

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission System
Operator, Inc.

Docket Nos. ER06-1099-000
ER06-1099-001

ORDER ACCEPTING AND SUSPENDING TARIFF SHEETS AND ESTABLISHING
TECHNICAL CONFERENCE

(Issued August 4, 2006)

1. On June 5, 2006, as amended on June 7, 2006, the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) filed proposed revisions to its Open Access Transmission and Energy Markets Tariff (TEMT), to amend its procedures for addressing shortage and emergency conditions occurring in the real-time energy market. The Midwest ISO requests an effective date of one day after the date when software becomes available to implement the new procedures.¹

2. As detailed below, the Midwest ISO's filing is insufficiently detailed and supported for us to determine whether the proposal is just and reasonable. Accordingly, this order directs Staff to convene a technical conference, with the participation of all intervening parties, to discuss the issues raised in this filing. This order also accepts and suspends the Midwest ISO's proposed revisions, effective the earlier of January 8, 2007, or a date the Commission specifies in an order issued after the technical conference. The Commission's acceptance of the proposed revisions is also subject to further orders following the technical conference.

I. Background and Summary of the Proposal

3. The Midwest ISO proposes to revise its current real-time energy market shortage condition procedures established in section 40.2.15 of the TEMT to include an Adequate

¹ The Midwest ISO estimates that the software will become available in mid-July 2006. The Midwest ISO will notify the Commission when all necessary measures are in place to support its proposed tariff revisions, and will request the effective date to be one day following such notification. Midwest ISO, June 7 Transmittal Letter at 1, 3.

Ramp Capability (ARC) procedure that it will use to address certain contingencies that may affect short-term reliability. The ARC procedure is included as a new Step One to the shortage procedures in section 40.2.15 of the TEMT. Also, the revisions modify and clarify the remaining procedures established in section 40.2.15 to be implemented with the occurrence of a short-term shortage condition.

4. As a transmission system operator, the Midwest ISO must plan, commit, and dispatch generation in an economic and reliable manner, which includes the maintenance of short-term reliability in the real-time energy market. This maintenance involves planning to avoid or resolve energy shortages that could result from the changes in forecasted load and Net Scheduled Interchange (NSI). The Midwest ISO states that it addresses these issues in accordance with good utility practice by managing the amount of available generation margin online.

5. The Midwest ISO states that it has evaluated ways to enhance its ability to manage potential real-time energy shortage conditions. In conjunction with its stakeholders, the Midwest ISO has determined that it is economically and operationally inefficient to maintain unnecessary online reserves during normal conditions, in anticipation of possible future shortage conditions. To avoid over-committing generating unit capacity, the Midwest ISO proposes to utilize a portion of the capacity beyond its economic maximum dispatch level, but below the emergency maximum dispatch level, excluding regulation, in order to respond to real-time energy shortage conditions, even when such shortage conditions do not yet constitute an emergency. The Midwest ISO notes that the uppermost portion of a generating unit's reserve capacity was occasionally utilized for reliability purposes prior to the imposition of the Day 2 market, and that similar reliability considerations warrant continuing that type of practice, modified to reflect price signals available in the Day 2 market.

6. During periods when the ARC procedure is implemented, the Midwest ISO states that the offer price for capacity dispatched shall be the higher of the market participant's submitted offer or a shortage condition peaker proxy offer. The Midwest ISO explains that capacity segments utilized under the ARC procedure shall be dispatched in merit order based on the offer price so determined, and shall be eligible to set locational marginal prices (LMPs). According to the Midwest ISO, the provisions established in Step One further require the Midwest ISO to post on its Open-Access Same-Time Information System the existence of conditions requiring it to dispatch capacity and the period of time that such capacity was dispatched pursuant to the ARC procedure.

7. If the new ARC procedure does not fully resolve a particular contingency within 60 minutes, or if the Midwest ISO requires more than the 50 percent of capacity available under the ARC procedure in order to address the contingency condition, the Midwest ISO will proceed to a revised Step Two which addresses emergency procedures. This revised Step Two combines the old Steps One, Two, and Three of section 40.2.15 into a new Step

Two, which addresses shortage conditions beyond the use of the ARC procedure. In Step Two, the Midwest ISO will have available for dispatch all capacity above the economic maximum level and below the emergency maximum level, less regulation, and can order capacity online that is offline and has been designated as available for use during emergency conditions. The offer price for such capacity shall be the higher of either the market participant's offer or \$1,000/MWh. The Midwest ISO also clarifies that any such capacity will be dispatched in merit order and shall be eligible to set the LMP.

8. The Midwest ISO notes that it is not required to implement Step One before implementing Step Two, but may initiate the procedures described in section 40.2.15 as necessary to address the severity of the shortage or emergency condition. The Midwest ISO claims that such implementation will be undertaken at its discretion, in accordance with good utility practice, in order to ensure the reliability of the transmission system. Also, the old Step Four, which provides for load shedding, remains unchanged, but is simply renumbered into a new Step Three.

III. Notice of Filing, Interventions, and Protest

9. Notice of filing was published in the *Federal Register*, 71 Fed. Reg. 34,914 (2006), with interventions and protests due on or before June 26, 2006. American Municipal Power-Ohio, Inc., WPS Companies,² and Duke Energy Shared Services, Inc. filed timely motions to intervene. Consumers Energy Company (Consumers Energy), the Coalition of Midwest Transmission Customers (CMTC) and Midwest Industrial Customers (MIC), Xcel Energy Services Inc. (Xcel Energy), the Midwest TDUs,³ and Wisconsin Electric Power Company (Wisconsin Electric) filed timely motions to intervene and comment or protest. The Midwest ISO filed an answer to the protests and CMTC and MIC filed an answer to the Midwest ISO's answer. Xcel Energy filed answers to the Midwest ISO's amendment to its filing.

² WPS Companies includes Wisconsin Public Service Corporation, Upper Peninsula Power Company, WPS Energy Services, Inc., and WPS Power Development, LLC.

³ The Midwest TDUs consist of Great Lakes Utilities, Indiana Municipal Power Agency, Lincoln Electric System, Madison Gas & Electric Company, Midwest Municipal Transmission Group, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Southern Minnesota Municipal Power Agency, and Wisconsin Public Power Inc.

IV. Discussion

A. Procedural Matters

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

11. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the Midwest ISO's answer because it has provided additional information that assisted us in our decision-making process. We are not persuaded to accept Xcel Energy's or CMTC and MIC's answers and will, therefore, reject them.

B. Issues Raised in Comments and Protests

1. Benefits of Changes

12. Opinions vary on the benefits of implementing the newly proposed shortage procedures in section 40.2.15. A number of intervenors support the changes. For example, Consumers Energy supports the ARC concept, and believes that these procedures will most likely reduce the level of Revenue Sufficiency Guarantee (RSG) payments.

13. However, other parties, including the Midwest TDUs, and CMTC and MIC, are not convinced that the changes will be beneficial. The Midwest TDUs state that it appears the procedure is not intended for a "real-time shortage" of energy but for a shortage of within-the-hour ramp capability. Along with CMTC and MIC, they state that with the ARC procedure, the Midwest ISO does not intend to commit as many generation resources up-front, and will dip into spinning reserves in real time if ramping capability becomes a limiting factor. To replenish spinning reserves, these parties say that the Midwest ISO will bring additional units online or ramp up other online units. Thus, use of the ARC procedure reflects an economic dispatch decision and not a true generation shortage.

14. These parties also state that the Midwest ISO has failed to show that the use of the ARC procedure will result in least-cost dispatch. They state that any reduction in RSG payments cannot be viewed in isolation, but must be evaluated along with the effects on LMPs. The Midwest TDUs state that the Midwest ISO filing fails to demonstrate that its proposal will produce just, reasonable, and not unduly discriminatory rates. They say

that the Commission must require the Midwest ISO to supply an analysis that considers both RSG and the impact of ARC-elevated LMPs before the proposed tariff change can be fairly evaluated.

15. The Midwest TDUs say the Midwest ISO's proposal would send peak or super-peak price signals during periods of ramp shortages. Rather than being an appropriate price signal reflecting "prevailing supply conditions" as the Midwest ISO claims, the Midwest TDUs believe the Midwest ISO's proposal could greatly increase LMPs over large portions of the Midwest as a result of the Midwest ISO's dispatch choices. They believe market participants will be unable to protect themselves from exposure to excessive LMPs associated with implementation of the ARC procedure. The Midwest TDUs also say that the Midwest ISO has failed to provide any analysis supporting witness Dr. Ronald R. McNamara's claim that total RSG payments will decline.

16. The Midwest TDUs say that the Midwest ISO does not provide any analysis of the competitiveness of the market for above-economic maximum generation capacity and the opportunities for exercising market power, potentially with locational impacts due to the constraints. They add that this tariff change may reduce the transparency of the causes of the price movements in the Midwest ISO's market and reduce the Midwest ISO's accountability for the costs imposed by its commitment choices.

17. The Midwest ISO answers that the proposed ARC procedure is an appropriate extension of the Midwest ISO's existing authority to address and resolve shortage conditions that may adversely affect system reliability through the dispatch of unit capacity in excess of such unit's economic maximum, but below its emergency maximum, excluding regulation. The Midwest ISO clarifies that the proposed language extends the authority the Midwest ISO already has by allowing it to incrementally address these issues before they develop into an emergency. The Midwest ISO also claims that there is no merit to the Midwest TDUs', CMTc and MIC's assertions that the ARC procedure's reliability rationale and price signal advantages are somehow undercut by the fact that the Midwest ISO's earlier "economic" dispatch decisions could affect the extent of ramp capability at the time energy shortages arise, because unforeseen energy shortages are by their very nature unpredictable with regard to ramp capability.⁴ According to the Midwest ISO, the ARC procedure is intended to provide the Midwest ISO an additional means of addressing system reliability and avoiding potential emergency conditions, while providing an appropriate payment to generation resources.⁵

⁴ Midwest ISO July 11, 2006 Answer at 10.

⁵ *Id.* at 11. *See also* McNamara Affidavit at 5.

18. The Midwest ISO further answers that during the brief periods of time when such resources are needed to address temporary supply and demand imbalance conditions that could lead to emergency conditions if not properly addressed, it is appropriate that prices reflect prevailing supply and demand conditions. It says failure to use pricing as proposed under the ARC procedure would undermine reliability during shortage conditions. The Midwest ISO asserts that that pricing based on the higher of the unit offer for generation above economic maximum or a proxy peaker price assures that prevailing market prices do not fall when ARC is employed, and thus do not discourage appropriate market responses.

2. Pricing

19. Consumers Energy, while supporting the ARC concept, believes that neither the filing nor the supporting affidavits provide sufficient detail on the Midwest ISO's method of calculating the shortage condition peaker proxy offer. In particular, it says neither the proposed TEMT language nor Dr. McNamara's explanation sufficiently identifies the components of the single-hour offer price, and whether it includes start-up costs, no-load costs, and/or the incremental energy offer. Consumers Energy also says the Midwest ISO must add language that identifies the specific methodology that will be used to convert the offer price into the proxy heat rate. It further argues that the Midwest ISO should clarify that natural gas combustion turbines are the only combustion turbines to be used in the calculation of the proxy price.

20. Wisconsin Electric says the Midwest ISO has omitted terms of the proxy heat rate calculation required to convert offer prices into heat rates. It says that the Midwest ISO should describe in its compliance filing why the particular proxy heat rate calculation was chosen. Wisconsin Electric also says that the Commission should require the Midwest ISO to post the monthly proxy heat rate that it calculates for each month, so all market participants know how their offers compare.

21. In its answer, the Midwest ISO clarifies that the single-hour offer price includes start-up and no-load costs, and the incremental energy offer. The Midwest ISO also clarifies the manner in which the offer price will be converted to the proxy heat rate. With respect to how the Shortage Condition Peaker Proxy (SCPP) Offer price will be calculated and what it will include, the Midwest ISO states that it is willing to incorporate such clarifications in its Business Practice Manuals or revise its TEMT language, as appropriate. Finally, the Midwest ISO rejects Consumers Energy's assertion that the calculation of the SCPP Offer price should only take into account natural gas-fired combustion turbines. The Midwest ISO states that the purpose of the SCPP methodology "is to provide a pricing proxy that reflects the type of unit(s) (*i.e.*, peaking units) that would otherwise have been dispatched to immediately resolve the reliability condition

before it develops into an Emergency.”⁶ The Midwest ISO states that the large majority of combustion turbine peaking units are natural gas fired, but that such combustion turbines may be both natural gas and/or oil-fired units.

3. Triggering Section 40.2.15

22. Xcel Energy states that the Midwest ISO must more clearly define the scope of the emergency conditions that implicate the emergency dispatch procedures, to ensure the fair and consistent dispatch of market participants’ generation facilities. It notes that the definition of “emergency” in section 1.80 of the TEMT is circular. Xcel Energy states that without a clear definition of an emergency, there could be inconsistent application of section 40.2.15’s real-time balancing of supply and demand. It says that the Commission should require the Midwest ISO to revise section 1.80 and/or section 40.2.15 to more clearly state what constitutes an emergency and the conditions under which section 40.2.15’s rates, terms and conditions should apply. Xcel Energy also says that the TEMT should explicitly state that by default, any time the Midwest ISO directs a generator to dispatch into its operating reserve range, the ARC procedure is in effect and the pricing provisions in section 40.2.15 should apply.

23. The Midwest ISO asserts that proposed section 40.2.15 clearly states that offline resources may be called upon only in Step Two of the shortage procedures. However, the Midwest ISO is willing to clarify this further in Step One by adding the adjective “online” to the phrase “Generation Resource” in order to indicate that Step One does not include offline resources. The Midwest ISO also says that Xcel Energy does not accurately recognize that the Step One ARC procedure applies to shortages that do not yet amount to an actual emergency or that the Step Two procedure applies not only to emergencies, but also to situations where shortage conditions last more than sixty minutes or the capacity dispatched under Step One fails to restore demand-supply balance.

4. Penalties and Reversion of Resources to the Market Participant

24. Xcel Energy states that the shortage procedures should be revised so that the market participants’ generation resources dispatched in Step One or Step Two are not assessed uninstructed deviation penalties or subject to RSG uplift or make-whole payments. Requiring market participants to dispatch a generation resource in response to a Step One or Step Two event may require that resource to deviate by more than 10 percent from the Midwest ISO’s real-time dispatch instructions and thus subject the

⁶ Midwest ISO July 11, 2006 Answer at 5.

market participant to RSG uplift charges, uninstructed deviation penalties, or the loss of eligibility to receive a full RSG make-whole payment.

25. Consumers Energy says that if a contingency occurs during a period when the Midwest ISO is using the ARC procedure, responsible market participants' ability to respond to the contingency and meet the requirements of the North American Electric Reliability Council (NERC) and/or the Regional Reliability Organization (RRO) may be impaired. Similarly, Consumers Energy says that the market participant's ability to meet load regulation requirements may be temporarily lessened when the Midwest ISO is utilizing the ARC procedure. Thus, it says, the NERC, RRO or another organization's performance measures for the responsible market participant may indicate a violation of criteria, and expose that market participant to sanctions. Consumers Energy says that throughout the stakeholder process it understood that the market participant would not be subject to penalties under these circumstances, and it asks for such clarification from the Midwest ISO and/or the Commission.

26. Xcel Energy states that section 40.2.15 must be revised to provide that the Midwest ISO will release operating reserves back to a market participant upon the occurrence of a reserve-sharing event if a Disturbance Control Standard event occurs while the Midwest ISO is requiring generators to be dispatched during Step One or Step Two of the shortage procedures. It notes that at the May 2, 2006 Midwest ISO Markets Subcommittee meeting concerning proposed section 40.2.15, stakeholders voted 27 to 0 that section 40.2.15 should state that market participants would not be subject to RSG uplift or uninstructed deviation penalties, or lose their RSG make-whole eligibility, when dispatched during either Step One or Step Two.

27. In its Answer, the Midwest ISO agrees that market participants should not be penalized for following its directives, including dispatch instructions and ARC instructions. It states that this is already recognized in section 10.7 of the TEMT, and that no further tariff changes are needed to avoid this situation. The Midwest ISO says it is willing to modify proposed section 40.2.15 to specify that the portion of operating reserves utilized pursuant to the ARC procedure would be returned to a market participant upon the occurrence of a reserve sharing or DCS event.

5. Waiver of the Required 60-Day Notice Period

28. CMTC and MIC note that in its transmittal letter, the Midwest ISO requests that the effective date of the proposed tariff sheets be June 6, one day after its filing.⁷ CMTC and MIC say that the Midwest ISO's request for waiver of the 60-day notice period

⁷ Midwest ISO later amended this to approximately mid-July, because its software was not ready for the change.

should be denied because the Midwest ISO did not show good cause for allowing the revised shortage procedures to go into effect immediately. They say that the Midwest ISO has not demonstrated that the proposed procedures address short-term reliability concerns as it claims. Although they agree that RSG payments may be reduced, CMTC and MIC believe the dollars will be made up, at least to some extent, in the form of higher energy prices. They further assert that the Midwest ISO has not shown whether the revised shortage procedures will improve the efficiency of the Midwest ISO coordinated markets, and will actually reduce RTO-related costs for customers. Until those questions are answered, the Commission should not rush to place the revised shortage procedures into effect.

C. Commission Determination

29. We find that the Midwest ISO has not demonstrated that good cause exists to justify waiver of the Commission's 60-day prior notice requirement.⁸ Accordingly, we will deny the Midwest ISO's request for waiver of this requirement.

30. The Midwest ISO's filing raises a number of issues that would benefit from further exploration by the advisory staff and the parties. In particular, we believe that the Midwest ISO needs to clarify several points about the shortage procedures. Specifically, the reserves in question in Steps One and Two of the shortage procedures and the circumstances under which the different steps can be implemented are not sufficiently clear. We also believe that the development of the proxy price needs to be discussed in more detail. In addition, we believe that the justification for the "higher of" pricing needs to be better established. Further, the application of market power mitigation within the new process needs to be clarified. The Midwest ISO needs to explain in more detail the effects on RSG of using ARC. The Commission suggests that the Midwest ISO consider how demand response may or may not be able to be integrated into its shortage procedures. Lastly, we are concerned that the new ARC procedure may harm reliability in the Midwest ISO region. As such, we find that a five-month suspension of the proposed rate is justified,⁹ and we will direct the Staff to convene a technical conference.

⁸ *Central Hudson Gas & Electric Corp.*, 60 FERC ¶ 61,106, at 61,339, *reh'g denied*, 61 FERC ¶ 61,089 (1992).

⁹ *West Texas Utilities Co.*, 18 FERC ¶ 61,189, at 61,375 (1982) ("[I]n cases in which...other, extraordinary factors indicate that the wholesale customers may suffer irreparable harm absent a five-month suspension, we shall order a maximum suspension.").

31. Our preliminary analysis of the Midwest ISO's proposed revisions to its TEMT indicate that they have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. Accordingly, we will accept the Midwest ISO's proposed tariff sheets for filing and suspend them for up to five months, to become effective the earlier of January 8, 2007, or a date specified in a further Commission order, subject to refund and to further orders following the technical conference.

The Commission orders:

(A) The Midwest ISO's revised tariff sheets is accepted and suspended, to be effective the earlier of January 8, 2007, or a date specified in a further order, subject to refund and subject to the outcome of a technical conference.

(B) The Commission's Staff is hereby directed to convene a technical conference to explore the issues raised in the Midwest ISO's proposed shortage procedure (including ARC), as discussed in the body of this order. The Staff is to report the results of the technical conference to the Commission within 90 days of the date of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.