

116 FERC ¶ 61, 068  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Nora Mead Brownell, and Suedeen G. Kelly.

Midwest Independent Transmission  
System Operator, Inc.

Docket Nos. ER06-731-001  
and ER06-731-002

ORDER GRANTING REHEARING AND REJECTING COMPLIANCE FILING

(Issued July 20, 2006)

1. On June 8, 2006, the Midwest Independent Transmission System Operator, Inc., (the Midwest ISO), among others, filed a request for rehearing of the Commission's Order Rejecting Extension of Broad Constrained Area (BCA) Mitigation.<sup>1</sup> In this order, the Commission grants rehearing and allows an extension of BCA mitigation for one year, beginning as soon as possible, but no later than August 1, 2006, and directs further filings.

**I. Background**

**A. Monitoring and Mitigation in Midwest ISO**

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 the Midwest ISO,<sup>2</sup> as set forth in Module D of the Midwest ISO's Open Access Transmission and Energy Markets Tariff (TEMT).

3. The Midwest ISO's market monitoring plan is implemented by an Independent Market Monitor (IMM). The monitoring plan establishes that the IMM

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<sup>1</sup> *Midwest Independent Transmission System Operator, Inc.*, 115 FERC ¶ 61,158 (2006) (May 9 Order).

<sup>2</sup> *Midwest Independent Transmission System Operator, Inc., et al.*, 108 FERC ¶ 61,163 (2004) (TEMT II Order), *order on reh'g*, 109 FERC ¶ 61,157 (2004) (TEMT II Rehearing Order).

will monitor the markets run by and the services provided by the Midwest ISO.<sup>3</sup> The market power mitigation plan imposes mitigation upon entities in constrained areas (areas in which a constraint is actively binding) that fail conduct and impact tests such that their conduct is significantly inconsistent with competitive outcomes (as indicated by conduct threshold levels) and would result in a substantial change in one or more prices in the energy market or in an Offer Revenue Sufficiency Guarantee (RSG) Payment (uplift charges to cover start-up and no-load costs) in the energy market (by exceeding impact thresholds).<sup>4</sup>

4. As accepted in the TEMT II Order and TEMT II Rehearing Order, electrical areas that may be subject to mitigation are classified as Narrow Constrained Areas (NCAs) or BCAs. As relevant here, BCAs are defined dynamically when constraints arise on flowgates. A BCA is as an electrical area in which sufficient competition usually exists, but within which a transmission constraint can result in substantial locational market power under certain market or operating conditions.<sup>5</sup>

5. When a transmission constraint becomes binding, the IMM identifies the generation units that are effective in managing the constraint, and defines them to be in the BCA. To determine which generation units are in the BCA, the resource's generation shift factor (GSF) for that flowgate is compared to a 6 percent Constraint Generation Shift Factor Cutoff (GSF Cutoff) for that same flowgate. If the absolute value of the generation resource's GSF exceeds the GSF Cutoff, then it will be included in the associated BCA. If upon being included in the BCA, the generation resource fails the conduct and impact tests, it may be subject to mitigation.<sup>6</sup>

6. The conduct test determines whether the generation resource has exceeded the conduct thresholds set forth in section 64.1 of the TEMT. That section lays out the thresholds for behavior which could potentially be problematic, *i.e.*, "significantly inconsistent with competitive conduct."<sup>7</sup> Categories of potentially problematic behavior include economic withholding, physical withholding, uneconomic production, and uneconomic market participant bids or virtual transactions.

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<sup>3</sup> Section 50.2 of the TEMT.

<sup>4</sup> TEMT II Order at P 245.

<sup>5</sup> Section 1.24 of the TEMT.

<sup>6</sup> TEMT II Order at P 265-67.

<sup>7</sup> Section 64.1.1 gives the specific thresholds for identifying physical withholding, section 64.1.2 gives those for economic withholding, and section 64.2.3 gives those for uneconomic production.

7. The impact test determines whether the generation resource has exceeded the impact thresholds set forth in section 64.2 of the TEMT. That section gives guidelines for price effects, *i.e.*, substantial changes in prices that will trigger mitigation if there is a binding constraint and the conduct test is also failed by the market participant. Impact thresholds set limits on the acceptable impacts on prices or on Offer Revenue Sufficiency Guarantee Payments to market participants.

**B. Conditional Approval of BCA Mitigation**

8. In the TEMT II Rehearing Order, the Commission noted that the difficulty in mitigating bids is to find the appropriate balance between under-mitigation and over-mitigation, because each has its costs. While under-mitigation may result in some exercise of market power that is not mitigated, over-mitigation means more frequent intervention in the market, and some competitive market results will be mitigated.<sup>8</sup> Mitigation is counterproductive to the extent it penalizes suppliers trying to resolve constraints, and when their higher offers reflect higher costs, not manipulation. Over-mitigation also can inadvertently lead to decreased confidence in the market and cause reliability problems to the extent that it keeps capacity out of the market over the long term.<sup>9</sup>

9. The Commission expressed concern that the application of mitigation, beyond the \$1,000 bid cap, in BCA areas would result in excessive mitigation. Specifically, we questioned whether the application of the GSF Cutoff captures the appropriate set of generators exerting possible market power and strikes the optimal balance between over-mitigation and under-mitigation. While we stated that we did not take lightly the potential for the exercise of market power in BCA areas, we also expressed concern that any mitigation be applied in an appropriate manner. We recognized our obligation to assure that monitoring and mitigation occur such that rates are just and reasonable for buyers and sellers.<sup>10</sup>

10. For these reasons, the Commission believed that the need for mitigation within BCAs should be re-evaluated after gaining some operational market experience. Thus, the Commission approved the use of BCAs as a method to screen for the use of mitigation in the Midwest ISO for a one-year period, ending April 1, 2006. In order to assess the BCA mitigation approach, the Commission required the IMM to submit quarterly reports to the Commission on BCAs and their associated mitigation. We stated that if we found problems with the IMM's

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<sup>8</sup> TEMT II Rehearing Order at P 230.

<sup>9</sup> TEMT I Order at P 316.

<sup>10</sup> TEMT II Rehearing Order at P 230-231.

discretion in the application of mitigation with BCAs, we would take appropriate action, including consideration of terminating the BCA provision before the end of the original one-year period.<sup>11</sup> The Commission also stated that the Midwest ISO could file to extend the use of BCA mitigation beyond the original one-year period, based on whether the benefits of such mitigation exceed its costs, in terms of over-mitigating versus under-mitigating the market.<sup>12</sup>

**C. Docket No. ER06-731-000: Midwest ISO's Requested Extension of BCA Mitigation Authority**

11. On March 10, 2006, the Midwest ISO submitted a filing requesting that the BCA mitigation provisions contained in Module D of the TEMT be extended for at least one year, to April 1, 2007.

12. The Midwest ISO stated that BCA mitigation was utilized during 2005 when transmission constraints or local reliability requirements in certain areas created substantial market power. The Midwest ISO stated that, in general, those conditions arose: (1) when important transmission lines and/or generation units were out of service and there was a corresponding "high value congestion" occurring that was not normally seen; (2) when market participants in an area bid their units inflexibly and the Midwest ISO had limited redispatch options for managing congestion; and (3) when the outage of baseload generation units caused unusual patterns of congestion or voltage support issues.

13. The Midwest ISO asserted that the market power that existed in those cases could manifest itself to allow a supplier to raise energy prices substantially in a specific area or to cause the Midwest ISO to make inflated Revenue Sufficiency Guarantee payments to the supplier to commit units in a certain area. The Midwest ISO stated that, while BCA mitigation was infrequent in 2005, in certain situations it was the only tool available to prospectively limit market power abuses.

14. The Midwest ISO stated that the IMM had analyzed the use of mitigation procedures in BCAs during the first year of market operations and that the Midwest ISO and the IMM had discussed the need for continued BCA mitigation authority. Based on this work, the Midwest ISO argued that BCA mitigation was essential and would continue to benefit energy markets within the Midwest ISO Region.

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<sup>11</sup> TEMT I Order at P 275.

<sup>12</sup> TEMT II Rehearing Order at P 231.

**D. The May 9 Order**

15. The May 9 Order rejected the requested one-year extension of BCA Mitigation on the basis that the Midwest ISO had inadequately justified the continued need for prospective, automated BCA mitigation. Among other things, the Commission stated that the Midwest ISO has not shown that BCA mitigation addressed the exercise of market power instead of, for the two binding constraints in the fourth quarter of 2005 that gave rise to BCA mitigation, altering legitimate price signals that reflect supply-demand imbalances and that would encourage market entry.<sup>13</sup>

**E. Docket No. ER06-731-001: Requests for Rehearing of the May 9 Order**

16. On June 8, 2006, the Midwest ISO filed a request for rehearing and/or clarification, motion for stay and request for expedited treatment. The Midwest ISO states that it interprets the May 9 Order as having terminated the Midwest ISO's mitigation authority within BCAs as of April 1, 2006 and that the IMM has ceased all mitigation within BCAs within the Midwest region.

17. Among other things, in an affidavit, the IMM states that with regard to the two mitigation events referred to in the May 9 Order, "the supplier whose resources were mitigated was pivotal for resolving the constraint, which means that it did not face competition. It failed the economic withholding conduct test by offering more than \$100 per MWh above its competitive reference level and this conduct resulted in a substantial increase in prices such that the impact test failed."<sup>14</sup> Midwest ISO states that the record shows that the Midwest ISO's implementation of mitigation within BCA's was limited to addressing legitimate events of substantial locational market power that either impacts energy prices or created the opportunity for pivotal suppliers to generate substantial RSG revenues.<sup>15</sup>

18. On June 8, 2006, the Organization of Midwest ISO States filed a motion for late intervention and request for rehearing and the Midwest Transmission-Dependent Utilities (Midwest TDUs) filed a request for rehearing. On June 23, 2006, the Midwest TDUs filed an answer in support of the Midwest ISO's motion for stay and for expedited treatment. On June 30, 2006, DC Energy, LLC filed a motion to intervene out-of-time.

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<sup>13</sup> May 9 Order at P 22.

<sup>14</sup> Patton Affidavit at P 46.

<sup>15</sup> Midwest ISO Request for Rehearing at 18.

**F. Docket No. ER06-731-002: Compliance Filing**

19. On June 8, 2006, the Midwest ISO filed to comply with the May 9 Order, but requests that the Commission hold in abeyance the establishment of an effective date until such time as the Commission has ruled on the Midwest ISO's request for rehearing filed simultaneously with the compliance filing.

20. Notice of Midwest ISO's compliance filing was published in the Federal Register, 71 Fed. Reg. 36,330 (2006), with protests and interventions due on or before June 29, 2006.

21. On June 29, 2006, Midwest TDUs and the Organization of Midwest ISO States filed comments supporting Midwest ISO's request that the Commission defer the effectiveness of the revised tariff sheets until the Commission has acted on the pending rehearing requests.

**II. Discussion**

22. We will grant rehearing in light of the arguments made by the Midwest ISO (and the IMM) regarding the continued appropriateness of this mitigation tool. Upon further consideration, we are persuaded that BCA mitigation, in those instances when it was applied during the previous year, addressed instances of locational market power that impacted energy prices or created the opportunity to generate excessive RSG revenues. Thus we are persuaded of the continued appropriateness of having BCA mitigation remain available for another year, commencing as soon as possible, but no later than the month following issuance of this order, *i.e.*, August 1, 2006, and extending twelve months thereafter.

23. We will not require that the IMM apply BCA mitigation to either energy prices or RSG mitigation from April 1, 2006 to present. Such *ex post* BCA mitigation of energy prices would be inconsistent with communication processes that otherwise would have been available to the IMM and market participants under the TEMT at sections 64.1.4.e and 64.3.<sup>16</sup> Moreover, *ex post* BCA mitigation could require a complex process of reconstructing the databases, running the computer model, and verifying the results to determine whether potential generator units (that met the GSF cutoff and the conduct test) also met the impact test.<sup>17</sup>

24. During the coming year, the IMM will be required to submit quarterly informational reports (to be submitted within thirty [30] days of the end of each

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<sup>16</sup> TEMT II Order at P 306, 331; TEMT II Rehearing Order at P 250.

<sup>17</sup> *See supra* P 7.

calendar quarter, with the first report due within thirty [30] days of the end of September 2006) to the Commission on BCAs and their associated mitigation to allow us to better assess the continuation of BCA mitigation in the future. (Should we find problems with the IMM's discretion in the application of BCA mitigation, we will take appropriate action, including consideration of terminating BCA mitigation before the end of this one-year extension.<sup>18</sup>) Should the Midwest ISO seek further extension of BCA mitigation authority at the end of the year, the Midwest ISO will need to demonstrate that "the benefits of such mitigation exceed its costs, in terms of over-mitigating versus under-mitigating the market."<sup>19</sup>

25. In light of this order extending BCA mitigation an additional twelve months, the compliance filing in Docket No. ER06-731-002 has now been overtaken, and we will direct the Midwest ISO to submit a new compliance filing covering two periods: the period from April 1, 2006 through the day prior to the re-establishment of BCA mitigation; and prospective application of BCA mitigation. In light of this order, we also find that we need not otherwise address the other pleadings noted above that were filed in Docket No. ER06-731-001.

The Commission orders:

(A) Midwest ISO's request for rehearing of the May 9, 2006 order is hereby granted, and extension of Midwest ISO's BCA mitigation authority is hereby granted, commencing as soon as possible, but no later than August 1, 2006, and extending twelve months thereafter.

(B) Midwest ISO is hereby direct to file quarterly informational reports, as provided in the body of this order.

(C) The Midwest ISO's compliance filing is hereby rejected as moot, and the Midwest ISO is hereby directed, within 30 days of the date of this order, to file a new compliance filing, as discussed in the body of this order.

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

( S E A L )

Magalie R. Salas,  
Secretary.

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<sup>18</sup> TEMT II Order at P 275.

<sup>19</sup> TEMT II Rehearing Order at P 231.

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Midwest Independent Transmission  
System Operator, Inc.

Docket Nos. ER06-731-001  
ER06-731-002

(Issued July 20, 2006)

KELLY, Commissioner, *concurring*:

I do not share the majority's concerns about the IMM possibly exercising undue discretion in applying BCA mitigation, and as I have previously stated,<sup>1</sup> I do not think it is necessary to require quarterly reports or a one-year sunset date on the use of BCA mitigation. However, I support this order granting rehearing because it extends the use of BCA mitigation in the Midwest ISO.

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Sudeen G. Kelly

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<sup>1</sup> See *Midwest Independent Transmission System Operator, Inc., et al.*, 108 FERC ¶ 61,163 (2004) (concurring statement).