Organization of MISO States

ORGANIZATION OF MISO STATES, INC.
Board of Directors Meeting
Conference Call Notes
October 11, 2007

John Norris, President of the Organization of MISO States, Inc. (OMS), called the October 11, 2007 Meeting of the OMS Board of Directors to order via conference call at approximately 2:00 p.m. (CDT). The following board members or their proxies participated in the meeting:

Robert Lieberman, Illinois
Greg Server, Indiana
John Norris, Iowa
Jeff Johnson, proxy for Mark David Goss, Kentucky
Angie Butcher, proxy for Monica Martinez, Michigan
Tom Pugh, Minnesota
Jeff Davis, Missouri
Greg Jergeson, Montana
Tim Texel, proxy for Eugene Bade, Nebraska
Susan Wefald, North Dakota
Valerie Lemmie, Ohio
Kim Pizzingrilli, Pennsylvania
Gary Hanson, South Dakota
Dan Ebert, Wisconsin

Absent
Manitoba

Agency members participating
Randy Rismiller- Illinois
Bob Pauley – Indiana
Robb Mork - Indiana OUCC
Jeff Kaman - Iowa
Rick Bertelson - Kentucky
Burl Haar - Minnesota
Mike Proctor - Missouri
Paul Centolella, Kim Wissman, Hisham Choueiki - Ohio
Kim Hafner - Pennsylvania
Randy Pilo - Wisconsin

Others on the call
Warren Day - ATC
Bill Malcolm - MISO
Bill Smith, Julie Mitchell - OMS Staff

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

Approval of Minutes of the September 13, 2007 Board Meeting

- Dan Ebert moved for approval of the September 13, 2007 OMS Board of Directors Meeting minutes as distributed to board members. Kim Pizzingrilli seconded the motion. The minutes were approved by a unanimous voice vote of the directors.

Treasurer's Report

Greg Jergeson presented the September OMS Treasurer's Report. (report follows minutes)

- The beginning balance as of September 1 for the Wells Fargo Business Performance Savings Account was $57,792.93. Interest earned for this month was $142.86. The September 30, 2007 balance was $57,935.79.

- The beginning balance as of September 1 for the Chase Bank One Checking account was $79,941.23. The total disbursements from the checking account for September 2007 were $23,502.19. Deposits, interest and adjustments were $40,036.96. As of September 30, 2007, the checking account bank balance was $96,476.00 and the book balance was $98,377.79 (with 4 checks outstanding).

- The total savings and checking account balances as of September 30, 2007 is **$154,411.79.**

Greg Jergeson moved to accept the September Treasurer's report as presented. Valerie Lemmie seconded the motion. A voice vote of the directors unanimously accepted the report.

Review of the Executive Committee Meeting on September 27

President Norris and Bill Smith highlighted the following items from the September 27 Executive Committee meeting.

- The Executive Committee discussed the OMS staff personnel issue which concerned correcting the current plan for retirement contributions. A resolution letter has been drafted to send to the IRS.
- The OMS Nominating Committee reported its progress in securing a slate of candidates to serve as officers for 2008.
- The position of OMS Secretary will remain unfilled until the 2008 election.
- Bill Smith presented a draft agenda for the OMS Annual Meeting. He indicated invitations to FERC commissioners had been sent, as well as one to David Patton the Market Monitor.
- The OMS Annual Meeting will take the same format as last year, with a Recognition Dinner on Wednesday, and the Annual meeting to follow on Thursday after the MISO Board meeting.
- OMS Work Group assignments were reviewed.
- The OMS Modeling Work Group drafted Hisham Choueiki to serve as its Chair.
- The Executive Committee reviewed agenda items for the November 11 Board meeting.

Executive Director's Report:

Bill Smith highlighted the following item that had come up since the OMS Executive Director's report, which follows the minutes, was distributed.

- MISO is refreshing its "Exploder" distribution list. Alison Johnson has sent out multiple reminders for those wishing to receive MISO material, and announcements, with directions for updating this list. Please refresh your entries before October 31, when accounts will be terminated if not updated.
- Graham Edwards was not available for this call - he was on an airplane.

BUSINESS

1. **MISO Advisory Committee Issues -** Dan Ebert
   Dan Ebert reviewed the MISO Advisory Committee agenda, referencing the following:
   - The October MISO Advisory Committee meeting does not appear to have any voting items on the agenda. Dan Ebert suggested it would likely be a "light" meeting, with primarily discussion items.
   - At this time, Dan Ebert mentioned the Midwest Governors Association (MGA) meeting on energy policy, November 14-15, 2007, to be held in Milwaukee. He invited all OMS commissioners to attend. He did note that the meeting overlaps with NARUC.

2. **MISO Planning Advisory Committee Issues** - Dan Ebert
   There will be no Planning Advisory Committee meeting this month. Julie Voeck was elected chair of the PAC at its last meeting.

3. **Resource Adequacy Status Report -** Jan Karlak, RAWG Chair
   Jan Karlak reported on the development of the OMS Resource Adequacy Proposal.
   - She highlighted each of the four main issue points:
     1. The Metrics (needed for long term resource adequacy) work is completed on Module E
     2. Demand Resources included in capacity assets
     3. Enforcement concept paper and tariff language
     4. Electronic Bulletin Board
   - RAWG is working with the MISO Supply Adequacy Work Group as well as the OMS MWDRI and MISO Demand Response Work Group to coordinate efforts on the Module E proposal.
   - Jan announced the interactive webcast RAWG is developing for November 20, at 1:00 pm CST at the Public Utilities Commission of Ohio, hosted by Commissioner Valerie Lemmie, to inform OMS Board Members of the four issues of the proposal to be considered for a vote at a Special OMS Board meeting on November 27.
   - Some commissioners requested that the Enforcement concept paper and draft tariff language be sent to OMS board members before the November 20 meeting if available.
   - Jan also highlighted the dates of upcoming meetings to be held to discuss the issues.
   - President Norris suggested an informational meeting be held for OMS commissioners on the Resource Adequacy issues of the draft Module E following the MGA energy summit on November 15 in Milwaukee.
   - Bill Smith indicated OMS could reimburse for travel to this meeting, once it is designated an OMS meeting. Susan Wefald requested telephone capability for the meeting be available for those unable to travel to Milwaukee.
   - **Gary Hanson offered a motion that if Dan Ebert receives enough responses from his invitation to OMS commissioners to attend the MGA summit, that OMS offer reimbursement of travel to Milwaukee on November 14 or 15 to those commissioners or staff wishing to attend an Resource Adequacy Informational session following the summit from 1 pm to 4 pm on November 15. Dan Ebert seconded the motion.**
     A voice vote of the directors unanimously approved the motion.

4. **Ancillary Services Market Filing -** Bill Bokram, Market WG Co-Chair
   Bill Bokram presented an overview of the Ancillary Services Market (ASM) issue. He then presented a draft filing for consideration that had been distributed to all OMS Board members. Ohio and Indiana offered amendments to the comment. Discussion followed concerning Ohio wording changes.

Kim Wissman, proxy for Valerie Lemmie, Ohio moved to offer second amendment language to the draft proposed by the Market Work Group. Bob Lieberman seconded the motion. The motion was approved by a majority voice vote of the directors. North Dakota and Pennsylvania abstained.

Additional discussion by the OMS board members followed.

Dan Ebert moved to approve the Ancillary Services Market comments draft filing to the FERC as proposed with two Ohio amendments distributed to the directors prior to the meeting. (Dan Ebert stated Randel Pilo and Hisham Choueiki would provide additional language to the introduction by noon on Friday, October 12 for the beginning of section 3). Kim Wissman, proxy for Valerie Lemmie, Ohio, seconded the motion.

A roll call vote was taken: Vote yes to approve comments:

Illinois -	**Yes**
Indiana -	**Abstain**
Iowa -	**Yes**
Kentucky -	**Yes**
Manitoba -	**Absent**
Michigan -	**Yes**
Minnesota -	**Yes**
Missouri -	**Yes**
Montana -	**Yes**
Nebraska -	**Yes**
North Dakota-	**Yes**
Ohio -	**Yes**
Pennsylvania-	**Abstain**
South Dakota-	**Yes**
Wisconsin -	**Yes**

Yes - 12, Abstain - 2, Absent - 1

By a majority vote of the states present, the comments were approved. Bill Smith contacted the members not available to vote at this time on the comments to determine if they wanted to join in the approval of the comments. (Approved document follows minutes.)

5. **Adoption of Demand Response Principles draft** - Bob Lieberman, Demand Response WG Chair

Bob Lieberman highlighted the Demand Response Principles draft that had been developed at the MWDRI meeting for OMS Commissioners and staff on September 24 in Chicago.

Bob Lieberman moved to adopt the Demand Response Work Group Principles draft as distributed to the directors prior to the meeting. Susan Wefald seconded the motion.

As discussion began, Angie Butcher, proxy for Monica Martinez, Michigan, asked if the vote on the Demand Response Principles could be tabled until the November OMS Board meeting. This would allow newly appointed Michigan commissioners to more fully consider the document.

Bob Lieberman then withdrew his motion. Susan Wefald withdrew her second.

President Norris asked that anyone with questions or comments about the principles document contact Bob Lieberman. Formal action on the demand principles document would take place at the November 8 OMS Board meeting.

6. **Comments on AEP Pricing Complaint -** Randy Rismiller, Pricing WG Chair

Randy Rismiller presented an overview of the AEP Pricing Complaint issue. He then presented a draft filing for consideration that had been distributed to all OMS Board members.
Rick Bertelson asked that new language be inserted to soften the tone. After some discussion, the document, newly amended, was put to a vote.

Susan Wefald moved to adopt the AEP Pricing Complaint comments draft filing to the FERC as amended after distribution to the directors prior to the meeting. Rick Bertelson, proxy for Mark David Goss, Kentucky, seconded the motion.

A roll call vote was taken: Vote yes to approve comments:

Illinois -	**Yes**
Indiana -	**Yes**
Iowa -	**Yes**
Kentucky -	**Yes**
Manitoba -	**Absent**
Michigan -	**Yes**
Minnesota -	**Yes**
Missouri -	**Yes**
Montana -	**Yes**
Nebraska -	**Yes**
North Dakota-	**Yes**
Ohio -	**No**
Pennsylvania-	**Abstain - to respond later**
South Dakota-	**Yes**
Wisconsin -	**Yes**

Yes - 12, No - 1, Abstain - 1, Absent - 1

By a majority vote of the states present, the comments were approved. Bill Smith contacted the members ready to vote at this time on the comments to determine if they wanted to join in the approval of the comments. (Approved document follows minutes.)

7. **Comments to MISO Board on Day 1/Day 2 Issues -** Bill Smith
Bill Smith reported that this is one of the "hot topics" the MISO AC proposed to offer for input. The Market Work Group recommended OMS not file a statement concerning this issue.

8. **Availability of KEMA Project for State Commissions -** Mike Proctor, Modeling WG
Mike Proctor reported on behalf of the work group about the KEMA Tool. Per Mike Holstein, states now have access to this tool. Mike Proctor suggested contacting Hisham Choueiki, Modeling Work Group Chair, if states are interested in obtaining information on this.

9. **FERC Technical Conference -** Bill Smith
Bill Smith reported on two FERC Technical Conferences involving issues of OMS interest:
   - October 12, 2007 - FERC Technical Conference - Washington, DC - involving retail competitive suppliers that serve customers with direct connection to their RTOs. It involves resource adequacy issues.
   - October 15, 2007 - FERC Technical Conference - Boston - on Order 890.

10. **Price of Extra High Voltage Transmission in Multiple RTOs** - Bill Smith
(This is the issue Steve Gaw raised at the September meeting.)
    - President Norris asked Bill Smith to distribute information about the joint RTO meeting to be held in Pittsburgh at the Airport Marriott on November 1 from 10 am -2 pm EDT concerning this issue.

11. **OMS Nominating Committee Status Report** - Bill Smith
    - The Nominating Committee's work is nearly complete. The committee's recommendations will be presented to the board at the November meeting.

12. **Bifurcation of MISO CEO/President**
At the September 13 OMS Board meeting, President Norris requested OMS board members to not proceed with approval of comments to FERC the OMS Long Term Development & Governance Work Group had prepared until he could speak further with Graham Edwards

about the issue of bifurcation of MISO CEO/President. MISO's Graham Edwards sent a letter responding to the concerns the OMS board had raised on this issue to President Norris which OMS distributed to all board members. President Norris referred to this letter in this meeting's discussion of the issue. No OMS comment will be sent to FERC regarding this.

ANNOUNCEMENTS:

- Bill Bokram announced Christine Ericson of Illinois as the new co-chair of the OMS Market Work Group.
- The next regular OMS Board meeting will be held November 8, 2007 at 2:00 pm CST
- The next regular OMS Executive Committee meeting will be held October 25, 2007 at 2:00 CDT
- October 3 – Briefing on ASM Filing
- October 15 - FERC Technical Conference - Boston
- October 16 – Planning Advisory Committee meeting – Carmel (CANCELLED)
- October 17 - Advisory Committee meeting – Carmel
- October 17 - WG chairs and key staff – Carmel - 3:00-5:00 pm EDT
- November 11 – OPSI–OMS lunch planned at NARUC
- November 27 - Special Board meeting on Resource Adequacy
- December 13 – OMS Annual meeting – Carmel

The meeting adjourned at 4:15 p.m. CDT

OMS

Organization of MISO States
Report of the Treasurer
Greg Jergeson, Montana Public Service Commission to the
Board of Directors
October 11, 2007
Report for September 2007

CASH ON HAND

The beginning balance as of September 1 for the Wells Fargo Business Performance Savings Account was $57,792.93. Interest earned for this month was $142.86. The September 30, 2007 balance was $57,935.79.

The beginning balance as of September 1 for the Chase Bank One Checking account was $79,941.23. The total disbursements from the checking account for September 2007 were $23,502.19. Deposits, interest and adjustments were $40,036.96. As of September 30, 2007, the checking account bank balance was $96,476.00 and the book balance was $98,377.79 (with 4 checks outstanding).

The total savings and checking account balances as of September 30, 2007 is **$154,411.79.**

OMS

TREASURER'S REPORT
Organization of MISO States
September 30, 2007

Wells Fargo Business Performance Savings Account

Balance as of 9/1/07			$ 57,792.93		
9/30/07	DEP	Interest on Savings	$ 142.86		
Business Performance Savings Account Balance at 9/30/07					$ 57,935.79

Chase Bank One Commercial Checking with Interest

Balance as of 9/1/07			79,941.23
9/21/2007	DEP	MISO Remittance	$ 40,000.00
9/28/07	DEP	Interest on Checking	36.96
		Total Deposits	$ 40,036.96

Checks and Charges

Date	Check #	Descriptions		
9/7/2007	2432	KY Travel to ASM Workshop--Columbus	$ 25.07	
9/7/2007	2433	MN Travel to MISO Capital Budget Meeting	$ 1,025.74	
9/7/2007	2434	WI Travel to MISO A/C	$ 455.23	
9/10//07	W/D	Paychex Fee	$ 99.60	
9/17/2007	2435	DWX Internet	$ 35.00	
9/17/2007	2436	DWX Internet	$ 125.00	
9/17/2007	2437	Intercall	$ 1,747.01	
9/17/2007	2438	100 Court Investors	$ 959.21	
9/17/2007	2439	Infomax Office Systems	$ 172.31	
9/17/2007	2440	Qwest	$ 240.95	
9/17/2007	2441	VOID		
9/17/07	2442	VOID		
9/17/2007	2443	VOID		
9/17/07	2444	Chase Card Services	$ 1,583.23	
9/17/07	2445	OH Travel to MISO Finance Committee	$ 257.40	
9/17/07	2446	IN OCA Travel to MISO A/C	$ 763.74	
9/17/07	2447	IA Travel to DRTF	$ 642.48	
9/17/07	2448	IA OCA Travel to MISO Meetings	$ 270.60	
9/27/07	W/D	Paychex, Payroll	$ 9,792.47	
9/28/07	W/D	Paychex, Taxes	$ 5,307.15	
Total Checks and Charges				$ 23,502.19

CHECKING ACCOUNT BALANCE 8/31/07	**$ 96,476.00**
CERTIFICATES OF DEPOSIT, SAVINGS AND CHECKING ACCOUNT BALANCES AS OF 8/31/07	**$ 154,411.79**

CHASE CHECKING ACCOUNT RECONCILIATION

	Check #		Amount
Bank Balance 9/30/07		$	98,377.79
Less Checks OS	2425	$	224.97
	2446	$	763.74
	2447	$	642.48
	2448	$	270.60
Book Balance 9/30/07		$	96,476.00

CHASE OMS VISA PURCHASES

ED	Travel to MISO A/C meeting and OPSI Annual Meetings	384.41
ED	Travel to MWDRI Steering Committee Meeting	321.30
ED	Travel to MISO A/C and BoD Meeting	244.59
ED	Hotel, MISO A/C Meeting	141.37
ED	Renewal of DC Bar Dues	188.00
ED	RTO 102 Lunch	40.98
ED	ASM Training, Madison, Lunch for attendees	200.51
OM	Fedex	7.63
OM	Fedex	13.44
OM	Hyvee Des Moines - office postage	41.00
	Total VISA Purchases	1,583.23

OMS

Organization of MISO States

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OMS Executive Director Report
October 9, 2007

FERC and DOE Activity

1. On September 18, the FERC granted the MISO's request to extend Broad Constrained Area mitigation measures, as the OMS recommended. Docket No. ER07-1182, 120 FERC ¶61,250.
2. On September 14, the OMS submitted a comment on the FERC's Advance Notice of Proposed Rulemaking in Docket RM07-19. Several work groups cooperated in preparing this comment.
3. The Midwest ISO filed on September 14 its revised tariff provisions to implement the Ancillary Services Market. MISO staff provided the OMS a briefing on the filing on October 3. The OMS Board will consider a response at its October 11 meeting.
4. On September 17, the OMS filed a statement of position on the post-transition pricing proposals filed on August 1 filings by the transmission owners in Dockets ER07-1233 and ER07-1261.
5. Also on September 17, the American Electric Power Company filed a complaint against MISO and PJM relating to transmission pricing. A response will be considered by the OMS board on October 11.
6. On September 28, the OMS Transmission Planning and Siting Work Group gave staff comments to MISO on the Open Season proposal intended to improve processing of the interconnection queue. MISO has opened a Generator Interconnection Queue Process Work Group to consider these issues.
7. On September 28, the OMS Long-Term Development and Governance Work Group gave staff comments to MISO staff on the MISO capital budget rankings for 2008.
8. On October 2, the Department of Energy designated National Interest Electric Transmission Corridors for the Mid-Atlantic and Southwest Areas. The OMS had made several comments on this

process in July; the DOE appears to have considered but not accepted these comments.

9. OMS staff will attend a FERC technical conference on Order 890 compliance filings on October 15 in Boston.
10. On September 11, 2007, Direct Energy Services, Sempra Energy Solutions, and Strategic Energy, appealed to FERC from Reliability First's determination (upheld by NERC) that they should be registered as load-serving entities. Reliability First's treatment differs from other regional reliability organizations. A technical conference is scheduled for October 12. (Dockets RC07-4, RC07-6, RC07-7).

<u>OMS-MISO Activity</u>:

1. The MWDRI Steering Committee met on September 24. It recommended demand resources principles to be considered by the OMS board on October 11. It also discussed how demand resources fit with the resource adequacy provisions being developed for MISO's Module E filing in December.
2. Hisham Choueiki of the Ohio Commission staff will chair the Modeling work group.
3. The OMS Resource Adequacy Work Group has revised its schedule for presenting recommendations on Module E amendments. Meetings are now planned as follows:
   - October 10 – Joint call of OMS RAWG/MWDRI Staff (Discussion of DRWG Issues and potential redline Module E Amendments)
   - October 24 – Joint call of OMS RAWG/MWDRI Staff (Continuing discussion of DRWG Issues and potential redline Module E Amendments, with efforts at consensus).
   - October 30 – Joint call of OMS RAWG/MWDRI Staff (if necessary to finish Module E efforts).
   - November 5 – Regularly scheduled DRWG call to finalize our jointly recommended Module E amendments.
   - November 20 – Final Resource Adequacy review (Module E amendments) – Webcast for commissioners.

- November 27 – Special OMS Board meeting on resource Adequacy (Module E amendments).

4. RTO 101 presentations are scheduled in Wisconsin, Minnesota, and Ohio. Other interested states should contact the OMS office for more information.

Public Relations

1. Presentations:
   - None
2. Pending speaking/meeting invitations:
   - Bill Smith and Jerry Lien have been asked to speak on the priorities and work activities of the OMS to the Upper Great Plains Transmission Coalition on October 22 in Bismarck.

Upcoming MISO Filing of Regional Interest

Filing Date	Docket No.	Description	Pursuant to Commission Order
12/7/2007	OA08-____	The Midwest ISO to submit its § 206 compliance filing pursuant to Order No. 890 containing non-rate terms and conditions (or a demonstration that previously approved variations continue to be "consistent with or superior to" the revised pro forma OATT).	Order No. 890 at ¶¶ 157, 161
December 2007	ER07-550	The Midwest ISO to submit a permanent Resource Adequacy plan.	119 FERC ¶ 61,311 (2007)
Mid-December 2007	ER08-____	The Midwest ISO to submit proposed revisions to the EMT pursuant to Section 205 concerning the redesign of the Midwest ISO's cost recovery adders.	N/A

Other upcoming dates:

- October 10 – Joint call of OMS RAWG/MWDRI Staff (Discussion of DRWG Issues and potential redline Module E Amendments)
- October 17 – Advisory Committee and Work Group chairs meeting (Carmel)

- October 24 – Joint call of OMS RAWG/MWDRI Staff (Continuing discussion of DRWG Issues and potential redline Module E Amendments, with efforts at consensus.)
- October 25 – OMS Executive Committee call
- October 30 – Joint call of OMS RAWG/MWDRI Staff (If necessary to finish Module E efforts).
- November 5 – Regularly scheduled DRWG call to finalize our jointly recommended Module E amendments.
- November 8 – OMS Board meeting
- November 11 – OPSI - OMS lunch at NARUC meetings
- November 12 – MISO breakfast at NARUC meetings
- November 20 – Final Resource Adequacy review (Module E amendments) – Webcast for commissioners
- November 27 – Special OMS Board meeting on resource Adequacy (Module E amendments)
- December 6 – OMS Board special meeting (if needed)
- December 12 – Advisory Committee and OMS Recognition Dinner
- December 13 – OMS Annual Meeting

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission System Operator, Inc.) Docket No. ER07-1372-000

COMMENTS OF THE ORGANIZATION OF MIDWEST ISO STATES
AND NOTICE OF INTERVENTION

I. Introduction

On September 14, 2007, the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") filed with the Federal Energy Regulatory Commission ("Commission") revisions and amendments to its Open Access Transmission and Energy Markets Tariff relating to the implementation of Day-Ahead and Real-Time Energy and Ancillary Services Markets ("ASM"). On September 19, 2006, the Midwest ISO filed proposed amendments to the 9/14/07 filing in order to correct minor typographical errors and inadvertently omitted language.

On September 26, 2007 the Commission issued a notice setting October 5, 2007, as the deadline for comments and protests. On September 26, 2007, the Commission issued a notice extending the deadline to October 15, 2007, for comment on Midwest ISO filing. The Organization of MISO States ("OMS") hereby submits its comments.

After review of the September 14 filing, the OMS has identified the following issues and recommendations for the Commission's consideration. Each of these points is discussed at greater length in its own subsection in section three of this document.

II. Statement of Issues

[summary of comments]

III. Discussion of the Midwest ISO's Proposed Ancillary Services Market Tariff

The OMS generally supports the Midwest ISO's proposed ancillary services market design, and offers these comments with the intent to improve and to ensure an efficient and workable ancillary services market.

A. Market Monitoring and Mitigation

On June 22, 2007 the FERC rejected without prejudice the Midwest ISO's February 15, 2007 Ancillary Services Market (ASM) proposal and provided directions to correct filing deficiencies in a future ASM filing.[1] Specifically, the Guidance Order directed the Midwest ISO to: (1) Submit a market power analysis, and (2) develop market readiness and reversion plans.[2] Where an RTO performs a market analysis demonstrating a lack of market power for certain ancillary services, the Commission has approved the sale of those ancillary services at market-based rates.[3] Where there is market power, the Commission considers on a case-by-case basis market power mitigation measures for sales involving ancillary services in these markets.[4] As OMS understands it, Midwest ISO's entire market design depends on the approval of market-based rates, so the procedures used to prevent the exercise of market power are therefore the cornerstone for approval of the ancillary service markets.

With regards to the Midwest ISO Market Power study submitted by Dr. David Patton, the OMS has a number of concerns. In concept, the OMS believes that the Conduct and Impact tests proposed by Dr. Patton for mitigating market power in the ancillary services markets would be just and reasonable as long as the "correct" relevant geographic market and the "appropriate" economic threshold are used. In the following discussion, the OMS highlights its concerns

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[1] *Midwest Independent Transmission System Operator, Inc.,* "Order on Ancillary Services Filing and Providing Guidance," 119 FERC ¶ 61,311 (2007) ("Guidance Order").
[2] Guidance Order, at P. 43 & P. 49.
[3] *Final Rule on Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities* (Order No. 697), 119 FERC ¶ 61,295 (2007), at P. 1069.

regarding the presence of market power opportunities in each of the seven defined geographic sub-regions studied by Dr. Patton, the relative size of the $50 per MW/hour economic threshold for the conduct test, the methodology for auditing/identifying physical withholding and the determination of a unit's average reference price within a operating reserve zone.

i. The Exercise of Market Power must be Mitigated

Among other things, Dr. Patton's market power study concludes that when the market power analysis is performed using the entire Midwest ISO footprint as the relevant geographic market, none of the participating suppliers will be likely to have market power, regardless of the metric used; namely the market share, the *Herfindahl-Hirshman* Index (HHI), or the pivotal supplier test.[5] On the other hand, Dr. Patton states that if specific sub-regions of the Midwest ISO are used as the defined relevant geographic market, the results indicate a clear presence of market power for all three metrics.[6] Dr. Patton states that the reason for using a sub-region in the analysis, rather than the entire Midwest ISO footprint, is the presence of transmission constraints in local areas that generally preclude a supplier physically located in one sub-region from participating in another sub-region.[7] In Dr. Patton's analysis, the sub regions serve as proxies for operating reserve zones in the proposal ancillary service markets.

The market analysis results in each of the seven analyzed sub-regions, and for each of the two products defined in the analysis (regulating reserve and contingency reserve), indicate the following:

- The presence of at least one supplier with more than a 20% market share in each of the seven sub-regions during the summer 2006 and winter 2006/2007 seasons

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[4] *Id*.
[5] Need a citation
[6] Seven sub-regions (or reserve zones) were analyzed by Dr. Patton in his affidavit: WUMS, Michigan, Minnesota, and Clusters #1, #4, #5, and #9.
[7] Need a citation

- An HHI concentration of more than 1,800 in each of the seven sub-regions during the summer 2006 and winter 2006/2007 seasons

- The existence of at least one pivotal supplier in both the Regulating Reserve (between 14.3% and 97.4% of the time period studied[8]) and the Contingency Reserve markets (between 34.4% and 100% of the time studied)

The OMS is concerned about Dr. Patton's market power analysis results of the seven studied Midwest ISO sub-regions. This concern is especially critical given the fact that several actual sub-regions of the Midwest ISO are often constrained on a daily basis. As such, the assumption that the defined geographic market is the entire Midwest ISO market is and will likely continue to be violated daily. Where Midwest ISO determines operating reserve zones, Dr. Patton's solution to this problem is to continually monitor the sub-regional markets created by these zones, apply the conduct and impact tests, and mitigate accordingly within each of the zones whenever the proposed defined economic threshold is triggered.[9]

The OMS is also concerned with the high percentage of time a pivotal supplier exists in each of the seven studied sub-regions. This is critical if one considers, for example, that there exists a pivotal supplier in Cluster #1 during 34% of the hours in a particular year. This implies that during 2,978 (.34 x 8,760 hours) hours, there is an opportunity for at least one pivotal supplier to exercise market power. Dr. Patton's response to this is that a supplier that is pivotal will not necessarily exercise market power.[10] This response is not sufficient to allay the concerns of the OMS. Indeed, even if a pivotal supplier does not exercise market power during all 2,978 hours of the year, there are clearly enough opportunities to exercise it and extract excessive profits during any portion of those 2,978 hours without failing Dr. Patton's test for an economic threshold.

[8] The time period studied for the pivotal supplier test spanned the hourly data from April 1, 2005 through June 30, 2007.

[9] Affidavit of David B. Patton, Attachment A, at P 54 & P 57

As stated earlier, Dr. Patton's sub-regional analyses indicate clear evidence of the potential for the exercise of market power during a large portion of the hours examined. Therefore, it would not be appropriate at this time for the Commission to approve ancillary services market where suppliers are allowed to charge market-based rates unless there is a comprehensive program in place to prevent or mitigate the exercise of market power. The OMS believes that the sub-regions, or reserve zones, are the correct relevant market areas and given that a competitive market in these reserve zones will not exist, the Commission must ensure that effective mitigation measures are in place.

ii. The Conduct and Impact Tests

In his affidavit, Dr. Patton states that he will consider a unit to have failed the economic threshold if its bid represents a 300% increase or an increase of $50 per MW/hour, whichever is lower, from a 90-day average reference price.[11] Dr. Patton further states that until there is sufficient historical market data, a cost-based average for each of the units will be used during a transition period.[12]

In this regard, the OMS has three concerns. The first concern is related to the accuracy of establishing a reference price for each generating unit. Dr. Patton's Affidavit does not include a comprehensive discussion as to how he intends to assess the accuracy and reliability of a submitted reference price. The OMS recommends that Dr. Patton should develop a formalized approach for evaluating the accuracy and appropriateness of a submitted reference price and report the results to the Commission and the OMS.

The second concern is that the $50 per MW/hour economic threshold proposed by Dr. Patton is "large enough" to allow a supplier with game theory skills to outplay an automated

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[10] OMS teleconference with Dr. Patton, September 27, 2007
[11] Market Power Study, Exhibit 1, at 36-37
[12] Market Power Study, Exhibit 1, at 37

computer code during certain hours of the year when a transmission constraint is binding. As explained above, a pivotal supplier does not need to exercise market power the entire domain of hours when it is pivotal to extract excessive profits.

The OMS disagrees with Dr. Patton as to what threshold should trigger a conduct test in a particular operating reserve zone. The OMS, therefore, proposes that an increase of $10 per MW/hour be used as the defined economic threshold for each of the two products (Regulating and Contingency Reserves) in each operating reserve zone during the initial 90-day period. At the conclusion of the 90-day period, Dr. Patton should report to the Commission and OMS on the behavior of the suppliers in each of the operating reserve zones for each of the two products. If the results of the first report indicate "fair game" behavior, the OMS proposes allowing the economic threshold to increase to $20 per MW/hour (a $10 increase from the previous threshold) during the following 90-day period. If, on the other hand, the results indicate the exercise of market power by certain pivotal suppliers for a large number of hours in a specific operating reserve zone for a specific product, the OMS proposes freezing the economic threshold at $10 per MW/hour for an additional 90-day period in that particular operating reserve zone for that particular product. The OMS proposes that the Commission direct the Independent Market Monitor (IMM) to use this iterative procedure in each reserve zone for each product, and authorize the IMM to increase or decrease the economic threshold by $10.00 until the economic threshold reaches $50.00 and the OMS receives four consecutive quarterly reports concluding "fair game" behavior in the ancillary services markets. If all goes well, at the completion of the fourth quarter post the commencement period of the ancillary services markets, the $50 per MW/hour threshold proposed by Dr. Patton will be reached.

In conclusion, the OMS finds that the conduct test submitted by Dr. Patton is incomplete and unpersuasive. The analysis raises more questions than it provides answers. The Commission must take into consideration that the IMM's analysis shows a Midwest ISO ASM rife with pivotal suppliers and the potential for market power abuse. The OMS is not convinced that an ASM market with mitigation using $50 per MW/hour thresholds affords sufficient protection to approve market-based rates. Under the Midwest ISO's proposal, it is not clear that mitigation and the use of market mechanisms would be less costly for customers than using a cost-based approach. Recognizing that the Commission and national policy have embraced the market approach that Midwest ISO's proposal depends on, the OMS urges the Commission to approve a tighter threshold, such as the one proposed above, for monitoring the exercise of market power be used. Without a tighter threshold, the illustrative analysis results presented by Dr. Patton indicate that the net benefits of moving to a market-based ASM approach that the Midwest ISO has estimated elsewhere will likely be significantly degraded. The OMS is concerned that there be no degradation in net benefits as a result of moving to market-based ASM.

Potomac Economics, the firm that conducted the ASM market power analysis here for the Midwest ISO, concluded earlier in 2007 that TXU Corporation likely manipulated Texas' electricity balancing market[13] The OMS notes, that in the market power analysis provided for the Midwest ISO, Potomac Economics provides no factual insight based on its experience in Texas or anywhere else it is a market monitor that a $50 per MW/hour threshold is appropriate or

[13] **"TXU Charged with Price Manipulation:** The Texas Public Utility Commission proposed a $210 million fine against TXU after a market monitor's report alleged economic withholding of generating capacity to raise prices in ERCOT's balancing market to levels as high as $200/MWh or more above marginal costs during times TXU was a pivotal supplier (when demand in the market cannot be satisfied without the resources of this supplier). TXU denies the charges." From FERC web site in Section, "Electric Power Markets: Texas (ERCOT)," as updated September 13, 2007.

would protect rate payers. For the reasons stated above, the Commission should err on the conservative side and choose a threshold less than the proposed $50 per MW/hour value. This would give the markets a chance to work. Unlike the move to the Day-2 wholesale energy market when there was a transition period of cost-based bidding, the Midwest ISO has not proposed a transition period for the ASM. This provides ample foundation for using a lower starting value for mitigation with relaxation of that threshold only after successful demonstration that market forces are sufficiently strong to check the potential for market power abuse.

The third concern has to do with the "price creep" phenomenon. The OMS is concerned that certain pivotal suppliers in a particular reserve zone will endeavor to extract excessive profits within the economic bounds set by the conduct test by exercising market power during certain hours of the year using a delta that is below Dr. Patton's proposed $50 per MW/hour threshold. Such an occurrence has a long-term negative impact on the market as pivotal suppliers may be exercising market power and contributing to an increase in their 90-day historical bid-based averages that are used by the IMM in future conduct tests. Additionally, price creep in the uncompetitive operating reserve zones will erode any ratepayer benefits that are derived from market-based ancillary services procurement. The OMS is not satisfied with the answer regarding the potential for suppliers with market power for the majority of hours during a year to have substantial reference price creep. The OMS, therefore, recommends that the Commission direct Midwest ISO and Dr. Patton to provide a detailed discussion of how Dr. Patton intends to monitor the price creep phenomenon and to include this discussion and his findings in each of the 90-day reports to the OMS during the first year of ancillary services market implementation.

iii. Physical Withholding

With regards to the issue of monitoring physical withholding, Dr. Patton states:

> Physical Withholding will affect both Energy Markets and Ancillary Services Markets, and the existing thresholds in the Midwest ISO Tariff are adequate to identify such conduct.[14]

The simultaneous monitoring and co-optimization of both the energy and ancillary services markets will significantly increase the complexity of the IMM's task. Accordingly, Dr. Patton's above statement appears to be too generic. The OMS urges the Commission to require Dr. Patton to provide a more formal and detailed explanation regarding the specific method and criteria that he intends to employ in auditing and identifying suppliers that physically withhold power in both the energy and ancillary services markets.

iv. Proposed Use of Reference Prices in Reserve Zones

The Midwest ISO proposes to run a quarterly "Reserve Zones" study that will incorporate transmission constraints and deliverability areas in order to ensure reliability.[15] According to the Midwest ISO, the resulting operating reserve zones may change quarterly based either on the outcome of the constraint analysis or on the Midwest ISO's proposal to require operating reserve "dispersal" across the Midwest ISO footprint.[16] As a result, a supplier physically located in one operating reserve zone during a particular quarter may be physically located in an alternative reserve zone during another quarter. The OMS is concerned that changes in the reserve zones may compromise the integrity of the proposed Conduct and Impact tests. Specifically, the OMS questions whether it is appropriate to use for a generating unit's reference price the historical

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[14] Market Power Study, Exhibit 1, at 36

[15] Midwest ISO Ancillary Services Markets Proposal Resubmission, Transmittal Letter, Docket No. ER07-1320-000, dated September 14, 2007, at 10, 37-39; *See* MIDWEST ISO Proposal, Attachment E, Testimony of Roy Jones; *See also*, Midwest ISO Proposed Tariff Sections 39.2.1A.c and 40.2.3.c.

[16] The OMS acknowledges that even though quarterly zones are not as accurate, they provide certainty of geographic market boundaries. This partially addresses a previous OMS concern in the original filing about the inability of market participants to hedge. [cite] The quarterly reserve zones better provide that hedging ability. On balance, the OMS views this use of longer-term quarterly reserve zone determinations as a positive change from the Midwest ISO's original proposal.

bid-based average of a unit that was located in reserve zone A during quarter 1, for a conduct test during quarter 2 if that unit is now located in reserve zone B. The OMS proposes that if such a scenario does occur, that the historical cost-based average of the unit be used rather than its bid-based average as its reference price. This is consistent with what Dr. Patton is proposing to use as reference prices for the first 90-day transition period post ancillary services market implementation.

v. The Disappearance of Section 50.4 from Module D of the Tariff

It its filing, the Midwest ISO proposes tariff sheets that delete Section 50.4 from Module D of its Tariff relating to the independence of the Independent Market Monitor. The deleted section states:

> **50.4 Independence of Market Monitoring**
> The IMM shall be granted complete independence to perform those activities necessary to provide impartial and effective market monitoring within the scope of the Plan. No person, party or agent, including the Transmission Provider, State Regulatory Commissions, or any other administrative oversight group responsible for the administration of the IMM activities, shall be granted authority to screen, alter, delete, or delay IMM investigations or the preparation of findings, conclusions, and recommendations developed by the IMM that fall within the scope of market monitoring responsibilities contained in the Plan. (Sheet No. 706)

The OMS discussed this omission during the MSC/ASM Market Power Study Review conference call with Dr. Patton on September 27, 2007. The Midwest ISO stated that that the deletion was an inadvertent error that would be corrected upon compliance. As a follow up, the Midwest ISO notified stakeholders via e-mail on October 1, 2007, that the deletion was inadvertent, and that the Midwest ISO will respond in its Answer to any comments on this deletion that the deletion was an error and that the Midwest ISO commits to correcting the error at the time of its compliance filing in the ASM proceeding. Given the importance of this section, the OMS requests that the Commission direct the Midwest ISO to correct this error.

B. Regulation Reserve Tolerance Band and Excessive/Deficient Energy Issues

The Midwest ISO proposes a tolerance band for generation resources providing regulating reserves of +/- four percent of the sum of the average dispatch target for energy for the resource plus the average regulation deployment instruction for the resource, if applicable, in the dispatch interval.[17]

The OMS recognizes that the tolerance band must strike a balance between meeting the technical requirements of the regulation product and allowing more participants for a competitive market. However, the Midwest ISO provides little support regarding the optimality of the proposed tolerance band of +/- four percent with a 6 MW minimum and a 20 MW maximum limit. This a point of concern for the OMS because, as Mr. Jones states in his testimony, a band that is too wide will result in an increase in the required amount of regulating reserve to be procured by the Midwest ISO to comply with the ERO standard and increase costs to customers.[18] On the other hand, a tolerance band that is too narrow will result in fewer resources and less diversity of market participants.

Mr. Jones explains that the proposed tolerance bands were developed by examining confidential performance data submitted by resources currently providing regulating reserves.[19] However, Mr. Jones also states that his analysis of the data showed that generation resources had the ability to operate successfully at various tolerance bands. While the Midwest ISO ultimately determined that the +/- four percent band was "appropriate", Mr. Jones does not explain why it is appropriate. Beyond stating that it believes that a +/- four percent band is appropriate, the

[17] Attachment E, at 114
[18] Attachment E, at 115
[19] Attachment E, at 115

Midwest ISO filing provides little supporting evidence regarding the optimality of the proposed +/- four percent band.

The OMS acknowledges that the data used by the Midwest ISO to develop the proposed tolerance band is confidential. However, given that the Commission's current data access provisions preclude the OMS from obtaining confidential data to verify the claims of the Midwest ISO, the OMS requests that the Commission require the Midwest ISO to provide an analysis, by owner or generator type and size if possible, of the impact of a 2% vs. 4% tolerance band on the number and diversity of market participants for the purpose of stakeholder review. If this is not possible, the OMS strongly urges the Commission to complete a thorough investigation into the optimality of the proposed regulation tolerance band. If the Commission's analysis concludes that the proposed band is not well-designed, then the Commission may want to consider an alternative approach to ensure the Midwest ISO procures the optimal level of regulating reserves and that generators committed to providing regulating reserves actually provide such reserves to the extent possible. Alternatives might include different tolerance bands based on generator type or unit size.

Regardless of the approach, the establishment of the tolerance band must be developed in conjunction with the penalties/charges for failing to meet the tolerance band to minimize "free-riding" generators, *i.e.*, those committed to providing regulation service and getting paid to provide regulation service, but not actually providing the regulation service that they are committed to and being paid for. Mr. Jones explains that any regulating reserve generation resource that fails to follow its set point instructions in three or more consecutive five-minute dispatch intervals within any single hour will be subject to excessive/deficient energy deployment charges.[20] This effectively means that a generator providing regulating reserve can fail to meet its set point requirement within the tolerance band in two-thirds (66 percent) of the dispatch intervals without being subject to the excessive/deficient energy deployment charge. The OMS questions the use of a standard that permits a resource to fail two-thirds of the time to provide the service at the levels it is committed to provide and being paid to provide, especially considering that the proposed tolerance band has been doubled to +/- four percent to make it easier to track the set point target.

If the Commission finds the above-mentioned standard acceptable, the OMS suggests an additional standard. In addition to the current standard requiring the generator to stay within the tolerance band around its set point requirement in three or more consecutive five-minute dispatch intervals within any hour or face the excessive/deficient energy deployment charges, the OMS proposes a new standard that would also expose the generator to the excessive/deficient energy deployment charge if it fails to stay within the tolerance band around its set point requirement for a given number of dispatch intervals within any hour, regardless of whether or not they are consecutive occurrences. Under this approach, it might be reasonable to allow a resource to deviate outside the band three to five times before the additional penalty would be applied.

Mr. Jones also states that the hourly values of excessive/deficient energy will be incorporated into the calculation of the real-time sufficiency guarantee (“RSG”) charges so that market participants with resources that have hourly excessive and deficient energy are charged a portion of the real-time sufficiency guarantee costs.[21] The implication of applying RSG charges to generators with hourly values of excessive/deficient energy as a penalty for excessive/deficient energy or as an inducement for generators to reduce excessive/deficient

[20] Attachment E, at 114
[21] Attachment E, at 114

energy is not adequately explained in the MIDWEST ISO filing. The OMS urges the Commission to require Midwest ISO to clarify this point.

Mr. Jones states that hourly excessive energy is credited at the lesser of the hourly offer cost associated with that energy or the hourly ex post LMP, whichever is less.[22] He states that deficient energy is credited at the hourly ex post LMP. The implication of this compensation arrangement as a penalty or as an inducement for generators to reduce excessive/deficient energy is not explained in the Midwest ISO filing. The OMS urges the Commission to require Midwest ISO to clarify this point.

Finally, Mr. Jones describes how the excessive/deficient energy deployment charge will be calculated and applied.[23] However, Mr. Jones' explanation of the calculation and application of this charge is not clear. The OMS urges the Commission to require Midwest ISO to clarify that discussion.

C. Demand Curves, Scarcity Pricing and Proper Financial Incentives

One of the key elements of ASM design is scarcity pricing implemented through the use of demand curves. According to Midwest ISO, the demand curves determine the price during periods of scarcity and thus send the appropriate price signals with respect to the value of those Operating Reserves.[24] Midwest ISO explains that Demand Curves are used in the market clearing process to represent the incremental reliability value of Capacity and Regulation Capability to the market at various deficiency levels on both a market-wide and zonal basis. 25 The scarcity prices thus produced "provide the correct price signal in both the short-term and

[22] Attachment E, at 116-117
[23] Attachment E, at 121
[24] Cover letter page 8
[25] Affidavit of Roy Jones, Exhibit No. E, page 54

long-term for Capacity and Regulation Capability."[26] In other words, the demand curves are what make Midwest ISO's Ancillary Services Market proposal work.

The Commission has directed Midwest ISO to file a long-term resource adequacy plan later this year, saying,

> The long-term resource adequacy plan due to be filed as Phase II should address giving the proper financial incentives such that new generation entry is economically feasible based on all revenues received from the Midwest ISO's market, including scarcity payments. [27]

The Commission later said that it expects the plan to "support the region's short-term reliability needs, and that it will encourage long-term planning and infrastructural investments" [28]

The proposed Demand Curves are central to providing the proper incentives. They may in fact be the single-most important item to be to be considered in the evaluation of Midwest ISO's markets design. While the OMS does not quarrel here how the curves are utilized in the market clearing process, we question the derivation of the curves, and Midwest ISO's choice for the prices used for setting those curves. To be clear, the curves must be properly derived such that the resulting prices provide the proper short-term and long-term financial incentives.

Midwest ISO must show how the demand curves and their respective pricing points provide those incentives. Midwest ISO has not yet done that. Midwest ISO has not demonstrated in this filing that the prices and the resulting demand curves used to provide the proper incentives for short-term reliability will also provide the proper incentives for longer-term resource adequacy. Midwest ISO must eventually tie this all together to demonstrate that the curves are properly set for both. OMS therefore asks that the Commission specifically condition any approval of the demand curves, offer caps, and VOLL on the Commission's findings resulting

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[26] Id at page 95
[27] ER07-550-000 6/22/07 Order at P 137
[28] 9/18/07 Order Granting Extension of Broadly Constrained Areas, ER07-1182-000 at P 37

from Midwest ISO's demonstration, in its Long-Term Resource Adequacy filing, that the prices and the resulting demand curves used to provide the proper incentives for short-term reliability will also provide the proper incentives for longer-term resource adequacy.

Midwest ISO's proposed demand curves are used to determine a market-clearing price based on finding the intersection of a supply curve to a demand curve. The supply curve consists of offers from resource providers that are arranged in economic order. The "demand" curve, however, is not based on demand bids, but instead set on prices that the Midwest ISO's thinks are the highest supply costs to supply operating reserves.[29] The various points on the demand curves are essentially proxies for demand bids. Midwest ISO has developed them from prices based on the existing energy and proposed ancillary services offer caps and its best estimate of the Value of Lost Load (VOLL).[30] Until Midwest ISO demonstrates how the resulting market prices provide the proper financial incentives in the bigger picture of long-term resource adequacy, the selection of these price levels, and the resulting demand curves, appear arbitrary. With the potential for market power in reserve zones, there is as much risk that prices will be too high as there is that prices will be too low.

When priced properly, Midwest ISO's energy and ancillary services markets, when added to other revenues, should provide prices that are high enough to "allow for the recovery of needed and prudent investment costs" but are not so high as to be unjust and unreasonable. [31]

Midwest ISO is still working on future changes to its tariff that will affect the success and pricing of Midwest ISO's markets. Examples include more effective participation of demand

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[29] Affidavit of Roy Jones at page 99
[30] $100/MW/Hour offer cap for contingency reserves, $500/MW/Hour offer cap for regulating reserves, $1,000/MWh offer cap for energy, and $3,500/MWh average outage cost for the Value of Lost Load (VOLL)
[31] 9/18/07 Order Granting Extension of Broadly Constrained Areas, ER07-1182-000 at P 35

response and the Long-Term Resource Adequacy Plan. [32] The resolution of these issues will have an impact on revenues from the Midwest ISO-run markets and other sources, and may require Midwest ISO to revise its demand curves. The OMS therefore requests the Commission and Midwest ISO to consider the development of Midwest ISO's markets as ongoing and subject to further changes.

Midwest ISO proposes to "work with Market Participants during the first year of Energy and ASM operation to determine methods to be use to update the VOLL in the future." [33] This is not enough. The OMS urges the Commission to direct Midwest ISO to work with stakeholders on ALL of the inputs to the demand curve by also considering changes in offer caps and any other changes towards revising the demand curves to provide the proper financial incentives.

D. ASM Cost Allocation

In its Guidance Order, issued June 22, 2007, the Commission found the Midwest ISO's cost allocation proposal in its February 15 filing "to be generally acceptable,"[34] stated that "it would be beneficial for the Midwest ISO to continue discussions with stakeholders on cost allocation issues . . ."[35]. The OMS on August 10, 2007, sought clarification that the Commission did not intend its statements to constitute approval of the Midwest ISO's February 15 cost allocation proposal and to keep the door open to alternative cost allocation proposals on re-filing. Consistent with the OMS interpretation that the Commission invited further discussion and refinement on the cost allocation proposal, the Midwest ISO invited and considered alternative cost allocation methods and facilitated analysis and stakeholder consideration of these

[32] For example, the Midwest ISO expect to file a tariff revision to provide for emergency demand response procedures

[33] Roy Jones Affidavit at page 105.

[34] Guidance order at footnote 70

[35] *Id*. at P 106.

alternatives. The OMS commends the Midwest ISO for its open and timely process that led to a new "hybrid" methodology that was submitted in the September 14 filing.

The OMS commends the Midwest ISO for moving in the right direction and supports a hybrid approach. [36] The hybrid approach is a middle ground approach and although it is a more superior approach than the Load Ratio Share (LRS) socialization approach included in the original ASM filing, it may not necessarily be the most cost causative approach for allocating ASM costs. As a result, the OMS urges Commission to direct the Midwest ISO to analyze the results of the allocation methodology one year following the start of the ASM market and provide a report to its stakeholders, broken down into each quarter or timeframe the reserve zones are static, that provides the following; 1) a description of the zones that were created and the dates the reserve zones were in effect, 2) the average AS cost (MCP * Cleared OR) for each product in each zone and non-zone, 3) the average revenues from each zone and non-zone, 3) the reasons the reserve zones were created, 4) a table showing what each zone and non-zone would have paid under the original LRS allocation proposal, the August 17, 2007 Market

[36] The Ohio Commission supports the original hybrid methodology that was voted on and approved at the Midwest ISO August 17, 2007 Market Subcommittee (MSC) meeting. The original hybrid methodology was proposed by the Midwest ISO as a middle ground solution that eloquently blended the pure load ratio share approach that was included in the original ASM filing and a pure zonal approach. While the original hybrid approach may not be perfect, it was a step in the right direction, unfortunately, the original hybrid approach was not included in the September 14, 2007 ASM filing, but rather a modified version of the hybrid proposal was included. While the original hybrid approach moved the allocation closer to a more appropriate allocation of costs, the modified hybrid proposal moves the allocation methodology back towards the load ratio share (socialization) methodology, thus diminishing some of the progress made in developing the original hybrid approach, which is a better and more cost causative allocation methodology.

The Ohio Commission commends the Midwest ISO for taking necessary action with its stakeholders to develop a better allocation methodology, however; Ohio is discouraged with the two-step forward, one-step back modified hybrid approach that was ultimately filed. Ohio urges FERC to direct the Midwest ISO to implement its original hybrid allocation approach, as approved at the August 17, 2007 MSC meeting.

Subcommittee (MSC) approved hybrid proposal, a pure zonal approach, and finally what each zone and non-zone paid under the modified hybrid proposal included in the Sept 14 ASM filing. The Midwest ISO should also include any recommendations it may have as a result of its analysis, with the ultimate goal of allocating costs on a cost causation basis; providing better ASM hedging opportunities for the Market Participants.

IV. Notice of Intervention

Pursuant to Rule 214(a)(2) of the Federal Energy Regulatory Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(a)(2), the Organization of MIDWEST ISO States files Notice of Intervention in this proceeding. Service of pleadings, documents, and communications should be made on the following:

William H. Smith, Jr.
Executive Director
Organization of MISO States
100 Court Avenue, Suite 218
Des Moines, Iowa 50309

V. Conclusion

The OMS respectfully requests that the Commission consider the above comments.

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

Illinois Commerce Commission
Indiana Utility Regulatory Commission **
Iowa Utilities Board
Kentucky Public Service Commission

Michigan Public Service Commission
Minnesota Public Utilities Commission
Missouri Public Service Commission **
Montana Public Service Commission
Nebraska Power Review Board
North Dakota Public Service Commission
Public Utilities Commission of Ohio
South Dakota Public Utilities Commission
Wisconsin Public Service Commission

The Manitoba Public Utilities Board and the Pennsylvania Public Utility Commission did not participate in this pleading. The Illinois Citizens Utility Board, the Indiana Office of Utility Consumer Counselor, the Iowa Office of Consumer Advocate, and the Minnesota Department of Commerce, as associate members of the OMS, participated in these comments and generally support these comments.

Respectfully Submitted,

William H. Smith, Jr.

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Dated: October 15, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Des Moines, Iowa, this 15th day of October, 2007.

William H. Smith, Jr.

DRAFT 10/05/07

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

American Electric Power Service Corporation v. Midwest Independent Transmission System Operator, Inc., and PJM Interconnection, L.L.C.	))))))	Docket No. EL07-101-000
Midwest Independent Transmission System Operator, Inc.	))	Docket No. ER05-6-100
Midwest Independent Transmission System Operator, Inc., PJM Interconnection, L.L.C., et al.	))	Docket No. EL04-135-003
Midwest Independent Transmission System Operator, Inc., PJM Interconnection, L.L.C., et al.	))	Docket No. EL02-111-120
Ameren Services Company, et al.	)	Docket No. EL03-212-116

COMMENTS OF THE ORGANIZATION OF MISO STATES, INC.

I. Introduction

Pursuant to Rule 211 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or "Commission"), 18 CFR 385.211, the Organization of MISO States ("OMS") hereby respectfully submits the following comments in the above-captioned dockets for the Commission's consideration.

II. Summary of AEP's Complaint

On September 17, 2007, American Electric Power Service Corporation, on behalf of certain operating companies of the American Electric Power System (collectively "AEP"), submitted a Complaint challenging the rate designs underlying the open access transmission tariffs ("OATTs") of PJM Interconnection, L.L.C. ("PJM") and the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO" or "MISO"). AEP alleges that the rate designs in the PJM and Midwest ISO OATTs are unjust, unreasonable, and unduly discriminatory and must be revised.[1] AEP proposes a replacement rate design that would share the costs of all existing and new "backbone" extra-high voltage ("EHV") transmission facilities[2] across the combined PJM/Midwest ISO Super Region.[3] AEP proposes that the costs of existing and new transmission facilities under 345 kV be allocated using the zonal license plate rate approach; *i.e.*, to the customers of the zone with which the facilities are built or located.[4]

AEP requests that the Commission initiate hearing procedures to allow for the development of a record that will support a just and reasonable and not unduly discriminatory transmission rate design for the Super Region.[5] AEP requests that the Commission establish a refund-effective date of October 1, 2007 for any rate changes.[6] AEP suggests February 1, 2008, as a second-best alternative refund effective date because that date would track the Commission's November 2004 Order, which set February 1, 2008 as the date for a reevaluated transmission rate design to take effect for transactions between PJM and Midwest ISO.[7]

AEP requests that its Complaint in the instant docket be consolidated with the ongoing proceedings in Docket Nos. ER05-6-100, *et al.*, which, according to AEP, raise issues similar in

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[1] AEP Complaint at 48.
[2] AEP defines EHV facilities as facilities at voltage levels of 345 kV and above.
[3] AEP Complaint at 4.
[4] AEP Complaint at 10.
[5] AEP Complaint at 4.
[6] AEP Complaint at 48.
[7] AEP Complaint at 49.

law and fact.[8] In Docket Nos. ER05-6-100, *et al.*, the Commission is considering an August 1, 2007 filing by PJM, the Midwest ISO, and certain PJM and Midwest ISO transmission owners (the "August 1 Filing"). The August 1 Filing was a response to the Commission's November 2004 Order that directed PJM and the Midwest ISO to formally reevaluate their cost allocation and rate design policies as applied to transmission facilities and to make a filing by August 1, 2007, proposing a transmission rate design to take effect February 1, 2008. The August 1 Filing describes what the filing parties in that case call the Independent RTO Pricing Design ("IRPD").[9] AEP argues that it would be inefficient to litigate in a separate docket, when the Commission already has an ongoing proceeding in which the PJM and Midwest ISO transmission rate designs and transmission cost allocation methods are at issue.[10] AEP states that the consolidation of its Complaint with the proceedings in Docket Nos. ER05-6-100, *et al.*, will not delay or disrupt the Commission's action on the August 1 Filing.[11]

AEP argues that it has built the most extensive transmission network in the Eastern Interconnection – a system that AEP claims provides service and benefits to consumers throughout the PJM/Midwest ISO Super Region.[12] AEP claims that its transmission system is located at the center of PJM and the Midwest ISO and integrates the two RTOs and supports their electric power markets.[13] AEP also claims that its existing transmission system facilitates the major new EHV projects that are planned for the Super Region.[14] AEP states that, despite these circumstances, the current PJM and Midwest ISO transmission rate designs "allocate the

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[8] AEP Complaint at 53-54.
[9] OMS submitted Comments on the IRPD filing on September 17, 2007.
[10] AEP Complaint at 54.
[11] AEP Complaint at 54.
[12] AEP Complaint at 2.
[13] AEP Complaint at 2.
[14] AEP Complaint at 4.

costs of AEP's existing EHV system exclusively to transmission customers within the AEP footprint."[15] AEP asserts that the current PJM and Midwest ISO transmission rate designs and cost allocation methods do not fairly allocate the costs of owning, operating, and maintaining AEP's EHV transmission system among the beneficiaries of that system.[16] AEP states that it is unjust and unreasonable to allow PJM and Midwest ISO customers to continue to use and benefit from the existing AEP EHV system without sharing in the costs of that system.[17] AEP recommends that the Commission acknowledge these core principles and direct the Super Region's participants, with the assistance of a Settlement Judge, to (once and for all) forge a regional consensus on the permanent rate design for which the Commission has been searching for more than half a decade.[18]

III. Summary of the OMS's Position and Recommendation in the Post Transition Transmission Pricing Proceeding

In its Comments submitted September 17, 2007, in Docket Nos. ER07-1233-000, ER07-1261-000, and ER05-6-100, *et al*. ("OMS PTTP Comments"), the OMS provided its advice and recommendations regarding transmission rate design issues similar to, or identical to, those raised by AEP in its Complaint in the instant docket. In those Comments, the OMS generally supported retention of the license plate rate design approach for existing transmission facilities within the Midwest ISO. The OMS also generally supported the stated rationale for retaining the current RECB methodology for new transmission facilities constructed in the Midwest ISO

[15] AEP Complaint at 3.
[16] AEP Complaint at 3.
[17] AEP Complaint at 4.
[18] AEP Complaint at 5.

region while urging the Midwest ISO and its stakeholders to continue to analyze and look at enhancements for the RECB methodology.[19]

In its PTTP Comments, the OMS also expressed support for the PJM/Midwest ISO IRPD proposal for transmission pricing between the RTOs and urged the Commission to accept it.[20] The PJM/Midwest ISO IRPD proposal would maintain the elimination of both rate pancaking and transaction-based pricing for transmission services sourcing in one RTO and sinking in the other.[21] Under the IRPD, network and firm point-to-point transmission customers would continue to pay the applicable zonal license plate charge in their sink zone regardless of whether their designated resources are located in their RTO or in the other RTO.

With respect to new "cross-border" transmission facilities (i.e., jointly planned facilities built entirely or partially in one RTO but providing benefits in the other RTO), the IRPD proposal would allocate the costs of such new facilities between the Midwest ISO and PJM in whatever way is finally determined in Docket No. ER05-6-000, *et al*.[22] The OMS noted that a filing has already been submitted to the Commission in that docket with respect to cross-border reliability projects and will be made with respect to cross-border economic projects.[23]

IV. Position and Recommendation of the OMS on AEP's Complaint

The OMS urges the Commission to dismiss the AEP Complaint.

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[19] The OMS noted that the RECB methodology has only been in place for a short period of time and took the position that it is simply too early to assess the continued effectiveness, justness, or reasonableness of the RECB cost allocation methodology. Some OMS States submitted different positions on this issue, particularly with respect to RECB's 20% region-wide cost sharing component. For example, the Illinois Commerce Commission does not support the 20% region-wide cost sharing component of RECB II. Wisconsin does not hereby waive any of its rights, claims and arguments regarding the propriety of costs recovered by RECB, the subject of pending litigation in the United States Court of Appeals for the D.C.Circuit.

[20] OMS PTTP Comments, at 11. The OMS did acknowledge that AEP's comments on the IRPD filing did "raise some thought-provoking issues." AEP has reiterated, elaborated on, and extended some of those issues in its Complaint in the instant docket.

[21] IRPD Filing at 9-10.

[22] IRPD Filing at 9.

[23] IRPD Filing at 9.

Commission acceptance of AEP's position and recommendation in the instant Complaint docket would upset and undo each of the transmission rate design aspects that the OMS supported in its recent PTTP Comments. First, the beneficiaries-based and cost causation-based RECB rate design for newly constructed transmission facilities within the Midwest ISO would be replaced with an approach that would share the costs of all new Midwest ISO transmission facilities of 345 kV and greater across the PJM/Midwest ISO Super Region on a load ratio share basis. Second, the costs of all new PJM transmission facilities of 345 kV and greater, regardless of whether or not they are determined to provide cross-border benefits, would be shared across the PJM/Midwest ISO Super Region on a load ratio share basis. Third, rather than retaining the zonal license plate rate approach for recovering the costs of all existing transmission facilities in the Midwest ISO region, the AEP proposal would retain that approach only for existing facilities under 345 kV and would share the costs of all existing Midwest ISO and PJM transmission facilities of 345 kV and greater across the PJM/Midwest ISO Super Region on a load ratio share basis.

While AEP makes some interesting points in its Complaint filing, as it did in its Comments on the PTTP filings, the best response to those points is the one previously recommended by the OMS in its PTTP Comments. Specifically, the OMS recommended that the Commission adopt "a new transition period of three or four years before the end of which the Commission would require a new re-examination of the continued reasonableness of using the zonal license plate rate methodology across the Midwest ISO and PJM."[24][25] The OMS

[24] OMS PTTP Comments at 11.

[25] The Indiana Utilities Regulatory Commission does not support a transition period that would involve another evaluation of the allocation of the costs of **existing** transmission facilities. These facilities were built and funded to deliver power from the utilities' generation to their loads, and allocating the costs of these facilities to those ratepayers for whom the facilities were built satisfies the basic cost causation principle. In

recommended that the Commission direct the RTOs and their stakeholders to work during the new transition period to develop and fine-tune metrics to quantify and measure benefits of existing, as well as new, transmission facilities. Similarly, the OMS expressed support for the regular, continued re-evaluation of the effectiveness of whatever cost allocation policy is developed for new cross-border transmission facilities.[26] Commission adoption of these recommendations would be responsive to the points raised in AEP's Comments in the PTTP docket and to AEP's Complaint in the instant docket.

V. Discussion

A. AEP's Complaint Does Not Identify Specific Beneficiaries or Quantify the Extent of Their Benefits.

AEP's Complaint fails, among other reasons, because AEP does not adequately support its assertions regarding the specific beneficiaries of AEP's transmission system. For example, AEP states that the AEP system "provides service and benefits to consumers throughout the combined region."[27] AEP provides a laundry list of arguments (asserted as "facts") that "transmission customers throughout PJM and the Midwest ISO benefit from AEP's strong EHV transmission system."[28] AEP states that its proposal "is just and reasonable because it ensures that the costs of facilities that support the integration of the Super Region are allocated to those who use, benefit from and depend on those facilities."[29] AEP states that its extra high voltage EHV transmission facilities "serve as the platform for the electricity markets that have developed

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addition, the IURC does not support a re-examination of the allocation of the costs of facilities built or under construction during the OMS proposed transition period. However, the IURC would support a re-examination for new facilities that have not yet been constructed.

[26] OMS PTTP Comments at 11.

[27] AEP Complaint at 2, underlining added.

[28] AEP Complaint at 24-32, underlining added.

[29] AEP Complaint at 39, underlining added.

in the region and <u>thus benefit market participants throughout the Super Region</u>."[30] Similarly, AEP's witness J. Craig Baker states,

> The Commission's refusal to implement a fair allocation of the cost of existing regional backbone facilities, coupled with its earlier elimination of T&O rates within the combined MISO-PJM region, would unfairly and unjustly allocate to the owners of the backbone facilities and their customers the entirety of the cost of these facilities even though the facilities <u>undoubtedly are used by and benefit third parties</u>.[31]

Despite this litany of assertions as to benefits and beneficiaries (AEP alternatively identifies the category of beneficiaries as customers, consumers, or market participants), AEP does not once <u>specifically</u> identify any particular beneficiaries, or quantify the extent of the benefits allegedly received by each likely beneficiary. AEP asserts that "the benefits derived by PJM and MISO customers who use the AEP EHV transmission system should be recognized in the design of transmission rates, even if the benefits are deemed to be 'general.'"[32] AEP witness Mr. Baker directly admits that "AEP did not attempt to show the extent to which each specific customer within the region used and benefited from backbone facilities.[33] Indeed, Mr. Baker claims that providing such a quantification or measurement of the asserted benefits that beneficiaries receive would be "futile."[34] Mr. Baker states that, "[w]hile we do not attempt to show that every 345 kV and above facility in the region will equally benefit every load in PJM and MISO, we have shown that the benefits of these facilities are 'sufficiently broad' to support an allocation of costs among customers throughout the Super Region."[35]

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[30] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 4, underlining added.
[31] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 38, underlining added.
[32] AEP Complaint at 35.
[33] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 20.
[34] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 20.
[35] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 21.

AEP cites the Commission's Opinion No. 494 as support for its assertion that an indication of generalized benefits is sufficient to support the regionalization of transmission facilities costs.[36] AEP cites the following Commission statement in Opinion No. 494 regarding the costs of new centrally planned PJM transmission facilities of 500 kV and above:

> In adopting a postage stamp allocation for new facilities at 500 kV and above, we do not suggest that every 500 kV project will benefit every load in PJM in equal measure. Nor are we required to find that every customer will benefit equally from every project. Rather, we need to find and we do find only that the benefits of such facilities are, as described above, sufficiently broad that they support a postage stamp allocation.[37]

However, this Commission statement from Opinion 494 is currently pending rehearing.[38] Furthermore, as AEP itself points out, Opinion No. 494 is internally inconsistent on the issue of the sufficiency of a showing of "generalized benefits."[39] Assertions of generalized benefits are not a sufficient basis upon which to allocate or re-allocate billions of dollars worth of transmission facilities costs.

AEP's witness, Mr. Baker testifies that, "A properly designed regional rate should distribute transmission costs commensurate with the benefits of participating in a broad regional market."[40] The OMS would go further to assert that a proper regional rate design would allocate the costs of new transmission facilities in direct proportion to the demonstrated, quantified benefits expected to be received by identified beneficiaries. In any event, AEP has not made either demonstration in its Complaint. Mr. Baker states that, under AEP's proposal, cost responsibility for transmission facilities is "assigned to those who use or benefit from such

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[36] AEP Complaint at 34.
[37] *PJM Interconnection L.L.C.*, Opinion No. 494, 119 FERC ¶ 61,063 at P 81 (2007) ("Opinion No. 494") (requests for rehearing pending).
[38] See *e.g.*, Request for Rehearing of the Illinois Commerce Commission.
[39] AEP Complaint at 34, footnote 53.
[40] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 34.

facilities, regardless of whether those users or beneficiaries are located inside or outside the transmission owner's footprint."[41] However, as the prior discussion of "generalized benefits" demonstrates, AEP's proposal does not identify specific beneficiaries or quantify the extent to which they are alleged to benefit and it does not specifically assign costs to those who benefit, but rather, arbitrarily allocates costs to all zones in the PJM/Midwest ISO Super Region on a load ratio share basis. The OMS suggests that the consumers of Montana or South Dakota would find it surprising to be charged the costs of new or existing transmission facilities in Maryland and Delaware—and vice versa.

B. The Remedy for Inefficient and Unfair Transmission Cost Socialization is <u>Not</u> Increased and Expanded Transmission Cost Socialization.

AEP describes the error of transmission cost socialization in its own Complaint filing that advocates transmission cost socialization. AEP states that the Commission's decision in Opinion No. 494 to socialize the costs of <u>new</u> 500 kV and above facilities in PJM means that AEP Zone customers will be paying approximately $90 million per year for transmission projects authorized by PJM in its 2006 and 2007 planning processes, even though AEP zone loads do not require these facilities and they will not directly benefit AEP Zone customers.[42] AEP states that such a rate design "penalizes" AEP Zone customers particularly because, at the same time, AEP customers will also be paying for all of the costs of AEP's <u>existing</u> 345, 500, and 765 kV facilities, including the new Jacksons Ferry – Wyoming 765 kV line, which increases transfer capability into eastern PJM but was completed too early to qualify for treatment as a "new" facility under the allocation adopted in Opinion No. 494.[43]

In describing the Commission's Opinion No. 494, AEP' witness Mr. Baker states,

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[41] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 40-41.
[42] AEP Complaint at 32.
[43] AEP Complaint at 32.

> In addition, under the Commission's ruling in the April 19 Order, customers in the AEP East zone will bear a load ratio share of about 17% of the cost of new backbone facilities built in PJM (including AEP). While the western part of the PJM transmission grid is already well-developed, the eastern part is underdeveloped and congested. In fact, at least four major 500 kV and higher voltage transmission projects are planned to be added to reduce congestion and lower the delivered price of power in eastern PJM. Under PJM's prior beneficiary-pays method, no costs of those projects would have been allocated to the AEP East zone, but the new policy contained in the Commission's April Order means that AEP customers will pay 17% of the costs of those projects while they are being built and after they go into service. By the time they are completed, AEP customers will likely be paying $90 million per year for them. That amounts to another increase of almost 20% in the present rate that already went up 50% because of T&O revenue elimination. Again, it is unfair for AEP and its customers to be allocated a significant share of these new backbone facilities (with no benefits to AEP's zonal load customers) and at the same time be required to bear all the cost of the existing backbone facilities that permit the new projects to go forward.[44]

Similarly, in describing the effects of the Commission's Opinion No. 494, AEP witness Mr. Dennis W. Bethel describes the unfair results of arbitrary transmission cost allocation with clarity as follows:

> In fact, the Commission's decision to socialize new 500 kV and higher voltage facilities in PJM adds insult to injury. Already, customers in the AEP Zone are paying about $1 million per year for a new 500 kV line being built by Allegheny and Dominion, the TrAIL project (502 JCT to Loudoun, via Mt. Storm and Meadow Brook). The TrAIL project is estimated to cost approximately $850 million by the time it is completed, which is projected to be in mid-2011. PJM determined in the 2006 PJM Regional Transmission Expansion Plan ("RTEP") that AEP Zone customers are not responsible for the system loadings that require construction of the TrAIL project (or any of its costs), but by the time the TrAIL project is completed, under the existing rate structure, customers in the AEP Zone are expected to be paying about $30 million a year for the project. But, that is just the tip of the iceberg. Allegheny will also be building the Prexy – 502 JCT line, a $120 million project, which, like TrAIL, was approved in the 2006 RTEP, and found to be needed to address problems that are in no way related to service for AEP Zone customers. The 2007 RTEP includes two more east PJM projects that will be socialized, and are expected to cost $2.7 billion. All together, assuming annual costs of about $540 million (20% of installed cost), AEP Zone customers will be charged approximately $90 million per year (17% load share) for these

[44] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 37-38.

> 2006 and 2007 RTEP projects under the socialization concept approved by the Commission for 500 kV and higher facilities, even though PJM has not identified AEP Zone customers as beneficiaries.[45]

Finally, AEP witnesses Dr. Larry Blank and Professor Douglas Gegax state as follows:

> Similarly, it is unfair that AEP customers are being asked to contribute to the cost of transmission upgrades that eliminate congestion into eastern PJM (with no benefits to AEP's zonal load customers), while the customers in eastern PJM make no contribution to the costs of AEP's existing EHV network from which they benefit.[46]

Mr. Baker, Mr. Bethel, Dr. Blank, and Professor Gegax are absolutely right on this. It is unfair for AEP and its customers, as well as other PJM zones and their customers, to be allocated a load ratio share of the costs of these new 500 kV and above PJM facilities, especially because PJM has demonstrated that such facilities provide the customers in AEP's zone, and customers in other western PJM zones, absolutely no benefits—not even "generalized" benefits.

Nevertheless, despite identifying transmission cost socialization that is divorced from beneficiaries analyses as a problem, AEP proposes in its Complaint more transmission cost socialization that is divorced from beneficiaries analyses. In particular, AEP would increase the current amount of cost socialization of PJM facilities to include all new facilities between 345 kV and 500 kV (the costs of new PJM facilities of 500 kV and above are already shared pursuant to Opinion No. 494) and all existing transmission facilities of 345 kV and above. In addition, AEP would increase the amount of cost socialization of Midwest ISO facilities to include all new facilities of 345 kV and above (currently, only 20% if such costs are shared within the Midwest ISO pursuant to the RECB methodology) and all existing transmission facilities of 345 kV and above. Furthermore, AEP would expand cost socialization that is divorced from beneficiaries

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[45] Direct Testimony of Dennis W. Bethel, Exhibit AEP-200 at 21-22.
[46] Direct Testimony of Dr. Larry Blank and Professor Douglas Gegax, Exhibit AEP-400 at 19.

analyses from its current limited and separate implementation within PJM and the Midwest ISO, respectively, to all load in the combined PJM/Midwest ISO Super Region.

The Commission should not adopt AEP's flawed proposal.[47] The proper remedy for the inefficiency and unfairness that results from arbitrary transmission cost socialization is not increased and expanded arbitrary transmission cost socialization as proposed by AEP in its Complaint. Rather, the solution is the development and fine-tuning of benefits and beneficiaries metrics as recommended by the OMS, and allocation of costs pursuant to such beneficiaries metrics once their accuracy has been demonstrated to be reliable.

C. In Considering the Re-Allocation of Existing, Fixed Transmission Costs, Equity--Rather than Efficiency--Arguments and Analyses Will Be More Useful to Policymakers Deciding Transmission Cost Allocation Policy.

In their testimony, AEP witnesses Dr. Blank and Professor Gegax provide an academic discussion about the concept of "sunk costs."[48] Dr. Blank and Professor Gegax argue that the costs associated with existing transmission investments should not be viewed as "eternally" sunk. Dr. Blank and Professor Gegax cite Bonbright, Danielson, and Kamershen in *Principles of Public Utility Rates* (1988, pp. 30-31) for the precept that: "The essential characteristics of a sunk investment is that the productive capital facilities are so specialized as to location or purpose that they cannot easily be converted to alternative productive uses."[49] Dr. Blank and Professor Gegax state that, from an economic and ratemaking standpoint, "one could argue that the costs of facilities are truly 100% sunk *only* if they have no value outside the purpose in which

[47] AEP cannot have it both ways. AEP's witnesses strenuously argue, and with powerful evidence, that AEP's zonal load customers will receive no benefits from the new transmission upgrade projects currently planned to be constructed in eastern PJM. (See, e.g., Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 37-38.) Nevertheless, AEP's witnesses also argue that "the grid is an integrated system that provides system-wide benefits." (Direct Testimony of Dr. Larry Blank and Professor Douglas Gegax, Exhibit AEP-400 at 25.)
[48] Direct Testimony of Dr. Larry Blank and Professor Douglas Gegax, Exhibit AEP-400 at 31-36.
[49] Direct Testimony of Dr. Larry Blank and Professor Douglas Gegax, Exhibit AEP-400 at 32.

they were originally intended and, in turn, could be retired without repercussion."[50] Dr. Blank and Professor Gegax argue that existing transmission facilities have alternative uses and can serve markets other than the zone within which they are physically located and are, therefore, not sunk.[51]

Dr. Blank and Professor Gegax's sunk cost argument seems to be aimed at rebutting arguments by others regarding the efficiency merits or demerits of re-allocating fixed costs. Nevertheless, while the arguments of Dr. Blank and Professor Gegax about sunk costs may be of academic interest, they are of little assistance for the practical application of making decisions about transmission cost allocation policy.

In this regard, AEP's witness Mr. Baker hits the nail on the head when he states, "When it comes to allocating fixed costs, the goal is fairness."[52] Mr. Baker states simply that, "I don't believe that anyone can reasonably argue that the current zonal rate design for existing facilities is fair to AEP's customers."[53] Without conceding to Mr. Baker's position about whether the current zonal rate design for existing facilities is fair or equitable to AEP's customers, the OMS states definitively that the arbitrary socialized rate design proposed by AEP in its Complaint is not fair or equitable to the customers in most, if not all, of the PJM and Midwest ISO zones. An equitable transmission cost allocation and rate design must be tied to reliable analyses of particularized benefits and the distribution of those benefits to specific transmission customers. AEP has not provided such analyses or proposed an equitable transmission cost allocation and rate design.

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[50] Direct Testimony of Dr. Larry Blank and Professor Douglas Gegax, Exhibit AEP-400 at 13.
[51] Direct Testimony of Dr. Larry Blank and Professor Douglas Gegax, Exhibit AEP-400 at 32.
[52] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 41.
[53] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 41.

D. AEP's Alternative 765 kV Proposal Suffers From All of the Same Flaws as Does AEP's Primary 345 kV Proposal and Should Be Dismissed for the Same Reasons.

As an alternative to its primary 345 kV and above voltage specification for transmission cost socialization, AEP also presents an alternative that would socialize the costs of all existing and new transmission facilities of 765 kV and above across the PJM/Midwest ISO Super Region and leave the costs of all other transmission facilities allocated to the zone in which such facilities are located.[54] Mr. Baker proposes the 765 kV alternative should the Commission find it would be less controversial than the 345 kV proposal.[55]

OMS asserts that AEP's alternative 765 kV proposal suffers from all of the same flaws as its primary 345 kV proposal and should be dismissed by the Commission for the same reasons. OMS does not find AEP's alternative 765 kV proposal to be any less controversial than its primary 345 kV proposal.

VI. Conclusion.

Wherefore, for the reasons explained above, the OMS recommends that the Commission dismiss AEP's September 17, 2007 Complaint.

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[54] See, e.g., Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 39-40, Direct Testimony of Dennis W. Bethel, Exhibit AEP-200 at 26-27, and Direct Testimony of Bernard M. Pasternack, Exhibit AEP-300 at 22-23.

[55] Direct Testimony of J. Craig Baker, Exhibit AEP-100 at 40.