

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission
System Operator, Inc.

Docket No. ER04-691-069

Public Utilities With Grandfathered
Agreements In the Midwest ISO Region

Docket No. EL04-104-064

ORDER DENYING REHEARING

(Issued August 8, 2006)

1. In an order dated March 3, 2006, the Commission approved, with modifications, a proposed plan for the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) independent market monitor (IMM) to screen for patterns of inefficient scheduling by holders of an expanded congestion cost hedge in the day-ahead energy market.¹ Two parties that hold such cost hedges requested rehearing of the Commission's findings, arguing, as described below, that the proposed screen will not properly identify the prohibited conduct. We will deny their requests for rehearing.

Background

2. On August 6, 2004, the Commission approved the Midwest ISO's Transmission and Energy Markets Tariff (TEMT) under which the Midwest ISO has initiated Day 2 operations in its fifteen-state region.² The Midwest ISO's Day 2 operations include,

¹ *Midwest Independent Transmission System Operator, Inc.*, 114 FERC ¶ 61,243, at P 13-17 (2006) (March 3 Order).

² *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 (TEMT II Order), *order on reh'g*, 109 FERC ¶ 61,157 (2004) (Rehearing Order I), *order*
(continued)

among other things, day-ahead and real-time energy markets and a financial transmission rights market for transmission capacity.

3. As part of the TEMT II Order, the Commission authorized the provision of expanded congestion cost hedges for five years to entities located in a Narrow Constrained Area (NCA) designated as such at the start of the market or within six months of the start of the market. The purpose of the expanded hedges was to guarantee market participants that were highly dependent on existing firm transmission service and were potentially subject to high congestion charges that they would receive sufficient financial transmission rights or an equivalent financial hedge to hold them harmless with respect to the changes in the market design.³

4. In approving the expanded congestion cost hedge, the Commission recognized that there would be incentives for an entity to nominate the full hedge on all transmission paths, even when the entity knows it will not use the full amount (*i.e.*, to over-schedule and create congestion), since to do so would allow it to profit from selling the excess energy into the real-time balancing energy market.⁴ Accordingly, the Commission required that holders of the expanded congestion cost hedges must schedule their external resources in the day-ahead market in order to obtain the congestion cost relief.⁵ The TEMT II Order also barred the holder of an expanded congestion cost hedge from scheduling external resources in the day-ahead market and then collecting “congestion relief” locational marginal pricing payments in the real-time market.

5. The IMM requested clarification, asserting that the TEMT II Order would create potentially inefficient incentives for committing and dispatching generation by holders of the expanded hedges.⁶ The IMM suggested that the Commission could prevent inefficient over-scheduling without distorting incentives to efficiently dispatch in the

on reh'g, 111 FERC ¶ 61,043 (2005) (Compliance Order I), *reh'g denied*, 112 FERC ¶ 61,086 (2005).

³ TEMT II Order, 108 FERC ¶ 61,163, at P 90.

⁴ Rehearing Order I, 109 FERC ¶ 61,157, at P 116; TEMT II Order, 108 FERC ¶ 61,163, at P 93.

⁵ TEMT II Order, 108 FERC ¶ 61,163, at P 92.

⁶ Request for Clarification of the Independent Market Monitor, Docket No. ER04-691-003, at 11-12 (Sept. 13, 2004).

real-time market by directing the IMM to monitor for over-scheduling and to report to the Commission any entities that the IMM found to be engaging in this behavior. The Commission granted the IMM's request and eliminated its scheduling restriction that would discourage holders of expanded hedges from deviating in the real-time market from their day-ahead schedules.⁷ The Commission also directed the IMM to file a monitoring plan to detect patterns of inefficient scheduling and associated mitigation measures.

6. On January 7, 2005, the IMM submitted its compliance filing, and proposed two different screens to monitor for patterns of inefficient scheduling.⁸ To address the concern that a holder of an expanded hedge might over-schedule in the day-ahead market to monetize the expanded hedge, the IMM proposed a screen that would be triggered if the holder of an expanded hedge scheduled an external resource when the locational marginal price at that resource's location was less than 50 percent of the resource's reference level as previously determined by the IMM. To address the concern that the holders of expanded hedges might schedule external resources that in the aggregate exceed the import capability into the NCA, the IMM proposed a screen that would trigger when the total day-ahead schedule of the holders of expanded hedges exceed the NCA's physical import capacity. The IMM explained that its screening proposals did not focus on the real-time dispatch of resources because it did not believe that the holders of the expanded congestion cost hedges could increase their congestion payments by altering their real-time output from the amount scheduled in the day-ahead market.⁹

7. In response, the Commission asserted that the IMM had misapprehended its concern with real-time dispatch of units receiving the congestion relief hedge.¹⁰ The Commission reiterated its concern that the IMM's proposed screens would allow holders of expanded congestion cost hedges to schedule transactions up to the full amount of the expanded hedges, even when their load requirements were substantially lower, and that they would have a financial incentive to do so. The Commission asserted that the IMM was off point with its statement that holders of expanded congestion cost hedges cannot increase their congestion payments by altering their real-time output, and again directed

⁷ Rehearing Order I, 109 FERC ¶ 61,157, at P 116.

⁸ Compliance Filing of the Midwest ISO Independent Market Monitor, Docket Nos. ER04-691-016 and EL04-104-015, at 7-9 (Jan. 7, 2005).

⁹ *Id.* at 9-10.

¹⁰ *See* Compliance Order I, 111 FERC ¶ 61,043, at P 91-92.

the IMM to submit a monitoring plan to detect inefficient scheduling and aggregate day-ahead scheduling.

8. In response, the IMM proposed to modify its screens to detect day-ahead schedules into the constrained area that exceed the quantity of economic imports needed to serve the market participant's native load.¹¹ It planned to develop a screen to detect instances when the day-ahead scheduled import is greater than 110 percent of the actual load minus the market participant's economic generation within the NCA. The IMM would consider generation within the constrained area to be "economic" if an entity's revenues at the applicable locational marginal price are equal to or greater than the entity's total operating costs as determined by its reference levels. The 10 percent threshold was meant to account for load forecast errors and operational risks faced by the participants.

9. The Commission found that the IMM's proposed screen would determine that over-scheduling has occurred, when in fact it has not.¹² The Commission was not convinced the screen was clear as to how forward energy contract terms might affect the analysis of economic imports in particular hours or that it was accurate in terms of its assumptions about the real-time dispatch (*i.e.*, the definition of economic generation does not consider whether the unit is economic compared to units located within or outside the NCA, and, therefore, does not address circumstances where it may be more efficient to import energy rather than generate it with units in the NCA).¹³ The proposed screen could thus have resulted in referrals to the Commission that would require additional facts and analysis, creating delay and uncertainty. Accordingly, the Commission required: (1) that the monitoring plan must provide a process for the IMM to compare day-ahead schedules and real-time activity to identify inefficient scheduling; and (2) that the Midwest ISO report to the Commission any findings of inefficient scheduling by holders of expanded congestion cost hedges beyond a 10 percent threshold.¹⁴

¹¹ Compliance Filing of the Midwest ISO Independent Market Monitor, Docket Nos. ER04-691-050 and EL04-104-048, at 4-5 (June 15, 2005).

¹² *Midwest Independent Transmission System Operator, Inc.*, 113 FERC ¶ 61,083, at P 36 (2005) (Market Rules Order).

¹³ *Id.* at P 34-36.

¹⁴ *Id.* at P 37.

10. The Midwest ISO submitted a subsequent compliance filing on November 23, 2005. It proposed to modify section 53.3.c of the TEMT to require the holders of expanded congestion cost hedges to report monthly to the IMM the hourly real-time physical schedules or metered injections associated with their generation on the source side, and hourly metered real-time load on the sink side of the expanded congestion cost hedge.¹⁵ The IMM is then to compare the real-time and day-ahead data on imports or injections and load, respectively, for the submitted expanded hedges. Such review will determine whether there are deviations that exceed the 10 percent threshold, and if so, whether any schedule changes on the sink side of the expanded congestion cost hedges are inconsistent with the physical use of the transmission system to support serving load by the market participant. The Commission accepted, with modifications, the Midwest ISO's proposal in the March 3 Order.

Requests for Rehearing

11. Madison Gas and Electric Company (MGE) and Wisconsin Public Service Corporation and Upper Peninsula Power Company (collectively, WPS Companies) filed requests for rehearing of the March 3 Order.

A. MGE's Request for Rehearing

12. MGE argues that there are two fundamental problems associated with the current approach to monitoring inefficient scheduling.¹⁶ First, MGE argues that the conduct prohibited by the TEMT provisions does not necessarily indicate the inefficient overscheduling that the Commission meant to prevent because it does not consider differences in operating costs. MGE asserts that, if an external resource can produce and deliver energy to a holder of the expanded congestion cost hedge for less than the holder can produce with its own resources within the NCA, then the holder has an economic incentive to import energy regardless of how the output of its other resources compares to its load.

¹⁵ Midwest ISO, Compliance Filing Revising Open Access Transmission and Energy Markets Tariff, Docket Nos. ER04-691-066 and EL04-104-062, at II.B (Nov. 23, 2005).

¹⁶ MGE notes that “[t]o date, MGE has not sought to take advantage of the expanded congestion cost hedges, but it seeks rehearing of the March 3 Order in furtherance of its interest in seeing that the rules to which it will become subject if it does seek to utilize the expanded hedges before their availability ends in 2010 are properly focused.” Madison Gas & Electric Company Request for Rehearing at 3.

13. Second, MGE believes that, even if the TEMT provisions correctly describe inefficient scheduling, they cannot isolate and identify those instances with the corresponding monitoring plan. According to MGE, the proposed monitoring plan is very similar to one that the Commission initially rejected. MGE proffered a screen that would trigger an IMM inquiry when a market participant schedules an external resource that both qualifies for the expanded hedge and has a reference level that exceeds 110 percent of the reference level of the most costly portion of the group of resources controlled by the market participant within the NCA that can most economically satisfy the market participant's total load. However, MGE acknowledges that requiring the IMM to monitor the import levels of the holders of the expanded hedges and then compare them to their load levels to determine whether the import is justified is a substantial endeavor for the IMM. MGE concludes that the additional monitoring requirements are too much for an event that is speculative and theoretical.

14. MGE asks the Commission to determine that the costs of the proposed monitoring plan exceed the benefits potentially realized by any reduction in inefficient scheduling, and to accept the monitoring plan that the IMM proposed in its January 7, 2005 compliance filing. MGE urges the Commission to consider that 15 months have elapsed since the discussion of a supplemental monitoring plan began and the expanded hedges are a transitional mechanism that will expire after 5 years.

15. We will deny MGE's request for rehearing. We agree with MGE that an entity may find it less expensive to import power into the NCA than to generate power there. However, we do not understand what scheduling pattern MGE is referring to when it states that certain patterns are likely to cause a false determination of inefficient scheduling associated with schedules covered by the expanded hedge. We made clear in the March 3 Order that, within the 10 percent threshold, the IMM should examine deviations in both injections and withdrawals associated with schedules covered by the expanded hedge. We noted that it is important to determine "... whether any schedule changes on the sink side of the expanded congestion cost hedge are inconsistent with the physical use of the transmission system to support serving load by the market participant who holds such hedge..."¹⁷ MGE has focused on scheduling imports, but the IMM will be concerned with deviations in both injections and withdrawals. Hence, MGE has not clearly explained why an entity scheduling imports (to displace more expensive generation inside the NCA) is likely to falsely cause concerns about inefficient scheduling under these rules. We therefore have no basis to find that market participants engaged in ordinary economic behavior will fail the IMM's screen often enough to cause

¹⁷ March 3 Order at P 14.

administrative difficulties for either themselves or the IMM. Importantly, we also observe that an entity whose conduct fails the IMM's screen will still have an opportunity to explain its actions to the IMM and to demonstrate that it is not gaming the market.

16. There is also not sufficient evidence in the record for us to conclude that the costs of the proposed market monitoring plan exceed its benefits, and so we are not persuaded to further adjust the screen. If, going forward, MGE finds that it is expending an unreasonable amount of resources responding to IMM inquiries that relate to ordinary import activities, it may bring its concern about the screen to the attention of the IMM (which files quarterly reports with the Commission regarding market rules), or, when appropriate, file a complaint with the Commission.

17. We also reject MGE's request that we accept and implement the screen proposed in the IMM's January 7, 2005 compliance filing. We have already considered and rejected that proposal.¹⁸ MGE's request amounts to an impermissible collateral attack on Compliance Order I.

B. WPS Companies' Request for Rehearing

18. If the Commission does not grant the relief MGE seeks, WPS Companies request clarification that the IMM should only consider the acts of a market participant to determine when the 110 percent threshold is exceeded. WPS Companies assert that the Commission should not consider instances where the day-ahead schedules vary due to actions outside the market participant's control, such as changes to output directed by the Midwest ISO or unscheduled outages. WPS Companies state that they support measures to monitor intentional over-scheduling. However, WPS Companies believe that the measures approved in the March 3 Order leave open the possibility that the screen will erroneously determine that over-scheduling has occurred. This possibility exists because of ambiguous tariff language that fails to consider the effects of third-party actions beyond the control of the monitored market participant, according to WPS Companies. Any such false positives also waste resources of market participants, the IMM, and the Commission, and therefore, WPS Companies assert that revisions are needed.

19. As we stated in response to MGE, we do not expect the monitoring plan to create a substantial administrative burden on the IMM or market participants. A market participant that fails the IMM's screen will have an opportunity to explain to the IMM why it has engaged in the particular conduct that caused the violation. The screen is intended to identify gaming, not ordinary market activities. If day-ahead schedules vary

¹⁸ See Compliance Order I, 111 FERC ¶ 61,043, at P 92.

due to circumstances beyond the market participant's control, and that variation should happen to trigger the screen, the market participant will be able to make that clear to the IMM.

The Commission orders:

MGE and WPS Companies' requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.