UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission System Operator, Inc.	))	 Docket No. ER08-394-003

COMMENTS
OF THE ORGANIZATION OF MISO STATES

Pursuant to the Federal Energy Regulatory Commission's (Commission) Rule 211 *Rules of Practice and Procedure* 18 C.F.R. § 385.211, the Organization of MISO States (OMS) appreciates the extended time for filing comments on this important filing which culminates years of effort by the Midwest ISO and its stakeholders.

The OMS continues to support an administrative approach to resource adequacy. The specific Module E financial settlements proposal of the OMS is attached as an appendix to these comments. While the Midwest ISO Module E proposal filed June 25, 2008 proposal is based on an administrative approach, it goes too far in setting a monthly deficiency charge at an unjust and unreasonable level and in injecting an unnecessary auction process that too closely resembles an RTO-run centralized capacity market. The filing also neglects to address the interrelationship of markets and the need for monitoring of new forms of market power inherent in the proposed structure. The Midwest ISO's compliance filing, including the financial settlements proposal and voluntary auction, deviates from OMS Board suggestions and principles, which received the majority of stakeholder votes. The OMS therefore recommends that the Commission require the Midwest ISO to accept modifications of its proposal in accordance with the administrative recommendation in the Appendix. At a minimum, the Commission should reject the Midwest ISO's proposed use of a capacity market in the form of an auction.

The OMS supports its recommendation to the FERC with comments on the following issues:

A. The Midwest ISO Proposal Deviates Too Far from the OMS Recommended Administrative Deficiency Process.

B. The Midwest ISO Needs to Re-examine Its CONE Proposal.

C. The Robinson Affidavit Characterization of the OMS-Proposed Administratively Determined Deficiency Charge is Inaccurate and Misleading.

D. The Midwest ISO Needs to Reconsider its Financial Settlement Charge Revenue Distribution Proposal.

E. The Midwest ISO Has Failed to Demonstrate the Impact of Interrelationships of ASM, Scarcity Pricing, and the Resource Adequacy Plan as Required by the Commission

F. The Midwest ISO has Failed to Comply with the Commission's Directives Concerning the Potential for Market Power [1]

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[1] The Indiana Utility Regulatory Commission ("IURC") and Indiana Office of Utility Consumer Counselor ("OUCC") believe that the Midwest ISO proposal is generally responsive to the "Administrative" model proposed by OMS, and that the addition of such provisions as a relatively straightforward voluntary auction and the purchase of additional capacity may be reasonable and appropriate adjustments to that model. Therefore, the IURC and OUCC's joinder in the OMS's comments is limited to our general support of the issues mentioned in Sections B and D of the OMS filing.

As to those sections, the IURC and OUCC believe the following better reflect Indiana's perspective –

B. The Midwest ISO, consistent with its practice of conducting open stakeholder processes, should be directed to revisit the CONE proposal after three (or so) years to ascertain if the CONE is too high or too low to produce the desired results.

D . The Midwest ISO's proposed voluntary auction may be a useful measure to facilitate purchases of incremental capacity needed to meet Planning Reserve Margin requirements and as a check against market power. The Midwest ISO's proposal to provide for actual capacity purchases to cover shortfalls by LSEs also may be a useful addition to the OMS proposal. However, the Midwest ISO should give further consideration as to whether its Financial Settlement Charge Revenue Distribution Proposal appropriately compensates companies that have planning reserves that have been relied upon by market participants that are deficient.

The Midwest ISO's proposals (e.g. the CONE and the voluntary auction) are merely intended as safeguards. The IURC and OUCC agree with the OMS filing on page 6 that, "[l]oad serving entities should abide by the clear and firm reliability requirement..." If we, as state commissions and consumer advocates, do our jobs of ensuring that our jurisdictional utilities have adequate resources consistent with their reliability requirements, these constructs become irrelevant.

I. Background and General Observations

On April 1, 2005, the Midwest ISO began operation of a wholesale energy market using locational marginal prices to manage transmission congestion. On September 9, 2008, the Midwest ISO is to begin operation of a centralized and co-optimized Energy and Ancillary Services Market (ASM).[2] In order to make sure these energy markets operate properly through time, the FERC required on April 15, 2005, and in several subsequent Orders that the Midwest ISO make tariff filings related to long-term resource adequacy during 2006-2008. Resource adequacy refers to making sure sufficient demand response and supply resources exist over time to ensure reliability and efficient operation of the energy markets. The resource adequacy topic is an important one because it can determine the resource mix brought to market to address electricity adequacy needs, and is an issue with large financial consequences. The Midwest ISO's June 25, 2008, filing adds enforcement of resource adequacy in the form of financial settlement provisions.

During the Midwest ISO stakeholder discussions, the parties discussed two basic ways to address enforcement of long-term resource adequacy: either using an administratively-based charge or using a market-based charge. The industry relied on both ways prior to the existence of the Midwest ISO and other ISOs, with the market being represented by a bilateral market.[3] The resource adequacy topic essentially covers the issue of whether planning reserves should be set by rule, tariff, or administrative regulatory actions versus a market approach using price signals as the prime mechanism to incent either new capacity resources to enter the market or for demand response to occur. Historically, states in the former MAIN and MAPP regions have used the planning reserves requirement that aligns more with using an administrative approach at the Midwest ISO on a forward going basis.

[2] This is relevant to the resource adequacy topic as price signals from the ASM will also incent demand and supply resources. With commencement of the ASM, when the Midwest ISO secures and deploys operating reserves, specifically regulating, spinning and supplemental reserves, to maintain reliability and in the presence of transmission system congestion, market clearing prices will be allowed to move along the electricity demand curve up to a value of $3,500 MWh. This construct will provide price signals and incent appropriate resource adequacy behavior.

[3] While both approaches recognize that the bilateral market will continue, it is the incentives that encourage or discourage bilateral contracts that is at issue.

Scope of the Midwest ISO's June 25, 2008, Filing

On June 25, 2008, the Midwest ISO submitted a compliance filing that addresses the Commission's directives in its March 26, 2008, order. In that order, the Commission required:

1. The Midwest ISO must address how it expects PJM's Reliability Pricing Model and the Midwest ISO's capacity procurement to function together to ensure resource adequacy, [4]

2. The Midwest ISO must explain the interrelationships of resource adequacy with ASM and scarcity pricing, and their impact on market efficiency and reliability,[5]

3. The Midwest ISO must evaluate the potential for the exercise of market power in its long-term resource adequacy plan and to address to what extent, if any, the mitigation scheme should be revised, [6] and

4. The Midwest ISO must make its Business Practices Manuals publicly available. [7]

The Commission also granted the requested 180-day extension to develop financial settlement/enforcement provisions and include them in this compliance filing.

The Midwest ISO's proposed Financial Settlements Approach for Module E

The Midwest ISO's financial settlements approach as put forth in the June 25, 2008, filing to FERC essentially includes these parts:

1. Load Serving Entities (LSEs) presently can use bilateral contracts or self build as at present, but face an $80,000 per MW/month administrative charge each month on amounts deficient if the Midwest ISO determines that the entity does not have sufficient planning reserves.

[4] March 26, 2008, Order at P. 378
[5] March 26,2008, Order at P. 386.
[6] March 26 order at P. 390
[7] March 26 order at P. 400

2. A voluntary auction for excess capacity run by the Midwest ISO using price clearing mechanisms that an LSE could use to procure planning reserves if deficient and hence avoid the administrative charge.

3. A redistribution of collected administrative charges to be paid to un-cleared generation offers in the voluntary capacity market to procure remaining planning reserve deficiencies in the Midwest ISO footprint or relevant zone.

4. If any administrative charge revenues remain after Step 3, the residual revenues would be redistributed to those entities that have met or exceeded their planning reserve requirements.

<u>The Midwest ISO's Proposed Approach Compared to the OMS Board's Approved Procedure</u>

During the past six months, the OMS Board developed its own Module E financial settlements approach. That approach is included as an appendix, and was approved by the OMS Board on May 19, 2008. The OMS Board supported

1. An Administrative Charge Based on the Cost of New Entry, CONE.

2. That a multiplier be used on the CONE charge, as an appropriate seasonal adjustment,

3. That revenues collected from the administrative charge would be distributed to those entities that meet planning reserve requirements.

Prior to passing the above proposed tariff approach, the OMS Board adopted on May 17, 2007, thirteen resource adequacy principles.[8] Specifically, OMS Board Resource Adequacy Principle Number 2 rejects the use of a capacity market operated by the Midwest ISO. Principle Number 2 states:

[8] See http://www.misostates.org/RevisedOMSResourceAdequacyPrinciples17MAY07FINAL.pdf

> "**OMS REVISED PRINCIPLE NUMBER 2:** All load serving entities (LSEs) should maintain sufficient capacity to meet peak load plus minimum planning reserve margin requirements at all times in order that resource deficiencies will be infrequent. OMS remains skeptical that price signals alone will be sufficient to ensure adequate and timely long-term capacity and demand resource additions. The OMS, at this time, does not endorse a forward-based capacity market operated by the Midwest ISO."

The OMS Board did not reject the use of a bulletin board facilitated by the Midwest ISO that might list available generation resources. Proposed Section 69.3.3 of OMS' approach as approved by the OMS Board on November 27, 2007, contained this statement:

> "**69.3.3 Facilitation of a Voluntary Capacity Exchange**
> The Transmission Provider shall maintain and enhance an **electronic bulletin** board platform that may be used by Market Participants to facilitate the ability of Market Participants that have excess Capacity Resources to confidentially enter into **voluntary bilateral transactions** with LSEs that have the need for Capacity Resources. The prices of such confidential transactions, but not the names of the parties, will be made public four (4) months after the fact to facilitate Capacity Resource price transparency." [**emphasis added]**

These statements reveal the difference between what the OMS Board desired, a bulletin board, versus what it did not, a centralized, Midwest ISO-operated capacity market that the Midwest ISO now proposes to utilize. That distinction is in the role that the Midwest ISO plays. Under a bulletin board, the Midwest ISO role is passive, essentially just a web site posting information. In the market approach, the Midwest ISO actively clears offers, and matches buyers and sellers using sophisticated tiered pricing and matching algorithms. It is this latter method that the OMS Board rejects, and so should the Commission.

II. Specific Issues and Analysis

A. The Midwest ISO Proposal Deviates Too Far from the OMS Recommended Administrative Deficiency Process.

The Midwest ISO's application formula for the Cost of New Entry (CONE) is too simplistic and will likely have perverse results. The sequential, cumulative application of an annual revenue requirement each month is not the economically correct price signal. The CONE and multiplier must be a little more complex and recognize: the risk periods individually, the cumulative monthly effects, and the logical avoidance behaviors. Thus, the CONE is set at such a high level that it is not just and reasonable. Further, at such a high level and in conjunction with the Midwest ISO's proposal to redistribute residual deficiency revenues only to those entities in the voluntary auction, it effectively forces participation in the auction market, making it involuntary or perhaps even encouraging inefficient overbuilding. Load serving entities should abide by the clear and firm reliability requirement established by the 1 day in 10 years LOLE criteria.

The proposed auction, though nominally a voluntary one, invites sellers to offer prices that approach the CONE. In other RTO jurisdictions, this kind of market construct has led to high capacity prices according to various stakeholders, controversial results, and ongoing litigation due to legal ambiguities.[9] While the Midwest ISO may feel the voluntary "excess capacity" auction is an improvement to the suggested OMS approach, most OMS members do not agree. The auction component of the filing should be rejected.

The Commission should also note other deficiencies in the Midwest ISO's June 25, 2008, filing. The Midwest ISO has failed to provide any cost benefit analysis of its proposed voluntary excess capacity auction. The absence of such an analysis itself is telling. A program should only be advanced when it can be shown to deliver a superior outcome, not when the concept is advanced on theoretical grounds or conjecture alone. Likewise, the Midwest ISO has not proposed appropriate market power or monitoring guidelines for its resource adequacy program, including the proposed voluntary capacity auction. If the Commission rejects the auction mechanism, the Commission should require that the Midwest ISO address these other deficiencies in compliance filings. Retaining the auction mechanism would increase the concerns about market power and the need to monitor that market in addition to the other Midwest ISO-administered markets.

[9] The OMS recently joined a legal pleading filed by NARUC before the US Court of Appeals that dealt with the jurisdictional issues associated with capacity markets. See *Connecticut Department of Public Utility Control v. FERC*, District of Columbia Circuit, Docket No. 07-1375.

The Commission should resolve the issues and concerns addressed here by requiring the Midwest ISO to adopt the OMS administrative proposal as contained in the Appendix to these comments. Some OMS members have raised issues that the setting of the administrative charge alone invites the potential for market power. Under a purely administrative approach as advanced by OMS, there is no behavior for an independent market monitor to mitigate because the form of compliance is either a bilateral arrangement or self build option. The Commission may want to create a reporting process from entities using bilateral arrangements who suspect market power abuse.

B. The Midwest ISO Needs to Re-examine Its CONE Proposal. [10]

The Midwest ISO states that the CONE value "shall be set at $80,000 per MW-month for the initial Planning Year, <u>subject to modifications by the Transmission Provider and the IMM</u>."[11] The Midwest ISO does not provide any detail regarding the underlined qualifying phrase regarding possible modifications. The Midwest ISO should be required to explain and clarify that qualification.

The Midwest ISO states that it has "developed an initial CONE of $80,000/MW-month, which is based upon the work conducted by the Midwest ISO's Independent Market Monitor regarding the capital, operating and other costs that would be incurred to develop a Capacity Resource in the Midwest ISO Region."[12] The Midwest ISO concluded that "there is no need at this time to use a 'multiple' of the annual CONE to calculate Financial Settlement Charges." [13] Consequently, the Midwest ISO is proposing to assess a penalty charge equal to $960,000/MW annually.

The Midwest ISO states its intent for the selected value of the CONE representation to "send the correct pricing signals." [14] It is not clear what the Midwest ISO means by "sending correct price signals," because the Midwest ISO has proposed a

[10] While the Missouri Public Service Commission did not endorse these OMS Comments in total, it does support the comments in this section B.
[11] Proposed Tariff Section 69.3.8 (Original Sheet No. 849), underlining added
[12] June 25 Transmittal Letter, at 10
[13] June 25 Transmittal Letter, at 10
[14] June 25 Transmittal Letter, at 10

deficiency charge that, on an annual basis, is twelve times the value determined by the Midwest ISO's Independent Market Monitor to represent the cost of new entry of a particular resource type. In this sense, the Midwest ISO's $80,000 per month penalty charge has no relationship to "correct price signals."

By way of comparison, PJM's Reliability Pricing Model ("RPM") uses an annual Net CONE approach which subtracts from the annual Gross CONE a value representing the sum over a year of the energy and ancillary services market revenues expected to be earned by a specific representative generation unit type. PJM's annual Gross CONE equals $72,207 and annual Net CONE equals $58,839 ($72,207-13,368).[15] In the five RPM auctions held so far, the clearing price for the unconstrained portion of the PJM area ranged from $14,892/MW/Year to $63,615.15 /MW/Year. When there is excess capacity in the market, the clearing price for annual capacity settles below the value of annual Net CONE and when the amount of available capacity in the market is closer to the target demand quantity, the price clears nearer to the annual Net CONE value. The Midwest ISO specifically rejects use of the Net CONE concept. For example, Section 69.3.8(b) of the Midwest ISO's proposed tariff states, "In calculating the CONE, the Transmission Provider and the IMM shall not consider the anticipated net revenue from the sale of capacity, Energy or Ancillary Services."[16]

The highest clearing price <u>possible</u> in the PJM RPM auction design for one megawatt of unforced capacity is 1.5 times annual Net CONE. In dollars, that equals roughly $88,259/MW/Year ($58,839 times 1.5). By contrast, for an annual one megawatt capacity deficiency, the Midwest ISO is proposing to charge 12 times annual Gross CONE. <u>The price signal that would be sent by the Midwest ISO's proposed $80,000 per month Gross CONE penalty charge unfortunately would be a signal for resource sellers to exercise their market power in an attempt to charge LSEs who are forced to buy in the auction, up to $960,000/MW annually for capacity.</u> The Commission should require the Midwest ISO to re-examine its proposal.

[15] 2011-2012 RPM Base Auction Planning Parameters, May 16, 2008
[16] Proposed Tariff Section 69.3.8(b) (Original Sheet No. 849)

C. The Robinson Affidavit Characterization of the OMS-Proposed Administratively Determined Deficiency Charge is Inaccurate and Misleading.

In an affidavit attached to the June 25 filing, the Midwest ISO's witness, Mr. Michael Robinson, testified that, "The administratively-determined proposal from the OMS would involve the payment of a seasonally adjusted financial settlement charge by LSEs with insufficient Planning Resources."[17] This statement is a fair characterization of the OMS proposal, as far as it goes. However, Mr. Robinson's description fails to acknowledge that the OMS proposal envisions a *monthly* settlement process. Mr. Robinson goes on to state, "The charge would be the product of a CONE value, a CONE multiplier and the number of MWs that an LSE was deficient during a given month".[18] This statement is also true as far as it goes. However, the OMS did not propose just any CONE value, as suggested by Mr. Robinson. Rather, the OMS proposed to calculate the <u>monthly</u> deficiency charge by multiplying <u>one-twelfth of the annual CONE value</u> by a specified <u>monthly</u> CONE multiplier and the number of deficient MWs. Mr. Robinson went on to state, "The proposed CONE value and its multiplier were left undetermined by the OMS, though specific examples were provided." [19]

Contrary to Mr. Robinson's characterization, the OMS proposal includes specific monthly multipliers to be applied as seasonal adjustments to the use of a monthly CONE (one twelfth of an annual CONE), as indicated in the attached Appendix to these Comments. Finally, Mr. Robinson concluded his description of the OMS proposal by stating, "The OMS envisioned a reasoned stakeholder process with the OMS RAWG, the SAWG and the Midwest ISO's Independent Market Monitor ("IMM") to arrive at the appropriate values over time." [20]

By comparison, the OMS's Proposal recommended just the annual CONE value be determined in the stated negotiation process. Once the annual CONE is determined,

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[17] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 7

[18] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 7

[19] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 7

[20] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 7

the rest of the factors were pre-specified, including dividing by twelve to get the monthly CONE and multiplying by the pre-specified monthly multipliers to recognize a seasonal adjustment for the peak months. (See Appendix to these Comments)

Mr. Robinson characterizes several attributes of the Midwest ISO's administratively-determined settlement charge approach as being positive.[21] One positive attribute Mr. Robinson attributes to the OMS's proposal is its alleged "mitigation of potential exercise of market power by imposing a clearly-defined price cap on Planning Resources."[22] However, the OMS proposal does not have any features to mitigate the exercise of market power at capacity prices equal to or lower than the monthly deficiency charge. Since the monthly deficiency charge would be calculated as some multiple of the monthly CONE value, this feature allows for considerable market power to be exercised.

Mr. Robinson characterizes all three major deficiency charge proposals, including the OMS proposal, as attempting to "not establish a financial settlement charge so high as to disrupt the energy market."[23] It is not clear what Mr. Robinson means by this statement. What is most likely to "disrupt the energy market" is the Midwest ISO's proposal to mandate that LSEs procure capacity in such a way that, in aggregate, the Midwest ISO market almost always will unnecessarily reflect available capacity in excess of expected demand and reserve requirements. Mr. Robinson's testimony does not establish confidence that the Midwest ISO fully understands the workings of the alternative deficiency charge proposals.

D. The Midwest ISO Needs to Reconsider its Financial Settlement Charge Revenue Distribution Proposal.

The Midwest ISO's proposal inappropriately links the auction mechanism and the redistribution of deficiency charge revenue. The OMS believes that the proposed distribution pressures participation in the auction and leads to excessive costs.

[21] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 12

[22] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 12

[23] Affidavit of Michael Robinson on Behalf of the Midwest Independent Transmission System Operator, Inc., at 12

The Midwest ISO proposes to distribute revenues received from assessing the Financial Settlement Charge "to LSEs that have met or exceeded the RAR standard during the following Month and also to suppliers that have participated in the immediately preceding voluntary capacity auction."[24] First, it is not clear what the Midwest ISO means by "the following Month." Second, it is unclear how the Midwest ISO is proposing to distribute revenues to LSEs that have met the RAR standard. Finally, it is not clear what "the immediately preceding voluntary capacity auction" means. The Midwest ISO's proposed tariff states in Section 69.3.9(a)(ii) that,

> *The Transmission Provider will distribute any remaining Financial Settlement Charge revenues to LSEs on a pro rata basis, based upon MW of peak load of LSEs that have met or exceeded their RAR in the applicable Planning Reserve Zone(s) during the Month.*[25]

The main concern here is that if there are any LSEs that exceed their RAR, then the Midwest ISO resource adequacy program design will have cleared more megawatts than the market-wide reliability requirement. The second concern is that the proposal could, under section 69.3.9.a.i distribute financial settlement-charge revenues to generators whose offers were above the auction clearing price, even if there was no net deficiency or if less expensive sources are available. The Midwest ISO should be required to explain and clarify the rationale for its proposed penalty revenue distribution approach.

E. The Midwest ISO Has Failed to Demonstrate the Impact of Interrelationships of ASM, Scarcity Pricing, and Resource Adequacy Plan as Required by the Commission

In its March 26, 2008, Order the Commission directed the Midwest ISO to address the interrelationships of it resource adequacy proposal with ASM and scarcity pricing, recognizing that the resource adequacy tariff provisions are only part of the total. The Commission said,

[24] June 25 Transmittal Letter, at 11
[25] Proposed Tariff Section 69.3.9(a)(ii) (Original Sheet No. 850A)

> *386. We note, however, that there is a need for resource adequacy requirements in the Midwest ISO despite these price signals. While we agree with the Midwest ISO that the ancillary services market, scarcity pricing and a long-term resource adequacy plan all play a role in ensuring resource adequacy, we also agree with American Transmission that the inter-relationship between these market features and their interactions needs to be further evaluated, particularly in terms of their impact on market efficiency and reliability. For this reason,* ***we require the Midwest ISO to explain these interrelationships and their impact on market efficiency and reliability as part of the 180-day compliance filing.*** [Emphasis added][26]

In its compliance filing, the Midwest ISO explains the interrelationships between these items, but nowhere in the filing does the Midwest ISO demonstrate the impact on market efficiency and reliability that FERC required. The Midwest ISO has failed to comply with this requirement.

The OMS has addressed this in previous comments, finding that "The Midwest ISO revised Module E filing, while targeting resource adequacy provisions and demand response programs, does not on its face present any linkages to infrastructural investments, measures to allow for recovery of needed and prudent investment costs, scarcity pricing, or market monitoring and mitigation measures where long-term resource adequacy planning and development are concerned." The OMS previously urged FERC to require the Midwest ISO "to provide the required demonstration that all the Phase II elements, when taken together with the Phase I operating elements of the Ancillary Services market, result in a process that provides just and reasonable prices as well as the proper financial incentives for new resource entry into the market." [27]

ASM is not yet in effect, so the Midwest ISO may not be able to satisfy this requirement at this time. The Midwest ISO Independent Market Monitor has stated that changes in Module E and ASM (with scarcity pricing) will change the financial incentives for new resources [28] The OMS therefore urges the Commission to require the Midwest ISO to provide the required analysis of the impact.

[26] March 26, 2008, Order at P. 386
[27] OMS comments filed January 28, 2008, in Docket No. ER08-394-000.
[28] See June 18, 2008, presentation of the Midwest ISO IMM 2007 State of Markets Report to the Midwest ISO BOD Markets Committee at slides 13-14,
http://www.midwestmarket.org/publish/Document/318dd6_119ce883271_-7c550a48324a?rev=7

F. The Midwest ISO has Failed to Comply with the Commission's Directives Concerning the Potential for Market Power.

In comments submitted to the Commission concerning the Midwest ISO's December 28, 2007, resource adequacy filing, several commenters expressed a concern that the Midwest ISO's proposal lacks the necessary protections against market power in the bilateral capacity market. In its March 26 Order, the Commission agreed with commenters that the issue of market power needed further evaluation. In particular, the Commission directed the Midwest ISO and Independent Market Monitor (IMM) to evaluate the potential for the exercise of market power in its long-term resource adequacy plan and to address to what extent, if any, the mitigation scheme should be revised as part of its 180-day submittal.[29]

The Midwest ISO's June 25 filing effectively dodges this critical issue. Indeed, nowhere in the June 25 filing does the Midwest ISO discuss its efforts with the IMM to evaluate the potential for exercise of market power by LSEs or market participants in the bilateral market. In fact, the only mention of the issue of market power is found in Section 69.3.5(h) of the proposed tariff. Specifically,

> *All actions of Market Participants making RAR Bids or PR Offers shall be subject to the provisions of Module D. The Transmission Provider will report any potential exercise of market power by LSEs or by Market Participants in the voluntary capacity auction procedures to the Independent Market Monitor.*

This response not only fails to comply with the Commission's direction in the March 26 Order, but also appears to not take the issue of market power in the bilateral markets seriously. As noted in previous OMS pleadings in this docket, applying requirements for planning reserve margins in the historically concentrated capacity markets in the Midwest gives rise to significant concern. Prior to such a requirement, an LSE could reject an unreasonable offer for capacity and effectively mitigate a seller's market power. However, under the Midwest ISO's resource adequacy approach, LSEs may no longer have such an option. Accordingly, the OMS urges the Commission to

[29] March 26 Order, at P. 390

require the Midwest ISO to work with the IMM to evaluate the potential for the exercise of market power in its resource adequacy plan and to address any revisions to its mitigation plan. The Midwest ISO must provide a market power study, clearly described in the Commission's March 26 Order as an evaluation of the "potential for the exercise of market power" and the Midwest ISO must provide a "mitigation scheme."[30]

III. Conclusion

The Midwest ISO's June 25th compliance filing, including the financial settlements proposal and voluntary auction, deviates from OMS Board suggestions and principles. The OMS therefore recommends that the Commission require the Midwest ISO to accept modifications of its proposal in accordance with the administrative recommendation in the Appendix. The Midwest ISO proposes for itself a role larger than running a bulletin board, and would actually become an exchange operator for capacity. Neither the need nor the benefits and costs of this type of auction or capacity market\exchange have been presented by the Midwest ISO in its filing. While the economic theory behind the Midwest ISO approach may be attractive, the proposal as presently put forth is deficient and seriously flawed, is invasive of states' rights, presents unknown administrative costs and undefined benefits, and the invites the continuing controversial results seen in neighboring RTOs.

In essence, the proposed Midwest ISO approach in many respects goes too far, significantly departing from the OMS Board's well-developed model that received the highest number of stakeholder votes. It does so based on a mischaracterization of the OMS-Proposed Administratively Determined Deficiency Charge.

While taking certain features, such as the calculation of the Cost of New Entry (CONE) to extremes unheard of in any other ISO or RTO, the Midwest ISO proposal misses essential elements that have the potential to lead to serious distortions in any current and natural bi-lateral market that may be in effect: the Midwest ISO has failed to comply with the Commission's directives concerning the potential for market power,

[30] March 26 Order, at P. 390

needs to re-examine its CONE proposal, and seriously needs to reconsider its financial settlement charge revenue distribution proposal. The Midwest ISO has failed to demonstrate the impact of interrelationships of ASM, scarcity pricing, and resource adequacy plan as required by the Commission.

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

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

The Indiana Utility Regulatory Commission generally supports these comments as indicated in footnote number one. The Illinois Commerce Commission voted no and filed separate comments in this docket on July 30, 2008. The Pennsylvania Public Utility Commission abstained from the vote on these comments. The Manitoba Public Utilities Board and the Nebraska Power Review Board did not participate in this pleading.

The Iowa Office of Consumer Advocate and the Minnesota Office of Energy Security, as associate members of the OMS, participated in these comments and generally support these comments. The Indiana Office of Utility Consumer Counselor as associate member of the OMS, participated in these comments and generally supports these comments as indicated in footnote number one.

Respectfully submitted,

FILED ELECTRONICALLY/AS
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Dated: July 31, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on all parties on the official service list compiled by the Secretary in this proceeding.

Dated at Des Moines, Iowa, this 31st day of July 2008.

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Appendix

OMS Administrative Proposal approved by the OMS Board of Directors May 19, 2008

<u>Long Term Resource Adequacy Administrative Proposal for Settlement</u>

69.3.5 Financial Settlement for LSEs That Have Insufficient Planning Resources

An LSE that does not identify sufficient Planning Resources in its Resource Plan shall be obligated to financially settle the planning reserve requirement before the operating month through payment of a Settlement Charge as described in Section 69.3.5.1.

69.3.5.1 Settlement Charge

An LSE that has insufficient Planning Resources shall pay a seasonally-adjusted Settlement Charge rate that equals the Cost of New Entry (CONE) as determined in section 69.3.5.2 times the CONE multiplier in accordance with Section 69.3.5.3. The Settlement Charge shall be the Settlement charge rate times the insufficiency. The Settlement Charge shall be debited by the Transmission Provider from the monthly account of each such LSE. The Transmission Provider shall credit all received Settlement Charge revenues proportionately to every LSE with qualified Planning Reserve Resources deliverable to the zone where an LSE is deficient during the month for which Settlement Charges were assessed.

69.3.5.2 Cost of New Entry

The CONE initially shall be calculated by the Transmission Provider using the following factors, as an example: the annual, levelized, pre-tax, weighted cost of capital for the typical installed costs of a new, simple cycle, natural gas fired, combustion turbine in the 80 megawatt class range. The CONE rate shall be stable for a minimum of three years. Every two years, the Advisory Committee will have the option of recommending modification of the CONE or agreeing to re-visit modification in two more years.

69.3.5.3 CONE Multiplier

Based on consideration of the recommendations made at the Advisory Committee and the review of the Independent Market Monitor, the Transmission Provider shall determine a monthly CONE Multiplier. Every year, the Advisory Committee will have the option of recommending review of the CONE multipliers in the event the Transmission Provider's seasonal capacity assessments and the annual market reports of the Independent Market Monitor for the past three years reveal a trend toward higher levels of insufficient capacity resources during summer peak months that the Transmission Provider determines is statistically significant. For example, if the CONE multiplier is initially set at 1.5 for the months of October through May of the Planning Year, increases to 2 times the CONE for the months of June and September, and 3 times the CONE for the months of July and August of the Planning Year, the monthly Settlement Charge rate is determined by dividing the annual fixed CONE by twelve and applying the monthly multipliers, as indicated below with a CONE for a typical unit installed in the Midwest using the factors outlined in section 69.3.5.2:

Annual CONE = $93,960/MW-year
Monthly Cone = $7.83/kW-month
1.5xCONE October – May $11.745/kW-month
2xCONE June and September $15.660/kW-month
3xCONE July and August $23.490/kW-month