

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Midwest Independent Transmission) Docket No. ER11-2798-000
System Operator, Inc.)

**MOTION FOR LEAVE TO ANSWER AND ANSWER OF
MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.**

Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213 (2010), the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”) respectfully requests leave to answer, and submits an answer to, protests filed in this docket by the Organization of MISO States, Inc. (“OMS”), Wisconsin Electric Power Company (“Wisconsin Electric”), and American Municipal Power, Inc. (AMP”) (Collectively, “protestors”). The OMS, Wisconsin Electric, and AMP protests challenge certain aspects of the Midwest ISO’s January 28, 2011 filing (“January 28 Filing”) pursuant to Schedule 34 of its Open Access Transmission, Energy and Operating Reserve Markets Tariff (“Tariff”) to recover a very small penalty assessed by ReliabilityFirst Corporation (“ReliabilityFirst”) under a Notice of Penalty (“NOP”) that was filed by the North American Electric Reliability Corporation (“NERC”) in Docket No. NP11-59-000.

I. Motion for Leave to Answer

The Commission has the discretion to accept answers to protests, and has done so when those answers help the Commission’s decision-making process. Examples of when the Commission has accepted such answers include: (1) clarification of complex issues, (2) provision of additional information, or (3) otherwise facilitating the development of the

record in a proceeding.¹ This answer is intended to assist the Commission by providing additional information regarding specific notice issues related to the Midwest ISO's filing in the above-captioned docket and the Midwest ISO's ability to pay the penalties assessed pursuant to the Settlement Agreement in Docket No. NP11-59-000. Accordingly, the Midwest ISO respectfully requests that the Commission accept this answer.

II. Answer

A. The Midwest ISO Cannot Pay the Penalty Specified in the NOP If The Commission Does Not Approve its January 28 Filing

As the Midwest ISO explained in its January 28 Filing, it is not authorized to use any revenues collected pursuant to its existing funding rate schedules for penalty payment. As described in more detail below, (1) those rate schedules restrict what the Midwest ISO can collect to actual "costs," and require that amounts collected in excess of actual "costs" be refunded to ratepayers, and (2) penalties to be paid to NERC or ReliabilityFirst are not "costs," within the context of the Midwest ISO rate schedules. Thus, it is imperative that the Commission approve the Midwest ISO's January 28 Filing so that the Midwest ISO can discharge its obligations to NERC and ReliabilityFirst.

A review of the objections raised by the protestors indicates that additional discussion of the limitations on the use of revenues other than those collected under Schedule 34 to pay penalties is warranted. More specifically, the Midwest ISO relies primarily on Rate Schedules 10, 16, 17, and 31 to fund its operations and, while each of these rate schedules is intended to

¹ See e.g., *Midwest Independent Transmission System Operator, Inc.*, 132 FERC ¶ 61,241 at P 17 (2010) (accepting the Midwest ISO's answer to a protest where the answer provided information that assisted the Commission in its decision-making process); *Midwest Independent Transmission System Operator, Inc.*, 131 FERC ¶ 61,185 at P 22 (2010) (holding same); *New York Independent System Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004) (accepting the NYISO's answer to protests because it provided information that aided the Commission in better understanding the matters at issue in the proceeding); *Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 61,017 at 61,036 (2000) (accepting an answer that was "helpful in the development of the record...").

allow the Midwest ISO to recover different aspects of its operational costs, they all operate in the same manner. That is, each rate schedule specifically defines the “costs” that the Midwest ISO is permitted to recover under that rate schedule and requires the Midwest ISO to develop a monthly charge based on “budgeted” costs for the relevant month. However, each month, the anticipated costs to be charged to each customer under these rate schedules for that month are adjusted to reflect the actual costs that the Midwest ISO incurred during the previous month.²

Consequently, the Midwest ISO is permitted under its rate schedules to collect only its actual operating costs as described in the above-referenced rate schedules. Amounts collected in excess of actual operating costs must be refunded each month after application of a “true up” mechanism.

Further, and equally as importantly, any penalty-related obligation to NERC and ReliabilityFirst is not a “cost” that may automatically be billed under Rate Schedules 10, 16, 17, or 31. The Commission’s long-standing ratemaking policy has traditionally prohibited public utilities from automatically passing penalty costs to ratepayers.³ Furthermore, the Commission has twice held that Midwest ISO may not automatically pass through penalty costs.⁴ Hence, when the operating mechanics of the Midwest ISO’s existing rate schedules (which require that amounts collected be tied to actual “costs”) are considered *in pari materia* with the above-referenced rulings, there is a clear prohibition against the payment of penalties by

² For example, Schedule 10, which the Midwest ISO uses to recover the costs of providing transmission service, provides that “[e]ach monthly charge shall be calculated based on budgeted costs and estimated MWhs of Transmission Service less the number of MWhs derived pursuant to Schedule 10-A Section II, Schedule 10-B Section II and Schedule 10-C Section II, which will be trued up in the following month’s calculation to reflect actual costs and actual MWhs of Transmission Service.”

³ See, e.g., *Entergy Services, Inc.*, 133 FERC ¶ 61,136 at P 39 (2010) (rejecting proposed tariff amendment that would have permitted automatic recovery of penalty amounts from ratepayers).

⁴ See *Midwest Independent Transmission System Operator, Inc.*, 119 FERC ¶ 61,222 at P 21 (2007); *Reliability Standard Compliance and Enforcement in Regions with Regional Transmission Organizations or Independent System Operators*, 122 FERC ¶ 61,247 at P 16 (2008).

Midwest ISO using revenue collected under rate schedules other than Schedule 34. Indeed, under those rulings, penalties are not “costs” for which the Midwest ISO may bill Tariff Customers outside of the Schedule 34 context. Consequently, because the Midwest ISO’s rate schedules require that the Midwest ISO’s monthly rates substantially reflect actual costs of operation and are further subject to “true up”, use of revenues collected outside of Schedule 34 to pay penalties would violate the filed rate doctrine.⁵

For these reasons, the Midwest ISO must have the ability to recover penalty payment costs under Schedule 34. Otherwise, its ability to comply with its obligations under the Settlement Agreement in NP11-059-000 and its solvency may well be at risk.

B. The Underlying Factual Circumstances Justify the Pass-Through of the Penalty to the Midwest ISO’s Ratepayers

The Commission should not set this matter for hearing as requested by OMS because the recovery of penalty costs by the Midwest ISO is justified in this instance. The Midwest ISO submits that the circumstances underlying the penalty in Docket No. NP11-59-000 justify the pass-through of the penalty to the Midwest ISO’s Tariff Customers. As the Midwest ISO demonstrated in the January 28 Filing, it has a comprehensive compliance program. Further, the CIP issues involved in the Settlement Agreement involved only minor documentation issues, were neither intentional nor grossly negligent, and did not involve senior Midwest ISO management. Indeed, the Midwest ISO neither admitted nor denied the alleged violation outlined in the NOP, and agreed to enter into the settlement to avoid potentially lengthy, costly litigation and to effectuate full and final resolution of the matter.

⁵ The filed rate doctrine would be implicated in this circumstance because -- by using monies collected for other purposes in order to pay penalties -- the Midwest ISO effectively would be charging customers for penalty costs. Such a charge would be inconsistent with the filed rate. *See Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 (1981) (the filed rate doctrine “forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority.”).

Had the Midwest ISO litigated the matter; such litigation would have required monetary expenditures far in excess of the \$7,000 penalty that the Midwest ISO agreed to pay under the settlement. Hence, in settling the allegations, the Midwest ISO was acting in the best interest of its stakeholders by minimizing both the penalty costs that may be approved for recovery from them, as well as the Midwest ISO's overall outlays of litigation-related expenses. To reject the pass-through under these circumstances would be detrimental to the Midwest ISO for the reasons described above, and may also complicate the Midwest ISO's ability to minimize stakeholder costs in the future. For these reasons, the requested pass-through of the penalty is justified, and the matter should not be set for hearing.

C. The Proposed Allocation Of Penalty Costs Is Just And Reasonable

In its protest, Wisconsin Electric challenges the Midwest ISO's proposed allocation of penalty costs, stating that the Midwest ISO's proposed allocation "is not sufficiently broad to include all of the customers taking all of the services provided by the [Midwest ISO]."⁶ The Midwest ISO submits that this argument fundamentally misstates the standard for judging whether the cost allocation proposal is just and reasonable. As the Commission has often recognized, particularly in the context of Regional Transmission Organizations ("RTOs") and Independent System Operators ("ISOs"), cost allocation decisions require a balancing of competing interests, including not only cost allocation considerations, but also administrative feasibility and efficiencies.⁷ For this reason, "[i]t is well-established that the Commission is not required to allocate costs with exacting precision, nor [is the Commission] obligated to reject any

⁶ Wisconsin Electric Power Company, at pp. 3-4.

⁷ See *California Independent System Operator Corporation*, 134 FERC ¶ 61,070 at P 53 (2011) (accepting CAISO allocation methodology for spreading integrated forward market and residual unit commitment uplift costs to convergence bids, stating that "[a]lthough the cost allocation system is imperfect, it does balance the interests of parties and provide an administratively feasible process").

rate mechanism that tracks the cost causation principle less than perfectly.”⁸ Cost allocations are appropriate “so long as there is an articulable and plausible reason to believe that the benefits are roughly commensurate with the costs.”

The Midwest ISO developed its allocation methodology for the penalty costs by attempting to balance the desire for a broad allocation with the need for administrative efficiencies, particularly for a civil penalty as small as the one that the Midwest ISO is seeking to collect. Schedule 10 charges are collected by the Midwest ISO to fund its transmission operations, one of the core functions for which the Midwest ISO was established. Schedule 10 charges are paid by a broad cross-section of Midwest ISO Tariff Customers, including many that also pay for service under Schedules 16, 17, and 31. At the same time, Schedule 10 billing determinants are relatively straightforward to calculate, and thus allow the Midwest ISO to calculate penalty allocations with minimal additional administrative costs. For these reasons, the proposed allocation methodology strikes an appropriate balance between broad cost allocation and administrative efficiencies. Indeed, under the proposed methodology, “there is an articulable and plausible reason to believe that the benefits are roughly commensurate with the costs,” and the methodology is therefore just and reasonable.

By contrast, Wisconsin Electric’s suggestion that the Midwest ISO strive for a broader allocation would substantially increase the Midwest ISO’s administrative costs as the Midwest ISO would have to determine a fair allocation of penalty costs among Schedule 10, Schedule 16, Schedule 17, and Schedule 31 customers, while also ensuring that customers paying for services under more than one of those rate schedules are not unfairly double-billed. The Midwest ISO would, then, have to make additional adjustments to its billing system to perform the necessary calculations. All of this effort would be undertaken for the purpose of including in the allocation

⁸ *Id.*

a negligible number of customers that would not be allocated penalty costs under the Midwest ISO's Schedule 10 proposal. Under the circumstances, the Midwest ISO submits that the additional costs of extending the allocation far outweigh any benefits associated with ensuring that all Tariff Customers (as opposed to most Tariff Customers) pay a portion of the penalty.

D. The January 28 Filing Provides Adequate Notice

The protestors challenge the Midwest ISO's use of the redacted, public version of its January 28 Filing as notice under Section 205 of the Federal Power Act ("FPA") and Schedule 34 of the Tariff. Specifically, the protestors argue that the Midwest ISO's use of a redacted, public version of its January 28 Filing does not provide sufficient notice to the Midwest ISO's Tariff Customers and Members under Section 205 of the FPA and Schedule 34 of the Tariff.

The Midwest ISO notes that, to address the notice issues raised by the protestors, it is submitting, contemporaneously with this answer, a supplemental filing that makes public the non-public version of the January 28 Filing. Nonetheless, the Midwest ISO submits that the notice that it originally provided to Tariff Customers and Members was adequate pursuant to Section 205 of the FPA and Schedule 34 as demonstrated by the conclusion stated in at least two of the protests that the Unidentified Registered Entity was the Midwest ISO and a conclusion by the third protestor that it would be "subject to the allocation of penalty costs".

In submitting both a redacted, public version, and an un-redacted, non-public version, of the January 28 Filing, the Midwest ISO sought to comply with the conflicting requirements of Section 205 of the FPA and Schedule 34 of the Tariff, which require notice, and 18 C.F.R. § 39.7(d)(4), which requires that the "disposition of each violation or alleged violation that relates to a Cybersecurity Incident or that would jeopardize the security of the Bulk-Power System if publicly disclosed shall be non-public unless the Commission directs otherwise." To date, all NOPs filed by NERC that have involved compliance with its Critical Energy

Infrastructure (“CIP”) reliability standards (including the NOP in NP11-59-000) have been submitted to the Commission in redacted form. Accordingly, to strike the appropriate balance and ensure compliance with all Commission regulations and the prevailing filing practices where cybersecurity issues are involved, the Midwest ISO submitted its January 28 Filing in both a non-public form and a public, redacted form, and used the public version of the filing to provide notice to its Tariff Customers and Members.⁹

The Midwest ISO respectfully submits that this filing strategy alerted interested parties that a non-public filing had been provided to the Commission, which any interested party could have requested from the Midwest ISO (as the public filing was posted on the Midwest ISO website). Further, the Midwest ISO respectfully asserts that, though it redacted the information necessary to ensure compliance with 18 C.F.R. § 39.7(b)(4), it concurrently made public sufficient information to provide adequate notice of its filing to its Tariff Customers and Members as required under Section 205 of the FPA and Schedule 34 of the Tariff.

Indeed, the requirements under Section 205 of the FPA are intended to “enable purchasers to know in advance the consequences of the purchasing decisions they make,” and are satisfied when “customers receive adequate notice of a rate in advance of the service to which it relates.”¹⁰ The Commission has made clear that customers have adequate notice as long as there is sufficient information in a rate filing to allow customers to understand the rate that is proposed

⁹ A review of the file list for docket ER11-2798 clearly indicates both the non-public and public versions of the Midwest ISO’s filing (Accession numbers 20110131-5035 and 20110131-4001).

¹⁰ *Transmission Access Policy Study Group v. FERC*, 223 F.3d 667, 709 (D.C. Cir. 2000), *affirmed sub. nom.*, *New York v. FERC*, 535 U.S. 1 (2002) (citing *Western Resources, Inc. v. FERC*, 72 F.3d 147, 149 (D.C. Cir. 1995)).

to be charged.¹¹ This same standard is reflected in Schedule 34 itself, which requires that, before the Midwest ISO is able to collect penalty costs from its ratepayers, the Midwest ISO must provide “notice to all Tariff Customers and Members that they may potentially be responsible for penalty costs assessed to the Transmission Provider that cannot be directly assigned under Section 2 of this Schedule.”

As the protestors note, the public version of the January 28 Filing is posted on the Midwest ISO’s website. The Midwest ISO also promptly served the public version of the January 28 Filing on all Tariff Customers, Members, state commissions within the Midwest ISO region, and other interested parties. Thus, although the public version of the filing only identifies the “Unidentified Registered Entity,” there was no uncertainty regarding the identity of the filing party and all Tariff Customers and Members had clear notice that the party filing for rate approval was the Midwest ISO due to its performance of its service obligations. Indeed, as indicated above, none of the protestors in this docket appeared to have an issue identifying the Midwest ISO as the filing entity.

Further, the Midwest ISO notes that the identity of the customers who would pay the rate for which the Midwest ISO is seeking approval is clear from the public version of the January 28 Filing. More specifically, the public version of the January 28 Filing states that the charge will be allocated:

on a *pro rata* basis to all Tariff Customers based upon the Schedule 10 billing determinants calculated during the calendar month immediately following the month in which this filing is accepted or approved by the Commission. Specifically, for that month, the URE will add total Network Load for that month to total Reserved Capacity for all Point-to-Point Transmission Service for that month. Then, each Tariff Customer’s share of the penalty will be calculated by

¹¹ See *Niagara Mohawk Power Corporation*, 126 FERC ¶ 61,173 at PP 12-16 (2009) (permitting the filing party’s originally-requested effective date, even where the Commission found the initial filing to be deficient, where customers had notice of the proposed rate in the initial filing, and that rate did not change between the initial and supplemental filings).

dividing that Tariff Customer's total Network Load for the month or the Tariff Customer's total Reserved Capacity for Point-to-Point Transmission Service for the month (whichever is applicable) by the sum of the total Network Load and total Reserved Capacity for all Point-to-Point Transmission Service for that month.¹²

Thus, the public version of the January 28 Filing provided adequate and timely notice of the rate proposed for approval as well as the filing party (the Midwest ISO) to any and all potentially affected parties, *i.e.*, Tariff Customers taking Network and Point-to-Point Transmission Service in the month after the Commission approves or accepts the January 28 Filing.

Finally, the public version of the January 28 Filing describes the potential impact of the charge proposed to be assessed, stating that the "impact of the penalty allocation on any one Tariff Customer is estimated to be extremely small" and that the "allocation of the penalty amount for which the URE is requesting recovery would result in a change of less than one one-thousandth of one cent per MWh."¹³

For these reasons, the Commission should find that the public version of the January 28 Filing provided both Tariff Customers and Members adequate notice pursuant to Section 205 of the FPA and Schedule 34 of the Tariff. Further, the Midwest ISO requests that Commission provide guidance regarding the submission of a cost recovery filing that complies with both the notice requirements of Section 205 of the FPA and the confidentiality requirements of 18 C.F.R. § 39.7(b)(4). The Midwest ISO requests this guidance because of the potential that this issue will arise again in the future. Indeed, the Midwest ISO understands that most RTOs and ISOs are pass-through entities like the Midwest ISO, and would face the same dilemma with respect to the conflict between the notice requirements of FPA Section 205 and the confidentiality

¹² Unidentified Registered Entity Request for Recovery of Charges, Docket No. ER11-2798-000, filed January 28, 2011 at pgs. 6-7.

¹³ *Id.* at pg. 7.

requirements of 18 C.F.R. § 39.7. All similarly-situated ISOs and RTOs must submit cost recovery filings under Section 205 of the FPA to the Commission to recover costs associated with penalty payments.

III. Conclusion

For the foregoing reasons, the Midwest ISO respectfully requests that the Commission reject the arguments set forth in the protests and approve the Midwest ISO's January 28 Filing.

Respectfully submitted,

/s/ Brian M. Zimmet

Brian M. Zimmet

Attorney for the Midwest Independent
Transmission System Operator, Inc.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents upon each person designated on the official service list for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 9th day of March, 2011, at Washington, D.C.

/s/ Brian M. Zimmet _____

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Document Content(s)

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