

Item C2

# OMS

Organization of MISO States

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December 7, 2006

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

Dear Mr. Edwards:

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

Sincerely,

/s/  
Steve Gaw  
President  
Organization of MISO States

copy: Bill Smith

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

**December, 2006**

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

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

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

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

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

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

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

## **Question 2. Rate Design – Overview**

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

### **Rate Design Goals**

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

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

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

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

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

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

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

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

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

### **OMS Role**

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

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

and,

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

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

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

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

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

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

### **History of Rate Design Debate**

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

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

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

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

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

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

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

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

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

While, perhaps, not directly relevant to the Midwest ISO transmission owners or to Midwest ISO stakeholders, the ongoing FERC proceeding investigating intra-PJM transmission rate design, FERC Dkt. No. EL05-121-000, may provide some guidance to stakeholders negotiating a post-transition transmission rate design for the combined Midwest ISO/PJM region. On May 31, 2005, the Commission issued an Order in that docket to examine the justness and reasonableness of continuing PJM’s modified zonal rate design during the transition period preceding the establishment of a single transmission rate design across the combined Midwest ISO/PJM region on February 1, 2008.<sup>10</sup>

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

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

### **Question 3. Midwest ISO & PJM**

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

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

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

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

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

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

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

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

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

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

...the RTOs and their transmission owners are directed to make a filing at least six months prior to the end of this period containing a reevaluation of fixed cost recovery policies for pricing transmission service between the two RTOs and proposing a rate design to take effect February 1, 2008.<sup>12</sup>

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

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

#### **Question 4. Rate Design Options**

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

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

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

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

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

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

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

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

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

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

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

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

<sup>16</sup> Order No. 2000, at 31,176-8.

<sup>17</sup> Order No. 2000, at 31,176-8.

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

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

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

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

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

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

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

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

#### **Question 5. Other Factors**

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

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

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

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

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

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

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

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

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