

**State Regulatory Authorities Sector Responses To the Advisory Committee
Hot Topic Questions
August 11, 2011**

Questions:

MISO's Independent Market Monitor (IMM) currently performs a variety of roles including market oversight and design advisor. Considering your understanding of the IMM role at MISO, please answer the following questions:

- 1. How does the role of the IMM in the MISO markets compare to the role of IMMs in markets operated by other RTOs? Are there practices employed elsewhere that should be considered in the MISO context?**

In some RTOs the IMM takes a more active role in the stakeholder process than does the MISO IMM. For example, the PJM IMM is often present at PJM stakeholder meetings and actively contributes to the stakeholder discussions. These contributions increase the stakeholder understanding of issues, which facilitates more productive stakeholder meetings. Also, the PJM IMM actively develops solutions to market inefficiencies, gaming opportunities and other inadequacies it perceives in the PJM markets and proposes them through the stakeholder process. In contrast, the MISO IMM typically offers a list of recommendations, which generally point out problems, but stops short of offering possible solutions to the problems. The PJM IMM proactively responds to stakeholder requests (especially those from state commissions) and acts on his own initiative to produce information and opinions on RTO issues. The MISO should consider whether it would be beneficial for the IMM to contribute more actively to the stakeholder process. The state regulators believe it would be beneficial and would like the IMM to take a more active role in MISO stakeholder process.

The MISO IMM does significant reporting to the RTO management, Board of Directors, and the state commissions, using extensive handouts of economic-oriented information. As part of the Informational Forum, the MISO prepares a "dashboard" summary to distribute information to its stakeholders. This is a good business practice. The state regulators encourage the IMM to explore the use of a new brief high level summary of this sort before or after major IMM reports to facilitate easier communication of information to a wider audience and highlight the most significant findings of the report. The state regulators would also find it useful for the IMM to go beyond the statistical metrics and highlight the most significant findings and implications of those findings. For example, the analysis could include information such as modified Lerner indices on a more granular scale, perhaps by month, season, broadly or narrowly constrained zones, etc. This would be in addition to the calculation to what the IMM offers in the annual State of the Market Report (SOM). (A modified Lerner index is simply the percentage above marginal cost or reference level that the energy market clears at appropriately adjusted for congestion and losses.)

With respect to the report itself, we recommend that the IMM provide sufficient analysis and explanation as to be meaningful to state regulators and other decision-makers. For example, the IMM has indicated in that the energy markets are workably competitive. In addition to the calculation offered in the SOM Report, the analysis could include information such as modified Lerner indices on a more granular scale, perhaps by month, season, broadly

or narrowly constrained zones, etc. This would be in addition to the calculation that the IMM offers in the annual SOM.

2. How does the role of the IMM differ from the role of regulatory bodies (state and federal) and other external monitors (eg. NERC)? Are their gaps or overlaps in roles of these entities that should be addressed?

FERC has the statutory obligation under the Federal Power Act to ensure that wholesale rates are just and reasonable and not unduly discriminatory. State regulators have their own separate statutory authority that is also reinforced by the Federal Power Act. The North American Electric Reliability Corporation (NERC) serves as the Electric Reliability Organization, with separate statutory authority over reliability of the grid. All of these are statutory obligations separate from monitoring markets. FERC may not delegate its authority to the IMM to ensure that RTOs comply with the Federal Power Act. Other stakeholders may be looking out for some interest (usually a particular business or consumer interest and sometimes the public interest), but they do not have any statutory authority to exercise in the area of market monitoring.

The IMM is a creature of the FERC, not of the states, and is independent of MISO management and the MISO Board, although some state functions are within the IMM's scope of surveillance. The IMM does not administer tariffs; this is the job of MISO. The IMM does not have regulatory authority over MISO. FERC does. Like the states, the IMM can make market improvement suggestions to MISO. Unlike the states, the IMM does not have regulatory authority over public utilities, such as load serving entities, and utility owned generation facilities in their respective states.

In terms of gaps, one area where it might be beneficial to have some additional independent oversight would be in the area of transmission planning, and the interplay between transmission planning and the markets. First, the MTEP process does not require MISO or the transmission owners/developers to notify affected states when they propose a particular project for MTEP consideration. Moreover, many state commissions lack the necessary resources to adequately monitor all the projects being planned in the MTEP process. In an age of greater regionalization of transmission planning, any one transmission project is more likely to affect many or all ratepayers in a region. The level of technical involvement and absolute number of transmission projects approved through RTO transmission plans may present gaps in the regulation and oversight of these regional plans. MISO's Market Monitoring Plan requires the market monitor to perform transmission system related functions such as reporting on the conduct of various entities attempting to exercise market power or reduce the quantity or quality of Transmission Service and/or monitoring the operation, use and congestion of the Transmission System since all these factors affect the competitive conditions of the region.¹ The plan does not appear to specifically include IMM monitoring, reporting and/or participation in MISO's transmission planning process. The IMM may not have the obligation or the necessary expertise to actively oversee the transmission planning process. Therefore, there may be a gap in the regulation of the regional transmission planning process.

Second, there appears to be a gap between the transmission planning process and the markets themselves. To the extent that there are many of the same entities in both the transmission planning process as well as the various markets, there is a risk that action in one

¹ Tariff Section 50.

arena could impact the other arenas. There does not appear to be adequate oversight or regulation to protect against gaming between these various constructs.

There may be overlaps where both the IMM actions and state regulation affect wholesale markets. The states' role is to set reasonable retail rates and to ensure adequate resources for those load serving entities under their jurisdiction. In most cases, the states and the IMM desire the same outcome. In situations where the IMM's role to prevent the exercise of market power in wholesale markets adversely affects the states' role, the states expect to continue to address their concerns in appropriate venues including the MISO stakeholder process and before the FERC.

3. Are there changes you would like to see in the IMM's role at MISO?

Yes. We would like to see an increased IMM role in the development and implementation of MISO's market design within the stakeholder process. In addition, we would like to see the IMM's role be more independent of MISO. While it is appropriate for the IMM to provide input to MISO on market design and tariff language, it is not appropriate for the IMM to ever represent MISO via testimony or affidavit in FERC filings, as that compromises the independence of the IMM. Instead, the IMM should always participate in the MISO stakeholder process and FERC proceedings as a separate and independent entity.

In addition, we believe that the magnitude and scope of IMM responsibility suggest that the IMM contract with MISO should be periodically reviewed for both cost-effectiveness and best practices. We recommend that the contract be subject to periodic competitive bidding to ensure that the overall package most benefits customers. The importance of the monitoring and mitigation functions requires a vigorous reexamination through a competitive bidding process on a periodic basis.

Finally, as noted above, a new role for the IMM regarding transmission planning may be appropriate. Presently, MISO conducts transmission planning for reliability lines, "economic" lines, "MVP" projects, and projects in the annual MTEP process. We believe that the process would greatly benefit from an IMM opinion regarding what is the efficient amount of congestion to be addressed (and mitigated) via projects in these planning processes. MISO should strive to achieve an efficient level of transmission infrastructure, and the IMM's professional insight could be quite useful in the planning process necessary to achieve such a goal and would help to provide parameters to a process which otherwise can appear to be very arbitrary. In so doing, the IMM would also serve to protect against any potential for gaming between the transmission planning and market constructs.

In the IMM's role as a market design advisor, the IMM includes recommendations for market design changes in the annual State of the Market Reports. On June 15, 2011, the Markets Committee of the BOD reviewed a presentation discussing MISO's response to the IMM's 2010 recommendations. Considering this design advisor role and the specific 2010 recommendations, please answer the following questions:

1. Which of the proposed market enhancements (slides 6-11) does your sector support? How would you prioritize the recommendations that you support?

The IMM has made recommendations to MISO for market improvement. Generally speaking, energy markets work best when seams issues, discontinuities and irregularities within and between adjacent markets are reduced. This is the focus of many of the IMM's

recommendations. In the abstract and in practice, the most efficient markets are those that are continuous in product scope and geographically contiguous. The OMS also recognizes that NERC and operational engineering issues can arise that might make what may be optimal in economic theory, less than desirable for the hands-on daily operation of the grid. In recognition of these balancing interests and in the spirit of prioritizing as requested, the OMS suggests the following IMM recommendations be given highest priority for MISO stakeholder consideration. In so doing, the OMS is not taking a position on the recommendations themselves.

First Priority for consideration:

- #1 CT Pricing;
- #2 Demand Response--Set Price;
- #4 Look-Ahead Capability;
- #6 Market Power Mitigation for Local Resource Commitments;
- #9 Short-Term Load Forecast; and
- #11 Real-Time Offer RSG Payments.
- #12 Spinning Reserve market improvement

The first priority recommendations focus on making market signals more accurate and transparent and implementing tools that enhance the information necessary to make appropriate decisions in day to day operation of the grid. These recommendations also appear to have positive impacts on electricity consumers. The OMS acknowledges the complexity associated with coordinating major projects such as ELMP, Ramp Management and Look Ahead Dispatch and supports thorough analysis of each of these recommendations.

The second list of priorities for consideration pertains to seams-type issues. At a time of capacity and energy surplus, taking actions in these areas will facilitate transactions across RTO areas, resulting in a lower overall cost of dispatch and enhance efficiency. These actions would also serve to make the markets more contiguous. The OMS realizes that MISO cannot make these changes alone, and that other RTOs would need to be actively and willingly involved.

Second Priority for consideration:

- #7 Market-to-Market Interchange Optimization;
- #8 Market-to-Market Other Coordination; and
- #13 Removing inefficient barriers to capacity trading with adjacent areas.

The OMS gives these recommendations second priority because the intricate seams-oriented nature of the issue requires cooperation from more than one RTO and perhaps FERC involvement where consensus cannot be reached. In addition, the impacts on electricity consumers in the MISO footprint are more ambiguous requiring careful analysis before moving forward.

The third priority concerns an ongoing dispute area between the IMM and MISO.

Third Priority for consideration:

- #3 on Constraint Relaxation.

This IMM recommendation is unclear and needs more study before the OMS can provide meaningful substantive comment. This IMM recommendation refers to the use of the constraint relaxation algorithm to set LMPs based on a transmission constraint's marginal value

limit when the constraint is unmanageable. The IMM estimates that this algorithm artificially reduced the value of congestion charges by more than \$300 million in 2010. The impact here is unclear. Reducing congestion charges would appear to increase the value to the MISO footprint by any common sense definition, but because MISO has not provided sufficient details regarding how it calculates its “value” to the region, the OMS is uncertain how to categorize this. Moreover, MISO and the IMM still seem to disagree on this issue. The IMM’s recommendation is made to improve the economic efficiency of the markets, yet MISO management has implemented a plan that is moving more slowly perhaps due to operational or engineering issues. MISO may also be loath because the impact on real time LMPs may be extremely large and beyond the acceptance level of market participants and regulators. No other RTO has agreed to discontinue this constraint relaxation algorithm. At this point in time there is still much confusion. This issue is complex, with numerous engineering, operational, and economic considerations. For a better understanding, both the IMM and MISO should provide a new report to OMS and all stakeholders and perhaps hold an explanatory workshop. It may be necessary to form a task force to properly analyze this issue. This recommendation was first made by the IMM in 2005. The OMS is concerned that the two sides have a nearly 7-year disagreement on this matter and have not yet found an amenable solution.

2. Which enhancements should not be pursued at this time?

#14 Sloped demand curve for in its resource adequacy construct

MISO should not implement a sloped demand curve concept as part of its capacity market construct. Doing so would introduce a variable requirement that would incent LSEs that own resources to opt-out of the auction in order to avoid the additional costs of being forced to purchase resources beyond their planning resource reserve requirement.² This would result in a thinly traded auction. In an RTO where the majority of LSEs own resources, this is not viewed as a market enhancement. The OMS is consistent in this regard and has indicated this position to MISO management and the Board on two previous occasions.³ The OMS supports MISO’s current construct with a fixed planning resource margin requirement and does not support this IMM recommendation.

In considering market design changes, MISO seeks guidance from several sources (Stakeholders, the IMM, the Markets Advisory Committee or MAC and others):

1. How should MISO weigh/balance the guidance provided by these various groups?

Guidance from state regulatory authorities should be given the highest consideration, especially in matters that affect the reliability and rates of retail electric service. MISO should continue to be mindful that while the design of its markets is very important, wholesale market prices are not the only, or the most important, information that state regulatory authorities use to determine resource and transmission needs for entities under their jurisdiction.

² Capacity market constructs with sloped demand curves are generally designed with an over-procurement bias so that the market clears at or above the planning reserve margin target.

³ OMS Resource Adequacy comments to the Board and Advisory Committee on December 1, 2010 and February 23, 2011.

2. What aspects of the IMM's role in the energy and ancillary markets designs and oversight does your sector support? Are there changes you would like to see in the IMM's role?

In the 2010 State of the Market report dated June 2011, the IMM indicates that the wholesale energy markets run by MISO are competitive. The basis for the IMM conclusion involves the use of certain economic-oriented metrics such as the measurement of profitability for virtual offers and bids, withheld generating capacity and output gap measurements, and any pricing above marginal costs. Some of these metrics are defined by the FERC tariff setting up the MISO markets, and some have been developed separate from the tariff by the IMM and MISO. The IMM also uses other knowledge in making the overall conclusion.

The OMS believes that MISO in conjunction with the IMM should prepare a new report for stakeholders and the states, suggesting which tariffs and procedures with respect to whether markets are workably competitive need updating or revising in light of new knowledge and expertise in the area. This is because some of the metrics were developed in the 2003 to 2005 period. The report should opine on any new metrics that should be put into the tariff. The states and stakeholders should be given the opportunity for a full vetting of this subject as it develops, before any update-type filing is made at the FERC. The importance of this subject is critical to states, since states evaluate the MISO markets on their continued competitive operation.

3. What is your sector's view of the role the IMM should play in the design and oversight of the capacity market?

The IMM should strongly consider the interests of the states, so that customers in such states do not find themselves either paying twice for capacity or paying for more reliability than is deemed necessary by specific states. Under federal law, State resource adequacy is the domain and jurisdiction of the states, and the IMM should not encroach on any state's resource adequacy determination.