

ORGANIZATION OF MISO STATES, INC.
Board of Directors Special Meeting
Conference Call Notes
December 7, 2006

The following board members or their proxies participated in the meeting:

Kevin Wright, Illinois
David Hadly, Indiana
John Norris, Iowa
AW Turner, proxy for Mark David Goss, Kentucky
Steve Gaw, Missouri
Laura Chappelle, Michigan
Ken Nickolai, Minnesota
Greg Jergeson, Montana
Tim Texel, proxy for Eugene Bady, Nebraska
Jerry Lein, proxy for Susan Wefald, North Dakota
Judy Jones, Ohio
Kim Pizzingrilli, Pennsylvania
Gary Hanson, South Dakota
Dan Ebert, Wisconsin

Absent

Manitoba

Non-proxy staff participating

Randy Rismiller, Illinois
Angie Butcher, Michigan
Tom Pugh, Minnesota
Nancy Campbell, Minnesota
Candace Beery, Montana
Kim Hafner, Pennsylvania
Greg Rislov, South Dakota

Also Bill Smith and Julie Mitchell - OMS Staff

The directors and proxies listed above established the necessary quorum for the meeting of at least eight directors being present.

Business Items

1. MISO Advisory Committee Issues – Judy Jones.

Judy Jones led the Board through the voting items on the agenda for the next MISO A/C meeting.

- **Committee Structure Ad Hoc Group Recommendations.** Bill Smith explained what the recommendations were and the Board talked over concerns and opinions. There were no objections to supporting the recommendations.
- **Advisory Committee Leadership Election.** The nominating committee has nominated Peggy Ladd as Chair and Patty Harrell as Vice Chair. There were no objections to supporting the nominating committee's selections for Chair & Vice Chair.
- **Data Posting Working Group Charter.** Bill Smith explained that the vote on this item had been deferred from a previous meeting so the charter could be

rewritten. He also said that the rewrite was probably of little interest to OMS members, but having the group up and running was. Support for this item was left up to the discretion of the A/C members.

- **OMS Report.** Judy Jones indicated that the OMS report would cover information from the Annual Meeting.

2. Report on MTEP Comments – TW&S WG – Jerry Lein/David Sapper.

Jerry Lein gave a brief summary of the MTEP 06 process.

3. Comment to MISO Board on Rate Design – Pricing WG – Randy Rismiller/Mike Proctor.

Randy Rismiller gave some background on the rate design transition period and then gave a briefing on the comments document.

- A big point in this document is what role does the OMS Board, and OMS as an organization, want to play in this stakeholder process that is being urged to be undertaken with respect to transmission rate design. The Pricing Group wanted to offer the Board three options to consider and the Board will need to choose one of those options or formulate a new option. The Pricing Group is recommending option #3.
- Randy Rismiller fully explained the different options and the Directors discussed the impact of those options.

The options were put to a voice vote. Option 3 received the most votes, 11-2, with one state not present. States voting for option 3 were: Illinois, Indiana, Iowa, Kentucky, Michigan, Missouri, Montana, Nebraska, North Dakota, South Dakota and Wisconsin. States voting for option 1 were: Ohio and Pennsylvania. Manitoba was not present.

- It was decided to include the option 3 language and note Ohio and Pennsylvania's support for the option 1 language in a footnote.

Ken Nickolai moved that the document with the option 3 language and a footnote for Ohio and Pennsylvania be submitted to the Board. Gary Hanson seconded. The motion was approved by unanimous voice vote.

4. Comment to FERC on RECB II Filing – Pricing WG – Randy Rismiller/Mike Proctor.

Mike Proctor gave an overview on the progress of the comment document and answered questions.

5. Approval of Comment on MISO's 2006-2008 Strategic Plan.

David Sapper presented a summary of the plan and its contents.

- Laura Chappelle offered some changes to the document.

Ken Nickolai moved to adopt the draft with Michigan's changes included. Dave Hadley seconded. The motion was approved by unanimous voice vote.

Upcoming Meetings

- The upcoming Executive Committee meeting was noted.
- The upcoming Annual Meeting was noted and logistics were discussed.

Recording of the call ended at 3:18pm CST.

MTEP '06 Stakeholder Review Schedule

November 22 Revised Posting

Include consideration of comments received Through November 18.

November 29 AC Meeting

- Report Overview
- Discussion of Baseline Reliability Projects Subject to Cost Sharing

December Distribution of Final Report to Board

Stakeholder Reviews of Cost Allocations for Baseline Reliability Projects and Transmission Access Projects Recommended in the Plan:

- January 10, 10-4 pm
- January 18, 10-4 pm
- January 25, 10-4 pm (if necessary)

February 14, 2007 AC Meeting

- Final report of cost allocations and stakeholder meetings

February 15, 2007 Board Meeting

- Report plan Highlights and Cost Allocations
- Seek Approval



Organization of MISO States

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December 7, 2006

T. Graham Edwards, President
Midwest ISO
701 City Center Drive
Carmel, Indiana 46032

Dear Mr. Edwards:

The OMS offers the following response to your November 2, 2006 request for comments and direction on the issue of transmission rate design. The OMS looks forward to being actively involved in the development of any new transmission rate design and to that end, looks forward to working with the Midwest ISO, the transmission owners, and with other stakeholders. If you have any questions regarding these comments, or if you would like to discuss these issues in more detail, please feel free to contact either myself or Bill Smith to make the necessary arrangements.

Sincerely,

/s/
Steve Gaw
President
Organization of MISO States

copy: Bill Smith

**Comments of the Organization of MISO States (“OMS”)
to the Midwest ISO
Regarding Transmission Rate Design**

December, 2006

Question 1. The Midwest ISO Board of Directors would like three (3) questions answered by the Sectors as part of an Executive Summary at the onset of your White Papers:

- **What are the three (3) key issues that [the OMS] wants the Board to know about the topic? What is [the OMS]’ specific recommendation for each issue?**

1) In general, transmission rate design should reflect the classic principles of “cost causers should be cost bearers” and “he who benefits should pay.” Transmission rate design should properly balance efficiency and equity objectives. Multiple reasonable variations of designing transmission rates exist to meet these principles and objectives. However, the OMS believes, as explained in more detail below in response to Question 4, that neither of the extremes on the transmission rate design spectrum—pure zonal license plate rate design or pure Midwest ISO-wide postage-stamp rate design—would constitute a reasonable method for recovering the costs of existing transmission facilities within the Midwest ISO when the current transition period ends on February 1, 2008. The OMS favors using open transparent stakeholder processes as the best way to vet all remaining rate design alternatives, and, potentially, achieve consensus on a single proposal that can be filed at the Federal Energy Regulatory Commission (FERC or Commission). The role that the OMS expects to perform in developing a new transmission rate design policy within a stakeholder process is discussed in more detail below in the OMS’ answer to Question 2.

2) In the course of making any change to the modified zonal license plate transmission rate design currently in place, unwarranted rate shock should be avoided. This does not mean that transmission rates should never be adjusted to reflect new assessments of regional efficiency and equity. Nor does it mean that all dramatic rate change must be avoided. To the extent that transmission costs are not currently equitably and efficiently being allocated, changes to the cost allocation would be in order (i.e., “cost shifting” is not always bad). However, when rate design does need to be modified, the effects of those modifications on transmission customers should be taken into account and the resulting rate impacts should be moderated as necessary, to avoid unwarranted rate shock. Rate modulation methods might include: phase-ins or advance notice of rate changes; temporarily shifting some of the effects on customers experiencing large positive rate shocks to those experiencing large negative rate shocks; or using regional point-to-point through-and-out rate revenues to offset some of the rate increases faced by some network transmission customers.

3) As a process matter, the Midwest ISO and its stakeholders should continue to use the Regional Expansion Criteria and Benefits (“RECB”) Task Force or other appropriate stakeholder groups to fine-tune the transmission rate design and cost allocation policy for “new” intra-Midwest ISO transmission facilities. For new transmission facilities to be built in the Midwest ISO that are projected to have benefits in PJM and for new transmission facilities to be built in PJM that are projected to have benefits in the Midwest ISO, the OMS encourages the continued use of the Inter-Regional Planning Stakeholder Advisory Committee (“IPSAC”) and cross-border forum between PJM and the Midwest ISO and the RECB forum within the Midwest ISO for reviewing any needed rate design/cost allocation modifications. With respect to developing and evaluating potential modifications to the current zonal license plate transmission rate design approach for “existing” transmission facilities (either intra-Midwest ISO or between PJM and the Midwest ISO), it may be useful to develop an additional stakeholder forum because neither RECB nor IPSAC is properly constituted for that task. The role that the OMS expects to perform in developing new transmission rate design policy within a stakeholder process is discussed in more detail below in the OMS’ answer to Question 2.

- **What is the dissenting opinion recommendation for each issue, if applicable?**

The OMS does not offer a response to this question at this time.

Question 2. Rate Design – Overview

- **What goals or principles should the TOs work towards during this process? What are your Sector’s general principles on transmission cost allocation?**

Rate Design Goals

The OMS has long supported the development of a comprehensive and objective cost causation and beneficiary-based cost allocation methodology for network transmission upgrades. Specifically, with respect to transmission upgrades associated with generator interconnections, the OMS in 2004 approved a resolution endorsing the following cost allocation principles:

- The cost allocation policy should be designed so that the Midwest ISO can satisfy the requirements of FERC’s Order 2003.
- The cost allocation policy should send appropriate signals to generators to efficiently locate their plants on the grid.
- The cost allocation policy should reflect the classic principles of “cost causers should be cost bearers” and “he who benefits should pay.”
- The cost allocation policy’s inherent incentives or disincentives to construct network improvements should be made transparent.

- The cost allocation policy should be designed to work well within the Midwest ISO's set of general network facility upgrade cost allocation policies (e.g., reliability, load growth or congestion relief driven).
- The cost allocation policy should not unnecessarily conflict with the various transmission company business models (e.g., vertically integrated, stand-alone affiliated).

The third principle-- the cost allocation policy should reflect the classic principles of "cost causers should be cost bearers" and "he who benefits should pay"-- is the foundation for the others. The OMS has been guided by this central principle, as well as the derivative principles cited above, in the context of its participation in the Midwest ISO stakeholders' RECB task force process and in other Midwest ISO stakeholder processes concerning rate design and cost allocation for proposed or new transmission facilities. With respect to transmission rate design/cost allocation for existing transmission facilities, as contrasted with prospective new transmission facilities, the "beneficiary" aspect of this principle is likely most relevant because cost causation is not as relevant once costs are sunk.

The OMS notes that equitable and efficient transmission rate design is not just a matter for the transmission owners to work toward as Question 2 posits. While the Commission explicitly charged the Midwest ISO - not the Midwest ISO transmission owners - with establishing procedures to ensure that a superseding rate proposal would be negotiated and filed with the Commission at end of the transmission period, the fair and equitable resolution of many of these issues is of critical importance to many Midwest ISO stakeholders, including the Midwest ISO transmission owners as a key stakeholder.¹ Furthermore, both the FERC and the Midwest ISO have long recognized the benefits of stakeholder input regarding the development of important Midwest ISO policies and processes.² Accordingly, the OMS expects that the Midwest ISO would continue to seek the participation of all interested stakeholders in developing a new transmission rate design.

The OMS acknowledges that identifying and forecasting transmission beneficiaries over future periods of time and under changing circumstances is always a difficult challenge. In particular, developing detailed metrics needed to implement a beneficiary-based transmission rate design presents a difficult challenge for the stakeholders and the Midwest ISO in the context of allocating the costs of existing transmission facilities. Accordingly, the OMS encourages the Midwest ISO to continue to work with the transmission owners, with the OMS, and with other stakeholders in an attempt to develop a consensus approach for transmission rate design/cost allocation. It is unlikely that there exists only one single "correct" or just and reasonable method of transmission rate design/cost allocation. Rather, it is likely that some subset of the

¹ *Midwest Independent Transmission System Operator, Inc., et. al.*, 84 FERC ¶61,231, (1998) at 62,168.

² *Midwest Independent Transmission System Operator, Inc.*, 113 FERC ¶61,194 (2005), at P. 12

spectrum of transmission rate design cost allocation methods could be considered just and reasonable. The Midwest ISO and its stakeholders are encouraged to develop an acceptable method through discussion and compromise.

OMS Role

With respect to the OMS' role in the process, the OMS points out that the Commission's Wholesale Power Market Platform White Paper states,

Regional state committees may agree on the form of access charge that will be filed by the RTO or ISO under section 205 of the Federal Power Act. That means the committee will decide whether to propose to move to a uniform rate for transmission service throughout the region (known as postage stamp rates), or whether to propose to maintain single, but different access charges depending on where power is taken off the grid (known as license plate rates).³

and,

Each regional state committee may determine which approach [e.g., license plate or postage stamp rates] the RTO or ISO should file with the Commission under section 205 of the FPA. If the regional state committee is unable to reach a decision on the methodology that should be used, the RTO or ISO would file its own proposal pursuant to section 205 of the FPA.⁴

The Commission's Wholesale Power Market Platform White Paper policy is clear that the Regional State Committee "will decide" on the transmission rate design that the RTO will file. If the Regional State Committee is "unable to reach a decision on the methodology that should be used," then the RTO would file its own proposal.

The OMS expects the Midwest ISO to comply with the FERC's directive to establish procedures to ensure that a superseding transmission rate proposal will be negotiated and filed with the Commission at the end of the transmission period. The OMS expects to participate within a stakeholder process with all interested stakeholders, including the transmission owners, in accomplishing the task of developing a new transmission rate design. However, the OMS also acknowledges the special role in this process given to it by the FERC in the Commission's Wholesale Power Market Platform White Paper. In that regard, the OMS will exercise the authority that is described in the Commission's Wholesale Power Market Platform White Paper concerning transmission rate design by actively participating in the stakeholder process, but asserting the right to

³ *White Paper on Wholesale Power Market Platform*, Appendix A, Dkt. No. RM01-12-000 (2003) at 8.

⁴ *White Paper on Wholesale Power Market Platform*, Appendix A, Dkt. No. RM01-12-000 (2003), at 6.

approve or reject any transmission rate designs that are developed in the stakeholder process before any filing is made at the FERC, i.e., “decide” on the transmission rate design that the Midwest ISO will file.⁵

History of Rate Design Debate

These issues and debates regarding transmission rate design and cost allocation are not new. These issues were a central topic of discussion prior to the formation of the Midwest ISO in the 1990s. The Midwest ISO transmission owners agreed to retain a zonal license plate rate design during a transition period ending February 1, 2008. The FERC accepted the transition period proposal but “direct[ed] the Midwest ISO to establish procedures to ensure that a superseding proposal can be negotiated and filed with the Commission at least six months before the end of the minimum six year transition period.”⁶

In addition, rate design was also the central topic of the PJM/Midwest ISO parties’ discussions that led to the “Going Forward Principles and Procedures” in an early effort to resolve the entire seams elimination cost adjustment (“SECA”) proceeding through settlement. In those 2004 settlement discussions, eighty-four (84) parties, some representing more than one entity, reached agreement-in-principle to shorten both the PJM and the Midwest ISO rate design transition periods and transition to a new combined region transmission rate design in lieu of PJM/Midwest ISO transmission owners collecting interim SECA amounts. The supporters of the “Going Forward Principles and Procedures” agreed to establish December 1, 2004 as the proposed effective date for a single transmission rate design across the combined PJM/Midwest ISO region.⁷

Pursuant to the “Going Forward Principles and Procedures,” the parties negotiated throughout the Summer and early Autumn of 2004 and, as a result, two competing transmission rate design proposals were filed with the FERC on October 1, 2004 by two competing sets of PJM/Midwest ISO transmission owners. The two competing proposals were named “the Unified Plan” and “the Regional Pricing Plan.” The Unified Plan proponents essentially supported retention of a modified zonal license plate approach for all pricing zones in the sub-region after December 1, 2004. The proponents of the Regional Pricing Plan proposed a hybrid approach that would use a combination of license plate, highway/byway, and flow based principles.

In an Order issued on November 18, 2004, the FERC rejected both the Unified Plan and the Regional Pricing Plan as being unacceptable resolutions of the SECA issue.⁸

⁵ Pennsylvania and Ohio would substitute the following for this sentence: “In that regard, the OMS will actively participate in the relevant Midwest ISO working groups as a stakeholder and contribute its ideas in that context.”

⁶ *Midwest Independent Transmission System Operator, Inc.*, et al, 84 FERC ¶ 61,231 at 62,182 (1998)

⁷ See, “*Report of the Chief Judge and Request of Parties for Expedited Approval of Going-Forward Principles and Procedures*” issued March 5, 2004 in Dkt. Nos. EL02-111-004 and EL03-212-002.

⁸ *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168 (2004), at P. 55.

However, the FERC stated that “we remain hopeful that parties in the combined PJM/Midwest ISO region will continue to develop and refine options for consideration when the license plate rate design is subject to formal reevaluation, including further evaluation of the numerous factual and design concerns raised by protesters in this proceeding concerning the Regional Pricing Proposal.”⁹

While, perhaps, not directly relevant to the Midwest ISO transmission owners or to Midwest ISO stakeholders, the ongoing FERC proceeding investigating intra-PJM transmission rate design, FERC Dkt. No. EL05-121-000, may provide some guidance to stakeholders negotiating a post-transition transmission rate design for the combined Midwest ISO/PJM region. On May 31, 2005, the Commission issued an Order in that docket to examine the justness and reasonableness of continuing PJM’s modified zonal rate design during the transition period preceding the establishment of a single transmission rate design across the combined Midwest ISO/PJM region on February 1, 2008.¹⁰

The intra-PJM transmission rate design issue was litigated in FERC Dkt. No. EL05-121-000. Several competing proposals were advanced in the case. One set of PJM transmission owners proposed to retain the modified zonal license plate rate design. Several different versions of voltage-based highway/byway rate design were advanced by several different sets of PJM transmission owners. The FERC Staff proposed to move to a PJM-wide postage stamp rates using a transition period to moderate rate shock. In an Initial Decision issued on July 13, 2006, the Presiding Administrative Law Judge (ALJ) largely sided with the FERC Staff proposal and recommended adoption of postage stamp rates across PJM. As of today, the FERC has not yet ruled on the ALJ’s Initial Decision in the PJM case.

The recitation of this history illustrates the importance and complexity of transmission rate design. However, it also illustrates the importance of trying to achieve consensus in developing a transmission rate design for the combined region in the post-transition period that can be acceptable to the broadest range of the Midwest ISO and PJM stakeholders. When competing transmission proposals were filed, e.g., in the pre-SECA and intra-PJM contexts, protracted litigation resulted. When consensus (or near consensus) was able to be reached concerning transmission rate design, for example by the Midwest ISO transmission owners in the period prior to the Midwest ISO’s formation, positive developments followed, i.e., formation of the Midwest ISO.

Question 3. Midwest ISO & PJM

- **What information and consideration should the TOs keep in mind regarding providing the right pricing signals to location of new loads, generation and**

⁹ *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168 (2004) at P. 65.

¹⁰ *Allegheny Power System Operating Companies*, 111 FERC ¶ 61,308 (2005) at P. 1.

transmission projects [with respect to] pricing of transmission service between the Midwest ISO and PJM?

The FERC has directed the Midwest ISO, PJM, the collective transmission owners and the collective stakeholders to develop and propose cost allocation and rate design methods for prospective new transmission facilities that may be built in one RTO but provide benefits within the other RTO. Specifically,

...the Commission will require the RTOs and their transmission owners to develop a proposal for allocating to the customers in each RTO the cost of new transmission facilities that are built in one RTO but provide benefits to customers in the other RTO. We note that in their Joint Operating Agreement, the Midwest ISO and PJM have committed to develop just such a methodology for allocating the costs of certain facilities through their joint regional planning committee. Accordingly, we will require that the RTOs and their transmission owners develop and file within 180 days of the date of this order a proposal for allocating to the customers in each RTO the cost of new transmission facilities that are built in one RTO but provide benefits to customers in the other RTO.¹¹

This FERC directive applies both to projects that produce reliability benefits and to projects that produce economic (congestion relief) benefits. Through the IPSAC and cross-border forums, PJM and the Midwest ISO, along with the PJM and the Midwest ISO stakeholders, have pursued a two-stage process for this effort—first tackling cost allocation for “reliability” projects and then tackling cost allocation for “economic” projects. Those efforts should continue and not be disrupted by attempts to develop a post-transition transmission rate design/cost allocation approach for all existing transmission facilities in the combined PJM and Midwest ISO region.

With its reference to “providing the right pricing signals to location of new loads,” Question 3 is not well-designed to get at the relevant transmission rate design/cost allocation issues between the Midwest ISO and PJM for existing transmission facilities. In formulating a cost allocation/rate design approach for new transmission facilities—either new transmission facilities that create cross-RTO benefits or new facilities that create only intra-RTO benefits—it may be useful to consider the impact of sending the “right pricing signals to location of new loads [or] generation” as discussed in the wording of Question 3. However, with respect to rate design/cost allocation for existing transmission facilities, such considerations do not directly apply. For existing facilities, sunk costs are sunk. Allocation of such sunk costs is principally a matter of equity rather than efficiency. The important price signals for existing transmission are short-run marginal costs of using the transmission system; i.e., congestion costs and losses, and the Midwest ISO and PJM have procedures on file for those matters.

¹¹ *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶61,168 (2004), at P. 60

With respect to cost allocation and rate design for existing transmission facilities within the combined PJM and Midwest ISO region, the FERC has stated that,

...the RTOs and their transmission owners are directed to make a filing at least six months prior to the end of this period containing a reevaluation of fixed cost recovery policies for pricing transmission service between the two RTOs and proposing a rate design to take effect February 1, 2008.¹²

In an Order issued May 31, 2005, the Commission reiterated its directive that “the PJM and Midwest RTOs and their transmission owners [are] to make a filing at least six months before February 1, 2008, to reevaluate the fixed cost recovery policies for pricing transmission service between the two RTOs and propose a rate design to take effect February 1, 2008.”¹³

In addition to respecting the “beneficiary should pay” principle and all normal equity objectives, a central focus of efforts to design new transmission rates for existing transmission facilities in the combined PJM/Midwest ISO region should be how transmission rate design can advance a joint and common market across the combined region.

Question 4. Rate Design Options

- **Given the various rate designs that could be adopted which designs would you support, which designs would you not support and why?**

As described above, both the Midwest ISO and PJM initially developed as RTOs using a pure zonal license plate rate design approach for recovering transmission costs. Each RTO currently uses a modified version of zonal license plate rate design. Each RTO has modified the zonal license plate rate design to provide for cross-zonal recovery of certain costs associated with new reliability-related transmission facilities (both intra-RTO and cross-RTO). Each RTO plans to further modify its current modified zonal license plate rate design approach to provide for cross-zonal recovery of certain costs of new economic (congestion relief related) transmission facilities (both intra-RTO and cross-RTO).

The issue now on the table is whether the zonal license plate rate design approach for recovering the costs of existing transmission facilities should be modified either on an intra-Midwest ISO basis or on a cross-RTO basis.¹⁴

In Order No. 2000, the Commission indicated that license plate rates may not be just and reasonable for RTOs after a transition period.¹⁵ The FERC stated that each

¹² *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶61,168 (2004), at P. 62

¹³ *Midwest Independent Transmission System Operator, Inc.*, 111 FERC ¶ 61,308 (2005) at P. 5.

¹⁴ The issue of transmission rate design for existing PJM transmission facilities is being addressed in FERC Dkt. No. EL05-121-000.

independent system operator (“ISO”) has struggled with the problem of cost shifting among the various individual transmission owners and that the FERC has allowed the flexibility to adopt a license plate rate for a transition period of five to ten years before moving to a single uniform access charge.¹⁶ The FERC emphasized that it was not requiring that an RTO continue or abandon the use of license plate rates, but the RTO would be required to justify its choice to continue or discontinue the use of license plate rates based on the factual situation of the particular RTO.¹⁷ In a more recent Order (issued May 31, 2005), the Commission stated that, as “previously recognized [] in an RTO environment, it is no longer clear that a zonal rate design is necessarily just and reasonable.”¹⁸

As described in response to Question 2 above, the range of possible transmission rate design approaches runs between retention of the existing modified zonal license plate rate design approach to complete socialization of costs via region wide (Midwest ISO or Midwest ISO/PJM) postage stamp rates. In between these two extremes, parties have explored various formulations of voltage-based highway/byway rate design, various types of distance sensitive or proximity-based rate designs, and various approaches for flow-based rate design.

It is the position of the OMS that neither of the extremes on this rate design spectrum—pure zonal license plate rate design or pure postage-stamp rate design—would constitute a just and reasonable method for recovering the costs of existing transmission facilities within the Midwest ISO, or between PJM and the Midwest ISO, after the transition period ends on February 1, 2008. The following examples are offered as a way to illustrate why the OMS believes that neither of these rate designs would be a reasonable method for cost recovery.

License Plate Rate Design: The primary issue with the pricing zone (license plate) rate design is that its charges are based on the concept of nearly isolated power systems. In this view, the power grid is seen as a set of ponds connected by canals. Within each pond, generation serves load and when excess generation is available, power will be shipped via a canal to a connected pond. In this concept, all we have to do is determine how to allocate the costs of the canals. But, the power grid does not function this way. Instead, it is a network, where power from multiple generators flows across multiple transmission lines whether or not it is serving load or is exporting power to another load. License plate rates were put in place primarily to deal with differences in

¹⁵ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), *aff’d sub nom. Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001). (Order No. 2000)

¹⁶ Order No. 2000, at 31,176-8.

¹⁷ Order No. 2000, at 31,176-8.

¹⁸ *Allegheny Power System Operating Companies*, 115 FERC ¶61,156 (2006), at P. 8, citing *Midwest Independent Transmission System Operator*, 110 FERC ¶ 61,107 (2005), at P. 3.

existing transmission costs that customers were historically paying in their rates. Such cost differences could be caused by varying load densities within each pricing zone, or difference in miles of transmission lines required to deliver generation to load within each pricing zone. However, the license plate rate concept does not take into account the benefits that loads in one pricing zone receive from the interconnected power grid. For example, to the extent that use of the system is a proxy for benefits, loop flows occur throughout the transmission system even when dispatch is from owned/contracted generation to load. Through loop flows, some pricing zones can be heavily leaning on their neighbors when compared to others, and yet zonal license plate rates fail to take such differences in the use of the transmission system into account. In short, a pure zonal license plate rate design in a network grid context fails the “beneficiaries pay” principle.

Postage Stamp Rate Design: The primary issue with the region-wide postage stamp rate design is that its charges are based on the concept of a tightly integrated power system. In this view, the power grid is seen as a large lake with generators pouring water into the lake and loads taking water out of the lake. As with the previous analogy, the power grid does not operate like a large lake. Moreover, location of sources (generators) and sinks (loads) within the power grid are critical to power flows that occur across that grid. It can be argued that these locational differences are best reflected in short-run (hourly) congestion costs that customers incur to deliver power from their generation sources to their load sinks. If such congestion charges were collected by the RTO and subtracted from the embedded costs of transmission, then that residual cost could be allocated by charging everyone on a load-ratio share basis. However, this is not what is meant by a region-wide postage stamp rate, where the full amount of embedded costs would be collected on a load-ratio share basis. Such an approach fails to take into account the locational differences that exist in the power grid. In short, a pure region-wide postage stamp rate design in a network grid context fails the “beneficiaries pay” principle.

While the OMS is opposed to pure application of both zonal license plate and region-wide postage stamp rate designs, the OMS is not opposed to exploring the possibility of modified or hybrid applications of license plate or postage stamp design principles. For example, both voltage-based highway/byway rate designs and flow-based rate designs use license plate and postage stamp concepts in hybrid form. Indeed, it is highly likely that any rate design that is ultimately implemented by the Midwest ISO will contain elements of both license plate and postage stamp rate design. The OMS is open to exploring all of these alternative rate design variations. However, at this time, both pure license plate rate design and pure region-wide postage stamp rate design should be put off the table so that analytical and policy-making resources can be concentrated on developing an acceptable proposal more centrally-located on the spectrum of available rate design options.

- **If a change in rate design results in a shifting or reallocation of costs, how should those costs be recovered?**

With respect to cost shifting that could result from changing the existing zonal license plate rate design policy, the OMS believes that active attempts should be made to avoid unwarranted rate shock when changing the transmission rate design/cost allocation approach. However, cost shifting that results from a more equitable or more efficient allocation of costs can be a positive change. When rate design does need to be modified, the rate impact on transmission customers should be taken into account and those rate impacts modulated as necessary to avoid unwarranted rate shock. Rate modulation methods might include phase-ins or advance notice of rate changes. Another approach might be to temporarily shift some of the effects on customers experiencing large positive rate shocks to those experiencing large negative rate shocks. An additional approach might use revenues produced from through-and-out transactions to offset negative customer rate impacts resulting from changing zonal license plate cost recovery.

- **What is your Sector's view as to whether the transmission rate design should consider existing transmission, new transmission or both?**

As noted above in response to Question 1.3, for new transmission facilities, the Midwest ISO and its stakeholders should continue to utilize the Regional Expansion Criteria and Benefits Task Force to develop the transmission rate design and cost allocation policy for "new" intra-Midwest ISO transmission facilities. For new transmission facilities with cross-border benefits, the OMS encourages the continued use of the Inter-Regional Planning Stakeholder Advisory Committee process. With respect to developing and evaluating potential modifications to the existing zonal license plate transmission rate design approach for "existing" transmission facilities, either intra-Midwest ISO or between PJM and the Midwest ISO, it may be useful to develop an additional stakeholder process as described above in response to Question 2.

Question 5. Other Factors

- **How should the cost allocation be designed for external transactions?**

It is presumed that the reference to rate design for "external transactions" in this question is a reference to design of through-and-out rates. With respect to through-and-out rates between the Midwest ISO and PJM, the FERC has eliminated those through-and-out rates (i.e., set them to zero). Therefore, no costs can be allocated to through-and-out rates between the Midwest ISO and PJM and no revenues recovered from such transactions. With respect to developing through and out rates for other deliveries outside the Midwest ISO, the OMS recommends that the Midwest ISO pursue the same type of arrangements with others that it has made with PJM, i.e., elimination of cross-RTO through and out rates. To the extent that such arrangements cannot be made, the Midwest ISO should continue its current pricing policies with respect to these rates.

- **How should the transmission rate design address new or exiting Midwest ISO transmission owners?**

With respect to transmission owning utilities that join the Midwest ISO in the future, the OMS recommends that rate design treatment for newly participating existing transmission facilities of new owners be designed with the following considerations in mind. First, if the zonal license plate approach is used, adding new transmission owners would create little difficulty. The new transmission owners could be integrated as a separate pricing zone or folded into an existing pricing zone with few complications. On the other hand, if the postage stamp rate design approach is selected, addition of new transmission owners and their accompanying load could well affect the system-wide postage stamp rate. Similarly, if a highway/byway rate design approach is used, either in whole or in part, the highway portion of the system rate could be changed by the addition of new transmission facilities and new loads to the RTO. If a flow-based method is chosen, the effect would be to charge the new load customers for their flows onto the existing Midwest ISO system and at the same time, charge existing load customers for their flows onto the new transmission system.

With respect to transmission owning utilities that decide to withdraw and leave the Midwest ISO in the future, the transmission rate for the remaining transmission owners may need to be re-calculated depending on the rate design method that is chosen. As explained above, with respect to existing transmission facilities and loads becoming part of the Midwest ISO, the effect of transmission facilities and loads leaving the Midwest ISO would be different depending on what transmission rate design method is in place.

- **The Transition Period – what parameters should be considered? For example, if a new transmission rate design is implemented, should it be implemented immediately or phased in over time?**

We presume that the reference in this question to “transition period” is not to the established transition period between now and February 1, 2008, but, rather is to a hypothetical concept of another transition period to phase any new transmission rate design beginning February 1, 2008. With respect to such a transition period issue, the OMS explained its position above in the context of modulating excessive rate shock. Depending on the relative magnitude of the rate impact resulting from any transmission rate design change, it might be necessary to employ some mitigating measures like a rate phase-in or the provision of advance notice of rate changes. Another approach might be to temporarily shift some of the effects on customers experiencing large positive rate shocks to those experiencing large negative rate shocks. Use of regional through-and-out rate revenues to offset some of the rate increase that could result from changed transmission rate design might also be considered.

- **If the TOs were to consider a review period, what parameters should be considered?**

If the meaning of this question is that a review period would involve a report being written on the impact of a new rate design, for example, one year after the new rate design is in place, the OMS is in favor of such an exercise. The purpose of a review should be to determine whether or not all the goals and objectives of the new rate design have been met. For example, if one of the goals of the new rate design is to attract new transmission systems into the Midwest ISO, a period of one year may be too short of a time to make an evaluation. On the other hand, if a goal is to minimize rate shock, then a period of one year is likely to prove useful. The OMS also thinks that it may be useful to have an automatic adjustment mechanism in place that raises or lowers rates each year depending on the limits set for rate shock; i.e., an automatic review period for certain goals.

Status Report on RECB II Comments by Mike Proctor

Section	Summary of Issues	Status
I	Summary of OMS's Position	Complete this summary when WG agrees on substantive issues.
II	<p>With respect to its planning process:</p> <ul style="list-style-type: none"> • The Midwest ISO needs to clearly set out an overall planning objective for the development of a portfolio of projects that provides region-wide benefits. • The Midwest ISO needs to clearly specify additional measures that it intends to use in meeting this overall planning objective. 	Subject to edits, but appears to be agreement in principle by the WG.
III	<p>With respect to calculating benefits for including a proposed project for cost allocation:</p> <ul style="list-style-type: none"> • The Midwest ISO should apply the No Loss provision to pricing zones rather than to Planning Sub Regions. • The Midwest ISO should apply the No Loss provision to the present value of Benefits rather than on a year-to-year basis <p>With respect to allocation of projects included for cost allocation:</p> <ul style="list-style-type: none"> • The Midwest ISO should only apply the 20% postage stamp rate to facilities that are 345 kV and higher and only when such facilities are shown to provide benefits to at least one pricing zone in each of the Planning Sub Regions. • The Midwest ISO should allocate costs of a project to the pricing zones for an initial period of five years before aggregating and spreading those costs to Planning Sub Regions. 	<p>Subject to edits, but appears to be agreement in principle by the WG.</p> <p>The region-wide postage stamp proposal is still under discussion.</p> <p>There appears to be agreement on the initial 5-year allocation to pricing zones.</p>
IV	<p>With respect to tariff language concerning project portfolios:</p> <ul style="list-style-type: none"> • Movement of sentences to help clarify the tariff language. • The addition of language regarding unreasonable cost allocations to help clarify the tariff language. • Require the Midwest ISO to provide an annual report on steps taken to develop project portfolios. 	Subject to edits, but appears to be agreement in principle by the WG.
V	<p>With respect to the determination of appropriate sub regions for cost allocation:</p> <ul style="list-style-type: none"> • Condition approval of the proposed tariff on the Midwest ISO filing with the Commission a report on the appropriate determination of sub regions for the purpose of allocating the costs of Regionally Beneficial Projects. 	Subject to edits, but appears to be agreement in principle by the WG.
VI	<p>With respect to the inclusion of costs associated with lower voltage facilities:</p> <ul style="list-style-type: none"> • Clarify proposed tariff language to include the costs associated with lower facilities needed to deliver the highest ration of benefits to costs from higher voltage projects or to better distribute the benefits of higher voltage facilities with the sub-regions. • The costs of these lower voltage facilities should not be included in a region-wide postage stamp allocation. 	<p>Subject to edits, but appears to be agreement in principle by the WG.</p> <p>Further WG discussion needed on the region-wide postage stamp allocation for lower voltage facilities.</p>

Section	Summary of Issues	Status
VII	<p>With respect to several clarifications of the Midwest ISO's November 1 filing:</p> <ul style="list-style-type: none"> • On the record description of the system load flow modeling to estimate benefits • Tariff should specify that the time period for calculating benefits should include at least ten years. • Project costs used to calculate benefit to cost ration should include revenue requirements over the same time period used to calculate costs. • Midwest ISO should perform sensitivity analysis on locations and amounts of new generation and demand-side resources to ensure robustness of benefits from candidate transmission projects. • Midwest ISO should provide more detail surrounding its vision for the development and filing of additional inclusion criteria. • Midwest ISO should clarify its planning process for developing portfolios of projects that provide benefits throughout eac sub region. • Midwest ISO clarifies and explains the concept of potential Regionally Beneficial Projects. • Concern expressed regarding the conservative nature of the Midwest ISO's proposed benefit to cost ratio for inclusion of projects for cost allocation. • Concerns that establishing fixed planning sub regions could result in planning seams issues. • Concern with th separate planning and cost allocation processes for Reliability Projects and Regionally Beneficial Projects. • Concern with potential conflicts in tariff language regarding Baseline Reliability Projects and Regionally Beneficial Projects. • Lack of explanation of what the Midwest ISO means by project reporting guidelines. • Concern with Midwest ISO's characterization of its filing as a compromise proposal. • Concern with lack of specification in tariff language. • Discussion of the need for the Commission to make changes to the tariff filed by the Midwest ISO – improvement does in and of itself is not sufficient for the Commission to determine that a filing results in just and reasonable rates. 	<p>The WG has not had time to review this list of comments regarding clarifications, but will do so at its December 8 meeting.</p>



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OMS Comments on the Midwest ISO 2006-2008 Strategic Plan Update

The Organization of MISO States (“OMS”) appreciates this opportunity to comment on the Midwest ISO 2006-2008 Strategic Plan Update (“Update”). The OMS strongly supports the Midwest ISO’s stated commitments in the Update to improve its existing operations and beneficially expand its operations.

In these comments, the OMS focuses on three critical ways in which the Midwest ISO should improve its Update. First, the Midwest ISO should specify its plans for improving its transmission planning operations. Second, the Midwest ISO should credibly clarify how it will “[embrace] its contractual obligation to maximize transmission owners’ revenue through efficient use of the transmission system” while meeting its obligation to be independent. Third, the Update should explicitly discuss MISO’s commitment to the stakeholder process.

The OMS also would like to use this opportunity to comment more generally on the importance of the Midwest ISO maintaining focus on its core functions and assuring stakeholders of the benefits of its operations. Lastly, the OMS would like to renew its commitment to assisting the Midwest ISO in its efforts to achieve excellence.

The Midwest ISO’s Regional Transmission Planning

The Midwest ISO’s Strategic Plan should convey the Midwest ISO’s commitment at the management level to improve its regional transmission planning operations.¹ To be a leader in energy markets and achieve operational excellence, the transmission system that the Midwest ISO operates should be excellent. As the Joint Board on Economic Dispatch for the PJM-MISO Region stated in its May 24, 2006 Report on Security Constrained Economic Dispatch (“Joint Board Report”), “Because adequate transmission infrastructure is important for the achievement of [security-constrained economic dispatch’s] least-cost and reliability objectives, the RTOs should devote adequate resources and substantial management attention to the transmission expansion planning process.”²

¹ The OMS notes this sentence on page three of the Update: “The strategic goals presented in this document reinforce Midwest ISO’s primary mission of providing its customers valued services; reliable, cost-effective systems and operations; dependable, transparent pricing; open access to markets; and transmission and generation planning for long-term efficiency.” (Emphasis added.) While there are and will be proper roles for the Midwest ISO in generation planning, it is and would not be appropriate for the Midwest ISO to be wholly responsible for generation planning. The Midwest ISO should amend the Update to clarify the intent of this reference to generation planning.

² Joint Board Report, p. 40.

The OMS recognizes that the Midwest ISO's transmission planning processes are still under development and that the resource needs will depend on those developments; however, the new planning processes that develop will require more Midwest ISO resources and innovative analytical techniques. MTEP06 falls short of the improvements in regional planning necessary to deliver fully the benefits of market-based central dispatch of generation and other developments in the Midwest ISO's operations. As the OMS suggested in its 2006 Annual Stakeholder Meeting comments, "The Midwest ISO should better integrate its transmission planning function with other functions of the Midwest ISO such as resource adequacy, maintenance, ancillary services markets development, and development of long-term transmission rights."

Further, the Midwest ISO should strive to make its MTEP reports suffice as stand-alone justifications for transmission upgrades. In some states, transmission projects are reviewed by state regulators before the projects are constructed and the costs are ultimately passed through to ratepayers. The documentation of need and examination of alternatives through the MTEP process could serve as useful information in the state's regulatory proceedings. In other states, however, there are limited opportunities for state regulatory review of particular transmission projects before the costs are passed through to ratepayers. As noted in the OMS Transmission Planning and Siting Working Group's comments on the draft MTEP 06 report, "In either case, if state regulators have confidence in the results of the planning process, it may avoid potential disputes in state or federal proceedings regarding specific projects and, ultimately, lead to a more efficient expansion of the transmission system."³

The Midwest ISO's Independence

The Midwest ISO's independence from stakeholders is critical for efficient market operations, reliability operations, and transmission expansion. Accordingly, the OMS notes with great interest the first "Supporting Initiative" contained in the Update:

1. Transmission Owner Revenue Maximization - The Company embraces its contractual obligation to maximize transmission owners' revenue through efficient use of the transmission system. Midwest ISO has committed to assigning a professional resource to work on revenue maximization opportunities in 2006. At the same time, the Company will pursue the implementation of market mechanisms (e.g., long-term FTRs and Auction Revenue Rights, "ARR") to promote the investment necessary to achieve stated transmission resource requirements by 2009. The Company will target this objective without losing sight of other obligations to its transmission owners, such as:

³ Letter to Jeff Webb, p. 3.

- Planning activities
- Custodial and trust relationship
- Prudent asset operation⁴

In its comments at the Midwest ISO's 2006 Annual Stakeholder Meeting, the OMS stressed the importance of MISO independence, stating that MISO must be careful not become an advocate for any one position or sector and that it needs to be a neutral operator of the market and an impartial information resource to all. The OMS also notes that the Joint Board Report states:

RTO independence is critical for the RTOs' ongoing credibility. Accordingly, PJM and MISO are encouraged to continue to strive for independence as a bedrock principle. Both state and federal regulators have a role in the oversight of RTO independence.⁵

On its face, it is unclear how the Midwest ISO can be independent of transmission owners (many of which have generation interests) while “[embracing] its contractual obligation to maximize transmission owners’ revenue.” Importantly, the Joint Board Report also points out that the assurance of RTO independence is an important foundation for confidence that RTOs will operate the grid and the markets in a manner fully consistent with the goal of maximizing the economic benefit to the public.⁶ Efficient use of the transmission system requires pricing the use of the transmission system at or near marginal cost (given separate mechanisms for recovering capital costs of transmission infrastructure). With relatively price-inelastic demand for use of the transmission system, however, maximizing transmission owners’ revenue likely requires pricing the use of the transmission system well above marginal cost. Accordingly, it is unclear how MISO can promote efficient use of the transmission system while meeting its fiduciary obligation to transmission owners.

Therefore, it is not enough for the Midwest ISO to assert simply that it will “[embrace] its contractual obligation to maximize transmission owners’ revenue through efficient use of the transmission system.” The Midwest ISO should clearly and credibly explain how it intends to (or can) do so.

The Midwest ISO's Commitment to the Stakeholder Process

The OMS notes that the Update does not address the Midwest ISO's commitment to fostering robust, effective stakeholder processes. The OMS greatly values fair and efficient stakeholder participation in the Midwest ISO's governance and development.

⁴ Update, p. 14.

⁵ Joint Board Report, p. 43.

⁶ *Ibid.*

Accordingly, the Midwest ISO should explicitly express its commitment to its stakeholder processes in the Update.

Expansion of the Midwest ISO's Functions

As the OMS suggested at the 2006 Annual Stakeholder Meeting, the Midwest ISO should not lose focus on its core functions as it expands its products and services into areas such as independent transmission coordination for individual utilities or operating a renewable energy credit exchange. Achieving excellence in reliability, market, and transmission planning operations should remain in the forefront of the Midwest ISO's mission.

Demonstrating Benefits

As the OMS stated in its comments at the 2006 Annual Stakeholder Meeting, the OMS values clear explanations and understandable measurements of the benefits and costs of Midwest ISO services. Specifically, the OMS supports a transparent and participatory ongoing granular evaluation of economic and reliability benefits, where state- or control area-level analyses are most useful to state regulators.

The Midwest ISO should rely on the best available objective measures to demonstrate benefits and, when relying on computer modeling, make assumptions and other model parameters explicit to stakeholders. Such analyses are critical for strong support of the Midwest ISO and the services it provides to stakeholders. As stated in the Joint Board Report:

An ongoing demonstration of benefits from PJM and MISO managed SCED is important for sustaining market participant and state regulator confidence in the RTOs. The RTOs should establish a clear benchmark to assess the degree to which the reliability and least cost objectives of optimal SCED, as described in EPA's SCED definition, are being captured.⁷

The OMS' Commitment to Assist

The OMS stands ready to assist the Midwest ISO in endeavors expected to deliver benefits to customers – especially in areas subject to or heavily dependent on state jurisdiction. The OMS has already demonstrated its commitment to assist MISO with regard to developing demand-side market participation as well as coordinating and streamlining permitting and siting processes for new transmission facilities.

⁷ Joint Board Report, p. 35.