UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission System	)	Docket Nos. ER07-1372-000
Operator, Inc.	)	ER07-1372-001

COMMENTS OF THE ORGANIZATION OF MISO STATES, INC. FOLLOWING TECHNICAL CONFERENCE

Summary

The results of the technical conference held December 6, 2007, do not change the market monitoring recommendation submitted by the OMS in its Comments filed October 15, 2007, with respect to market power issues in Midwest ISO's Ancillary Services Market ("ASM"). In fact, responses at the technical conference reinforce the conclusion that the Midwest ISO should use the OMS-proposed $10/MWh adder over reference levels with the indicated ratchet mechanism, allowing the adder to drift up or down depending on a market participant's behavior in the ASM.

As indicated in the Midwest ISO's Answer, filed November 5, 2007, both the Midwest ISO and Dr. David Patton, its independent market monitor ("IMM"), accept using the market monitoring approach proposed by the OMS. The Commission has before it the often sought but rarely seen consensus of the states, the RTO and IMM. This consensus respects and reflects the Commission's guidance on issues of market power in prior Commission decisions. For these reasons, and because market power issues loom larger in the ASM than in other energy markets, the FERC should direct the Midwest ISO to make a compliance filing implementing the OMS-proposed $10/MWh adder mechanism for the ASM including the ratcheting component. Dr. Patton did not find this market monitoring conduct and impact approach unreasonable at the technical conference, as long as the ratcheting mechanism allows the values to drift up to the companion values used in the MISO wholesale energy market following proper competitive behavior by market participants.

Choice of an Appropriate Adder Mechanism

At the December 6 technical conference, OMS representatives asked a number of questions related to reference levels and market monitoring in the ASM. With respect to market monitoring, they asked Midwest ISO and the IMM three important questions:

> 1) How do the market power measures compiled by the IMM for the Midwest ISO's ASM compare to the similar measurements for the wholesale energy market?
> 2) Were market participants more or less likely to engage in market power abuse in the ASM or the energy market?
> 3) Is there a statistical or factual way of determining an appropriate adder over reference levels rather than using the arbitrary approach in the Midwest ISO's original proposal?

At the technical conference, the answer to question #1 was not known.[1] The answer to question #2 was that if measurements were similar, the incentives or disincentives for the exercise of market power would likely be the same in either the ASM or the wholesale energy market. As for question #3, the IMM did not believe such an approach would be possible given the many uncertainties affecting measurement of marginal costs. Dr. Patton and Dr. Lawrence Kirsch, an economist who appeared on behalf of the Midwest TDUs, concurred that in standard microeconomic theory, if there were no uncertainty over the factors affecting marginal costs, the adder over reference levels for market power monitoring purposes would in fact be zero.

Since the conference, OMS representatives have conducted research on question #1, and have found, in fact, that the measurements of market power in the ASM are substantially worse than for the wholesale energy market. This adverse finding, discussed below, means the likelihood of the exercise of market power in the ASM is greater than in the wholesale energy market, essentially answering question #2. The answer to question #3 indicates that no true scientific or statistical basis for picking the adder presently exists. This unfortunate situation means careful attention must be taken in picking the appropriate adder value.

Given that uncertainty does affect the appropriate adder over the reference levels for market monitoring purposes, the certainty at the present time about the potential for

[1] Nothing pejorative is meant here as the ability to recall all results of all market power studies for MISO over the past five years is beyond anyone's capability. It was hoped fragments could be recalled.

market power abuse actually implies that the adder should take on a smaller value. While such matters as unknown generator wear and tear (an example discussed at the conference) can affect the adder in the positive direction, the very start up of a new market, given the market power measures identified forth by the IMM, implies a certainty that, without effective market monitoring, the whole ASM, in its design and operation, could lead to non-competitive outcomes. This fact strongly suggests that the adder should lean heavily towards zero at the outset to protect end-user customers from market power abuse or from those aspects of a brand new Midwest ISO market that may be found inadequate only after operational experience. From this reference point, the OMS proposal is the most reasonable approach for the FERC to take.

Market Concentration Is Worse in the Midwest ISO ASM than in the Wholesale Energy Market[2]

That market power is larger in the ASM than in the MISO wholesale energy market can be gleaned from a simple inspection of the HHI calculations made at the time the wholesale energy market was commencing and those HHI calculations in the recent study conducted by Dr. Patton.

The following table reports the HHI statistics compiled by the MISO IMM in his State of the Market Report for 2004 for the wholesale energy market.[3]

[2] The analysis that follows focuses on the HHI values due to the visual ease of comparison. An analysis of pivotal supplier relationships can also be made to show the same conclusion. In Dr. Patton's prepared direct testimony filed March 31, 2004 in Docket ER04-691-00 with respect to the wholesale energy market, the IMM found at pages 12 to 14 that the area known as WUMS had more than half of the 51 flowgates with at least one pivotal supplier. That 2004 analysis suggested two areas of prime concern, WUMS and North WUMS, which are presently considered narrowly constrained areas. In the present 2007 ASM pivotal supplier analysis, the IMM reports widespread pivotal supplier concerns throughout the Midwest ISO footprint. In both the four congested areas and three separate clusters for either regulation or contingency reserves, the IMM found pivotal frequencies exceeding 34 percent and as high as 100 percent. In contrast, for the MISO footprint the pivotal frequency was zero to about 3 percent. These values can be found in the handout distributed at the technical conference at pages 11 and 12.

[3] Table 3, Page 10, "2004 State of the Market Report, Midwest ISO," Potomac Economics, Ltd., June 2005. The full report is available on the Midwest ISO website under IMM.

Table 1--2004 Market Concentration in Midwest ISO Sub-Regions

MISO Sub-region	HHI
ECAR	770
MAIN	1,745
MAPP	1,275
WUMS	2,642
MISO	356

In contrast, Table 2 reports the HHI statistics as presented by the IMM at the December 6 technical conference.[4]

Table 2--Market Concentration Ranges Covering the Four Seasons Using HHI Statistic for Various ASMs

Study Area	Regulation Reserves	Contingency Reserves
MISO Footprint	825 — 938	796 — 931
Congested Areas [WUMS, Minnesota NCA, and Michigan]	3,590 – 6,641	2,998 – 6,397
Clusters	1,788 – 8,809	1,641 – 8,710

A comparison between Table 1 and Table 2 shows that the concentration is about 2 to 3 times higher in the ASM than in the wholesale energy market. To the extent the HHI measures the likelihood for the exercise of market power, this comparison indicates that the potential is higher in the ASM. This higher potential and the ASM market startup argue strongly for a lower threshold value for the adder. In this case, the OMS has suggested a $10/MWh value as compared to the $36/MWh to $100/MWh conduct thresholds presently used in the wholesale energy market. In fact, the OMS suggestion comports nicely with the very finding by the Commission that mitigation needs to be stronger in areas of higher concentration or higher likelihood of the exercise of market power. In its August 6, 2004, Energy Markets Order, the Commission stated:

[4] Pages 10, 11, and 12, "Midwest ISO Ancillary Services Market, IMM Market Power Study," Presentation Handout at FERC Technical Conference, Dr. David Patton, Independent Market Monitor, Potomac Economics, December 6, 2007.

> We support the use of tighter thresholds in areas that are more likely subject to the exercise of market power. This is because when the exercise of market power is more probable, the costs of interfering with the market are more likely to be overshadowed by the benefits of preventing the exercise of market power.[5]

Conclusion:

The results of the December 6 technical conference do not change the market monitoring comments already submitted by the OMS with respect to market power issues in Midwest ISO's Ancillary Services Market. In fact, responses at the technical conference and the analysis above reinforce the concept that the Midwest ISO should use the OMS-proposed $10/MWh adder over reference levels with the indicated ratchet mechanism. The Commission has before it a rare consensus of the states, the RTO, and IMM. This consensus respects and reflects the Commission's own guidance on issues of market power in prior decisions. Consequently, the Commission should direct the Midwest ISO to make a compliance filing implementing the OMS-proposed $10/MWh adder mechanism for the ASM, including the ratcheting component.

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

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

[5] Paragraph 258, page 80, "Order Conditionally Accepting Tariff Sheets To Start Energy Markets and Establishing Settlement Judge Procedures," Dockets ER04-691-000 and EL04-104-000, Federal Energy Regulatory Commission, Issued August 6, 2004.

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

The Iowa Office of Consumer Advocate and the Minnesota Department of Commerce, as associate members of the OMS, participated in these comments and generally support these comments.

Respectfully Submitted,
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Dated: December 19, 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 19th day of December, 2007.

William H. Smith, Jr.