121 FERC 61,280
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission System Operator, Inc. — Docket No. ER08-109-000

ORDER ACCEPTING, AS MODIFIED, PROPOSED TARIFF REVISION

(Issued December 20, 2007)

1. On October 30, 2007, Midwest Independent Transmission System Operator, Inc. (Midwest ISO) submitted for filing proposed revisions to its Open Access Transmission and Energy Markets Tariff (TEMT) pursuant to section 205 of the Federal Power Act (FPA).[1] Midwest ISO proposes to amend the TEMT to allow it to accelerate the timing of monthly allocations and auctions of Financial Transmission Rights (FTRs) for February through May 2008, in order to transition to Midwest ISO's new system for the allocation of Auction Revenue Rights (ARRs) and Long-Term Firm Transmission Rights (LTTRs). For the reasons stated below, we accept the proposed revisions, as modified herein, to be effective January 1, 2008.

I. Background

2. On January 29, 2007, Midwest ISO submitted proposed revisions to the TEMT to provide for LTTRs, as directed by the Commission in Order No. 681.[2] These revisions were conditionally accepted by the Commission on May 17, 2007.[3] Pursuant to the May 17 Order's conditional approval of the provisions regarding ARRs and LTTRs, Midwest ISO started obtaining registration data for ARR Entitlements to enable the

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[1] 16 U.S.C. § 824d (2000).

[2] *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, FERC Statutes and Regulations ¶ 31,226, *order on reh'g*, Order No. 681-A, 117 FERC ¶ 61,201 (2006).

[3] *See Midwest Independent Transmission System Operator, Inc.*, 119 FERC ¶ 61,143 (2007), *reh'g pending* (May 17 Order).

Annual ARR Allocation to begin in 2008.[4] In preparing for the transition to the new ARR-LTTR allocation and FTR auction system, Midwest ISO determined the existing software cannot simultaneously process activities under the old FTR system and the new ARR-LTTR system during February through May 2008. Midwest ISO determined that during this period the old system's last FTR monthly true-up allocations and auctions would overlap with the initial software processing activities for the new system.

3. Midwest ISO considered two possible ways to address such transitional software issues. The first option was to create a temporary infrastructure for new ARR-LTTR software to be used parallel to the existing software from February through May 2008, at which point there would be a permanent move from the old to the new software. Midwest ISO concluded that this option (Option 1) was too costly and complicated as it would entail: (i) significant additional software and hardware expenses and other resources; (ii) the risk of delay in the construction of production and testing infrastructure; (iii) the complexity of interfacing with, and the cost of maintaining, two software systems; and (iv) the added complication of further information technology resource needs of the anticipated ancillary services markets. The second option (Option 2) was to accelerate the processing of the February through May 2008 monthly FTR true-up allocations and auctions by performing them in January 2008. Option 2 also requires the management of secondary market FTR transfers. The Service Requests for these secondary market FTR transfers must be submitted at least two weeks in advance of the transfer's effective date. In recognition of the shortcomings of Option 1, Midwest ISO elected to pursue Option 2.

II. Midwest ISO Proposal

4. In this filing, Midwest ISO proposes to amend its TEMT to include a new section 45.8 to accelerate the FTR Auctions. In order to implement and facilitate the transition to ARRs and LTTRs, Midwest ISO will conduct in January 2008 the monthly FTR Allocations and Auctions for February, March, April and May 2008. Within two weeks after the results of the monthly FTR Auctions are posted, Midwest ISO asserts that the existing FTR computer system and software shall be terminated and taken offline. Proposed section 45.8 of the TEMT provides that after software termination, Midwest ISO will manually administer the secondary market FTR transfers. Section 45.8 provides that, to the extent that other provisions of the TEMT run contrary to the provisions of section 45.8, the other sections shall be deemed modified to the extent necessary to allow such transitional activities.

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[4] As noted by Midwest ISO, capitalized terms not otherwise defined have the meanings ascribed to them in section 1 of the TEMT. *See* Transmittal Letter at note 1.

5. Midwest ISO notes that members of the Market Subcommittee raised concerns about the unavailability of auction collateral if Midwest ISO adopted Option 2.[5] Under Option 2, market participants will be required to establish sufficient credit in January 2008 to cover their total bids for the monthly FTR Auctions from February through May 2008. Each FTR Auction will continue to be settled on the first calendar day of the month to which the auction pertains. Thus, total auction collateral amounts submitted at the beginning of the accelerated auction bidding window would be unavailable to market participants until the monthly settlement of each auction.

6. Midwest ISO asserts that a mechanism already exists under the FTR Auction credit process, Attachment L, section III.B.5 of the TEMT, to allow for the reallocation of credit or refund of collateral in excess of gross bids or measured exposures from FTR auction transactions. According to Midwest ISO, such reallocation/refunds shall take place in two stages: (1) at the close of the bid window, and (2) when the bids are cleared. In addressing concerns about unavailable credit, Midwest ISO notes that the revenues from each FTR Auction shall be transferred to credit in the form of Measured Exposure.[6] Midwest ISO explains that the transitional auction will be subject to the FTR Auction credit and revenue allocation provisions of Attachment L, section III.B.5 of the TEMT, concerning allocation of credit from FTR Auction activities, and section 45.6 of the TEMT, concerning allocation of surplus revenues from FTR Auction activities.[7]

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[5] Collateral must be posted prior to the bidding window and remain until the monthly auctions settle.

[6] Measured Exposure is the value of a day-ahead or real-time energy charge/credit that has been settled and/or calculated, but not yet invoiced. *See* Midwest ISO FERC Electric Tariff, Third Revised Volume No. 1, Second Revised Sheet No. 1232.01 and 1232A.

[7] Section 45.6 of the TEMT provides that FTR auction revenue surpluses will be used to fund FTRs every month. If the surplus exceeds FTR funding needs, the residual surplus will be accumulated to fund FTR deficiencies that have been carried forward to year-end. If the year-end residual auction revenue surplus exceeds the year-end FTR funding deficiencies, the remaining surplus will be distributed to Network Integration Transmission Service and firm point-to-point transmission service customers on a pro rata basis based on their share of billing determinants for the calculation of charges under Schedule 10 and Schedule 23. *See Midwest Independent Transmission System Operator, Inc.*, 121 FERC ¶ 61,062, at P 30 (2007).

III. Notice of Filing and Responsive Pleadings

7. Notice of Midwest ISO's filing was published in the Federal Register,[8] with protests and interventions due on or before November 20, 2007. Timely motions to intervene were filed by PSEG Energy Resources & Trade LLC, Exelon Corporation, Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc., and DC Energy Midwest, LLC. Timely motions to intervene and protests were filed by Alliant Energy Corporate Services, Inc. and the Integrys Energy Group (collectively, Integrys) and SESCO Enterprises LLC and EPIC Merchant Energy, LP (collectively, Financial Marketers). A timely motion to intervene and comments was filed by Dynegy Power Marketing, Inc. (Dynegy Power). On December 5, 2007, Midwest ISO filed a response.

8. Integrys and Financial Marketers note that Midwest ISO has neither received endorsement nor approval of Option 2 from its stakeholders. Integrys and Financial Marketers state that Midwest ISO has not provided any data to substantiate its decision to choose Option 2 over Option 1. Financial Marketers also argue that Midwest ISO has failed to show that the costs of a temporary work-around for implementing the LTTR-ARR system outweigh the costs and risk for market participants in the existing market or explain why it will take four months to transition from one software system to another. Financial Marketers request that the Commission reject Midwest ISO's proposal without prejudice to Midwest ISO proposing a plan to transition to its new software without disrupting existing FTR markets.

9. Dynegy Power, Integrys and Financial Marketers argue that the proposed accelerated allocation is problematic since it would require market participants to compress credit allocations for four months of auction activity into one month. Because of transitional software issues, Dynegy Power and Integrys maintain that Midwest ISO proposes to calculate potential exposure for the FTR auctions differently than before, which requires market participants to allocate enough FTR Auction Credit to cover participation in four months of auctions at the highest assumed credit exposure to ensure that Midwest ISO will not reject the participant's auction bid or offer outright. They contend that this proposal increases credit exposure for market participants, which could lead to limited participation in the auction process and potentially impact other market activities. Financial Marketers argue that every market participant's cost of doing business will be significantly increased by the need to tie up additional security and credit.

10. Integrys argues that section III.B.5 of Attachment L to the TEMT does not lessen credit exposure from Midwest ISO's proposal because it reduces credit exposure only for

[8] 72 Fed. Reg. 64,208 (2007).

the difference between "as bid" FTRs and actually awarded FTRs. Section III.B.5 does not lessen credit exposure associated with the acquisition of four months of FTRs in a single month according to Integrys. Integrys believes that Midwest ISO's proposal will have an adverse financial impact on market participants that are active in the FTR Auctions because market participants must allocate a specific portion of their Total Credit Limit to cover any auction exposure FTR Bids may cause.

11. Integrys argues that Midwest ISO's proposal to settle the auctions by month does not mitigate the credit issue. Integrys contends that monthly settlements extend the amount of time required for the FTR credit, causing unavailability of credits for the energy and virtual markets. Furthermore, Integrys asserts that Option 2 violates section 45.2.3 of the TEMT because market participants will not have up-to-date information on congestion costs when determining their bids for the four months of auctions. Integrys argues that Midwest ISO should revise its TEMT to relax collateral requirements.

12. Dynegy Power, Financial Marketers and Integrys assert that Midwest ISO's proposal reduces the benefit of the monthly auctions for market participants. They support the ability to make decisions based on more accurate month-ahead data that provides a greater ability to hedge against congestion than data forecasted five months ahead. They argue that Midwest ISO's proposal would require extending the forecast period from one to five months seriously degrading the ability of market participants to accurately predict load patterns, generator outages, weather patterns and the many other factors essential to a successful hedge.

13. Financial Marketers contend that the change from a monthly FTR auction to the proposed quarterly auction is a fundamental change in the monthly FTR product that could be extremely harmful to market participants. Additionally, Financial Marketers assert that seasonal FTRs were auctioned in May 2007 for the four following quarters with the understanding that market participants would be able to hedge those positions through the monthly FTR auctions.

14. Financial Marketers argue that because of the high risk created by this four-month product, the proposal is likely to significantly depress FTR trading for the period and is likely to adversely affect FTR pricing as well. Furthermore, Financial Marketers assert that the risk of default to Midwest ISO's system from the use of a four-month FTR is significantly higher than the risk posed by a monthly FTR. Financial Marketers argue the additional risk in the FTR market could result in additional under-funding of FTRs and exacerbate existing shortfalls.

15. Integrys asserts that a tariff amendment that purports to impact any other inconsistent tariff provision without identifying those provisions, as proposed by Midwest ISO, is inherently defective.

16. If the Commission accepts Midwest ISO's proposal, Financial Marketers request that the Commission require: (1) all transmission owners to post all planned outages for the February through May period; and (2) all generation owners to notify Midwest ISO of all planned outages for the February through May period so that an accurate Long-Term Outage Schedule Report can be made prior to the FTR auction.

17. In its answer, Midwest ISO states that its credit requirements for the proposal to accelerate the monthly FTR auctions balance the need to protect the Energy Markets from default through adequate credit requirements, and the need to facilitate participation in such markets by making the credit requirements manageable. Midwest ISO submits that it has addressed the credit concerns of market participants by adopting the reallocation/refund mechanism set forth in section III.B.5 of Attachment L to the TEMT. In accordance with that mechanism, Midwest ISO notes that any collateral amount that exceeds the market participant's gross bids or measured exposures from the FTR auction can be reallocated or refunded, first when the bid window closes, and second, when the bids are cleared. Consequently, as the transitional FTR auctions proceed, a market participant can gradually reduce its posted collateral in proportion to the gross and cleared bids. While Integrys argues that such reduction of credit exposure is still subject to Midwest ISO's approval, Midwest ISO affirms that this condition also applies to regular FTR auctions, as it is reasonable and necessary for Midwest ISO to assess credit issues in light of all relevant factors. Midwest ISO also gives its assurance that its approval of credit exposure reductions will not be unreasonably withheld.

18. If Midwest ISO is not allowed to accelerate the monthly FTR auctions as proposed, Midwest ISO asserts that it will either need to cancel such auctions altogether, or hold such auctions as currently scheduled but postpone the initial ARR allocation to 2009. Midwest ISO submits that the latter scenario is inconsistent with the statutory and regulatory mandate to make ARRs available as soon as possible.

19. In addition, Midwest ISO recognizes that the acceleration of the monthly FTR auctions will result in market participants not having month-ahead data to take into account in deciding whether or not to participate in the accelerated FTR auctions for March through May 2008. However, Midwest ISO believes that the acceleration of the auctions is better for market participants than cancelling such auctions entirely due to Midwest ISO's inability to move forward with the auctions in any other way that would not delay the 2008 ARR allocation. Midwest ISO believes that the accelerated auctions will still enable market participants to adequately hedge their risks, and Midwest ISO notes that it has adjusted the associated credit requirements to make them manageable while also protecting against default.

20. Midwest ISO also argues that its proposed tariff revisions do identify several existing provisions that must be deemed amended in order to authorize the transitional acceleration of monthly FTR auctions. Midwest ISO states that it included fairly

common catch-all language, also used elsewhere in the tariff, and likewise widely employed in other tariff, contractual and statutory contexts.

21. Midwest ISO notes that it advised and consulted the stakeholders about the LTTR transition issues since early July 2007. However, Midwest ISO asserts that it is not necessary for it to obtain stakeholder approval of the proposed tariff revisions, particularly because they ultimately involve compliance with the Commission's directives regarding LTTRs.

IV. Discussion

A. Procedural Matters

22. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

23. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest, unless otherwise permitted by the decisional authority. We will accept Midwest ISO's answer, because it has provided information that has assisted us in our decision-making.

B. Commission Determination

24. We find that Midwest ISO's proposal to perform the February through May 2008 monthly FTR true-up allocations and auctions in January 2008 is reasonable. Because the existing FTR software cannot simultaneously process activities under the old FTR system and the new ARR-LTTR system during the period (i.e., February through May 2008), Midwest ISO is limited in its response to this problem. Midwest ISO selected a method that allows for the implementation of LTTRs while minimizing: (1) costs of additional software, hardware and other resources; (2) the impact on the existing FTR system; and (3) delays in implementing the ARR-LTTR system. We believe that it is not reasonable to spend money building a new system that would only be employed for four months until the new ARR-LTTR allocation and FTR auction system is ready. We conclude that Midwest ISO has proposed a reasonable mechanism for addressing this implementation issue related to the mandated transition to LTTRs.

25. With regard to protesters' arguments that Option 2 is not financially feasible for market participants because it requires them to provide sufficient collateral to cover four months of FTR bidding upfront thereby increasing the credit costs of the option, we agree with Midwest ISO that it is not necessary to relax the credit requirements for the transitional FTR auction. As the Commission has stated in its initial review of Midwest ISO's credit policies, we do not consider it reasonable to reduce the credit collateral

requirements for certain market participants and thereby increase the risk of default costs being allocated to other market participants. As the Commission previously determined:

> An effective credit policy must consider all charges owed by the customers to which it applies because such charges directly impact exposure to non-payment. In this regard, we recognize that the Midwest ISO's credit policy is collective, such that a default by a market participant without sufficient financial security backing it affects all market participants. Thus, a default has the potential to reverberate throughout the entire market. Further, an effective credit policy must achieve balance among customer classes…. Therefore, the credit policy must accurately reflect each market participant's exposure so that the unsecured credit granted may be adjusted accordingly. [9]

26. In any event, we find that Midwest ISO has reasonably addressed protesters' concerns over increased credit costs by adopting the reallocation/refund mechanism set forth in section III.B.5 of Attachment L to the TEMT.[10] This mechanism should alleviate concerns over credit costs, as it provides that any collateral amount put forth upfront that exceeds a market participant's gross bid or measured exposure from the FTR auction can be reallocated or refunded, first when the bid window closes, and second, when the bids are cleared.[11] We also note that market participants can manage their credit requirements by transacting in the secondary market. For example, to the extent a market participant is unable to post collateral upfront for all its market activities at the January 2008 FTR allocation, it can purchase more FTRs in the secondary market later in the month when it has more collateral available after the initial bids close. Moreover, Midwest ISO has a process for addressing requests for reductions of credit exposure, and has reiterated that it will not unreasonably withhold approval of such a request.

27. Because we find that Midwest ISO has adequately addressed concerns over increased collateral requirements that may be faced temporarily by market participants during the transitional FTR auctions provided for in section 45.8, we do not expect that

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[9] *Midwest Independent System Operator, Inc.*, 112 FERC ¶ 61, 206, at P 32 (2005).

[10] *See* Second Revised Sheet No. 1230.

[11] This is illustrated by an example provided for in Midwest ISO's Answer. Midwest ISO explains that if a $10 million collateral were to be posted prior to an FTR auction, and gross bids totaling $8 million are determined, then $2 million of the collateral can be refunded as soon as the auction window closes; and if out of the $8 million gross bids, only $3 million worth of bids are cleared, then the $5 million in excess collateral can be refunded or reallocated once the auction is cleared. Midwest ISO goes on to explain that the entire collateral would not be "locked in" any longer than it would otherwise be in a regular FTR auction. *See* Midwest ISO Answer at 7-8.

implementing this option will result in a significant decrease in participation or function of the FTR auctions. For this reason, we reject the argument of Financial Marketeers that reduced participation in the FTR auctions due to increased collateral requirements will somehow result in the underfunding of FTRs.

28. We are also not persuaded by protesters' arguments that extending the forecast period will significantly degrade the risk management benefits of the FTR allocation and auction. While market participants can take a position for the entire four months, they also have the option of managing their risk by trading in the secondary market. Moreover, while we recognize that the acceleration of the monthly FTR auctions will result in market participants not having month-ahead data to take into account in deciding whether or not to participate in the accelerated FTR auction for March through May 2008, we agree with Midwest ISO that this must be balanced against the need to move without delay to the 2008 ARR allocation.[12] Nonetheless, to facilitate transactions during this temporary period, we encourage Midwest ISO to provide stakeholders with any additional market information that it can make available.

29. We agree with Integrys that Midwest ISO needs to specifically identify any tariff provisions that may conflict with section 45.8, and therefore direct Midwest ISO to remove the words "but not limited to" from the last paragraph of section 45.8. Midwest ISO must submit a revised tariff sheet reflecting this change within 30 days of the date of this order.

30. We will not require Midwest ISO to revise its TEMT to add provisions requiring all transmission owners to post all planned outages and requiring generation owners to notify Midwest ISO of all planned outages as requested by the Financial Marketeers. Section 38.2.5.h of the TEMT already provides for the reporting of planned outages to Midwest ISO and the posting of this information by Midwest ISO.

The Commission orders:

(A) Midwest ISO's proposed new section 45.8 of its TEMT, as modified, is hereby accepted, as discussed in the body of this order.

[12] *See* Midwest ISO Answer at 10.

(B) Midwest ISO is hereby directed to submit a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.