UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission System Operator, Inc.	))	**Docket No. ER11-4081-000**

THE ORGANIZATION OF MISO STATES' MOTION FOR LEAVE TO FILE AND ANSWER TO IMM AND CAPACITY SUPPLIERS

The Independent Market Monitor ("IMM") has moved for leave to file out of time a Comment docketed on Monday, September 19, 2011 ("IMM Comment").[1] Pursuant to Rule 213,[2] the Organization of MISO States (OMS) hereby answers that motion. The OMS also requests leave to answer simultaneously to other pleadings filed in this matter.

I. MOTION FOR LEAVE TO ANSWER

On July 20, 2011, the Midwest Independent Transmission System Operator, Inc., ("Midwest ISO" or "MISO") submitted proposed revisions and amendments to Module E of its Open Access Transmission, Energy and Operating Reserve Markets Tariff ("Tariff"), pursuant to Section 205 of the Federal Power Act ("FPA").[3] MISO stated that the purpose of the proposed Tariff revisions is "to file a permanent solution to ensure the deliverability of Load Modifying Resources in MISO's voluntary capacity auction and to incorporate locational capacity market mechanisms, in compliance with Commission Orders regarding RAR [Resource Adequacy Requirements]."[4]

[1] The IMM Comment is eLibrary Accession No. 20110919-5035. Its Acrobat file name refers to September 15, and the Comment appears to have been submitted for eFiling on the evening of Friday, September 16, which is the date identified in the Certificate of Service. However, because that submission occurred after the 5 p.m. close of Commission business, and pursuant to Rule 2001(a)(2), the filing date is listed as Monday, September 19, 2011.
[2] 18 C.F.R. § 385.213.
[3] 16 U.S.C. § 824d (2011).
[4] The MISO Transmittal Letter to FERC, p. 1.

Comments and protests were filed by numerous parties on or about September 15, 2011. A number of those parties have urged the Commission to direct the Midwest ISO to revise its RAR proposal to more closely resemble capacity markets operated by the three Eastern Regional Transmission Organizations ("RTOs"). While answers to protests are not permitted as a matter of right under the Commission's Rules of Practice and Procedure, the Commission often permits such an answer where it will provide information that will assist the Commission in its decision making process.[5] The OMS seeks leave herein to file this answer to such comments explaining why a centralized capacity auction modeled on the eastern RTOs is inappropriate for the MISO footprint.

II. ANSWER

The OMS opposes a centralized forward auction for the following reasons: (1) there is no need for such a construct; (2) it raises significant jurisdictional issues; (3) it could impose substantial and unnecessary economic burden on ratepayers; and, (4) it could jeopardize the historic long-term resource adequacy of the region. In their comments on the MISO RAR proposal, the Capacity Suppliers assert that the RAR proposal does not comply with Commission directives in earlier orders.[6] However, the MISO RAR proposal as well as the OMS modifications to this proposal, do in fact comply with Commission directives and orders. A prior Commission order makes clear that a centralized capacity auction is not required in order to deal with locational deliverability issues and load modifying resource participation.[7] In addition, the Capacity Suppliers argue that a centralized capacity auction is the "best available measure to

[5] *See, e.g., Xcel Energy Operating Cos.*, 123 FERC ¶ 61,053, at P 10 (2008) (accepting pleadings that provided information useful in the decision-making process); *Morgan Stanley Capital Group, Inc. v. New York Indep. Sys. Operator, Inc.*, 93 FERC ¶ 61,017, at p. 61,036 (2000) (accepting answer "helpful in the development of the record"); *New York Indep. Sys. Operator, Inc.*, 91 FERC ¶ 61,218, at p. 61,797 (2000) (allowing answer "useful in addressing the issues arising in these proceedings"); *Central Hudson Gas & Elec. Corp.*, 88 FERC ¶ 61,138, at p. 61,381 (1999) (accepting pleadings because they helped to clarify the issues).
[6] The Capacity Suppliers' Protest ("Suppliers Protest") is eLibrary Accession No. 20110915-5201.
[7] 131 FERC ¶ 61,228 (June 8, 2010) at P 8.

ensure continuing resource adequacy."[8] The use of the word "continuing" artfully avoids acknowledging that there is currently no problem with resource adequacy in the MISO footprint. Under state resource adequacy planning and more recently MISO's transmission planning, states have adequately planned for current and future needs. The MISO footprint continues to have capacity well in excess of the required reserve margin and that condition is projected to extend for at least ten more years.[9]

A. A Centralized Capacity Auction is not Necessary

Capacity auctions were promoted in the eastern United States to address the "missing money" problem--the fact that it is difficult for peak generators to raise sufficient revenue to cover their costs. This occurs in the Eastern markets because generation owners and developers are commonly unregulated entities, so there is no mechanism for states or commissions to order them to build needed generation. This is not a problem in the Midwestern market. Load Serving Entities ("LSEs") that are retail electric utilities have a legal obligation to ensure reliable, safe and reasonably priced electric service. State statutes establish these requirements, consumer advocates and other interested parties monitor utility compliance with these requirements, and state utility commissions review or approve utility resource plans and investigate utility performance to ensure that utilities meet their reliability and resource adequacy obligations.

B. Resource Adequacy is under State Jurisdiction

A centralized forward auction raises federal-state jurisdictional issues and, in traditionally regulated states, may violate the federal-state jurisdictional boundaries in the Federal Power Act. Although all load located in the Midwest ISO may not be under state regulatory jurisdiction, an overwhelming percentage is under state jurisdiction. States retain jurisdiction over how load serving utilities will meet any capacity requirement that may be

[8] The Capacity Suppliers' Protest ("Suppliers Protest") is eLibrary Accession No. 20110915-5201, p. 2.
[9] Draft MISO Transmission Expansion Plan 2011, p. 100.

implemented in a regional transmission organization which serves its state. States have exclusive jurisdiction over whether, how, where, and when new generating resources are constructed. States typically carry out this authority through integrated resource planning and certificate of need cases. New generating facilities and transmission projects undergo thorough analysis by the sponsoring utility, and are subject to analysis and testimony from all interested stakeholders. When a state issues a certificate of need, it has determined the best way for a utility to meet its share of overall state resource needs. This determination encompasses the needs of electric generating capacity, energy production and transmission of that energy. The ability of states to determine their future needs, and their ability to address those needs by determining the way that seems best to them, is a fundamental aspect of their jurisdictional authority. It is essential that any new resource adequacy construct not be set up to allow market participants, any market monitoring authority, or the Federal Energy Regulatory Commission to infringe upon or impair state jurisdictional authority.

The OMS will not support a resource adequacy construct that hampers the states' ability to determine how their future energy needs will be met.

The Capacity Suppliers' comments could be read to suggest that the state regulatory authorities (and also MISO) will not continue their long history of appropriate resource and transmission planning over the coming years. There is simply no foundation for such a suggestion.

C. Attempts to preserve the "market integrity" of an eastern style capacity auction will unreasonably impinge on states' jurisdiction over resource adequacy.

In the MISO footprint, the determination of what is efficient or effective in the long term lies squarely within state jurisdiction. Relying on price signals from a centralized forward auction will not achieve long-term efficiency. Mandatory capacity auctions are not like other markets. Capacity is not a homogeneous one-dimensional product that is easily understood or well-defined by market participants. Some buyers and sellers are not willing participants. The demand curve is administratively determined and does not necessarily represent willingness to pay. Supply is manipulated by market rules such as Minimum Offer Price Rules ("MOPRs"). Attempts to preserve the "market integrity" of capacity auctions can unreasonably interfere with states' jurisdiction over resource adequacy.

The IMM criticizes MISO's use of a vertical demand curve located at the planning resource requirement (i.e. a fixed resource requirement) and recommends the use of a sloped demand curve in the Midwest ISO capacity market.[10] The IMM's objections to a vertical demand curve are based on the theoretical assumption that reliability is a well-defined product in that buyers of capacity can accurately assess the marginal benefit of an additional unit of reliability. This does not accurately describe the reality of the electrical grid. As there is little empirical data to define the willingness to pay for additional reliability, the demand curve must be administratively determined. Thus, as one stakeholder expressed so well, a downward sloping demand curve represents "willingness to administer" not willingness to pay. The slope of any demand curve currently used for capacity auctions is administratively determined and not based on empirical data describing the behavior of market participants. The price established by an administratively determined downward sloping demand curve is no more accurate than the price achieved through an auction that is closely monitored by the IMM with a vertical demand curve.

An auction with a sloped demand curve has the potential to undermine the states' rights to determine resource adequacy because it could obligate LSEs to purchase capacity beyond the states' determined appropriate planning reserve margin and make capacity payments to

[10] The IMM Comment is eLibrary Accession No. 20110919-5035, pp. 5-10.

resources not under the states' regulatory control. An auction with a vertical demand clears the exact quantity that a state commission must plan for based on the Midwest ISO's planning reserve margin. A vertical demand curve ensures that the equilibrium amount of capacity determined in the auction equals the planning reserve margin that meets the reliability standard. This is the clear target that is planned for by LSEs which owns generation. In contrast, a variable requirement from a sloped demand curve creates an unpredictable quantity that could result in an unnecessary increase in cost to ratepayers. The burden is on the IMM to present evidence from existing capacity auctions that administratively determined downward sloping demand curves ensure the desired reliability standard for resource adequacy for those LSEs that own their resources and at lower overall cost to all market participants individually and jointly.

The Capacity Suppliers argue that the opt-out provision should be eliminated.[11] The opt-out procedures are essential to ensuring that utilities and their ratepayers will not have to pay higher costs for capacity when a utility already has sufficient generation and demand resources to meet its load. This is a critical provision in MISO's Resource Adequacy proposal.

The Capacity Suppliers state that the forward period should be extended to five years.[12] The OMS is concerned that a planning resource requirement beyond one year would add costs and uncertainty with no corresponding benefits. The reason for this is that future changes in forecasts and less accuracy in forecasting beyond one year lead to higher costs for utilities and their ratepayers. If the MISO filing is accepted, it should remain intact.

Both the IMM[13] and the Capacity Suppliers[14] call into question the MOPR restrictions

[11] The Capacity Suppliers' Protest ("Suppliers Protest"), is eLibrary Accession No. 20110915-5201, pp. 3, 16, 25.
[12] The Capacity Suppliers' Protest ("Suppliers Protest") is eLibrary Accession No. 20110915-5201, pp. 2, 16.
[13] The IMM Comment is eLibrary Accession No. 20110919-5035, pp. 13-15.
[14] The Capacity Suppliers' Protest ("Suppliers Protest") is eLibrary Accession No. 20110915-5201, pp. 2, 16, 45.

included in the MISO Filing. Capacity construction and procurement tends to be lumpy (i.e., constructed or procured in large amounts at a time) because of the economies of scale and cost savings of building fewer larger generation units. Utilization of a MOPR in the MISO footprint, which is predominantly vertically integrated and state-regulated, if permitted at all, must be done in a very measured fashion otherwise it is likely to lead to capacity not clearing the capacity market or raising the overall clearing price, neither of which is good for ratepayers. Inclusion of a MOPR provision in the MISO tariff, if not subjected to very specific limitations, implies state commission prudency decisions regarding resource investments by their jurisdictional utilities cannot be relied on to be in the public interest. There is no basis for that premise.

The OMS is very concerned about the application of a MOPR to the utilities in their jurisdictions. Given the states' abilities to provide capacity resources, and their demonstrated track record in doing so, the OMS can see no public interest rationale supporting the use of a MOPR in the MISO construct. MISO's proposed exemptions and special conditions for use of a MOPR under the RAR filing appear to be an effort by MISO to craft a MOPR that recognizes MISO's singular industry structure of regulated retail entities and will minimize the likelihood of unintended consequences given those numerous industry conditions that set it apart from other RTOs.

Capacity is not a homogeneous, single-attribute commodity, a tacit assumption embedded in the arguments of the IMM and the Capacity Suppliers. Eastern-style auctions fundamentally separate generation capacity from its physical attributes such as: the generator's fuel source, fuel transportation, combustion process, emissions, cooling requirements, load following capability, electrical characteristics, and transmission system characteristics. These auctions do not incorporate load forecast uncertainty due to weather and other drivers. The singular element of a capacity only auction compromises the transmission network's electrical dynamic and steady-state stability characteristics, as well as the Northern American Electric Reliability Corporation operating and planning standards. Resource adequacy is a long term planning process that cannot be split into separate, unrelated, commodities on the electrical network. At any time during this process, capacity suppliers are free to negotiate a purchase power agreement with an LSE. States have seen such activity for long-term needs assessments as well as for short-term hedging opportunities associated with meeting new EPA requirements such as the Cross-State Air Pollution Rule. As part of resource adequacy planning, state commissions make decisions on resources that will affect retail rates of the utilities under their jurisdiction for decades into the future, and do not rely on or need additional locational capacity price signals beyond the current residual auction. State and regional planners plan for a significantly longer term using criteria that are significantly broader than price alone. As part of resource adequacy planning, state commissions make decisions on resources that will affect retail rates of the utilities under their jurisdiction for decades into the future. Simplistic capacity auctions will not achieve efficient resource adequacy in the long run.

D. Capacity auctions are not working. End the experiment. Do not extend it into the Midwest.

Eastern-style capacity auctions have failed to incentivize generation where it is needed most, despite high prices in these regions. Very little new generation has been built since these auctions have been implemented. Instead they have perpetuated the life of inefficient, dirty, older generation.[15] Both New Jersey and Maryland utilities have issued requests for proposals for new generation because the PJM reliability pricing model has been unsuccessful in attracting

[15] Wittenstien and Hausman, Synapse Energy Economic, Inc. "Incenting the Old, Preventing the New."

appreciable new generation even though prices in Eastern Maryland are approximately double that of the rest of the PJM region.[16]

Capacity auctions have resulted in a substantial transfer of wealth from electricity consumers to generators. Prior to the introduction of the PJM capacity auction, capacity costs made up less than one percent of the wholesale price of electricity, including a low of 0.04 percent in 2005. In 2010 capacity costs accounted for 18.1 percent of the total wholesale price.[17] Billion dollar investments in generating resources that can serve load in the MISO footprint for decades are better left to state resource planning processes.

III. CONCLUSION

Eastern-style capacity auctions have failed to incentivize generation where it is needed most, despite high prices in these regions. Very little new generation has been built since these auctions have been implemented. Instead they have perpetuated the life of inefficient, dirty, older generation. There is no evidence that a short-term capacity market will achieve the desired long-term mix of resources that each state prefers as it assesses the multiple factors affecting the determination of long-term resource adequacy. Whether the mix of resources available to any state over the long-term will be "efficient," or the lowest cost, lies in the judgment of the state. Billion dollar investments in generating resources that can serve load in the MISO footprint for decades are better left to state resource planning processes where success has been demonstrated for decades.

The OMS submits these comments because a majority of the members have agreed to generally support them. Individual OMS members reserve the right to file separate comments

[16] "Maryland utilities order by regulators to issue new generation RFP by Friday," *Platts Electric Utility Week*, October 3, 2010.
[17] PJM 2010 State of the Market Report, Volume 2 ("Detailed Analysis"), Table 1-9, page 22.

regarding the issues discussed in these comments. The following members generally support those comments:

Indiana Utility Regulatory Commission
Michigan Public Service Commission
Minnesota Public Utilities Commission
Missouri Public Service Commission
North Dakota Public Service Commission
South Dakota Public Utilities Commission
Wisconsin Public Service Commission

The Kentucky Public Service Commission, the Manitoba Public Utilities Board, and the Public Utilities Commission of Ohio did not participate in this pleading. The Illinois Commerce Commission, the Iowa Utilities Board and the Montana Public Service Commission abstained on this vote.

Respectfully Submitted,

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Dated: October 14, 2011

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 14th day of October, 2011.

William H. Smith, Jr