



STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Robert F. Lieberman
Commissioner

160 North LaSalle Street
Chicago, Illinois 60601

October 17, 2006

The Honorable xxx
Illinois Commerce Commission
527 E Capitol Ave
Suite 700
Springfield, IL 62704

Dear Commissioner:

I have been with the Illinois Commerce Commission approximately 18 months and before that spent ten years running the Center for Neighborhood Technology in Chicago, where we developed and managed community-based energy efficiency and demand response programs. Over that period of time, I have observed significant changes in the electric industry. One of the most striking—and perhaps under-appreciated—is the urgent need to strengthen our wholesale markets and deliver benefits to retail customers by developing a robust regional demand response capability within our retail markets. I have been monitoring with interest the outputs from the New England Demand Response Initiative (NEDRI) and the Mid-Atlantic Demand Response Initiative (MADRI). I believe that it is now time for the Midwest states to take similar regional action to address this important regional issue and create a Midwest Demand Response Initiative (MWDRI). The following pages reflect my initial thoughts on why this Initiative should be undertaken and what we can hope to accomplish.

I am sending you this letter in the hopes that you also believe that this is an Initiative that should be undertaken and join me as a member of the Steering Committee.

Resource Adequacy in the Midwest—Seeking the Balance between Demand Response and New Supply-Side Investment

As Benjamin Franklin said, on the signing of the Declaration of Independence, “We must all hang together, or assuredly we shall all hang separately.” State regulators in the Midwest need to work together towards the goal of building a broad customer-based demand response capability

with retail price-responsiveness, or they will assuredly face a future of separately approving the pass-through of higher and higher wholesale electricity prices.

Against the backdrop of rising energy prices, shrinking regional reserve margins and new regional wholesale electricity markets, the value of robust demand response programs and price-responsive markets is becoming increasingly clear, for states both restructured and vertically integrated. Without a retail market that responds to price increases with dynamic reductions in demand, regulators in the Midwest will soon face an electricity system seriously out of balance—demand will outstrip supply and wholesale and retail electricity prices will rise further. As wholesale market price caps become institutionalized and administratively-determined capacity markets become the norm, states will continue to cede regulatory authority — intentionally or otherwise—to new regional organizations regulated solely by FERC with only a vague accountability to the states they serve. Retail customers will pay for new generating plants before they are built, and with no guarantee that investment in new capacity will actually occur, or produce appropriate fuel diversity.

A robust demand and price-responsive market would discipline wholesale markets by reducing generators' market power, moderating price spikes and volatility, and reduce the need for investment in expensive new power plants and transmission lines. As a result, demand response would lower average prices for everyone, in both restructured and vertically integrated states.

But there are at least two significant barriers to the creation of such a market in the Midwest.

The first is that, despite their best efforts, inclinations or intentions, neither FERC nor the RTOs can create robust demand- and price-responsive retail markets. Retail pricing is the sole responsibility of state regulators. As the authors of the recent draft competition report to Congress said:

“...an important component of effective market operation is customer response to prices. The demand for power ... is derived entirely from consumption choices at the retail level... Yet state regulators set the prices for retail customers. State regulators generally have treated wholesale rates as an input into retail prices...” (p.44)

The policy, programs and knowledge to create a robust demand- and price- responsive retail market are not in the regulatory toolkit of most Midwestern states. Regulators need to learn how to do it.

The second barrier could be the more difficult one. Even if state regulators learn how to create and implement robust demand response in retail markets, it is challenging to capture the value of these actions for our retail consumers. For eighty years, individual state regulation operated independent of the actions of other states—Illinois largely ignored what Indiana did, and vice versa. Now, with each state a relatively small portion of the demand in a large regional wholesale market, an individual state's work to foster a price-responsive retail market will have only a small effect on disciplining the wholesale market, and the benefits that do occur will flow to all retail customers across the Midwest. This market scale problem combined with the “free-rider” problem has justified state regulatory inaction for years.

The Need for a Midwest Demand Response Initiative

To address these two barriers, I invite you to join me in establishing a Midwest Demand Response Initiative. The purpose of this initiative is to build upon and expand the work of the New England and Mid-Atlantic Demand Response Initiatives. Working with the Organization of MISO states and MISO itself, MWDRI will help Midwest state commissions and policy makers quantitatively and qualitatively understand the value and the necessity of a region-wide demand- and price-responsive retail market capability while also addressing the two barriers discussed above: building the knowledge base among Midwestern regulators, staff and stakeholders about how to create such a market; and building the will to do it together.

A MWDRI process, building on the NEDRI and MADRI foundation with the assistance of committed DOE funding, could be up and running by January, 2007. Eighteen to twenty-four months later, we hope MWDRI can claim the following accomplishments:

- Create the tools necessary to visualize and value a robust price-responsive retail market in the Midwest
- Estimate the value of implementing such a retail market, from a price, cost and resource adequacy perspective
- Inventory current status of price-responsive programs in the region including but limited to distributed resources, advanced metering, pricing, demand-response technologies and energy efficiency.
- Create prototype program and rate design options to help state regulatory commissions achieve MWDRI objectives
- Develop consensus for state advocacy to align wholesale market value with retail price-responsive initiatives
- Develop consensus strategies for regional and state implementation

For this initiative to be effective, it must be connected to our states' public utility commissions. It is the PUCs—acting singularly and—hopefully, jointly—that will implement pricing and programmatic initiatives at the customer level to create a robust price-responsive retail market. The Midwest PUCs are currently working on regional issues through OMS. We envision building on this existing framework to further develop the demand response work that has been initiated through the OMS. Since it will be up to the PUCs to advocate these regional reforms, it will be critical for them to present a unified voice. I believe that the work that can be done through the MWDRI can accomplish that objective. It is for this reason that I would like to see at least one Commissioner from each state in the Midwest on the MWDRI Steering Committee.

If you would be willing to provide your expertise, assistance and leadership by becoming as a member of the MWDRI Steering Committee, please acknowledge by sending me a signed copy of the signatory page (below) with your contact information. With your help I hope we can achieve the appropriate balance of electric supply investment and demand response in the Midwest.

Sincerely,



Robert F. Lieberman
Commissioner
Illinois Commerce Commission

I am pleased to be a signatory to the Midwest Demand Response Initiative (MWDRI) and I am willing to serve as a member of the Steering Committee.

Signed _____ Date _____

My Contact Information:

Business Phone:

Business Fax:

Mobile Phone:

Email address:

This information can be faxed to: 312.814.1818

Midwest Demand Response Initiative October, 2006

Preliminary Goal

- Create the regional knowledge base necessary to allow the Midwest states to develop and implement price-responsive retail markets

Preliminary Objectives

- Create the tools necessary to visualize and value a robust price-responsive retail market in the Midwest
- Estimate the value of implementing such a retail market, from a price, cost, system operations and resource adequacy perspectives
- Inventory current status of price-responsive programs in the region including but not limited to distributed resources, advanced metering, pricing, demand-response technologies and energy efficiency.
- Create pro forma/prototype program and rate design options to help state regulatory commissions achieve MWDRI objectives
- Develop consensus for state advocacy to align wholesale market value with retail price-responsive initiatives
- Develop consensus strategies for regional and state implementation

Steering Committee

- Comprised of commissioners from MISO states, DOE, EPA and the Midwest ISO
- Provide overall strategic direction and policy guidance for the initiative
- Helps secure financial resources
- Provides a “regional” focus on the initiative

Tentative Schedule

- Phase I: Getting Organized—October 2006 - December 2006
 - Initial Steering Committee meetings
 - Ground rules
 - Recruit additional Commissioners
 - Recruit business, consumer, utility and vendor advisory councils
 - Prepare background materials
- Phase II: Visioning and valuing—January - April 2007
 - Develop estimates of the value of implementing a robust price and demand response market from both a wholesale and retail perspective using a computer-based interactive simulation tool
 - Initial stakeholder meetings with MWDRI Steering Committee
 - Meet with state commissions, and other interested parties. to share with them the value estimates

- Allow participants to experiment with the computer-based interactive simulation tools
 - Begin an active dialogue concerning the value of a robust retail market
 - Develop consensus among the state commissions to undertake a more active role in better aligning the wholesale market value with retail price-responsive initiatives

- Phase III: Inventory and Prototypes —May - December 2007
 - Identify and inventory the current status of price-responsive programs in the region.
 - Identify the barriers to the expansion of these programs
 - Determine the most feasible solution for addressing these barriers
 - Steering Committee review of barriers and solutions
 - Conduct workshops to develop pro forma/prototype program and rate design options for state regulatory commissions, MISO, utilities and demand response providers
 - Business and consumer groups will be encouraged to participate
 - Publish the prototype programs and rate design options on a MWDRI-sponsored website and share them with the Midwest stakeholder communities.
 - Include policy papers, handbooks, presentations, etc.
 - Steering Committee review of findings and the prototype programs and rate design options
 - Develop consensus strategies for regional and state implementation
 - Develop consensus as to the desired outcome and the timeline for meeting these objectives

- Phase IV: Implementation Strategies—January - June 2008
 - Steering Committee consideration of demand response programs and options for implementation and leadership within their respective state commissions
 - Meet with the state commissions to identify the programs and rate design options that best meet the needs of their respective states
 - Develop protocols for measurement and evaluation of demand response program reach, penetration, costs, benefits and impacts and secure commitment from states, utilities and MISO to collect these data and conduct systematic program evaluation.
 - Continue to update the MWDRI website with lessons learned as the states proceed with their implementation of programs and rate design options.

Preliminary Technical Assistance Support

- Regulatory Assistance Project – Project Facilitation
- Lawrence Berkley Laboratory – Inventory, Policy Analysis and Prototype Development
- Interdisciplinary Center for Economic Science – Interactive Computer Simulations

Preliminary Financial Support

- USDOE Office of Electricity Delivery and Energy Reliability (Committed)
- MISO (Committed)
- USEPA (?)