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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), which, when implemented, will allow the Midwest ISO to initiate Day 2 operations in its 15-state region.¹ The Midwest ISO's Day 2 operations will include, among other things, day-ahead and real-time energy markets and a Financial Transmission Rights (FTR) market for transmission capacity. These markets incorporate the major features used successfully in three eastern ISOs – PJM Interconnection, L.L.C. (PJM), New York Independent System Operator, Inc. (NYISO) and ISO New England (ISO-NE). In order to address the Midwest ISO's unique features, the TEMT II Order required the Midwest ISO to implement specific market startup safeguards and confidence-building measures at startup and for a transition period.

2. Today's order addresses issues raised in the compliance filing of the TEMT II Order. The order first addresses those issues most critical to market start-up, namely cost-based bidding and FTR allocation.² Next, the order addresses certain issues that have generated controversy on new and fundamental market design issues, namely the FTR congestion hedge, automatic mitigation and control area mitigation. The order then addresses all the remaining compliance issues, such as the System Supply Resource (SSR) program and credit standards as well as related issues, such as seams agreements. We find the Midwest ISO to be in compliance on these major issues, in accordance with the market design features approved in the TEMT II Order. Therefore the primary purpose of this order is to provide clarity and certainty for the market start-up. We will also require additional compliance actions that refine the market features and provide

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.

² The other start-up safeguards, the reliability audit and marginal loss refund mechanism, are addressed later in the order since they do not deal with issues that have a significant impact on market start-up. The remaining start-up safeguards, the temporary cutover plan and the price correction authority, will be addressed in a future order.

additional clarity. This order will require that all compliance filings be made within 30 days of the date of this order. Our order benefits customers because it provides further guidance and clarification to the Midwest ISO and its stakeholders prior to the March 1, 2005 start of the Day 2 energy markets.

I. Background

3. On December 20, 2001, the Commission found that the Midwest ISO's proposal to become a Regional Transmission Organization (RTO) satisfied the requirements of Order No. 2000,³ and thus granted the Midwest ISO RTO status.⁴ The Commission also determined that the Midwest ISO's proposal for congestion management was a reasonable initial approach to managing congestion that satisfied the requirements of Order No. 2000 for Day 1 operation of an RTO, but directed it to develop a market-based approach to manage congestion to satisfy the requirements for Day 2 operations under Order No. 2000.

4. Subsequently, the Midwest ISO filed a petition for declaratory order – the culmination of over a year of stakeholder discussions⁵ – that sought the Commission's endorsement of the general approach represented in three proposed market rules (Market Rules). The Market Rules proposed in the filing would provide for: (1) a security-constrained, centralized bid-based scheduling and dispatch system (*i.e.*, day-ahead and real-time market rules); (2) FTRs for hedging congestion costs; and (3) market settlement rules. The Commission approved the general direction of the Midwest ISO's proposals, reserving judgment on some issues and providing guidance on others.⁶

³ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs. ¶ 31,089 (2000), *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).

⁴ *Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001) (RTO Order), *reh'g denied*, 103 FERC ¶ 61,169 (2003).

⁵ See Doying testimony at 4 (March 31, 2004).

⁶ *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,196 (Declaratory Order), *order on reh'g*, 103 FERC ¶ 61,210 (2003) (Declaratory Order Rehearing).

5. On July 25, 2003, the Midwest ISO filed a proposed TEMT pursuant to section 205 of the FPA (July 25 Filing). The July 25 Filing included terms and conditions necessary to implement a day-ahead energy market, a real-time energy market and FTRs. The July 25 Filing met with numerous protests, many of which alleged that the filing was incomplete and premature. Following a stakeholder vote, the Midwest ISO filed a motion to withdraw the proposed TEMT, but it requested “any and all guidance the Commission can give the Midwest ISO and its stakeholders on the matters presented in the July 25th Filing.”⁷

6. The Commission granted the Midwest ISO’s motion to withdraw the July 25 Filing and provided, on an advisory basis, guidance on a number of issues raised in that filing.⁸ The Commission stated in the TEMT I Order that it expected its guidance to better enable the Midwest ISO to prepare and file a complete version of the TEMT or a similar proposal. The Commission instructed the Midwest ISO to include five elements in its revised energy markets filing: (1) a *pro forma* System Support Resource Agreement; (2) a marginal loss crediting mechanism; (3) a methodology for initial FTR allocations; (4) creditworthiness provisions; and (5) market mitigation measures.

7. The Midwest ISO filed a revised TEMT on March 31, 2004 (March 31 Filing), raising an issue that will be important to the operation of the proposed energy markets. The Midwest ISO stated in its transmittal letter, and through the testimony of two witnesses, that it would be unable to operate its energy markets without integrating an estimated 300 pre-Open Access Transmission Tariff (OATT) GFAs that are currently effective in the Midwest ISO region. It also concluded that up to 40,000 megawatts of transmission service – about 40 percent of total load in the region⁹ – was likely to be

⁷ Motion to Withdraw Without Prejudice the July 25 Energy Markets Tariff Filing at 5, Docket No. ER03-1118-000 (Oct. 17, 2003).

⁸ *Midwest Independent Transmission System Operator, Inc.*, 105 FERC ¶ 61,145 (2003) (TEMT I Order), *reh’g dismissed*, 105 FERC ¶ 61,272 (2003).

⁹ The Midwest ISO stated that, after reviewing all of the contracts listed in Attachment P of the OATT, the specific details of the contracts, such as usage, scheduling requirements and megawatt quantity or capacity, were not readily apparent on the face of some of the contracts. The Midwest ISO added, however, that about half the contracts had a specific megawatt value associated with them, and that in the aggregate those contracts accounted for approximately 20,000 megawatts of capacity. The Midwest ISO projected that the remaining half of the GFAs were likely to be associated with a similar number of megawatts.

associated with the GFAs.¹⁰ The Midwest ISO argued that allowing holders of GFAs scheduling rights similar to their current practice would require a physical reservation, or carve-out, of transmission capacity in the day-ahead energy market and until the scheduling deadline prior to real-time dispatch. It stated that this “cannot be accomplished without negatively impacting the Midwest ISO’s ability to reliably operate the Energy Markets and without placing excessive financial burden on other Market Participants.”¹¹

8. In an order issued May 26, 2004, the Commission gave an initial response to the threshold GFA issue.¹² The Commission explained that “the development of the Midwest ISO as an RTO has reached a point at which the Commission must examine the potential conflict between our desire to preserve the GFAs and our instructions that the Midwest ISO should develop a market-based system of congestion management.”¹³ The Commission identified a need for further information about the GFAs and a desire to better understand how the GFAs and the proposed energy markets would affect one another. Accordingly, the Commission initiated an investigation, under section 206 of the FPA, of the GFAs “to decide whether GFA operations can be coordinated with energy market operations, whether and to what extent the [Transmission Owners] should bear the costs of taking service to fulfill the existing contracts and whether and to what extent the GFAs should be modified.”¹⁴

9. The Commission issued two orders addressing the merits of the March 31 Filing. The first of these – the TEMT II Order – accepted and suspended the proposed TEMT and permitted it to become effective March 1, 2005, subject to conditions and further

¹⁰ The Midwest ISO’s analysis assumed a peak capacity of 97,000 megawatts. *See* McNamara testimony at 84 n.5 (March 31, 2004).

¹¹ Midwest ISO Transmittal Letter at 9 (Oct. 5, 2004).

¹² *Midwest Independent Transmission System Operator, Inc.*, 107 FERC ¶ 61,191 (2004), reh’g pending (Procedural Order).

¹³ *Id.* at P 65. *See also* Declaratory Order at P 29-32, 64 (“We continue to believe that customers under existing contracts, both real or implicit, should continue to receive the same level and quality of service under a standard market design.”); Declaratory Order Rehearing at P 27-31; *cf.* TEMT I Order at P 22 (encouraging the Midwest ISO to resubmit its energy markets proposal).

¹⁴ Procedural Order at P 67.

orders on GFAs and Schedules 16 and 17 of the Midwest ISO Tariff.¹⁵ The Commission also accepted certain tariff sheets to be effective on August 6, 2004, subject to conditions and further order on GFAs. 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.

10. On September 15, 2004, the Commission issued an order that concluded its investigation of the GFAs and addressed how the GFAs should be treated in the Midwest ISO's energy markets.¹⁶ The GFA Order divided the GFAs into several categories, with differing consequences for their treatment in the Midwest ISO's energy and FTR markets. Among other things, the GFA Order required the Midwest ISO to carve some of the GFAs out of its markets and accepted the tariff sheets that described the prospective treatment of GFAs.

11. On November 8, 2004, the Commission issued an order on rehearing of the TEMT II Order. The TEMT II Rehearing Order denied rehearing and reaffirmed the TEMT II Order on most issues, including market start-up safeguards, application of marginal losses, mitigation, the resource adequacy program and the SSR program, except in limited instances. It granted rehearing and clarification with regard to certain issues raised regarding FTR allocation and postponed the establishment of Automatic Mitigation Procedures (AMP). The TEMT II Rehearing Order also provided clarification on various other issues, as described *infra*.

¹⁵ Schedule 16 provides for a deferral of costs related to the development and implementation of the system and processes required to administer FTRs and the recovery of those deferred costs and the costs related to the ongoing administration of FTRs. Schedule 17 provides for a deferral of start-up costs related to the establishment of energy markets and recovery of such deferred costs and the ongoing costs of providing Energy Markets Service once the markets are operational.

¹⁶ *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236 (2004) (GFA Order).

II. Compliance Filings

12. On September 7, 2004, the Midwest ISO submitted its first compliance filing in response to the TEMT II Order (September 7 Compliance Filing). The September 7 Compliance Filing proposed to revise the TEMT to eliminate the Michigan-specific energy imbalance provisions contained in Schedules 4, 4A, 4B and 4C – Michigan. (As described *infra*, the Midwest ISO has separately proposed a new Schedule 4 for regional energy imbalance service.)

13. On October 5, 2004, the Midwest ISO submitted its second compliance filing in accordance with the TEMT II Order (October 5 Compliance Filing). The October 5 Compliance Filing addresses a host of issues in the TEMT, as this order will describe in further detail. The issues range from developing tariff language for the market startup safeguards to revising the FTR allocation mechanism to revising certain market mitigation measures to making minor changes to wording throughout the tariff. The Midwest ISO states that it consulted its stakeholders and the Organization of MISO States (OMS) regarding those issues that the Commission directed it to discuss with stakeholders.

III. Notice of Filings and Responsive Pleadings

14. Notice of the September 7 Compliance Filing was published in the *Federal Register*, 69 Fed. Reg. 56,209 (2004), with interventions and protests due on or before September 28, 2004. Notice of the October 5 Compliance Filing was published in the *Federal Register*, 69 Fed. Reg. 61,367-68 (2004), with interventions and protests due on or before October 26, 2004. The parties listed in Appendix A filed interventions, protests and comments on the compliance filings as detailed below.¹⁷ AMP-Ohio and Exelon included motions to file out of time in their protests to the October 5 Compliance Filing. The Midwest ISO filed a motion for leave to answer and answer to the protests to the October 5 Compliance Filing on November 19, 2004. Indiana Municipal Power Agency and Wisconsin Public Power Inc. (IMPA and WPPI) filed a motion for leave to answer and a response to the Midwest ISO's Answer on December 3, 2004.

¹⁷ Acronyms and short forms used for party names throughout the order can also be found in Appendix A.

IV. Discussion

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will deem OMS's comments in Docket No. ER04-691-004 to have been filed in Docket Nos. ER04-691-007 and EL04-104-006, as they appear to address the October 5 Compliance Filing. As AMP-Ohio and Exelon's late protests to the October 5 Compliance Filing will not unduly burden other parties or disrupt this proceeding, we will grant their motions to file out of time.

16. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2003), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the Midwest ISO's answer, and IMPA and WPPI's response thereto, because they have provided information that assisted us in our decision-making process.

B. Significant Compliance Issues

17. Significant compliance issues include those issues that have significant implications for market start-up or have resulted in significant controversy on fundamental market design issues among parties. We first address market start-up issues, followed by the market design issues.

1. Transitional Limits on Supply Offers in the Energy Markets

18. The TEMT II Order established transitional mechanisms for managing exposure to locational marginal prices (LMPs) and transmission usage charges. In this order the Commission required market participants to submit cost-based bids for Generation Resources to the day-ahead market, Reliability Assessment Commitment (RAC) process and real-time market for two months following the start of the Day 2 market. Our purpose was not to manage potential market power, but rather 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 proposed TEMT.

The Commission directed the Midwest ISO to file tariff sheets implementing this temporary transition LMP pricing plan. The TEMT II Order stated that the tariff sheets should describe the pricing mechanism and designate a sunset date upon which they will expire and the longer-term LMP pricing tariff sheets become effective.¹⁸

19. The Midwest ISO states that it has added a new section 40.A that implements a transitional LMP pricing plan under which market participants must submit cost-based offers for Generation Resources to the day-ahead energy market, RAC and real-time energy market for 60 days after the Day 2 market starts. By its own terms, this proposed transitional provision shall automatically sunset at the end of the 60-day period. The proposed new provision also seeks to qualify section 39.2.5 (“Generation Offer (or Demand Response Resource Offer) Rules in the Day-Ahead Energy Market”), section 40.1.4 (“Offer Requirements and Specifications for the RAC Process”) and section 40.2.3 (“Offer Rules and Obligations for Market Participants in the Real-Time Energy Market”).

20. The Midwest ISO states that under this approach, the Independent Market Monitor (IMM) and the Midwest ISO will initially identify the appropriate cost components, and then collect the relevant data from market participants. The IMM will use such data to develop Reference Levels that shall be updated daily based on fuel price adjustments, using an appropriate commodity price index (*e.g.*, for gas or oil).

a. Comments

21. WPS Resources expresses concern that the Midwest ISO intends to adjust cost-based bids resulting in potential over or under recovery, based on the Compliance Filing statement that the Midwest ISO intends to adjust reference levels each day to reflect changes in fuel market prices. WPS contends bids for generators with fixed price fuel contracts should not be adjusted. WPS asserts more detail is needed so that market participants have the information necessary to determine if the Midwest ISO proposal is compliant.

22. Coalition MTC proposes that the Commission keep in place its cost-based bidding until the Midwest ISO and the IMM implement the required or expedited manual mitigation procedures in the day-ahead market.

¹⁸ TEMT II Order at P 63.

23. Dominion supports the proposal to reflect variations in fuel costs, plant operating conditions, opportunity costs and a risk premium in the determination of generator costs.

24. Detroit Edison requests that the Commission require the Midwest ISO to: (1) clarify the exact cost components on which it plans to base the bids; (2) provide affected parties with an opportunity to comment on such components; and (3) allow each party to participate in the development of its own cost-based rate.

25. Cinergy argues the Commission cannot mandate cost-based sales at the reference levels determined by the IMM for Cinergy-owned generation since the process is not fully developed, unclear and the Midwest ISO has not shown that the process will produce reference levels that will result in just, reasonable and not unduly discriminatory rates. Cinergy also expresses concern that this compliance filing not limit Cinergy's rights to propose its own rates for its own generation or propose alternatives to the rates set by the IMM. Cinergy reserves its rights with respect to the establishment of rates for its own generation,¹⁹ its right to challenge IMM-determined rates under the just and reasonable standard of section 205 of the Federal Power Act²⁰ (FPA) and to propose alternative rates under the just and reasonable standard.

b. Discussion

26. We clarify how the cost-based bidding transition mechanism works, to respond to the issues raised by commenters. While the cost-based offer mechanism requires that offers be cost-based, as we affirmed in the TEMT II Rehearing Order,²¹ the final price paid and received by market participants in the LMP energy market will reflect the price of the marginal unit that clears the market. Therefore, the purpose of the transitional mechanism is not to tie the rate paid to recovery of each seller's costs, as implied by WPS Resources. Further, in response to WPS Resources, the correct fuel price to use in establishing a spot production cost proxy to provide a reference price for the spot offer is the spot fuel price (based on the appropriate price index), as proposed by Midwest ISO, not the pre-day-ahead contracted fuel price paid by the supplier. Our concern here is to limit spot offers, not to address the prices in long-term contracts.

¹⁹ See *Atlantic City Electric Co v. FERC*, 295 F.3d 1, 10-11 (D.C. Cir. 2002).

²⁰ 16 U.S.C. § 824d (2000).

²¹ See TEMT II Rehearing Order at P 91.

27. We also clarify that entities that self-schedule will produce at their own marginal production cost and not be exposed to the LMP energy markets (although still potentially exposed to LMP-based congestion charges for transmission costs) nor have to submit cost-based offers into those markets (as long as they do not physically withhold). Ideally, of course, suppliers will find that it is more efficient to submit all their supply that is in the price range of the spot market into that market, but this is not a requirement of participation in the Midwest ISO energy markets. Under these terms, we do not expect that the mechanism will restrict Cinergy's ability to set its own rate for its own generation. In any event, Cinergy retains its right to propose rates under FPA section 205 absent an agreement otherwise, so long as its proposal meets section 205's substantive and procedural requirements.

28. We believe the process outlined by the IMM for developing reference levels that includes discussion with market participants of price forecasts, risk and opportunity cost elements, provides for sufficient consultation with suppliers and will result in an accurate assessment of costs, including fuel costs, thereby addressing WPS Resources', Detroit Edison's and Cinergy's concerns. We disagree with the Cinergy position that basing cost-based offers upon Reference Levels in section 40.A is not clear. Section 40.A cites to section 64.1.4 which provides, in section 64.1.4.b.i, for a process of calculating reference levels based on an estimation of costs by the IMM in consultation with market participants. We expect the IMM will develop cost estimates according to the steps detailed in Dr. Patton's affidavit²² and based on the criteria in section 64.1.4.b.i, and market participants will offer at these levels. Since nothing in the process outlined by the IMM indicates that the determination of reference levels will be deferred, we do not believe Cinergy's rights will be limited.

29. While we recognize the concern of Cinergy that offers must be tied to the cost formulas and the reference levels set by the IMM, we believe the goal of ensuring a smooth market start-up will be facilitated to the extent the cost formula and the derivation of costs for cost-based reference levels can be understood by market participants and reflect consultation with them.

30. The 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. Parties may also file complaints with the Commission to the extent they consider the operation of the mechanism unjust, unreasonable and unduly discriminatory. We also consider the Midwest ISO and IMM identification and listing of the cost elements to be comprehensive and the description of

²² See Affidavit of David B. Patton, Ph.D. at P 31 (Oct. 5, 2004).

the process for developing cost-based bids complete, and therefore we have sufficient information to make a determination that the mechanism results in just and reasonable rates.

31. Addressing concerns raised by Coalition MTC, we will not extend the effectiveness of the cost-based offer mechanism beyond two months. As we stated in the TEMT II Rehearing Order, the safeguard is not a mitigation plan.²³ We consider our directives with respect to expedited mitigation, discussed below, to be the appropriate method for ensuring effective mitigation during market start-up.

2. Issues Related to the FTR Allocation Process

32. The TEMT II Order addressed a number of issues related to the FTR allocation process, including conversion of existing transmission service to FTRs and the rules for allocation and restoration of FTRs. The Commission found that the Midwest ISO allocation proposal largely placed network and firm point-to-point service on an equal footing. However, the TEMT II Order stated that entities converting existing firm point-to-point transmission service should be allowed to aggregate their total eligible megawatts and allocate those megawatts between their eligible points of delivery and receipt among the four tiers in the same fashion that entities converting existing network service are able to do. To the extent that such competition for particular paths results in pro-rationing, both network and point-to-point service would have to be pro-rationed on an equitable basis.

33. The TEMT II Order also stated that the Commission will grant no FTR preference between long-term contracts based on contract duration should a *pro rata* allocation become necessary.

34. The TEMT II Order further required the Midwest ISO to include in its tariff a provision guaranteeing that a customer with a transmission contract that is executed prior to the effective date of the tariff but under which service will not commence until after the start of the energy markets will receive the same rights as other existing customers under the current OATT.

²³ See TEMT II Rehearing Order at P 83.

35. Additionally, the TEMT II Order required the Midwest ISO to offer the “redirect” option for such zonal FTR requests that PJM has recently established and the Commission has approved.²⁴

36. The Commission required a number of measures to extend eligibility for restoration of base-load FTRs that were nominated but not awarded in the initial allocation. The Commission extended eligibility for such restoration to existing firm transmission service from resources that meet the proposed TEMT’s definition of base-load capacity or scheduling factor if only weekdays are considered. The Commission also extended restoration on a seasonal basis to parties that have existing annual firm transmission service under which they schedule power that meets the proposed TEMT’s definition of base-load capacity or scheduling factor for the summer peak season. The Commission also extended the restoration period to five years to allow for additional experience and adjustment to the LMP and FTR pricing systems.

37. The Commission also rejected tariff section 43.2.5 in the TEMT II Order and required the Midwest ISO to establish a procedure for entities to make a showing that existing base-load network or point-to-point rights qualify for restoration based on capacity or scheduling factors over the prior 12 months.

38. The Commission further required the Midwest ISO to offer nomination of monthly FTRs, peak and off-peak, in Tiers 2, 3 and 4, if possible by the first allocation and if not, then by the subsequent re-allocation.

39. In the TEMT II Order, the Commission determined the initial FTR allocation should remain valid only for a limited period, to allow market participants time to adjust their positions based on market experience. The Commission also determined that following that initial period, the Midwest ISO’s annual FTR allocation should follow PJM’s schedule, from June 1 of each year to May 31 of the following year. The Commission required the Midwest ISO, with assistance from OMS and stakeholders, to study the technical and implementation issues associated with an adjustment in the FTR allocation after three months of market operations.

40. Finally, the Commission rejected proposed TEMT sections 43.2.6 and 43.7.3, proposing remedial state action, because they were poorly defined and may be read to improperly alter the boundaries between this Commission’s, and the state commissions’ jurisdiction.

²⁴ *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,223 at P 50 (2004).

41. In its October 5 Compliance Filing, the Midwest ISO has amended section 42.2.4, which has been revised as section 43.2.4, to allow aggregation of the megawatt capacity represented by point-to-point transmission service reservations and to extend the restoration period from 3 years to 5 years.

42. The Midwest ISO also modified section 43.2.4, to provide that a market participant may aggregate the total amount of megawatts of its point-to-point transmission service reservations and allocate them between eligible points of delivery and receipt. Sub-sections (a), (b), (c) and (d), which respectively concern each of the four FTR allocation Tiers, have also been supplemented by inserting the following phrase after each relevant reference to point-to-point entitlements: “or aggregation thereof.” The Midwest ISO states that since the option to aggregate point-to-point entitlements is mentioned in conjunction with the references to network service entitlements, the revised tariff provisions “sufficiently imply that in situations where any pro-rationing is required, FTRs for point-to-point and network transmission service will be pro-rationed equitably.”²⁵

43. The Midwest ISO has amended section 43.2.1.a to clarify that if a party elects not to exercise a rollover right after having nominated FTRs for the corresponding transmission service, the FTRs will be terminated. In support Midwest ISO states that the nominating party will not be compelled to hold such FTRs. Midwest ISO also claims that if termination of such FTRs causes a violation of simultaneous feasibility and revenue inadequacy, payments to FTR holders will be prorated accordingly.

44. The Midwest ISO has revised section 43.2.1.a in order to state that transmission contracts executed before the TEMT’s effective date, but involving transmission service that will not begin until after Day 2 market startup will have the same rights as other existing customers with respect to eligibility for FTR allocation.

45. Additionally, the Midwest ISO claims that the rights of existing customers concerning FTR allocation are subject to the condition that any market participant that fails to provide all of the information requested during the FTR Registration period will be deemed to have waived any rights to participate in the initial FTR nomination process.

46. The Midwest ISO also states that it has modified section 43.5.4.a to incorporate a redirect option based on the approach the Commission has approved for PJM. Also the Midwest ISO has amended section 43.2.5 to allow FTR restoration for weekday-only capacity, and to use a 12-month period for demonstrating eligible capacity and

²⁵ Midwest ISO Transmittal Letter at 12 (Oct. 5, 2004).

scheduling factors. In support, the Midwest ISO states that it interprets the full discussion of the Commission to more narrowly require that this section be revised to allow the weekday-only calculation of capacity, and the use of a 12-month period to evaluate capacity and scheduling factors.²⁶

47. In response to a directive to offer nomination of monthly FTRs, peak and off-peak, in Tiers 2, 3 and 4, if possible by the first allocation and if not, then by the subsequent re-allocation, the Midwest ISO states that the earliest time it can offer monthly FTRs is during the second annual allocation. The Midwest ISO also states that it is not possible to accept counterflow flowgate rights (FGRs) by the first annual allocation. As in the case of monthly FTRs, the Midwest ISO's current systems are not yet capable of adding counterflow FGRs to restore curtailed FTRs.

48. The Midwest ISO further states that the concept of adding counterflow FGRs to restore curtailed FTRs has not been sufficiently defined to enable the Midwest ISO to identify and put in place the systems or adjustments required to implement such FGRs.

49. The Midwest ISO states that it has discussed and studied with the OMS and the stakeholders the technical and implementation issues arising from making the initial FTR allocation valid only for three months. The Midwest ISO claims that the parties have opted to have a full re-allocation, and have agreed on an alternative timeline that retains a six-month period for the initial allocation, to be followed by a re-allocation for the subsequent period until the following June 1 in order to synchronize its annual FTR allocation with PJM's schedule.

50. The Midwest ISO has deleted the provisions of section 43.2.6 that provided an alternate process for the restoration of FTRs and of section 43.7.3 that provided remedial state action for the restoration of FTRs. Although the Commission invited the Midwest ISO to consider revised proposals addressing alternative means for restoring FTRs, and further encouraged state commissions to comment on any such proposals, the Midwest ISO states that it has not had an adequate opportunity to develop such alternative proposals. The Midwest ISO states that it will continue to evaluate, and discuss with stakeholders, alternative proposals relating to FTR restoration.

51. The Midwest ISO has revised section 43.2.4 of the TEMT to state that market participants seeking to nominate, or be allocated FTRs associated with existing network integration transmission service entitlements must have associated Network Resources designated for a term of one year or longer. Midwest ISO has also revised section 43.2.4

²⁶ *Id.* at n.48.

to provide a transition mechanism during the Midwest ISO's initial FTR allocation period that will allow market participants with long term network integration transmission service entitlements to nominate and be allocated FTRs from generation resources that were used to serve the market participant's network load over the prior twelve month period when the market participant does not have Network Resources designated annually or longer.

52. The TEMT II Rehearing Order addressed the issue of FTRs for parties with annual network integration service but network resources that are designated as such for less than one year, for example, for one season.²⁷ The Commission clarified that it did not intend for such parties to be disqualified from the initial FTR allocation, given that they have the expectation of continued long-term transmission service. The Commission stated further that network resources that are clearly designated as such for particular seasons (or months within a season) should only be eligible for FTRs corresponding to those seasons.

53. Finally, the Midwest ISO states that as a result of the need for it to evaluate and respond to the directives of the GFA Order, it appears that the earliest date that the four-tier FTR allocation will be completed and available for Commission and market participant review is January 31, 2005.

a. Comments

54. OMS supports the proposed two-staged implementation because the twelve month period will coincide with the same twelve month period used by PJM, it will allow market participants approximately three months of experience before making nominations in the second stage and gives the Midwest ISO and stakeholders a window of opportunity to discover problems and propose changes before the subsequent allocation process is implemented.

55. OMS requests the Commission adopt the Midwest ISO proposal to allow FTRs to be allocated to market participants that do not have network resources under contract for one year or longer as a transition mechanism and renews its rehearing request that the Commission allow FTRs to be allocated to market participants that have multi-year contracts on seasonal network resources.

²⁷ TEMT II Rehearing Order at P 157.

56. Midwest TDUs assert that the Midwest ISO proposes to allow only one month, not the obligatory and necessary 90 days, for federal and state commission review of, and stakeholder review of and business response to, finalized and filed FTR allocations.

57. WPS Resources object that conditional firm transmission service customers are not entitled to FTRs. WPS Resources consider this aspect of the proposal to be unjust and unduly discriminatory because these customers must pay redispatch costs and, in addition, pay congestion costs. Therefore, according to WPS Resources, these customers will be billed twice for the same redispatch service.

58. WPS Resources make several proposals with respect to shorter-term Designated Network Resource (DNR) contracts, as follows: (1) the Midwest ISO should expand the window during which customers with shorter-term DNR contracts could rearrange their energy supplies from the first allocation period to the second allocation period, to allow time for renegotiation; and (2) the Midwest ISO should assure all load-serving entities that they will be eligible to receive FTRs equivalent to the network load they serve with short-term DNRs during the transition period. According to WPS Resources, FTR entitlements for short-term DNRs should be allocated based on historical service provided.

59. Coalition MTC state the Compliance Filing inappropriately restricts FTR nominations and candidate FTRs to yearly designated network resources.

60. Detroit Edison objects to the Midwest ISO proposal to define, in the initial FTR allocation, additional annual FTR entitlements based upon generation resources that were used to serve the market participant's network load for any length of time during the prior 12-month period. Detroit Edison contends this provision is unduly discriminatory in favor of retail access suppliers that did not designate sufficient network resources to meet their peak load on an annual basis by creating new FTRs for them to hedge the difference between the amount of their peak load for which they have designated network resources for a year or more and their remaining peak load. According to Detroit Edison, the proposal would allow retail access suppliers to designate FTRs from any generator relied upon in the past year to supply their network load, even if these retail access suppliers have not designated network resources for a year or more. Detroit Edison points out that this provision is contrary to the Commission's decision not to allow DTE to claim seasonal FTRs, and instead to require DTE to seek to hedge this risk in subsequent FTR auctions. Detroit Edison also asserts that the Midwest ISO proposal is problematic in that historical energy use, not historical firm transmission reservations, is being proposed to determine the eligibility for FTR allocations.

61. Detroit Edison states that the proposal unduly and unfairly discriminates in favor of alternative energy suppliers and against traditional suppliers. If network customers that have failed to secure network resources up to their forecasted load can claim FTRs based on historical uses of a generator that are less than a year in duration, Detroit Edison believes there is no reason that an existing network customer should not be allocated FTRs based on its prior firm transmission reservations used for seasonal purchases. According to Detroit Edison, this should be made available as an option even for network customers with existing annual DNRs equal to or greater than its peak load (*i.e.*, network customers should be able to choose which FTRs they want to submit as candidates for FTR allocation.) Additionally, states Detroit Edison, existing network customers should be allowed to request such FTRs at the same time that the new FTRs are being created for those alternative energy suppliers that have not secured network resources up to their forecasted peak load.

62. Constellation argues that there is no basis for the Midwest ISO's proposal to limit the allocation of FTRs to Network Integration Transmission Service (network service) customers associated with network resources designated on a less-than-annual basis to the initial allocation of FTRs. Constellation asserts the Midwest ISO proposal is inconsistent with the Commission determination that all network service is long-term service and the Commission's recognition that a network service customer's utilization of a network resource for less than one year "does not transform [the network service customer's] long-term network service into a short-term transaction."²⁸ Constellation points out that the Midwest ISO will deprive existing network service customers (including wholesale customers and retail customers served by competitive suppliers) of service equivalent to their existing transmission entitlements based solely on the duration of the individual network resources that, when combined, supported their long-term service over the year(s) that they have taken network service.

²⁸ See *Madison Gas & Electric Co. v. Wisconsin Power & Light Co.*, 80 FERC ¶ 61,331 at 62,103 & n.4 (1997) (citing *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 at 31,752-53 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part, remanded in part sub nom.* Transmission Access Policy Study Group, *et al.* v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom.* New York v. FERC, 122 S.Ct. 1012 (2002)).

63. Constellation argues that a proposal to restrict the allocation of FTRs in this manner clearly favors the incumbent load-serving entities that have fleets of "steel-in-the-ground" network resources (and thus designated network resources of one year or longer), and will disadvantage the new market entrants that rely on a portfolio of purchases (and thus a collection of less-than-annual network resources). Constellation states that this requirement will result in inefficient and uneconomical utilization of resources, decreased service options and increased costs for end-use customers. Constellation recommends the Commission require that the TEMT provide for FTR allocations to all network customers, all of which are, by definition, long-term transmission service customers, regardless of the duration of the network resources they obtain from time to time. Constellation requests the Commission require the Midwest ISO to strike its proposed insert on Substitute Original Sheet No. 613 ("that have been designated for a period of one (1) year or longer") and the last sentence of its proposed insert on Original Sheet No. 613A ("This provision shall only be effective during the Transmission Provider's initial FTR allocation.").

64. Dynegy asserts the Commission should reject the transition mechanism for initial FTR allocation since: (1) it would award such customers FTRs to which they are not justly entitled, through a proxy that relies on false assumptions; (2) this excessive award would be to the direct detriment of those to which the FTR would otherwise have been allocated; and (3) the self-reporting aspect with no verification by the resource owner is an invitation to misrepresentation. Dynegy explains that to grant FTRs to such customers in the initial allocation as if they had firm transmission rights and generation capacity over the previous twelve months would materially exceed their reasonable expectations, and award them FTRs that they do not justly deserve. According to Dynegy, this proposal would be a windfall to those customers, and would therefore be inequitable. Moreover, states Dynegy, absent this proposal, network service customers that lack annual DNRs will not be bereft of opportunities for obtaining congestion hedges subsequent to the FTR allocation. Dynegy notes that the Midwest ISO's FTR market will provide such opportunities in the monthly and annual auctions.

65. Dynegy also contends that the process in the transition phase whereby network service customers identify generation resources they used over the past twelve months creates the potential for misrepresentation, since these entities may not have actually purchased capacity from the generation resources, and also creates the potential for a windfall for such network service customers. Dynegy also notes this process is inconsistent with the Day-2 procedures that require proof that the Generation Owner accepts designation as a network resource. Dynegy recommends a similar requirement be established for the transition phase and that generation resources be notified at the time of submission and participate in the verification process, all of which should precede the initial FTR allocation.

66. In its Answer, the Midwest ISO states that the transitional provisions in the tariff providing FTR entitlement for short-term designated network resources provides a “reasonably balanced means” for complying with the TEMT II Rehearing Order while also not providing parties with short-term transmission rights with favorable treatment.²⁹ The Midwest ISO argues that the initial allocation period of six months is sufficient to allow parties that hold short-term network resource designations to make arrangements to increase their eligibility for FTRs in the subsequent allocations.

67. AMP-Ohio asserts that the Midwest ISO’s proposed language on FTR allocation (“ . . . provided, that a Market Participant may aggregate the total MW of its Firm Point-to-Point Transmission Service reservations and allocate them between eligible Points of Delivery and Points of Receipt.”) misinterprets the Commission’s directive³⁰ that was designed to place customers serving load with point-to-point transmission on a level playing field with network transmission customers. AMP-Ohio argues that the proposed language will limit network service customers to nominating FTRs based on their individual network service agreements, while point-to-point customers may aggregate different transmission reservation serving different loads, allowing them to select the most valuable FTRs earlier in the nomination process than network service customers.

68. AMP-Ohio states that the aggregation of reservations should be on a load basis and proposes the following revision: “. . . provided, that a Market Participant may aggregate the total MW of its Firm Point-to-Point Transmission service reservations *used to serve a single load* and allocate them between eligible Points of Delivery and Points of Receipt.”

69. In its Answer, the Midwest ISO states that AMP-Ohio’s position on aggregation departs from the terms of the TEMT II Order and misconstrues the treatment of network service in FTR allocation. First, the Midwest ISO argues that the TEMT II Order intended for aggregation of point-to-point service between any eligible points of receipt and delivery up to the tier limit. Second, the Midwest ISO argues that it similarly aggregates all network integration transmission service in the same fashion, allowing market participants to allocate the megawatts between any eligible points of receipt and delivery.

²⁹ Midwest ISO Answer at 10.

³⁰ *See* TEMT II Order at P 181.

70. Midwest TDUs assert that the Midwest ISO proposes to allow only one month, not the obligatory and necessary 90 days, for federal and state commission review of, and stakeholder review of and business response to, finalized and filed FTR allocations. In its Answer, the Midwest ISO argues that the review period will be sufficient given the additional requirements on the process since the TEMT II Order and that market participants should have focused their concerns on specific flaws in the process rather than its outcome.

71. Constellation's Answer notes that the Commission clarified in the TEMT II Rehearing Order that the Midwest ISO must grant FTRs based on network resource designations with a duration of less than one year. Constellation alleges that the Midwest ISO's Answer indicates that the Midwest ISO incorrectly believes that it may limit awards based on such designations to the 2005 FTR awards only.

72. IMPA and WPPI filed a joint response to Midwest ISO's Answer. They argue, similarly to AMP-Ohio, that they should be able to convert network service into FTRs from network resources to network load in specific control areas rather than to the aggregate of their network load across all control areas. They argue that this is necessary because they must operate separate parts of their systems separately, on a control area basis, reflecting the current operational and resource adequacy requirements of the Midwest ISO. Both parties state that the priority given to allocation of Option B GFAs in Tier I crowds out certain FTRs that they would like to receive in Tier I. This is exacerbated under the aggregation rule, because the GFAs may displace FTR awards in control areas that the GFAs do not serve.

73. IMPA further states that due to the seam between Midwest ISO and PJM, IMPA is eligible for insufficient FTRs in Tier I relative to its total load in PJM. However, IMPA also provides an email that notes that its load in PJM is served by "other resources" than those in Midwest ISO.

74. IMPA and WPPI further claim that they had attempted to reach resolution on this issue with Midwest ISO in good faith before the close of the Tier I nomination process, but that Midwest ISO failed to clarify its position until making it known in its Answer. They argue that Midwest ISO should not be able to change its interpretation of the tariff after market participants have made decisions based on prior interpretations.

75. IMPA and WPPI request that the Commission adopt AMP-Ohio's language and direct Midwest ISO allow GFAs and FTRs for loads in separate control areas to be treated separately in the FTR allocation process, rather than aggregated. In the absence of this change, they argue that market participants should be allowed to revisit their allocation requests. However, they also note that if the Commission seeks to "rush to completion of an the allocation process that is being built atop an unjust and unreasonable

first tier,”³¹ the Commission should direct now that parties being harmed by Midwest ISO’s error will be made whole at the next practicable opportunity, such as later FTR allocation tiers or the next FTR allocation.

b. Discussion

76. In response to WPS Resources, we note that “conditional firm service,” as referred to in its comments, is not a service provided under the OATT or proposed as a service under the TEMT, nor is it a defined term in either the OATT or Module A of the TEMT. We direct the Midwest ISO to provide an explanation of the service, and proposed tariff language that describes the service and the applicable procedures for obtaining FTRs. Based on that submission, we will address WPS Resources’ concerns.

77. With respect to the Midwest ISO’s explanation that it cannot provide monthly FTRs until the second FTR allocation, we will accept that implementation schedule. We do so because we are convinced that otherwise, the initial FTR allocation will be delayed to accommodate the increased FTR modeling runs, and hence the start of the market will be delayed. In addition, we believe that most of the situations where parties could be disadvantaged in the initial allocation period by the lack of a more “granular” FTR duration have been addressed in the TEMT II Rehearing Order.

78. With respect to the Midwest ISO’s explanation that it does not have enough definition for the concept of counterflow FGRs to allow for the implementation in the initial FTR allocation, we agree. As we stated in the TEMT II Rehearing Order, upon reconsideration, we found that at least in one interpretation, such rights could be assigned to reduce parties’ exposure to congestion charges, but only by shifting costs to other parties (or the Midwest ISO footprint as a whole through uplift) that were assigned to “hold” the FGRs.³² That was not our intention in the TEMT II Order. As we said in the TEMT II Rehearing Order, the stated objective of OMS and the Commission in proposing such rights was to “reduce the harm” (if any) through the assignment of such rights.³³ Because FTR restoration will last for 5 years, there is still time to work on methods to improve coverage for parties that are adversely affected by FTR pro-rationing and to reduce any uplift associated with the provisions to enhance FTR coverage. For these reasons, we again urge OMS and the Midwest ISO to continue to examine the

³¹ IMPA and WPPI, pg. 11.

³² TEMT II Rehearing Order at P 181.

³³ *Id.*

specification and implementation of counterflow FGRs and any other financial transmission right concept that serves the goal of improving hedging against congestion charges and file any workable proposals with us at the soonest possible date.

79. With respect to the eligibility for FTRs of parties with network integration transmission service but with network resources that are designated as such for less than one year, we recognize that in revised section 43.2.4, the tariff offers FTR entitlements to such resources, but only during the initial FTR allocation period of six months. We believe that this approach is not appropriate for parties that have expectations of long-term transmission service. Hence, we will accept provisionally the revisions to the Midwest ISO tariff, to be operative for the period that encompasses the initial FTR allocation, but, for the reasons discussed below, will require Midwest ISO to revise its tariff in accord with the requirements in this order at least 90 days prior to the second FTR allocation.

80. In its Answer, Midwest ISO appears to identify at least two types of parties that have contracts that fall under this category: parties with short-term designated network resources that may not have multi-year contracts for those resources (e.g., competitive retail choice suppliers) and parties with short-term designated network resources that do have multi-year contracts, many on a seasonal basis. The Midwest ISO states that this transitional provision provides a “reasonably balanced” means of providing FTRs to parties that fall into this category generally for an adjustment period of 6 months while not being too biased towards such resources and hence against network resources designated as annual or more in duration.³⁴ We would agree that such a balance is necessary, but neither the filed tariff nor the supporting documentation explains how the balance is being struck. For example, in its Answer, the Midwest ISO states that it is registering seasonal network resources, but it is not clear whether these entitlements are only for the initial FTR allocation or whether seasonal resources that have network service with a history of renewal will be eligible for subsequent FTR allocations. It is also not clear what the implications of this rule are for load-serving entities in retail choice states.

81. We will require the Midwest ISO to clarify what the relationship is between short-term, annual and longer-term network resource designation and eligibility for FTRs in the FTR allocations subsequent to the initial Day 2 allocation.

³⁴ Midwest ISO Answer at 10.

82. In short, the transitional mechanism for assigning FTRs to parties with network service but less than annual designated network resources is sufficient for the initial allocation period. In that period, it should provide coverage for such parties, but restrict their eligibility to nominate until later tiers that accommodate less than annual FTRs. The tariff as filed does not, however, provide adequate explanations for the continued allocation of FTRs to such resources and hence we will require that the relevant tariff sections are filed again not later than 90 days prior to the second annual FTR allocation. This requirement should resolve Constellation's concern that the Midwest ISO is incorrectly construing the Commission's requirements in the TEMT II Rehearing Order.

83. With respect to AMP-Ohio, we disagree that the aggregation of point-to-point transmission service should only be with respect to serving a single load. Pursuant to the Midwest ISO tariff, network customers state their total FTR eligibility by aggregating their total forecast peak load and can then specify receipt and delivery points among all eligible network resources and loads.³⁵ There is no explicit requirement that FTR eligibility for network service is aggregated by network service agreement, hence network customers should not be at a disadvantage relative to point-to-point customers.

84. In response to IMPA and WPPI, we note that all parties in the Midwest ISO with Option B GFAs are subject to a certain amount of crowding out of their FTR nominations in Tier I. In the TEMT II Order, we accepted the Midwest ISO's FTR allocation process (with modifications).³⁶ We understand IMPA and WPPI's concern that their Option B GFAs should not crowd out Tier I awards of FTRs in parts of their systems that the Option B GFAs do not serve. But Tier I is not the end of the FTR allocation process, so it is premature to claim that the FTR awards will be unjust and unreasonable if this rule is in effect. Following Tier I, there is the Tier II allocation, which is itself followed by a restoration of base-load FTRs, and then by the subsequent rounds of the allocation. For that reason, we see no need to restart the Tier I allocation at this time.

85. Moreover, an examination of FTR settlement principles will show that any feasible set of FTRs of the same megawatt amount awarded to cover a set of eligible injection and withdrawal points, will have the same congestion cost hedging properties. That is, even though the party requesting the FTRs believes that it will schedule particular resources to serve load in one area and a different set of resources to serve load in another area, and that its FTRs should map that expected scheduling and dispatch, in fact any feasible set of the allocated FTRs corresponding to the aggregate requested

³⁵ Module C, section 43.2.4, Original Sheet Nos. 613-25.

³⁶ TEMT II Order at P 154.

injection and withdrawal quantities at the points will result in the same congestion hedge under LMP. That is, an FTR could be specified from a source in one control area to a sink in another control area and as long as the aggregate set of points of injection and withdrawal were covered, the total awarded FTRs would have the appropriate hedging property.³⁷

86. We will not require the Midwest ISO to change its interpretation of the current rules for the initial FTR allocation, and we do not believe that the current Midwest ISO rules will, in and of themselves, adversely affect the hedging properties of the awarded FTRs. However, we do not at this time find anything unreasonable in IMPA and WPPI's request that entities operating network resources and loads separately in multiple control areas should be able to disaggregate their FTR requests to convert network service by control area if they so choose. However, we have not examined the implementation aspects of this option. Hence, we will require the Midwest ISO and stakeholders to examine the merits of this option and file the results with us no later than 3 months prior to the subsequent FTR allocation.

87. With respect to IMPA's claim of a seams problem in the FTR allocation, IMPA does not make clear in the joint answer why it should be eligible in Tier I for FTRs equal to its total load in PJM and the Midwest ISO. In particular, it notes that "other resources" are used to serve that load but does not establish that those other resources are being nominated for FTRs, whether in the Midwest ISO or PJM. Therefore, we do not find at this time that the Midwest ISO has inappropriately characterized IMPA's eligibility for FTRs.

88. In response to Midwest TDUs' protest about the lack of availability of the initial FTR allocation for market participant review at least 90 days prior to the start of the Day 2 market, we understand the concern that sufficient time be available to evaluate FTR awards and seek corrective measures, if possible, by the Midwest ISO. First, we point out that results of the earlier tiers of the FTR allocation will be available before the

³⁷ Consider the following example in which a party serves 30 MW of load in control area A with 30 MW of supply also located in control area A and similarly serves 70 MW of load in control area B with supply located in control area B. It is eligible for 100 FTRs. The following are equivalent FTR allocations from the perspective of congestion hedging (all injection and withdrawal points are those requested in the nomination): (1) 30 FTRs with injection and withdrawal points in A and 70 FTRs with injection and withdrawal points in B; and (2) 30 FTRs with injection points in A and withdrawal points in B and 30 FTRs with injection points in B and withdrawal points in A and 40 FTRs with injection and withdrawal points in B.

final overall allocation result, allowing participants to monitor the process as it unfolds. More generally, market participants must also understand that much of the delay in the FTR allocation process has been due to adaptations in the allocation rules and modeling to accommodate market participant concerns. In the TEMT II Order, we stressed completing the modeling accurately through more effective communication between Midwest ISO and participants and providing sufficient safeguards to protect the most vulnerable parties in the allocation. Then, in our TEMT II Rehearing Order, we required further changes in the FTR modeling, again to address concerns of market participants. Further, in the TEMT II Rehearing Order, we noted that the FTR modeling assumptions “are part of commercial readiness and that the Midwest ISO would not certify readiness in the event of continued problems in the initial allocation.”³⁸ Hence, we will accept the Midwest ISO’s proposed schedule for providing the final results of the initial FTR allocation to market participants. Upon review of the initial FTR allocation, if we find that the results appear to undermine the benefits that we foresee from the Day 2 market, then we will carefully consider whether a delay in the market start is required to ensure that sufficient hedges against congestion charges are available for all parties and what the best means are to do so.

3. Transitional Safeguards for FTR Allocation

a. Background

89. In the TEMT II Order, the Commission found it appropriate to provide an expanded congestion cost hedge to entities located in an Narrow Constrained Area (NCA) designated as such at the start of the market or within six months of the start of the market.³⁹ This measure will be allowed for a five-year transition period. Our decision to provide this coverage to entities in significantly congested load pockets stems from our intention to guarantee market participants that are highly dependent on existing firm transmission service and that are potentially subject to high congestion charges that they will receive sufficient FTRs or an equivalent financial hedge to hold them harmless with respect to the changes in the market design. The Commission found this additional hedge particularly appropriate given that the proposed Midwest ISO FTR allocation provides for flexible FTR nomination, which could result in oversubscription on the most congested lines.

³⁸ TEMT II Rehearing Order at P 190.

³⁹ TEMT II Order at P 90.

90. The Commission directed the Midwest ISO to file tariff sheets detailing the additional congestion hedge for NCAs as well as tariff sheets setting out the uplift recovery and credit mechanism associated with the transition FTR process, including specification of the schedule through which uplift costs will be recovered.⁴⁰

91. In the transmittal letter accompanying the October 5 Compliance Filing, the Midwest ISO states that it has incorporated the TEMT II Order's eight "rules" into a new section 43.2.6 of the TEMT, but is not clear on how to implement some of them.⁴¹

92. The Midwest ISO claims that it intends to treat a Network Resource as "internal" if such resource is internal to the state although external to the control area. Moreover, Midwest ISO states that since this rule refers to "Network" Resources, the rule implicitly excludes Point-to-Point Transmission Service into NCAs.

93. In the case of imports involving a system purchase for which a particular generator cannot be identified as the energy supplier, and for which a capacity factor consequently cannot be determined, the Midwest ISO states that it shall use the scheduling factor for the transmission service to determine the order in which the FTRs must be nominated.

94. In its compliance filing, the Midwest ISO states that paragraph 92 also requires the entity electing coverage to schedule in the day-ahead market its external resources specified in external FTRs. The Midwest ISO states congestion coverage shall apply to the lesser of the capacity associated with the FTR or the capacity scheduled in the day-ahead market. If load scheduled in the day-ahead market is less than the sum of the external FTRs sinking at the load zone CPnode,⁴² the congestion relief will be deemed

⁴⁰ *Id.*

⁴¹ The transmittal letter indicates that the Midwest ISO has deleted the text of section 43.2.6 of the TEMT, and that in its place the Midwest ISO has added the NCA congestion hedge provisions required by the TEMT II Order. Midwest ISO Transmittal Letter at 15 (Oct. 5, 2004).

⁴² CPnodes are individual points for which bids and offers will be submitted to the Midwest ISO.

available for the lesser of the sum of the FTRs or the load scheduled. If the sum of the schedules of the resources and imports for the external FTRs exceeds the scheduled load, the congestion relief would be allocated on a pro-rata basis to the holders of the FTRs.⁴³

95. With respect to the TEMT II Order's limits on "congestion relief" payments through the real-time energy market to holders of the enhanced coverage that change their real-time schedules beyond a tolerance band based on the day-ahead schedule, the Midwest ISO requests that the Commission convene a technical conference after November 15, 2004, when the Midwest ISO will comply with the GFA Order, to discuss such issues. In support, the Midwest ISO states that a technical conference will enable the Commission staff, the IMM and stakeholders to discuss the optimal methodology for implementing this rule and how it can best be integrated with the other tariff provisions, such as the GFA provisions. The Midwest ISO also notes that the Commission requested that the IMM review the efficacy of this rule.⁴⁴

96. In the TEMT II Rehearing Order, the Commission modified some of the rules for the additional congestion protection that had been required in the TEMT II Order. Notably, the Commission agreed with WUMS Load-Serving Entities to allow this coverage to extend to all resources with existing long-term transmission service that are located outside the NCA, rather than outside the control area and the state boundaries.⁴⁵ The Commission removed the penalties for deviations from the day-ahead schedule to support the efficiency of the dispatch, but required the IMM to monitor such deviations.⁴⁶ The Commission clarified that uplift to support this additional coverage would be assigned to all Midwest ISO load (rather than being localized in the NCA) and would not be assigned to neighboring ISOs.⁴⁷ And the Commission clarified that parties seeking the

⁴³ The Midwest ISO states that it intends to file a mechanism to correct prices in case of temporary market or system operational problems three months before market start.

⁴⁴ In the TEMT II Rehearing Order, however, the Commission waived this requirement and instead directed the IMM to file a monitoring plan to detect patterns of inefficient scheduling and associated mitigation measures. The IMM's compliance filing is due on January 7, 2004.

⁴⁵ TEMT II Rehearing Order at P 117.

⁴⁶ *Id.*

⁴⁷ *Id.*

congestion protection would not have to nominate the total FTRs associated with their forecast peak load, but would be subject to the requirement to hold counterflow FTRs inside the NCA, if that supported the awards of External FTRs.⁴⁸

b. Comments

97. WUMS Load-Serving Entities claim the proposed Compliance Filing fails to address the end date transition for congestion cost coverage, thereby unreasonably prejudicing WUMS Load-Serving Entities.

98. WUMS Load-Serving Entities request clarification that the congestion cost guarantee not expire in the middle of the FTR year, and that the coverage remain effective until the first allocation process following the termination of the five-year transition period.

99. WUMS Load-Serving Entities request that in section 43.2.6.a the word “holds” be replaced with the phrase “has requested and been denied in the allocation process” to ensure that the additional protection is applied accurately to those entities that do not have sufficient FTRs. WUMS Load-Serving Entities state that if the party already holds such FTRs, then it does not need additional coverage.

100. WUMS Load-Serving Entities request the Commission to require the Midwest ISO to revise the definition of External FTRs to apply to network resources external to the WUMS NCA, consistent with the Commission’s apparent goal to protect the WUMS load-serving entities from increased congestion costs for resources external to the WUMS NCA in the Day 2 market. The WUMS Load-Serving Entities submit that making eligible for coverage FTRs from network resources “external to the NCA” would be the correct approach to achieve the Commission’s objectives in crafting such protection and to minimize any potential uplift to others.

101. WUMS Load-Serving Entities also contend that the Commission should require the Midwest ISO to revise the tariff language in section 43.2.6.a.iii to state clearly that “credits” shall be applied so that the net congestion charge associated with External Resources scheduled in accordance with the tariff is zero, consistent with the TEMT II Order.

⁴⁸ *Id.*

102. WUMS Load-Serving Entities further request the Commission to clarify the effect of the requirement in section 43.2.6.a.iv.c that entities must nominate the total FTRs associated with forecast *peak* load, consistent with the WUMS LSEs' rehearing request and direct the Midwest ISO to clarify the condition so that if an entity does not desire to nominate FTRs equal to its peak, it need not do so (i.e., the requirement should be up to its peak). This revision to the condition, according to the WUMS Load-Serving Entities, would serve the Commission's dual goals of providing extended protection against congestion costs, while at the same time minimizing potential uplift costs to other market participants.

103. In its Answer, the Midwest ISO states that it believes that WUMS Load-Serving Entities have misread the TEMT II Order. Midwest ISO argues that revenues from all allocated External FTRs will be used to compensate eligible parties for congestion costs or used against accumulated uplift costs associated with the additional congestion hedge.

104. Midwest TDUs assert that the Midwest ISO's response to other FTR-related rulings is too weak to assure holders of existing long-term firm rights that they will receive the substantial hedging that the Order directs. In particular, they request that parties in PJM are allocated uplift charges to support the expanded congestion cost coverage for NCAs.

105. Coalition MTC claims that the Midwest ISO has not completely complied with the TEMT II Order, which required the Midwest ISO to file tariff sheets setting forth the uplift recovery and credit mechanism associated with the transition FTR process, including specification of the schedule through which the uplift charge will be recovered. Coalition MTC states that while the Midwest ISO identified in its compliance filing that the uplift is charged to all load, the Midwest ISO has failed to identify the rate schedule and/or rate design through which costs associated with the uplift credit in section 43.2.6.b will be recovered from customers.

106. AMP-Ohio asserts there is nothing in the TEMT II Order mandating that uplift charges be recovered from all load. AMP-Ohio argues that it is more equitable to allocate these charges to the NCAs in which the congestion occurs.

c. Discussion

107. With respect to the Midwest ISO's request for a technical conference to discuss the implementation of the TEMT II Order's limits on real-time congestion relief payments to parties with the enhanced congestion cost protection, given that the Commission removed this requirement in the TEMT II Rehearing Order, this issue is moot.

108. We will accept WUMS Load-Serving Entities' request that the additional congestion cost protections for NCAs will expire with the annual FTR allocation subsequent to the 5-year period measured from the start of the Day 2 market. We do not, however, agree with WUMS Load-Serving Entities that such parties will be left "without FTRs." The TEMT II Order and the Midwest ISO tariff filed in compliance make clear that parties electing such coverage will hold FTRs. So upon expiration of such coverage they would still hold FTRs. However, in keeping with the concern raised by WUMS Load-Serving Entities we do agree that, if the expanded coverage terminates prior to the annual FTR allocation, such parties could have difficulty adjusting their FTR portfolio (through the monthly FTR auctions) to fit their new circumstances. Hence, we will grant their request.

109. We agree with WUMS Load-Serving Entities that the words "holds External FTRs" in section 43.2.6.a could be changed to improve clarity, although the intent of the section appears clear and we agree with Midwest ISO in its Answer regarding the role of External FTRs in relation to the additional congestion hedge. As we stated in the TEMT II Order, the purpose of the additional coverage is to allow those parties that are eligible for such External FTRs to nominate all such External FTRs for external sources that they need for full protection and to receive as many External FTRs as possible through the annual FTR allocation. However, any surplus revenues produced by the External FTRs would be assigned by Midwest ISO to the costs, if any, of providing the additional coverage.⁴⁹ To be clear, we will require the Midwest ISO to make the following change to the tariff: the words "It holds External FTRs" should be replaced with the phrase "It is eligible for External FTRs that were nominated but not awarded through the FTR allocation process..." We will also require that the Midwest ISO add the settlement rules for External FTRs to the tariff.

⁴⁹ For example, Entity A is eligible for 100 FTRs to a generation unit designated as "external" to the NCA. It receives 80 External FTRs through the annual allocation process. For some hours of the year, these External FTRs generate surplus revenue: that is, FTR revenues are greater than congestion charges associated with the external resource. These surplus revenues are held by the Midwest ISO. In other hours, the 80 External FTRs are not sufficient to cover congestion charges associated with the external resource. In those hours, the Midwest ISO uses the surplus FTR revenues, if available, or uplift charges to provide the party with the External FTRs with a net zero congestion charge.

110. In the TEMT II Rehearing order, the Commission addressed WUMS Load-Serving Entities' request for coverage for External Sources to include those outside the NCA but within the state. Compliance with that order will require the Midwest ISO to replace the phrase in section 43.2.6.a.1, "those that have source points outside the Control Area and the state..." with "those that have source points outside the NCA."

111. We addressed WUMS Load-Serving Entities' request that entities eligible for the expanded congestion cost hedge not be required to nominate FTRs up to their peak load in the TEMT II Rehearing Order. There we stated that our language in the TEMT II Order "could be too stringent and could require parties within an NCA to nominate and accept FTRs from intermediate and peaking resources in the NCA that they do not want."⁵⁰ Our revision of this requirement was aimed at nominations of FTRs internal to the NCA. However, to be eligible for External FTRs, the party that elects the additional coverage must nominate all the eligible External FTRs associated with the existing transmission service that it is trying to hedge.⁵¹ The tariff should be modified slightly to make this point clear. In section 43.2.6.a.iv.a, the tariff states that "...Market Participants that wish to maintain eligibility for expanded Cost of Congestion relief for External FTRs are not required to nominate all FTR entitlements..." This appears to be consistent with the TEMT II Rehearing Order. Section 43.2.6.a.iv.b then makes clear that failure to nominate an FTR entitlement eligible to be an External FTR for an external resource will result in failure to be eligible for the additional coverage. However, in section 43.2.6.a.iv.c, the tariff states that parties seeking the enhanced coverage "must nominate Candidate FTRs up to each Market Participant's total FTR nomination eligibility by the end of the nomination process." To be clear, this section should read "must nominate Candidate External FTRs up to each Market Participant's total External FTR nomination eligibility by the end of the nomination process."

112. We agree with Coalition MTC that the Midwest ISO has not included enough specificity in the TEMT as to the rate design of the uplift charge. Therefore, we direct Midwest ISO to revise section 43.2.6.b to reflect how the uplift charge is calculated and assessed to load.

⁵⁰ TEMT II Rehearing Order at P 118.

⁵¹ For example, if a party has existing firm transmission service for up to 100 MW from a generation resource external to the NCA, it must nominate 100 MW of FTRs to be eligible for the additional coverage.

113. In response to Midwest TDUs, we have already clarified in the TEMT Rehearing Order that entities in PJM will not be assessed uplift charges to support the expanded congestion cost protection for parties in NCAs.⁵²

114. In response to AMP-Ohio, we addressed the reasons why uplift to support the expanded congestion cost hedge for NCAs will not be allocated to the NCA in the TEMT II Rehearing Order.⁵³

4. Automatic and Expedited Mitigation

a. Background

115. In the TEMT II Order, the Commission found that while real-time markets could mitigate much of the potential for the exercise of market power in the day-ahead market, some exercise of market power there can still occur. Given these concerns, the Commission directed the IMM to devise appropriate tariff language for the Midwest ISO to file in its compliance filing to implement an automatic mitigation procedure or other measures (such as manual expedited mitigation) to prevent the one-day lag in mitigation that would otherwise occur in the day-ahead market.

116. The IMM and the Midwest ISO now propose an expedited mitigation procedure under which day-ahead mitigation will be triggered for all resource offers that exceed conduct thresholds, without regard to whether such offers violate market impact thresholds.

117. The IMM also recommends that the Commission not approve the conduct-only expedited mitigation proposal for several reasons. Dr. Patton explains that implementation of such a procedure will likely result in mitigation occurring on a daily basis to suppliers that do not have market power. Additionally, Dr. Patton notes that under the proposed expedited mitigation proposal, there will be an increased demand on the IMM to address unit-specific mitigation questions from such suppliers, especially regarding those suppliers' specific reference levels. Finally, Dr. Patton explains that application of such an expedited mitigation measure will not likely be effective because the day-ahead market is voluntary, and suppliers can simply not offer their resources, or submit high-priced virtual load bids at their generator's location to nullify the mitigation.

⁵² *See* TEMT II Rehearing Order at P 111.

⁵³ *Id.*

b. Comments

118. Midwest TDUs state that the IMM has not justified its position. According to Midwest TDUs, mechanisms to implement automated or expedited manual mitigation appear insufficiently explored and the Commission has at least two viable alternatives to the IMM position: (1) apply mitigation based upon the conduct thresholds alone; or (2) extend cost-based bidding until automated or expedited manual mitigation can be implemented. The Midwest TDUs contend that the FPA does not allow the Commission to choose the IMM position, which results in customers being exposed to unmitigated exercises of market power in the day-ahead market.

119. Coalition MTC states that the Commission should not accept Dr. Patton's request that the Commission not implement the expedited (conduct test only) mitigation procedures for the day-ahead market, which the IMM and the Midwest ISO filed in order to comply with the TEMT II Order's requirement for prospective mitigation in that market. Coalition MTC states that the procedures should be implemented because: (1) the FPA requires the Commission to ensure that rates are just and reasonable; (2) the claims that limited mitigation will not be effective are premised upon factual misstatements; and (3) the Midwest ISO and the IMM have failed to demonstrate that expedited mitigation is not a viable alternative. Alternatively, if the Commission does not reject the IMM's request, Coalition MTC requests that the Commission maintain cost-based bidding until automated or expedited manual mitigation measures are in place to ensure that day-ahead markets produce just and reasonable prices.

120. Coalition MTC explains that the Commission cannot permit market-based sales absent "empirical proof" that "existing competition would ensure that the actual price is just and reasonable."⁵⁴ According to Coalition MTC, contrary to the IMM's assertion that the day-ahead market is strictly voluntary, in fact it relies on a must-offer requirement for designated network resources. Also, while the IMM asserts generators will employ virtual bidding to circumvent mitigation in the day-ahead market, Coalition MTC says this strategy would produce price divergence between day-ahead and real-time markets. Coalition MTC dismisses the IMM's claim that the conduct-only approach would be ineffective as an attempt to blame problems on behavior that has no relationship to either the conduct or impact tests associated with either day-ahead or real-time markets. Finally, Coalition MTC claims that the IMM has provided insufficient information for the Commission to render conclusions about the viability of expedited manual mitigation and does not address options for managing IT resources.

⁵⁴ Coalition MTC Protest at 5 (quoting *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir. 1984)).

121. In contrast, a number of commenters agree with the IMM's recommendation not to implement the interim mitigation approach as it would result in over-mitigation, and mitigate when there has been no market impact. Dominion says this would be compounded by the must-offer requirement on generators. WPS Resources recommends that the Commission require the Midwest ISO to upgrade its software so that automatic mitigation will occur at the start of the Day 2 markets, rather than adopting the interim mitigation. Cinergy cites to Commission precedent rejecting automatic mitigation procedures due to the lack of software for such procedures.⁵⁵ Cinergy agrees with the IMM recommendation and says that the expedited manual mitigation would result in mitigation of suppliers that do not have market power, and harm the market, consumers and competition, as Dr. Tabors explains.⁵⁶ Cinergy also notes that imposing mitigation on suppliers without market power will likely make the process of setting unit reference levels more contentious.

122. LG&E considers the expedited mitigation procedures unjust and unreasonable because mitigation is triggered by conduct only, with no regard to market power. LG&E states that the IMM is factually incorrect when he states the day-ahead market is voluntary since DNRs must offer. Therefore, according to LG&E, these units must offer into a flawed expedited procedure.

c. Discussion

123. In the TEMT II Rehearing Order, the Commission allowed the IMM to delay adoption of the automated mitigation or expedited manual mitigation for the day-ahead market.⁵⁷ However, to address concerns about the possibility for the exercise of market power, the Commission required the IMM to do the following three things: (1) file quarterly reports to show where mitigation would have been applied were there not a lag in mitigation, and to show the associated dollar impact on the market; (2) develop and file a safety-net plan for instituting mitigation if a pattern of behavior develops in the day-ahead market in which mitigation is repeatedly needed but cannot be applied due to the

⁵⁵ Cinergy Protest at 3 (citing *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,280 at P 105 (2003)).

⁵⁶ See Exhibit CIN-4 at 21.

⁵⁷ TEMT II Rehearing Order at P 258-59.

lag; and (3) file a plan and an associated timeline under which it will resolve this problem for the longer term by instituting automated or expedited manual mitigation in the market.⁵⁸ We believe that these measures will appropriately address the potential for the exercise of market power while allowing market operations to begin in a timely manner.

124. The TEMT II Rehearing Order appropriately addresses the parties' concerns. We understand that market participants must participate in the day-ahead market to some degree, and that is why we have set out protections for that market, as discussed above. The requirements for reporting of any under-mitigation and the development of a safety-net plan means that the Commission can avoid over-mitigation in the day-ahead market while ensuring that it is not left unprotected if a pattern of abuse develops. The requirement for the Midwest ISO to continue to pursue expedited manual or automatic mitigation reflects our belief that such mitigation is feasible, and should be enacted as soon as possible.

125. As such, we will allow the Midwest ISO to remove section 64.2.2.b from its tariff, consistent with our ruling in the TEMT II Rehearing Order. Thereafter, it must also provide the required quarterly reports (showing where mitigation would have been applied were there not a lag in mitigation, and showing the associated dollar impact on the market) until it has imposed automatic mitigation or expedited manual mitigation in the day-ahead market.

5. Control Area Mitigation

a. Background

126. 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, the Commission directed the IMM to develop and implement a monitoring plan, and to notify the Commission should it find any such behavior.

127. The Midwest ISO states that it has coordinated with the IMM to develop and implement a plan for monitoring and reporting anti-competitive behavior at the control area level. The IMM has proposed using a conduct and impact framework to monitor and report anti-competitive behavior at the control area level. Under this proposed framework, the IMM will focus first on the conduct of the entity in question and then determine if such conduct had a significant impact on market outcomes. The market

⁵⁸ *See id.* at P 259.

impact is measured by the change in LMPs, uplift expenses, or other specified market outcomes. The IMM says that actions that do not have a material effect on the market results are not likely to reflect attempts to exercise market power or to manipulate market outcomes. Control area operators' actions that significantly affect market outcomes that cannot be justified by the control area operation would be referred to the Commission for enforcement under Market Behavior Rule 2.

128. Dr. Patton's testimony says that there are two exceptions to the presumption that actions not affecting market outcomes in the short-run do not warrant investigation or enforcement: (1) undue discrimination and affiliate favoritism; and (2) actions that have long-term market effects. Undue discrimination and affiliate favoritism would be detected via control area market screening and via the anonymous complaint process in Module D. Dr. Patton says that the IMM would identify actions and policies by control area operators that have market effects, such as by creating barriers to efficient entry of new generation.⁵⁹ Information on both classes of these exceptions would be reported to the Commission for appropriate action.

129. In monitoring control areas, the IMM says it will focus on specific control area functions that may raise significant issues.⁶⁰ These functions include: (1) maintenance of operating reserves and regulation; (2) load forecasting; and (3) local reliability and congestion management requirements. The IMM will attempt to identify reserve surpluses, shortages and uneconomic actions taken by the control areas that will significantly affect the Midwest ISO markets. The IMM will perform independent load forecasts to detect any systematic load forecasting errors. If forecasting errors by control areas result in operator actions that adversely affect the market, the IMM says it will consult with the Midwest ISO and the Control area about the causes of the errors and report its findings to the Commission. The IMM will monitor constraint information and associated redispatch information, and screen for redispatch instructions that are inconsistent with local constraints. If the redispatch instructions cannot be justified and either materially affect the market outcomes or harm competing market participants, the matter will be referred to the Commission for action under Market Behavior Rule 2.

⁵⁹ Affidavit of David B. Patton, Ph.D. at P 12-13 (Oct. 5, 2004).

⁶⁰ However, the IMM says the monitoring will not be limited to these functions to the extent that other functions and responsibilities are a source of market power, manipulation, or discrimination concerns.

130. The Midwest ISO has added a new section 53.1.g to the monitoring section of the TEMT which specifies the conditions, functions, or actions that will be monitored with respect to control area operators. The new language says that the following will be monitored:

The actions taken by Control Area Operators, including but not limited to: a) the conduct of Control Area Operators, including, but not limited to, unnecessarily withholding capacity from the Energy Markets by arranging for more spinning, non-spinning and Operating Reserves than is justifiably needed for reliability purposes, b) causing more units to be committed through the RAC process or other supplemental processes than needed for reliability purposes, c) taking actions that are economically inefficient to resolve imbalances in the Control Area d) failing to maintain reasonable levels of ACE and e) and (SIC) redispatching Generation Resources in a manner that is not necessary to resolve local constraints or satisfy local reliability requirements.

b. Comments

131. LG&E argues that the Midwest ISO proposal subjects control area operators to Commission jurisdiction over their actions to maintain reliability, thereby creating conflicts between NERC and the IMM. LG&E contends that it is unclear whether a control area operator will be penalized if it follows a NERC directive. According to LG&E, the standards provide no clear guidance as to which entity would make determinations on a “legitimate reliability reason” or what criteria would be used and therefore it is impossible to predict the type of conduct considered impermissible.

132. LG&E claims the IMM plan is inconsistent with the Balancing Authority Agreement, filed on October 5, 2004. Specifically, the IMM plan does not recognize that the Balancing Authority Agreement gives the Midwest ISO the authority to commit units, that the balancing area operator follows the Midwest ISO’s directions regarding unit commitment, the Midwest ISO approves and confirms the implementation of Scheduled Interchange with External Balancing Authorities, and the Midwest ISO calculates the Net Scheduled Interchange for each Balancing Authority and performs inadvertent interchange tasks.

133. LG&E states that the IMM's description of Operating Reserves and Regulation is in conflict with section 4.12.2 of the Balancing Authority Agreement. According to LG&E, that section provides that Balancing Authorities are only responsible to "coordinate the deployment of regulation and operating reserves within the Midwest ISO" and specifically states that the Midwest ISO "shall provide the information to the Balancing Authority necessary to allow the deployment." In the October 5 Compliance Filing, Dr. Patton states that he is concerned that, to the extent reserves are held on relatively low-cost resources or excess quantities of reserves are maintained, the LMPs may be adversely affected.⁶¹ However, under the Balancing Authority Agreement, the Midwest ISO coordinates the information with the Balancing Authorities, according to LG&E.

134. Midwest ISO TOs object to sections 50.3, 53.1.g and 61.1 which require control area operators to comply with the obligations of the IMM's plan, make control area operators subject to the IMM's responsibilities and add control area operators as entities from which the IMM may obtain data. Midwest ISO TOs state that these provisions impose obligations on control area operators and therefore are inconsistent with the terms of the Balancing Authority Agreement filed on October 5, 2004, raise the same legal issues the Midwest ISO TOs sought to avoid by entering into the Balancing Authority Agreement, and raise enforceability issues, *i.e.*, if there is not jurisdiction over control area operators performing control area functions, then the tariff provisions can not be enforced against the control area operators. Therefore, the Midwest ISO TOs propose that the Midwest ISO revise the TEMT to state that for the purposes of Module D, the references to control area operators are to market participants with control area functions and any obligations relate only to such market participants.

135. LG&E also contends that it is unclear why the IMM must establish additional processes for standards of conduct complaints that are normally handled by the Commission. In contrast, Midwest TDUs assert the identification of monitored activity set forth in section 53.1.g., should specifically cover: (1) affiliate favoritism or preference; and (2) control area operation in a discriminatory manner. According to the Midwest TDUs, the market benefit that can be derived from control area operation can lead to discriminatory conduct and impede competition. The Midwest TDUs also note that Module D contains no requirement that the IMM report to the Commission conduct that is preferential or discriminatory, despite Dr. Patton's statement that such "conduct will be identified and referred to the Commission even when it does not significantly

⁶¹ Affidavit of David B. Patton, Ph.D. at P 15 (Oct. 5, 2004).

affect aggregate market prices or costs.”⁶² For this reason, state the Midwest TDUs, Module D needs to be revised to specify that preferential and discriminatory conduct will be monitored and reported.

136. The Midwest TDUs also claim the IMM should report all other conduct that falls under section 53.1.g rather than applying a market impact screen. The Midwest TDUs explain that, given the range of possible harms stemming from abuses of control area operations, distilling the harm to a quantity that triggers the IMM's reporting obligation could be extremely difficult, time-consuming and ineffective due to the great potential for gaps caused by the inability to anticipate all the ways the market could be manipulated. According to the Midwest TDUs, this problem pertains especially to affiliate favoritism or discriminatory behavior that can undermine confidence in a supposedly open, non-discriminatory market, with or without a readily quantified market impact. The Midwest TDUs say that thus, Module D should require reporting of all conduct that falls under section 53.1.g, and not just conduct that also satisfies a market impact screen.

137. Also, the Midwest TDUs contend the IMM's reporting obligation with respect to control area operators should not be limited to conduct violating Market Behavior Rule 2, which the IMM seems to contemplate.⁶³ They say that Market Behavior Rule 2, which is a condition to market-based rate tariffs, could well not reach some control area operations, for example, to the extent that such operations do not occur under market based rates. In addition, the standard remedy for market behavior rule violations – disgorgement of ill-gotten profits and possibly revocation of market-based rate authority – may not be appropriate or relevant to control area operation misconduct.

138. LG&E also considers the use of terms such as “legitimate safety or reliability concerns,” “unnecessarily withholding,” and “justifiably needed” in the standards for monitoring of control area operators, to be unreasonably vague.

⁶² *Id.* at P 12.

⁶³ *See id.* at P 11. *See also* Module C, section 53.3, Original Sheet No. 716A.

c. Discussion

139. In the TEMT II Order the Commission established that it is appropriate for the IMM to monitor for anti-competitive problems at the control area level, including withholding on so-called reliability grounds and for affiliate favoritism.⁶⁴ The Commission directed the IMM to develop and implement a plan for dealing with anticompetitive behavior at the control area level, and to notify the Commission should it find any such behavior. Control areas in the Midwest ISO have a variety of configurations for control of generation and transmission. Most control area operators own both transmission and generation, and control load within their control areas. Some control area operators that only own transmission may, nevertheless, have affiliates that own generation or control load within the control area. We agree with the IMM that these relationships may motivate anti-competitive behavior on the part of control area operators. We also agree that independent control area companies will need to be monitored to assure that they do not engage in anti-competitive conduct.

140. This issue is particularly important in the Midwest ISO, where there are 37 control areas within its reliability authority and 21 within its markets, and control areas retain a number of crucial functions including coordinating operating reserves and regulation, load forecasting, relieving constraints not recognized in the Midwest ISO model, and redispatching generation as needed to relieve those constraints.⁶⁵ Maintaining these functions at the control area level provides control area operators with opportunities for anti-competitive behavior that must be monitored.

141. We recognize the concerns raised by LG&E about the Midwest ISO's proposal in light of the scope of our jurisdiction and possible conflicts with NERC directives. We do not foresee any circumstances in which the Midwest ISO's proposal would override NERC directives and do not intend such a result. As to jurisdiction, we believe this issue is premature, in that we can not anticipate all jurisdictional issues that may arise at this time. We will address jurisdictional issues as they occur when the market is running. For today, suffice it to say that we cannot authorize any IMM actions exceeding our

⁶⁴ TEMT II Order at P 256.

⁶⁵ Pursuant to the TEMT II Order, the Midwest ISO and the Midwest ISO TOs filed a Balancing Authority Agreement on October 5, 2004, that proposes to reallocate energy market functions between the Midwest ISO and the control areas (known under the NERC Functional Model as Balancing Authorities). Our findings in this section are subject to the outcome of the Commission's consideration of the Balancing Authority Agreement.

jurisdiction under the FPA, and anyone subject to such action who believes it to exceed our jurisdiction may raise the issue with the Commission. We will review such matters expeditiously.

142. In establishing standards for monitoring and mitigating, it is important for market participants to have a clear idea of what constitutes inappropriate market behavior. To the degree possible, standards must be laid out in the tariff and must be objectively quantifiable. Just as for the actions of other market participants, this is true for those of control area operators. It is also important that the control area operators not be penalized for following the directions of NERC, the Midwest ISO, local reliability committees or of individual states, or for actions taken for a legitimate business purpose.

143. We find that some of the procedures discussed in the IMM's testimony for monitoring of control area operators are not laid out in the tariff. In particular, the IMM's testimony discusses conduct and impact as a screening mechanism for referral of actions to the Commission. The testimony says:

Consistent with the monitoring and mitigation provisions proposed for all other types of conduct identified in Module D, we propose the use of a conduct and impact framework to monitor the Control Area Operators. Under this framework, we will focus first on the conduct of the entity in question and then determine if such conduct had a significant effect on the market outcomes.⁶⁶

While conduct to be monitored is laid out in section 53.1.g of the tariff, it is not clear if all instances of such conduct are to be screened for a market impact. No definition of impact is given beyond the statement in the testimony that conduct will be examined to see if it has a significant impact. The thresholds in the tariff for conduct and impact are in the mitigation section of the tariff, which does not appear to apply to actions of control area operators.⁶⁷ The testimony also refers to "actions that cannot be justified by the Control Area Operator" being referred to the Commission, but the tariff does not appear

⁶⁶ Affidavit of David B. Patton, Ph.D. at P 9 (Oct. 5, 2004).

⁶⁷ We do not believe that instances of anti-competitive control area operator behavior that do not have a market impact (which is yet to be defined by the IMM) need be reported to the Commission, as requested by the Midwest TDUs. However, we agree that *all* instances of affiliate preference or discrimination or those actions having long-term impacts should be reported.

to provide for consultation between the control area operator and the IMM. The only such consultation is found in section 63 which does not appear to apply to the actions of control area operators.

144. Nor do the standards for control area operators conduct contained in the TEMT reflect that monitoring for control area operators are relevant only for actions over which they have control and discretion. The tariff language on monitoring of control area operations must make the standards objectively quantifiable, and to clarify that the 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 of individual states. Indeed, it is actions of the control area operators beyond these required actions that should be the focus of monitoring and ultimately mitigation.

145. We also find that the standards laid out in the TEMT for monitoring control area operators' actions are not sufficiently objectively quantifiable and must be revised. For example, we find that in section 53.1.g, both occurrences of the language "but not limited to" must be removed. The phrase "unnecessarily withholding" must be further defined. Some of the other concerns about lack of specificity in the tariff and potential penalties for actions required by other parties can be solved simultaneously. We find that the language "...by arranging for more spinning, non-spinning and Operating Reserves than is justifiably needed for reliability purposes" is not sufficiently clear, and require the Midwest ISO to replace it with "by arranging for more spinning, non-spinning and Operating Reserves than is required by Regional Reliability Committee guidelines." This also addresses the issue LG&E raises, eliminating the penalization of parties for following NERC guidelines on these issues. Also in section 53.1.g, we find that the language "needed for reliability purposes" associated with the RAC process is too vague, and will require the Midwest ISO to replace the specified language with "than the Midwest ISO determines in the RAC process." Likewise, we find that the language "failing to maintain reasonable levels of ACE" is not objectively identifiable, and the Midwest ISO must replace it with "failing to maintain levels of ACE required by the reliability coordinator."

146. We disagree with LG&E about the need for processes to deal with standards of conduct complaints. This section of the tariff is establishing procedures for the IMM to monitor for such violations and to report them to the Commission. We find that it is appropriate for the tariff to detail the IMM's obligation to monitor for conduct which is discriminatory or involves affiliate favoritism. We agree with the Midwest TDUs assertion that the identification of monitored activity set forth in § 53.1.g. must

specifically cover: (1) affiliate favoritism or preference; and (2) control area operation in a discriminatory manner. Also, Module D must be revised to specify that preferential and discriminatory conduct by control area operators will be monitored and reported to the Commission.

147. With respect to the Midwest TDUs' concern regarding Market Behavior Rule 2, we agree that the IMM's reporting obligation should not be limited to Market Behavior Rule 2, as it will not cover control area operator actions that do not occur under market-based rates. We believe that the IMM should report all control area operator actions that are anti-competitive. As we stated in the TEMT II Order, there are a number of ways in which a control area operator could manipulate the market. For example, while the operating reserve decisions made by control area operators do not encompass market-based offers, the designation of generators to provide operating reserves could affect energy market prices in a manner that confers advantage to a particular seller of energy. However, we believe that the tariff already covers such reporting by the IMM. Section 53.1.g establishes that it will monitor for such behavior. Section 63.3.d of the tariff establishes that the IMM shall monitor for other categories of conduct that distort competitive outcomes of any of the markets of the Midwest ISO, and provides that it will seek authorization to mitigate the effects of such conduct from the Commission.

C. Readiness and Market Startup Safeguards

1. Reliability, Performance Assessment and Audit

a. Background

148. The TEMT II Order listed three primary readiness issues that need to be addressed in order to implement the Day 2 markets reliably and effectively: (1) generic reliability issues, especially those identified by the Task Force and subsequent NERC audit; (2) reliability issues that could emerge as a result of the implementation of the Day 2 market – for example, as control area operators change functional responsibilities; and (3) readiness to operate the market such that, assuming that reliability is ensured, market systems and measurements used to develop market prices are sufficiently accurate and dependable.

149. In its filing, Midwest ISO states that consistent with the directives of the TEMT II Order, the compliance filings for the “cut over” plan and price correction mechanism, as well as certain aspects of the other safeguards, will be filed on December 1, 2004, with the exception of the requirement of a certification of readiness, which will be filed on January 30, 2005. With the present filing, the Midwest ISO states that it submits explanations and proposed tariff language addressing the 60-day compliance requirements of the first, third, fourth, and fifth transitional safeguards.

150. The TEMT II Order noted that “the Midwest ISO has not explicitly addressed in the proposed TEMT the matter of ensuring that the transition in functional responsibilities will not adversely affect reliability.”⁶⁸ The Commission therefore ordered the Midwest ISO to file an explanation of this matter.⁶⁹ In its compliance filing, the Midwest ISO states that the revised TEMT provisions ensure that the transition in functional responsibilities will improve reliability because the Midwest ISO has reached a settlement with the Transmission Owners and the Balancing Authorities to clarify the functional responsibilities of each entity. Midwest ISO states that a detailed settlement agreement with proposed modified TEMT provisions is being filed concurrently with the subject Compliance Filing in accordance with paragraph 138 of the TEMT II Order.⁷⁰

b. Protests and Comments

151. OMS agrees with the Midwest ISO compliance language regarding the continuing process between the Midwest ISO and OMS regarding market readiness. OMS states it will use the Metrics Interpretative Guide and Readiness Advisor process to obtain information to make recommendations on additional metrics and may make an informational filing 30 days prior to market start-up to advise the Commission on OMS’s views on market readiness

152. WPS Resources states that the Midwest ISO has not adequately satisfied the metric-related requirements specified in the TEMT II Order.⁷¹ WPS Resources cites to the incomplete and vague guidelines, and the fact that the commercial operations and readiness plan are not addressed in the October 5 Compliance Filing.

⁶⁸ TEMT II Order at P 54.

⁶⁹ *Id.*

⁷⁰ Midwest ISO Transmittal Letter at 10-11 (Oct. 5, 2004).

⁷¹ *See* TEMT II Order at P 55.

c. Discussion

153. Inasmuch as the Midwest ISO and OMS are meeting to discuss metrics related to commercial operations readiness and the testing plan, as confirmed by the OMS in their comments, we consider the Midwest ISO to be in compliance with the requirements of the TEMT II Order. Based on representations of OMS, we expect these consultations to continue with additional refinement of the metrics as necessary, thereby addressing the concerns of WPS Resources.

154. We find the Midwest ISO response to be acceptable on the reliability impacts of the functional responsibilities transition. We are addressing the issue of functional responsibilities in a separate order on a Balancing Authority Agreement filed, as required by the TEMT II Order, by the Midwest ISO and Midwest ISO TOs on October 5, 2004.

2. Transitional Safeguards for Exposure to Marginal Loss Charges

a. Background

155. We have supported the use of marginal losses in LMP in prior Midwest ISO orders because it leads to a least-cost dispatch that reflects the true costs of transmission.⁷² Knowing the loss component of the locational price allows the dispatcher to serve load at a particular location with less expensive generation than if losses were not taken into account in the dispatch. The scope of the Midwest ISO market, with significant potential losses if certain generation were dispatched for spot power through the centralized market, makes it important to ensure that a true least-cost dispatch is attained.

156. As with other aspects of the energy markets, in the TEMT II Order we determined that it was necessary to take steps to build experience with LMP while mitigating its impact for a period of time.

157. However, the transition to LMPs reflecting marginal losses has been contentious in other ISOs and RTOs with respect to the allocation of the surplus loss revenues, leading to revisions in the allocation methodology once experience is gained. To give market participants more time to adjust to the LMP approach for 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 will be given this refund based either on historical loss

⁷² See, e.g., Declaratory Order at P 31.

charges associated with existing transmission service, or otherwise on average loss charges calculated by the Midwest ISO.⁷³ In the TEMT II Order, the Commission made this transitional loss refund approach available to all existing transmission customers for a period of five years and to all new transmission customers for a period of one year from the start of the Day 2 markets.⁷⁴

158. The Commission directed the Midwest ISO to develop a single methodology for the refund of the difference between marginal and average losses and to file tariff sheets implementing the transitional loss calculation measure and refund mechanism within 60 days from the date of the TEMT II Order.

159. The TEMT II Order additionally directed the Midwest ISO to continue discussing with its stakeholders the post-transition method for refunding the marginal losses surplus, and to submit an appropriate refund method to the Commission.⁷⁵

160. In its compliance filing, Midwest ISO has revised section 40.6 to provide for a transitional mechanism, available for a period no longer than five years, to refund to load-serving entities the difference between the marginal loss charge and average losses on a Balancing Authority Area basis.⁷⁶ Under this approach, customers in Balancing Authority Areas that have the highest actual losses will receive a greater proportion of the Marginal Loss Surplus share than customers in Balancing Authority Areas with relatively lower losses. The Midwest ISO states that a significant majority of Market Subcommittee members supported the adoption of a revised “loss pool” approach that would more specifically define the “pools” to which excess revenues will be refunded based on Balancing Authority Areas.

⁷³ TEMT II Order at P 74.

⁷⁴ *Id.* at P 73.

⁷⁵ *Id.* at P 79.

⁷⁶ The TEMT defines “Balancing Authority Area” as: “The collection of Resources, transmission systems, and Loads within the metered boundaries of Balancing Authority.” Module A, section 1.18, Original Sheet No. 51.

161. The Midwest ISO also states that many stakeholders agreed that appropriate aspects of this modified “loss pool” approach should also be incorporated into the transitional method for refunding the difference between marginal and average losses. According to the Midwest ISO, this approach provides more granularity and, as such, less averaging.

162. The Midwest ISO claims that the proposed revisions to section 40.6 optimally address the concerns identified by the Commission regarding the initially proposed method for refunding surplus revenues resulting from collection of marginal losses. The Midwest ISO states that the proposed modified approach targets the refund of such surplus with more specificity than the initial TEMT proposal. The revised methodology also refunds surplus losses revenue to entities based on the difference between the marginal losses amounts collected and average losses experienced by such entities on a Balancing Authority basis.

163. In contrast to the TEMT II Order, the Midwest ISO believes that it is not appropriate to distinguish between existing and new customers under this transitional framework because the energy markets will be more successful if the TEMT does not discriminate between different types of energy transactions, even during a limited transition period.⁷⁷ In support, the Midwest ISO points out that stakeholders voted overwhelmingly (22 to 3) in favor of a “non-discriminatory” approach.

164. The Midwest ISO has also revised section 38.8.3.b.iii to clarify that the determination of the difference between marginal losses and system losses shall be based on procedures that will be detailed in the Business Practice Manuals.

b. Protests and Comments

165. Midwest TDUs assert that the methodology for the marginal loss surplus refund proposed by the Midwest ISO will divert refunds from the market participants who disproportionately fund it (typically small, transmission-dependent load-serving entities) to other market participants who happen to reside in the same control area (typically larger load-serving entities that operate control areas).

⁷⁷ Midwest ISO Transmittal Letter at 7 (Oct. 5, 2004).

166. Midwest TDUs state that the Midwest ISO inappropriately departed from the intent of the TEMT II Order by rejecting the “bifurcated” approach that distinguished between existing and new transmission customers. Midwest TDUs imply that this will disadvantage load-serving entities that will have to pool their refunds with both existing and new customers.

167. WPS Resources contend that the Midwest ISO proposal is not in compliance with the TEMT II Order because it does not contain: (1) a description of the method the Midwest ISO would use to calculate marginal losses per transmission customer; (2) a method to develop average system losses and associated costs; (3) a process by which the Midwest ISO will determine historic loss payments per transmission customer; and (4) 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 the revised section 38.8.3 provides for the Business Practice Manuals to contain the detailed procedures to determine the difference between marginal and system average losses. However, WPS Resources note that the manuals are incomplete and contain no detail.

168. Dominion claims the determination of the difference between marginal and system losses must be detailed in tariffs, and not in the Business Practices Manual as proposed by the Midwest ISO, because these provisions impact rates and the Midwest ISO filing does not comply with the Commission directive to file tariff sheets to implement the transitional loss calculation.⁷⁸ Dominion also supports the Midwest ISO proposal to define “loss pools” as individual Balancing Authority Areas.

169. Detroit Edison supports the Midwest ISO proposal to refund excess payments on a Balancing Authority Area basis.

170. Dynegy supports the marginal loss refund and urges the Commission to accept it as the most equitable solution reached by a clear consensus of stakeholders.

c. Discussion

171. We will accept the Midwest ISO’s proposal to apply the TEMT II Order’s requirement for a transitional safeguard on marginal loss charges through the refund of the marginal loss charge surplus on a Balancing Authority basis, rather than through the

⁷⁸ See TEMT II Order at P 657.

previously proposed “loss pools.” We agree that this approach has greater granularity than the prior one, and is consistent with our intentions with respect to not exposing participants to charges different than their average actual losses. It also has the advantages of stakeholder support and ease of implementation.

172. We are concerned, however, that there could still be some market participants within the Balancing Authority that are not made eligible for a sufficient share of the refund through the load ratio share calculation. This could include entities with remote generation well outside the territory of the Balancing Authority. We will require the Midwest ISO to explain how it is determining the marginal loss surplus refund for such entities.

173. We are also concerned, as per the views expressed by WPS Resources, that the tariff does not address the needs of parties with historical loss charges as required by the TEMT II Order. If a market participant currently has a transmission contract with another party that specifies an average or incremental loss charge for each transaction over some period, and the parties seek to continue to settle against that contract for the transition period, then the Midwest ISO should provide any loss charge data that would facilitate meeting the contract terms.⁷⁹ We will require the Midwest ISO to explain how such historical loss contracts are being accommodated.

174. We will accept the Midwest ISO’s and stakeholders’ decision to adopt a non-discriminatory approach to the refund of the marginal loss surplus, rather than the “bifurcated” approach that we required in the TEMT II Order. Our purpose in the TEMT II Order was not to add additional complexity to the start of the Day 2 market, but rather to provide an accurate marginal loss price signal as soon as possible for new transmission customers and developers of new generation and transmission. We note further that our requirement that Midwest ISO review and improve the accuracy of the refund over time should allay Midwest TDUs’ concern that new customers will dilute the refunds to existing customers.

⁷⁹ For example, party A has a transmission contract with party B that includes a 3 percent average loss charge calculated over some period, such as one season. If average actual losses are higher than 3 percent, then party A benefits; if they are lower, party B benefits. The marginal loss surplus refund method the Midwest ISO proposes should keep party A paying very close to its actual losses; however, these losses on average may be higher (or lower) than party A’s historical loss charges under its contracts. Party B, under the contract terms, should then be responsible for the portion of party A’s loss above this average; similarly, party A should be required to pay back to party B when it pays loss charges below the contracted amount.

175. With respect to WPS Resources' concerns about lack of detail on the refunding mechanism, we note that in our TEMT II Order, we directed the Midwest ISO to file tariff sheets implementing the transitional loss calculation measure.⁸⁰ Therefore, the Midwest ISO did not comply with the Commission's requirements by referencing the Business Practice Manuals for the necessary detail. We required the methodology to be included in the TEMT because it directly impacts the rates paid by transmission customers.⁸¹ The Midwest ISO is therefore directed to put the detail implementing the transitional loss calculation and refund mechanism in the TEMT.

D. Other Issues Related to the FTR Allocation Process

1. Illustrative FTR Allocation

a. Background

176. The TEMT II Order recognized and agreed with many of the concerns about the illustrative FTR allocation results. The Procedural Order previously stated our interest in not repeating the illustrative FTR allocation, but rather moving towards a process to establish a final initial allocation that addresses stakeholder concerns about the FTR modeling and allows sufficient time to correct errors and include adjustments to the allocation (e.g., by state commissions) before the start of the Day 2 market. The Procedural Order requires that the initial allocation be filed 90 days prior to the start of the market.⁸²

177. In its compliance filing, the Midwest ISO states that it has cancelled any further "illustrative" FTR allocations.

b. Discussion

178. We accept the Midwest ISO's compliance, via its transmittal letter, with our decision not to require further illustrative FTR allocations prior to the first actual initial FTR allocation.

⁸⁰ See TEMT II Order at P 75.

⁸¹ See 18 C.F.R. § 35.1(a) (2004)

⁸² See Procedural Order at P 95.

2. FTR Rules for Generation Additions and Retirements and Network Upgrades and Expansion

a. Background

179. The TEMT II Order directed the Midwest ISO to clarify the rules for FTRs from network resources that are retired. If a network resource is retired, then this could change the feasible set of FTRs. Maintaining the outstanding FTR associated with the retired resource could then create a revenue inadequacy. The Midwest ISO and stakeholders should determine whether to allow the FTR to remain as-is through the allocation period, whether to adjust it for purposes of simultaneous feasibility, or whether to terminate it.

180. The Commission also directed the Midwest ISO to begin discussions with stakeholders on the need for, and feasibility of, long-term FTRs within 180 days of the start of the Day 2 markets.

181. In its compliance filing, the Midwest ISO clarifies that maintaining FTRs associated with retired network resources would not necessarily have an adverse impact on simultaneous feasibility or on revenue adequacy. Simultaneous feasibility is more likely to be threatened by the termination of FTRs pertaining to retired network resources, and would in no event be undermined by the retention of such FTRs. The Midwest ISO proceeded to have discussions with stakeholders whether such FTRs should be kept intact through the allocation period, adjusted for purposes of simultaneous feasibility, or terminated. The Midwest ISO and the stakeholders agreed that such FTRs shall remain in effect through the end of the allocation period.

b. Protests and Comments

182. WPS Resources is opposed to requiring market participants to retain FTRs after a generator is retired. WPS Resources specifically object to the requirement that market participants must retain counterflow FTRs, that they were forced to accept during the Restoration Phase, beyond the useful life of the market participant's generator. WPS Resource considers this policy discriminatory.

183. In its Answer, the Midwest ISO states that retirement decisions are made sufficiently in advance that market participants should be able to adjust FTR holdings accordingly, *e.g.*, by nominating FTRs such that FTR and generation unit retirements coincide.

c. Discussion

184. We will accept the Midwest ISO's tariff revision that FTRs associated with retired units will remain in effect through the allocation period.

185. We do not understand WPS Resources' contention that a market participant assigned counterflow FTRs in the restoration phase would have to hold those FTRs for a retired unit. The revised tariff section 43.6.4 states that Midwest ISO will not settle counterflow FTRs with the holder of such FTRs for the remainder of the allocation period after the unit retirement. This would seem to address WPS Resources' concern.

3. FTRs in Retail Choice States

186. In the TEMT II Order, the Commission found that it was appropriate that Auction Revenue Rights (ARRs) will follow load shifts on a daily basis and that the TEMT was not clear in this regard. Hence, the Commission required the Midwest ISO revise its tariff accordingly to clarify this rule.

187. The Midwest ISO states that it has revised section 43.7.2 to clarify that ARRs will follow load shifts daily. Dominion counters that the Midwest ISO inadvertently omitted this section in its compliance filing.

188. As Dominion notes, the Midwest ISO has not filed the revised section 43.7.2. We will therefore require the Midwest ISO to file this section within 30 days of the date of this order.

4. Locational Marginal Pricing

a. Background

189. The Midwest ISO proposed to use LMP to settle energy sales and purchases in the day-ahead market and the real-time market, to calculate transmission usage charges in both of the markets, and to settle FTRs in the day-ahead market. The Midwest ISO further notes that LMP provides a long-term price signal that can be used to assist investment decisions in generation and transmission. The Commission conditionally accepted Midwest ISO's proposal in the TEMT II Order.

190. In the TEMT II Order, the Commission required the Midwest ISO to clarify that external transactions will not be double-charged for congestion and losses. The Commission also required the Midwest ISO to clarify that power delivered from a non-jurisdictional Midwest ISO generation unit with existing firm transmission service at the

Midwest ISO boundary is not subject to congestion or loss charges. However, if such a unit schedules power into the Midwest ISO footprint, or offers it into the Midwest ISO energy markets, it will be scheduled and dispatched in accord with LMPs.

191. In its compliance filing, Midwest ISO states that external transactions will not be double-charged for congestion and losses and that section 39.3.3.c of the TEMT has been modified to make such clarification.

192. Additionally, Midwest ISO clarifies that power delivered from a non-jurisdictional Midwest ISO generation unit with existing firm transmission service at the Midwest ISO boundary is not subject to congestion or loss charges. However, if such a unit schedules energy into the Midwest ISO footprint, or offers it into the Midwest ISO energy markets, it will be scheduled and dispatched in accordance with LMP scheduling procedures.

b. Comments and Protests

193. WPS Resources assert the Compliance Filing is deficient since it does not clarify that external transactions will not be double-charged for congestion and losses, as required by the TEMT II Order. In its Answer, the Midwest ISO responds that this point has been clarified in section 39.3.3.c.

c. Discussion

194. WPS Resources is incorrect in stating that the tariff is not in compliance on the issue of double-charging external transactions. As the Midwest ISO notes, this requirement has been complied with in revised tariff section 39.3.3.c.⁸³

E. Marginal Losses

1. Background

195. In the TEMT II Order, the Commission approved the Midwest ISO's implementation of LMP with a marginal loss component with clarification and modification and subject to the safeguard measure discussed in the order. The marginal loss pricing rules will be applicable to all entities requesting new transmission service from the Midwest ISO one year after the start of the Day 2 markets and to all market

⁸³ This is in the redlined version of the tariff on Original Sheet No. 517. The redlined version does not include all section numbering, so it may appear as if a redline section is part of another section.

participants following the termination of the transition period delineated in section IV (B). The Commission also required the Midwest ISO to consider additional measures to provide loss hedging instruments for new transmission customers at the termination of the transition period, if not sooner.

196. The Commission also required the Midwest ISO and stakeholders to develop proposals for financial loss rights that could be implemented following the termination of the transition period.

197. The Midwest ISO states that after discussions with its stakeholders, it has developed a transitional refund mechanism it believes complies with the TEMT II Order. The Midwest ISO maintains that further refinement of a long-term marginal losses surplus refund mechanism will occur within a reasonable period of time. The Midwest ISO further notes that it will work with stakeholders to develop additional methods for hedging losses once the transition period is terminated, such as financial loss rights.

2. Discussion

198. Given that we have accepted Midwest ISO's proposal not to distinguish between existing and new transmission customers during the transition period on marginal losses, we will not at this time establish a timeframe for consideration of how marginal losses will be treated following that period. However, we encourage the Midwest ISO and stakeholders to monitor the experience with marginal loss pricing, to evaluate how other regional markets undertake refunds of surplus marginal loss charges, and to study new instruments for hedging loss charges.

F. Market Monitoring and Market Power Mitigation

1. Mitigation of Cost-Based Bids

a. Background

199. During the 60-day initial start-up when sellers will submit cost-based bids, the IMM proposes a 10 percent threshold to screen for violations of the cost-based offer requirement. Dr. Patton testifies that the 10 percent threshold has been adopted to reflect uncertainties in the underlying cost parameters. For example, the fuel prices used to

adjust the reference prices can vary from actual prices incurred by suppliers due to: the one-day lag in the reporting of gas price information through public sources, the lack of data on imbalance charges and other ancillary fuel expenses, and basis differentials between the plant's location and public pricing point.⁸⁴

200. The IMM proposes to report to the Commission's Office of Market Oversight and Investigation, on a weekly basis (with automatic notification of the seller), offers that exceed the threshold. This approach relies on the Commission's enforcement authority to ensure compliance with the cost-based offer requirement. As an alternative, the IMM software would be modified to implement 'mitigation' of bids based only on conduct rather than on conduct and impact using thresholds based on known or expected variations such as fuel cost changes.

b. Protests and Comments

201. Midwest TDUs assert that the IMM proposal will cause price increases resulting from excessive offers to go unremedied, and rates will be unjust and unreasonable. The proposal, according to the Midwest TDUs, represents the kind of *ex post* mitigation that is at odds with the Commission's preference for *ex ante* mitigation regimes.

202. As an alternative, the Midwest TDUs propose that the IMM implement mitigation based only on conduct offers. Midwest TDUs contend that sellers are required to submit cost-based offers in any event during the 60-day period, so there is no harm to automatically mitigating them down to the cost-based reference level when their bids exceed the threshold by 10 percent.

c. Discussion

203. The IMM's proposal for dealing with cost based bids is appropriate. Cost-based bids are being implemented for an interim two-month period only, during market start-up. During this period, market participants will have a clear idea of their reference prices. We do not expect bidding that exceeds the 10 percent thresholds. The rules establish a clear standard for bidding regardless of market conditions. Rather than mitigating such bids, referring them for enforcement action is appropriate. We believe that using the Commission's enforcement authority for bids exceeding a company's threshold is sufficient to deter this behavior. We do not believe it is necessary to have the software modified to implement mitigation of bids based only on conduct rather than conduct and impact using thresholds based on known or expected variations such as fuel cost changes.

⁸⁴ See Affidavit of David B. Patton, Ph.D. at P 32 (Oct. 5, 2004).

2. BCAs

a. Background

204. The Commission directed the IMM to coordinate with the Midwest ISO so that active BCAs and the associated flowgates are identified on the Midwest ISO website, as well as all prior BCAs and the associated flowgates.

b. Discussion

205. The Midwest ISO modified its tariff such that active and prior BCAs are to be listed on its website. However it did not provide that the associated flowgates would be listed. We direct the Midwest ISO to modify section 63.4.2.e accordingly and file the change within 30 days of the issuance of this order.

3. NCAs

a. Background

206. In the TEMT II Order, the Commission stated that the language in section 63.4.1.e could lead to a misinterpretation, and required the Midwest ISO to change the language to make clear that the NCA distinction will be removed only if the transmission constraints defining the area are expected to be binding for less than the 500 hours, perhaps because they have been binding for less than the 500 hours in the past.⁸⁵

207. The Midwest ISO says it has inserted language in section 63.4.1.e to clarify that an NCA designation will be removed only if transmission constraints are expected to be binding for less than 500 hours.⁸⁶

⁸⁵ TEMT II Order at P 284.

⁸⁶ The TEMT II Order noted that the Midwest TDUs incorrectly referred to section 64.3.1.e in their discussion of the definition of NCAs, and that the Midwest ISO should “file to correct this cross-reference,” which should have been to section 63.4.1.e. *See* TEMT II Order at n.199. However, the Midwest ISO does confirm the accuracy of the Commission’s statement that the provision that should have been cited is section 63.4.1.e. The Midwest ISO seeks guidance on what other corrective steps, if any, the Commission requires the Midwest ISO to take on such a third-party mistake.

b. Protests and Comments

208. Midwest TDUs assert the submitted tariff sheet (No. 759) still includes language permitting removal if “transmission constraints ... have been... binding for fewer than five hundred (500) hours during a given twelve (12)-month period.” Accordingly, Midwest TDUs request that the tariffs be modified to reflect the Commission directive.

c. Discussion

209. We find that the modified language in section 63.3.4.1.e is not in compliance with the Commission's order. In particular, the point of the required change was that an NCA designation could be removed if the transmission constraints are expected to be binding for less than 500 hours, but not automatically just because there were less than 500 hours in which the constraint was binding the previous year. Rather, the number of hours of constraint in the previous year could be considered in the assessment of whether the constraint was expected to be binding 500 hours or more in the next year. The insertion of the word “only” does not allow for other reasons for the removal of the designation of an NCA area such as when there are no longer any pivotal suppliers in the area. Thus, we require the Midwest ISO to modify section 63.4.1.e to remove the word “only” and the words “have been or.” The Midwest ISO must file this tariff change within 30 days of the issuance of this order.

4. NCA Identification and Designation

a. Background

210. The analysis performed by the IMM found only two flowgates that meet the definition of a NCA and that are not within the WUMS or Northern WUMS region. The Commission questioned the IMM’s assertion that flowgate Rocky Run-Northpt+Weston-Rocky Road should not be an NCA because it is expected to affect only a localized area and price effects are likely to be small. The Commission directed the IMM to clarify why this flowgate should be omitted from NCA status.

211. The Midwest ISO was directed to clarify or correct the tariff language in section 65.2.2.e such that it is evident which mitigation measures are to remain in effect for the duration of any hour in which there is an interval for which such mitigation is deemed warranted. In particular, the Midwest ISO was directed to make clear what type of withholding section 65.2.2.e applies to, and whether it applies to BCAs, NCAs or both.

212. Also, the Commission found that the text of the IMM's analysis submitted with Dr. Patton's testimony listed the flowgates that significantly limit imports into WUMS and North WUMS. It did not, however, include six flowgates that are included in Table A-1 of Appendix A of that analysis, which details flowgates into and within WUMS.⁸⁷ However, the Commission noticed that six other flowgates are listed twice in the text of the market analysis, and we believe that this may be an editorial error.⁸⁸ The Commission directed the IMM to clarify in a compliance filing why the six flowgates in the Appendix but not the list of flowgates associated with the WUMS and North WUMS NCAs should be omitted, or revise the list of flowgates to include them. The Commission also directed the IMM to identify in that compliance filing all units that, under the current proposal, will be subject to NCA thresholds.

213. The Midwest ISO says that it has revised sections 65.2.2.e and 64.1.1.e to make clear which mitigation measures are to remain in effect for the duration of any hour in which there is an interval for which such mitigation is deemed warranted; what type of withholding section 65.2.2.e applies to; and whether it applies to BCAs, NCAs or both.

214. According to the IMM, there are two reasons for the Rocky Run-Northpt+Weston-Rocky Road not being classified as an NCA. First, the effect of the constraint is extremely local with the units at a single plant primarily affecting the flows over the flowgate. Second, the generating plant is owned by the same company that serves the load in the area whose LMPs would be affected by the constraint. The incentive for the participant to withhold the resources is limited. The IMM has committed to monitor this constraint to determine whether a third NCA should be defined and report on this issue to the Commission once the market is in operation.⁸⁹

⁸⁷ These include Stiles-Amberg 138 for Morgan-Plains, Stiles-Pioneer for N.Appl-WhiteClay 138, Green Lk-Roeder 138 for N Appleton-Ror, N.Appleton-Lostdauphin 138 for Kewaunee Xfrm, and Kewaunee 345/138 Xfrm, Kewaunee Xfrm-N Appleton.

⁸⁸ These include Flow South, Highway V-Preble 138 Flo Lost Dauphin-Red Maple, Highway V-Preble+N Applton-White Clay, N Appleton-Wh Clay 138 for Stiles – Pulliam 138, Stiles4-Pulliam 138+Stiles5-Pulliam 138, and Stiles-Amberg & Stiles-Crivitz Flo Morgan-Plains.

⁸⁹ See Affidavit of Dr. David B. Patton, Ph.D. at P 40 (Oct. 5, 2004).

215. The Midwest ISO submits the IMM's clarification regarding propriety of omitting or including the flowgates associated with WUMS and North WUMS in the list of NCAs. According to the IMM, the omission of these six flowgates was an editorial error. A revised Market Analysis report is included in the compliance filing.

216. In the compliance filing, the Midwest ISO also submitted the IMM's identification of all units that will be subject to the proposed NCA thresholds.

b. Protests and Comments

217. Midwest TDUs claim that the list of units subject to NCA thresholds is not up to date and therefore units are missing. Also, according to Midwest TDUs, the list entries should reflect CPnodes (individual points for which bids and offers will be submitted to the Midwest ISO) rather than generating units. They say this would be particularly helpful in the case of jointly-owned units, because the list would reflect the bidders subject to the NCA thresholds and whose behavior the mitigation measures are designed to monitor.

c. Discussion

218. While the Midwest ISO has made some modifications to 65.2.2.e in order to clarify the language, we find that one additional change is needed so that conduct thresholds for both physical and economic withholding are referenced. In particular, the Midwest ISO must add the language "and 64.1.2", to section 65.2.2.e, so that it reads "...in accordance with the conduct thresholds of Sections 64.1.1 and 64.1.2..." The Midwest ISO is directed to make this change within 30 days of the issuance of this order.

219. We accept the IMM's justification for not declaring Rocky Run-Northpt+Weston-Rocky Road to be an NCA. As stated, the IMM should continue to monitor to see if a change in status is needed. We also accept the corrections to the flowgate list associated WUMS and North WUMS.

220. The IMM has filed the list of generating units that will be subject to the proposed NCA thresholds as required. If the list is not current, the IMM must re-file that list within 30 days of the issuance of this order. We do not believe it is important for the IMM to identify the CPNodes associated with the NCA. The purpose of the posting of the units associated with the NCA is to let the bidders know if their units are associated with the NCA, and thus, which thresholds will apply to them. Bidders will know their units, even if only partial ownership is involved.

5. Reference Levels

a. Background

221. The Commission accepted the approach proposed in the TEMT for calculating reference levels. The methods used are similar to those approved in other markets that mitigate through conduct and impact thresholds.⁹⁰ However, the Commission believed that the process of determining the reference levels should be laid out in more detail. In that regard, the Commission ordered the IMM to file with the Commission to more clearly specify what factors it considers in the marginal cost calculation in order to include legitimate risks and opportunity costs in establishing reference prices.⁹¹ The Commission also directed the IMM to discuss how these costs are estimated for different output levels.

222. In his affidavit, Dr. Patton explained: (1) the process the IMM will use to determine unit-specific reference levels; (2) the factors that the IMM will consider in the marginal cost calculation in order to ensure that reference levels include legitimate risk and opportunity costs; and (3) how such costs are estimated for different output levels.⁹²

223. According to Dr. Patton, in the case of the normal reference price process, a market participant may propose for IMM review a value that reflects its opportunity costs and explain how it calculated the value. The IMM will be collecting specific information through its cost-based data survey that will allow the Midwest ISO to calculate these factors.⁹³

224. Dr. Patton further explained that for energy limitations, he will generally forecast the highest-priced hours in which an energy-limited resource can be expected to operate. Dr. Patton states that a rational supplier would offer its resource at no lower than this value. He adds that energy-limited participants' expectations regarding prices may vary

⁹⁰ See, e.g., *New York Independent System Operator, Inc.*, 99 FERC ¶ 61,246 at 62,045 (2002).

⁹¹ Examples might include fuel costs at different output levels, risks of breakdown at certain levels of output, and costs of repairs, as well as the opportunity cost of not being able to run the unit while it is down.

⁹² Affidavit of David B. Patton, Ph.D. (October 5, 2004).

⁹³ *Id.* at 29-36.

from his own and will typically accept the participants' price forecast unless it is substantially higher without reasonable justification. Since hourly price data will not exist prior to the start of the Midwest ISO markets, the IMM will develop hour price forecasts using hourly price data from adjacent regions together with the daily bilateral prices available from *Megawatt Daily* for locations in the Midwest to estimate hourly prices in the Midwest region.

225. Dr. Patton indicated that a similar process will be used to estimate risk factors where relevant for certain generating resources. He states that the cost-based survey will collect the parameters necessary to calculate the expected value of the operational risks facing a generating unit.

226. The compliance filing states that both the risks and opportunity costs can vary over the output range of the resource. To account for these changes over the output range of a unit, the IMM will rely primarily on information provided by the supplier indicating how the limitations and risk parameters change at different output levels. The methodology for calculating the values would be the same as described above although the input parameters can change by output level.

b. Protests and Comments

227. According to the Midwest TDUs, the Commission should reject the IMM's proposal to rely on data, especially price forecasts, from sellers who will have great interest in inflating price forecasts and cost estimates.⁴³ At a minimum, the Commission must insist that the IMM make objective determinations regarding opportunity and risk costs consistent with the TEMT Order's requirement that the "IMM should independently establish the reference levels."⁹⁴

228. Parties also raised issues in the Order on Rehearing, which the Commission deferred to this Compliance Order. In particular, Ameren wanted additional specificity in how reference levels will be set, as well as a definition of what constitutes "legitimate risks and opportunity costs." Ameren also said that the Commission should clarify definitions and parameters to be used in undertaking the standardized survey and setting the initial reference levels, in order to provide for consistent reference levels among entities with similar cost structures.

⁹⁴ TEMT II Order at P 306.

c. Discussion

229. We believe that the detail the IMM has provided on the calculation of reference prices is sufficient. However, in any surveys for determination of reference prices that the IMM issues, it must include basic definitions of the terms, so that there will be consistency across market participants in developing reference prices. With respect to Ameren's concerns, we believe that "legitimate risks and opportunity costs" include intertemporal opportunity costs caused by run-time restrictions, operational risks such as the risks of unit failure (including costs of repairs and costs of foregone sales during the repair period), short-term fluctuations in fuel prices or availability, and possibly, other factors.

230. We find that the IMM's proposal for price forecasts for energy limited resources is acceptable. The IMM will only accept the price forecasts when they are not substantially higher than its own forecasts. These resources will have an incentive to produce during all the peak hours that they can, and it is in the market's interest to allow those resources to be conserved (by having a reference price that reflects their intertemporal opportunity costs) for hours when those supplies are most valuable. If the thresholds were set too low, these resources might have their bids accepted during non-seasonal peak hours, making them unavailable when they are needed more. That said, the IMM should monitor for energy limited resources making price forecasts over time that are substantially out of line with prices that occur in the market.

231. We also believe that it is appropriate for the IMM to use the information it gathers on operational risks in the surveys to help establish reference prices. This information will allow the IMM to make adjustments, when appropriate, to the basic figures it has for operational risks for different types of units.

6. Behavior Subject to Mitigation

a. Background

232. In the TEMT II Order, the Commission found the types of conduct to be subject to mitigation are appropriately identified.⁹⁵ However, the Commission concluded that the Midwest ISO had not defined some of the types of conduct subject to withholding in a manner that includes clear, objectively quantifiable standards. In particular, physical withholding and what actions constitute false deratings or inappropriate outages or unavailability of a unit are not sufficiently defined. The Commission required

⁹⁵ *Id.* at P 327.

clarification of what operating a transmission facility in a manner inconsistent with “Good Utility Practice” means. The Commission also stated that operating a facility in a manner that “causes or contributes to a Binding Transmission Constraint” is not sufficiently limited to justify the label of physical withholding, and required the Midwest ISO to clarify the phrase.

233. The Commission further directed the Midwest ISO to establish clear, objectively identifiable standards for what constitutes an improper balance between bidding in the day-ahead and real-time energy markets.

234. The Midwest ISO states that it has clarified the definition of physical withholding in section 63.3.a in order to provide “clear, objectively quantifiable standards” on: (1) what actions constitute false deratings or inappropriate outages or unavailability of a units; (2) what manner of operating a transmission facility would be considered inconsistent with Good Utility Practice; and (3) what manner of operation that “causes or contributes to a Binding Transmission Constraint” could justifiably be defined as physical withholding.

235. In the compliance filing, the Midwest ISO states that the TEMT has been revised to specify that false deratings or inappropriate outages of a generating unit involve taking units out of service for technical reasons that are either untrue or exaggerated.

236. The Midwest ISO states that it has modified the TEMT to clarify that a transmission facility shall be considered physically withheld if the outage or derating involves all three of the following conditions: (1) it is uneconomic, in the sense that it could have been scheduled or conducted at much lower foreseeable cost to the market (*e.g.*, if it could have been done during off-peak hours); (2) it is not justified by legitimate safety or reliability concerns (the Midwest ISO believes that this standard is more specific than the previous version’s general reference to “Good Utility Practice”); and (3) it contributes to a binding transmission constraint. The Midwest ISO says that the revised proposition’s enumeration of such conditions uses the conjunction “and,” correcting the earlier version’s use of “or,” which inaccurately suggested that any kind of congestion-causing derating constitutes physical withholding.

237. The Midwest ISO states that it has revised section 65.4.2.d to establish ± 10 percent as the threshold level of divergence between the day-ahead and real-time market prices at which the IMM would determine that an unwarranted divergence in energy prices was caused by a participant’s conduct that should be mitigated.

b. Protests and Comments

238. Midwest SATCs consider the proposed revisions to section 64.1.1.d to be vague and subjective, particularly the term “legitimate safety or reliability concern.” Midwest SATCs propose that this term be replaced by “Good Utility Practice” and that the definition be supplemented with clarifications that, in the context of transmission facility outages, the term “Good Utility Practice” means compliance with any reliability standards applicable to the operation of a transmission facility, such as those that may be imposed by NERC, local reliability committees or individual states. This recommendation, according to Midwest SATCs, is consistent with guidance provided elsewhere in the TEMT II Order, wherein the Commission advised that it “expects public utility compliance with NERC's reliability standards, clarifying that Good Utility Practice includes compliance with these standards.”⁹⁶ Midwest SATCs also propose that section 64.1.1.d should: (1) reference those provisions of the tariff and related Market Protocols and Business Practices that govern outage scheduling;⁹⁷ and (2) include a statement indicating that in no event will an entity be deemed to have engaged in physical withholding if it complies with those provisions, protocols, and practices.

239. Midwest SATCs request that a presumption be made, unless it is established that such functional separation is compromised, or that a facility is taken out of service for the purpose of influencing prices or conditions in the market, that transmission facility outages scheduled by transmission owners and independent transmission companies are consistent with Good Utility Practice. Midwest SATCs also request that the Commission direct the Midwest ISO to consult with transmission owners and independent transmission companies (including all of the Midwest SATCs) before submitting a revised physical withholding provision in this proceeding.

⁹⁶ *Id.* at P 42.

⁹⁷ *See* Module C, section 38.1.1.e, Original Sheet No. 350 (entrusting the Midwest ISO with the responsibility to “. . . coordinate and reschedule as necessary transmission facilities outage schedules operated within the Transmission Provider Region.”). *See also* Draft Market Protocols § 7.2 (November 2003) and draft Business Practices Manual for Outage Operations (July 2004) (both available at: <http://www.midwestmarket.org/Docs/GuidingDocuments.htm>) (establishing guidelines for scheduling transmission outages).

240. WPS Resources claims that the Midwest ISO proposal to force convergence of real-time and day-ahead market LMPs is unnecessary and likely to stifle markets. WPS Resources assert the Midwest ISO inappropriately applied the methodology to all transactions, whereas the IMM proposed to restrict it to virtual transaction behavior. WPS Resources also points out that Midwest ISO reliance on ISO-NE and NYISO data for the proposed 10 percent threshold is misplaced, since those markets are long-standing tight power pools. Also, according to WPS Resources, those markets gave market participants a significant period of time to gain experience before imposing convergence penalties. In light of these facts, WPS Resources propose that price divergence outside the band be treated as a threshold for initiating an investigation to determine whether a market participant engaged in virtual transactions acted improperly.

241. AMP-Ohio contends that the Midwest ISO did not comply with the Commission's directives in the TEMT II Order because section 65.4.1.d.i does not identify what type of deviation is targeted and the deviation is defined as greater than and less than 10 percent, which is a universal set, and section 65.4.1.d.ii fails to define what will be considered a "substantial portion" of load served in the real-time market. AMP-Ohio recommends the tariff must define and quantify "substantial portion" by providing a screen for the amount of energy that a load-serving entity can purchase from the real-time markets.

c. Discussion

242. The Midwest ISO states that the TEMT has been revised to specify that false deratings or inappropriate outages of a generating unit involve taking units out of service for technical reasons that are either untrue or exaggerated. In addition, it says that a transmission facility shall be considered physically withheld if the outage or derating involves all three of the following conditions: (1) it is uneconomic, in the sense that it could have been scheduled or conducted at much lower foreseeable cost to the market (*e.g.*, if it could have been done during off-peak hours); (2) it is not justified by legitimate safety or reliability concerns (the Midwest ISO believes that this standard is more specific than the previous version's general reference to "Good Utility Practice"); and (3) it contributes to a binding transmission constraint. The Midwest ISO says that the revised proposition's enumeration of such conditions uses the conjunction "and," correcting the earlier version's use of "or," which inaccurately suggested that any kind of congestion-causing derating constitutes physical withholding. We agree that outages (either complete or partial) must be true, unexaggerated, and economic in 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), before being determined to be physically withheld. We also find that the phrase "legitimate safety or reliability concern," like "Good Utility Practice," is not sufficiently objectively quantifiable for the determination of what conduct qualifies as physical withholding.

243. Physical withholding is addressed in sections 63.3.a and 64.1.1.d of the TEMT. We do not see the changes that the Midwest ISO discusses having made here in the definition of physical withholding in either section, except that 64.1.1.d has removed the language “inconsistent with Good Utility Practice,” and has replaced it with “not justified on the basis of legitimate safety or reliability concerns.”⁹⁸ In particular, the Midwest ISO has not specified that a transmission facility shall be considered physically withheld if the outage or derating involves all three of the following conditions: (1) it is uneconomic, in the sense that it could have been scheduled or conducted at much lower foreseeable cost to the market (*e.g.*, if it could have been done during off-peak hours); (2) it is not justified by legitimate safety or reliability concerns; and (3) it contributes to a binding transmission constraint. The only “or” (in section 63.3.a) has not been replaced. In addition, sections 63.3.a and 64.1.1.d appear inconsistent, in that section 63.3.a.i retains the language “Good Utility Practice” while that same language has been replaced in section 64.1.1.d. We also do not see the language the Midwest ISO says it submitted on false deratings or inappropriate outages.

244. We find that the Midwest ISO has not defined some of the types of conduct subject to withholding in a manner that includes clear, objectively quantifiable standards as required. It has not redefined physical withholding and the concepts of what actions constitute false deratings or inappropriate outages or unavailability of a unit in an acceptable manner.⁹⁹ The TEMT II Order required clarification of what it means to operate a transmission facility in a manner inconsistent with “Good Utility Practice,” yet no change was made in section 63.3.a.i. Section 64.1.1.d changes the language from “inconsistent with Good Utility Practice” to “not justified on the basis of legitimate safety or reliability concerns.” However, we agree with Midwest SATCs that the language “legitimate safety or reliability concerns” is vague and subjective. It is not objectively quantifiable, and thus we will not accept this language.

245. The Midwest ISO must re-file within 30 days of the issuance of this order to provide for objectively quantifiable standards for the determination of physical withholding. In doing so, it must define the concept of false deratings. It must also 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

⁹⁸ However, we accept the changes to section 63.3.a that were made to remove the language “but is not limited to” and “or contributes to.”

⁹⁹ Elsewhere in that order, we directed the removal of the phrase “, but is not limited to,” from section 63.3.a.i, and “or contributes to” from section 64.1.1.d, and we accept those changes.

market (such as during off-peak periods). In addition, the Midwest ISO must replace the language “Good Utility Practice” and “legitimate safety and reliability concerns” with language that is objectively quantifiable. The Midwest ISO must modify the phrase at the end of section 63.3.a.i from “or causes a Binding Transmission Constraint” to “and causes a Binding Transmission Constraint.” The standards should specify that market participants will not be determined to be guilty of physical withholding when they are following the directions of control area operators, NERC or the Midwest ISO.

246. However, in response to Midwest SATCs, we do not believe that the market protocols and business practices should govern the interpretation of what constitutes the physical withholding, because they are subsidiary to the tariff. However, a market participant could certainly cite to those protocols and practices in any investigation of physical withholding that is conducted. We will not require the Midwest ISO to consult with market participants before developing the standards defining physical withholding.

247. Contrary to the comments of WPS Resources, we believe that the proposed tariff language appropriately focuses on both virtual and other market participant bids, as was specified in the proposed tariff language evaluated in the TEMT II Order. In addition, the Midwest ISO was instructed to adopt tariff language that clarified what an improper balance between bidding in the day-ahead and real-time markets would be, not to develop a standard that would be a flag for further review.

248. The phrase “substantial portion of their loads” must be defined in section 65.4.2.d. We find that the changes made to sections 65.4.2.d and 65.5.c, laying out standards for what constitutes improper balance of prices in the day-ahead and real-time markets, are appropriate. However, in section 63.3.a.iv the term “substantial divergence” needs to be defined relative to this standard, either directly or by citation to sections 65.4.2.d and 65.5.c. In both of these sections, however, the Midwest ISO has not changed the language “contributed to” to “caused,” as the TEMT II Order required.¹⁰⁰ These additional changes must be filed within 30 days of the issuance of this order.

¹⁰⁰ The TEMT II Order noted in a number of places, Module D of the TEMT uses the phrase “causes or contributes to” or sometimes just “contributes to” to identify conduct that is, essentially, proscribed. We found that, in the context of Module D, proscribed conduct should be conduct that “causes,” and that the phrase “contributes to” merely adds duplicative and unnecessary language and may create confusion and uncertainty in the future. Accordingly, in Module D of the TEMT, we directed the phrase “contributes to” to be removed wherever it appears, and replace it with “causes.” The Midwest ISO states that it has removed the phrase “contributes to” whenever it appears in Module D and replaced it with the word “causes.”

249. Finally, the Midwest ISO claims that it has revised sections 65.2.2.e and 64.1.1.e to make clear which mitigation measures are to remain in effect for the duration of any hour in which there is an interval for which such mitigation is deemed warranted; what type of withholding section 65.2.2.e applies to; and whether it applies to BCAs, NCAs or both. However, section 65.2.2.e now refers to the conduct thresholds for economic and physical withholding in section 64.1.1. Only the thresholds for physical withholding are included in this section. The Midwest ISO must add a reference in section 65.2.2.e to section 64.1.2 as well, in order to capture the thresholds for economic withholding.

7. Sanctions

a. Background

250. Penalty charges are imposed upon market power abuses that cannot be dealt with prospectively, such as physical withholding that can only be identified *ex post* through investigations and/or audits. In cases dealing with physical withholding, uneconomic production, or deviations from “Good Utility Practices,” it appears that evaluation of the conduct would involve subjective judgments. The Commission’s Market Behavior Rules establish that this type of inquiry is to be conducted by the Commission, not by the market monitor. Recent Commission decisions have authorized market monitors to enforce certain ISO and RTO tariff matters if those matters: (1) are expressly set forth in the tariff; (2) involve objectively-identifiable behavior; and (3) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff.¹⁰¹ The Midwest ISO’s proposal did not meet these requirements, particularly the requirement that the enforcement relate to objectively identifiable behavior.

251. As such, the Commission required that, in the event that the IMM identifies potential tariff violations for which penalty charges are provided in the tariff, the IMM shall refer such matters to the Commission. The Commission stated that it believed that TEMT section 65.3 is sufficiently detailed to guide the IMM with respect to identification of behaviors that warrant referral for penalty charges. Thus, rather than to provide a basis

¹⁰¹ See *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC 61,218, *clarified*, 105 FERC ¶ 61,277 (2003), *order on reh’g*, 107 FERC ¶ 61,175 (2004). See also *California Independent System Operator Corporation*, 106 FERC ¶ 61,179 (2003), *reh’g denied*, 107 FERC ¶ 61,118 (2004), *reh’g pending* (permitting the California ISO’s market monitor to administer certain behavior-related tariff provisions and to charge penalties for certain behavior).

for the IMM and RTO to undertake the imposition of penalty charges (as stated in the tariff), section 65.3 criteria should be used to trigger a referral to the Commission. The Commission would then exercise its judgment as to whether the tariff has been violated, and any associated penalty charge may be proper.

252. The Commission also required the Midwest ISO to include the Commission's Market Behavior Rule 2, as applicable, in its tariff.¹⁰²

253. Further, the Commission ordered that until the TEMT establishes clear, objectively quantifiable standards for what constitutes an improper bidding balance between the day-ahead and real-time markets, it may not establish limitations (such as how much can be bid in each market) on such behavior. Additionally, the Commission stated that the TEMT must establish clear, objectively identifiable standards for what the limitations will be before it can impose such limitations.

254. Finally, the Commission found that section 65.4.3.c states that "The Allowance Level and the Penalty Level shall be established at levels deemed effective and appropriate to mitigate the market effects described in this Section 64.4." However, there is no section 64.4 in the tariff. The Midwest ISO was directed to correct the tariff to provide the appropriate citation.

255. In response, the Midwest ISO says it has incorporated Market Behavior Rule 2 in a new section 53.3.

256. The Midwest ISO also states that the October 5 Compliance Filing has established clear, objectively quantifiable standards for: (1) what constitutes an improper bidding balance between the day-ahead and real-time markets (as previously discussed); and (2) the limitations for bidding into the day-ahead and real-time energy markets.

257. Finally, the Midwest ISO says, the typographical error in the cross-reference to a non-existent section 64.4 has been corrected to refer to section 65.4.

¹⁰² In exercising its discretion to determine the appropriate remedy for violations of Market Behavior Rule 2, as added to the Midwest ISO's tariff, the Commission will apply the policies and principles set forth in *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218, *clarified*, 105 FERC ¶ 61,277 (2003), *order on reh'g*, 107 FERC ¶ 61,175 (2004), and subsequent relevant precedent.

b. Discussion

258. We find that the Midwest ISO has not modified its tariff to provide that the IMM will forward potential violations that would be subject to penalty charges to the Commission for a determination of whether sanctions are appropriate. Instead, the TEMT continues to refer to the Midwest ISO imposing penalty charges if the IMM determines that the market participant has engaged in the stated behaviors, without any reference to the Commission making a determination with respect to the appropriate sanctions. The tariff must be modified to provide that if the IMM identifies potential tariff violations for which penalty charges are provided in the tariff, it must make a confidential referral of the violations to the Commission for the Commission to determine the appropriate penalty charges, which the Midwest ISO can then collect. The Midwest ISO must modify its tariff accordingly within 30 days of the issuance of this order.

259. The Midwest ISO has included a modified Market Rule 2 in its tariff, in a new section 53.3. In particular, the Midwest ISO has changed the wording from "Actions or transactions undertaken by a seller" in Market Rule 2 to "Actions or transactions undertaken by a Market Participant." However, given that the Midwest ISO is using the Market Behavior Rule 2 for Control Area Operators' behavior (in addition to using it for sellers), we find that this change is appropriate because, as modified, it allows for the use of the rule for control area operators.

260. With respect to the tariff language associated with limitations for bidding into the day-ahead and real-time markets when an imbalance occurs between the markets, we find that the Midwest ISO has added in section 65.5.3 clear limitations to be placed upon virtual bidders when there is an improper balance between the day ahead and real time markets. However, the Midwest ISO has not established clear standards for limitation on bidding into the day-ahead and real-time markets when the bidding is by a market participant that makes purchases on behalf of a load-serving entity. The Midwest ISO must modify section 65.4.3 of its tariff to establish clear standards of the degree to which such a market participant's bidding will be constrained.

261. The Midwest ISO did not file a tariff change with respect to section 65.4.3.c, which states that "The Allowance Level and the Penalty Level shall be established at levels deemed effective and appropriate to mitigate the market effects described in this Section 64.4." There is no section 64.4 in the tariff. The Midwest ISO must correct the tariff to provide the appropriate reference.

262. Finally, the Midwest ISO has struck the entire dispute resolution section 67 from its tariff in compliance with the TEMT II Order.¹⁰³ However, upon consideration of the Midwest ISO's revised tariff sheet, we find that subsections 67.d and -.e, which included measures to deal with improper substitution of a default offer and a statement that section 67 does not restrict parties' rights to make appropriate filings with the Commission, remain a necessary part of the TEMT. These subsections do not address penalty charge determination by the Midwest ISO and have not been rendered unnecessary by the Commission's rejection of such measures. We therefore direct the Midwest ISO to reinstate these subsections.

G. System Supply Resources, Demand Response Resources, Offer Caps and Emergency Procedures

1. Demand Response Resources

a. Background

263. The Commission generally agreed with the goals and overall framework of the proposed Demand Response Resources (DRR) program. The Commission did direct the Midwest ISO to revise section 39.2.10.b to describe how Midwest ISO will identify DRRs available only in Maximum Generation Emergencies. Also, the Midwest ISO was directed to explain what price verification of DRR offers above the \$1,000 safety-net level would entail.¹⁰⁴ Third, the Midwest ISO was ordered to provide further detail on how it intends to measure the response of DRRs and what actions it would take for non-compliance. Also, Midwest ISO was directed to explain how DRR measurement concerns are properly addressed by not paying DRRs a revenue sufficiency guarantee, not subjecting them to penalties for uninstructed deviations or the \$1,000 bid cap that applies to generation resources. Finally, the Midwest ISO was ordered to explain why DRRs should not: (1) participate in the RAC process; (2) serve as a capacity resource; or (3) provide operating reserves. And, as noted previously, the Commission required further explanation for the lack of symmetry between generation and demand response resources.

¹⁰³ TEMT II Order at n.223.

¹⁰⁴ See Module C, section 40.2.3.b.ix, Original Sheet No. 550.

264. The Midwest ISO states that it has revised section 39.2.10.b to state that it will identify DRRs available only in Maximum Generation Emergencies. DRRs willing to curtail only under emergency conditions shall be accommodated by allowing market participants to designate these assets as only available under emergency situations during the registration process.

265. In its October 5 Compliance Filing, the Midwest ISO states that all offers made by DRRs over \$1,000/MWh will be monitored per the terms of Module D of the TEMT, because the asymmetric treatment between generation resources and DRRs creates potential opportunities for market manipulation.

266. Midwest ISO also states that the ability of DRRs to respond as intended will be verified as part of the registration process for DRR certification. The responses of DRRs shall be measured by metering or statistical estimation. The measurement of DRR responses is an element of DRR market design being addressed in the Midwest ISO stakeholder process. If a DRR fails to comply with the demand response related instructions of the Midwest ISO, the following actions will be taken: Failure to comply with dispatch instructions will be reported to the market monitor, and after further review could be subject to the sanctions contained in Module D of the TEMT.

267. The Midwest ISO states that DRRs will not be subject to penalties for uninstructed deviations, and that DRRs will not be subject to the \$1,000/MWh offer cap that applies to generation resources. Because of the difficulty in measuring compliance of DRRs to dispatch instructions and because these issues are being addressed in the Demand Response Task Force, the Midwest ISO states that it is appropriate at this time to relax the uninstructed deviation penalties, \$1,000/MWh offer cap and revenue sufficiency guarantee.

268. The Midwest ISO states that after further review, DRRs should be eligible to participate in the Midwest ISO RAC process because of the certification steps contained within the registration process. Similarly, DRRs can serve as capacity resources or provide operating reserves to the extent existing state or reliability resource organizations allow.

b. Protests and Comments

269. Coalition MTC asserts that the Midwest ISO erred in deleting language that provides an exemption to demand response resources from uninstructed deviation penalties.

c. Discussion

270. With the exception noted by Coalition MTC, the Commission accepts the Midwest ISO's compliance filing as it applies to DRRs. The Midwest ISO must address Coalition MTC's concern that an exemption from uninstructed deviation penalties for DRRs was inadvertently deleted from the tariff in its next compliance filing.

2. Emergency Procedures

a. Background

271. The Commission accepted the proposed Emergency Procedures subject to modifications.¹⁰⁵ First, the Midwest ISO was directed to modify the TEMT to assure that the least-cost option, whether economic or emergency, is scheduled or dispatched. 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 was ordered to exclude market participants from making separate offers for emergency purchases to the extent each is already providing offers for supplies outside the economic minimum and maximum range. Fourth, the Midwest ISO was directed to specify in the TEMT the information DRRs are required to provide to support bids above the \$1,000 bid cap applicable to generation resources. Finally, the Commission ordered the Midwest ISO to modify the TEMT to allow such resources to respond on an emergency basis only, in addition to participating by bidding into the markets.

272. Midwest ISO claims that it has modified its Emergency Procedures to ensure that the Midwest ISO would deploy the Generation Resources constituting the least-cost option to address the emergency, regardless of whether the least cost option is from an economic or emergency supply.¹⁰⁶

¹⁰⁵ See TEMT II Order at P 387.

¹⁰⁶ The tariff revisions involve the combination of Subsections (a) and (b) of section 39.2.10; and the combination of Subsections (a) and (c) of section 40.2.15.

273. Midwest ISO states that as directed by the TEMT II Order, it has revised sections 39.2.10 and 40.2.15 to integrate notification and emergency purchase procedures into the sequence of steps used to resolve real-time shortages.

274. Midwest ISO has also added a new step to the Emergency Procedures for the real-time energy market in section 40.2.15 to permit the use of emergency purchases, with notification, to address shortage conditions.

275. The Midwest ISO has also revised section 40.2.17(a) to provide that market participants already providing offers from supplies outside the economic minimum and maximum range are excluded from making separate offers for emergency purposes.

276. Finally, the Midwest ISO has modified sections 39.2.5(f) and 40.2.3(b)(ix) to provide additional details on the information that DRRs will be required to provide in support of bids above the \$1,000 bid cap.

277. Parties did not comment on the tariff changes to the emergency procedures and the Commission accepts this aspect of the compliance filing.

b. Discussion

278. We accept the Midwest ISO's modifications to sections 39.2.10 and 40.2.15 that assure that the least-cost option, whether from the economic or emergency range, is scheduled and dispatched, and that describe a process for acquiring supplies from emergency purchases. However, sections 39.2.5.f and 40.2.3.b.ix, that provide additional information on DRRs, have been omitted. Also, sections 40.2.15.c and 40.2.17.a have been omitted, and section 40.2.15.n appears to be misnumbered. We direct the Midwest ISO to make appropriate corrections to these sections of the TEMT in its next compliance filing, in accordance with the instructions in the TEMT II Order.

H. Resource Adequacy Requirements

1. Designated Network Resources

a. Background

279. In the TEMT II Order, the Commission required the Midwest ISO to flexibly apply the Network Resource requirements initially in recognition of the need to allow time for a transition period. The Commission also required the consistent use of the definition of Network Resources in section 1.217 for the interim Resource Adequacy Requirement (RAR) proposal. The Commission further directed the Midwest ISO to file additional details about the specific resources that qualify to satisfy the Network Resource requirements.

280. In addition, the Commission directed the Midwest ISO to revise Original Sheet No. 819, section 69.1, titled Designation of Network Resources to make this sentence grammatically correct by deleting the word “designated” before the word “Network” and by making “Resources” singular.

281. The Midwest ISO states that it has revised section 69.1.3 to eliminate the reference to a grace period for compliance with the new Network Resource requirements. The Midwest ISO believes that a grace period is no longer necessary since section 69.1.3.e states that pre-existing Network Resources accepted by the Midwest ISO and confirmed by Network Customers before the effective date of the TEMT shall be deemed to satisfy the deliverability requirements of Module E for the term of the confirmed designation. Therefore, such pre-existing Network Resources have thus been effectively grandfathered under the new requirements of Module E.

282. The Midwest ISO claims that a resource shall qualify as a Network Resource if it meets: (1) ownership or equivalent contractual right requirements under section 69.1.2.a, which has been revised to include an explicit cross-reference to the definition of Network Resource in section 1.217; and (2) deliverability requirements under section 69.1.2.b. Deliverability requirements shall be determined in accordance with the testing and study process that has been further specified in the revised version of section 69.1.3. The Midwest ISO also states that it amended sections 30.1 and 70.1.2 to clarify that DRRs and behind-the-meter generation may also qualify as Network Resources if they otherwise meet the requirements for such resources.

283. The Midwest ISO states that it has revised section 69.1 (“Designation of Network Resources”) to delete the word “designated” and to make the phrase “Network Resources” singular.

b. Protests and Comments

284. The Midwest TDUs assert that instead of simply adopting the preexisting definition of Network Resources in section 1.217, as the TEMT II Order directed, the Midwest ISO's compliance filing adopts a new definition, and thereby further confuses the requirements for Network Resource designation. The Midwest TDUs explain that the Midwest ISO claims to have made “appropriate tariff revisions to clarify how resources may qualify as Network Resources based on criteria consistent with the definition of a Network Resource in Section 1.217.”¹⁰⁷

¹⁰⁷ Midwest TDUs Protest at 19 (quoting Midwest ISO Transmittal Letter at 29 (Oct. 5, 2004)).

285. Further, state the Midwest TDUs, the Midwest ISO goes on to explain:

A resource shall qualify as a Network Resource if its meets:
(i) ownership or equivalent contractual right requirements under Section 69.1.2.a, which has been revised to include an explicit cross-reference to the definition of "Network Resource" in Section 1.217; and (ii) deliverability requirements under Section 69.1.2.b.¹⁰⁸

According to the Midwest TDUs, the Midwest ISO's purported compliance is neither compliant nor a reasonable mechanism to ensure resource adequacy. The Midwest TDUs contend that the compliance filing fails to follow the Commission's express directive since the proposed tariffs require contractual rights "equivalent" to ownership. The Midwest TDUs propose that the Midwest ISO be instructed to remove the "ownership or equivalent contractual right" requirements and substitute a reference to section 1.217 as the TEMT II Order required.

286. The Midwest TDUs further contend the Midwest ISO erred by substituting aggregate deliverability for load-specific deliverability. The Midwest TDUs claim this approach is wrong for reliability and inconsistent with Order No. 2003-A's¹⁰⁹ express provision for network customers to obtain load-specific deliverability for Network Resources by requesting network service along with energy resource interconnection service.

287. The Midwest TDUs state that the Midwest ISO's use of an aggregate deliverability standard for new Network Resources and extensions of existing Network Resources beyond their current reservation runs counter to the Order No. 2003-A clarification that a network transmission customer can designate a new Network Resource, with Network Resource designation and upgrade requirements based upon the specific deliverability of

¹⁰⁸ *Id.*

¹⁰⁹ *Standardization of Generator Interconnection Agreements and Procedure*, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs. ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, 69 Fed. Reg. 15,932 (Mar. 26, 2004), FERC Stats. & Regs. ¶ 31,160 (2004) (Order No. 2003-A), *order on reh'g*, 109 FERC ¶ 61,287 (2004) (Order No. 2003-B).

the new resource to the customer's particular network loads.¹¹⁰ Furthermore, the Midwest TDUs point out, the Midwest ISO's departure from load-specific deliverability undermines its ability to tie the Network Resource designation process to long-term transmission rights, which are necessary to provide load-serving entities and the investment community the delivered price certainty required for investments in baseload coal-fired generation, which in turn is crucial to maintain reliability and assure long-term price stability.

288. The Midwest TDUs also claim the Midwest ISO's use of an aggregate deliverability standard directly conflicts with several state and Regional Reliability Committee resource adequacy requirements. For example, MAPP's resource adequacy requirements expressly require a resource to be deliverable to the individual load-serving entity claiming it as reserves.¹¹¹ The Midwest TDUs state that the Midwest ISO proposal to adopt an aggregate deliverability standard ignores the reality of transmission constraints and threatens the Midwest ISO's ability to ensure that load pockets stay lit. According to the Midwest TDUs, this proposal is patently inconsistent with the *Policy Statement on Matters Related to Bulk Power System Reliability*,¹¹² in which the Commission committed to ensuring appropriate reliability standards are in place before allowing an ISO or RTO to become operational.

289. WEPCO objects to the requirement in section 69.1.3.v that an existing Network Resource must be designated on the Midwest ISO Open Access Same-Time Information System (OASIS) in order to be deemed deliverable at the outset of the Midwest ISO energy market, thereby excluding a number of existing, interconnected generation units

¹¹⁰ See Order No. 2003-A at P 535 (resources taking Energy Resource Interconnection Service can also be designated as Network Resources, using a process "completely analogous to the approach that a Network Customer now uses when it constructs a new Network Resource to serve its Network Load"); *In The Matter Of: Consent Markets, Tariffs And Rates - Electric*, 852nd Commission Meeting, Open Meeting, Tr. at 34:11-17 (March 3, 2004).

¹¹¹ Section 4.2.2.6.1.4 of the *MAPP Generation Reserve Sharing Pool Handbook* requires that a "supplier's generation equipment is connected to the transmission system through facilities adequate to deliver the required capability to the purchasing Pool Participant." See also section 4.2.2.4 and 4.2.3.1.6 (accreditation only for resources to the level of their firm transmission).

¹¹² See *Policy Statement on Matters Related to Bulk Power System Reliability*, 107 FERC ¶ 61,052 at P 36 (2004).

that are currently Designated Network Resources. Therefore, WEPCO requests that the Commission require the Midwest ISO to amend its proposal in section 69.1.3.v to include all interconnected generation units currently designated as Network Resources in its determination of deliverability, irrespective of whether those units are somehow associated with OASIS. To do otherwise according to WEPCO, may render a significant number of units otherwise clearly designated as Network Resources, undeliverable or subject to proof of deliverability, this notwithstanding that those units currently are used to serve network load.

290. WEPCO also requests that section 69.1.3 be amended to provide for the rollover of network resource designations at the end of the 10-year period for those units that will continue to be designated as Network Resources, thus, avoiding the potential issue of a currently designated resource arbitrarily losing that designation.

291. MidAmerican expresses concern that section 69.1.3 indicates that all generation resources must be located within the Midwest ISO, which would unreasonably limit the amount of supply by excluding external resources from qualifying as Network Resources. Mid-American cites section 69.1.3.iii, which addresses generation resources “interconnected to the Transmission System,” thus excluding external resources. Mid-American also notes that this section appears to conflict with the definitions of Generation Resource in section 1.121,¹¹³ External Resources in section 1.95¹¹⁴ and Network Resource in section 1.217,¹¹⁵ which, taken together, indicate that external resources can qualify as Network Resources.

c. Discussion

292. We find that the Midwest ISO has generally complied with the Commission’s directive in the TEMT II Order to clarify the qualifications for designation of Network Resources, except in limited places detailed below. We accept that pre-existing designated network resources will be “grandfathered” under the new language in section 69.1.3 of Module E.¹¹⁶ This decision is consistent with our conditional approval

¹¹³ Module A, section 1.121, Original Sheet No. 80.

¹¹⁴ *Id.* at section 1.95, Original Sheet No. 73.

¹¹⁵ *Id.* at section 1.217, Original Sheet No. 106.

¹¹⁶ Midwest ISO Transmittal Letter at 29 (Oct.5, 2004). We note that the Midwest ISO cites section 69.1.3.e, but the tariff lists a section 69.1.3.v, Original Sheet No. 823B.

of the interim plan in Module E on the basis that it is a short-term transition mechanism to ensure that the day-to-day reliability needs of the region are met similar to the way they are today.¹¹⁷ Therefore, it is reasonable for the Midwest ISO to allow existing Network Resources to qualify as Network Resources under the new regional reliability requirements of Module E. We also accept, as filed, the Midwest ISO's new definition in section 1.217a, Network Resource Interconnection Service.¹¹⁸

293. We disagree with the Midwest ISO's statement on page 29 of their transmittal letter that the reference to a grace period at the discretion of the Transmission Provider in section 69.1.3 has been eliminated. Although the grace period language was removed from section 69.1.3, it was simply moved to a new section 69.1.4, that clearly lists a possible grace period for compliance with the Network Resource requirements. However, we will not direct the Midwest ISO to eliminate this section despite its apparent conflict with the transmittal letter. If the Midwest ISO does indeed find that it is no longer necessary to allow for a grace period they can choose not to allow one according to section 69.1.4. We find that it is acceptable that the Midwest ISO retain the discretion to allow for a grace period for compliance as long as the grace period is extended to all market participants subject to the requirements of Module E.

294. The Commission accepts the Midwest ISO proposal to use aggregate deliverability in section 69.1.3 as the standard to determine which resources a load-serving entity may count on for reserves. We disagree with the Midwest TDUs' comments that adopting an aggregate deliverability standard ignores transmission constraints. We find that the Midwest ISO must take constraints into account to determine whether or not a resource is deliverable under the System Impact Studies requirement of section 69.1.1.b.¹¹⁹ Accordingly, we do not find that reliability will be negatively impacted by the Midwest ISO's adoption of an aggregate deliverability standard.

295. Moreover, we disagree with the Midwest TDUs that the Midwest ISO's requirement for aggregate deliverability is counter to the provisions of Order No. 2003-A. Order No. 2003-A gave independent transmission providers, such as RTOs, flexibility to determine their interconnection procedures.¹²⁰ Additionally, as noted by the Midwest

¹¹⁷ See TEMT II Order at P 421.

¹¹⁸ Module A, section 1.217a, Substitute Original Sheet No. 106.

¹¹⁹ Module E, section 69.1.1.b, Substitute Sheet No. 821.

¹²⁰ Order No. 2003-A at P 48.

TDUs, Order No. 2003-A states that “. . . a Network Customer that does not need all of the features of Network Resource Integration Service (NRIS) may determine the most economical and practical approach to interconnecting a new Network Resource is to request Energy Resource Interconnection Service and at the same time request Network Integration Transmission Service under the Transmission Provider’s OATT.”¹²¹ Existing resources that are interconnected to the transmission system prior to NRIS being offered, or have been interconnected with Energy Resource Interconnection Service, may request performance of deliverability study by making a request for NRIS under Attachment X or Attachment R to the tariff.¹²² Taken together, the Commission finds that these requirements demonstrate that there is flexibility built into the Midwest ISO’s interim resource adequacy plan in regards to the designation of Network Resources.

296. Under a regional market structure, the designation of a Network Resource is a contractual term and does not imply that the resource will always physically provide its capacity to the designated load. Going forward, other economic arrangements may become necessary under the new market structure to ensure that all loads are covered by sufficient reserves and that proper investment incentives are in place. However, we reiterate that this is an interim resource adequacy plan. The long-term resource adequacy plan will include capacity payments to ensure that efficient financial investments in Network Resources are made. We direct the Midwest ISO to consider, with its stakeholders, the deliverability of Network Resources on a locational or zonal basis in the development of the permanent resource adequacy plan. The Commission has previously found in the New England RTO that a zonal deliverability standard can help to ensure that market participants do not pay for capacity they cannot use due to system constraints.¹²³ A properly structured permanent resource adequacy plan will provide reasonable assurances to the investment community about the financing of baseload generation resources. As previously stated, we encourage all stakeholders provide their input on the long-term plan through these forums.

¹²¹ *Id.* at P 535.

¹²² *See* Module E, section 69.1.3.ii. Original Sheet No. 823A.

¹²³ *See Devon Power LLC*, 107 FERC ¶ 61,240 at P 9 (2004), *order on reh’g*, 109 FERC ¶ 61,154 (2004).

297. We withhold judgment on the Midwest ISO's compliance filing regarding the designation of Network Resources in section 69.1.2.a. While the Midwest ISO states that it complied with the TEMT II Order's directives to clarify Network Resource requirements and use the definition of Network Resource consistently,¹²⁴ the Midwest ISO did not file a revised Original Sheet No. 820. We assume this is an oversight on the Midwest ISO's part and therefore we again direct it to file section 69.1.2.a, Original Sheet No. 820, including an explicit cross-reference to the tariff definition of a Network Resource in section 1.217. Regardless of the Midwest ISO's oversight, we decline to adopt the Midwest TDUs' suggestion to delete the "ownership or equivalent contractual rights" requirement from section 69.1.2.a because the Commission interprets this section as sufficiently flexible to satisfy the Midwest TDUs' concerns. The Commission reads the essence of the Midwest TDUs' argument and the Midwest ISO's definition in section 1.217 as meaning that various generation resources may qualify as Network Resources provided that the same capacity is not simultaneously claimed by two parties. As written, section 69.1.2.a allows a generation resource to be designated as a Network Resource by fulfilling either of two requirements.¹²⁵ This flexibility coupled with an explicit cross reference to the Network Resource definition in section 1.217 as directed above will satisfy the Midwest TDUs' concerns because the Midwest ISO cannot violate one section of the tariff to enforce another.

298. We agree with WEPCO that the requirement in section 69.1.3.v that Network Resources designated under the OASIS reservation process may exclude existing Network Resources. We direct the Midwest ISO to amend section 69.1.3.v to include all interconnected generation units currently designated as Network Resources, irrespective of whether or not those units are associated with the OASIS process.¹²⁶ This will maximize the available pool of potential Network Resources to ensure that the reliability needs of the region are met. Interconnected generation units must still be able to satisfy the tests for aggregate deliverability and be certified deliverable according to the requirements of section 69.1.3.v.

¹²⁴ Midwest ISO Transmittal Letter at 29 (Oct. 5, 2004).

¹²⁵ The two requirements are in section 69.1.2.a.i (designating a generation resource registered with the Midwest ISO by the market participant) or section 69.1.2.a.ii (designating a generation resource registered with the transmission provider by another market participant and providing proof that the generation owner accepts the designation of Network Resources and the commensurate responsibilities). *See* Module E, section 69.1.2.a.i. -ii, Original Sheet No. 820.

¹²⁶ Module E, section 69.1.3.v, Original Sheet No. 823B.

299. We will not direct the Midwest ISO to adopt WEPCO's suggestion to allow for an automatic roll-over of the 10-year reservation term of Network Resources. We reiterate that the requirements of Module E are temporary and they will sunset upon the adoption of a new permanent resource adequacy plan. Going forward, Network Resources will need to be evaluated under the new paradigm and it is therefore inappropriate to order 10-year roll-over rights that guarantee current Network Resources remain designated as such.

300. We agree with MidAmerican that external resources should be able to qualify as Network Resources provided that they pass the deliverability test and the external resources are willing to pay for any necessary upgrades should the resource fail to pass the Market Transition Deliverability Test.¹²⁷ We also agree that section 69.1.3 requires additional clarification to make this known and consistent with the rest of the tariff. Therefore we direct the Midwest ISO to modify section 69 to state that external resources may qualify as Network Resources provided that they are deliverable to load within the Transmission Provider region as specified by section 69.1.2.b.¹²⁸ The Commission directs the Midwest ISO to submit this tariff clarification in a compliance filing within 30 days.

2. Twelve Percent Default Reserve Margin

a. Background

301. In the TEMT II Order, the Commission agreed with the Midwest ISO on the need for a default reserve margin and also agreed with intervenors that the proposal the Midwest ISO filed did not contain sufficient details for proper evaluation. The Commission directed the Midwest ISO to file the necessary details, including the reserve margin calculation, capacity that counts toward satisfying the reserve margin, the consequences of non-compliance and the effective time period of this requirement.

¹²⁷ *Id.* at section 69.1.3.iv, Original Sheet No. 823B.

¹²⁸ *Id.* at section 69.1.2.b, Substitute Original Sheet No. 821.

302. In response to these Commission directives, the Midwest ISO reiterated that the 12 percent reserve margin is not a generally applicable minimum reserve requirement. Instead, it is a default provision that the Commission has found reasonable to apply where there is no applicable state or Regional Reliability Committee reserve margin requirement.¹²⁹ Any entity, therefore, that is subject to any state- or Regional Reliability Committee-established reserve requirement will not be subject to the reserve requirement established in Module E.

303. The Midwest ISO has added a new section 68.2.3 outlining the method of calculating the reserve margin and the available capacity to satisfy that margin. Under this provision, each year load-serving entities are required to submit forecasted monthly peak hour demand and capacity information from which the Midwest ISO shall calculate the reserve margin. Reported capacity must be supported by network resources that meet Module E's contractual and deliverability requirements. However, the Midwest ISO states that existing designated Network Resources accepted by the Midwest ISO and confirmed by network customers before the effective date of the TEMT shall be deemed to satisfy deliverability requirements during the term of the confirmed designation.¹³⁰

304. If a market participant fails to comply with the 12 percent reserve margin requirement, the Midwest ISO states that it shall report the violation to the Commission and recommend reasonable penalty charges or other remedies enforceable through Commission proceedings pursuant to section 38.2.8. Finally, the Midwest ISO stated that the 12 percent margin requirement will sunset upon the Midwest ISO adoption of a permanent RAR plan.

b. Protests and Comments

305. The Midwest TDUs object to the Midwest ISO's requirement that non-control area TDU interruptible load must carry reserves, arguing that the requirement is discriminatory and contrary to Commission regulations.¹³¹

¹²⁹ See TEMT II Order at P 415.

¹³⁰ Module E, section 69.1.3.v, Original Sheet No. 823B.

¹³¹ See 18 CFR § 35.13(h)(28)(iii)(A)(1) (net peak load restricted to peak firm load).

306. The Midwest TDUs state that those who purchase firm system power, backed by the seller's reserves, should not be deprived of their arrangement and be forced to carry a reserve responsibility that they have paid another responsible entity to bear. According to the Midwest TDUs, the Adjusted Capacity and Adjusted Demand and related definitions should be modified so that the Midwest ISO's reserve calculation places responsibility for carrying reserves for a specified load once and on the entity contractually obligated to provide them. The Midwest TDUs claim that the Midwest ISO's resource adequacy procedures should use a single set of definitions for purchases and sales "assured available by the reserve capacity of the supplier" to make sure only one entity and the right entity is held responsible for carrying reserves associated with a firm system purchase or sale.

307. WPS Resources assert the Midwest ISO proposal is deficient because it fails to explain how it will verify load-serving entities' compliance with resource adequacy requirements, including those set by states and Regional Reliability Committees. Also, states WPS Resources, the proposal is not clear on whether the default 12 percent reserve margin is a planning reserve margin or an installed reserve margin and WPS Resources requests the Commission to clarify whether entities subject to a state or Regional Reliability Committee-imposed reserve requirement that is less than the Midwest ISO's default 12 percent reserve margin are exempt from the Midwest ISO's higher default reserve requirement. Also, WPS Resources request clarification on the following: (1) whether the 12 percent default reserve margin would apply at the start of the Day 2 markets; and (2) the procedures by which the Midwest ISO would determine whether its load-serving entities in the East Central Area Reliability Coordination Agreement (ECAR) or other regions would satisfy its requirements. Finally, WPS Resources assert that the October 5 Compliance Filing does not provide the Midwest ISO with the authority to assess penalties if load-serving entities fail to satisfy its requirements.

308. LG&E requests clarification from the Midwest ISO that an appropriate adequacy standard is in effect for load in Kentucky. LG&E states that Kentucky has a state integrated resources process in effect and does not have retail access. Thus, LG&E maintains that it has an obligation to serve native load and adequate resources to fulfill those obligations.

309. Detroit Edison urges the Commission to accept the 12 percent reserve margin and expresses concern with the Midwest ISO's statement that there is no need for an annual planning reserve requirement for ECAR. Detroit Edison states that this will degrade reliability since over 40,000 megawatts of load may be excluded from the requirement.

310. WEPCO asserts that the Midwest ISO should explicitly state that the exclusion for lower reserve margin requirements applies only to state mandated annual requirements and specifically state that lower daily operating reserve margins are insufficient to meet this exception.

311. AMP-Ohio contends that the Commission must direct the Midwest ISO to inform each transmission customers serving load in the Midwest ISO region which reserve margin standard applies as well as evaluate each customer's resources. AMP-Ohio further recommends the Midwest ISO be required to provide its findings to each customer and allow each customer to challenge the findings.

312. WPS and Quest protest the requirement in section 68.2.3 that market participants may only update their adjusted capacity up to 30 days prior to the first day of any month. WPS and Quest further argue that the Commission should direct the Midwest ISO to allow changes to adjusted capacity and adjusted demand until the day-ahead scheduling deadline.

c. Discussion

313. We find the Midwest ISO's compliance filing provides sufficient details on the 12 percent default reserve margin for Commission acceptance. We approve of the limited nature of this requirement, along with its stated interim effective period.¹³² However, despite the Midwest ISO's statement that the 12 percent requirement will sunset upon the Midwest ISO's adoption of a permanent resource adequacy plan, the tariff does not reflect this. Therefore, for clarity, we direct the Midwest ISO to state in Module E that its requirements will sunset upon the adoption of a long-term resource adequacy plan in the Midwest ISO in a further compliance filing within 30 days.¹³³ We find this to be consistent with the Commission's prior directives in the TEMT II Order regarding Module E.¹³⁴

¹³² See Midwest ISO Transmittal Letter at 31 (Oct. 5, 2004).

¹³³ The statement should be placed in the Introduction of Module E, Original Sheet No. 810.

¹³⁴ See TEMT II Order at P 411 ("We direct that the interim tariff sheets will sunset upon Commission approval of a permanent RAR plan that includes an Installed Capacity component.").

314. We will not direct the Midwest ISO to make the clarifications requested by WEPCO. We find that section 68.2.3 is sufficiently clear to determine that the 12 percent reserve margin requirement does not apply in states where a reserve margin presently exists and that the Midwest ISO will not require any reserve margin that is in excess of a state's reserve margin. We will also not direct the Midwest ISO to clarify that this default reserve margin requirement refers to a planning reserve margin. As noted elsewhere in this order, the 12 percent requirement is very limited in scope and it will sunset upon the adoption of a permanent resource adequacy plan for the Midwest ISO.

315. The Commission does not agree with WPS Resources that the Midwest ISO must develop a region-wide resource adequacy program that applies across the entire Midwest ISO footprint before the Midwest Market launch of the Day-2 markets. We find that it is appropriate to allow the Midwest ISO to rely on the pre-existing reliability standards in the interim period until a permanent plan that enjoys stakeholder input is adopted. However, we clarify that we interpret section 68.2.3, where it states that the Midwest ISO will not require any reserves in excess of such requirements established by any state, to mean that the Midwest ISO will not change preexisting reserve standards regardless of whether they are higher or lower than 12 percent. We also clarify that all requirements of Module E, except in the case of a universal grace period, apply at the start of the Midwest ISO Day-2 markets and sunset upon the adoption of a long-term resource adequacy plan as discussed herein.

316. We acknowledge AMP-Ohio's concerns regarding tariff customers' lack of understanding about which resource adequacy standards and requirements are applicable to them. In response, we note that the treatment of state standards regarding resource adequacy was clarified in the TEMT II Rehearing Order.¹³⁵ It is instrumental to the success of any market that its participants understand the rules they must abide by. We encourage communication between the Midwest ISO and all of its market participants so that any questions regarding applicable rules are answered prior to market start-up to ensure a successful market launch. However, we decline to adopt AMP-Ohio's suggestion that the Commission require the Midwest ISO to contact each transmission customer serving load in the Midwest ISO region to inform them of applicable standards, evaluate the customer's resources, and then allow each customer to challenge any findings made by the Midwest ISO. The tariff is a generally applicable document, but the resource adequacy requirements in Module E are meant to codify regional standards and will therefore vary by region. It is impractical for the Midwest ISO to state in its tariff what reserve numbers apply to each individual market participant. Furthermore, much of the requested dialogue between the Midwest ISO and load-serving entities is inherent in

¹³⁵ See TEMT II Rehearing Order at P 326-28.

the application of the Module E requirements. Market participants subject to the requirements of Module E notify the Midwest ISO which resources they intend to designate as Network Resources. More specifically under the 12 percent reserve margin, load-serving entities submit their forecasted monthly peak hour demand and capacity from which the Midwest ISO will calculate the requirement. In all of these requirements the Commission anticipates that there will be dialogue before appropriate standards are determined.

317. We decline to adopt Detroit Edison's request for an annual reserve margin of 12 percent to apply to all load-serving entities. Granting this request would distort the backstop nature of the default reserve margin requirement. The Commission conditionally approved the 12 percent reserve margin, pending more details, on the basis of the Midwest ISO's commitment to codify the pre-existing state and Regional Reliability Committee reliability standards in the interim period until a permanent plan that includes stakeholder input is filed with the Commission. In this case we accept the Midwest ISO's statement that this requirement is not generally applicable as a minimum reserve requirement. Therefore any entity that is already subject to a state or Regional Reliability Committee-established reserve requirement will not be subject to the default reserve margin in Module E. We find that for the interim period when Module E is in effect, a 12 percent reserve margin only applicable where no pre-existing standard is in effect is a reasonable requirement, because present reserve margins are effective and will be preserved. However, we are not prejudging the merits of a minimum reserve requirement as part of the permanent resource adequacy plan and we encourage Detroit Edison to raise their views through the resource adequacy stakeholder process underway to develop the permanent plan.

318. We decline to direct the Midwest ISO to clarify that Kentucky has an appropriate resource adequacy standard in effect for native load. We find the Midwest ISO's assertion that "any entity that is subject to any state- or RRO-established reserve requirement will not be subject to the reserve requirement established in Module E" to be sufficient to provide reasonable assurances to states, such as Kentucky, that to the extent that they have reserve margins in place no additional reserves will be required by Module E.¹³⁶ The Midwest ISO has given assurances in the new section 68.2.3, in addition to those given in its transmittal letter, that it will not require any reserve margin that is in

¹³⁶ See Midwest ISO Transmittal Letter at 30 (Oct. 5, 2004).

excess of such requirements established by any state in which the Midwest ISO operates.¹³⁷ Finally, we note that if LG&E is concerned that an appropriate adequacy standard is in effect for load in Kentucky, this issue would be most appropriately addressed by the Kentucky Public Service Commission.

319. We accept the Midwest ISO's new definitions in sections 1.3a and 1.3b to clarify their calculations of Adjusted Capacity and Adjusted Demand. We accept the Midwest ISO's new definitions in sections 1.118a and -b and sections 1.296a and -b. We agree with comments that both the buyer and seller should not have to bear redundant responsibilities for reserves. However, we do not interpret the combination of these six sections (1.3a, 1.3b, 1.118a, 1.118b, 1.296a, and 1.296b) to result in buyers paying twice for the same reserves. We likewise accept the definitions in sections 1.153a and 1.153b for Interruptible Demand and Interruptible Load respectively. The Commission disagrees with comments that the definition of Interruptible Load has to treat non-Control Area interruptible load as firm. Section 1.153b defines interruptible load as the amount of customer load, in accordance with contractual arrangements, that can be interrupted by the control area operator.¹³⁸ Therefore if the TDUs have contracts for interruptible load where they call the interruption and not the control area operator, they can notify the control area operator of these arrangements, and if the 12 percent reserve requirement applies, it will be calculated accordingly. We find that this is a reasonable arrangement in those limited circumstances where there is no state or RRO standard in effect. Presumably the control area operator already knows of these contractual arrangements and therefore the needed reserves will not increase substantially going forward under the interim plan. Finally, we note that the definitions related to reserve-sharing are further discussed *infra*, in section IV.J.1 of this order.

320. We do not agree with WPS and Quest that section 68.2.3 should be modified to allow adjustments to adjusted capacity and adjusted demand until the day-ahead scheduling deadline. It is important to note that according to section 68.2.3, compliance with the 12 percent reserve margin is only applicable to those market participants that operate in states in which the Midwest ISO is unable to determine whether a pre-existing adequacy standard is in effect.¹³⁹ WPS and Quest did not claim in their protest that they would be subject to the 12 percent reserve margin, but the Commission understands that they have customers in many states. Thirty days strikes the Commission as an

¹³⁷ Module E, section 68.2.3, Original Sheet No. 818B.

¹³⁸ Module A, section 1.153b, Substitute Original Sheet No. 88.

¹³⁹ Module E, section 68.2.3, Substitute Original Sheet No. 818.

appropriate balance between giving the Midwest ISO adequate time to calculate new adjusted capacity and adjusted demand requirements, while allowing market participants a reasonable opportunity to update changes to their contractual arrangements.

321. However, the Commission is in limited agreement with WPS and Quest regarding updates to adjusted demand. The Midwest ISO filed a new section 68.2.3 which states that market participants are permitted to update adjusted capacity up to 30 days prior to the first of any month, but the Midwest ISO did not include updates to adjusted demand. Updates to capacity and demand are meant to reasonably reflect the contractual arrangements of market participants subject to the 12 percent reserve margin requirement, and the Commission finds the exclusion of updates to adjusted demand to be unbalanced and unjustified. Therefore, the Commission directs the Midwest ISO to modify section 68.2.3 to state that market participants are permitted to update adjusted capacity and adjusted demand based on current contractual arrangements up to thirty days prior to the first day of any month.¹⁴⁰

3. Jurisdictional Issues

a. Background

322. The TEMT II Order required the Midwest ISO to explain the source of its authority to require market participants that are currently members of reserve sharing groups to receive prior approval from the Midwest ISO before withdrawing from reserve sharing groups, per the terms of section 68.1.1.d.

323. In the October 5 Compliance Filing, the Midwest ISO states that as the NERC Reliability Authority, the Midwest ISO is responsible for ensuring reliability of operations and supply. Such responsibility means, at a minimum, that market participants must provide the Midwest ISO with notice of their intent to withdraw from any reserve-sharing group of which they are a member. In addition, any such market participant seeking to withdraw from a reserve-sharing group also must provide the Midwest ISO with information adequate to demonstrate the ability of the market participant to meet its resource adequacy requirements.

¹⁴⁰ We direct the Midwest ISO to modify Original Sheet No. 818B through a compliance filing within 30 days of the issuance of this order.

b. Protests and Comments

324. The Midwest TDUs assert that the Midwest ISO's proposed reserve-sharing definitions are inconsistent and inappropriate since they conflict with current industry practice, in which non-control area TDUs actively participate in such groups (*e.g.*, MAPP). If read to exclude non-control areas from participating in reserve sharing, according to the Midwest TDUs, these discriminatory definitions would unfairly deprive such TDUs of the essential reliability and economic benefits of reserve sharing, unduly burdening small systems in a manner long recognized to be contrary to the FPA.¹⁴¹

325. Exelon renews its protest that the Midwest ISO has no authority to require its approval before members of reserve sharing groups may withdraw. They argue that the Midwest ISO did not provide any justification or legal authority, beyond being a Reliability Authority, for such a requirement in their compliance filing. According to Exelon, a Reliability Authority in the NERC Functional Model has no authority to interfere with agreements for reserve sharing entered into voluntarily by control areas. Further, they assert that the rules for withdrawal from reserve sharing groups are generally provided for in agreements between the control areas. However, Exelon does not object to a requirement only to provide notice of intent to withdraw from reserve sharing groups. In that case, Exelon requests that the Midwest ISO make a further compliance filing to amend section 68.1.1.d to state this change.

c. Discussion

326. We agree with Exelon that the NERC Functional Model does not grant the Midwest ISO the authority to require its approval before members of reserve sharing groups may withdraw from these groups. In the transmittal letter accompanying the Midwest ISO's compliance filing, the Midwest ISO explains that as the Reliability Authority, it is responsible for ensuring the reliability of operations and supply.¹⁴² The Midwest ISO then goes on to state that it interprets this responsibility to mean that at a minimum market participants seeking to withdraw from reserve sharing groups must give notice of their intent and provide the Midwest ISO with information to demonstrate that the market participant can continue to meet its resource adequacy requirements.

¹⁴¹ See, *e.g.*, *Gainesville Utils. Dept. v. Florida Power Corp.*, 402 U.S. 515 (1971) (*Gainesville*).

¹⁴² See Midwest ISO Transmittal Letter at 31 (Oct. 5, 2004).

327. The Commission agrees with the Midwest ISO's limited interpretation of its authority regarding the withdrawal of members from reserve sharing groups. We interpret the Midwest ISO's need for adequate information to demonstrate continued compliance with the requirements of Module E to mean that market participants that withdraw from reserve sharing groups are required to show how they will continue to secure adequate reserves. Therefore, we direct the Midwest ISO to revise section 68.1.1.d of the TEMT to strike "the prior approval of" and replace with "giving prior notice to". In addition, we direct the Midwest ISO to further state in section 68.1.1.d that members of reserve sharing groups seeking to withdraw must continue to abide by the requirements of Module E and adequately demonstrate that the withdrawing reserve group member can continue to meet its applicable reserve requirements. In addition, we do not view the Midwest ISO as having the authority to exclude non-control areas from participating in reserve sharing groups. Accordingly, we direct the Midwest ISO to revise section 1.261a, defining a Regional Reserve Sharing Agreement, to expand its applicability, pluralize Control Area(s), and identify their reference to "not members."¹⁴³

4. Commission Directives

a. Background

328. In the TEMT II Order, the Commission emphasized that our approval of Module E was conditioned on it being a short-term transition mechanism to ensure that the day-to-day reliability needs are met similar to the way they are today. However, expeditious progress toward a long-term RAR plan for the entire Midwest ISO region is essential. The Commission directed that Midwest ISO sunset the interim tariff sheets contained in Module E when the long-term RAR tariff sheets are approved by the Commission.¹⁴⁴

329. The Commission also directed the Midwest ISO to file additional support about the specific resources that may qualify as Network Resources and to use its existing definitions of DNRs in lieu of a new definition in section 69.2. The Commission also directed the Midwest ISO to file the procedures for Alternative Capacity Resources to qualify to meet DNR requirements.

¹⁴³ The Commission finds this definition lacks clarity and directs the Midwest ISO provide clarity for this statement, "Control Area that are not members" to explain what membership is referred to by this statement. *See* Module A, section 1.261a, Substitute Original Sheet No. 117.

¹⁴⁴ *See* TEMT II Rehearing Order at P 330.

330. Midwest ISO states that it is diligently working with individual state policymakers, state regulatory agencies, OMS and Regional Reliability Committees on the development of a long-term RAR plan and proposes to have in place a long-term RAR plan on or about June 1, 2006.

331. In the transmittal letter accompanying its compliance filing, the Midwest ISO acknowledges that the must-offer requirement established in section 69.2 of Module E will sunset when the Commission approves a permanent RAR plan.¹⁴⁵

332. The Midwest ISO states that it has added one sentence to section 30.1 to clarify that DRRs and behind-the-meter generation can be designated as Network Resources by meeting the same Network Resources requirements and following the same procedures applicable to other resources. On the other hand, the TEMT uses the term “alternative capacity resources” to refer to the DRRs and behind-the-meter generation that elect not to qualify as Network Resources or that other circumstances preclude from so qualifying, but nonetheless may receive special treatment to the extent that they satisfy the criteria to count toward the state or Regional Reliability Committee resource adequacy standards.

333. The Midwest ISO further states that DRRs and behind-the-meter generation constitute a larger set of resources where alternative capacity resources are a subset. DRRs and behind-the-meter generation can qualify as Network Resources under the same terms applicable to other resources, but even if they do not qualify (*i.e.*, by their own choice or by reason of incidental circumstances – not by their very nature), they can still be treated as alternative capacity resources. Thus, there is no need to specify separate Network Resource criteria and procedures for DRRs and behind-the-meter generation. The sub-category of alternative capacity resources does not prevent DRRs and behind-the-meter generation from qualifying as Network Resources, if they choose to do so, and they meet the other Network Resource requirements.

b. Protests and Comments

334. Dominion asserts the proposed timeframe for implementing a permanent resource adequacy requirement unnecessarily delays implementation until June 2006. Dominion recommends that the Commission order implementation no later than December 31, 2005. Dominion states that the Midwest ISO is not complying with Commission guidance to expedite its development of a permanent resource adequacy model.¹⁴⁶

¹⁴⁵ See Midwest ISO Transmittal Letter at 30 (Oct. 5, 2004).

¹⁴⁶ See Declaratory Order at P 49-50.

c. Discussion

335. We accept the Midwest ISO's statement that it intends to file a long-term resource adequacy plan on or about June 1, 2006.¹⁴⁷ We find that this is a reasonable time frame to develop a long-term resource adequacy plan that can satisfy both stakeholders' concerns and the region's reliability needs. The Commission clarified the requirements of any long-term resource adequacy plan in the TEMT II Rehearing Order, stating that the long-term plan could not directly conflict with the PJM resource adequacy plan and reiterating its encouragement of a common installed capacity market with PJM.¹⁴⁸ Therefore, we deny Dominion's request to reject the Midwest ISO's proposed time frame for implementing a long-term resource adequacy plan by June 1, 2006. We agree with Dominion that expeditious progress to the filing of a long-term plan is essential, but we disagree that December 31, 2005 has any significance other than being six months earlier than the current Midwest ISO proposal.

336. We note the Midwest ISO's statement that they have added a sentence to section 30.1 to clarify that Demand Response Resources may qualify as Network Resources.¹⁴⁹ However, the Midwest ISO did not file tariff sheets to this effect. Therefore, the Commission directs the Midwest ISO to file section 30.1, with a sentence stating that Demand Response Resources may qualify as Network Resources, in a compliance filing within 30 days of this order.¹⁵⁰

I. Attachment L: Credit Policy

1. Overall Credit Requirements

a. Background

337. In the TEMT II Order, the Commission found that the Midwest ISO did not adequately explain the methodology that underlies its proposed Table 1. Therefore, the Commission directed the Midwest ISO to refile Table 1 with a matrix similar to PJM's or

¹⁴⁷ See Midwest ISO Transmittal Letter at 31 (Oct. 5, 2004).

¹⁴⁸ See TEMT II Rehearing Order at P 319.

¹⁴⁹ See Midwest ISO Transmittal Letter at 29 (October 5, 2004).

¹⁵⁰ Module B, section 30.1, Original Sheet No. 307.

NYISO's or to thoroughly justify any differences. In addition, section II (B), Original Sheet No. 1219, lists a credit score range of 1 to 6. This conflicts with the scores in Table 1, which run from 0-6. The Midwest ISO was directed to explain or eliminate this discrepancy.

338. The Commission also directed the Midwest ISO to define in Module A the financial measures: (1) Tangible Net Worth; (2) Working Capital Limit; (3) Operating Cash Flow; and (4) any other undefined terms that it intends to use in conjunction with Table 1.¹⁵¹ In addition to defining all relevant terms, the Midwest ISO must include calculations and justifications for each.

339. In addition, the Commission ordered the Midwest ISO to adopt an unsecured credit "floor," similar to the one in use in the NYISO markets, in its credit assessment of public power participants to ensure their ability to fully participate in the Midwest ISO markets.¹⁵² However, the Commission previously allowed PJM to retain some discretion in its credit policy to consider alternative measures to determine financial strength and creditworthiness for cooperative and municipal participants. The Commission accepted the Midwest ISO's proposal to retain the same discretion in its credit policy.¹⁵³ The Commission found that that discretion is to be permissible so long as it does not work to exclude otherwise creditworthy participants.

340. The Midwest ISO has revised Table 1 of Attachment L to eliminate the distinctions between five business sectors. Instead, the Midwest ISO explains that the new Table 1 provides the suggested unsecured credit limit as a function of an entity's credit score and its tangible net worth depending on whether the entity is classified as a "Public Power" entity or a "Non-Public Power" entity. Public Power entities are generally organized as not-for-profit companies with limited member equity. By contrast, Non-Public Power entities are generally for-profit enterprises with substantial

¹⁵¹ For guidance we directed the Midwest ISO to review the NYISO OATT, Fourth Revised Sheet No. 69.

¹⁵² See NYISO OATT, Attachment W, Original Sheet No. 729B.

¹⁵³ See PJM, Attachment Q, Original Sheet No. 523 C&F, where it states that, "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."

owner equity. As such, all other things being equal, a Public Power entity will have significantly less tangible net worth than a Non-Public Power entity, even if both are: (a) electric utilities, (b) serve the same amount and type of electric load, (c) own the same amount and type of electric generating capacity, and (d) have similar operating expenses.

341. In order to account for the different capitalization structures between public power entities and non-public power entities, the Midwest ISO states that the Credit Practices Task Force, a stakeholder group, voted to adopt the two sets of values in Table 1 of the revised Attachment L – one set of values for public power entities and one set of values for non-public power entities. The Midwest ISO argues that the credit scoring model in the revised section II.A of Attachment L was developed over several months by a cross-section of stakeholders.

342. Additionally, the Midwest ISO has corrected the typographical error in Table 1 to reflect a potential range of scores of 1 to 6 (rather than 0 to 6).

343. The Midwest ISO states that it has also revised its credit policy to provide an unsecured credit floor for public power entities of \$250,000. The unsecured credit floor is now embodied in a new section II.B.2 of Attachment L.

b. Protests and Comments

344. The Midwest TDUs claim the TEMT identifies, but fails to define, nine quantitative benchmarks that account for 40 percent of public power entities' credit score. They also assert the creditworthiness standards need to be revised to accurately reflect public power creditworthiness standards.¹⁵⁴ As examples, Midwest TDUs propose the definition of Debt to Equity be modified to account for revenue deferral and that Tangible Net Worth should be modified to include both cash and equity. Midwest TDUs also propose that the Midwest ISO-proposed earnings-related benchmarks (Earnings Before Interest and Taxes (EBIT) Interest Coverage, Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) Interest Coverage, and Pre-Tax Return on Equity) be revised to 5 percent weights for each, rather than the proposed 10 percent weights.

¹⁵⁴ Midwest TDUs cite to typical measures of public power creditworthiness, as used by major credit agencies, such as Current Ratio, Debt Service Coverage, Days Cash on Hand, Operating Margin, Net Plant as a ratio to Net Debt, and Debt as a ratio to Equity and Deferred Revenue.

c. The Midwest ISO's Answer

345. The Midwest ISO filed a motion for leave to answer the comments about its compliance filing, regarding, among other topics, its credit policies and standards. The Midwest ISO stated that it intends to submit a “clean-up” filing to fix several grammatical errors and omissions from the October 5 Compliance Filing, about 60 days prior to market launch or January 1, 2005.¹⁵⁵

346. The Midwest ISO acknowledged the Midwest TDUs' concerns that several quantitative financial measures used in the credit scoring process were omitted from the compliance filing and stated that it will include those items in its clean-up filing. The definitions the Midwest ISO states it omitted accidentally were related to public and non-public power ratios used in the credit scoring model.¹⁵⁶

347. The Midwest ISO also responds to the Midwest TDUs' claims that the tariff's financial benchmarks understate the creditworthiness of public power entities. They answer that the creditworthiness benchmarks proposed are based on an analysis of a universe of public power entities only, and the benchmarks are therefore reasonable and appropriate. Also, the Midwest ISO states that the standards were discussed by stakeholders representing both public and non-public power sectors, and not a single public power entity opposed the final public power credit scoring model. However, according to the Midwest ISO, the Midwest TDUs did not participate in this stakeholder process. The Midwest ISO concludes that it is unfair for the Midwest TDUs to propose a new credit scoring approach after the fact, which deprives other stakeholders of an opportunity to discuss this alternative. Therefore, the Midwest ISO states that the credit scoring model provides reasonable creditworthiness standards that are adequate for the market start.

348. The Midwest ISO next responds to numerous comments submitted by Epic and SESCO listing the general system enhancements they seek and in particular the allocation of the total credit limit to FTR auctions and virtual transactions. In general, the Midwest ISO states that it does not have the resources to implement all of the changes sought by Epic and SESCO prior to market start-up, and instead the Midwest ISO suggests that Epic and SESCO should submit their proposals through the stakeholder process to determine whether the incremental improvements merit additional expenditures.

¹⁵⁵ We note that January 1, 2005 is a holiday, so the filing would most likely be received on January 3, 2005.

¹⁵⁶ See Midwest ISO Answer at 14 n.27 for a listing of the omitted terms.

349. The Midwest ISO acknowledges two flaws in the creditworthiness standards. The first is in the formula for the Total Potential Exposure calculation regarding the Maximum Negative Bid, because it currently includes negative FTR bids and offers; it should be limited to only FTR offers. The second flaw relates to the FTR Auction Potential Exposure calculation. The Midwest ISO agrees with Epic and SESCO that both sides of a bid/offer at a particular node should be counted whether or not they are of equal value for the FTR Auction Potential Exposure calculation. The Midwest ISO states that it will make these changes in its clean-up filing 60 days before market start-up. Nevertheless, the Midwest ISO urges the Commission to reject Epic and SESCO's arguments because they contain fundamental flaws in their reasoning.

350. Regarding the FTR auctions, the Midwest ISO states that Epic and SESCO fail to account for the possibility that all negative bids may not be accepted and therefore if the credit requirement does not account for this other market participants are exposed to increased risk of non-payment. According to the Midwest ISO, this security shortfall occurs because not enough negative bids could be accepted to offset all of the positive bids accepted and there would be insufficient funds owed to the market participant from the negative bids to offset the exposure to non-payment created by acceptance of the positive bids.

351. Regarding the virtual megawatt-hours limit, the Midwest ISO proposes new language for section III.A of Attachment L that states in the tariff that the sum of the absolute value of virtual bids/offers may not exceed its virtual megawatt-hours limit.

352. Finally, the Midwest ISO responds to Epic and SESCO's complaint that the Midwest ISO retained the use of the 97th percentile in the credit calculation for virtual trading, but properly shifted to the 50th percentile for the FTR Auction market. The Midwest ISO responds that Epic and SESCO failed to convince other stakeholders of the merits of their position during the stakeholder process, and the TEMT II Order did not require the Midwest ISO to change the calculation of the proxy price for virtual trading. Therefore, the Midwest ISO asserts that the Commission should not allow Epic and SESCO to revise the tariff now, without giving other stakeholders the opportunity to respond, because other stakeholders will be carrying the risk of any credit defaults.

d. Discussion

353. We generally accept the Midwest ISO's compliance filing, subject to the revisions directed herein, and we direct the Midwest ISO that in the interest of reducing the number of filings to the Commission, they may consolidate their clean-up edits filing with the 30-day compliance filing directed elsewhere in this order.

354. We find that the Midwest ISO's answer responds to the Midwest TDUs' concerns about the omission of 9 quantitative terms from the credit scoring model. We withhold judgment on the omitted terms until the Midwest ISO submits them through their clean-up filing or the 30-day compliance filing. We also acknowledge and agree with the Midwest TDUs at footnote 45, that they retain the right for further comment on the definitions when the Midwest ISO submits them.

355. In regards to the Midwest TDU's comments on the quantitative criteria terms used in the credit scoring model in the Midwest ISO's compliance filing, we disagree. 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.¹⁵⁷ Likewise, we find the Midwest ISO's proposal to weigh financial criteria heavier than qualitative criteria for non-public power entities in the development of the total composite credit score to be reasonable and acceptable.¹⁵⁸ The Midwest ISO's proposal is consistent with the Commission's recent policy statement where we stated that RTOs must consider both qualitative and quantitative factors in their assessment of credit risk.¹⁵⁹ In general, we agree with statements that public power entities have good credit records and that this may not be reflected through financial statements alone. Therefore the Midwest ISO proposal to weigh qualitative factors heavier than financial ones demonstrates to the Commission that public power market participants will not be discriminated against in the credit scoring process. For example, the Midwest ISO states that the qualitative score will assess all non-financial information, and at a minimum will include these characteristics: rates/regulations, legal risks, demographics, price risk, credit ratings, other. We find these terms enable the Midwest ISO to capture the unique nature of the public power market participant's good credit where it may not be reflected through a solely financial measure, such as tangible net worth, alone.

¹⁵⁷ Public power sector market participants' credit scores are developed through analysis of a financial score that is weighted 40 percent and a qualitative score that is weighted 60 percent. *See* Attachment L, Substitute Original Sheet Nos. 1219-1219B.

¹⁵⁸ Non-public power sector market participants' credit scores are developed through analysis of a financial score that is weighted 60 percent and a qualitative score that is weighted 40 percent. *See* Attachment L, Original Sheet Nos. 1219B-D.

¹⁵⁹ *See Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 at P 13 (2004) (Creditworthiness Policy Statement).

356. We note that the Midwest ISO has a vibrant stakeholder process underway and that stakeholders voted 17 in favor to 3 not in favor, for the final credit scoring model, with no public power participants voting against the model.¹⁶⁰ This is a significant margin of passage and the Commission values the stakeholder process to determine regional creditworthiness requirements.¹⁶¹ Because credit is a collective market mechanism, in that all market participants share in the extension of credit and therefore share in the losses, significant weight should be given to the outcome of the stakeholder process. While the Commission cannot accept any proposal from the stakeholder process that is unduly burdensome or unduly discriminatory, we find the Midwest ISO's current proposal is not unduly burdensome or discriminatory, as discussed more fully below. We encourage all Market Participants to participate in the stakeholder process and to vet their proposals through that forum to gauge overall stakeholder benefits before submitting proposals to the Commission. Finally, we note that ISO and RTO credit policies are subject to further refinement, and customers that believe they have been discriminated against in the credit scoring process have remedies available to them.¹⁶²

2. Market Activity Categories and Total Potential Exposure

a. Background

357. The Commission directed the Midwest ISO to adopt a two-day collateral window in the same manner as directed for PJM.¹⁶³ In addition, the Commission directed the Midwest ISO to clarify the proposed "MPD" calculation, particularly the definition of the "proxy" it refers to, and explain why the Midwest ISO does not accommodate seasonal

¹⁶⁰ See Midwest ISO Answer at 15.

¹⁶¹ See Creditworthiness Policy Statement at P 2 ("The Commission believes that the development of creditworthiness requirements specific to each ISO/RTO through a stakeholder process is appropriate because of the greater variability and difficulty required to measure the credit exposure of providing these additional services.").

¹⁶² See *id.* at P 15.

¹⁶³ *PJM Interconnection, L.L.C.*, 104 FERC ¶ 61,309 at P 23 (2003), *order on reh'g*, 109 FERC ¶ 61,286 (2004). PJM was directed to report on the feasibility of a one-day credit window. The collateral window in the Midwest ISO will begin as two days at market startup, but may be revisited in the future.

variations in the calculation through the use of a price differential that is less than 12 months.¹⁶⁴ The Commission noted that PJM uses a rolling two-month reference period, and NYISO uses a rolling 90-day window.¹⁶⁵ The Commission also directed the Midwest ISO to clarify the Virtual Transactions Credit Requirement by filing in section III A.1, Original Sheet No. 1223, a definition of each of the three acronyms used to calculate this requirement. Such a clarification should include what each letter of the MPD, the DMWhL, and the VMEW stands for.

358. Additionally, the Commission directed the Midwest ISO to clarify and sufficiently justify the necessity of additional creditworthiness requirements beyond those that apply to virtual transactions or other market activities. Should the Midwest ISO retain distinct FTR Credit Auction requirements, the Commission directed it to clarify the acronyms used for the calculation similar to those directed for virtual transactions. This includes the acronyms: MPB, MNB, P, and G outlined in section III B.1, Original Sheet No. 1226.

359. Further, the Commission directed the Midwest ISO to file all formulas relating to the Total Potential Exposure calculation, for all categories of market activity.

360. The Midwest ISO states that it has reduced its proposed six-day estimated exposure window for virtual transactions to a two-day estimated exposure window. This change has been made in the formula for establishing Virtual Transmission Potential Exposure in section IV.A.3 of Attachment L. The Midwest ISO also commits to study, with stakeholder involvement, the feasibility of moving to a one-day virtual transactions estimated exposure window, and will file a progress report within 180 days of the date of the TEMT II Order.

361. In the compliance filing, the Midwest ISO has clarified the calculation of the virtual transactions credit limit in the Credit Policy by explaining: (1) what each letter of the acronyms “MDP,” “DMWhL” and “VMEW” stand for; (2) explaining within the definition of “MDP” what a “proxy” for the first day of each month would be; and (3) by explaining why the Midwest ISO does not accommodate seasonal variations in this calculation through the use of a price differential that is less than twelve months.¹⁶⁶ Midwest ISO has also added additional details to the formula for determining the virtual

¹⁶⁴ See Attachment L, Section III(A)(1), Original Sheet No. 1223.

¹⁶⁵ See PJM OATT, Attachment Q, Substitute Original Sheet No. 523I.01; NYISO OATT, Attachment W, First Revised Sheet No. 734.

¹⁶⁶ TEMT II Order at P 447.

transactions credit limit, as specified in section IV.A.3. Midwest ISO further states that “MDP” stands for “Market Price Differential,” “DMWhL” stands for “Daily MWh Limit,” and “VMEW” stands for “Virtual Measured Exposure Window.”

362. In the absence of Midwest ISO-specific historical data, the Midwest ISO states that it turned to actual historical data used in settlements for the PJM, ISO-NE and NYISO energy markets during 2003. The Midwest ISO believes the actual historical price differentials from these three markets will serve as a reasonable proxy for the 97th percentile price differential that would exist in the Midwest ISO energy markets were actual historical data available.

363. The Midwest ISO states that the data used for proxy development was actual day-ahead and real-time LMPs reported by each of these market operators as used in billing calculations. A random sample of LMP billing node differentials was created by the Midwest ISO from the raw data obtained. Sample size was just over 1,000,000 aggregate node differentials for PJM, 130,000 node differentials for NYISO, and based on all elemental node differentials for ISO-NE from commencement of market start-up on March 1, 2003 until December 13, 2003. The Midwest ISO created the 97th percentile value for each data set using the following formula, assuming normal distribution:
97th percentile = mean + (approximately 1.88 * standard deviation).

364. The Midwest ISO claims that the proposed twelve-month average data is expected to provide the best proxy because it represents a blend of data from the prior year-season and data from more current periods. In addition, a 12-month average will provide a more stable proxy so that market participants can better manage their credit.

365. The Midwest ISO states that in Attachment L, there is not a separate credit requirement for virtual transactions and for the FTR auction. Instead, a portion of the Participants Total Credit Limit is allocated to FTR auction activity and virtual transaction activity. The balance of the Total Credit Limit is available for all other transmission service and market activities. The need to allocate a portion of the Total Credit Limit to these two activities is due to the inability to simultaneously compare exposure to non-payment across all transaction activities when deciding whether to accept or reject a bid or offer, where the decision to accept or reject is based on whether sufficient credit was available to support the bid or offer.

366. The formula for calculating the FTR Auction Potential Exposure now states that “MPB” stands for “Maximum Positive Bid,” “MNB” stands for “Maximum Negative Bid/Offer,” “P” stands for the “Set of all positive Bids to be submitted by a given Market Participant during an open FTR Bid window” and “G” stands for the “Set of all negative Bids or Offers to be submitted by a given Market Participant during an open FTR Bid window.”¹⁶⁷

367. The Midwest ISO states that it has removed from the TEMT all “Category A” and “Category B” language. Specifically, section II.G of the Credit Policy has been deleted in its entirety, and section IV.A has been revised to remove the last paragraph in this section, which had discussed how the Total Potential Exposure calculation would have been altered for Category B participants.

368. In doing so, the Midwest ISO states that it is compelled to point out to the Commission two facts. First, Attachment L as submitted did not contain an unconditional requirement for a Participant to grant a first-priority security interest in accounts receivable. This “requirement” was in reality an option for those Participants that wished to have their credit limit based on their net bill and not gross charges owed. Second, the removal of this “option” potentially exposes all Participants to a significant uplift of an uncollectible obligation in the event a Participant declares bankruptcy, and a bankruptcy judge finds that the Midwest ISO must pay to the bankrupt entity all FTR revenue owed without netting this revenue against charges owed to the Midwest ISO on behalf of market participants. This is because under the revised Attachment L as ordered by the Commission the credit limit is compared to the *net* financial obligation to determine if sufficient credit support has been provided relative to a Participant’s activity. This level of credit support will not be sufficient to cover the gross charges of a bankrupt Participant under the circumstances described above.

b. Protests and Comments

369. Epic and SESCO claim that the net effect of the Midwest ISO's proposed credit policies is that for at least fifteen days of each month a virtual trader that wishes to participate in the FTR market loses the ability to use its full posted collateral. They add that although a trader may have \$1 million in posted collateral, only a fraction of this credit may be useable for up to one-half of the month. The effect of this policy, according to Epic and SESCO, is to needlessly increase credit costs and to depress highly beneficial trading activity. Epic and SESCO further assert that the net result of this process is underutilized credit dollars and depressed trading activity.

¹⁶⁷ Section IV.A.4 of Attachment L.

370. Epic and SESCO propose that the Midwest ISO be directed to eliminate distinct or “allocated” credit requirements from its proposed tariffs. Epic and SESCO assert that the values of the total FTR auction bids, along with other market activities, should be looked at together because, so long as a participant does not exceed the Total Credit Limits imposed by the Midwest ISO, there is no risk to the market and no separate contract or credit allocation is needed. According to Epic and SESCO, if the Midwest ISO is concerned that it does not have the ability to see exposure on a simultaneous basis, it can consider all bids/offers on a “last in/first out” basis. Epic and SESCO explains that when a daily bid/offer for the virtual and/or physical market is received by the Midwest ISO, it would essentially be time-stamped. As bids/offers are entered into the FTR market they would be time-stamped as well. At the deadline for the particular market, the Midwest ISO could then run a credit check against the participant's total available credit. Epic and SESCO also claim that if the market participant exceeds its credit limit, the Midwest ISO could remove bids/offers on a “last in/first out” basis until there is enough credit available to cover all positions. Once the corresponding FTR market is settled, the Midwest ISO could then reevaluate the available credit based on the cleared FTRs.

371. Epic and SESCO recommend that the Commission: (1) direct the Midwest ISO to eliminate separate virtual trading megawatt-hours limit and contract; (2) reject the proposed FTR “allocation” process; and (3) require that all credit must remain available to trade across market segments.

372. Epic and SESCO assert the Midwest ISO should only require an entity to post collateral to cover its “positive” exposure when bidding in the FTR auction. The Midwest ISO proposal increases the credit requirement by requiring that credit owed to the Midwest ISO as another element of market exposure and adds them to the MPB. Epic and SESCO also argue that the tariff should use the greater value of the bid/offer for calculating the credit that must be provided, rather than counting both bids and offers if the two are not equal as the Midwest ISO proposes.

373. Epic and SESCO state that the 97th percentile for virtual trading is too restrictive and should be set at the 50th percentile used for the FTRs auction markets. Epic and SESCO also claim that there is no basis for discriminating against virtual trading since both virtual trading and FTRs are financial transactions. Epic and SESCO cite data from other markets, such as PJM, to demonstrate that the 50th percentile is reasonable. Finally, Epic and SESCO object to the discriminatory treatment of financial traders that are required to sign a contract that limits the total megawatt-hours that can be bid or offered.

c. Discussion

374. We accept the Midwest ISO's compliance filing clarifying the requirements to engage in areas of market activity such as virtual trading, FTR auctions, and the physical energy market. We find that the Midwest ISO's creditworthiness proposal does not create excessive collateral burdens on those participants that wish to participate in the various areas of market activity. We also recognize the Midwest ISO's current inability to simultaneously see exposure across various types of market activity.¹⁶⁸ We agree with the Midwest ISO that system enhancement proposals from stakeholders should be submitted through the stakeholder process.¹⁶⁹ However, in general, credit allocated to a market participant that is not exposed to claims against it, should be available to the market participant as soon as is reasonably possible. For example, there may be merit to the adoption of a "last in/first out" process, where bids are "time-stamped" and available credit could be recalculated after market settlement. However, the Commission finds that the absence of a process to time-stamp bids at market start-up does not result in undue discrimination and to order it now would undercut the stakeholder process which must consider the implementation costs of this proposal.

375. We accept the Midwest ISO's proposed remedy for the FTR Auction Potential Exposure calculation.¹⁷⁰ We find that it is acceptable for the Midwest ISO to rename the Minimum Negative Bid as the Minimum Negative Offer to reflect that it will only be composed of negative FTR offers. We will allow the Midwest ISO to submit this change through its proposed clean-up filing 60 days prior to market start-up or through a compliance filing within 30 days of this order to eliminate redundant filing burdens on the Midwest ISO.

376. We likewise accept the Midwest ISO's proposed remedy to correct Attachment L, section III.A.4, titled "Enforcing the Virtual MWh Limit."¹⁷¹ This correction will count both sides of a bid/offer at a particular node, regardless of whether the bid and offer are for the same MW value.

¹⁶⁸ See Midwest ISO Answer at 17.

¹⁶⁹ See *id.*

¹⁷⁰ *Id.* at 18.

¹⁷¹ Attachment L, Substitute Sheet No. 1225.

377. We agree with the Midwest ISO that the TEMT II Order only directed the Midwest ISO to clarify the definition of the proxy and explain why it does not accommodate seasonal variations in the calculation.¹⁷² We find reasonable the Midwest ISO's explanation that absent any real operating data, it used historical price data from the eastern energy markets during 2003 as a proxy for the 97th percentile price differential that would exist in the Midwest ISO markets were actual historical data available. However, we share EPIC and SESCO's concerns that while the Midwest ISO adopted the use of the 50th percentile for the credit calculation for the FTR auction market, they retained the use of the 97th percentile for the virtual trading credit requirement. Therefore, we direct the Midwest ISO to submit through a compliance filing within 30 days of the issuance of this order, justification for the adoption of the 50th percentile for FTRs, and retention of the 97th percentile for virtual transactions.

378. We agree with the Midwest ISO that EPIC and SESCO's argument regarding the potential exposure calculation for FTR auctions cannot be accepted because they assume that all negative FTR bids will be accepted to offset its positive FTR bids.¹⁷³ This could create a situation where there are insufficient funds owed to the market participant to cover the acceptance of positive FTR bids. Therefore, the Total Potential Exposure calculation must reflect this possibility to ensure that credit allocations are not overextended. However, as previously mentioned, the time period required by the Midwest ISO to clear bids and calculate credit exposure should be as short as reasonably possible. The Midwest ISO's proposal for the FTR auctions is reasonable for market start-up, but the Midwest ISO and its stakeholders should continue to study ways reduce the time required to clear credit allocations and streamline the creditworthiness requirements to eliminate unnecessary burdens.

379. We disagree with the Midwest ISO's statements about the removal of the Category A and B language from Attachment L. We do not view the Category A and B distinction as a true "option" for participants subject to the creditworthiness requirements of the tariff. The Commission understands the Midwest ISO's desire to secure the interests of itself and Market Participants in any future bankruptcy proceedings. However, we find that all Market Participants should be able, and would most likely desire, to have their credit limit based on their net bill, not their gross charges owed. Therefore, Category B classification was an option that Market Participants would have only taken if they could not have legally granted a first-priority security interest to the

¹⁷² TEMT II Order at P 447.

¹⁷³ Accepted negative FTR bids create funds owed to the market participant versus accepted positive FTR bids which create charges owed by the market participant.

Midwest ISO, and was therefore discriminatory to groups of stakeholders that rely on debt financing through the Rural Utilities Service. Accordingly, the Commission cannot approve of a requirement that is not used in the other established regional energy markets, and does not have any legal precedent in bankruptcy law.¹⁷⁴

3. Financial Reporting and Financial Security

a. Background

380. In the TEMT II Order, the Commission directed the Midwest ISO to explicitly state in section V.B.1 of Attachment L the interest rate and methodology used to calculate any interest that accrues to the benefit of participants that post cash deposits, and to revise Exhibit V, the Cash Collateral Agreement, accordingly.¹⁷⁵ The Commission further directed the Midwest ISO to revise Section V.B.1 to release and pay interest on a quarterly basis, and Exhibit V, the Cash Collateral Agreement.

381. The Midwest ISO states that it has revised its Credit Policy in order to: (1) state the interest rate and the methodology for calculating interest on cash deposits, and (2) provide for the quarterly release and payment of such interest.¹⁷⁶

b. Discussion

382. We accept the Midwest ISO's compliance filing, which states that interest will accrue on cash deposits at the Midwest ISO's overnight bank rate and that accrued interest will be released quarterly to the applicant and/or participant.¹⁷⁷ We also accept the Midwest ISO's changes to Exhibit V, the Cash Collateral Agreement, to reflect the statement of interest.¹⁷⁸

¹⁷⁴ See Holstein testimony at 13 (Mar. 31, 2004).

¹⁷⁵ TEMT II Order at P 460.

¹⁷⁶ The relevant revisions were made to section V.B.1 and the Cash Collateral Agreement attached as Exhibit V to Attachment L.

¹⁷⁷ Attachment L, Substitute Original Sheet No. 1241.

¹⁷⁸ *Id.* at Substitute Original Sheet No. 1277.

4. Billing and Invoicing

a. Background

383. We directed the Midwest ISO to state in section 7.6 of the TEMT that the invoice schedule shall be weekly, and to clarify its procedures to invoice for the energy markets. We determined that section 11.1 should be revised to include a sentence that states the Midwest ISO official credit policy is found in Attachment L. This will provide additional clarity and is consistent with the previously-approved, corresponding section 11 of the PJM tariff.¹⁷⁹

384. We directed the Midwest ISO to revise sections 7.5 and 7.9 regarding disputed amounts. The Midwest ISO must include specific provisions for the resolution of invoicing disputes or a reference to direct readers to the relevant area of the tariff. Furthermore, section 7.9 must mirror the language in section 7.5 so that Transmission Customers and market participants have equal right to dispute invoice amounts.

385. We also directed the Midwest ISO to revise the definition of default, in section 1.62, to include a reference to the default provisions in section 7.13 and list the distinct default timelines for Transmission Customers and market participants.

386. The Commission directed the Midwest ISO to either remove specific language and replace it with “subject to the receipt of approval from the Commission,” or identify any circumstances, other than in the circumstance where an alternate supplier is required under a state retail access program, in which the Midwest ISO would argue that it is appropriate to terminate service without prior Commission approval.¹⁸⁰

387. We directed the Midwest ISO to remove the language in section 7.8 stating that “upon the occurrence of a default, the Transmission Provider shall (i) suspend any pending Market Activities of the Market Participant and (ii) annul any eligible confirmed transmission reservations of the Market Participant” immediately and prior to Commission approval.¹⁸¹ Similarly we also directed the removal of language in section 7.4 that states, “upon the occurrence of a default, the Transmission Provider, or

¹⁷⁹ See *Outback Power Marketing v. PJM Interconnection, L.L.C.*, 105 FERC ¶ 61,106 at P 3 n.3 (2003).

¹⁸⁰ See *PJM Interconnection, L.L.C.*, 95 FERC ¶ 61,215 at 61,712 (2001).

¹⁸¹ Module A, section 7.8, Original Sheet No. 172.

ITC where applicable, shall annul eligible confirmed reservations of the transmission customer...”¹⁸² Annulments of eligible confirmed transmission reservations have previously been found to amount to termination of service, which is subject to Commission review and approval.

388. Finally, we ordered the Midwest ISO to remove the words “without limitation” and replace them with the word “reasonable.”¹⁸³

389. The Midwest ISO has added the phrase, “On a weekly basis,” to the beginning of section 7.6 of the TEMT to clarify that the Midwest ISO will use weekly billing and invoicing procedures, including those related to the energy markets.

390. The Midwest ISO stated in its transmittal letter that it has also revised section 11.1 of the TEMT to add a sentence stating that its official credit policy is found in Attachment L.

391. Additionally, Midwest ISO states that it has revised sections 7.5 and 7.9 of the TEMT to provide that invoicing disputes shall be resolved pursuant to the dispute resolution procedures in section 12 of the TEMT.

392. The Midwest ISO has revised the definition of Default in section 1.62 to include a reference to the default provisions in section 7.13 and to list the distinct default timelines for transmission customers and market participants.

393. The Midwest ISO has partially revised section 7.14.a to replace the clause “subject to the receipt of any approval of the Commission that may be necessary” with “subject to the receipt of approval from the Commission.”

394. The Midwest ISO has removed the language in section 7.8 stating that “upon the occurrence of a default, the Transmission Provider shall (i) suspend any pending Market Activities of the Market Participant and (ii) annul any eligible confirmed transmission reservations of the Market Participant” immediately and prior to Commission approval. The Midwest ISO has also removed similar language in section 7.4 that states, “upon the occurrence of a default, the Transmission Provider, or ITC where applicable, shall annul eligible confirmed reservations of the transmission customer...”

¹⁸² *Id.* at section 7.4, Original Sheet No. 161.

¹⁸³ PJM OATT section 16.2, Original Sheet No. 52.

395. Finally, the Midwest ISO has revised section 7.14(d) to remove the words “without limitation” and to include the word “reasonable” with respect to the collection of attorneys’ fees.

b. Discussion

396. We accept the Midwest ISO’s compliance filing regarding the billing procedures listed in section 7 of Module A, except as noted otherwise herein. The Midwest ISO states in its transmittal letter that it revised section 11.1 to cross-reference Attachment L;¹⁸⁴ however, the Midwest ISO did not file a redlined/strikeout and clean tariff sheet to comply with this directive. Therefore, we direct the Midwest ISO to refile section 11.1, Original Sheet No. 209, to include an explicit cross-reference to the credit policy in Attachment L in a further compliance filing within 30 days of the date of this order.¹⁸⁵

397. We accept the Midwest ISO’s filing to revise the definition of default, to state the use of weekly invoicing, to remove the language authorizing automatic suspension of market activities in section 7.4 and 7.8, and to revise section 7.14.d. to replace “without limitation” with “reasonable.”

398. We find that the Midwest ISO did not comply with the Commission’s directives in regards to section 7.14.a to remove the language “subject to the receipt of any approval from the Commission that may be necessary.”¹⁸⁶ We find that the Midwest ISO complied with the directive by revising section 7.14.a.iv, but neglected to revise section 7.14.a.iii to remove similar language. Therefore, we direct the Midwest ISO to revise section 7.14.a to remove all language stating, “subject to the receipt of any approval from the Commission that may be necessary,” and to replace it with “subject to the receipt of approval from the Commission.”¹⁸⁷

¹⁸⁴ See Midwest ISO Transmittal Letter at 38 (Oct. 5, 2004).

¹⁸⁵ See TEMT II Order at P 474.

¹⁸⁶ *Id.* at P 477.

¹⁸⁷ Module A, section 7.14.a, Substitute Sheet No. 184-185.

5. Uplift Charge for Uncollectible Default Accounts

a. Background

399. The Commission directed the Midwest ISO in the TEMT II Order to modify its proposal to explain the process for a defaulting customer to cure the default after the uplift charge for its bad debt is assessed to other customers.¹⁸⁸ Additionally, the Commission ordered the Midwest ISO to state in the TEMT that any amounts later recovered for a particular bad debt loss should be allocated to the customers that paid the uplift charge resulting from that bad debt loss.

400. The Commission found in the TEMT II Order that the Midwest ISO's proposed formula rate in the TEMT satisfies the notice requirements of the FPA for charging the uplift charge.¹⁸⁹ However, the formula for the allocation of the uplift charge contained minor flaws that need to be addressed by the Midwest ISO.¹⁹⁰

401. The Commission also required the Midwest ISO to incorporate into the TEMT a requirement found in PJM's uplift charge provisions that requires a member in default to take all possible measures to mitigate the impact of the default on other members not in default – including, but not limited to, loading its own generation to supply its own load to the maximum extent possible.¹⁹¹ Additionally, the Commission required that the Midwest ISO clarify the provision to specify the steps that it will ordinarily take before implementing the uplift charge.

¹⁸⁸ See Attachment U to NYISO's OATT, section 4.0 which requires among other things, that a defaulting customer pay all outstanding and unpaid obligations to cure the default.

¹⁸⁹ See *Public Utilities Commission of the State of California v. FERC*, 254 F.3d 250, 254-56 (D.C. Cir. 2001). See also *Alabama Power Company v. FERC*, 993 F.2d 1557, 1567-68 (D.C. Cir. 1993).

¹⁹⁰ For example, we stated that in the formula component “% Loss for MPa,” the term “Charges” should read “Market Charges” and the component should have a divisor, presumably “MPa (Market Charges + Market Credits)” to create a percentage. In the formula component “Loss Obligation of MPa,” the term “Total Loss” should read “Uncollectible Obligation.”

¹⁹¹ See PJM Operating Agreement at section 15.4.

402. In its October 5 Compliance Filing, the Midwest ISO states that it corrected the minor flaws in the formula rate for allocating the uplift charge for uncollectible debt to market participants. The Midwest ISO also states that it has modified the TEMT to specify the steps it will ordinarily take before implementing the uplift charge; to explain the process for a defaulting customer to cure a default after the uplift charge for its bad debt has been assessed to other customers; and to clarify that any amounts later recovered for a particular bad debt loss should be allocated to the customers that paid the resulting uplift charge. Additionally, the Midwest ISO has incorporated a requirement that a party in default take all possible measures to mitigate the impact of the default on other non-defaulting parties.

b. Discussion

403. We believe that further clarification is necessary in section 7.10.c which states that any funds attributable to a bad debt that has already been uplifted to market participants will be returned to the market participants on a *pro rata* basis. Since there are many potential methods to allocate the funds on a *pro rata* basis, section 7.10.c is not sufficiently clear as to the allocation method for returning the funds to those that previously paid the uplift. We direct the Midwest ISO to clarify that the allocation methodology for the return of funds previously uplifted is the same methodology that was used for the uplift.¹⁹²

404. Additionally, section 7.10 of the TEMT is not sufficiently clear regarding the steps the Midwest ISO will take to minimize the bad debts loss.¹⁹³ Specifically, the Midwest ISO's proposed language would allow it to take alternate actions to minimize the uncollectible costs of enforcement or collection even if such action resulted in a larger total uplift charge.¹⁹⁴ The Commission explained in the TEMT II Order that the

¹⁹² See Attachment U to NYISO's OATT, section 3.0 which requires the same methodology be used for allocating the recovered uplifted funds as was originally used for the uplift charge.

¹⁹³ See TEMT II Order at P 492.

¹⁹⁴ For example, pursuant to the proposed language, the Midwest ISO may forgo taking any of the steps, as delineated in section 7.10 of the TEMT, before implementing the uplift charge because it would save the Midwest ISO uncollectible costs of enforcement or collection. However, such action by the Midwest ISO would inevitably result in a higher uncollectible obligation on market participants and quite likely a higher uplift charge.

Midwest ISO could take alternate actions, as necessary, to minimize the (total) bad debts loss. The Midwest ISO must modify the proposed language to clarify that the alternate action may be taken as necessary, if the Midwest ISO believes that the alternate action will reduce the total uplift charge assessed to market participants.

405. Further, the Midwest ISO has corrected some of the minor flaws in the formula identified by the Commission in the TEMT II Order, however, other flaws remain. For example, “MP ALL Market Charges = Market Credits in weekly invoicing cycle” should read “/ MP ALL (Market Charges + Market Credits) in weekly invoicing cycle.”

J. Other Tariff Issues

1. Miscellaneous Module A Issues

a. Background

406. The Commission’s jurisdiction over distribution facilities is defined in a recent order addressing a variety of generation interconnect issues and the application of Order Nos. 2003, *et al.*, to the Midwest ISO.¹⁹⁵ That order clearly contemplates Commission jurisdiction over low-voltage transmission facilities to the extent they are used to transmit electric energy in interstate commerce on behalf of a wholesale purchaser pursuant to a Commission-filed OATT, and the low-voltage transmission facilities in question are “owned, controlled, or operated by the Transmission Provider or the Transmission Owner, or both, [and] are used to provide transmission service” under the Midwest ISO OATT.¹⁹⁶ Accordingly, the Commission directed the Midwest ISO to revise the definition to reflect the Commission’s definition.

407. The Midwest ISO states that it has revised the definition of “Distribution Facilities” to conform to the definition that the Commission has approved. In addition, the Midwest ISO also revised the related definition of “Wholesale Distribution Service.”

¹⁹⁵ See *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,027 (2004).

¹⁹⁶ See *id.*

408. The Midwest ISO added a number of new definitions in sections 1.3.a and -b; 1.18.a; 1.30.a; 1.60.a; 1.61.a and -b; 1.69.a; 1.75.a; 1.80.a; 1.86.a and -b; 1.94.a; 1.98.a; 1.105.a; 1.118.a, -b and -c; 1.125.a; 1.142.a; 1.151.a; 1.153.a and -b; 1.167.a; 1.188.a; 1.217.a; 1.223.a, -b and -c; 1.237.a; 1.238.a; 1.250.a, -b, -c and -d; 1.261.a; 1.296.a and -b; 1.330.a and 1.334.a.

b. Protests and Comments

409. AMP-Ohio asserts the Midwest ISO designates “Distribution System” as a defined term in the definition of “Energy Resource Interconnection Service,” but there is no corresponding definition in Module A.

410. Midwest TDUs assert that the Midwest ISO’s proposed reserve-sharing definitions are inconsistent and inappropriate since they conflict with current industry practice in which non-control area TDUs actively participate in such groups (*e.g.*, MAPP). If read to exclude non-control areas from participation in reserve sharing, according to Midwest TDUs, these discriminatory definitions would unfairly deprive such TDUs of the essential reliability and economic benefits of reserve sharing, unduly burdening small systems in a manner long recognized to be contrary to the FPA.¹⁹⁷ Nor does it make sense, according to Midwest TDUs, to restrict reserve sharing benefits to agreements between Midwest ISO and non-Midwest ISO member control areas.

c. Discussion

411. We accept the Midwest ISO revision to the definition of “Distribution Facilities.”

412. We agree with AMP-Ohio that “Distribution System” is undefined and therefore direct the Midwest ISO to define this term.

¹⁹⁷ See, *e.g.*, *Gainesville*.

413. Both definitions of Reserve Sharing cited by Midwest TDUs provide for control areas to share in the provision of Operating Reserves in response to the loss of a Generation Resource. These actions will ensure reliability will be maintained for the overall system, thereby providing reliability and economic benefits to all entities that use the system including TDUs. Therefore we do not agree with Midwest TDUs position that these arrangements, as defined, will burden small systems.¹⁹⁸

414. The Midwest ISO has been organized so that control area operators manage all the reserve requirements of their control area, and share reserves with other control areas if needed in the limited circumstance discussed above. We believe it is important that the current roles be maintained during market start, thereby ensuring a smooth market start-up and avoiding confusion. To the extent parties wish to explore alternative methods of sharing reserves in the future, we encourage them to do so in the Midwest ISO stakeholder process. Finally, we do not agree with the Midwest TDUs' statement that reserve sharing is limited to agreements between Midwest ISO and non-Midwest ISO member control areas. The definition of Reserve Sharing in section 1.269 applies to Control Areas that are designated to operate consistent with the Midwest ISO policies and procedures, which is a broader definition than just non-Midwest ISO member control areas

415. We accept the new definitions added by the Midwest ISO inasmuch as they clarify the applicability and intent of other provisions of the TEMT.

2. Schedule 4: Michigan

a. Background

416. In the TEMT II Order, the Commission required the Midwest ISO to eliminate the Michigan-specific Schedule 4s. The Commission explained that while control area operators and generators work cooperatively with the Midwest ISO to balance the system, ultimately the Midwest ISO is the entity that provides the energy imbalance

¹⁹⁸ We note, as the Commission did in the TEMT II Rehearing Order, that *Gainesville* does not provide guidance inasmuch as that decision did not address reserve sharing. See TEMT II Rehearing Order at P 213.

service and charges market participants for the service. The Commission stated that it had also previously required the elimination of the Midwest ISO's Michigan-specific Schedule 4s as of January 1, 2003.¹⁹⁹

417. The Commission directed the Midwest ISO in the TEMT II Order to file a Schedule 4 to its TEMT to set forth the terms, conditions and rates for region-wide energy imbalance service. The Commission stated that Midwest ISO is supposed to include an energy imbalance schedule in the TEMT in order for the TEMT to be complete and compliant with Order No. 888.²⁰⁰ The Commission stated that the energy imbalance schedule submitted in the compliance filing should, similarly to PJM's and NYISO's Schedule 4, explain when the service is provided and require the Midwest ISO to offer this service to serve load in the Midwest ISO's footprint, and the Transmission Customer must purchase the service from the Midwest ISO. Additionally, the Commission stated the Schedule 4 should also provide the energy imbalance rates, which were presumably the hourly LMPs.

418. The Midwest ISO filed two compliance filings to satisfy the Commission's requirements. In the September 7 Compliance Filing, the Midwest ISO proposes to eliminate the Michigan-specific Schedule 4s that have been retained in the TEMT. The Midwest ISO submits in the October 5 Compliance Filing a new Schedule 4 for regional energy imbalance service, stating that it will offer energy imbalance service and that the service must be purchased from the Midwest ISO. Additionally, the proposed Schedule 4 states that imbalances will be resolved over a single hour at the real time LMP. However, Midwest ISO's energy imbalance proposal is different from the energy imbalance schedules accepted by the Commission for other ISOs in that the proposed Schedule 4 does not include a deviation band of +/- 1.5 percent.

b. Protests and Comments

419. In response to the September 7 Compliance Filing, the Midwest SATCs indicate that they support the withdrawal of the Michigan-specific Schedule 4s but ask the Commission to acknowledge that the Midwest ISO is the provider of last resort for imbalance service and the administrator of imbalance service. Midwest SATCs reiterate this request in response to the October 5 Compliance Filing, stating that the filed

¹⁹⁹ The Commission also stated that if Detroit Edison wants Schedule 4 of its Ancillary Services Tariff eliminated, it must file a notice of cancellation with the Commission. TEMT II Order at n.315. *See also* 18 C.F.R. § 35.15 (2004).

²⁰⁰ *See* TEMT II Order at P 516 (citing Order No. 888 at 31,715).

schedule should be revised to explicitly state that the transmission owners, independent transmission companies and control area operators are not required to provide or administer the service.

c. Discussion

420. We accept the Midwest ISO's September 7 Compliance Filing eliminating the Michigan-specific Schedule 4s. However, we reject as unnecessary the Midwest SATCs requests for further clarification. We have already acknowledged in our TEMT II Order that the Midwest ISO is ultimately the provider of the energy imbalance service and as the provider of the service, the Midwest ISO must, by definition, administer the service. We acknowledged in the TEMT II Order that the control area operators and generators must work cooperatively with the Midwest ISO to balance the system (*e.g.*, respond to the Midwest ISO's dispatch instructions); however, they are not the providers of the service and customers would not contract with them to receive the energy imbalance service. Thus, we believe the language in the proposed Schedule 4 is sufficiently clear that the Midwest ISO, as the Transmission Provider, will provide this service since it will offer the service and customers must purchase the service from the Midwest ISO.

421. With respect to the lack of a deviation band, we note that other LMP-based markets have incentives for transmission customers to minimize deviations. For example, for deviations outside of the band, PJM pays only 70 percent of the LMP for over-delivery and requires payment of the higher of 150 percent of the LMP or \$100/MWh for under-delivery. The Midwest ISO's proposal does not have these incentives and the Midwest ISO has not supported any change from the current Commission policy of incorporating deviation bands in energy imbalance provisions. Therefore, we will require the Midwest ISO to either incorporate a deviation band in its energy imbalance provision, as exists in the other LMP-based markets, or explain with testimony why a deviation band is not necessary.

422. In the TEMT II Order the Commission encouraged the Midwest ISO to submit its revised inadvertent energy proposal when it filed its energy imbalance schedule so that the Commission could review both proposals at the same time to ensure that customers would not be charged twice for the same imbalances. Midwest ISO has submitted its energy imbalance provision but not its revised inadvertent energy provision. Therefore, our conditional acceptance of the energy imbalance schedule is subject to the resolution of the revised inadvertent energy provision.

3. Miscellaneous Module C Issues

a. Penalties for Uninstructed Deviations

i. Background

423. The Commission conditionally accepted the uninstructed deviation penalties proposal in section 40.3.4, subject to the Midwest ISO's compliance with certain directives. The Commission directed the Midwest ISO to clarify the process it intends to use for generators that trip after receiving dispatch instructions, particularly if they propose exemptions from deviation penalties.

424. The Commission noted in the TEMT Order that the future tariff filing must include language on the procedures and criteria for certifying intermittent resources.²⁰¹ Those procedures need to be completed and filed with the Commission prior to market start-up. In addition, the Commission required the Midwest ISO to file more detail on the resources that are eligible to be exempt from uninstructed deviation penalties, such as emergency conditions, resources in test mode, resources in start-up or shut-down mode, and run-of-the-river hydro units. The Commission also directed the Midwest ISO to develop procedures to exempt intermittent resources and file those procedures with the Commission prior to market start-up.

425. The Midwest ISO states that it will not provide dispatch instructions to generators that trip. Once the data received by the Midwest ISO indicates that a generator is no longer on-line, the Midwest ISO will continue to issue a zero dispatch instruction until the data indicates that a generator is on-line. Consequently, explains the Midwest ISO, no exemption to the uninstructed deviation penalty is necessary in this instance.

426. Finally, the Midwest ISO has submitted tariff provisions to: (1) clarify the procedures and criteria for certifying and exempting intermittent resources; and (2) provide more detail on resources eligible to be exempt from uninstructed deviation penalties.

²⁰¹ *See id.* at P 99.

ii. Protests and Comments

427. Coalition MTC did not object to the proposed tariff changes to accommodate intermittent resources. However, it does object to the removal of language that provides an exemption for DRRs on Substitute Original Sheet No. 587. Coalition MTC states that this appears to be a typo because it conflicts with page 27 of the Midwest ISO transmittal letter for the compliance filing. Therefore Coalition MTC asks the Commission to direct the Midwest ISO to reinstate the exemption for demand response resources.

iii. Discussion

428. We accept the Midwest ISO's compliance filing regarding our directives from the TEMT II Order to revise the uninstructed deviation penalty structure so that over-generation and under-generation are both penalized at 40 percent of the applicable LMP. We likewise accept the Midwest ISO's clarification of the certification of intermittent resources and exemptions to the deviation penalties, with one exception discussed below.

429. However, we find that the Midwest ISO has not complied with the Commission's directive to clarify the procedures for generators that trip after receiving dispatch instructions.²⁰² The Midwest ISO's clarification stated that it would not continue to issue dispatch instructions to generators that are not on-line and therefore no additional exemption to the uninstructed deviation penalty is warranted. However, the scenario in question was not treatment of generators that are clearly off-line; instead the directive for clarification references cases where the Midwest ISO has already sent a dispatch instruction to a generator that trips offline after the instruction has been sent. Therefore, the Midwest ISO is directed to clarify, within 30 days, whether units that trip after receiving dispatch instructions are exempt from deviation penalties.

430. In addition, the Commission agrees with Coalition MTC that the removal of language that exempts DRRs from uninstructed deviation penalties on Substitute Original Sheet No. 587 was in error. We direct the Midwest ISO to resubmit Substitute Original Sheet No. 587 with the section on Treatment of Demand Response Resources reinstated.²⁰³

²⁰² *See id.* at P 533.

²⁰³ Module C, section 40.3.4.d.ii, Original Sheet No. 587.

b. Generator Shortfall Uplift Charge

431. In the TEMT II Order, the Commission directed the Midwest ISO to clarify the TEMT to state that the Midwest ISO will determine, on a daily basis, whether a generator recovers its costs, consistent with Dr. McNamara's testimony.

432. In its compliance filing, the Midwest ISO has amended sections 39.2.9.f and 40.2.13 to clarify that the Midwest ISO shall determine the generator shortfall uplift charge on a daily basis.

433. We accept the Midwest ISO's filing as compliant with the Commission's TEMT II Order. However, we note that we required additional changes to the generator shortfall uplift sections in the TEMT II Rehearing Order and we will address those issues in a future order on the TEMT II Rehearing Order's compliance filing.

c. Inadvertent Energy**i. Background**

434. In the TEMT II Order, the Commission rejected the Midwest ISO's inadvertent energy proposal, without prejudice to the Midwest ISO's filing a new proposal.²⁰⁴ In doing so, the Commission identified a number of issues requiring further clarification. The Commission stated that the Midwest ISO should explain step-by-step how it plans on calculating inadvertent energy and charging or crediting the costs of inadvertent energy. Additionally, the Commission encouraged the Midwest ISO to explain whether its inadvertent energy proposal is compatible with PJM's and whether it will facilitate a move to a common market. The Commission also directed the Midwest ISO to address why section 40.7.2 refers to "market ratio share," and whether the proposed billing determinants are just and reasonable²⁰⁵ and how in-kind payments with external control areas would be allocated. The Commission recognized intervenors' concerns that there may be overlaps with energy imbalance service and directed the Midwest ISO to

²⁰⁴ TEMT II Order at P 597-98.

²⁰⁵ The Commission also stated that if the Midwest ISO intends to use the billing determinants in Schedule 17 for inadvertent energy, it should include support demonstrating the proposed billing determinants are just and reasonable. Moreover, the Midwest ISO should incorporate into section 40.7 of the TEMT its proposed billing determinants rather than reference Schedule 17 billing determinants which may change as a result of future Commission order.

explain how it would avoid such overlaps. The Commission encouraged the Midwest ISO to file a new inadvertent energy provision when it files its Schedule 4 for energy imbalance service to permit sufficient time for Commission review of both provisions prior to the commencement of the energy markets.

435. In the transmittal letter to its October 5 Compliance Filing, the Midwest ISO claims that it has initiated its review of the issues identified by the Commission in connection with a revised inadvertent energy proposal, but is not prepared to submit such a new proposal with this compliance filing. The Midwest ISO states that it requires more time to fully evaluate the issues raised by the Commission, discuss these issues with its stakeholders, and reach an appropriate resolution prior to making another filing with the Commission. The Midwest ISO intends to continue this process and submit a revised inadvertent energy proposal for Commission review prior to commencement of the energy markets.²⁰⁶

ii. Discussion

436. As discussed above, the Commission encouraged the Midwest ISO in the TEMT II Order to file its inadvertent energy proposal at the same time it filed its energy imbalance Schedule 4 to facilitate the concurrent review of both provisions by the Commission. The Midwest ISO has submitted its proposal for energy imbalance service but not for inadvertent energy service. Therefore, we have conditionally accepted the energy imbalance service subject to the acceptance of Midwest ISO's revised inadvertent energy provision. We direct Midwest ISO to file within 30 days from the date of this order its inadvertent energy proposal.

²⁰⁶ Midwest ISO Transmittal Letter at 42-43 (Oct. 5, 2004).

d. Attachment W: Market Participant Agreement**i. Background**

437. The TEMT II Order directed the Midwest ISO to modify section 38.2.2.h of the TEMT to state that the Market Participant Agreement in Attachment W will be executed upon the Midwest ISO's approval of the rest of the Market Participant Application.²⁰⁷ In lieu of a signed Market Participant Agreement, the Commission permitted the Midwest ISO to require a Market Participant Applicant to submit a representation, such as a letter, that the applicant will be able to execute the Market Participant Agreement when its application is approved.

438. The TEMT II Order further directed the Midwest ISO to hold the requirement to execute the Market Participant Agreement in abeyance for parties that have outstanding GFA issues, pending resolution of those issues through a subsequent order in this proceeding.²⁰⁸

439. Finally, the Commission directed the Midwest ISO to modify or clarify the requirements listed in sections 8.0 and 9.0 of the Market Participant Agreement. As filed, section 8.0 indicates that a market participant must notify the Midwest ISO in writing "of any unexpected material adverse change in circumstances that may affect the Market Participant's status as a Market Participant, within twenty-four (24) hours of learning of the requirement."²⁰⁹ Section 9.0 states that a market participant must "notify the Midwest ISO in writing of any non-material adverse changes" that may affect the Market Participant status at least 72 hours prior to the change.²¹⁰ The Commission held that any adverse change to market participant status would be material, and instructed the Midwest ISO to revise section 9.0 accordingly – perhaps by deleting "non-" so that the paragraph would refer only to "material adverse changes." The Commission added that if the Midwest ISO intended for market participants to notify the Midwest ISO of non-material changes, the Midwest ISO must clarify this. The Commission also required the Midwest ISO to add definitions of material and non-material adverse changes to the Market Participant Agreement and to provide relevant examples of each. Additionally,

²⁰⁷ TEMT II Order at P 603.

²⁰⁸ *See* Procedural Order at P 78.

²⁰⁹ Attachment W, Original Sheet No. 1691.

²¹⁰ *Id.* at Original Sheet No. 1692.

the Commission required the Midwest ISO to clarify what notification, if any, it will require of a market participant that expects a material adverse change that will affect the market participant's status, and what event will trigger the notification requirement.

440. In its transmittal letter, the Midwest ISO states that it has amended section 38.2.2.h in order to: (1) remove the requirement that market participant Applicants execute the Market Participant Agreement before the Market Participant Application is approved; and (2) hold in abeyance the requirement for execution of the Market Participant Agreement with respect to parties that have pending GFA issues before the Commission.

441. The Midwest ISO goes on to say that it has deleted the prefix "non-" from the phrase "non-material adverse change" in section 9.0 of the Market Participant Agreement. (We note that the Midwest ISO has also, of its own accord, inserted the words "that the Market Participant intends to implement and" between "circumstances that" and "may affect" in that section.) It has made a similar deletion in section 38.2.3.b of the TEMT. The Midwest ISO thinks these deletions render it unnecessary to provide a definition and examples of "material adverse change." It notes that Module A of the TEMT contains definitions of the terms "Material" and "Material Change."²¹¹

442. Finally, the Midwest ISO clarifies that the notice contemplated by section 9.0 of Attachment W concerns future changes that the market participant itself is about to implement, and which are therefore within its foresight and control.

ii. Discussion

443. The Midwest ISO's proposed changes to Attachment W largely satisfy the requirements of the TEMT II Order. We will accept them subject to further modification.

444. The Midwest ISO's amendments to section 38.2.2.h satisfy the Commission's requirements that: (1) Market Participant Applicants not be required to execute the Market Participant Agreement prior to the Midwest ISO's approval of the Market Participant Application; and (2) parties with outstanding GFA issues not be required to execute the Market Participant Agreement until those issues have been resolved. The Midwest ISO has also elected to insert a requirement that the Market Participant Applicant represent, as part of its application, that it will be able to execute the

²¹¹ Module A, sections 1.190-91, Original Sheet Nos. 97-98.

Market Participant Agreement when its application has been approved. We accept the Midwest ISO's proposed tariff language. We will require the Midwest ISO to correct the reference to "Docket No. EL04-401-000" in the last sentence of this section. The reference should be to Docket No. EL04-104-000.

445. We accept the Midwest ISO's revisions to section 9.0 of Attachment W and to section 38.2.3.b of the TEMT. Removing the prefix "non-" and adding the words "that the Market Participant intends to implement and" better clarifies that section 8.0 applies to material adverse changes that the market participant does not expect, while section 9.0 applies to material adverse changes that the market participant anticipates and can control. We note that section 9.0 does not appear to address circumstances in which a market participant reasonably anticipates, but cannot control, an adverse material change (such as a change to the status of its Designated Agent), yet section 38.2.3.b appears to require a Market Participant *Applicant* to notify the Midwest ISO of such a change. We do not understand why the TEMT makes this distinction. We will therefore require that the Midwest ISO further modify section 9.0 of the Market Participant Agreement to insert the phrase "learns of or" between the words "Market Participant" and "intends" in the modified section 9.0.

446. Finally, we reject the Midwest ISO's assertion that deleting "non-" from section 9.0 of the Market Participant Agreement and section 38.2.3.b of the TEMT make it unnecessary to define a material adverse change. While both sections 8.0 and 9.0 now apply to material adverse changes only, there is little context to lend meaning to the phrase "material adverse change." We acknowledge that Module A defines "Material" and "Material Change." However, these definitions are financial in nature, while market participant status also depends on technical and operational capability.²¹² We reiterate our requirement that the Midwest ISO provide examples of material and non-material changes; however, we will waive the requirement that the Midwest ISO add these examples to the Market Participant Agreement itself. The Midwest ISO may comply with this requirement by providing an explanation in its next compliance filing.

²¹² See, e.g., Module C, section 38.2.2.b, Original Sheet No. 368 (specifying that a market participant or its Designated Agent must comply "with all applicable metering, data storage and transmission, and other reliability operation, planning and accounting standards and requirements for operating in the Transmission Provider Region . . .").

e. Schedule 17

447. Midwest TDUs complain that the Midwest ISO made changes to the billing determinants of the administrative charge for the energy markets in Schedule 17 that were not required by the Commission.²¹³ Further, Midwest TDUs state that the proposed change in the billing determinant could result in double-counting.

448. In its answer, the Midwest ISO states that the proposed change to the billing determinant should have been taken out because the change was made to reflect the Midwest ISO's revised inadvertent energy proposal (which ultimately was not included in the compliance filing). The Midwest ISO states that it is prepared to support its change to the billing determinant when it files its revised inadvertent energy proposal.

449. Since the Midwest ISO has acknowledged that the change was not intended to be made in this filing and that it will support the proposal in a future filing, we will reject the modification to the billing determinant without prejudice to Midwest ISO's future inadvertent energy filing.

K. Seams Issues

1. Background

450. 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 of seams resolution, including detailed plans as to how Midwest ISO will address seams absent seams agreements, so that the most current seams resolutions can be factored into the FTR allocations.

451. Regarding PJM, the Midwest ISO states that in accordance with previous Commission orders, a Joint Operating Agreement was executed by the Midwest ISO and PJM (Midwest ISO-PJM JOA), and filed with the Commission.²¹⁴ The provisions of the

²¹³ The billing determinants for the Schedule 17 charge are the sum of all injections and extractions from the transmission system and virtual trades which are defined as the estimated Bids or Offers settled in the day ahead energy market which are not actually injected or extracted from the transmission system.

²¹⁴ See Midwest ISO Transmittal Letter at 43-44 (Oct. 5, 2004) (citing *Alliance Companies*, 100 FERC ¶ 61,137 (2002); *Midwest Independent Transmission System Operator, Inc. and PJM Interconnection, L.L.C.*, 106 FERC ¶ 61,251, *order on reh'g*, 108 FERC ¶ 61,143 at P 58, 59 (2004)).

Midwest ISO-PJM JOA and the congestion management process incorporated into the Midwest ISO-PJM JOA are now being implemented on schedule, as indicated in periodic reports to the Commission.

452. With respect to MAPP, the Midwest ISO states that the non-Midwest ISO members of MAPP have met with the Midwest ISO several times over the last six months to develop a Seams Operating Agreement (SOA). According to the Midwest ISO, the parties have reached agreement in principle on the most important seams issues to facilitate the administration of the MAPP Schedule F tariff after the start-up of the Midwest ISO energy markets. Structured as an agreement between the Midwest ISO and MAPPCOR, the document is patterned after the Midwest ISO-PJM JOA, although modified to reflect that there is no RTO-to-RTO relationship as there is with PJM and that reliability coordination is already provided under an existing agreement between the Midwest ISO and MAPPCOR. The document contains assurances of continued data transfers from MAPPCOR to the Midwest ISO. The parties planned to continue meeting after the filing of the compliance filing to work out the remaining issues.²¹⁵ On December 1, 2004, the Midwest ISO filed a status report on the negotiations. It stated that the parties are still working on finalizing the agreement and only a few detailed issues remain outstanding, including the issue of netting generation-to-load impacts, and the question of how to share unused flowgate allocations. The parties calculate that to successfully resolve outstanding issues, reduce the agreement to a final written form and obtain stakeholder approval, they will need until January 15, 2005. The Midwest ISO contends that this schedule will still provide the Commission with adequate time to review the agreement before energy market start-up.

453. Regarding the Tennessee Valley Authority (TVA), the Midwest ISO states that PJM, Midwest ISO and TVA signed a data exchange agreement in May 2004 to address the exchange of critical operating data to enhance real time operations among the three reliability coordinators, which will provide better visibility by all three parties into the systems of the others.

454. Further, the Midwest ISO claims a Joint Reliability Coordination Agreement addressing other aspects of seams operations is now being negotiated. That agreement, also patterned after the JOA, would provide for additional coordination of flowgates among the three parties. Nothing in the Joint Reliability Coordination Agreement will

²¹⁵ The Midwest ISO clarifies that the issues raised by Otter Tail regarding the difficulty of establishing the energy markets in Otter Tail's control area as a result of the joint ownership of generation and North Dakota Export (NDEX) redispatch rules are being addressed in the context of the MAPP seams discussions.

contradict or modify the JOA between PJM and Midwest ISO, filed with the Commission. Because TVA is non-jurisdictional, and because the JOA controls the two entities that are jurisdictional, there is no plan to file the Joint Reliability Coordination Agreement.

455. The Midwest ISO also states that it has executed an Interim Coordination Agreement with the Ontario Independent Market Operator (IMO) to address seams operating issues. The Interim Coordination Agreement establishes a framework to resolve operating issues across the international interconnections in Michigan, Minnesota and Manitoba, and provides for the exchange of critical operating data, including data relating to outages.

456. The Midwest ISO states that a “coordination committee” has been formed to implement details of the Interim Coordination Agreement and to address future operating issues, including: (1) data exchange requirements, formats, and methodologies; (2) developing and issuing operating instructions and security limits; (3) implementing the requirements of the applicable NERC regional coordinating committee; and (4) providing assistance in an emergency and system restoration.

457. The Midwest ISO states that it began negotiations with Southwest Power Pool (SPP) on seams issues in late 2003, using the PJM agreement as the pattern for discussions. On August 2, 2004, SPP filed an unexecuted JOA as its compliance filing in Docket No. ER04-1096-000, noting that the Midwest ISO had declined to execute a JOA unless it included enhanced coordination principles. The Midwest ISO filed a protest, attaching an alternative draft JOA.

458. On October 1, 2004 the Commission issued an Order in Docket No. ER04-1096-000, accepting SPP’s JOA for filing as an interim solution, subject to SPP’s committing to file by December 1, 2004 either: (1) a revised JOA with the Midwest ISO addressing market-to-non-market issues (including a congestion management process and coordinated flowgates); or (2) an executed version of the draft JOA included in the Midwest ISO’s protest.²¹⁶ On December 2, 2004, SPP filed an executed JOA.

²¹⁶ *Southwest Power Pool, Inc.*, 109 FERC ¶ 61,008 at P 2, Ordering Paragraph (2004).

459. In the event that one or more of the seams arrangements cannot be concluded with a detailed resolution of all issues, Midwest ISO plans to continue meeting with the affected neighbor to reach a mutually satisfactory outcome. Until that time, the Midwest ISO states that its energy markets will operate as the PJM market does today, and will schedule all transactions as indicated in its tariffs.

460. The Midwest ISO and its neighbors will use TLRs to address loop flow congestion, in the absence of other alternatives. The data exchange agreements, which have been acceptable to all parties, will improve the ability of the Midwest ISO to identify and address congestion in these circumstances, and to minimize the use of TLRs.

2. Protests and Comments

461. WPS Resources assert that the October 5 Compliance Filing is deficient because it does not adequately address seams issues as required in the TEMT II Order. For example, although the methodology for coordinating flowgates has been discussed, the flowgates that will be subject to reciprocal control have not been listed and the allocation of flowgate capacity between Midwest ISO and MAPP entities has not been resolved. WPS Resources state that various seams agreements must be coordinated to avoid unintended consequences.

462. LG&E contends that the data exchange agreement between the Midwest ISO, PJM and TVA is insufficient and does not resolve critical seams issues. According to LG&E, the Midwest ISO's characterization of those discussions indicate no issues have been resolved, does not put into effect any plan of redispatch or reliability coordination.

463. Detroit Edison claims that the Interim Coordination Agreement between the Midwest ISO and the Ontario IMO is insufficient and does not resolve critical seams issues. In particular, Detroit Edison argues that a mechanism must be developed to provide for payment of LMP market costs caused by redispatch within the Midwest ISO to avoid a TLR affecting the Ontario IMO. Based on the transmittal letter that accompanied the October 5 Compliance Filing, Detroit Edison states that no issues have been resolved and therefore the Commission should order the Midwest ISO to vigorously pursue a complete resolution of all seams issues with the IMO and to report regularly to the Commission on the progress made.

3. Discussion

464. We are encouraged by the progress the parties have made toward filing an SOA, developed by MAPP members and the Midwest ISO, by the commencement of the energy markets. If the parties are unable to file the SOA by January 15, 2005, the Midwest ISO must file another status report on that date. When the parties reach

agreement on the allocation of flowgate capacity between the Midwest ISO and MAPP, we will address the specifics of the proposal. We are satisfied with the procedures the Midwest ISO proposes to use in the interim until the seams agreements can be filed.²¹⁷ With respect to LG&E's concerns, we note that the data exchange between the Midwest ISO, PJM and TVA is limited to the exchange of real-time operational data between the Midwest ISO and PJM energy markets and the TVA area, which is not an energy market. We expect that reliability issues between TVA and the Midwest ISO will continue to be resolved in the same way they are currently, so that redispatch and possibly TLR procedures will continue to be used. Therefore, the exchange of data represents an enhancement in reliability coordination that is helpful, but not critical, to market start. Likewise, with respect to Detroit Edison's concerns, we consider the Interim Coordination Agreement between the Midwest ISO and the Ontario IMO to be limited to real-time operational issues, and therefore the data exchange amounts to an enhancement to reliability coordination and is not meant to be a replacement for ongoing reliability procedures currently in effect such as redispatch. Accordingly, we consider the progress made on these agreements sufficient for market start-up purposes. We do not see the need for the filing of additional reports. Our requirement for a progress report in the TEMT II Order was to ensure that the most current seams resolutions could be factored into FTR allocations. Inasmuch as these data exchange agreements will not affect FTR allocations, we will not require updates.

465. We agree with Detroit Edison that a mechanism needs to be developed to provide for the payment of new LMP market costs caused by redispatch within the Midwest ISO to avoid a TLR affecting the IMO. We note that the Midwest ISO-PJM JOA includes a provision that in the event that redispatch occurs in order to coordinate congestion management during the market to non-market phase, including redispatch necessary to respect the other party's flowgate, the party responsible for the flow that required the redispatch shall bear the costs of the redispatch to the extent the costs may be recovered under the party's OATT. Accordingly, we direct the Midwest ISO to develop such a mechanism in an agreement with the Ontario IMO and to file the agreement before market start-up.

²¹⁷ See TEMT II Order at P 639 (finding that the absence of seams agreement should not impede energy market start-up, but the Midwest ISO must have at least a specific, transparent plan for how it will handle the market-to-non-market seams).

L. Business Practice Manuals

466. Midwest ISO TOs cite sections 38.1 and 39.2.5.a as examples of sections that should be revised, per the TEMT II Order,²¹⁸ to the extent that they define rates, terms and conditions of service by reference to the Business Practices Manual instead of setting them forth in the TEMT and rate schedules. Our standard for inclusion of provisions in the tariff are those practices that affect rates and services significantly, that are realistically susceptible of speculation and are not so generally understood as to render recitation superfluous.²¹⁹ Section 38.1 states the Transmission Provider shall provide all market services for the energy markets and Markets Activities in accordance with the terms of this Tariff, Business Practices Manuals, and related agreements. To the extent the Midwest ISO has included provisions for services in its tariff that meet our standards, as directed in the TEMT II Order, and Midwest ISO TOs have not provided information to indicate otherwise, we do not have a basis to require additional items be added to the tariff. Section 39.2.5.a states that standing offers may be updated or removed by making the offer unavailable, consistent with the Business Practices Manual. This service provision does not trigger the tariff filing requirements of our standard, in that it represents an administrative process that is not a significant activity. Therefore, we will not require these provisions be included in the tariff.

M. Acceptance of Tariff Revisions and Compliance Filing Deadlines

467. We accept the Midwest ISO's proposed revisions and deletions, as required by the TEMT II Order and not discussed elsewhere in this order, to the following sections: 38.2.4; 38.6.8; 40.3.4.c.ii; 51.2.b.i; 52.3.b; 53.1.f; 53.2.a.i; 54.3.b and -.c; 63.2.a.i, -.ii; 63.2.b; 63.3.a.i, and. iii; 63.3.b and -.e; 63.4.1.g; 63.4.2.d; 64.1.1.e; 64.1.3.a.i and -.ii; 64.2.1.a; 65.3.1..b and -.d; 65.3.2.a, -.b, -.c, . d and -.e; 65.3.3; 65.3.4; 65.5.3.a; and 66.b.

468. 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. The tariff sheets we have accepted above will become effective, subject to further orders, on March 1, 2005. With respect to the tariff sheets to which we have required further modifications, we will require the Midwest ISO to file modifications.

²¹⁸ *Id.* at P 656.

²¹⁹ See *Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, 64 FERC ¶ 61,139 at 61,988 (quoting *City of Cleveland v FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985)).

469. To the extent that the order does not specify due dates for individual compliance requirements, the Midwest ISO is required to address those requirements within 30 days of the date of this order. The Midwest ISO must address all compliance requirements within 30 days of the date of this order; however, it may elect to satisfy any portion of the compliance requirements this order imposes by including its responses in the “clean-up” filing it plans to make 60 days prior to market start-up.

The Commission orders:

(A) The Midwest ISO’s compliance filing is hereby accepted in part, as modified, and rejected in part as described in the body of this order, to become effective March 1, 2005.

(B) The Midwest ISO is hereby required to make compliance 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) Commissioner Kelly concurring in part with a separate statement attached.

Linda Mitry,
Deputy Secretary.

Appendix A

Parties Filing Pleadings Responsive to September 7 Compliance Filing

Midwest SATCs – American Transmission Company LLC, GridAmerica LLC, International Transmission Company and Michigan Electric Transmission Company, LLC

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

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

Parties Filing Pleadings Responsive to October 5 Compliance Filing

AMP-Ohio – American Municipal Power-Ohio, Inc.

Cinergy – Cinergy Services, Inc.

Coalition MTC – Coalition of Midwest Transmission Customers

Constellation – Constellation Power Source, Inc. and Constellation NewEnergy, Inc.

Detroit Edison – Detroit Edison Company

Dominion – Dominion Retail, Inc., Dominion Energy Marketing, Inc. and Troy Energy, LLC

Dynegy – Dynegy Power Marketing, Inc. and Dynegy Midwest Generation, Inc.

Epic and SESCO – Epic Merchant Energy LP and SESCO Enterprises LLC

Exelon – Exelon Corporation

LG&E – LG&E Energy LLC

MidAmerican – MidAmerican Energy Company

Midwest ISO TOs – Ameren Services Company, as agent for Union Electric Company d/b/a AmerenUE, Central Illinois Public Service Company d/b/a AmerenCIPS and Central Illinois Light Co. d/b/a AmerenCilco; Aquila, Inc. d/b/a Aquila Networks (f/k/a Utilicorp United, Inc.); Cinergy Services, Inc. (for Cincinnati Gas & Electric Co., PSI Energy, Inc. and Union Light Heat & Power Co.); City Water, Light & Power (Springfield, Illinois); Hoosier Energy Rural Electric Cooperative, Inc.; Indianapolis Power & Light Company; LG&E Energy Corporation (for Louisville Gas and Electric Co. and Kentucky Utilities Co.); Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northern Indiana Public Service Company; Northern States Power Company and Northern States Power Company (Wisconsin), subsidiaries of Xcel Energy, Inc.; Northwestern Wisconsin Electric Company; Otter Tail Corporation d/b/a Otter Tail Power Company; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana); and Wabash Valley Power

Association, Inc.

Midwest SATCs – American Transmission Company LLC, GridAmerica LLC, International Transmission Company and Michigan Electric Transmission Company, LLC

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.

OMS – Organization of MISO States

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 Power Service Corporation, Upper Peninsula Power Company and WPS Power Development Inc.

WUMS LSEs – Wisconsin Electric Power Company, Edison Sault Electric Company, Wisconsin Public Service Corporation, Upper Peninsula Power Company, Wisconsin Power and Light Company, Madison Gas and Electric Company, Wisconsin Public Power, Inc. and the Wisconsin Retail Customers Group (consisting of Wisconsin Industrial Energy Group, Inc., Wisconsin Paper Council, Wisconsin Merchants Federation and Citizens Utility Board)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission
System Operator, Inc.

Docket Nos. ER04-691-004
ER04-691-007
EL04-104-006

(Issued December 20, 2004)

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

I dissent from the portion of this order that accepts the Midwest Independent Transmission System Operator, Inc.'s (MISO) compliance filing authorizing the MISO's Independent Market Monitor (IMM) to establish reference prices. In my view, authorizing MISO's IMM to establish reference prices constitutes an unlawful delegation of the Commission's ratemaking authority.

Section 205 of the Federal Power Act (FPA) vests exclusive authority with the Commission to set the rates and charges for wholesale electric sales of energy.¹ As described in the Commission's order, reference prices, while perhaps not "rates" themselves, ultimately dictate the price that generators are paid in certain circumstances.² They certainly do not appear to be formula rates.³ Moreover, this order clearly states that MISO's IMM will "establish" reference prices.⁴ These reference prices may serve as a price cap. Thus, in my view, the conclusion is inescapable that by authorizing the IMM to

¹ 16 U.S.C. § 824d (2000).

² Order at PP 229-31.

³ In calculating reference prices, the IMM considers "legitimate risks and opportunity costs," which are broadly defined to include "intertemporal opportunity costs caused by run-time restrictions, operational risks such as the risks of unity failure (including costs of repairs and costs of foregone sales during the repair period), short-term fluctuations in fuel prices or availability, and possibly, other factors." Opinion at P229.

⁴ Order at P 231.

establish reference prices, the IMM is performing a ratemaking function assigned to the Commission under the FPA.

Under *U.S. Telecomm. Ass'n v. FCC*,⁵ federal agencies such as the Commission cannot subdelegate their authority to outside entities--private or sovereign--absent an affirmative showing of congressional authorization.⁶ The FPA contains no provision authorizing the Commission to delegate its ratemaking authority. Moreover, the U.S. Court of Appeals for the District of Columbia Circuit recently rejected the notion that market monitors like the IMM can be deemed "the functional equivalent of Commission staff."⁷ Since the IMM is an outside party, the Commission cannot lawfully delegate its ratemaking authority to the IMM by authorizing the IMM to establish reference prices. Accordingly, I dissent from that portion of the Commission's order.

Joseph T. Kelliher

⁵ 359 F.3d 554 (D.C. Cir. 2004)

⁶ *Id.* at 565-66.

⁷ *Electric Power Supply Association v. FERC*, No. 03-1182, slip op. at 17 (D.C. Cir. Dec. 10, 2004).

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission
System Operator, Inc.

Docket Nos. ER04-691-004
ER04-691-007

(Issued December 20, 2004)

KELLY, Commissioner, *concurring*:

Midwest ISO's proposed organized markets, like other organized markets, grant independent market monitors (IMM) a certain amount of flexibility to deal with situations that may arise. One example of such IMM flexibility is the ability to determine reference prices for mitigation purposes.

As I understand the process, the IMM must be able to react very quickly to changes in market conditions to prevent relatively small and transient market problems from cascading quickly into general market failures, as happened in California during its 2001 crisis. Because no standard regulatory process could keep up with this necessarily fast pace, IMM-determined reference prices are not filed for prior approval by the Commission. Given the great complexity of the market rules and procedures for organized markets, especially during start-up, this flexibility to react quickly appears essential.

On the other hand, concerns have been raised that affording this level of discretion to market monitors may be an inappropriate delegation of the Commission's duties.

I am sensitive to these concerns but I also believe that organized markets, like the one that Midwest ISO is creating, require an IMM to have this type of flexible authority to address problems in real time. Organized markets generate tremendous volumes of data and the longer a problem is allowed to persist, the greater the volume of information that must be studied and the more difficult it becomes to address the problem in a timely fashion. In organized markets the public is best served through real-time correction of problems, which requires an IMM to have adequate authority to act in a timely manner.

While attention needs to be given to the scope of authority we permit the IMM to exercise, I do not believe that this compliance filing is the proper place to explore options not contemplated in the earlier orders dealing with the Midwest ISO's proposed organized markets. The ultimate answer may be for FERC to become the employer of the IMM, either through contract or directly, or for FERC

to have appellate review of some IMM decisions, but these concepts are more appropriately considered in other proceedings.¹ Perhaps the Commission's response to *EPSA* on remand will address this concern as well. In the meantime, I support this aspect of the current Midwest ISO market design, for without it, the public will not be adequately protected.

Sudeen G. Kelly

¹ Especially in light of the recent court remand on the issue of *ex parte* communications between the Commission and market monitoring units [*Electric Power Supply Ass'n v. FERC*, No. 03-1182, 2004 U.S App. Lexis 25470, (D.C. Cir. Dec. 10, 2004)(*EPSA*)]. Among other things, *EPSA* essentially rejected the Commission's attempt to treat IMMs hired by regulated entities as "the functional equivalent of [FERC] employees" (*Id.* at * 17).