

among the states; to make recommendations to the Midwest ISO, the Midwest ISO Board of Directors, the Commission, other relevant government entities and state commissions as appropriate; and to intervene in proceedings before the Commission to express the positions of the OMS member agencies. The OMS files this timely Notice of Intervention pursuant to the authority conferred by its bylaws and the authorization of its Board of Directors.

Service of all pleadings, documents, and communications in this matter should be made on the following:

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III. Summary of OMS Positions on Issues in the June 6 Filing

The OMS recognizes that the Midwest ISO intends its June 6 Filing to provide the Commission and the Midwest ISO stakeholders with a better understanding of the Midwest ISO's resource adequacy efforts to date and its future plans.³ Given the significant impact that resource adequacy policy will have on the Midwest ISO's customers, the OMS has a keen interest in the June 6 Filing and offers the following discussion on the June 6 Filing as feedback to both the Midwest ISO and the Commission. In summary, the OMS Comments are as follows:

A. Resource Adequacy Paradigms in Various Regions

The June 6, 2006 filing by the Midwest ISO in the instant docket reveals that stakeholder meetings have addressed similarities and differences between

Public Service Commission, the Michigan Public Service Commission, the Minnesota Public Utilities Commission, the Missouri Public Service Commission, the Montana Public Service Commission, the Nebraska Power Review Board, North Dakota Public Service Commission, the Ohio Public Utilities Commission, the Pennsylvania Public Utility Commission, the South Dakota Public Utilities Commission, and the Wisconsin Public Service Commission. The Manitoba Public Utilities Board is also a member of the OMS.

³ June 6 Filing, at 5

resource adequacy paradigms in other regions.⁴

The OMS supports the development of a more complete resource adequacy proposal with a phased implementation along the lines described in the June 6 filing. Based on our review of capacity constructs under development or in use elsewhere, the OMS would not advise adoption by the Midwest ISO of any of those capacity constructs in total.

B. Resource Adequacy Requirement – Phase I Operating Reserve and Regulation Market

In Phase I, the Midwest ISO plans to integrate short-term Contingency Reserves and Regulation (e.g., Ancillary Services) into the Energy Market.⁵ The June 6 Filing describes the Phase I consolidation of some balancing authority functions and the transfer of others to the Midwest ISO. The OMS supports further development of the proposed functional consolidation, as it appears the most likely result will be significant savings and improved operational efficiencies.

The outline for an ancillary services market, also described in the June 6 Filing, shows a probability of a favorable benefit-to-cost relationship. Accordingly, the Midwest ISO should proceed with detailed planning, in conjunction with its stakeholders, to develop the details of this market design. Noting the Midwest ISO has yet to discuss Ancillary Services cost allocation, the OMS will follow future cost allocation discussions and amendments made to Midwest ISO. With the inclusion by the Midwest ISO of demand responsive resources in the Ancillary Services Market design, the OMS recognizes that such approaches affect retail customers and as such, should be coordinated with State-approved interruptible and demand response programs.

C. Resource Adequacy Requirement – Phase II

In Phase II, the Midwest ISO plans to undertake a long-term integration of shortage pricing with the Energy Market. Important elements of Phase II are to

⁴ June 6 Filing, at 4

⁵ June 6 Filing, at 5

include implementing demand-side response to market pricing signals; develop longer term financial transmission rights (FTRs); facilitate use of longer-term energy contracts by market participants; resolve the seams issues with neighboring RTOs and non-market regions; and coordinate Resource Adequacy standards with requirements ultimately developed through the ERO and the Regional Reliability Organizations in the Region.⁶ The OMS looks forward to continuing discussion of how the Midwest ISO intends to achieve these objectives and the Midwest ISO's analysis showing that the Phase II objectives are sufficient to ensure short-term reliability needs while encouraging long-term investment and reasonable retail rates.

IV. Background

In the June 6 Filing, the Midwest ISO states that efficient, accurate and transparent price signals are critical to enable market participants to make better-informed real-time decisions regarding both the current value of energy and future investment decisions.⁷ In particular, the Midwest ISO states that enhanced energy price signals can improve the quality of investment decisions and reduce the costs associated with risks.⁸ Accordingly, the Midwest ISO states that it has focused its efforts on investigating ways that it can improve energy price signals in order to reflect more accurately the value of energy.⁹

The Midwest ISO favors a two-phase approach to implementing a resource adequacy plan. In particular, the June 6 Filing refers to the Midwest ISO's Generation Adequacy Assessment for the summer of 2006 that forecasts an expected 18% reserve margin for the ISO footprint.¹⁰ According to the Midwest ISO, this margin allows it the time needed to take a phased approach to development of a permanent resource adequacy plan. The Midwest ISO further cites discussions with stakeholders supporting a phased approach and its belief

⁶ June 6 Filing, at 7-8

⁷ June 6 Filing, at 2-3

⁸ June 6 Filing, at 3

⁹ June 6 Filing, at 4

¹⁰ June 6 Filing, at fn. 15

that a two-phase approach to implementing a permanent resource adequacy plan is more efficient and productive than attempting to accomplish all of the necessary objectives at one time.¹¹

Accordingly, a significant portion of the June 6 Filing is focused on the general framework of the proposed two-phase approach. Specifically, in Phase I, the Midwest ISO proposes to integrate short-term contingency reserves and regulation into the energy markets.¹² The June 6 Filing states that the Midwest ISO anticipates filing detailed Phase I plans with Commission in the fall of 2006.¹³

In Phase II, the Midwest ISO proposes to undertake a long-term integration of shortage pricing with the energy markets.¹⁴ The June 6 Filing further states that the Midwest ISO expects Phase II to include initiatives such as the implementation of more or different demand-side management (“DSM”) programs, the development of long-term financial transmission rights (“FTRs”), the facilitation of longer-term energy contracts, the coordination and resolution of seams issues with neighboring regional transmission organizations (“RTOs”) and non-market regions and the coordination of resource adequacy requirements with national resource adequacy standards developed by the Electric Reliability Organization (“ERO”) and the Regional Reliability Organizations in the Midwest ISO region.¹⁵ The Midwest ISO states that it anticipates making its Phase II filing with the Commission in 2007.¹⁶

V. Discussion

A. Balancing Authority Consolidation

The Midwest ISO’s April 3, 2006, filing in Docket No. ER04-691-000 described considerable cost savings and operational benefits that could be achieved through the consolidation of some balancing authority (“BA”) functions,

¹¹ June 6 Filing, at 5

¹² June 6 Filing, at 5

¹³ June 6 Filing, at 7

¹⁴ June 6 Filing, at 5

¹⁵ June 6 Filing, at 7-8

¹⁶ June 6 Filing, at 8

the transfer of other functions to the Midwest ISO and the creation of an ancillary services market (“ASM”) which would allow the dispatch of energy and certain ancillary services to be co-optimized.

The OMS believes the centralization of some, and transfer of other, BA functions can be a needed step to achieve lower costs to electricity users, increased market efficiency and continued regional reliability. These transfers to the Midwest ISO and functional consolidations would be followed by individual BA determinations of their future operations and options. It is our understanding that each BA may consider how it will operate in the future, whether it will continue to operate or how it might combine operations with neighboring BAs. Given that the current BA Agreement does not preclude the consolidation of balancing authorities, the OMS is encouraged by the Midwest ISO’s and the different BAs’ analytical efforts to study the reliability and efficiency impacts and potential benefits of increasing the size of physical BA boundaries in the future.

B. Phase I – Integration of Short-term Contingency Reserves and Regulation into the Energy Markets

In its April 3, 2006 filing, the Midwest ISO describes the Phase I integration into its market operations of contingency reserves and regulation (“ancillary services”) that are required to support real-time energy deliveries and to maintain system reliability. The Midwest ISO intends to implement a two-part financial settlement ASM that would allow energy prices to reflect more accurately the price of delivery of energy to a given location at a given time with a given mix of resources. The Midwest ISO states that an ASM will serve customers more reliably and at lower cost by providing improved, transparent price signals in the energy and ancillary service markets, as well as a consistent platform to support the region’s short-term reliability needs, while not conflicting with the resource adequacy requirements of PJM.¹⁷

(1) Cost Benefit Studies

There has been much discussion regarding the benefits and costs of ISOs,

¹⁷ June 6 Filing, at 4

both in general and for specific aspects of their service offerings. Indeed, numerous studies have been performed using various methodologies — all of which have their strengths and weaknesses.

Any useful benefit-cost analysis requires the systematic collection of data in a process designed for analyses to more clearly determine, compare and understand the impacts that RTOs have on reliability, wholesale market structure, as well as the conduct and performance of load-serving entities’ (as buyers and sellers) and other market participants. Such analyses require empirical determinations of baseline conditions or other types of “control samples” in order to measure and assess the impacts of the changes, such as BA functional consolidation and ASM implementation. Ideally, before changes are implemented, the Midwest ISO or other independent parties would begin gathering and maintaining data needed to determine baseline conditions. It is important to consider the design of a cost-benefit study prior to implementing the ASM so that a ‘look-back’ evaluation can accurately compare the costs of historical ancillary services to the costs of the future ASM proposal.

Prior to implementation of BA functional consolidation or the ASM, the Midwest ISO and its stakeholders have an opportunity to start thinking about how such studies should be conducted to produce meaningful output and, just as importantly, to put in place a process to systematically collect relevant data reflecting operations and other conditions pre- and post-BA functional consolidation and pre- and post-ASM implementation.¹⁸ Such data and analyses could help the OMS, the Midwest ISO and the Commission better understand how the Midwest ISO’s proposals might ultimately impact retail customers through changes in Midwest ISO operations and wholesale markets. A well designed study and the subsequent analyses might better position the Midwest ISO to make necessary changes to improve market performance and its operations over time.

¹⁸ Subsequent to the June 6 filing, MISO proposed a new Data Collection Work Group (as part of the Ancillary Service Market Project) for the purpose of collecting such data. OMS looks forward to working with MISO on this effort.

(2) Ancillary Services Cost Recovery

While the Midwest ISO and its stakeholders are examining development of an ASM for regulation and operating reserves (spinning and non-spinning), state regulators are especially mindful that cost recovery for these services is currently accomplished in the ancillary services schedules in each Transmission Owner's current open access tariff and referenced by the Midwest ISO's energy markets tariff. These schedules are usually cost-based. The OMS seeks to understand how the wholesale schedules would change to ensure that the costs and revenues are being fairly assigned, allocated and eventually recovered from retail customers.

At this point, the Midwest ISO has yet to discuss cost allocation in the ASM design forum. Given that certain ASM costs may be included in a utility's retail rate base regulated by individual states or otherwise impact retail rates, the OMS will follow and participate in future ASM cost allocation discussions at the Midwest ISO. If utilities transfer ancillary services functions to the Midwest ISO due to operational and/or cost advantages, the OMS would expect the use of a reasonable and fair cost allocation method that appropriately assigns costs to the balancing authority or to the market participant. The OMS would also follow how amendments are made to the Midwest ISO's Energy Market Tariff, the Midwest ISO's Transmission Owners' ancillary services tariffs and other related agreements, such as the BAs' Agreement and the Transmission Owners' Agreement.

(3) The Impact of Demand Response on Short-term Contingency Reserves and Regulation (Ancillary Services)

Recently, the Midwest ISO has included demand responsive resources in ASM design discussions of regulation response. Cost recovery may also affect certain demand response resources in the ASM. For example, historical levels of operating reserves, as demonstrated in seasonal assessments by the former ECAR regional reliability region, have varied depending on whether interruptible load is included in the reserve margin calculation. Some OMS states have approved

interruptible load tariffs for large and small retail customers. Such tariffs offer reduced rates to customers willing to risk and endure periodic electricity service interruptions. Any region-wide market approach to the provision of regulation service and operating reserves affects retail customers, and as such, should be coordinated with State-approved interruptible and demand response programs.

(4) Proceeding with Phase I

The June 6 Filing states that the Midwest ISO will file detailed Phase I plans with the Commission in the fall of 2006. The June 6 Filing also commits the Midwest ISO to continued work with its stakeholders to determine the best way to proceed with Phase I.¹⁹ Given the importance of the changes that an ASM would bring, the OMS has participated in the discussions on balancing authority functional alignment, deliverability tests, and ASM design. To better inform state commissions, the OMS has scheduled a conference with Midwest ISO staff on July 20, 2006, to offer the OMS Board of Directors an opportunity to discuss the proposed ASM in more detail.

Many important ASM market design elements have not yet been fully developed. The OMS expects that on-going communication will provide Midwest ISO market participants the opportunity to explore all aspects of ASM design. The OMS has initially identified several issues at this time that warrant further examination. These issues include replenishment reserves, scarcity pricing and self supply of ancillary services.

First, the OMS suggests that the Midwest ISO provide the pros and cons of various design alternatives under consideration for the ancillary services market(s). For example, during a June 28, 2006, ASM design meeting, the Midwest ISO provided a list of Five Options for Contingency Reserve Replenish Options and asked for stakeholder preferences. Since the risk and cost information was not provided with the five options, it was difficult to comment. For future meetings, it was suggested that the Midwest ISO provide the pros and cons of each option to aid in the decision-making process. Overall, the OMS

¹⁹ June 6 Filing, at 7

would appreciate reviewing a matrix for the various ASM design alternatives showing estimated costs and benefits, the reliability impacts, the likelihood of meeting NERC or ERO standards and customer rate impacts. Such a matrix would provide OMS members with the information necessary to determine the differences between both the *status quo* and the new ASM proposals and the implications of any necessary trade-offs.

Second, recent discussions in the ASM design forum have considered the possibility of shortages of ancillary services. Since scarcity pricing may be a part of the market for ancillary services, the OMS is seeking more information as to how the ASM markets would operate under scarcity pricing conditions.

A third market design issue that needs resolution is the self-supply of ancillary services, which is currently done under cost-based rates. The Midwest ISO's ancillary services white paper states that the simultaneous co-optimization approach of ancillary services and energy will minimize overall production costs in the Midwest region compared to current market and cost-based methods.²⁰ Since it is not yet clear how self-supply might work, information on this topic would allow the OMS to better assess the overall ASM market design.

As the above examples illustrate, many design elements of the ASM have not yet been fully developed. The OMS looks forward to participating in the design process, particularly as it relates to each state's varied and diverse responsibilities to retail customers and the reliability of the electricity market.

C. Phase II Long-term Resource Adequacy

Phase II in the June 6 Filing intends to incorporate five components: implementing demand-side response to market pricing signals; developing longer term financial transmission rights (FTRs); facilitating use of longer-term energy contracts by market participants; resolving the seams issues with neighboring RTOs and non-market regions; and coordinating Resource Adequacy standards with requirements ultimately developed through the ERO and the Regional Reliability Organizations in the Region. For the most part, all five of the Phase II

²⁰ *Midwest ISO Ancillary Service Market White Paper*, Version 3.0 (2006), at 1

elements discussed in the June 6 Filing should either help to improve the efficiency of the energy markets or provide market participants with tools to manage or minimize their exposure to various market risks. Accordingly, the OMS believes that the Midwest ISO should pursue these five elements. As noted above, the OMS acknowledges that the Midwest ISO intends to make a more detailed Phase II filing in 2007. However, the OMS would appreciate continuing discussion of how the Midwest ISO intends to achieve these objectives and analysis showing that the Phase II objectives are sufficient to ensure short-term reliability needs while encouraging long-term investment and reasonable retail rates.

(1) Impact of Phase II Plans on Current Arrangements

Capacity investment costs for incumbent load serving entities' and vertically-integrated transmission owners' resources are typically recovered through State-approved rates. Further, a very large percentage of customers in the Midwest ISO footprint are supplied under current contracts, reserve sharing agreements or self-supply arrangements. The OMS is also concerned about the proposal's potential implications on current arrangements, double recovery, and future rates for combined energy-plus-capacity-cost bilateral arrangements.

(2) Understanding Phase II Market that Integrates Shortage Pricing with the Energy Market

Like the efforts of the Midwest ISO stakeholder process, the OMS also has made a concerted effort to understand the various RTOs' reasons for, and design of, capacity markets. RTO-operated capacity markets have been evolving over time because of problems resulting from initial market designs. Because of the proposed changes in RTO capacity market designs, the OMS recently invited persons familiar with the New England RTO, New York RTO, PJM and ERCOT capacity constructs to a meeting held in Chicago on May 8-9, 2006, to learn more about these revised market designs for RTO capacity markets.²¹

At this time, the Midwest ISO is not proposing to implement an RTO-

²¹ The OMS notes that ERCOT is not implementing a capacity market.

operated capacity market, but has instead proposed sending price signals regarding capacity shortages through a co-optimized energy and ancillary services (operating reserves and regulation) market in conjunction with other Phase II elements. Although the Midwest ISO proposal is not totally new or unique, it is difficult to find comparable examples outside of New Zealand or Australia. For example, while ERCOT has had competitive portfolio bids for ancillary services and balancing energy since July 2001, the Texas “energy-only” resource adequacy and market power rules to implement a market similar to the Midwest ISO Phase II approach is not expected to be finalized until the Summer of 2006.

The Midwest ISO made two presentations to the OMS regarding the capacity reserve position for the region. The first presentation was made at the OMS Chicago meeting on May 8-9, 2006. At this meeting, the OMS asked the Midwest ISO to provide additional information which was then presented in Columbus on June 21.

The Midwest ISO presentation in Columbus indicated that through the summer of 2009, the reserve margin is expected to be above 15% based on signed interconnection agreements, and may stay above this level through 2016 based on interconnection requests in the Midwest ISO queue for interconnection agreements. In addition, the Midwest ISO’s Module E reports indicate that the overall reserve level for 2006 is 18% and is expected to stay at this level through the summer of 2008 based on signed interconnection agreements. Thus, setting aside locational adequacy issues, it appears that any decision on the implementation of a region-wide, RTO-operated capacity market can prudently be delayed for at least one year. With the Midwest ISO’s current capacity levels estimated at a reserve level of 18%, there is no apparent need for an immediate decision on this issue.

The June 6, 2006 filing by the Midwest ISO in the instant docket reveals that the stakeholder meetings have addressed the similarities and differences between resource adequacy paradigms in other regions.²² The OMS supports the development of a more complete resource adequacy proposal with a phased

²² June 6 Filing, at 4

implementation along the lines described in the June 6 filing. Based on our review of capacity constructs under development or in use elsewhere, the OMS would not advise adoption by the Midwest ISO of any of those capacity constructs in total. However, the OMS looks forward to continuing discussion of how the Midwest ISO intends to achieve its objectives and the Midwest ISO's analysis showing that the Phase II objectives are sufficient to ensure short-term reliability needs while encouraging long-term investment and reasonable retail rates.

**(3) Coordinating Resource Adequacy Standards with the ERO
and the Regional Reliability Organizations in the Region:
Reserve Sharing Agreements**

In looking at long-term resource adequacy, the OMS has examined the traditional role of planning reserve margins. This topic has been of primary importance among many of the OMS States. The generation resources in these States have been included in joint ownership, reserve sharing, and other voluntary cooperative agreements for more than 30 years through reserve sharing pools of investor-owned utilities, municipal agencies, cooperatives, public power districts, federal power marketing agencies and Canadian participants. The Midwest ISO offers to administrate a Planned Reserve Sharing Groups ("PRSG") for the Midwest ISO Region.²³ This PRSG is open to both members and non-members of the Midwest ISO, and the Midwest ISO will assist its members in meeting the planning reserve standards that have been proposed by the MRO and RFC. The exact form of the Midwest ISO assistance was not detailed in its information filing. The Midwest ISO believes that with sufficient transmission, increasing the size of the PRSG will result in smaller reserve margin requirements and will likely result in a more uniform reserve margin throughout the Midwest ISO region.

The Midwest ISO is responding to requests for additional explanation and information with respect to work in progress that had not been completed as of the time of this filing. OMS has planned follow-up discussion with Midwest ISO

²³ June 6 Filing, at 2-3

Staff on two important fronts: (1) more detailed information of “subregional geographic” reserve margins based on load and resource data, and (2) how the Midwest ISO is assisting Reliability First load serving entities (LSEs) to determine planning reserve requirements for the new RFC PRSGs. We understand that the RFC’s PRSG resource adequacy determination will include contractual enforcement that closely mirrors a draft set of MRO requirements. Many states have relied upon a regional reliability organization’s enforcement of planning reserves margins, daily operation reserves, and a seasonal reliability assessment. Despite the changes to how planning reserve margins are set and who is responsible for the enforcement provisions, the states remain concerned that the planning reserve margins are sufficient to ensure both adequacy and reliability while avoiding unnecessary costs.

(4) Risk Exposure

The Midwest ISO’s resource adequacy proposal relies on “efficient, accurate, and transparent pricing signals to market participants.” These pricing signals include the potential for scarcity pricing, to “assist market participants in making future investment decisions” in facilities (generation, transmission, and demand-side management resources) needed to assure customers are served reliably and economically. The Midwest ISO states that “Enhanced energy price signals can improve the quality of investment decisions and reduce the costs associated with risks.”²⁴

In discussions with Midwest ISO personnel prior to, and after the June 6 filing, state commission personnel have pointed out the importance of appropriate complementary elements if the Midwest ISO’s Phase II plan is to be successful. These complementary pieces include: (1) adequate consideration of price responsive demand in Midwest ISO markets; (2) having Midwest ISO markets inform the Midwest ISO’s regional transmission expansion planning of transmission’s value to market efficiency; and (3) having Midwest ISO market participants act with an understanding that day ahead and real time energy

²⁴ June 6 Filing, at 3

markets, whether co-optimized with operating reserve and regulation ancillary services markets or not, are but pieces, not the whole, of a healthy energy asset portfolio.

These issues do not imply that the Midwest ISO's proposal cannot be successful. Neither do they imply that the Midwest ISO is necessarily responsible to assure that all of these elements are in place. Nonetheless, the more pieces that are missing, the greater the risk profile for Midwest ISO market participants.

(a) Reducing Risk Exposure through Price Responsive Demand

One of the important elements of Phase II is implementing demand-side response to market pricing signals. It appears that for this approach to work effectively there will need to be a significant increase in demand response resources and other tools to manage the increased price risk. Moreover, in order for market prices to increase to levels where the market will clear during times of capacity shortages, demand willing to cut back usage when paid high enough prices to do so needs to be developed. Otherwise, supply will simply remain short of demand and the price will be determined by the bid cap placed on generation. Such a shortage would then result in involuntary curtailment of load rather than load voluntarily cutting back use when paid high enough prices to induce such voluntary curtailments.

The June 6 Filing states that RTOs are in agreement that demand side response to market pricing signals improves the efficiency of Energy Markets.²⁵ Such demand side response programs also help to mitigate price spikes and to reduce the potential for entities to exercise market power. Even though the Midwest ISO seems to recognize the importance of demand response, a comprehensive regional demand response plan or process is not currently under development. For example, though some states in the Midwest ISO footprint have energy efficiency and demand response programs, no steps have been taken

²⁵ June 6 Filing, at 7

to assure they are consistent with each other or any Midwest ISO market design.²⁶ Additionally, no studies have been undertaken to determine the impact that current levels of demand response will have on market prices or on reducing the exercise of market power. Though the Midwest ISO appears to have adequate supply and demand resources to maintain reliability over the next several years, the OMS advises that more work on demand response must be accomplished for Midwest ISO energy markets to remain healthy in the future. Though the OMS is committed to doing its part to enhance the viability of demand response resources in the Midwest ISO footprint, a successful effort will take the efforts of all stakeholder groups coordinated by the Midwest ISO.²⁷

The June 6 Filing also suggests that the States within the Region can assist the Midwest ISO in developing DSM programs.²⁸ This appears to be one of the areas that the Midwest ISO believes will require significant “additional analysis and stakeholder discussions to determine the specific design, rules, costs and benefits of such tariff changes.”²⁹ While the Midwest ISO advises state regulators on retail customer rate design³⁰ little is said in the June 6 Filing about what specific actions the Midwest ISO expects in the wholesale market.

The Midwest ISO should explain exactly how it envisions LSE’s managing their load in the aggregate to respond to wholesale prices, or the extent

²⁶ The Pennsylvania PUC notes that it is a member of the Mid-Atlantic Distributed Resources Initiative (MADRI) which seeks to identify and remedy retail barriers to the development of distributed generation, demand response and energy efficiency in the Mid-Atlantic region. MADRI was established by the utility commissions of Delaware, District of Columbia, Maryland, New Jersey and Pennsylvania, along with the U.S. Department of Energy (DOE), U.S. Environmental Protection Agency (EPA), Federal Energy Regulatory Commission (FERC) and PJM Interconnection.

²⁷ Section 1252 of the Energy Policy Act of 2005 encourages states to investigate providing reliable and affordable demand response service to the public, particularly to respond to peak demand and emergency needs. Such state initiatives can use advanced time-based “Smart” meters and communications technologies, devices and systems, and educate consumers on the availability, advantages, and benefits of advance metering and communications technologies. Department of Energy technical assistance to states and regional organizations may offer a useful way to coordinate regional demand response activities.

²⁸ June Filing, at 7

²⁹ June 6 Filing, at 5

³⁰ See June 6 Filing at 7, wherein the Midwest ISO advises departing from “flat” retail rates, considering fixed time-of-use rates, or better yet using real-time hourly prices to send price signals. The latter retail rate design, the Midwest ISO counsels, will make the wholesale market “more competitive”—particularly if load serving entities who find themselves exposed to spot prices” can hedge their company’s risk by initiating DSM programs for their customers.

and conditions under which retail demand response behind an LSE should or could participate directly in the wholesale market as market participants. In addition, the OMS is unaware of any determination of how the relevant parties should and would treat current or new demand response resources in the determination of planning reserve margins. For example, the Midwest ISO did not explain in its June 6 Filing to what extent and how it would treat a portion of load behind a retail meter on “equal footing” with supply.³¹

The OMS encourages the Midwest ISO to augment its stakeholder efforts to address these unanswered issues related to the roles of demand-side resources in wholesale electricity markets and as alternative resource adequacy resources. The OMS offers its leadership in state regulatory efforts to develop demand-side response capability in retail markets. It is critical that wholesale and retail demand-side programs work in concert.

(b) Transmission’s Value to Reliability, Resource Adequacy, and Market Efficiency

In previous comments to the Commission, the OMS has emphasized the need for a properly executed regional transmission expansion planning process. Specifically, in Docket No. AD05-7-000, the OMS stated:

A properly executed regional transmission planning process, including siting with appropriate cost allocation for reliability and regionally beneficial upgrades to the transmission system, is likely the most important factor in reducing congestion costs in the long term.

The OMS restated that point in Docket No. RM06-8-000:

At the outset of these comments, the OMS would like to reiterate one of the major points it previously has made in Docket No. AD05-7-000: ‘To guarantee long-term transmission rights absent grid expansion is likely to mean shifting the congestion costs among market participants without lowering the overall level, and therefore risks, of these congestion costs.

Implementing the overall objectives of long-term transmission rights (‘to provide increased certainty regarding the congestion cost risks of long-term transmission service in organized electricity markets that will help load-serving entities and other market participants make new investments

³¹ In its Midwest ISO Ancillary Service Market Detail Design White Paper Version 2.0., the Midwest ISO says that demand response can participate on an “equal footing” with supply.

and other long-term power supply arrangements’) likely will require a significant expansion in the transmission system, and this expansion will not happen overnight.

As indicated earlier in these comments, for a region-wide PRSG to be effective in the Midwest ISO region, the Midwest ISO must determine the transfer capabilities of the transmission system needed to reduce reserve margins. Reduction in reserve capacity margins is an economic benefit that the Midwest ISO has only preliminarily begun to consider in its evaluation of benefits from transmission expansion.

The Midwest ISO appears to be in the process of attempting to evolve its regional transmission expansion process. The OMS advises that these efforts, aimed at using transmission to unlock efficiency and value, will be critically important to assure that the Midwest ISO’s resource adequacy initiative is fully able to provide enhanced energy price signals that can both improve the quality of investment decisions and reduce the costs associated with risks, while at the same time maintaining reliability and resource adequacy. Enhanced transmission planning should be added as a sixth element in the Midwest ISO’s Phase II long-term resource adequacy plan.

(c) Healthy Energy Asset and Contract Portfolios

Some states in the OMS are beginning to receive anecdotal evidence that points to some market participants having an inadequate understanding of the complexities of Midwest ISO markets. In looking at a broader energy policy effort, some OMS states have understood that the Midwest ISO’s day-ahead and real-time energy markets are but pieces of, but not an entire healthy energy asset portfolios. The ability of a market participant to extract value for its customers in a market will depend on the overall quality of the market participant’s portfolio—not necessarily on any one or two pieces of the portfolio.

Consequently, the OMS views the Midwest ISO’s resource adequacy initiative as: (1) a potentially important improvement designed (but not guaranteed) to allow market participants to more reliably and economically serve customers; and (2) not a panacea. Co-optimizing energy markets with operating

reserve and regulation ancillary services markets may serve to make a portion of a market participant's energy asset portfolio more efficient, reliable, and economic. However, many OMS member states believe that to assure their customers receive adequate service, market participants must look beyond Midwest ISO energy markets to the entirety of assets in their portfolios, including self-supply, bilateral contracts and the timely availability of those assets.

Many OMS member states believe that maintaining an appropriate mix will assure that market participants can extract a balanced value from the market to meet the needs of their customers; otherwise they risk having others extract value from them. Although both market participants and the Commission may focus on the Midwest ISO's initiative in this proceeding, the healthiness of market participants' total portfolios must remain in the bigger picture.

(5) Integration of Longer-Term Financial Rights and Transmission Planning into Regional Resource Adequacy Considerations

In prior comments to the Commission, the OMS has examined long-term transmission rights as a means for hedging against congestion costs from a generation source to a load sink.³² While the OMS supports the desire by all market participants to reduce market risks from congestion costs, we recognized that physical transmission rights never constituted an absolute ability to flow a particular transaction all hours of the year, particularly when deliverability from the most economic resources is restricted by transmission constraints. In such cases, more expensive generation must be redispatched to maintain power system reliability.³³

The OMS also noted that any realistic consideration of long-term transmission rights must take into consideration the relationship between resource deliverability standards and the ability to hedge congestion costs on a long-term

³² "Comments of the Organization of MISO States on Establishing Long Term Transmission Rights in Markets with Locational Pricing," Docket No. AD05-7-000, *Long Term Transmission Rights in Markets Operated by Regional Transmission Organizations and Independent System Operators* (June 30, 2005) at 1.

³³ June 6 Filing, at 2

basis. Guaranteeing such transmission rights absent grid expansion will simply shift congestion costs among market participants without lowering the overall level of congestion and its risks.³⁴ Without adequate grid expansion, longer-term transmission rights are likely only to redistribute congestion cost among market participants.

Fundamental to establishing an effective RTO environment for long-term firm transmission rights at the Midwest ISO will be coordination of: 1) the allocation of existing financial transmission rights; 2) transmission expansion required for deliverability; and 3) the allocation of the costs of resulting transmission upgrades necessary to grant such rights.

The OMS continues to be concerned that the apportionment of risks in the design of longer-term FTRs for the purposes of resource adequacy should avoid undue discrimination and disruption of real-time market dispatch.³⁵ Therefore, OMS will continue to be actively involved in the stakeholder process involving any further refinement of the Midwest ISO's regional transmission planning process, transmission cost allocation methods and financial transmission rights in order to understand how long-term transmission planning can be better integrated into regional resource adequacy considerations.

VI. Conclusion

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

³⁴ June 6 Filing, at 3-5

³⁵ June 6 Filing, at 7-8

Montana Public Service Commission
Nebraska Power Review Board
North Dakota Public Service Commission
Public Utilities Commission of Ohio
Pennsylvania Public Utility Commission
South Dakota Public Utilities Commission
Wisconsin Public Service Commission

The Manitoba Public Utilities Board did not participate in these comments:

The Minnesota Department of Commerce, the Iowa Office of Consumer Advocate and the Indiana Office of Consumer Counselor 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
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Tel: 515-243-0742

Dated: July 14, 2006

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 July, 2006.

William H. Smith, Jr.
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