ORAL ARGUMENT SCHEDULED FOR OCTOBER 7, 2004

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 03-1238
Consolidated with 03-1254

MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC. AND MIDWEST ISO TRANSMISSION OWNERS,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITION FOR REVIEW OF ORDERS OF THE FEDERAL ENERGY REGULATORY COMMISSION

JOINT REPLY BRIEF OF PETITIONERS AND INTERVENOR IN SUPPORT OF PETITIONERS

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GLOSSARY

Budget Act	Omnibus Budget Reconciliation Act
FCC	Federal Communications Commission
FERC	Federal Energy Regulatory Commission
FERC Br.	Brief of Respondent Federal Energy Regulatory Commission
FPA	Federal Power Act
ISO	Independent System Operator
ISO-NE	ISO New England Inc.
Midwest ISO or MISO	Midwest Independent Transmission System Operator, Inc.
NOPR	Notice of Proposed Rulemaking
NRC	Nuclear Regulatory Commission
NYISO	New York Independent System Operator, Inc.
OATT	Open Access Transmission Tariff
OMOI	Office of Market Oversight and Investigations
P	Internal paragraph references to FERC orders issued after June 26, 2002. See http://www.ferc.gov/whats-new/hd-archives/2002/2002-2.asp
Pet. Br.	Joint Initial Brief of Petitioners and Intervenor In Support of Petitioner
R.	Record Item number in FERC's certified index of record
RTO	Regional Transmission Organization

SMD	Standard Electricity Market Design
SPP	Southwest Power Pool

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Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITION FOR REVIEW OF ORDERS
OF THE FEDERAL ENERGY REGULATORY COMMISSION

JOINT REPLY BRIEF OF PETITIONERS AND INTERVENOR IN SUPPORT OF PETITIONERS

Petitioners Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") and Midwest ISO Transmission Owners,[1] and Intervenor in

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[1] For purposes of this appeal, the Midwest ISO Transmission Owners consist of: Ameren Services Company, as agent for Union Electric Company d/b/a AmerenUE, Central Illinois Public Service Company d/b/a AmerenCIPS, and Central Illinois Light Co. d/b/a AmerenCilco; Cinergy Services, Inc. (for Cincinnati Gas & Electric Co., PSI Energy, (continued . . .)

Support of the Petitioners, the New York Independent System Operator, Inc. ("NYISO"), submit this reply brief in response to the April 19, 2004 answering brief of Respondent Federal Energy Regulatory Commission ("FERC") ("FERC Br.").

I. SUMMARY OF ARGUMENT

FERC made several arguments in response to Petitioners' and Intervenor in Support of Petitioners' Initial Brief ("Pet. Br."). None of the arguments withstand scrutiny. FERC argues that the Petitioners' arguments are a collateral attack on Order No. 641.[2] This is incorrect as Petitioners provided compelling evidence of changed circumstances that substantially undercuts the continued validity of FERC's current annual charges regulations. Specifically, FERC's assumption of an "accelerated trend" toward decreasing the amount of regulation of electric

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(. . . continued)

Inc., and Union Light Heat & Power Co.); City Water, Light & Power (Springfield, IL); Hoosier Energy Rural Electric Cooperative, Inc.; Indiana Municipal Power Agency; Indianapolis Power & Light Company; LG&E Energy Corporation (for Louisville Gas and Electric Co. and Kentucky Utilities Co.); Lincoln Electric System; Montana-Dakota Utilities Co.; Northern States Power Company and Northern States Power Company (Wisconsin), subsidiaries of Xcel Energy Inc.; Northwestern Wisconsin Electric Company; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana); and Wabash Valley Power Association, Inc. Individual Midwest ISO Transmission Owners may not support every legal argument set forth in this joint brief, but the individual entities have not indicated those limited issues where there is not total support by footnote because of the common belief that the Court should require FERC to initiate a rulemaking on remand.

2 Revision of Annual Charges Assessed to Public Utilities, Order No. 641, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,109 (2000), reh'g denied, Order No. 641-A, 94 FERC ¶ 61,290 (2001).

power sales has not proven to be accurate. Moreover, the pace of Regional Transmission Organization ("RTO") formation and the forecasted unbundling of retail transactions has not developed as anticipated by FERC in adopting Order No. 641.

On the issue of cost responsibility, Petitioners have shown that the current regulations have resulted in unanticipated and unreasonable cost shifts that operate as disincentives to RTO participation. Yet, FERC continues, inexplicably, to insist that this argument is jurisdictionally barred, notwithstanding that it is based entirely on post-Order No. 641 events and, therefore, by definition, cannot represent a collateral attack on Order No. 641.

Likewise, other arguments presented in support of Petitioners' rulemaking request stand unrebutted. For example, as to including non-jurisdictional transmission volumes in the annual charges assessment, FERC continues to avoid any coherent explanation in response to the argument that the agency is attempting to collect indirectly charges that it cannot collect directly from non-jurisdictional entities. In the same way, FERC's inconsistent handling of annual charges across the various industries it regulates has yet to be credibly explained.

Because the orders under review do not reflect reasoned decision-making, and are otherwise arbitrary and capricious, the Petitions for review should be granted and the orders remanded.

II. ARGUMENT

A. Contrary To FERC's Assertion, Petitioners Have Raised Credible Claims Of Changed Circumstances And New Evidence And FERC Has Not Shown That It Provided Reasonable Support For Its Refusal To Initiate A Rulemaking In Light Of These Changed Circumstances.

1. There Is No Jurisdictional Bar to Petitioners' Challenges.

In the face of Petitioners' specific delineation of changes in circumstances that warranted a re-examination of FERC's three-year old regulations, the agency relies primarily on the inapposite assertion that Petitioners are collaterally estopped from raising such a challenge. To the contrary, Petitioners' request for initiation of a new rulemaking was not a collateral attack on FERC's prior rulemaking, but rather was a request for a fresh review in light of demonstrated errors – as revealed through the passage of time – in the original assumptions and rationale underlying Order No. 641.[3]

A claim of collateral estoppel is inappropriate when there has been a change in relevant facts. See, e.g., Mont. v. United States, 440 U.S. 147, 159 (1979)

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[3] FERC incorrectly states that the Midwest ISO, NYISO, and PJM Interconnection, L.L.C. ("PJM") requested that FERC revert to its pre-Order No. 641 methodology. FERC Br. at 4-5. In fact, their petition for rulemaking expressly requested the initiation of a rulemaking to reevaluate, and modify if necessary, the assumptions and policy considerations underlying Order No. 641, and only noted that an appropriate form of interim relief in connection with the July 2003 bills would be to use the pre-Order No. 641 methodology. See Petition of Midwest ISO, NYISO, and PJM for Rulemaking Concerning Annual Charges Assessed to Public Utilities Under 18 C.F.R. Part 382, FERC Docket No. RM00-7-000, filed on Dec. 3, 2002 at 6, 17-18 ("MISO Petition"); R.55.

(noting the principle of collateral estoppel is inapplicable where the essential facts in a prior proceeding have changed in a subsequent action raising the same issues); Comm'r of Internal Revenue v. Sunnen, 333 U.S. 591, 599 (1948) (commenting that the principle of collateral estoppel "is not meant to create vested rights in decisions that have become obsolete or erroneous with time"). In the instant case, the Petitioners supported their request to revisit FERC's annual charge regulations by showing that a substantial change in facts has occurred since the issuance of Order No. 641. This assertion has not been rebutted by FERC.

Thus, the changed circumstances presented by Petitioners constitute a radical change that requires a meaningful response from FERC. See, Tesoro Alaska Petroleum Co. v. FERC, 234 F.3d 1286, 1290-91 (D.C. Cir. 2000); NLRB Union v. FLRA, 834 F.2d 191, 196 (D.C. Cir. 1987); Hadson Gas Sys. v. FERC, 75 F.3d 680, 684 (D.C. Cir. 1996) (quoting Am. Horse Prot. Ass'n v. Lyng, 812 F.2d 1, 5 (D.C. Cir. 1987) ("perhaps the strongest case for initiating such a rulemaking is where 'a petition has sought modification of a rule on the basis of a radical change in its factual premises'")). FERC's reliance on Georgia Industrial Group[4] and City of Nephi[5] is entirely misplaced: neither case involved any predicate claim of changed circumstances or request for new rulemaking. Georgia

[4] Ga. Indus. Group v. FERC, 137 F.3d 1358 (D.C. Cir. 1998).

[5] City of Nephi v. FERC, 147 F.3d 929 (D.C. Cir. 1998).

Industrial Group involved a challenge to case-specific implementation of FERC's pregranted abandonment procedures that were codified as part of FERC's Order No. 636 regulations. City of Nephi is even further removed, as it dealt with petitioner's failure to seek rehearing (and the consequent loss of judicial review rights) of a specific rate determination made by FERC.

Here, the orders under review involve the agency's denial of Petitioners' request for rulemaking.[6] This request was based on Petitioners' showing of changes in circumstances that occurred after adoption of the existing regulations. Petitioners sought timely rehearing of FERC's original order denying the rulemaking and properly preserved all arguments in support of judicial review. Nothing in FERC's brief shows otherwise.[7]

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6 Midwest Indep. Transmission Sys. Operator, Inc., 103 FERC ¶ 61,048 ("April 11 Order"), order on reh'g, 104 FERC ¶ 61,060 (2003) ("Rehearing Order").

7 FERC is correct in asserting that the issue of including non-jurisdictional transmission in the calculation of FERC annual charges was considered in the Order No. 641 rulemaking. However, as explained infra, the full implications of this decision have only manifested themselves through the passage of time. In particular, encouraging non-jurisdictional transmission owners to join RTOs and/or Independent System Operators ("ISOs") and to participate in the development of centralized markets is demonstrably incompatible with the comparatively higher annual charges that are assessed to RTOs and ISOs.

2. FERC Has Offered No Meaningful Rebuttal to Petitioners' Demonstration of Specific Changes In Circumstances that Invalidate the Agency's "Focus on Transmission" Rationale.

In support of the request for rulemaking, Petitioners identified a series of changed circumstances directly relevant to FERC's "focus on transmission" rationale that originally supported Order No. 641.[8] FERC continues to resist any direct or meaningful response to these changed circumstances.

Since FERC adopted Order No. 641, several events have occurred that indicate that the rationale behind FERC's adoption of Order No. 641 is no longer sound. These events include initiatives by FERC related to the development of energy markets in the Standard Electricity Market Design ("SMD") proceeding,[9] the collapse of the California markets and related investigations into price

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8 MISO Petition at 14-15; R.55; Comments in Support and Request for Expedited Action of the Midwest ISO Transmission Owners, FERC Docket No. RM00-7-000, filed on Feb. 14, 2003 at 6-9; R.58; Request for Rehearing of the Midwest ISO Transmission Owners, FERC Docket No. RM00-7-009; filed May 12, 2003 at 5-8 ("Midwest ISO Transmission Owners Rehearing Request"); R.61; Request for Rehearing of the Midwest Indep. Transmission Sys. Operator, Inc., FERC Docket No. RM00-7-009, filed May 12, 2003 at 12-15 ("MISO Rehearing Request"); R.62.

9 Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, Notice of Proposed Rulemaking, IV FERC Stats. & Regs. ¶ 32,563 (2002) ("SMD NOPR").

volatility,[10] and FERC's investigations regarding market-based rate authority.[11] As Petitioners pointed out, these developments exposed the fallacy of the principal justification relied upon by FERC in promulgating the Order No. 641 regulations – viz., that the agency's regulatory focus was in the midst of an accelerated trend that would substantially reduce, if not eliminate, the need for dedicated resources with respect to wholesale power sales markets. Pet. Br. at 15-23.

a. FERC continues to avoid evidence of changed circumstances.

The record confirms that Petitioners' evidence of changed circumstances was not accorded meaningful consideration. For example, FERC failed to confront Petitioners' argument that the progression of retail unbundling and competition had not lived up to FERC's expectations. See Pet. Br. at 17-18. The lack of increase

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10 See Pet. Br. at 19-20. See, e.g., In re Cal. Wholesale Elec. Antitrust Litig., 244 F. Supp. 2d 1072 (S.D. Cal. 2003); Idacorp Energy, L.P. v. Overton Power Dist. No. 5, Case No. CV OC 0107870D (Idaho Dist. Court, 4th Dist.) (Complaint filed Nov. 30, 2001); Pub. Utils. Comm'n v. Sellers of Long Term Contracts to the Cal. Dept. of Water Res., 103 FERC ¶61,354 (2003) (proceeding involving complaints related to long-term contracts); Nev. Power Co. v. Enron Power Mktg., Inc., 105 FERC ¶ 61,185 (2003) (proceeding resulting from complaints alleging dysfunctions in the California spot markets causing forward contracts to be unjust and unreasonable); PacifiCorp v. Reliant Energy Servs., Inc., 105 FERC ¶ 61,184 (2003) (proceeding addressed complaints regarding certain forward bilateral contracts); Nev. Power Co., 99 FERC ¶ 61,047, order on reh'g, 100 FERC ¶ 61,273 (2002) (FERC initiated formal hearing into the pricing terms of approximately 165 power sales contracts to determine whether these terms were the product of, or materially affected by, market manipulation); Fact-Finding Investigation of Potential Manipulation of Elec. & Natural Gas Prices, 98 FERC ¶ 61,165 (2002) (FERC initiated investigation into allegations of market manipulation by power marketers).

11 Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003).

of retail competition means that many retail sales continue to be bundled sales.[12] See Pet. Br. at 17-18.[13] This, Petitioners argued, was a significant development (or non-development) since the level of retail unbundling has a direct impact on the magnitude of costs that are ultimately absorbed by RTO or ISO members. FERC's brief makes no attempt to address the implications of this erroneous assumption.[14]

Elsewhere FERC avoided Petitioners' evidence by erecting "strawman" arguments that have little to do with the continued validity of the annual charges regulations, as challenged by Petitioners. For example, contrary to FERC's argument, Petitioners have not disputed that oversight of transmission operations has imposed additional demands on FERC's regulatory resources following industry restructuring. Rather, Petitioners maintain, and have shown, that the anticipated diminution of oversight responsibility (and reduced regulatory

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12 In states where there is no ISO or RTO, retail sales that are bundled sales do not take service under a FERC open access transmission tariff ("OATT"). Whereas, in an ISO or RTO context bundled retail customers are deemed to take service under the ISO or RTO FERC OATT.

13 This fact also accounts for continued unequal treatment between public utilities that are members of RTOs and ISOs and those that are not, as discussed infra.

14 FERC also argues, FERC Br. at 22-23, that power sellers will be contributing to annual charge recovery, "albeit indirectly," by virtue of their use of utility transmission facilities. FERC's analysis that electric power market sellers pay their share of FERC's annual expenses because they also take transmission, does not fairly treat such sellers. It results in an indirect charge, which is not proportionate to the regulation required by the power market sales. FERC's increased activity regulating power market sales and the lack of an anticipated decrease in power market sales does not justify collecting such charges in an indirect manner.

manpower requirements) in the wholesale power markets have not materialized as expected. In this regard, the unequivocal workload predictions in Order No. 641, upon which FERC's transmission-only annual charge assessments were based, stand in sharp contrast to FERC's own acknowledgement, years later, that the electric industry was in a "state of flux"[15] and that restructuring initiatives designed to promote regional transmission development and retail competition "[have] not been smooth or uniform."[16]

FERC also attempts to make much of the fact that Petitioners "recognized the substantial change in circumstances" between FERC's adoption of Order No. 472[17] and Order No. 641.[18] However, this argument ignores that under Order No. 472, when FERC's regulatory resources were spent primarily on sales, annual charges were assessed on both sales and transmission. It is inconsistent for the current annual charges only to be assessed on transmission transactions and not sales transactions, because, as FERC explains, its earlier regulations assessed

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15 Rehearing Order at P 16.

16 White Paper - Wholesale Power Market Platform, Docket No. RM01-12-000 (April 28, 2003) at 3, available at http://www.ferc.gov/industries/electric/indus-act/smd/nopr.asp.

17 Annual Charges Under the Omnibus Reconciliation Act of 1986, Order No. 472, 1986-1990 FERC Stats. & Regs., Regs. Preambles ¶ 30,746, clarified, Order No. 472-A, 1986-1990 FERC Stats. & Regs., Regs. Preambles ¶ 30,750, order on reh'g, Order No. 472-B, 1986-1990 FERC Stats. & Regs., Regs. Preambles ¶ 30,767 (1987), order on reh'g, Order No. 472-C, 42 FERC ¶ 61,013 (1988).

18 See FERC Br. at 39.

annual charges on transmission transactions even though the primary "focus" was sales and not transmission.[19]

Finally, FERC defends its orders by asserting that "the Commission was well within its discretion in adopting the Order No. 641 methodology." FERC Br. at 25. In support, FERC relies on the legislative history of the Omnibus Budget Reconciliation Act ("Budget Act") and court precedent in an attempt to show that the Order No. 641 regulations represent a reasonable exercise of the agency's discretion to establish a methodology for the recovery of regulatory program costs. See FERC Br. at 23-25.

Once again, FERC's arguments miss their mark. As noted, Petitioners are before the Court on review of FERC orders that deny the existence of changed circumstances as they relate to the continued validity of the agency's annual charge regulations. The issue is not whether these regulations were valid when promulgated, but rather whether they remain valid based on unanticipated changes in circumstances that are inconsistent with the fundamental grounds relied upon by FERC in originally adopting these regulations. In this regard, FERC's reliance on Florida Power & Light Co. v. United States, 846 F.2d 765 (D.C. Cir. 1988), is inapplicable. FERC Br. at 24. Florida Power involved the ability of the Nuclear Regulatory Commission ("NRC") to assess annual charges under the Budget Act.

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[19] See FERC Br. at 39 (citing MISO Petition at 11-12; R.55).

Nowhere in Florida Power is there discussion of any issue of changed circumstances related to the NRC's determination of the method to assess annual charges.

b. To the extent that FERC purported to address changed circumstances, it failed to show that the assumptions and rationale supporting Order No. 641 remain valid.

FERC comes closest to a direct response to Petitioners' changed circumstances argument in asserting that the post-Order No. 641 initiatives cited by Petitioners are only incidentally related to wholesale markets. See FERC Br. at 43-47; see also Rehearing Order at n.34 (noting that it is issuing orders that should decrease the amount of electric energy market orders). However, as shown below, FERC mis-characterizes the substance of the cited initiatives.

Petitioners do not dispute that recent FERC actions relating to market-based authority have a transmission-related component. But, FERC cannot credibly deny that there is a comparable, if not greater, component to these initiatives that is targeting market behavior as it concerns electricity wholesales. For example, one of the principal objectives of the SMD NOPR is to develop energy markets within or through RTOs,[20] a point largely ignored by FERC.

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[20] See SMD NOPR at PP 3-15.

Moreover, FERC refers to several more recent orders as validating Order No. 641's focus-on-transmission assumptions and rationale. FERC Br. at 46-48. Not surprisingly, FERC neglects to mention other recent initiatives that clearly target market activities. Specifically, FERC continues to promote a joint and common market within the Midwest ISO and PJM with the ambitious goal of coordinating all market activity across the two systems.[21]

In addition, FERC's ongoing investigations of the failures of the Western power markets,[22] its commitment to prevent future similar failures,[23] and its recent rulemakings and orders regarding market-based rate authority (including, inter alia, the expressed need to address and potentially reform the market-based rate application analysis procedures)[24] cannot be reconciled with FERC's assertion, on

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21 See PJM Interconnection, L.L.C., 106 FERC ¶ 61,277, at P 3 n.4 (2004) (recognizing that PJM and the Midwest ISO will not begin operating their joint and common market until 2005 at the earliest); Alliance Cos., 100 FERC ¶ 61,137, at PP 40, 57 (2002) (FERC originally required PJM and the Midwest ISO to form a functional common market by October 1, 2004 and to file frequent progress reports).

22 See, e.g., Enron Power Mktg., Inc., 103 FERC ¶ 61,346 (2003), reh'g denied, 106 FERC ¶ 61,020 (2004) (examining gaming practices and anomalous market behavior of entities in the Western energy markets); Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, 103 FERC ¶ 61,347 (2003) (directing the Office of Market Oversight and Investigations ("OMOI") to examine the activities of participants in the Western energy markets).

23 See, e.g., Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations, 103 FERC ¶ 61,349 at P 37 (2003) (order seeking comments on proposed revisions to market-based rate tariffs and authorizations).

24 Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003); see also Market-Based Rates For Pub. Utils., 107 FERC ¶ 61,019 (2004) (initiation of rulemaking proceeding on market-based rates); AEP Power

(continued . . .)

brief, that these activities represent "one-time effort[s] to cure a highly unusual situation" or are "either transmission-related or nearing FERC resolution."[25]

Nor does this assertion withstand scrutiny in light of FERC's own Annual Performance Reports. These reports reflect the agency's commitment, over the next five-years, to ensure proper operation of energy markets and have in place procedures that will recognize and respond to wholesale power sales market problems.[26] Similarly, the creation of the OMOI within the agency to oversee the energy markets is indicative of FERC's on-going commitment to examine and address market issues. FERC's attempt to characterize the creation of the OMOI

(. . . continued)

Mktg., Inc. 107 FERC ¶ 61,018 (2004) (order adopting new interim generation market power screens for use in analysis of market-based rate authority applications); Acadia Power Partners, LLC, 107 FERC ¶ 61,168 (2004) (order establishing procedures for pending and future market-based rate authority applications and triennial market-based rate reviews).

25 FERC Br. at 49.

26 "Annual Performance Report for Fiscal Year 2002," Federal Energy Regulatory Commission, February 2003, at 6-9, available at http://www.ferc.gov/about/strat-docs/FY02-PR.pdf; "Annual Performance Report for Fiscal Year 2003," Federal Energy Regulatory Commission, February 2004, at 4-6, 8-10 available at http://www.ferc.gov/about/strat-docs/FY03-PR.pdf) ("[t]he Commission's primary emphasis must be to facilitate a full transition to competitive wholesale energy markets as soon as possible" Id. at 4. "FERC must offer the public and market participants credible assurance that FERC will identify and remedy energy market problems." Id. at 5.); see also "2003 Annual Report," Federal Energy Regulatory Commission, at 11-12 available at http://www.ferc.gov/about/strat-docs/FY03-AnRp.pdf (describing how OMOI developed a series of regular reports to report energy market developments to FERC, and in some cases, the public).

as a mere staff reorganization is derisory.[27] See FERC Br. at 45-46. By establishing the OMOI as a new, separate office, FERC signaled that wholesale power sales markets would continue to require FERC's regulatory resources and that an office solely dedicated to market oversight and enforcement matters was appropriate.

FERC states that it has taken recent steps "that should reduce the need for such [market-based remedial] orders." FERC Br. at 46 (citing Rehearing Order at n.34). However, even more recently FERC issued additional orders with new interim tests for generation market power for use in analyzing applications for market-based rate authority[28] and initiated a rulemaking to investigate the analyses used in granting market-based rate authority.[29] These regulatory actions do not show a movement away from wholesale power market oversight, but rather a recognition of the need to learn from past mistakes and to avoid (or at least be better prepared for) future market disruptions.

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27 See Press Release, Federal Energy Regulatory Commission, William F. Hederman, Jr. Appointed Director of New FERC Office of Market Oversight and Investigations (April 10, 2002) available at http://www.ferc.gov/press-room/pr-archives/2002/2002-2/newofficedir.pdf. (FERC Commissioner Pat Wood describes the OMOI as an "important new office").

28 AEP Power Marketing, Inc., 107 FERC ¶ 61,018 (order adopting new interim generation market power screens for use in analysis of market-based rate authority applications).

29 Market-Based Rates For Public Utilities, 107 FERC ¶ 61,019 (2004) (initiation of rulemaking proceeding on market-based rates). Included in the investigation is that FERC plans to consider "whether there should be new Commission regulations promulgated expressly for electric market-based rate filings." Id. at P 3.

B. Demonstrated Changes In Circumstances Have Shown That FERC's Annual Charge Regulations Operate In Conflict With FERC's RTO Initiatives.

FERC argues that Petitioners' "policy" argument alleging disincentives to RTO formation is not properly before this Court. FERC Br. at 19-20. Petitioners, however, supported the petition for rulemaking by citing the unanticipated cost-shifting implications that have resulted from implementation of FERC's annual charge regulations under Order No. 641 due to changed circumstances.

FERC's disparate treatment of bundled retail load transmitted by RTOs/ISOs, versus bundled retail load transmitted over non-RTO/ISO facilities, has caused unexpected cost shifts due to the stalled development of RTOs and ISOs, the delays associated with retail unbundling at the state level, and the slow-down in generation divestiture. Pet. Br. at 23-25. These developments supported the Petitioners' request for rulemaking because FERC's current method of assessing annual charges has resulted in incompatibility with its other policies of promoting RTO/ISO formation and participation. The effect of FERC's implementation of its annual charges regulations has been the imposition of rate penalties that FERC promised would not be levied against RTO participants.

FERC argues that there is no inequity in treating services differently in the RTO/ISO context versus the non-RTO/ISO context. FERC Br. at 27-29. In support, FERC argues that for bundled transactions in the RTO/ISO context,

transmission service is being provided under a FERC-jurisdictional OATT, whereas in the non-RTO/ISO context this is not the case. Id. FERC also argues that this policy would not be a disincentive to RTO membership because it is merely shifting costs associated with a regulatory burden from the state to FERC. Id. at 29.

FERC, however, ignores the inequity produced by this requirement because in an RTO or ISO members are required to take transmission service for bundled native load under a FERC-jurisdictional OATT.[30] This inequity is compounded by the fact that generally a utility's native load is large compared to its overall volume of transactions. Moreover, because RTO growth has not occurred as quickly as assumed in Order No. 641, and because retail unbundling also has not progressed at the pace originally anticipated by FERC, the magnitude of the cost shift has been directly affected by FERC's erroneous assumptions.

FERC further argues that transmission providers that offer unbundled transmission service should pay more annual charges to correspond to the greater amount of jurisdictional services they are providing. FERC Br. at 29. FERC states that because the magnitude of such charges is small and spread out among many

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30 See Southwest Power Pool, Inc. 106 FERC ¶ 61,110, at P 108 (2004); Midwest Indep. Transmission Sys. Operator, Inc., Opinion No. 453, 97 FERC ¶ 61,033, at 61,169 (2001), order on reh'g, Opinion No. 453-A, 98 FERC ¶ 61,141 (2002), order on remand, 102 FERC ¶ 61,192, order denying reh'g, 104 FERC ¶61,012 (2003), appeal pending, Case No. 02-1121, et al. (D.C. Cir.).

public utilities, it is reasonable to assess the annual charges on unbundled retail transmission. FERC Br. at 29.

Again, however, FERC ignores the significant changes in circumstances that undermined FERC's efforts to restructure the markets and promote regional grid management. Following issuance of Order No. 641, for example, FERC aggressively pursued, only to eventually abandon, the concept of establishing four mega-RTOs that would cover the entire national transmission grid.[31] Furthermore, retail unbundling initiatives, and the prospect of greater transmission volumes being added to the annual charge calculation (which would, in turn, mitigate somewhat the inequitable cost shifts resulting from FERC annual charge assessments) have unexpectedly and indefinitely been placed on hold in several states. See Pet. Br. at 17-19. Also, utility divestiture of generation assets – another assumption that FERC relied upon in Order No. 641 and another anticipated vehicle for increasing unbundled transmission volumes – failed to develop at the pace contemplated by FERC. Id.

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31 See, e.g., Cleco Power LLC, 101 FERC ¶ 61,008, at P 7 (2002) (recognizing that mediation efforts to establish a single RTO for the Southeast resulted in an impasse owing to fundamental differences on critical issues regarding RTO structure); RTO Informational Filings, 104 FERC ¶ 61,296, at PP 5-7 (2003) (terminating the mediation proceeding established to explore the possibility of a single Northeast-wide RTO noting that the proceedings were overtaken by subsequent events including the approval of PJM as an RTO and new market rules for the ISO New England Inc. ("ISO-NE")).

Ironically, FERC further responds to the RTO-disincentive argument by noting that this argument was raised in the Order No. 641 rulemaking proceeding. FERC argues that it properly declined to postpone implementation of its new regulations based on the "Commission's expectation that all individual public utilities (as well as others) would join RTOs [and thereby] eliminate any claimed unfairness between individual utilities in terms of assessment of annual charges." FERC Br. at 30.

This is a telling concession by FERC. It demonstrates that FERC considered universal utility membership in RTOs to be an essential assumption underlying its Order No. 641 annual charge regulations. Of course, the passage of time has exposed the error in this assumption. Universal utility membership in RTOs has not been realized and only two approved and operating RTOs have been established.[32] Had FERC's expectations come to pass, Petitioners would not be absorbing millions of dollars of additional annual charge assessments and the continued validity of the Order No. 641 regulations would not be at issue. Instead,

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[32] The two approved and operating RTOs are the Midwest ISO and PJM. FERC recently conditionally approved the Southwest Power Pool ("SPP") as an RTO, although it is not yet operational as an RTO. Southwest Power Pool, Inc. 106 FERC ¶ 61,110. Previously, FERC anticipated that SPP would merge with the Midwest ISO. See Midwest Indep. Transmission Sys. Operator, Inc., 103 FERC ¶ 61,283 (2003) (noting that the Midwest ISO and SPP terminated their prospective merger). Additionally, ISO-NE has been operating as an ISO since 1997, and FERC recently conditionally granted it RTO status. ISO New England Inc., 106 FERC ¶ 61,280 (2004).

FERC's predictions have proven wrong, with RTO members bearing the brunt of FERC's faulty forecast.

Finally, FERC argues that the amount of the annual charges assessed to RTOs is relatively small and should not act as a disincentive to joining or maintaining membership in an RTO. FERC Br. at 29. FERC also claims that Petitioners "failed to cite a single instance" where annual charges operated to discourage RTO participation. FERC Br. at 30.

FERC's assertions, however, fail to reconcile FERC's ongoing policy to promote RTO and ISO formation with admittedly higher annual charges that come as a consequence of RTO/ISO membership. Moreover, even the allegedly "small" increases conceded by FERC cannot be squared with the agency's explicit commitment in Order No. 2000, where it assured the industry that voluntary participation in an RTO would not result in any additional rate-related burdens.[33]

For the first time on brief, FERC acknowledged Petitioners' reference (offered in the rulemaking petition) to the decision by Eastern Kentucky Power Cooperative to delay its membership in the Midwest ISO due to the prospect of incurring FERC annual charges. FERC Br. at 30-31. FERC's dismissive response,

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[33] Reg'l Transmission Orgs., Order No. 2000, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,089 at 31,172 (1999), order on reh'g, Order No. 2000-A, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000), petitions for review dismissed sub nom, Pub. Util. Dist. No. 1 v. FERC, 272 F.3d 607 (D. C. Cir. 2001).

to the effect that FERC couldn't possibly interpret this statement as evidence that the existing regulations were discouraging RTO formation, is utterly inexplicable. Apparently aware that it simply overlooked or ignored this evidence below, FERC now insists that it does not mean what it says.

C. Including The Load Of Non-Jurisdictional RTO Members In Calculating The Annual Charges To Be Assessed To The RTO Does Not Take Into Account The Changed Circumstances.

FERC states that in an RTO or ISO "all retail transactions involve an unbundled retail transmission component which is jurisdictional transmission." FERC Br. at 34 (citing Order No. 641 at 31,855 n.69). On this basis, FERC defends inclusion of non-jurisdictional transmission volumes in the calculation of assessed annual charges. Petitioners disagreed, arguing that FERC's action raises a threshold issue of FERC's authority under the Federal Power Act ("FPA") and that, in any event, FERC's defense of its decision to include these volumes was inconsistent with FERC's statements regarding an RTO's ability to recover annual charges. Pet. Br. at 28-29; Midwest ISO Rehearing Request at 9-12; Midwest ISO Transmission Owners Rehearing Request at 14-15.

FERC argues this issue was addressed in Order No. 641 but was not appealed, and therefore cannot be raised in this proceeding. FERC Br. at 34-35. However, the court is not foreclosed from examining rules and regulations even when the statutory period for judicial review of the order promulgating those rules

and regulations has passed. See Graceba Total Communications, Inc. v. FCC, 115 F.3d 1038, 1040 (D.C. Cir. 1997) (quoting Functional Music, Inc. v. FCC, 274 F.2d 543, 546 (D.C. Cir. 1958) ("Because 'administrative rules and regulations are capable of continuing application,' limiting review of a rule to the period immediately following rulemaking 'would effectively deny many parties ultimately affected by a rule an opportunity to question its validity.")). In addition, contrary to FERC's contention, Petitioners are not estopped from challenging this issue and seeking review here because the new evidence and/or changed circumstances presented by Petitioners removes any claim of preclusion. See supra Montana, 440 U.S. at 159.

To begin, non-jurisdictional transmission volumes should not be included in the calculation of annual charges to public utilities and are not included in the non-RTO or non-ISO context. Their inclusion overextends FERC's jurisdictional reach and operates as another self-evident disincentive to non-jurisdictional entities that are considering RTO membership. In defense of the Petitioners' jurisdictional challenge, FERC responded that "[t]he Commission is not seeking to collect annual charges from non-public utilities" so that no FPA issue arises.[34] The incongruity pointed out by Petitioners was that FERC's later statements could not be squared with the agency's statements concerning the recoverability of such

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[34] Rehearing Order at n.35; see also April 11 Order at n.25.

costs. On this latter issue, FERC maintains that annual charges are "no different than any other cost incurred by an RTO" and cited Petitioners' "fail[ure] to explain, because they cannot, how these annual costs differ from any other cost an RTO (or any other public utility) seeks to recover." FERC Br. at 35 (citing Rehearing Order at n.35); see also Rehearing Order at P 19 & n.35; April 11 Order at P 15 & n.25.

In the first place, FERC's assertions are on their face contradictory. FERC cannot defend inclusion of non-jurisdictional volumes on grounds that FERC is not collecting annual charges from non-jurisdictional entities and then state that an RTO's ability to recover an allocable share of annual charges from these entities should not be in question. FERC's first statement disavows any attempt to directly regulate non-jurisdictional entities; the second statement confirms FERC's intention to indirectly regulate these entities by directing that they bear an allocable share of FERC annual charges.

FERC's assertion that annual charges are no different from any other costs incurred by an RTO overlooks one obvious distinction: FERC annual charges are designed to recover regulatory program costs associated with FERC's exercise of authority under the FPA. FERC's FPA authority extends only to the activities of "public utilities" as defined by the Act.[35] Prior to Order No. 641, FERC did not

[35] 16 U.S.C. §§ 824, 824d.

assess annual charges to non-jurisdictional entities[36] and indeed, it maintains that it is not doing so today. Yet FERC cannot have it both ways: FERC cannot, on the one hand, maintain that annual charges are "no different" from other costs reflected in a public utility's jurisdictional rates and still insist, on the other hand, that collection of these charges in an RTO's rates "is not the same as the Commission collecting annual charges from non-public utilities." Rehearing Order at n.35; see also FERC Br. at 35.

Finally, this treatment highlights another inconsistency with FERC's incentive-based policy to encourage RTO formation. As stated earlier, FERC's rationale for adopting Order No. 641 was in part based on the expectation that RTOs would be widespread and that retail unbundling would continue at the contemplated pace. These expectations, however, have not been realized. Meanwhile, FERC continues to assess annual charges on non-jurisdictional transmission only where the non-jurisdictional transmission is part of an RTO. This disparate treatment compounds the unfairness and inequity of FERC's actions and undermines FERC's ostensible objective of promoting RTO membership.

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36 See Order No. 641 at 31,841-42 (summarizing the method for collecting annual charges prior to Order No. 641 as FERC measured total volumes of sales and transmission and exchanges for all assessable "public utilities" based on data submitted under FERC Reporting Requirement No. 582).

D. FERC Has Not Supported The Inconsistent Annual Charge Methodologies That Apply To Regulated Industries.

FERC argues that there is no incompatibility between the methodology used to recover annual charges from gas pipelines and the methodology used to recover electric annual charges. FERC Br. at 37-38 (citing Rehearing Order n.37). FERC states that because gas sales are no longer regulated, the annual charges being assessed on FERC-regulated sales and transportation effectively results in only charges being assessed on transportation, even though FERC has not updated its regulations as applied to gas pipelines.

As Petitioners stated in their initial brief (and FERC did not refute), bundled retail sales continue to account for a large portion of load across public utility transmission facilities. Pet. Br. at 37-38. These bundled retail sales are excluded from the annual charge assessments for public utilities that have elected not to join RTOs and ISOs. (As noted, this disparate treatment – the exclusion of non-RTO/ISO bundled load from annual charges assessment and allocation – causes RTO and ISO member utilities to absorb a disproportionate amount of FERC annual charges.)

FERC's response – i.e., that the level of jurisdictional natural gas sales has declined in recent years – provides no support for FERC's failure to account for comparatively higher volumes of wholesale electric sales in the assessment of

electric annual charges. As Petitioners explained (Pet. Br. at 37), it is FERC's electric fee regulations that are improper and outdated, not its gas fee regulations.

On brief, FERC introduces a new defense to explain the regulatory dichotomy between gas and electric annual charges. FERC argues that bundled retail service is not taken under a jurisdictional tariff, so it is not subject to FERC regulation and no annual charges are assessed on such bundled retail service. FERC Br. at 38. However, this explanation proves nothing. As Petitioners have shown, it is fundamentally unfair and inconsistent with FERC's broad restructuring initiatives to burden RTO and ISO-member utilities with greater annual charge responsibilities than similarly situated utilities that are not members of an RTO or ISO.[37] Because the gas pipeline industry is not structured on a regional basis (i.e., with nothing comparable to RTOs or ISOs), all users of the nation's gas pipeline grid pay on a relatively equivalent basis. It is this disparate treatment that undercuts any attempt by FERC to reconcile its electric annual charge regulations and its natural gas annual charge regulations.

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37 Pet. Br. at 33-36.

III. CONCLUSION

For the reasons set forth herein, Petitioners request that the orders under review be remanded.

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7) of the Federal Rules of Appellate Procedure and Circuit Rule 32(a)(2), I hereby certify that the textual portion of the foregoing brief (exclusive of tables of contents and authorities, glossary, certificates of service and length, and signature block, but including footnotes) contains 6,348 words as determined by the word-counting feature of Microsoft Word 97.

Jeffrey G. DiSciullo

Dated: May 18, 2004

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on May 18, 2004, he caused a true and correct copy of the foregoing Brief of Petitioners to be served by United States mail, first class postage prepaid, on the following counsel of record:

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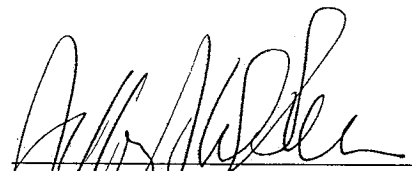

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