

125 FERC ¶ 61,316
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Southern Company Services, Inc.

Docket No. ER09-88-000

ORDER CONDITIONALLY ACCEPTING TARIFF AMENDMENTS

(Issued December 18, 2008)

1. On October 17, 2008, Southern Company Services, Inc. (Southern), acting as agent for Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company and Southern Power Company (collectively, Southern Companies), submitted revised and new tariff sheets to Southern Companies' market-based rate tariff (Amended Tariff Sheets).¹ The Amended Tariff Sheets would establish Day-Ahead and Hour-Ahead energy auctions (Proposed Auctions) in the Southern Balancing Authority Area.

2. Southern Companies have proffered an innovative proposal to advance the goals of increasing price discovery, transparency and liquidity in Southeastern bilateral markets. This proposal is recognized even by protestors as a significant positive step forward. Southern Companies propose to amend their tariff so that they can obtain a finding from the Commission that the auction proposal will mitigate prospectively any ability that Southern Companies may have to exercise market power in the Southern Balancing Authority Area, and to avoid further litigation over their market-based rate authority. Southern Companies currently have Commission authorization to sell power and energy at market-based rates, and Southern Companies could have implemented the Proposed Auctions without seeking to formally amend their market-based rate tariff. This order conditionally accepts Southern Companies' proposal, including the Amended

¹ Southern Company Services, Inc., Proposed Amendment to Southern Companies' Market-Based Rate Tariff, Docket No. ER09-88-000 (Filed October 17, 2008) (Proposed Auctions Filing).

Tariff Sheets as set forth below. We direct Southern Companies to submit a compliance filing indicating whether and how they intend to proceed with revising the auction proposal, as conditioned herein.

I. Background

3. Southern Companies propose to institute, for at least a three-year period, an auction process for certain short-term energy products in the Southern Balancing Authority Area. Southern Companies explain that the Proposed Auctions do not replicate a “Standardized Market Design” wholesale market. Instead, the Proposed Auctions are a mechanism through which Southern Companies would make standardized cost-based wholesale offers to the existing marketplace. Southern Companies represent that this market structure reflects the implementation of the Commission’s open access policies, the implementation of state retail regulation, and integrated resource planning. As the companies note, the Southeastern United States is served principally by vertically integrated public utilities and other market participants that rely heavily upon self-owned generation and long-term wholesale contracts. According to Southern Companies, adding a standard, cost-based short-term auction to the market will enhance the options available to present and future market participants. Further, while Southern Companies understand that market participants would prefer a broader auction process, they state that accepting the Proposed Auctions at this time may demonstrate the potential viability of a broader platform and will enhance market options now without prejudicing further developments.

4. Southern Companies request that the Commission accept the Amended Tariff Sheets for filing without suspension, modification, condition, or hearing. Southern Companies contend that, if implemented, the Proposed Auctions would mitigate any perceived horizontal market power in the Southern Balancing Authority Area. Although Southern Companies assert that they do not possess horizontal market power, the companies claim that if the Commission finds that they do possess horizontal market power in the Southern Balancing Authority Area, then the Proposed Auctions are an adequate means to mitigate that market power.² If, on the other hand, the Commission finds that Southern Companies lack horizontal market power, Southern Companies urge the Commission to nonetheless approve the Proposed Auctions as a positive step towards enhancing transparency in Southeast wholesale electricity markets.

² Southern Companies do not believe that the Commission should consolidate consideration of the Amended Tariff Sheets with the proceeding on Southern’s Delivered Price Test (DPT), Docket No. EL04-124, or Southern Companies’ recently submitted market power update. *Updated Market Power Analysis of Southern Company Services, Inc.*, Docket No. ER96-780-020 (August 29, 2008).

5. In addition, the Amended Tariff Sheets obligate Southern Companies to report quantities and prices of sales made through the Day-Ahead and Hour-Ahead Auctions to either a reputable index developer or data hub.³ The Amended Tariff Sheets also obligate Southern Companies to make the market clearing prices of the Proposed Auctions publicly available.⁴ As such, the companies request that the Commission grant them safe harbor protection under *Policy Statement on Natural Gas and Electric Price Indices*.⁵ Specifically, Southern Companies request that the Commission “expressly confirm” that they will receive safe harbor protection consistent with the Policy Statement on Price Reporting.⁶ In the Policy Statement on Price Reporting, the Commission identified minimum standards for both price index developers and data providers, i.e. market participants that report transaction data to price index developers.⁷ With respect to data providers, the Policy Statement on Price Reporting sets out the steps they should take to ensure that the prices they report accurately reflect market activity.

6. Southern Companies request action by or at the December 2008 Commission meeting so that they can implement the computer and other systems required to operate the Proposed Auctions as quickly as possible.

A. Overview of Proposed Auctions

7. Southern Companies propose to condition their ability to sell at market-based rates within the Southern Balancing Authority Area on the establishment and operation of Day-Ahead and Hour-Ahead Auctions for an initial period of at least three years. Through the Proposed Auctions, Southern Companies would offer to sell at cost-based prices all of their Available Capacity. For purposes of the Proposed Auctions, Southern Companies define Available Capacity as any thermal Controlled Capacity⁸ that can be

³ Amended Tariff Sheets, Rules of Bid-Based Energy Auction, § 4.2.1

⁴ *Id.* § 4.2.3.

⁵ *Policy Statement on Natural Gas and Electric Price Indices*, 104 FERC ¶ 61,121 (Policy Statement on Price Reporting), *on clarification*, 105 FERC ¶ 61,282 (2003), *order on further clarification*, 112 FERC ¶ 61,040 (2005).

⁶ Proposed Auctions Filing at 35.

⁷ The Commission subsequently codified these requirements in 18 C.F.R. §35.41(c) (2008).

⁸ Controlled Capacity is capacity controlled by Southern Companies through ownership or contractual arrangement and is included by Southern Companies as a dispatchable resource.

dispatched to provide energy sold through the Day-Ahead Auction or the Hour-Ahead Auction, excluding capacity reasonably expected to serve load, capacity needed for operating reserves, capacity needed for existing third-party sales, and other capacity unavailable due to outage or other operational constraints.⁹

8. As proposed, Southern Companies would be the only sellers/offerors in the Proposed Auctions. Southern Companies explain that a single seller auction is appropriate because the Proposed Auctions mitigate concerns and allegations regarding Southern Companies' potential horizontal market power, not that of other market participants. In addition, according to Southern Companies, establishing the operational infrastructure for the Proposed Auctions would be more complicated if there was more than one seller. Since Southern Companies have designed the Proposed Auctions to be up and running on a very tight timeline, providing for additional sellers would interfere with Southern Companies' implementation schedule. Southern Companies state that, in due time, they are amenable to: (a) expanding the Proposed Auctions to include sellers other than Southern Companies; (b) working with market participants to move the Proposed Auctions to an independent administrator so other sellers could be added more easily; and/or (c) expanding the Proposed Auctions to include additional products.¹⁰

9. Southern Companies propose to have an "Auction Administrator," staffed by Southern Companies employees who meet the definition of "support employees," as specified in 18 C.F.R. § 358.4(a)(4), or employees performing similar "back office" administrative functions, initially manage and administer the Proposed Auctions.¹¹ Any audit processes would be overseen by an Independent Auction Monitor approved by the Commission.¹²

10. Southern Companies note that participants in the Proposed Auctions would not be restricted from pursuing bilateral purchases from the Southern Companies, except as expressly restricted by the Amended Tariff Sheets. Furthermore, Southern Companies assert that since they would continue to engage in market-based bilateral transactions

⁹ Proposed Auctions Filing at 9. Available Capacity is determined pursuant to Appendix DA-1 of the Amended Tariff Sheets for the Day-Ahead Auction and pursuant to Appendix HA-1 for the Hour-Ahead Auction.

¹⁰ Proposed Auctions Filing at 18-19.

¹¹ See Amended Tariff Sheets, Rules of the Bid-Based Energy Auction, § 2.1, 3.4.

¹² Southern Companies commit to submit a filing to the Commission proposing the Independent Auction Monitor within 30 days of an order approving the Proposed Auctions.

outside of the Proposed Auctions, parties contemplating bilateral transactions would take into account that Southern Companies, subject to third-party verification, would be offering all available uncommitted thermal resources through the Proposed Auctions at cost-based prices. Thus, Southern Companies assert that implementation of the Proposed Auctions will discipline behavior in the long-term markets.

B. Day-Ahead Auction

11. The Day-Ahead Auction would take place every business day, excluding weekends and North American Electric Reliability Corporation (NERC) holidays, provided that Southern Companies have Available Capacity to sell.¹³ Two products would be offered in the Day-Ahead Auction: (1) 50 MW blocks of Firm LD Energy¹⁴ for a term of 16 hours (6:00 a.m. through 10:00 p.m.), and (2) 50 MW blocks of Recallable Energy¹⁵ for the same 16 hour period. Southern Companies explain that they selected 50 MW blocks of energy because these blocks are a standard, frequently traded and well-understood commodity volume used for energy trades in the Southeast. Southern Companies opted for the 16 hour period term because the 6 a.m. to 10 p.m. time period encompasses the commonly recognized peak period hours in the Southeast.

12. There are three stages to the Proposed Auctions: the period prior to the opening of the bid period (Pre-Bid Period), the period during which bids may be submitted (Bid Period), and market clearing. During the Pre-Bid Period, Southern Companies would identify to the Auction Administrator the number of Day-Ahead Firm LD and Recallable Energy Blocks available for sale. The amount of Recallable Energy for sale would be based on: (a) generating units online, but indicating potential for unexpected outage; (b) generating units offline, scheduled to return, but indicating potential for delayed return; and (c) other generating units that cannot reasonably be offered except as Recallable Energy without impairing reliability. Day-Ahead Energy Blocks available but

¹³ The Day-Ahead Bid Period would begin at noon Central Prevailing Time (CPT), two NERC business days prior to the day of physical delivery, and end at 6:30 a.m. CPT, one day prior to the day of physical delivery.

¹⁴ Firm LD Energy is “Energy sold whereby a party shall be relieved of its obligations to sell and deliver or to purchase and receive without liability only to the extent that, and for the period during which, such performance is prevented by Force Majeure.” Amended Tariff Sheets, Rules of the Bid-Based Energy Auction, § 2.22.

¹⁵ Recallable Energy is “Energy sold whereby Seller, upon experiencing a supply side disruption, has the right, but not the obligation, to curtail the delivery of such Energy without liability on the part of Seller.” Amended Tariff Sheets, Rules of the Bid-Based Energy Auction, § 2.42.

not offered as Recallable Energy Blocks would be offered by Southern Companies as Firm LD Energy Blocks. Southern Companies note that given the limited circumstances in which Recallable Energy Blocks may be curtailed, the recallable product offered by Southern Companies is distinct from the standard, non-firm energy product generally traded in the marketplace today, where sellers can curtail for any reason, including economic reasons.

13. Southern Companies note that some Day-Ahead Energy Blocks may be linked to or contingent upon the sale of other Day-Ahead Energy Blocks. For example, if a unit can only be dispatched at a certain level, say 100 MW, then this unit would only clear if both of the 50 MW Energy Blocks from it were sold in the Day-Ahead Auction. Similarly, if a 600 MW unit had a minimum operating limit of 400 MW, the 200 MW of energy beyond the minimum operating limit from that unit would be contingent upon the first 400 MW clearing the Day-Ahead Auction: the 200 MW would only clear if the first 400 MW cleared. Southern Companies explain that where blocks of energy are contingent upon or linked to one another, they will notify the Auction Administrator.

14. After providing the number of available Day-Ahead Energy Blocks, but before the start of the Lock-Down Period,¹⁶ Southern Companies may notify the Auction Administrator of any change in the number of Day-Ahead Energy Blocks available for sale, provided that any change is the direct result of one or more of the following occurring after the initial notification: (a) a non-discretionary event affecting one of the primary inputs to the calculation of Available Capacity; or (b) Southern Companies entering into one or more sales of energy outside of the Day-Ahead Auction.¹⁷

15. Southern Companies would also notify the Auction Administrator of the Seller Offer Prices for each of the Day-Ahead Energy Blocks during the Day-Ahead Pre-Bid Period. The Seller Offer Price would be capped at the sum of: (a) the Average Variable Costs of a unit; (b) 10 percent of the Average Variable Costs of the unit; and (c) a Commission-approved demand charge.¹⁸ For Day-Ahead Energy blocks that are linked or contingent upon one another, the Seller Offer Price would also include Commitment Costs (startup costs).

¹⁶ The one hour period from 5:30 a.m. to 6:30 a.m. prior to the close of the Day-Ahead Bid Period

¹⁷ See Amended Tariff Sheets, Rules of the Bid-Based Energy Auction, § 5.2.1.2.

¹⁸ The \$21.43/MWh cost-based demand charge Southern Companies propose to include in the Seller Offer Price is part of a new cost-based rate tariff which was filed for approval on the same day as the auction filing. *Southern Companies' Cost-Based Rate Tariff*, Docket No. ER09-92-000 (October 17, 2008).

16. During the Day-Ahead Bid Period, Day-Ahead Auction participants would submit bids to purchase one or more of the Day-Ahead Energy Blocks offered by Southern Companies. Bids would be expressed as an implied heat rate in MMBtu/MWh, and could be modified or withdrawn at any time during the Day-Ahead Bid Period. During the Day-Ahead Bid Period, Southern Companies would refrain from making, other than through the Day-Ahead Auction, any sales of 50 MW Energy Blocks to be delivered in the Southern Balancing Authority Area for delivery during the 6 a.m. to 10 p.m. CPT time period on the Delivery Day that corresponds to the bid period. Subject to the Lock-Down Period restrictions, Southern Companies would still be permitted to sell other products pursuant to their market-based rate authority.

17. Once the Day-Ahead Bid Period closes, the Auction Administrator would evaluate the bids for Firm and Recallable Day-Ahead Energy Blocks and clear the auction. Day-Ahead Energy Blocks would be awarded as follows. First, all Day-Ahead Energy bids would be sorted in descending order (from highest to lowest implied heat rate) to simulate a downward sloping economic demand curve. Second, all Seller Offer Prices would be sorted in ascending order (from lowest to highest implied heat rate) to simulate an upward sloping supply curve. The intersection of the supply and demand curves would be determined by plotting the quantity on the curves where the next highest Day-Ahead Energy bid is less than the next lowest Seller Offer Price. Day-Ahead Energy bids which do not exceed this quantity on the demand curve would be granted their bid for Day-Ahead Energy blocks; bids which exceed this quantity would not be awarded Day-Ahead Energy Blocks.

18. Bidders awarded Day-Ahead Energy Blocks would pay a price calculated by multiplying the Henry Hub Midpoint gas price published by Platts Megawatt Daily for the Gas Flow Day by the implied heat rate representing the greater of (a) the highest non-winning Day-Ahead Energy Bid or (b) the Seller Offer Price of the last Day-Ahead Energy Block sold.

19. Once the Auction Administrator clears the Day-Ahead Auction, it would notify bidders of their awarded Day-Ahead Energy blocks. Upon being notified that they have been awarded Day-Ahead Energy Blocks, buyers would be responsible for taking delivery from the delivery point, including all transmission reservations and scheduling, pursuant to Southern Companies' Open Access Transmission Tariff (OATT).

20. With respect to Recallable Energy Blocks, Southern Companies would have the right to curtail delivery of such energy only in the event the company experienced a supply-side disruption affecting the Available Capacity offered in the Day-Ahead Auction. Southern Companies would curtail Recallable Energy Blocks in the priority order established by the Auction Administrator. Buyers with lower bid prices would be curtailed before buyers with higher bid prices, and in the event that two or more buyers had the same bidding price, bids submitted later in time would be curtailed prior to bids submitted earlier in time as between the buyers. Subject to reliability requirements,

buyers of Recallable Energy Blocks could request to not be curtailed at a price equal to the Hour-Ahead Auction market clearing price.

C. Hour-Ahead Auction

21. The Hour-Ahead Auction is based on the same framework as the Day-Ahead Auction, but would take place every hour of every day, including weekends and NERC Holidays. The Hour-Ahead Auction is limited to non-firm energy sales of one clock hour in duration. Bids to purchase energy through the Hour-Ahead Auction would be submitted in 1 MW increments (with a 1 MW minimum) and would be required to state the maximum price the bidder is willing to pay in \$/MWh.

22. Prior to the start of the Hour-Ahead Bid Period, Southern Companies would submit to the Auction Administrator a supply curve representing the amount of Hour-Ahead power available for sale for the next delivery hour¹⁹ and the associated Seller Offer Prices. The Hour-Ahead Bid Period would begin 60 minutes prior to the top of the delivery hour and end 45 minutes prior to the top of the delivery hour. The Hour-Ahead Lock-Down Period is a five minute period prior to the close of the Hour-Ahead Auction.

23. During the Hour-Ahead Bid Period, Southern Companies would refrain from making, other than through the Hour-Ahead Auction, any energy sales to be delivered at a point inside the Southern Balancing Authority Area for delivery during the delivery period corresponding to the Hour-Ahead Bid Period. During the Hour-Ahead Lock-Down Period, Southern Companies would refrain from making sales outside of the Hour-Ahead Auction process that would impact either the Available Capacity or the Seller Offer Prices of energy offered for sale in the Hour-Ahead Auction.

24. At the close of the Hour-Ahead Bid Period, the Auction Administrator would evaluate the received bids. As in the Day-Ahead Auction, a supply curve would be constructed and all Hour-Ahead Energy bids would be sorted from highest to lowest to simulate a downward sloping economic demand curve. The intersection of the Hour-Ahead demand and supply curves would be plotted by locating the quantity on the curves where the next highest Hour-Ahead Energy Bid is less than the next lowest Seller Offer Price. All Hour-Ahead Bids that do not exceed this quantity on the demand curve would be granted, unless any of the Hour-Ahead power is linked with other Hour-Ahead power with higher Seller Offer Prices that exceed the intersection point.

25. Southern Companies also note that if the marginal Hour-Ahead Energy Bid is willing to accept an amount of Hour-Ahead Energy that is less than the full amount in the

¹⁹ This amount is determined pursuant to Amended Tariff Sheets, Rules of the Bid-Based Energy Auction, Appendix HA-1.

Hour-Ahead Energy Bid, the Auction Administrator will accept the Hour-Ahead Bid to the extent the lesser amount of energy is available and offered at a price less than or equal to such marginal Hour-Ahead Energy Bid. If the marginal Hour-Ahead Energy Bid does not accept a lesser award, then the bid will be rejected.

26. Buyers of Hour-Ahead energy would pay a price based on the market clearing price, calculated as the greater of (a) the highest non-winning Hour-Ahead Bid or (b) the Seller Offer Price of the last MW sold in the Hour-Ahead Auction for such delivery hour. As with the Day-Ahead Auction, buyers would be responsible for taking delivery from the delivery point, including all transmission reservations and scheduling (i.e., tagging) requirements. In the event Southern Companies would need to curtail delivery of Hour-Ahead Power, they would do so in the order established by the Auction Administrator, as described above.

II. Notice of Filing and Responsive Pleadings

27. Notice of Southern Companies' filing was published in the *Federal Register*, 73 Fed. Reg. 63,956 (2008), with interventions and protests due on or before November 7, 2008.

28. Alabama Municipal Electric Authority, Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc., Sawnee Electric Membership Corporation and Coweta-Fayette Electric Membership Corporation, and South Mississippi Electric Power Association filed timely motions to intervene. Dalton Utilities filed a timely motion to intervene and supportive comments. Southeast Electricity Consumers Association (Southeast Consumers) filed a timely motion to intervene and protest. Shell Energy North America (US), L.P. (Shell) filed a timely motion to intervene and protest, and a motion to consolidate. Energy Consulting Group, LLC filed a motion to intervene out of time. J.P. Morgan Ventures Energy Corporation, BE Alabama LLC, BE Colquitt LLC, BE Rayle LLC, BE Satilla LLC and BE Walton LLC (collectively, J.P. Morgan Entities) filed a motion to intervene out of time and comments, which they subsequently moved to withdraw on December 17, 2008.²⁰

29. Dalton Utilities support the Proposed Auctions on the grounds that the auctions would supplement existing bilateral trading options, and provide an hourly spot market index, which would add transparency and facilitate efficient decisions with regard to supply development and demand side management. Dalton Utilities also state that the

²⁰ Request to Withdraw Out-of-Time Intervention and Comments of J.P. Morgan Ventures Energy Corporation, BE Alabama LLC, BE Colquitt LLC, BE Rayle LLC, BE Satilla LLC, BE Walton, LLC, Docket Nos. ER09-88-000 and ER09-92-000 (Dec. 17, 2008).

Proposed Auctions would mitigate potential market power concerns, even though they believe that short-term prices are competitive and reflect actual demand conditions.

30. Southeast Consumers express concerns about the impact of the Proposed Auctions on Southern Companies' retail customers. According to Southeast Consumers, if the Commission accepts the Proposed Auctions, then it must ensure that the auctions will not adversely affect Southern Companies' retail customers. Southeast Consumers are primarily concerned that the Auction, once implemented, will lead to substantially higher wholesale energy prices. Higher wholesale energy prices, Southeast Consumers explain, could result in a concomitant increase in energy prices for the Southern Companies' retail operating companies.²¹ Southeast Consumers assert that these higher costs will be passed on to retail customers via fuel adjustment mechanisms.²²

31. Shell commends Southern Companies for proposing the Day-Ahead and Hour-Ahead Auctions and views the Proposed Auctions as a positive step towards resolving market power issues in the Southern Balancing Authority Area. Shell, however, urges the Commission to set the Proposed Auctions for hearing. According to Shell, the Proposed Auctions cannot be implemented as proposed for several reasons. First, Shell asserts that a single seller auction would not provide adequate supply, liquid trading, or efficient price formation. Specifically, Shell claims that the alleged must offer requirement will not provide a reliable source of short-term power since the amount available is variable. Second, Shell contends that the cost-based offer cap will actually result in Southern Companies' resources being paid an amount significantly over their cost-based offer caps since *all* resources clearing the auction will receive the market clearing price set by the marginal unit. As proposed, Shell asserts that infra-marginal resources would earn revenues far above their cost offers. Third, Shell opposes Southern Companies' inclusion of a demand charge by arguing that it is unsupported by Commission precedent. Shell also claims that the Proposed Auctions will not adequately mitigate Southern Companies' horizontal market power and that the Commission should consolidate consideration of the Proposed Auctions with consideration of Southern Companies' 2008 Market Power Update.

²¹ Southern Companies state that “[r]etail ratepayers are entitled to a contribution to the fixed costs associated with the capacity that supports the proposed Auction mechanism and the resulting cost-based prices.” Proposed Auctions Filing at 25-26.

²² Southeast Consumers observe that their concerns are somewhat ameliorated by the fact that the Proposed Auctions are limited to sales by Southern Companies for resale, explicitly prohibit sales to affiliates, and that off-system sale margins will likely flow back to ratepayers.

32. On November 21, 2008, Southern Companies filed an answer to the Shell and Southeast Consumers protests.²³ Southern Companies assert that the Shell protest should be rejected because it lacks merit. Furthermore, Southern Companies allege that the issues raised by Shell are policy-based, not fact-based, and therefore do not require a hearing.

33. Responding to Shell's objection that the Proposed Auctions do not, as proposed, include other sellers, Southern Companies explain that since administration of the Proposed Auctions by an independent third-party may increase the likelihood and implementation of participation by additional sellers in the future, the companies would not object to the Proposed Auctions being administered by an independent third-party. Nevertheless, Southern Companies allege that whether other parties may sell through the Proposed Auctions is irrelevant to mitigating any perceived horizontal market power Southern Companies may have. According to Southern Companies, the key determination as to whether they can exercise horizontal market power is whether they can withhold supply from the market. Southern Companies claim that implementation of the Proposed Auctions would eliminate their ability to withhold supply.

34. In response to Shell's claim that the Proposed Auctions will not adequately mitigate market power concerns for longer-term markets and transactions, Southern Companies explain that the Commission has recently held that, absent barriers to entry, long-term capacity markets are inherently competitive, and that adequately mitigating horizontal market power in short-term markets would also mitigate horizontal market power in long-term markets. Thus, according to Southern Companies, without short-term horizontal market power or barriers to entry there can be no long-term horizontal market power. As a result, Southern Companies conclude that by mitigating their perceived ability to withhold supply in the short-term, the Proposed Auctions will also mitigate any perceived long-term horizontal market power. Southern Companies characterize Shell's arguments as collateral attacks on these recent Commission findings on long- and short-term market power and urge the Commission to reject them as such.

35. Regarding Shell's concern that energy from infra-marginal units will be sold at prices above their offer caps, Southern Companies claim that Shell's concern is misplaced. Southern Companies respond that selling energy from the infra-marginal units at prices above their offer caps is not an indication of horizontal market power, and that the pricing methodology for energy sold in the Proposed Auctions is "fundamentally no different" than the methodology used in energy markets administered by Independent System Operators (ISO) or Regional Transmission Organizations (RTO), which operate

²³ Request for Leave to Submit Answer and Answer of Southern Company Services, Inc., Docket No. ER09-88-000 (November 21, 2008) (Southern Companies Answer).

on a “pay as cleared” basis.²⁴ Southern Companies further argue that forcing infra-marginal resources to sell at less than the market clearing price would create a windfall for buyers who purchase power at below the market clearing price. According to Southern Companies, these entities would use the low priced power themselves or resell it at higher market prices. In either case, Southern Companies claim that sales of energy from infra-marginal units at market clearing prices are not an exercise of horizontal market power.

36. Southern Companies also respond to Shell’s allegation that including a demand charge is contrary to the Commission’s default mitigation for sellers that fail one of the indicative horizontal market power screens. Southern Companies argue that inclusion of the demand charge is not precluded by the Commission’s default mitigation practices since default mitigation does not foreclose consideration of other types of mitigation based on economic principles. Southern Companies also note that including a demand component for short-term sales is consistent with the structure of a variety of ISO/RTO capacity markets.

37. Finally, Southern Companies argue that the Commission should reject Shell’s motion to consolidate consideration of the Proposed Auctions with Southern Companies’ 2008 Market Power Update. According to Southern Companies, Shell’s request is based on a flawed conclusion that the Commission cannot evaluate the Proposed Auctions without analyzing Southern Companies’ horizontal market power. Southern Companies repeat their claim that the Proposed Auctions mitigate any “perceived horizontal market power” and, furthermore, that the issue of whether the companies have such market power is irrelevant since the Proposed Auctions will prevent any withholding by them. Southern Companies also assert that consolidating the dockets will likely delay the start of the Proposed Auctions. According to Southern Companies, if anything, acting on the Proposed Auctions should moot the need to continue proceedings with respect to the 2008 Market Power Update.

38. Southern Companies oppose the Southeast Consumers’ protest on the grounds that Southeast Consumers fail to name any legal entities that are represented by it or the association’s own status as a legal entity itself. Nonetheless, Southern Companies address Southeast Consumers’ concern that the Proposed Auctions may increase wholesale market prices by explaining that Southeast Consumers will maintain the right to seek redress for rates they believe are unjust and unreasonable under the Federal Power Act. Similarly, Southeast Consumers could pursue concerns related to retail rates before the relevant state commission. In either case, Southern Companies allege that Southeast Consumers’ concerns are unfounded since the Proposed Auctions will supplement

²⁴ Southern Companies Answer at 11.

existing energy markets rather than replace them, and a must-offer requirement and cost-based clearing price are unlikely to increase prices.

III. Discussion

A. Procedural Matters

39. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

40. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2008), the Commission will grant Energy Consulting Group, LLC's late-filed motion to intervene given its interests in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

41. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.213(a)(2) (2008) prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Southern Companies' answer because it has provided information that assisted us in our decision-making process.

42. The Commission grants J.P. Morgan Entities' request to withdraw their late-filed motion to intervene and comments.

43. The Commission rejects Shell's request to consolidate this proceeding with consideration of Southern Companies' updated market power analysis filed in Docket No. ER96-780-020. The Commission is concurrently issuing a separate order in that docket.

B. General Findings on the Auctions Proposal

44. A number of the intervenors in this proceeding have recognized that Southern Companies' proposal represents a significant step forward. Southern Companies deserve to be commended for introducing an innovative proposal to advance the goals of increasing price discovery, transparency, and liquidity in the Southeastern bilateral markets. The Commission also takes this opportunity to commend Southern Companies for undertaking this initiative and is encouraged by the many positive aspects of the proposal.

45. Because Southern Companies currently have Commission authorization to sell power and energy at market-based rates, Southern Companies could have implemented the Proposed Auctions without seeking to formally amend their market-based rate tariff. However, Southern Companies state that they propose to amend their tariff so that they can obtain a finding from the Commission that the auction proposal will mitigate

prospectively any ability that Southern Companies may have to exercise market power, and to avoid further litigation over their market-based rate authority.

46. As discussed further below, the basic structure of the auction proposal appears sound. According to Southern Companies, the Proposed Auctions include a must offer obligation for any Available Capacity, the requirement to make offer bids at cost, and a single market clearing price mechanism. In addition, the Proposed Auctions include an Independent Auction Monitor that would ensure that all Available Capacity is offered into the auctions and verify that the auctions were conducted properly.

47. We find that Southern Companies' Proposed Auctions implemented under the conditions set forth in this order will sufficiently mitigate any potential that Southern Companies may have to exercise market power in the Southern Balancing Authority Area.²⁵ If Southern Companies will implement the first condition when they launch the Proposed Auctions and they commit to implement the second condition within one year of the date of this order, then the Commission would be satisfied that the resulting auctions would be adequate to mitigate any potential market power that Southern Companies might have in the Southern Balancing Authority Area.

48. The first condition we impose on our acceptance of Southern Companies' Proposed Auctions, which must be implemented by the commencement of the auction, is that the role and responsibilities of the Independent Auction Monitor must be further developed. As an initial matter, the Auction Administrator and the Independent Auction Monitor must have confidential access to each other to ensure a free exchange of information. In addition to the responsibilities described in the Proposed Auctions Filing, Southern Companies must ensure that the Independent Auction Monitor is authorized to: (1) verify Southern Companies' Available Capacity calculations, including the companies' inputs into those calculations; (2) confirm that any transmission service necessary to accommodate a purchase under the auctions is not unreasonably withheld;²⁶ and (3) independently file reports with the Commission regarding the auction process as described herein.

²⁵ Southern Companies' proposal included a commitment to refrain from filing changes that would have the effect of terminating the Day-Ahead Energy Auction and the Hour-Ahead Energy Auction during an initial three-year period commencing on the date of the first auction. Proposed Auctions Filing at n.4. We accept that commitment.

²⁶ We presume that Southern Companies would provide transmission service for generation sold under this proposal under terms that are comparable to what is accorded to Southern Companies' own generation.

49. Specifically, for the next three years the Independent Auction Monitor must report to the Commission every twelve months regarding the functioning of the auctions. At a minimum, such reports should include the following: (1) the clearing price for each auction; (2) the amount of energy offered and sold by each seller (identified by name) in each auction; and (3) the amount of energy bid on and purchased by each buyer in each auction. In addition, the Independent Auction Monitor's report must identify any instances where it was unable to verify Southern Companies' Available Capacity calculations and inputs or where issues arose involving availability or the terms of transmission service needed to accommodate an auction purchase. The Independent Auction Monitor must also report any complaints relating to the auctions or other serious concerns to the Commission as soon as possible rather than waiting for the next report. The Independent Auction Monitor must have independent authority to prepare and submit all such reports without any prior review or approval by Southern Companies or any other outside sources.

50. In addition, Southern Companies must also file, as part of the compliance filing described below, the contract governing the relationship between them and the Independent Auction Monitor, including the conditions under which Southern Companies may dismiss the Independent Auction Monitor.

51. The second condition we impose on our acceptance of Southern Companies' Proposed Auctions (to commence within one year of the date of this order) is that the auctions be expanded to include sellers other than Southern Companies. In this regard, we note that Southern Companies have stated that they are amenable to: "(a) expanding the Proposed Auctions to include sellers other than Southern Companies; (b) work with market participants to move the Auction to an independent administrator so other sellers could be added more easily; and/or (c) expanding the Auction to include products other than those proposed herein."²⁷ While Southern Companies have indicated they are amenable to including third-party sellers in the auction process, we recognize that doing so will take additional time and believe that it is reasonable to allow Southern Companies additional time to implement this condition. Southern Companies should submit a separate compliance filing no later than 60 days prior to the expansion of the auction to allow third-party sellers to participate, consistent with this order.

52. In sum, third-party seller participation in the auctions and the increased oversight authority of the Independent Auction Monitor, as described above, would provide the Commission with a sufficient basis to find that Southern Companies have mitigated the potential to exercise generation market power in the Southern Balancing Authority Area. If Southern Companies accept the Commission's conditions as

²⁷ Proposed Auctions filing at 19.

explained above, Southern Companies would implement the revised auctions in two phases. During the first phase, Southern Companies would commence operation of the Proposed Auctions with the increased Independent Auction Monitor oversight described above. Within one year of the issuance of this order, Southern Companies must revise the auctions to allow third-party sellers to participate.

53. Within 30 days of issuance of this order, Southern Companies must file a compliance filing informing the Commission whether they accept the conditions imposed by this order and submitting for Commission approval the name of and proposed contract with the Independent Auction Monitor. The Commission will issue an order on that compliance filing. Upon issuance of that order, Southern Companies will have 30 days to initiate the auctions.²⁸

C. Safe Harbor Determination

1. Southern Companies' Request for Safe Harbor Determination

54. Because Southern Companies propose to report the quantities and prices of sales made through the Proposed Auctions to an index developer or a data hub, Southern Companies request that the Commission expressly confirm that they will receive protection under the Policy Statement on Price Reporting.

2. Commission Determination

55. In the Policy Statement on Price Reporting, the Commission established a rebuttable presumption for data providers that the transaction data they submitted to index developers was accurate, timely, and submitted in good faith where they abided by certain standards.²⁹ Under the market behavior rules, where a seller with market-based

²⁸ This time line is appropriate based on Southern Companies' representation that they could commence operation of the Proposed Auctions no later than 60 days after the date of the Commission's order accepting the Proposed Auctions Filing. Proposed Auctions Filing at 35-36.

²⁹ The standards included adopting and making public a Code of Conduct applicable to buying and selling natural gas or electricity and to reporting data regarding these transactions to index developers; ensuring that trade data is reported by a department of the company that is independent from and not responsible for trading; reporting each bilateral, arm's-length transaction between non-affiliated companies in the physical markets; cooperating with an index developer's error resolution process; and retaining all relevant data relating to reported traders for a minimum of three years. Policy Statement on Price Reporting, 104 FERC ¶ 61,121 at P 34, 37.

rate authority reports transactions to electric or natural gas index price publishers, the seller must do so in accordance with the standards established in the Policy Statement on Price Reporting.³⁰ In addition, unless they have already notified the Commission, sellers must notify the Commission of their price reporting status, including any changes to that status.

56. If Southern Companies implement elect to implement the auctions as revised in this order, then the Commission will treat Southern Companies' request for a safe harbor determination as notification under 18 C.F.R. § 35.41(c) that the companies will engage in price reporting pursuant to their market-based rate authority if and when the revised auctions commence operation. As part of their responsibilities under their market-based rate tariff, Southern Companies must comply with these reporting standards if they report transactions.

The Commission orders:

(A) The Amended Tariff Sheets are conditionally accepted, subject to Southern Companies submitting the compliance filing described in Ordering Paragraph (B).

(B) Southern Companies must submit a compliance filing within 30 days of the date of issuance of this order to inform the Commission of whether they plan to proceed with revising their auction proposal, based on the findings provided in this order. This compliance filing should indicate how Southern Companies intend to comply with the conditions regarding the Independent Auction Monitor. Southern Companies should submit a separate compliance filing no later than 60 days prior to the expansion of the auctions to allow third-party sellers to participate, consistent with this order.

(C) The Commission will treat the request for a safe harbor determination on price reporting as notification that if and when Southern Companies implement the auctions, as

³⁰ 18 C.F.R. § 35.41(c) (2008).

revised in this order, they will report pricing data to index developers and/or data hubs in accordance with 18 C.F.R. § 35.41(c) (2008).

By the Commission. Commissioner Kelly dissenting in part with a separate statement attached.

Commissioner Moeller concurring in part with a separate statement to be issued at a later date.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Southern Company Services, Inc.

Docket No. ER09-88-000

(Issued December 18, 2008)

KELLY, Commissioner, *dissenting in part*:

In this case, Southern Companies offers an innovative proposal to mitigate any market power they might have within the Southern Balancing Authority Area. Rather than propose mitigated, cost-based rates that would govern short and mid-term sales in the bilateral market from its various units, Southern Companies proposes to establish an auction market overseen by an independent Auction Monitor and an Auction Administrator. More specifically, they propose to set up a single clearing price, bid-based auction market for energy with cost-based offer caps applicable to each of the units that it would bid into the market. Further, Southern Companies proposes to impose a “must offer” obligation that would require that all of its available capacity is offered into the Day-Ahead and Hour Ahead auctions. Such an auction market holds great promise for increasing price discovery, transparency and liquidity in the Southern Balancing Authority Area.

The majority conditions acceptance of the proposal on Southern Companies further developing its proposal. Southern Companies would, among other things, be required to provide third party sellers the opportunity to participate in both the Day-Ahead and Real-Time auctions within a year and expand the role and responsibility of the independent auction monitor. I agree with the majority that these enhancements should be adopted.

The concern I have with the proposal is the cost-based offer cap. Southern Companies proposes that each of its selling resources limit its supply offers into the auctions to incremental cost, plus 10%, plus a demand charge of \$21.43/MWh. This demand charge is part of a new cost-based rate tariff, which was filed by Southern Companies on the same day as the auction filing.¹ The majority makes no mention of the cost-based offer cap, but I believe the Commission should address whether the inclusion of the demand charge proffered by Southern Companies is appropriate.

¹ Southern Companies’ Cost-Based Rate Tariff, October 17, 2008, Docket No. ER09-92-000.

The criteria by which the Commission must evaluate a cost-based offer cap in an auction market is found in Order No. 697. In that Order we explained that when a seller has market power it must be mitigated through a cost-based rate methodology. For sales of power of one week or less, we prescribed a default mitigation rate at the seller's incremental cost plus a 10 percent adder. We stated that "an incremental cost rate that allows a fair recovery of the incremental cost of generating with a 10 percent adder to provide for a margin over incremental cost is reasonable. Incremental costs plus 10 percent represents a conservative proxy for a reasonable rate available in a competitive market."² However, we did not rule out the possibility that a default mitigation rate for short term sales could include a contribution to fixed/capacity costs.³ We said "where mitigated sellers can properly justify such contributions, they may propose to recover contributions to fixed/capacity costs under the Commission's mitigation policy."⁴ Indeed, we noted that in certain auction markets, certain generators are mitigated through an offer cap of incremental cost plus 10 percent. However, they are nevertheless paid the market clearing price. This effectively allows the mitigated generator to regularly receive revenues greater than its incremental cost plus 10 percent.

The issue in this case is more complex. The offer cap here includes incremental cost plus 10 percent, plus a \$21.43/MWh demand charge. The record is unclear as to how much this demand charge contributes to each unit's fixed/capacity cost. However, it is clear that it does represent some contribution to fixed/capacity costs. The single clearing-price auction format will provide inframarginal units the opportunity to recover a portion of fixed/capacity costs. However, permitting Southern Companies' resources to supplement supply offers with the demand charge will provide for the same recovery. In essence, I see the demand charge and the single clearing-price auction format as directed at achieving the same objective and, as such, are duplicative. I am concerned that the inclusion of the demand charge, in combination with the single clearing price auction, may allow units to charge excessive rates for short term sales, particularly during the first phase, when third-party participation is not required. I am

² *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, at P 621 (Order No. 697), *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh'g*, Order No. 697-A, 73 Fed. Reg. 25,832 (May 7, 2008), FERC Stats. & Regs. ¶ 31,268 (2008).

³ *Id.* P 625

⁴ *Id.*

concerned that the Commission has approved this market design without sufficient evidence to justify it, and, indeed, without even a recognition that a problem may exist.

I understand that if many third party sellers participate in these auction markets, price discipline could be achieved. However, at this point, we have no idea whether this market will attract sufficient numbers of sellers to be competitive. In the absence of this information and in the absence of a record to justify a \$21.43/MWh demand charge, I would not approve the addition of this demand charge to the offer cap. Southern Companies states that the energy auction proposal “will result in a higher degree of price transparency than is the case today for bilateral electricity transactions in the Southern BAA or the southeastern U.S. generally.”⁵ While this is true relative to the status quo, I believe that the objective of price transparency would be best served without inclusion of the demand charge.

For these reasons, I respectfully dissent in part.

Suedeem G. Kelly

⁵ Southern Company Services, Inc. October 17, 2008 Proposed Amendment to Southern Companies' Market-Based Rate Tariff, Docket No. ER09-88-000, Affidavit of Rodney Frame P23.