CALIFORNIA ISO

California Independent
System Operator

November 9, 2001

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

**Re: Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council in Docket No. EL01-68-000**

Dear Secretary Boergers:

Enclosed please find an electronic filing of the Comments of the California Independent System Operator Corporation on West-Wide Price Mitigation for the Winter Season. Thank you for your attention to this filing.

Respectfully submitted,

Margaret A. Rostker

Counsel for The California Independent
System Operator Corporation

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

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| **Investigation of Wholesale Rates of )**<br>**Public Utility Sellers of Energy and )**<br>**Ancillary Services in the Western )**<br>**Systems Coordinating Council )** | **Docket No. EL-01-68-000** |

**COMMENTS**
**OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**
**ON WEST-WIDE PRICE MITIGATION FOR THE WINTER SEASON**

## I. Introduction

On October 29, 2001, the Federal Energy Regulatory Commission (the "Commission") held a technical conference seeking comments on the west-wide price mitigation prescribed in the Commission's June 19, 2001 Order. Pursuant to the Commission's Notice of the above-referenced conference, dated October 12, 2001, the California Independent System Operator Corporation ("ISO"), which provided testimony on west-wide price mitigation at that conference, now submits additional written comments.

## II. The Need For West-Wide Price Mitigation Remains

A number of factors combined to allow California to escape the predictions of disastrous capacity shortages and skyrocketing electricity prices for the Summer of 2001, including moderate weather, unprecedented conservation, declining natural gas prices, and, just as importantly, the Commission's April 26, 2001 and June 19, 2001 price mitigation orders. Those orders provided reasonable and effective price mitigation, eliminated the prospects for megawatt laundering, and ensured capacity would be made available to serve demand.

While California avoided disaster in Summer 2001, the fundamental conditions leading to the need for west-wide price mitigation have not improved to the point where the mitigation can be relaxed or eliminated either for this coming winter or for Summer 2002. The forced or scheduled outage of much of California's aging generation portfolio created the shortages that led to rolling blackouts in Winter 2000, and that generation portfolio has since grown a year older. Path 15, the electricity bottleneck between Northern California and Southern California and a major transmission artery carrying Southwest thermal generation to the Pacific Northwest in the winter, has not been expanded and is still a pinch point in the western grid. Below-normal hydro conditions persist in the Pacific Northwest. While some new generation has been added in California and throughout the West in the last year, the fundamental conditions have not changed to where dependable, workably competitive markets have emerged or are poised to emerge from the chaos of the last twelve months.

Parties have expressed concern that the load serving entities in the Pacific Northwest will not be able to acquire sufficient electricity supplies to meet demand if those supplies are subject to a California-based price cap. They argue that the current price cap methodology should be abolished, applied regionally, or replaced with very high price caps. Arguments for the abolition of price caps or for re-instituting high price caps fail to account for California's experience – that the high prices that can and do result under high price caps have not served as a sufficient incentive to ensure adequate capacity is developed and offered to the market. Such caps have only served as to encourage market gaming and to needlessly transfer wealth. The Commission's existing price mitigation methodology recognizes that both price mitigation and an obligation to offer capacity are simultaneously required. Under current conditions, lifting or modifying price caps to ensure adequate supplies is dubiously effective medicine at best and an economy-wrecking disease at worst.

The ISO strongly urges the Commission to leave the existing price mitigation in place at least through Summer 2002. The ISO prefers that price mitigation be maintained until an affirmative demonstration that the fundamental conditions have improved to allow the price mitigation to be relaxed or lifted has been made. Moreover, as detailed below, the ISO recommends certain improvements to the existing price mitigation.

## III. Must-Offer Obligation

The ISO strongly urges the Commission to clarify with precision the appropriate implementation of the must-offer obligation for generating units with long start-up times. The April 26 Order required generators to offer the ISO all of their capacity in real time if it is available and not already scheduled to run through bilateral arrangements. At issue is the concept of what is "available". Generators argue that a unit shut down for economic reasons is not available and therefore that unit's capacity need not be offered to the ISO. The ISO holds that a unit is available if it not broken and capable of producing. (It is worth noting that many of the same generators that argue that a mechanically capable unit that is shut down for economic reasons is not available are earning regular and substantial payments from RMR contracts for units exactly in that state – mechanically available but shut down.) Because load is not constant throughout the day, some generators with long start-up times (usually twelve or more hours) that need to be on and producing energy during peak times may not be required to operate above minimum load during the rest of the day. These marginal generators understandably want to recover the costs of inefficient operation at minimum load. The ISO believes it is inequitable that generators with market-based rates operating within a portfolio of other generators with market-based rates should be able to guarantee the recovery of minimum load costs for individual units through the ISO's markets and then be free to earn greater profit with those market-based rates in other markets.   The ISO urges the Commission to clarify the must-offer obligation by imposing an equitable solution to this problem – a solution that allows for greater assurance of cost recovery but does not subsidize market participation.

## IV. Decremental Bids

The Commission should expand the must-offer obligation to include decremental bids.  To follow changing load, deal with forecast error and address local reliability issues, a power system operator must be able to both increase and decrease generation.  The must-offer obligation and proxy bid aspects of the Commission's price mitigation orders provided a necessary and effective tool to increase generation at reasonable rates.  No such tool exists to reduce generation at reasonable rates.  Generators may, but currently are not required to, submit decremental, or "dec" bids to the ISO.  Such bids effectively are offers to purchase energy from the ISO's real time market and therefore avoid the costs of generating that energy.  In theory, a supplier should be willing to purchase energy to satisfy their obligations to produce energy at some price just below their variable cost of production, thereby avoiding that variable cost.  In practice, the ISO's supply of dec bids is often very small.  Moreover, those dec bids are often submitted with negative prices – in essence, an offer to be *paid to take* – not *paid to produce* - energy.  Such offers are clearly unreasonable.  The ISO urges the Commission to extend the must-offer obligation to dec bids and, similar to the proxy price requirement for incremental bids, to require those bids to be submitted at reasonable, if not cost-based, levels.

## V. Creditworthiness Adder

The Commission should eliminate the 10% creditworthiness adder for sales in California.  The creditworthiness adder is redundant to the Commission's requirement for the ISO to provide assurance of a creditworthy backer.  Moreover suppliers acknowledge that this adder has not accomplished its desired goal.

## VI. Re-setting The Clearing Price

The ISO finds merit in permitting the clearing price limit to change based on changing gas price, but only provided that re-setting the limit occurs both when gas prices move up and when the prices shift downwards as well.  Further, the ISO does not oppose either the creation of more regional price limits (recognizing differences between gas pricing points) or allowing the price limits to change as gas prices change.

## VII. Conclusion

The ISO thanks the Commission for the opportunity to provide additional comments on west-wide price mitigation.

Respectfully submitted,

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Dated: November 9, 2001

## CERTIFICATE OF SERVICE

I hereby certify that I have this day electronically served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, CA, this 9th day of November, 2001.

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Margaret A. Rostker