

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission  
System Operator, Inc.

Docket No. ER06-1112-000

**MOTION TO INTERVENE AND INITIAL COMMENTS OF THE  
ELECTRICITY CONSUMERS RESOURCE COUNCIL  
("ELCON")**

Pursuant to Rules 214 of the Federal Energy Regulatory Commission's ("FERC" or "Commission") Rules of Practice and Procedure, the Electricity Consumers Resource Council ("ELCON") hereby files this Motion to Intervene and Initial Comments in the above referenced proceeding.

ELCON is the national association of large industrial consumers of electricity. Within the footprint of the Midwest ISO is one of the highest concentrations of US manufacturing capacity of any region in the country. As such, we have a strong interest in the design of the Midwest ISO's energy and ancillary services markets, and any changes that are proposed to those markets. We appreciate the opportunity to comment on the Midwest ISO's Compliance Information Filing ("Compliance Filing") regarding the status of its efforts to develop a replacement for the interim resource

adequacy plan that the Commission approved as Module E of the Midwest ISO's Open Access Transmission and Energy Markets Tariff ("EMT").

### **Summary of ELCON's Comments**

ELCON supports the Midwest ISO's proposed permanent approach to resource adequacy if it remains the Commission's avowed policy to promote real competition in wholesale electricity markets. Unlike the resource adequacy requirements ("RAR") implemented by other FERC-approved ISOs and RTOs, the approach proposed by the Midwest ISO is consistent with both the theoretical and practical requirements of wholesale competition where a nodal pricing scheme is used. In particular, the approach is faithful to the role of short- and long-term price signals for ensuring short-term reliability and efficient investment decisions for generation and transmission infrastructure.

The approach—if successful—also produces an end-state market with the “look and feel” of other competitive markets, such as a liquid forward market with a prominent role for price-responsive loads, a market orientation with a customer focus, and the allocation of investment risk based on market principles, not regulatory intervention. If the Midwest ISO's RAR is approved, ELCON urges the Commission to ensure that a phase-in of market pre-conditions eliminate the risk of undue harm to end users because the structural protections against market power have not yet been implemented.

## Comments of the Electricity Consumers Resource Council

The Midwest ISO's proposed RAR is noteworthy for what it does not include: a series of ad hoc regulatory mechanisms that have become a fixture of other RTO market designs which distort price signals and require further regulatory intervention (e.g., LICAP) to ensure short-term reliability and long-term investment. These mechanisms evolved on a trial-and-error basis in response to real or perceived market failures.<sup>1</sup> The upshot of the intervention is the lack of faith in the ultimate workability of wholesale competition in this industry. ELCON continues to believe that, if competition can be made to work, it should be encouraged. Within the regional markets subject to FERC jurisdiction, the efforts of the Midwest ISO are perhaps our last great hope that this may happen.<sup>2</sup> If real competition cannot be made to work, then the public debate going forward must be refocused on the appropriate federal-state regulatory framework, and the degree to which cost-of-service regulation should be reinstated where it was abandoned. It is ELCON's judgment that the hybrid market/regulatory model currently being pursued in PJM, NYISO, ISO-New England, and California is unsustainable.

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<sup>1</sup> The California debacle was a real market failure. The reaction to this debacle was to impose "safeguards" in other markets that were intended to prevent a similar market failure, even though the unique features and missteps in the California market at that time did not exist elsewhere.

<sup>2</sup> The ERCOT market, which is not subject to FERC jurisdiction, is also adopting the same type of resource adequacy mechanism as proposed by the Midwest ISO. Industrial consumers in the ERCOT market are generally pleased with the level of competition in the ERCOT market. The retail market in ERCOT is considered by many industry observers to be the most successful in the US. This success is, in part, derived from the success at the wholesale level.

The Midwest ISO's proposed RAR is often called an "energy-only" market ("EOM"). ELCON agrees that:

The term "energy only" market is a misnomer and actually refers to a series of closely linked sub-markets for spot energy, operating reserve, other related ancillary services and bilateral contracts. The common bond is that all depend upon cost-effective, transparent spot energy prices in order to function efficiently and effectively.<sup>3</sup>

The main features of the EOM market design are:

- Market incentives based on scarcity pricing rather than centralized administrative intervention drive long-term investment decisions;
- Load-serving entities use bilateral contracts to insulate themselves (and their customers) from price volatility;
- Price-responsive loads (i.e., customers able to offer demand response) have access to the spot energy and ancillary services markets to mitigate price volatility and enhance short-term reliability;
- Spot energy prices are capped at a level that reflects the willingness to pay of customers who cannot respond in real time to the spot prices;
- Pricing consistency between energy and operating reserves, which ensures that customers benefit from the lowest bid-based cost; and

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<sup>3</sup> Compliance Filing at 4 n.13.

- Generators are exposed to spot energy prices and are not provided artificial payments for “missing money.”<sup>4</sup>

However, the pre-conditions necessary to successfully implement the EOM are not mutually exclusive, and this is our overarching concern.

For example, the implementation of scarcity pricing requires some relaxation of existing price caps. But clearly price caps must not be relaxed before a liquid forward market is in place with demand response. The transmission infrastructure must also be sufficiently robust to withstand the local market power of generators. Many industrial consumers are worried that piecemeal implementation of the EOM market design will expose them to price spikes before the necessary structural requirements are in place. Therefore a set of market pre-conditions is needed to prevent this risk.<sup>5</sup> These pre-conditions should include demonstrations that:

1. Suppliers are sufficiently risk adverse to exposure to spot energy prices that they will willingly negotiate bilateral contracts without the level of risk premiums typically required in contracts offered in the Northeast ISO/RTO

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<sup>4</sup> See Midwest Independent Transmission System Operator, Inc. “An Energy-Only Market for Resource Adequacy in the Midwest ISO Region,” November 23, 2005.

<sup>5</sup> Market designs have been implemented on a piecemeal basis in all FERC-approved ISOs and RTOs, often producing unintended consequences that are harmful to end users in the early stages. The “harm” is often easy money to suppliers who use the regulatory process to preserve their windfall and resist market corrections that establish real competition.

markets. In other words, spot price volatility creates the incentive to do a bilateral that protects both loads and suppliers from risk.

2. Prices are set by supply and demand, constrained by competition among generators, price responsive load, and price caps sets at the average "value of lost load."
3. The wholesale market is predominantly a forward market with only limited purchases in the spot market. This requires the ability to get firm transmission service for the duration of a long-term forward contract.
4. The members of the Organization of MISO States ("OMS") support the EOM design with conforming actions in the retail markets (e.g., enable demand response, encourage LSEs to forward contract where and when forward markets are sufficiently liquid and robust, and establish reserve levels).
5. And there is transmission adequacy such that local market power of generators is eliminated or mitigated by the independent market monitor.

To its credit, the Midwest ISO is proposing a phased approach to a permanent resource adequacy plan. Compliance Filing at 5-8. Phase I would integrate ancillary services with the energy market. A detailed plan for Phase I would be filed with the Commission in Fall 2006. The main features of Phase II are the implementation of scarcity pricing in the energy market, demand response, and long-term FTRs; the

facilitation of long-term (longer than a year) contracts for energy; and the resolution of seams issues with neighboring markets. The Midwest ISO proposes a filing with FERC on Phase II in 2007.

The two phases proposed by the Midwest ISO are ambitious in scope and timing. We recommend that the Commission support such a phase-in that is conditioned on the five interdependent, pre-conditions we list above. This is necessary to ensure that the structural protections of a competitive wholesale market are in place before end-use customers (or LSEs) are exposed to scarcity pricing and/or an ill-formed forward market. The balancing act that confronts the Midwest ISO as it attempts to implement this market design is crucial. We strongly oppose going forward with any half-hearted attempt to meet these pre-conditions on a piecemeal basis or to compromise them in any other way that produces distorted market price signals and the type of dysfunctional wholesale electricity market that prevails in other FERC-jurisdictional ISOs and RTOs.

### **Description and Standing of ELCON**

Electricity Consumers Resource Council ("ELCON") is the national association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable, and efficient electricity supply for all users at competitive rates. Many ELCON members operate major facilities in the footprint of the Midwest ISO. ELCON member

companies produce a wide range of products from virtually every segment of the manufacturing community. Many members also generate some of their power requirements.

### Notices and Communications

The following persons are designated by ELCON to receive service and communications on its behalf with regard to this proceeding:

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Respectfully submitted,

/s/ John A. Anderson  
Dr. John A. Anderson  
President & CEO  
ELCON

Dated: July 14, 2006

**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 of this proceeding.

Dated at Washington, DC: July 14, 2006

/s/ W. Richard Bidstrup  
W. Richard Bidstrup