120 FERC ¶ 61,250
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Midwest Independent Transmission System Operator, Inc. — Docket No. ER07-1182-000

ORDER GRANTING EXTENSION OF
BROAD CONSTRAINED AREA MITIGATION

(Issued September 18, 2007)

1. In this order, the Commission accepts for filing Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) proposal to permanently extend the Broad Constrained Area (BCA) mitigation measures in its Open Access Transmission and Energy Markets Tariff (TEMT or tariff), effective July 21, 2007, as discussed below.

I. Background

2. On August 6, 2004 and November 8, 2004, the Commission issued orders that, among other things, established market monitoring and market power mitigation for Midwest ISO,[1] as set forth in Module D of the TEMT. In Midwest ISO, market power mitigation measures are implemented by an Independent Market Monitor (IMM) and may be applied to energy, start-up, and no-load offers in two types of electrical areas: Narrow Constrained Areas (NCAs) and BCAs.

[1] *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 FERC ¶ 61,163 (TEMT II Order), *order on reh'g*, 109 FERC ¶ 61,157 (2004) (TEMT II Rehearing Order), *order on reh'g*, 111 FERC ¶ 61,043; *reh'g denied*, 112 FERC ¶ 61,086 (2005), *aff'd sub nom. Wisconsin Public Power, Inc. v. FERC*, 2007 U.S. App. LEXIS 17257, No. 04-1414, (D.C. Cir. 2007) (*Wisconsin*). Section 1.320 of the TEMT defines "Transmission Provider" as Midwest ISO or any successor organization. For clarity, we will refer to Midwest ISO wherever the TEMT refers to the Transmission Provider.

3. An NCA is identified in advance and defined by one or more transmission constraints that are expected to be binding[2] for at least 500 hours during a given twelve-month period and within which one or more suppliers are pivotal.[3] Mitigation may be applied when a supplier exceeds both the conduct and impact thresholds.[4]

4. A BCA is not identified in advance but is dynamically defined when one or more transmission constraints are binding and can result in substantial locational market power. When a transmission constraint becomes binding, the IMM determines whether a generation resource should be included in a BCA by comparing a resource's generation shift factor (GSF) for that flowgate to the Constraint GSF Cutoff.[5] Mitigation measures may be applied to a generation resource within a BCA if the generator's offer exceeds both the conduct and impact thresholds.[6]

5. In the TEMT II Rehearing Order, as part of its evaluation of whether Midwest ISO's proposal for market monitoring and mitigation was just and reasonable, the Commission accepted Midwest ISO's proposal to use BCA mitigation for a one-year period.[7] During that one-year period, the IMM was required to submit quarterly reports

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[2] Section 1.23 of the TEMT defines "Binding Transmission Constraint" as "a transmission constraint that causes a change in the dispatch or commitment of one or more Electric Facilities to avoid or relieve the constraint limit from being exceeded."

[3] A supplier is pivotal when the output of some of its generation resources must be changed to resolve a transmission constraint during some or all hours when the constraint is binding. Section 63.4.1 of the TEMT.

[4] The conduct thresholds specify behavior that could be significantly inconsistent with competitive conduct. To exceed the conduct threshold for economic withholding, a generator's offer price would need to be substantially above its competitive reference level. A generator's reference level is intended to reflect its marginal costs. The impact thresholds identify conduct that causes a substantial change in locational marginal prices (LMP) or revenue sufficiency guarantee (RSG) payments.

[5] A generation resource's GSF is the incremental increase or decrease in flow on a flowgate associated with an incremental increase or decrease in a generation resource's output. If the absolute value of a generation resource's GSF exceeds the 6 percent GSF Cutoff, then it will be included in the associated BCA. Section 63.4.2 of the TEMT.

[6] We note that NCAs are generally subject to tighter thresholds than BCA mitigation, because NCAs are expected to be subject to the potential exercise of market power more often. *See* TEMT II Order at P 277.

[7] TEMT II Rehearing Order at P 227.

to the Commission to allow the Commission to assess the use of BCA mitigation.[8] The TEMT II Rehearing Order further stated that, if Midwest ISO determines that BCA mitigation is required beyond the one-year period, it could file to extend such measures.[9]

6. On March 10, 2005, Midwest ISO filed a request for a one-year extension of the BCA mitigation provisions contained in Module D of its tariff in accordance with the Commission's directives in the TEMT II Rehearing Order. The Commission rejected Midwest ISO's request and directed Midwest ISO to remove the BCA mitigation provisions from its tariff.[10] Midwest ISO filed a request for rehearing of the May 9 Order. In response to Midwest ISO's request for rehearing, the Commission granted rehearing, permitted the use of BCA mitigation for an additional year, expiring July 21, 2007, and again required the filing of quarterly reports. The Commission found that BCA mitigation addressed instances of locational market power that impacted energy prices or created the opportunity to generate excessive RSG revenues.[11]

7. On July 20, 2007, Midwest ISO filed a request for a permanent extension of its BCA mitigation authority. Midwest ISO argues that prospective, automated BCA mitigation ensures reasonable prices better than retroactive remedies and contends that the benefits of BCA mitigation substantially outweigh its potential costs. Midwest ISO included in its filing an affidavit from the IMM supporting Midwest ISO's request for permanent extension of its BCA mitigation authority. Midwest ISO requests waiver of the Commission's 60-day prior notice requirement to make the proposed extension effective on July 21, 2007.

II. Notice of Filing and Responsive Pleadings

8. Notice of Midwest ISO's filing was published in the *Federal Register*,[12] with motions to intervene and protests due on or before August 10, 2007. The Organization of MISO States (OMS), the Coalition of Midwest Transmission Customers (CMTC),

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[8] *Id.*

[9] *Id.* at P 231.

[10] *Midwest Indep. Transmission Sys. Operator, Inc.*, 115 FERC ¶ 61,158 (2006) (May 9 Order), *reh'g granted*, *Midwest Indep. Transmission Sys. Operator, Inc.*, 116 FERC ¶ 61,068 (2006) (July 20 Order).

[11] July 20 Order at P 22.

[12] 72 Fed. Reg. 42,407-08 (2007).

Midwest Transmission Dependent Utilities (Midwest TDUs)[13] and Integrys Energy Group, Inc. (Integrys)[14] filed timely motions to intervene and comments supporting the proposed permanent extension of BCA mitigation. The Public Service Commission of Wisconsin (Wisconsin Commission) filed a notice of intervention that adopted the OMS comments in support of Midwest ISO's request. Wisconsin Electric Power Company and Constellation[15] filed timely motions to intervene without substantive comments.

9. Ameren Services Company (Ameren) and Dynegy[16] filed separate protests, requesting that the Commission grant an extension of BCA mitigation subject to a one-year sunset provision. The Electric Power Supply Association (EPSA) and Reliant Energy Inc. (Reliant) filed separate protests, requesting that the Commission discontinue BCA mitigation authority or, at least, refrain from granting permanent BCA mitigation authority.

10. On August 28, 2007, Midwest ISO filed a motion for leave to answer and answer to the protests.

III. Discussion

A. Procedural Matters

11. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[17] the notice of intervention and the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

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[13] For the purposes of this proceeding, Midwest TDUs include Great Lakes Utilities, Indiana Municipal Power Agency, Lincoln Electric System, Madison Gas and Electric Company, Midwest Municipal Transmission Group, Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Southern Minnesota Municipal Power Agency, and Wisconsin Public Power Inc.

[14] For the purposes of this proceeding, Integrys includes Integrys Energy Group, Inc., and its subsidiaries, Wisconsin Public Service Corporation, Upper Peninsula Power Company, and Integrys Energy Services, Inc.

[15] For the purposes of this proceeding, Constellation includes Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.

[16] For the purposes of this proceeding, Dynegy includes Dynegy Power Marketing, Inc., Dynegy Midwest Generation, Inc., and Dynegy Power Corp.

[17] 18 C.F.R. § 385.214 (2007).

12. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Midwest ISO's answer because it has provided information that assisted us in our decision-making process.

B. Substantive Matters

13. While the majority of commenters support Midwest ISO's continued use of BCA mitigation, several commenters express concern over certain aspects of the proposal. We address these concerns below.

1. Over-Mitigation Versus Under-Mitigation

a. Midwest ISO's Filing

14. Midwest ISO contends that BCA mitigation has been appropriately applied to exercises of market power. Midwest ISO and the IMM note that BCA mitigation has almost always been applied to pivotal suppliers, which suggests that the suppliers had market power and that this market power could be abused in the future.[18] When BCA mitigation was applied to non-pivotal suppliers, Midwest ISO contends that the next best option for managing the transmission constraint was much more costly (*i.e.*, providing the supplier with the ability to raise prices). In addition, Midwest ISO notes that BCA mitigation is applied infrequently, reducing the risk and potential costs of over-mitigation.[19] However, Midwest ISO argues that the infrequent use of BCA mitigation is not determinative of its continuing necessity.

15. Midwest ISO contends that it is highly unlikely that a supplier would exceed both the conduct and impact thresholds when it is not exercising market power. The IMM explains that a supplier with the incentive and ability to raise energy prices by $100 per MWh to exceed the impact threshold has market power almost by definition.[20] The IMM adds that a supplier's competitive energy offer level rarely rises by $100 per MWh for

[18] The IMM states that two-thirds of the hours during 2005 and 2006 had an active BCA constraint with at least one pivotal supplier. The IMM adds that 60 percent of active BCA constraints during 2006 had a pivotal supplier.

[19] The IMM states that BCA mitigation has been applied infrequently, in only .02 percent of all intervals since market start.

[20] Section 64.2.1.a of the TEMT indicates that a supplier's offer will exceed the impact threshold if it causes LMP in a BCA to increase by more than 200 percent or $100 per MWh, whichever is lower.

legitimate reasons and, when it does, a supplier may request that the IMM adjust its reference level to avoid exceeding the conduct threshold.[21]

16. Midwest ISO argues that substantial under-mitigation could occur without BCA mitigation measures. According to Midwest ISO, real-time RSG costs could have substantially increased, by almost $4 billion, without BCA mitigation during 2006 and the first half of 2007, because start-up and no-load offers outside NCAs would be limited only by the number of digits permitted by Midwest ISO's software (*i.e.*, $99,999,999).[22]

17. Midwest ISO also argues that prospective BCA mitigation provides better protection from market power abuses than do retroactive remedies alone. Midwest ISO notes that the Commission's enforcement authority cannot address high-priced offers unless such conduct is deemed deceptive, fraudulent, or manipulative. In addition, the IMM states that it may be difficult to foresee that a constraint will be binding for 500 hours, leaving market power abuses unmitigated until the constraint can be designated as an NCA. Relying more heavily on NCA mitigation in lieu of BCA mitigation may cause over-mitigation, the IMM argues, because the NCA mitigation conduct and impact thresholds are substantially lower than the BCA mitigation thresholds. The IMM also contends that filings submitted under section 205 of the Federal Power Act (FPA)[23] cannot deter market power abuse or address market power mitigation that has already occurred because market rule changes or new mitigation authority cannot be retroactively imposed.

b. Responsive Pleadings

18. CMTC, OMS, and Midwest TDUs argue that the IMM's affidavit provides persuasive evidence that BCA mitigation is necessary to ensure competitive markets, address market power that may be difficult or impossible to remedy by other means, and reduce potential RSG costs resulting from under-mitigation. Midwest TDUs and OMS note that BCA mitigation almost always mitigates pivotal suppliers and does not result in the mitigation of suppliers that do not have market power. Midwest TDUs add that the Commission previously found that pivotal suppliers can possess market power, which

[21] Section 64.1.2 of the TEMT indicates that a supplier's offer will exceed the conduct threshold for economic withholding in a BCA if its offer exceeds its reference level by more than 300 percent or $100 per MWh, whichever is lower.

[22] Among other things, the IMM's analysis assumes that generators committed to maintain system reliability during non-competitive conditions submitted no-load and start-up offers at just 1 percent of the software digit maximum (*i.e.*, $1,000,000) and energy offers at the $1,000 offer cap.

[23] 16 U.S.C. § 824d (2000).

justifies the imposition of mitigation measures.[24] They also point out that the conduct and impact thresholds prevent over-mitigation.[25]

19. According to Midwest TDUs, BCA mitigation does not cause over-mitigation, because the program is automated and rarely used. They maintain that there is a substantial risk of under-mitigation without BCA mitigation because three out of four of Midwest ISO's sub-regions are highly concentrated and at risk for market power exercise.[26] In addition, Midwest TDUs contend that the Commission does not have the discretion to ignore the unjust and unreasonable rates and undue discrimination or preference that could result without BCA mitigation. Midwest TDUs also contend that unmitigated market power that could exist without BCA mitigation could undermine the legal basis for the Commission's authorization of market-based rates for sellers in the Midwest ISO market.

20. Midwest TDUs argue that Midwest ISO's alternative market power mitigation options are insufficient without BCA mitigation. They assert that NCA mitigation may not be an effective or appropriate substitute for BCA mitigation because, among other things, NCA mitigation could not be used if the IMM does not foresee that a constraint will be binding for at least 500 hours and designate it as an NCA, or if the IMM does not expect such a situation to repeat itself. Midwest TDUs argue that a filing with the Commission under section 205 is unwieldy and, unlike prospective BCA mitigation, could not retroactively address exercises of market power. Midwest TDUs also argue that the $1,000 per MWh offer cap is an ineffective substitute for BCA mitigation because market power can harm the market at prices far below the $1,000 cap.[27]

21. Several protestors question the continuing need for, and appropriateness of, BCA mitigation. In its protest, EPSA argues that BCA mitigation should not be extended because it causes over-mitigation and reliability problems, as well as decreases confidence in the market. According to EPSA, the application of BCA mitigation to non-

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[24] *See* Midwest TDUs Comments at 9 (citing *ISO New England, Inc.*, 104 FERC ¶ 61,039, at P 39 (2003)).

[25] *See Midwest Indep. Transmission Sys. Operator, Inc.*, 102 FERC ¶ 61,280, at P 38, *order on reh'g*, 105 FERC ¶ 61,147 (2003) (October 29 Order).

[26] Midwest TDUs contend that the 2006 State of the Market Report suggests that the three sub-regions have Herfindahl-Hirschman Indices that exceed 2,000.

[27] Start-up and no-load offers in Midwest ISO's real-time market are not subject to an offer cap. However, tariff sections 39.2.5.f and 40.2.3.b.ix specify an offer cap of $1,000 per MWh for energy offers in the real-time market and for energy, start-up and no-load offers in the day-ahead market.

pivotal suppliers is inappropriate because their ability to raise prices reflects the natural and desired outcome of a competitive market and provides important price signals. Ameren contends that BCA mitigation is not necessary to mitigate pivotal suppliers because the IMM has not demonstrated that pivotal suppliers would attempt to exercise their market power. In addition, EPSA and Reliant contend that BCA mitigation is unnecessary because the program has been used infrequently. They note, however, that even infrequent mitigation can give rise to over-mitigation. Reliant is concerned that BCA mitigation may be applied more frequently if it is permanently extended. Ameren argues that BCA mitigation is unnecessary because it is infrequently applied and a generator would have difficulty manipulating the market using market power that occurs unpredictably and exists for only brief periods.

22. In response to the IMM's contention that, without BCA mitigation, the Midwest ISO market could have incurred substantial increases in RSG costs, EPSA and Reliant argue that the IMM's analysis is speculative and unrealistic. EPSA argues that such inflated real-time start-up and no-load offers would have been subject to intensive scrutiny under the Commission's market conduct rules. EPSA further maintains that capping such offers instead of continuing BCA mitigation is more efficient. Reliant also contends that the IMM does not provide an analysis of the costs and benefits of BCA mitigation of energy prices. EPSA and Reliant argue that Midwest ISO has adequate tools to protect against market power without BCA mitigation, including NCA mitigation, the $1,000 per MWh offer cap, section 205 filings, and the IMM's general obligation to mitigate any conduct that substantially distorts competitive outcomes. EPSA also contends that the Commission's anti-market manipulation regulations and penalty authority are sufficient to deter and address market power abuses.

23. Ameren requests that the Commission increase the $100 per MWh conduct and impact thresholds for BCA mitigation to $250 per MWh to improve price signals and encourage market entry. Ameren adds that the conduct and impact thresholds should be periodically reviewed because of inflation and higher fuel, labor, and maintenance costs.

24. In its answer, Midwest ISO notes that the potential for market power abuse is high and that protestors do not provide evidence of over-mitigation. Midwest ISO contends that the infrequency of BCA mitigation does not suggest that it is unnecessary, and may in fact indicate the program's efficacy in deterring exercises of market power. Midwest ISO argues that the conduct and impact thresholds are designed to prevent the mitigation of suppliers without market power, and that a supplier may request an adjustment of its reference level to prevent erroneous mitigation. Midwest ISO adds that the IMM manually reviews every instance of BCA mitigation to ensure proper application. Midwest ISO also contends that the IMM's analysis of potential additional RSG costs was a straightforward example of the risks of rescinding BCA mitigation. Finally, Midwest ISO argues that alternatives to BCA mitigation authority are not sufficient to address potential market power abuses, and, if a market participant knows of a superior

alternative to BCA mitigation, it may propose it in the stakeholder process or propose it to the Commission via a filing under section 206 of the FPA.[28]

c. Commission Determination

25. Based on two years' data and experience regarding BCA mitigation measures, we find that BCA mitigation appropriately balances the risk of over-mitigation and under-mitigation. In light of this experience, we will extend BCA mitigation on a permanent basis without attaching an annual sunset date or requiring the IMM to submit additional quarterly reports, as discussed below.

26. We find that the BCA mitigation program is designed to appropriately mitigate the exercise of market power in Midwest ISO and does not cause over-mitigation. While BCA mitigation may have been applied infrequently, the frequency of mitigation does not indicate whether mitigated suppliers had the ability to exercise market power or whether the presence of the conduct and impact thresholds deterred the exercise of market power. Indeed, we note that BCA mitigation has almost always been applied to pivotal suppliers, which suggests that the supplier faced insufficient competition and had market power. In other cases, non-pivotal suppliers may have market power due to their electrical location relative to a transmission constraint. However, whether suppliers are pivotal or non-pivotal, their offers must have exceeded both the conduct and impact thresholds, indicating that they were exercising market power and should have been mitigated. In this regard, no one has provided evidence that the conduct and impact thresholds are set at inappropriate levels. For example, Ameren has not supported its argument that the conduct and impact thresholds are too low.

27. Without continuing BCA mitigation, we are concerned that under-mitigation will occur. We agree with Midwest ISO that BCA mitigation prospectively addresses market power abuses that cannot be appropriately remedied by the other mitigation tools currently at Midwest ISO's disposal. Without BCA mitigation, transitory market power abuses (*i.e.*, those of less than 500 hours' duration that would not be subject to NCA mitigation) will not be prospectively mitigated, including in the hours prior to the designation of a new NCA. Indeed, based on information provided in the IMM's quarterly reports, we note that during the 1,453 hours prior to the designation of the latest Midwest ISO NCA,[29] BCA mitigation of energy offers was applied to a total of 1,297 MWh for eight generation units later included in the NCA. Furthermore, we do not agree that the Commission's anti-manipulation rules and penalty authority obviate the need for BCA mitigation as currently designed. We are concerned that real-time no-load

[28] 16 U.S.C. § 824e (2000).

[29] *Midwest Indep. Transmission Sys. Operator, Inc.*, 118 FERC ¶ 61,020 (2007).

and start-up offers are not subject to the $1,000 offer cap and could provide an opportunity to generate excessive RSG payments absent BCA mitigation.

2. Scarcity Pricing

a. Midwest ISO's Filing

28. According to Midwest ISO, BCA mitigation thresholds should not hinder scarcity pricing permitted by its $1,000 offer cap. The IMM contends that the BCA mitigation thresholds are designed to allow scarcity pricing that encourages market entry to occur when high-cost units must be ramped up and low-cost units must be ramped down to manage congestion. The IMM explains that high-cost units and some output segments have reference levels that extend up to the $1,000 per MWh level to reflect their higher costs, so they would not exceed the conduct thresholds that could trigger BCA mitigation and, if dispatched, their offers would give rise to scarcity pricing. The IMM adds that scarcity pricing exists during shortages, because operating reserves released have offer prices of at least $1,000 per MWh associated with that segment of energy and are not subject to mitigation.[30] In addition, the IMM argues that generators increasing their offer prices in excess of the conduct thresholds would probably not be mitigated because they would not exceed the impact thresholds with high prices prevailing during such shortages. Furthermore, the IMM evaluated the Midwest ISO energy markets during 2005 and 2006 and found no evidence that BCA mitigation prevented prices from rising to efficient levels during tight conditions.

b. Responsive Pleadings

29. In their supportive comments, OMS and Midwest TDUs point out that the IMM has shown that BCA mitigation does not hinder appropriate scarcity pricing during shortages. Midwest TDUs note that the tariff releases operating reserves at prices of at least $1,000 per MWh during emergencies, creating a sufficient scarcity price

[30] Section 40.2.15 of the TEMT states the Adequate Ramp Capability (ARC) procedures for releasing operating reserves during system shortages and emergencies. Section 40.2.15.a.i states that during Step One of the ARC procedures operating reserves are dispatched with an offer price that is the higher of the market participant's submitted resource offer or the shortage condition peaker proxy offer, but in no case exceeding $1,000 per MWh. Section 40.2.15.b states that during Step Two operating reserves are dispatched with an offer price that is the higher of the market participant's submitted resource offer or $1,000 per MWh.

mechanism. Midwest TDUs also contend that the Commission has previously concluded that BCA mitigation measures would not inhibit scarcity pricing.[31]

30. In their protests, Dynegy, EPSA, and Reliant assert that permanent extension of BCA mitigation is not appropriate absent a comprehensive market design, which would include resource adequacy and scarcity pricing provisions, and may conflict with long-term market entry and reliability goals. They argue that the Commission has recognized that resource adequacy, market power mitigation, demand response programs, and any scarcity pricing programs should be considered together to ensure market efficiency, adequate cost recovery, and system reliability. EPSA contends that it is difficult to determine whether a permanent extension of BCA mitigation is appropriate because the landscape of the transmission grid and pattern of congestion will change in the future due to potential market changes, including implementation of the Ancillary Services Market, a demand curve for operating reserves, and long-term financial transmission rights. Dynegy adds that the Ancillary Services Market should provide the demand elasticity necessary to mitigate potential exercises of market power.

31. EPSA and Reliant argue that Midwest ISO's prices do not attract needed investment because of the infrequency of price spikes associated with tight supply and demand conditions. EPSA maintains that BCA mitigation is applied when extenuating circumstances in the market should produce high prices and thus results in abnormal and illogical market behavior. EPSA argues that the IMM's affidavit conflicts with its earlier finding that there is insufficient scarcity pricing in Midwest ISO. EPSA asserts that the IMM performed an analysis that suggested that price signals were suppressed during a summer emergency condition in Midwest ISO. EPSA and Reliant add that the extension of BCA mitigation would further suppress scarcity prices and that Midwest ISO is currently experiencing falling capacity margins.

32. Reliant argues that, contrary to the IMM's assertions, scarcity pricing sufficient to encourage market entry does not occur in Midwest ISO. Reliant contends that the IMM has provided no evidence of such scarcity pricing and that the IMM has recognized this lack of scarcity pricing in the Ancillary Services Market proceeding.[32] Reliant argues that Midwest ISO's inadequate market design prevents prices from reflecting the long-run marginal costs of needed investment. As such, it generates little incentive to make forward contracts reflecting these long-run costs and leaves potential investors less able to secure market-based rates contracts. Reliant also argues that extending BCA mitigation would dampen price signals needed for investment and demand-side participation because it results in a *de facto* lowering of the $1,000 per MWh offer cap.

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[31] *See* Midwest TDUs Comments at 11 (citing October 29 Order, 105 FERC ¶ 61,147, at P 17-18).

[32] *See* Reliant Protest at 12 n.28.

Reliant argues that only scarcity pricing and resource adequacy mechanisms will remedy this problem and that a permanent extension of BCA mitigation is inappropriate until such programs are implemented.

33. In its answer, Midwest ISO argues that allowing suppliers to exercise market power is not an efficient scarcity pricing mechanism, and that appropriate scarcity pricing is already permitted within the BCA mitigation framework. Midwest ISO explains that scarcity prices occur when operating reserves are released at prices of at least $1,000 per MWh during emergencies and when high-cost units are ramped up or down to manage congestion. Midwest ISO adds that relying on market power to create scarcity prices will deter entry by competitors and spur entry primarily by the dominant supplier, further enhancing market power. In addition, Midwest ISO argues that relying on market power to generate scarcity pricing would not provide for needed investment in areas in which no single supplier holds a dominant position.

34. Midwest ISO argues that the Commission did not mention resource adequacy or scarcity pricing provisions as a pre-condition for future extensions of BCA mitigation authority, and that, while such mechanisms are important, they are not determinative of the question of mitigation. Midwest ISO notes that it has an interim resource adequacy plan in its tariff and that it will file a long-term resource adequacy plan with the Commission by the end of 2007. Midwest ISO adds that allowing unmitigated market power will cause non-competitive prices and will not improve price signals or otherwise compensate for an incomplete market design.

c. Commission Determination

35. We recognize that Midwest ISO's market will likely undergo significant changes, including the anticipated implementation of its long-term resource adequacy plan and development of demand resources, that may necessitate adjustments to the market monitoring and mitigation plan in Module D of the TEMT. Indeed, as Dynegy, EPSA, and Reliant suggest, an appropriate combination of mitigation measures, resource adequacy provisions, demand response programs and any scarcity pricing measures are needed to ensure that prices are just and reasonable and allow for the recovery of needed and prudent investment costs. Thus, Midwest ISO will need to examine whether the BCA and NCA mitigation programs remain necessary or require modification as Midwest ISO's market design continues to evolve.[33] However, we will evaluate any needed Module D adjustments, including any changes involving BCA mitigation measures, as appropriate in the relevant future proceedings. In light of the circumstances

[33] In particular, we suggest that Midwest ISO examine whether two different mitigation methods based on the BCA and NCA criteria are necessary. We encourage Midwest ISO to explore the adoption of one consistent mitigation method that appropriately mitigates market power in all areas of the system.

presented, the anticipated market changes are not determinative of our permanent extension of BCA mitigation authority at this time, given the current structure of Midwest ISO's market and its interim resource adequacy plan.

36. We find that BCA mitigation addresses market power concerns without undermining current incentives for market entry and long-term resource adequacy. Currently, scarcity pricing in Midwest ISO occurs when offer segments above the highest reference level are accepted and when operating reserves are released as part of Midwest ISO's ARC procedures.[34] We agree with Midwest ISO's analysis that BCA mitigation does not interfere with these scarcity pricing mechanisms because, as the IMM states, operating reserves used during shortages are not subject to mitigation and would set prices at scarcity levels during those periods. We further note that before the use of operating reserves is needed, high-cost units or output segments have reference levels that reflect their higher costs and are allowed to offer at prices a certain amount above their reference levels without exceeding the conduct thresholds, thus setting prices at scarcity levels when dispatched.

37. Many of the protestors' concerns relate to whether the interim resource adequacy plan and current scarcity pricing mechanisms are sufficient to encourage market entry and adequate cost recovery in general, rather than to BCA mitigation's specific effect on these provisions. We expect that Midwest ISO's long-term resource adequacy plan will be filed by the end of 2007,[35] that it will support the region's short-term reliability needs, and that it will encourage long-term planning and infrastructural investments. Consequently, we find that these protestors' concerns would be more appropriately addressed in that proceeding.

3. Permanent Extension and Reporting Requirements

a. Midwest ISO's Filing

38. Midwest ISO argues that the IMM has shown that the factors that create local market power and necessitate BCA mitigation are neither transitory nor expected to dissipate over time because it is uneconomic to invest in sufficient transmission and other infrastructure necessary to eliminate all contingencies that could generate local market power. The IMM also notes that BCA mitigation is implemented primarily through automated processes and does not involve human discretion in the application of the conduct and impact thresholds. To ensure that BCA mitigation is accurately applied, the IMM states that it manually reviews all intervals where BCA mitigation has occurred and

[34] *Supra* note 29.

[35] *Midwest Indep. Transmission Sys. Operator, Inc.*, 116 FERC ¶ 61,292, at P 13 (2006).

periodically samples intervals that were not subject to mitigation. To date, the IMM states that it has not detected any errors in the automated results.

b. Responsive Pleadings

39. OMS agrees with Midwest ISO's assessment that the factors that create local market power will continue indefinitely. Midwest TDUs argue that a one-year sunset on BCA mitigation is unnecessary because BCA mitigation appropriately balances over-mitigation and under-mitigation. Midwest TDUs contend that the Commission already removed the possibility that the IMM could exercise undue discretion in applying BCA mitigation by requiring the application of a six percent GSF Cutoff. Midwest TDUs add that BCA mitigation is automated, highly accurate, and does not require human involvement or undue discretion on the part of the IMM.

40. Furthermore, Midwest TDUs argue that the Commission should not burden Midwest ISO with the necessity of filings repeatedly requesting reauthorization. Midwest TDUs also contend that the one-year sunset risks "exposing consumers to the risks of unmitigated market power," as the Commission did when it discontinued BCA mitigation authority for over three months in 2006.[36] In addition, Midwest TDUs note that, while Midwest ISO requests a permanent extension of BCA mitigation, Midwest ISO would still be able to make a section 205 filing to eliminate or modify BCA mitigation measures or the Commission could eliminate BCA mitigation measures under section 206 if it finds that they are unjust and unreasonable.

41. In their protests, Ameren and Dynegy contend that the IMM should report on BCA mitigation quarterly and that the Commission should review the measures annually to ensure that they remain necessary and respond to market changes. Ameren argues that BCA mitigation should be reviewed annually to ensure that the program sends the proper price signals, does not over-mitigate the market, and does not create a disincentive for generators to offer into the market during shortages. According to Ameren, a permanent extension of BCA authority is unnecessary because the IMM has other tools to mitigate market power, including: (1) the $1,000 offer cap; (2) NCA mitigation; (3) section 205 filings; and (4) the Commission's anti-manipulation regulations and penalties. Dynegy adds that, if these tools prove insufficient, more narrowly targeted mitigation measures could be adopted instead of BCA mitigation.

42. Ameren contends that, while a generator may request that the IMM adjust its reference level, this practice unfairly places the burden of justifying such a change on a generator. Ameren also contends that it is uncertain whether the IMM will accept such adjustments or respond to such a request in a sufficiently timely manner to prevent the application of mitigation.

[36] Midwest TDUs Comments at 12.

43. In its answer, Midwest ISO notes that it did not request any change to the quarterly reporting requirement, and that such reports provide sufficient opportunity for the Commission to review BCA mitigation four times each year. However, Midwest ISO argues that BCA mitigation measures should not be subjected to a one-year sunset date. Midwest ISO agrees that in the long-term BCA mitigation may become unnecessary in certain areas, but contends that such a possibility does not suggest that the measures are currently unnecessary. Midwest ISO acknowledges that the mitigation measures may be lifted if warranted in the future. Midwest ISO argues that BCA mitigation measures should be permanently extended because local market power in BCAs will not disappear in the foreseeable future absent massive and likely uneconomic investment in new transmission capability. Lastly, Midwest ISO argues that generators rightly bear the burden to justify adjustments to reference levels set by tariff thresholds, and that such requests are extremely rare.

c. Commission Determination

44. Initially, we approved BCA mitigation for a one-year period because we were concerned that the IMM could exercise undue discretion over its application of BCA mitigation or that BCA mitigation would not appropriately mitigate market power.[37] However, as explained above, we find that BCA mitigation appropriately mitigates the exercise of market power. We are also persuaded that the possibility that the IMM could exercise undue discretion over BCA mitigation is remote.

45. We find that the IMM cannot apply BCA mitigation in excess of the objective tariff provisions and thresholds.[38] We note that none of the protestors allege any specific instance of undue discretion by the IMM. While the tariff provides the IMM with the discretion to consult market participants in order to adjust their individual reference levels or justify offers in excess of the conduct and impact thresholds, we find that such actions would result in more lenient reference levels and less mitigation, rather than over-mitigation. With regard to Ameren's argument that the IMM could exercise undue

[37] *See* TEMT II Order at P 275. We find that the IMM's record of conduct in applying BCA mitigation and the objective tariff thresholds for BCA mitigation alleviate the concerns about the potential for abuse that the Commission expressed in *Wisconsin. Cf. Wisconsin* at mimeo 38-41. As a result, based on this experience and Midwest ISO's representations here, we find that the risk of undue discretion no longer justifies an annual sunset provision for BCA mitigation measures.

[38] The Commission initially expressed concern about the IMM's discretion in determining the GSF Cutoff for specific flowgates. However, we find that the Commission's requirement that the IMM use a six percent GSF Cutoff removes the possibility that the IMM could exercise undue discretion when applying the GSF Cutoff.

discretion in approving reference level changes,[39] we note that Midwest ISO states that such requests are extremely rare.[40] However, in the event that the IMM were to deny a change to a generator's reference level, the generator's reference level would default to the objective measures provided in the tariff.

46. We find that eliminating BCA mitigation or granting only a one-year extension would be disruptive to Midwest ISO's energy markets. Permanent extension of BCA mitigation authority will help to ensure that market power abuses are appropriately mitigated. While we understand protestors' concerns that BCA mitigation may need to be adjusted in the future, such modifications should be considered as appropriate in future proceedings.[41]

47. With regard to the reporting requirement, the IMM is required to report on the efficacy of the BCA mitigation program, including any recommended changes to its mitigation procedures, on an annual basis through the State of the Market Report.[42] As such, we will not require the IMM to continue filing quarterly reports regarding BCA mitigation. Those reports were required on an interim basis to allow the Commission to assess BCA mitigation, including whether to revoke BCA mitigation authority prior to the expiration of the one-year period or to extend it for additional one-year periods. We find that the quarterly reports are no longer necessary because we are satisfied that annual reporting through the State of the Market Report will allow us to sufficiently assess the BCA mitigation program in the future.

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[39] If a market participant believes that a change to the tariff's reference level provisions is warranted, we encourage them to work through the stakeholder process.

[40] None of the protesters provide a specific instance where the IMM has exercised undue discretion when denying requests for reference level changes.

[41] In particular, we note that Midwest ISO's market monitoring and manipulation plan in its tariff may need to be modified upon resolution of the Commission's Advance Notice of Proposed Rulemaking regarding Wholesale Competition in Regions with Organized Electric Markets in Docket Nos. RM07-19-000 and AD07-7-000. 72 Fed. Reg. 36,276 (July 2, 2007), FERC Stats. and Regs. ¶ 32,607 (2007).

[42] Section 66.a.i of the TEMT requires that, as a component of its annual report, the IMM shall review and report on "the extent to which mitigation has taken place, including the number of Generation Resources mitigated, and the number of MWh mitigated." Section 66.b requires that the IMM recommend tariff changes in its annual report if it "determines that inappropriate application of the Mitigation Measures causes an inability of existing Generation Resources or new Generation Resources to operate profitably, or an understatement of Energy prices during shortage conditions."

48. For good cause shown, we will grant Midwest ISO's request for waiver of the prior notice requirement[43] and make Midwest ISO's filing effective on July 21, 2007. As the prior authorization expired July 20, 2007, this waiver will permit the existing measures to continue in full force and effect.

The Commission orders:

Midwest ISO's request for a permanent extension of its BCA mitigation authority is hereby granted, effective July 21, 2007, as discussed in the body of this order.

By the Commission. Commissioner Wellinghoff concurring with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

[43] 18 C.F.R. § 35.3(a) (2007). *See Central Hudson Gas and Electric Co.*, 60 FERC ¶ 61,106, *reh'g denied*, 61 FERC ¶ 61,089 (1992).

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission
System Operator, Inc. Docket No. ER07-1182-000

(Issued September 18, 2007)

WELLINGHOFF, Commissioner, concurring:

The Commission stated recently that robust demand-side management programs are of vital importance for a workable Midwest ISO energy market.[1] We directed the Midwest ISO to work with the Organization of MISO States and other stakeholders on participation of demand resources in the markets and market design modifications. The Midwest ISO has begun a collaborative process with its stakeholders to develop demand resources that are capable of participating in the energy markets. That work is ongoing.

Demand response can mitigate generator market power. The Commission made this observation in its recent Advance Notice of Proposed Rulemaking on Wholesale Competition in Regions with Organized Electric Markets:

> Demand response can help reduce the potential for market manipulation by reducing generator market power. As more demand response is available during peak periods, power suppliers need to account more for the price responsiveness of load when they consider higher-price bids. The more demand response is able to reduce the peak price, the more downward pressure it places on generator bidding strategies by increasing the risk to a supplier that it will not be dispatched if it bids too high.[2]

[1] *Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,292 at P 55 (2006) (evaluating the Midwest ISO's June 6, 2006 proposal for subsequent filings to implement a long-term resource adequacy program).

[2] 119 FERC ¶ 61,306 at P 39 (2007).

Thus, development of demand response may affect the need for tools that otherwise mitigate generator market power. As I have stated before, my view is that demand response can mitigate generator market power most efficiently.

Today, I vote to accept Midwest ISO's proposal to permanently extend the Broad Constrained Area mitigation measures. I have done so in large part because the Midwest ISO does not yet have sufficient demand response to mitigate generator market power. Consistent with our previous directives, I encourage Midwest ISO to continue efforts to develop demand resources so that the need for other forms of mitigation will be reduced.

For these reasons, I respectfully concur with the Commission's order.

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Jon Wellinghoff
Commissioner