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1. In an order dated August 6, 2004, the Commission approved the Midwest Independent Transmission System Operator, Inc.’s (Midwest ISO) proposed Transmission and Energy Markets Tariff (TEMT), under which the Midwest ISO has initiated Day 2 operations in its 15-state region.¹ The Midwest ISO’s Day 2 operations

¹ *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 (TEMT II Order), *order on reh’g*, 109 FERC ¶ 61,157 (2004) (TEMT II Rehearing Order). The TEMT contemplates that all services provided pursuant to its terms and conditions will be provided by a Transmission Provider. In turn, the TEMT defines “Transmission Provider” as the Midwest ISO or any successor organization. *See* Module A, section 1.320, Original Sheet No. 133. For clarity, we will refer to the Midwest ISO wherever the TEMT refers to the Transmission Provider.

include, among other things, day-ahead and real-time energy markets and a Financial Transmission Rights (FTR) market for transmission capacity.

2. The TEMT II Order required the Midwest ISO to make an assortment of compliance filings to implement various Commission directives. The Commission accepted the Midwest ISO's first two compliance filings on December 20, 2004, subject to further modifications.² Today's order will address the requests for rehearing of Compliance Order I, as well as the Midwest ISO's January 21, 2005 filing to comply with that order and to further comply with the TEMT II Order. A concurrent order will address the requests for rehearing of the TEMT II Rehearing Order, as well as the Midwest ISO's filing to comply with that order. Our order benefits customers because it clarifies important questions regarding procedures under the Day 2 energy markets.

I. Background

3. The TEMT II Order accepted and suspended the proposed TEMT and permitted it to become effective March 1, 2005, subject to conditions and further orders. The Commission also accepted certain tariff sheets (pertaining to FTRs) to be effective on August 6, 2004, subject to conditions and further order. In order to address the Midwest ISO's unique features, such as the fact that it lacks experience operating as a single power pool and has only a short period of experience operating under a single reliability framework, the Commission ordered the Midwest ISO to implement additional safeguards to ensure additional protections for wholesale customers during startup and transition to fully-functioning Day 2 energy markets. Separately, the Commission analyzed the grandfathered agreements (GFAs) that will be effective in the Midwest ISO region past the time of energy-market startup, and divided them into categories with differing consequences for their treatment in the energy markets.³ In an order issued February 17, 2005, the Commission granted the Midwest ISO's motion to change the effective date of the TEMT to April 1, 2005.⁴

² *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,285 (2004) (Compliance Order I).

³ *See Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236 (2004) (GFA Order).

⁴ *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,169 (2005) (Motion Order).

4. The Commission has accepted, subject to modification, the Midwest ISO's first three filings to comply with the TEMT II Order. Compliance Order I addressed the first two of those filings, which, *inter alia*: (1) proposed to revise the TEMT to eliminate Michigan-specific energy imbalance provisions; (2) developed tariff language for market startup safeguards; (3) modified the FTR allocation process; (4) made new proposals for automatic market power mitigation and control area mitigation; and (5) revised various other aspects of the TEMT.⁵ As described *infra*, the Midwest ISO was required to make further filings to comply with Compliance Order I.

5. Compliance Order II,⁶ which was issued on January 21, 2005, accepted: (1) proposed rules providing for corrective measures in the event of temporary inability to calculate accurate market prices; (2) a proposed plan for cutover to decentralized power system operations in the event of a serious failure of the Day 2 energy market operations; (3) an update on the Midwest ISO's effort to adjust the day-ahead energy trading deadline from 0900 EST to 1100 EST, and (4) a Readiness Advisor Verification Plan. The Midwest ISO was required to make further filings to comply with Compliance Order II, and those filings will be addressed in a future order.

II. Requests for Rehearing of Compliance Order I

6. Five parties filed requests for rehearing of Compliance Order I: Cinergy Services, Inc. (Cinergy), Detroit Edison Company (Detroit Edison), the Midwest ISO, Midwest TDUs⁷ and WPS Resources Corporation (WPS Resources). Consumers Energy Company (Consumers) filed a motion to answer and an answer to the Midwest ISO's

⁵ Most of these changes were proposed in a Midwest ISO compliance filing dated October 5, 2004 (October 5 compliance filing).

⁶ *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,049 (2005) (Compliance Order II).

⁷ The Midwest TDUs are: Great Lakes Utilities, Indiana Municipal Power Agency, Lincoln Electric System, Madison Gas and Electric Company, Midwest Municipal Transmission Group, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Southern Minnesota Municipal Power Agency, Upper Peninsula Transmission Dependent Utilities and Wisconsin Public Power Inc.

request for rehearing, and the Midwest ISO filed an answer to Consumers. The parties' arguments on rehearing will be described in detail below.⁸

7. On March 1, 2005, Detroit Edison filed a motion to lodge in this proceeding the protest it submitted on February 8, 2005, in Docket No. ER04-691-021, *et al.* Detroit Edison states that the Motion Order acknowledged Detroit Edison's concerns regarding the Midwest ISO's failure to implement an effective seams agreement with the Ontario Independent Electricity System Operator (Ontario IESO), but did not identify the dockets or subdockets in which it would address the substance of these concerns. Detroit Edison states that this proceeding appears to be the only other forum in which Ontario seams agreement issues have been raised, and infers that the Commission intended to shift its examination of those issues here. Detroit Edison asks to lodge its earlier protest in this proceeding in order to ensure a complete record.

8. On February 14, 2005, and March 24, 2005, LG&E Energy LLC (LG&E) submitted motions to lodge letters from Steven D. Phillips of LG&E to James Torgerson of the Midwest ISO. Executed copies of Market Participant Agreements between Louisville Gas and Electric Company and Kentucky Utilities Company and the Midwest ISO, and between LG&E Energy Marketing Inc. and the Midwest ISO, are attached to the letters. Mr. Phillips' letters both state that by executing, and performing duties under, the Market Participant Agreements, LG&E and its affiliates do not waive any right to contest the TEMT or its implementation. The letters note that LG&E has filed a petition for review in the United States Court of Appeals for the D.C. Circuit, and that the petition is pending.⁹

⁸ Six sets of requests for rehearing in this proceeding are pending before the Commission, and today's orders will address four of them. Unless another date is specified, all citations to requests for rehearing that appear in this order will refer to filings made on January 19, 2005, in response to Compliance Order I. All references to the Midwest ISO's compliance filing, unless otherwise specified, will be to the January 7, 2005 filing.

⁹ The court recently issued an order holding the case in abeyance. *See Wisconsin Public Power, Inc. v. FERC*, No. 04-1414 (D.C. Cir. Jan. 4, 2005).

III. The Midwest ISO's Compliance Filing

9. The Midwest ISO submitted a compliance filing January 21, 2005, in accordance with Compliance Order I. Its requests that the Commission accept its filing one day out of time, because inclement weather prevented it from timely hand-delivering its filing. The Midwest ISO notes that the Commission's Rules of Practice and Procedure do not permit electronic filing of compliance filings.

10. The Midwest ISO's filing proposes modifications to the TEMT that relate to: (1) the FTR allocation process; (2) automated and expedited mitigation; (3) control area mitigation; (4) transitional safeguards for exposure to marginal loss charges; (5) FTRs in retail choice states; (6) market monitoring and market power mitigation; (7) emergency procedures; (8) resource adequacy requirements; (9) credit policy; and (10) other, miscellaneous tariff issues. The filing also includes new tariff language to comply with the GFA Order. The latter portion of the Midwest ISO's filing will be addressed, along with numerous other GFA issues, in a companion to this order.

11. Notice of the Midwest ISO's compliance filing was published in the *Federal Register*, 70 Fed. Reg. 5,991 (2005), with interventions and protests due on or before February 11, 2005. The parties listed in Appendix A to this order filed protests.¹⁰ Michigan Agencies filed a protest and a motion for the Commission to accept it one day of out time. Otter Tail filed a request to file comments out of time and comments in support of WPS Resources' protest. The Midwest ISO filed a motion for leave to answer and an answer on February 28, 2005.

IV. Discussion

A. Procedural Matters

1. Procedural Matters Related to Requests for Rehearing

12. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a request for rehearing unless otherwise ordered by the decisional authority. We are not persuaded to accept Consumers's answer to the Midwest ISO's request for rehearing and will, therefore, reject it. Accordingly, we will also reject the Midwest ISO's answer to Consumers's answer. We will grant LG&E's two motions to lodge.

¹⁰ Acronyms and short forms used for party names throughout the order also can be found in Appendix A.

13. Detroit Edison has presented its concerns regarding the need for a seams agreement between the Midwest ISO and the Ontario IESO on four occasions prior to filing its Motion to Lodge. Its February 11, 2005 protest to the Midwest ISO's compliance filing did not raise these issues; however, at the time, Detroit Edison had protested the Midwest ISO's Readiness Certification and the Seams Operating Agreement between the Midwest ISO and MAPPCOR on the basis that there did not exist a satisfactory seams agreement between the Midwest ISO and the Ontario IESO.

14. Detroit Edison could not reasonably have predicted in which proceeding the Commission would respond to the substance of its protests. As we declined to address Ontario issues in three prior orders,¹¹ we will accept Detroit Edison's motion to lodge a prior protest in this proceeding. The March 1 protest contains arguments broader than those Detroit Edison raised on its request for rehearing, so permitting Detroit Edison to lodge it here will not unnecessarily duplicate material already in the record.

2. Procedural Matters Related to Compliance Filing

15. Associated Cooperatives and Basin Cooperatives included motions to intervene with their protests to the Midwest ISO's compliance filing. The entities that joined in these protests are already parties to these proceedings; therefore, their motions to intervene are unnecessary.

16. Given the early stage of this proceeding, their interest, and the lack of prejudice to other parties, we will grant Otter Tail's motion for leave to file comments one day out of time. Because Michigan Agencies' protest addresses GFA issues, it will be addressed in the companion order on GFA matters.

17. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), 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 information that assisted us in our decision-making process.

¹¹ See *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,290 at P 50 (2005); *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,289 at P 40 (2005) (Readiness Order); Motion Order at P 18.

B. Readiness and Market Startup Safeguards**1. Transitional Limits on Supply Offers in the Energy Markets****a. Background**

18. The TEMT II Order required market participants to submit cost-based offers for generation resources in the day-ahead market, Reliability Assessment Commitment (RAC) process, and real-time market for two months following the start of the Day 2 markets, and directed the Midwest ISO to file tariff sheets implementing the temporary transition locational marginal pricing (LMP) plan. The purpose of this transitional mechanism was not to manage potential market power, but to afford the Midwest ISO and market participants experience with the energy markets and congestion pricing under LMP prior to allowing for the less-restrictive energy bidding under the TEMT. Compliance Order I accepted the Midwest ISO's filing.

b. Requests for Rehearing

19. Cinergy seeks rehearing of Compliance Order I on the basis that it improperly delegated ratemaking authority to the Independent Market Monitor (IMM) when it authorized the IMM to establish reference prices that will act as a price caps in the day-ahead and real-time energy markets. Cinergy argues that Compliance Order I did not address Cinergy's arguments that the Commission cannot lawfully delegate ratemaking authority or find that the process for determining reference levels, which is not fully developed yet, is just and reasonable.

20. Cinergy challenges the statement in Compliance Order I that "[t]he consultation process, combined with the data collection and verification by the IMM, will provide market participants with ample opportunity for input while also ensuring an accurate assessment of costs."¹² It argues that the "opportunity for input" must come in a rate proceeding before the Commission, and that the Commission must find that the rates are just and reasonable, not that there is "an accurate assessment of costs." Cinergy adds that the problem is exacerbated by vague language in section 40A of the TEMT, which does not make clear how much discretion the IMM and the Midwest ISO have to vary the rate even from the IMM-determined level.

¹² Cinergy Request for Rehearing at 3 (quoting Compliance Order I at P 30).

21. Cinergy argues that the Commission cannot delegate to the IMM the authority to determine a just and reasonable rate, and that market participants should not have to resort to the Commission's complaint proceedings to challenge rates that the Commission has not approved. It adds that allowing the IMM to set reference prices restricts Cinergy's right to set rates for its own generation and that the capped price for Cinergy's generation will not be approved under section 205 of the Federal Power Act (FPA).¹³ Cinergy states that the perception of need for reference prices does not make up for the lack of legal justification for delegating authority to the IMM. Cinergy therefore urges the Commission to revoke the provisions of the TEMT that delegate to the IMM the authority to set reference levels that will act as price caps. In the alternative, if the Commission establishes a mechanism for Commission review of reference level determinations, that mechanism must be made available, and requested reviews completed, prior to the implementation of pricing at reference levels.¹⁴

22. The Midwest TDUs argue that the Commission's acceptance of the reference level setting process and the calculation of marginal costs violates the FPA. They state that reference levels are used, among other things, to establish wholesale rates and conditions, which are subject to sections 205 and 206 of the FPA. When used as default bids, reference levels become the rate the seller demands for wholesale sales; when the default bid sets the market-clearing price, it becomes the rate that all sellers in the market receive. According to the Midwest TDUs, the Commission is responsible for ensuring that these rates are just and reasonable and cannot delegate its rate-setting role to the IMM.

23. The Midwest TDUs aver that the unlawful delegation is aggravated because only the seller and the IMM are involved in the rate-setting process. According to the Midwest TDUs, the IMM may rely upon sellers' price forecasts, but purchasers have no say in whether such forecasts are just and reasonable.¹⁵ Thus, even if the Commission could delegate its ratemaking function to the IMM, the process follows none of the FPA's

¹³ 16 U.S.C. § 824d (2005).

¹⁴ Cinergy notes that the potential problem presented with review of such issues prior to market start-up is because reference levels will be default offer caps during the transition period. It opines that many companies probably would be less concerned about the accuracy of reference levels on the first day of market implementation than sometime shortly thereafter, if reference levels were to be used only for market power mitigation.

¹⁵ Midwest TDUs Request for Rehearing at 12 (citing Compliance Order I at P 230).

public notice requirements. The Midwest TDUs also note that the reference level process is not subject to any ongoing public reporting requirement, which is essential to the lawfulness of the Commission's market-based rates program.¹⁶ They also state that the IMM is an "interested person" whose communications are subject to *ex parte* restrictions and disclosure requirements, yet the TEMT reference level provisions do not ban such communications or require their disclosure.¹⁷

c. Discussion

24. We recognize that concerns have been raised and the Commission has invited comments on the establishment and use of reference prices by RTOs, ISOs or their market monitors in Docket No. PL05-6-000.¹⁸

25. As we found in Compliance Order I, the reference-level setting process results in just and reasonable rates. The IMM has outlined a process for developing reference levels that includes discussion with market participants of price forecasts, risk and opportunity cost elements, and that provides for sufficient consultation with suppliers. Dr. Patton's October 5, 2004 affidavit provides further detail as to how the reference levels will be generated.¹⁹ As we have previously found, the tariff provides a reasonably specific description of the reference level-setting process.²⁰ We have also accepted Dr. Patton's explanation of how the IMM will execute the tariff requirements. As such, the process of setting reference levels will take place within specific, commission-approved parameters, and it is not an improper delegation of our ratemaking authority to permit it.

¹⁶ *Id.* (citing *State of California ex rel. Bill Lockyer, Attorney General v. FERC*, 383 F.3d 1006, 1013 (9th Cir. 2004)).

¹⁷ *Id.* at 12-13 (citing *Electric Power Supply Ass'n v. FERC*, 2004 U.S. App. LEXIS 25470 at *25-*30, 391 F.3d 1255 (2004)).

¹⁸ *See Notice Inviting Comment on the Establishment and Use of Reference Prices*, Docket No. PL05-6-000 (Apr. 1, 2005).

¹⁹ *See* Affidavit of David B. Patton, Ph.D., Docket Nos. ER04-691-007 and EL04-104-006 (Oct. 5, 2004).

²⁰ *See* Compliance Order I at P 28.

2. Transitional Safeguards for Exposure to Marginal Loss Charges

a. Background

26. To give market participants more time to adjust to the LMP approach to setting prices and to develop confidence in market processes, the TEMT II Order stated that the Midwest ISO must implement LMP with marginal losses, but refund the difference between the marginal loss charge and either an average loss or a historical loss charge to all existing transmission customers. Entities were given this refund based either on historical loss charges associated with transmission service, or otherwise average loss charges calculated by the Midwest ISO.²¹

27. Compliance Order I accepted the Midwest ISO's proposal to apply the transitional safeguard through the refund of the marginal loss charge surplus on a Balancing Authority basis, since this approach has greater granularity than the previous "loss pools" approach, is consistent with the Commission's goal of not exposing participants to charges different than their average actual losses, has stakeholder support, and can be implemented. In that order, the Commission also expressed its concern that market participants with remote generation well outside the territory of the Balancing Authority would not be eligible for a sufficient share of the refund through the load share calculation and directed the Midwest ISO to explain how it is determining the marginal loss surplus for such entities.²²

28. In Compliance Order I, the Commission stated its concern that the TEMT does not address the situation in which a market participant that has a transmission contract that specifies an average or incremental loss charge for each transaction chooses to continue to settle such a contract against their transmission contracts for the transition period. The Commission therefore directed the Midwest ISO to explain how such historical loss contracts will be accommodated in the TEMT.²³

²¹ See TEMT II Order at P 73.

²² See Compliance Order I at P 171-72.

²³ *Id.* at P 173.

29. In the TEMT II Order, the Commission required the Midwest ISO to move various materials, such as the formulas for calculating LMPs, from its draft Business Practices Manuals to the TEMT.²⁴ The Commission also noted, in Compliance Order I, that the Midwest ISO's reference to the Business Practices Manuals for detail regarding the implementation of the transitional loss calculation and refund mechanism was not appropriate. The Commission therefore directed the Midwest ISO to insert the appropriate detail regarding the transitional loss calculation and refund mechanism directly into the TEMT.²⁵

b. Requests for Rehearing

30. The Midwest TDUs argue that their protest to the Midwest ISO's October 5 Compliance filing demonstrated that refunds of the marginal loss surplus must be granular enough to prevent cross-subsidies among load-serving entities that share a control area – that is, that refunds of marginal loss surpluses should not be pooled. They allege that Compliance Order I agreed that pooling would be inappropriate, but that it did not adopt an adequate remedy; rather, it only required the Midwest ISO to explain how it is determining the marginal loss surplus refund. The Midwest TDUs argue that, to the extent Compliance Order I left open the possibility of accepting a different explanation, it is in error.

31. WPS Resources argues that the Midwest ISO's October 5 Compliance filing did not explain how to calculate marginal losses for external transactions that sink into a Balancing Authority area. WPS Resources seeks clarification that the Midwest ISO must further modify its tariff to provide for this calculation.

c. Compliance Filing and Responsive Pleadings

32. The Midwest ISO, in its compliance filing, maintains that its proposed approach will be applied on a non-discriminatory basis, not taking into account whether specific load-serving entities may have higher or lower loss charges associated with specific transactions given the fact that entities with transactions outside of the Balancing Authority area may experience lower loss charges than those associated with transactions within the Balancing Authority area.

²⁴ TEMT II Rehearing Order at P 557-64.

²⁵ *See* Compliance Order I at P 175.

33. To address the Commission's concerns regarding the historical loss contracts, the Midwest ISO notes that LMP data that will be published for all market participants, including marginal energy, congestion and loss components, respectively, and the Midwest ISO will provide all information necessary to facilitate bilateral settlement between such parties.

34. To comply with the Commission's request in Compliance Order I that the detail regarding the transitional loss calculation and refund mechanism be incorporated directly into the TEMT, the Midwest ISO states that it has revised section 38.8.3.b.iii of the TEMT to state that the difference between Marginal Losses and System Losses shall be determined by dividing the amount of Marginal Losses for a transaction by two. This methodology, according to the Midwest ISO reflects the approximate two-to-one relationship between marginal and average losses.

35. The Midwest ISO notes that in its January 7, 2005 compliance filing, it committed to move, in the instant compliance filing, materials that have cost implications or impose terms from the Business Practices Manuals to the TEMT. As of January 7, 2005, the Business Practices Manuals in question had not yet been fully developed and vetted in the appropriate stakeholder process, so the Midwest ISO was then unable to add the necessary language from the Business Practices Manuals to the TEMT, as required in the TEMT II Rehearing Order. The Midwest ISO now indicates that it published final draft versions of all Business Practice Manuals on January 15, 2005, for stakeholder review, and indicated its intent to submit applicable provisions of the Business Practices Manuals in the TEMT. The Midwest ISO states that it is currently reviewing the Business Practices Manuals to identify appropriate provisions to include in the TEMT. It commits to submit a further compliance filing upon completion of this review, and requests the Commission's approval to move forward with this effort.

36. WPS Resources argues that the Midwest ISO's marginal losses proposal will not protect all market participants during the transition period from having to pay for losses that exceed either a system average rate or the market participant's historical losses charges, and it fails to include the necessary detail in the TEMT.

37. WPS Resources states that, in its protest to the Midwest ISO's October 5 Compliance filing, it noted that the compliance filing: (1) did not describe a method that the Midwest ISO would use to calculate marginal losses per transmission customer; (2) did not have a method to develop average system losses and associated costs; (3) did not include a process by which the Midwest ISO would determine historic loss payments per transmission customer; and (4) did not contain a methodology to calculate the refund necessary to protect market participants from increased loss costs or the procedure to

provide the refund. WPS Resources states that it now recognizes that the Midwest ISO's proposal lacks a methodology to calculate the refund of marginal loss surplus for external transactions sinking into a Balancing Authority.

38. WPS Resources argues that the instant compliance filing also lacks the important detail needed to address marginal losses and comply with the Commission's directives. WPS Resources argues that the Midwest ISO's compliance filing does not explain how a market participant's exposure to losses costs will be limited to either system average losses or historic losses. It adds that it appears that the only change the Midwest ISO made to address this deficiency was to revise section 38.8.3.b.iii of the TEMT "to state that the difference between Marginal Losses and System Losses shall be determined by dividing the amount of Marginal Losses for a transaction by two." WPS Resource questions the Midwest ISO's justification for its formula, which indicates that the methodology "reflects the approximate two to one relationship between marginal and average losses."

39. The Midwest ISO's revision is problematic for three reasons, WPS Resources says. First, the Midwest ISO offers no study results, analysis or statistical comparison to support its proposed two-to-one relationship between system average losses and marginal losses. Second, WPS Resources observes, the Midwest ISO inserted its formula only into section 38.8.3.b.iii, a section that applies solely to GFAs, whereas the TEMT II Order stated that the marginal losses protection provisions apply to all existing customers for five years during the transitional period and for one year to new customers. Finally, WPS Resources argues that, other than the formula, the Midwest ISO has provided no further detail in the TEMT and continues to state that marginal losses will be calculated "consistent with the procedures described in the Business Practices Manuals."

40. Finally, WPS Resources argues that the Midwest ISO's revision does not comply with paragraph 172 of Compliance Order I, which directed the Midwest ISO to explain how it will determine the marginal loss surplus refund for market participants located in a Balancing Authority Area that may not receive a sufficient share of the surplus using the load ratio share calculation. WPS Resources states that the Midwest ISO's response, that "the Marginal Losses Surplus refund for these entities will be determined in the same manner as for other entities in the same Balancing Authority Area," and that its "approach will be applied on a non-discriminatory basis, not taking into account whether specific load serving entities may have higher or lower loss charges associated with specific transactions," suggests that those entities will not receive a sufficient refund. WPS Resources adds that the Midwest ISO's response implies that no one will receive a refund sufficient to limit their exposure to charges different than their historic or system average losses.

41. The Midwest TDUs note that the Midwest ISO's initial TEMT filing proposed to pool marginal loss surpluses, both across load-serving entities within a given control area and across slices of control areas that were deemed to have similar losses. The Midwest TDUs state that the TEMT II Order required that, for five years, the Midwest ISO credit surpluses "to those participants whose costs from marginal losses exceed the costs that would result from average loss pricing," thereby restoring them to "a historical loss charge or average losses for those participants."²⁶ The Midwest TDUs argue that the only issue left open for the compliance filing was the method for calculating the average losses to which each eligible market participant was to be restored.

42. The Midwest TDUs argue that the Midwest ISO's January 19 compliance filing does not consider whether specific load-serving entities may have higher or lower loss charges associated with specific transactions. They challenge the Midwest ISO's assertion that this approach is non-discriminatory. The proposal, according to the Midwest TDUs, awards identical surplus shares to all load-serving entities located in the same control area, no matter how much those entities contributed to the marginal loss surplus, and is unduly discriminatory. The Midwest TDUs also oppose the Midwest ISO's statement that it is mathematically possible that, for some transmission-dependent utilities with remote resources, pooled refunds will be smaller than individualized refunds. They argue that the Midwest ISO has not attempted to show that this might be true. Further, the Midwest TDUs state that Dr. Patton, in his role as market monitor for the New York Independent System Operator, Inc. (NYISO), has testified that losses tend to increase as power moves over greater distances. Consequently, the Midwest TDUs state that pooling the surplus across disparate load-serving entities within a control area would impose an immediate cost shift on transmission-dependent utilities.²⁷ They state that assigning transmission-dependent utilities only a load ratio share of their control area's refund will leave them bearing much higher losses than they had under an average or a historical cost regimen, and disproportionately exposed to marginal losses.

²⁶ Midwest TDUs Request for Rehearing at 9-10 (quoting TEMT II Order at P 73).

²⁷ As an example, the Midwest TDUs state that Missouri River Energy Services will have to pay about \$4 million per year into the surplus pool, but will get "far less" out, resulting in a potential cost shift that may double its transmission access charge. Midwest TDUs Protest at 7 (citing Midwest TDUs Protest at 24 (May 7, 2004)).

43. The Midwest TDUs go on to state that applying marginal losses to legacy commitments to remote generation (which have adopted average losses) would frustrate transmission-dependent utilities' investment-backed expectations. For some transmission-dependent utilities, the costs of such economic dislocation could be far greater than any benefits from the proposed markets, according to the Midwest TDUs. They add that if each control area, rather than each load-serving entity constituent, is kept whole, the winners in that averaging will have a strong incentive to oppose control area consolidation while the transition mechanism applies. The Midwest TDUs add that control area consolidation should be resolved on its own merits, not made insoluble by control-area-based distribution of the marginal loss surplus.

44. The Midwest TDUs allege that the Midwest ISO has strengthened the connection between control area operators' experienced marginal losses and those entities' share of the marginal loss surplus. They note that the Midwest ISO has replaced multi-control area pools with single-control area pools, extended the refund mechanism to new resources, and (in the instant filing) sought to define average losses as half the experienced marginal loss level, making the surplus distribution turn even more directly on the control area's own experienced marginal loss. The Midwest TDUs state that for the five-year transition period, there is no real dispute that close matching between marginal loss charges and loss surplus refunds is desirable. They note that with sunk investment in remote baseload units, switching to marginal losses strips away much of the value of those resources, but probably not to the point where the load-serving entity that owns the unit will be better off without its output. Consequently, the efficiency justifications for marginal losses have little force when applied to existing units.

45. In its answer, the Midwest ISO states that it believes the revisions proposed in the January 21 compliance filing meet the requirements of Compliance Order I. It notes that it has reduced the potential for cost shifts between market participants by reducing the size of the area within which losses are allocated on a *pro rata* basis, from loss pools to Balancing Authority Areas. The Midwest ISO states that going to the granular level the Midwest TDUs advocate would undo the incentives of marginal losses and result in inefficient dispatch. It notes that the current TEMT provisions reduce the efficiency gains associated with marginal losses by targeting losses at the Balancing Authority Area level, and argues that the Commission should not allow the erosion of the benefits of marginal losses by targeting loss refunds even more narrowly. The Midwest ISO also indicates its willingness to add language to the TEMT that clarifies that the formula for marginal losses applies to all existing customers, in response to WPS Resources' concern that section 38.8.3.b.iii only applies to GFAs.

d. Discussion

46. We disagree with the Midwest TDUs' statement that the Commission did not provide a remedy for the pooling method of determining marginal loss refunds. The Commission accepted a Balancing Authority basis for determining refunds because it is more granular than the loss pool method, and asked for more detail on the treatment for customers such as the TDUs that have load and generation in different control areas. The Midwest ISO has answered that requirement in its compliance filing. We find that the ruling in Compliance Order I was appropriate; accordingly, we deny the rehearing request.

47. The TEMT defines Marginal Losses as the "Transmission System marginal system losses that arise from changes in demand at the Commercial Node, which are served by changes in generation at the Reference Bus."²⁸ The Transmission System, in turn, is composed of:

[T]ransmission facilities owned or controlled by entities that have conveyed operational control to the Transmission Provider . . . [and] facilities that are not controlled or operated by the Transmission Provider but are facilities that the Transmission Owners, by way of the Agency Agreement, have allowed the Transmission Provider to use in providing service under this tariff.²⁹

The TEMT description of Marginal Losses is clear, and accordingly we deny WPS Resources' rehearing request. Marginal Losses are only calculated for on-system marginal losses, and therefore marginal losses for imports would be calculated based on the marginal losses for the portion of the transmission path on the Midwest ISO-controlled system. The TEMT description of Marginal Losses is clear, and accordingly we deny WPS Resources' rehearing request.

48. Our purpose in Compliance Order I was to ascertain how smaller entities with generation sources well outside the control area of the load would be impacted by the marginal loss refund mechanism and then determine if such treatment was just and

²⁸ Module A, section 1.178, Second Substitute Original Sheet No. 94.

²⁹ *Id.* at section 1.328, First Revised Sheet No. 136.

reasonable and not unduly discriminatory. The Midwest ISO answer in its compliance filing is that all entities are treated the same in each Balancing Authority area, so that the marginal loss surplus is distributed *pro rata* based on load ratio share.

49. Per the terms of section 40.6, the allocation of the marginal loss refund, or surplus, to market participants is a two step process. First, the overall surplus is allocated to Balancing Authorities on the basis of the cost of supplying losses to Load within the Balancing Authority. Then, that amount is allocated to market participants within the Balancing Authority on the basis of the load ratio share. While the first step appears to appropriately allocate more of the surplus to Balancing Authorities with high losses,³⁰ the next step then allocates that amount *pro rata* based on the load ratio share, taking no account of which entities have higher losses within the Balancing Authority. By this method, the largest entities in the Balancing Authority will receive the largest share of the surplus. Therefore, large entities could obtain surpluses that could exceed the actual difference between their marginal losses and average or actual losses, while smaller entities may obtain less of the surplus than their actual difference.

50. We recognize that it is not possible to return the loss surplus based on actual transactions for each market participant.³¹ Instead, losses must be refunded on an aggregate basis that avoids cross-subsidies to the extent possible. The Midwest ISO, with stakeholder input, has refined this aggregate distribution method with a smaller geographic area, the Balancing Authority, as the basis for determining refunds. However, this approach still does not address different losses among market participants within the Balancing Authority, and the possibility that these differences could result in significant cross-subsidies.

51. We will accept the Midwest ISO's proposal for refunding overcollected marginal loss charges, but require the Midwest ISO to make an informational filing that provides data on losses among market participants within Balancing Authorities, based on the first six months of market experience. Such information will provide information and analysis bearing on the issue of whether certain market participants are paying more in

³⁰ As part of the compliance filing, directed in the following text, we require the Midwest ISO to explain the data sources and methodology used to derive the cost of supplying losses to Load scheduled by market participants within the Balancing Authority areas, and to provide the allocations for all Balancing Authority areas.

³¹ See Testimony of Ronald R. McNamara at 52 (Mar. 31, 2004); Midwest ISO Transmittal Letter at 6 (Oct. 5, 2004) (“ . . . there is no way to physically disaggregate the loss pool into the contribution ‘caused’ by each transaction.”).

losses in the energy market compared to before the market started, and the extent of cross-subsidies in the Midwest ISO method. We will also require the Midwest ISO to submit a proposal for redressing any identified cross-subsidies, and ensuring that market participants are not exposed to losses that exceed average or actual losses in a filing that includes proposed tariff language. Both filings are due 270 days after market start.

52. For the marginal loss information filing, we will require the following information. For each market participant, grouped by Balancing Authority, we require: (1) the marginal loss surplus allocated over the first six months of energy market operations, expressed in megawatt-hour terms, not in dollar terms; and (2) the average or actual losses in megawatt-hour terms. We require the Midwest ISO to specify the data source and calculation method for determining the average or actual losses. Finally, we direct the Midwest ISO to supplement this data with an estimate and analysis of the marginal losses³² and average or actual losses for selected market participants, all in megawatt-hour terms, including but not limited to entities with load in one control area and distant generation in another control area. We also require that the Midwest ISO explain the feasibility of calculating or estimating the marginal losses for each market participant, including a description of the steps it would take to accomplish this task.

53. Responding to issues raised in WPS Resources' protest, with respect to the calculation of losses for individual customers, we recognize that the Midwest ISO cannot calculate marginal losses on this basis, and that the marginal loss surplus is calculated from aggregate information. We accept the Midwest ISO's formula in section 38.8.3.b.iii and recognize that the formula is not needed in other parts of the tariff since the marginal loss surplus calculation for non-GFA entities is described in sections 39.3.5, 40.5 and 40.6. As part of the informational filing, we will require a detailed explanation for the basis of the approximate two-to-one relationship between marginal and average losses.³³

³² Marginal losses are defined as the Midwest ISO's best estimate of the market participant's actual marginal losses, and not the imputed marginal losses as derived in section 40.6.

³³ See Midwest ISO Transmittal Letter at 5 (Jan. 21, 2005). We believe the marginal loss surplus formulas account for external transactions sinking into a Balancing Authority, and therefore we see no need for a separate calculation in tariffs.

3. Transitional Safeguards for FTR Allocation

a. Background

54. Compliance Order I required clarifying revisions to section 43.2.6 of the TEMT to better specify eligibility for expanded congestion relief for entities with source points outside the NCA, the nomination requirements for obtaining congestion relief, and the uplift mechanism.³⁴

b. Compliance Filing and Responsive Pleadings

55. The Midwest ISO states that it made the revisions required by Compliance Order I.

56. WPS Resources notes that in the TEMT II Rehearing Order, the Commission required the Midwest ISO to replace the phrase “those that have source points outside the Control Area and the state” in section 43.2.6.a.i with “those that have source points outside the NCA.” WPS Resources states that the Midwest ISO corrected the first reference to “Control Area or State,” but that the second sentence of that subsection should be corrected to read “In contrast, internal FTRs (i.e., those that have source points within the NCA) are not eligible for the relief described herein.” In addition, WPS Resource says that a change made in section 43.2.6.a.i should also have been made in section 43.2.6.b. The protection is applied not to holders of external FTRs, but to those who were eligible for external FTRs that were nominated but not awarded through the FTR allocation process.

57. In its answer, the Midwest ISO states that it is willing to make WPS Resources’ proposed change to section 43.2.6.a.i to make the description of internal FTRs in the second sentence the converse of the description of external FTRs in the first sentence.

c. Discussion

58. We agree with WPS Resources that the phrase “within either the Control Area or the state” should be replaced by “within the NCA” in section 43.2.6.a.i to accurately define the conditions for receiving the expanded cost of congestion relief. The phrase “holder of the External FTR” should be replaced by “Market Participant eligible for External FTRs that were nominated but not awarded through the FTR allocation process” in section 43.2.6.b to accurately describe entities eligible for uplift credit.

³⁴ See Compliance Order I at P 109-12.

C. FTR Allocation Issues**1. Timeline and Filing Requirement****a. Background**

59. The TEMT II Order repeated the Procedural Order's directive that the Midwest ISO file initial FTR allocations 90 days prior to energy market start-up.³⁵ Compliance Order I accepted the Midwest ISO's plan to submit its FTR allocation to the Commission and market participants on January 31, 2005, in recognition of the time needed to implement changes in FTR modeling required by Commission directives in the TEMT II Order and TEMT II Rehearing Order. The Commission also stated that it would carefully consider the need for delaying market start-up if the results appear to undermine the benefits expected from the Day 2 market.³⁶

b. Requests for Rehearing

60. WPS Resources argues that it is arbitrary and capricious for the Commission to waive its requirement that the Midwest ISO file its initial FTR allocation at least 90 days prior to market start-up. WPS Resources cites the Declaratory Order, the Procedural Order and the TEMT II Order to establish that the Commission has consistently imposed such a requirement.³⁷ It then argues that the Commission waived that requirement in Compliance Order I, and that that order "is general, ambiguous and not tailored to address the Commission's concerns that underlined the need" for the filing.³⁸ WPS Resources asks the Commission to clarify either that: (1) the Midwest ISO is still subject to the 90-day FTR allocation filing requirement; or (2) that the Midwest ISO must provide protections to those who do not receive a level of financial protection reasonably

³⁵ See TEMT II Order at P 202. The FTR allocation process takes place over four successive and cumulative tiers. In each tier, a market participant is allowed to nominate up to a percentage of its maximum nomination eligibility less the FTRs awarded in the prior tier. Market participants are eligible for restoration of FTRs that are pro-rated. See TEMT II Order at P 144.

³⁶ See Compliance Order I at P 88.

³⁷ WPS Request for Rehearing at 2-4 (quoting Declaratory Order at P 64-65, 68; Procedural Order at P 95; TEMT II Order at P 202).

³⁸ *Id.* at 5.

close to their current physical protections due to the Midwest ISO's market design. In the alternative, WPS Resources seeks rehearing of the Commission's decision to waive the 90-day FTR allocation filing requirement.

61. The Midwest TDUs allege that the Commission's decision to allow a shortened period for FTR allocations is unjustified. Both WPS Resources and the Midwest TDUs challenge the Commission's reasons for accepting a shortened FTR allocation procedure.

62. First, WPS Resources and the Midwest TDUs disagree with the Commission's argument that making results from early FTR allocation stages available before final allocation results will allow market participants to monitor the process. WPS Resources states that the results of Tiers 1 and 2, the Restoration Phase, and Tier 3 of the Midwest ISO's FTR allocation process belie problems with the treatment of partial path service and generation reserve contingencies, yet the Midwest ISO is unwilling to fix the procedures. WPS Resources argues that by the time Tier 4 is completed, market participants will have only 28 days to evaluate the results and make alternative plans for hedging exposure to variable costs.

63. The Midwest TDUs argue that until the FTR allocation process is completed, neither participants nor the Commission can know its results or the extent to which their "firm rights to financial delivery of energy injections have been liquidated and taken without compensation."³⁹ They also contend that the Commission's argument that review of initial tier results can substitute for review of completed allocation results contradicts the position that the Midwest ISO and the Commission have taken when reviewing those results. As problems with the FTR allocation process have become apparent during Tiers I and II, the Midwest TDUs argue that the Midwest ISO and the Commission have asserted that market participants should not worry because complaining market participants may get FTRs in later tiers.⁴⁰ For example, the Midwest TDUs argue that Missouri River Energy Services has received a pro-rated allocation of FTRs for load at Marshall, Minnesota, because the Commission erroneously classified the applicable GFA and the Midwest ISO has not changed its FTR model to compensate for the error.

³⁹ Midwest TDUs Request for Rehearing at 4.

⁴⁰ *Id.* at 4-5 (citing Compliance Order I at P 84).

64. Second, WPS Resources and the Midwest TDUs take issue with the Commission's statement in Compliance Order I that delays in the FTR allocation process have been due to adaptations in the allocation rules and modeling to accommodate market participant concerns. WPS Resources argues that the Midwest ISO has attempted to address some market participant concerns, but has decided not to address many other concerns, including the process it uses to model generation reserve contingencies. WPS Resources also states that the FTR process is the heart of customer protection in an LMP market, and that it must be correctly implemented before market start-up.

65. The Midwest TDUs argue that the issue is not whether the Midwest ISO should be blamed for its lateness, but whether the completed FTR allocations live up to the White Paper statement that FTRs should be allocated according to existing contracts and service arrangements to hold customers harmless.⁴¹ They allege that the adaptations to the Midwest ISO's initial plans and model were needed, but that it is inappropriate for the Midwest ISO to use the adaptations as an excuse for truncating the 90-day review; further, if the Midwest ISO had proceeded with an illustrative allocation, the necessary adaptations to the FTR allocation process could have been identified earlier.

66. Third, WPS Resources notes that the Commission relied on the Midwest ISO's promise not to certify that the market is ready if there are ongoing problems in the FTR allocation. WPS Resources contends that market participants question whether the Midwest ISO is the best judge of its level of preparedness. It argues that that responsibility falls to market participants, but that market participants have told the Midwest ISO of problems only to have their concerns ignored. For example, WPS Resources indicates that four of twelve Business Practice Manuals that the Midwest ISO claims are not subject to revision before the March 1, 2005 market start-up date have never been provided to stakeholder committees for review and verification; the other eight manuals are still in draft form and contain "significant yet unresolved technical and policy issues."⁴²

67. Finally, WPS Resources argues that the Commission's promise to consider whether a delay in market start-up is warranted "if we find that the results appear to undermine the benefits that we foresee from the Day 2 market" does not address the Commission's intent to give market participants an opportunity to evaluate and

⁴¹ Midwest TDUs Request for Rehearing at 6 (citing "White Paper: Wholesale Power Market Platform," at 10 (Apr. 28, 2003), *available at* http://www.ferc.gov/industries/electric/indus-act/smd/white_paper.pdf).

⁴² WPS Request for Rehearing at 7.

understand their initial FTR allocation in light of their own load-serving circumstances. WPS Resources argues that if overall, Midwest ISO-wide benefits exceed costs, then those market participants whose benefits exceed their costs must be required to compensate market participants whose costs exceed their benefits as a result of the Midwest ISO's market design.

68. The Midwest TDUs argue that the Commission's statement indicates that the Commission may abridge the rights of some FTR nominators "in pursuit of the amorphous, unproven, and diffused benefits" of the Day 2 markets, which are distributed differently than the rights that supposedly are being held harmless. They add that starting the energy markets: (1) does not justify accepting whatever FTR allocation the Midwest ISO is able to complete before March 1, 2005; and (2) is not incompatible with fulfilling the commitment that each long-term firm transmission rights holder will receive FTRs worth as much as the financial deliverability rights it is losing.

c. Discussion

69. We deny WPS Resources' request for rehearing to the extent it alleges that the Commission arbitrarily and capriciously waived its requirement that the Midwest ISO file initial FTR allocations with the Commission 90 days prior to energy market start-up. As stated in Compliance Order I, the Midwest ISO made available – and filed with the Commission – the results of the earlier tiers of the FTR allocation. Parties had the opportunity to protest, and at least one party took advantage of it.⁴³

70. Even if the Commission erred in permitting the Midwest ISO to file its FTR allocation results 60 days prior to energy market start-up, rather than 90 days, two other actions by the Midwest ISO mitigates the potential harm that the parties allege. First, the Midwest ISO delayed energy market start-up by one month in order to accommodate market participants' concerns that their software and communications systems be ready.⁴⁴ The Midwest ISO was able to complete and file FTR allocations on time, January 31, 2005. Market participants therefore had 30 extra days prior to energy market start-up to

⁴³ See *Southern Indiana Gas and Electric Company v. Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,109 (2005) (denying in part complaint that the Midwest ISO had allocated too many FTRs to a particular GFA).

⁴⁴ See Motion Order at P 3-4 (“[T]he Midwest ISO agreed to a 30-day delay of the market start to allow for testing, training and refining of market participants’ internal systems.”).

evaluate and understand their initial FTR allocation in light of their load-serving circumstances. We find that this was sufficient time to correct errors and include adjustments to the allocation, fulfilling the requirements of the TEMT II Order.

71. Second, the Midwest ISO promised not to certify that its energy markets were ready for start-up unless the FTR allocation was working properly. It also employed a Market Readiness Advisor to independently evaluate the Midwest ISO's progress toward market readiness using over 100 readiness metrics. The Midwest ISO certified that its market was ready to start on April 1, 2005, when it had completed 106 out of 125 readiness metrics, with 13 additional metrics pending review by the Market Readiness Advisor, three metrics pending documentation, and three metrics not achieved.⁴⁵ Parties were afforded the opportunity to comment on market readiness to the Commission, but none, including WPS and the Midwest TDUs, filed to indicate that the Midwest ISO energy markets were not ready because of problems with the FTR allocations.

72. We do not, however, take lightly the issue of holding market participants harmless from the impacts of the LMP market. We will require the Midwest ISO to make an informational filing that summarizes market participants' experience in obtaining their full FTR allocations and the impact of the allocations from actual market data. That document must be filed within 60 days of the date of this order. That information will be incorporated into the proceeding to address the Midwest ISO's proposal for the next FTR allocation process.⁴⁶

73. We find WPS Resources' argument that market participants whose benefits exceed costs must compensate market participants whose costs exceed their benefits to be extraneous to the issue at hand in Compliance Order I, and therefore we dismiss rehearing on this issue.⁴⁷

⁴⁵ See Readiness Order (approving the Midwest ISO's certification that it was ready to start its energy markets on April 1, 2005).

⁴⁶ The Midwest ISO filed revisions to its FTR allocation process on March 10, 2005, to comply with Compliance Order I. See Docket Nos. ER04-691-029 and EL04-104-028. The Commission will address this compliance filing in a future order.

⁴⁷ We note that the Missouri River Energy Services issue the Midwest TDUs cite is being addressed in a separate order.

2. Restoration Phase

a. Background

74. Compliance Order I clarified that the congestion cost hedge for entities located in NCAs will terminate with the annual FTR allocation subsequent to the five-year period measured from the start of the Day 2 energy markets, thereby ensuring that the congestion cost hedge will not expire prior to the annual FTR allocation.⁴⁸

b. Requests for Rehearing

75. The Midwest TDUs allege that Compliance Order I did not respond to their argument that the duration of traditional restoration be lengthened so as to end coincident with the end of an FTR allocation year, rather than mid-year. The Midwest TDUs argue that if the restoration period ends in the middle of an allocation year, then the holders of previously-restored FTRs will have to purchase monthly auctioned FTRs to fill in their hedges until the next year's allocation. The Midwest TDUs note that this would also create a situation in which the NCA-specific hedge would remain intact, but without support from restored baseload counterflow resources. They argue that the Commission should clarify that transitional restoration will be lengthened so as to end when a new FTR allocation year begins, not mid-year.

c. Discussion

76. We clarify that the transitional restoration will be lengthened by the appropriate number of months to end at the same time the transitional congestion hedge ends, namely the beginning of the annual FTR allocation that follows the fifth year of Midwest ISO energy market operations.

3. Flowgate Rights

a. Background

77. The TEMT II Order directed the Midwest ISO to offer transmission customers the option to accept counterflow flowgate rights (FGRs) to restore pro-rated base-load FTRs for which restoration through assignment of counterflow FTRs based on historical usage is not available.⁴⁹ Compliance Order I, in response to a Midwest ISO explanation

⁴⁸ See Compliance Order I at P 108.

⁴⁹ See TEMT II Order at P 191.

that it does not have enough definition for the concept of counterflow FGRs to allow for implementation in the initial FTR allocation, urged the Organization of MISO States (OMS) and the Midwest ISO to continue to examine the specification and implementation of counterflow FGRs and any other financial transmission right concept that improves hedges against congestion charges and to file any workable proposals at the earliest possible date.⁵⁰

b. Requests for Rehearing

78. Midwest TDUs note that according to Compliance Order I, the TEMT II Order was not intended to create FGRs if the FGRs' costs would be localized on particular FGR holders or uplifted to the Midwest ISO footprint.⁵¹ The Midwest TDUs state that if this means that the costs of FGRs will be placed on entities that have a duty to build transmission sufficient to make long-term firm rights simultaneously feasible, then Compliance Order I "may ultimately reach a defensible regimen."⁵² However, the Midwest TDUs argue that if this "means that FGRs should be created only when they're a free lunch," then it is not reasonable.⁵³

79. The Midwest TDUs also argue that Compliance Order I's statement that the FGR remedy is not needed until five years after energy market start-up is unreasonable. They argue that if the Commission has ruled against promptly awarding FGRs whose costs will be uplifted or placed on delinquent facility builders, then it should reconsider that ruling and provide for such FGRs.

c. Discussion

80. The Commission's statements regarding FGRs in the TEMT II Rehearing Order and Compliance Order I were general principles on cost shifting, not findings on a proposal based on record evidence. We see no need to revisit those statements. We believe that the Midwest TDUs have misinterpreted the Commission's timing expectation

⁵⁰ See Compliance Order I at P 78.

⁵¹ Midwest TDUs Request for Rehearing at 3 (citing Compliance Order I at P 78).

⁵² *Id.*

⁵³ *Id.*

for addressing FGRs. The Commission did not conclude that an FGR remedy is not needed for five years, but rather the Commission expects the Midwest ISO to file workable proposals at the soonest possible date. For these reasons, we dismiss the requests for rehearing.

81. The Midwest ISO indicated in its compliance filing that it does not have enough definition to implement the FGR proposal of the Midwest TDUs. Nonetheless, in Compliance Order I, we encouraged the Midwest ISO to develop workable proposals for FGRs and submit a filing at the earliest possible date.

4. Conditional Firm Service

a. Background

82. In its protest to the Midwest ISO's October 5 compliance filing, WPS Resources stated that conditional firm service customers are not entitled to FTR. WPS Resources argued that this aspect of the Midwest ISO's FTR allocation proposal was unjust and unduly discriminatory because conditional firm service customers must pay redispatch costs and congestion costs; therefore, they would be billed twice for the same redispatch service.

83. The Commission, in Compliance Order I answered that "conditional firm service" is not a service provided under the OATT, proposed under the TEMT, or defined in either tariff.⁵⁴ The Commission directed the Midwest ISO to provide an explanation of this service, including proposed tariff language that describes this service and the applicable procedures for obtaining FTRs, and stated that it would address WPS Resources' concerns based on that submission.

b. Compliance Filing and Responsive Pleadings

84. In its compliance filing, the Midwest ISO agrees that there is no "conditional firm service" under the OATT or the TEMT, and states that it does not intend to offer the service. It explains that it has granted firm transmission service, predicated on a requirement for generation redispatch, in certain circumstances. FTR entitlements in those circumstances are defined consistent with the transmission service as granted. As such, the Midwest ISO states that it does not need to revise the TEMT.

⁵⁴ See Compliance Order I at P 76.

c. Discussion

85. We accept the Midwest ISO's explanation of the reference to "conditional firm service" that appeared in WPS Resources' protest to the October 5 compliance filing. We note that WPS Resources has not protested this interpretation. As there can be no conditional firm service customers under the TEMT, we will dismiss WPS Resources' earlier argument that the Midwest ISO's FTR allocation proposal discriminates against such customers.

D. Automated and Expedited Mitigation

1. Background

86. In the TEMT II Rehearing Order, the Commission allowed the IMM to delay adoption of automated or expedited manual mitigation for the day-ahead energy market. In doing so, the Commission cited the likelihood that real-time and virtual trading will substantially limit the potential for significant harm, other tasks facing the IMM in the short time frame to market start-up, the Commission's change in position on this issue, and the IMM's concerns about the possibility for harm in instituting manual mitigation.⁵⁵

87. In Compliance Order I, the Commission further discussed its reasoning for allowing the IMM to delay adopting automated or expedited manual mitigation for the day-ahead market, including its requirement that the IMM continue to provide quarterly reports showing where mitigation would have been applied were there not a lag in mitigation, and to show the associated dollar impact on the market. Consistent with this discussion, the Commission allowed the Midwest ISO to remove section 64.2.2.b from the TEMT.⁵⁶ In its compliance filing, the Midwest ISO deleted this section.

2. Requests for Rehearing

88. Cinergy agrees with the Commission's decision in Compliance Order I to authorize the Midwest ISO to remove from the TEMT provisions relating to automated or expedited mitigation procedures. It notes, however, that the Commission directed the Midwest ISO to continue to work toward developing such procedures. Cinergy requests clarification in light of *Edison Mission Energy, Inc. v. FERC*,⁵⁷ which was released

⁵⁵ See TEMT II Rehearing Order at P 258-59.

⁵⁶ See Compliance Order I at P 123-25.

⁵⁷ 394 F.3d 964 (D.C. Cir. 2005) (*Edison Mission*).

subsequent to Compliance Order I, that any automated or expedited mitigation measure that the Midwest ISO and the IMM develop must be supported by record evidence that: (1) it will not apply to areas of the Midwest ISO market that are not workably competitive; and (2) it will be devised in such a way as to allow scarcity pricing and not deter entry into the market.

3. Discussion

89. The Court of Appeals remanded *Edison Mission* to the Commission for further proceedings that are ongoing at this time.⁵⁸ We will not pre-empt those proceedings here. We will address the applicability of *Edison Mission* to the Midwest ISO automated mitigation program after a proposal has been filed. At that time, Cinergy can state its position on the merits of that proposal, including how *Edison Mission* should impact it. For these reasons, we deny rehearing of Cinergy's request.

E. Market Monitoring and Market Power Mitigation

1. Control Area Mitigation

a. Background

90. In the TEMT II Order, the Commission found it appropriate for the IMM to monitor for anti-competitive problems at the control area level. However, because the control area operators' responsibilities vary across the Midwest ISO footprint, the Commission directed the IMM to develop and implement a monitoring plan, and to notify the Commission should the IMM find any such behavior.⁵⁹

91. In Compliance Order I, the Commission responded to the Midwest ISO compliance filing and the IMM's testimony by stating concerns that the monitoring and mitigation plan discussed in the testimony was not fully reflected in the tariff. In particular, the IMM's testimony cited to conduct and "effect" being monitored, yet: (1) the proposed tariff sheets did not clearly state whether all instances of conduct are to be screened for a market impact; (2) there was no definition of "impact"; (3) the thresholds in the TEMT for conduct and impact did not appear to apply to control area operators' actions. In addition, the standards of conduct for control area operators did not reflect that they are relevant only for actions over which they have control and discretion.

⁵⁸ *Id.* at 969.

⁵⁹ TEMT II Order at P 256.

The Commission required that the tariff language on monitoring of control area operators be objectively quantifiable, and directed the Midwest ISO to clarify that control area operators' actions will not be subject to enforcement action when they are following directions from the North American Electric Reliability Council (NERC), the Midwest ISO, local reliability councils, or individual states. In accordance with these concerns, the Commission directed the Midwest ISO to revise the control area mitigation language in section 53.1.g of the TEMT.⁶⁰

92. The Commission also addressed, in Compliance Order I, concerns regarding the identification of monitoring activity by the IMM and directed that such monitored activity set forth in section 53.1.g specifically cover: (1) affiliate favoritism or preference; and (2) control area operation in a discriminatory manner. The Commission directed the Midwest ISO and the IMM to revise Module D to specify that preferential and discriminatory conduct by control area operators will be monitored and reported to the Commission.⁶¹

b. Requests for Rehearing

93. Cinergy argues that it is inappropriate to extend Market Behavior Rule 2 to control areas. It states that it has been concerned that the rule is unduly vague, even as applied to entities transacting at market-based rates, and that the application of the rule to other activities "would be an uncertain process at best."⁶² Cinergy professes that the Commission should not take a standard developed for one type of entity and apply it to another without explaining how that application is to be accomplished.

94. The Midwest TDUs argue that Compliance Filing I could cause confusion because, while the Commission stated that the IMM should report control area operator actions that are anticompetitive, it also indicated that "instances of anti-competitive control area operator behavior that do not have a market impact . . . need [not] be reported to the Commission, as requested by the Midwest TDUs."⁶³ The Midwest TDUs seek clarification (or in the alternative, rehearing) that there will be no exception to the requirement to report anticompetitive control area operator behavior. They argue that it

⁶⁰ See Compliance Order I at P 143-45.

⁶¹ *Id.* at P 146.

⁶² Cinergy Request for Rehearing at 8.

⁶³ Midwest TDUs Request for Rehearing at 13 (citing Compliance Order I at n.67).

may be very difficult to distill the potential harm to a quantity that triggers the IMM's reporting obligation because of the potential number of ways that the market could be manipulated.

c. Compliance Filing and Responsive Pleadings

95. The Midwest ISO made revisions to sections 53.1.g and 53.3.b pursuant to the Commission's directives in Compliance Order I. Specifically, the Midwest ISO added a conduct and impact screen in section 53.3.b that requires the IMM to report to the Commission any conduct in section 53.1.g that has an impact on LMP prices of more than \$50/MWh or results in uplift costs for a day of more than \$10/MW within a control area, and requires the IMM to report all instances of affiliate favoritism or discriminatory control area operations to the Commission.

96. Additionally, the Midwest ISO deleted terms that were not objectively quantifiable, such as "but not limited to," and replaced general terms such as "needed for reliability purposes" with language citing the requirements of the Reliability Authority or Regional Reliability Organization.

97. The Midwest TDUs note that the Midwest ISO's October 5 compliance filing proposed a market impact test for instances other than affiliate favoritism or discrimination. They argue that the Commission should require the Midwest ISO to eliminate the market impact test, stating that Compliance Order I required the IMM to report all anti-competitive control area conduct. As noted in their request for rehearing, the Midwest TDUs argue that no market impact test should be applied because of the difficulty of catching and monetizing such competitive harms, and the number of possible harms. Further, the Midwest TDUs argue that requiring the IMM to report all anti-competitive behavior by control area operators would provide the Commission with information it needs to evaluate problems associated with the continuing existence of the Midwest ISO's multiple control areas.

98. WEPCO argues that in section 53.1.g, the Midwest ISO should restrict control area operations that are "unduly discriminatory," not just "discriminatory," in keeping with the Commission's statutory standard. In the same section, WEPCO suggests that the Midwest ISO change "failing to maintain levels of [Area Control Error] required by the Reliability Authority" to "failing to maintain levels of [Area Control Error] required by NERC," because Area Control Error is a NERC-mandated standard.

99. WPS Resources argues that the Midwest ISO's proposed tariff revisions do not comply with the Commission's directives. It states that the Midwest ISO can easily comply with the Commission's instructions by stating in the TEMT that "control area operators will not be subject to enforcement actions or penalties when they are following the directions of NERC, the Midwest ISO, local reliability councils, or of individual states."

d. Discussion

100. We clarify that, although we expect the IMM to monitor all control area operator actions and notify the Commission of anti-competitive behavior that could result in harmful market impacts to Midwest ISO customers, we do not require that the IMM report each of those instances that do not have a market impact. We do, however, require that all instances of affiliate favoritism or discriminatory control area operations be reported to the Commission, since these actions may violate Market Behavior Rule 2.

101. We believe that the IMM's proposed price thresholds of \$50/MWh or \$10/MWh for uplift are low enough to protect customers from the impacts of specific control area actions defined in section 53.1.g and the reporting requirement for all instances of affiliate favoritism or discriminatory actions by control areas are also appropriate. We note that the proposed thresholds are more comprehensive than any of the other conduct and impact thresholds since they apply to the entire Midwest ISO energy market, and are not conditioned on being in BCAs or NCAs. The Midwest TDUs' proposal, to report all conduct in section 53.1.g, irrespective of market impact, would add a significant reporting burden with little additional benefit for customers.

102. Recognizing the difficulty of establishing the cause and effect of certain control area actions, in the context of a myriad of other energy market activities, we believe a reasonable threshold needs to be set that will address significant customer impacts. We expect the IMM to monitor all control area actions and propose refined monitoring procedures and possibly different thresholds, based on its analysis of the Midwest ISO energy market. For these reasons, we deny the Midwest TDUs' request for rehearing and accept the proposed revision to section 53.3.b.

103. Cinergy's request for rehearing on Market Behavior Rule 2 is a collateral attack on the Commission's orders approving that rule. We previously denied Cinergy's request for rehearing on this issue in the TEMT II Rehearing Order.⁶⁴ The application of Market Behavior Rule 2 to control area behavior or other specific conduct can be determined in a

⁶⁴ TEMT II Rehearing Order at P 261-63.

proceeding adjudicating alleged violations. As detailed in the recently-approved Balancing Authority Agreement,⁶⁵ control areas perform a wide range of functions, including management of inadvertent energy, load forecasting and deployment of operating reserves, that provide opportunities to manipulate prices, market conditions or market rules. For these reasons we deny Cinergy's request for rehearing.

104. We agree with WPS Resources that section 53.1.g needs additional language to comply with the requirements of the Compliance Order I. In that order, the Commission required that the tariff language clarify that control area operators' actions will not be subject to enforcement action when they are following the directions of NERC, the Midwest ISO (as may be reflected by their roles specified in the Balancing Authority Agreement), local reliability councils, or by individual states.⁶⁶ We direct the Midwest ISO to incorporate this language in revised tariff sheets.

105. With regard to WEPCO's issues with section 53.1.g, we agree that the Midwest ISO should define NERC in section 1.208a as the North American Electric Reliability Council and that "discriminatory" should be replaced by "unduly discriminatory," reflecting the Commission's statutory standard. We see no need to change the requirement in this subsection that control areas maintain levels of Area Control Error required by the Reliability Authority. NERC, based on its audits and testing in 2003 and 2004, has designated the Midwest ISO as a reliability coordinator. In this role, the Midwest ISO is expected to implement NERC standards in its management of system operations.

2. Behavior Subject to Mitigation

a. Background

106. The TEMT II Order approved provisions for monitoring by the IMM of LMP markets and prices. The TEMT II Order also required that the types of conduct subject to mitigation must be defined in clear, objectively-quantified standards. The Commission, in Compliance Order I, approved provisions that establish +/- 10 percent as the level of divergence between the day-ahead and real-time market price at which the IMM would determine that an unwarranted divergence in energy prices was caused by a participant's conduct that should be mitigated. The Commission also required the Midwest ISO to

⁶⁵ See *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,177 (2005).

⁶⁶ See Compliance Order I at P 144.

define economic operation of facilities as operating the facility such that the outage or derating is scheduled, to the degree possible, at a time that minimizes the costs to the market (such as during off-peak periods).

b. Request for Rehearing

107. WPS Resources notes that, in its October 5 compliance filing, the Midwest ISO proposed to establish 10 percent as the threshold level of divergence between day-ahead and real-time energy market prices at which the IMM would find that an unwarranted divergence was caused by a market participant's conduct. WPS Resources notes that the Midwest ISO proposed this threshold based on studies of the New England and New York markets, which have a history of operating as tight power pools, but the Midwest ISO has no such history. It goes on to argue that it is not clear whether the Commission addressed its concern on the merits in Compliance Order I, and asks the Commission to clarify (or find on rehearing) that the 10 percent divergence test is to be treated as a threshold for initiating an investigation, not as a *de facto* conclusion that market participants engaged in virtual transactions have acted improperly.

c. Compliance Filing and Responsive Pleadings

108. The Midwest ISO complied with the Commission directives in its compliance filing, and added the following language to section 64.1.1.d of the TEMT:

A transmission facility shall be deemed physically withheld if it is (a) scheduled out of service for technical reasons that are not true or cannot be verified, (b) scheduled out of service during periods that result in market costs that are more than 100 percent (100%) higher, or (c) not operated in accordance with Transmission Provider's Dispatch Instructions and such failure to conform to Transmission Provider's Dispatch Instructions causes a Binding Transmission Constraint. A transmission facility shall not be deemed withheld if it is subject to a forced outage or is out of service for maintenance in accordance with a maintenance schedule approved by the Transmission Provider.

109. The Midwest TDUs argue that neither the limitation of service outages to "technical reasons" nor the requirement for a doubling in market costs is justified. They state that Compliance Order I does not mandate prohibiting only false or unverifiable outages due to "technical reasons," and argue that the outage of a transmission facility for any reason that is not true or cannot be verified should be deemed physical withholding. The Midwest TDUs further state that the Midwest ISO's proposal to allow all

withholding other than those premised on “technical” reasons will produce a loophole, because “technical” is not a defined term. The Midwest TDUs argue that a transmission facility operator could claim that it took a transmission facility out of service for economic or safety reasons that are not true or verifiable. The Midwest TDUs therefore conclude that the limitation to “technical” reasons should be removed from section 65.1.1.d, as well as from the other sections of the TEMT where the term appears.

110. Next, the Midwest TDUs argue that the Midwest ISO has not justified finding a transmission facility is physically withholding capacity where the facility is “scheduled out of service during periods that result in market costs more than 100 percent (100%) higher.” They note that the new language does not define “market costs,” and that Compliance Order I does not call for limiting the definition of physical withholding to just those that double market costs. Further, the Midwest TDUs challenge the Midwest ISO’s claim that the new language complies with the Compliance Order I directive to “define economic operation of facilities as operating the facility such that the outage or derating is scheduled, to the degree possible, at a time that minimizes the cost to the market (such as during off-peak periods).”⁶⁷ The Midwest TDUs argue that the Midwest ISO’s allowance for a doubling of costs does not do that, and that the Midwest ISO should have adopted the language suggested in Compliance Order I.

d. Discussion

111. The Commission in Compliance Order I approved the divergence threshold as one of the conduct thresholds that meets the “clear and objectively quantifiable” standard the Commission set in the TEMT II Order. This test is appropriate for the Midwest ISO since its day-ahead and real-time energy market design has most of the same features as NYISO and ISO New England, Inc. (ISO-NE), which also use this same threshold. We do not consider power pool characteristics, factors that bear on reliability management only, to be relevant to the divergence test. Rather, we look to the design of the markets in which offers and bids are made for our determination to approve the threshold. We clarify that Compliance Order I states that the divergence test will apply to virtual and physical bids, and that order confirmed that evidence of divergence would not be a threshold for further review, but rather would trigger the specified mitigation.⁶⁸ For these reasons, we deny the request for rehearing.

⁶⁷ *Id.* at P 245.

⁶⁸ *See id.* at P 247.

112. We consider the proposed revision to section 64.1.1.d, subsection (b), which defines physical withholding to be when a transmission facility is scheduled out of service during periods that result in market costs that are more than 100 percent higher, to be problematic. We do not believe it is possible to isolate the cause of market price increases to a transmission outage, with enough confidence to assess penalties, when that outage does not result in a binding constraint. However, revising the definition to incorporate binding constraints would unfairly assess penalties if the transmission operator had valid technical reasons for an outage, and a binding constraint occurred. To avoid these problems, we direct the Midwest ISO to delete subsection (b). To ensure that the market monitoring and mitigation plan accomplishes the original intent of our requirement in the Compliance Order I, we will require the IMM to monitor, and report to the Commission, the behavior of transmission operators to determine if there is a pattern of scheduling outages that increases market costs compared to an alternative, and lower cost impact, outage scheduling. We require the Midwest ISO to add this language to the TEMT in its compliance filing.

113. We accept the proposed subsection (a) of section 64.1.1 to be in compliance with the requirements of Compliance Order I. We understand this provision to require physical withholding penalties when an operator claims it needs to take a transmission facility out of service for reasons related to maintaining the facility, maintaining an acceptable level of operating performance, or upgrading facilities, for example, that is untrue or unverified. We consider the term “technical” to be a generally understood term that refers to such activities, and therefore we do not see the need to define the term nor do we consider it a loophole. If an operator claimed an outage was caused for economic reasons, as Midwest TDUs posit, then the outage would not be for technical reasons, and therefore would result in physical withholding penalties.

114. We also require revisions as follows. We require the Midwest ISO to replace “and” in the phrase “for technical reasons that are not true and cannot be verified” with “or” in section 63.3.a, thereby making the section consistent with section 64.1.1.d. The term “opearing” should be replaced with “operating” in section 64.1.1.b. The Midwest ISO is also required to replace “654.4” in section 65.4.3.c with “65.4”.

F. Emergency Procedures

1. Background

115. In the TEMT II Order, the Commission accepted the proposed Emergency Procedures subject to the Midwest ISO making certain modifications.⁶⁹ First, the Midwest ISO was directed to specify that it would make sure the least-cost option is scheduled in an emergency. Second, the Midwest ISO was directed to integrate notification and emergency purchases, in contrast to purchases from the emergency range, into the sequence of steps used to resolve real-time shortages. Third, the Midwest ISO must exclude market participants from making separate offers outside the economic minimum and maximum range. Fourth, the Midwest ISO was directed to specify the information Demand Response Resources must provide to support bids above the \$1,000/megawatt-hour bid cap.

116. The Midwest ISO submitted revisions to the TEMT in its October 5 compliance filing. In Compliance Order I, the Commission accepted the changes to sections 39.2.10 and 40.2.15, which assure that the least-cost option will be used and describe the process to acquire supplies from emergency purchases. However, the Commission noted that information on the Demand Response Resources had been omitted in sections 39.2.5.f, 40.2.3.b.ix, 40.2.15.c, 40.2.17.a, and that section 40.2.15.n appeared to be incorrectly numbered.⁷⁰

2. Compliance Filing and Responsive Pleadings

117. The Midwest ISO submits that the references to included tariff sheets was inappropriately provided in its October 5, 2004, Compliance filing as the Commission did not request such modifications to the tariff sheets. The Midwest ISO explains that it did, however, provide the requested explanation regarding this issue in sections (G)(I)(b) and (c) on page 26 of its October 5, 2004 filing letter. As such, according to the Midwest ISO, the inclusion of the reference to included tariff sheets was an administrative oversight. The Midwest ISO states that footnote 103 of the Midwest ISO's October 5, 2004, filing letter explains that section 40.2.15.c was consolidated with section 40.2.15.a and revisions to 40.2.17.a were submitted in the October 5, 2004, Compliance filing. The Midwest ISO also explains that it cannot find the incorrect numbering.

⁶⁹ TEMT II Order at P 387.

⁷⁰ See Compliance Order I at P 278.

3. Discussion

118. We accept the Midwest ISO's explanation for the consolidation of section 40.2.15.c into section 40.2.15.a, and the revisions to section 40.2.17.a. Our prior error directed the Midwest ISO to renumber section 40.2.15.n, but upon further review, we now realize that the order included a typographical error and should have required the Midwest ISO to renumber section 40.2.17.n. The Midwest ISO has, however, corrected the error in its tariff clean-up filing. We accepted that filing subject to the outcome of proceedings in which specific changes had been ordered.⁷¹ As the issue is now resolved, we will waive our requirement that the Midwest ISO correct the error in this proceeding.

G. Resource Adequacy Requirements

1. Interim Resource Adequacy Proposal

a. Background

119. The Commission generally accepted the Midwest ISO's interim resource adequacy proposal in the TEMT II Order on the basis that it will operate as a transition mechanism to ensure day-to-day reliability needs are met similar to the way it is currently done.⁷² In addition, the Commission directed the Midwest ISO to work expeditiously toward the filing of a long-term resource adequacy plan. In the TEMT II Order, the Commission also directed the Midwest ISO to make several clarifying changes to Module E, addressing among other things, the effective time period for Module E, its breadth and scope, and the must-offer requirement for designated Network Resources.

120. Responding to the Commission's directives, the Midwest ISO filed several changes to its Module E proposal in an October 5, 2004 filing. The Commission acted on these changes in Compliance Order I. In that order, the Commission accepted the Midwest ISO's proposal to file a long-term resource adequacy plan on or about June 6, 2006 and that the interim plan would sunset upon Commission acceptance of the long-term plan.⁷³ The Commission also discussed the other components of the interim plan and directed further revisions as is further discussed herein.

⁷¹ See Readiness Order at P 47.

⁷² See TEMT II Order at P 421-22.

⁷³ *Id.* at P 335.

b. Requests for Rehearing

121. WPS Resources argues that the Commission summarily dealt with one of its arguments regarding a Midwest ISO-wide resource adequacy process, but did not address WPS Resources' remaining concerns. WPS Resources argues that the Commission should direct the Midwest ISO to develop a region-wide resource adequacy program and requirement, and phase in that requirement over a reasonable period of time.

122. WPS Resources also states that the Midwest ISO must modify its interim resource adequacy proposal to: (1) develop penalties applicable when load-serving entities fail to satisfy their resource adequacy requirements; (2) identify a date certain when the Midwest ISO, in coordination with the OMS, will file a region-wide resource adequacy plan that will be phased in over a reasonable period of time and that will apply to load-serving entities on a non-discriminatory basis; and (3) explain how the Midwest ISO will ensure that its region-wide resource adequacy plan and PJM's resource adequacy plan will be consistent.

c. Discussion

123. In the TEMT II Rehearing Order, the Commission stated that, "However, at a minimum, the long-term RAR plan that the Midwest ISO files cannot directly conflict with the PJM RAR plan."⁷⁴ We find this is sufficient guidance for the Midwest ISO and stakeholders to use as a long-term resource adequacy plan is developed and no further guidance from the Commission is needed at this time. Therefore, we deny rehearing regarding WPS Resources' request for the Commission to explain how the Midwest ISO's resource adequacy plan and PJM's resource adequacy plan will be consistent.

124. The Commission approved Module E on the basis that it was "a transition mechanism to bridge the gap between market start-up and the implementation of a permanent RAR plan."⁷⁵ The Commission also directed the Midwest ISO to submit a compliance filing listing the date when it proposes to file a long-term RAR plan.⁷⁶ As noted, the Midwest ISO complied with this directive by stating, "...the Midwest ISO proposes to have in place a permanent RAR plan on or about June 1, 2006."⁷⁷ The

⁷⁴ *Id.* at P 319.

⁷⁵ *See id.* at P 396.

⁷⁶ *Id.* at P 421.

⁷⁷ *See* Midwest ISO Transmittal Letter at 31 (Oct. 5, 2004).

Commission accepted this directive in Compliance Order I as a reasonable time frame to develop a permanent RAR plan.⁷⁸ The Commission also denied a similar request by PSEG for the Commission to establish a fixed date for the interim plan to expire in the TEMT II Rehearing Order, reasoning that, "...a directive now would undermine the ongoing stakeholder work on this issue," and a directive of this nature would undercut our prior directives for the Midwest ISO to come up with a date.⁷⁹ We find no convincing reason to now overturn prior Commission orders, and we deny rehearing on this issue.

2. Twelve Percent Default Reserve Margin

a. Background

125. In the TEMT II Order, the Commission conceptually agreed with the Midwest ISO on the need for a default resource adequacy requirement where the Midwest ISO could not find any reserve requirement in place. In general, the default reserve margin preserves preexisting reserve requirements and expires when a permanent resource adequacy plan is adopted in the Midwest ISO. However, the Commission directed that additional details were needed to properly evaluate the reserve requirement.⁸⁰ The Midwest ISO filed additional details to comply with this directive on October 5, 2004. In the Compliance I Order, the Commission accepted the default reserve margin requirement, finding that it now possessed enough details for tariff customers to understand its requirements and ordered further clarifications.⁸¹

b. Requests for Rehearing

126. Detroit Edison requests rehearing of Compliance Order I, stating that the Commission erred by failing to define the Midwest ISO's "default" reserve margin as a planning reserve margin applicable to all load-serving entities not otherwise subject to state or NERC reliability council planning reserve requirements. Detroit Edison renews

⁷⁸ See Compliance Order I at P 335.

⁷⁹ *Id.* at P 320.

⁸⁰ See TEMT II Order at P 415.

⁸¹ See Compliance I Order at P 313-321.

its request that the Commission direct the Midwest ISO to impose a 12 percent planning reserve requirement in the interim resource adequacy plan on all load-serving entities serving load within the Midwest ISO footprint, unless such load-serving entities are currently subject to state or reliability council planning reserve requirements.

127. WPS Resources requests clarification, or rehearing of Compliance Order I, arguing the Midwest ISO must modify its interim resource adequacy proposal to define the procedures it will use to verify compliance with its default reserve margin requirement.

128. The Midwest TDUs argue that the 12 percent reserve margin uses definitions of Adjusted Capacity and Adjusted Demand that result in discriminatory reserve calculations by unfairly burdening those that make purchases backed by reserves. In addition, the Midwest TDUs argue that the Midwest ISO's definitions for System Firm Capacity Purchases and System Firm Capacity Sales result in the buyer in effect paying twice for the same reserves. The Midwest ISO's definitions are confusing to the Midwest TDUs, in that they find the definitions restrict a buyer's ability to purchase firm system power from a supplier that serves load outside of the Midwest ISO, or a generator without other native load in the Midwest ISO, by requiring the buyer to carry reserves to serve load for which its supplier has already agreed to carry. Therefore, on rehearing, the Midwest TDUs request the Commission to require the Midwest ISO to use definitions that make the seller responsible for carrying reserves associated with firm system sales.

c. Compliance Filing and Responsive Pleadings

129. The Midwest ISO revised sections of Module E regarding the twelve percent default reserve margin. The Midwest ISO revised the introduction of Module E to state that the resource adequacy requirements of Module E expire when a long-term resource adequacy plan is implemented. The Midwest ISO also states that it revised section 68.2.3 to permit updates to Adjusted Capacity and Adjusted Demand based on current contractual arrangements up to 30 days in advance of the first day of any month.

d. Discussion

130. We deny rehearing with regard to the Midwest TDUs' request to modify the definitions in sections: 1.3a (Adjusted Capacity), 1.3b (Adjusted Demand), 1.296a (System Firm Capacity Purchases), and 1.296b (System Firm Capacity Sales). The Commission finds that these definitions, taken together, appropriately define how the default reserve margin is calculated. Furthermore, we note that the terms Adjusted Capacity and Adjusted Demand are terms that are applicable only in the limited areas where the default reserve margin is used and only for the interim period that Module E is in effect. We further note that, the calculation of Adjusted Capacity and Adjusted

Demand account for current contractual arrangements as defined in Module E and may be updated every 30 days.⁸² We also note that the Commission directed the Midwest ISO to clarify the 12 percent default reserve margin with regard to Adjusted Demand⁸³ and those clarifications are discussed in this order. We encourage the Midwest TDUs to utilize all the provisions of Module E to ensure that, where the 12 percent reserve margin is applicable, it reflects the unique nature of some of their member's contractual arrangements regarding operating reserves.⁸⁴

131. We likewise deny Detroit Edison's request for rehearing about the reserve margin. The default reserve margin is not intended to be a planning reserve margin. The requirements of Module E are intended to preserve the flexibility to meet reserve requirements that load-serving entities currently possess under each region's requirements. The 12 percent reserve margin is intended for market participants that serve load and are not subject to any state or regional reliability council margin requirements. Planning reserve requirements are based on long-term reserve needs, which are not addressed by this requirement. The default reserve margin is a back-stop measure, intended to be applicable for the interim period until a permanent plan is adopted. Updates to the Adjusted Capacity figure used in the reserve margin calculation are permitted on a monthly basis. In regions such as the East Central Area Reliability Council (ECAR), the amount of Network Resources needed may be updated on a daily basis; in the Mid-Continent Area Power Pool (MAPP) and the Mid-America Interconnected Network, Inc. (MAIN), updates are permitted monthly. As the Midwest ISO has stated with respect to load-serving entities' ability to designate resources to meet reserve requirements, the Midwest ISO "is not changing the [load-serving entities'] ability to make daily operating designations for network resources as long as they are deliverable."⁸⁵ We find that it is not practical or appropriate to superimpose a long-term planning measure on a short-term transitional requirement.

⁸² See Module E, Original Sheet No. 818B.

⁸³ See Compliance Order I at P 321.

⁸⁴ *Id.* at P 319.

⁸⁵ See Module E Implementation FAQ at 4 (last updated Mar. 23, 2005), available at http://www.midwestiso.org/plan_inter/documents/Resource_Adequacy/FAQ%20Follow%20On_03_23_05.pdf.

132. We deny the rehearing request of WPS Resources regarding Midwest ISO verification of compliance with the default reserve margin requirement, and the development of penalties for load-serving entities that fail to satisfy their resource adequacy requirements. In the present plan, the Midwest ISO does not need to establish penalties for market participants to comply with requirements that are established at the state or regional level. The Midwest ISO has stated that failures to comply with the 12 percent reserve margin requirement will be reported to the Commission along with a reasonable penalty recommendation or other remedies enforceable through Commission proceedings pursuant to section 38.2.8.⁸⁶ The Commission has also previously denied rehearing of modifications to section 38.2.8 because the Commission believes “the provision clearly contemplates Commission adjudication of failures to comply with the tariff that may result in sanctions or penalties.”⁸⁷ Therefore, we see no reason to grant rehearing to WPS Resources on the penalty issue.

133. We also deny rehearing regarding the verification of compliance with the default reserve margin requirement. While the interim resource adequacy plan is a regional plan, it is also an amalgamation of local resource adequacy plans because Module E preserves the reliability requirements of each respective reliability region and state in the Midwest ISO service territory. Therefore, we are satisfied that the Midwest ISO has stated in section 3 of its Business Practices Manual for Resource Adequacy that each market participant serving load in the Midwest ISO must comply with the appropriate Regional Reliability Organization governing that location.⁸⁸ In addition, the Midwest ISO recognized in section 3.1.2 that each market participant must comply with the applicable state or provincial regulations regarding resource adequacy.⁸⁹ We find this arrangement acceptable during the initial phase of the Midwest ISO regional energy market.

⁸⁶ See Midwest ISO Transmittal Letter at 31 (October 5, 2004).

⁸⁷ See TEMT II Rehearing Order at P 522.

⁸⁸ See Draft Manual No. 011, “Business Practices for Resource Adequacy” Version 1 at 11 (last updated Dec. 17, 2004), available at http://www.midwestiso.org/plan_inter/documents/Resource_Adequacy/BPM_for_Resource_Adequacy_r3_March%2023_2005.pdf.

⁸⁹ *Id.* at 13.

3. Definitions Related to Module E

a. Background

134. The Midwest ISO submitted several new definitions in Module A of its October 5, 2004 filing to comply with numerous Commission directives in the TEMT II Order to clarify the tariff. In the Compliance I Order, the Commission generally accepted these new definitions, on the basis that they would clarify the applicability and intent of the tariff.⁹⁰ Several of these new definitions related to implementing the requirements of Module E.

b. Requests for Rehearing

135. The Midwest TDUs ask the Commission to rehear its decision to accept the definitions in sections 1.261a (Regional Reserve Sharing Agreement) and 1.269 (Reserve Sharing Group).⁹¹ The Midwest TDUs allege that the Commission misunderstands how reserve sharing works in parts of the Midwest ISO region. According to the Midwest TDUs, section 1.269 distorts the way reserves are handled in MAPP and MAIN for non-control area utilities. Currently, non-control area utilities have the right to participate in the reserve-sharing pool, they have the right to call on operating reserves, and they are obliged to supply reserves when called upon by others. According to the Midwest TDUs, this relationship with reserves exists because the MAPP Agreement does not restrict its reserve-sharing pool to just control area operators. (As an example of the overlapping reserve responsibilities, the Midwest TDUs cite Missouri River Energy Services, which is a “Reliability Member” of MAPP, a Midwest ISO participant and a member of the reserve-sharing pool.) The Midwest TDUs state that there is no reason for the Commission or the Midwest ISO to set up definitions that interfere with the continued participation of non-control area utilities in MAPP’s reserve-sharing pool.

⁹⁰ See Compliance I Order at P 415.

⁹¹ As discussed herein, the Midwest TDUs’ comments on the Midwest ISO’s compliance filing support the Midwest ISO’s revised definition of Regional Reserve Sharing Agreement because it accommodates the participation of non-control areas in reserve sharing groups. However, the Midwest TDUs continue to protest the definition of Reserve Sharing Group because it does not make similar accommodations.

136. The Midwest TDUs again ask the Commission to revise the definition of Interruptible Load in Module A, section 1.153b, so that a non-control area utility's interruptible load is excluded from the firm load for which it must carry reserves, with no involvement of the control area utility. (They note that the definition for Interruptible Demand in Module A, section 1.153a, has the same defect, but the term is never used in the TEMT.) The Midwest TDUs state that these definitions ignore the fact that non-control area utilities have interruptible contracts with their retail customers under which they, not the control area operator, call the interruption. The Midwest ISO's definitions, according to the Midwest TDUs, force the transmission-dependent utility to choose between treating interruptible load as firm or transferring control over this arrangement to the control area – a competitor – which has no responsibility for serving the transmission-dependent utility's load. The Midwest TDUs allege that Compliance Order I misread the definitions as requiring a non-control area utility to provide its host control area with notice that the transmission-dependent utility has interruptible load, when in fact the definitions require the load to be interruptible by a control area operator.⁹² The Midwest TDUs question why a control area operator would need this notice, because knowing that a transmission dependent utility has interruptible load will not affect the reserves the control area must carry for its own firm load.

137. The Midwest TDUs allege that the Commission's acceptance of the Midwest ISO's definitions amounts to a taking of a non-control area's right to interrupt its retail customers. They state that the Commission has neither acknowledged nor justified that action. They revive their request that the Commission require the Midwest ISO to revise its interruptible load definitions to exclude load that a non-control area utility can interrupt from firm load for which reserves are required. If the Commission insists on notice to control area utilities, then the Midwest TDUs ask that the Midwest ISO be required to conform its definitions to the notice requirement that Compliance Order I describes.

c. Compliance Filing and Responsive Pleadings

138. The Midwest ISO states that it revised sections of Module E regarding jurisdictional issues in compliance with Commission directives. The Midwest ISO states that it revised section 68.1.1.d to strike language requiring the Midwest ISO's approval prior to members withdrawing from reserve sharing groups, and replace it with language stating that members are required to give prior notice to the Midwest ISO before withdrawing from reserve sharing groups. However, the withdrawing members must

⁹² Midwest TDUs Request for Rehearing at 23 (citing Compliance Order I at P 319).

continue to abide by the other requirements of Module E and demonstrate that they can continue to meet the applicable reserve requirement. In addition, the Midwest ISO revised the definition of a Regional Reserve Sharing Agreement in section 1.261a to expand its applicability and to pluralize Control Area(s). Also the Midwest ISO further clarified the meaning of “Control Areas that are not members” in section 1.261a by stating that the agreement is an arrangement between a Midwest ISO member (i.e., a signatory to the Midwest ISO Agreement) and one or more entities to share the provision of operating reserves in response to a loss of a generation resource.⁹³

139. The Midwest TDUs support the Midwest ISO’s revised definition of Regional Reserve Sharing Agreement in section 1.261a. They state that the new definition correctly accommodates the current participation of non-control areas in Reserve Sharing Groups. The Midwest TDUs note, however, that the revised definition of Regional Reserve Sharing Agreement is inconsistent with the definition of Reserve Sharing Group, which is defined as an “arrangement between two or more Control Areas to share the provision of Operating Reserve in response to a loss of a Generation Resource.”⁹⁴ As “crucial provisions” of the TEMT use ‘Reserve Sharing Group’ instead of ‘Regional Reserve Sharing Agreement,’ the Midwest TDUs argue that it is essential for the Reserve Sharing Group definition to be conformed to the Regional Reserve Sharing Agreement definition.⁹⁵

140. The Midwest TDUs argue that the Midwest ISO should be directed to revise its definition of a Reserve Sharing Group because it preserves the benefits of reserve sharing for participants that operate control areas, but interferes with the continued participation of non-control area utilities. Citing case law, they argue that this is unduly discriminatory and preferential, especially in the absence of a claim of undue burden.⁹⁶ They add that the Commission appears to incorrectly view the Midwest TDUs as seeking new rights to participate in reserve sharing groups in which they do not now participate.

⁹³ See Midwest ISO Transmittal Letter at 9 (Jan. 21, 2005).

⁹⁴ Module A, section 1.269, Original Sheet No. 119.

⁹⁵ Midwest TDUs Protest at 10.

⁹⁶ Midwest TDUs Protest at 13 and n.19 (citing *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156, 1772 (D.C. Cir. 1979)).

141. In its answer, the Midwest ISO states that it is willing to make the proposed change to the definition of “Reserve Sharing Group” consistent with the recently-revised definition of “Reserve Sharing Agreement.”

d. Discussion

142. We grant rehearing to the Midwest TDUs regarding the four definitions related to reserve sharing, interruptible load and demand, and non-control area utility’s responsibilities with respect to each.⁹⁷ The Commission’s understanding of the current allocation of control area responsibilities is largely based on the recently adopted Balancing Authority Agreement.⁹⁸ The Balancing Authority Agreement is a contract among the Midwest ISO and the various Balancing Authorities in the Midwest ISO region that allocates responsibilities associated with TEMT implementation. Section 4 of this agreement stipulates that the Midwest ISO will, among other things, provide information to the Balancing Authorities (i.e., control areas) necessary to allow deployment of regulation and operating reserves. In turn, the Balancing Authorities will provide the Midwest ISO with the identities of generating units subject to reserve sharing, and coordinate the deployment of regulation and operating reserves.⁹⁹

143. We agree with the Midwest TDUs that the definition of a Reserve Sharing Group in section 1.269 appears unbalanced when compared to the revised Regional Reserve Sharing Agreement in section 1.261a. We also note the Midwest ISO agrees that section 1.269 should be revised to remove the reference to “Control Areas” and instead refer to entities.¹⁰⁰ Therefore, we direct the Midwest ISO to revise section 1.269, Reserve Sharing Group, to remove the reference to Control Areas and instead refer to “entities” to accommodate the participation of non-control area utilities consistent with the recently revised definition of a Reserve Sharing Agreement. However, we are not clear whether or not the definitions of interruptible demand, interruptible load, and direct control load management require revision. Therefore, we direct the Midwest ISO to study the

⁹⁷ The four definitions in Module A are: (1) section 1.69a, Direct Control Load Management; (2) section 1.153a, Interruptible Demand; (3) section 1.153b, Interruptible Load; (4) section 1.269, Reserve Sharing Group.

⁹⁸ See *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,177 (2005).

⁹⁹ *Id.* at P 10-12.

¹⁰⁰ See Motion for Leave to Answer of the Midwest ISO at 17. February 28, 2005.

exchange of operating information between the Midwest ISO, its control areas, and its non-control area utilities, to determine if the Module A definitions that govern these interactions are consistent with actual market operations. As previously noted, there is a revised agreement that governs the division of responsibilities between the Midwest ISO, as the Reliability Authority, and the Control Areas as the Balancing Authorities. We also acknowledge that the implementation of reserve sharing procedures will continue beyond market start-up.¹⁰¹ Consistent definitions that reflect the actual, operational rights and responsibilities of all Midwest ISO market participants are needed, particularly in regard to the exchange of reserve information and market operations. Therefore, we direct the Midwest ISO to comply with these directives regarding the respective allocation of rights to interrupt load referenced in the three definitions through a filing within 30 days of the issuance of this order. In its compliance, the Midwest ISO must clarify the rights and responsibilities of non-control area utilities, such as Missouri River Energy Services, that have unique operating characteristics because of their location with respect to the Midwest ISO region.

4. Network Resources

a. Background

144. Network Resources are designated by market participants, at least annually; to demonstrate which resources they are relying on to comply with their resource adequacy standards. In the TEMT II Order, the Commission accepted the Midwest ISO's proposal to designate Network Resources, but directed the Midwest ISO to file additional details about the specific resources that qualify to satisfy the Network Resource requirements.¹⁰² The Midwest ISO submitted a filing on October 5, 2004 to comply with this directive and the Commission issued an order stating that the Midwest ISO had generally clarified the qualifications for designation of Network Resources.¹⁰³ The Commission also accepted the aggregate deliverability standard, finding that it would recognize system constraints

¹⁰¹ "Indeed, the Midwest ISO continues to work with its stakeholders on details of implementation in matters such as reserve sharing and reversion plan testing. Such shared involvement will continue up to and after market launch." *See* Midwest ISO Transmittal Letter at 3-4 (Feb. 15, 2005) (accompanying the Midwest ISO Certification of Market Readiness).

¹⁰² *See* TEMT II Order at P 404.

¹⁰³ *See* Compliance Order I at P 292.

and would not negatively impact the reliability of the grid.¹⁰⁴ Finally, the Commission directed the Midwest ISO to revise the Network Resource qualifications to allow external resources to qualify as Network Resources and to allow resources to qualify irrespective of their association with the Open-Access Same-Time Information System (OASIS) process.¹⁰⁵

b. Requests for Rehearing

145. The Midwest TDUs renew numerous requests regarding the designation of Network Resources in the Midwest ISO's interim resource adequacy plan. Specifically, the Midwest TDUs argue that the Commission should not have accepted the aggregate deliverability requirement in Module E, section 69.1.3. On rehearing, the Midwest TDUs state that there should at least be available an option of load-specific delivery for all existing and new resources. The Midwest TDUs argue that the aggregate deliverability requirement conflicts with existing state and regional reliability council requirements for load-specific delivery of resources and undermines reliability and long-term price stability. The Midwest TDUs also argue that aggregate deliverability violates the intent of Order Nos. 2003-A and -B and does not make sense for the Midwest ISO region where a resource deliverable in Kentucky could count as reserves for a load-pocket in Wisconsin.

c. Compliance Filing and Responsive Pleadings

146. The Midwest TDUs argue that the new language of section 69.1 compounds the Midwest ISO's and the Commission's errors in abandoning the requirement that Network Resources be specifically deliverable, rather than aggregately deliverable, to Network Load. The Midwest TDUs state that, as they argued in their Request for Rehearing, aggregate deliverability of Network Resources makes no sense. They assert that the Commission must not abandon the load-specific deliverability that load serving entities rely upon to ensure reliable and economic power supply resources for their customers.

147. Further, the Midwest TDUs argue that the Midwest ISO's compliance language must also reference deliverability, as specified in section 69.1.3, in addition to section 69.1.2.b. They state that section 69.1.3.v assures that "Generation Resources that have been accepted by the Midwest ISO and confirmed by Network Customers as designated Network Resources under the OASIS reservation process in place prior to the effective

¹⁰⁴ *Id.* at P 294.

¹⁰⁵ *Id.* at P 298-300.

date of this Tariff will be accepted by the Midwest ISO as deliverable to the Network Loads of the Network Customer for the term of the confirmed designation.”¹⁰⁶ The Midwest TDUs argue that Network Resources that are External Resources should not be treated differently from Network Resources that are Internal Resources, especially where the External Resource is already relied upon by the Network Customer as Network Resource. They also allege that it would be unreasonable and unlawful to frustrate Network Customers' reliance on the specific deliverability of existing Network Resources, whether located internally or externally.

148. In its answer, the Midwest ISO states that the Midwest TDUs' argument regarding aggregate deliverability is a reiteration of a rehearing request, and that the Midwest ISO is therefore in no position to comply with the Midwest TDUs' request.

149. The Midwest ISO notes that in Compliance Order I, the Commission ordered it to file section 30.1 of the TEMT, to which the Midwest ISO had intended to add a sentence that would clarify that Demand Response Resources may qualify as Network Resources. The Midwest ISO's compliance filing includes a revised section 30.1.

150. The Midwest ISO also states that it changed section 69.1.2.a of Module E to include a cross-reference to the definition of a Network Resource in section 1.217 of the tariff. The Midwest ISO also states that it revised section 69.1.3.v of Module E to include all interconnected generation units currently designated as Network Resources, irrespective of whether or not those units are associated with the OASIS process. In addition, the Midwest ISO states that it complied with the Commission directive to modify section 69 to state that external resources may qualify as Network Resources provided they meet the deliverability requirements of section 69.1.2.b. Finally, the Midwest ISO filed a revised section 30.1 that states that Demand Response Resources may qualify as Network Resources.

d. Discussion

151. We accept the Midwest ISO's filing as compliant with the Commission's directives in the Compliance I Order. The Midwest ISO has filed tariff sheets that allow an external resource to qualify as a Network Resource, provided that the resource meets the deliverability requirements of Module E. The Midwest ISO has also cross-referenced the definition of a Network Resource in section 1.217 of Module A, and clarified that existing network resources are eligible to be designated as Network Resources irrespective of the resource's association with the OASIS reservation process.

¹⁰⁶ See Module E, section 69.1.3.v, Original Sheet No. 823B.

152. We deny the Midwest TDUs' request for rehearing to remove the aggregate deliverability requirements, in favor of load-specific requirements. The Midwest TDUs did not submit any additional arguments to support a load-specific deliverability standard for Network Resources beyond those addressed in the December 20, 2004 Order. We are not convinced that changes to the Network Resource's aggregate deliverability requirements are needed beyond those that were directed in the December 20 Order.¹⁰⁷ In regards to the Midwest TDUs' concerns with the external resource qualification process, the Commission directed the Midwest ISO to modify the Network Resource section of Module E, to include all existing Network Resources, irrespective of their association with OASIS or their present externality to the market.¹⁰⁸ These requirements remain until the interim plan expires.

153. The aggregate deliverability requirement helps to ensure that the amount of economic Network Resources available to the region's load is maximized to enhance reliability and market prices. An aggregate deliverability standard does not preclude existing Network Resources from continuing as such under Module E. In addition, current Network Resources may use a portion of their capacity to serve their load obligations and bid the remainder into the market depending on the constraints affecting deliverability.¹⁰⁹ We agree with the Midwest TDUs that in theory a resource could be deliverable from Kentucky to a Wisconsin/Upper Michigan load-serving entity, but we find that practicality would likely prevent this from being an economic transaction. To pass an aggregate deliverability test, the resource would need to overcome all constraints to deliverability and pay for the requisite Network Upgrades to accommodate such a transaction. We find that in practice there should be a more economic alternative to the Midwest TDUs' suggestion that a resource in Kentucky could count as Network Resource for a WUMS Load-Serving Entity, particularly when marginal losses are fully accounted for, as they will be after the five year transition period expires.¹¹⁰

¹⁰⁷ See Compliance Order I at P 292-300.

¹⁰⁸ *Id.* at P 298-300.

¹⁰⁹ The Midwest ISO recently clarified the deliverability requirements for Network Resources and Module E implementation on the Midwest ISO website, found at: http://www.midwestiso.org/plan_inter/resource.shtml (last accessed on 2/16/05.)

¹¹⁰ See Protest of the Midwest TDUs at 21 (Feb. 11, 2005).

154. In addition, we find the Midwest TDUs' arguments that an aggregate deliverability standard fails to support efficient investment in Network Resources to be premature. The Commission cannot guarantee, before market start-up and more than one year before the Midwest ISO files its permanent resource adequacy plan, that all generating units currently designated as Network Resources will have a guaranteed revenue stream under the market framework. However, the nature of the permanent Network Resource requirements are currently under discussion at the Midwest ISO and the Commission will evaluate their merits when the Midwest ISO files its long-term resource adequacy plan.

155. We find that the Midwest ISO has complied with the Commission's directives regarding the Resource Adequacy provisions of Module E. The Midwest ISO's revisions clarify the procedures and requirements of Module E, thereby aiding all users of the tariff. Therefore, we accept the substitute tariff sheets for filing in the Midwest ISO's Transmission and Energy Markets Tariff and the effective date of March 1, 2005. However, we note that the Midwest ISO's filing in section 30.1, Designation of Network Resources, contains a minor typographical error. The Midwest ISO revised section 30.1 by adding "Demand Response Resources may qualify as Network Resources subject to meeting the criteria described in this section 30 and section 69.1.2 of Module D of this Tariff." We note that section 69.1.2 is in Module E of the tariff, not Module D.

H. Credit Policy

1. Creditworthiness Criteria

a. Background

156. The Commission noted that the Midwest ISO needed to file its creditworthiness criteria in the tariff and not in its Business Practices Manuals.¹¹¹ As a part of the initial TEMT filing, the Midwest ISO included its creditworthiness procedures as Attachment L. The Commission conditionally accepted these procedures and required the Midwest ISO to make several changes to further clarify its methods of credit evaluation.¹¹² The Midwest ISO submitted changes to Attachment L in its October 5 compliance filing. The Commission generally accepted the Midwest ISO's modifications to Attachment L,

¹¹¹ See *Midwest Independent Transmission System Operator, Inc.*, 105 FERC ¶ 61,145 at P 129 (2003).

¹¹² See TEMT II Order at P 429.

finding that they did not create excess collateral burdens for market participants, but also directed the Midwest ISO to clarify some outstanding issues related to credit through either its clean-up edits filing or a further compliance filing within 30 days.¹¹³

157. The Midwest ISO submitted a clean-up edits filing on December 22, 2004 that fixed minor typographical errors in the TEMT and provided additional clarity about the requirements of Attachment L. Those additions to Attachment L were briefly discussed, but the Commission deferred ruling on their merits until this proceeding because several of the issues overlapped with the rehearing requests to Compliance Order I.¹¹⁴ The Midwest ISO's January 21 compliance filing contained further edits to Attachment L to comply with Compliance Order I. The Midwest ISO's clean-up edits filing, the January 21 Compliance filing, and the rehearing requests to Compliance Order I are discussed herein.

b. Requests for Rehearing

158. The Midwest TDUs state that the Commission should withhold judgment on all undefined quantitative and qualitative criteria contained in Attachment L. The Midwest ISO first proposed definitions for these criteria in its "clean-up" filing on December 22, 2004. The Midwest TDUs seek rehearing of any of the creditworthiness criteria accepted by Compliance Order I.

159. The Midwest TDUs argue that to the extent the Commission accepted any quantitative and qualitative criteria it was in error because these criteria systematically understate the creditworthiness of public power entities. The Midwest TDUs seek alterations or rehearing regarding many of the qualitative and quantitative criteria. According to the Midwest TDUs, the creditworthiness requirements use quantitative criteria that are not relevant to public power entities, and are discriminatory because they understate public power's creditworthiness. As examples of irrelevant criteria, the Midwest TDUs cite Earnings Before Income Tax (EBIT) and Pre-tax Return-on-Equity, because public power entities do not pay income taxes. In addition, the Midwest TDUs state that the quantitative criteria, Working Capital and Tangible Net Worth, give undue credit allocations to large utilities by basing credit scoring on a fixed dollar value instead of a ratio. The Midwest TDUs also state that these financial criteria fail to account for

¹¹³ See Compliance Order I at P 374-375.

¹¹⁴ Readiness Order at P 46.

the relative value of assets and liabilities. The Midwest TDUs state that if the percentage of Working Capital and Tangible Net Worth measures are retained, the Commission should require on rehearing that the Midwest ISO to cut in half the upper and lower bounds of the Working Capital and Tangible Net Worth benchmarks.

160. According to the Midwest TDUs, the Commission also erred by accepting proposed Current Ratio measure because it fails to give a complete view of the assets available to public power participants to meet their credit obligations. At a minimum the Midwest TDUs ask the Commission to require that the creditworthiness qualitative criteria recognize the degree of risk and liquidity of an entity with investments in treasury and government-backed investments.

161. The Midwest TDUs also state that because they have low earnings they are discriminated against by earnings related benchmarks in the quantitative criteria. According to the Midwest TDUs, in the case of public power, low earnings do not translate into low creditworthiness because public power entities seek earnings sufficient to cover their costs, but not substantially more. The Midwest TDUs also state that investor owned utility's earnings are not reduced to reflect dividend payments, but public power entities do not pay dividends and therefore their earnings reflect the bottom-line. Therefore, the Midwest TDUs request that the Commission on rehearing adopt the Midwest TDUs' suggestion to weigh EBIT interest coverage, Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) interest coverage, and Pre-Tax return on equity as 5 percent each, rather than the 10 percent currently stated in Attachment L. The Midwest TDUs also request the Commission to modify the Debt/Equity and Pre-tax Return-on-Equity financial benchmarks to reflect that public power entities generally do not have substantial equity. The Midwest TDUs also request the Commission to consider their proposal to require the Midwest ISO to use credit rating agency reports as a measure of public power creditworthiness.

162. The Midwest TDUs state that the Commission violated its Policy Statement on Creditworthiness¹¹⁵ for transparent creditworthiness requirements by accepting "other" as a category of the qualitative criteria to determine an entity's creditworthiness. Also, the Midwest TDUs protest that they will receive an overall credit score and will not receive a breakdown of how they scored under individual qualitative criteria. Therefore, the

¹¹⁵ *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 at P 10 (2004).

Midwest TDUs request the Commission to condition acceptance of the Midwest ISO's qualitative criteria upon the requirement that the Midwest ISO provide market participants with a written report of how the market participant was evaluated under each of the qualitative criteria.

163. Finally, the Midwest TDUs contend the Commission has put undue reliance on the stakeholder process to support discriminatory creditworthiness standards. The Midwest TDUs state that the lack of public power opposition in the stakeholder process does not provide a basis for the Commission to ignore the Midwest TDUs' complaints and accept discriminatory criteria.

c. Compliance Filing and Responsive Pleadings

164. As noted, the Midwest ISO filed numerous corrections and clarifications to its credit policy in Attachment L through its December 22, 2004 tariff "clean-up" filing.¹¹⁶ In addition, the Midwest ISO filed additional changes to Attachment L in compliance with the Commission's directives in Compliance Order I.

165. Those changes to Attachment L include renaming the Minimum Negative Bid as the Minimum Negative Offer in the FTR Auction Potential Exposure calculation. In addition, the Midwest ISO has revised the Virtual Transaction Potential Exposure formula to use the fiftieth percentile in the calculation of the Marginal Price Differential over the previous 12 months, to make it identical to the corresponding differential used in the FTR auction market. The Midwest ISO states that the change to the Marginal Price Differential was voted on and approved by the members of the Midwest ISO credit practices task force.

166. The Midwest ISO has revised section 11.1 of the TEMT to include an explicit cross-reference to the credit policy in Attachment L. In addition, the Midwest ISO has revised section 7.14.a.iii to remove all language stating, "subject to the receipt of any approval from the Commission that may be necessary", and replace it with "subject to the receipt of approval from the Commission." The Midwest ISO has also revised and clarified its methodology to allocate uplift charges for uncollectible default accounts. The Midwest ISO states that the methodology used for the return of funds previously uplifted is the same methodology that was used for the uplift. The Midwest ISO has also revised section 7.10 to clarify that alternate action may be taken as necessary to minimize

¹¹⁶ The Commission accepted those corrections and clarifications, and made them effective April 1, 2005, subject to the outcome of other pending proceedings in which the Commission is considering the merits of the changes. *See* Readiness Order at P 47.

bad debt loss if the Midwest ISO believes that the alternate action will reduce the total uplift charge assessed to market participants. Finally, the Midwest ISO corrected minor flaws in the formula rate for allocating the uplift charge for uncollectible debt to market participants on tariff sheet no. 175. Specifically, the Midwest ISO has changed “MP ALL Market Charges = Market Credits in weekly invoicing cycle” to “/ MP ALL (Market Charges + Market Credits) in weekly invoicing cycle.”

d. Discussion

167. We clarify that the Commission generally approves of the Attachment L creditworthiness clean-up edits as is discussed herein. In the TEMT II Order, the Commission issued directives to the Midwest ISO to clarify, define, and justify terms used in conjunction with the unsecured credit allocation matrix.¹¹⁷ We find that the Midwest ISO has included terms which further clarify the creditworthiness requirements applicable to all applicants for credit under the tariff in compliance with prior Commission directives. We also find that there is a sufficient amount of clarity present in Attachment L so that applicants have the ability to reasonably understand how their creditworthiness is determined consistent with similar procedures used in other RTOs and ISOs.

168. We likewise accept the Midwest ISO’s clarifications and corrections to Attachment L and sections 7 and 11 of Module A filed on January 21, 2005. We find it acceptable that the Midwest ISO will use the fiftieth percentile in its calculation of the Marginal Price Differential as part of the Virtual Transaction Potential Exposure calculation. This is consistent with the credit calculation for the FTR auction market, and it was voted on and approved by the Midwest ISO credit practices task force. We also accept that the Midwest ISO may take alternate actions under section 7.10 as necessary to minimize bad debt loss, if the Midwest ISO believes that the alternate action will reduce any uplift to other market participants.

169. Despite the Midwest ISO’s statement that it revised section 7.14.a.iii to remove all language stating, “subject to the receipt of any approval from the Commission that may be necessary,” and replace it with language stating, “subject to the receipt of approval from the Commission,”¹¹⁸ the appropriate revised tariff sheets were not filed with the

¹¹⁷ See TEMT II Order at P 438.

¹¹⁸ See Midwest ISO Transmittal Letter at 10 (Jan. 19, 2005).

Commission in either the Midwest ISO's December 22, 2004 clean-up edits filing or the January 19, 2005 Compliance filing. Therefore, we must again direct the Midwest ISO to submit revised tariff sheet nos. 184-185 with the appropriate revisions to section 7.14.a.iii in a compliance filing within 30 days of the issuance of this order.

170. We do not find that the creditworthiness criteria proposed by the Midwest ISO in Attachment L systematically discriminate against any entities subject to its provisions, including public power participants. To the contrary, we find that Attachment L is reasonably accommodative to all market participants and the changes proposed by the Midwest ISO further clarify the credit procedures used, but do not substantially alter the core structure of Attachment L, which was already approved by the Commission. Therefore, we deny rehearing regarding the qualitative and quantitative metrics used to evaluate creditworthiness of market participants. This decision is consistent with the Commission's prior decision to accept the Midwest ISO's proposal to weigh qualitative criteria heavier than quantitative criteria for public power participants.¹¹⁹

171. The objective of the Midwest ISO markets is to obtain long-term benefits for all the Midwest ISO customers. The creditworthiness criteria are subject to possible future revision should there be a demonstrated need. Inappropriate restrictions on access to credit for a certain class of tariff customers would be one such need. However, the present filing does not support such a claim. The Commission will continue to closely monitor the markets after the Midwest ISO markets commence operations, including credit, and will address issues that arise in a timely manner. Finally, we remind all customers of the Midwest ISO tariff that the Commission "will consider taking action on a case-by-case basis or entertain complaints to address significant problems if the goals of transparency and the consideration of qualitative, as well as quantitative, factors are not met. To the extent a transmission customer believes that an RTO has discriminated in the application of its creditworthiness standards, that customer may contact the Commission's enforcement hotline¹²⁰ or file a complaint"¹²¹

¹¹⁹ See Compliance Order I at P 355 ("We find the Midwest ISO's proposal to weigh qualitative criteria heavier than financial criteria to develop a total composite credit score for public power utilities a reasonable and acceptable approach.").

¹²⁰ Customers that believe an RTO has discriminated against it may contact the Commission's enforcement hotline by phone at (888) 889-8030 or by e-mail at hotline@ferc.gov.

¹²¹ See *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 at P 15 (2004).

172. We find the creditworthiness requirements are non-discriminatory and accommodative to all market participants, including the broad class of participants characterized as public power. In our acceptance we note that the Midwest ISO has incorporated specific provisions that recognize the unique nature of public power participants. For example, Attachment L recognizes that certain applicants may not be able to comply with all of the financial statement requirements and allows that “alternate requirements may be specified by the Transmission Provider.”¹²² In addition, Attachment L states that when considering financial statements and other related information in the initial credit application of cooperatives, government agencies and municipalities, “the Transmission Provider may request additional information as part of the overall financial review process and will consider other relevant factors in determining financial strength and creditworthiness.”¹²³ We find statements such as these reasonably demonstrate that the Midwest ISO, as the Transmission Provider, has filed a credit policy that reasonably accommodates all applicants.

173. We find that Attachment L contains sufficient data collection measures to ensure the Midwest ISO receives an accurate representation of the credit strength of all applicants for service under the tariff. The initial credit evaluation will consider nine information sources to evaluate creditworthiness, including: (1) rating agency reports; (2) financial statements and related information; (3) references; (4) litigation, commitments, contingencies; (5) other disclosures; (6) estimated peak load data; (7) virtual transactions designation; (8) FTR auction designation; and (9) other. These nine measures are coupled with five similar measures used in the ongoing credit evaluation to maintain an accurate profile of the applicant’s creditworthiness.

174. We also deny the Midwest TDUs’ request for the Midwest ISO to use rating agency reports as moot. Attachment L already contains provisions to use rating agency reports for initial and ongoing evaluations of the credit strength of all applicants.¹²⁴ In addition, the qualitative measures use rating agency ratings assigned to unsecured debt.¹²⁵

¹²² See Attachment L, First Revised Sheet No. 1210.

¹²³ *Id.*

¹²⁴ *Id.* at 1208 and 1214.

¹²⁵ *Id.* at 1219B(v).

175. Therefore, we do not agree that the ratios and benchmarks used in Attachment L understate public power's creditworthiness and we deny rehearing on these issues accordingly. We also find no basis to change the ratios of Earnings Before Income Taxes (EBIT), Earnings Before Income Taxes, Depreciation, Amortization (EBITDA) Interest Coverage, and Current Ratio from 10 percent to 5 percent, as the Midwest TDUs have requested.

176. In addition, we find that the Midwest ISO has various measures in Attachment L that consider public power's long-term debt and to recognize their assets. First, the quantitative measures are weighted 40 percent¹²⁶ of the overall credit score, whereas the qualitative measures are weighted 60 percent for public power entities.¹²⁷ This structure under-weights the impact of the financial metrics initially, and over-weights the qualitative metrics where public power has credit strength.¹²⁸ Second, Attachment L weighs total debt/total capitalization and long-term debt/equity at 20 percent, as opposed to the 10 percent weighting of the other financial measures. Third, the measures used, the weightings, and the corresponding scores generated are based on stated best industry practices and consultations with credit specialists from Arthur Anderson LLP and Deloitte and Touche LLP.¹²⁹ The measures were also refined, based on Commission feedback given in the TEMT II order, over a period of several months by a cross-section of stakeholders participating in a sub-task force created by the Credit Scoring Task Force

¹²⁶ *Id.* at 1219.01, which lists the financial measures and their respective weightings as: 1) current ratio – 10 percent; 2) working capital – 10 percent; 3) tangible net worth – 10 percent; 4) EBIT interest coverage – 10 percent; 5) EBITDA interest coverage – 10 percent; 6) pre-tax return on equity – 10 percent; 7) long-term debt/equity – 20 percent; 8) total debt/total capitalization – 20 percent. These measures are then given a score between 1(highest) – 6(lowest) based on a table titled “Public Power Financial Benchmarks” listed as sheet no. 1219A.

¹²⁷ *Id.* at 1219B, which lists the qualitative factors considered as: 1) the ability to set rates without seeking regulatory approval; 2) financial protections for unsecured creditors related to the formation and governance of public power entities; 3) the number and composition of members or customers of the entity; 4) the exposure to energy price risk for load served 5) rating agency ratings assigned to unsecured debt; 6) other non-financial measures of creditworthiness.

¹²⁸ See Fitch Ratings, U.S. Public Power 2005 Outlook (Mar. 16, 2005).

¹²⁹ See Testimony of Michael P. Holstein at 7 (Mar. 31, 2004).

to develop the model.¹³⁰ Fourth, we find that the measures of EBIT and EBITDA should result in similar ratios and credit allocations despite the Midwest TDUs' statement that "public power entities, of course do not pay income taxes." Attachment L defines EBIT interest coverage as $-(\text{interest expense} + \text{income taxes} + \text{net income}) / \text{interest expense}$ and EBITDA interest coverage as $-(\text{depreciation} \ \& \ \text{amortization} + \text{interest expense} + \text{income taxes} + \text{net income}) / \text{interest expense}$.¹³¹ If public power entities do not pay income taxes, this result should be reflected in the net income figure, which would equate to roughly the same interest coverage ratio. It is also important to recognize that the EBIT and EBITDA measures combined account for 20 percent of the quantitative portion of the score and the entire quantitative portion accounts for 40 percent of the overall score, so that these two measures combined account for 8 percent of the overall score. Given the long history of the development of these measures and their basis in industry best practices, we do not find it reasonable to order the Midwest ISO to cut the weight of some of the credit measures by half. We note that changes to the creditworthiness criteria, as suggested by the Midwest TDUs, are most appropriately raised first in the stakeholder process so that other members with a financial stake in the market may evaluate the proposed changes, offer suggestions, and ultimately vote on any changes.

177. Accordingly, we do not agree that the Commission has relied too heavily on the stakeholder process in past orders. By referring interveners to the stakeholder process, the Commission is recognizing that the Midwest ISO, as the independent, non-profit operator of the grid, does not have the same financial stake in the creditworthiness criteria as the members of the Midwest ISO do, in that all members may be exposed to uplift caused by the default of any one member. Therefore, it is appropriate that the Commission consider stakeholder support, especially on matters related to credit. We clarify that no decision on the creditworthiness criteria is based solely on a stakeholder vote, but for criteria that are otherwise acceptable to the Commission, we do consider the

¹³⁰ See Midwest ISO Transmittal Letter at 33 (Oct. 5, 2004).

¹³¹ Attachment L, Original Sheet No. 1219.01.

level of stakeholder support when making a decision.¹³² However, we emphasize that nothing precludes the Commission from directing changes to the creditworthiness criteria for clear cases of discriminatory credit policies, but we do not find the present Attachment L filing to be such a case.

178. We deny rehearing regarding the transparency of the Midwest ISO's creditworthiness requirements. We do not agree that Attachment L lacks the required transparency or contradicts the Commission's policy statement on credit-related issues. The passage of the policy statement cited by the Midwest TDUs referred to OATT transmission providers. The cited passage was the Commission's response to non-ISO/RTO OATT transmission providers that did not post their credit criteria or make it publicly available. The Midwest ISO is an RTO so this does not apply, and regardless, the Midwest ISO has filed their credit policies. In the policy statement, the Commission stated, "...if credit processes are neither posted on an OASIS site nor incorporated into a tariff, transmission customers do not have the ability to judge whether the application of a transmission provider's credit procedures was done on a reasonable, comparable, and non-discriminatory basis. Furthermore, without such transparency, the Commission believes that transmission customers are unable to determine ex ante the general amount of security, if any, they need to provide... to participate in an ISO/RTO market."¹³³ In addition the Commission stated, "RTOs must consider both qualitative and quantitative measures in their assessment of the credit risk of a party and post the criteria they use to determine these factors."¹³⁴ We find the Midwest ISO has met these standards by maintaining detailed credit policies in the tariff through Attachment L, defining the relevant terms used in Attachment L and Module A, and providing examples of how a composite credit score is calculated.

179. We deny rehearing regarding the Commission's acceptance of credit measures that include a category to consider "other" relevant factors in the creditworthiness requirements. We disagree with the Midwest TDUs that this category violates the

¹³² Even though this filing has been approved through the stakeholder process, we must address its merits and be able to find the proposal just and reasonable. *See PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,309 at P 19 (2003), *order on reh'g*, 109 FERC ¶ 61,286 (2004); *New York Independent System Operator, Inc.*, 104 FERC ¶ 61,311 at P 29, *clarification granted*, 105 FERC ¶ 61,340 (2003).

¹³³ See Policy Statement on Electric Creditworthiness, 109 FERC ¶ 61,186 at P 10-11 (2004).

¹³⁴ *Id.* at P 13.

Commission's requirements for transparent credit requirements. Furthermore, we find that inclusion of "other" relevant factors into an RTO's credit policy does not make an otherwise transparent credit policy opaque. The Commission has previously allowed RTOs/ISOs to consider "other" relevant factors when making a credit determination and we see no reason to disallow the Midwest ISO from doing so here. For example, Attachment Q entitled "PJM Credit Policy", states, "In the credit evaluation of Cooperatives and Municipalities, PJM may request additional information as part of the overall financial review process and will consider 'other' alternative measures in determining financial strength and creditworthiness."¹³⁵ In addition, we note that section 1.2.1 of Standard & Poor's "Code of Practices and Procedures" which refers to the rating process states that, "Analysts on the analytical team may, and at the request of an issuer shall, meet with the issuer's management to review in detail the issuer's key operating and financial plans, management policies, and 'other' credit factors that have, or could potentially have, an impact on the rating."¹³⁶ We expect that when the Midwest ISO considers "other" relevant factors there will be an exchange of information between the Applicant for credit and the RTO which would identify what "other" considerations were used to develop the credit score. However, we do not find that these considerations need to be given a specific weight in the credit allocation beyond the 60 percent qualitative weight in the assessment of creditworthiness. Finally, we note that allowing the RTO to consider some of the non-financial items labeled as "other" could very likely add to the creditworthiness score of public power participants.

I. Other Tariff Issues

1. Miscellaneous Module A Issues

a. Compliance Filing and Responsive Pleadings

180. The Midwest ISO added a definition in section 1.208 of the TEMT: "NERC: The North American Regional Reliability Council." It also defined "On-Peak" in section 1.232 as the period of time between 0600 EST and 2200 EST on Business Days.

¹³⁵ See PJM tariff, Attachment Q, Original Sheet Nos. 523 B & C.

¹³⁶ See Standard & Poor's Ratings Services Code of Practices and Procedures, September 2004, section 1.2.1 at page 3:
<http://www2.standardandpoors.com/spf/pdf/fixedincome/Code of PP 9-22-04.pdf> (last accessed Mar. 8, 2005).

181. WEPCO requests that the Midwest ISO define “NERC” as North American Electric Reliability Council, rather than North American Regional Reliability Council.

182. WPS and Quest argue the definition of on-peak hours should be changed to eastern prevailing time,¹³⁷ since this is the time standard used by PJM and NYISO. According to WPS and Quest, failure to make this change would result in the Midwest ISO’s on-peak times not matching the on-peak times for PJM and NYISO from October to April, making scheduling power and transmission cumbersome, confusing and complicated and resulting in a loss in market efficiency. WPS and Quest propose the following revised definition of on-peak: Period of time between 0700 hours through 2300 hours eastern prevailing time on Business Days. They also propose that the definition of Day be revised as follows: A twenty-four (24) hour period beginning at 0000 hours eastern prevailing time.

b. Discussion

183. We accept WEPCO’s revised definition of NERC, and direct the Midwest ISO to make this revision. We agree with WPS and Quest that a revised definition of eastern prevailing time would result in efficiency benefits, and we also expect it would be a necessary step in creating a joint and common market with PJM. We encourage the Midwest ISO to revise its schedules to this standard, and we direct the Midwest ISO to make an information filing detailing its progress and expected implementation schedule within 90 days of the date of this order.

2. Schedule 4

a. Background

184. In Compliance Order I, the Commission conditionally accepted the Midwest ISO’s proposed Schedule 4, which set forth the terms, conditions and rates for region-wide energy imbalance service.¹³⁸ The Commission noted that the Midwest ISO’s energy imbalance proposal did not include a deviation band of +/- 1.5 percent, which would provide an incentive for transmission customers to minimize schedule deviations. As the Midwest ISO had not supported any change from the Commission policy of incorporating

¹³⁷ Prevailing time is defined to be (a) standard time between the last Sunday in October and the first Sunday in April, and (b) daylight savings time between the first Sunday in April and the last Sunday in October.

¹³⁸ Compliance Order I at P 422.

deviation bands in energy imbalance provisions, the Commission directed it to either incorporate a deviation band in its energy imbalance provision or to file testimony to explain with testimony why a deviation band is not necessary.¹³⁹

b. Requests for Rehearing

185. The Midwest TDUs state that in the TEMT II Order, the Commission required the Midwest ISO to eliminate the Michigan-specific energy imbalance change and file a Midwest ISO-wide Schedule 4.¹⁴⁰ They then observe that in Compliance Order I, the Commission required the Midwest ISO to adopt a deviation band with penalties or explain why it is not necessary.¹⁴¹ The Midwest TDUs argue that the Commission's position was correct in the TEMT II order – that the correct charge for energy imbalances in an LMP market is the real time LMP. They request rehearing of the Commission's statements in Compliance Order I regarding a deviation band.

186. The Midwest TDUs argue that the imposition of deviation bands in LMP markets that include control areas is inconsistent with the TEMT II Order and contrary to the Commission's finding in Order No. 2000 that all market participants should have equal access to imbalance service.¹⁴² They assert that the obligation to pay LMP for imbalances sends the correct price signal to promote appropriate scheduling, and that this signal is strengthened because there are additional charges for participation in the real-time energy market. The Midwest TDUs also note that the Midwest ISO already has uninstructed deviation penalties, and argue that no further disincentive is required. Finally, they challenge the Commission's assertion that other RTOs with LMP rely on deviation bands. The Midwest TDUs state that ISO-NE's Schedule 4 applies the locational price; NYISO's Schedule 4 charges the locational price for customers with service agreements under the NYISO tariff; and PJM uses LMPs, without a deviation band or penalties, for network customer imbalances. The Midwest TDUs urge the Commission not to require a deviation band for point-to-point service, as PJM does.

¹³⁹ *Id.* at P 421.

¹⁴⁰ Midwest TDUs Request for Rehearing at 31 (citing TEMT II Order at n.313).

¹⁴¹ *Id.* (citing Compliance Order I at P 421).

¹⁴² *Id.* (citing Order No. 2000 at 31,142).

c. Compliance Filing and Responsive Pleadings

187. The Midwest ISO submitted the testimony of Mark J. Volpe, Director of Regulatory Affairs for the Midwest ISO, in support of the filed Schedule 4. Mr. Volpe's testimony explains why the Midwest ISO has not chosen to include a deviation band, similar to that in PJM's Schedule 4, as part of its proposed Energy Imbalance Service, Schedule 4, as required by the Compliance Order I.¹⁴³ Mr. Volpe states his belief that provisions similar to the PJM deviation bands¹⁴⁴ would discourage transmission customers from utilizing point-to-point transmission service because market participants will receive only 70 percent of the real-time LMP price for over-deliveries or energy sales, and they will have to pay the higher of 150 percent of the real-time LMP or \$100/megawatt-hour. Mr. Volpe states the Midwest ISO views this rate treatment as penalizing entities with transaction schedules outside of the deviation bands, thereby providing a financial disincentive for further use of the point-to-point service upon implementation of the energy markets.

188. Mr. Volpe further explains that the Midwest ISO has a fiduciary responsibility to its transmission owners to maximize revenues associated with transmission service.¹⁴⁵ If these provisions were implemented and the level of point-to-point revenues decreased as a result, the Midwest ISO would be in violation of a fundamental obligation to transmission owners, states Mr. Volpe. He also explains that there is evidence that inclusion of these provisions in the PJM tariff has resulted in a decrease in the level of point-to-point transmission service, based on his understanding that point-to-point transmission service is hardly, if ever used by transmission customers in PJM for those transactions sourcing and sinking within the PJM Interconnection, and that these customers rely primarily on Network Integration Transmission Service for this load.

¹⁴³ See Compliance Order I at P 421.

¹⁴⁴ The PJM deviation bands are +/- 1.5 percent with a minimum of 2 megawatts of the scheduled transaction to be applied hourly to any energy imbalance that occurs as a result of the transmission customer's scheduled transactions and applies only to transmission customers taking point-to-point transmission service, according to Mr. Volpe.

¹⁴⁵ Article Three, Part D of the Agreement of the Transmission Facilities Owners To Organize the Midwest Independent Transmission System Operator, Inc. specifies the terms of this provision, according to Mr. Volpe.

Mr. Volpe concludes by stating his belief that a similar situation would occur in the Midwest ISO, i.e., a decrease in the volume of point-to-point transmission service if these provisions were required in the Midwest ISO Schedule 4.

189. The Midwest TDUs support the Midwest ISO's conclusion that imbalance bandwidths and penalties are not needed in Schedule 4. They argue that bandwidths and penalties would be unduly discriminatory and (in a market that includes control areas) contrary to Order No. 2000's finding that all market participants should have equal access to imbalance service. The Midwest TDUs state that the Commission has recognized the treatment of noncontrol area utility energy imbalances to be discriminatory, as compared with control area operators:

In the NOPR, we noted that unequal access to balancing options can lead to unequal access in the quality of transmission service, and that this could be a significant problem for RTOs that serve some customers who operate control areas and other customers who do not. We conclude that control area operators should face the same costs and price signals as other transmission customers and, therefore, also should be required to clear system imbalances through a real-time balancing market. We believe that providing options for clearing imbalances that differ among customers would be unduly discriminatory.¹⁴⁶

The Midwest TDUs add that the obligation to pay LMPs for imbalances sends the right price signal to promote appropriate scheduling. This signal is strengthened by the additional charges imposed on real-time market participants, such as the costs associated with the RAC. And because the day-ahead market is used to close all FTR positions, a shift to real time could adversely affect FTR values, making them a less effective hedge. Finally, the Midwest TDUs note that the Midwest ISO already has separate uninstructed deviation penalties, and argues that no further disincentive is required.

¹⁴⁶ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089, at 31,142 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Feb. 25, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd*, *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

190. The Midwest TDUs argue that other RTOs with LMP do not rely on deviation bands to incent customers to schedule properly. They note that ISO-NE's Schedule 4 has no deviation band, but simply applies the locational price. NYISO's Schedule 4 charges the real-time locational price for those customers with service agreements "under the ISO Services Tariff," and PJM's Schedule 4 uses LMPs, without deviation bands or penalties, for network customer imbalances.

191. Next, the Midwest TDUs state that the Commission should not adopt a deviation band even for point-to-point service, as PJM does, given the need for continued Midwest ISO point-to-point service to work in combination with GFAs and to work around the Midwest ISO's seams. They add that the prevalence of continued control areas in the Midwest ISO makes the PJM precedent for use of bandwidths and penalties for point-to-point service inapplicable, because it would unduly discriminate against non-control area utilities, contrary to the dictates of Order No. 2000.

192. WPS Resources argues that the Midwest ISO has not provided a reasonable justification for eliminating the deviation band, and that the Commission should require the Midwest ISO to restore it. Citing Mr. Volpe's testimony, WPS Resources states that the Midwest ISO's only rationale for arguing against a deviation band is that it may reduce transmission owner revenue by reducing the number of customers that take internal point-to-point transmission service. WPS Resources believe that providing a point-to-point transmission service customer with a deviation band is a distinct benefit. Absent a band, any minor difference between a customer's scheduled and actual transmission service would result in the unintentional purchase or sale of energy from/into the energy markets. However, with the band, the point-to-point customer is protected against such costs so long as its deviations are truly minor (e.g., as determined by the band width).

193. WPS Resources states that the Midwest ISO offers nothing that would justify deviating from the Commission's practice of requiring an energy deviation band. Although Mr. Volpe suggests that point-to-point transmission service in PJM for transactions that source and sink in PJM (which employs an energy deviation band) is hardly ever used, Mr. Volpe offers no proof that the energy deviation band is the cause for that reduction. WPS Resources hypothesizes that there may be several reasons why PJM customers rely on network service rather than point-to-point service, such as convenience and flexibility.

194. In its answer, the Midwest ISO agrees with the Midwest TDUs' observation that uninstructed deviation penalties already help to discourage improper scheduling behavior, and that they need not be supplemented with deviation bandwidths for energy imbalances. The Midwest ISO notes that it provided testimony that specifically addresses the inappropriateness of including a deviation bandwidth in Schedule 4.

d. Discussion

195. We disagree with Midwest TDUs' implication that the requirement of deviation bands for energy imbalances violates Order No. 2000. Our reading of the provision cited by Midwest TDUs is that control areas and transmission customers should have equal access to balancing options, and control areas are required to clear system imbalances through the real-time energy market, thereby ensuring the same costs and price signals for control areas and transmission customers. The requirements of the provision cited by Midwest TDUs go no further. Nor is the requirement of deviation bands contrary to the SMD NOPR. The provision cited by Midwest TDUs requires all transmission owners and customers to resolve imbalances through the same procedures, to avoid the undue advantage transmission owners may have if they settle imbalances in-kind energy exchanges. To draw the conclusion that this language, from either Order No. 2000 or the SMD NOPR, prohibits deviation penalties for imbalances over reaches the intent of those provisions.

196. Also, we do not consider Compliance Order I to be inconsistent with the TEMT II Order. The TEMT II Order simply required the filing of a Schedule 4 service, including the requirement in footnote 313 that the proposal indicate when the service is provided and provide rates for the service, presumably the hourly LMP. We consider those instructions as general guidance only, and not detailed specifications of the Midwest ISO filing that would preclude deviation bands.

197. Our intent in requiring deviation bands was to conform the Midwest ISO and PJM terms of service, thereby facilitating the transition to a joint and common energy market. However, the Midwest TDUs' point that a deviation band could hinder flexibility is well taken, particularly when customers need to transact over energy markets characterized by extensive seams and other constraints. Our ultimate aim is to encourage as many transactions as possible within and across the ISO energy markets, thereby maximizing the efficiency benefits of regional energy markets. We consider the fact that customers must pay the real time LMP for imbalances to be an adequate inducement for them to act rationally in an energy market and that uninstructed deviation penalties provide additional incentives to keep actual energy flows close to scheduling parameters. We also note that the original Schedule 4 Imbalance Service did not have deviation bands, and therefore the imposition of deviation bands would represent a change in the terms of service. And finally, deviation bands may discourage point-to-point service, as noted by the Midwest ISO. For these reasons, we grant rehearing and accept the Midwest ISO's proposal to not include a deviation band for imbalance service.

198. We disagree with assertions made by WPS Resources. First, customers will pay the real-time LMP price for imbalances, even within the deviation band, thereby negating the benefit of deviation bands according to WPS Resources. Second, not all RTOs and ISOs have deviation bands, contrary to WPS Resources' assertion. Both NYISO and ISO-NE have imbalance schedules that do not include deviation bands.

3. Miscellaneous Module C Issues

a. Inadvertent Energy

i. Background

199. In the TEMT II Order, the Commission rejected the Midwest ISO's Inadvertent Energy proposal, as set forth in proposed section 40.7 of the TEMT, without prejudice to the Midwest ISO filing a new proposal to address the Commission's concerns.¹⁴⁷ The Commission stated that the "manner by which the Midwest ISO intends to calculate Inadvertent Energy and charge for it is not clear."¹⁴⁸ Among other things, the Commission noted that the Midwest ISO proposed to calculate Inadvertent Energy for each control area, whereas in centralized dispatch there is no tagging of intra-Midwest ISO schedules, and thus no net scheduled interchange between control areas. The Commission further noted that the Midwest ISO did not explain how it will calculate Inadvertent Energy for each control area, or explain how there will be no overlap with energy imbalance service. The Commission further directed that the Midwest ISO: (1) address the allocation of in-kind payments with external control areas; and (2) explain how any Inadvertent Energy proposal would be consistent with the common market to be established with PJM.¹⁴⁹

200. Compliance Order I noted that it conditionally accepted the Midwest ISO's proposal on energy imbalance service subject to the acceptance of a revised inadvertent energy provision. The Commission therefore directed the Midwest ISO to file its inadvertent energy proposal.¹⁵⁰

¹⁴⁷ TEMT II Order at P 598.

¹⁴⁸ *Id.* at P 597.

¹⁴⁹ *Id.* at P 597-98.

¹⁵⁰ *See* Compliance Order I at P 436.

ii. Compliance Filing and Responsive Pleadings

201. The Midwest ISO, in its compliance filing, submits revised provisions with respect to inadvertent energy. Under proposed section 40.7 of the TEMT, the Midwest ISO proposes to account for, record, and settle on the following two categories of inadvertent energy: (1) inadvertent energy with non-Midwest ISO entities within the Eastern Interconnection; and (2) inadvertent energy between control areas within the Midwest ISO region.

202. The Midwest ISO states that, under section 40.7.1, inadvertent energy between the Midwest ISO region and other transmission systems will continue to be accounted for and settled in kind, using NERC Policy 1.F, for those transmission providers adjacent to the Midwest ISO who have not executed a joint operating agreement addressing market-to-market flows between transmission systems.¹⁵¹ However, according to the Midwest ISO, where other transmission providers in the Eastern Interconnection have executed a joint operating agreement with the Midwest ISO, inadvertent energy will be accounted for and settled under the rates, terms and provisions of the applicable joint operating agreement. The Midwest ISO explains that this is currently the case between the Midwest ISO and PJM,¹⁵² and is specifically addressed in proposed section 40.7.3 of the TEMT.

203. Inadvertent energy between control areas within the Midwest ISO region (Intra-Market Inadvertent Energy) also will be calculated and recorded as outlined in NERC Policy I.F, states the Midwest ISO. These control areas will continue to report actual and scheduled net inadvertent energy interchange. However, the Midwest ISO explains that, pursuant to the NERC RTO Inadvertent Interchange Accounting Waiver, Intra-Market Inadvertent Energy will be financially settled on an hourly basis with the Midwest ISO. The Midwest ISO adds that such financially settled inadvertent energy will be removed from the control areas' balance account and will be aggregated into the Midwest ISO's system-wide Inadvertent Energy account. The Midwest ISO's inadvertent energy account will then be settled in kind with the inadvertent energy accounts of adjacent transmission providers, according to NERC policy, standards, and/or waivers.

¹⁵¹ The Midwest ISO sometimes refers to such accounting under the NERC Policy 1.F as accounting for "Traditional Inadvertent Energy."

¹⁵² See *Midwest Independent Transmission System Operator, Inc. and PJM Interconnection, L.L.C.*, 106 FERC ¶ 61,251 (2004).

204. Under proposed section 40.7.2, the Midwest ISO will financially value inadvertent energy between control areas at the applicable LMP to calculate whether the Inadvertent Energy Value results in a surplus or shortage. The Inadvertent Energy Value for a control area will be the control area's average generation LMPs multiplied by the inadvertent energy megawatt amount (which is the difference between the control area's net actual interchange and net scheduled interchange).¹⁵³

205. The Midwest ISO explains that there are no overlaps between inadvertent energy and Energy Imbalance Service because Schedule 4 - Energy Imbalance Service is used only to financially settle load imbalances within specific control areas and will not address energy imbalances between control areas or outside the Midwest ISO, which are appropriately addressed by the methodologies and NERC policies described above.

206. WPS Resources argues that the Midwest ISO's inadvertent energy provisions do not appear to comply with the Commission's directives and are hard to understand. WPS Resources does not understand why the Midwest ISO maintains its focus on settling inadvertent energy between control areas located within the Midwest ISO footprint. With the advent of Day 2 energy markets, WPS Resources argues, each generator customer that over- or under-supplies, and each load customer that over- or under-consumes, will settle for that variation from its schedule. As such, it is not clear what intra-Midwest ISO control energy differences would be measured and labeled inadvertent energy, or to whom the money for supplying any internal inadvertent energy would be paid. WPS Resources asks that to the extent the Midwest ISO's inadvertent energy procedures are required for a subset of control areas within the Midwest ISO, the TEMT must be clarified.

207. Second, WPS Resources argues that the Midwest ISO's proposal may cause generators supplying intra-Midwest ISO inadvertent energy to under-recover their costs. It notes that the Midwest ISO will value inadvertent energy at the Inadvertent Energy Value. To the extent that intra-Midwest ISO inadvertent energy is measured and compensated, WPS Resources argues that the Midwest ISO's proposal could lead to a generator being dispatched to supply inadvertent energy for compensation that is less than its bid price (i.e., a control area average LMP versus the generator's actual LMP). Moreover, it is not clear how the Midwest ISO would communicate to the generator when the generator is scheduled to supply energy for which it would receive its LMP versus inadvertent energy, for which it would receive average LMP.

¹⁵³ See Module A, section 1.141, Second Substitute Original Sheet No. 85.

208. Third, WPS Resources states that other than suggesting that the product of the inadvertent energy amount and the control area average LMP equals the value of the inadvertent energy, the TEMT has no provisions that explain how, and to or from whom, payment will be made or collected for intra-Midwest ISO inadvertent energy. WPS Resources concludes that the Commission should direct the Midwest ISO to provide the precise detail identified in the TEMT II Order and Compliance Order I.

209. Otter Tail submitted comments in support of WPS's protest. Otter Tail agrees that the Midwest ISO should not settle inadvertent energy on an intra-Midwest ISO control area basis. It argues that each generator customer that over- or under-supplies will settle for the variation from its schedule, and each load customer that under- or over-consumes energy will settle with the Midwest ISO for its variation. Consequently, Otter Tail argues that there should be no intra-Midwest ISO control area energy differences to be measured and labeled inadvertent energy.

210. Otter Tail also alleges that the Midwest ISO's proposal appears to contradict the Balancing Authority Agreement. It states that the Balancing Authority Agreement prohibits the Midwest ISO from assessing costs to Balancing Authorities associated with inadvertent interchange, yet the Midwest ISO's compliance filing apparently proposes to do so because the Midwest ISO will settle inadvertent interchange.

211. Finally, Otter Tail argues that the Midwest ISO's compliance filing is ambiguous. Otter Tail argues that the Midwest ISO has not explained what intra-Midwest ISO control area energy differences would be measured and labeled inadvertent energy, and what entities would receive money for supplying inadvertent energy.

212. In its answer, the Midwest ISO clarifies that any required payments for under- or over-supply, or under- or over-consumption, within and between the Control Areas, shall be settled between market participants. For purposes of clarification, the Midwest ISO would be willing to add language to section 40.7.2 of the TEMT to ensure that the Inadvertent Energy Value to be settled hourly on a financial basis will be market participants' responsibility. This calculation of inadvertent energy would not lead to double payment for the same thing because energy imbalance charges apply only to imbalances within a single control area (i.e., intra-control area imbalances), which are subject to Schedule 4. By contrast, inadvertent energy within the Midwest ISO region (i.e., Intra-Market) applies between or among control areas, which would be subject to section 40.7.2.

213. The Midwest ISO further states that its inadvertent energy proposal does not involve any potential violation of the Balancing Authority Agreement with respect to costs associated with inadvertent interchange because, as previously stated, the costs under sections 40.7.1 and 40.7.2 are borne by markets participants, not control areas or Balancing Authorities.

iii. Discussion

214. The Midwest ISO proposal requires further explanation and definition. We are concerned that the method for calculating inadvertent energy cannot track the cause of the inadvertent energy to the appropriate market participant and transaction, and therefore does not provide a basis for accurate accounting. The basis for our concern is two-fold. First, the Midwest ISO does not tag transactions for imbalances between control areas within the Midwest ISO footprint in the Day 2 energy market, and therefore has no basis for connecting inadvertent energy amounts to individual market participants and transactions. And second, the Midwest ISO method of accounting for net scheduled interchange does not differentiate between load and generation for within-the-control-area transactions and load and generation for outside-the-control area transactions, thereby assigning internal transaction imbalances to net scheduled interchange.¹⁵⁴ For these reasons, we require the Midwest ISO to provide a detailed explanation of its accounting of inadvertent energy to individual market participants and transactions in a compliance filing within 60 days of the date of this order.

215. Our concern with the accounting for inadvertent energy also has implications for LMP pricing. To the extent the Midwest ISO is not differentiating between imbalances within the control area and between control areas, the LMP price for generation must assume that all imbalances, internal and external, are settled at the same average LMP. We require the Midwest ISO to address this issue as part of the compliance filing. We also require the Midwest ISO to develop proposals that provide for accurate tracking of inadvertent energy and ensure prices can be differentiated between internal and external transactions,¹⁵⁵ or alternatively to explain why such alternatives are not possible.

¹⁵⁴ Our understanding of the derivation of net scheduled interchange is based on Exhibit 1 filed by the Midwest ISO on February 23, 2005 in Docket Nos. ER04-691-027 and EL04-104-026. We require the Midwest ISO to file this Exhibit and an accompanying explanation as part of the compliance filing.

¹⁵⁵ We agree with WPS Resources and Otter Tail that the ideal pricing for these transactions would be at the LMP for each individual transaction, with no averaging.

216. Addressing the issues raised by parties, we interpret the Midwest ISO answer that market participants pay for inadvertent energy between control areas in the Midwest ISO footprint to mean that market participants with negative inadvertent energy balances will pay the generators in the control area of the load. We require the Midwest ISO to clarify its answer by providing illustrative examples indicating how the average LMP is calculated for load that must pay an inadvertent energy balance, which generators are determined to be eligible for payment, the basis of their compensation and the method for notifying generators of the price they will receive for inadvertent energy.

217. We believe the Midwest ISO answer – that market participants pay for inadvertent energy – addresses Otter Tail’s concerns about Balancing Authorities being assessed costs. Nonetheless, as part of the compliance filing order we require the Midwest ISO to explain the interplay between this proposal and the implementation of inadvertent energy payback procedures, as provided for in the Balancing Authority Agreement.¹⁵⁶

218. Finally, we repeat our requirement that the Midwest ISO explain whether its proposal is compatible with PJM treatment, and the impact on the transition to a joint and common market.

219. We do not have the information necessary to determine if the proposed tariff sheets dealing with inadvertent energy are just and reasonable. Therefore, the proposed tariff sheets are accepted subject to refund and subject to revision in future orders.

b. Penalties for Uninstructed Deviations

i. Background

220. The Midwest ISO proposed in the TEMT penalties of 40 percent of the applicable LMP price for violations of dispatch instructions beyond a tolerance band of plus or minus 10 percent. Deviations within the tolerance band are not assessed a penalty and there is a 5-megawatt minimum and a 25-megawatt maximum. In addition, the band is adjusted for the megawatts of regulation capacity the resource provided, and intermittent resources (i.e., wind) and demand response resources are exempt from the penalty. The Commission conditionally accepted the Midwest ISO’s proposal and directed further clarifications in the TEMT II Order.¹⁵⁷ In the Compliance Order I, the Commission

¹⁵⁶ See *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,177 at P 11 (2005).

¹⁵⁷ See TEMT II Order at 533-36.

accepted the Midwest ISO's revisions to the penalty structure so that penalties for over- and under-generation are both penalized at 40 percent of the applicable LMP. In addition, the Commission directed the Midwest ISO to further clarify the procedures for generators that go offline after receiving dispatch instructions and to resubmit tariff sheets stating that demand response resources are exempt from uninstructed dispatch penalties.

ii. Compliance Filing and Responsive Pleadings

221. The Midwest ISO revised section 40.3.4.d.v of the TEMT to clarify that generation units that trip and go off-line after receiving a dispatch instruction from the Midwest ISO are exempt from any deviation penalties. In addition, the Midwest ISO filed additional language to clarify the treatment of Demand Response Resources by filing a new section 40.3.4.d.vi.

iii. Discussion

222. We accept the Midwest ISO's clarifications to the Uninstructed Deviation Penalties section provided by their filing of Second Substitute Original Sheet No. 587A (Superseding Substitute Original Sheet No. 587A), and a new Original Sheet No. 587A.01. We find that the Midwest ISO has complied with all the Commission's directives related to Uninstructed Deviation Penalties and no further clarifications are needed. These changes ensure that tariff customers understand when penalties may apply, and that Demand Response Resources are exempt from Uninstructed Deviation Penalties consistent with the Commission's encouragement of the use of these resources.

J. Seams Issues

1. Seam Between the Midwest ISO and Ontario IESO

a. Background

223. Compliance Order I directed the Midwest ISO to develop a mechanism in an agreement with the Ontario IESO and file the agreement before market start-up. The mechanism would provide for the payment of new LMP market costs caused by redispatch within the Midwest ISO to avoid a TLR affecting the Ontario IESO.¹⁵⁸

¹⁵⁸ See Compliance Order I at P 465.

b. Requests for Rehearing and Responsive Pleadings

224. In its request for rehearing, Detroit Edison expresses concern that a coordination policy between the Midwest ISO and the Ontario IESO will not be in place when the Day 2 energy markets open. It argues that the absence of such an agreement will impair reliable market operations and provide unduly discriminatory benefits to “a certain class of market participants external to [the Midwest ISO]” in violation of section 205 of the FPA. Detroit Edison argues, as it did in its protest to the October 5 Compliance filing, that if the Midwest ISO redispatches generation to avoid calling a TLR that would affect Ontario IESO loads, the Midwest ISO must have a mechanism for the Ontario IESO to pay these redispatch costs and compensate affected suppliers within the Midwest ISO. Detroit Edison argues that the Commission erred in failing to require the Midwest ISO and the Ontario IESO to submit a coordination agreement by a date certain. It urges the Commission to direct the parties to submit an agreement for Commission and party review by February 1, 2005.

225. In its protest,¹⁵⁹ Detroit Edison argues that the Midwest ISO’s failure to pursue aggressively an effective seams agreement between the Midwest ISO and Ontario IESO that provides for comparable treatment for energy transactions affecting congestion at IESO flowgates will result in degradation of reliability for transactions sinking in the Michigan Electric Coordinated System (MECS). Detroit Edison explains that Michigan’s exposure to curtailment will be increased dramatically because all transactions sinking within the Ontario IESO are shielded from curtailment unless and until all other non-firm transactions are curtailed, e.g., non-firm transactions in MECS, and because there will be fewer transactions available for curtailment in the Day 2 markets. Detroit Edison asserts it is not aware of any studies that demonstrate that treatment of transactions for curtailment purposes will be treated in the same way in the Day 2 market as they were in the previous “market to non-market” environment. Detroit Edison argues the risks of this situation are heightened by the fact that one of the four lines is out of service on the intertie between MECS and the Ontario IESO. Detroit Edison states its belief that these factors demonstrate the need for a seam agreement that fully addresses how congestion will be managed and how congestion-related redispatch costs will be allocated fairly among responsible entities. Detroit Edison concludes by requesting that the Commission set a date certain, in no event later than June 1, 2005, to implement an effective seams agreement, require that the Midwest ISO submit reports on a regular basis detailing the status of its negotiations and expected date of finalization, require that the Midwest ISO submit a detailed monthly report to the Commission identifying all TLRs issued on

¹⁵⁹ Detroit Edison filed this protest on February 8, 2005 in Docket No. ER04-691-021, *et al.*, and lodged it in this proceeding as described above.

Ontario IESO flowgates, the resulting impacts (e.g., transactions curtailed, generation dispatched) and how the Midwest ISO has addressed these impacts so as to fully protect the interests of Midwest ISO loads.

226. The Midwest ISO seeks rehearing or clarification of the Commission's instruction that it develop a payment mechanism based upon LMP redispatch within the Midwest ISO to avoid TLR procedures affecting the Ontario IESO.¹⁶⁰ The Midwest ISO states that its October 5 compliance filing included an Interim Coordination Agreement with the Ontario IESO that addressed reliability issues across the interconnections by: (1) including data exchange requirements, formats and methodologies; (2) developing and issuing operating instructions and security limits; (3) implementing NERC and regional coordinating council requirements with respect to the Midwest ISO and Ontario transmission systems; and (4) providing assistance during an emergency and during system restoration. It notes that the Commission found that the Interim Coordination Agreement was an enhancement to reliability coordination, but not a replacement for ongoing reliability procedures currently in effect, such as redispatch.

227. The Midwest ISO notes that Detroit Edison filed a protest to the October 5 Compliance filing that argued that generation would be redispatched within the Midwest ISO to avoid a TLR affecting the Ontario IESO. The Midwest ISO further states that Detroit Edison believed that a payment mechanism to account for LMP-related market costs associated with this type of redispatch would be needed in the energy markets. Further, the Midwest ISO alleges that the Compliance Order I requirement that the Midwest ISO develop a payment mechanism for LMP market redispatch costs prior to market start-up is premised on the incorrect assumption that LMP-based market redispatch will be occurring between the Midwest ISO and the Ontario IESO in order to avoid a TLR.

228. The Midwest ISO states that the Ontario IESO may call a TLR to relieve congestion without the use of local control actions. Neither the Midwest ISO nor the Ontario IESO needs (or wants) the other to redispatch their generators to solve congestion on the other's system. The Midwest ISO states that this arrangement is in place in part because the Midwest ISO and the Ontario IESO have different markets, and that their agreement is comparable to the arrangements that the Ontario IESO currently has with NYISO and ISO-NE. The Midwest ISO also states that Compliance Order I is in error to the extent that it requires the Midwest ISO and the Ontario IESO to further develop, agree to, and submit for approval a payment mechanism for phantom redispatch

¹⁶⁰ Midwest ISO Request for Rehearing at 1-2 (citing Compliance Order I at P 465).

costs. The Midwest ISO asks the Commission to clarify that no agreement regarding this scenario is required because the Midwest ISO and the Ontario IESO will not be incurring LMP market redispatch costs. It argues that because the Commission has recognized the parties' progress on seams as sufficient for market start-up, no additional arrangements or agreements between itself and the Ontario IESO are needed before the market start-up date.

c. Discussion

229. We do not see the need to require a redispatch mechanism or a seams agreement for such a mechanism inasmuch as the Midwest ISO states there will be no situation that would require redispatch for Ontario IESO transactions, and therefore the issues raised by Detroit Edison will not occur. As described by the Midwest ISO, the Ontario IESO has not requested, and does not require, redispatch from the Midwest ISO to avoid a TLR on Ontario IESO flowgates. Accordingly, since redispatch is not needed, neither the Midwest ISO or Ontario IESO pay redispatch costs resulting from a TLR, obviating the need for a mechanism to recover these costs.

230. In light of the Midwest ISO description of redispatch procedures and the fact that the Midwest ISO and Ontario IESO have an Interim Coordination Agreement to address real-time operational issues, we agree with the Midwest ISO that there is not a reliability issue at this seam, and therefore the Midwest ISO should continue its discussions with the Ontario IESO on ongoing seams issues as appropriate. For these reasons, we deny the request for rehearing of Detroit Edison and grant the rehearing request of the Midwest ISO.

231. With respect to Detroit Edison's protest, based on statements by the Midwest ISO that the Midwest ISO and Ontario IESO will manage transactions and curtailments at their seam during Day 2 energy market operations in the same manner as previously, and that neither ISO is relying on the other ISO to manage their own in-system TLRs, we do not see the need for additional studies or reports, and we have no basis to conclude that curtailments will increase significantly, as Detroit Edison alleges.

2. MAPP and SPP Seams

a. Background

232. In the TEMT II Order, the Commission required the Midwest ISO to file any seams agreements resolving seams issues, or to file a status report regarding the progress on seams resolution, including detailed plans as to how Midwest ISO will address seams issues absent seams agreements, so that the most current seams resolutions can be factored into the FTR allocations. On December 2, 2004, SPP submitted an executed Midwest ISO-SPP joint operating agreement (JOA).

233. Compliance Order I required the Midwest ISO to file another status report on the MAPP agreement, to the extent it could not file its Settlement Agreement by January 15, 2005. The Midwest ISO and MAPP filed a Seams Operating Agreement (SOA) on February 1, 2005.

b. Requests for Rehearing

234. WPS Resources states that the Midwest ISO has not finalized an agreement with MAPP on the allocation of flowgate capacity between Midwest ISO and MAPP parties, and that many issues that exist between the Midwest ISO and MAPP also exist between the Midwest ISO and other neighbors. WPS Resources argues that given the close relationship between the Midwest ISO, MAPP and SPP, the seams agreement between the Midwest ISO and SPP should be completed at the same time as the agreement between the Midwest ISO and MAPP. WPS Resource also notes that the seams agreements between the Midwest ISO and the Ontario IESO, and between the Midwest ISO and TVA, are in their preliminary stages and are not expected to be completed before the scheduled Day 2 market start-up.

235. WPS Resources argues that the Midwest ISO has not complied with the Commission's requirements regarding seams issues, and the Commission has not explained why the Midwest ISO should not have to comply. WPS Resources requests clarification or a finding on rehearing that before the Day 2 markets start, the Midwest ISO must either: (1) complete its seams agreements with neighboring regions; or (2) file a "clear and comprehensive plan for addressing seams issues until such time that all seams agreements are finalized and implemented."¹⁶¹

¹⁶¹ WPS Request for Rehearing at 12-13.

3. Discussion

236. With the execution and approval of the Midwest ISO-MAPP SOA,¹⁶² the Midwest ISO-PJM JOA,¹⁶³ and the Midwest ISO-SPP JOA,¹⁶⁴ we believe the Midwest ISO has met our objective of completing the seams agreements necessary to start the energy market. These agreements addressing the major seams issues combined with the protocols and data exchanges for the Ontario IESO and TVA provide comprehensive coverage of seams issues. We note that in addition to the current coverage provided by seams agreements and other arrangements, the Midwest ISO continues to work with neighboring systems on progress toward additional agreements. Therefore, we do not see a need for detailed plans on seams agreements from the Midwest ISO. Accordingly, we dismiss WPS Resources' rehearing request.

K. Disposition of Filing

237. We accept the Midwest ISO's proposed revisions and deletions, as required by Compliance Order I and not discussed elsewhere in this order, to the following sections of the TEMT: 1.86.a; 38.2.2.h; 39.2.5.f; 40.2.3.b.ix; 40.2.15.c; 40.2.17.a; 43.7.2; 63.3.a.i and -.iv; 63.4.1.e; 63.4.2.e; 64.1.1.b and -.d; 65.2.2.e; 65.3.1.a and -.b; 65.4.2.d; 65.4.3; 65.5.2.c; 67.d and -.e; Attachment W, section 9.0.

238. We have reviewed the filed tariff sheets and, with the exceptions described above, find them to be just and reasonable. We therefore accept the Midwest ISO's compliance filing, as modified. With respect to the tariff sheets to which we have required modifications, the Midwest ISO must make the compliance filings described above.

The Commission orders:

(A) The requests for rehearing of Compliance Order I are hereby granted in part and denied in part, as described in the body of this order.

¹⁶² *Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,290 (2005).

¹⁶³ *Midwest Independent Transmission System Operator, Inc. and PJM Interconnection, L.L.C.*, 106 FERC ¶ 61,251, *order on reh'g*, 108 FERC ¶ 61,143 (2004).

¹⁶⁴ *Southwest Power Pool, Inc.*, 110 FERC ¶ 61, 031 (2005).

(B) The Midwest ISO's January 21, 2005 compliance filing is hereby accepted, subject to the revisions described in the body of this order.

(C) The Midwest ISO is hereby required to make compliance filings and informational filings, as described in the body of this order.

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

(S E A L)

Linda Mitry,
Deputy Secretary.

Appendix A

Parties Filing Protests to the Midwest ISO's Compliance Filing

* **Associated Cooperatives** – Associated Electric Cooperative, Inc. and Northeast Missouri Power Cooperative

* **Basin Electric Cooperatives** – Basin Electric Power Cooperative, Central Power Electric Cooperative, Inc., and East River Electric Cooperative, Inc.

Detroit Edison – Detroit Edison Company

Hoosier – Hoosier Energy Rural Electric Cooperative, Inc.

Joint Cooperatives – National Rural Electric Cooperative Association, Corn Belt Power Cooperative, Dairyland Power Cooperative and Southern Illinois Power Cooperative

Michigan Agencies – Michigan Public Power Agency and Michigan South Central Power Agency

Midwest TDUs – Great Lakes Utilities, Indiana Municipal Power Agency, Lincoln Electric System, Madison Gas and Electric Company, Midwest Municipal Transmission Group, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Southern Minnesota Municipal Power Agency, Upper Peninsula Transmission Dependent Utilities, and Wisconsin Public Power Inc.

Otter Tail – Otter Tail Corporation

WEPCO – Wisconsin Electric Power Company

WPS and Quest – WPS Energy Services, Inc. and Quest Energy, L.L.C.

WPS Resources – WPS Resources Corporation, on behalf of Wisconsin Public Service Corporation, Upper Peninsula Power Company, WPS Power Development, Inc. and WPS Energy Services, Inc.

* Filing included a motion to intervene.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission
System Operator, Inc.

Docket Nos. ER04-691-018
ER04-691-019

Public Utilities With Grandfathered Agreements
In the Midwest ISO Region

Docket Nos. EL04-104-017
EL04-104-018

(Issued April 15, 2005)

Joseph T. KELLIHER, Commissioner *dissenting in part*:

I dissent from the portion of this order that denies the Midwest TDUs' and Cinergy's requests for rehearing of Compliance Order I on the ground that it improperly delegated ratemaking authority to the Midwest ISO's IMM when it authorized the IMM to establish reference prices for the day-ahead and real-time energy markets. As I previously explained,¹ in my view, authorizing the Midwest ISO's IMM to establish reference prices constitutes an unlawful delegation of the Commission's ratemaking authority under section 205 of the FPA.²

In denying rehearing, the Commission places great weight on the fact that the Midwest ISO's tariff and the IMM have described a detailed process by which the IMM sets reference levels.³ In my view, the level of detail outlined by the IMM and the tariff is irrelevant to the question of whether the Commission can vest the IMM with authority to set reference level prices in the first place. Under the FPA, the Commission is authorized to set rates, and the courts have made clear that such authority cannot be delegated to an outside entity in the absence of an affirmative congressional authorization.⁴

¹ *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,285 at 62,401-02 (2004) (Kelliher, dissenting in part).

² 16 U.S.C. § 824d (2000).

³ Order at P 25.

⁴ *U.S. Telecomm. Ass'n v. FCC*, 359 F.3d 554, 565-66 (D.C. Cir. 2004)

The Commission also points out that it has established a proceeding to seek comment on the establishment and use of reference prices by RTOs, ISOs or their market monitors.⁵ While I support the Commission's effort to examine reference price issues in that generic proceeding, the mere fact that the Commission has initiated that proceeding does not allow the Commission to unlawfully delegate its ratemaking authority to the Midwest ISO's IMM in the meantime. Accordingly, I would grant rehearing and reject the portion of the Midwest ISO's compliance filing authorizing the IMM to set reference prices.

Joseph T. Kelliher

⁵ Order at P 24 citing *Notice Inviting Comment on the Establishment and Use of Reference Prices*, Docket No. PL05-6-000 (Apr. 1, 2005).