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August 27, 2010

VIA EMAIL

Mr. Paul J. Feldman
Chairman, Board of Directors
Midwest Independent Transmission System Operator, Inc.
P.O. Box 4202
Carmel, Indiana 46082-4202

Re: Improper Offer of Concessions to Duke Ohio and Midwest ISO's Violation of Order 719 Responsiveness Criteria

We are writing to request a meeting as soon as possible with the Midwest ISO Board and management to raise concerns regarding Midwest ISO's offer of substantial concessions to Duke Ohio in an attempt to establish incentives for its continued membership in Midwest ISO. We believe that the Midwest ISO violated all four responsiveness criteria of FERC Order 719 in the process – inclusiveness, fairness in balancing competing interests, representation of minority positions, and ongoing responsiveness.

As a matter of substance, the incentives had the purpose of enhancing the revenue streams of one transmission owner to the potential detriment of consumers, whose circumstances apparently were not viewed as significant by Midwest ISO's management. As a matter of process, Midwest ISO's flirtations with Duke Energy took place behind closed doors, violating all principles of ISO/RTO responsiveness. Although the negotiations between Duke Energy and Midwest ISO apparently were extensive, covering a period of several months earlier in 2010, they came to light only in a recent Duke Energy filing with FERC. Midwest ISO's conduct in this matter shows that the industrial community's frequently stated concerns – that the ISO/RTO governance process is stacked in favor of the supplier side and that there is a complete lack of responsiveness to consumers – continue notwithstanding Order No. 719 and the other recent efforts of FERC to address the shortcomings in the organized markets.

As Midwest ISO has previously recognized, going back to Order No. 2000, the core principles for governance are independence, openness, and lack of bias. Order 719 and other FERC organized market initiatives subsequently have focused on responsiveness to stakeholders. Midwest ISO's filings with FERC have asserted, time and time again, that its processes enable full participation by all stakeholder interests. In its dealings with Duke Energy, however, Midwest ISO failed to act with fidelity to these principles, raising serious questions about the credibility of its management systems and practices.

As outlined in Midwest ISO's May 4, 2010 letter to Duke Energy, the substantial concessions had the explicitly stated purpose to "commit [Midwest ISO] to some concrete initiatives" to "significantly mitigate the risk and expand opportunity for [Duke Ohio] without [Duke Ohio] having to leave the Midwest ISO." These multiple incentives are significant and substantive departures from Midwest ISO's current market design and included:

- Allowing Duke's CD and CCD units [units jointly owned with other utilities] to move into PJM's capacity market and dispatch to allow Duke Ohio to achieve more favorable terms relating to load switching, duration and price, to the detriment of consumers.
- Transferring load forecasting from load serving entities to the local balancing authority in retail choice states.
- Imposing additional costs relating to the value of capacity on load serving entities. Midwest ISO proposed to accomplish this in retail choice states by either a capacity auction conducted by the Midwest ISO or by using a capacity price determined in the PJM auction, with duration and other features matching the PJM outcome.
- Adding a 36-month capacity reporting requirement to add duration to the capacity obligation of load serving entities.

In effect, Midwest ISO staff proposed a redesign of the Midwest ISO market to satisfy the parochial demands of one transmission owner for higher capacity pricing for its generation assets, such as that available in PJM, to the detriment of consumer interests. As Duke Energy points out in a recent FERC filing opposing Midwest ISO's attempt to block Duke Ohio's departure,[1] Midwest ISO now concedes that PJM's Reliability Pricing Model results in high pricing that harms consumers. In particular,

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[1] Answer of Duke Energy in Docket No. ER10-1562, Aug. 10, 2010.

Midwest ISO told FERC that "[w]hile utilities realize an economic benefit, consumers … may be required to bear new and unnecessary costs," that "it is axiomatic that Duke's gain is a mirror image of cost to customers," and that "Duke's anticipated benefits… rest on assumptions that do not justify…potential harm to consumers from the proposed change."[2] And yet, three months ago, it offered a secret deal to Duke Ohio based on that same pricing, with no evidence that these harms to consumers gave it any pause.

The ISOs/RTOs are supposed to be "independent" grid operators, not beholden to transmission owners or other stakeholder groups just to retain their membership. Midwest ISO's extraordinary efforts to retain Duke Energy are particularly surprising given its own representations to FERC that membership is fully voluntary and that "[s]hould any entity believe that its views are not being given fair consideration, that entity may pay its withdrawal fee and leave the organization."[3]

The problem here was compounded by the fact that it occurred behind closed doors. In February 2010, FERC held a conference to explore the responsiveness of the ISOs and RTOs to their customers and other stakeholders. That proceeding followed FERC's issuance of four responsiveness criteria in Order 719 – inclusiveness, fairness in balancing competing interests, representation of minority positions, and ongoing responsiveness. In its subsequent compliance filing, Midwest ISO states that it was already meeting these criteria.[4] And yet, less than one year later, Midwest ISO's conduct here violates all four criteria.

- *First*, Midwest ISO's conduct was not inclusive in that it offered substantial incentives to Duke Ohio with no opportunity for consumer interests or other stakeholders to present their views. In fact, Midwest ISO's activities were not disclosed until months later.
- *Second*, Midwest ISO's conduct did not exhibit fairness in balancing diverse interests. Midwest ISO's positions suggest that it is dominated by transmission owners and does not equitably consider the interests of consumers or other stakeholder categories.

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[2] *Id.*

[3] Comments of Midwest ISO on Notice of Proposed Rulemaking in Docket No. RM07-19, April 21, 2008, at p. 32 (further noting that "[t]he Commission, for its part, has indicated that there is a very low threshold for withdrawal").

[4] Answer of Midwest ISO in Docket No. ER09-1049, June 15, 2009, at p. 22 ("Midwest ISO demonstrated that its current stakeholder representation structure and processes generally comply with Order No. 719 by providing numerous and open communication channels between the Midwest ISO Board and stakeholders.").

- *Third*, the action favored the supply-side interests that are more concentrated and have far greater resources, with no opportunity for presentation of dissenting or minority positions.
- *Fourth*, Midwest ISO has not taken any action indicative of ongoing responsiveness respecting this matter; rather, it failed to disclose it.

In the same FERC conference, ELCON noted the very issue that has arisen in Midwest ISO's dealings with Duke Ohio:

> [ISOs/RTOs] are voluntary, so dissatisfied supply side participants have some ability to walk, and there inevitably will be strong motivation to keep them satisfied. From a consumer perspective, the cost of doing so may not be justified by the benefits.

Clearly, this structural feature of the ISOs and RTOs offers no excuse for Midwest ISO's conduct. To the contrary, Midwest ISO's management cannot retain any credibility as an independent, unbiased decision maker if it succumbs so readily to the very conflict of interest issue about which it should be most vigilant.

Midwest ISO's Order 719 compliance filing asserted that "[t]he Midwest ISO Board is dedicated to maintaining an open line of communication with all stakeholders and customers." In its comments to FERC on the proposed rulemaking that led to Order 719, Midwest ISO urged FERC to exercise "special caution" in making responsiveness reforms, noting that "each member must feel that the management of the organization is cognizant of its issues and objectives," and that "[a]s the only 'ground-up' RTO, the Midwest ISO is particularly attuned to member concerns and has developed a number of *fora* to vet those concerns and achieve consensus where possible."[5]

In that spirit, we would appreciate the opportunity to meet with Midwest ISO's Board and management at your earliest convenience to discuss the steps to be taken to prevent recurrence of the conduct discussed herein and processes for achieving full and open participation and, ultimately, sound and balanced governance. We also recommend that the Board take all necessary and prudent steps to review this matter to ensure that none of the four criteria in Order 719 are breached in the future.

Sincerely yours,

John A. Anderson
President and CEO
Electricity Consumers Resource Council (ELCON)

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[5] Comments of Midwest ISO in Docket No. RM07-19, Sept. 14, 2007, at p. 31.

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cc: Midwest ISO Board of Directors
Midwest ISO President and CEO, John Bear
Midwest ISO General Counsel
Midwest ISO Advisory Committee
Midwest Independent Market Monitor
FERC Docket No. ER09-1049-000