

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Midwest Independent Transmission) System Operator, Inc.)	Docket No. ER04-961-000
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**COMMENTS
OF THE INDIANA UTILITY REGULATORY COMMISSION, THE
MICHIGAN PUBLIC SERVICE COMMISSION, AND THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pursuant to the Federal Energy Regulatory Commission's ("FERC" or "Commission") Rule 211 *Rules of Practice and Procedure* 18 C.F.R. 385.211, the Indiana Utility Regulatory Commission, Michigan Public Service Commission, and Pennsylvania Public Utility Commission (IN, MI, and PA Commissions) request leave for late filing and hereby submit the following Comments in support of the Midwest Independent System Operator's ("MISO") June 25, 2004 filing of Schedule 21 regarding the provision of reactive power.

I. Background

In response to a request by the Organization of MISO States ("OMS") the FERC issued a Notice on July 14, 2004, granting an extension of time for the filing of comments, interventions, and protests to and including July 30, 2004. The OMS filed the request on July 9, 2004 to allow OMS and its constituent State Commissions sufficient time to analyze the MISO's proposal and make a recommendation as to whether the MISO's Schedule 21 or an alternative approach would be preferable. While the majority of OMS states agreed to the filing made by OMS on July 29, the IN, MI, and PA Commissions have reservations about potential unintended consequences that could result from the FERC's acceptance of the OMS filing. It is with considerable reluctance, that the IN, MI, and PA Commissions wish to share those concerns with the FERC.

II. Summary of Comments

The IN, MI, PA Commissions believe that the FERC should accept MISO's proposed Schedule 21 filing as an interim service with instructions to engage State Commissions and stakeholders that participate in the MISO, the PJM ("PJM LLC"), and the Southwest Power Pool ("SPP") in a concerted effort to develop a unified approach to reactive supply and voltage control service (reactive power) in the broader context of a regional common-market. We believe that this is consistent with the MISOs stated intention and the FERC's expressed desire to have a common market. Adoption of similar (or equivalent, if feasible) protocols among the MISO, PJM and SPP will enhance efficiencies to foster expanded trade across the RTO boundaries. If viewed in this context, we believe that some of the concerns voiced by our colleagues in the OMS would be lessened by viewing the MISO's proposed Schedule 21 as an interim step towards a more comprehensive solution.

To be clear, there is no dispute among OMS State Commissions that the MISO needs to establish a tariff to address reactive power. We believe the OMS adequately articulated the need for reactive power. The OMS understands –especially following the August 2003 blackout – that the operations of a robust grid must be capable of handling multiple contingencies. The OMS also acknowledged that those entities that provide reactive power should be fairly compensated. Despite having substantial common-ground with our colleagues in the OMS, the IN, MI, and PA Commissions are not sanguine that a resolution of the legitimate concerns and aspirations raised by the OMS is achievable in a timely manner. We also note that MISO's 2004 Coordinated Summer Assessment identifies several areas where more Reactive Power is needed, and recommends additional facilities. Moreover, the need for additional Reactive Power is likely to increase and, as such, we do not believe the public interest is well served by further delay as MISO and interested parties work towards an eventual consensus. Since Schedule 21 was thoroughly analyzed and debated in MISO's open stakeholder process, we believe that it is the "best" available result within the required time constraints.

The IN, MI, and PA Commissions are concerned that a failure to resolve this matter, within the requisite time-frame, could result in several unintended consequences. First, as mentioned previously, adequate provision of reactive power services is critical to the operation of the transmission system. Reactive power will help maintain a stable and secure electric transmission system within the MISO footprint and beyond. Without the adoption of Schedule 21, as an interim measure, the MISO footprint will be foregoing the benefits of enhanced reliability achieved as a result of additional reactive power sources. Second, a failure to resolve the matter will unjustly prevent compensation for Independent Power Producers (“IPPs”) thereby creating undue discrimination since the vast majority of generators are already compensated for the provision of reactive power through retail rates. Third, in considering the time and resources spent on this issue from State Commissions, MISO, and stakeholders, the ideal next step is to accept Schedule 21 as an interim measure and refocus staff resources elsewhere. (e.g., resource adequacy, transmission pricing). Finally, a delay in accepting the MISO’s Schedule 21 – at least as an interim approach – may add to uncertainty in the financial markets that could result in an increase in MISO’s costs and ultimately increased costs to our citizens.

III. Discussion

We believe that, within the OMS, there is agreement that the provision of volt amperes reactive (“VARs”) is essential and should be fairly compensated. The OMS in its comments recommends rejecting Schedule 21 because, in the OMS’ majority view, it “creates issues of unfairness and discrimination.” A rejection of the filing, however, will result in an inability of the MISO to compensate IPPs for provision of reactive power. Without a tariff provision in-place, only traditional utilities that are able to recover the costs of supplying reactive power through their retail rates would be compensated. The failure to compensate IPPs would be unduly discriminatory and therefore result in a situation that the OMS was expressly trying to prevent.

The IN, MI, and PA Commissions contend that, in the absence of a viable alternative to the MISO Schedule 21, the MISO proposal should be accepted. While the IN, MI, and PA Commissions agree with the aspiration for having a “needs” test to better identify and compensate those generators that are required to furnish reactive power, we believe that there is agreement that such a test is not feasible (at least currently) since we can not predict with certainty where VARs will be needed. Indeed, after lengthy study, no party has come forward with a proposal on a methodology that could be used to determine need. The alternative approach, suggested by the OMS, is to establish a zonal cost recovery approach predicated upon “homogeneous” characteristics of suppliers. In its current form, the proposal is too nebulous to be accepted. Even if the zonal proposal had sufficient detail as to what constitutes homogeneity, we are concerned that such an approach may institutionalize a “Balkanization” of the MISO that may make it more difficult to institute other MISO-wide proposals such as the provision of other ancillary services, transmission pricing, or resource adequacy. MISO, its stakeholders and OMS are currently working on a Resource Adequacy proposal that will likely address many of the same issues raised in this filing. In the end, the benefits of a zonal approach may not be warranted by the additional costs and may not be consistent with the PJM – MISO – SPP common market result that should be the desired outcome.

The IN, MI, and PA Commissions believe that the FERC, under the Federal Power Act, must approve the MISO’s filing unless it finds that the “differences” mentioned by the OMS constitute “undue discrimination” within the meaning of the FPA or, to the contrary, for the MISO not to have Schedule 21 would, in itself be unjust and unduly discriminatory for some generators. While all Pennsylvania generators in the PJM region are compensated for the provision of reactive power, in Indiana and Michigan, only traditional utilities currently recover their costs of providing reactive power since it is embedded in their retail rates. Independent Power Producers in Indiana and Michigan currently do not receive compensation for providing reactive power. The IN, MI, and PA Commissions, and in fact the majority of OMS states believe that all

generators that are eligible should receive compensation. Further, we believe that there is agreement that no entity should receive “double” compensation. Failure to approve Schedule 21 as an interim measure, would deny compensation for one group of generators (i.e, Independent Power Producers) while other generators (i.e., traditional utilities) would continue to be compensated and this result would violate the provisions of the FPA against unjust and unreasonable rates or would be unduly preferential or result in unduly discriminatory treatment. The fact that some generation in the MISO is deregulated while most generation is not is one of the complexities that distinguish the MISO from the PJM.

The OMS believes that “Opportunity Costs” should be recovered. The IN, MI, and PA Commissions agree that a generator should be paid for any lost revenues associated with a reduction of real power because it was required to increase the production of reactive power. However, the IN, MI, and PA Commissions have reservations about the practicality of implementing a compensation structure that includes recovery of opportunity costs at this time. In the absence of a detailed methodology for incorporating opportunity costs in the present MISO markets (recognizing the current differences with the PJM), this is a matter that is best left to the State Commissions, stakeholders and the respective RTOs in the longer-term development of a common market. The following factors should be considered:

- a. Schedule 21 is akin to a “reservation charge.” As such it is intended to provide compensation for the capability to provide VARs even if a specific generator is not actually called upon to generate reactive power. In this construct, routine compensation combined with payment of the incremental difference associated with sales forgone may result in over-compensation for most generators. This is especially true since, most traditional utilities are almost certainly recovering some of these costs through the retail rates (e.g., Fuel Adjustment Clause).
- b. If generators are already receiving base compensation, the opportunity costs should only be given in those instances where the supplier of VARs can demonstrate that

they have borne a burden in-excess of the base compensation provided by Schedule 21.

- c. Compensating generators for opportunity costs in the current MISO markets is likely to entail added administrative fees (expert technicians and development of software) that could be in excess of the benefits.

The IN, MI, and PA Commissions are concerned that the OMS request for the FERC to review equity issues in Schedule 2 raises concerns about the provision of other ancillary services that have not been justified. OMS did not undertake a detailed analysis of other ancillary services. The lack of specificity seems to place the onus on the MISO to establish a “needs” test without guidance from the OMS as to what standard to apply. We are, therefore, concerned that the lack of specificity as to: the standards that MISO would be asked to employ, what ancillary services may be unduly discriminatory, or how any and all ancillary services would be provided for on a zonal basis gives MISO too little guidance. In sum, the OMS’ well intentioned effort to find an equitable solution does not provide a viable alternative to the MISO’s Schedule 2.

IV. Summary

FERC Should Approve MISO’s Proposed Schedule 21. The IN, MI, and PA Commissions therefore request the FERC to approve Schedule 21 as an interim solution and to require MISO, PJM and SPP to continue to work together on a long term solution that will address the concerns raised by our three commissions, the OMS and other parties, as the FERC may determine the relevant issues. The IN, MI, and PA Commissions believe that the OMS is right to be concerned that Schedule 21 is not the “ideal” solution. Unfortunately, no one, including the OMS has been able to offer a viable alternative to MISO’s Schedule 21. Ultimately, the “best” solution is one that derives from a robust and open stakeholder process in the context of developing a common market among the PJM, MISO and SPP. However, the FERC should not wait to begin reactive power compensation for IPPs.

The IN, MI, and PA Commissions also agree that the OMS is right to be concerned that differences in Schedule 2 and 21 not be unduly discriminatory. We are deeply concerned, however, that in the absence of Schedule 21 as an interim measure to compensate all generators, only those traditional utilities that are able to recover reactive power costs (and opportunity costs to varying extents) in their retail rates will be compensated. IPPs will not be able to recover their legitimate costs. As a result, a rejection of Schedule 21, and the attendant disparate treatment, will result in the undue discrimination that the OMS was striving to prevent.

The IN, MI, and PA Commissions wish to emphasize that our different perspectives on this matter are legitimate differences of opinion. Our momentary differences in no way diminish our support for the continued evolution of the OMS. We have every confidence that the FERC will give due consideration to our position, the position of the OMS, as well as the positions of stakeholders and the MISO.

Respectfully submitted,

FILED ELECTRONICALLY W/ FERC

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Indiana Utility Regulatory Commission
And in behalf of the
Michigan Public Service Commission
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Dated: August 16, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing to be served on all parties on the official service list compiled by the Secretary in this proceeding.

Eric A. Eisen