

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Midwest Independent)	Docket No. ER07-1372-000
System Operator)	Docket No. ER07-1372-001

**REQUEST FOR REHEARING
OF THE ORGANIZATION OF MISO STATES**

Pursuant to Rule 713 of the rules and regulations of the Federal Energy Regulatory Commission (Commission), 18 C.F.R. § 385.713, the Organization of MISO States (OMS) respectfully submits this Request for Rehearing of the Commission's February 25, 2008 Order on Ancillary Services Filing in the above captioned docket.¹

I. SPECIFICATION OF COMMISSION ERROR

The Commission erred in: (1) not establishing a more transparent and more rigorous process for determining generating unit reference levels; and (2) not establishing a mechanism for oversight of both the reference price-setting process and the review of reference price levels accepted by the Midwest ISO independent market monitor (IMM).² The reference price-setting process accepted by the Commission in the February 25 Order provides undue discretion to the IMM in establishing the reference level, which is the key element in assessing whether sellers exercise market power in the Midwest ISO ancillary services market. Accordingly, mechanisms should be developed whereby the Commission would have a significant role in overseeing the reference price-setting process and whereby the Commission and state commissions would have an opportunity to review the reference prices determined by the IMM.

¹ *Midwest Independent Transmission System Operator, Inc.* 122 FERC ¶ 61,172 (2008) (February 25 Order)

² *See e.g.*, February 25 Order at PP 124-155.

II. LIST OF ISSUES

Do the weaknesses in the reference price-setting process contained in Section 64.1.4 of the Midwest ISO's tariff render the resulting reference prices unjust, unreasonable, or unduly discriminatory under Section 205 of the Federal Power Act?

III. ARGUMENT

A. Review of the OMS Comments in this Proceeding.

In each of its various Comments to the Commission in this proceeding, the OMS expressed concerns about the Midwest ISO proposed reference price determination process and urged the Commission to require "effective mitigation to address the exercise of market power."³

Specifically, the OMS stated,

In this regard, the OMS has three concerns. The first concern is related to the accuracy of establishing a reference price for each generating unit. Dr. Patton's Affidavit does not include a comprehensive discussion as to how he intends to assess the accuracy and reliability of a submitted reference price. The OMS recommends that Dr. Patton develop a formalized approach for evaluating the accuracy and appropriateness of a submitted reference price and report the results to the Commission and the OMS.⁴

and,

...the reference levels must reflect true marginal cost of service, so the Commission should in this docket make clear to the Midwest ISO and the IMM the proper way to calculate the reference levels and put that method in the tariff.⁵

With respect to uncertainty in the factors affecting marginal cost and the acceptable threshold over the reference price, the OMS observed that,

Dr. Patton and Dr. Lawrence Kirsch, an economist who appeared on behalf of the Midwest TDUs, concurred that in standard microeconomic theory, if there were

³ Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 2.

⁴ Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 8.

⁵ Reply Comments of the Organization of Midwest ISO States Following Technical Conference, (January 11, 2008) at 2.

no uncertainty over the factors affecting marginal costs, the added over reference levels for market power monitoring purposes would in fact be zero.⁶

and,

...the very start up of a new market, given the market power measures identified forth [sic] by the IMM, implies a certainty that, without effective market monitoring, the whole ASM, in its design and operation, could lead to non-competitive outcomes.⁷

The above statements clearly illustrate that the OMS holds strong concerns about the possible exercise of market power in the Midwest ISO's new ancillary services market. The OMS expressed particular concern about the absence of a formalized approach for evaluating the accuracy and appropriateness of the accepted reference prices and a concern that, under the Midwest ISO proposed process, the accepted reference prices might not reflect the true marginal cost for generating units. In light of those concerns, the OMS recommended action by the Commission in overseeing the reference price-setting process and an opportunity for the Commission and state commissions to review the reference prices established by the IMM.⁸

The Commission did not address the OMS concerns and recommendations in this regard in the February 25 Order.

B. Review of the Commission's February 25 Decision.

In the February 25 Order, the Commission did not address the OMS concerns on this issue and accepted the Midwest ISO proposed method of determining reference levels with only minor changes not relevant to the issue here.⁹

The Commission observed that, under the Midwest ISO proposal, reference levels will be based upon estimates of a generator's marginal costs, including legitimate risks and opportunity

⁶ Comments of the Organization of Midwest ISO States Following Technical Conference (December 19, 2007), at 2.

⁷ Comments of the Organization of Midwest ISO States Following Technical Conference (December 19, 2007), at 3.

⁸ Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 8.

⁹ February 25 Order at P 137.

costs.¹⁰ The Commission noted that the tariff sets forth three methods (in order of application) for calculating a unit's reference levels: (1) offer-based, (2) price-based, and (3) consultative.¹¹ The Commission noted that, when the Midwest ISO ancillary services market begins, "there will be no history of accepted offers or market clearing prices."¹² Therefore, for at least the first ninety days of operation of the new Midwest ISO ancillary services market, the "consultative" process will be used to establish each generating unit's reference price.

C. Review of the Consultative Process for Establishing Reference Prices.

The consultative process by which the reference price will be established between the generators and the IMM is set forth in its entirety in Section 64.1.4.iii of the Midwest ISO tariff which describes the process as follows:

iii. A level determined in consultation with the Market Participant submitting the Offer or Offers at issue and intended to reflect a unit's marginal costs, including legitimate risks and opportunity costs, or justifiable technical characteristics for physical Offer parameters, provided such consultation has occurred prior to the occurrence of the conduct being examined. Such consultation may be initiated by either the IMM or the Market Participant.¹³

Section 64.1.4.e of the Midwest ISO tariff provides a mechanism that a generator may use to get its IMM-determined reference price modified when it is not satisfied. Section 64.1.4.e states,

e. Upon request by a Market Participant or at the initiative of the IMM, the IMM shall consult with a Market Participant with respect to the Reference Levels determined for that Market Participant. If cost data or other information submitted by a Market Participant indicates to the satisfaction of the IMM that the Reference Levels for that Market Participant should be changed, revised Reference Levels shall be determined, communicated to the Market Participant, and implemented, as soon as practicable. The IMM shall provide a written explanation of its determination to the Market Participant upon request.¹⁴

¹⁰ February 25 Order at P 124.

¹¹ February 25 Order at P 124.

¹² February 25 Order at P 125.

¹³ Midwest ISO tariff Section 64.1.4.iii.

¹⁴ Midwest ISO tariff Section 64.1.4.e.

D. Lack of Transparency, Vagueness, and Lack of Oversight in the Reference Price-Setting Process Add Up to Undue Discretion for the IMM.

These quoted sections of the Midwest ISO tariff show that the consultative process for establishing generating units' reference prices will be a non-transparent process available only to the generating company and the IMM. There are no constraints or instructions in the tariff on what information a generating company can submit to the IMM in support of the company's proposed reference level. Furthermore, there are no specified benchmarks in the tariff for the IMM to use in assessing whether the generator's proposed reference price is an accurate representation of each generating unit's marginal cost—other than the general admonition that the IMM must allow “legitimate risks and opportunity costs.”

The lack of specified benchmarks in the Midwest ISO tariff concerning the information submitted by generators in support of their proposed reference levels causes concern, as there are no established mechanisms for the Commission to oversee the reference price-setting process or opportunities for a state commission to review the IMM's decisions concerning the setting of generator reference prices.

Not only does the Midwest ISO tariff not contain any specified benchmarks to guide the consultative process for determining reference prices, the Midwest ISO tariff does not even define the terms that might create a framework and establish boundaries necessary for the process to work properly. For example, while the Midwest ISO tariff requires the IMM to include “legitimate risks and opportunity costs” in the determination of reference prices, the tariff does not define those terms.¹⁵ Indeed, the tariff definition of the term “Reference Levels” is so general as to provide

¹⁵ “Lost Opportunity Cost” is defined in Section 1.176a of the Tariff as: “The LMP revenues that were not realized relative to a theoretical future operating point.” However, that does not seem particularly relevant to the way that the term “opportunity cost” is used in Section 64.1.4.iii.

no additional illumination to the process. Specifically, Section 1.259 of the Midwest ISO tariff defines “Reference Levels” as follows:

1.259 Reference Levels: In the context of Module D, calculations intended to reflect a Resource’s marginal costs, including legitimate risk and opportunity costs.

In other contexts, the Commission has expressed great concern for transparency of regional transmission organization operations. For example, in the February 25 Order, the Commission expressed concern with the lack of transparency in the Midwest ISO proposed process for the auditing of physical withholding by generating companies and took steps to remedy that lack of transparency.¹⁶ However, the consultative process set forth in Section 64.1.4.iii of the Midwest ISO tariff that the IMM and the generating companies will use to establish critically important reference price levels is entirely non-transparent. The Commission stated in the February 25 Order that “transparency is important to build market participants’ confidence in the fairness of the [] process and prevent undue discretion by the IMM.”¹⁷ Yet, the Commission took no steps to improve transparency in the reference price-setting process.

The lack of transparency, vagueness, and lack of oversight in the Midwest ISO’s proposed reference price-setting process allows too much leeway for generating companies and could result in the IMM exercising undue discretion. Why the Commission took no action to address undue IMM discretion in this critical area is especially puzzling, as in other contexts, the Commission has expressed great concern that the IMM not be permitted to exercise too much discretion. Indeed, elsewhere in the February 25 Order, the Commission concluded that the Midwest ISO proposal

¹⁶ February 25 Order at P 151.

¹⁷ February 25 Order at P 151.

allowed the IMM too much discretion and took steps to reduce the IMM's discretion.¹⁸

Preventing undue IMM discretion in the process for determining generating unit reference levels is no less important, and is arguably much more important, than preventing undue IMM discretion in the "fair game" assessment process or the process of auditing generating companies for physical withholding.

The lack of transparency, vagueness, and lack of oversight in the reference price-setting process, all of which together create an environment in which the generating companies may not be properly restrained and the IMM may exercise undue discretion, is very troubling. It is especially troubling given that, for at least the first ninety days of operation of the new Midwest ISO ancillary services market, the "consultative" process will be the only process that is used to establish each generating unit's reference price. Because the reference price is the base on which the IMM will apply the conduct and impact tests to assess whether a generator is exercising market power, the reference price-setting process must be improved. The Commission should not permit vagueness, lack of transparency and lack of oversight in a process as important as the reference price-setting process.

This concern about the reference setting process is not limited to the consultative method. The offer-based method and the price-based method of setting the reference price also exhibit vagueness, lack of transparency and lack of oversight. However, the weaknesses in the consultative process are particularly notable and those weaknesses will be magnified because the consultative process will be in place for the critical first ninety days of operation of the Midwest ISO ancillary services market.

¹⁸ See, e.g., February 25 Order at P 122 concerning the IMM's assessment of "fair game" behavior, and February 25 Order at P 151 concerning the IMM's audits of physical withholding.

E. State Regulators, and Their Regional State Committee--the OMS--Can Serve a Useful Role in Reviewing the Reference Price-Setting Process and the IMM's Reference Price Level Determinations.

In its Comments in this proceeding, the OMS advocated the development of “a formalized approach for evaluating the accuracy and appropriateness of a submitted reference price.”¹⁹ The OMS recommended that the IMM be required to report the results of the reference price determination process to “the Commission and the OMS.”²⁰ Those recommendations were sound, but were not addressed or acted on in the Commission’s February 25 Order. We reiterate those recommendations here and urge the Commission to promptly implement them.

State regulators have extensive historical experience and considerable expertise in assessing and determining energy companies’ prudent costs. The Commission would do well to make use of state regulators’ extensive historical experience and considerable expertise in reviewing the reference price-setting process which involves many of the same skill-sets as are involved in the more traditional cost determination processes that state regulators know well. State regulators also have a significant interest in the establishment of accurate reference prices, as improperly inflated reference prices can lead to improperly inflated locational marginal prices that are paid by retail customers and improperly deflated reference prices could affect generator revenues that could lead to resource adequacy issues. State regulators are unbiased and act in pursuit of the public interest. Thus, state regulators are particularly well-suited to play a role in reviewing the reference price-setting process and the reference prices established by the IMM. This role should be designed to constitute the “formalized approach for evaluating the accuracy

¹⁹ Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 8

²⁰ Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 8

and appropriateness of a submitted reference price” which was previously recommended in OMS Comments.²¹

The OMS also previously recommended that the IMM be required to report the results of the reference price determination process to “the Commission and the OMS.”²² Since the data involved in the reference price-setting process will be both commercially sensitive and market sensitive, the utmost care must be taken in handling such data. State regulators have long experience in properly handling such highly confidential data. However, the currently-effective data access provisions of the Midwest ISO’s tariff effectively limit the ability of many state commissions to receive or view data such as that underlying generating unit reference price levels or even the IMM-determined reference price. In order to improve the current absence of oversight over the IMM’s reference price setting decisions and to reduce the undue discretion of the IMM in that process, the Midwest ISO’s policy that limits state regulators’ access to confidential IMM data must be modified.²³

IV. CONCLUSION

Wherefore, for all of the reasons explained above, the OMS recommends and requests that the Commission rehear its decisions in the February 25 Order regarding establishment of generator reference prices. As explained above, the Midwest ISO’s proposed process for establishing reference prices suffers from lack of transparency, vagueness, and lack of oversight. The Commission must address the unrestrained flexibility that the Midwest ISO tariff provides to the generating companies and the undue discretion that the Midwest ISO tariff provides to the IMM regarding the reference price-setting process. To remedy these flaws, more specificity

²¹ Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 8.

²² Comments of the Organization of Midwest ISO States and Notice of Intervention (October 15, 2007), at 8 .

²³ Without needed data, state commissions are unable to effectively exercise their legitimate Federal Power Act Section 206 complaint rights regarding IMM-determined reference prices.

must be injected into the process of establishing reference prices and a role should be created for state regulators in reviewing the reference price-setting process and the reference prices established by the IMM. The OMS further requests any and all other appropriate relief.

The OMS submits these comments because a majority of the members have agreed to generally support them. The following members generally support these comments. Individual OMS members reserve the right to file separate comments regarding the issues discussed in these comments:

Illinois Commerce Commission
Indiana Utility Regulatory Commission
Iowa Utilities Board
Kentucky Public Service Commission
Michigan Public Service Commission
Minnesota Public Utilities Commission
Missouri Public Service Commission
Montana Public Service Commission
North Dakota Public Service Commission
Public Utilities Commission of Ohio
Wisconsin Public Service Commission

The Manitoba Public Utilities Board, the Pennsylvania Public Utility Commission, and the South Dakota Public Utilities Commission did not participate in this pleading. The Nebraska Power Review Board abstained from this pleading.

The Indiana Office of Utility Consumer Counselor, the Iowa Office of Consumer Advocate and the Minnesota Office of Energy Security,²⁴ as associate members of the OMS, participated in these comments and generally support these comments.

Respectfully Submitted,
William H. Smith, Jr.
William H. Smith, Jr.
Executive Director

²⁴ The Minnesota Office of Energy Security now exercises the consumer advocacy functions previously performed by the Minnesota Department of Commerce.

Organization of Midwest ISO States
100 Court Avenue, Suite 218
Des Moines, Iowa 50309
Tel: 515-243-0742

Dated: March 24, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Des Moines, Iowa, this 24th day of March, 2008.

William H. Smith, Jr.