

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

Midwest Independent System Operator, Inc.)

Docket Nos. ER07-550-000 and
ER07-550-001

REQUEST FOR CLARIFICATION

I. INTRODUCTION

Pursuant to Rule 212 of the Federal Energy Regulatory Commission’s (“Commission” or “FERC”) Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, the Organization of MISO States (“OMS”) hereby requests clarification of the Commission’s “Order on Ancillary Services Filing and Providing Guidance” issued on June 22, 2007, in the above-captioned dockets.

The OMS is submitting this Request for Clarification out of an abundance of caution to ensure that the OMS does not inadvertently fail to exhaust its rights to administrative remedies should the Commission interpret its June 22 Order to have made a finding regarding the justness and reasonableness of the Midwest ISO’s February 15 ASM cost allocation proposal.

II. PURPOSE OF SEEKING CLARIFICATION

OMS seeks clarification of the Commission’s statements that, “We agree with the Midwest ISO that allocating the costs of procuring and deploying contingency reserves on a market load ratio share, which includes export schedules, is a reasonable approach”¹ and “We find this cost allocation to be generally acceptable as discussed in the Cost Allocation section”²

¹ ER07-550 Order on Ancillary Services Filing and Providing Guidance at P 104.

² *Id.* at footnote 70.

and “we consider a market-wide allocation of ancillary services costs to be reasonable.”³ The OMS seeks clarification that the Commission did not intend its statements to constitute approval of the Midwest ISO’s February 15 cost allocation proposal or to constitute a finding that the Midwest ISO’s February 15 cost allocation proposal is, or would be, just and reasonable.

The OMS interprets the Commission’s statements on ancillary services cost allocation as keeping the door open to other cost allocation proposals, and expressing an intent and expectation to entertain alternative cost allocation proposals on re-filing. The Commission’s Order gives support for the OMS’s interpretation at various points in the text. The Order, for example, states, “To help facilitate progress on such a revised proposal in a timely fashion, we provide guidance, as discussed below, on the major design elements of the ASM proposal in order to preview the Commission’s perspective and the factors the Commission will consider in reviewing a revised proposal.”⁴ The Commission’s Order states that, “at this stage in considering the Midwest ISO’s proposal, the Commission has not addressed all issues raised by commenters.”⁵ The Commission’s Order directs the Midwest ISO to use the time available prior to re-filing to “improve stakeholder understanding of the proposal, and work with stakeholders on issues of concern.”⁶ Specifically, with respect to the cost allocation issue, the Commission stated that “it would be beneficial for the Midwest ISO to continue discussions with stakeholders on cost allocation issues . . .”⁷

As was explained in the OMS’s Comments, the OMS has strong concerns about the Midwest ISO’s ASM cost allocation proposal.⁸ The OMS asks the Commission to clarify its

³ *Id.* at P 106.

⁴ *Id.* at P 50.

⁵ *Id.* at P 50.

⁶ *Id.* at P 2.

⁷ *Id.* at P 106.

⁸ ER07-550 Comments of the Organization of MISO States, March 20, 2007 at 14-20.

intention and expectation for the Midwest ISO to work with the OMS and other interested parties on the cost allocation issue so that an improved proposal can be submitted by the Midwest ISO on re-filing.

III. BACKGROUND OF THE CASE

On February 15, 2007, the Midwest ISO filed with the Commission revisions and amendments to its Open Access Transmission and Energy Markets Tariff to implement an Ancillary Services Market (“ASM”). The Commission’s June 22, 2007, Order rejected the filing without prejudice and provided guidance. The guidance was designed to enable the Midwest ISO to prepare and re-file a more complete proposal. The Commission’s Order directs the Midwest ISO to use the time available prior to re-filing to “improve stakeholder understanding of the proposal, and work with stakeholders on issues of concern.”⁹

The OMS seeks limited clarification of the June 22 Order regarding the cost allocation issue.

IV. DISCUSSION OF COST ALLOCATION

A. The Midwest ISO’s Cost Allocation Proposal

Under the Midwest ISO’s ASM proposal, locational marginal prices (“LMP”) for energy and market clearing prices (“MCP”) for operating reserves will be calculated for each hour in the day-ahead market and for every dispatch interval in the real-time market. LMPs and MCPs will be based on market participants’ energy offers and operating reserve offers, including separate offers submitted for regulating reserves, spinning reserves, and supplemental reserves. The Midwest ISO asserts that through the simultaneous co-optimization algorithm, and based on the offers submitted, it will be able to commit and dispatch the resources that provide the least cost

⁹ ER07-550 Order on Ancillary Services Filing and Providing Guidance P 2.

solution to serve energy and operating reserve requirements. LMPs are nodal-based and MCPs are zonal-based with the zones potentially changing daily.

While energy payments and energy cost allocation are aligned—both are based on the nodal price (i.e., load pays the LMP and generators receive the LMP)—the same is not the case with the Midwest ISO’s February 15 ancillary services market design proposal. Under the Midwest ISO’s ASM proposal, ancillary service suppliers would be paid the MCP in their zone, but load would not be charged that zonal MCP. Instead, load would be pro rata charged the system average cost of ancillary services under the Midwest ISO’s February 15 proposal.

B. The OMS Comments

The OMS Comments opposed the Midwest ISO’s arbitrary allocation of ancillary services costs to load. OMS recommended a more detailed evaluation of cost causation and ancillary services beneficiaries and advocated development of a cost allocation mechanism more finely tuned toward allocating costs to these cost causers and beneficiaries. The OMS Comments cited exports, for example, as ASM beneficiaries to which ASM costs should be allocated.

However, assuming *arguendo*, that ASM costs would be allocated to load, OMS objected to the Midwest ISO’s proposal to allocate those costs pro rata across the Midwest ISO footprint.

OMS stated,

The OMS also has a concern on a separate, but related matter regarding cost allocation. An ASM design element calls for the development of operating reserve zones which may create additional cost allocation inequities. In accordance with the proposed ASM tariff, the Midwest ISO intends to utilize reserve deliverability zones across the footprint. An ASM market clearing price will be derived for each of the zones, resulting in the possibility of varying the cost to provide ancillary services across the footprint. The Midwest ISO recognizes the different levels of service, the different pricing curves used and the resulting effects on locational market prices and market clearing prices when it pays resources. Although the cost may vary significantly with location, especially during reserve deployment

events, the Midwest ISO proposes to assign the costs across the entire footprint using a load ratio share allocation method. This approach is inappropriate because it makes no attempt to align costs with cost causers on the load side of the Midwest ISO's market. It is also inconsistent with the methodology used to allocate revenue to pay market participants. [footnote omitted] For revenue, the Midwest ISO calculates costs at each location to pay resources. [footnote omitted] The OMS plurality urges the Commission to require the Midwest ISO to develop an allocation methodology that recognizes the price differences across the Midwest ISO footprint.¹⁰

The OMS also stated,

Additionally, OMS continues to be very concerned with the lack of matching the ASM revenues and the ASM costs assigned because of the ancillary services market design. Even if the generation of a load serving entity is chosen to provide its required ancillary services on a 100% basis, if it is located in a zone where the market price is below the system-wide average, the costs for ancillary services will exceed the payments that the load servicing entity will receive for providing ancillary services.¹¹

The OMS Comments highlighted the inequity in the Midwest ISO's cost allocation proposal emphasizing the difficulty for a market participant seeking to gain a level of prior certainty between what it would pay for ancillary services and what it would be paid. The OMS Comments also described the inefficiencies inherent in the Midwest ISO's proposal, pointing out that obscuring the locational nature of operating reserve shortages would mute price signals that are critically important to curing operating reserve shortage problems.¹²

C. The Midwest ISO Answer

In its Answer to Commenters, the Midwest ISO continued to advocate for its filed proposal and expressed a belief that allocating operating reserve procurement costs on a reserve zone basis can lead to severe equity issues.¹³ The Midwest ISO offered a three-zone example in

¹⁰ ER07-550 Comments of the Organization of MISO States, March 20, 2007 at 15.

¹¹ *Id.* at 22.

¹² *Id.* at footnote 16.

¹³ Midwest ISO Answer at 32.

an effort to illustrate their argument.¹⁴ In the example provided by the Midwest ISO, 40% of market load would not incur Operating Reserve procurement costs.¹⁵ The OMS would agree that this would not be an equitable outcome. However, the Midwest ISO's example does not appear to constitute a reasonable depiction of the type of zones that the Midwest ISO's ASM proposal would actually create, the way that the marginal clearing price would be determined in each zone, or system constraints that limit the amounts of reserves allowed to clear in a zone. In MISO's example, 50% of the reserves are located in a zone that represents only 20% of the market. It is unclear to the OMS how 40% of market load can be outside of a Reserve Zone and thus not be subject to Operating Reserve Procurement Costs.

The Midwest ISO cited Commission Orders for California and New York as precedent for its proposal.¹⁶ However, the Midwest ISO failed to acknowledge the distinction between the single-state ISOs in California and New York and the multi-state Midwest ISO, which is the geographically largest and most heterogeneous of the RTOs.

The Midwest ISO failed to address the inequities in its own proposal that result from its dynamic zone proposal. The Midwest ISO also failed to convincingly support its argument that allocating so as to match ancillary services costs within the ASM zones to the load within those zones would be more inequitable than allocating those costs pro rata across all load in the Midwest ISO region. Furthermore, the Midwest ISO completely failed to address comments pointing out the market inefficiencies and poor price signals that would be created by its proposal.

D. The Commission's Order

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 30.

Implementation of the Midwest ISO's disjointed approach between ancillary services charges and ancillary services payments would lead to numerous inefficiencies and inequities, some of which were mentioned in the Commission's June 22 Order. For example, the Commission notes in the "Hedging" section of its June 22 Order certain commenters' observation that, "market participants who self-schedule could receive less revenue for self-supply priced at the zonal clearing price, while paying a portion of the market-wide load ratio share"¹⁷ Similarly, in the "Reserve Zone" section, the Commission notes FirstEnergy's comment about "a disconnect between zonal reserve requirements and reserve cost allocations, because reserve zones are set based on physical characteristics of the transmission system, but costs are allocated Midwest ISO-wide on a load ratio share basis."¹⁸

The Commission's June 22 Order does not address the equity issues arising from the disjoint in the Midwest ISO's proposal between operating reserve payments and operating reserve costs. Rather, the Commission's Order simply states, without explanation, that "ancillary services are provided for the benefit of the entire market."¹⁹

With respect to the market design efficiency issue, the Commission's Order states,

"The Midwest ISO proposal provides that resources would be paid for reserves based on their marginal clearing price and market participants would be charged for reserves procured by the Midwest ISO on a market-wide load ratio share basis. [footnote omitted] Hence, while suppliers of reserves will be paid scarcity prices for each MW, buyers will not pay those prices, but rather will pay the average procurement price per MW, which is likely to be less than the scarcity price. Furthermore, the Midwest ISO anticipates that the hours of the highest scarcity prices (*i.e.*, \$3,500/MW/Hour) will likely be less than the 20 to 30 hours of total expected scarcity hours per year. While it is possible that market participants may pay more for reserves than their resources receive in payment, to the extent the resources are in low cost zones with low marginal clearing prices, we do not expect the difference between payments and revenues to represent a significant exposure to scarcity pricing, as commenters contend, and therefore we

¹⁷ ER07-550 Order on Ancillary Services Filing and Providing Guidance at P 73.

¹⁸ *Id.* at P 85.

¹⁹ *Id.* at P 106.

do not consider complete zone hedging to be necessary for the efficient functioning of the market.”²⁰

Accordingly, the Commission concludes its cost allocation discussion by stating that “it would be beneficial for the Midwest ISO to continue discussions with stakeholders on cost allocation issues . . .”²¹

V. CONCLUSION

The OMS agrees with the Commission that “it would be beneficial for the Midwest ISO to continue discussions with stakeholders on cost allocation issues . . .”²² OMS seeks clarification that the Commission expects the Midwest ISO to engage in such discussions on the cost allocation issue so that MISO can re-file “a revised proposal in a timely fashion.”²³ OMS seeks clarification that the Commission’s June 22 Order did not approve the Midwest ISO’s February 15 cost allocation proposal and does not contain any finding that the Midwest ISO’s February 15 cost allocation proposal is, or would be, just and reasonable.

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
Iowa Utilities Board
Kentucky Public Service Commission
Michigan Public Service Commission
Minnesota Public Utilities Commission
Missouri Public Service Commission
Montana Public Service Commission
Nebraska Power Review Board
North Dakota Public Service Commission

²⁰ *Id.* at P 92.

²¹ *Id.* at P 106.

²² *Id.* at P 106.

²³ *Id.* at P 50.

Pennsylvania Public Utility Commission
Public Utilities Commission of Ohio
Wisconsin Public Service Commission

The Manitoba Public Utilities Board and the South Dakota Public Utilities Commission did not participate in this pleading. The Indiana Utility Regulatory Commission abstained from this pleading.

The Indiana Office of Utility Consumer Counselor and the Iowa Office of Consumer Advocate, 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
Organization of MISO States
100 Court Avenue, Suite 218
Des Moines, Iowa 50309
Tel: 515-243-0742

Dated: August 10, 2007

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 10th day of August, 2007.

William H. Smith, Jr.