

127 FERC ¶ 61,054
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission System
Operator, Inc.

Docket Nos. ER08-394-007
ER08-394-009

ORDER ON REHEARING AND COMPLIANCE

(Issued April 16, 2009)

1. On October 20, 2008, the Commission issued an order¹ conditionally accepting, subject to a future compliance filing, the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) proposed financial settlement provisions for resource adequacy, as set forth in Module E of its Open Access Transmission and Energy Markets Tariff (Tariff).² On November 19, 2008, the Midwest ISO submitted the required compliance filing (Compliance Filing) in Docket No. ER08-394-007. In this order, we deny requests for rehearing of the Financial Settlements Order and conditionally accept the Midwest ISO's Compliance Filing subject to an additional compliance filing.

I. Background

2. As part of a two-phased approach, the Midwest ISO filed Phase II of its proposed long-term resource adequacy plan on December 28, 2007.³ In a March 26, 2008 order, the Commission conditionally accepted the Midwest ISO's proposal in Phase II, subject

¹ *Midwest Indep. Transmission Sys. Operator, Inc.*, 125 FERC ¶ 61,060 (2008) (Financial Settlements Order).

² *Midwest Independent Transmission System Operator, Inc.*, FERC Electric Tariff, Fourth Revised Vol. No. 1 (Midwest ISO Tariff).

³ The Midwest ISO filed Phase I of its resource adequacy plan, its proposed ancillary services market, on February 15, 2007, and it was conditionally accepted on February 25, 2008. *Midwest Indep. Transmission Sys. Operator, Inc.*, 122 FERC ¶ 61,172, *order on reh'g*, 123 FERC ¶ 61,297 (2008).

to its completion of financial settlement provisions for its resource adequacy program, and ordered two compliance filings.⁴

3. On May 27, 2008, the Midwest ISO filed the first compliance filing to address various issues including, but not limited to, the planning reserve margins for load modifying resources, the methodology for calculating planning reserve margins, and the verification of resources for planning reserves. The Commission conditionally accepted this compliance filing on October 20, 2008, and directed further compliance filings.⁵

4. On June 25, 2008, the Midwest ISO submitted the second compliance filing containing its proposed financial settlement provisions. The Midwest ISO generally proposed to hold a voluntary capacity auction each month to allow load serving entities (LSEs) that have insufficient capacity for the month to satisfy their resource adequacy requirements with planning resources from market participants that have excess planning resources. Under the proposal, the Midwest ISO would administer each month's auction five days prior to the start of the month. This voluntary capacity auction would allow deficient LSEs (i.e., those LSEs that lack sufficient capacity to meet their resource adequacy requirements) to acquire sufficient capacity and thereby avoid financial penalties.

5. For those LSEs that continued to be deficient, the Midwest ISO would assess a financial settlement charge based upon the annual cost of new entry (CONE)—that is, the capital, operating, and other costs that would be incurred to develop a capacity resource in the Midwest ISO. The Midwest ISO proposed an initial CONE value of \$80,000/MW, which would be applied monthly for each month that an LSE was deficient. The CONE value would be reviewed annually so that it reflected current market conditions.

6. The Midwest ISO further proposed to distribute financial settlement charge revenues to: (1) LSEs that have met or exceeded their resource adequacy requirements during the following month; and (2) to suppliers that participated in the immediately preceding voluntary capacity auction. Under the Midwest ISO's proposal, suppliers that do not clear in the voluntary capacity auction will be selected in least cost order up to the amount needed to fully satisfy any aggregate LSE deficiency for the month. These suppliers would be paid on an as-offered basis. Any remaining financial settlement charge revenues would be distributed to qualifying LSEs on a *pro rata* basis, based upon

⁴ *Midwest Indep. Transmission Sys. Operator, Inc.*, 122 FERC ¶ 61,283 (March 26 Order), *order on reh'g*, 125 FERC ¶ 61,061 (2008) (October 20 Rehearing Order), *reh'g denied*, 126 FERC ¶ 61,143 (2009).

⁵ *Midwest Indep. Transmission Sys. Operator, Inc.*, 125 FERC ¶ 61,062 (2008), *order on reh'g*, 126 FERC ¶ 61,144 (2009) (February 19 Compliance Order).

MWs of peak load of LSEs in the applicable planning reserve zone. The Midwest ISO stated that these revenue distribution procedures will provide an economic incentive for participation in the voluntary capacity auction.

7. As noted above, the Commission accepted these proposed provisions in the Financial Settlements Order on October 20, 2008, subject to further compliance. The Commission also ordered the Midwest ISO's Independent Market Monitor (Market Monitor)⁶ to submit a filing describing its methodology for determining whether market power is being exercised in the voluntary capacity auction and mitigation measures that could be used to prevent market power.⁷ On November 19, 2008, the Midwest ISO submitted the Compliance Filing in Docket No. ER08-394-007. On that same day, the Market Monitor filed its methodology for monitoring the voluntary capacity auction and the types of market mitigation measures that could be used to prevent market power.

II. Requests for Rehearing

8. Several parties requested rehearing of the Financial Settlements Order including: Ameren Services Company (Ameren); Duke Energy Corporation (Duke); Dynegy Power Marketing, Inc. (Dynegy); the Illinois Commerce Commission (Illinois Commission); Integrys Energy Services, Inc. (Integrys); the Michigan Public Service Commission (Michigan Commission); the Public Service Commission of Wisconsin (Wisconsin Commission); Reliant Energy, Inc. (Reliant); and Wisconsin Public Service Corporation and Upper Peninsula Power Company (WPSC/UPPCO).

III. Notice of the Compliance Filing and Responsive Pleadings

9. Notice of the Midwest ISO's Compliance Filing was published in the *Federal Register*, 73 Fed. Reg. 73,320 (2008), with interventions and protests due on or before December 10, 2008.

10. Comments and protests on the Compliance Filing and on the Market Monitor's filing were filed by: the Coalition of Midwest Transmission Customers (CMTC); Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (Constellation); Consumers Energy Company (Consumers Energy); The Detroit Edison Company (Detroit Edison); Duke; Exelon Corporation (Exelon); FirstEnergy Service Company (FirstEnergy); Illinois Commission; the Illinois Municipal Electric Agency

⁶ The Midwest ISO's Tariff requires the Independent Market Monitor to monitor and evaluate the Midwest ISO market to ensure efficiency and competitiveness and to provide recommendations where appropriate.

⁷ Financial Settlements Order, 125 FERC ¶ 61,060 at P 155.

(Illinois Municipal); Indianapolis Power & Light Company (IPL); Midwest Transmission-Dependent Utilities (Midwest TDUs); the Organization of Midwest ISO States (OMS); and Reliant. On December 12, 2008, Xcel Energy Services, Inc. (Xcel) filed a motion for leave to file comments out of time and a protest of the Market Monitor's filing.

11. Answers to these comments and protests were filed by Duke, the Market Monitor, the Midwest ISO, and the Midwest TDUs.

IV. Substantive Matters

A. Procedural Matters

12. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure⁸ prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept the answers of Duke, the Market Monitor, the Midwest ISO, and the Midwest TDUs because they have provided information that assisted us in our decision-making process.

13. We will accept Xcel's motion to file comments out of time and its protest.

B. Rehearing

14. In this order we affirm the Commission's determinations in the Financial Settlements Order, and therefore deny the requests for rehearing, on the following issues: (1) the role of the Midwest ISO in procuring capacity on behalf of deficient LSEs; (2) the proposed CONE value, its calculation and its assessment to deficient LSEs; (3) the need for a market power study of the Midwest ISO capacity market; (4) delaying the start of the resource adequacy program; and (5) load shedding penalties.

1. Procurement of Capacity on Behalf of Deficient LSEs

a. Financial Settlements Order

15. The Midwest ISO proposed to use the financial settlement revenue from a deficient LSE to procure capacity to cover the deficiency. If additional financial settlement revenue remained after this process was complete, the Midwest ISO proposed to distribute the revenue on a *pro rata* basis to those LSEs that met or exceeded their resource adequacy requirements. In the Financial Settlements Order, the Commission generally accepted the Midwest ISO's proposal to distribute financial settlement charge revenue on a *pro rata* basis to all LSEs that have met their capacity obligations.

⁸ 18 C.F.R. § 385.213(a)(2) (2008).

However, the order rejected the Midwest ISO's proposal to use financial settlement charges to procure additional capacity (i.e., to cover LSEs that fail to provide sufficient capacity) from sellers who were not previously selected in the voluntary auction.⁹ The Commission found that the proposal was inconsistent with the voluntary capacity auction and the approach to capacity requirements as consisting of only financial settlements. The Commission instead directed the Midwest ISO to distribute the full amount of any deficiency revenue to LSEs who met their resource adequacy requirements so as to provide an incentive for available capacity resources to bilaterally contract or bid into the auction and be accepted.¹⁰

b. Requests for Clarification and Rehearing

16. Several parties¹¹ argue that the Financial Settlements Order failed to provide reasoned analysis for denying the Midwest ISO's proposal to procure capacity on behalf of deficient LSEs. They contend that the Midwest ISO's financial settlement proposal, as modified by the Financial Settlements Order, does not provide a viable mechanism to remedy deficient LSEs. They argue that the Midwest ISO must be the backstop for procuring capacity for deficient LSEs. Otherwise, they claim that a deficient LSE could remain deficient leading to reliability issues. These parties believe that the Financial Settlements Order is contrary to the fundamental premise of the Midwest ISO's resource adequacy program—that is, a loss of load expectation (LOLE) of one day in ten years. One party, Duke, asserts that the Financial Settlements Order impermissibly revisits the Commission's previous decisions approving the Midwest ISO's use of the LOLE model as the basis for its program.

17. Duke and Dynegy further argue that the Financial Settlements Order is contrary to Commission precedent. In particular, they note that the Commission has previously approved the New York Independent System Operator, Inc.'s (New York ISO) resource adequacy program, which requires the New York ISO to procure capacity for deficient LSEs.¹² Duke asserts that the Federal Power Act does not authorize the Commission to reject a tariff proposal (like the Midwest ISO's proposal) unless the Commission finds the policy to be unjust and unreasonable. Given the New York ISO precedent, Duke

⁹ Financial Settlements Order, 125 FERC ¶ 61,060 at P 132.

¹⁰ *Id.*

¹¹ Ameren, Duke, Dynegy, Integrys, Reliant and WPSC/UPPCO.

¹² Duke November 18, 2008 Request for Rehearing at 4 (citing New York Independent System Operator, Inc., FERC Electric Tariff, Original Volume No. 2 § 5.13.3).

claims that the Midwest ISO's proposal necessarily fell within a "zone of reasonableness" that should have been approved by the Commission.

18. Several parties also question the Commission's justification for denying the Midwest ISO's proposal. For example, Ameren questions the logic of the Commission's statement that the Midwest ISO's proposal was inconsistent with its "approach to the capacity requirements as consisting of only financial settlements."¹³ Ameren, as well as several other parties, believe that the Midwest ISO's decision to purchase capacity as a backstop is not inconsistent with the voluntary nature of the capacity auction. Reliant notes that LSEs can obtain capacity voluntarily through bilateral transactions both before and after the voluntary auction. They assert that the Midwest ISO would purchase capacity only as a last resort to cover any deficiency.

19. WPSC/UPPCO and Reliant disagree with the Commission's finding that by refunding all deficiency charge revenues to LSEs on a *pro rata* basis, "resources would have an incentive to bilaterally contract or bid into the auction and be accepted."¹⁴ WPSC/UPPCO contend that under the Midwest ISO's proposal, market forces already provide the necessary incentive to offer in the voluntary auction, because there is no guarantee that, on a month-to-month basis, deficiency revenue will exist. Reliant agrees and adds that there is no foundation in the record to assume that resources would rather gamble on the potential for higher prices resulting from an after-auction selection by the Midwest ISO than to accept the prices available through being selected in the voluntary auction or negotiating a post-auction bilateral agreement.

20. Other parties question how the Commission's finding will impact a supplier's incentive to offer capacity in the voluntary auction or through bilateral contracts. For example, Ameren claims that the Commission's finding removes the incentive for suppliers to continue to make capacity available following the close of the voluntary auction, which would be necessary to meet any outstanding capacity needs by deficient LSEs. It believes that market participants may decide to sell the capacity and associated energy outside of the Midwest ISO in an effort to maximize the value of their investment.

21. Ameren further contends that ensuring that available capacity is maintained within Midwest ISO will expand supply in the energy market thereby putting downward pressure on prices, which should lower prices for consumers. It adds that in circumstances when excess capacity is available and an LSE is deficient, the LSE may be

¹³ Ameren November 19, 2008 Request for Rehearing at 8 (citing Financial Settlements Order, 125 FERC ¶ 61,060 at P 132).

¹⁴ Reliant November 19, 2008 Request for Rehearing at 9 (citing Financial Settlements Order, 125 FERC ¶ 61,060 at P 132).

able to “lean” on the excess capacity. In this instance, Ameren submits that market participants would not be fully compensated even though they provided something of value to the market when the capacity is used.

22. Integrys contends that the Commission’s finding is premised on the faulty assumption that competition among suppliers does not work. Integrys submits that excess capacity not sold in the bilateral market should be sold in the voluntary market so that both sellers and buyers receive and pay a competitive fair market price for capacity. It adds that any holders of less expensive sources of capacity would be pushed by competitive forces to offer it into the auction to receive fair value.

23. Finally, Duke and Dynegy recommend that, if the Commission nevertheless denies rehearing, it should direct the Midwest ISO to propose an alternative approach to procuring capacity on behalf of deficient LSEs in order to ensure reliability. They believe that there must be a mechanism to cover any capacity shortages for deficient LSEs.

c. Commission Determination

24. We are not persuaded by arguments raised on rehearing that the Midwest ISO should procure capacity on behalf of deficient LSEs. As an initial matter, we consider misplaced the concerns raised by parties regarding reliability. While the resource adequacy program plays a role in ensuring longer-term reliability, it is not the only means by which the Midwest ISO manages reliability. We emphasize that the financial charges assessed to deficient LSEs, in combination with scarcity pricing, should together provide long-term incentives for LSEs to obtain adequate capacity via bilateral contracts such that additional procurement by the Midwest ISO is unnecessary.¹⁵ It is important to note that the Midwest ISO’s resource adequacy program is premised on LSEs meeting their planning reserve requirements primarily through bilateral contracting. As the Midwest ISO emphasized when it filed its proposed financial settlement provisions, “[w]hile the Midwest ISO considered the methods used in other RTOs/ISOs [regional transmission organizations], ultimately, the Midwest ISO and many of its stakeholders believe that the Midwest ISO footprint is unique and that what is effective in other RTOs/ISOs may prove unworkable in the Midwest ISO Region.”¹⁶ Accordingly, the Midwest ISO proposed an “energy only construct” “because centralized procurement projections can disrupt the workings of a bilateral capacity market. Further, imposing capacity requirements directly on LSEs sends valuable, real-time pricing signals.”¹⁷ The Midwest

¹⁵ Financial Settlements Order, 125 FERC ¶ 61,060 at P 98.

¹⁶ Midwest ISO June 25, 2008 Filing at 4 (footnotes omitted).

¹⁷ *Id.* at 4 (footnotes omitted).

ISO noted that the “[s]takeholders agree as to the importance of bilateral contracting and the Midwest ISO’s position that markets work best when buyers and sellers voluntarily participate.”¹⁸

25. While the Midwest ISO’s approach to resource adequacy is somewhat different than the resource adequacy programs developed by other regional transmission organizations, we nevertheless approved this approach because, as the Midwest ISO stated, it was consistent with a market that is predominantly managed by traditional, vertically-integrated utilities and spans multiple state and local jurisdictions.¹⁹ It also was supported by the OMS, and by extension the states,²⁰ which opposed the centralized capacity markets found in other eastern regional transmission organizations,²¹ and by a majority of market participants.²²

26. In this context, we believe that the purpose of the Midwest ISO’s voluntary auction is to allow interested LSEs to procure any remaining capacity needs from suppliers willing to make their resources available in the market. Instead of forcing deficient LSEs to purchase capacity via the Midwest ISO, a financial settlement charge will apply. We reiterate that the auction is a last-resort measure to procure incremental amounts of capacity one month ahead of time, if available, and should not be construed as a substitute for the need of LSEs to arrange for long-term capacity.²³

27. We do not agree with Duke’s assertion that the Financial Settlements Order revisited the issue of whether the Midwest ISO should use a LOLE of one day in ten years. The Financial Settlements Order was not intended to and did not impact the Midwest ISO’s requirement to use a LOLE standard of one day in ten years in developing planning reserve margins that each LSE must meet, or else face a deficiency charge.

¹⁸ *Id.* at 7 (footnote omitted).

¹⁹ *See* Midwest ISO December 28, 2007 Filing, Affidavit of Richard Doying at P 25 (Docket No. ER08-394-000).

²⁰ *See, e.g.*, March 26 Order, 122 FERC ¶ 61,283 at P 68 (“[T]he states should play a central role in developing resource adequacy policies in the region...The Midwest ISO has worked very closely with the OMS and other stakeholders for many months to design a resource adequacy proposal that is supported by the states and respectful of their authority.”)

²¹ Financial Settlements Order, 125 FERC ¶ 61,060 at P 19.

²² Midwest ISO June 25, 2008 Filing at 7 (footnotes omitted).

²³ Financial Settlements Order, 125 FERC ¶ 61,060 at P 104.

28. We also disagree with parties who assert that, because the Midwest ISO will not procure capacity on behalf of deficient LSEs, suppliers will seek to sell their capacity and associated energy outside of the Midwest ISO. Again, we believe that the financial settlement charge and scarcity pricing provide sufficient incentive for LSEs to meet their resource adequacy requirements by procuring sufficient capacity from suppliers. Similarly, scarcity pricing serves to ensure that suppliers will offer into the Midwest ISO markets such that competitive prices result. In circumstances under which an LSE somehow chooses to remain deficient, we expect any “excess” capacity not under a resource adequacy obligation to still have the opportunity to receive scarcity prices. In sum, we find that parties offer mere speculation in asserting that sufficient capacity will not be maintained and that suppliers will not be adequately compensated or will not offer their capacity at competitive prices.

29. We reject arguments suggesting that the auction will not result in competitive prices unless the Midwest ISO procures capacity on behalf of deficient LSEs. To the extent that they have not already contracted bilaterally, suppliers must bid into the auction competitive prices to receive revenues for their capacity in the Midwest ISO market. While we believe commenter concerns regarding the efficiency of the voluntary auction are unfounded, we encourage the Midwest ISO and stakeholders to discuss further enhancements to the voluntary auction to ensure that it maximizes the participation of suppliers and is an effective and useful option for obtaining capacity.

30. We do not believe that our previous decisions regarding the New York ISO’s resource adequacy program require us to reach a different result in this case. We continue to reject a one-size-fits-all approach to resource adequacy in the various RTOs and reaffirm the need to allow for regional differences for the reasons we discuss above.²⁴ As Duke acknowledges, there are significant differences between the New York ISO market, as well as other eastern markets, and the Midwest ISO market. Unlike the former, the Midwest ISO does not face the same degree of transmission and generation constraints that are faced by the New York ISO. Moreover, unlike the New York ISO’s long-standing history of procuring capacity as a former power pool, the Midwest ISO has never been in the business of procuring capacity or power to ensure system reliability. As noted above, the Midwest ISO is predominantly composed of traditional, vertically integrated utilities and there is no evidence suggesting that these utilities have failed to provide sufficient capacity for reliability purposes. If anything, most LSEs appear to have excess capacity—a fact supported by Ameren’s concern that deficient LSEs may “lean on” excess capacity provided by other LSEs. Based on these factual differences, we found that the Midwest ISO’s proposal had not been shown to be reasonable given the

²⁴ See, e.g., *Midwest Indep. Transmission Sys. Operator Corp.*, 116 FERC ¶ 61,292, at P 53 (2006).

Midwest ISO's voluntary capacity auction. We continue to support that decision in this order.

31. Finally, we will not grant rehearing based on Ameren's concern that deficient LSEs may "lean on" excess capacity on the system without providing sufficient compensation. As noted above, we believe that deficient LSEs will contract in the bilateral market to cure their deficiency rather than face the financial settlements charge. Thus, we find it unlikely that a deficient LSE will "lean on" excess capacity without providing compensation and there is no evidence suggesting otherwise. Accordingly, we will not require the Midwest ISO to revise its Tariff at this time. However, if such conduct were to occur in the future, an affected party could seek relief through a section 206 proceeding.

2. Assessment of CONE

a. Financial Settlements Order

32. In the Financial Settlements Order, the Commission determined that the Midwest ISO failed to provide sufficient justification for its proposal to apply the annualized CONE value of \$80,000/MW to deficient LSEs for each month's deficiency.²⁵ The Commission concluded that the Midwest ISO had not shown this value to be just and reasonable when applied on a monthly basis and that the deficiency charges could be excessive if applied to an LSE with deficiencies in multiple months. As noted in the order, the Commission maintained that the monthly deficiency charge should recognize the different supply-demand situations in different months of the year, the cumulative monthly effects of the penalties, and the incentives to contract and build capacity.²⁶ Accordingly, the Commission directed the Midwest ISO to provide additional justification for its CONE value and to propose a more granular monthly deficiency charge, which should be tailored to deter deficiencies without being excessive on a monthly or cumulative basis.²⁷

b. Requests for Rehearing

33. Reliant requests that the Commission grant rehearing and accept the Midwest ISO's proposal to impose a financial settlement charge equal to the annual CONE for any month in which an LSE is deficient. Reliant asserts that the Commission is obligated

²⁵ Financial Settlements Order, 125 FERC ¶ 61,060 at P 74, 97.

²⁶ *Id.* P 99.

²⁷ *Id.* P 74, 99.

under section 205 of the Federal Power Act to approve a rate unless that rate is unjust and unreasonable. Reliant believes that the Commission's desire to see if the Midwest ISO and stakeholders can develop and agree on a more "granular" financial settlement charge is not an appropriate basis for rejecting the Midwest ISO's proposal, which Reliant contends was not shown to be unjust and unreasonable.

34. Reliant also asserts that the Commission erred in rejecting the proposal on the erroneous assumption that if an LSE had a constant load profile and was inadequate for six months, it would pay six times the annual CONE for every MWh of its deficiency, which could lead the LSE to overbuild to avoid the risk of inaccurate load forecasts or generation outages. Reliant contends that there is little risk that a responsible LSE will incur excessive, cumulative penalties under the Midwest ISO's proposal such that it will be forced to overbuild capacity. Reliant asserts that a monthly deficiency charge based on the annual CONE gives a strong incentive to LSEs that might otherwise try to shirk their resource adequacy obligations.

35. The Wisconsin Commission also requested rehearing of the Financial Settlements Order. Although the Wisconsin Commission does not specifically challenge the Commission's decision to reject the Midwest ISO's proposal regarding CONE, it informs the Commission that various proposals are being considered by stakeholders in response to the Financial Settlements Order. The Wisconsin Commission notes that it is still reviewing these proposals.

36. WPSC/UPPCO assert that the Commission erred by finding that month-ahead settlement provisions are sufficient to promote long-term resource adequacy. WPSC/UPPCO believe that resource adequacy is assured in the short-term only when long-term resources are procured and that short-term resource adequacy deficiencies are as damaging, if not more so, than long-term deficiencies because it is easier to take steps to avert a long-term crisis than one that may occur in the immediate future. WPSC/UPPCO state that neither the Commission in the Financial Settlements Order nor the Midwest ISO in its filing address how resource adequacy is maintained in a capacity-short environment. WPSC/UPPCO contend that the Financial Settlements Order focused on how the month-ahead deficiency charges will create new capacity in the long-term (by way of new construction), but that this long-term solution does not address short-term deficiencies.

c. Commission Determination

37. We deny the requests for rehearing regarding our decision rejecting the Midwest ISO's proposal to assess the annualized CONE value as a monthly penalty to deficient LSEs. While Reliant correctly notes that the Commission has an obligation under section 205 to approve rates that are just and reasonable, the filing party has the burden of demonstrating that the rate is just and reasonable in the first instance. In the Financial Settlements Order, we concluded that the Midwest ISO failed to provide sufficient

justification for its CONE value of \$80,000/MW.²⁸ The Financial Settlements Order further found that the Midwest ISO had not shown the CONE value to be just and reasonable when applied on a monthly basis and that the deficiency charges would be excessive if applied to an LSE with deficiencies in multiple months. The Commission noted that the Midwest ISO's proposal also failed to account for "different supply-demand situations in different months of the year, the cumulative monthly effects of the penalties, and the incentives to contract and build capacity."²⁹ Accordingly, we ordered the Midwest ISO on compliance to re-evaluate its proposed CONE value, as well as its application to deficient LSEs, to ensure that the penalty was not excessive and, thus, unjust and unreasonable.

38. The arguments raised by Reliant do not change this conclusion. We rejected the Midwest ISO's proposal, in large part, because the Midwest ISO failed to show that its calculation and assessment of CONE was not excessive. We continue to believe that the Midwest ISO's assessment of CONE must take into account certain real-world facts that may impact the cost of capacity, like monthly differences in supply and demand and how the assessment of a penalty in successive months may be excessive or how it may impact an LSE's incentive to build new capacity. The consideration of these factors is critical to ensure that the Midwest ISO's assessment of CONE reaches a reasonable balance between incentivizing the creation of new capacity, while not assessing excessive penalties that are unjust and unreasonable. Because the Midwest ISO failed to address these issues in the first instance, we correctly rejected its proposal and asked for a new proposal on compliance.

39. Nor do we agree with WPSC/UPPCO's assessment that the Midwest ISO proposed month-ahead deficiency charges cannot address the problem of resolving immediate resource deficiencies because resource adequacy requires more than month-ahead commitments. As discussed later in this order, the Commission is accepting the Midwest ISO's revised proposal on compliance to charge the annualized CONE value only for the first month that a LSE is deficient. We expect that the assessment of the annual cost of new entry for a single month deficiency will provide an incentive for LSEs to make long-term commitments for capacity resources. While WPSC/UPPCO characterize the Midwest ISO program as one that encourages LSEs to play the market on a monthly basis, the cost of treating resource adequacy as a monthly commitment is to pay the gross annual cost of new entry. Under this framework, we believe LSEs have an economic incentive to look beyond their monthly requirements.

²⁸ *Id.* P 74.

²⁹ *Id.* P 97.

40. Finally, with regard to the Wisconsin Commission's filing, it appears that the Wisconsin Commission is merely alerting the Commission to facts regarding the Midwest ISO's Compliance Filing regarding CONE. Those issues are addressed below.

3. Gross versus Net CONE

a. Financial Settlements Order

41. In the Financial Settlements Order, the Commission accepted the Midwest ISO's proposal to base its capacity deficiency penalty on gross CONE rather than net CONE.³⁰ As the basis for its decision, the Commission cited the Midwest ISO's explanation that unlike other RTOs that use the CONE as a proxy for the value of capacity within the region, the Midwest ISO's CONE value establishes a financial settlement charge to encourage LSEs to comply with Module E. Thus, the Commission stated that the CONE was intended to reflect the cost of constructing new capacity resources within the Midwest ISO region, rather than the net value of a capacity resource, which would likely include consideration of revenues from capacity, energy or ancillary services sales.

b. Request for Rehearing

42. The Illinois Commission argues that the Commission erred in accepting a deficiency charge based on gross CONE rather than net CONE. The Illinois Commission asserts that a capacity market should be designed so as to permit the marginal unit (or the potential marginal new entrant, if cheaper than the marginal unit) an opportunity to recover its variable costs plus some contribution to fixed costs. Such a market design, according to the Illinois Commission, would take into account all streams of revenue available to the marginal unit or the potential marginal new entrant, such as wholesale energy and ancillary services markets.

43. The Illinois Commission contends that the Midwest ISO's deficiency charge should be high enough, but no higher than needed to induce LSEs (in conjunction with expected revenues from all other revenue streams), to build or contract for capacity. The Illinois Commission states that that price level is the same level as is needed to induce new entry, i.e., the net CONE. The Illinois Commission asserts that setting the deficiency charge penalty at some higher level will lead to inefficient results, potentially by creating excessive incentives for new entry. The Illinois Commission also notes that the Midwest ISO has adopted scarcity pricing, which would create further incentives for LSEs to be resource adequate.

³⁰ *Id.* P 101. A net CONE approach subtracts from the annual gross CONE a value representing the sum over a year of the energy and ancillary services market revenues expected to be earned by a specific representative generation unit type. *Id.* P 78.

44. The Illinois Commission also contends that, unless the Commission reverses its decision to accept the Midwest ISO's gross CONE proposal, the decision will conflict with Order No. 719.³¹ In particular, the Illinois Commission contends that the decision is contrary to the statement that "[u]nder all existing capacity market rules, the revenues earned from the sale of energy and ancillary services are accounted for in the calculation of capacity payments so that customers will not be double charged."³²

c. Commission Determination

45. We deny the Illinois Commission's request for rehearing and find that the gross CONE calculation is a reasonable basis for determining deficiency charges in the Midwest ISO. As we stated in the Financial Settlements Order, the CONE value, under the Midwest ISO's financial settlement framework, is used as the basis for calculating the deficiency charges assessed to deficient LSEs.³³ The net CONE approach adopted by other regional transmission organizations involves calculating the value of capacity or the appropriate price to compensate resources selling capacity into the market. The Midwest ISO's use of the CONE is much more limited, and serves only as an input to determining the penalty assessed to deficient LSEs in the resource adequacy program. The Illinois Commission's concern about violating Order No. 719's prohibition against double charging is thus inapplicable because financial settlement charges only apply to deficient LSEs and the Midwest ISO does not intend to use the gross CONE as part of a blanket "capacity payment" that every LSE is required to pay.

46. In addition, we find that the deficiency charge must be set higher than the price that it would cost the LSE to build or contract for capacity. The primary aim of the financial settlements provisions, as the Illinois Commission notes, is to *induce* the LSE to build or contract for capacity to meet its resource adequacy requirements. If the deficiency charge is equal to the price to build or contract for capacity, as proposed by the Illinois Commission, the LSE will be indifferent as to whether to pay the penalty or meet its resource adequacy requirements. The deficiency charge must therefore be higher and thus we find that the gross CONE value is appropriate.

³¹ *Wholesale Competition in Regions with Organized Electricity Markets*, Order No. 719, 73 Fed. Reg. 64,100 (Oct. 28, 2008), FERC Stats. & Regs. ¶ 31,281 (2008) (Order No. 719).

³² *Id.* P 201

³³ Financial Settlements Order, 125 FERC ¶ 61,060 at P 101.

4. Market Power

a. Financial Settlements Order

47. In the Financial Settlements Order, the Commission addressed concerns raised by various market participants regarding the ability of LSEs to exercise market power in the capacity market. Although several parties wanted a market power study, the Commission denied that request because the Market Monitor's analysis showed that market power abuse was unlikely.³⁴ To that end, the Commission noted the Market Monitor's analysis indicating that because resource adequacy requirements apply market-wide in the Midwest ISO, suppliers throughout the Midwest ISO region must compete to sell capacity in the Midwest, which should produce efficient prices for capacity.

48. We further noted that the risk of market power was mitigated by the Commission's decision to reject the Midwest ISO's proposal to utilize the financial settlement charges to procure capacity for sellers not selected in the voluntary auction and to apply an annual CONE on a monthly basis. As the Financial Settlements Order indicated, the decision on both issues reduces the risk that an LSE will withhold capacity.

49. The Commission also emphasized that the Market Monitor will be obligated to monitor for market power in the capacity auction under section 69.3.5.h and Module D of the Tariff. As the Commission noted, the Market Monitor (as well as the Midwest ISO) has an obligation to report instances of market power abuse when it is detected.

50. Notwithstanding this decision, the Commission directed the Market Monitor to explain, in general terms, how it would monitor market power in the voluntary capacity auctions and to describe, without disclosing specific triggers, under what conditions it would report to the Commission that further modifications are necessary. The Commission also required the Market Monitor to specify the methods it will use to determine whether market power is being exercised and whether additional mitigation measures are needed, and what those mitigation measures might look like.³⁵

b. Requests for Rehearing

51. The Michigan Commission and Illinois Commission generally argue that the Commission erred by not requiring a market power study. In this context, they assert that while the Commission relied upon the Market Monitor's finding that there was a low likelihood of market power, they note that this conclusion was not supported by a market

³⁴ *Id.* P 152.

³⁵ *Id.* P 155.

power study and, thus, was not based on reasoned decision-making. The Michigan Commission emphasizes that a study was particularly important because the Market Monitor admitted that “abuses of market power or manipulation are not impossible.”³⁶

52. The Illinois Commission also challenges the Market Monitor’s conclusion that market power is unlikely, arguing that its conclusion was based on the faulty premise that resource adequacy requirements under Module E would apply region-wide. Although the Market Monitor concluded that the region-wide application would increase competition among suppliers, the Illinois Commission argues that this conclusion fails to account for constrained locational deliverability areas. Nor does the Illinois Commission agree with the Market Monitor’s conclusion that low levels of market concentration will reduce the likelihood of market power.³⁷ It cites a recent report by the PJM Independent Market Monitor, which concluded that structural market power could be exercised in a tight capacity market, irrespective of market concentration levels. The Illinois Commission believes that the Midwest ISO’s capacity market is substantially similar to the PJM market.³⁸

53. The Michigan Commission and Illinois Commission also challenge whether the Market Monitor needed to provide a more specific discussion of its market monitoring plan. Both parties request more specific guidance from the Market Monitor to explain how it will monitor market power in the voluntary capacity auctions and prevent the exercise of market power. The Illinois Commission is concerned that the focus of the Commission’s directive is too narrow, because it is limited only to a discussion of the monthly auctions and appears aimed at only identifying triggers under which the Market Monitor would report to the Commission that further modifications are necessary.

54. The Illinois Commission further claims that the Commission erred by finding section 69.3.5.h of the Tariff sufficient to prevent the exercise of market power. It notes that the section is limited to stating that all actions of market participants will be subject to the provisions of Module D and that the Midwest ISO will report any potential

³⁶ Michigan Commission November 19, 2008 Protest at 3-4 (citing July 31, 2008 Comments of the Midwest ISO’s Market Monitor, Docket No. ER08-394).

³⁷ Illinois Commission November 19, 2008 Protest at 9 (citing PJM Independent Market Monitor November 6, 2008 Comments at 32-34, Docket No. EL08-47-000) (“In the context of a market with an extremely inelastic demand curve, the existence of two jointly pivotal suppliers, regardless of the amount of excess capacity available, does not provide a market structure that will result in a competitive outcome.”)

³⁸ *Id.* at 13-14 (citing PJM Independent Market Monitor September 12, 2008 Analysis of the 2011/2012 RPM Auction at 1).

55. Finally, the Michigan Commission and Illinois Commission contend that the Commission must prevent market power from occurring and not just mitigate its occurrence. They assert that this is particularly relevant for the monthly auction which, while voluntary, provides capacity sellers with the conditions for exercising market power because the sellers know that capacity buyers have an obligation to buy to avoid the financial settlement charge. The Illinois Commission emphasizes that even if market power abuse is discovered, there may be a time delay before the Commission can investigate and take appropriate action. This delay would harm market participants and the market itself. The Illinois Commission concludes that an *ex ante* market power mitigation process that can be administered by the Midwest ISO must be specified in the Tariff.

c. Commission Determination

56. We are not persuaded by the requests for rehearing that a separate market power study of the entire Midwest ISO capacity market is needed. As explained in the Financial Settlements Order and below, we continue to find that the exercise of market power is unlikely based on the structure of the Midwest ISO's resource adequacy program in Module E, as well as the seller-specific market-based rate analyses conducted by the Commission.

57. We continue to support the Market Monitor's conclusion that region-wide application of Module E will create competition among capacity sellers, which in turn reduces the likelihood of market power. The Illinois Commission is mistaken to assert that locational constraints will prevent this competition. On the contrary, in the February 19 Compliance Order, we accepted the Midwest ISO's proposal to "not disqualify capacity resources from meeting the planning reserve margin requirements of an LSE in an import-restricted zone if the LOLE [Loss of Load Expectation] study

reveals congestion that limits aggregate deliverability of some qualified resources.”³⁹ Instead, the Midwest ISO will address such constraints by creating a new planning zone and adjusting the planning reserve margin for the zone.⁴⁰ We believe that the Midwest ISO’s proposal, as we found in the February 19 Compliance Order, will help to ensure that capacity resources can be used for resource planning purposes and should minimize the risk that locational constraints will prevent competition among suppliers.

58. Similarly, we find the Illinois Commission’s citation of the PJM Independent Market Monitor’s report to be inapposite. The PJM Independent Market Monitor study focuses on potential market power within “locational deliverability areas”—i.e., defined areas in the PJM market with transmission constraints that limit import capability and offer pivotal suppliers the ability to withhold. In contrast, the Midwest ISO’s resource adequacy program does not require that capacity be procured on a locational basis and, more importantly, the Midwest ISO will address any constraints by creating new planning zones. As such, the concerns raised in the PJM Independent Market Monitor’s report should not be of concern in the Midwest ISO because locational constraints on deliverability should be addressed by the Midwest ISO’s proposal to create new planning zones and sellers should be able to compete across the Midwest ISO market.

59. A market power study is not necessary given the Commission’s ongoing analysis of a seller’s market-based rate authority under Order No. 697, which includes an analysis of its market-based rate authority for the sale of capacity.⁴¹ Under that order, the Commission requires sellers seeking market-based rate authority to perform the same type of market power analysis that would be performed in the market power study requested by the Illinois Commission and the Michigan Commission. In this context, a market power study would be duplicative and therefore is unnecessary.

60. Moreover, the individual seller’s market-based rate analysis is only part of the Commission’s market-based regulatory rate regime, which also includes post-approval oversight through reporting requirements and ongoing monitoring. For sellers in regional transmission organizations, the Commission has additionally implemented market monitoring and rules to mitigate the exercise of market power in the organized markets

³⁹ February 19 Compliance Order, 126 FERC ¶ 61,144 at P 45.

⁴⁰ *Id.*

⁴¹ See *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity, and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252, at P 2-5, 943-955 (2007) (Order No. 697). See also *Midwest ISO Process Document and Data: Market Based Rates for Wholesale Sales, Regulatory and Economic Studies Department* (updated January 28, 2009).

and uses market monitors to help oversee the market behavior and market conditions.⁴² The Commission is not, however, required to separately analyze the competitiveness of the entire market before permitting participants to charge market-based rates, as the courts have recently upheld.⁴³

61. As for the Illinois Commission's concern regarding the sufficiency of Module D and section 69.3.5.h to address and mitigate market power, we share many of its concerns regarding the need for more specific language in the Tariff. As set forth in more detail in the compliance section, we are directing the Midwest ISO to work with the Market Monitor to develop and file proposed revisions to the Tariff setting forth the Market Monitor's monitoring and mitigation plan for the voluntary capacity auctions. We also agree with the Illinois Commission that *ex ante* mitigation procedures are needed to immediately address issues of market power at the Midwest ISO level. To the extent that the Illinois Commission has further concerns regarding these provisions, it can raise those concerns when the Midwest ISO submits its compliance filing.

62. Finally, the Illinois Commission appears to contend that the Market Monitor should monitor the entire Midwest ISO capacity market and not just the monthly capacity auction. On this matter we disagree. The Illinois Commission provides no justification as to why the Market Monitor should monitor the entire bilateral capacity market, despite the fact that the Market Monitor does not currently monitor the bilateral markets for energy and ancillary services. Section 50.2 of Module D of the Tariff specifically states that the Market Monitor will monitor the markets and services provided by the Transmission Provider, but will not monitor bilateral energy, ancillary services or capacity markets except "to periodically assess the effects of these Markets and Services administered by the Transmission Provider, or the effects of the Transmission Provider Markets and Services on these markets."

⁴² Order No. 697, FERC Stats & Regs. ¶ 31,252 at P 3-5.

⁴³ See *Blumenthal v. FERC*, 484 F.3d 558 (D.C. Cir. 2009).

5. Transition Period

a. Financial Settlements Order

63. In the Financial Settlements Order, the Commission rejected requests to delay the start of Module E.⁴⁴ The Commission found that these requests repeated arguments previously raised regarding the effective date of Module E. The Commission concluded that it would repeat its findings in the March 26 Order⁴⁵ and the Rehearing Order⁴⁶ that there is sufficient time between the submittal of the compliance filings, the Commission issuance of orders on these filings and the start of the planning year in June 2009 for market participants to obtain the details necessary to make informed decisions on obtaining resources and ensure that they avoid the financial settlement provisions.

b. Request for Rehearing

64. On rehearing, the Illinois Commission argues that the Commission erred in not requiring a transition period into the Midwest ISO's resource adequacy program. The Illinois Commission states that it has legitimate concerns regarding the start of the resource adequacy program and that the Commission incorrectly described its concerns as merely a request to delay in the Financial Settlements Order. The Illinois Commission states that it remains skeptical that the Midwest ISO will be ready to implement the resource adequacy program by June 1, 2009, and that the Commission should transition into the market start-up for a year or two even if the Midwest ISO were ready on June 1, 2009.

65. The Illinois Commission asserts that, unless there is sufficient time for potential new entrants to observe the new capacity market design, assess their market opportunities and take steps to enter the market, entities already selling capacity in the Midwest will remain unchallenged and the LSEs that are obligated by revised Module E to purchase capacity will be at the mercy of these capacity sellers and the market power that these sellers will wield.

66. The Illinois Commission argues that the Commission should adopt a reasonable transition period so that the positive long-term objectives of the resource adequacy program can occur. The Illinois Commission believes that the lack of a transition period may lead to unreasonable capacity price levels. For example, the Illinois Commission

⁴⁴ Financial Settlements Order, 125 FERC ¶ 61,060 at P 184.

⁴⁵ March 26 Order, 122 FERC ¶ 61,283 at P 411-415.

⁴⁶ October 20 Rehearing Order, 125 FERC ¶ 61,061 at P 77.

submits that consumer representatives have persuasively made the argument linking a short transition period with high capacity prices in PJM's capacity market revision.⁴⁷

67. The Illinois Commission states that an additional reason favoring a brief delay in the start of the Midwest ISO's revised capacity market design (Phase II of the Midwest ISO's resource adequacy program) is that the Midwest ISO's ancillary services market (Phase I of the Midwest ISO's resource adequacy program) is not yet up and running.

68. The Illinois Commission asserts that if the Commission does not adopt a formal transition period, the Commission should at least waive the application of the deficiency charge penalty for the first year or two of the resource adequacy program. According to the Illinois Commission, waiver of the deficiency charge penalty would be one method to mitigate market power of incumbent capacity sellers and provide potential new entrants with time and an opportunity to enter the market and compete.

c. Commission Determination

69. We deny the Illinois Commission's request for a delay in the start of the resource adequacy program. The Illinois Commission characterizes its request as a request for a transition period, and states that the Commission erroneously referred to this request as a request for delay. Regardless of whether the Illinois Commission's request is characterized as a request for delay or a transition period, we will maintain our findings in the March 26 Order and the Financial Settlements Order that such a request is unnecessary for the effective start of the resource adequacy program. Further, we note that the Midwest ISO's ancillary services market became effective on January 6, 2009 and is now running.⁴⁸

70. Finally, we repeat our finding in the Financial Settlements Order that the Market Monitor analysis indicated that because all resource adequacy requirements apply market-wide in the Midwest ISO, suppliers throughout the Midwest ISO region (and those in adjacent regions) must compete to sell capacity in the Midwest, which should produce efficient prices for capacity.⁴⁹ Consequently, we do not share the Illinois Commission's concern that "incumbent capacity sellers" in the Midwest ISO will

⁴⁷ Illinois Commission November 19, 2008 Protest at 17 (citing *Maryland Pub. Serv. Comm'n v. PJM Interconnection, L.L.C.*, Docket No. EL08-67-000 (filed May 30, 2008)).

⁴⁸ "Midwest ISO Launches Ancillary Services Market," Midwest ISO News Release, January 6, 2009.

⁴⁹ October 20 Rehearing Order, 125 FERC ¶ 61,061 at P 151.

exercise market power over LSEs that are obligated to purchase capacity under the revised Module D. We also note that the Commission has dismissed the complaint in PJM that the Illinois Commission cites. There, the Commission found in part that there was an insufficient basis to change the prices resulting from the initial capacity auctions.⁵⁰

6. Load Shedding Penalty

a. Financial Settlements Order

71. The Commission agreed with the Midwest ISO that deficiency charge revenues should be distributed to all LSEs that have met their resource adequacy obligations on a *pro rata* basis, rather than on the basis of how much excess capacity the LSEs may have. The Commission reasoned that if revenue was distributed back to LSEs on the basis of excess capacity, this would create an incentive for LSEs to not offer or contract with other LSEs who might be short, and thereby receive deficiency revenue.⁵¹ The Financial Settlements Order also noted the Midwest ISO argues that this allocation mechanism is consistent with the current involuntary load shedding protocols, which are performed on a *pro rata* basis.⁵²

b. Request for Rehearing

72. WPSC/UPPCO argues that the Commission should remove the load shedding penalty for LSEs that obtain sufficient capacity. They assert the Midwest ISO's involuntary load shedding requirements, which sheds load on a *pro rata* basis among all LSEs, may penalize responsible LSEs that maintain sufficient capacity. WPSC/UPPCO assert that two similarly situated utilities, one that is capacity short and the other with adequate capacity, will each experience the same amount of load shedding. WPSC/UPPCO believe that such an arrangement is not logical, equitable or conducive to the promotion of resource adequacy.

c. Commission Determination

73. WPSC/UPPCO's request for rehearing is outside the scope of the instant proceeding. The load shedding protocols in the Midwest ISO are not subject to discussion as part of our findings on the Midwest ISO's long term resource adequacy

⁵⁰ *Maryland Pub. Serv. Comm'n v. PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,276 (2008).

⁵¹ Financial Settlements Order, 125 FERC ¶ 61,060 at P 131.

⁵² *Id.* P 129.

program. We note that the basis for load shedding is currently subject to a filing in Docket No. ER09-660-000. Accordingly, we deny rehearing on this issue.

C. Compliance Filing

74. In this order we conditionally accept, with further compliance requirements, the Midwest ISO's and the Market Monitor's proposals for the following items: (1) market monitoring and mitigation; (2) justification and proposed assessment of CONE to deficient LSEs; and (3) the determination of deliverability for load modifying resources.

1. Market Monitoring and Mitigation

75. The Commission directed the Market Monitor to explain in general terms how it intends to monitor market power in the voluntary capacity auctions and describe, without disclosing specific triggers, under what conditions it would report to the Commission that further modifications are necessary. The Market Monitor was also directed to specify the methods it will use to determine whether market power is being exercised and whether additional mitigation measures are needed, and what additional mitigation measures might look like.⁵³

a. Market Monitor Informational Filing

76. In its informational filing, the Market Monitor describes how it will monitor for market power in the Midwest ISO's capacity market and a general framework for market power mitigation that may be proposed to the Commission if necessary.

77. The Market Monitor states that market monitoring will be facilitated by the Midwest ISO's voluntary auction proposal because the Market Monitor will have access to information regarding all resources that have been designated to satisfy an LSE's capacity requirements, as well as the offers to sell capacity from all previously undesignated resources. As part of its monitoring efforts, the Market Monitor states that it will utilize screens to identify suppliers that are physically or economically withholding capacity from the market.

78. The Market Monitor states that capacity is physically withheld from the Midwest ISO capacity market when it: (1) is not designated to satisfy any LSE's capacity requirement (including LSEs in external market areas) prior to the voluntary auction; (2) is not offered in the voluntary capacity auction; and (3) is not subsequently designated to satisfy any LSE's capacity requirement or is exported to a lower priced market. In addition, the Market Monitor asserts that physical withholding normally requires that the

⁵³ *Id.* P 155.

product be economic to sell—that is, the prevailing price is higher than the supplier’s marginal cost of selling the product. In capacity markets, however, the Market Monitor notes that the marginal cost of selling capacity is generally zero because the net revenues available from most regional transmission organizations’ energy and ancillary services markets are sufficient to keep the resource in operation. In this context, the Market Monitor concludes that most suppliers should be willing to be “price-takers” in the capacity market and contends that this has been demonstrated to be true in the Northeast capacity markets. The Market Monitor speculates that some parties may argue that failing to offer in the voluntary auctions cannot be considered physical withholding because the market is voluntary. The Market Monitor responds that what these parties would be ignoring is the fact that the physical withholding screen requires that the resource also not be sold through the bilateral market before or after the voluntary auctions.

79. The Market Monitor states that the screen for economic withholding is very similar to the screen for physical withholding. However, while the physical withholding screen identifies resources that are not offered in the voluntary auction, the economic withholding screen identifies resources that do not clear in the voluntary capacity auction due to their offer prices. Because the marginal cost of supplying capacity should be zero for most resources (excluding the opportunity costs of exporting capacity to neighboring regions), the Market Monitor believes that resources failing to clear in the auction or being sold in the bilateral market can be deemed to have economically withheld.

80. Following the physical and economic withholding screens, the Market Monitor states that it will perform two additional analyses prior to referring a matter to the Commission or proposing mitigation measures. First, it will seek information regarding the going-forward costs of the withheld unit. According to the Market Monitor, if the revenues from the capacity, energy and ancillary services markets together are not sufficient to cover the going-forward costs (the costs of keeping the unit in operation), then it is rational for the supplier to retire the unit rather than sell its capacity. In such cases, the Market Monitor will not find the unit to have been withheld.

81. Second, the Market Monitor will evaluate the impact of the potential withholding on capacity prices. The Market Monitor submits that it will simulate the capacity auction market to estimate the prices that would have prevailed in the voluntary market had the withheld capacity been offered competitively. If the simulation shows that the withheld capacity raised the prices by a material amount, the Market Monitor will refer the conduct to the Commission and propose mitigation that would prevent such conduct in the future.

82. The Market Monitor states that it does not believe that section 50.2 of the Tariff, which prohibits monitoring of bilateral capacity markets by the Market Monitor, would preclude or encumber the market monitoring process discussed in its filing.

83. With respect to potential mitigation, the Market Monitor states that the most effective mitigation for economic and physical withholding is a must-offer provision that requires that capacity be designated to satisfy an LSE's capacity requirement or offered in the voluntary market at a competitive offer price level. The Market Monitor notes that the competitive offer price level would be set at the higher of the price the supplier has the opportunity to receive in an external market or the resource's net going forward cost (going forward costs less anticipated net revenues from energy and ancillary services). According to the Market Monitor, such a provision would prevent the supplier from withholding capacity in the future without compelling the supplier to sell capacity at a price less than its marginal costs. However, the Market Monitor explains that the details of such an approach would need to be reviewed and approved by the Commission prior to its implementation.

b. Protests

i. Evaluation of Market Power

84. OMS and the Illinois Commission argue that the Midwest ISO and the Market Monitor have failed to provide a market power analysis of the capacity market, as required by the March 26 Order.

ii. Section 69.3.5.h

85. Several parties argue that there is insufficient information on the Market Monitor's market monitoring and mitigation procedures and that these procedures must be incorporated in the Tariff. In particular, Xcel believes that the Market Monitor fails to comply with the Commission's directive in the Financial Settlements Order to explain how it intends to monitor market power in the voluntary capacity auction. Xcel urges the Commission to reject the Market Monitor's filing and direct the Market Monitor to resubmit a more narrowly tailored filing in which the Market Monitor is limited to evaluating whether auction bids and offers that are made voluntarily into the auction are fair. Xcel adds that the Market Monitor should evaluate both the supply and demand of capacity in relation to the cost of self-supplying or building capacity, such as compared to the cost of new entry. Xcel submits that the Market Monitor should not be developing a process to review all uses or allocation of capacity from a market participant's entire portfolio in order to evaluate the exercise of market power.

86. OMS and the Illinois Commission note that the Financial Settlements Order specifically stated that proposed section 69.3.5.h does not adequately define the scope of the Market Monitor's role and required this section to be revised. Noting that neither the Market Monitor nor the Midwest ISO proposed modifications to section 69.3.5.h in order to comply with this directive, OMS and the Illinois Commission contend that market monitoring and mitigation procedures are matters significantly affecting rates and therefore must be included in the Tariff. In addition, OMS and the Illinois Commission

contend that section 69.3.5.h is ambiguous because it states that the Midwest ISO, not the Market Monitor, will be doing the market power monitoring.⁵⁴

iii. Voluntary Capacity Auction

87. Xcel and IPL argue that the Market Monitor's withholding screens turn the Midwest ISO's voluntary capacity auction into a mandatory auction, which is a collateral attack on prior Commission orders. To that end, IPL argues that the physical withholding screens will make the auction mandatory because an LSE may not be able to sell its capacity for a number of reasons. For example, an LSE's internal engineering analysis for resource requirements—which may be more up to date than the analysis on file with the Midwest ISO—may show that the LSE has a greater resource capacity need. In these cases, it is good utility practice to keep the additional capacity for its own use and certainly should not be deemed economic withholding.

88. Xcel further raises the timing issues associated with an LSE's determination to either participate in the auction or participate in the bilateral market. Xcel notes that a supplier may have capacity available, but not sold, near the end of the month when the monthly auction takes place, because the supplier is looking for a buyer whose terms are not coincident with the monthly auction or may be in the process of attempting to sell the capacity of a unit in conjunction with other products. According to Xcel, the fact that the supplier does not offer the capacity into the voluntary market is not in any way a "withholding" from the market.

89. IPL argues that mandating participation under the Market Monitor's proposed mitigation scheme may be the easiest way to prevent withholding, but it amounts to "killing a gnat with an elephant gun." IPL states that there are numerous means to preventing withholding short of mandating participation, including caps on market clearing prices and that the voluntary nature of the auction need not be eviscerated.

90. Xcel and IPL also take issue with the notion that suppliers should be willing to be price-takers in the capacity market. Xcel believes that if a supplier is not able to receive fair compensation for its available capacity through the voluntary capacity auction, it should have the right to explore other avenues for compensation, including more conventional, structured transactions that may include the sale of capacity as well as energy. IPL asserts that the logical application of the Market Monitor's economic withholding screen is that the Market Monitor would consider an offer above zero dollars, which fails to clear in the market, to be a presumptive exercise of market power.

⁵⁴ Section 69.3.5.h provides that "[t]he Transmission Provider will report any potential exercise of market power by LSEs or by Market Participants in the voluntary capacity auction procedures to the Independent Market Monitor."

IPL believes that this approach leaves LSEs little choice but to offer at zero dollars to avoid being flagged for economic withholding. IPL contends that such “compliance through fear” is not consistent with a voluntary market.

91. IPL further challenges the Market Monitor’s assertion that the marginal cost of selling capacity is generally zero. IPL states that the Market Monitor’s compliance filing calls to mind ISO New England’s mitigation of Installed Capacity bids to zero dollars based on a “zero marginal cost theory,” which resulted in a full-scale revamping of the ISO New England capacity market. IPL asserts that one of the reasons for a capacity market is that the net revenues from energy and ancillary services markets are not always sufficient to provide full cost recovery and are rarely sufficient to provide full cost recovery of peaking units. In addition, IPL argues that the marginal cost of capacity is more than zero because regular costs such as taxes and ongoing maintenance are incurred to maintain a generating facility. While the Market Monitor implies that it will consider such costs in the “second stage” of an inquiry into withholding, IPL believes that the inquiry should never even get that far because the Market Monitor should recognize up front that bidding above zero dollars is not economic withholding.

iv. Identifying Potential Capacity Resources

92. OMS and the Illinois Commission assert that the Market Monitor should be required to identify the universe of potential capacity resources. OMS and the Illinois Commission believe that the Market Monitor does not describe how he will determine resources that have not entered into bilateral contracts with Midwest ISO LSEs, not entered into capacity arrangements with buyers outside the Midwest ISO market, and not offered into the Midwest ISO’s voluntary auction. The Illinois Commission states that it is difficult to see how the Market Monitor will be able to institute proper tariff language associated with the market monitoring proposal without first identifying all possible capacity resources.

v. Scope of Monitoring Plan

93. Several parties express concern regarding the scope of the Market Monitor’s monitoring procedures. OMS and the Illinois Commission note that under section 50.2 of the Midwest ISO’s existing Module D, the Market Monitor is explicitly precluded from monitoring bilateral capacity markets. The Illinois Commission asserts that the Market Monitor needs to be able to monitor the bilateral capacity market in the Midwest ISO region, and the Market Monitor’s proposal in fact requires it to monitor the bilateral capacity market in the Midwest ISO region in order to screen for both physical and economic withholding. Accordingly, OMS and the Illinois Commission recommend that section 50.2 be modified to provide for the explicit monitoring of bilateral capacity markets.

94. On the other hand, IPL objects to removing the prohibition in section 50.2 on the Market Monitor's monitoring of bilateral energy or capacity markets. IPL asserts that the regulation of bilateral markets is beyond the purview of the Midwest ISO and, thus, monitoring of bilateral markets should be beyond the purview of the Midwest ISO's Market Monitor. IPL contends that it is the Commission that is charged with ensuring that just and reasonable rates exist in jurisdictional electric markets, and empowering the Market Monitor to monitor bilateral capacity markets in the Midwest would effectively constitute a delegation of authority from the Commission to the Market Monitor.

95. Similarly, Xcel asserts that the focus of the Market Monitor should be limited to the evaluation of market power in the voluntary capacity auction. Xcel asserts that the appropriate role for a Market Monitor in the auction context is to monitor the bids and the offers that are made into the auction and to determine whether they are fair. Xcel states that the Market Monitor can evaluate the supply and demand of capacity in relation to the cost of self-supplying or building capacity, such as compared to the CONE. However, Xcel contends that the Market Monitor should not be developing a process to review all uses or allocation of capacity from a market participant's entire portfolio in order to evaluate the exercise of market power in a voluntary market.

vi. Explanation of Cost Accounting

96. OMS and the Illinois Commission assert that the Market Monitor should be directed to explain how "going forward costs" and "net going forward costs" will be calculated. They state that the calculations require a numerical expectation of capacity revenues, energy revenues, and ancillary services revenues, and that the Market Monitor did not explain how the projection of revenues for any of these services will be forecasted. The Illinois Commission adds that other regional transmission organizations, including PJM, have run into controversy in developing workable proposals to forecast future energy and ancillary revenues, and that there is no reason to believe that the matter would prove any easier in the Midwest ISO context. The Illinois Commission believes that a miscalculation of capacity costs or revenues from the energy and ancillary services markets could result in resources inappropriately passing the mitigation screen that should instead be identified for possible withholding. Further, the Illinois Commission asserts that the explanations of the calculations are important for instilling confidence that the costs and revenues will be appropriately estimated.

vii. Determination of "competitive offer price level" and Market Simulation

97. The Illinois Commission asserts that the Market Monitor's suggestion for calculating the "competitive offer price level" in the auction simulation lacks sufficient detail. The Illinois Commission asserts that the appropriate technique for approximating a "competitive offer" is a quantitative matter of great uncertainty, and overestimation could inappropriately permit withholding. The Illinois Commission further believes that

allowing the use of external market price as a proxy for a competitive offer may allow a resource to game the system through withholding. The Illinois Commission presents the example of a resource that is deliverable to a higher-priced external market, but does not sell into that external market and is also withheld from the Midwest ISO's bilateral market and voluntary capacity auction. The Illinois Commission notes that, under the Market Monitor's mitigation proposal, a resource in such a situation could be offered into the subsequent voluntary capacity auction at the external market price, which is still likely to be greater than Midwest ISO's auction clearing price, and the resource would not clear the voluntary auction even with zero net going forward cost.

98. OMS and the Illinois Commission also state that the Market Monitor has not explained how the proposed simulation of the auction market will work. They assert that the Market Monitor has not explained whether the hypothetical "competitive offers" for potentially withheld resources will be entered into the simulation individually or in combination. The Illinois Commission states that without this detail, there is little confidence that the voluntary auction simulation will adequately capture the presence of noncompetitive behavior.

c. Market Monitor and Midwest ISO Answers

99. The Market Monitor disagrees with protestors' concerns that its monitoring program would turn the voluntary capacity auction to a mandatory auction. The Market Monitor asserts that its monitoring approach is only designed to identify market power abuses. The Market Monitor states that for unoffered capacity to be an abuse of market power, the supplier must have the ability to raise prices.

100. The Market Monitor states that the following suppliers can refuse to submit offers into the voluntary capacity auction without being referred to the Commission:

- Suppliers that sell their capacity bilaterally before the voluntary auction.
- Suppliers that sell their capacity bilaterally after the voluntary auction.
- Suppliers that designate their capacity to satisfy their own capacity requirements.
- Suppliers that export their capacity to another area at a price that is comparable to or higher than the expected Midwest ISO capacity price.
- Suppliers whose capacity is not economic to sell in the Midwest ISO.
- Suppliers whose withholding would not raise prices (i.e., suppliers that do not have market power).

According to the Market Monitor, the first four types of suppliers have effectively provided their capacity to the market and, therefore, are not withholding capacity. The Market Monitor states that the fifth type of supplier is only likely to exist if the capacity is being retired because the markets are not covering the supplier's going forward costs. The Market Monitor asserts that the sixth type of supplier does not have market power and is therefore free to not offer its unsold capacity in the voluntary auction. Based on its experience with other capacity markets, however, the Market Monitor states that it is extremely rare for a supplier that lacks market power to not sell its capacity in the market. The Market Monitor concludes that the only suppliers that would be identified under its market monitoring approach are suppliers that withhold their capacity from the market and where such withholding results in substantially higher prices—the definition of an exercise of market power.

101. However, the Market Monitor acknowledges that if the voluntary market is thinly traded, it may indicate larger price effects associated with capacity not offered into the market and such price effects should not be the subject of a market power referral or mitigation efforts. Thus, the Market Monitor proposes a quantity threshold that will ensure that the withholding of small quantities of unsold capacity—that is, an amount that should not materially affect prices—will not be deemed to be an exercise of market power. Based on the size of the Midwest ISO market, the Market Monitor believes that such a quantity threshold would likely be in the range of 500 MW to 2000 MW.

102. In response to arguments that sellers may refuse to sell capacity as a hedge against the loss of other generating units, the Market Monitor states that actions that are economic will not be considered withholding and if physical hedging can be demonstrated to be economic, it would accept that explanation. Given typical outage rates for most units, however, the Market Monitor states that it is unlikely that physical withholding could be economically justified for potential withholding quantities in excess of the quantity threshold. As a result, the Market Monitor has not identified the use of this strategy in other capacity markets it monitors.

103. The Market Monitor argues that there are no native load needs or reliability considerations that would cause a utility with excess capacity to choose not to sell that capacity to LSEs in need of capacity. The Market Monitor states that protestors' arguments are based on the flawed premise that selling capacity through the voluntary market would prevent the supplier from using that capacity to serve its native load. The Market Monitor notes that capacity sales do not include the sale of energy or such other obligations that may limit the suppliers' ability to use its resources to serve its load.

104. The Market Monitor disagrees with arguments that its approach exceeds the scope mandated by the Commission to monitor the voluntary capacity market. The Market Monitor notes that the only way to identify withholding in the voluntary market is to know which resources are available to be sold in that market (i.e., those that have not previously been sold bilaterally). Moreover, the Market Monitor contends that this action

does not constitute monitoring of the bilateral market, which would require information on bilateral bids, offers, and prices that it will not be collecting.

105. The Market Monitor submits that it does not expect suppliers to offer to sell their capacity at a loss in the Midwest ISO region, and it will consider all relevant opportunity costs. The Market Monitor states that if a supplier has the opportunity to export its capacity to another area at a price of \$4 per KW-month, the Market Monitor will assume marginal costs of \$4 per KW-month rather than zero. The Market Monitor states that it is important to recognize, however, that opportunity costs only exist when there is a legitimate opportunity. The voluntary capacity auction market occurs five days before the deadline to certify capacity for the month in the Midwest ISO. Thus, the Market Monitor notes that if it is too late at that point to sell the capacity bilaterally to a buyer in another area, then the prevailing capacity price in that area is not truly a foregone opportunity. Nonetheless, the Market Monitor asserts that given the central location of the Midwest ISO and its many interconnections with adjacent markets and control areas, the Market Monitor recognizes that opportunity costs are likely to be a substantial component of most suppliers' marginal costs of selling capacity.

106. The Market Monitor states that while its prior filing focused on monitoring suppliers in the Midwest ISO for abuses of market power, it also will monitor the conduct of deficient LSEs in the capacity market. The Market Monitor is concerned in particular about two strategies that may be employed to depress capacity prices, though it will monitor all conduct that may inefficiently influence capacity prices. First, the Market Monitor will monitor for the withholding of load from the voluntary market, which may artificially deflate capacity prices. In this context, just as supply can be withheld to raise capacity prices, the Market Monitor states that an LSE may choose to be deficient rather than submit a competitive bid to buy capacity, which would tend to lower capacity prices. The Market Monitor submits that it would use a quantity threshold and evaluate the price effects of any conduct it detects to determine whether the conduct should be referred to the Commission.

107. The Market Monitor adds that if an LSE procures capacity bilaterally after the voluntary market at a price that is not substantially above the clearing price in the voluntary market, it will be deemed not to have engaged in conduct that warrants further investigation. The Market Monitor notes that this is comparable to a supplier that sells its capacity after the voluntary market.

108. Second, the Market Monitor states that it will monitor for under-forecasting of load. The Market Monitor asserts that if the quantity and price effect are substantial, and the forecasting error cannot be justified adequately, it will refer the participant to the Commission for potential enforcement.

109. The Midwest ISO, in its answer, states that it understands the concerns of stakeholders regarding market monitoring, but believes that the Market Monitor is the proper entity to respond to market monitoring concerns.

d. Duke Response to the Market Monitor Answer

110. Duke characterizes the Market Monitor's proposal as rewriting the Midwest ISO resource adequacy proposal and argues that the Market Monitor's standards are harmful, unworkable, and unnecessary. Duke asserts that the Market Monitor's monitoring standards would effectively convert the voluntary auction into a mandatory auction because of the fear of referrals.

111. Duke explains that under the Market Monitor's proposal there would be no safeguards to prevent Market Monitor monitoring standards from artificially constraining prices. Duke states that a properly functioning voluntary auction, free of artificial constraints, should equilibrate towards a true market price. Duke's expert witness, Mr. Robert Stoddard, hypothesizes that the Market Monitor's proposal will not allow equilibration of prices, because in times of general surplus, the low price offers by generation coupled with the Market Monitor's effective must offer requirement can be expected to result in very low prices. Mr. Stoddard states that in times of general shortage, conversely, prices would tend to be very high, and that this swinging between pricing extremes will render inoperable a central benefit of the voluntary auction, which is to promote the price discovery that will occur when market prices equilibrate. Duke points out that mandatory auctions have been reformed in other markets to prevent this sort of price volatility.

112. Mr. Stoddard asserts that the Market Monitor's monitoring will strip the benefits of transparent market prices, which ordinarily signal both the bilateral market and potential investors, thus efficiently promoting contracting and new construction. Also, bilateral contracting activities that otherwise could be expected to occur after the voluntary auction and through the following month would be substantially diminished, and the efficiency gains that such activities would produce would be lost.

113. Duke also states that under the Market Monitor proposal, generation owners will not be able to recover long-run going forward costs, including the costs of retiring a unit. Duke asserts that the Market Monitor's approach fails to recognize that the Midwest is a single natural market, notwithstanding that it contains two regional transmission organizations, and that the market constructs in these two markets should not artificially create price separation where naturally there should be none. The availability of a benchmark of a fair, market-determined price, such as the PJM reliability pricing model price, is necessary to prevent the natural tendency of the Midwest ISO resource adequacy program to artificially depress the price for capacity.

114. In addition, Duke asserts that the Market Monitor's proposal discriminates against state resource decisions. Duke gives the example of a vertically integrated utility subject to a potential charge of withholding if that utility does not offer into the voluntary auction capacity not consumed by its load, despite that capacity being dedicated under the state regulatory arrangement to the service of that load.

115. Duke asserts that the Market Monitor's proposal is unworkable because Midwest ISO's monthly capacity auctions were not designed as a market with must-offer requirements nor with any of the necessary features incorporated in the eastern markets to ensure reasonable price formation when bids are closely monitored and subject to mitigation. Duke contends that the primary mechanism in the Midwest ISO for moderating prices is voluntary participation. Duke believes that by effectively removing this feature from the Midwest ISO capacity market, the Market Monitor undermines this fundamental design and puts the Midwest ISO's resource adequacy program on a path towards the same failures that have been raised in the eastern regional transmission organizations.

116. Duke also questions the practicality of the Market Monitor's proposal. Duke notes that while the Market Monitor will not collect data about bilateral contracts, it may nevertheless find economic withholding if the bilateral contract price is too low. In other words, Duke believes that the Market Monitor is also proposing to monitor the bilateral markets, which is beyond its authority.

117. Duke asserts that the exercise of market power in the Midwest ISO voluntary auction is highly unlikely because the voluntary auction will clear on a region-wide basis, and thus the potential pool of participants, both capacity and load, is enormous. Mr. Stoddard concludes that it is improbable that any supplier can know whether its capacity is on the "price cusp" and hence attempt to raise prices through withholding. He adds that the normal safeguards in place in other markets where market power theoretically could be exercised are sufficient, including the Commission's comprehensive scheme for ensuring that companies do not have market power when they obtain market-based rates and do not subsequently obtain market power due to changed circumstances.

118. Duke asks that the Market Monitor be required to withdraw its filings and instead propose monitoring that could be used only to determine whether the voluntary auction contains design flaws, and for the Market Monitor to recommend modifications or mitigation measures to the Commission as appropriate. Duke argues that this would be consistent with the Commission's compliance directive in the Financial Settlements Order.

e. **Commission Determination**

119. In the Financial Settlements Order, we directed the Market Monitor to submit an informational filing that explained in general terms, how it would monitor market power in the voluntary capacity auctions and to describe, without disclosing specific triggers, under what conditions it would report to the Commission that further modifications are necessary. While the Market Monitor's filing complied with this directive, after reviewing the filing and the comments, we agree with several parties that the market monitoring plan must be filed as part of a proposed revision to Module D of the Tariff. Upon further review, we also agree that the proposed Tariff provisions must contain sufficient detail for market participants to understand how the Market Monitor will monitor for withholding, when a market participant will be subject to mitigation, and what mitigation will be applied. Accordingly, we direct the Midwest ISO to work with the Market Monitor and market participants to file proposed Tariff provisions addressing the monitoring and mitigation of the capacity auction within 30 days of the issuance of this order.

120. We also find that the proposed Tariff provisions must include specific mitigation measures. These measures may include, for example, automatic mitigation for economic withholding and sanctions when necessary for physical withholding.⁵⁵ We do not agree with the Market Monitor's proposal to simply refer potential exercises of market power to the Commission. On the contrary, we find that the Midwest ISO's Tariff should contain provisions to address and mitigate potential exercises of market power at the Midwest ISO level. Accordingly, we direct the Midwest ISO, in consultation with the Market Monitor, to include specific Tariff provisions outlining mitigation measures in its compliance filing. Consistent with Order No. 719, these mitigation measures, as applied on a prospective basis after their effective date, should be conducted by the Midwest ISO rather than by the Market Monitor (although the Tariff may provide that the Market Monitor provide the inputs), and should be as non-discretionary as possible.⁵⁶

121. We are not suggesting, however, that the Market Monitor should abandon its plan to screen for physical and economic withholding, or should never refer a matter to the Commission. On the contrary, we find that screens to define withholding are necessary to prevent potential exercises of market power in the capacity auction. For example, the proposed Tariff revisions should specify the calculation of going forward costs. At the very least, the provisions should include the same level of detail as in the monitoring and

⁵⁵ See *infra*, P 78-79 for a discussion of the Market Monitor's proposal to screen for physical and economic withholding. Automatic mitigation procedures would revise a capacity bid or offer in the monthly auction to a defined level before the auction clears.

⁵⁶ See Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 370-379.

mitigation provisions of the energy and ancillary services markets under Module D. We find that detailed tariff provisions will help to ensure competitive outcomes in the monthly capacity auctions and, as discussed earlier in this order, the market power analysis requested by OMS and the Illinois Commission is unnecessary.⁵⁷

122. Likewise, any proposed Tariff provisions must provide clear guidance regarding when a decision not to offer capacity into the capacity auction will not be considered an exercise of market power. For example, in its answer, the Market Monitor explained that it would not find physical withholding to be evidence of an exercise of market power when: (1) the decision is economic, e.g., the capacity is not receiving its going forward costs and is therefore retiring; (2) the decision would not raise market prices; or (3) the amount of unoffered capacity is below a stated quantity threshold. These exceptions must be clearly set forth in the Tariff filing.

123. In addition, we direct the Midwest ISO, in consultation with the Market Monitor, to explicitly address the effect of the eligibility rules. For example, the Market Monitor does not appear to account for planning resources that are not eligible to be offered into the monthly auction.⁵⁸ Nor has the Market Monitor indicated the status of resources that could become eligible to participate in the monthly auction, but intentionally decide to remain ineligible and that have not contracted bilaterally for capacity. The Midwest ISO should address these issues in its compliance filing.

124. This compliance filing also should address Duke's concern regarding how the market monitoring plan could result in volatile prices for capacity. While the existence of volatile prices by itself does not indicate that the capacity market design is unjust and unreasonable, it appears that PJM, the New York ISO and ISO New England have all modified their capacity markets in part to incorporate what Mr. Stoddard refers to as "stabilization factors," such as a demand curve and/or forward procurement.⁵⁹ We therefore direct the Midwest ISO, in consultation with the Market Monitor, to address

⁵⁷ As noted above in the rehearing section, we also disagree with the argument that section 69.3.5.h does not adequately define the scope of the Market Monitor's role.

⁵⁸ Midwest ISO Tariff section 69.3.5.c identifies the eligibility requirements for planning resource offers in the monthly capacity auction.

⁵⁹ See *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006), *order on reh'g*, 119 FERC ¶ 61,318, *order on reh'g*, 121 FERC ¶ 61,173 (2007); *Devon Power L.L.C.*, 115 FERC ¶ 61,340, *order on reh'g*, 117 FERC ¶ 61,133 (2006), *aff'd in relevant part Maine Pub. Utils. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008); *New York Indep. Sys. Operator, Inc.*, 103 FERC ¶ 61,201, *order on reh'g*, 105 FERC ¶ 61,108 (2003) *aff'd Electricity Consumers Resource Council v. FERC*, 407 F.3d 1232 (D.C. Cir. 2005).

whether, in light of the monitoring and mitigation plan, it expects capacity prices will provide sufficient revenues for resources needed to maintain reliability to remain in the market, and thus whether “stabilization factors” would be necessary.

125. As noted by several parties, section 50.2 of the Tariff generally precludes the monitoring of bilateral markets, including the bilateral capacity market. That section, however, does not prevent the Market Monitor from examining how bilateral contracts may impact the capacity auction. We find that such an assessment is consistent with the recognition in section 50.2 that the Market Monitor may periodically assess the effects of the bilateral markets on the markets administered by the Midwest ISO.

126. Parties also expressed concern that the Market Monitor’s proposed definition of withholding will negatively impact the bilateral market. We do not expect that the Market Monitor’s proposal will undermine the bilateral market. We note that the Market Monitor’s answer indicates that bilateral contracting after the auction will be facilitated by assuming that load is not being withheld if market participants execute bilateral contracts after the voluntary auction at a price that is not substantially above the clearing price. We find this aspect of the Market Monitor’s proposal to be consistent with a resource plan that relies primarily on bilateral contracting, and responsive to Duke’s concern that bilateral contracting activities may be substantially diminished by the Market Monitor’s plan to examine how bilateral contracts may impact the capacity auction.

127. In response to comments from Duke’s witness Mr. Stoddard stating that the Market Monitor does not indicate over what timeframe he will measure going forward costs, we direct the Midwest ISO, in consultation with the Market Monitor, to consider whether the appropriate timeframe should be based on the assumption of a permanent retirement of the resource and, if it disagrees with such an assumption, to explain and support its choice of an alternative timeframe. Finally, in response to parties’ concerns regarding the evaluation of opportunity costs, we direct the Midwest ISO, in consultation with the Market Monitor, to address in the compliance filing whether opportunity costs should account for the potential to export to PJM’s market for replacement capacity and to identify other legitimate opportunity costs that may exist.

2. CONE Value and Deficiency Charge

a. Financial Settlements Order

128. As noted above, the Financial Settlements Order found that the Midwest ISO failed to provide adequate information to show that an annualized CONE value of \$80,000/MW was just and reasonable when applied on a monthly basis.⁶⁰ The

⁶⁰ Financial Settlements Order, 125 FERC ¶ 61,060 at P 74, 97.

Commission directed the Midwest ISO to reconsider its proposal in light of differing supply-demand situations for various months, the cumulative monthly effects of the penalties, and how such a charge could impact a deficient LSE's incentive to contract and build capacity.⁶¹ Accordingly, the Commission directed the Midwest ISO to provide additional justification for its CONE value and to propose a more granular monthly deficiency charge, which should be tailored to deter deficiencies without being excessive on a monthly or cumulative basis.⁶²

b. Midwest ISO Compliance Filing

129. In its Compliance Filing, the Midwest ISO states that it has reviewed the methodology used in other RTOs and consulted with the Market Monitor regarding the CONE value. The Midwest ISO notes that the annualized CONE value of \$80,000/MW, or \$80,000/MW-year, was based on the Market Monitor's 2007 State of the Market Report, which reviewed the overnight capital costs with a five percent contingency factor and the fixed operating and maintenance costs for a conventional combustion turbine in the Midwest ISO.⁶³ In addition, the Market Monitor added an additional 7.5 percent to cover financing costs and 6.5 percent to account for inflation. Together, the Market Monitor assumed capital costs of \$555/kW and fixed operating and maintenance costs of \$12.55/kW-year.

130. To arrive at the annualized CONE value based on these cost numbers, the Market Monitor assumed various common accounting assumptions in the energy industry, including a 50/50 debt to equity ratio, 15 year depreciation, 20 year project life and loan term, 7 percent loan interest rate, 3 percent escalation factor, 2.5 percent gross domestic product (GDP) deflator, 43 percent combined state and federal tax rate, and 12 percent return on equity.⁶⁴ The Midwest ISO notes that these assumptions are similar to assumptions used in other regional transmission organizations.

131. The Midwest ISO further notes that the \$80,000/MW-year CONE value is consistent with CONE values in other regional transmission organizations. For example, the Midwest ISO notes that the current CONE value in the PJM market ranges from \$72,000 to \$74,000/MW-year, depending on the region in PJM. However, the Midwest

⁶¹ *Id.* P 99.

⁶² *Id.* P 74, 99.

⁶³ Midwest ISO November 19, 2008 Compliance Filing, Letter of Transmittal at 6, Docket No. ER08-394-007.

⁶⁴ *Id.*

ISO also points out that PJM has proposed to increase these values to between \$131,000 and 142,000/MW-year for the next regional reliability auction in 2012.⁶⁵ In the New York ISO, the CONE value ranges from \$92,000 to \$218,000/MW-year depending on the region.⁶⁶ The CONE value in ISO New England is \$90,000/MW-month.⁶⁷ Based on this analysis, the Midwest ISO believes that a CONE value of \$80,000/MW-year is just and reasonable.

132. As for the assessment of this penalty, the Midwest ISO notes that the Financial Settlements Order rejected the Midwest ISO's original proposal to apply the annualized CONE value of \$80,000/MW for every month in which an LSE is deficient. It states that the Commission found that such a penalty could be excessive if applied to an LSE that is deficient in multiple months. The Commission, it notes, directed the Midwest ISO to "propose more granular monthly deficiency charges that are tailored to deter deficiencies without being excessive on a monthly or cumulative basis."⁶⁸

133. Based on this direction, the Midwest ISO has modified section 69.3.7 of the Tariff to provide that for the first month during any planning year that an LSE is deficient, it will be charged 100 percent of the annualized CONE value for that month's deficiency. If the LSE is deficient again by an amount less than or equal to the maximum of any previous monthly deficiency during a planning year, the financial settlement charge will be 25 percent of the annualized CONE value if the deficiency occurs between July and August or between December and February. For any subsequent deficiency during any other month during a planning year, the LSE will be assessed a financial settlement charge of 8.3 percent (i.e., one-twelfth) of the annualized CONE value. If an LSE has an increase in its deficient MW amount greater than any previous maximum monthly amount for the planning year, the Midwest ISO will assess the annualized CONE value to the incremental amount above the previous maximum monthly deficiency.⁶⁹ The Midwest ISO asserts that this revised plan will create incentives for LSEs to procure sufficient capacity without imposing an excessive penalty on deficient LSEs.

⁶⁵ *Id.* at 8.

⁶⁶ *Id.* at 9.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* at 9-10.

c. Protests

134. Illinois Municipal challenges the Midwest ISO's initial CONE value of \$80,000/MW-year. Illinois Municipal states that the information the Midwest ISO has provided amounts to a mere recital of the factors considered and the types of calculations used, and the methodology the Midwest ISO describes is vague and unsupported. According to Illinois Municipal, the Midwest ISO should provide the spreadsheet analysis supporting its initial CONE value and showing all input assumptions and the mathematical formulae used to compute each element of the overnight construction cost and annual costs which it attributes to the CONE value.

135. Illinois Municipal also asserts that the Tariff provisions describing the subsequent CONE calculation filings should be revised to make clear that the filings will be made under section 205 of the Federal Power Act. Illinois Municipal states that in its Compliance Filing, the Midwest ISO has made no Tariff changes to the governing Tariff provision, section 69.3.8.c. Illinois Municipal asserts that to conform to the Financial Settlements Order the Midwest ISO should be make clear that its revised CONE value will be filed under section 205.

136. In addition, various parties challenge the Midwest ISO's methodology for assessing the CONE value to deficient LSEs. Some parties argue that the Midwest ISO's proposal continues to be excessive and, thus violates the Financial Settlements Order.⁷⁰ Other parties argue that the proposal does not provide sufficient incentive for deficient LSEs to procure sufficient capacity, especially in summer and winter peak months.⁷¹ In other words, the Midwest ISO's proposal is being challenged by parties on both sides of the fence—some who think the penalty is too high and some who think it is too low.

137. Reliant, First Energy, Exelon, Detroit Edison and the Wisconsin Commission argue that the proposed methodology does not provide sufficient incentive for deficient LSEs to procure capacity, especially in the peak months (July, August, December, January, and February). Some of these parties would resolve the issue by assessing a higher percentage of the annualized CONE value in peak months regardless of whether it is the first occurrence or second occurrence. For example, these parties would have the Midwest ISO impose a charge equal to 150 percent of the annualized CONE value for the first month of a deficiency if the deficiency occurred in July, August, December, January or February. However, they would only assess 25 percent of the annualized CONE value if the first deficiency occurred in non-peak months, like March, April, May, October or November. Other parties, like Exelon, would simply require the Midwest ISO to increase

⁷⁰ Illinois Commission, Constellation, CMTC, Illinois Municipal.

⁷¹ Reliant, First Energy, Exelon, Detroit Edison, Wisconsin Commission.

the first deficiency penalty to 150 percent of the annualized CONE value, regardless of the month, and increase the deficiency charge for subsequent deficiencies in peak months to 50 percent of the annualized CONE value. Without higher deficiency charges in peak months, these parties argue that a deficient LSE may have an incentive to accept the penalty instead of procuring sufficient capacity.

138. In contrast, several parties argue that the Midwest ISO's proposal creates an excessive penalty for deficient LSEs. For instance, Constellation argues that the Midwest ISO has failed to justify its proposal to assess 100 percent of the annualized CONE value for the first deficiency. Constellation also argues that the settlement charge will drive the price of capacity up since it acts as a *de facto* cap on capacity prices, and the proposal creates upward pressure by creating artificial constraints. Constellation also believes that the charge should be higher for summer peak months than winter peak months, since summer peak months are periods of greater demand. The Illinois Commission notes that under the Midwest ISO's proposal, a deficient LSE could be charged 2.75 percent of annualized CONE value if it is deficient for an entire year. The Illinois Commission believes such a charge to be excessive.

139. Finally, a few parties argue that the Midwest ISO's proposed Tariff language in section 69.3.7 is ambiguous and does not comport with its explanation of how deficiency charges would be assessed. In particular, these parties note that section 69.3.7 does not mention what the charge will be if a subsequent deficiency occurs in June. Constellation states that section 69.3.7 is ambiguous and inconsistent with the Midwest ISO's explanation of this section in its transmittal letter.

d. Commission Determination

140. We find that the Midwest ISO has met the requirements of the Financial Settlements Order and justified the annualized \$80,000/MW initial CONE value. As set forth in its Compliance Filing, the Midwest ISO based its annualized CONE value of \$80,000/MW on the Market Monitor's 2007 State of the Market Report, which reviewed the overnight capital costs with a five percent contingency factor and the fixed operating and maintenance costs for a conventional combustion turbine in the Midwest ISO. In addition, the Market Monitor incorporated reasonable figures for financing costs and inflation. The Market Monitor also made various accounting assumptions regarding CONE, including, but not limited to, a 50/50 debt equity ratio, a 15-year depreciation rate, tax rates, and a 20-year project life. We find these assumptions, as well the annualized \$80,000/MW CONE value, to be consistent with industry practice and find it to be just and reasonable.

141. We will not order the Midwest ISO to provide the spreadsheet analysis requested by the Illinois Commission or the input assumptions and the mathematical formulae used to compute each element of the overnight construction cost and annual costs which it attributes to the CONE value. The Illinois Commission has provided no evidence

showing that the assumptions used by the Midwest ISO may be contrary to industry practice or unreasonable. Nor do we find any reasonable basis to question the Midwest ISO's calculation or assumptions. On the contrary, it appears that the Midwest ISO's calculation of CONE appears to be consistent with CONE values used in other regional transmission organizations.

142. We also will not order the Midwest ISO to make Tariff revisions stating that it will file any future revisions to the CONE value under section 205. As noted in the Financial Settlements Order, the Midwest ISO has an obligation to file its revisions to the CONE value under section 205 of the Federal Power Act.⁷² We find that this direction should satisfy the Illinois Municipal's concerns regarding future filings.

143. As for the Midwest ISO's proposed assessment of CONE to deficient LSEs, we find this proposal to be just and reasonable and we will accept it, subject to the compliance filing ordered below. In the Financial Settlements Order, we made clear our concerns that Midwest ISO's original proposal (which would have assessed \$80,000/MW for each month of deficiency) may have been excessive, especially if the LSE was deficient in consecutive months. Thus, we directed the Midwest ISO to revise its Tariff to be more granular on a monthly basis by: (1) considering monthly variations in supply-demand (i.e., differences between peak and non-peak months) and (2) finding a reasonable balance between deterring deficiencies and avoiding excessive penalties.⁷³

144. The Midwest ISO's proposal satisfies this directive. By assessing the annualized CONE value of \$80,000/MW for the first deficiency, the Midwest ISO is requiring a deficient LSE to pay 12 times the monthly CONE for a single month's violation. This charge, on one hand, provides a significant deterrent for LSEs to avoid a deficiency in the first instance, especially as LSEs may only be deficient in the one month in which the forecasted peak load for the year occurs. On the other hand, this charge is not too high to be excessive. In short, we find that the Midwest ISO's proposal appropriately balances the interest in ensuring that LSEs have sufficient incentive to comply with their resource adequacy requirements with the interest in avoiding gross incentives to overbuild capacity.

145. For months other than the month of the initial deficiency, the Midwest ISO's revised proposal provides for varying charges depending on whether the deficient month is a peak or off-peak month. This is consistent with the Commission's directive in the Financial Settlements Order to propose a granular deficiency charge that recognizes the different supply-demand situations in different months of the year. Further, the revised

⁷² Financial Settlements Order, 125 FERC ¶ 61,060 at P 75.

⁷³ *Id.* P 99-100.

proposal does not retain the penalty structure that the Commission found to be excessive in the Financial Settlements Order, under which the Midwest ISO assesses the annualized CONE value to an LSE for every month that it is deficient. Instead, by applying the annualized CONE value for the first month's deficiency and, in subsequent months, applying the annualized CONE value for only the incremental amount exceeding the maximum monthly deficiency for prior months, the proposal again balances between deterring deficiencies and avoiding gross incentives to overbuild capacity.

146. We are unable to approve the alternative plans proposed by Reliant or Exelon. While their proposals may be reasonable (a decision we need not make here), the Commission is obligated to approve the Midwest ISO's proposal if that proposal is just and reasonable. The Commission's authority does not "extend to determining whether a proposed rate schedule is more or less reasonable than alternative rate designs."⁷⁴ Here, we find that the Midwest ISO's proposal is just and reasonable and need not determine whether the other proposals are more (or less) just and reasonable.

147. As for Constellation's argument that the proposed assessment of CONE will increase capacity prices, we find that Constellation's argument is ambiguous and unsupported by any evidence. However, if Constellation is concerned that certain market participants may withhold to artificially increase prices, we find that Constellation's concerns should be addressed by the Market Monitor's plan to monitor for any exercise of market power, as discussed above. In addition, we believe that LSEs will have sufficient incentives to procure capacity even after they are assessed a deficiency charge. This is because the assessment of CONE is not the sole means for ensuring adequate incentives for capacity procurement in the Midwest ISO—scarcity pricing also serves this function.

148. Finally, as to concerns regarding the ambiguity of section 69.3.7, we agree that the proposed language is ambiguous and should be revised in a compliance filing. In particular, we direct the Midwest ISO to address the ambiguities raised by Constellation and other parties in their protest regarding the application of the CONE to deficient LSEs. We therefore direct the Midwest ISO to revise this section and submit corresponding Tariff revisions in a compliance filing within 30 days of the date of this order.

3. Deliverability of Load Modifying Resources

149. In the Financial Settlements Order, the Commission accepted the Midwest ISO's commitment to develop appropriate Business Practice Manual provisions to address how

⁷⁴ *Cities of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984).

it will determine the deliverability of load modifying resources in order to qualify as planning resources eligible to participate in the monthly auction.⁷⁵

a. Midwest ISO Compliance Filing

150. On compliance, the Midwest ISO states it currently proposes to determine the deliverability of load modifying resources by applying similar universal deliverability analyses used to determine if a generation resource can qualify for network resource interconnection service. At a November 4, 2008 Demand Response Working Group meeting, the Midwest ISO indicated that participants suggested that if an LSE is meeting its resource adequacy obligations with resources deemed universally deliverable, then using a load modifying resource as a load reduction frees up the universally deliverable resource to meet other LSEs' needs in the energy balance, and the load modifying resource should therefore be qualified to participate in the auction. The Midwest ISO states that it does not believe, however, that all aspects and consequences of this potential market design change have been fully studied and vetted by the Midwest ISO and stakeholders. The Midwest ISO indicates that it will further address the issue through the stakeholder process and "may propose changes to the Tariff and/or Business Practice Manuals as may be necessitated by such discussions."⁷⁶

b. Comments

151. CMTC contends that the Midwest ISO has not complied with the requirement to address deliverability of load modifying resources. It argues that the Midwest ISO instead avoided the issue by passing its responsibility to the "stakeholder process" with an undefined timeline. CMTC argues that unlike generation resources, whose deliverability status is both known and publicly posted, the deliverability of a load modifying resource is not known or posted. It argues that in order for planning resources, including load modifying resources, to participate in the auction, such resources must be deemed to be universally deliverable. CMTC urges the Commission to direct the Midwest ISO to implement the proposed default outcome as suggested at the November 4, 2008 Demand Response Working Group meeting until the Midwest ISO can propose and the Commission approve an alternative approach.

⁷⁵ Financial Settlements Order, 125 FERC ¶ 61,060 at P 54.

⁷⁶ Midwest ISO November 19 Compliance Filing at 4 (Docket No. ER08-394-007).

c. Answers

152. The Midwest ISO asserts that section 69.3.5.c of the Tariff provides that planning resources must be universally deliverable across the Transmission Provider system in order to participate in the voluntary capacity auction. Midwest ISO submits that if a demand resource or behind-the-meter generation cannot demonstrate that it is deliverable, it will not qualify as a planning resource because the auction can only be run if there is a common product. The Midwest ISO explains that if the auction consists of planning resources that are only locally deliverable and other planning resources that are universally deliverable, an LSE making a resource adequacy requirement bid would not be able to determine whether the product it received would satisfy its resource plan.

d. Commission Determination

153. The Midwest ISO initiated a stakeholder process to address how it can determine the deliverability for load modifying resources so that they can qualify as planning resources eligible to participate in the monthly auction and is still considering the outcome of that process. While we appreciate the challenges associated with this task, the Midwest ISO must timely determine the deliverability of load modifying resources.⁷⁷ We direct the Midwest ISO, in the compliance filing to be made within 30 days of this order, to propose a methodology for determining the deliverability of load modifying resources in order to allow these resources to participate in the monthly auction. If the Midwest ISO is unable to propose a methodology in its compliance filing, then it must explain the status of stakeholder discussions, provide a detailed timeline for the development by stakeholders of deliverability rules for load modifying resources and, for the interim, propose a mechanism for participation of load modifying resources in the monthly auction.

4. Procurement of Capacity on Behalf of Deficient LSEs

a. Midwest ISO Compliance Filing

154. The Midwest ISO states it has modified section 69.3.9.a.i of the Tariff to remove the language allowing the Midwest ISO to use financial settlement revenues to procure additional capacity not taken in the voluntary auction.

b. Comments

155. In response to the Midwest ISO's Compliance Filing, FirstEnergy notes that it supports the rehearing requests made by other companies regarding the distribution of

⁷⁷ Financial Settlements Order, 125 FERC ¶ 61,060 at P 54.

financial settlement charge revenues. FirstEnergy believes that, while the *pro rata* basis for distribution of the Financial Settlement Charge Revenues is appropriate, the Midwest ISO should be permitted to ensure resource adequacy within its footprint by either acquiring additional resources before the *pro rata* distribution or mandating that a deficient LSE procure necessary planning resources.

c. Commission Determination

156. We find that FirstEnergy's protest appears to be an untimely request for rehearing. Nonetheless, we addressed these issues in the rehearing section of this order.

5. Other Issues

157. Midwest ISO's Compliance Filing contains other minor Tariff revisions and clarifications. We find these proposed Tariff revisions to be reasonable and accept them.

The Commission orders:

(A) The requests for rehearing are hereby denied, as discussed in the body of this order.

(B) The Midwest ISO is hereby directed to make a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.