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March 22, 2006

RECEIVED

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

MAR 23 2006

PUBLIC SERVICE
COMMISSION

**RE: In the Matter of the Application of Louisville Gas and Electric Company and
Kentucky Utilities Company for Authority to Transfer Functional Control of
Their Transmission System**
Case No. 2005-00471

Dear Ms. O'Donnell:

On November 18, 2005, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively the "Companies") filed their application for authority to transfer functional control of their transmission system in the above-referenced proceeding.

The application states in part that on October 7, 2005, in *LG&E Energy LLC, Louisville Gas & Electric Company et al*, Docket Nos. EC06-4-000 & EC06-20-000, the Companies petitioned the Federal Energy Regulatory Commission ("FERC") for an order authorizing the transfer of the functional control of their facilities from the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") back to themselves and authorizing the Companies to enter into agreements with the Tennessee Valley Authority ("TVA") to the extent necessary for TVA to act as the Companies' North American Electric Reliability Council-certified reliability coordinator and with the Southwest Power Pool, Inc. ("SPP") to serve as the Companies' open access transmission tariff administrator. A complete copy of the Companies' FERC application was enclosed as Application Exhibit 2. The testimony of Mr. Michael Beer, Vice President of Federal Regulation and Policy, also describes the Companies' proceeding at the FERC.

On December 22, 2005, the Commission issued an order in this proceeding holding LG&E and KU's application in abeyance pending the final outcome in Case No. 2003-00266.¹

¹ Case No. 20003-00266, Investigation into the Membership of the Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator, Inc.

The Commission's Order further stated that if the Commission granted the requested relief in that proceeding, the Commission would then move expeditiously to review the application presented in this proceeding.

On January 10, 2006, the Companies filed with FERC in *LG&E Energy LLC, Louisville Gas & Electric Company et al*, Docket Nos. EC06-4-000 & EC06-20-000, revised Attachment M of their Open Access Transmission Tariff containing a final and executed ITO Agreement and a final Reliability Coordinator Agreement, as well as a Withdrawal Agreement between Applicants and Midwest ISO, which sets out the obligations of each party in accommodating the Companies' withdrawal, including a Withdrawal Fee Methodology.

On February 3, 2006, the Companies filed a joint motion with this Commission requesting leave to amend their joint application to include the final withdrawal agreement with the Midwest ISO, the reliability agreement coordinator agreement with TVA and the independent transmission organization agreement with TVA. A complete electronic copy of these final agreements was enclosed on compact disc marked as Amended Application Exhibit 1. On February 23, 2006, the Commission issued an order, granting the Companies' motion for leave to amend and accepting for filing the tendered joint amended application.

On March 17, 2006, FERC issued its *Order Conditionally Approving Request to Withdraw from the Midwest ISO*, 114 FERC ¶ 61,282. In that order, the FERC conditionally approved the Companies' proposed withdrawal from the Midwest ISO and directed the Companies to make a compliance filing. A complete copy of this order is enclosed. The conditions imposed by the FERC are acceptable to the Companies. Overall, the Commission found with respect to the Companies' proposal to withdraw from the Midwest ISO:

- 1) That the Companies have complied with the terms of the Midwest ISO Transmission Owners' Agreement ("TOA");
- 2) That their proposal, upon compliance with certain conditions, satisfies certain Merger Conditions that had previously been placed upon the Companies;
- 3) That the Companies' proposed open access transmission tariff ("OATT"), including certain changes proscribed by the Commission, is "consistent with or superior to" the *pro forma* OATT established by the Commission by Order No. 888; and
- 4) That the Section 205 tariff filing, also subject to certain conditions, is just reasonable, and not unduly discriminatory.

The Commission required the Companies to make compliance filings prior to completing their withdrawal from the Midwest ISO. The Companies expect to make these compliance filings

Elizabeth O'Donnell
March 22, 2006
Page 3

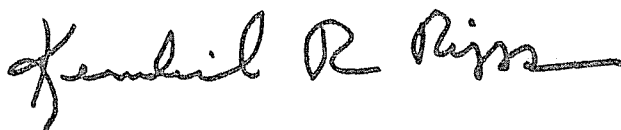
with FERC in early April and to be eligible to exit MISO thirty days thereafter, subject to the FERC's and this Commission's authorizations.

To ensure a smooth and orderly transition the Companies, together with TVA and SPP, have established June 1, 2006, as the target scheduling date to transfer reliability coordination and tariff administration, and are presently taking planning steps to meet this objective. It is important to complete this operational transfer on or before June 1, 2006, for reliability reasons. Completing the transfer of the Companies' reliability coordination function by a June 1 will help ensure that adequate and orderly resources and planning processes, and testing measures can be devoted to the transfer and the transfer and associated systems testing take place prior to the months in which peak demand on the Companies' system is expected to occur.

To achieve the transfer of operational control of the LG&E/KU system by June 1, the Companies must begin to take immediate steps to achieve this goal. Certain transition steps require as much as a 60-day lead time. The Companies therefore respectfully request that the Commission enter an order in Case No. 2003-00266 as soon as reasonably possible. Should such order grant the Companies their requested relief in that proceeding, the Companies again respectfully request that the Commission then move expeditiously to review the application presented in this proceeding and enter an order as soon as possible in order to permit the Companies to complete the transfer and exit by June 1.

If the Commission has any questions or needs any additional information in connection with its evaluation of the application filed in this proceeding, please contact me at your earliest convenience.

Very truly yours,



Kendrick R. Riggs

KRR/ec

Enclosures

cc: All persons of record as having filed Motions for Intervention (w/encl.)
Kent W. Blake
Elizabeth L. Cocanougher

114 FERC ¶ 61,282
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

RECEIVED

MAR 23 2006

PUBLIC SERVICE
COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Sudeen G. Kelly.

Louisville Gas and Electric Company, *et al.*

Docket Nos. EC06-4-000 and
EC06-4-001

LG&E Energy LLC

Docket Nos. ER06-20-000 and
ER06-20-001

ORDER CONDITIONALLY APPROVING
REQUEST TO WITHDRAW FROM THE MIDWEST ISO

(Issued March 17, 2006)

TABLE OF CONTENTS

	<u>Paragraph</u>
I. INTRODUCTION	1
II. BACKGROUND	8
A. Applicants and the Midwest ISO	8
B. Applicants' Merger	10
C. Applicants' Initial Filing in this Case	12
D. Applicants' Amended Filing	15
III. NOTICE OF FILINGS AND RESPONSIVE PLEADINGS	18
IV. DISCUSSION	21

A.	Procedural Matters	21
B.	Standards of Review	22
C.	Whether Applicants’ Proposal to Withdraw Meets the Standards in the TO Agreement	31
1.	Withdrawal Notice	32
2.	Users Held Harmless	33
3.	Existing Obligations (Exit Fee)	52
4.	Construction of Facilities	61
5.	Other Obligations	62
6.	Regulatory Approval	63
D.	Whether Applicants’ Replacement Arrangements Satisfy Applicants’ Merger Conditions	66
E.	Whether Applicants’ Replacement Arrangements are Consistent With or Superior to the Commission’s <i>Pro Forma</i> OATT	96
F.	Rate De-Pancaking	99
G.	Curtailed Priority	120
H.	Independent Transmission Organization Selection and Duties	130
I.	Reliability Coordinator Selection and Duties	154
J.	Regional Coordination and Seams Issues	169
K.	Cost Recovery for System Expansions and Transmission Upgrades	192

L.	Rates	195
M.	Market-Based Rate Authority	199
N.	Additional Filings and Procedures	202

UNITED STATES OF AMERICA
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Docket Nos. EC06-4-000 and
EC06-4-001

LG&E Energy LLC

Docket Nos. ER06-20-000 and
ER06-20-001

ORDER CONDITIONALLY APPROVING
REQUEST TO WITHDRAW FROM THE MIDWEST ISO

(Issued March 17, 2006)

I. Introduction

1. On October 7, 2005, as amended on January 10, 2006, LG&E Energy LLC, on behalf of its public utility operating company subsidiaries, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (collectively, Applicants), submitted under sections 203 and 205 of the Federal Power Act (FPA)¹ a proposal to withdraw their transmission facilities from the transmission system operated by the Midwest Independent Transmission System Operator, Inc. (Midwest ISO). In place of their existing arrangements with the Midwest ISO, Applicants propose to delegate certain tariff administration duties to the Southwest Power Pool, Inc. (SPP), serving as an Independent Transmission Organization. In addition, Applicants propose to appoint the Tennessee Valley Authority (TVA) to serve as their Reliability Coordinator.

¹ 16 U.S.C. §§ 824b and 824d (2000), *as amended* by the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594, 983-84 (2005) (EPAAct 2005).

2. Applicants state that their request to withdraw from the Midwest ISO and their proposed replacement arrangements satisfy: (i) the withdrawal provisions of the Midwest ISO Transmission Owners' Agreement (TO Agreement);² (ii) the conditions established by the Commission in connection with Applicants' merger (Applicants' Merger Conditions);³ (iii) the Commission's non-discriminatory, open access transmission requirements (Order No. 888);⁴ and (iv) the Commission's policies on Regional Transmission Organizations (RTOs), as they apply to the Midwest ISO's ongoing status and operations (Order No. 2000).⁵ Applicants further state that their proposed replacement arrangements are comparable to the tariff administration protocols conditionally accepted by the Commission for Entergy Services, Inc. (Entergy), Duke Power (Duke), and MidAmerican Energy Company (MidAmerican).⁶

² See Midwest ISO FERC Electric Tariff, First Revised Rate schedule No. 1.

³ *Louisville Gas and Electric Co.*, 82 FERC ¶ 61,308 (1998) (*LG&E/KU Merger Order*) and *E.ON AG*, 97 FERC ¶ 61,049 (2001) (*E.ON Merger Order*) (collectively, Merger Orders).

⁴ Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part and rev'd in part sub nom.* Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

⁵ Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (2000), FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd*, *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

⁶ *Entergy Services, Inc.*, 110 FERC ¶ 61,295 (*Entergy Guidance Order*), *order on clarification*, 111 FERC ¶ 61,222 (2005); *Duke Power*, 113 FERC ¶ 61,288 (2005) (*Duke Independent Entity Order*); and *MidAmerican Energy Co.*, 113 FERC ¶ 61,274 (2005) (*MidAmerican Transmission Service Coordinator Order*).

3. In this case, we address a proposal made by transmission-owning members of a Commission-approved RTO to withdraw from that RTO. The following legal standards apply to this proposal. First, the proposal must satisfy the terms of the TO Agreement respecting withdrawal. Second, the proposal must satisfy the concerns underlying Applicants' Merger Conditions, particularly those relating to independence and rate de-pancaking. Third, the proposal, insofar as it modifies Applicants' OATT, must be "consistent with or superior to" the *pro forma* OATT. Finally, the proposed section 205 filings must be just, reasonable and not unduly discriminatory.

4. For the reasons discussed below, we find that Applicants' request to withdraw from the Midwest ISO and proposed replacement arrangements warrant conditional approval. First, we find that, with certain conditions discussed below, Applicants' withdrawal request meets the requirements of the TO Agreement. We find, for example, that Applicants meet their hold harmless obligation as it relates to existing service (*i.e.*, service arranged as of the date Applicants provided notice of their intent to withdraw), subject to the requirement that Applicants make a compliance filing to implement, and in some cases clarify, their hold harmless commitment. We also find that Applicants meet, as conditioned here, their obligation to pay an exit fee. Specifically, we accept Applicants' proposed methodology to determine their exit fee, but require that this exit fee, once finalized, be filed with the Commission.

5. We next address Applicants' Merger Conditions. First, we find that the proposed operation of Applicants' transmission system by an Independent Transmission Organization and a Reliability Coordinator satisfies concerns relating to vertical market power if it is revised to: (i) meet certain independence requirements discussed below; and (ii) transfer certain transmission planning duties to SPP. We also find that Applicants' proposal satisfies concerns relating to horizontal market power, provided that Applicants ensure that loads located in the KU requirements customers' destination market do not pay pancaked transmission rates.

6. We next address Applicants' proposed deviations from the Commission's *pro forma* OATT. We accept Applicants' submittals, subject to the revisions discussed below regarding Applicants' proposed Rate De-Pancaking Maintenance Plan, Independent Transmission Organization duties, and Reliability Coordinator duties. We also address Applicants' proposed reliance on TVA's existing Joint Reliability Coordination Agreement with the Midwest ISO and PJM Interconnection, L.L.C. (PJM) (an agreement to which Applicants are not currently parties). We require Applicants to finalize their arrangements regarding their proposed reliance on this agreement and to submit their

proposal in a compliance filing. We also condition our acceptance of Applicants' proposed rates on a section 205 filing that includes a proposed return on equity.

7. Finally, we dismiss without prejudice Applicants' proposed mechanism to recover the cost of system expansions and transmission upgrades (a proposal that would require individual customers to fund certain expansions necessary to satisfy their interconnection and delivery service requests). This proposal is dismissed as premature because, as Applicants acknowledge, it is not a precondition of their withdrawal from the Midwest ISO.

II. Background

A. Applicants and the Midwest ISO

8. The Midwest ISO is a not-for-profit corporation authorized by the Commission to independently operate the Midwest ISO transmission system.⁷ The Midwest ISO transmission system, which currently includes Applicants' transmission facilities, spans a 15-state region and the Canadian Province of Manitoba, with an approximately 1.1 million square mile service area and over 97,000 miles of transmission lines. The generation capacity of the Midwest ISO is approximately 135,000 megawatts. In addition to its transmission system, the Midwest ISO manages a Day-Ahead Energy Market, a Real-Time Energy Market, and a Financial Transmission Rights (FTR) Market (collectively, the Day 2 Market).

9. Applicants are primarily engaged in the generation, transmission, and distribution of electric energy in Kentucky. They are subsidiaries of LG&E Energy LLC (now E.ON US), which is a subsidiary of E.ON AG (E.ON), a multi-national energy company. Applicants' transmission facilities are located on the southeastern edge of the Midwest ISO's footprint and are bordered by TVA to the south, PJM to the east, and Big Rivers

⁷ The Commission initially authorized the establishment of the Midwest ISO under the standards set forth for independent system operators (ISOs) in Order No. 888. *See Midwest Independent Transmission System Operator, Inc.*, 84 FERC ¶ 61,231, *order on reconsideration*, 85 FERC ¶ 61,250, *order on reh'g*, 85 FERC ¶ 61,372 (1998). The Commission subsequently approved the Midwest ISO's establishment as an RTO. *See Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001), *reh'g denied*, 103 FERC ¶ 61,169 (2003).

Electric Corporation (Big Rivers) to the west. Applicants' transmission facilities cover an approximately 7,300 square mile region, with 2,420 miles of transmission lines (100 kilovolts and above) and about 8,729 megawatts of generation capacity.

B. Applicants' Merger

10. In 1997, the Commission conditionally approved Applicants' and their respective affiliates' merger using the criteria established by the Commission in the *Merger Policy Statement*.⁸ The merger application raised concerns regarding increased vertical market power through the combination of LG&E's and KU's transmission and generation facilities, but these concerns were addressed by Applicants' commitment to turn over control of their transmission facilities to the Midwest ISO. The merger application also revealed certain horizontal market screen failures in the KU requirements customers' destination market, but these failures were remedied by the elimination of pancaked rates due to Midwest ISO membership, which broadened the geographic market for purchases by these customers. In sum, the Commission found that Applicants' proposed mitigation measures (applicable to the KU requirements customers' destination market), their proposed ratepayer protection mechanisms (applicable to Applicants' wholesale requirements customers), and their anticipated participation in the then-proposed Midwest ISO, taken together, ensured that the merger was consistent with the public interest (that is, that the merger did not adversely affect competition, rates, or regulation).

11. In conditionally approving Applicants' merger, the *LG&E/KU Merger Order* stated that a subsequent request made by Applicants to withdraw from the Midwest ISO would be evaluated by the Commission in relation to its effect on competition in the KU requirements customers' destination market.⁹ The Commission also stated that it would

⁸ See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs. ¶ 31,044 (1996), *order on reconsideration*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997).

⁹ *LG&E/KU Merger Order*, 82 FERC ¶ 61,308 at 62,219-24. The Commission, while addressing the need to mitigate market power applicable to the KU destination market, was not required to address LG&E's destination market. LG&E, then as now, has no wholesale requirements customers within its control area, i.e., its wholesale energy sales are made only into other control areas.

use its authority under section 203(b) of the FPA to address any additional concerns raised by such a request.¹⁰

C. Applicants' Initial Filing in this Case

12. In their October 7, 2005 filing (Initial Filing), Applicants state that while they are committed to the Commission's regional transmission objectives, their status as vertically integrated utilities has raised significant cost issues regarding their continued participation in the Midwest ISO. Applicants add that these concerns became particularly magnified following the Midwest ISO's implementation of its Day 2 Market, a market design which Applicants protested at the time that it was proposed.¹¹

13. Applicants state that they further analyzed the cost impact of this new market during an evidentiary proceeding convened by the Kentucky Public Service Commission (Kentucky Commission).¹² Applicants state that in that proceeding, the evidence showed

¹⁰ Section 203(b) of the FPA states that "[t]he Commission may grant any application for an order under this section [concerning a proposed merger or disposition of jurisdictional facilities] in whole or in part and upon such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission." 16 U.S.C. § 824b. Following Applicants' merger, Applicants were involved in two other mergers: first, the merger of Applicants' parent, LG&E Energy Corporation, with Powergen plc in 2000; and second, Applicants' indirect acquisition by E.ON AG in 2001. *See Louisville Gas & Electric Co.*, 91 FERC ¶ 61,321 (2000); *E.ON Merger Order*, 97 FERC ¶ 61,049. Neither merger involved operational or physical changes to Applicants' system.

¹¹ *See Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163, *order on reh'g*, 109 FERC ¶ 61,157 (2004) (order conditionally accepting the Midwest ISO's proposed Open Access Transmission and Energy Markets Tariff (Transmission and Energy Markets Tariff), including the terms and conditions necessary to implement a market-based congestion management program and energy spot markets).

¹² *See Investigation into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator, Inc.*, Kentucky Public Service Commission Case No. 2003-266 (July 17, 2003) (Kentucky Commission Investigation).

that their stand-alone operation under a Commission-approved OATT would be less expensive than their continued participation in the Midwest ISO or any other RTO option that they had studied. Applicants' analyses concluded that, even with the payment of an exit fee (a condition to their withdrawal under the TO Agreement, as discussed below), Applicants' withdrawal from the Midwest ISO would result in a significant net economic benefit for both Applicants and their customers.

14. Given these considerations, Applicants seek to withdraw from the Midwest ISO and to resume operation as a stand-alone transmission system under a Commission-approved OATT. To implement these objectives, Applicants submit proposed replacement arrangements, including a proposed OATT, identify additional arrangements they will need to negotiate with the Midwest ISO and its transmission owners, and seek an order from the Commission requesting three specific findings: first, that their proposal to withdraw from the Midwest ISO satisfies the requirements of the TO Agreement; second, that their proposed replacement arrangements satisfy Applicants' Merger Conditions; and third, that their proposed deviations from the Commission's *pro forma* OATT are just and reasonable.¹³

D. Applicants' Amended Filing

15. In their January 10, 2006 filing (Amended Filing), Applicants submit a withdrawal agreement with the Midwest ISO (Withdrawal Agreement) addressing, among other things, Applicants' exit fee obligation under the TO Agreement, specifically, the methodology proposed by Applicants for calculating that exit fee. Applicants also submit executed agreements with SPP and TVA concerning their respective duties as Applicants' Independent Transmission Organization and Reliability Coordinator.¹⁴

¹³ Concurrent with their Initial Filing, Applicants filed a similar proposal with the Kentucky Commission requesting approval to regain functional control of their transmission facilities from the Midwest ISO. On December 22, 2005, the Kentucky Commission issued an order holding its ruling on Applicants' proposal in abeyance, pending its decision in the Kentucky Commission Investigation.

¹⁴ In their Initial Filing, Applicants submitted copies of these agreements in draft form only, due to Applicants' still pending negotiations with SPP and TVA.

16. Applicants state that their on-going negotiations with individual parties have also resulted in agreements addressing specific aspects of Applicants' withdrawal proposal, including rate pancaking issues and the status of certain existing contracts. Applicants state that these agreements have been reached with the following parties: (i) Big Rivers; (ii) East Kentucky Power Cooperative, Inc. (East Kentucky Coop); (iii) Frankfort Electric and Water Plant Board and the Cities of Barbourville, Bardstown, Bardwell, Benham, Berea, Corbin, Falmouth, Madisonville, Nicholasville, Paris, and Providence, Kentucky (Kentucky Municipals); (iv) Illinois Municipal Electric Agency (Illinois Municipal); (v) Indiana Municipal Power Agency (Indiana Municipal); (vi) Owensboro Municipal Utilities (Owensboro Municipal); and (vii) Paducah Power System, Glasgow Electric Plant Board, Princeton Electric Plant Board, and Hopkinsville Electric System (TVA Distributor Group).¹⁵

17. Applicants request that the Commission accept their submittals for filing without suspension or hearing, to be effective upon Commission acceptance of the rates contained in their Initial Filing. Applicants also request waiver of the Commission's notice requirements, as may be applicable to the implementation of their withdrawal proposal.

III. Notice Of Filings And Responsive Pleadings

18. Notice of Applicants' Initial Filing was published in the *Federal Register*, with interventions, protests and comments due on or before November 15, 2005.¹⁶ Notices of

¹⁵ See *Louisville Gas and Electric Co. and Kentucky Utilities Co.*, Docket No. ER06-518-000 (filed January 20, 2006) (Big Rivers Agreement); *Louisville Gas and Electric Co. and Kentucky Utilities Co.*, Docket No. ER06-519-000 (filed January 20, 2006) (East Kentucky Coop Agreement); *Louisville Gas and Electric Co. and Kentucky Utilities Co.*, Docket No. ER06-600-000 (filed January 20, 2006) (Indiana Municipal Agreement); *Louisville Gas and Electric Co. and Kentucky Utilities Co.*, Docket No. ER06-601-000 (filed February 2, 2006) (Illinois Municipal Agreement); and *Louisville Gas and Electric Co. and Kentucky Utilities Co.*, Docket No. ER06-602-000 (filed February 2, 2006) (Kentucky Municipals, Owensboro Municipal, and TVA Distributor Group Agreement). In addition, Indiana Municipal submitted a substitute protest on February 2, 2006 stating that it has reached agreement with Applicants on all but one issue concerning curtailment priority, as discussed in section IV.G, below.

¹⁶ 70 Fed. Reg. 61,272 (2005).

intervention and motions to intervene were timely filed by the entities noted in Appendix A to this order. In addition, motions to intervene out-of-time and protests were submitted, on November 16, 2005, by the Electric Power Supply Association (EPSA) and Williams Power Company, Inc. (Williams). Protests and comments were also filed by numerous other entities, as discussed more fully below. On November 30, 2005, Applicants filed an answer responding to these protests and comments, which is also discussed below.

19. Notice of Applicants' Amended Filing was published in the *Federal Register* with interventions, protests and comments due on or before January 25, 2006.¹⁷ Responsive pleadings were timely filed by the entities noted in Appendix B to this order. In addition, on February 2, 2006, SPP filed a motion to intervene out-of-time and comments and Applicants filed an answer.

20. On February 15, 2006, the Midwest ISO filed a motion to strike a portion of Applicants' Initial Filing, namely exhibit E to that filing, which consists of the prepared testimony of Ms. Bailey, a former Commissioner. The Midwest ISO asserts that Ms. Bailey's testimony was submitted in violation of Rule 2103 of the Commission's Rules of Practice and Procedure,¹⁸ which states that "[n]o person having served as a member ... of the Commission may practice before or act as attorney, expert witness, or representative in connection with any proceeding or matter before the Commission which such person has handled, investigated, advised, or participated in the consideration of while in the service of the Commission." On February 16, 2006, Applicants submitted an answer contesting the applicability of Rule 2103, but agreeing to withdraw the testimony at issue. Applicants state that they do so in order to ensure that this case is processed in a timely manner.

¹⁷ 71 Fed. Reg. 3,508 (2006).

¹⁸ 18 C.F.R. § 385.2103(a) (2005).

IV. Discussion

A. Procedural Matters

21. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,¹⁹ the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. In addition, we will accept, for good cause shown, the unopposed, late-filed interventions submitted by EPSA, Williams, and SPP. Rule 213(a) of the Commission's Rules of Practice and Procedure prohibits an answer to a protest unless otherwise ordered by the decisional authority.²⁰ We accept Applicants' answers because they provide information that assisted us in our decision-making process.

B. Standards of Review

1. Applicants' Position

22. Applicants assert that their proposal to withdraw from the Midwest ISO is subject to a standard of review that is based on both statutory requirements and contractual obligations. First, the proposal is subject to the just and reasonable standard of FPA section 205. Second, it is subject to the terms and conditions of the TO Agreement addressing withdrawal requests. And third, Applicants state that their proposed replacement arrangements are subject to Applicants' Merger Conditions and thus to review under section 203. In addition, Applicants point out that their proposed revisions to the Commission's *pro forma* OATT must be considered under the Commission's "consistent with or superior to" standard set forth in Order No. 888. Finally, Applicants argue that the Commission's RTO formation policies, as set forth in Order No. 2000, do *not* apply here because authorization to establish an RTO has not been requested.²¹

¹⁹ *Id.* at § 385.214.

²⁰ *Id.* at § 385.213(a)(2).

²¹ See Amended Filing at 3-4, *citing Duke Independent Entity Order*, 113 FERC ¶ 61,288 at P 18.

2. Responsive Pleadings

23. The Midwest ISO claims that under the Commission's precedent regarding RTO withdrawal, Applicants are required to demonstrate that their proposed replacement arrangements meet the principles of Order No. 2000 and are otherwise just and reasonable under FPA section 205.²² The Midwest ISO also argues that the Commission must consider whether Applicants' withdrawal will really be less costly to Applicants than staying in the Midwest ISO. In addition, the Midwest ISO argues that any revisions to the Transmission and Energy Markets Tariff necessary to accommodate Applicants' withdrawal are subject to review under FPA section 206 and must also comply with a settlement agreement regarding allocation of section 205 filing rights among the Midwest ISO and its transmission owners.²³ The Midwest ISO also states that the Commission must make the determination here whether allowing Applicants to enjoy the benefits of the Midwest ISO grid management and market operations, directly or indirectly, without paying the same costs as the members of the Midwest ISO would constitute an undue preference.

24. Cinergy argues that Applicants should be allowed to withdraw from the Midwest ISO only if the Midwest ISO finds that Applicants' withdrawal will not impair reliable

²² See Midwest ISO protest at 8-10, *citing Guidance on Regional Transmission Organizations and Independent System Operator Filing Requirements Under the Federal Power Act*, 104 FERC ¶ 61,248 (2003) (order clarifying that arrangements to join or exit an RTO that do not involve a transfer of ownership or other proprietary interest in transmission facilities or a lease of jurisdictional transmission facilities, will be reviewed under section 205 and not under section 203); *Pennsylvania-New Jersey-Maryland Interconnection*, 105 FERC ¶ 61,294 at P 36 (2003) (order rejecting PJM transmission owner agreement provision prohibiting a section 205 review of withdrawals from the PJM RTO); *ISO-NE New England, Inc.*, 106 FERC ¶ 61,280 at P 59 (*ISO-NE RTO Order*) (order clarifying that RTO withdrawal requests will be considered, in part, based on the effects of the proposed withdrawal on the ongoing status and operation of the RTO); and *Southwest Power Pool, Inc.*, 109 FERC ¶ 61,010 at P 20 (2004) (order finding that withdrawal from SPP membership is subject to Commission approval under section 205).

²³ *Id.* at 10, n. 19, *citing Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,380 (2005).

operation of the Midwest ISO's transmission system or the operation of its Day 2 Market. Similarly, WPS Companies ask that the Commission consider whether Applicants' proposed withdrawal will significantly harm the remaining Midwest ISO stakeholders. EPSA too urges the Commission to consider the effects of Applicants' withdrawal on the Midwest ISO. EPSA argues that Applicants' withdrawal, in this regard, must meet the standards of both Order No. 888 and Order No. 2000 in a manner that is equal to or superior than the services currently provided by the Midwest ISO. Finally, FirstEnergy argues that Applicants' withdrawal must be measured against the Commission's precedents and RTO policies in addition to Applicants' contractual obligations under the TO Agreement. FirstEnergy asserts that the Commission has the authority, under FPA sections 205 and 206, to ensure that all parties to the TO Agreement meet their commitments and obligations.

3. Applicants' Answer

25. Applicants reiterate their position that the standards of review in this case are contractual (arising under the TO Agreement) and statutory, that is: (i) whether Applicants' proposal is just and reasonable under FPA section 205 and (ii) whether Applicants' proposal satisfies Applicants' Merger Conditions under FPA section 203. Applicants add that the Commission's RTO formation policies are not relevant here because Order No. 2000 makes RTO participation voluntary. Applicants note that, by contrast, were they required to meet the Commission's RTO formation requirements as a condition of their withdrawal, they would be required, in effect, to create or join an RTO, thus making RTO membership mandatory.

26. Applicants also respond to the Midwest ISO's assertion that any term or condition of the Midwest ISO Transmission and Energy Markets Tariff that must be changed because of Applicants' withdrawal request must be considered under FPA section 206. Applicants argue that the tariff changes included in their filing contain no such revisions and state that, in any event, the TO Agreement does not require Applicants to seek such changes under section 206.

4. Commission Findings

27. We review Applicants' proposals in this case using the following four standards. First, Applicants' proposal to withdraw from the Midwest ISO must comply with the withdrawal provisions in the Commission-approved TO Agreement. Second, Applicants' proposed replacement arrangements must comply with Order No. 888 and the standard of review under that order for proposed tariff provisions that differ from the *pro forma*

OATT, i.e., the proposed deviations must be shown to be “consistent with or superior to” the *pro forma* OATT.²⁴ Third, Applicants’ withdrawal from the Midwest ISO requires us to consider whether Applicants’ proposed replacement arrangements adequately address the market power concerns attributable to their merger and previously addressed by the Commission when it established Applicants’ Merger Conditions. Fourth, any replacement arrangements submitted under section 205 must be just, reasonable and not unduly discriminatory.

28. We now turn to intervenors’ arguments respecting these standards. With regard to this first standard -- the standard for withdrawal from an RTO -- the Commission has stated that because a transmission owner’s withdrawal can have a substantial effect on other market participants and the markets themselves, we are required to consider the effect of the requesting party’s withdrawal on the RTO and its remaining members.²⁵ While the Commission has not provided further guidance regarding its application of this standard, we note that, here, the effect of Applicants’ withdrawal on third parties will be fully addressed by the consumer protection provisions of article V of the TO Agreement (*see* section IV.C, below) and by the satisfaction of Applicants’ Merger Conditions (*see* section IV.D, below).

29. We reject intervenors’ argument that Applicants’ withdrawal request must be supported by a cost/benefit analysis demonstrating that Applicants’ departure from the Midwest ISO will be a “benefit” that exceeds the “cost” of their continued membership. The Commission has stated that participation in an RTO is voluntary. Moreover, the just and reasonable standard under the FPA is not so rigid as to limit rates to a “best rate” or “most efficient rate” standard. Rather, a range of alternative approaches often may be just and reasonable. Thus, we will not require Applicants to submit such an analysis.

30. We also reject the Midwest ISO’s argument that Applicants’ replacement arrangements be required to meet the standards applicable to an RTO under Order No. 2000. Applicants are not seeking to establish or operate as an RTO. Rather, they are seeking approval to adopt an OATT that varies from the *pro forma* OATT and thus must demonstrate that their replacement arrangements are consistent with or superior to the *pro forma* OATT. We also reject Cinergy’s argument that Applicants’ withdrawal request

²⁴ *See* Order No. 888 at 31,770.

²⁵ *ISO-NE RTO Order*, 109 FERC ¶ 61,147 at P 41.

should be made subject to certification by the Midwest ISO. This requested veto allowance is neither required nor permitted under the TO Agreement and would otherwise be inconsistent with the rights of a public utility under the FPA.²⁶ Finally, we need not consider here the Midwest ISO's argument that Applicants' proposal, to the extent it may require revision to the Midwest ISO Transmission and Energy Markets Tariff, must be considered under FPA section 206. As Applicants note in their answer, no such revisions are before us here.

C. Whether Applicants' Proposal to Withdraw Meets the Standards in the TO Agreement

31. Article V of the TO Agreement (Withdrawal of Members) sets forth six conditions that must be met by a transmission owner seeking to withdraw from the Midwest ISO. For the reasons discussed below, we find that Applicants have satisfied four of these requirements, and have satisfied, subject to conditions, the remaining two requirements.

1. Withdrawal Notice

32. Article V, section 1 of the TO Agreement states that “[a] Member who is also an Owner may, upon submission of a written notice of withdrawal to the President, commence a process of withdrawal of its facilities from the Transmission System.” Article V, section 1 further provides that “[s]uch withdrawal shall not be effective until December 31 of the calendar year following the calendar year in which notice is given....” Applicants state that they have satisfied the written notice requirement by providing their notice of withdrawal on December 28, 2004 to the President of the Midwest ISO. We agree that Applicants have satisfied this requirement.

2. Users Held Harmless

a. Applicants' Proposal

33. Article V, section 2(A) of the TO Agreement requires a transmission owner seeking to withdraw from the Midwest ISO to hold existing customers harmless.²⁷ To

²⁶ See *Atlantic City Electric Co. v. FERC*, 295 F.3d 1 (D.C. Cir. 2002).

²⁷ Article V, section 2(A) states:

(continued)

meet this obligation, Applicants commit that existing transmission arrangements – both existing Midwest ISO transmission contracts and agreements that are grandfathered from the Midwest ISO Transmission and Energy Markets Tariff – will keep the same service and pricing. Specifically, Applicants state that customers taking service under an existing agreement will receive the same service and pricing that these customers currently receive for service through Applicants' system and the Midwest ISO/PJM systems and for arrangements for network and point-to-point service wholly within Applicants' system.²⁸ Applicants state that they will also continue to honor existing Midwest ISO short-term and long-term transmission contracts that require service within Applicants' system.

34. With respect to existing Midwest ISO transmission contracts that rely on Applicants' system but have sources or sinks in other zones, Applicants state that they will not re-impose pancaked charges and that customers taking service under these contracts will continue to be customers of the Midwest ISO.²⁹ Applicants state that these customers will continue to receive the same service they receive today.³⁰ Finally,

Users taking service which involves the withdrawing Owner and which involves transmission contracts executed before the Owner provided notice of its withdrawal shall continue to receive the same service for the remaining term of the contract at the same rates, terms, and conditions that would have been applicable if there were no withdrawal. The withdrawing Owner shall agree to continue providing service to such Users and shall receive no more in revenues for that service than if there had been no withdrawal by such Owner.

²⁸ Applicants add that under the Midwest ISO Transmission and Energy Markets Tariff, they are not billed for network service provided to their native load and that similarly, for these existing transactions, they will not bill themselves under their proposed OATT.

²⁹ Applicants note, however, that they will require these customers to sign a transmission service agreement for the portion of service taken by such customers over Applicants' system.

³⁰ Applicants list two such contracts in attachment E of their proposed OATT, both of which involve Illinois Municipal.

Applicants state that customers with agreements that are grandfathered under the Transmission and Energy Markets Tariff (that is, agreements currently listed as such in attachment P to that tariff) will continue to take service at existing rate levels. Applicants state that these customers may also be entitled to certain rate reductions and will face no degradation in the quality of their existing service.

b. Responsive Pleadings

35. CMTC argues that Applicants' hold harmless obligation requires Applicants to address both existing service and new service. Therefore, Applicants must offer new service, and not just existing service, at non-pancaked rates. In addition, CMTC argues that Applicants should be required to de-pancake any other rates or costs if those rates or costs would have been de-pancaked at any time in the future had Applicants remained in the Midwest ISO. CMTC argues that customers must continue to have access to the same quality and flexibility of service available under the Midwest ISO Transmission and Energy Markets Tariff.

36. The Midwest ISO argues that Applicants' hold harmless obligation can be interpreted to include all Midwest ISO transmission service flowing over Applicants' transmission facilities, including all flows over Applicants' facilities for transactions wholly within the Midwest ISO (*i.e.*, for loop flow). The Midwest ISO states that the loop flows resulting from Applicants' departure will likely require the negotiation of a seams agreement prior to Applicants' withdrawal and that, consistent with Applicants' hold harmless obligation, this agreement should not be permitted to alter any rate, term or condition that was in effect prior to Applicants' notice of withdrawal.

37. In addition, the Midwest ISO asserts that Applicants have not addressed how they will hold the Midwest ISO transmission owners harmless from any increased responsibility for future operating costs and from any decrease in revenue distributions. Ameren concurs, noting that Applicants' withdrawal will require it to pay more of the Midwest ISO's administrative and operational costs. Ameren argues that customers should be held harmless from any such rate increase.

38. Intervenors also raise concerns regarding the extent to which Applicants' hold harmless commitment honors existing FTRs. The Midwest ISO notes that upon Applicants' withdrawal, Applicants' financial obligations for counter-flow FTRs will cease and that this could harm customers. EME argues that its FTRs are not set to expire until June 2006, and, therefore, Applicants should not be permitted to withdraw from the Midwest ISO before that date.

39. Dynegey argues that Applicants do not adequately address how they will implement their hold harmless commitment, including their obligation to provide transmission service to customers with existing contracts. Dynegey also argues that Applicants fail to explain how these contracts will be treated under Applicants' OATT. In particular, Dynegey seeks clarification that Applicants will continue to honor the "no cost deliverability" entitlement from Dynegey's generating facility in Oldham, Kentucky, which is interconnected with Applicants' system (Bluegrass Facility). Dynegey also seeks clarification that there will continue to be available transmission capacity for delivery from the Bluegrass Facility to the Midwest ISO. In addition, Dynegey asserts that Applicants' commitment to their existing "transmission customers" regarding their "existing transmission arrangements" is ambiguous as it relates to service for the Bluegrass Facility because a transmission service reservation or contract is not required for delivery of energy from the Bluegrass Facility into the Midwest ISO market as of the effective date of the Midwest ISO Day 2 Market.

40. Dynegey also raises concerns regarding existing sales of reactive power from the Bluegrass Facility. Dynegey states that under its interconnection agreement with Applicants, Applicants are required to pay for reactive power supplied by the Bluegrass Facility if the Commission accepts a reactive power tariff for the facility, an authorization which the Commission has now conditionally granted.³¹ Dynegey states that under this tariff, Applicants are not required to pay for reactive power service because the Midwest ISO does so under schedule 2 of the Transmission and Energy Markets Tariff. Upon Applicants' withdrawal, however, reactive power from the Bluegrass Facility will not be eligible for compensation under schedule 2. Accordingly, Dynegey asks that Applicants' withdrawal be conditioned on the Bluegrass Facility's reactive power tariff remaining in effect and on Applicants assuming sole responsibility for payment for reactive power from that facility.

c. Applicants' Answer

41. Applicants challenge CMTC's assertion that the TO Agreement requires Applicants to pay a share of future operating costs of the Midwest ISO. Applicants also challenge the argument raised by the Midwest ISO and EME that Applicants' withdrawal should not be permitted to disrupt the allocation and settlement of FTRs. Applicants respond that they should not be held responsible for the effect of their proposal on these

³¹ See *Bluegrass Generating Co., L.L.C.*, 110 FERC ¶ 61,349 (2005).

allocations because, under the TO Agreement, the hold harmless requirement applies only to service in place prior to the day the withdrawing member provides notice of withdrawal. Applicants note that they provided notice of withdrawal before the Midwest ISO's implementation of FTRs. Applicants also insist that their proposal holds customers harmless because, while customers may not have FTRs, they will receive the same level of firm service to which they were entitled before December 28, 2004, *i.e.*, the date on which Applicants gave notice of their intent to withdraw.

42. Applicants also respond to the Midwest ISO's concerns about loop flow. Applicants assert that loop flow issues will be addressed by TVA, serving as Applicants' Reliability Coordinator, and will be resolved under the Joint Reliability Coordination Agreement and Congestion Management Process in place between TVA, PJM and the Midwest ISO.³² Finally, with respect to issues involving compensation for reactive power, as raised by Dynegy, Applicants acknowledge that they are a party to an interconnection agreement with Dynegy and that this agreement obligates them to purchase reactive power.

d. Commission Findings

43. We find that Applicants' commitment to hold existing customers harmless meets the "Users Held Harmless" obligation of the TO Agreement, subject to revision, clarification, and the submittal of a compliance filing.

44. As an initial matter, we clarify Applicants' commitment in several respects. First, Applicants' commitment, as it relates to their obligations under the TO Agreement, applies to *existing* transmission arrangements – both existing Transmission and Energy Markets Tariff transmission contracts and grandfathered agreements. We understand this commitment to apply to contracts entered into before December 28, 2004, *i.e.*, before the date Applicants gave notice of their intent to withdraw from the Midwest ISO. While Applicants' proposal does not identify each of the customers that they will treat as "existing" customers (other than the customers they identify as taking service under grandfathered agreements and Illinois Municipal, a customer under two long-term firm transmission agreements), the plain language in the TO Agreement references contracts

³² See section IV.J, below. As discussed below, Applicants are not currently parties to the Joint Reliability Coordination Agreement or to the Congestion Management Process it incorporates.

“executed before the transmission owner provided notice of its withdrawal.” Therefore, we construe Applicants’ hold harmless commitment as being tied to this date.

45. Second, we clarify that this hold harmless commitment means that these existing customers will enjoy the same service and pricing that they would have been entitled to receive, absent Applicants’ withdrawal. This commitment is unqualified, *i.e.*, Applicants do not condition this commitment on an agreement from the Midwest ISO to provide reciprocal rate treatment.³³ We therefore construe Applicants’ commitment to mean that existing transmission customers will not pay pancaked transmission rates or pancaked ancillary service rates (either between Applicants’ system and the Midwest ISO or between Applicants’ system and PJM). Rather, these customers will continue to receive service at the same rates, level of service, and quality of service that they would have received absent Applicants’ withdrawal.

46. Third, Applicants also fail to define the term “contracts” when they state that they will hold harmless “existing contracts.” However, we read this commitment to extend to grandfathered agreements, executed transmission service agreements under the Transmission and Energy Markets Tariff that cover specific transactions, or a confirmed reservation on the Midwest ISO open access same-time information system (OASIS) in existence as of the notice date. This interpretation is consistent with article V, section 2(a), of the TO Agreement, which imposes a hold harmless commitment on any “transmission contract” predating the notice of withdrawal.

47. We next turn to concerns raised about the reach of the hold harmless requirement. We agree with intervenors that Applicants’ commitment to hold existing customers harmless must address FTRs and loop flow. The heart of these concerns relates to allocation of flowgate capacity and corresponding real-time management of loop flows. These issues are addressed under the Joint Reliability Coordination Agreement.³⁴ Consistent with the TO Agreement requirement that customers with existing contracts “continue to receive the same service for the remaining term of the contract at the same rates, terms, and conditions that would have been applicable if there were no withdrawal,” the Midwest ISO must have access to flowgate capacity necessary to

³³ By contrast, Applicants’ rate de-pancaking proposal (*see* section IV.F of this order, below) is conditioned on such a commitment.

³⁴ *See* section IV.J of this order, below.

provide customers with existing contracts the same service that these customers would have received absent Applicants' withdrawal. Therefore, Applicants must ensure that the Joint Reliability Coordination Agreement provides for the allocation of flowgate capacity and real-time management of loop flows necessary for customers with existing contracts to continue to receive the same service they would have received absent Applicants' withdrawal.

48. Applicants' filing also fails to address how existing contracts will be incorporated into their stand-alone OATT or what, if any, provisions in their OATT relate specifically to existing customers. Accordingly, Applicants must file a specific proposal to implement their hold harmless commitment and include therein: (i) a list of all customers and transactions that will be covered by their commitment³⁵ and (ii) revisions to their OATT necessary to protect customers with existing contracts.

49. We reject intervenors' arguments that Applicants' hold harmless obligation extends to all Midwest ISO customers and market participants without regard to those customers' current transmission arrangements. The TO Agreement plainly states that the hold harmless provision applies only to *existing* service, not *future* service, and only for the remaining term of the contract for existing service.

50. We also reject the argument that Applicants must address, as part of their hold harmless obligation, future operating costs of the Midwest ISO or the future allocation of revenues within the Midwest ISO. The Midwest ISO does not claim that total operating costs will increase as a result of Applicants' withdrawal. Nor does the Midwest ISO point to a particular operating cost that would have been lower had Applicants never joined the Midwest ISO. Applicants *are* responsible, as part of their exit fee obligation (as discussed in section IV.C(3), below), for their existing financial obligations. However, intervenors cite to no provision in the TO Agreement that would require Applicants to pay future operating costs or to protect remaining members from the possible reallocation of future revenues.

51. Finally, regarding Dynegy's Bluegrass Facility, we find that Dynegy's requested rate treatment is not covered by Applicants' hold harmless obligation. Dynegy concedes

³⁵ Given that some of this information may be in the possession of the Midwest ISO, rather than Applicants, we direct Applicants and the Midwest ISO to work together to prepare such a list.

that it does not have a contract or reservation for transmission service to cover the output of its facility. Therefore, the plain language of article V, section 2(A) of the TO Agreement does not encompass the Bluegrass Facility. Dynegy, in this case, is not a user “taking service which involves the withdrawing Owner and which involves transmission contracts executed before the Owner provided notice of its withdrawal....” Additionally, we note that Dynegy’s concern about reactive power sales from its Bluegrass Facility were addressed by Applicants in their answer, where Applicants acknowledge that they have an obligation to purchase reactive power from the Bluegrass Facility even after they withdraw from the Midwest ISO.

3. Existing Obligations (Exit Fee)

a. Applicants’ Proposal

52. Article V, section 2(B) of the TO Agreement states that “[a]ll financial obligations incurred and payments applicable to time periods prior to the effective date of such withdrawal shall be honored by the Midwest ISO and the withdrawing Owner.”

53. Applicants acknowledge this obligation as a requirement to pay an “exit fee” to the Midwest ISO. In their Amended Filing, moreover, Applicants propose an exit fee methodology, as agreed to by the Midwest ISO in the parties’ Withdrawal Agreement. Applicants state that this exit fee methodology is based, in part, on the requirements of the Midwest ISO Transmission and Energy Markets Tariff, which sets forth the financial obligations of a withdrawing entity at schedules 10, 16, and 17.³⁶ As such, Applicants

³⁶ Under schedule 10 (ISO Cost Recovery Adder) a withdrawing transmission owner is required to pay its share of the Midwest ISO’s deferred costs, *i.e.*, the unamortized pre-operating costs and undepreciated capital costs, plus any costs that are not recovered during the initial 6-years of the Midwest ISO’s operations, due to the 15 cent/MWh cap on the ISO Cost Recovery Adder during that period. The withdrawing transmission owner’s total responsibilities equal its pro rata share of deferred costs, based on a load ratio share calculation, calculated for each year of the initial 6-years of the Midwest ISO’s operations and then summed for that period less any deferred costs paid by the transmission owner. The withdrawing transmission owner may pay these amounts amortized over a five-year period, with interest, or may elect to pay these costs prior to that date.

(continued)

state that they were required to enter into negotiations with the Midwest ISO regarding these calculations and that these negotiations resulted in the agreed-to methodology included in the parties' Withdrawal Agreement.

54. Under the Withdrawal Agreement, Applicants state that they will be responsible for a pro rata share of the Midwest ISO's financial obligations allocated among schedules 10, 16 and 17 services based on the ratio of Applicants' billing determinants to the total of all other billing determinants for such service.³⁷ The withdrawal fee is calculated based on the Midwest ISO's financial obligations as recorded on its balance sheet included in its financial statements as of the withdrawal date.³⁸

Under schedule 16 (FTR Administrative Service Cost Recovery Adder) and schedule 17 (Energy Market Support Administrative Service Cost Recovery Adder), the withdrawing transmission owner is required to pay its share of all Midwest ISO un-depreciated capital expenditures and un-amortized deferred costs plus the net interest costs over the remaining life of the debt instrument used to finance the development of the service. Schedules 16 and 17, however, do not specify a methodology for determining the withdrawing transmission owner's total responsibility for such un-recovered costs. Rather, they provide that such responsibility shall be based on the outcome of a negotiated or contested settlement accepted by the Commission.

³⁷ Applicants state that the final allocation of financial obligations will be based on 12 months of actual billing determinants, with a preliminary calculation based on the first 5 months of actual data (April 1, 2005 – August 31, 2005) and a true-up calculation performed 30 business days after the date of Applicants' withdrawal based on actual billing determinants for the twelve months preceding the withdrawal. A true-up will be necessary because 12 months of historical billing determinants will not be available for schedules 16 and 17 at the time of Applicants' withdrawal.

³⁸ These obligations are recorded as long-term liabilities, including: (i) accrued liabilities; (ii) capitalized leases net of current portion; (iii) deferred revenue; and (iv) notes payable. Some financial obligations have payments that extend after the withdrawal date. The financial obligations also include interest payments owed on all debt outstanding and all capitalized lease obligations outstanding as of the withdrawal date.

b. Responsive Pleadings

55. Cinergy, FirstEnergy, Wisconsin Electric, and Ameren, in their comments on Applicants' Initial Filing, support Applicants' right to withdraw from the Midwest ISO provided that all conditions of the TO Agreement are met, including payment of an appropriate exit fee covering Applicants' share of the Midwest ISO's fixed capital costs. Intervenor note, however, that the justness and reasonableness of Applicants' exit fee commitment cannot be determined until such time as the final exit fee is filed with the Commission in the form of a proposed rate.

56. Detroit Edison asserts that the Commission should condition Applicants' withdrawal from the Midwest ISO on the requirement that Applicants' corporate owner and/or Applicants' customers bear the *entirety* of the exit fee due under the TO Agreement. Detroit Edison argues, for example, that it would be unfair to allow any portion of these costs to be allocated to the Midwest ISO's remaining members. Ameren argues that the Commission should require the Midwest ISO to reduce its ongoing costs so that any costs associated with the Applicants' withdrawal are not simply reallocated to the remaining transmission owners and transmission customers. Finally, intervenors argue that the negotiation of the exit fee should not have been conducted in private, *i.e.*, by excluding other Midwest ISO members. FirstEnergy agrees that the Midwest ISO should not be the only entity permitted to negotiate with Applicants, but suggests that the negotiating parties be limited to Applicants, the Midwest ISO, and the parties to the TO Agreement.

c. Commission Findings

57. We accept Applicants' proposed methodology to determine their exit fee, as submitted in their Withdrawal Agreement with the Midwest ISO, subject to Applicants' submittal of their final exit fee, once it is calculated, in a compliance filing and subject to the additional conditions discussed below.

58. First, we agree that Applicants' proposed methodology is consistent with schedules 10, 16 and 17 of the Midwest ISO Transmission and Energy Markets Tariff. Use of actual billing determinants for the twelve month period preceding the withdrawal date, for example, is consistent with the load ratio share formula specified in schedule 10. We also find that this methodology is appropriate for determining a withdrawing transmission owner's share of undepreciated capital expenditures and un-amortized deferred costs associated with schedules 16 and 17. We also note that the Midwest ISO and Applicants engaged in negotiations over the appropriate method to calculate

Applicants' financial obligations and that no intervenor, in its comments, challenges Applicants' compliance with schedules 10, 16 and 17.

59. With respect to Detroit Edison's concern that no portion of the exit fee costs be allocated to remaining Midwest ISO members, we note that Applicants have not proposed here to recover any costs associated with the exit fee and Detroit Edison will have the opportunity to raise any concerns if Applicants make a filing under section 205 to recover these costs. With respect to Ameren's and Detroit Edison's concerns regarding the Midwest ISO's ongoing operating costs, article V, section 2(B) of the TO Agreement provides that the withdrawing transmission owner is obligated to honor all existing financial obligations incurred and payment applicable to time periods prior the effective date of the withdrawal. This provision, however, does not require that a withdrawing transmission owner contribute to the ongoing operating costs of the Midwest ISO.³⁹ Moreover, there is no requirement in the TO Agreement for the Midwest ISO to reduce its ongoing operating costs by an amount corresponding to Applicants' withdrawal. It is also speculative to suggest that remaining Midwest ISO members' costs will increase or decrease as a result of Applicants' withdrawal. In either event, we find that schedules 10, 16 and 17 provide only for recovery of un-amortized deferred costs and undepreciated capital costs incurred prior to the effective date of Applicants' withdrawal.

60. In addition, we find that the TO Agreement does not require that Applicants' exit fee be negotiated with entities other than the Midwest ISO. Article V of the TO Agreement does not impose any such requirement and we therefore decline to order it. Finally, we direct Applicants to submit the calculation of their final exit fee to the Commission as a compliance filing 30 business days after the effective date of Applicants' withdrawal from the Midwest ISO. In that filing, Applicants should provide the documentation that the Midwest ISO provides to Applicants to demonstrate that their proposed exit fee was calculated pursuant to the methodology accepted here.

4. Construction of Facilities

61. Article V, section 2(C) of the TO Agreement provides that "[o]bligations relating to the construction of new facilities pursuant to an approved plan of the Midwest ISO

³⁹ Similar concerns regarding on-going operating cost are also addressed in section IV.C(2) of this order, above, regarding Applicants' hold harmless obligation.

shall be renegotiated as between the Midwest ISO and the withdrawing Owner.” Applicants, in their Amended Filing, state that they have reached an agreement with the Midwest ISO that includes a commitment from Applicants that they will construct certain facilities in accordance with the Midwest ISO’s 2005 Transmission Expansion Plan. We agree that this commitment satisfies section 2(C) of the TO Agreement.

5. Other Obligations

62. Article V, section 2(D) of the TO Agreement provides that “[o]ther obligations between the Midwest ISO and the Withdrawing Owner shall be renegotiated as between the Midwest ISO and the withdrawing Owner.” Applicants have not identified, nor has the Midwest ISO, any such “other obligation” that requires negotiation. Accordingly, we find that this requirement has been satisfied.

6. Regulatory Approval

63. Article V, section 3 of the TO Agreement provides that “the withdrawal by an Owner of its facilities from the Midwest ISO shall be subject to applicable federal and state regulatory approvals or procedures....” Applicants assert that their filing satisfies this requirement, that is, that their proposed withdrawal warrants Commission approval, because: (i) Applicants’ replacement arrangements include Applicants’ proposed adoption of the Commission’s *pro forma* OATT, with certain proposed modifications (*see* section IV.E, below); (ii) Applicants satisfy Applicants’ Merger Conditions (*see* section IV.D, below); and (iii) all remaining TO Agreement requirements governing Applicants’ withdrawal from the Midwest ISO, as discussed above, have been met.

64. The Midwest ISO argues that Applicants’ proposal to withdraw from the Midwest ISO does not warrant regulatory approval because the terms upon which Applicants’ seek to withdraw reflect a strategy of cost avoidance. Specifically, the Midwest ISO asserts that Applicants intend to avail themselves of the PJM/Midwest ISO Joint Operating Agreement (*see* section IV.J below) to manage loop flow, rely on the PJM/Midwest Joint Reliability Coordination Agreement to provide TVA with sufficient information to perform Reliability Coordinator functions (*see Id.*), and sell into and buy from the Midwest ISO markets when it is economically advantageous to do so. The Midwest ISO argues that, as such, Applicants propose to benefit from the on-going existence of the Midwest ISO, while paying for the services offered by the Midwest ISO only on a selective, as-needed basis.

65. We agree with Applicants that Applicants' requested withdrawal from the Midwest ISO, with revisions discussed elsewhere in this order, warrants Commission approval. We will not consider, here, the concern expressed by the Midwest ISO regarding Applicants' potential ability to use and/or benefit from the Midwest ISO's regional markets while avoiding some or all of the costs attributable to RTO membership. Rather, we find that this issue raises broader, generic concerns with implications applicable to all RTOs and ISOs and to all market participants with whom they interact, whether directly or indirectly. Accordingly, we announce here our intention to establish a technical conference in the near future for the purpose of hearing from all interested parties concerning these important issues.

D. Whether Applicants' Replacement Arrangements Satisfy Applicants' Merger Conditions

1. Applicants' Position

66. Applicants state that in the *LG&E/KU Merger Order* and *E.ON Merger Order*, the Commission accepted Applicants' Midwest ISO membership as mitigating any competitive concerns attributable to Applicants' merger.⁴⁰ Applicants further state that under those orders, their withdrawal proposal must be evaluated, here, to ensure that Applicants' merger continues not to harm competition in the KU requirements customers' destination market and otherwise satisfies FPA section 203. Applicants argue that their withdrawal proposal satisfies Applicants' Merger Conditions by: (i) establishing an Independent Transmission Organization and a Reliability Coordinator that will act independent of Applicants; and (ii) preserving de-pancaked rates.⁴¹ Applicants argue that their proposed allocation of duties to an Independent Transmission Organization and a Reliability Coordinator will effectively mitigate concerns regarding vertical market power to the same extent that the Commission found that Midwest ISO

⁴⁰ *See* n.3, *supra*.

⁴¹ In addition to our discussion of these proposals here, Applicants' Independent Transmission Organization proposal is also discussed in section IV.H of this order, below, Applicants' Reliability Coordinator proposal is discussed in section IV.I, and Applicants' rate de-pancaking proposal is discussed in section IV.F.

membership would in the *LG&E/KU Merger Order*.⁴² Applicants argue that these proposals, taken together, will achieve the same objectives as Midwest ISO membership and thus satisfy the Applicants' Merger Conditions with respect to both horizontal and vertical competitive issues.

67. Applicants' witness, Dr. Hieronymus, compares Applicants' proposals to similar proposals recently addressed by the Commission in the *Duke Independent Entity Order*⁴³ and *Entergy Guidance Order*.⁴⁴ Dr. Hieronymus concludes that Applicants' proposal is superior in terms of both independence and increasing market competitiveness. In addition, he states that, unlike Duke's and Entergy's proposals, Applicants' proposal includes transmission planning oversight and coordination by an independent Reliability Coordinator.

68. Dr. Hieronymus argues that because both the Reliability Coordinator and the Independent Transmission Organization will be fully independent from Applicants, they will have no incentive to harm competition in any relevant market by favoring Applicants over their competitors. Dr. Hieronymus reasons that, because there is little independent generation in Applicants' control area, the competition faced by Applicants comes mostly from outside, through transmission through or into the control area. He argues that Applicants will have no ability to harm competition by denying access or raising costs to competitors because transmission requests by competitors will be accepted (or denied) by the Independent Transmission Organization and any transmission loading relief would be called by the Independent Reliability Coordinator, not by Applicants. Dr. Hieronymus concludes that the transaction will not harm competition.

⁴² The benefits of Midwest ISO membership cited by the Commission, in this regard, were: (i) impartial transmission planning to reduce congestion; (ii) fair and efficient congestion management; (iii) removal of abuses of native load priority; (iv) elimination of incentives to curtail competitors' generation; and (v) removal of incentives to game OASIS management. *See LG&E/KU Merger Order*, 82 FERC ¶ 61,308 at 62,222.

⁴³ 113 FERC ¶ 61,288.

⁴⁴ 111 FERC ¶ 61,222.

69. With respect to horizontal competitive issues, Applicants state that the expanded market access identified by the Commission in the *LG&E/KU Merger Order* as an additional benefit of Applicants' participation in the Midwest ISO is preserved under their proposal because transmission rates for new service into and through their system will remain de-pancaked, assuming that the Midwest ISO and its transmission owners agree to Applicants' rate de-pancaking proposal.

70. Applicants state that Dr. Hieronymus has also analyzed the effect of Applicants' withdrawal on competition in the Midwest ISO for both "economic capacity" and "available economic capacity."⁴⁵ Specifically, Dr. Hieronymus has analyzed these factors for ten season and load conditions, involving peak, super peak, and off-peak periods for summer, winter and shoulder seasons, and an "extreme" summer super peak condition. Applicants state that their analysis of economic capacity shows that the post-transaction market is unconcentrated for all season and load levels, based on a Herfindahl-Hirschman Index (HHI) measure of market concentration.⁴⁶ Specifically, Applicants report changes in market concentration ranging from only 46 HHI to 63 HHI, all within the Commission's screening threshold.⁴⁷

⁴⁵ A supplier's economic capacity is the amount of capacity that could compete in the relevant market, given market prices, running costs, and transmission availability. A supplier's available economic capacity is its economic capacity, minus its native load obligation.

⁴⁶ The HHI is a widely accepted measure of market concentration that is calculated by squaring the market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between these firms increases. Markets in which the HHI is less than 1000 are considered unconcentrated; markets in which the HHI is 1000, or more, but less than 1800 are considered moderately concentrated, and markets where the HHI is 1800 or more are considered highly concentrated.

⁴⁷ The Commission has adopted the Federal Trade Commission/Department of Justice Horizontal Merger Guidelines, which state that, in a horizontal merger or acquisition, an increase of more than 50 HHI in a highly concentrated market, or an increase of 100 HHI in a moderately concentrated market, fails its screen and warrants further review. *See Merger Policy Statement*, 79 FERC ¶ 61,321.

71. Applicants state that for available economic capacity, the post-transaction market is unconcentrated for eight of the ten season and load levels, moderately concentrated in the summer and shoulder off-peak periods, with one screen failure for the shoulder off-peak period, in which the transaction raises market concentration from 1,014 HHI to 1,120 HHI. Applicants argue, however, that this single screen failure for available economic capacity does not indicate harm to competition because: (i) it occurs in a barely concentrated market, at an assumed shoulder price of \$35 per megawatt hour; and (ii) the analysis did not include imports into the Midwest ISO, which would materially reduce market concentration.

2. Responsive Pleadings

72. The Midwest ISO, WPS Companies, CMTC, and Dynegy argue that Applicants' continuing membership in the Midwest ISO, or a comparable RTO, is the only means of satisfying Applicants' Merger Conditions. In particular, the Midwest ISO states that the Commission was clear in both the *LG&E/KU Merger Order* and *E. ON Merger Order* that RTO membership was an essential condition of the merger approvals. The Midwest ISO further states that competition in the Midwest will be harmed if Applicants leave the Midwest ISO and that Applicants have not shown that their proposed alternative arrangements will adequately mitigate the harm to competition resulting from their withdrawal.

73. The Midwest ISO also argues that Applicants' proposed operating model is inferior to an RTO because it lacks features such as market-based congestion management and real-time balancing markets. The Midwest ISO further argues that Applicants' withdrawal will create a new market/non-market seam. WPS Companies agree, arguing that because Applicants have significant transfer capability with PJM and with TVA, removing this transfer capability from the Midwest ISO's operational control would create new seams between both the Midwest ISO and PJM and between the Midwest ISO and TVA.

74. EME requests that the Commission consider the horizontal and vertical market power effects of Applicants' proposed withdrawal and the smaller geographic markets of the stand-alone service territory that will result. Dynegy also expresses concerns about the effect on competition in both the remaining Midwest ISO footprint and within Applicants' proposed footprint. Dynegy and WPS Companies also express concern regarding the effect of Applicants' withdrawal on the viability of the Joint and Common Market. WPS Companies argue that the withdrawal will undermine this expanded market and request that the Commission set this issue for hearing.

75. The Midwest ISO and EPSA argue that Applicants' proposed division of responsibilities among the Reliability Coordinator, the Independent Transmission Organization, and Applicants, is inherently unstable because it multiplies the opportunity for miscommunication and inadvertent, or even opportunistic, contradictory actions. The Reliability Coordinator may have the incentive to favor Applicants' interests, given its own interest in renewal of its contract.

76. Finally, WPS Companies note that PJM and the Midwest ISO transmission owners have filed a proposal for the cross-border allocation of the cost of certain transmission expansion projects in Docket No. ER05-6-023, *et al.*, a proposal that is designed to permit the recovery from one RTO of certain costs incurred by the adjacent RTO when constructing certain reliability projects within its footprint.⁴⁸ WPS Companies request that the Commission consider the effect of Applicants' withdrawal on this proposal.

3. Applicants' Answer

77. Applicants argue that their withdrawal proposal does not seek an exemption from Applicants' Merger Conditions; rather, it proposes to meet these conditions by a means not contemplated by the Commission at the time of the Merger Orders. Applicants note that at that time, RTO membership may have been the only effective condition available to the Commission for ensuring that market power would be mitigated. However, since that time there have been innovations in independent grid management and administration, including the development of Applicants' proposed operating model. Applicants insist that their proposal can achieve the same benefits of an ISO or RTO that the Commission identified in the Merger Orders, namely eliminating Applicants' ability to use their transmission assets to harm competition in any relevant wholesale market.

78. Applicants also respond to the Midwest ISO's arguments that Applicants' proposed operating model is inferior to an RTO because it lack features such as market-based congestion management, real-time balancing markets and independent market monitoring. Applicants assert that their proposed operating model, while not identical to an RTO, adequately mitigates the merger-related harm to competition cited by the Commission when it established Applicants' Merger Conditions.

⁴⁸ See *Midwest Independent Transmission System Operator, Inc.*, 113 FERC ¶ 61,194 (2005) (*Midwest ISO Cross-Border Order*).

79. Applicants also respond to the arguments raised by WPS Companies and Dynegy regarding the creation of new seams, in particular the concern over Applicants' transfer capability with TVA. Applicants respond that their proposals will not create any seams-related problems because, among other things, their proposed OATT would continue de-pancaked rates. In addition, TVA already has a "border" agreement with the Midwest ISO, and Applicants' selection of TVA as its Reliability Coordinator will merely move the point at which the existing seams exist while otherwise maintaining the status quo regarding the management of these seams. Applicants state that their proposals will not decrease the Midwest ISO's transfer capability.

4. Commission Findings

80. We find that, with some revision, Applicants' withdrawal proposal satisfies the concerns that were addressed by Applicants' Merger Conditions. First, Applicants' proposal satisfies concerns relating to vertical market power, subject to our independence requirements, as discussed in sections IV.H and IV.I of this order, below, and revision of Applicants' transmission planning proposal such that additional approval authority is granted to the Independent Transmission Organization. Applicants' proposal also satisfies concerns relating to horizontal market power, as discussed below, and subject to modifications to Applicants' rate de-pancaking proposal, as discussed in section IV.F of this order.

81. The Commission, in the *LG&E/KU Merger Order*, outlined five specific areas where an independent entity such as an ISO can mitigate transmission-related vertical market power.⁴⁹ We will consider each of these issues here.⁵⁰

⁴⁹ *LG&E/KU Merger Order*, 82 FERC ¶ 61,308 at 62,222:

[I]f properly structured, an ISO . . . can improve the process for determining system expansion needs because that process will no longer be dominated by a transmission operator that also owns generation assets. A properly structured ISO would have no economic stake in maintaining congested interfaces. Moreover, an ISO could eliminate the potential for the strategic use of the transmission owner's priority to use internal system capacity for native load. The ISO could also eliminate the incentive to engage in strategic curtailments of generation owned by the transmission operator's generation service competitors. Also, any incentives for gaming OASIS operations could be removed. These benefits will promote

(continued)

(i) System Expansion

82. The Commission, in the *LG&E/KU Merger Order*, found that an ISO can improve the process for determining system expansion needs because that process would not be dominated by a transmission operator that also owns generation assets. We find that Applicants' proposal, with modification, adequately addresses concerns regarding system expansion.

83. Under attachment L to Applicants' proposed OATT, transmission planning duties are divided between Applicants (the transmission owner), SPP (the Independent Transmission Organization), and TVA (the Reliability Coordinator). Applicants' responsibilities include the initial preparation of: (i) Planning Criteria, i.e., the standards, procedures and business practices used by Applicants in developing the Annual Plan; (ii) the Base Case Model, used for evaluating the need for transmission upgrades;⁵¹ (iii) the Transmission Study Criteria, used to evaluate the need for upgrades for new delivery or interconnection service; and (iv) the Annual Plan, i.e., the document identifying all transmission upgrade projects on Applicants' system necessary to satisfy the Planning Criteria and the Base Case Model. Attachment L also provides that TVA will serve as the Transmission Planning Authority and will be responsible for performing certain duties assigned to the "Planning Authority," as defined under the North American

generation entry and competition because the affected markets will be perceived by potential entrants as fairer as a result of the transmission system no longer being controlled by their generation service competitors.

⁵⁰ We note that our analysis in this section presumes that Applicants will also comply with the requirements set forth in section IV.H and IV.I of this order (addressing independence requirements and related issues).

⁵¹ Applicants define the Base Case Model, for purposes of transmission planning, as the annual and seasonal power flow models that are developed by Applicants to include all existing long term uses of Applicants' system, including network integration transmission service, firm transmission service for Applicants' native load, long term point-to-point transmission service, and firm service provided under grandfathered agreements.

Electric Reliability Council (NERC) standards, and will review and evaluate Applicants' plans to address reliability inadequacies.⁵²

84. With respect to SPP's assigned planning duties, under attachment L, SPP will post on OASIS the Planning Criteria, Applicants' business practices for transmission planning, and a description of any disputes between Applicants and TVA regarding the development of the Planning Criteria, Base Case Model, or Annual Plan.⁵³ In addition, SPP will be responsible for OASIS management and OASIS duties, including accepting and processing requests for transmission service, and determining Available Transmission Capability and Total Transmission Capacity. Applicants further state that the SPP will process all generation interconnection requests and be responsible for System Impact Studies.

85. With respect to Applicants' proposed allocation of transmission planning duties, we direct Applicants to modify their proposal in order to achieve the same level of independent, non-market participant transmission planning that exists today under their existing arrangements with the Midwest ISO. This revision is necessary because independent, non-market participant transmission planning is essential to mitigating, over the long term, the vertical market power concerns discussed in the *LG&E/KU Merger*

⁵² TVA will also, among other things: (i) review and approve the Planning Criteria to ensure that the criteria are sufficiently defined for customers to understand how planning is conducted; (ii) review and approve the Base Case Model to ensure that it reflects annual and seasonal power flows consistent with the Planning Criteria; and (iii) conduct an independent reliability assessment of the Annual Plan and submit suggested changes to Applicants. As part of the reliability assessment for the Annual Plan, TVA will also seek to identify whether there are upgrade projects in the Annual Plan that are not necessary to meet the Planning Criteria or the requirements of the Base Case Model. Applicants and TVA will also participate in a Transmission Planning Conference with regulators to review the Annual Plan.

⁵³ The Independent Transmission Organization will also utilize the Base Case Model and Transmission Study Criteria developed by Applicants and approved by the Reliability Coordinator for processing transmission service requests. Finally, the Independent Transmission Organization will participate with Applicants and the Reliability Coordinator in updating the model as part of any regional model development processes.

Order and which Applicants sought to satisfy by turning control over transmission planning to the Midwest ISO. Accordingly, to satisfy Applicants' Merger Conditions, SPP's role must be expanded to ensure that it, as an independent, non-market participant, will have the authority to ensure that transmission planning on Applicants' system is done on an independent, non-discriminatory basis.

86. On compliance, then, Applicants must modify their proposed allocation of duties listed in attachment L to their OATT and in all related agreements to give the Independent Transmission Organization the same authority over Applicants' transmission planning duties that the Midwest ISO has currently.⁵⁴ This will ensure that system expansion needs are identified and addressed in a manner comparable to that contemplated by Applicants' Merger Conditions. Specifically, Applicants must assign to the Independent Transmission Organization approval authority over all models, planning criteria, study criteria, plans, studies, the methodology for calculating Available Transmission Capability, and any inputs or numerical values provided by Applicants to the same extent as the Midwest ISO has authority over these matters today. Moreover, while the Reliability Coordinator may retain authority to certify transmission plans for reliability purposes, the Independent Transmission Organization must have ultimate review and approval authority over such planning functions to the same extent that the Midwest ISO has today. We will therefore require Applicants to clarify, on compliance, how the Independent Transmission Organization and the Reliability Coordinator will coordinate with each other in performing these duties. Applicants must also propose a mechanism to resolve any disputes that may arise between the two.

87. With respect to WPS Companies' concerns regarding the Midwest ISO/PJM cross-border pricing proposal, we find that this proposal as accepted by the Commission in Docket No. ER05-6-000, does not affect Applicants' withdrawal. WPS Companies have not identified any expansion upgrade projects on, or affecting, Applicants' system that would be eligible for cost recovery under this proposal, or that would otherwise affect our analysis of whether Applicants' replacement arrangements mitigate the increased market power attributable to their merger.

⁵⁴ See TO Agreement at appendix B.

(ii) Lack of Economic Stake in Maintaining Congested Interfaces

88. The *LG&E/KU Merger Order* found that a properly-structured ISO would have no economic stake in maintaining congested interfaces. We find that Applicants' proposal adequately addresses concerns regarding Applicants having an economic stake in maintaining congested interfaces.

89. Under Applicants' proposal, SPP and TVA are independent from Applicants and will perform functions that take away Applicants' ability to maintain congested interfaces. SPP will calculate Available Transmission Capability and Total Transmission Capability and will be responsible for ensuring that Available Transmission Capability values are calculated on a nondiscriminatory basis consistent with the Available Transmission Capability methodology. SPP will also validate interchange schedules, including verification of valid sources, sinks and transmission arrangements for such schedules. In addition, TVA will be responsible for coordination of the interfaces between Applicants' system and that of the Midwest ISO and PJM under the Joint Reliability Coordination Agreement. Neither SPP nor TVA would benefit from higher prices in Applicants' markets, and, therefore, SPP and TVA do not have the incentive to maintain congested interfaces on Applicants' system for the purpose of creating higher prices in Applicants' markets.

(iii) Potential Abuses Relating to a Transmission Providers' Use of its Internal System Capacity

90. The *LG&E/KU Merger Order* found that an independent entity such as an ISO could eliminate the potential for the strategic use of the transmission owner's priority to use internal system capacity for native load, *i.e.*, the transmission owner's use of network service reserved for native load to make off-system sales. We find that Applicants' proposal adequately addresses this concern.

91. Under Applicants' proposal, SPP is independent from Applicants and from market participants and will perform functions that take away Applicants' ability to improperly use their native load priority to make off-system sales. SPP will be receiving and approving/denying all transmission service requests, as well as calculating and posting Available Transmission Capability. SPP will also have authority to validate interchange schedules, including verification of valid sinks and transmission arrangements for such schedules. As an independent entity, SPP, like the Midwest ISO, will have no incentive to facilitate any such abuse.

(iv) Strategic Curtailments

92. The *LG&E/KU Merger Order* found that an independent entity such as an ISO could eliminate the incentive to engage in strategic curtailments of generation owned by the transmission owner's generation service competitors. We find that Applicants' proposal adequately addresses concerns about strategic curtailments. Under Applicants' proposal, TVA, not Applicants, will have the sole ability to curtail generation by imposing Transmission Loading Relief directives. In addition, TVA will be subject to the ERO standards and review by the independent ERO.

(v) Gaming OASIS

93. An OASIS operator that also owns generation assets would have the ability and incentive to understate the calculation of Available Transmission Capability posted on its OASIS site in order to foreclose rival generators. We find Applicants' proposal adequately addresses this concern.

94. Under Applicants' proposal, SPP will be responsible for both Available Transmission Capability calculation and the posting of Available Transmission Capability on OASIS and, as an independent entity, has no incentive to game OASIS operations. In addition, TVA will review Applicants' Base Case Model used by the SPP for calculating Available Transmission Capability for reliability purposes. Finally, TVA, not Applicants, will determine Available Flowgate Capacity values and flowgate allocations, and, SPP will have the authority to review these values.

95. Finally, we find that Applicants' proposal to maintain de-pancaked transmission rates, as modified in section IV.F of this order, below, will preserve the KU requirements customers' access to competing suppliers, and thus will preserve the expanded geographic scope of the market that resulted from Applicants' participation in the Midwest ISO. Moreover, as Applicants note, their proposal will not decrease transfer capability between Applicants' system and the remainder of the Midwest ISO footprint. Competing suppliers within the Midwest ISO footprint will therefore retain the ability to compete for sales into the KU requirements customers' market (the only relevant market identified in the *LG&E/KU Merger Order* as being harmed by the combination of Applicants' generation assets).

E. Whether Applicants' Replacement Arrangements are Consistent with or Superior to the Commission's Pro Forma OATT

96. Applicants propose to adopt their pre-Midwest ISO OATT, including deviations from the Commission's *pro forma* OATT as previously accepted by the Commission. In addition, Applicants propose deviations from the *pro forma* OATT that would: (i) implement their proposed Rate De-Pancaking Maintenance Plan; (ii) appoint SPP to serve as an Independent Transmission Organization; (iii) appoint TVA to serve as their Reliability Coordinator; (iv) incorporate other revisions to the *pro forma* OATT, as required by the Commission's orders regarding standardized interconnection procedures;⁵⁵ (v) update Applicants' methodology for assessing Available Transmission Capability; and (vi) provide for cost recovery for system expansions and transmission upgrades.

97. We will accept Applicants' proposed deviations from the *pro forma* OATT to the extent these deviations were previously accepted by the Commission before Applicants joined the Midwest ISO, *i.e.*, as these deviations previously appeared in Applicants' prior OATT. We will also accept the "minor modifications" in, for example, the main body of Applicants' OATT and in the standard interconnection agreements and procedures that deviate from the *pro forma* OATT only to the extent necessary to reflect the division of responsibilities between Applicants, the Independent Transmission Organization and the Reliability Coordinator. We will reject, in part, and conditionally accept, in part, Applicants' proposed deviations from the *pro forma* OATT as they relate to our findings, below, regarding Applicants' proposed Rate De-Pancaking Maintenance Plan (section IV.F), Independent Transmission Organization duties (section IV.H), Reliability Coordinator duties (*see* section IV.I), and system expansion pricing plan (section IV.K).

⁵⁵ *See Standardization of Small Generator Interconnection Agreements and Procedures*, Order No. 2006, 70 Fed. Reg. 34100 (Jun. 13, 2005), FERC Stats. & Regs., Regulations Preambles, Vol. III, ¶ 31,180, at 31,406-551 (2005), *order on reh'g*, Order No. 2006-A, 70 Fed. Reg. 71760 (Nov. 30, 2005), FERC Stats. & Regs., Regulations Preambles, Vol. III, ¶ 31,196 (2005), *reh'g pending*; *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, FERC Stats. & Regs. ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, 106 FERC ¶ 61,220, *order on reh'g*, Order No. 2003-B, 109 FERC ¶ 61,287 (2004), *order on reh'g*, Order No. 2003-C, 111 FERC ¶ 61,401 (2005).

98. Finally, Applicants recognize that their proposed deviations relating to their methodology for calculating Available Transmission Capability may need to be reviewed and possibly modified by SPP (serving as their Independent Transmission Organization), based on SPP's own requirements.⁵⁶ Accordingly, we require Applicants to submit, in their compliance filing, any necessary changes to their methodology for calculating Available Transmission Capability and to provide appropriate support, following SPP's completion of its assessment.

F. Rate De-Pancaking

1. Applicants' Proposal

99. Applicants propose to offer the same de-pancaked transmission rates that are in effect today for new service under their OATT (*i.e.*, for service not otherwise addressed above regarding Applicants' hold harmless obligations covering *existing* contracts), subject to certain exceptions discussed below and also subject to reciprocal treatment from the Midwest ISO and PJM.⁵⁷

100. Specifically, Applicants propose to charge a non-pancaked transmission rate for point-to-point transmission service for drive-through, drive-in, or drive-out transactions between Applicants' system and points within the Midwest ISO and PJM. In addition, Applicants propose to provide and facilitate network service between points of receipt and points of delivery intersecting their facilities and those of the Midwest ISO and PJM at the same non-pancaked rates that are in effect today.⁵⁸ Applicants state that customers

⁵⁶ Section 6.1 of attachment L of Applicants' proposed OATT provides that the Independent Transmission Organization shall have authority to independently review Applicants' description of the methodology for calculating Available Transmission Capability to ensure that these criteria are sufficiently defined for customers to understand how transmission service requests are processed and evaluated.

⁵⁷ Applicants acknowledge that, to date, this reciprocity agreement has yet to be obtained.

⁵⁸ Applicants state that transactions that sink within Applicants' system, or transactions that occur entirely within Applicants' system, will be charged the same zonal rate that is currently charged under the Midwest ISO Transmission and Energy Markets Tariff.

eligible to receive a non-pancaked rate under Applicants' reciprocity firm service would also be subject to a new, lower, curtailment priority.⁵⁹

101. Finally, Applicants state that certain transactions would be subject to a re-pancaked transmission charge. These transactions would include three transaction categories. First, it would include transactions that: (i) source in a control area outside of Applicants' and the Midwest ISO/PJM systems (*e.g.*, TVA); (ii) take service over Applicants' and the Midwest ISO/PJM systems; and (iii) sink in a control area outside of Applicants' and the Midwest ISO/PJM systems (*e.g.*, SPP).⁶⁰ Second, it would include transactions that: (i) source in a control area outside of Applicants' and the Midwest ISO/PJM systems; (ii) sink within the Midwest ISO/PJM systems; and (iii) take service over Applicants' system even though a path that does not use Applicants' system is available.⁶¹ Third, it would include transactions that: (i) source in a control area within the Midwest ISO/PJM systems; (ii) sink in a control area outside of Applicants' and the

⁵⁹ Schedules 7 and 8 of Applicants' proposed OATT describe the transactions eligible for service at non-pancaked transmission rates. While these transactions would not be subject to pancaked transmission rates, they would be charged pancaked ancillary service rates. In addition, transactions that source within Applicants' system and sink in a control area outside of Applicants' system, but where no service over the Midwest ISO/PJM systems takes place, would be charged Applicants' OATT rate instead of the Midwest ISO through-and-out rate (*i.e.*, Applicants' OATT rate would replace the current through-and-out rate).

⁶⁰ These transactions would be subject to the applicable Midwest ISO/PJM through-and-out-rates plus Applicants' OATT rate. Such transactions are currently charged only the applicable Midwest ISO/PJM through-and-out rates. In the alternative, Applicants state that they would be willing to continue charging only the Midwest ISO through-and-out-rates on these transactions so long as Applicants continue to receive their appropriate share of revenues for service through and out of the Midwest ISO.

⁶¹ These transactions would be subject to the applicable Midwest ISO/PJM license plate zonal rate plus Applicants' OATT rate. Such transactions are currently charged only the applicable Midwest ISO/PJM license plate zonal rate. Applicants state that the imposition of their OATT rate on such transactions is necessary to prevent gaming.

Midwest ISO/PJM systems; and (iii) take service over Applicants' system even though a path that does not use a Applicants' system is available.⁶²

2. Responsive Pleadings

102. The Midwest ISO argues that while its Transmission and Energy Markets Tariff eliminates rate pancaking throughout its control area and PJM (a rate benefit Applicants currently enjoy as Midwest ISO members), Applicants, if they are permitted to withdraw from the Midwest ISO, will not, and should not, be entitled to receive RTO member benefits. The Midwest ISO asserts that Applicants, under these circumstances, will face pancaked rates for service into the Midwest ISO and through to PJM. The Midwest ISO adds that entities declining to be a part of an RTO should not be extended the privilege of region-wide rates.

3. Applicants' Answer and Amended Filing

103. Applicants state that their rate de-pancaking proposal represents their best effort at meeting Applicants' Merger Conditions. Applicants also assert that where, as here, they are willing to provide the benefits of non-pancaked rates on a reciprocal basis to the Midwest ISO, it would be unfair and discriminatory for the Midwest ISO not to extend these same benefits to Applicants.

104. In their Amended Filing, Applicants also discuss the issue of transmission capacity hoarding. Applicants state that the Commission should ensure that the Independent Transmission Operator is alert for circumstances where hoarding could arise and make sure that the Independent Transmission Operator takes the necessary actions to prevent hoarding of transmission capacity.

⁶² These transactions would be subject to the applicable Midwest ISO/PJM through-and-out rates, plus Applicants' OATT rate. Such transactions are currently charged only the applicable Midwest ISO/PJM through-and-out rates. Applicants state that the imposition of their OATT rate on such transactions is necessary to prevent gaming.

4. Responsive Pleadings Addressing Applicants’ Amended Filing

105. The Midwest ISO argues that Applicants’ Amended Filing fails to adequately address the issue of transmission hoarding. The Midwest ISO notes that SPP has recently been found by the Commission to have insufficient safeguards in place to prevent hoarding. The Midwest ISO also expresses concern regarding Applicants’ settlement agreements with certain of their customers, which purport to address these customers’ concerns regarding rate de-pancaking and other matters.⁶³ The Midwest ISO argues that these agreements have no bearing on evaluating Applicants’ proposal and provide for “settled” rates not generally available to others.

106. WPS Companies argue that Applicants’ Amended Filing fails to address the prospect of additional rate de-pancaking that may be implemented in the context of the Midwest ISO/PJM Joint and Common Market. WPS Companies argue that Applicants should ensure that their de-pancaking proposal also implements any future de-pancaking implemented in the Joint and Common Market, including rate de-pancaking between RTOs for ancillary services.

107. Cinergy argues that the elimination of rate pancaking, as proposed by Applicants, presents issues of lost revenues and questions whether there should be a mechanism to recover lost revenues resulting from Applicants’ withdrawal and the rate de-pancaking proposal.⁶⁴ Cinergy expresses its concern that much remains to be examined in considering Applicants’ withdrawal and associated rate effects. Cinergy states that it is willing to work collaboratively with Applicants and other transmission owners in evaluating whether the elimination of rate pancaking between Applicants and the Midwest ISO will necessitate lost revenue recovery once a formal proposal is made under the Midwest ISO Transmission and Energy Markets Tariff.

⁶³ See note 15, *supra*.

⁶⁴ Cinergy notes that there is an ongoing Seams Elimination Cost Adjustment charge proceeding involving the elimination of rate pancaking between the Midwest ISO and PJM and a mechanism to recover revenues lost as a result. See Cinergy comments on Amended Filing at 4, *citing Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168 (2004) (*Seams Elimination Order*).

5. Commission Findings

108. We accept Applicants' proposal to maintain rate de-pancaking as part of their stand-alone OATT, subject to revision and the submittal of a reciprocity agreement (or, in lieu of a reciprocity agreement, a suitable alternative arrangement). Subject to these conditions, we find that Applicants' de-pancaking proposal will address our concerns regarding horizontal market power and will also be consistent with or superior to our *pro forma* OATT.

109. In the *LG&E/KU Merger Order*, the Commission found that Applicants' merger raised horizontal market power concerns with respect to the KU requirements customers' destination market, but that mitigation measures, including Applicants' commitment to join the Midwest ISO, adequately addressed these concerns. Specifically, the Commission found that Applicants' participation in the Midwest ISO, by making available transmission service at non-pancaked rates, increased the number of suppliers able to reach the KU requirements customers' destination market, thereby expanding the geographic scope of the market and adequately lowering market concentration. Thus, the Commission conditioned its approval of Applicants' merger on their participation in the Midwest ISO.⁶⁵

110. Here, we find that Applicants' de-pancaking proposal, with some revisions discussed below, will maintain rate de-pancaking between Applicants' system and the footprint of the remaining Midwest ISO membership and thereby provide mitigation comparable to that achieved by their Midwest ISO membership. As such, Applicants' proposal, if implemented in compliance with the conditions discussed below, will satisfy Applicants' Merger Conditions.

111. We note, however, that Applicants' proposal cannot be implemented at this time, in the absence of a reciprocity agreement with the Midwest ISO and its transmission owners. We further note that Applicants' ability to obtain this commitment remains unclear. The Midwest ISO argues, in this regard, that non-pancaked rates should not be extended to Applicants because the benefit of these rates should only be extended to RTO members. We encourage the maintenance of rate de-pancaking and encourage Applicants to pursue their negotiations with the Midwest ISO and its remaining

⁶⁵ *LG&E/KU Merger Order*, 82 FERC ¶ 61,308 at 62,222-223.

transmission owners.⁶⁶ However, we will not require that these entities consent to Applicants' requests.⁶⁷

112. In the event Applicants are unable to secure these commitments, then, Applicants must have in place an alternative proposal to address horizontal market power concerns as they relate to the KU requirements customers' destination market. Accordingly, we condition our section 203 approval of Applicants' withdrawal on Applicants' willingness and ability to shield its KU requirements customers from any re-pancaking of rates for transmission service between Applicants' transmission system and the remaining members of the Midwest ISO.

113. If Applicants wish to withdraw from the Midwest ISO without a reciprocity agreement with the Midwest ISO entities, they must file a mechanism to hold the KU requirements customers harmless against any increased transmission costs resulting from rate re-pancaking. Without a reciprocity agreement, KU requirements customers that rely on transmission service over the Midwest ISO to serve their loads on Applicants' system will face re-pancaked base transmission rates.⁶⁸ KU requirements customers will also

⁶⁶To facilitate these negotiations, we offer the use of the Commission's Alternative Dispute Resolution (ADR) service. For more information on ADR, call 1-877-337-2237 or visit <http://www.ferc.gov/legal/adr.asp>.

⁶⁷ We also note that Applicants propose to maintain de-pancaked rates for service between their system and PJM. While we encourage Applicants to pursue this option as well, our requirements here, as they relate to Applicants' Merger Conditions, apply only to mitigating the horizontal market power concerns for the KU requirements customers' destination market. This condition requires only that Applicants maintain the expanded geographic scope between their system and the Midwest ISO system. As discussed *infra*, we construe Applicants' hold harmless commitment to mean that existing transmission customers will not pay pancaked rates for those services absent the withdrawal.

⁶⁸ For imports from the Midwest ISO after Applicants withdraw, KU requirements customers will be subject to charges under the Midwest ISO Transmission and Energy Markets Tariff schedule 7 (long-term firm and short-term firm point-to-point transmission service), schedule 8 (non-firm point-to-point transmission service), and schedule 14 (regional through and out rate) *in addition to* charges under Applicants' OATT schedule 7 (long-term firm and short-term firm point-to-point transmission

(continued)

face ancillary service charges from both the Midwest ISO *and* Applicants if they use the Midwest ISO system to serve their load.⁶⁹ One way Applicants could mitigate this re-pancaking of rates for KU requirements customers is to reimburse KU requirements customers for all additional costs incurred by such customers that are due to re-pancaking of transmission and ancillary service rates and that occur as a result of Applicants' withdrawal.⁷⁰

114. If, however, Applicants are able to secure a reciprocity agreement and are able to implement their de-pancaking proposal, we find that certain modifications are required. First, we note that Applicants' proposal maintains rate de-pancaking for only transmission rates, but reintroduces pancaked rates for ancillary services for transactions between the Midwest ISO and Applicants' control area. As such, the proposal does not preserve the expanded geographic scope of the market that resulted from their participation in the Midwest ISO and that was required to address horizontal market power concerns. Accordingly, we condition our section 203 authorization on Applicants' submittal of a reciprocity agreement that will maintain de-pancaked ancillary services rates between Applicants' system and the Midwest ISO system, or an alternative proposal that, as discussed above, maintains the expanded geographic scope of the KU requirements customers' destination market.

115. We also reject Applicants' proposal to re-implement pancaked rates covering certain specified transactions for the purpose of preventing gaming.⁷¹ Applicants fail to support this proposal. For example, Applicants fail to identify the specific types of activity that should be deterred and how their proposal to charge a pancaked rate would

service) schedule 8 (non-firm point-to-point transmission service) and schedule 9 (network integration transmission service).

⁶⁹ The two ancillary service rates that will be re-pancaked include schedule 1 (scheduling, system control and dispatch service) and schedule 2 (reactive supply and voltage control from generation sources service).

⁷⁰ Applicants could set up a mechanism under their OATT that grants a credit to KU requirements customers for any re-pancaked charges those customer pay to the Midwest ISO.

⁷¹ *See* P 101, *supra*.

accomplish this objective. We also note that the applicability of these re-pancaked rates would depend on whether a given transmission path that does not use Applicants' transmission system is available. This option, however, would create rate uncertainty, particularly if Applicants make this determination *after* a transmission customer has already scheduled and completed a transaction. Applicants, in their reciprocity agreement, must eliminate rate re-pancaking for all service under their OATT.

116. We also require Applicants to clarify the services that will be subject to their de-pancaking proposal. Applicants refer to the service that will be provided under their de-pancaked rate proposal as "reciprocity firm" service. However, Applicants' proposed OATT makes reference to both reciprocity firm service, reciprocity non-firm service, and reciprocal network integration transmission service. We find that the applicability of Applicants' OATT to these services is unclear. Therefore, we require Applicants, in their compliance filing, to address the nature and scope of these proposed services and to revise their proposal, as may be necessary, to make clear how these services will be incorporated into their OATT.⁷²

117. We agree with Applicants that SPP, serving as their Independent Transmission Organization, should address hoarding concerns. Therefore, Applicants must modify their proposal to provide a mechanism to identify and prevent the hoarding of transmission capacity that can result from the implementation of their de-pancaking proposal. SPP should monitor and report to the Commission any instances of hoarding.

118. We direct Applicants to make a compliance filing, at least 30 days prior to their withdrawal, containing either a reciprocity agreement for non-pancaked transmission service and ancillary service rates under the Midwest ISO Transmission and Energy Markets Tariff, subject to the conditions discussed above, or an alternative proposal, as discussed above, to maintain the expanded geographic scope of the KU requirements

⁷² Among other things, Applicants must clarify what sections of their OATT will apply to reciprocity firm and reciprocal network integration transmission service. For example, it is not clear whether reciprocity firm service and reciprocal network integration transmission service are implicated when the OATT makes reference to firm point-to-point transmission service and network integration transmission service. In addition, Applicants must explain how reciprocal network integration transmission service relates to schedules 7 and 8 of their OATT, which deal only with point-to-point service.

customers' destination market. Alternatively, Applicants may make a new filing proposing alternative measures to address the horizontal market power concerns raised in the *LG&E/KU Merger Order*.

119. Finally, in response to Cinergy's concerns regarding lost revenues resulting from Applicants' withdrawal from the Midwest ISO and/or the implementation of their rate de-pancaking proposal, we find that the instant proceeding is not the appropriate forum to address these issues. Moreover, it is unclear whether lost revenues would be incurred under Applicants' proposal, given the fact that rates are currently de-pancaked.⁷³ These issues, however, can be discussed as part of the ongoing negotiations regarding reciprocal service at non-pancaked rates between Applicants, the Midwest ISO and its transmission owners if in fact a reciprocity agreement is negotiated.

G. Curtailment Priority

1. Applicants' Proposal

120. For new service under their OATT, Applicants propose to give native load, network, and intra-zonal point-to-point service customers the highest protection against curtailment, with a second-tier priority given to reciprocity firm service customers and a third-tier priority given to non-firm service customers.

121. Applicants assert that it is appropriate to give reciprocity firm service a second-tier priority given the rate treatment applicable to this proposed service. Applicants argue that the Commission's policy, in this regard, is to allow a different curtailment priority for firm point-to-point customers where, as here, these customers will receive an

⁷³ Cinergy references the ongoing Seams Elimination Cost Adjustment proceeding, involving the elimination of rate pancaking between the Midwest ISO and PJM. *See Seams Elimination Order*, 109 FERC ¶ 61,168. In that proceeding, however, lost revenues are an issue because through-and-out rates for transmission services between the Midwest ISO and PJM have been eliminated, thus giving rise to lost revenues. Here, by contrast, rates between license plate pricing zones in the Midwest ISO are de-pancaked today and will remain so under Applicants' proposal. Thus, it does not appear that Applicants' proposal will result in any instances of lost revenue.

appropriate rate adjustment.⁷⁴ Applicants further argue that, because reciprocity firm customers will be charged what will effectively be a zero rate for service over Applicants' system (*i.e.*, a de-pancaked rate), they will, in fact, be receiving an appropriate "rate adjustment." In addition, Applicants suggest that the proposed curtailment priority is consistent with EPCRA 2005, section 1233, which provides that load serving entities are entitled to use their transmission rights to the extent required to meet their service obligations.

2. Responsive Pleadings

122. The Midwest ISO and AMP-Ohio argue that Applicants' proposal is discriminatory to the extent it gives Applicants' native load customers (including all network, zonal, and intra-zonal point-to-point customers) a higher curtailment priority than other customers. The Midwest ISO adds that, under Order No. 888, curtailments necessary to relieve a constraint must be made on a comparable, pro rata basis for network, native load, and firm point-to-point customers. The Midwest ISO and AMP-Ohio further argue that according reciprocity firm customers a lower curtailment priority than they currently have under the Midwest ISO's Transmission and Energy Markets Tariff violates Applicants' hold harmless obligations under the TO Agreement.

123. The Midwest ISO also disputes Applicants' claim that the proposed bifurcated curtailment priority is an allowed exception to the requirements of Order No. 888. The Midwest ISO argues that in *Northern States Power*, the curtailment exception relied upon by Applicants was allowed by the Commission only where shedding of bundled retail load would otherwise be required, where the utility has otherwise exhausted all of its network and native load generation redispatch options, and where the firm point-to-point transmission customer whose firm service is being curtailed has the option to not shed its load. The Midwest ISO notes that Applicants' proposal has no such conditions.

3. Applicants' Answer

124. Applicants assert that their proposal addresses EPCRA 2005, section 1233, which codifies native load service priorities and provides that load serving entities are entitled to

⁷⁴ Transmittal letter at 23, *citing Northern States Power Co.*, 89 FERC ¶ 61,178 at 61,551 (1999) (*Northern States Power*).

use their transmission rights to the extent required to meet their service obligations.⁷⁵ Applicants also note that their curtailment priority proposal reflects the fact that reciprocity firm service is free in most circumstances. Applicants argue that it would be discriminatory and inconsistent with EAct 2005, section 1233 to provide free service to reciprocity firm customers, charge native load customers, and then curtail all customers on a pro rata basis.

4. Commission Findings

125. Applicants have not shown that their proposed curtailment priorities are consistent with or superior to the *pro forma* OATT and therefore we reject them. The *pro forma* OATT provides access to firm transmission service, subject to the availability of transmission capacity, for all transactions, regardless of receipt or delivery point, and provides equal curtailment priority for all firm service, including network and native load. Applicants' proposal, by contrast, would deny transmission service at the same level of firmness as network and native load for all transactions between their system and the RTOs providing rate reciprocity.

126. While Applicants assert that their proposed curtailment priority is consistent with EAct 2005, section 1233, this argument is not persuasive. The issue here is whether Applicants' proposal satisfies Applicants' Merger Conditions that they *voluntarily* offered to obtain Commission approval of their merger. We therefore have no occasion here to address the scope of section 1233.

127. Applicants' reliance on *Northern States Power* is also misplaced. In that case, the Commission permitted firm point-to-point service to be curtailed without requiring *pro*

⁷⁵ Pub. L. No. 109-58, § 1233(b), 119 Stat. 594, 960. EAct 2005, section 1233 adds a new section 217 to the FPA which provides as follows:

The Commission shall exercise the authority of the Commission under this Act in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities to satisfy the service obligations of the load-serving entities, and enables load-serving entities to secure firm transmission rights (or equivalent tradable or financial rights) on a long-term basis for long-term power supply arrangements made, or planned, to meet such needs.

rata curtailment of network and native load, but only to avoid load shedding, and only if the point-to-point service customer is made whole for redispatch costs incurred in such events. Specifically, this curtailment authorization was granted for the limited purpose of relieving a constraint, but only after all generation re-dispatch options for curtailment of network and native load transactions have been exhausted *and* only if the firm point-to-point customer has redispatch options through which it can avoid load shedding and is made whole for the costs of such redispatch. Thus, the firm point-to-point customer would continue to receive the same curtailment priority as all other firm customers, subject to an obligation not provided in the *pro forma* OATT to provide redispatch service, if available, to avoid shedding of network and native load, and subject to its being reimbursed for the cost of such service. Here, by contrast, Applicants would deny transmission service at the same level of firmness as network and native load for all transactions with certain specified receipt and/or delivery points.

128. In addition, as discussed above in sections IV.D and IV.F of this order, Applicants' proposal to maintain de-pancaked rates is essential to mitigate the horizontal market power concerns addressed by the Commission in the *LG&E/KU Merger Order*. However, Applicants' proposed curtailment priority, by treating reciprocity firm service transactions as inferior in quality by virtue of their curtailment priority, will impede access by suppliers in the Midwest ISO to the KU requirements customers' destination market. As such, Applicants' curtailment proposal does not preserve the expanded geographic scope of the market necessary to meet Applicants' Merger Conditions.

129. Accordingly, we require Applicants to follow the curtailment priorities provided in the *pro forma* OATT and to include in their compliance filing all revisions to their OATT necessary to comply with this finding.

H. Independent Transmission Organization Selection and Duties

1. Applicants' Proposal

130. Applicants' proposal to establish an Independent Transmission Organization consists of attachment L to their OATT (describing this entity's duties) and an Agreement with SPP, submitted by Applicants in their Amended Filing (SPP Agreement).

131. Under Applicants' proposal, SPP will be responsible for: (i) administering Applicants' OATT; (ii) processing and evaluating transmission service requests (*i.e.*,

granting or denying these requests, including requests made under network service and point-to-point service agreements); (iii) overseeing Applicants' generator interconnection process, including the performance of Interconnection Feasibility Studies and Interconnection System Impact Studies; and (iv) operating and planning reliability. Attachment A to the SPP Agreement lists each task assigned to SPP, as well as those assigned to TVA. Applicants propose to retain control over all tasks and duties not assigned to these entities, including the authority to make section 205 filings to amend their OATT.

132. Applicants state that SPP will perform its duties independent of Applicants. First, SPP and its employees are barred from having any affiliation with Applicants, transmission customers, or market participants. In addition, SPP is prohibited from discriminating in favor of, or against, any transmission customer, including Applicants' merchant generation division. Applicants also state that SPP's employees are subject to the Commission's standards of conduct.⁷⁶ SPP will also be required to post its policies on Applicants' OASIS to prevent any conflicts of interest or other ethical concerns relating to the administration of these policies. Subject to certain confidentiality limitations, SPP will have access to any transmission information it needs to carry out its duties.

133. Applicants state that they selected SPP to serve as their Independent Transmission Organization, after a Request for Proposal process. Applicants state that SPP was selected because it is sufficiently independent of Applicants and because the Commission has already determined, in the *Entergy Guidance Order*, that SPP is an appropriate entity for serving as an independent overseer of transmission. Applicants further state that while SPP is physically removed from Applicants' transmission system, physical proximity is not required for SPP to perform its designated duties. Applicants state that SPP can perform its duties on a remote basis through the use of computer software and

⁷⁶ See *Standards of Conduct for Transmission Providers*, Order No. 2004, FERC Stats. & Regs., Regulations Preambles ¶ 31,155 (2003), *order on reh'g*, Order No. 2004-A, III FERC Stats. & Regs. ¶ 31,161 (2004), 107 FERC ¶ 61,032 (2004), *order on reh'g*, Order No. 2004-B, III FERC Stats. & Regs. ¶ 31,166 (2004), 108 FERC ¶ 61,118 (2004), *order on reh'g*, Order No. 2004-C, 109 FERC ¶ 61,325 (2004), *order on reh'g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), *appeal docketed sub nom.*, *National Gas Fuel Supply Corporation v. FERC*, No. 04-1183 (D.C. Cir. June 9, 2004).

communications links.⁷⁷ Finally, Applicants assert that SPP is a suitable candidate to serve as an Independent Transmission Organization, given its experience, personnel and infrastructure.

2. Responsive Pleadings

134. The Midwest ISO and EPSA argue that the proposed division of responsibilities between TVA, SPP, and Applicants is inherently unstable because the structure multiplies the opportunity for miscommunication and inadvertent, or even opportunistic, contradictory actions. The Midwest ISO also argues that as a contract employee of Applicants, SPP will have an incentive to favor Applicants' transactions in order to get its contract renewed.⁷⁸

135. CMTC challenges Applicants' claim that SPP, because it has been established as an RTO, will be independent from Applicants. CMTC argues that the Commission's orders establishing SPP as an RTO, while relevant to SPP's own geographic footprint, have no applicability here. CMTC further argues that Applicants' proposed allocation of duties to SPP does not grant SPP all of the RTO functions contemplated by Order No. 2000. CMTC asserts that SPP will not be permitted to exercise sufficient independence, as required by Order No. 2000.

3. Applicants' Answer

136. Applicants respond to the Midwest ISO's argument that Applicants' proposals, by dividing key transmission duties among three entities, will be inherently unstable. Applicants submit that this same critique could be leveled against the Midwest ISO itself, since it too divides its operations between market administration and reliability coordination matters. Applicants also dispute the charge that their proposal will invite opportunistic behavior. Applicants respond that, in fact, their proposed division of duties makes them unable to engage in opportunistic actions.

⁷⁷ Applicants add that SPP's geographic location will, in fact, be a benefit to Applicants because it will remove any incentive for SPP to administer Applicants' OATT in a manner that creates advantages for its own system.

⁷⁸ The Midwest ISO also questions SPP's ability to manage Applicants' transmission allocations at their flowgates, as discussed below.

137. Applicants also respond to CMTG's assertion that SPP will not be sufficiently independent, consistent with Order No. 2000. Applicants submit that SPP, a Commission-approved RTO, has already been found by the Commission to possess sufficient independence with respect to its existing RTO functions. Applicants assert that SPP will operate Applicants' facilities with this same degree of independence.⁷⁹ Finally, Applicants respond to the Midwest ISO's claim that SPP might favor Applicants in order to ensure that its contract will be renewed. Applicants respond that these assertions are speculative and otherwise inconsistent with the Midwest ISO's own request to serve in a similar capacity with respect to Duke Power and the Mid-Continent Area Power Pool.⁸⁰

4. Commission Findings

138. For the reasons discussed below, we accept attachment L of Applicants' proposed OATT as it relates to Applicant's Independent Transmission Organization proposal, and the SPP Agreement, subject to a compliance filing clarifying the division of responsibilities among Applicants, SPP, and TVA.

139. The operational independence that Applicants state that they vest in SPP is a critical element in our consideration of Applicants' proposal to withdraw from the Midwest ISO. In particular, it bears on the vertical market power concerns discussed in section IV.D of this order, above. Accordingly, we must determine, here, whether Applicants' proposed allocation of duties to SPP will make it sufficiently independent of market participants, including Applicants, and if so, whether it will have sufficient authority to address the vertical market power concerns discussed in section IV.D of this order.

⁷⁹ Applicants note, for example, that SPP and its employees may not be affiliated with Applicants, any transmission customer, or any market participant (attachment L, section 3.2) and may not discriminate against any transmission customer or in favor of Applicants' merchant generation division (attachment L, section 3.3). In addition, SPP's employees will be subject to Order No. 2004 (standards of conduct) and other guidelines relating to conflicts of interest issues (attachment L, section 3.3.1). SPP will also have access to any transmission information it requires to fulfill its designated duties.

⁸⁰ See note 6, *supra*.

140. In the *Entergy Guidance Order*, the Commission found that SPP is generally independent. Nonetheless, we must determine, here, whether SPP, under the SPP Agreement, will operate independently of Applicants. With the modifications to the Independent Transmission Organization proposal directed in this order, we find that SPP will be sufficiently independent from Applicants.

141. As a threshold matter, we disagree with the Midwest ISO that giving three separate entities responsibilities for the operation of Applicants' system will make Applicants' system unstable. A division of duties, consistent with the guidelines we provide below, is acceptable. First, however, Applicants must clearly identify each entity's responsibilities. We agree with Cinergy that attachment A to the SPP Agreement lacks sufficient detail.⁸¹ Accordingly, we direct Applicants to amend their proposal by withdrawing attachment A and providing, in its place (at attachment L to their OATT), detailed information, including the specific tasks and duties each entity will perform.⁸²

⁸¹ Attachment A, for example, does not reflect certain tasks that had been identified by Applicants in the chart included in their Initial Filing (e.g., attachment A does not address the review and determination of Total Transfer Capability or the allocation of transmission losses). In addition, the terms "Lead," "Review," and "Approve and Coordinate" require clarification. For example, attachment A states that Applicants will lead the task of monitoring implementation of the transmission expansion plan and that TVA, as the Reliability Coordinator, will review and approve. It is unclear, however, exactly what TVA would review and approve regarding Applicants' monitoring efforts. Moreover, attachment A does not include duties for processing generation interconnection requests. Nor does it explain the criteria that will be used to perform these tasks, or clearly state that all criteria used to perform these tasks (e.g., Planning Criteria, Interconnection Study Criteria) will be independently evaluated by SPP to ensure that they are non-discriminatory.

⁸² In their Initial Filing, Applicants provided a chart delineating the responsibilities for certain tasks as between Applicants, TVA and SPP. This chart, however, was not included in Applicants' proposed OATT, nor was it included in the draft SPP Agreement. In the finalized version of the SPP Agreement included in Applicants' Amended Filing, Applicants replace the blank attachment A of the draft SPP Agreement with a chart that is nearly identical to the chart included in the Initial Filing.

142. To ensure that SPP will be able to perform its duties in an independent, non-discriminatory manner that can be understood by market participants, transparency is critical. Accordingly, we require Applicants to submit in their compliance filing detailed protocols for each duty, specifying who will perform each duty. We also find it appropriate to include these protocols in attachment L because this delineation of duties will relate to both SPP and TVA.⁸³

143. Applicants' compliance filing must also reflect the changes in duties required elsewhere in this order. For example, in section of IV.D of this order, we require changes in Applicants' proposed allocation of transmission planning duties. In addition, Applicants must discuss in their attachment L protocols the process for reviewing and determining Total Transmission Capacity and the process for allocating transmission losses.⁸⁴ Applicants must also revise attachment L and the SPP Agreement to state expressly that SPP has sole authority to grant or deny requests for generation interconnection.

144. We also require Applicants to revise attachment L and the SPP Agreement to make clear that SPP will have access to all data it needs from Applicants to perform its duties in an independent, transparent and reliable manner. As proposed, section 3.5 of attachment L and section 5.1 of the SPP Agreement state that SPP is entitled to any data, subject to appropriate confidentiality provisions, that are necessary to achieve the purposes and objectives of attachment L. However, this provision needs to be clear and we therefore direct Applicants to modify these provisions to state that SPP will have access to all data that it believes are necessary to perform its duties and that it requests from Applicants (subject to appropriate confidentiality provisions).

145. Section 6.4 of attachment L states that the Independent Transmission Organization must "perform or cause to be performed" system impact studies required for new

⁸³ In other words, it is inappropriate to include the delineation of duties as an attachment to the SPP Agreement, because the Reliability Coordinator is not a party to this agreement.

⁸⁴ These matters were listed in the chart included in Applicants' Initial Filing, but were not included in Applicants' attachment A, as submitted in their Amended Filing.

transmission service requests.⁸⁵ However, it is unclear whether this language permits the Independent Transmission Organization to delegate the performance of these studies to Applicants or other market participants. Accordingly, we direct Applicants to clarify that any such delegation of responsibilities will be to entities that are also independent of Applicants and other market participants.

146. We further require Applicants to modify the SPP Agreement to make clear that Applicants do not have veto authority over SPP personnel matters, including SPP's selection of its contract manager. Under section 2.1 of the SPP Agreement, SPP is required to post a list of its personnel that will perform duties for Applicants. While we understand the need to share information with respect to these matters, Applicants must not have influence over SPP's decisions. Any such influence could affect SPP's independence and thus invalidate the use of SPP to mitigate merger-related concerns.

147. Section 3.1 of the SPP Agreement establishes compensation for the initial four year term of the agreement. Compensation for subsequent terms or for new services is subject to negotiation. In addition, if SPP provides similar service to third parties, the parties are required to renegotiate these fees. Under these provisions, however, Applicants could essentially veto the Independent Transmission Organization's compensation by refusing to provide SPP with the resources necessary for it to perform its duties. This puts the Independent Transmission Organization's independence in question.

148. Similarly, if SPP were to provide Applicants with additional services, then depending on the terms, conditions and rates for such services, SPP's independence could be diminished. We recognize that no entity will perform the Independent Transmission Organization duties if the compensation is not adequate. Therefore, we require that Applicants revise their agreement to provide that if there are disputes over compensation, including negotiation of fees for subsequent terms, any re-negotiation of fees, or negotiation of fees for additional services, Applicants will timely file notice of such disputes with the Commission and ask it to resolve the dispute. Applicants must also revise the agreement to give SPP the authority to file notice with the Commission of any such dispute.

⁸⁵ Other sections of attachment L (*e.g.*, section 7.4.2, addressing feasibility studies and 7.5.2, addressing system impact studies) contain similar language.

149. Section 8.4 of the SPP Agreement states that nothing in the agreement is intended to limit or abridge any rights that Applicants may have to file with the Commission under section 205 to revise the rates, terms or conditions of Applicants' OATT. However, section 17.3 of the SPP Agreement limits these rights as it relates to changes to the SPP Agreement:

This Agreement shall not be varied or amended unless such variation or amendment is agreed to by the parties in writing and accepted by FERC. The Parties explicitly agree that neither Party shall unilaterally petition to FERC pursuant to the provisions of section 205 or 206 of the [FPA] to amend this Agreement or to request that FERC initiate its own proceeding to amend this Agreement.

As such, while section 8.4 preserves Applicants' right to file under section 205 to make changes to the OATT, section 17.3, as proposed, would limit Applicants' right to file to make changes to the SPP Agreement, even though the SPP Agreement will be a part of Applicants' OATT. To address this inconsistency, we require Applicants to modify sections 8.4 and 17.3, as necessary, to clarify the filing rights of each party.

150. Applicants' proposed OATT also contains apparent conflicts regarding the responsibility for filing service agreements. Under section 30.5, for example, Applicants can file service agreements for network integration transmission service with the Commission; however, under section 15.3, the Independent Transmission Organization can file service agreements for point-to-point service. Section 1.46 provides that both the Independent Transmission Organization and Applicants file service agreements with the Commission. Therefore, we direct Applicants to modify their OATT to remove these apparent conflicts and to clarify that Applicants are responsible for filing service agreements with the Commission.

151. In addition, Applicants state that the Independent Transmission Organization will have oversight over a stakeholder process. However, there is no further information in the application or in the proposed OATT regarding this process. Accordingly, we direct Applicants to revise their OATT, including attachment L, to explain Applicants' proposal for a stakeholder process.

152. Moreover, section 12.1 of the SPP Agreement provides for the Independent Transmission Organization to make regular reports to the Commission and retail regulators as required or requested. The provision does not state the content or frequency of the reports. Therefore, during the initial term of the SPP Agreement, we will require

SPP to bring any disputes with Applicants to our attention as soon as practicable. It must also make semi-annual reports to the Commission, beginning six months after the withdrawal date, detailing concerns expressed by stakeholders and the Independent Transmission Organization's response to those concerns as well as any issues or tariff provisions that hinder the Independent Transmission Organization from performing its required duties. The Commission may add to these reporting requirements in future Commission orders, as necessary.

153. Finally, we require modification of the confidentiality provisions of the SPP Agreement to conform to the Commission's decision in *MidAmerican*.⁸⁶

I. Reliability Coordinator Selection and Duties

1. Applicants' Proposal

154. Applicants' proposal to establish a Reliability Coordinator consists of attachment L to their OATT (describing this entity's duties) and Applicants' final agreement with TVA (TVA Agreement), as submitted in Applicants' Amended Filing.⁸⁷ Under Applicants' proposal, the Reliability Coordinator will perform all duties identified for Reliability Coordinators under NERC standards and certain additional duties discussed more fully below.⁸⁸

⁸⁶ See *MidAmerican Transmission Service Coordinator Order*, 113 FERC ¶ 61,274 at P 48-50 (where the Commission required inclusion of language stating that a party must provide information to the Commission upon request and that neither party to the agreement may notify the other party if the Commission requests such information).

⁸⁷ Applicants state that their proposals are similar to those recently addressed by the Commission in the *Duke Independent Entity Order*, 113 FERC ¶ 61,288 and the *MidAmerican Transmission Service Coordinator Order*, 113 FERC ¶ 61,274.

⁸⁸ In addition, Applicants propose to assign certain transmission planning duties to the Reliability Coordinator. However, for the reasons discussed in section IV.D of this order, above (addressing Applicants' Merger Conditions), we are modifying this aspect of Applicants' proposal.

155. Applicants state that their proposal to withdraw from the Midwest ISO, as amended, addresses issues relating to system reliability by delegating certain duties to a Reliability Coordinator.⁸⁹ Applicants state that TVA was selected to serve as Applicants' Reliability Coordinator pursuant to a request for proposal process. Applicants state that TVA was selected because of its operational capabilities, experience, geographic location, the interconnectivity of its system relative to Applicants' facilities, pre-existing seams agreements to which TVA is a party, and cost considerations (TVA was the lowest-cost bidder).

156. Applicants add that the choice of TVA also makes sense because of the existing relationship between TVA and the state of Kentucky. TVA already serves as the Reliability Coordinator for East Kentucky Coop and Big Rivers, and Applicants' control area is embedded in TVA's reliability footprint. Applicants assert that this relationship will facilitate additional interconnections between their system and TVA's system and will ensure that no new seams are created when Applicants withdraw from the Midwest ISO.

157. Further, Applicants state that TVA, as a governmental entity, has many unique characteristics that will ensure its independence and ensure that it performs its duties in a non-discriminatory manner. For example, Applicants claim that, as a non-profit governmental corporation, TVA will not seek to maximize its own profit, as a for-profit organization would do. Additionally, TVA is statutorily prohibited from directly or indirectly marketing TVA generated power outside of the TVA footprint, with the exception of making limited sales to neighboring utilities to facilitate congestion management and redispatch involving generation. Applicants assert that since TVA has no stake in wholesale markets outside of its footprint, TVA has no ability to discriminate against one market participant in favor of another. Moreover, Applicants claim that TVA is bound by its own Standards of Conduct, which require TVA to treat its transmission customers on a non-discriminatory basis and to operate its transmission system so as to not preferentially benefit TVA's bulk power trading unit.

158. Applicants state that TVA, in its role as Applicants' Reliability Coordinator, will perform all duties identified for Reliability Coordinators by NERC. TVA will also be responsible for: (i) transmission planning and regional coordination; (ii) approving (or

⁸⁹ Related seams issues addressing loop flow management and inter-regional congestion management are addressed separately, below, in section IV.J.

denying) Applicants' proposed maintenance schedules based on reliability considerations; (iii) identifying and mandating upgrades required to maintain reliability; (iv) making non-binding recommendations relating to economic transmission system upgrades; (v) administering seams agreements; (vi) approving Applicants' Planning Criteria and Base Case Models, including Applicants' projected annual and seasonal power flows; and (vii) reviewing Applicants' Annual Plan, *i.e.*, all transmission upgrade projects necessary to satisfy the Planning Criteria and Base Case Model.⁹⁰

159. Applicants state that all remaining NERC obligations (*i.e.*, those not required to be performed by Reliability Coordinators) will be performed by Applicants themselves. Among other things, they will retain ultimate responsibility for addressing reliability problems as the control area operator for their facilities, including the responsibility for taking any action necessary to protect the reliability of their system.

2. Responsive Pleadings

160. Intervenors assert that Applicants have not demonstrated that their proposal will promote regional reliability⁹¹ or improve transactional efficiencies currently provided by the Midwest ISO.⁹² The Midwest ISO argues that Applicants' reliability proposals appear to represent a significant step back in time, contrary to the spirit and intent of both Order No. 2000⁹³ and the regional reliability policy enshrined in EAct 2005.⁹⁴ EPSA

⁹⁰ Applicants state that the Annual Plan will be submitted to the Reliability Coordinator, who will then perform an independent reliability assessment and evaluation and make suggestions to Applicants. Applicants state that after the Annual Plan has been finalized, the Reliability Coordinator will transfer the Annual Plan to the Independent Transmission Organization for posting on OASIS.

⁹¹ WPS Companies state that it is not clear what effect the reliability coordinator proposal will have on seams in the region.

⁹² *See, e.g.*, EME protest at 6 (urging the Commission to refrain from sacrificing for the benefit of Applicants the reliability that has been achieved by the creation and implementation of the Midwest ISO).

⁹³ *See* Midwest ISO protest at 12, *citing* Order No. 2000 at 30,998.

⁹⁴ The Midwest ISO notes that EAct 2005 directs the establishment of a new, independent Electric Reliability Organization that would have the authority to set and

(continued)

echoes these concerns, noting that Applicants' proposal relies on transmission loading relief procedures to manage congestion. Detroit Edison stresses that transparency and oversight are necessary during the transition because the successful transfer of Reliability Coordinator responsibilities is a complex logistical task that is very important to the operational integrity of the Eastern Interconnection.

161. Intervenors also raise concerns regarding the selection of TVA as Applicants' Reliability Coordinator. The Midwest ISO acknowledges TVA's commendable reliability record. However, the Midwest ISO and EPSA comment that TVA lacks the tools necessary to provide market-based congestion management because TVA is prohibited under its enabling statutes from re-dispatching its generation in a manner that would be a sale or receipt of power beyond its statutorily defined "fence." The Midwest ISO submits that this lack of authority could, among other things, limit TVA's ability to order or require the redispatch of Applicants' system.⁹⁵ The Midwest ISO also questions TVA's experience in dealing with reliability issues, given the geographical and demographic characteristics of the region it oversees.

162. Midwest ISO states that section 1.5 of the TVA Agreement allows Applicants to avoid following any directive that Applicants determine will violate any state or federal law or the terms of any governmental approval applicable to Applicants. Midwest ISO is concerned that this provision will be used by Applicants to limit load shedding under Kentucky law⁹⁶ even though the law was ruled unconstitutional by the courts.⁹⁷ The Midwest ISO notes that NERC standards currently provide a limited exemption from following Reliability Coordinator directives when those directives violate statutes or regulations. However, that limited exemption was not intended to allow balancing

enforce mandatory nationwide reliability standards. The Midwest ISO also points to EPAct section 1298, which requires the establishment of federal-state joint boards to study the issue of security-constrained economic dispatch as a means of promoting regional reliability.

⁹⁵ EPSA protest at 7, n.11, *citing Alabama Power Co. v. Tennessee Power Authority*, 948 F. Supp. 1010, 1030 (N. D. Ala. 1996).

⁹⁶ Midwest ISO protest at 11, *citing Ky. Rev. Stat. Ann. § 278.214*.

⁹⁷ *Id.* at 6, *citing Kentucky Power Company v. Huelsmann*, 352 F. Supp. 2d 777 (E.D. KY 2005).

authorities to pick and choose which state laws (particularly when ruled unconstitutional) they may follow in emergencies.

163. The Midwest ISO is concerned that expanding the NERC exemption to include “any governmental approval” would introduce state utility commissions into the reliability standard-setting business. Midwest ISO states that it is critical to know before an emergency occurs whether Applicants’ generation will be available. Therefore, Applicants should specify in this proceeding which laws may make it unsafe or illegal to follow the reliability coordinator’s directives. This will avoid debates over the applicability of vague references during an emergency.

3. Applicants’ Answer

164. Applicants state that their reliability proposals will promote regional grid reliability and/or improve transactional efficiencies. Applicants note that TVA’s existing region is comparable to the regions overseen by ISO-NE New England, Inc. (ISO-NE) and the New York Independent System Operator, Inc. In addition, Applicants assert that TVA will be better suited than the Midwest ISO to be Applicants’ Reliability Coordinator because Applicants’ control area is embedded in TVA’s reliability footprint. Applicants argue that transferring their reliability duties to TVA will remove certain of the existing seams and congestion management issues between the Midwest ISO and TVA, particularly as they relate to the interaction of KU and the East Kentucky Coop systems.

165. Applicants also respond to the arguments raised by the Midwest ISO and EPSA that TVA cannot order redispatch of generation located within its reliability area in a manner comparable to the services provided by the Midwest ISO under its Day 2 Market. Applicants state that TVA has a proven track record in meeting the reliability requirements for which it is currently responsible. Applicants assert that TVA’s impressive reliability record using transmission loading relief measures, and the fact that other entities have also effectively relied on these measures in their control areas, mitigates this concern. Further, Applicants state that the Midwest ISO continues to use transmission loading relief measures and so-called “manual redispatch” procedures under its Day 2 Market to manage congestion.

4. Commission Findings

166. We conditionally accept Applicants’ Reliability Coordinator proposal. While we agree with the Midwest ISO and EPSA that reliance on transmission loading relief procedures is not the most efficient method for controlling congestion, these procedures,

when used, are implemented according to NERC standards and are an acceptable practice for maintaining grid reliability. Moreover, while the role of regional security-constrained economic dispatch in promoting reliability is currently being studied,⁹⁸ RTO participation is voluntary and Order No. 2000 standards for the Day 2 Market are not required as part of Applicants' proposal. Nonetheless, we find that Applicants have not made clear what role they will play in conjunction with TVA's implementation of transmission loading relief procedures and the issuance of energy emergency alerts. Therefore, Applicants must explain in a compliance filing the role Applicants will play in carrying out these duties.

167. Additionally, we will require certain modifications to the TVA Agreement. Similar to our required modifications described above with respect to the SPP Agreement, Applicants must modify the confidentiality provisions, key personnel provisions (i.e., Applicants may not veto designation of personnel to perform duties on their behalf), and budget provisions (i.e., Applicants must bring disputes to the Commission). We also reject Applicants' proposal allowing TVA personnel to have up to \$15,000 in Applicants' securities. Such a policy could create a bias on the part of TVA personnel when TVA calls for curtailments and would be inconsistent with section 9.1 of attachment L, which requires employees of the Reliability Coordinator to divest all such securities within six months.

168. In addition, we find that section 1 of attachment A is unclear regarding the software needed to analyze new transmission service requests and fully participate in the Joint Reliability Coordination Agreement and regarding which party will be responsible for such software. Therefore, we require Applicants in their compliance filing to clarify these matters.

⁹⁸ See Pub. L. No. 109-58, § 1298, 119 Stat. 594, 960 (section 1298). EPCA 2005, section 1298 adds a new section 223 to the FPA that requires the Commission to convene joint boards on a regional basis to study the issue of security constrained economic dispatch for the various market regions and to submit a report to Congress regarding the recommendations of the joint boards within one year.

J. Regional Coordination and Seams Issues**1. Applicants' Proposal**

169. Applicants state that in addition to the reliability procedures that will be performed by TVA under the TVA Agreement (as addressed in section IV.I, above), system reliability, including inter-regional coordination and congestion management across seams, will also be addressed pursuant to existing reliability coordination protocols to which TVA, the Midwest ISO and PJM are a party, i.e., under these parties' Joint Reliability Coordination Agreement and the Congestion Management Process it incorporates. Applicants state that, as such, seams management will be unaffected by Applicants' withdrawal.

170. Applicants explain that, beginning in May 2004, the Midwest ISO, PJM, and TVA began exchanging certain data and information in order to facilitate inter-regional coordination, system reliability, and efficient market operations for the Midwest ISO and PJM, including the allocation and management of transmission capacity on their respective flowgates. Applicants state that in furtherance of these objectives, in April 2005, these parties executed a Joint Reliability Coordination Agreement, which includes a Congestion Management Process.

171. Applicants state that the Joint Reliability Coordination Agreement provides for data flow between TVA and the Midwest ISO and PJM, and coordinated congestion management on flowgates affected by flows from TVA and either the Midwest ISO or PJM, or flowgates of any Joint Reliability Coordination Agreement party and a third party that executes a reciprocal coordination agreement. Applicants explain that the Joint Reliability Coordination Agreement outlines system coordination among the parties, including coordination of scheduled outages, emergency operations, transmission expansion planning, and reactive power coordination. Applicants state that the Congestion Management Process details the specific procedures for congestion management on coordinated flowgates, which are designated by criteria established in the Congestion Management Process, and contains provisions for re-allocating unused capacity on flowgates from one reciprocal entity to another to permit more efficient use of the transmission system. Applicants propose, upon their withdrawal, to participate in these existing arrangements.

2. **Responsive Pleadings Addressing Applicants' Initial Filing**

172. The Midwest ISO asserts that, because the Joint Reliability Coordination Agreement is dependent on data exchange protocols developed by the two RTOs through their Joint Operating Agreement, the Applicants' request to rely on, and benefit from, these protocols, via the Joint Reliability Coordination Agreement, is a proposal that, in effect, seeks to benefit from the two RTOs while shouldering none of the costs attributable to RTO membership. The Midwest ISO argues that such an arrangement would give Applicants unwarranted economic advantage by securing Midwest ISO services for free, or at a discount, through TVA. The Midwest ISO adds that allowing this arrangement would also discourage any future ISO or RTO from entering into market-to-non-market seams agreements with its neighbors.⁹⁹

173. The Midwest ISO asserts that Applicants' proposal also fails to address whether, or how, their transmission flowgates will be integrated into their Congestion Management Process. The Midwest ISO points out, for example, that Applicants fail to address whether Applicants intend to participate as a party to the Joint Reliability Coordination Agreement or be recognized as a "reciprocal entity" under the Congestion Management Process.¹⁰⁰ Cinergy shares this concern and requests that Applicants be required to be a signatory to the Joint Reliability Coordination Agreement and its Congestion Management Process. Cinergy states that these protocols should be adapted and revised

⁹⁹ The Midwest ISO points out that it currently calculates and reports transmission capacity allocations on 425 reciprocal flowgates that are subject to the Congestion Management Process, including 25 flowgates owned by Applicants. Three of these flowgates have participated in the market-to-market redispatch process. The Midwest ISO argues that this process has provided enhanced efficiencies that transmission loading relief measures cannot offer.

¹⁰⁰ The Midwest ISO notes that if Applicants are not treated as reciprocal entities, they will not be entitled to receive an allocation under the Congestion Management Process methodology for those flowgates that are affected by regional flows. The Midwest ISO adds that, as such, market flows from PJM and the Midwest ISO will not be controlled or curtailed on these flowgates to accommodate Applicants' flows, thus subjecting Applicants to a significant increase in the frequency and impact of transmission loading relief activity.

to reflect the new relationship between TVA and Applicants, whose location between TVA and the Midwest ISO will, upon Applicants' withdrawal, affect the Joint Reliability Coordination Agreement, and that the revised agreement be filed as a condition of withdrawal. Cinergy also urges the Commission to require Applicants to consult with the Midwest ISO, PJM and TVA to determine how the Joint Reliability Coordination Agreement should be amended. Cinergy adds that this agreement, in its current form, may not apply to Applicants and disputes testimony implying that Applicants' participation in this agreement is optional.

174. The Midwest ISO states that, regardless of whether Applicants intend to participate in the Congestion Management Process, Applicants will not be able to participate in the Midwest ISO's market-to-market redispatch process (a process which, as the Midwest ISO asserts, effectively expands the efficiencies of an organized market by determining if an adjoining market can redispatch generation to solve congestion at a lower cost than re-dispatching within the home market).¹⁰¹ The Midwest ISO argues that if Applicants withdraw their flowgates from the functional control of the Midwest ISO, the flows on these flowgates will require either transmission loading relief measures to relieve congestion or internal market redispatch, regardless of cost. The Midwest ISO argues that this will result in the use of less efficient generation to replace curtailed transactions that would occur if Applicants remain Midwest ISO members.

175. EPSA joins the Midwest ISO in warning that increased inefficiencies and costs will result due to the limited tools that will be available to TVA in managing congestion across seams. EPSA argues that the Commission should not accept Applicants' request to step back from the region-wide, market-based congestion management, reliability and energy market functions currently provided by the Midwest ISO.

176. The Midwest ISO further notes that Applicants' proposed OATT, at attachment L (in describing their proposed Reliability Coordinator/Independent Transmission

¹⁰¹ As noted above, since the start of the Midwest ISO energy market, three flowgates in Applicants' system have been the subject of market-to-market redispatch between PJM and the Midwest ISO. The Midwest ISO argues that this process has allowed PJM market transactions to flow without the need for more expensive internal redispatch by PJM and without the need to resort to transmission loading relief curtailments. The Midwest ISO submits that this process has resulted in payments from PJM and reduced the congestion costs within the Midwest ISO.

Organization duties), makes no reference to which entity will coordinate Available Transmission Capability calculations or transmission service reservations under the Congestion Management Process. The Midwest ISO argues that while the Congestion Management Process contemplates the reallocation of unused capacity on flowgates, from one reciprocal entity to another, it is unclear whether Applicants proposed agent, SPP, will be able to perform the necessary allocations.¹⁰²

177. WPS Companies point out that Applicants' system has significant transfer capability with PJM and TVA and that removing this transfer capability from the Midwest ISO's operational control will have the balkanizing effect of creating new seams between the Midwest ISO and PJM and between the Midwest ISO and TVA. WPS Companies also argue that Applicants' withdrawal from the Midwest ISO will adversely affect the Joint and Common Market, currently under development by the Midwest ISO and PJM, and interfere with the coordinated operations between the RTOs pursuant to their own seams agreement.

3. Applicants' Answer and Amended Filing

178. Applicants, in their answer, reiterate their commitment to work with TVA and SPP to ensure that their internal processes meet the requirements of the Joint Reliability Coordination Agreement and its Congestion Management Process. Applicants' Amended Filing, moreover, includes an executed TVA Agreement with TVA, with an attachment A that identifies and assigns numerous responsibilities necessary to implementing a revised Joint Reliability Coordination Agreement, including flowgate coordination information as required under the existing seams agreements.

179. Applicants also take issue with WPS Companies' assertion that Applicants' withdrawal from the Midwest ISO will compromise the effectiveness of the PJM/Midwest ISO Joint and Common Market. Applicants insist that their departure from the Midwest ISO will not affect development and implementation of "super region"

¹⁰² Specifically, the Midwest ISO notes that, to date, SPP's allocation software has had an unsatisfactory performance record with respect to its respective market-to-non-market operations. The Midwest ISO submits that if Applicants' filing is accepted, it should be accepted subject to SPP's demonstration that the problems it has experienced in calculating the allocations on its own flowgates have been resolved and that it is able to take on additional calculations, as proposed by Applicants.

operations across the RTOs, because Applicants' system comprises only a small percentage of the area. Applicants also reiterate their assertion that no new seams will be created as a result of their withdrawal.

180. Applicants also dispute intervenors' assertions that, if permitted to withdraw from the Midwest ISO, Applicants will become "free riders" on the Midwest ISO and PJM markets. Applicants argue that they only will be sharing information between reliability coordinators. Applicants further assert that their historical cost contributions to the Midwest ISO and their commitment in this proceeding to pay an exit fee absolves them of any charge that they will receive any undue benefits as a result of their withdrawal.

4. Responsive Pleadings Addressing Applicants' Amended Filing

181. WPS Companies argue that Applicants' Amended Filing fails to address the seams concerns raised by intervenors in their protests. WPS Companies argue, for example, that Applicants' Amended Filing fails to offer any assurance that their proposed alteration of the existing TVA/Midwest ISO seam will not further exacerbate current seams issues. WPS Companies further assert that, subject to stakeholder input, the Joint Reliability Coordination Agreement should be revised to reflect the changed seam and eliminate seams issues at the Applicants' border.

182. Cinergy argues that the Amended Filing fails to provide sufficient detail regarding how joint reliability issues will be resolved among neighboring entities and whether Applicants and SPP should be made parties to the Joint Reliability Coordination Agreement. Cinergy requests that Applicants be required to clarify and provide additional information regarding regional reliability coordination issues.

5. Commission Findings

183. We accept, in principle, Applicants' proposal to rely on TVA's Joint Reliability Coordination Agreement with the Midwest ISO and PJM to address the interregional coordination and seams issues presented by Applicants' filing. However, we require Applicants to file their proposed Joint Reliability Coordination Agreement with the Commission in a compliance filing at least 30 days prior to their withdrawal.

184. Applicants cite to the existing Joint Reliability Coordination Agreement and its Congestion Management Process, i.e., to the regional coordination agreement between TVA, the Midwest ISO and PJM, as the reliability protocols on which they intend to rely in addressing issues relating to system reliability and inter-regional system coordination.

We agree that the duties set forth in this agreement, if made applicable to Applicants' stand-alone system, could significantly enhance Applicants' ability to address regional coordination issues. Moreover, as discussed above, the provisions for flowgate coordination under the Joint Reliability Coordination Agreement will facilitate a solution to Applicants' hold harmless obligation under the TO Agreements.

185. We also find that the activities to be performed by TVA, under Applicants' proposal, will affect significantly the jurisdictional service provided under Applicants' OATT. For example, the allocation of flowgate capacity under the Joint Reliability Coordination Agreement will affect whether there is available capacity to grant a request for transmission service on Applicants' system. In addition, the Joint Reliability Coordination Agreement outlines how parallel flows on Applicants' system, from the Midwest ISO's market, will be controlled when transmission loading relief procedures are implemented. These provisions, particularly as they address parallel flows associated with network and native load transactions in the Midwest ISO's Day 2 Market, are not provided for in the transmission loading relief procedures themselves. Therefore, consistent with FPA section 205(c) and the Commission's regulations,¹⁰³ and consistent with Commission precedent,¹⁰⁴ the Joint Reliability Coordination Agreement and its Congestion Management Process must be filed with the Commission. If Applicants decide not to proceed with their proposal to coordinate with the RTOs and TVA under the Joint Reliability Coordination Agreement, they will need to file their alternate arrangements through a new section 205 filing.

¹⁰³ 16 U.S.C. § 824d(c) (2000). *See also* 18 C.F.R. § 35.1 (2005) (providing that “[e]very public utility shall file with the Commission and post, in conformity with the requirements of this part . . . all contracts which in any manner affect or relate to such rates, charges, classifications, services rules, regulations or practices. . .”).

¹⁰⁴ *See, e.g., North American Reliability Council*, 85 FERC ¶ 61,353 at 62,262 (requiring NERC transmission loading relief procedures to be filed with the Commission pursuant to FPA section 205 and stating that changes in operating practices need to be filed if they affect, for example, reservation, scheduling and curtailment provisions of the *pro forma* OATT) and *MidAmerican*, 113 FERC at P 47 (requiring the Transmission Service Coordinator agreement to be filed with the Commission pursuant to FPA section 205 because it affects acceptance or rejection of transmission service requests and interconnection requests).

186. Applicants state that the Congestion Management Process incorporated by reference in the Joint Reliability Coordination Agreement is an existing Commission-approved rate schedule, as agreed to by the Midwest ISO and PJM in their Joint Operating Agreement.¹⁰⁵ In its protest, the Midwest ISO agrees, stating that the Congestion Management Process methodology in the Joint Reliability Coordination Agreement is identical to the methodology contained in the Midwest ISO/PJM Joint Operating Agreement (an agreement, we note, that has been amended on several occasions since it was originally accepted for filing). However, the Commission requires public utilities to post full and complete rate schedules and tariffs, rather than incorporating rates by reference. Accordingly, we will require that Applicants include the text of the Congestion Management Process with their Joint Reliability Coordination Agreement when it is filed.¹⁰⁶

187. We note, however, that to date, Applicants have not become a party to the Joint Reliability Coordination Agreement, are not named as reciprocal entities, and are not otherwise subject to this agreement. We agree with intervenors that Applicants should be required to clarify, in contractual terms, their commitment to the Joint Reliability Coordination Agreement and its Congestion Management Process. However, we will not prejudge here how Applicants must comply (whether Applicants must become signatories, be named as reciprocal entities or operating entities, or become subject to the terms and conditions by some other means, such as through SPP or TVA acting as their agent).

188. We also agree with Cinergy that section 3.6 of the Joint Reliability Coordination Agreement, addressing “Ongoing Review and Revisions,” provides parties a process to

¹⁰⁵ Applicants cite Midwest ISO Rate schedule FERC No.5 and PJM Rate schedule FERC No. 38 (Midwest ISO/PJM Joint Operating Agreement).

¹⁰⁶ If parties to the Joint Reliability Coordination Agreement intend to be bound by the Congestion Management Process methodology contained in the Midwest ISO/PJM Joint Operating Agreement, they may specify that their agreement will be revised to track any changes approved by the Commission to the applicable Midwest ISO/PJM Joint Operating Agreement. Of course, if the parties choose such an approach, they must also file changes to the Joint Reliability Coordination Agreement and Congestion Management Process to reflect changes in the Midwest ISO/PJM Joint Operating Agreement.

use to develop such a revised agreement – one that incorporates Applicants in a manner appropriate to the new circumstances and changed boundaries for which TVA will be responsible.

189. We also agree with intervenors that TVA's options for managing congestion across regional seams on Applicants' behalf at coordinated flowgates will be limited because it will not participate in the RTOs' market-to-market economic redispatch protocols. However, as discussed above, Order No. 2000 standards for Day 2 markets are not required to be part of Applicants' proposal.

190. As for the Midwest ISO's assertion that Applicants' participation in the Joint Reliability Coordination Agreement would give them an unwarranted economic advantage by allowing them to benefit from coordination protocols developed by the two RTOs, and thus secure RTO services, for free, we find this issue premature. If the Midwest ISO and PJM believe that their counterparties under the Joint Reliability Coordination Agreement should share in the costs incurred by the RTOs in developing and implementing the Joint Reliability Coordination Agreement, they could file a proposal with the Commission to recover such costs from TVA and Applicants, and we would consider the issue at that time.

191. We share intervenors' concerns that responsibilities must be sufficiently delineated under Applicants' proposal for the Joint Reliability and Coordination Agreement to function properly. Therefore, we will require Applicants to delineate such responsibilities and protocols when they file the revisions to attachment L directed elsewhere in this order. Similarly, we agree with the Midwest ISO that the responsibilities and communication systems and protocols on which the Joint Reliability Coordination Agreement reliability protocols depend must be clear.

K. Cost Recovery for System Expansions and Transmission Upgrades

192. Applicants state that in addition to the replacement arrangements necessary to accomplish their withdrawal from the Midwest ISO, they are also proposing a cost recovery mechanism for system expansions and transmission upgrades, as set forth at attachment N to Applicants' proposed OATT. Applicants state that their cost recovery

proposal is modeled on the pricing proposal submitted by Entergy Services, Inc., in Docket No. EL05-1065-000.¹⁰⁷

193. Under Applicants' proposal, system upgrades are classified as either Base Case Model Upgrades (expansions or upgrades necessary to meet existing transmission and interconnection service commitments consistent with reliability standards on Applicants' transmission system) or as Supplemental Upgrades (all other expansions and upgrades). Applicants state that the costs attributable to a Base Case Model Upgrade would be recovered through Applicants' transmission rates, including point-to-point and network integration transmission service rates, bundled retail rates, and rates charged under grandfathered customers. Applicants propose that Supplemental Upgrades be paid for by the requesting party.

194. We will dismiss without prejudice Applicants' attachment N pricing proposal. This pricing proposal is unrelated to either the requirements of the TO Agreement or Applicants' Merger Conditions. Applicants also do not claim that their request to withdraw from the Midwest ISO is in any way contingent on their transmission pricing proposal. It is therefore premature for Applicants to propose a new pricing scheme as part of this filing. Our focus here is to provide guidance and findings on Applicants' proposal to withdraw from the Midwest ISO. If, based on this guidance, Applicants decide to proceed with their proposal to withdraw from the Midwest ISO, they may resubmit a stand-alone pricing proposal in a separate filing. In the meantime, Applicants are hereby directed, in their compliance filing, to remove attachment N from their OATT.

L. Rates

195. For transmission service, Applicants propose to adopt, at attachment O to their OATT, the same rate formula currently in effect in attachment O to the Midwest ISO

¹⁰⁷ Entergy first submitted its proposal in the form of a declaratory request in Docket No. EL05-52-000. In addressing that request, in the *Entergy Guidance Order*, we stated that we were prepared to grant Entergy's proposed transmission pricing proposal on a two-year experimental basis subject to certain enhancements, including monitoring and reporting conditions. See *Entergy Guidance Order*, 110 FERC ¶ 61,295 at P 66.

Transmission and Energy Markets Tariff.¹⁰⁸ Applicants also propose to adopt their current rates for ancillary services.¹⁰⁹

196. The Midwest ISO does not oppose the attachment O rate formula but argues that it is inappropriate to allow Applicants to use in their formula rate the return on equity (ROE) the Commission approved for generic use by all Midwest ISO transmission owners. The Midwest ISO states that its ROE was approved for the Midwest ISO, not for a stand-alone company.

197. We accept the attachment O rate formula for use in Applicants' stand-alone OATT, subject to revision. We agree with Applicants that the proposed rate formula represents an appropriate rate methodology for inclusion in Applicants' stand-alone OATT.¹¹⁰ However, Applicants must exclude the cost of certain facilities in Virginia that the Commission has found to serve a distribution function and not a transmission function.¹¹¹ We will also accept Applicants' proposal to retain their existing ancillary

¹⁰⁸ Applicants propose to utilize this rate formula for transmission service provided under schedule 7 (covering long-term firm and short-term firm point-to-point transmission service), schedule 8 (covering non-firm point-to-point transmission service), and schedule 9 (covering network integration transmission service). Applicants note that under the Midwest ISO's attachment O rate formula, rates for transmission-owning members are updated annually, effective June 1 of each year, based on FERC Form No. 1 data as supplied for the previous calendar year. Applicants propose to update their rates utilizing this same methodology.

¹⁰⁹ Applicants explain that at the time they joined the Midwest ISO, certain portions of their prior OATT (including those provisions addressing ancillary services) remained in effect.

¹¹⁰ See, e.g., *Midwest Independent Transmission System Operator, Inc.*, Opinion No. 453, 97 FERC ¶ 61,033 (2001), *order on reh'g*, Opinion No. 453-A, 98 FERC & 61,141 (2002), *order on remand*, 102 FERC ¶ 61,192 (2003), *reh'g denied*, 104 FERC ¶ 61,012 (2003), *aff'd sub nom. Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004).

¹¹¹ See *Louisville Gas & Electric Co.*, 109 FERC ¶ 61,330 at P 8-9 (2004) (order affirming Presiding Judge's finding that certain facilities in Virginia that perform a distribution function must be excluded from the formula rates used in an interconnection
(continued)

services rates. However, we agree with the Midwest ISO that it is inappropriate for Applicants, once they withdraw from the Midwest ISO, to use an ROE that was approved for use by all of the transmission owning members of the Midwest ISO. Applicants' filing is silent regarding what ROE Applicants propose to utilize in their formula rate—it only provides at note P to the proposed attachment O formula that the ROE will be supported in the original filing. Accordingly, Applicants must file a proposed ROE for use in their formula rate, along with appropriate support, in a new section 205 filing.

198. We also note that Applicants are not seeking at this time to recover costs associated with their Independent Transmission Organization or Reliability Coordinator proposals. Therefore, the question of whether these costs are just and reasonable is not before us. However, if Applicants propose to include these costs in rates for transmission service or revise their cost recovery methodology in a future filing, Applicants will be required to demonstrate that recovery of these costs is just and reasonable.

M. Market-Based Rate Authority

199. We reject intervenors' protests regarding the need to consider here Applicants' market-based rate authorizations. Applicants commit to filing a "change in status" report with the Commission within 30 days of their withdrawal from the Midwest ISO addressing the effects of their withdrawal on the market-based rate authority granted to Applicants and their affiliates.

200. EPSA, Detroit Edison, the Williams Companies, CMTC, and EME raise concerns regarding the adequacy of this commitment. These intervenors point to the market power implications associated with Applicants' proposed withdrawal. Detroit Edison argues that Applicants should be required to sell into the Midwest ISO at cost-based rates. Applicants respond, in their answer, that the appropriate proceeding in which to consider these issues is a change of status proceeding. In response to Detroit Edison's argument that Applicants should be required to sell into the Midwest ISO at cost-based rates, Applicants assert that they will lack market power in Midwest ISO's market.

agreement and transmission service agreement between Applicants and East Kentucky Coop.), *order denying reh'g*, 111 FERC ¶ 61,323 at P 50 (2005).

201. We agree that concerns regarding Applicants' market-based rate authority are beyond the scope of this proceeding. We also note that Applicants have filed an updated market power analysis reflecting Applicants' withdrawal proposal.¹¹² Intervenors may renew their concerns in that proceeding.

N. Additional Filings and Procedures

202. We recap here the findings set forth above regarding Applicants' remaining compliance obligations.¹¹³ We also address the needs for the parties to resolve pending issues. First, we note that the compliance requirements set forth above will not be necessary if Applicants do not proceed with their withdrawal request. We also note that Applicants' ability to comply with these requirements will depend, in part, on the willingness and consent of other parties, including the Midwest ISO and its transmission owners, to resolve remaining issues regarding Applicants' proposal and, in so doing, to enter into bilateral or multi-party agreements with Applicants regarding such issues as rate pancaking and inter-regional loop flows. We issue no directives to these parties regarding these matters.

203. With respect to Applicants' withdrawal obligations under the TO Agreement, we require Applicants to make a compliance filing to implement their hold harmless commitment and a finalized exit fee.

204. With respect to Applicants' Merger Conditions, we require Applicants to make a compliance filing that includes: (i) a reciprocity agreement for non-pancaked transmission service and for non-pancaked ancillary services on the Midwest ISO's system, or an alternative proposal to maintain de-pancaked rates for the loads located in the KU requirements customers' destination market, as discussed above; (ii) a revision to Applicants' Independent Transmission Organization and Reliability Coordinator proposal

¹¹² See *LG&E Energy Marketing Inc., et al.*, Docket No. ER94-1188-038, *et al.* (filed January 30, 2006). Applicants updated their market power analysis at the Commission's direction. See *LG&E Energy Marketing, Inc.*, 113 FERC ¶ 61,229 at P 13 (2006).

¹¹³ Because these obligations are discussed above in their broader context, any ambiguities that may be claimed to exist here are to be resolved by reference to those sections of our order.

transferring certain designated transmission planning duties to SPP and clarifying the division of responsibilities as between Applicants, the Independent Transmission Organization, and the Reliability Coordinator; and (iii) a revision to Applicants' Independent Transmission Organization and Reliability Coordinator proposal addressing our findings, above, regarding the independence of these entities.

205. Finally, with respect to Applicants' proposed OATT, we require Applicants to submit a compliance filing that includes: (i) a tariff mechanism addressing the concerns discussed above regarding the hoarding of capacity and appropriate mitigation measures to be performed by the Independent Transmission Organization; (ii) a Joint Reliability Coordination Agreement; (iii) a revised proposal, as may be required by SPP, concerning Applicants' methodology for calculating Available Transmission Capability; (iv) revised tariff language making clear how reciprocity firm and reciprocal network integration service will be incorporated into Applicants' OATT; and (v) a revised OATT incorporating the *pro forma* OATT provision discussed above regarding curtailment priority and eliminating Applicants' proposed pricing mechanism. Applicants must also propose an ROE for use in their formula rate in a new section 205 filing.

The Commission orders:

(A) Applicants' proposed withdrawal from the Midwest ISO is hereby conditionally approved, as discussed in the body of this order.

(B) Applicants are hereby directed to make a compliance filing, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

Appendix A

Motions to Intervene and Notices of Intervention
In Response to Applicants' Initial Filing

Ameren Services Company, Alliant Energy Corporate Services, Inc., Aquila, Inc., City of Columbia, MO., City of Springfield, IL, Great River Energy, Hoosier Energy Rural Electric Cooperative, Inc., Indiana Municipal Power Agency, Indianapolis Power & Light Company, Minnesota Power, Superior Water, L&P, Montana-Dakota Utilities Co., Xcel Energy Inc., Northwestern Wisconsin Electric Company, Otter Tail Power Company, Southern Illinois Power Cooperative, Southern Indiana Gas & Electric Company, and Wabash Valley Power Association, Inc. (Midwest ISO Transmission Owners)

American Municipal Power-Ohio, Inc. (AMP-Ohio) *

American Transmission Company LLC, International Transmission Company, and Michigan Electric Transmission Company

Big Rivers Electric Corporation (Big Rivers)

Cinergy Services, Inc. (Cinergy) *

Coalition of Midwest Transmission Customers (CMTC) *

Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.

Detroit Edison Company (Detroit Edison) *

Dynegy Power Marketing, Inc. and Bluegrass Generation Company, L.L.C. (Dynegy) *

East Kentucky Power Cooperative, Inc. (East Kentucky Coop)

Edison Mission Energy, Edison Mission Marketing & Trading, Inc., and Midwest Generation EME, LLC (EME) *

Electric Power Supply Association (EPSA) * **

Exelon Corporation

FirstEnergy Service Company (FirstEnergy) *

Frankfort Electric and Water Plant Board and the Cities of

Barbourville, Bardstown, Bardwell, Benham, Berea,
Corbin, Falmouth, Madisonville, Nicholasville, Paris,
and Providence, Kentucky (Kentucky Municipals) *
Illinois Municipal Electric Agency (Illinois Municipal) *
Indiana Municipal Power Agency (Indiana Municipal) *
Kentucky Industrial Utility Customers, Inc.
Lincoln Electric System
Midwest Independent Transmission System Operator, Inc.
(Midwest ISO) *
Northern Indiana Public Service Company
Owensboro Municipal Utilities (Owensboro Municipal)
Paducah Power System, Glasgow Electric Plant Board, Princeton
Electric Plant Board, and Hopkinsville Electric System
(TVA Distributor Group)
Peabody Energy Corporation
Public Service Commission of the Commonwealth of
Kentucky (Kentucky Commission)
Williams Power Company, Inc. (Williams) * **
Wisconsin Electric Power Company (Wisconsin Electric) *
WPS Resources Corporation, Wisconsin Public Service
Corporation, Upper Peninsula Power Company, WPS
Energy Services, Inc., and WPS Power Development,
LLC (WPS Companies) *

* protest or comment

** motion to intervene out-of-time

Appendix B

Parties Responding to
Applicants' Amended Filing

Ameren Services Company
Cinergy Services, Inc.
Edison Mission Energy, Edison Mission Marketing &
Trading, Inc. and Midwest Generation EME, LLC
Illinois Municipal Electric Agency
Indiana Municipal Power Agency
Midwest Independent Transmission System Operator, Inc.
Southwest Power Pool, Inc. **

** motion to intervene out-of-time