

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

Public Citizen, Inc.)	Docket No. EL 15-70-000
)	
v.)	
)	
Midcontinent Independent System Operator, Inc.)	
)	
)	
The People of the State of Illinois By Illinois Attorney General Lisa Madigan)	Docket No. EL15-71-000
)	
v.)	
)	
Midcontinent Independent System Operator, Inc.)	
)	
)	
Southwestern Electric Cooperative, Inc.)	Docket No. EL15-72-000
)	
v.)	
)	
Midcontinent Independent System Operator, Inc., Dynegy, Inc., and Sellers of Capacity into Zone 4 of the 2015-2016 MISO Planning Resource Auction)	

(Not Consolidated)

**MOTION FOR LEAVE TO RESPOND AND
REPLY COMMENTS OF THE ILLINOIS COMMERCE COMMISSION**

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. §§ 385.212, 385.213, the Illinois

Commerce Commission (“ICC”) submits this Motion for Leave to Respond and Reply Comments in the above-captioned proceeding.

The reply comments respond to issues raised in initial comments filed by parties regarding the complaints against the Midcontinent Independent System Operator, Inc. (“MISO”) submitted to the Commission by the Illinois Attorney General and Public Citizen, Inc. on May 28, 2015, and the Southwestern Electric Cooperative on May 29, 2015, regarding MISO’s planning resource auction (“PRA”). These issues significantly impact the state of Illinois. The reply comments are intended to clarify the record and assist the Commission in its decision-making process.

On June 2, 2015, the ICC submitted its Notice of Intervention in Docket No. EL15-71-000. On June 3, 2015, the ICC submitted its Notice of Intervention in Docket Nos. EL15-70-000 and EL15-72-000. As such, the ICC is a party to these dockets. On June 29, 2015, the ICC submitted timely comments in the above captioned dockets (“June 29 Comments”).

I. MOTION FOR LEAVE TO RESPOND

The ICC’s motion seeks leave under Commission Rules of Practice and Procedure 212 and 213 to respond to comments submitted in these proceedings. 18 C.F.R. §385.212, 213. While the initial Notice of Comment deadline did not provide for reply comments in this proceeding, given the breadth and importance of the issues involved, the ICC requests permission to respond to comments made by other participants in these proceedings to clarify the record and assist the Commission’s decision-making.

An answer may be made to any pleading if not prohibited. 18 C.F.R. §385.213(3). In particular, a reply that assists the decisional process by providing clarification, thereby benefiting

all parties, establishes good cause and may be filed.¹ The Commission has also found good cause to permit a reply where the pleading helps to explicate issues that are important to the proceeding and that may have an impact on the course of the Commission's regulatory oversight.² The Commission will also permit such a response where it enhances the record.³ These reply comments clarify the record in a way that will assist the decisional process, thereby benefiting all parties. With this response and reply comments, the ICC does not seek to delay or disrupt the administrative process and will not prejudice any other party. Rather, the reply comments clarify and explicate key issues in this proceeding and, in so doing, enhance the record. As such, there is good cause for the reply comments, and the ICC moves for their consideration.

II. SUMMARY OF THE JUNE 29 COMMENTS

The June 29 Comments advised the Commission to direct MISO to work with its stakeholders, in an expeditious manner, to reexamine specific design elements of the MISO PRA and to submit tariff changes prior to the 2016 PRA to ensure that the 2016 PRA, and future PRAs, produce just and reasonable capacity prices.⁴ The June 29 Comments urged the Commission to reexamine the effectiveness of MISO's current method for calculating the reference level as a means to mitigate market power and whether the "safe harbor" reference level concept should be abandoned in favor of unit-specific cost offers, particularly in the presence of a pivotal supplier.⁵ The June 29 Comments also recommended that the Commission reexamine how MISO develops zonal auction parameters such as the local clearing requirement

¹ *Independent Oil & Gas Ass'n of West Virginia*, Docket No. RI74-188-003 (Dec. 21, 1983) (J. Nacy) (Unreported); *Natural Gas Pipeline Co. of America* 52 FERC ¶ 61,219 (1990) (permitting response to protest).

² *Buckeye Pipe Line Co., L.P.*, 45 FERC ¶ 61,046 (1988).

³ *New York Irrigation Dist.*, 46 FERC ¶ 61,379 (1989).

⁴ June 29 Comments, at 2.

⁵ June 29 Comments, at 7.

("LCR") and the capacity import limit ("CIL"), how MISO implements them in the PRA, how they impact the PRA clearing prices for each local resource zone ("LRZ") and order MISO to correct any existing design flaws.⁶ Finally, the June 29 Comments recommended that the Commission direct MISO to consolidate LRZs 4 and 5 on the basis that the two zones are becoming increasingly interconnected and that consolidation would dilute the ability of a pivotal supplier to exercise market power.⁷

After reviewing the initial comments submitted to the Commission by other parties to this proceeding, the ICC urges the Commission to direct MISO to take immediate steps to correct identified market design flaws. The ICC offers the following reply comments for the Commission's consideration.

III. REPLY COMMENTS

A. Arguments that The Results of the 2015-2016 PRA for LRZ 4 Support the Elimination of MISO's Use of a Vertical Demand Curve are Inapplicable.

In their comments, Dynegy, NRG, EPSA and MISO's Independent Market Monitor ("IMM") express their dissatisfaction regarding the Commission's previous approval of MISO's choice to use a vertical demand curve design to clear its capacity auction. These comments simply ignore the outcome for LRZ 4 in the 2015-2016 PRA. For example, Dynegy states,

A vertical demand curve, like that in the PRA, can lead to a large change in price when there is a shift in the level of the offers occurring around the fixed local reliability requirement. In the 2015/16 PRA, a decrease in the quantity of supply offered into the auction as price taking (i.e. at a zero or very low price like \$0.01) and a corresponding increase in the quantity of supply offers at material prices resulted in a sharp upward shift in the point at which the supply curve intersected with the fixed LCR requirement for Zone 4.⁸

⁶ June 29 Comments, at 7-9.

⁷ June 29 Comments, at 9.

⁸ Answer of Dynegy Inc., Dynegy Marketing and Trade, LLC, and Illinois Power Marketing Company, ("Dynegy Answer"), Exhibit B, at P 54.

NRG contends that “The defining attribute of a vertical demand curve is ‘boom or bust’ price volatility.”⁹ NRG goes on to state:

Typically, with a vertical demand curve, a small surplus drives prices to essentially zero and a minor shortage will send prices straight up to the price cap. [footnote omitted] The price volatility surrounding vertical demand curves is the reason that they have fallen out of favor in every other organized capacity market. [footnote omitted] Given the expectation of price volatility inherent in the MISO capacity market design, the Commission should reject any suggestion that price volatility is probative of market manipulation.¹⁰

Similarly, EPSA argued that “price volatility is a direct and foreseeable consequence of using a vertical demand curve, rather than a downward-sloping demand curve like that employed in the other capacity markets.”¹¹ MISO’s IMM restated its belief that “the flawed vertical demand curve that is at the core of the MISO capacity market design can result in unstable capacity prices” and that “...as the surplus decline to zero, the market will suddenly start to clear at much higher prices.”¹²

Despite these parties’ attempt to use the \$150 clearing price for LRZ 4 to lobby for the use of a downward sloping demand curve, the auction clearing results for LRZ 4 do not support their narrative. The 2015-2016 PRA results do not provide any information that would favor or disfavor the use of a sloped demand curve, as opposed to a vertical demand curve, in MISO’s PRA. The shape of the demand curve has little to do with the outcome of the 2015-2016 PRA – especially in the case of LRZ 4. Consequently, demand curve arguments are inapplicable.

The assertion that a “small surplus” in a capacity auction with a vertical demand curve will drive prices “to essentially zero”, is false. Consider the amount of available capacity for

⁹ Protest and Comments of the NRG Companies, (“NRG Comments”), at 9.

¹⁰ NRG, at 9-10.

¹¹ Protest of Electric Power Supply Association (“EPSA Protest”), at 11.

¹² Comment of MISO IMM under EL15-70, et. al.. (“IMM Comments”), at 7-8.

LRZ 4 during the 2015-2016 PRA.¹³ As MISO notes, there were almost 12,000 MWs available in LRZ 4 – 1,580 MWs in excess of the planning reserve margin requirement of 10,420 MWs and 3,142 MWs were offered in Zone 4 that did not clear.¹⁴ In short, the level of demand and supply in LRZ 4 was not “tight.” While MISO’s 2015-2016 capacity auction utilized a vertical demand curve and LRZ 4 experienced more than a “small surplus,” prices were not driven anywhere near zero.

It was Dynegy itself who, in the 2015-2016 auction, contributed to the “shift in the [higher] level of the offers occurring around the fixed local reliability requirement.”¹⁵ For Dynegy to now use its own business offer strategy as a reason for the Commission to eliminate MISO’s use of a vertical demand curve in the auction is self-serving.

The 2015-2016 LRZ 4 MISO PRA results cannot be used to judge the impact of the use of the vertical demand curve on the PRA because the LRZ 4 auction price results were not driven by the interaction of supply and demand. Indeed, next to LRZ 8, LRZ 4 has the highest percentage of resources, relative to its planning reserve margin requirement, of all the MISO zones.¹⁶ Moreover, a significant amount of uncommitted capacity was available in LRZ 4. According to the reasoning of parties critical of the vertical demand curve, the Zone 4 clearing price should have been at or about \$0. Because the clearing price in Zone 4 was driven by the Local Clearing Requirement in an LRZ with a pivotal supplier, and not supply and demand,

¹³ 2015/2016 Planning Resource Auction Results (Extended), May 14, 2015. (“MISO PRA Report”) <https://www.misoenergy.org/Library/Repository/Report/Resource%20Adequacy/AuctionResults/2015-16%20PRA%20Summary%20Extended.pdf>

¹⁴ MISO PRA Report, at 6.

¹⁵ Answer of Dynegy Inc., Dynegy Marketing and Trade, LLC, and Illinois Power Marketing Company, (“Dynegy Answer”), Exhibit B, at P 54.

¹⁶ MISO PRA Report, at 6. Compare “Total Offer Submitted” plus “Total FRAP” to “PRMR” (11,156 + 838 = 11,994 to 10,420).

however, the reasoning of these parties does not apply here, is flawed, and should be disregarded.

Similarly, because the clearing price in Zone 4 was driven by the Local Clearing Requirement and the “shift in the level of the offers,”¹⁷ not supply and demand fundamentals, those results neither support, nor undermine, arguments attributing “price volatility” to the use of a vertical demand curve. For these reasons, the Commission should disregard the comments of parties who claim that the 2015-2016 Zone 4 PRA price results warrant switching from a vertical demand curve to a sloped demand curve in future PRAs. Because those price results were driven by the local clearing requirement and generator offer levels, not supply and demand, they do not provide evidence either supporting or opposing continued use of a vertical demand curve in MISO’s PRA.

B. Until Legitimate Methods for Determining a Lost Opportunity Cost Component for Calculating the Reference Level are Developed, Opportunity Costs Should be Excluded from that Calculation.

In the June 29 Comments, the ICC urged the Commission to reexamine the effectiveness of MISO’s current reference level approach to mitigate market power, particularly in LRZs with a pivotal supplier.¹⁸ The ICC notes that several parties¹⁹ have expressed similar concerns with the process by which the IMM determines the reference level for the MISO LRZs, including the complaint in Docket No. EL15-82-000 filed by the Illinois Industrial Energy Consumers (“IIEC”) against MISO regarding some of the same MISO auction provisions at issue here.²⁰

¹⁷ Answer of Dynegy Inc., Dynegy marketing and Trade, LLC, and Illinois Power Marketing Company, (“Dynegy Answer”), Exhibit B, at P 54.

¹⁸ June 29 Comments, at 7.

¹⁹ For example, *see* Intervention and Comments of the Joint Consumer Advocates under EL15-70, et al, at 8 and Motion to Intervene and Comments of Sierra Club under EL15-70, *et. al.* (“Sierra Club Comments”), at 28-29.

²⁰ Illinois Industrial Energy Consumers v. Midcontinent Independent System Operator, Inc., Docket No. EL15-82-000, filed June 30, 2015, (“IIEC Complaint”).

The IIEC provides several reasons why the process in which the IMM establishes the lost opportunity costs used to set reference levels is flawed.²¹ The most telling aspect of the IIEC's complaint is the examination of the IMM's use of PJM's daily capacity resource deficiency rate as a lost opportunity cost for resources offering into the MISO PRA.²²

The IIEC notes that the IMM's reference level setting process erroneously assumes that: (1) PJM market participants will need this replacement capacity; (2) that they will need it for the entire planning year; and (3) that the MISO resources have the transmission capacity to deliver it to PJM.²³ As IIEC points out, in LRZ 4 alone, Dynegy offered almost 3,425 MWs, at very near or above, the reference level. IIEC states that unless it can be reasonably demonstrated that PJM auction participants are in need of at least 3,425 MW of replacement capacity, need it for the entire 2015-2016 planning year and that Dynegy had transmission capacity reserved to move it, the PJM daily capacity deficiency rate should not be included as a lost opportunity cost for resources in MISO that participate in the MISO PRA.²⁴

The ICC acknowledges the theoretical validity of incorporating lost opportunity cost in calculating a reference level that would mimic a competitive offer level. Because the current method for calculating opportunity costs has flaws, continued use of that method is no longer just and reasonable and, therefore, should be excluded from the calculation, particularly for LRZs with a pivotal supplier. As the IIEC notes, if the opportunity cost element is eliminated, then capacity resources that do not request a facility-specific reference level would have a conduct

²¹ IIEC Complaint, Exhibit No. IIEC-5, at P 33-35.

²² IIEC Complaint, Exhibit No. IIEC-5, at P 40-42.

²³ IIEC Complaint, Exhibit No. IIEC-5, at P 43.

²⁴ IIEC Complaint, at 14-15.

threshold equal to ten percent of MISO's CONE.²⁵ As an example, in the 2015-2016 PRA, the CONE value for LRZ 4 was approximately \$250 per MW-day.²⁶ This would result in a conduct threshold of approximately \$25 per MW-day. Under the current tariff, for resources for which this conduct threshold is not sufficient, a facility-specific reference level could be requested from the MISO IMM, which would be based on the resource's annual going forward cost, but without any allowance for lost opportunity costs.^{27,28}

C. The Commission Should Direct MISO to Modify its LCR Calculation Methodology Prior to the 2016-2017 PRA.

In its June 29 Comments, the ICC noted significant concerns regarding the relationship between the LCR, the capacity import limit ("CIL") and the role these parameters play in achieving MISO's stated reliability goals within each LRZ.²⁹ The ICC urged the Commission to reexamine how MISO develops these auction parameters, how MISO implements them in the PRA, and how they impact the PRA clearing prices for each LRZ.³⁰

Both the Sierra Club and IIEC posit that MISO's current LCR calculation is unjust and unreasonable, in that it fails to account for capacity associated with resources physically located within a LRZ that have been sold into neighboring capacity markets.³¹ IIEC states that these exports create physical counter-flow benefits similar to the benefits associated with exports from

²⁵ The current conduct threshold is the opportunity cost reference value, plus 10 percent of CONE.

²⁶ MISO PRA Report, at 9.

²⁷ IIEC Complaint, Exhibit No. IIEC-5, at 48.

²⁸ The concerns raised by parties in this proceeding support the ICC's call for the Commission to reexamine the effectiveness of MISO's current reference price setting process as a means to mitigate market power, particularly in LRZs with a pivotal supplier. While the IIEC's complaint clearly illustrates several problems with the criteria used to set the reference level, they are likely not the only issues that need to be addressed if the reference levels are to be an effective deterrent against the exercise of market power, particularly in LRZs with a pivotal supplier.

²⁹ June 29 Comments, at 8.

³⁰ June 29 Comments, at 9.

³¹ Sierra Club Comments, at 10-11; IIEC Complaint, at P 37.

one MISO LRZ to another.³² The IMM also recognizes that MISO’s current tariff provisions requiring that the auction be cleared and prices be set as if these resources do not exist does not accurately reflect the true supply and demand conditions in the zone. In its 2014 State of the Market Report, the IMM stated:

The capacity clearing prices in Zone 4 in the 2015/2016 planning resource auction cleared at higher prices than all other areas in MISO due to the binding local clearing requirement. The binding of the local clearing requirement in Zone 4 was impacted by roughly 1,200 MW exported from Zone 4 to PJM. These resources will continue to be dispatched by MISO and can be utilized to satisfy local requirements and manage congestion into the area. Yet, the current Tariff provisions require that the auction be cleared and prices be set as if these resources do not exist, which does not accurately reflect the true supply and demand conditions in the zone. This issue will become even more important next year as exports to PJM grow.³³

To address this concern, the IMM recommends that MISO file tariff revisions to treat local capacity exports as creating counter-flow over the interfaces into the zone, which would cause the capacity to be replaced by the lowest-cost capacity from any area in MISO, rather than requiring that additional capacity be procured from within the zone.³⁴ This would be a good start.

In the June 29 Comments, the ICC identified discrepancies associated with unutilized CIL that directly contributed to the \$150 clearing price in LRZ 4 for the 2015-2016 PRA.³⁵ The issues raised by the ICC and other parties with regard to the LCR and CIL calculations warrant Commission action to ensure these parameters are just and reasonable for the upcoming 2016-2017 PRA.

³² IIEC Compliant, at P 36.

³³ *2014 State of the Market Report for the MISO Electricity Markets*, Potomac Economics, June 2015 (“2014 State of the Market Report”), at 100-101.

³⁴ 2014 State of the Market Report, at 100-101.

³⁵ June 29 Comments, at 8.

D. The Commission Should Direct MISO to Implement Needed Modifications to its PRA Construct Prior to the 2016-2017 PRA.

In the June 29 Comments, the ICC requested that the Commission direct MISO to work expeditiously with its stakeholders to review design elements of the MISO PRA construct and to submit tariff changes prior to the 2016-2017 PRA to ensure that PRAs produce just and reasonable capacity prices.³⁶ The ICC also requested that the Commission direct MISO to consolidate LRZs 4 and 5 in order to dilute the ability of a pivotal supplier to exercise its market power.³⁷

In its response to the three complaints, MISO states that it is currently engaged in a broad range of stakeholder discussions regarding its resource adequacy requirements and is prepared to consider proposals to modify the manner in which auction clearing prices are established prospectively.³⁸ MISO argues that the stakeholder process would more inclusively engender broad stakeholder and state regulator involvement as compared to settlement judge procedures.³⁹ MISO further argues that the stakeholder process will help ensure that all of MISO's stakeholders have the opportunity to fully participate in discussions, that appropriate analysis of alternatives can be performed and presented, and that any resulting tariff changes are vetted by the broadest possible stakeholder community, including state regulatory authorities.⁴⁰

The ICC generally supports using the stakeholder process when considering changes to MISO's resource adequacy requirements and tariff provisions. Broad stakeholder and state regulator involvement should be encouraged whenever possible. In this instance, however,

³⁶ June 29 Comments, at 10.

³⁷ June 29 Comments, at 10.

³⁸ Answer to Complaints of Midcontinent Independent System Operator, Inc. under EL15-70, *et al.*, ("MISO Answer"), at 8.

³⁹ MISO Answer, at 8.

⁴⁰ MISO Answer, at 35.

various parties, including the IMM, IIEC and ICC, have identified specific concerns with specific elements of MISO's PRA construct and have also provided specific solutions to address those flaws. Moreover, timeliness is critical. The 2016-2017 PRA is rapidly approaching and inserting these specific, urgent matters into a broad, general, unfocused, and ongoing MISO discussion process is unlikely to produce the focused and urgent change that is needed.

The ICC recognizes that MISO's capacity construct is evolving. Having reviewed comments in these proceedings, and given the outcome of the 2015-2016 PRA for LRZ 4 and its impact on ratepayers, however, it is clear that the Commission and MISO cannot allow these issues to linger throughout the duration of the lengthy MISO stakeholder process. Rather than wait for MISO to possibly provide a recommendation at some point in the future, which may or may not address the issues raised here, the Commission should take immediate steps to correct the market design flaws and issue an order directing MISO to expeditiously: (1) remove (at least temporarily) the lost-opportunity cost provisions from the calculation of the reference level; (2) modify the LCR calculation methodology to account for capacity associated with resources physically located within a LRZ that have been exported into neighboring capacity markets; and (3) consolidate LRZs 4 and 5. The Commission should also provide MISO with specific direction and guidelines regarding these issues and deadlines for filing these revisions with the Commission.

Such an approach would allow MISO to address specific short-comings with its PRA construct in a timely manner (prior to the 2016 PRA) and still allow the broad range of stakeholder discussions regarding MISO's resource adequacy requirements. As noted above, MISO's PRA construct is evolving and will likely be subject to fine-tuning into the foreseeable future. This evolution should not excuse the serious flaws identified by parties in this

proceeding. While the ICC appreciates MISO's desire to review and consider any changes to its PRA construct through the stakeholder process, MISO should implement urgently needed solutions to identified flaws.

IV. CONCLUSION

WHEREFORE, for the foregoing reasons, the ICC respectfully requests that the Commission grant the ICC's motion for leave to respond and consider these reply comments. In order to ensure a just and reasonable MISO auction design for the 2016-2017 and subsequent delivery years, the ICC urges the Commission to direct MISO to expeditiously correct the identified flaws in MISO's current auction design by: (1) removing (at least temporarily) the lost-opportunity cost provisions from the calculation of the reference level; (2) modifying the LCR calculation methodology to account for capacity associated with resources physically located within a LRZ that have been exported into neighboring capacity markets; and (3) consolidating LRZs 4 and 5 for PRA purposes. The Commission should also disregard the comments of parties in this case who claim that the 2015-2016 Zone 4 PRA price results warrant switching from a vertical demand curve to a sloped demand curve in future PRAs. The ICC further requests any and all other appropriate relief.

Respectfully submitted,

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ILLINOIS COMMERCE COMMISSION

Dated: July 28, 2015

CERTIFICATE OF SERVICE

I hereby certify that I caused copies of the foregoing document of the Illinois Commerce Commission to be served this day upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Chicago, Illinois, this 28th day of July, 2015.

Respectfully submitted,

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On behalf of the
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