

135 FERC ¶ 61,082
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Midwest Independent Transmission
System Operator, Inc.

Docket No. ER08-394-023

ORDER ON COMPLIANCE FILING

(Issued April 27, 2011)

1. This order accepts the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) July 31, 2009 compliance filing, which contains the Midwest ISO's annual recalculation of the Cost of New Entry (CONE) (July 31 Filing), to be effective June 1, 2010.

I. Background

2. In an order issued on October 20, 2008 (October 20 Order),¹ the Commission conditionally accepted the Midwest ISO's proposal, among other things, to allow load serving entities (LSE) with insufficient capacity to satisfy their resource adequacy requirements with planning resources acquired from market participants with excess planning resources. The provisions allow deficient LSEs to acquire sufficient capacity either through the bilateral markets or via a voluntary capacity auction. However, for those LSEs that continue to be deficient, the Midwest ISO proposed to assess a financial settlement charge based upon the annual CONE—that is, the estimated annual capital, operating, and other costs that would be incurred to develop a capacity resource in the Midwest ISO.

3. In the October 20 Order, the Commission accepted the Midwest ISO's proposal to reassess and recalculate the CONE value on an annual basis.² However, the Commission

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

² *Id.* P 75-76.

did not accept the Midwest ISO's estimated annual CONE value of \$80,000/MW.³ Rather, the Commission found that the Midwest ISO had not provided adequate information for the Commission to determine the reasonableness of the proposed initial CONE figure. Therefore, the Commission required the Midwest ISO to further justify the calculation of the initial CONE figure in a compliance filing and to provide additional information including a detailed description of the process for determining the CONE value, the input data, and the assumptions used to derive the CONE value.

4. The Commission also raised concerns that the proposed monthly financial settlement charge equal to the annual CONE value, i.e., \$80,000/MW-month, for each month's deficiency, could be excessive when charged to LSEs in multiple months. Accordingly, the October 20 Order rejected the Midwest ISO's proposal to assess the full annual CONE value for each month's deficiency and directed it "to propose a more granular monthly deficiency charge, which should be tailored to deter deficiencies without being excessive on a monthly or cumulative basis."⁴

5. On compliance, the Midwest ISO provided additional justification for its CONE estimate of \$80,000/MW, including detailed information regarding its basis for the estimate. In particular, the Midwest ISO noted that its CONE value 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. The Market Monitor determined that capital costs for such a turbine would be \$555/kW and the fixed operating costs would be \$12.55/kW-year. The Market Monitor further made certain assumptions regarding the costs of the combustion turbine, including a 50/50 debt to equity ratio, 15-year depreciation, 20-year project life and loan term, 7 percent interest rate, 3 percent escalation factor, 2.5 percent GDP deflator, 43 percent combined federal and state tax rate, and 12 percent return on equity.

6. The Midwest ISO also proposed revisions as to how the penalty would be assessed. For the first deficiency in any month, the Midwest ISO proposed to assess the full annual CONE value, \$80,000/MW-month. For any subsequent monthly deficiencies, the Midwest ISO proposed to assess a penalty of 8.3 percent (or one-twelfth) of \$80,000/MW, unless the deficiency occurred between the peak months of July through August or December through February, in which case the monthly penalty would be 25 percent of \$80,000/MW.

³ *Id.* P 74.

⁴ *Id.* P 100.

7. The Commission accepted the Midwest ISO estimated CONE value, as well as its monthly assessment proposal, on April 16, 2009, to be effective June 1, 2009.⁵ In that order, the Commission found that the Midwest ISO's estimated annual CONE value of \$80,000/MW was just and reasonable. The Commission further found that the Midwest ISO's methodology and its assumptions were consistent with industry practice and were just and reasonable.⁶

II. Notice of Compliance Filing and Responsive Pleadings

8. Notice of the July 31 Filing was published in the *Federal Register*, 74 Fed. Reg. 40,177 (2009), with interventions and comments due on or before August 21, 2009. The Illinois Municipal Electric Agency and the Coalition of Midwest Transmission Customers (collectively, Protestors) filed a joint protest to the Midwest ISO's filing. Calpine Corporation filed a motion to intervene out of time on August 24, 2009. The Midwest ISO filed a motion to answer and answer to the protest. Protestors also filed an answer to the Midwest ISO's answer.

III. Discussion

A. Procedural Matters

9. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure⁷ prohibits an answer to a protest or an answer, unless otherwise ordered by the decisional authority. We will accept the answers of the Midwest ISO and Protestors. These answers have provided information that assisted us in our decision-making process.

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,⁸ the Commission will grant Calpine Corporation's untimely, unopposed motion to intervene out of time given its interest in the proceeding, the early stage of this proceeding, and the absence of any undue prejudice or delay caused by the filing.

⁵ *Midwest Indep. Transmission Sys. Operator, Inc.*, 127 FERC ¶ 61,054, at P 140-148 (2009) (April 16 Order).

⁶ *Id.* P 140-141.

⁷ 18 C.F.R. § 385.213(a)(2) (2009).

⁸ 18 C.F.R. § 385.214 (2009).

B. Substantive Matters

1. Midwest ISO Filing

11. The Midwest ISO proposes to set the estimated annual CONE value for Planning Year 2010/2011 (i.e., June 1, 2010 through May 31, 2011) at \$90,000 per MW.⁹ The Midwest ISO emphasizes that its estimate is based on the 2009 Energy Outlook Analysis issued by the Energy Information Administration, which was the most current analysis available and reflects estimated costs for the 2009 Planning Year. The report contained detailed cost information for several types of resources in the Midwest ISO region, including the costs associated with gas combustion turbine resources. The Midwest ISO asserts that its use of cost data for a new combustion turbine is consistent with Commission policy.¹⁰

12. The Midwest ISO notes that the estimated annual CONE value of \$90,000/MW-year is based on the overnight capital costs with a five percent contingency factor and the fixed operating and maintenance costs for a conventional combustion turbine. Midwest ISO notes that combustion turbines have been used as the basis for the cost of new entry in other regional transmission organizations (RTO) and independent system operators (ISO) and this basis has been approved by the Commission. To calculate this value, the Market Monitor determined that capital costs for such a turbine would be \$638/kW and the fixed operating costs would be \$12.55/kW-year. The Market Monitor further made certain assumptions regarding the costs of the combustion turbine, including a 50/50 debt to equity ratio, 15-year depreciation, 20-year project life and loan term, 7 percent interest rate, 3 percent escalation factor, 2.5 percent GDP deflator, 43 percent combined federal and state tax rate, and 12 percent return on equity.

13. The Midwest ISO explains that while it could have adjusted the 2009 estimates to reflect the capital and operating costs for the 2010 Planning Year, the Midwest ISO decided not to adjust these values, in part, because there was a current excess reserve position in the Midwest ISO and a decrease in demand. The Midwest ISO further notes that there was no strong opposition from stakeholders to using the Market Monitor's suggested approach to determining these estimated values. The Midwest ISO also believes that the proposal is reasonable, in part, because the market for capacity requires

⁹ In its filing, the Midwest ISO indicated that the filing was being made jointly with its independent market monitor, Potomac Economics. However, since the market monitor is not a jurisdictional entity and cannot submit a section 205 filing, the order treats the filing as though only the Midwest ISO proposed changes to its tariff.

¹⁰ Midwest ISO Transmittal Letter at 4 (citations omitted).

capacity costs to be recovered during a relatively short period, often during one month during the summer. In addition, the Midwest ISO notes that, unlike other RTOs and ISOs, where the CONE value is charged to parties to represent the actual cost of capacity, in the Midwest ISO the CONE value does not set prices but just establishes the penalty that will be charged for deficiencies.

2. Protest

14. Protesters argue that the Commission should reject the Midwest ISO's proposed CONE value, claiming that the request is without support and has not been shown to be just and reasonable. They claim that the record is sparse and does not support the proposed 12.5 percent increase from the initial annual CONE value of \$80,000 per MW. They assert that Market Monitor's analysis alone is not sufficient to justify the proposal. Nor do they believe that the Midwest ISO has justified the assumptions used by the Market Monitor to reach its estimated CONE value.

15. Protesters argue that the Midwest ISO must develop a CONE estimate based on the actual cost of entry for the specific region—not a figure derived by referencing general assumptions and values developed for other RTOs and ISOs. Protesters assert that the Commission has rejected the very type of generalized approach that the Midwest ISO used here.¹¹ Protestors further contend that the Midwest ISO has not justified the five percent contingency factor and an additional 7.5 percent to reflect financing costs.¹² Protesters claim that support for each of these factors is fundamental to meeting the requirements of section 205.

16. Protesters take exception to the Midwest ISO's justification for the CONE value based on the CONE value's role in the determination of the monthly penalty, stating that it is unlikely that a generator is built on the expectation of recovering its cost on the basis of one-month's capacity sales per year. They also argue that the Midwest ISO fails to show how the recovery period has any relation to the cost of building. Finally, Protesters

¹¹ Protesters Protest at 4-5 (citing *PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,275, at P 52 (2009)).

¹² Protestors also argue for more detail in the explanation of the assumptions. Protesters note that these assumptions are the same as those used to support the original CONE value. They also ask for an explanation on the following: (1) whether the 3 percent escalation factor and 2.5 percent GDP deflator results in duplicative cost accounting; (2) whether the 15-year depreciation is for tax depreciation or book depreciation; (3) whether a 20-year project life and 43 percent combined federal and state tax rate is appropriate; and (4) evidence supporting the fixed operation and maintenance value of \$12.55 per kW-year.

assert that if it is less important for an annual value to be precise, as the Midwest ISO claims, then there is credible reason and support for making no rate change.

3. Answers

17. In its answer, the Midwest ISO responds that the Market Monitor and the Midwest ISO have complied with the Tariff by conducting the necessary analysis to calculate a proper CONE value for the next Planning Year. The Midwest ISO explains that it included numerous factors when evaluating the CONE value, including: (1) the type of physical generation facilities and the applicable fixed operating and maintenance costs for such facilities; (2) the applicable financial factors (such as overnight capital costs and 5 percent contingency cost for cost overruns); (3) an appropriate debt to equity ratio, depreciation time frame and project life; (4) interest rates and escalation factors; (5) consideration of tax implications; and (6) a reasonable return on equity.

18. These assumptions, according to the Midwest ISO, are the same assumptions that Midwest ISO used to justify the initial annual CONE value of \$80,000/MW, which the Commission accepted in the April Order. As for the increase to \$90,000/MW, the Midwest ISO notes that the Producer Price Index (PPI) for electric power generation rose 10.2 percent from 2007 to 2008 and this increase, along with inflation, caused the increase.

19. The Midwest ISO reiterates that three methods for recalculating CONE were discussed with stakeholders at the Market Subcommittee meeting on July 7, 2009, and also at the Supply Adequacy Work Group meeting on July 9, 2009. According to the Midwest ISO, no stakeholders (including Protesters) expressed an objection to the use of this methodology during their meetings. The Midwest ISO contends that in the absence of any credible, documented evidence from Protesters that any of the factors were not reasonable, the Commission has no basis for rejecting its proposal.¹³

20. In response, Protesters argue that the Midwest ISO's answer should be rejected because it fails to provide any new information or arguments.¹⁴ If, however, the Commission were to consider the answer, the Protesters reiterate their view that the Midwest ISO has not provided sufficient justification for its proposed CONE value.

¹³ The 2008 State of the Market Report is *available at*: http://www.midwestiso.org/publish/Document/7e7fdb_1225bf59491_7e090a48324a/2008%20State%20of%20the%20Market%20%20Final%20text.pdf?action=download&_property=Attachment.

¹⁴ 18 C.F.R. § 385.213. Protesters request that should the Commission accept the Midwest ISO's answer, it should also accept their answer in response.

21. Protesters further challenge the Midwest ISO's claim that the Protestors have an obligation to provide evidence showing that the assumptions are not just and reasonable. Protesters argue that such an assertion turns the respective statutory burdens of sections 205 and 206 inside out. Protestors explain that the Midwest ISO, as the filing party, bears the burden of demonstrating that its proposal is just and reasonable. Protestors do not believe that the Midwest ISO has met that burden.

22. Moreover, contrary to the Midwest ISO's answer, Protesters do not consider relevant the discussions of possible methods for recalculating the annual CONE values with stakeholders. Protesters state that methodology alone cannot support a rate proposal under section 205 and that there must be some basis in the record supporting the proposed CONE value. They point out that the Commission has made clear it will make its own assessments when exercising its statutory responsibility.¹⁵

4. Commission Determination

23. We accept the proposed revised annual CONE value of \$90,000 per MW, to be effective June 1, 2010. As noted in its answer, the Midwest ISO's proposed CONE value was calculated based on the same methodology and all of the same assumptions that were used in its previous CONE estimate, with the exception of an updated capital cost estimate. In the April 16 Order, the Commission found that the methodology and the assumptions were consistent with industry practice and just and reasonable.¹⁶ Protestors have provided no basis to revisit that decision here. Nor have they provided us with a basis to question the justness and reasonableness of the Midwest ISO's methodology for estimating the CONE value. We continue to find the methodology and assumptions – including the updated capital cost estimate, discussed below -- to be just and reasonable.

24. While Protestors generally challenge the increase in the proposed CONE value, that change was the result of an increase in the capital cost estimate, from \$555 per kW to \$638 per kW based on analysis developed by the Energy Information Administration for the 2009 Annual Energy Outlook.¹⁷ We note that the Midwest ISO used the 2008 Annual Energy Outlook to determine the \$555 per kW capital cost estimate that we accepted to establish the initial annual CONE value and find that the Midwest ISO's use of the 2009 Annual Energy Outlook, reflecting capital cost information that updates the

¹⁵ See *Midwest Indep. Transmission Sys. Operator, Inc.*, 128 FERC ¶ 61,052, at P 18 & n.20 (2009) (citation omitted).

¹⁶ April 16 Order, 127 FERC ¶ 61,054 at P 140.

¹⁷ Midwest ISO Transmittal Letter at 4.

earlier analysis used in the previous year's CONE estimate, for its increased capital cost estimate is just and reasonable.

25. We also disagree with Protestors' claim that the proposed CONE value is not tied to the cost of entry specific to the Midwest ISO region. The record plainly demonstrates otherwise. The Midwest ISO used the 2008 State of the Market Report for the Midwest ISO and that report examined the cost of new entry for the Midwest ISO region based on a region-specific analysis in the 2009 Annual Energy Outlook. As noted above, this is the same type of analysis that the Commission accepted for the Midwest ISO's previous CONE estimate. We find no reasonable basis to question the validity of that study. With regard to Protestors' concern with duplicative cost accounting in the 3 percent escalation factor and 2.5 percent GDP deflator assumptions, we do not find any basis for duplication of costs. These assumptions, typical for project cost accounting, simply assume that operating costs increase at 3 percent per annum over the 20-year project life, and that all future costs are brought back into a current dollar value with a 2.5 percent per annum deflator.

26. Finally, we do not agree with Protestor's claim that the Midwest ISO has not provided sufficient support for its CONE estimate. As the Commission has emphasized, the purpose of the CONE estimate is to set a value for penalties in the event that an LSE is resource deficient and to determine the economic withholding threshold for auction bidding mitigation.¹⁸ As discussed above, we find that the Midwest ISO has provided sufficient evidence to support the CONE value and we find it to be just and reasonable.

The Commission orders:

The Midwest ISO's proposed tariff provisions are hereby accepted for filing, to become effective June 1, 2010, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

¹⁸ April 16 Order, 127 FERC ¶ 61,054 at P 45.