

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell, Joseph T. Kelliher,  
and Suedeen G. Kelly.

Midwest Independent Transmission System  
Operator, Inc.

Docket No. ER02-485-004

ORDER ON REMAND

(Issued June 3, 2005)

1. This case is before the Commission on remand from the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit Court).<sup>1</sup> At issue is the Commission's prior determination in this proceeding to implement an upward adjustment of 50 basis points (incentive adder) to the rate of return on common equity component (ROE) used in the formula calculation of transmission service rates for Midwest Independent Transmission System Operator, Inc. (Midwest ISO) transmission owners (TOs).<sup>2</sup> This Commission directed the adder to incent transmission-owning entities to turn over operational control of their transmission facilities to Midwest ISO. In this order, we vacate our prior determination regarding the incentive adder in Docket No. ER02-485-000 in light of the D.C. Circuit Court's decision, and we observe that MidwestISO or the TOs can make a filing under section 205 of the Federal Power Act<sup>3</sup> to include an incentive adder.<sup>4</sup>

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<sup>1</sup> *Public Service Commission of the Commonwealth of Kentucky v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005).

<sup>2</sup> *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2003) (September 23 Order), *reh'g denied*, 102 FERC ¶ 61,143 (2003) (February 5 Order).

<sup>3</sup> 16 U.S.C. § 824d (2000).

<sup>4</sup> While this proceeding was pending, the Commission approved a settlement that addresses the division of filing rights between Midwest ISO and the TOs. *See Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,380 (2005).

## **Background**

2. After an evidentiary hearing concerning Midwest ISO's proposed rates, the September 23 Order affirmed the methodology set forth in the presiding judge's initial decision in determining the ROE. In addition, the Commission, acting *sua sponte*, implemented an upward adjustment of 50 basis points to the ROE as an incentive for the turning over of operational control of transmission facilities. The Commission stated:

There are, however, policy reasons to make upward adjustments – particularly with regard to the level of operational independence that the Midwest ISO provides. In this case, we will make an upward adjustment of 50 basis points from the proxy group midpoint for the turning over of operational control of transmission facilities. We will consider providing additional upward adjustments for greater levels of independence. The Commission will be clarifying its incentive rate policy in the near future with concrete statements of the behavior and performance we wish to incentivize.<sup>5]</sup>

On rehearing, the Commission rejected the intervenors' argument that implementing the 50 basis point premium in this case required prior Commission notice.<sup>6</sup> The Commission also elaborated on its policy reasons for providing the 50 basis point premium, noting its previous recognition of the benefits of RTOs and citing complaints by market participants about their difficulties in gaining equal access to the transmission grid.<sup>7</sup>

3. The Public Service Commission of the Commonwealth of Kentucky, the Coalition of Midwest Transmission Customers, Dairyland Power Cooperative, Industrial End Users-Ohio, and the Midwest TDUs<sup>8</sup> (collectively, Petitioners) filed a petition for review with the D.C. Circuit Court.

4. On February 18, 2005, the D.C. Circuit Court issued its decision,<sup>9</sup> noting that, when Midwest ISO and its TOs first filed for a proposed rate increase, they sought an

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<sup>5</sup> September 23 Order, 100 FERC ¶ 61,292 at P 31.

<sup>6</sup> February 5 Order, 102 FERC ¶ 61,143 at P 12.

<sup>7</sup> *Id.* at P 13-14.

<sup>8</sup> The Midwest TDUs include several municipal electric utilities.

<sup>9</sup> *Supra* note 1.

incentive adder of 100 basis points, but the Commission declined to consider the proposed incentive adder and set the proposed rate increase for hearing, limiting the subject matter of the hearing to “ROE rates that essentially provide for appropriate cost recovery.”<sup>10</sup> The D.C. Circuit Court held that the Commission’s hearing order did not place the petitioners on notice that the Commission would consider an incentive-based premium in assessing Midwest ISO’s rate proposal and that the Commission ultimately applied the premium without considering record evidence. As a result, the D.C. Circuit Court held that the parties to the proceeding were denied a chance to present their side of the case regarding the incentive-based premium. The D.C. Circuit Court took no position concerning the petitioners’ substantive challenges to the incentive-based premium.<sup>11</sup>

### **Discussion**

5. As noted above, the D.C. Circuit Court has remanded the incentive adder issue on procedural grounds. We continue to believe that implementation of incentives to encourage participation by transmission owners in a regional transmission organization (RTO) such as Midwest ISO is sound policy. Accordingly, in light of the D.C. Circuit Court’s decision, we vacate the September 23 Order and the February 5 Order with respect to their implementation of the 50 basis point incentive premium in Midwest ISO’s ROE, and observe that Midwest ISO or the TOs can make a filing under section 205 of the FPA to include an incentive adder.

6. Because the 50 basis point incentive adder was approved and implemented without prior notice, as established by the D.C. Circuit Court, we will direct Midwest ISO and the TOs to make refunds, with interest,<sup>12</sup> for the period beginning at the time Midwest ISO started collecting the adder as part of the ROE through the date this order is issued.

#### **The Commission orders:**

(A) Midwest ISO and the TOs are hereby directed to make refunds, with interest, within 30 days of the date of this order, as discussed in the body of this order.

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<sup>10</sup> *Midwest Independent Transmission System Operator, Inc.*, 98 FERC ¶ 61,064 at 61,065 (2002).

<sup>11</sup> 397 F.3d at 1011-13. The court affirmed the Commission’s orders in all other respects.

<sup>12</sup> *See* 18 C.F.R. § 35.19a (2004).

(B) Midwest ISO and the TOs are hereby directed to file a refund report with the Commission within 15 days that refunds are made.

By the Commission. Chairman Wood and Commissioner Brownell concurring with a joint statement attached.

( S E A L )

Linda Mitry,  
Deputy Secretary.

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Pat WOOD, III, Chairman, and Nora Mead BROWNELL, Commissioner *concurring*:

We believe that it is appropriate for the Commission to actively explore the provision of ROE adders as an incentive for joining an RTO. Therefore, we would have preferred to institute a section 206 proceeding that would have avoided the potential delay of Midwest ISO and/or the TOs developing a section 205 filing, while still allowing all parties the additional due process mandated by the D.C. Circuit Court.

Pat Wood, III

Nora Mead Brownell