141 FERC ¶ 61,204
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission System Operator, Inc. — Docket No. ER10-1361-001

ORDER ON REHEARING AND CLARIFICATION

(Issued December 11, 2012)

1. In an order issued July 30, 2010, the Commission rejected the Midwest Independent Transmission System Operator, Inc.'s (MISO) proposed revisions to its Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff) to further refine the allocation of the costs of Operating Reserves.[1] For the reasons discussed below, we deny the request for rehearing of the July 30 Order. We also provide clarification and deny the motion to submit supplementary data.

I. Background

2. On September 14, 2007, as amended on September 19, 2007,[2] MISO submitted a filing to implement a Day-Ahead and Real-Time Ancillary Services Market. In this

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[1] *Midwest Indep. Transmission Sys. Operator, Inc.*, 132 FERC ¶ 61,088 (2010) (July 30 Order). Operating Reserves are the capability above firm system demand maintained to provide for Regulation, load forecast error, equipment forced and scheduled outages, and local area protection. They consist of Regulating Reserve and Contingency Reserve. MISO FERC Electric Tariff, section 1.486.

[2] *See* Midwest Independent Transmission System Operator, Inc. Electric Tariff Filing To Reflect Ancillary Services Markets, Docket No. ER07-1372-000 (filed September 14, 2007) and Midwest Independent Transmission System Operator, Inc. Amendment To Tariff Filing Regarding Ancillary Services Markets, Docket No. ER07-1372-001 (filed September 19, 2007). On January 6, 2009, MISO started its Ancillary Services Market.

filing, MISO divided its reserves markets into zones and specified a zonal requirements analysis in order to allow for the reliable dispersion of Operating Reserves throughout the MISO Balancing Authority Area. These filings proposed allocating the costs of Regulating and Operating Reserves via two rates in schedules 3, 5, and 6.

3. On February 25, 2008, the Commission issued an order conditionally accepting MISO's September filings, subject to certain compliance and reporting requirements.[3] However, the Commission found MISO's zonal rate proposal unjust and unreasonable due to resulting inequities between market participants in reserve zones with low reserve requirements and those in reserve zones with high reserve requirements.[4] The Commission required MISO to file a revised allocation "that allocates costs of reserves in a zone to load in the zone."[5]

4. On March 26, 2008, MISO submitted its compliance filing to the ASM Order, including a revised zonal cost allocation method (Grouped Zonal Method) applicable to schedules 3, 5, and 6. The Grouped Zonal Method allocates net Operating Reserve procurement costs within Binding Settlement Zones[6] to real-time Load[7] within the Binding Settlement Zone, and allocates net Operating Reserve procurement costs within Non-Binding Settlement Zones[8] to real-time Load within the Non-Binding Settlement Zones.

[3] *Midwest Indep. Trans. Sys. Operator, Inc.*, 122 FERC ¶ 61,172 (2008) (ASM Order).

[4] *Id.* P 412.

[5] *Id.* P 421.

[6] Binding Settlement Zones are Reserve Zones with market clearing prices for reserves greater than the minimum market clearing price for reserves in all Reserve Zones in the day-ahead and real-time reserve markets. (*See* section 1.51 of Midwest ISO's Tariff).

[7] All Loads used to calculate reserve charges exclude Carved-Out Grandfathered Agreement (GFA) load.

[8] Non-Binding Settlement Zones are the combination of all Reserve Zones that are not Binding Settlement Reserve Zones. (*See* section 1.459 of Midwest ISO's Tariff).

5. On June 23, 2008, the Commission issued an order denying rehearing of the ASM Order's requirement that reserve costs in a zone be allocated to load in the zone.[9] On the same day, the Commission issued an order that, among other things, accepted MISO's Grouped Zonal Method, and further required a compliance filing to provide a revised cost allocation for Carved-Out GFAs.[10] On December 18, 2008, the Commission denied rehearing of the ASM Rehearing Order and accepted MISO's further compliance filings, regarding the allocation of reserve procurement costs.[11]

6. On May 28, 2010, MISO filed proposed revisions to its Tariff to allocate Operating Reserve costs based on a Market Load Ratio Share Method.[12] MISO

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[9] *Midwest Indep. Trans. Sys. Operator, Inc.*, 123 FERC ¶ 61,297, at P 19 (2008) (ASM Rehearing Order):

> We deny the requests for rehearing of the Commission's requirement that reserve costs in a zone be allocated to the load in the zone, but provide some clarification. Contrary to the arguments of certain parties, we consider this cost allocation reflective of cost causation, since reserves are procured to manage local reliability. We interpret Midwest TDUs' argument to be that there is some amount of reserves that are procured in a zone that are above and beyond the requirements of the zone, and therefore the costs of these reserves should not be allocated to the zone. We do not dispute Midwest TDUs' argument that reserves in one zone can benefit another zone, but, as the Commission acknowledged in the ASM Order, the primary purpose of the reserves in a zone is to manage local reliability in the zone; a zonal cost allocation thus best reflects cost causation. Simply put, the Midwest ISO will not purchase reserves unless it can manage reliability in the zone in which the reserves are located.

[10] *Midwest Indep. Trans. Sys. Operator, Inc.*, 123 FERC ¶ 61,296, at PP 26-30 (2008).

[11] *Midwest Indep. Trans. Sys. Operator, Inc.*, 125 FERC ¶ 61,322, at PP 16-19, 23-26 and 40-42 (2008).

[12] In the Market Load Ratio Share Method, "the total procurement cost for each Operating Reserve product is allocated to the appropriate Cost Allocation Distribution Volume defined as Market Load in the case of Regulation Reserve or Market Load plus physical exports for Spinning and Supplemental Reserve. This method produces one allocation rate per Reserve product for the entire footprint and does not account for variances between reserve clearing in individual Reserve Zones, variation in Market

(continued…)

explained that a cost allocation study it performed indicated that the currently effective Grouped Zonal Method allocated a lower percentage of Regulating Reserve costs to constrained Reserve Zones that frequently bind on minimum zonal Regulating Reserve requirements. As a result, a larger amount of Regulating Reserve costs were shifted to non-constrained Reserve Zones. For this reason, MISO concluded that the currently effective Grouped Zonal Method needed to be replaced in order to balance the equities between the cost of reserves on a zonal and market-wide basis, taking into account the reasons for binding constraints and for price separation, and the parties that are paying for reserves. MISO asserted that the Market Load Ratio Share Method avoids the disproportionately larger allocation of Regulating Reserve procurement costs to non-constrained Reserve Zones under the current Grouped Zonal Method.

7. In the July 30 Order, the Commission rejected MISO's proposal, stating that it was not just and reasonable because it did not follow the Commission's cost causation principles. The Commission explained that the proposed Market Load Ratio Share Method did not take into account how MISO purchases reserves, nor the reasons for the incurrence of reserve costs. Noting that the result of the proposed Market Load Ratio Share Method would be that all zones would pay the same megawatt hour rate for Regulating Reserves, even though some zones have significantly higher cost reserves than other zones, the Commission found that this would produce a subsidy from low-cost to high-cost zones that was unduly discriminatory. The Commission concluded that since MISO has zonal reserve requirements based on a reliability analysis for each respective zone, a proper methodology would require the load beneficiaries in each Binding Settlement Zone to pay for the higher cost of meeting the reserve requirements of the zone.[13]

8. The Commission also stated in the July 30 Order that an alternative allocation considered by MISO, the Adjusted Group Zonal Method, created a subsidy to Non-Binding Settlement Zones since this method subtracted the costs of high-cost reserves from Non-Binding Settlement Zone costs.[14]

Clearing Prices between Reserve Zones, obligation and actually cleared reserve volumes." *See* MISO May 28, 2010 filing at Tab C at 4.

[13] July 30 Order, 132 FERC ¶ 61,088 at P 43-48.

[14] *Id.* P 51.

II. Requests for Clarification and Rehearing and Other Pleadings

9. MISO filed a request for rehearing. The Illinois Commerce Commission (Illinois Commission) filed a motion for clarification. Midwest TDUs filed a response.

10. On August 30, 2010, as supplemented on September 9, 2010, MISO filed a motion to submit a supplementary analysis of reserve procurement data. On September 22, 2010, Midwest TDUs[15] filed a response in support of the MISO motion.

III. Discussion

A. Procedural Matters

11. We will deny MISO's August 30 motion. As the Commission has explained, it "generally will not consider new evidence on rehearing, because we cannot resolve issues with any efficiency or finality if parties are permitted to submit new evidence and thus have us chase a moving target."[16]

12. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d)(2) (2011), prohibits answers to requests for rehearing. Accordingly, we will reject the answer of Midwest TDUs.

B. Request for Rehearing and Request for Clarification

13. In its request for rehearing, MISO states that regulation and frequency response are intended to preserve system reliability and to spread out the procurement of Regulating Reserves throughout the footprint, thereby benefitting the entire system. Therefore, according to MISO, zonal reserve requirements for constrained zones do not include the costs of all reserves that may be required to manage reliability within those zones, as the Commission recognized in the July 30 Order,[17] and constrained zones benefit from the clearing of additional Regulating Reserves on non-constrained zones to fill the gap. MISO also asserts that procurement within a reserve zone is insufficient to meet zonal reliability requirements for Contingency Reserves.

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[15] The Midwest TDUs consist of Madison Gas & Electric Company, Midwest Municipal Transmission Group, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Municipal Energy Agency of Nebraska, Southern Minnesota Municipal Power Agency, and WPPI Energy.

[16] *Southern California Edison Co.,* 102 FERC ¶ 61,256, at P 17 and n.5 (2003).

[17] July 30 Order, 132 FERC ¶ 61,088 at P 45.

14. MISO disagrees with the July 30 Order's finding that Non-Binding Settlement Zones do not receive any benefit from the procurement of higher cost reserves in the Binding Settlement Zone[18] for two reasons: (1) the entire system would be in unstable system conditions without these higher cost reserves; and (2) deployment of reserves is done pro-rata based on cleared volumes, independent of reserve zone or location of individual resources.

15. MISO faults the Commission for not taking into account whether the cost shift resulting from the Market Load Ratio Share Method is significant in amount or percentage when it concluded that the Market Load Ratio Share Method was unduly discriminatory.[19]

16. MISO contends that the Market Load Ratio Share Method is consistent with cost causation because the dispersal of operating reserves throughout the MISO footprint and among the reserve zones is primarily caused by the need to maintain system reliability and therefore benefits all system loads. In support of its contention, MISO cites to language in its Tariff that states that market-wide and zonal reserve requirements are set to comply with Applicable Reliability Standards, reserve zones are configured to ensure the reliability of the transmission system and reserve zones are dispersed in a manner that prevents adverse operating conditions that affect the reliability of the transmission system.[20] MISO argues that reserve zones are the incidental means of achieving a system reliability benefit.

17. MISO also cites to testimony provided in the September, 2007 filings in Docket No. ER07-1372 asserting that reserve zones are used to ensure proper dispersion in the clearing of operating reserves throughout the MISO region to avoid potential adverse conditions that may result when all operating reserves are cleared within a localized area and to disperse the clearing of operating reserves throughout the MISO Balancing Authority Area in accordance with Good Utility Practice.

18. MISO claims that the July 30 Order was in error when it stated that the Market Monitor analysis warranted a departure from its earlier ruling that found a Market Load Ratio Share Method reasonable. MISO asserts that the Market Monitor's identification of constrained areas and the need for zones does not justify any change in the prior ruling's premise that reserves are procured for system reliability. MISO states that the

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[18] *Id.* P 46.

[19] *Id.* P 47.

[20] MISO Rehearing Request at 11-12.

Commission reiterated the reasonableness of a Market Load Ratio Share Method after it received the Market Monitor report.[21]

19. MISO argues that the Commission was incorrect in concluding that the higher prices of reserves in Binding Settlement Zones is caused by MISO's procurement of reserves based on reliability. On the contrary, MISO asserts that the higher prices result from resource characteristics, locational constraints, demand or contingencies and other factors comprising the environment in which reserves must be procured.

20. MISO asserts that its use of reserve zones to achieve dispersion does not preclude acceptance of the Market Load Ratio Share Method based on Commission precedent that accepted a system-wide allocation of the costs of procuring reserves in the California Independent System Operator Corporation (CAISO) region.[22] MISO asserts that Commission precedent in CAISO rejected arguments that system-wide cost allocation for sub-regional deficiencies runs contrary to the principle of cost causation[23] and found that there would be no subsidization under the system-wide cost allocation because CAISO imposed regional limits on the self-provision of ancillary services.[24] Taking issue with the statement in the July 30 Order that the Market Load Ratio Share Method rendered zone requirements and prices unnecessary,[25] MISO claims that the market load ratio share method will not distort price signals and cites to precedent in CAISO proceedings finding that prices would send appropriate signals to available resources.[26]

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[21] ASM Order, 122 FERC ¶ 61,172 at P 391.

[22] *California Independent System Operator Corp.*, 116 FERC ¶ 61,274, at P 309 (2006), *order on reh'g*, 119 FERC ¶ 61,076 (2007).

[23] *California Independent System Operator Corp.*, 131 FERC ¶ 61,280, at P 50 (2010).

[24] *California Independent System Operator Corp.*, 119 FERC 61,076, at P 91 (2007).

[25] July 30 Order, 132 FERC ¶ 61,088 at P 48.

[26] *California Independent System Operator Corp.*, 131 FERC ¶ 61,280, at P 51 (2010).

21. With respect to the Commission's finding on the Adjusted Group Zonal Method,[27] the Illinois Commission requests clarification that a method which subtracts costs from the Non-Binding Settlement Zone and adds them to the Binding Settlement Zone at a rate equal to the lower price of reserves in the Non-Binding Settlement Zone – and not the average price between the Binding Settlement Zone and Non-Binding Settlement Zones – would not create a subsidy to the Non-Binding Settlement Zone and would, therefore, satisfy cost causation principles.

22. The Illinois Commission believes that the Commission mischaracterized the cost of reserves in Non-Binding Settlement Zones as an average of high and low priced reserves when this cost is in fact equal to the cost of lower priced reserves in the Non-Binding Settlement Zone. The Illinois Commission maintains that the Commission's inaccurate conclusion likely arises from an ambiguity contained in the Marginal Clearing Price purchased "overall" in the day-ahead or real-time market in the cost allocation study. Had the study characterized this price as the price for reserves cleared in the Non-Binding Settlement Zone instead of the ambiguous term "overall," the Commission conclusion would likely have been different, according to the Illinois Commission. The Illinois Commission bases its interpretation of the definition of Marginal Clearing Price on language in the Tariff for determining market clearing prices and its understanding of the constrained optimization process.

23. MISO contends that the Adjusted Grouped Zonal Method does not average higher cost reserves when computing allocations to Binding Settlement Zones and therefore this method does not create a subsidy to Non-Binding Settlement Zones, contrary to the Commission's conclusion in the July 30 Order.[28] MISO asserts that by assigning the entire premium paid for dispersing reserves for reliability and deliverability only to Binding Settlement Zones, the Adjusted Group Zonal Method may result in a subsidy to Non-Binding Settlement Zones and therefore this method does not sufficiently recognize the system-wide requirements and benefits underlying zonal procurement.

C. Commission Determination

24. We deny MISO's request for rehearing. We agree with MISO that the zonal requirements analysis undertaken by MISO and provided in its May 28 Filing showed that constrained zones benefitted from the clearing of additional Regulating Reserves in non-constrained zones.[29] However, based on the facts and record of zonal procurement

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[27] *Id.*

[28] *Id.* P 51.

[29] July 30 Order, 132 FERC ¶ 61,088 at PP 45-46.

of reserves to manage local reliability in this proceeding, this finding does not justify the Market Load Ratio Share Method. The Market Load Ratio Share Method still remains inappropriate – even in light of this benefit – as MISO has not shown that it would result in an allocation of the cost of higher cost reserves in Binding Settlement Zones to the Non-Binding Settlement Zones that is appropriate in the circumstances of zonal procurement of reserves to manage local reliability. These higher cost reserves are procured to manage reliability in Binding Settlement Zones, as MISO confirmed in its explanation that when a binding constraint occurs, the increased prices reflect the cost of clearing more reserves in that constrained reserve zone than would otherwise be cleared based solely on economics.[30] Therefore, the higher cost reserves procured in the Binding Settlement Zone were caused by and benefit load in that zone. We also note that higher cost reserves in a zone provide an incentive to build transmission capabilities that would eliminate or reduce transmission constraints, thereby allowing greater access to low cost reserves in other zones and reducing zonal reserve costs. MISO has not persuaded us that it is reasonable to allocate these higher costs incurred for the benefit of load in constrained zones to Non-Binding Settlement Zones. Accordingly, since the Market Load Ratio Share Method would allocate these higher costs to Non-Binding Settlement Zones in a manner that is not appropriate in the circumstances of zonal procurement of reserves to manage local reliability, as we found in the July 30 Order, it is not a reasonable cost allocation method.

25. In response to MISO's argument that the deployment of higher cost reserves confers a system-wide benefit and therefore these costs should be allocated to Non-Binding Zones, we note that while market participants in Non-Binding Zones could get a benefit from higher costs reserves from Binding Zones, they may get a greater benefit from lower cost reserves in the Non-Binding Zone. This benefit can occur when Binding Zones are able to send reserves to other zones since the Binding Zones are constrained only for imports to the zone and are not constrained exporting from the zone. However, arguing that the higher cost reserves provide a benefit because they are deployed does not mean their "benefit" justifies allocating these higher costs to Non-Binding Zones with lower cost alternatives that would be deployed but for the local reliability management by MISO in Binding Zones.

26. Additionally, the July 30 Order explains why the mixing of the costs of higher cost reserves from Binding Settlement Zones, which represent the costs required to maintain local reliability in those zones, with the lower costs of the Non-Binding Settlement Zones does not result in appropriate allocation of costs. The July 30 Order also cites data showing that the Marginal Clearing Prices for Regulating Reserves in the Binding

[30] *Id.* P 47 n.26.

Settlement Zones were higher than in the Non-Binding Settlement Zone.[31] We find these explanations and data to be sufficient for the Commission's determination in the July 30 Order.

27. MISO's positions on the system-wide reliability benefits of Operating Reserves, including citations to testimony in its September 2007 filing in Docket No. ER07-1372, and reliability standards, repeat positions that the Commission addressed in that docket[32] and therefore we find that they are collateral attacks on previous Commission orders addressing these issues and affirming that reserve zones are developed to address local reliability.[33] Therefore, the time for MISO to raise these issues was in that proceeding, and accordingly we find them to be beyond the scope of this proceeding. In any event, the July 30 Order did not rely on those determinations in Docket No. ER07-1372. Rather, it focused on how MISO purchases reserves and the reasons for the incurrence of reserve costs based on its May 28, 2010 filing, as discussed above.

28. We reiterate, as we explained in the July 30 Order,[34] that MISO's reliance on earlier Commission statements supporting a Market Load Ratio Share Method is misplaced since those statements were made prior to the Market Monitor's analysis of MISO reserve markets and its identification of constrained areas and the need for specific reserve zones. MISO's reliance on the ASM Order references to load ratio share[35] is unavailing. Those references were addressing a different issue – namely, whether a cost allocation based on energy usage, or load, would be reasonable or if the cost allocation should be based on system capacity. The Commission determined that a cost allocation based on energy usage was the reasonable cost allocation. This determination has no bearing on the reasonableness of a market-wide versus zonal cost allocation, as is recognized in the separate treatment of these issues in the ASM Order.

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[31] *Id.* P 47 n.25.

[32] *See* footnote 9, *infra*, as an example.

[33] *See* ASM Order, 122 FERC ¶ 61,172 at PP 417-418 ("The purpose of zones is to determine minimum reserve requirements for load within a defined geographic area, thereby ensuring reserves are located to effectively resolve local reliability needs and ensure optimum operating conditions, as the Midwest ISO explains in its proposal [footnote].") and ASM Rehearing Order, 123 FERC ¶ 61,297 at PP 19-27.

[34] July 30 Order, 132 FERC ¶ 61,088 at P 49.

[35] ASM Order, 122 FERC ¶ 61,172 at P 391.

29. Further, the statement in the July 30 Order that the higher prices of reserves in Binding Settlement Zones is caused by MISO obtaining reserves for those zones on a reliability basis[36] was based on MISO' explanation in its answer that when a binding constraint occurs, the increased prices reflect the cost of clearing more reserves in the constrained Zone than would otherwise be cleared based solely on economics. While other factors such as demand and contingencies can play a factor in resulting prices, as MISO notes in its rehearing request, the impact of zonal procurement plays a major role in determining zonal prices, as MISO's answer confirms.[37]

30. The Commission's determinations in the July 30 Order were based on the record in this proceeding and the MISO Tariff. Accordingly, the Commission's findings have been determined by the data and analysis provided by MISO in its filing and by the procedures outlined in the Tariff for developing zones and procuring reserves on a zonal basis. While CAISO may have a different cost allocation, we do not find that precedent to be a bar to our findings in this proceeding. Rather, we consider it appropriate that the facts and analysis specific to the record in this proceeding provide the basis for a just and reasonable cost allocation. We note that the Commission is not required to implement identical cost allocations in every RTO region.[38]

31. With regard to the Adjusted Group Zonal Method, we clarify, as requested by the Illinois Commission, the statement in the July 30 Order that, "because the Non-Binding Settlement Zones do not reflect the high prices of the Binding Settlement Zones, a subtraction from the Non-Binding Zone's costs based on these high-cost reserves creates a subsidy to Non-Binding Settlement Zones.".[39] The Commission's conclusion is based on its analysis of the Adjusted Group Zonal Method calculation, in which zonal costs are the sum of zonal costs plus system-wide costs.[40] As noted correctly by the Illinois Commerce Commission, for a Non-Binding Settlement Zone this calculation would result

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[36] July 30 Order, 132 FERC ¶ 61,088 at P 47.

[37] In the future and over time, if transmission expansion projects help relieve constraints, then reserve prices in the zone may converge or equalize.

[38] *Southwest Power Pool, Inc.*, 110 FERC ¶ 61,103, at PP 22-23 (2005) (finding that differences between RTO regions may be warranted given the different circumstances of the markets); *Midwest Indep. Transmission Sys. Operator, Inc.*, 102 FERC ¶ 61,196, at P 43 (2003) (same).

[39] July 30 Order, 132 FERC ¶ 61,088 at P 51.

[40] MISO Filing, ASM Cost Allocation Analysis at 8-9.

in a subtraction of system-wide costs from zonal costs. The system-wide costs are the product of the Marginal Clearing Price for reserves purchased overall, according to the definition given in the MISO May 28, 2010 filing. The Commission interpreted this definition to mean the system-wide average Marginal Clearing Price, resulting in a subtraction based on a system-wide Marginal Clearing Price that includes the cost of higher priced reserves. Based on the facts in this proceeding, it appears that a more appropriate calculation would be to subtract the excess reserves based on the lower price in the Non-Binding Settlement Zone, a method the Illinois Commerce Commission endorses in its clarification request. However, based on its analysis, the Commission determined that the Adjusted Group Zonal Method did not achieve this desired result.

The Commission orders:

The request for rehearing is hereby denied and the request for clarification is hereby granted.

By the Commission. Commissioner Clark is not participating.

(S E A L)

Kimberly D. Bose,
Secretary.