-zone SECA charges, in part, because Classic PJM Cos. are treated as one control area and the SECA may not accurately assign the costs on a zonal or sub-zonal basis.

d. July 23 Order

84. In the July 23 Order, the Commission stated that it would allow charges on a sub-zonal basis, since sub-zonal charges best align the benefits of eliminating rate pancaking with the associated lost revenues. The Commission reasoned that transactions cannot be traced to load in various zones of the Classic PJM Cos.' region because of operation of the PJM spot market and stated that Classic PJM Cos. should address alternative

¹³⁵ See Initial Decision at P 97.

¹³⁶ See, e.g., Dairyland Power Brief on Exceptions at 5-6, Midwest ISO TOs Brief on Exceptions at 26, Michigan Agencies Brief on Exceptions at 27. Other parties indicated their support of a sub-zonal option, but submitted such arguments in their Briefs Opposing Exceptions (Illinois Power at 17; New PJM Cos. at 32).

methodologies for evaluating the relative benefits from import transactions between the various zones of the Classic PJM COs.' region.

e. Commission Decision

85. We will allow the SECA to be charged on a sub-zone basis. The SECA is designed to collect revenue from each zone, or sub-zone, in proportion to the benefits that the load within the zone, or sub-zone, will realize when it no longer has to pay pancaked rates for transmission purchased from transmission owners in the other RTO to serve its load. We find that, by permitting the SECA to be charged on a sub-zone basis, the benefits of eliminating rate pancaking are more closely aligned with the associated lost revenues so that load will not be significantly burdened by the transition to a common market.

86. However, we note that some parties believe that the determination of SECAs by sub-zones is difficult to administer. We acknowledge that customers within a zone will have to balance the benefits of creating sub-zonal SECAs against the difficulty in administering the SECA on a sub-zone basis. Therefore, we will accept calculation of the SECA on a sub-zonal basis unless all the sub-zones within a zone agree otherwise. We note that whether the SECA is calculated on a zonal or sub-zonal basis, the overall cost responsibility for the zone should remain the same.

87. We direct the Midwest ISO and PJM to consult with the customers in the other RTO as to whether they want their SECA calculated on a zonal or sub-zonal basis. If the parties in the zone agree that they want their SECAs calculated on a zonal basis, then we order Midwest ISO and PJM to submit their data on a zonal basis. Otherwise, Midwest ISO and PJM should provide the data on a sub-zonal basis.

5. Opt-Out for Michigan and Wisconsin

a. Presiding Judge's Ruling

88. The Presiding Judge ruled that Michigan and Wisconsin customers should be able to opt out of the SECA and continue paying the RTORs. The Presiding Judge noted that the record indicates that Michigan and Wisconsin will have more on-system generation and import less in the future than in the historical test periods considered in this proceeding, noting in particular evidence that there would be an addition of considerable native zone generation in Michigan and Wisconsin in calendar-year 2003. The Presiding Judge stated that if Michigan and Wisconsin customers are expected to take and pay for considerably less through and out service in the future because their need for imported power would be less, a SECA based on past payments would be unfair and could not legitimately be considered a replacement for future lost revenues. The Presiding Judge added that it was no defense to the proposed opt-out that other customers are not given

the same option since no other customer groups appeared in this Section 206 proceeding to demonstrate a similar inequity. The Presiding Judge concluded that having forgone the use of this forum which was devised for that purpose, other customer groups may nonetheless still file a Section 206 complaint seeking to opt out of any SECA that may be adopted by the Commission for similar reasons.¹³⁷

b. Briefs on Exceptions

89. Several parties objected to the Presiding Judge's finding that Michigan and Wisconsin customers should be allowed to opt out of a SECA charge and instead pay pancaked rates.¹³⁸ They asserted that permitting this opt out will mitigate the overall efficiencies resulting from eliminating pancaking in the rest of the region and/or that this opt out is unduly discriminatory and preferential.¹³⁹ GridAmerica stated that "a patchwork of zones potentially subject to RTORs interspersed within a region that has eliminated the RTORs will erode the benefits of the inception of the Midwest ISO/PJM real-time and day-ahead common markets currently under development."¹⁴⁰ Certain Classic PJM TOs asserted that allowing a Michigan and Wisconsin opt out would not only be unlawfully discriminatory, but would also violate the previously stated policy that no RTO be treated preferentially.¹⁴¹ Illinois Power argued that an opt-out should not be allowed because there are other mechanisms, such as the sub zone options, that could address the concerns of Michigan and Wisconsin, without perpetuating the existence of pancaked rates.¹⁴²

¹³⁷ See Initial Decision at P 94.

¹³⁸ See, e.g., GridAmerica Brief on Exceptions at 21, Classic PJM Companies Brief on Exceptions at 19, Illinois Power Brief on Exceptions at 17, Maryland and Pennsylvania Commissions Brief on Exceptions at 19.

¹³⁹ For example, several parties argued that the Classic PJM region should also be allowed to opt out of paying a SECA, and instead pay the applicable RTORs, because Certain Classic PJM TOs will be disadvantaged as a result of the SECA and they did not cause the seams problems. See JCA Brief on Exceptions at 26-27, Certain Classic PJM TOs Brief on Exceptions at 19 and Maryland and Pennsylvania Commission Brief on Exceptions at 19.

¹⁴⁰ See GridAmerica Brief on Exceptions at 22.

¹⁴¹ See Classic PJM Companies Brief on Exceptions at 19.

¹⁴² See Illinois Power Brief on Exceptions at 21.

c. Briefs Opposing Exceptions

90. Midwest ISO TOs stated that the opt-out option is reasonable because it addresses the unique circumstances of Michigan and Wisconsin, including an unusually high level of imports during the 2001 test year due to generation plant outages, and significant increases in generation within Michigan and Wisconsin since then that will result in a decreased reliance on imports to serve load in Michigan and Wisconsin in the future. They argued that the SECA disproportionately impacts Michigan and Wisconsin customers, noting that these customers would end up paying approximately 81 percent of the SECA charges.¹⁴³ The Michigan Commission supported the right of Michigan and Wisconsin to have the option of continuing to pay the RTORs instead of paying the SECA charge. It argued that due to the considerable new generation locating in Michigan, it is unfair for Michigan and Wisconsin customers to pay SECA charges based on the level of past purchases.

91. Michigan Agencies also supported the opt-out, stating that, if not for the New PJM Cos.' choice to join PJM, the Michigan and Wisconsin utilities would not be separated from the rest of the Midwest ISO footprint and would not incur charges that would not have existed had the former Alliance Companies joined Midwest ISO instead of PJM.

92. Consumers supported Michigan and Wisconsin's being allowed to opt-out, but only for the transition period during which the SECA would be in effect. Commission staff supported the opt-out provision as a means of mitigating the heavy financial burden on entities in Michigan and Wisconsin.

93. New PJM Cos. asserted that the opt-out provision is not supported by substantial and persuasive record evidence.¹⁴⁴ However, Michigan Agencies requested the Commission to clarify that its silence on the opt-out provision does not constitute rejection of the proposal. According to Michigan Agencies, a rejection of the opt-out provision will create unjust results for several parties.¹⁴⁵

d. Commission Decision

94. While we understand the concerns about the impacts on Michigan and Wisconsin entities as a result of the lost revenue recovery mechanism, the Commission cannot allow

¹⁴³ See TRRG Brief on Exceptions at 59.

¹⁴⁴ See New PJM Cos Rehearing at 35.

¹⁴⁵ See Michigan Agencies Brief Opposing Exceptions at 12-14; Michigan Commission Brief Opposing Exceptions at 5-6.

Michigan and Wisconsin entities to “opt-out” of the SECA and continue to pay pancaked rates. The Commission has already found that rate pancaking distorts economic choices and precludes the benefits of more efficient and competitive markets.

95. The Midwest ISO TOs, which proposed the opt-out provision on behalf of Michigan and Wisconsin entities, presented three reasons for the opt-out provision.¹⁴⁶ First, Midwest ISO TOs stated that creation of the Midwest ISO creates other economic paths that may be available to customers who in 2001 used the former Alliance Companies' systems. Second, they maintain that a significant portion of the MWs shown by the NERC tag data to be sinking in Michigan was exported to Canada under exclusive international border buy-resale restrictions that are no longer in place. Third, they submit that the test year data are not representative for other reasons, such as an unusual level of generation plant outages in 2001.¹⁴⁷

96. We find that the use of data for the 2002 and 2003 calendar years will be more representative of future economic paths than 2001 test period data because that data will not reflect the 2001 unit outages which concerned the Midwest ISO TOs and will include new generation that came on line in Michigan since 2001. In addition, since we are agreeing with the Presiding Judge regarding adjustments to the NERC tag data for "hubbing" transactions in the development of the SECA, Michigan and Wisconsin customers will have the opportunity to show in the implementation stage that transactions tagged as sinking in their zones actually sink in another zone or RTO as a result of buy-sell transactions. Moreover, the two year transition period we have ordered will mitigate the effects of the SECA on Michigan and Wisconsin. Therefore, we find that with the modifications we have ordered, the SECA is just and reasonable as a transitional rate mechanism to be assessed to Michigan and Wisconsin entities to mitigate cost shifts that would otherwise occur due to the elimination of the RTORs.

D. Compliance Filings

97. As explained earlier, the Commission is granting rehearing and taking action to establish a transitional lost revenue recovery mechanism in this proceeding. Midwest ISO and PJM are directed to file compliance filings to change the rate design by eliminating the RTORs for transactions sinking in the combined region and implementing lost revenue recovery mechanisms consistent with the findings in this order, within 45 days of the date of this order. This should provide Midwest ISO and PJM with sufficient time to consult with the parties. Midwest ISO and PJM should also provide all

¹⁴⁶ Detroit Edison, as a member of TRRG, also states that its transmission bill will increase significantly as a result of the SECA.

¹⁴⁷ See Ex. MISO TOs-1 at 20.

supporting documents containing all calculations and data, including NERC tag data. We expect the parties in the region to work cooperatively in the preparation of these filings, and encourage them to attempt to resolve issues before the filings are made.

The Commission orders:

(A) The requests for rehearing of the July 23 Order that pertain to Docket No. EL02-111 are hereby granted in part, and denied in part, as discussed in the body of this order.

(B) Midwest ISO and PJM are hereby directed to submit compliance filings, within 45 days of the date of this order, as discussed in the body of this order.

(C) Midwest ISO is hereby directed to consult with the customers in PJM regarding calculating their transactions, and Midwest ISO and PJM are hereby directed to work together regarding the submission of Midwest ISO's data, as discussed in the body of this order.

(D) Midwest ISO and PJM's compliance filings in Docket Nos. EL02-111-005, EL02-111-006 and EL02-111-008 are hereby dismissed, as discussed in the body of this order.

(E) New PJM Companies' regional SECA proposal and complaints filed in Docket Nos. EL02-111-007 and EL03-212-002 and EL03-4-000, et al. are hereby dismissed, as discussed in the body of this order.

(F) Midwest ISO and PJM are hereby directed to submit to the Commission, within six months from the date of this order, and for each six-month period thereafter, a report detailing the progress made to develop a long-term solution to inter-RTO pricing for the Midwest ISO/PJM region to take effect at the end of the two-year transition period.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.