ORAL ARGUMENT SCHEDULED FOR ______________.

No. 00-1174 and Consolidated With 00-1175
00-1176, 00-1177, 00-1178, 00-1179, 00-1180,
00-1181, 00-1182, 00-1184

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION

Respondent.

On Petition for Review of Orders of the
Federal Energy Regulatory Commission

JOINT REPLY BRIEF OF JURISDICTIONAL UTILITIES

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

FEDERAL CASES*

* Authorities upon which we chiefly rely are marked with asterisks.

FEDERAL STATUTES

ADMINISTRATIVE REGULATIONS

ADMINISTRATIVE CASES

MISCELLANEOUS

GLOSSARY

FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
ISO	Independent System Operator. An ISO is an organization that supervises the operational use of transmission facilities owned by public utilities within a defined region. An An ISO can be an RTO if it satisfies the minimum characteristics and functions set forth in Order No. 2000.
Pancaked Rates	A "pancaked" transmission rate regime is one where the access charges or rates charged to customers are summed in circumstances where transmission service is provided over the facilities of more than one transmission service provider. Pancaked Rates therefore consistent of the sum of the rates charged to transmission customers for the use of more than one transmission system.
RTO	Regional Transmission Organization. An RTO is an entity that controls the operation of transmission facilities. An RTO can take one of several forms – an ISO, a for-profit transmission company, or combinations of the two. To become an RTO, the entity must satisfy the minimum characteristics and functions set forth in Order No. 2000.

SUMMARY OF ARGUMENT

Petitioners' opening brief established that the Federal Energy Regulatory Commission ("FERC") had both exceeded its statutory authority and engaged in arbitrary and capricious rulemaking by depriving the owners of transmission assets of the ability to set the tariff rates applicable to transmission services. Petitioners pointed out that FERC has never had statutory authority to initiate rates, only to review them; that it could not gain such authority by insisting that owners provide their services through a middleman; and that such a process created a serious risk of leaving the owners with an insufficient revenue stream. Petitioners also explained that FERC did not need to deprive transmission owners of their tariff-setting rights in order to achieve its regulatory objectives.

FERC's principal thrust is not to answer these arguments, but to assert that they should be deferred to a later date. FERC argues that petitioners—the utilities whose assets will be governed by the regulation—do not have standing to challenge its terms. However, petitioners face the loss of statutory rights that allowed them to initiate rates and the threat of inadequate revenue and lost customer relationships. FERC seeks to diminish those injuries by arguing that its contemplated new procedures would protect the utilities, but this confuses FERC's position on the merits with the question of standing. The legal issues posed here are ripe, and petitioners face hardship if review is withheld.

FERC asserts that, when an RTO takes the form of an Independent System Operator ("ISO")—in which the assets are still owned by the participating utilities but operations are supervised by ISO management, FERC can grant "exclusive" filing rights to the ISO. Nothing in Section 205 of the Federal Power Act ("FPA") gives FERC this authority. FERC argues that both the owners and the ISOs are public utilities, but even if this were true, it does not explain why one set of institutions—the ISOs—would be given *exclusive* power to set initial tariff rates for transmission services. As petitioners have already shown, this is contrary to decades of judicial precedent as well as the structure of the FPA. It is the owners of the assets—not the newly-created ISOs—that have a constitutionally protected interest in receiving adequate compensation for their investment in property devoted to public use.

FERC fails to identify *any* rate discrimination that would justify this radical change in the ratemaking process. Intervenors suggest a rationale not invoked by FERC—the elimination of pancaked rates—but fail to explain why FERC could not deal with that issue through its review of rate filings by transmission owners under Section 205.

FERC does not show why it is entitled to eviscerate the transmission owners' rights under *Mobile-Sierra* to allocate filing responsibilities and the burden of proof by contract. Contrary to FERC's argument, the fact that more than one public utility may be involved is a reason to allow and enforce such agreements, not to condemn them. In fact, FERC compounds its error by refusing in its "Open Architecture" policy to permit the parties to limit by contract the rights of the RTO to initiate unilateral changes to the enabling agreements. This makes the utility transferring its assets subject to the risk of a different structure imposed by the RTO unilaterally. By the same token, FERC now purports to leave the transmission owners subject to the risk of paying additional interconnection and expansion costs without the statutory protections of Sections 210-212. Order No. 2000 is fundamentally flawed insofar as it contemplates the present transfer of billions in assets without any assurances against such future risks.

I. THIS COURT HAS JURISDICTION TO REVIEW FERC'S RULEMAKING.

This Court should reject FERC's efforts to stave off judicial review. *See* FERC's Brief at 22-28. As the owners of the transmission assets that will be governed by Order No. 2000, the utilities clearly have a direct stake in the outcome of this appeal, and their legal challenges are ripe for judicial review.

A. The Jurisdictional Utilities Have Shown An Injury-In-Fact.

The jurisdictional utilities are "aggrieved" within the meaning of 16 U.S.C. § 824*l*(b). Aggrievement requires injury in fact, fairly traceable to the challenged rulemaking and redressable by the relief sought. *See Exxon Company v. FERC,* 182 F.3d 30, 43 (1999). FERC's assertion that petitioners have not been aggrieved by Order No. 2000 ignores altogether the impact of this rulemaking upon the jurisdictional utilities.

In a challenge to administrative action, standing "depends considerably upon whether the plaintiff is himself an object of the action (or foregone action) at issue. If he is, there is ordinarily little question that the action or inaction has caused him injury, and that a judgment preventing or requiring the action will redress it."

Lujan v. Defenders of Wildlife, 504 U.S. 555, 561-62 (1992). Here, as the owners of transmission assets, petitioners are the targets of the RTO rulemaking at issue and face <u>multiple</u> injuries as a consequence of the rulemaking.

First, the utilities face the loss of a concrete benefit that was provided by Congress and stripped away by Order No. 2000—namely, the right to make and file changes to the rates for services to customers.[1] Without more, this deprivation of a legislative benefit constitutes injury in fact. *See CC Distribs., Inc. v. United States*, 883 F.2d 146, 149-51 (D.C. Cir. 1989) (loss of statutorily conferred opportunity to compete for a contract constitutes injury for standing purposes).

There is nothing speculative about this injury. FERC's decision to deny transmission owners the right to design and file rates is clear and binding. The regulation provides: "The [RTO] *must have* exclusive and independent authority under Section 205 ... to propose rates, terms and conditions of transmission service provided over the facilities it operates." 18 C.F.R. § 35.34(j)(1)(iii) (emphasis added). This is a rule, not a policy statement. In addition, Order No. 2000 requires that utilities join RTOs within a reasonable period or explain why they have not done so, or face severe penalties. Under these circumstances, the utilities' threat of injury is sufficiently concrete and imminent to support standing. *See Babbitt v. Farm Workers*, 442 U.S. 289, 298-99 (1979); *see also Virginia v. American Booksellers Ass'n, Inc.*, 484 U.S. 383, 393 (1988).

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[1] The term "rates" is used as defined in petitioner's opening brief. Utilities' Brief at 24 n.13.

Moreover, FERC's intervening actions confirm that the threat of injury to the utilities' protected rights is real. *See Blum v. Yaretsky*, 457 U.S. 991, 1001 (1982) (considering the threat of injury to be "quite realistic" since "similar determinations" had already been made by the review committees). For example, in September 2000, FERC summarily rejected a carefully designed ISO scheme that preserved the filing rights of the transmission owners without compromising the ISO's independence, ruling the utility members must relinquish their Section 205 filing rights. *See Pennsylvania-New Jersey-Maryland Interconnection,* 92 FERC ¶ 61,282, 61,961-62 (2000); *see also Alliance Companies*, 94 FERC ¶ 61,070, mimeo at 12 (2001) (rejecting a proposal that allowed transmission owners to request changes in their pre-approved price methodology, on the ground that it violated the "requirement in Order No. 2000 that the RTO have the exclusive right to set RTO transmission rates.").[2] Thus, since Order No. 2000's issuance, FERC has insisted that independence requires the relinquishment of the owners' Section 205 filing rights.

Petitioners have demonstrated other injuries in fact. They allege that Order No. 2000 places them at risk of losing their investments in transmission assets because its mandated changes to Section 205 procedures leave them without adequate assurances of recovering their revenue requirements. *See* Utilities' Brief at 37-48. FERC turns standing analysis on its head when it argues that the

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[2] FERC strenuously opposed the PJM members' motion to coordinate the oral argument in the PJM case with this case. As the PJM members pointed out, that appeal would show the current impact of the rule.

jurisdictional utilities lack standing because the "procedures" adopted in Order No. 2000 minimize the threat posed by FERC's changes. The adequacy of those procedures is an issue that must be considered on the merits and it has been forcefully contested. *See* Utilities' Brief at 41-48. FERC cannot rely on its own challenged position on the merits as a demonstration that the utility petitioners have not suffered an injury:

> This reasoning falls into the familiar trap of confusing the merits of a case with the threshold requirement of standing to present a challenge. In this action, we cannot assume that the FTC will prevail on the merits in order to close the courthouse door to all potential litigants. Rather, we take the opposite track.

Public Citizen v. FTC, 869 F.2d 1541, 1549 (D.C. Cir. 1989); *accord Louisiana Energy and Power Authority v. FERC*, 141 F.3d 364, 368 (D.C. Cir. 1998).

There are other injuries in fact. Order No. 2000 presents a real and immediate threat of (1) taking away the utilities' rights to contract directly with current and potential customers to provide transmission services; (2) stripping away key management decisions concerning operation of their businesses; and (3) decreasing the rates the companies will be paid for transmission services. These are all injuries in fact. *See, e.g., Wedges/Ledges of California, Inc. v. City of Phoenix, Arizona*, 24 F.3d 56, 61 (9th Cir. 1994) ("It is well settled that a provider of goods or services has standing to challenge government regulations that directly affect its customers and restrict its market."); *United States v. Storer Broadcasting Company*, 351 U.S. 192, 199-200 (1956).

Order No. 2000 has an impact upon the utilities' *current* business decision-making and investment plans. They are currently negotiating the terms of their RTO agreements, and need to develop a framework that protects them from inadequate revenues, future unfavorable changes in ISO structure, or additional interconnection costs. *See Rio Grande Pipeline Company v. FERC*, 178 F.3d 533, 540 (D.C. Cir. 1999) (injury demonstrated where FERC's order impacts company's "present economic behavior – investment plans and creditworthiness— and its future business relationships"); *Great Lakes Gas Transmission Limited Partnership v. FERC*, 984 F.2d 426, 430-31 (D.C. Cir. 1993).

Given the foregoing, the utility petitioners have demonstrated not one, but several, injuries in fact that are a direct consequence of FERC's actions and redressable by a favorable judgment.

B. The Issues Are Ripe For Review.

FERC also seeks deferral of judicial review on ripeness grounds. *See* FERC's Brief at 27-28. In determining that FERC's rulemaking is ripe for review, the Court "evaluate[s] both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration." *Abbott Laboratories v. Gardner*, 387 U.S. 136, 149 (1967). When a petitioner presents purely legal questions on review, the Court "assume[s]" the case is fit for review and need not reach the issue of hardship to the parties. *See Natural Resources Defense Council v. EPA*, 22 F.3d 1125, 1133 (D.C. Cir. 1994).

Here, the issues are fit for review. First, petitioners raise legal issues that require no further factual development, such as whether FERC has the authority to change Congress' scheme for the filing of rates and whether these dramatic changes are justified based on the rulemaking record. Having raised these legal questions, the utilities need not await further development. *See Pacific Gas & Elec. Co. v. State Energy Resources Conservation and Dev. Comm'n*, 461 U.S. 190, 201-02 (1983); *American Petroleum Institute v. EPA*, 906 F.2d 729, 739 & n.13 (D.C. Cir. 1990).

Second, FERC's position on these legal issues has "crystallized" sufficiently for purposes of judicial review. *See Rio Grande*, 178 F.3d at 540-41. FERC's codification of the new rate filing procedures in 18 C.F.R. § 35.34(j)(1)(iii) needs no further consideration. It is a final, binding rule that unequivocally states the RTOs "*must have* exclusive and independent authority under section 205" over the pertinent facilities. *Accord Eagle Picher Industries v. EPA*, 759 F.2d 905, 917 (D.C. Cir. 1985) (reasoning that the agency's decision was issued "as a regulation, after notice-and-comment proceedings, and contains no equivocal or tentative language"). Similarly, FERC has clearly ruled that it will not permit contractual protection for the utilities from unilateral changes to the ISO structure and has refused to enforce the utilities' rights to protections under Sections 210-212. Utilities' Brief at 61. In fact, during the pendency of this appeal, FERC summarily rejected a challenge to one of its RTO requirements in a specific application proceeding by saying that such a challenge constituted an impermissible "collateral attack" on Order No. 2000. *See Alliance Companies*, *supra*, mimeo at 12.[3] Therefore, the legal issues raised here have been distilled to their final form and are ripe for review.

At the same time, the hardship to petitioners from any delay in consideration of these issues is severe. Petitioners have been directed to file plans for the placement of billions of dollars of transmission assets in RTOs whose minimum characteristics are specified in the regulation. Once the jurisdictional utilities join an RTO in this fashion, FERC may assert that they cannot depart without a showing that withdrawal is in the public interest. *See* Utilities' Br. at 31-32 & n.18.

Thus, the utilities need to know *now*, as they attempt to structure these complex agreements, who will have the power to set tariff rates for service. They also need to know whether FERC will have the power to accept *ad hoc* changes to the RTO's powers and obligations under the enabling agreements. Similarly, they need to know under what conditions they can be forced to bear transmission expansion or interconnection costs. Transmission owners cannot be left in a legal limbo where they are unable to obtain judicial review of these issues now, face these threats at a later date, and yet cannot then withdraw from the RTO. Nor can they rely on individual proceedings, for in view of the Commission's findings and

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[3] Similarly, in the wake of Order No. 888, FERC consistently took the position that the parties could not deviate from the general rules of that order in a specific application because such positions were a "collateral attack" on the regulation. *See, e.g.*, *New England Power Company*, 85 FERC ¶ 61,181, 61,733 (1998); *New York State Electric & Gas Corp.*, 79 FERC ¶ 61,371, 62,550-51 (1997).

directions, the owners must negotiate their agreements now in accordance with FERC's framework; they do not have the luxury of testing it by developing and filing agreements that are inconsistent with the regulation. [4]

Pacific Gas is on-point in this regard. There, the Supreme Court determined that a group of utilities could challenge a state law imposing a moratorium on the construction of nuclear power plants. *See* 461 U.S. at 197-200. Noting the long lead time and the millions of dollars that had to be expended simply to proceed to the licensing stage in the course of developing a nuclear power plant, *see id.* at 201 n.13, the Supreme Court envisioned enormous hardship were the industry required to chart a course of action without knowing whether the moratorium was valid. *See id.* at 201-02. The Supreme Court concluded, "the issue ... should be decided now."

By the same token, the legal issues posed by FERC's new regulation, which are critical to petitioners' current investment decisions, are ripe for this Court's review.

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4 Creating an ISO from the assets of multiple utilities is an enormously complex task that requires both extensive lead time and upfront capital expenditure. For example, the California Independent System Operator required three years for its formation at a cost of over $300 million. *See* "APX Gambles In Nevada," 5 Utilities IT (2000), *available in* 2000 WL 24203065.

II. THE COMMISSION IS NOT ENTITLED TO *CHEVRON* DEFERENCE BECAUSE ITS INTERPRETATION OF THE FPA IS INCONSISTENT WITH CONGRESSIONAL INTENT AND JUDICIAL PRECEDENT.

Petitioners argued in their opening brief that FPA Section 205 did not give FERC the power to deprive transmission asset owners of their ability to design and file the rates governing transmission service to the public over their own facilities. FERC responds that the RTO and the transmission owners are each "public utilities" within the meaning of the statute, and because the "FPA does not explicitly address who has filing authority or responsibility in this situation," FERC Br. at 33, FERC has authority to make that decision. This is a profound misuse of the *Chevron* doctrine.

In the first place, FERC's reliance on Section 205's silence merely begs the question: FERC has not established its authority, in the first instance, to insert an RTO between the transmission owners and their customers and to require the transmission owners to provide service only to the RTO (and not the public). An agency may not gain a power that Congress did not grant by applying the *Chevron* framework to congressional silence. *Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995) ("To suggest ... that *Chevron* step two is implicated any time a statute does not expressly negate the existence of a claimed administrative power...is both flatly unfaithful to the principles of administrative law ... and refuted by precedent.") (citations and quotations omitted).

Second, in this instance it is clear that Congress affirmatively did not intend to give FERC this authority. As petitioners pointed out in their initial brief, more than four decades of precedent establish that Congress intended that public utilities have the freedom to set the initial rates applicable to their assets, subject only to Commission review for reasonableness. Utilities' Brief at 24-31. FERC has nothing to say about this extensive body of precedent.[5] A court does not defer to agency interpretation where Congressional intent is clear. *See Chevron*, 467 U.S. at 842-43.

Moreover, the Court's obligation to discern congressional intent does not stop where the statutory language does. *See Food and Drug Administration v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132-33 (2000). Time and again, the Supreme Court has stressed that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme. *See id.*

Here, FERC's assertion of power is inconsistent with the regulatory structure that Congress enacted into law. The FPA's regulatory scheme established under Sections 205 and 206 was "built ... on a foundation of private contracts." *Sunray-Mid-Continent v. FPC*, 364 U.S. 137, 154 (1960); *accord Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968) ("The regulatory system created by the Act is premised on contractual agreements voluntarily devised by the regulated companies.").

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[5] Only several weeks ago, the First Circuit recognized that FERC "is now becoming hostile to *Mobile-Sierra*." *Boston Edison Co. v. FERC*, 233 F.3d 60, 68 (1st Cir. 2000).

Under the statutory scheme, Congress vested the Commission with limited jurisdiction to ensure that all rates charged are "just and reasonable," but otherwise intended that the "the rate-making powers of … companies … be no different from those they would possess in the absence of the Act: to establish ex parte, and change at will, the rates offered to prospective customers; or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer." *United Gas Pipe Line v. Mobile Gas,* 350 U.S. 332, 343 (1956); *Boston Edison Company v. FERC*, 856 F.2d 361, 371-2 (1st Cir. 1988); *Western Massachusetts Electric Company*, 23 FERC ¶ 61,025, 61,063-64 (1983) (state "impermissibly attempted to alter this statutory scheme" when it directed the company to file change in rates), *aff'd,* 729 F.2d 886 (1st Cir. 1984). Thus, Congress made a deliberate choice not to preempt the ability of the contracting parties to create their own arrangements for the filing of initial rates, subject to Commission review.

FERC has now decided, however, that as between two public utilities, *only* the RTO can file the rates for services provided with the assets of the transmission owners. Under the regulation, there can be no sharing of that authority, by contract or otherwise. The RTO "must have *exclusive* and *independent* authority" to initiate rates. 18 C.F.R. § 35.34(j)(1)(iii) (2000) (emphasis added). Thus, FERC not only prohibits the owner from directly contracting with its customers, but prohibits it from having any authority whatsoever over what rates will be filed in the first instance with the Commission. FERC has effectively squeezed the transmission owners out of the contract formation process and thereby removed the central "foundation" of the statutory scheme. *See Sunray-Mid-Continent*, 364 U.S. at 154.

In *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116 (1990), and again in *Norfolk Southern Railway Co. v. Shaklin,* 529 U.S. 344 (2000), the Supreme Court explained the rule that an agency, even one charged with the administration of a statute, is not free to interpret a statute in direct contravention of well settled case law. "Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning." *Maislin*, 497 U.S. at 131; *Norfolk Southern*, 529 U.S. at 356. Thus, FERC's interpretation of Section 205 is not entitled to *Chevron* deference because it conflicts with longstanding judicial interpretation of that statute.

FERC's reading also destroys the deliberate balance between Sections 205 and 206 of the FPA. Utilities' Brief at 19, 29-30. These provisions impose upon FERC the burden of proving unlawful rates initiated by the utility. FERC is "not free to blend, or pick and choose at will between its sections [205 and 206] authority." *Sea Robin Pipeline Company v. FERC*, 795 F.2d 182, 183 (D.C. Cir. 1986). Order No. 2000 swaps the duties and rights in those provisions. The ISO receives from FERC the power to file the initial rates, while the owner of the transmission assets must relinquish its discretion to initiate rates within the zone of reasonableness and is accorded only the limited right to challenge those rates as unreasonable under Section 206. The courts have repeatedly rejected FERC's attempts to assume rate-setting powers under Section 205 and relegate the owners of the jurisdictional assets to relief under Section 206. Utilities' Brief at 29-30. FERC does not even acknowledge this momentous shift in the discretion to select rates and in the burden of proving unlawfulness.

FERC's theory, as presented in its brief, is that both the ISO and the participating transmission owner are public utilities, so that FERC can allocate rate-filing responsibilities between them. The definition of public utility, even if applicable,[6] does not give FERC the right to take the wholly irrational course of giving the ISO the *exclusive* right to make rate filings with respect to transmission services, while fencing the owner out of this process. Consistent with constitutional imperatives, the case law recognizes that the purpose of ratemaking is to protect and encourage investment. *See Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1176-78 (D.C. Cir. 1987). Thus, it is the investment of the *owner* of the assets (not the plan of an alleged operator) that must be protected through the rate filing regime. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-08 (1989) ("The guiding principle has been that the Constitution protects utilities from being limited to a charge *for their property* serving the public which is so

[6] FERC assumes without discussion that the ISO is the operator of the transmission assets and therefore a public utility. Depending upon the agreed structure, the ISO may have only limited supervisory authority over certain facilities, while the owners would be responsible for the physical operation and maintenance of its transmission assets. *See* Order No. 2000, at 31,091; J.A.__. This appeal, however, does not turn on whether an ISO is a public utility, for even if it were, FERC has failed to come up with a reasonable explanation as to why the ISO, rather than the owner and physical operator of the assets, should have exclusive filing rights.

'unjust' as to be confiscatory.") (emphasis added); *Louisiana Public Service Commission v. FCC,* 476 U.S. 355, 364-65 (1986); Utilities' Brief at 26, 37-38. The failure of the Commission's interpretation to protect the investments of the owners—in disregard of decades of precedent emphasizing that this is the central purpose of ratemaking—is also pertinent under a *Chevron* analysis. *See Salt River Project Agricultural Improvement and Power District v. FPC*, 391 F.2d 470, 474 & n.11 (D.C. Cir. 1968) ("our concern is not simply with Congress' language, but with its logic as well").

Cases such as *Baltimore Refuse Energy Systems Co.*, 40 FERC ¶ 61,366 (1987), on which FERC relies, cannot salvage the Commission's actions. *See* FERC's Brief at 35 & n.11. In those "sale lease-back" cases, the lending financial institutions received revenue protection in the form of hard assets as collateral for their loans. FERC held that because these entities with technical legal title were not public utilities within the meaning of Section 201(e) of the FPA, they had no obligations or abilities with regard to rates under Section 205. Those cases do not suggest that FERC has authority to mandate that one public utility would have *exclusive* rate-setting powers as against another public utility owning the affected transmission assets.

FERC has taken a radical step in placing billions of dollars of transmission assets under the control of RTOs, and then asserting that the owners of those assets in an ISO structure will have no authority to file the rates at which the public will be charged for service. FERC cannot find authority for this action in the silence of the FPA. Nor can it ignore the history, structure and accumulated precedent of that statute, which accord to the owners the right to enter into contracts setting the rates for services generated with their assets.

III. FERC HAS NOT PRESENTED A REASONED ANALYSIS OF BENEFITS AND RISKS THAT WOULD JUSTIFY GIVING EXCLUSIVE RATE-FILING AUTHORITY TO THE ISO.

Petitioners' opening brief pointed out that, even if FERC had the authority to grant exclusive rate-filing authority to the ISO, FERC had not presented a reasoned analysis justifying this radical step. FERC still has not done so. It has not pointed to any evidence of discrimination in rates that would justify the need to give exclusive authority to an independent entity; it has not attempted to show how the operational problems that were identified in Order No. 2000 would be affected by the ratemaking regime it prescribed; and it has not shown how it would avoid the huge risks to transmission owners and other practical defects in that regime that were identified in petitioners' initial brief. This is a complete failure of reasoned decision-making.

A. FERC Has Not Presented A Sufficient Legal Predicate To Support Giving Exclusive Rate-Filing Authority To The ISO.

Petitioners pointed out in their initial brief that Order No. 2000 effects a radical change in the ratemaking process—separating the design and filing of rates from the determination of revenue requirements—and that FERC bore a heavy burden of justifying this departure from past practice. FERC does not disagree with this assessment of precedent. However, it makes no effort whatsoever to shoulder the burden.

First, even though FERC by its own statement promulgated the regulation pursuant to FPA Section 205, FERC's brief on appeal fails to point to any finding of unlawful or discriminatory rates that would justify the invocation of that section. Section 205 requires, as a prerequisite for any action taken by the Commission under that Section, that FERC find filed rates to be unjust and unreasonable. *See* 28 U.S.C. § 824d(a) (1994); *FPC v. Texaco,* 417 U.S. 380, 394 (1974) ("The Commission may have great discretion as to how to ensure just and reasonable rates, but it is plain enough to us that the Act does not empower it" to act without first complying "with that standard."); *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1501 (D.C. Cir. 1984). Since FERC's brief does not identify any findings of discriminatory or unlawful rates, the Court "must assume ... that the rates [are] reasonable." *Maislin*, 497 U.S. at 116 n.10.[7]

Second, FERC does not purport to show in its brief how the problems that it did identify in Order No. 2000—such as perceptions of discrimination in the operation of the grid and other operational inefficiencies—would be any way ameliorated by its radical change in the ratemaking process. Facing a direct challenge on this point in petitioners' brief, FERC still has not "articulated an

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[7] Indeed, given the regulatory safeguards already in place, it is doubtful that FERC could ever make a generic finding of rate discrimination. Utilities' Brief at 50.

explanation for its action including a rational connection between the facts found and the choice made." *Farmers Union*, 734 F.2d at 1499-1500.

All that FERC can offer in its brief (p. 32) is a passage from Order No. 2000 stating that the elimination of the utilities' own rate filing powers is "necessary" to ensure the RTO's independence. This passage has already been addressed by petitioners (Br. at 50-51), who pointed out that its language is vague, its reasoning is circular, and that its substance falls far short of justifying the Commission's action. The central unanswered question is: why is independence in ratemaking necessary at all? Like Order No. 2000, FERC's brief is silent on this point.

Intervenors seek to come to the rescue of FERC by relying upon a ground not presented by FERC, either in the relevant portion of its Order or in its brief. *See SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947). Citing to other portions of Order No. 2000, the intervenors argue that vesting ISOs with exclusive ratemaking authority is necessary to eliminate pancaking of transmission access charges. Brief of Intervenors In Support of FERC, at 6-10.

FERC did not rely on "pancaked rates " as a justification for exclusivity, and for good reasons. First, "pancaking" of transmission charges—separate charges for the crossing of each utility's transmission system—has not been held to be, in itself, "unjust and unreasonable" within the meaning of Section 205.[8] Second, if

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[8] In an earlier decision, FERC found that "pancaked" rates are *not* unjust and unreasonable and this Court sustained that judgment. *See Fort Pierce Utilities Authority v. FERC*, 730 F.2d 778 (D.C. Cir. 1984).

FERC now views pancaked rates as unlawful, it could eliminate such rates without interfering with the utilities' Section 205 rights. If FERC can show that such rates are unjust and unreasonable, it could invoke its true powers under Section 205 to reject any such rate filings. But the elimination of "pancaked rates" clearly does not require a rule that the ISO have the *exclusive* power to file rates for transmission service to the public. As long as the Commission requires a single transmission rate for any transmission transaction within the RTO, it is immaterial whether the owners may have had some role in designing it. For example, the NY ISO transmission owners provide regional transmission service at non-pancaked rates through an independent ISO while maintaining certain Section 205 filing rights. Thus, considerably less drastic alternatives are available to achieve the elimination of pancaked rates.

Indeed, intervenors' argument illustrates precisely what is wrong with FERC's action. They have identified a rate-design practice that has *not* been held to be unlawful. They suggest that FERC should deal with it, not by developing appropriate new ratemaking policies, but rather by substituting the ISO as the sole initiator of *all* transmission rates to the public. This kind of subterfuge—dictating particular kinds of rate filings by preempting the rate filing powers of the public utilities—is exactly what the courts have repeatedly held is beyond the FERC's reach. Utilities' Br. at 28-29; *Cf. Maislin,* 497 U.S. at 129-30, 132 (agency cannot adopt ratemaking principle without establishing unlawfulness of existing rates).

Order No. 2000 suffers from a profound disconnect between identified needs and prescribed remedies. It is predicated on findings that market participants perceive discrimination in the *operation* of the transmission grid. Since FERC may not have the ability to supervise those operations day-to-day, it has insisted that oversight of those operations be turned over to an independent system operator. However, FERC approves all initial rates and tariffs charged to customers for transmission service and reviews all filed modifications. It has no need to interject an ISO in this situation. In fact, neither FERC nor the intervenors have met petitioners' challenge of showing any form of discrimination in rates since the adoption of Order No. 888. If discrimination in rates is not a part of the problem, independence in ratemaking need not be a part of the solution.

B. FERC Has Not Shown That It Gave Reasoned Consideration To The Risks Inherent In Allocating Exclusive Rate Design Authority To The ISO.

At the same time that FERC has failed to present a good reason for exclusive ISO control over rate design, FERC has failed to present any serious analysis of the risks created when prices for services provided by the transmission assets are not set by their owners. Petitioners described the risks faced by transmission owners who place billions of dollars of transmission assets in an ISO. Utilities' Brief at 37-39. The utilities' ties with their many customers are severed and replaced with one entity that has no assets and is independently managed by persons who represent other constituencies and interests. *Id.* Petitioners showed that each of the supposed protections for the owners was illusory, since the ability of the ISO to meet their revenue requirements was ultimately dependent upon the revenues raised through rates charged the public for transmission services. *Id.* at 40-48.

In its responsive brief, FERC ignores these obvious problems. It simply repeats the deficient reasoning in Order No. 2000. FERC's Brief at 36-37. For example, it once again asserts that the utilities could obtain contractual protections from the ISO, but does not try to explain why a contractual obligation would have any value if the ISO has no assets to back it up. It also persists with the thought that "[n]othing in Order No. 2000 precludes transmission owners from participating in, but not controlling, RTOs' designing of rates to transmission customers," (FERC Br. at 37), even though the regulation on its face refers to the need for "independent" and "exclusive" RTO authority over rate filings.

FERC does not even address the procedural nightmare created by its scheme under which transmission owners participate as intervenors in proceedings relating to rates for transmission services using their transmission assets, while customers participate as intervenors in proceedings to set revenue requirements for the owners. Under that approach, petitioners pointed out (Br. at 43-44), transmission owners would not only lose the right to select the initial rate and to determine the timing of the filing, but would not even be able to receive any retroactive relief if they did ultimately prove that the rate chosen by the ISO was too low. On this point, FERC did not have a word of comfort or explanation.

This Circuit's precedent, of course, requires more from the agency. *See, e.g., Jersey Central,* 810 F.2d at 1175-82; *Farmers Union*, 734 F.2d at 1510-27. Where an administrative agency changes its course, this Court has required the agency to provide more support for its decision than would be required in the case of a new decision. Here, FERC changed rules and practices that had been consistent for 60 years. It is asking investor-owned utilities to place billions of dollars of transmission assets under the control of independent entities, as has already been done in California. In view of the gravity of the risks and the severity of the departure from traditional ratemaking, FERC is required to give meaningful consideration to the risks involved and possible means of mitigating them.

IV. FERC ONCE AGAIN FAILS TO RESPOND TO THE ARGUMENT THAT ORDER NO. 2000 DEPRIVES TRANSMISSION OWNERS OF CONTRACTUAL RIGHTS UNDER THE *MOBILE-SIERRA* DOCTRINE.

In their opening brief (at 53-57), petitioners argued that, under the *Mobile-Sierra* doctrine,[9] transmission owners may enter into an RTO agreement that limits, by contract, the RTO's ability to make unilateral tariff modifications under Sections 205 and 206. FERC's sole rejoinder is that petitioners fail to recognize that an RTO is a "public utility" under the FPA. *See* FERC's Br. at 33. This one-sentence response completely misses the point, as the *Mobile-Sierra* doctrine applies to *all* public utilities. Consequently, FERC's generic refusal to permit an allocation of Section 205 filing rights by contract represents a dramatic departure from established law.

The freedom of contract protected by *Mobile-Sierra* ensures that the parties have the right to define their respective Section 205 filing rights concerning proposed tariff changes, to determine the standard of review to be applied by the Commission, and to allocate the burden of proof. *Papago Tribal Utility Authority v. FERC*, 732 F.2d 950, 953 (D.C. Cir. 1983). Order No. 2000, however, does not permit the parties to make such allocations of filing rights and burdens. For example, by insisting that RTOs have exclusive Section 205 filing rights, FERC

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[9] *Mobile*, 350 U.S. 332; *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

ensures that RTO filings can be reviewed only to determine whether the proposed change constitutes one of several potentially just and reasonable results. Moreover, the burden of proof in challenging RTO-proposed modifications would be placed on the party challenging the modification—the transmission owner.[10] By stark contrast, where the RTO is by contract limited to proposing modifications under Section 206, the RTO would have the burden to show that the proposed change is required by the public interest.[11] Thus, the categorical insistence in Order No. 2000 on exclusive Section 205 filing rights for the RTO prevents the parties from proposing their own arrangements for sharing responsibility for tariff changes as contemplated by *Mobile-Sierra*.

FERC's assertion that RTOs are "public utilities" (FERC's Br. at 33) fails to confront the plain fact that Order No. 2000 alters the statutory framework of the FPA as interpreted by the Supreme Court under the *Mobile-Sierra* doctrine. This fundamental change results from the fact that, while FERC categorizes RTOs as public utilities, it also denies them the discretion as public utilities to limit their Section 205 rights by contract. Because this view contradicts the core principle of *Mobile-Sierra*—that a utility can bind itself by contract with regard to the filing of new rates—this Court is not required to give it deference. *Demarest v. Manspeaker*, 498 U.S. 184 (1991); *Pubic Employees Retirement System of Ohio v.*

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10 *See cases cited in* Utilities Br. at 55-56 n. 20.

11 *Id.*

Betts, 492 U.S. 158 (1989); *ANR Pipeline Co. v. FERC*, 870 F.2d 717, 720 (D.C. Cir. 1989).

Furthermore, FERC's decision to endow RTOs with exclusive Section 205 filing rights stands in direct contradiction to its pre-Order No. 2000 orders approving the New York Independent System Operator ("NYISO"), wherein Section 205 filing rights are divided between the NYISO and its participating Transmission Owners and decision-making on tariff modifications is shared by a non-stakeholder ISO Board and a Management Committee comprised of representatives from all market sectors. *Central Hudson Gas & Electric Corp., et al.*, 88 FERC ¶ 61,138 (1999). FERC discussed in Order No. 2000 the bifurcated governance structure in New York without holding it inconsistent with the independence criterion under the Final Rule. Order No. 2000 at 31,073; J.A.__. FERC also concluded in Order No. 2000 that "[w]hat the Commission has approved for ISO forms of governance can be used as models for governance of RTO's that are ISOs." Order No. 2000-A at 31,232; J.A.__. Therefore, the Final Rule is not only at odds with the *Mobile-Sierra* doctrine allowing RTOs to limit contractually Section 205 filing rights, it represents a change in policy contrary to pre-existing FERC precedent.

Order No. 2000's dramatic departure from established law has not been acknowledged or explained by FERC.[12] However, this court has held that a federal

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[12] The courts have previously noted FERC's marked insouciance, if not outright hostility, towards the *Mobile-Sierra* doctrine over the past thirty years. *See, e.g.*, *Boston Edison Co. v. FERC*, 233 F.3d 60, 68 (1st Cir. 2000); *Papago*

(Continued ...)

agency "must conform to its prior practice and decisions or explain the reason for its departure from such precedent." *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971). No such explanation was provided in the instant case.

V. FERC HAS FAILED TO RESPOND TO THE NEW YORK TRANSMISSION OWNERS' OPEN ARCHITECTURE CONCERNS.

The Open Architecture policy incorporated in the RTO regulations also contravenes the *Mobile-Sierra* doctrine. Indeed, FERC compounds its error in rejecting the parties' attempts to allocate Section 205 rights by contract when it insists that transmission owners who transfer operational control[13] over their facilities to RTOs should have no ability to ensure via contract that fundamental contractual or tariff provisions originally agreed upon and approved by the Commission are not later unilaterally altered by the RTO. This form of contractual restriction on future changes is essential to protect the fundamental interests of the transmission owners' customers, shareholders and bondholders. Thus, the Commission's Open Architecture policy—which would eviscerate any such

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Tribal Util. Auth. v. FERC, 610 F.2d 914 (D.C. Cir. 1979); *Richmond Power & Light Co. v. FPC,* 481 F.2d 490, 496-97 (D.C. Cir.), *cert. denied,* 414 U.S. 1068 (1973).

[13] The term "operational control" does not mean that RTOs will physically operate the Transmission Owners' facilities in the traditional sense of the word. Transmission Owners will continue to physically operate their respective transmission facilities subject to coordination by the RTO.

contractual agreements—exacerbates the negative impact of the Final Rule on the transferred investments of the Transmission Owners.

The NY Transmission Owners pointed out in the opening brief that FERC has acted inconsistently with its findings in Order No. 2000-A when it refused to modify the categorical ban in §35.34(l) to permit some limitations on the RTO's ability to modify its enabling agreement with the transmission owners. Utilities' Brief at 60-61. FERC's brief does not answer this point.

FERC suggests that any RTO-proposed changes would require Commission approval. FERC's Brief at 42-43. However, this suggestion misunderstands the NY Transmission Owners' concerns. The NY Transmission Owners have objected to according RTOs the power to change unilaterally the terms of their enabling agreements. FERC recognizes the validity of this concern, but fails to recognize the different rights accorded parties and FERC under Section 205 as opposed to Section 206. Under FERC's Open Architecture policy, the RTO need not show under Section 206 that an existing contract term has become unreasonable and contrary to the public interest, but only that its proposed change under Section 205 is one of many potentially just and reasonable alternatives. FERC's attempt to prevent the parties from exercising their *Mobile-Sierra* rights to define, by contract, the ability of RTOs to unilaterally change the terms and conditions for operational control over the billions of dollars in assets that were transferred to them without meeting the higher standard under Section 206 is neither lawful nor even explained by the Commission.

Moreover, FERC has failed to reconcile its Open Architecture policy with its recognition of the importance of limiting an RTO's ability to change certain provisions prior to the time it commences operation. FERC recognized on a parallel issue in Order No. 2000-A the importance of such advance notice:

> We continue to believe that liability issues should be addressed on a case-by-case basis. We agree with Duke that it is important that issues concerning liability and how liability provisions can or cannot be changed over time should be addressed during the collaboration process and resolved before the RTO begins operation.

Order No. 2000-A at 31,373-74; J.A. __. FERC's reasons for providing advance notice with respect to liability provisions that "can or cannot be changed over time" have direct application to RTO enabling agreements as a whole. *See* Utilities' Brief at 60-62.

FERC has presented *no* basis, reasonable or otherwise, upon which to reconcile its Open Architecture policy with the FPA or the *Mobile-Sierra* doctrine and thus this policy must be rejected.

VI. FERC'S RESPONSE ON TRANSMISSION EXPANSION AND INTERCONNECTION IS INCONSISTENT WITH ORDER NO. 2000 AND IS MERELY A POST HOC RATIONALIZATION.

As the NY Transmission Owners previously demonstrated, FPA Sections 210, 211 and 212 require that *FERC* find, among other things, that expansion or physical interconnection with a utility is in the public interest and that the Transmission Owner's costs are recoverable before a utility can be required to make the investment necessary to expand its system or to provide a physical interconnection. 16 U.S.C. §§824i, 824j, 824k (1994); *see also* Utilities' Brief at 63. At every possible juncture of the Order No. 2000 process, the NY Transmission Owners have sought reassurance from FERC that the creation of an RTO will not deprive them of these important statutory rights. Indeed, in Order No. 2000-A, FERC stated:

> NY Transmission Owners seek three clarifications on planning and expansion issues: ... (2) clarify that the Commission intends to require RTOs to adhere to the statutory requirements under FPA Sections 210, 211 and 212 concerning any mandated interconnections or expansions, including statutory provisions respecting cost recovery...

Order No. 2000-A at 31,381; J.A. __. FERC clearly understood the NY Transmission Owners' request for rehearing, and at no point in its response did FERC state that Sections 210-212 were irrelevant.

Now, in its brief, FERC's counsel contends that Sections 210-212 have no applicability to its decision that an RTO have responsibility for planning, directing and arranging expansions within its region. FERC's Brief at 40. Moreover, FERC's counsel now asserts that the Commission expressly stated it did not, and need not, rely on its authority under Sections 210-212 for any of the Order No. 2000 requirements. *Id.* However, FERC's statement was contained in a broader discussion of statutory authorities that "may be relevant to encourage RTOs." Order No. 2000 at 31,046; J.A.__. Contrary to FERC's implication, FERC did not include in its discussion of expansion and interconnections any statement that it was not relying and did not need to rely on Sections 210-212 for authority concerning RTO-mandated expansions, interconnections and compensation related thereto. *See* Order No. 2000 at 31,157-167; J.A.__; Order No. 2000-A at 31,380-382; J.A.__. Nor does FERC point to any other authority for ordering expansion or interconnection.

If FERC had concluded that Sections 210-212 were inapplicable, one would expect that FERC would have so stated in direct response to the NY Transmission Owners' request for rehearing. Yet, FERC was silent on this issue. Instead, FERC paraphrased what it understood the NY Transmission Owners' concerns to be, and claimed to agree with them by stating, "[w]e agree that a transmission owner is entitled to compensation for construction undertaken at the direction of an RTO . . ." *Id.*

The response of FERC's counsel on brief that the Commission did not, and need not, rely on Sections 210-212 of the FPA is nothing more than a post hoc rationalization developed in response to the NY Transmission Owners' appellate arguments. As such it is entitled to no consideration. *Burlington Truck Lines v. U.S.*, 371 U.S. 156, 168-69 (1962); *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1575 (D.C. Cir. 1993).

The NY Transmission Owners requested that FERC clarify that it would fulfill its statutory responsibilities by requiring expansions and interconnections under the RTO structure to be consistent with Sections 210-212 and reviewing such expansions and interconnections and permitting only those that meet the statutory criteria. FERC failed to provide the requested clarification. Its argument that it responded to the NY Transmission Owners' "real concerns" and that they are now barred from seeking review of a favorable decision is untenable. FERC's Brief at 40-41. The Court should reverse and remand this portion of the Final Rule with instructions that FERC provide that any expansion or interconnection of transmission facilities will be consistent with and considered pursuant to FPA Sections 210-212.

CONCLUSION

The Court should vacate the portions of the Orders identified herein and remand for further proceedings.

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CERTIFICATE OF LENGTH

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 7,994 words as determined by the word-counting feature of Microsoft Word 8.0.

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I, ALICE E. LOUGHRAN, hereby certify on February 7, 2001, I caused a true and correct copy of JOINT REPLY BRIEF OF JURISDICTIONAL UTILITIES to be served, by delivery in the United States Mail, first class postage prepaid, on counsel for respondent and all other counsel of record, as identified in the attached service list.

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