

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

Ameren Services Company  
on behalf of:  
Union Electric Company  
Central Illinois Public Service Company

Docket Nos. EL03-212-000  
EL03-212-001

American Electric Power Service Corporation  
On behalf of:  
Appalachian Power Company  
Columbus Southern Power Company  
Indiana Michigan Power Company  
Kentucky Power Company  
Kingsport Power Company  
Ohio Power Company  
Wheeling Power Company

Dayton Power and Light Company

Exelon Corporation  
On behalf of:  
Commonwealth Edison Company  
Commonwealth Edison Company  
of Indiana, Inc.

FirstEnergy Corporation  
On behalf of:  
American Transmission Systems, Inc.

Illinois Power Company

Northern Indiana Public Service Company

ORDER FINDING EXISTING RATE DESIGN FOR THROUGH AND OUT SERVICE  
UNJUST AND UNREASONABLE, DIRECTING COMPLIANCE FILINGS TO  
IMPLEMENT NEW RATE DESIGN,  
AND DENYING REHEARING

(Issued November 17, 2003)

1. In this order, we find that the rate design for through and out (T&O) service under the individual Open Access Transmission Tariffs (OATTs) of certain former Alliance Companies (Companies or former Alliance Companies)<sup>1</sup> is not just and reasonable when applied to transactions sinking in the proposed Midwest Independent Transmission System Operator (Midwest ISO)/PJM Interconnection, LLC (PJM) region (*i.e.*, the combined footprints of the Companies, Midwest ISO and PJM, hereinafter “combined region”) and we require the Companies to file compliance filings to implement a new rate design for such service, effective April 1, 2004. In addition, we deny requests for rehearing of the July 23 Order<sup>2</sup> that relate to Docket No. EL03-212-000.<sup>3</sup> This order benefits customers because it ensures that the rate design under the individual-company OATTs of non-regional transmission organization (RTO) members does not obstruct the realization of efficient and competitive regional electricity markets by RTO members.

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<sup>1</sup> American Electric Power Service Corp. on behalf of Appalachian Power Co., Columbus Southern Power Co., Indiana Michigan Power Co., Kentucky Power Co., Kingsport Power Co., Ohio Power Co., and Wheeling Power Co. (collectively, AEP), Ameren Services Co. on behalf of Union Electric Co. and Central Illinois Public Service Co. (collectively, Ameren), Commonwealth Edison Co. on behalf of itself and Commonwealth Edison Co. of Indiana (collectively, ComEd), FirstEnergy Corp. on behalf of American Transmission Systems, Inc. (ATSI) (collectively, FirstEnergy), Illinois Power Co. (Illinois Power), Northern Indiana Public Service Co. (NIPSCO) and Dayton Power and Light Co. (DP&L).

FirstEnergy and NIPSCO are now members of the Midwest ISO as participants of GridAmerica, which commenced its operations on October 1, 2003. See Midwest ISO Press Release, GridAmerica Begins Operations Under Midwest ISO (October 1, 2003), <http://www.miso.com>. Accordingly, we will not discuss ATSI and NIPSCO as this order no longer applies to them, and we will dismiss them from this proceeding.

<sup>2</sup> Midwest Independent Transmission System Operator, *et al.*, 104 FERC ¶ 61,105 (2003) (July 23 Order).

<sup>3</sup> Rehearing requests of the July 23 Order concerning Docket No. EL02-111-000 are being addressed in an order in Docket No. EL02-111-004, *et al.*, being issued concurrently with this order.

## I. Background

2. In the Initial Decision in Docket No. EL02-111-000,<sup>4</sup> the Presiding Judge determined that there was a lack of precedential authority that would permit him to eliminate the RTORs between the expanded Midwest ISO and expanded PJM under the circumstances of that proceeding. The Presiding Judge added that if, in a change of policy, the Commission was to order it, he would recommend that the Commission adopt, without requiring the filing of new rate cases, a mechanism such as one of the Seams Elimination Charge/Cost Adjustment/Assignment (SECA) proposals by the parties to prevent cost shifting between customers of the two RTOs.

3. In the July 23 Order, the Commission disagreed with the Presiding Judge's finding that there was a lack of precedential authority allowing him to eliminate the Regional Through and Out Rates (RTORs) between the expanded Midwest ISO and expanded PJM under the circumstances of that case. The Commission concluded that the Midwest ISO and PJM RTORs, when applied to transactions sinking within the Midwest ISO/PJM footprint, are unjust and unreasonable. The Commission directed PJM and Midwest ISO to make compliance filings within 30 days eliminating those RTORs, effective November 1, 2003. The Commission also stated that, even with the elimination of the Midwest ISO and PJM RTORs, in the near term the region will still be riddled with seams, with the T&O rates under the individual tariffs of the Companies acting as toll gates that impede the realization of more efficient and competitive electricity markets in the region and that preserve a competitive advantage for the non-RTO members' generation. Accordingly, the Commission established an investigation under Section 206 of the Federal Power Act (FPA)<sup>5</sup> in Docket No. EL03-212-000 to determine whether the Companies' T&O rates should be eliminated.

4. On October 14, 2003, the Commission issued an order in Docket Nos. EL02-111-000 and EL03-212-000,<sup>6</sup> extending the effective date for the elimination of the RTORs to

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<sup>4</sup> Midwest Independent Transmission System Operator, Inc., et al., 102 FERC ¶ 63,049 (2003) (Initial Decision).

<sup>5</sup> 16 U.S.C. § 824e (2000).

<sup>6</sup> Midwest Independent Transmission System Operator, et al., 105 FERC ¶ 61,060 (2003).

a date that was to be set in the order on rehearing of the July 23 Order, which is being issued concurrently with this order.<sup>7</sup>

## **II. Notice and Filings**

### **A. Docket No. EL03-212-000**

5. Notice of the initiation of proceedings and refund effective date in Docket No. EL03-212-000 was published in the Federal Register, 68 Fed. Reg. 46,175 (2003). The July 23 Order, which was published in the Federal Register, 65 Fed. Reg. 45,799 (2003), directed all notices of intervention to be filed with the Commission on or by August 8, 2003. The entities that filed timely and late motions to intervene or notices of intervention are listed in Appendix A of this order.

6. On August 15, 2003, AEP, Ameren, ComEd, DP&L, FirstEnergy,<sup>8</sup> Illinois Power and NIPSCO filed responses to the July 23 Order. On September 4, 2003, Wisconsin Public Service Corp. and Upper Peninsula Power Co. (WPSC/UPPCO) filed comments responding to the Companies' submittals, to which ComEd and DP&L jointly filed an answer. Ormet Primary Aluminum Corp. (Ormet) and Consumers Energy Company (Consumers Energy) also filed comments responding to AEP's submittal.

7. In addition, on August 15, 2003, Certain Classic PJM Cos. Transmission Owners<sup>9</sup> (Certain Classic PJM Cos. TOs) filed preliminary comments and Wisconsin Electric Power Co. and Alliant Energy Services Corp. (collectively, WEPCO/Alliant) and WPSC/UPPCO filed initial comments. AMP-Ohio; Cinergy Services, Inc. on behalf of Cincinnati Gas & Electric Co., PSI Energy, Inc. and the Union Light, Heat & Power Co. (collectively, Cinergy Services); Midwest ISO Transmission Owners (Midwest ISO

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<sup>7</sup> As stated in our concurrent order in Docket No. EL02-111-004, et al., the new effective date is April 1, 2004.

<sup>8</sup> On September 12, 2003, FirstEnergy filed a supplemental response to the July 23 Order.

<sup>9</sup> West Penn Power Co., Monongahela Power Co., Potomac Edison Co. all d/b/a Allegheny Power; Baltimore Gas and Electric Co., Pepco Holdings, Inc. and its affiliates Potomac Electric Power Co., Atlantic City Electric Co., and Delmarva Power & Light Co.; PPL Electric Utilities Corp.; Public Service Electric and Gas Co.; Rockland Electric Co.; and UGI Utilities, Inc.

TOs); Multiple TDUs;<sup>10</sup> Detroit Edison; Madison Gas and Electric Co. (MDG&E); and, jointly, Michigan Agencies<sup>11</sup> and the City of Hamilton filed comments. ComEd and DP&L filed a joint answer to the comments submitted in the proceeding.

**B. Docket No. EL03-212-001**

8. On August 4, 2003, New PJM Companies<sup>12</sup> (New PJM Cos.) filed a request for expedited clarification or, alternatively, rehearing of the July 23 Order. Illinois Power filed a motion in support of New PJM Cos.' request. Certain PJM Cos., Consumers Energy and Wisconsin Electric filed answers opposing New PJM Cos.' request, and Michigan Agencies filed a response in opposition to New PJM Cos.' and Illinois Power's filings. In addition, Coalition of Municipal and Cooperative Users of New PJM Cos. Transmission, Indiana Municipal Power Agency, Southeast Michigan System and Wisconsin Public Power, Inc. (collectively, Muni-Coop Coalition) jointly filed a response in opposition to New PJM Cos.' filing. Subsequently, New PJM Cos. filed an answer to the answers.

9. On August 11, 2003, GridAmerica Companies<sup>13</sup> (GridAmerica) filed a request for clarification and request for expedited consideration, and Michigan Agencies filed a partial answer opposing Grid America's filing and subsequently filed a response to GridAmerica's filing. New PJM Cos. and Detroit Edison also filed answers. On August 14, 2003, New PJM Cos filed a supplement to its answer to the answers, to which Multiple TDUs filed an answer. On August 22, 2003, Midwest ISO TOs filed motions for clarification. Cinergy Services filed an answer to Midwest ISO TOs' motion for clarification.

10. On August 15, 2003, Illinois Power filed a request for rehearing of the July 23 Order as it pertains to the ongoing FPA Section 206 investigation that included a

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<sup>10</sup> Indiana Municipal Power Agency; Michigan Cities of Croswell, Dowagia, Sebawaing and Sturgis; Nordic Energy; and Thumb Electric Cooperative; ElectriCities of North Carolina, Inc.; Blue Ridge Power Agency; Central Virginia Electric Coop.; Craig-Botetourt Electric Coop.; Old Dominion Electric Coop.; and Virginia Municipal Electric Assoc. No. I.

<sup>11</sup> Michigan Public Power Agency and Michigan South Central Power Agency.

<sup>12</sup> AEP, ComEd, and DP&L.

<sup>13</sup> Ameren Services and FirstEnergy.

response and suggestions for future actions. On August 22, 2003, AEP, ComEd, DP&L, Grid America, and the Pennsylvania Commission filed requests for rehearing.

#### **IV. Discussion**

##### **A. Procedural Matters**

11. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(c) (2003), the timely, unopposed motions to intervene and notices of intervention serve to make the entities that filed them parties to this proceeding.

12. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2003), we will grant the entities' untimely motions to intervene, in light of their interest in this proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay.

13. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2003), prohibits an answer to an answer unless otherwise ordered by the decisional authority. We will accept Multiple TDUs', New PJM Cos.' and Commonwealth Edison's answers, as they have aided us in our decision making process in this proceeding.

##### **B. Justness and Reasonableness of Companies' T&O Rates**

14. In the July 23 Order, the Commission found that even with the elimination of the Midwest ISO and PJM RTORs, in the near term, the region will still be riddled with seams, with the T&O rates under the Companies' tariffs acting as toll gates that impede the realization of more efficient and competitive electricity markets in the region and that preserve a competitive advantage for the non-RTO participants' merchant functions. The Commission provided the Companies with an opportunity to explain to the Commission why the T&O rates under the individual-company OATTs are or are not unjust, unreasonable or unduly discriminatory or preferential. As explained below, consistent with our responsibility under the FPA to ensure that rates, charges and practices of public utilities are just and reasonable,<sup>14</sup> we find that the T&O rates are unjust, unreasonable and unduly discriminatory or preferential.

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<sup>14</sup> 16 U.S.C. § 824d (2000); 16 U.S.C. § 824e (2000).

**1. Ameren**

15. Ameren expects the Section 206 investigation will become moot as it anticipates joining an RTO by November 1, 2003.<sup>15</sup> Ameren contends that its T&O rates are just and reasonable and should not be eliminated without providing for continued recovery of the revenues lost by their elimination. Ameren states that to eliminate its T&O rates without a lost revenue recovery mechanism would be unjust and unreasonable and a retail rate freeze leaves it without means of recouping lost T&O service revenues until at least mid-2006.<sup>16</sup> It requests that the Commission find that the continued application of its individual T&O rates is just and reasonable until it joins an RTO. However, Ameren is willing to waive its T&O rates subject to: (1) the simultaneous elimination of the T&O rates of all transmission providers in the proposed Midwest ISO/PJM footprint; and (2) the Commission's adoption of a replacement lost revenue recovery mechanism.

**2. ComEd**

16. ComEd requests that the Commission conditionally dismiss it from this proceeding, subject to notice that it will be allowed to join PJM effective November 1, 2003.<sup>17</sup> ComEd expresses concern that it could be held responsible for refunds due to the October 4 refund effective date.

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<sup>15</sup> Ameren notes that proceedings before the Missouri Public Service Commission regarding Ameren's participation in GridAmerica have been suspended to allow parties to engage in settlement discussions. See Ameren Response at 6.

<sup>16</sup> Ameren states that the approximately \$45 million in revenues that it collects from T&O rates applicable to transactions sinking outside its control area are embedded in cost-of-service studies that were the basis for its current bundled retail rates in Missouri. Ameren asserts that the approved retail rates resulted from a "black box settlement," and hence, there is no settlement cost-of-service line item labeled RTOR revenue. Ameren assumed that it would receive this revenue in the future to fund part of its transmission cost-of-service and that no additional revenues from Missouri ratepayers would be needed. See Ameren Response at 9 and Attachment A.

<sup>17</sup> We note, however, that PJM recently announced its extension of the date on which it will integrate ComEd into PJM as it is currently reviewing the events of the August 14 blackout and related reliability concerns. PJM will announce a new schedule for integrating ComEd and other transmission owners as its reliability review proceeds. See PJM News Release, Electricity Outage Lessons Learned to be Applied to Ongoing Integration Efforts (Aug. 20, 2003), [http:// www.pjm.com](http://www.pjm.com).

17. In addition, ComEd contends that the July 23 Order does not present substantial evidence showing that its existing T&O rates are unjust and unreasonable or give adequate consideration to potential cost shifts to retail rate payers and utility shareholders if the T&O rates are eliminated.<sup>18</sup>

### 3. DP&L

18. In addition to the arguments against eliminating its T&O rates discussed later in this order,<sup>19</sup> DP&L claims that, pending its anticipated membership in PJM<sup>20</sup> and a simultaneous replacement of its existing transmission rate design, there is no basis to find its T&O rates unjust and unreasonable. In particular, DP&L states that the Commission's reference to "tollgates" does not apply to DP&L because, given its location in the region, transmission users have multiple options that would allow them to bypass the DP&L transmission system if its T&O rate was significantly out of line with available alternatives. It concludes that "it is highly unlikely that DP&L would or could act as a 'tollgate,' contrary to the Commission's assumption."<sup>21</sup>

19. DP&L also states that its currently effective rate design and rates, including its point-to-point rate applicable to T&O service, were established by settlement, effective

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<sup>18</sup> ComEd states that its currently effective rate design and rates were established by settlement in Docket No. ER99-4470-000, et al., effective February 5, 2000, and that its point-to-point rate is currently \$0.950 per KW-month. It also notes that its bundled retail rates are frozen through January 1, 2005. See ComEd Response at 5.

<sup>19</sup> DP&L also expresses concern that the October 4, 2003 refund effective date would leave it without recourse to recover lost revenues if its T&O rate is eliminated on that date. See DP&L Response at 7. DP&L adds that the Commission's elimination of DP&L's existing rates would be discriminatory and unfairly singles out DP&L, as compared to other utilities that are not subject to this investigation. It states that the policy implications of such elimination include discouraging RTO development and transmission investment. Id. at 12.

<sup>20</sup> DP&L anticipates that its transmission system will be integrated into the PJM market and transmission service over its transmission system coming under the PJM OATT in Spring or Fall 2004.

<sup>21</sup> See DP&L Response at 10. In addition, AEP contests the characterization of its T&O rates as a toll gate and asserts that wholesale users of the transmission system should pay a fair share of the costs of its extensive transmission system. See AEP Response at 33.

December 19, 1997.<sup>22</sup> It asserts that currently a retail rate freeze is in place during the development period for retail competition, so if a change is made to the unbundled transmission component of retail rates to reflect the elimination of T&O service revenues, there would be an offsetting change to the distribution charge, effectively rendering it unable to pass this through to retail customers during the market development period.

#### 4. Illinois Power

20. Illinois Power proposes to report back to the Commission by October 1, 2003 regarding its RTO plans. Illinois Power asserts that its rates are just, reasonable, and not unduly discriminatory or preferential and are entitled to a presumption of lawfulness because neither the Commission nor any other party has proven otherwise, in accordance with Section 206 of the FPA. It requests that the Commission provide guidance on appropriate transitional rate structures and that the Commission defer further action in Docket No. EL03-212-000 with respect to Illinois Power until October 1, 2003, by which time Illinois Power expects to be able to make a firm commitment on its RTO plans.<sup>23</sup>

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<sup>22</sup>DP&L cites Dayton Power and Light Co., 88 FERC ¶ 61,242 (1999).

<sup>23</sup> Exelon Corp. has since entered into an agreement with Dynegy Inc. to acquire substantially all of the operating assets of Illinois Power. The transaction is expected to close in the fourth quarter of 2004, pending regulatory approval and the passage of legislation in Illinois. In its announcement of the acquisition, Exelon stated that legislation, to be introduced in the Illinois General Assembly during its November session, is necessary to facilitate the acquisition and would give the Illinois Commerce Commission the authority to set rates for four year after the end of a state-mandated transition period on December 31, 2006. See Exelon News Release, Exelon Corporation Announces Acquisition of Illinois Power's Assets from Dynegy, Inc. (Nov. 3, 2003), *available at* <http://www.exeloncorp.com/corporate/newsroom>. We note that at the September 29 and 30, 2003 hearing conducted by the Commission into the RTO status of certain of the former Alliance Companies, Illinois Power stated that will continue to evaluate its options for RTO participation in the event that no transaction with Exelon occurs. See Commission Inquiry into Midwest ISO/PJM RTO issues initiated in Docket No. ER03-262-001 *et al.*; Tr. at 184: 16-20. In addition, Exelon indicated that if the negotiations for the purchase of Illinois Power were successful, it planned to bring Illinois Power, along with ComEd, into PJM. *Id.* at 147: 6-12.

5. AEP

21. AEP restates its legal and procedural concerns from its rehearing request, as summarized later in this order.<sup>24</sup> AEP also asserts that eliminating the Companies' T&O rates is not necessary at this time. However, it indicates that it is not wedded to a transactional charge for T&O service as long as there is a method of obtaining a fair contribution from wholesale users of its transmission system through a lost revenue recovery mechanism. AEP seeks dismissal of the instant proceeding for the following reasons.

22. AEP argues that there is no evidence in the record that eliminating its T&O rates would result in the greater efficiency or increased competition assumed by the Commission;<sup>25</sup> instead, a principal impact would be a shift in revenue from AEP's transmission business to generators<sup>26</sup> and other load serving entities. AEP states that transactions are now occurring predominantly from the South and West to North and East directions, and almost all of the available transmission capacity from AEP to PJM has been sold on a firm basis to annual or seasonal customers, at least through the summer of 2004. According to AEP, capacity on AEP's transmission lines into Michigan is essentially fully subscribed during the summer peak periods when there is a substantial demand for imported energy into Michigan. It states that the July 23 Order contains no analysis concerning the determination of whether elimination of the T&O rates would produce more short-term generation efficiencies than transmission and long-term

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<sup>24</sup> AEP also argues that it has not unduly delayed joining an RTO, contrary to the Commission's July 23 Order's implication that it purposefully delayed. AEP asserts that the Commission should resolve its differences with the states regarding RTO development so that AEP can join an RTO.

<sup>25</sup> AEP claims that "free-riding" by wholesale transmission service customers will discourage transmission investment, thereby adversely affecting efficiency in the long term. For example, AEP states it recently upgraded the capability of the interface with Michigan. AEP states that no rational transmission operator would have made the investment in a regime where the users of the upgraded capacity would be able to avoid altogether payment of transmission rates. AEP explains that, where the interfaces are fully subscribed, users should see a price signal that incents the expansion of transmission capacity. When excess capacity is available, AEP believes the current rules incent transmission providers and resellers to discount down to the level of short run marginal costs. See AEP Response at 4-5.

<sup>26</sup> AEP also states that rents will shift among generators if T&O rates are eliminated. Id. at 5.

generation inefficiencies<sup>27</sup> and, whether, and to what extent, the reduced transmission costs will be translated into lower prices for customers.

23. In addition, AEP asserts that, even if the Commission decides to eliminate its T&O rates, there is no reason to eliminate the rates under existing firm transmission service agreements. According to AEP, the costs under those agreements are sunk and should not, therefore, affect efficiency since choices made by the holders of these transmission rights should not be influenced by competing sellers of wholesale power.

24. AEP argues that eliminating T&O rates without providing a revenue-neutral alternative for transmission providers would chill efficient transmission investments and provide erroneous price signals to generators. Further, AEP states that until transmission expansion is planned, a price signal should incent generators to locate new generation on the other side of the constraints.

25. Further, AEP contends that there is no evidence that maintaining the existing T&O rate would preserve any undue competitive advantage for AEP's generation. AEP states that there is no reason why a seller in Midwest ISO or PJM should be disadvantaged in competing for transactions into or through the AEP system. AEP asserts that Midwest ISO had, prior to the issuance of the July 23 Order, decided to discount its "out" transmission rates where necessary to meet competition, and that the July 23 Order removes Midwest ISO and PJM's RTORs for transactions that sink into the other RTO. AEP states that with the elimination of the RTORs, sellers of generation from the Midwest ISO and from AEP into PJM face the same base transmission charges. AEP submits that, similarly, sellers of generation coming from PJM and from AEP into Midwest ISO face the same transmission charges.

26. AEP also claims that eliminating the T&O rates would be discriminatory because T&O customers would not have to pay for use of the transmission system while other customers, including AEP's native load customers, will continue to pay for service on AEP's transmission system. AEP also contends that it would be discriminated against

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<sup>27</sup> AEP witness Joe D. Pace questions the economic efficiency arguments underlying the Commission's reasoning for eliminating T&O rates. Mr. Pace states that there are significant impediments to achieving the efficiency gains that the Commission expects, given the high sunk cost and low marginal cost nature of the industry. He states that short-run marginal cost pricing must be implemented consistently and notes that any short-run benefits may be offset by even greater reductions in long-run efficiency unless access charges are established in a non-distorting way and a means of efficiently funding expansions of the network is in place. Moreover, according to Mr. Pace, neither short-run nor long-run efficiencies may materialize unless prices in competing or complementary industries are set in a similar manner. *Id.*, Affidavit of Joe Pace at 6-9.

vis-à-vis RTO members because it would receive the disadvantages of RTO membership without receiving benefits such as centralized transmission planning, shared transmission costs, and the ability to obtain electric power from a much larger geographic area at one flat rate without pancaked transmission rates. AEP also states that the Companies are being discriminated against as compared to other non-RTO member utilities that will be able to continue charging their T&O rates. AEP also faults the July 23 Order as providing no support or rational explanation to justify treating the utilities in the Midwest ISO/PJM footprint differently from those in all the rest of the United States or why the footprint constitutes a “region” for which rate pancaking need be eliminated.<sup>28</sup> Even though AEP believes generally that elimination of T&O rates would be discriminatory, AEP witness Mr. Pace states that under certain conditions, the Commission’s policy goals would not be discriminatory.<sup>29</sup>

## 6. Other Comments

27. Several interested entities state that the Companies are legally obligated to join RTOs as a condition of the Commission’s approval of several relevant mergers,<sup>30</sup> and

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<sup>28</sup> For example, AEP points out the inconsistency in the fact that if T&O rates are eliminated as the Commission plans, then transmission from Central Missouri to Hoboken, New Jersey would be essentially free, yet a transaction from Hoboken to Connecticut would bear pancaked charges (*i.e.*, one by PJM and the other by New York ISO). See AEP Response at 32.

<sup>29</sup> Mr. Pace states:

[T]he only logical and non-discriminatory way to accomplish the Commission’s stated objective in this case (creating a common market encompassing the PJM, MISO and former Alliance company areas) is to: (a) eliminate all [T&O] rates of PJM and MISO to each other, as well as to the [Companies]; (b) eliminate the [T&O] rates of all the [Companies] to PJM, MISO and one another; and (c) replace those rates with an alternative revenue recovery system that is as efficient and fair as practical, and applies the same principles of cost recovery to all transmission owners in the new expanded common market.

Id., Affidavit of Joe Pace at 4.

<sup>30</sup> For example, Multiple TDUs state that the Commission’s approval of the Ameren-CILCO merger was conditioned upon Ameren and CILCO’s commitment to participate in Midwest ISO. See Multiple TDUs Comments at 22. They also state that  
(continued...)

fault the Companies for the subsequent delays in joining RTOs.<sup>31</sup> They assert that, in accepting the Companies' choices, the Commission relied on their express commitments to join RTOs and expected that benefits would quickly accrue. Several entities also advocate eliminating the Companies' T&O rates in order to achieve appropriate scope and configuration within the expanded region.<sup>32</sup>

28. A number of entities support eliminating the Companies' T&O rates on the ground that they obstruct more competitive and efficient electricity markets.<sup>33</sup> For example, Cinergy Services argues that imposing T&O rates between utilities or regions is inefficient because T&O rates constitute artificial "taxes" on power transactions, and

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(...continued)

the Commission relied upon the following Companies' commitments to join RTOs in allowing their mergers and withdrawals: (1) ComEd's commitment to join an RTO when it both allowed the merger that created Exelon and allowed ComEd to withdraw from Midwest ISO; (2) Illinois Power's participation in Midwest ISO as mitigating adverse effects of the merger between Dynegy and Illinova, and Illinois Power's commitment to RTO participation when it allowed Illinois Power to withdraw from Midwest ISO; (3) NIPSCO's commitment to join a Commission-approved RTO within one year of the closing of the Columbia-NiSource merger; (4) AEP's commitment to place all of its eastern and southwestern transmission facilities under market-independent regional control by the end of 2001 when it allowed the AEP-CSW merger. They also state that FirstEnergy is required to join an RTO as a condition of the merger that formed it and state that DP&L is under a statutory obligation to participate in an operational, federally-approved regional transmission entity on January 1, 2001. *Id.* at 22-23.

<sup>31</sup> See, e.g., AMP-Ohio Comments at 2; Michigan Agencies and City of Hamilton Comments at 4; Cinergy Services Comments at 9; WPSC/UPPCo Initial Comments at 3.

<sup>32</sup> See, e.g., Cinergy Services Comments at 9-14; MDG&E Comments at 4; and Michigan Agencies and City of Hamilton Comments at 4.

<sup>33</sup> See, e.g., Cinergy Services Comments at 14; Michigan Agencies and City of Hamilton Comments at 3; WEPCO/Alliant Initial Comments at 8.

distort the efficiency of power markets.<sup>34</sup> It asserts that T&O rates' inefficiency derives from their design to recover sunk costs, and, consequently, bear no relation to the marginal cost of transmitting power (i.e., congestion costs and transmission losses) which form the basis for efficient generation dispatch. It argues that the same T&O rate applies to every cross-seam transaction regardless of that transaction's cost impact on the transmission system.<sup>35</sup> Further, Midwest ISO TOs state that fairness dictates eliminating the T&O rates of all intervening transmission owners if the Commission is eliminating the Midwest ISO and PJM RTORs because the timely elimination of rate pancaking in the expanded region is critical to achieving competitive and efficient electric markets, which was fundamental to the Commission's acceptance of the Companies' RTO choices.<sup>36</sup>

29. Some entities argue that the Companies are benefiting by continuing to collect access charges for use of their transmission systems<sup>37</sup> while receiving significant

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<sup>34</sup> See, e.g., Cinergy Services Comments, Exhibit 1, Testimony of Michael B. Rosenzweig at 7-8. Mr. Rosenzweig's response to the query of whether his analysis of the Midwest ISO and PJM RTORs also applies to the T&O rates of the Companies, provides in pertinent part:

Prior to the Commission's order, the MISO through and out rate was an added cost so that the prices of any sales to AEP were higher by the MISO through and out rate of \$2.21. Generators not subject to the MISO through and out rate would have been handed a competitive advantage by virtue of the seam: those who could sell profitably at less than \$27.21/MWH but not \$25/MWH in my example would be able to undercut the MISO generation, even though they would be a less efficient choice economically. The Commission order solved this problem for sales from MISO to AEP but not for sales from MISO to PJM. Sales from MISO to PJM must go through the AEP "tollgate" and pay the AEP through and out rate of \$1.42. Generators in PJM whose breakeven price is less than \$26.42 but more than \$25 still have a competitive advantage over the generator in MISO, even though they are less efficient.

<sup>35</sup> For example, the same T&O rate is applied whether power is being transmitted 50 miles or 1,000 miles and whether a particular power sale increases or alleviates congestion. See Cinergy Services Comments at 16.

<sup>36</sup> See Midwest TOs Comments at 4.

<sup>37</sup> See, e.g., MDG&E Comments at 6; WEPCO/Alliant Comments at 9-10.

transmission cost reductions due to the formation of RTOs in their region<sup>38</sup> and the ensuing competitive advantages.<sup>39</sup> They also assert that, if the Companies' T&O rates are not eliminated, the Commission will not get the benefits that it expects and will reward those entities that avoid RTO membership.<sup>40</sup> For example, Consumers Energy argues that allowing AEP to import power from Midwest ISO and PJM without paying an RTOR while requiring customers in Midwest ISO and PJM to pay AEP's individual T&O rates would reward AEP for failing to fulfill its commitments to join an RTO. Consumers Energy supports eliminating AEP's T&O rates, stating that not doing so would preserve an unfair and unreasonable competitive advantage for AEP's merchant arm. It states that AEP may lose its ability to recover revenues exceeding those approved by regulators, and will likely suffer no resulting cost-based injury.<sup>41</sup> Entities also state

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<sup>38</sup> For example, Multiple TDUs argue that the MISO/PJM RTORs should be maintained for transactions to serve the bundled retail load of RTO non-participants, even while the Commission eliminates the MISO/PJM RTORs and the non-participants' T&O rates. They claim that RTO non-participants, such as AEP, have been enjoying the opportunity to obtain significant transmission expense reductions from the de-pancaked rates of utilities in its region that have joined Midwest ISO and PJM. They contend that such benefits should be considered when evaluating non-participants' claims to lost revenue recovery, and that if the RTORs are eliminated for transactions to serve the bundled load of non-participants, this benefit should be credited against any non-participants' allowable lost revenue recovery. See Multiple TDUs Comments at 7-11. As addressed in our companion order in Docket No. EL02-111-000, et al., we deny Multiple TDUs' request to maintain the RTORs for transactions to serve the bundled retail load of RTO non-participants as this would perpetuate significant market inefficiencies.

<sup>39</sup> For example, WEPCO states that the T&O rates act as toll gates that preserve a competitive advantage for RTO non-participants' merchant functions. It asserts that elimination would accelerate at least ComEd's and AEP's compliance with the Commission-stipulated merger conditions to join an RTO. See WEPCO Comments at 6; see also Cinergy Services Comments at 17-18; Multiple TDUs Comments at 4.

<sup>40</sup> In support, Midwest ISO TOs state that there are far more transactions between Midwest ISO and the Companies joining PJM than exist between Midwest ISO and the PJM footprint. See Midwest ISO TOs Comments at 5; see also WEPCO/Alliant Initial Comments at 11-12; Michigan Agencies and City of Hamilton Comments at 7.

<sup>41</sup> Consumers Energy states that AEP's merchant arm would receive the revenue previously allocated to AEP's transmission function, thereby preserving the total revenues of the corporate entity. It asserts that load growth and increased point-to-point

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that it would be unfair for the Commission to eliminate the Midwest ISO/PJM RTORs for transactions within the combined region without simultaneously eliminating the individual T&O rates therein.<sup>42</sup>

30. Ormet, a native load transmission customer of AEP, opposes eliminating AEP's T&O rates. It states that eliminating AEP's T&O rates without a lost revenue recovery mechanism could increase its costs up to \$4.4 million dollars annually because the transmission cost-of-service formally paid by T&O service customers would be passed on to native load customers through the rates for network integration transmission service and point-to-point transmission service.<sup>43</sup> Further, Ormet asserts, as AEP is not a member of an RTO, it would not receive the benefits of RTO participation to offset this potential rate increase.

## **7. Companies' Response to Comments**

31. In ComEd and DP&L's joint response to the comments regarding the elimination of the Companies' T&O rates, they state that there is no basis for finding the Companies' T&O rates to be unjust and unreasonable.<sup>44</sup> They contend that parties' comments repeat

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transactions since the test-year underlying AEP's current rates have reduced costs to network customers, including AEP's distribution entities. Noting AEP's assertion that the current rolling-average load ratio share rate for network customers is \$1.08 per kW-month, it states that to the extent AEP distribution entities are collecting transmission costs in their rates based upon the approved stated point-to-point transmission rate of \$1.42 per kW-month, these entities are likely over-collecting transmission costs from their retail customers. It submits that AEP would likely remain whole by either allocating prior-year revenue over-recoveries of AEP distribution entities to AEP transmission or by increasing the cost responsibility of network customers like AEP distribution entities. See Consumers Energy Answer in Response to AEP at 21-22.

<sup>42</sup> See, e.g., Michigan Agencies and City of Hamilton Comments at 4-5, Midwest ISO TOs Comments at 4; Certain PJM Comments at 3.

<sup>43</sup> See Ormet Comments at 6.

<sup>44</sup> In their response to Cinergy Service's comments, ComEd and DP&L argue that the material presented by Dr. Rosenzweig is insufficient, as demonstrated in the Docket No. EL02-111-000 proceeding, in which he had initially submitted the testimony which is presented here. They state that Dr. Rosenzweig's economic analysis was limited to a

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the Commission's reasoning without adding anything new or substantive to the record. In addition, they argue that those favoring eliminating T&O rates do not acknowledge that elimination of a substantial portion of a utility's revenues, without an alternative lost revenue recovery mechanism, will increase regulatory uncertainty and inhibit transmission development. ComEd and DP&L state that the reasons for the delay in RTO membership cannot be blamed on the Companies as the reasons are complex and involve action by a number of parties including the Commission.<sup>45</sup>

## 8. Commission Determination

32. Consistent with our responsibility under the FPA to ensure that rates, charges and practices of jurisdictional public utilities are just and reasonable,<sup>46</sup> we find that the rate design for T&O service under the Companies' OATTs is not just and reasonable for transactions sinking in the combined region. Accordingly, we order compliance filings to eliminate the unjust and unreasonable rate design, and establish a new rate design for such T&O service, effective April 1, 2004. This effective date coincides with the effective date for the same new rate design for regional through and out service under the PJM and Midwest ISO OATTs, established in an order on rehearing of the July 23 Order being issued concurrently with this order. This new rate design is transitional in nature and will remain in effect for a two-year period. This new rate design is based on the existing rate and revenues for T&O service, but will recover these revenues from customers in the region in proportion to the benefits such customers will receive from the elimination of the unjust and unreasonable rate design, through a non-bypassable surcharge for delivery to load. This new rate design will eliminate the injurious effects on efficient use of the grid associated with rate pancaking, while mitigating cost shifting among customers and revenue losses that would otherwise occur if rate pancaking were eliminated without a transitional rate mechanism.

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short-run marginal analysis. They argue that, under his theoretical construct, T&O rates anywhere in the country would be unjust and unreasonable and that his analysis fails to adequately balance the pure economic theory with the historic and regulatory setting in which the theory must be applied. They doubt the empirical nature of Dr. Rosenzweig's evidence, stating that it was shown on cross-examination in Docket No. EL02-111-000 to be anything but empirical. See ComEd and DP&L Answer at 4-5.

<sup>45</sup> See ComEd and DP&L Answer at 6.

<sup>46</sup> 16 U.S.C. § 824d (2000); 16 U.S.C. § 824e (2000).

33. A number of the Companies have responded that they are willing to depart from the use of the existing rate design for T&O service, as long as customers using their transmission facilities for T&O service make a fair contribution to the cost of these facilities.<sup>47</sup> The new rate design adopted in this order responds to their concerns. Further, as discussed below, we will adopt their recommendations and allow the existing T&O rate design to remain in effect for existing transactions during a two-year transition period.

34. Some of these Companies, however, expect to transfer or have already transferred operational control of their transmission facilities to an RTO before April 1, 2004; to the extent that their transmission facilities are in an RTO by April 1, 2004, this order will not apply to them. For the other Companies, we have previously initiated an inquiry to explore the impediments to these utilities' implementation of their voluntary commitments to join PJM or Midwest ISO.<sup>48</sup> We expect that they will transfer their facilities to an RTO by the end of the transition period.

35. We are taking the unprecedented action here to eliminate the T&O rates of individual companies that are not yet members of an RTO because of the set of circumstances we face in the Midwest ISO/PJM region. As discussed in more detail below, transmission owners in the Midwest ISO/PJM region have moved forward to establish RTOs in the region to realize the benefits of more efficient and competitive electricity markets. However, given the Companies' location in the heart of the region and their failure to join a RTO, their existing T&O rates leave the region riddled with seams that deny the RTO members the benefits of more efficient and competitive electricity markets and hinders the realization of goals of Order No. 2000. As such the individual company T&O rates are no longer just and reasonable and not unduly discriminatory.

36. As we explained in the July 23 Order and earlier in Order No. 2000, RTOs will eliminate rate pancaking within a region of appropriate scope and configuration, thereby facilitating the realization of competitive and efficient markets.<sup>49</sup> In the July 23 Order, the Commission found that a proper alignment of the Companies can promote more efficient and competitive markets. Some of the Companies, including Illinois Power and New PJM Cos., are located between two functioning RTOs in the region and have close

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<sup>47</sup> See AEP Response at 6; Ameren Response at 10; NIPSCO Response at 5.

<sup>48</sup> See New PJM Companies, et al., 104 FERC ¶ 61,274 (2003).

<sup>49</sup> See July 23 Order, 104 FERCat P 29; Order No. 2000 at 31,024, 31,082-84, 31,174-75.

links with their neighboring utilities in the Midwest ISO. Specifically, some Companies are located in the heart of the common market that those RTOs and their members seek to achieve,<sup>50</sup> and significantly “island” Michigan and Wisconsin from the remainder of the Midwest ISO. The Commission recognized the Companies’ unique position vis-à-vis the Midwest ISO and PJM when it approved their status as RTOs. The Commission conditioned its approval of Midwest ISO and PJM as RTOs on their attaining sufficient scope and configuration to meet the requirements of Order No. 2000. With respect to Midwest ISO, the Commission found that Midwest ISO’s configuration problem along its eastern border would be solved by the successful integration of some or all of the Companies into the Midwest ISO.<sup>51</sup> Likewise, after finding that PJM exhibited insufficient scope to meet the requirements of Order No. 2000, on rehearing, the Commission found that PJM’s planned expansion to incorporate some of the former Alliance Companies alleviated concerns regarding scope and configuration.<sup>52</sup>

37. Subsequently, the Companies decided to join either Midwest ISO or PJM. However, the choices of the Companies produced unjust and unreasonable rates, terms and conditions of transmission service. The Commission could, therefore, only accept the RTO choices of the Companies subject to several conditions, including, as particularly relevant here, the resolution of pancaked T&O rates<sup>53</sup> and the creation of a common market across the proposed Midwest ISO/PJM region. These conditions mitigated the adverse effects of the seams resulting from certain of the Companies’ RTO choices so that the seams did not obstruct the attainment of efficient and competitive

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<sup>50</sup> We have previously noted the close links among the individual companies and between the individual companies and neighboring RTOs. July 23 Order, 104 FERC at P 33; Alliance Companies, et al., 103 FERC ¶ 61,274 at P 27-30 (2003).

<sup>51</sup> Midwest Independent Transmission System Operator, Inc., 97 FERC 61,326, order on reh’g, 103 FERC ¶ 61,169 (2001).

<sup>52</sup> See PJM Interconnection, LLC, et al., 96 FERC ¶ 61,061 (2001), order on reh’g, 101 FERC ¶ 61,345 (2002).

<sup>53</sup> The timely elimination of rate pancaking in the Midwest ISO/PJM region, which is critical to achieving competitive and efficient electric markets, was fundamental to our decision to accept the Companies’ RTO choices. See Alliance Companies, et al., 103 FERC ¶ 61,274 (2003).

markets in the region.<sup>54</sup> In conditionally accepting the Companies' RTO choices more than a year ago, the Commission relied upon their express intentions and commitments to join the RTOs they had chosen, so that, by acting expeditiously in allowing each company to proceed to join the RTO of its choosing, those choices would be implemented, and the resulting benefits would be quickly realized. However, most of the Companies still have not joined an RTO, leaving the region riddled with seams with pancaked individual-company T&O rates.<sup>55</sup> Given their location and the close links between the Companies and the neighboring RTOs, the T&O rates of these RTO non-participants contribute to seams in the heart of the Midwest ISO/PJM region. Their continuing lack of participation in a RTO prevents the realization of more efficient and competitive markets, and the attainment of the goals of Order No. 2000, by RTO members in the region.<sup>56</sup>

38. While we recognize that the Companies have taken many steps towards joining a RTO, their progress is insufficient for turning over their facilities to an operational RTO. Therefore, the Commission previously initiated a proceeding to work with the Companies to help resolve the obstacles that they face in turning over their facilities to a RTO.<sup>57</sup> Our action here assures that more efficient and competitive markets can be realized in the meantime.

39. The evidence in the record demonstrates that eliminating the T&O rates would improve efficiency. In the investigation in Docket No. EL02-111-000, witnesses such as Michael B. Rosenzweig, of Coalition Against Seams, showed that T&O rates are inherently inefficient. Additionally, Mr. Rosenzweig presented an analysis that demonstrated that T&O rates adversely affect trade within the proposed Midwest ISO/

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<sup>54</sup> See July 23 Order at P 32-35. In the July 23 Order, the Commission characterized rate pancaking across the seam of these two RTOs as "intra-RTO" rate pancaking and prohibited under Order No. 2000 because Order No. 2000 requires that RTOs eliminate rate pancaking over a region of appropriate scope and configuration. July 23 Order at P 35.

<sup>55</sup> As discussed in our companion order in Docket No. EL02-111-000, *et al.*, this is one of a series of Commission orders, including the July 23 Order, that document the problems of RTO scope and configuration in this region.

<sup>56</sup> As the Midwest ISO TOs note, there are far more transactions between the Midwest ISO and the Companies joining PJM than there are between the Midwest ISO and the existing PJM footprint. See Midwest ISO TOs Comments at 5.

<sup>57</sup> See *New PJM Companies*, 104 FERC ¶ 61,274 (2003).

PJM footprint.<sup>58</sup> For example, Mr. Rosenzweig stated that, based on his review of transmission service requests, exports from Midwest ISO fell dramatically in the month that Midwest ISO began operations and only began to increase when Midwest ISO began discounting the RTOR.<sup>59</sup> As we noted in the July 23 Order, only four parties in the proceeding in Docket No. EL02-111-000 objected to the elimination of the regional T&O rates at issue in that proceeding. However, even certain of these parties recognized the inefficiencies related to the T&O rates and the benefits of eliminating them.<sup>60</sup>

40. As for the specific concerns raised in this proceeding, we disagree with AEP that limited available transmission capacity on its system will limit the benefits of eliminating its T&O rates. AEP argues that its capacity into PJM is already sold on a firm basis through the summer of 2004, and with the elimination of rate pancaking on the seams, only capacity made available after the summer of 2004 could be used to access subsequently available for more efficient generation. However, AEP also acknowledges that it did not do an analysis of the extent to which some of its capacity into PJM might be available for short-term transactions as hourly conditions evolve.<sup>61</sup> Further, if AEP's capacity into Michigan is typically subscribed during the summer peak period and expected to be fully subscribed next summer, by eliminating rate pancaking effective April 1, 2004, customers may be able to make more efficient transactions next summer than they would if we delayed elimination of rate pancaking.<sup>62</sup> Additionally, off-peak periods in the summer and in other periods would still be available for more efficient transactions.

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<sup>58</sup> Mr. Rosenzweig included evidence of financial harm caused by the existence of the T&O rates in the region. See Cinergy Services Comments, Exhibit No. CIN-2 at 13-18.

<sup>59</sup> Mr. Rosenzweig added that, despite the discounts in the Midwest ISO RTOR, the level of export service never returned to the level that prevailed before the Midwest ISO began operations. See Cinergy Services Comments, Exhibit No. CIN-2 at 5.

<sup>60</sup> In the proceeding in Docket No. EL02-111, a witness for companies joining PJM recognized that elimination of rate pancaking would represent an improvement. Tr. at 185. Additionally, existing PJM companies also recognized that T&O rates are inefficient and should be eliminated when a common market is implemented. See Exhibit No. Certain Classic PJM TOs-1 at 24.

<sup>61</sup> See AEP Response, Exhibit No. JCB-1 at 9-11.

<sup>62</sup> For example, if Michigan load currently imports power from AEP and pays the AEP T&O rate, with the elimination of the Companies' T&O rates, they might be able to import more efficient power from other companies within the proposed Midwest ISO/PJM region.

41. We also disagree with AEP that the T&O rates provide useful price signals. Rates that reflect embedded transmission costs on a transactional basis, as the T&O rates do, can have distorting effects on economic choices. Therefore, rates to recover embedded costs must be re-designed carefully to avoid such effects. As discussed above, the Companies' T&O rates prevent efficient economic choices, and, given the Companies' location, the T&O rates must be replaced with a more efficient methodology for pricing T&O service.

42. With respect to AEP's argument that elimination of T&O rates will shift rents among generators, we expect rents to shift among generators due to the elimination of rate pancaking, but we do not expect such rent-shifting to happen indiscriminately. We expect rents to shift from the inefficient generators to the efficient generators to reflect the increase in efficiency in the proposed Midwest ISO/PJM footprint from the elimination of the T&O rates in the region.

43. AEP states that, as a result of our July 23 Order, its generation and Midwest ISO generation pay the same transmission rate to sell power to load in the existing PJM footprint, and therefore, AEP's generation does not have a competitive advantage over other generation. AEP is correct that our July 23 Order when implemented would eliminate the adverse effects of rate pancaking between PJM and Midwest ISO. The elimination of rate pancaking for transactions between the two RTOs helps promote efficiency and competition and eliminate some of the undue competitive advantages that certain power sellers, such as the Companies' merchant interests, have vis-à-vis other generators for certain transactions; however, given the unique positioning of the Companies between the two RTOs and their failure to date to join RTOs, there remain many more seams in the proposed Midwest ISO/PJM region beyond the seams among PJM, AEP and Midwest ISO.

44. The seams among the individual Companies and between the Companies and the RTOs continue to provide them with undue competitive advantages. For example, ComEd's T&O rates limit the exports into AEP, protecting AEP's generation. That is, these seams and the pancaking of T&O rates on these seams protect the Companies' generation from competitive markets in the region. Therefore, they must be eliminated. In addition, while the Commission may be able to limit some of the undue competitive advantage of a particular company's generation for certain transactions by eliminating rate pancaking between PJM and Midwest ISO, promoting efficiency and competition, let alone equity and fairness, requires the removal of all rate pancaking in the combined region to mitigate the effects of the seams within the region.

45. Moreover, absent our action here, the Companies that have not joined an RTO will be able to take advantage of the elimination of pancaked rates in their neighboring RTOs while denying reciprocal benefits to other transmission owners that have successfully

pursued RTO formation. Permitting the Companies to benefit in this way vis-à-vis other transmission owners that are in an RTO is not only inequitable, but it also gives the wrong incentives; namely, it unfairly disadvantages those transmission owners that are in RTOs and rewards those transmission owners that have not joined an RTO. As we stated earlier, AEP is able to import electric power over the transmission systems of each RTO without paying pancaked rates to wheel over the system of each individual transmission owner in each RTO.<sup>63</sup> Therefore, our action here also does not unduly disadvantage AEP relative to RTO participants.<sup>64</sup> Further, we remain concerned by the length of time that has transpired since several of the Companies committed to join RTOs as part of their merger proceedings; elimination of rate pancaking for T&O service over their facilities is one step towards achieving the regional benefits that would accrue had they fulfilled their voluntary RTO commitments.

46. As discussed above, we find that the rate design for T&O service under the Companies' individual OATTs, when applied to transactions sinking anywhere within the combined region, is unjust and unreasonable and must be eliminated.<sup>65</sup> We will eliminate it effective April 1, 2004, to coincide with the elimination of the existing rate design for T&O service under the Midwest ISO and PJM OATTs in our order on rehearing of the July 23 Order, which is being issued concurrently with this order, and to allow sufficient time to implement a new rate design for T&O service, as discussed below. However, initially, during the two-year transition period, we will eliminate the existing rate design only for new transactions; the existing rate design will not be eliminated for those transactions existing as of April 1, 2004, under the Companies' OATTs until the end of the transition period. As AEP states, there would be little efficiency benefit to eliminating the existing rate design for existing firm transmission service reservations.

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<sup>63</sup> Multiple TDUs are correct that, absent our action here today, AEP could have been required to pay non-pancaked rates for transmission service over the individual transmission systems in the Midwest ISO and PJM which would exceed the corresponding Midwest ISO and PJM RTOR. See Order No. 2000 at 31,180; GridFlorida LLC, et al., 94 FERC ¶ 61,363 at 62,337 (2001).

<sup>64</sup> Some of the other problems that AEP raises with respect to elimination of the individual company T&O rates can be easily remedied in the compliance filings that we are directing in this order. For example, there will be no subsidization of wholesale transmission service customers by shareholders and other customers that pay for transmission service, and no disincentives to transmission investment because of "free-riders," if AEP were to file a mechanism to recover lost revenues.

<sup>65</sup> AEP is correct that the July 23 Order did not require the filing of cost support. See AEP Response at 41. The issue before us is a change in rate design that will improve the efficiency and competitive markets in the proposed Midwest ISO/PJM region.

The transmission costs associated with such transactions are sunk and will have little effect on the power purchase and sales decisions of the holders of those transmission rights. Eliminating the existing rate design for T&O service only for new transactions will minimize lost revenues to be recovered under the new transitional rate design.

47. Accordingly, we will direct compliance filings within 45 days of this order to eliminate the existing T&O rates, as discussed above, and to implement a new transitional rate design, as discussed below, effective April 1, 2004.

### **C. Lost Revenue Recovery Mechanism**

#### **1. Superseding Rate Design for T&O Service**

48. The July 23 Order did not reach the issue of a lost revenue recovery mechanism since it only initiated a Section 206 investigation into the Companies' individual T&O rates. However, the Companies raise similar concerns regarding recovery of revenues lost as a result of the elimination of their T&O rates as they raise in Docket No. EL02-111 with respect to the elimination of the RTORs.<sup>66</sup> As indicated in their individual responses to the investigation, the Companies support the adoption of a lost revenue recovery mechanism if their T&O rates are eliminated. For example, Ameren is willing to waive its T&O rates if a lost revenue recovery mechanism is put in place simultaneously. In addition, AEP states that it is not wedded to its T&O rate design if a transitional rate mechanism is in put in place to recover lost revenues.

49. On the other hand, Multiple TDUs and Detroit Edison contend that non-RTO member transmission owners should not be eligible for lost revenue recovery mechanisms if they are not participating in an RTO.<sup>67</sup> Multiple TDUs assert that AEP in particular, because of the substantial uncertainty surrounding its RTO participation, is not entitled to a lost revenue recovery mechanism before it joins an RTO because such mechanisms were intended to maintain the revenue neutrality for entities when they

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<sup>66</sup>See, e.g., Ameren Response at 8-9 ; AEP Response at 15, DP&L Response at 14; see also order in Docket No. EL02-111-004, et al, being issued concurrently with this order.

<sup>67</sup> See Multiple TDUs' Comments at 10, Detroit Edison Answer to New PJM's Motion for Expedited Clarification at 5.

joined an RTO.<sup>68</sup> Multiple TDUs state that utilities like AEP should not be able to recover lost revenues because they are late in fulfilling legal obligations to join an RTO. They claim that the receipt of T&O service revenues and market advantages from the continuation of rate pancaking, after the date when they should have joined an RTO, should be counted as a sufficient transitional mechanism. We disagree. We find that the Companies have raised valid concerns about the recovery of lost revenues and about resulting cost shifts that would occur upon the elimination of the T&O rates without simultaneously replacing them with a lost revenue recovery mechanism.

50. Transitional lost revenue recovery mechanisms, if properly structured, can serve as a reasonable transition mechanism to address revenue losses resulting from the elimination of rate pancaking. By recovering lost revenues from load on each system proportionate to the benefit that the load receives from the elimination of rate pancaking, and recovering such costs through a non-bypassable surcharge for delivery within the system, such transitional lost revenue recovery mechanisms better control cost-shifting than conventional license plate rates without transitional surcharges while simultaneously avoiding the injurious effects on efficient use of the grid associated with rate pancaking.<sup>69</sup>

51. In this proceeding, as well as in the order in Docket No. EL02-111-004, *et al.*, being issued concurrently with this order, we find it necessary to move forward to establish a lost revenue recovery mechanism to replace the T&O rates when they are eliminated. By fixing the superseding rate in this Section 206 proceeding, the Commission will mitigate cost shifting during the transition period and ensure just and reasonable rates upon the elimination of the T&O rates.

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<sup>68</sup> Multiple TDUs contend that AEP's shareholders have continued to enjoy the benefits of AEP's merger with CSW while the principal customer-oriented merger condition, RTO participation, has remained unfulfilled. They assert that it may be appropriate to place part of the burden of any revenue shortfall resulting from T&O rate elimination on AEP's shareholders. Detroit Edison would assess the cost responsibility for revenue shortfall on the local customers of the non-RTO member transmission owner. See Multiple TDUs' Comments at 8-9.

<sup>69</sup> Native load customers are ultimately responsible for the costs of the utilities' transmission system. Historically, revenues for T&O service have offset part of the cost of the transmission system that otherwise would be paid by native load. The transitional lost revenue recovery mechanism will prevent the transmission rates for native load from increasing as a result of the elimination of rate pancaking, thereby preventing cost-shifting from T&O service customers to native load.

## **2. Cost-of-service Requirement**

52. The July 23 Order found that the RTO members need not file updated cost-of-service studies to support proposals to recover revenues lost due to the elimination of the RTORs.

53. New PJM Cos. request clarification as to whether non-RTO members must file cost-of-service updates to support proposals to recover lost revenues and if they must further demonstrate that lost revenue recovery will not result in an over-recovery of their updated revenue requirement.

54. Illinois Power incorporates New PJM Cos.' clarification request and also specifically urges against a cost-of-service requirement for non-RTO members to recover revenues lost due to the elimination of T&O rates. Illinois Power states that should the Commission eliminate its T&O rates, it is essentially imposing a rate structure in the region as if all the Companies were in an RTO. It states that the elimination of the T&O rates would result in a single charge for any delivery within the Midwest ISO/PJM footprint, regardless of the RTO membership status of individual utilities within the footprint. It concludes that there is no valid basis to impose upon non-RTO members a different standard for justifying lost revenue recovery.<sup>70</sup>

55. Opposing entities assert that any non-RTO members' proposals for lost revenue recovery or increased rates must be justified by complete cost-of-service updates.<sup>71</sup> They state that the exemption from this requirement should be inapplicable to non-RTO members, whom they argue should not benefit from this policy before they become RTO members.<sup>72</sup> Multiple TDUs also support requiring non-RTO members seeking a lost revenue recovery mechanism to also demonstrate that they would otherwise be deprived of the ability to recover their cost-of-service due to the elimination of rate pancaking.<sup>73</sup>

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<sup>70</sup> See Illinois Power Motion in Support of New PJM at 3-4.

<sup>71</sup> See Consumers Energy Answer in Opposition to New PJM at 7-8; Detroit Edison Answer to New PJM at 3-4; Wisconsin Electric Answer to New PJM at 9; Michigan Agencies Opposition to New PJM at 6-8 and Application for Rehearing and Motion at 5-11.

<sup>72</sup> See Michigan Agencies' Opposition to New PJM at 8; Wisconsin Electric Answer to New PJM at 10-11.

<sup>73</sup> Multiple TDUs state that a non-cost-based filing for pancake-replacement surcharges amounts to an innovative rate filing under 18 C.F.R. § 35.34(e), and the associated rate impacts must be quantified and subjected to a cost-benefit evaluation.

56. AEP provides a limited cost-of-service analysis in support of its current T&O service revenue level. It claims that its existing rates are cost justified and that without its T&O service revenue, it would under recover its cost-of-service by nearly one-third. It further claims that passing this revenue shortfall onto its network customers would yield nearly a 25 percent rate increase.<sup>74</sup>

57. The July 23 Order made it clear that RTO members would not be required to provide updated cost-of-service information in order to file for a transitional lost revenue recovery mechanism. However, the July 23 Order did not decide whether the requirement would be imposed on non-RTO members. In prior rulings, we have not required RTO members to file an updated complete cost-of-service to justify transitional surcharges to recover lost revenues resulting from the elimination of rate pancaking, as doing so would create an unnecessary impediment to RTO formation.<sup>75</sup> Here, that concern is not implicated in our elimination of non-RTO members' T&O rates. However, given that we are eliminating all T&O rates within the proposed Midwest ISO/PJM region, we believe it is necessary to provide both RTOs and the individual former Alliance Companies with an equitable opportunity to recover lost revenues on a transitional basis. Therefore, we clarify that we will not require non-RTO members to make cost-of-service filings as a prerequisite to lost revenue recovery. We have previously accepted the existing rates of these companies as just and reasonable and the Section 206 investigation in this proceeding focuses on the design of the rates for T&O service, not the level of those rates. The new rate design being implemented in this proceeding will merely change the form of those rates while maintaining the revenues produced by the existing rates.<sup>76</sup>

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<sup>74</sup> See AEP Response at 42.

<sup>75</sup> See *Alliance Companies, et al.*, 94 FERC ¶ 61,070, *reh'g denied*, 95 FERC ¶ (2001); *Alliance Companies, et al.*, 99 FERC ¶ 61,105 at 61, 446 (2002); *PJM Interconnection L.L.C. and Allegheny Power*, 96 FERC ¶ 61,060 (2001).

<sup>76</sup> In addition, the Commission continues to monitor and review regulated rates to ensure that they remain reasonable. To that end, the Commission recently proposed to revise its regulations by establishing quarterly financial requirements and make changes to the existing FERC Annual Reports to help in achieving the goal of vigilant oversight by providing the Commission with more timely, relevant, reliable and understandable financial information. This additional financial reporting will aid the Commission in, among other things, assessing the economic consequences of transactions and evaluating the adequacy of existing traditional cost-based rates.

### 3. Specific Attributes of Lost Revenue Recovery Mechanism

58. Several parties request clarification regarding the July 23 Order's determination that lost revenue recovery mechanisms should be based on a test period consisting of the most recent 12 months for which data are available. Certain parties express opposition to using the most recent 12 months as the test period for any proposed lost revenue recovery mechanism, and propose alternative time periods such as the most recent calendar year<sup>77</sup> and data from test year 2001.<sup>78</sup> Parties also express reservations about relying on NERC tag data to develop lost transmission revenues without a hearing.<sup>79</sup>

59. We refer parties to our order in Docket No. EL02-111-004, et al., being issued concurrently with this order, in which we make findings with respect to appropriate transitional lost revenue recovery mechanisms and direct Midwest ISO and PJM to submit, through compliance filings, lost revenue recovery surcharges to be implemented simultaneously with the elimination of their RTORs. Similarly, here we will direct the Companies to file compliance filings, consistent with the SECA mechanism that we prescribe in our order in Docket No. EL02-111-004, et al. The surcharges would be simultaneously implemented with the elimination of the Companies' T&O rates, effective April 1, 2004, and remain in effect for a two-year period. We will direct the Companies to submit compliance filings within 45 days of the date of this order that provide the Commission with the lost revenue recovery charges calculated pursuant to the methodology prescribed in the order in Docket No. EL02-111-004, et al. The Companies should also provide all supporting documents containing all calculations and data, including NERC tag data. We expect the parties in the region to work cooperatively in the preparation of these filings, and encourage them to attempt to resolve issues before the filings are made.

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<sup>77</sup> See, e.g., New PJM Motion at 6, GridAmerica Motion 11.

<sup>78</sup> See Midwest ISO TOs' Request for Rehearing and Clarification at 32. They state that use of data after the year 2001 is not reasonable with respect to Midwest ISO TOs as it creates significant problems because such data is aberrational with the start-up of Midwest ISO in 2002 and would create under-recoveries. Id.

<sup>79</sup> See, e.g., Certain PJM Cos. Answer in Opposition to New PJM at 11; State of Michigan and MPSC Rehearing/Clarification Request at 7-8.

**D. Rehearing Requests**

**1. FPA Section 206**

60. On rehearing, a number of the entities contend that the Commission's initiation of the Section 206 proceeding in Docket No. EL03-212-000 violated the requirements of FPA Section 206.<sup>80</sup> They argue that the Commission has not met its burden to make a prima facie case for its FPA Section 206 proceeding as there is insufficient evidence to support initiating this proceeding.<sup>81</sup> Certain entities refer to the record in Docket No. EL02-111-000 as lacking evidence supporting the elimination of individual company rates. In addition, they assert that eliminating the T&O rates without establishing a replacement lost revenue recovery mechanism would violate FPA Section 206 and would amount to an unlawful taking in which companies would be deprived of the opportunity to earn a return on their investment in regulated assets. For the same reason, they oppose a refund effective date of October 4, 2003, which they support changing to November 1, 2003, the date set by the July 23 Order for the elimination of Midwest ISO/PJM RTORs and the date which the July 23 Order contemplates for the commencement of recovery of lost revenues. They argue that the earlier October 4, 2003 refund effective date would leave them without a way to recover revenues lost upon the elimination of their T&O rates.

61. A number of entities also argue that the July 23 Order seeks to impermissibly shift the Commission's burden under Section 206 of the FPA to the subject companies to make FPA Section 205 filings to recover revenue losses, which they assert would not practically implement a regional SECA-type solution.<sup>82</sup> They state that, alternatively, they would have to attempt to recover lost revenues from their native load customers or force their shareholders to absorb the losses.

62. Certain entities raise other concerns. They argue that the July 23 Order gave inadequate notice regarding their T&O rates or how they would be changed, thus limiting their ability to respond to the July 23 Order.<sup>83</sup> Some entities also object to the paper hearing established by the July 23 Order, arguing that it is inadequate to address the

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<sup>80</sup> See, e.g., AEP Rehearing at 11; ComEd Rehearing at 7; DP&L Rehearing at 10.

<sup>81</sup> See, e.g., Illinois Power Rehearing at 11.

<sup>82</sup> See, e.g., ComEd Rehearing at 12; Illinois Power Rehearing at 14; DP&L Rehearing at 12.

<sup>83</sup> See, e.g., AEP Rehearing at 18 and Illinois Power Rehearing at 12.

issues in this proceeding.<sup>84</sup> For example, GridAmerica states that the July 23 Order failed to give adequate time and guidance for a meaningful response.

## **2. FPA Section 202(a) and Order No. 2000**

63. Several entities argue that the Commission is attempting to compel Companies' participation in an inter-regional coordination arrangement, in violation of Order No. 2000<sup>85</sup> and inconsistent with FPA Section 202(a).<sup>86</sup> They assert that Order No. 2000 only provides for voluntary participation in RTOs and that FPA Section 202(a) gave the Commission the ability to encourage, but not compel, the interconnection and coordination of transmission facilities. They contend that the Commission is doing indirectly, through the elimination of T&O charges for deliveries to those RTOs, what it cannot do directly.

## **3. Commission Response**

64. As discussed above, we are eliminating the Companies' T&O rates, effective April 1, 2004, simultaneously with the implementation of a new transitional rate design for T&O service. We are not ordering refunds here. Thus, our actions in this proceeding moot concerns with recovering lost revenue in the context of the October 4, 2003 refund effective date established in this investigation.

65. With respect to their procedural concerns, the July 23 Order gave adequate notice that the T&O rates under their individual-company OATTs were expressly at issue in this proceeding and provided the Companies with adequate opportunity to file in response. In addition, as discussed above, we are not attempting to compel RTO participation as we are taking action to ensure just and reasonable rates in these circumstances.

66. The Companies have also requested rehearing concerning various issues regarding recovery of lost revenues in the event that the Commission finds their T&O rates unjust

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<sup>84</sup> See, e.g., AEP at 15; GridAmerica at 18; Pennsylvania Commission at 8.

<sup>85</sup> Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,089 at 31,074 (1999), order on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,092 (2000), aff'd sub nom. Public Utility District No. 1 of Snohomish County Washington, et al. v. FERC, 272 F.3d 607 (D.C. Cir. 2001).

<sup>86</sup> 16 U.S.C. § 824(a) (2000); see, e.g., AEP Rehearing at 20; DP&L Rehearing at 20; ComEd Rehearing at 9.

and unreasonable. We will deny these requests for rehearing, as the July 23 Order made no determination concerning the justness and reasonableness of the Companies' T&O rates or the recovery of lost revenues.

The Commission orders:

(A) The requests for rehearing are hereby denied, as discussed in the body of this order.

(B) The through and out rates under the OATTs of AEP, Ameren, ComEd, Illinois Power, and DP&L for transactions sinking within the combined region (Midwest ISO, PJM and Companies' footprints) are hereby eliminated effective April 1, 2004, as discussed in the body of this order.

(C) Companies are directed to make compliance filings, as discussed in the body of this order, within 45 days of the date of issuance of this order.

(D) ATSI and NIPSCO are hereby dismissed from this proceeding, as discussed in the body of this order.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.

**Appendix A**  
**Docket No. EL03-212-000, et al.**  
**Timely Motions to Intervene and Notices of Intervention**

Allegheny Power and Wolverine Power Supply Cooperative, Inc.  
American Municipal Power, Inc. of Ohio (AMP-Ohio)  
Baltimore Gas and Electric Company  
Blue Ridge Power Agency  
Buckeye Power, Inc.  
Cinergy Services, Inc. on behalf of The Cincinnati Gas & Electric Co.; PSI Energy, Inc.  
and Union Light, Heat and Power Co. (Cinergy Services)  
Cities of Dowagiac and Sturgis, Michigan  
City of Hamilton, OH (City of Hamilton)  
Coalition of Municipal and Cooperative Users of New PJM Cos.  
Consumers Energy Co. (Consumers Energy) and Illinois Cities  
Dairyland Power Cooperative  
Detroit Edison Co. (Detroit Edison)  
Duke Energy Corporation  
Duke Energy North American, LLC  
Edison Mission Energy, Edison Mission Marketing and Trading, and Midwest  
Generation EME, LLC  
Illinois Commerce Commission  
Illinois Municipal Electric Agency and Indiana Municipal Power Agency, (collectively,  
Muni-Coop Coalition)  
International Transmission Co.  
Madison Gas & Electric Co. (MDG&E)  
Maryland People's Counsel Office, Wabash Valley Power Assoc. Inc., and Illinois  
Commerce Commission  
Maryland Public Service Commission  
Michigan Public Power Agency and Michigan South Central Power Agency  
(collectively, Michigan Agencies)  
MidAmerican Energy Co.  
Midwest Independent Transmission System Operator (Midwest ISO)  
Midwest ISO Transmission Owners (Midwest ISO TOs), including: Alliant Energy  
Corporate Services, on behalf of Interstate Power and Light Company (f/k/a IES Utilities  
Inc. and Interstate Power Company); Hoosier Energy Rural Electric Cooperative, Inc.;  
Indianapolis Power & Light Company; LG&E Energy Corporation on behalf of  
Louisville Gas and Electric Co. and Kentucky Utilities Co.; Lincoln Electric System;  
Minnesota Power (and its subsidiary Superior Water L&P); Montana-Dakota Utilities  
Company; Northern States Power Company, subsidiaries of Xcel Energy, Inc.; Southern  
Illinois Power Cooperative; Southern Indiana Gas & Electric Company (d/b/a Vectren  
Energy Delivery of Indiana); Wabash Valley Power Association, Inc.

Nordic Marketing, LLC  
Ohio Public Utilities Commission  
Ormet Primary Aluminum Group (Ormet)  
PJM Industrial Customer Coalition and Coalition of Midwest Transmission Customers  
PPL Electric Utilities Corp. and PPL Energy Plus, LLC  
PSEG Companies  
Public Service Commission of Wisconsin  
Rockland Electric Co.  
Southeast Michigan Systems  
Virginia Electric and Power Company  
Wabash Valley Power Association, Inc.  
Wisconsin Electric Power Company (Wisconsin Electric)  
Wisconsin Public Power, Inc.

**Docket No. EL03-212-000**  
**Late Motions to Intervene**

Alliant Energy Corporate Services, Inc. (Alliant)  
Constellation NewEnergy, Inc.  
Duke Energy Corp.  
Grid America LLC  
Michigan Electric Transmission Co., LLC  
North Carolina Electric Membership Corp.  
Pennsylvania Office of Consumer Advocates  
Pepco Holdings, et al.  
State of Michigan and the Michigan Public Service Commission  
Steel Dynamics, Inc.

**Appendix B**  
**Docket No. EL03-212-000, et al.**  
**The Five Former Alliance Companies that have not yet joined either**  
**PJM or Midwest ISO.**

