No. 13-443

In the Supreme Court of the United States

MICHIGAN ATTORNEY GENERAL BILL SCHUETTE, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

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INTRODUCTION

The Seventh Circuit's decision conflicts with long-established D.C. Circuit precedent concerning the "cost-causation" standard. Under that standard, costs assessed against utilities must be proportional with the project benefits, "comparing the costs assessed against *a party* to the burdens imposed or benefits drawn *by that party*." *Midwest ISO Transmission Owners* v. *FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004) (emphasis added). Both the Commission and MISO claim that there is no circuit split, emphasizing that the Seventh Circuit "expressly acknowledged" the cost-causation principle and quoted some of the same D.C. Circuit cases cited by Petitioners. But acknowledging the principle is different from adhering to it.

The Seventh Circuit departed from the party-specific cost-causation principle when it held that the requirement was satisfied because *all* grid users can be presumed to gain *some* benefit from any new transmission project that increases grid reliability and because only a "crude" comparison of costs and benefits was possible. Pet. App. 14a. That holding effectively dispenses with the requirement of *any* comparison—"crude" or otherwise—of benefits to and costs imposed on grid users in the now 15-state MISO area. It was enough, the Seventh Circuit held, that MISO had proffered a study estimating that the total benefits of the so-called multi-value projects to *all* users would exceed the *total* costs, Pet. App. 12a–13a, and "that there is no reason to think" that the overall environmental and reliability benefits of the subsidized wind-power projects "will be denied to particular subregions of MISO." Pet. App. 14a.

Under the cost-causation principle as the D.C. Circuit has long construed it, Michigan's minimal interconnection to the MISO electric transmission system—an undisputed record fact—is dispositive. Significantly, neither MISO nor the Commission even attempt in their respective briefs to rebut the Petitioners' showing that:

- Only 3.5% of Michigan's interconnections to the electric grid are through MISO. Pet. App. 82a.

- Michigan utilities—and their customers—are nonetheless being required to pay the costs of all MVP transmission projects—regardless of location—based upon Michigan's share (approximately 18%) of the total electricity consumed in MISO as a whole. Pet. App. 84.

- It is therefore impossible for the benefits realized by Michigan's customers to be even "roughly" proportional to the costs imposed on them for those projects. Pet. App. 81a–84a.

- The Seventh Circuit's premise that "the construction of high voltage lines from Indiana to Michigan is one of the multi-value projects and will enable more electricity to be transmitted to Michigan at lower cost," Pet. App. 16a, is flatly contradicted by the record. Pet. 14, 18.

In addition to the legal significance of the split with the D.C. Circuit, which considers most petitions for review of Commission decisions, this case presents issues of exceptional practical significance.

The Commission orders at issue involve the allocation of more than $4.5 billion in costs for the 16 "starter MVP" projects already approved. And those initial projects "are just the beginning," Pet. App. 12a, of an anticipated stream of other very costly transmission lines within MISO's "multi-value project" scheme approved by the Commission and upheld by the Seventh Circuit.

Those enormous costs will be imposed upon individuals and businesses throughout Michigan and in 14 other states within MISO. Moreover, the Seventh Circuit's virtual evisceration of the cost-causation principle in this case can only encourage other regional transmission organizations to embark on similar efforts to socialize hugely expensive wind farm projects across state lines without due regard to the benefits realized—or not realized—within the various states forced to pay for them and the varying policies of those states concerning renewable energy. This Court should grant review.

ARGUMENT

I. The Seventh Circuit's decision conflicts with the legal standards established by the D.C. Circuit to determine "just and reasonable" utility rates under 16 U.S.C. § 824d.

The Seventh Circuit's opinion pays lip service to the "cost-causation" principle established by the D.C. Circuit. It quotes *K N Energy*, *Inc.* v. *FERC*, 968 F.2d 1295, 1300 (D. C. Cir. 1992), for the proposition that "all approved rates [must] reflect to some degree the costs actually caused by the customer who must pay

them," and it also quotes *Midwest ISO Transmission Owners* v. *FERC*, 373 F.3d at 1368. Pet. App. 5a. But the Seventh Circuit's substantive holding in this case violates the cost-causation principle, creating a circuit conflict warranting review by this Court.

Like the Commission, Br. in Opp. 17, the Seventh Circuit rebuts an argument no one is making: that the MVP criteria cannot "ensure[ ] that every utility in MISO's vast region will benefit from every MVP project, let alone in *exact proportion* to its share of the MVP tariff," and that "[i]t's impossible to allocate these cost savings with any *precision* across MISO members." Pet. App. 11a, 13a (emphasis added). But Petitioners are not seeking exact proportionality. They simply seek a meaningful "compar[ison of] the costs assessed against *a party* to the burdens imposed or benefits drawn *by that party*." *Midwest ISO Transmission Owners*, 373 F.3d at 1368 (emphasis added).

The Seventh Circuit effectively eschewed even the most minimal party-specific comparison. Instead, it relied on (a) MISO's estimates of *total* project costs and benefits; (b) the Commission's conclusory assertion, unsupported by substantial evidence in the record, that certain estimated savings would be "spread almost evenly across all Midwest ISO planning regions"; (c) the Court's observation that there was no reason to believe that perceived (albeit unquantified) environmental benefits of wind power would be denied to particular subregions of MISO; and (d) a presumption that any new transmission line provides *some* benefit of increased reliability to any party connected to the grid. Pet. App. 12a–14a.

What the Seventh Circuit did not require (contrary to the standard articulated by the D.C. Circuit), and the record does not contain, is some—any—comparison of costs and benefits *to parties* and substantial evidence that the costs imposed upon Petitioners are even "roughly" proportional to any benefits Petitioners will derive from the MISO's multi-value projects. Indeed, the unrebutted record evidence of Michigan's minimal interconnection to MISO shows just the opposite is true.

Contrary to the suggestions by the Commission, Br. in Opp. 11, 14, 16, and MISO, Br. in Opp. 13, neither *Western Massachusetts Electric Co.* v. *FERC*, 165 F.3d 922, 927 (D. C. Cir. 1999), nor *Midwest ISO* obviate the particularized comparison of costs and benefits required under the cost-causation principle established by the D.C. Circuit, or support the Seventh Circuit's holding here. Indeed, *Midwest ISO* itself repeats that requirement. 373 F.3d at 1368.

In *Midwest ISO*, the costs the court determined could be spread across all the users were truly regional costs—"the administrative costs of *having* an [independent system operator]" for the region. 373 F.3d at 1369 ("MISO's startup expenses"). But the D.C. Circuit still emphasized that "the costs of *using* the system" should be tied to "the specific benefit of *using*" the system, *id.* at 1371, which is consistent with its repetition of the principle that courts must "compare the costs assessed against a party to the burdens imposed or benefits drawn by that party," *id.* at 1368.

In *Western Massachusetts*, a utility argued that certain upgrades to its transmission facilities made after a new generating facility connected to it benefitted *only* the newly connected generator. On that basis, the utility argued before the Commission that *none of the costs* of the upgrades should be "rolled into" the transmission rates the utility charged all of its customers. 165 F.3d at 924 (utility arguing the generator should bear "the entire cost" of the grid upgrades).

After a full evidentiary hearing, which included specific testimony about the physical configuration of the upgrades and the expected use of the upgraded facilities by other customers, the Commission disagreed with the utility. And consistent with its policy, the Commission assigned the cost of system-wide benefits "to all customers on an integrated transmission grid." *Id*. The D.C. Circuit affirmed, holding that the Commission's "presumption of a system-wide benefit was . . . based on substantial evidence" in the record. *Id*. at 928. But the court also recognized that a new generating facility that intentionally "located its plant far from the utility's lines knowing that the interconnection costs would be spread among the utility's customers"—as the wind farms are doing here—would have to deal with resistance from the utility, and "would wind up paying for the interconnection," which would encourage it to "keep the costs of interconnection at a minimum." *Id*. Thus the D.C. Circuit did not abandon cost-causation, but rather believed the market would deter that sort of cost-shifting.

In short, *Western Massachusetts* and similar cases simply held that customers on a fully integrated grid benefitted from it, and could therefore properly be charged *at least some* of the costs of grid upgrades—a proposition Michigan does not dispute. They neither considered nor decided the issue presented here—whether a cost-allocation scheme that allocates 18% of a grid upgrade's cost to a state that has only 3.5% of its interconnections on that grid, while allocating *none* of the cost to the new generators connecting to the grid, can satisfy the cost-causation proportionality standard.

The Commission's and MISO's other arguments in opposition are likewise without merit. First, the fact that the Commission order requires MISO to provide annual status reports on MVPs is of no legal significance. The possibility that the Commission might in the future "modify or rescind its approval of the MVP tariff," Pet. App. 12a, does not cure the legal deficiency of the Commission's order approving rates that are not, on the existing record, "just and reasonable" as required by 16 U.S.C. § 824d.

Second, the Commission's assertions about its cost-causation analysis—that it "conducted an exhaustive analysis of benefits that would be realized by Michigan utilities specifically from the MVP program" and that the analysis satisfies the cost-causation principle—do not withstand scrutiny. Comm'n Br. in Opp. 18–19. To begin, the Commission's analysis, Hoosier App. 149–53, looks at only half of the necessary comparison: it considers only claimed benefits to Michigan and does nothing

whatsoever to compare the claimed benefits, even crudely, to the costs imposed.

And, even as to the purported benefits, it certainly is not "exhaustive." On the contrary, the Commission's discussion is one-sided. With the exception of a footnote briefly referring to correspondence from Michigan's Governor and Chamber of Commerce, the Commission relies exclusively upon materials submitted by MISO. It ignored two extensive affidavits submitted by Petitioners, Pet. App. 79a–129a, which presented specific facts disputing MISO's claims. Among other things, the affidavits also directly refute the Commission's assertion that the MVP projects would relieve alleged congestion and transmission constraints within Michigan and strengthen Michigan's connections to the network. Hoosier App. 148–51. In fact, the uncontroverted evidence in the record showed that none of the proposed MVPs, including the Michigan Thumb Project, would provide *any* new connections between Michigan and the rest of MISO, Pet. App. 126a, and that, even with the starter MVPs, only 3.5% of Michigan's grid interconnections are to MISO. Pet. App. 82a.

Third, the Commission's and MISO's emphasis on the stakeholder "negotiation" that preceded MISO's submission of its MVP proposal to the Commission is legally misplaced. Comm'n Br. in Opp. 6, 26; MISO Br. in Opp. 17–18. An advisory stakeholder process is no substitute for actual regulatory oversight.

The Seventh Circuit's departure from the cost-causation principle established by the D.C. Circuit warrants review by this Court.

II. The Seventh Circuit's decision denying an evidentiary hearing conflicts with D.C. and First Circuit precedent.

The Commission must hold an evidentiary hearing "'when a genuine issue of material fact exists,'" unless the disputed issues "'may be adequately resolved on the written record.'" *Cajun Elec. Power Co-Op, Inc.* v. *FERC*, 28 F.3d 173, 177 (D.C. Cir. 1994). Here, the disputed issues could not be, because Petitioners "proffered several facts that raise serious doubts" about the decision and that "FERC has not adequately addressed." *Id.*

Here, the extensive affidavits Petitioners submitted to the Commission, Pet. App. 79a–129a, raised material factual disputes regarding the relative costs and benefits of the MVP proposal to Michigan utilities and ratepayers and regarding the asserted reasonableness of the tariff. Hoosier App. 304; Pet. 22. The Seventh Circuit brushed aside the Commission's denial of Petitioners' hearing and discovery requests with the conclusory statement that the disputed issues could be adequately resolved on the basis of written submissions. Pet. App. 17a.

The Commission now asserts that "Petitioners . . . do not claim that FERC failed to consider the written materials they submitted." Comm'n Br. in Opp. 27. That is simply untrue. To the contrary, the Petitioners argued that the Commission "ignored"

and "fail[ed] to meaningfully address" the Petitioners' affidavits. Pet. 6, 25.

Moreover, the record does not support the Commission's suggestions that it specifically recognized and adequately resolved the factual issues presented in the Petitioners' written submissions, Comm'n Br. in Opp. 27–28. None of the three cited excerpts from the Commission's decision support those conclusions. As noted above, the first excerpt, Hoosier App. 147–53, does not even mention, let alone provide any reasoned response to, the Petitioners' affidavits. The second excerpt, Hoosier App. 382–83, briefly summarizes some of Petitioners' contentions and references one affidavit, but provides no response to or analysis of it. The third, Hoosier App. 476–79, neither mentions nor responds to any of the affidavits.

Indeed, the closest these come to addressing the issues is that the third briefly mentions (but does not respond to) a comment separately submitted by one of the Petitioners, the Michigan Public Power Association, noting that Michigan utilities would be required to pay approximately 20% of the cost of the projects proposed by MISO, while not obtaining any benefit under Michigan's renewable energy statute.

The Commission also noted separate comments from another Michigan-based organization (not one of the Petitioners) that Michigan ratepayers would receive little or no benefit from distant MVP projects. In response, the Commission made general assertions, unsupported by any data or analyses, that "the strongly-integrated transmission network provides reliability and efficiency benefits to all that

are interconnected to it." Hoosier App. 477. But the Commission neither acknowledged nor responded to the Petitioners' affidavits demonstrating the minimal extent of Michigan's interconnection to the rest of MISO. And, most importantly, the Commission pointed to no facts in the record, or a reasoned explanation of how, under the circumstances, the generalized benefits to Michigan's ratepayers could possibly be even roughly commensurate with the costs imposed on them.

In sum, here, as in *Cajun Electric Power Co-Op, Inc.*, 28 F.3d at 180, the Commission "ignored [an] important question of fact" and, as in *Central Maine Power Co.* v. *FERC*, 252 F.3d 34, 47 (1st Cir. 2001), failed to adequately address issues that "require more reasoned consideration than FERC afforded."

Under these circumstances, the Seventh Circuit departed from the established precedent of the D.C. and First Circuits by failing to remand to the Commission for an evidentiary hearing.

The Seventh Circuit's omission was particularly troubling here. It not only upheld the Commission's arbitrary and unwarranted denial of Petitioners' hearing request, but then, like the Commission, faulted Petitioners for not more fully developing evidence and alternative analyses to those in MISO's application. Pet. App. 12a, 14a, 17a. Of course, that would only have been possible if the Commission had granted the Petitioners' hearing and discovery requests.

The Seventh Circuit emphasizes the "voluminous" nature of the record, Pet. App. 15a, and implies that the Petitioners had a full and fair opportunity before the Commission to develop a record to challenge the MISO's proposal. But this point rings hollow. Because of the denial of an evidentiary hearing and discovery, the "voluminous" evidence in the record is largely the one-sided evidence submitted by MISO, evidence that the Commission did not allow anyone to test. Billions of dollars are at stake and not a single party was allowed to ask for a single piece of information in discovery. Nor was a single party allowed to ask a single question on cross-examination about how MISO purported to determine the benefits that would accrue to Michigan ratepayers and that the asserted benefits were even roughly commensurate with the costs.

CONCLUSION

Given the circuit split resulting from the Seventh Circuit's decision and the magnitude of the interests involved, this Court should grant review.

Respectfully submitted,

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Dated: JANUARY 2014