UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission System Operator, Inc.	))	**Docket No. ER09-1049-002**

Comments of the Organization of MISO States[1]

I. Background

On October 2, 2009, the Midwest ISO filed revisions to its Open Access Transmission, Energy and Operating Reserve Markets Tariff ("Tariff"). The objective of the proposed revisions is to accommodate the participation of Aggregators of Retail Customers ("ARCs") in the Midwest ISO's Energy and Ancillary Services markets in accordance with Orders 719 and 719-A.

On October 7, the Commission issued a Notice of Filing which established October 23, 2009 as the date for filing interventions and comments in this docket.

On October 9, 2009, the Organization of MISO States ("OMS") filed a Notice of Intervention and Motion for an Extension of Time requesting an extension of the due date for comments until November 6, 2009. On October 13, 2009, Detroit Edison filed a Motion for an Extension of Time joining in and in support of the OMS motion.

On October 14, 2009, the Commission issued a Notice of Extension of Time that established November 6, 2009 as the due date for comments in this proceeding.

[1] These comments are supported by the following OMS members: 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, Pennsylvania Public Utility Commission, South Dakota Public Utilities Commission, and Wisconsin Public Service Commission. As more fully explained in the Conclusion, these comments are not supported by the Illinois Commerce Commission and the Manitoba Public Utilities Board.

II. Comments

A. OMS Supports the Midwest ISO Proposal for ARC Participation in the Energy Market.

The OMS is not opposed to the participation of ARCs in the Midwest ISO's markets provided that the Commission enforces the conditions and limitations it established in Orders 719 and 719-A. OMS suggests that Commission decisions on the Tariff revisions proposed in this filing should be governed by the standard of 'first do no harm.' That is, non-participating customers should not be forced to bear an increase in costs, reduction in reliability, or increase in risk as a result in ARC participation in the Midwest ISO markets. OMS believes that the proposal put forth by the Midwest ISO meets that standard and recommends that the proposal be approved by the Commission.

OMS does not believe that the Commission should award ARCs with explicit or implicit subsidies through the compensation mechanism. There may be reasons why individual State Commissions may want to provide subsidies. However, any such subsidies would be borne by individual LSEs and their non-participating customers. Therefore, decisions relating to such subsidies should be left to the State Commissions (or other local regulatory bodies) that regulate LSEs in the Midwest ISO region.[2]

OMS has not conducted a meticulous analysis of the detailed Tariff provisions included in the filing. Rather, OMS has focused its efforts on analyzing the broad structure that the Midwest ISO has proposed for accommodating the participation of ARCs in the Midwest ISO's Energy Market. OMS has not analyzed and takes no position on the Tariff revisions related to ARC participation in the Midwest ISO Ancillary Services Market.

[2] Order 719 refers to such regulatory bodies as "Relevant Electric Retail Regulatory Authorities" or "RERRAs."

B. OMS Supports the Proposed Compensation Formula.

In simple terms, ARCs operate by engaging in arbitrage between retail rates and wholesale market LMPs. ARCs buy energy in retail markets that retail customers have an option to buy as a condition of their status as retail customers of an LSE. ARCs then simultaneously sell that energy into the wholesale market. This arbitrage is obviously profitable during hours when the retail rate is less than the wholesale LMP. However, ARCs do not have anything to sell in the wholesale market unless it is first purchased from the LSE at the retail rate.

OMS supports the proposal by the Midwest ISO that the appropriate compensation for ARCs is LMP – Retail Rate.[3] This compensation formula is based on two paired components, the "buy" side of the arbitrage and the "sell" side. The buy side of the formula is represented by the Retail Rate. The sell side is represented by the LMP.

There are two reasons why this formula produces the appropriate result. One is that the formula compensates LSEs for a portion of the costs which are directly assigned to them under the proposed compensation mechanism. The second is that the formula prevents the provision of a distorted price signal to ARCs and participating retail customers.

The Midwest ISO Demand Response Working Group held extensive discussions of what was referred to as the "missing money problem." The missing money problem arises due to the requirement that the Midwest ISO be revenue neutral in its daily settlements in the Energy Market. The missing money problem can be simply stated as follows: If the Midwest ISO makes payments to ARCs for load reductions, where does the money for these payments come from? The provision of a load reduction by an ARC requires the Midwest ISO to make two payments, one to the generator and one to the ARC, but it has only one source of revenue, the ultimate purchaser of the energy. The Midwest ISO has to find a source for the second payment.

[3] In its Filing and proposed tariff language, the Midwest ISO uses the term "Marginal Foregone Retail Rate" or "MFRR." For ease of understanding, OMS prefers to shorten this to "Retail Rate."

A method of dealing with the missing money problem known as the "reconstituted load proposal" was advanced by the Midwest ISO. In its filing, the Midwest ISO refers to this solution as the direct assignment of the costs to the LSE of the payments made to an ARC. Under the reconstituted load solution, each LSE's actual hourly energy withdrawals in the energy market are "reconstituted" to include MWh load reductions during that hour which had been sold into the energy market by ARCs from each LSE's load zone. That is, a quantity of MWhs equal to the MWhs of load reduction are added back to the LSE's hourly metered MWh quantity and the total settled at the LMP. The ARC would be paid for the MWh load reductions at the same LMP. In effect, payments to the ARC would be directly billed to the LSE. The LSE thus becomes the source of the second payment. This results in revenue neutrality for the Midwest ISO.

Under the reconstituted load proposal, an LSE will face the same costs in the wholesale energy market whether or not a retail customer participating with an ARC consumes MWhs or provides these MWh as a load reduction to the ARC. Either way, the LSE pays for those MWhs. However, if a retail customer provides a load reduction to an ARC, the LSE's metered retail energy sales go down, and its retail revenue goes down. The LSE is now missing money in the form of a reduction in retail revenue. This is a problem for the LSE because its costs remain the same, but its revenue is reduced. The LSE is no longer indifferent.

If the amount of lost retail revenue was guaranteed to be small, LSEs and the State Commissions might be willing to absorb the loss. However, the Commission is definitely advocating a bigger role for ARCs in its orders and in its recently released Strategic Plan. Expectations are that demand response will be playing a bigger role in organized energy markets in the future. LSEs and State Commissions are more likely to support the provision of demand response by ARCs in the Midwest ISO if non-participating customers do not have to bear additional costs as a result.

In addition to the loss of revenue to the LSE, the lack of a payment by the retail customer (or the ARC) to the LSE would result in a "distortionary subsidy" to the retail customer and the ARC. This concept has been addressed in various reports and in comments to the Commission in other proceedings.[4] In other words, payment of the full LMP is not an efficient price signal to the retail customer and the ARC. Unless the retail rate is subtracted, an ARC would find in profitable to sell load reductions when the retail rate exactly follows the LMP or even when the retail rate exceeds the LMP. This absurd result underscores the conclusion that payment of the LMP alone would be a distorted price signal.

To avoid shifting responsibility for the cost of reconstituted energy to non-participating customers and to remove the distorted price signal, LSEs and State Commissions could revise retail tariffs for customers that do business with ARCs to include billing for energy which has not been consumed and metered. These tariff revisions could be complex, time consuming and could possibly involve novel legal issues – namely, billing retail customers for energy which they have not consumed and which was not metered. LSEs would also have to develop and implement billing mechanisms for participating retail customers that can accommodate billing information from outside of their normal metering and data acquisition systems. It would also place State Commissions in the role of revising retail rate structures in order to remove a price distortion created by a wholesale market pricing mechanism.

[4] For example, see "Fostering Economic Demand Response in the Midwest ISO," The Brattle Group, December 30, 2008, at page 31.

In response to these concerns, the Midwest ISO agreed to utilize its settlement system to compensate LSEs for the lost retail revenue and remove the price distortion. The result is the proposed ARC compensation formula: LMP – Retail Rate.

OMS supports the direct assignment of the cost of LMP-based payments made to ARCs to the LSE that provides retail service to the customer that provides the load reduction.[5] Direct assignment of the costs is appropriate as the arbitrage opportunities available to ARCs only arise due to differences between individual LSE's retail rates and wholesale market LMPs. Direct assignment of these costs will create an incentive for individual LSEs to more closely align their retail rates with wholesale market LMPs.

It can be expected that ARCs will attempt to persuade the Commission that the Midwest ISO compensation formula is defective because it results in a payment to ARCs less than the full LMP.[6] For the reasons discussed above, the Commission should reject these arguments.

LSEs and State Commissions will have a significant disincentive to support the participation of ARCs in the Midwest ISO energy markets unless the proposed compensation formula and settlement mechanism is approved. The Midwest ISO proposal resolves the issues associated with lost retail revenues, eliminates State Commission legal concerns about the revising retail rate schedules and billing retail customers for energy which is not metered or consumed, and results in an efficient price signal for ARCs and retail customers that are offering load reductions into the Midwest ISO Energy Market.

[5] However, as discussed above, these costs cannot be directly assigned to an LSE unless that LSE recovers the retail revenue associated with the load reduction.

[6] See Comments and Protest of Demand Response Supporters in "PJM Interconnection, Inc.," Docket No. EL09-68, September 26, 2009 at pp. 11-12.

C. OMS Supports the Proposed Options for the Specification of the Marginal Forgone Retail Rate ("MFRR" or "Retail Rate").

The potential options shown in the filing for the determination of the Marginal Forgone Retail Rate appear to be complex.[7] However, all of the possible options effectively allow State Commissions to specify the Retail Rate or provide an opportunity for State Commissions to do so. State Commissions also have the option to provide a subsidy to ARCs and participating retail customers by specifying a MFRR that is less than the actual rate paid by the participating customer, or zero. OMS supports the proposed options.

D. OMS Takes No Position on the Acquisition and Sale of Capacity by ARCs but Reserves the Right to Request Changes to Module E in the Future.

The Midwest ISO is proposing that ARCs may attain the rights to capacity through retail load reductions and that ARCs may sell such capacity in the voluntary capacity auction under the provisions of Module E of the Tariff or under a bilateral arrangement. OMS is not opposed to ARCs attaining capacity credits for load reductions on the same basis that LSEs can under Module E. However, this proposal received little attention or scrutiny in the Midwest ISO Demand Response Working Group. It is not clear how LSEs will be compensated for this capacity through retail rate structures and if there is a "missing money" issue related to the acquisition of such capacity. OMS has not analyzed the implications of this proposal and takes no position on it at this time. It is possible that changes to Module E of the Tariff could be required in the future to deal with these issues. OMS reserves the right to the suggest revisions to the Tariff in the future in order to resolve such issues.

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[7] See Application Letter at page 16.

III. Conclusion

In its recently released Strategic Plan, the Commission established a goal of eliminating barriers to participation by demand resources in organized wholesale retail markets. OMS supports this objective. Third-party ARCs will likely play a large role in implementing demand response resources because of their ability to achieve economies of scale, implement new technology and provide demand response services to customers that take retail electric service from multiple LSEs. ARCs can also provide a competitive check on LSEs in the provision of demand response to customers. However, the Commission must remain cognizant that the vast majority of demand response programs have been and will likely continue to be developed and implemented by LSEs under the auspices of the State Commissions.

Implementing market structures that allow for the participation of ARCs should not include the establishment of inefficient price signals which result in a cost burden on other customers. Further, State Commissions and LSEs should not be forced to make expensive and complex changes to retail tariffs and billing systems in order to accommodate the participation of ARCs. This would likely result in State Commissions either taking action to "opt-out" or declining to "opt-in" under the provisions approved in Order 719-A.

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.

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
Pennsylvania Public Utility Commission
South Dakota Public Utilities Commission
Wisconsin Public Service Commission

The Illinois Commerce Commission abstained from the vote on these comments. The Manitoba Public Utilities Board did not participate in this pleading.

The Minnesota Office of Energy Security and the Indiana Office of Utility Consumer Counselor, as associate members of the OMS, participated in these comments and generally support these comments.

Respectfully Submitted,
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Dated: November 5, 2009

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 5th day of November, 2009.

William H. Smith, Jr.
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