

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION
101 FERC ¶ 61,105

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

California Independent System Operator Corporation Docket No. ER99-4462-001

ORDER DISMISSING REQUESTS FOR REHEARING

(Issued October 31, 2002)

1. This order dismisses requests for rehearing filed in the above-captioned proceeding, because they are now moot, having been addressed in subsequent Commission orders.

Background

1. In California Independent System Operator Corporation, 86 FERC ¶ 61,059 (1999), the Commission allowed the California Independent System Operator Corporation (California ISO) to retain its authority to specify purchase price caps for ancillary services and imbalance energy until November 15, 1999, but directed it to eliminate the price caps by that date. The Commission added that the California ISO could file an extension of its price cap authority if its experience with the market reforms over the Summer of 1999 indicated serious market design flaws still existed.

2. On September 17, 1999, in Docket No. ER99-4462-000, the California ISO filed proposed tariff revisions to extend its price cap authority for imbalance energy and ancillary services for one year -- until November 15, 2000 (Amendment No. 21). The California ISO noted that, at the direction of the California ISO's Board, the price caps were raised from \$250 to \$750 per MW or MWh (depending on service), effective September 30, 1999. However, the California ISO stated that if the Commission approved the proposed amendment it would lower the price caps to \$500 effective June 1, 2000, if the California ISO Board determined that certain conditions were met. In addition, the California ISO stated that, after the Summer of 2000, the California ISO would recommend to its Board an implementation plan to eliminate the price caps.

3. In California Independent System Operator Corporation, 89 FERC ¶ 61,169 (1999) (November Order), the Commission accepted for filing the proposed tariff revisions filed

by the California ISO to extend its purchase price cap authority for imbalance energy and ancillary services until November 15, 2000. In the November Order, the Commission recognized that in prior orders we had expressed concerns about the California ISO retaining a purchase price cap and had stated that a purchase price cap was not the ideal way to operate a competitive market. However, we stated that, upon further reflection, the purchase price cap at issue was acceptable for an additional 12 months because the proposed cap was not a cap on what a seller of ancillary services would charge to the California ISO but rather was a cap on what the California ISO as purchaser was willing to pay. We explained that the California ISO had no more, or less, discretion than any other buyer of services, and that, on the facts of this case, the California ISO's purchase price cap did not serve to set the seller's rate.¹

4. The Commission also found that intervenors' concern that the California ISO retained excessive discretion regarding the purchase price cap was unsupported. We stated that sellers of ancillary services and imbalance energy who were dissatisfied with the California ISO's purchase price cap could choose instead to sell these services in the California Power Exchange (PX) or the bilateral markets. We stated that they were not required to sell to the California ISO, and thus the California ISO could not dictate their prices. Finally, we found without merit assertions that the purchase price cap infringed on the Commission's ratemaking authority. We stated that the California ISO was not establishing the prices that sellers would charge because generators were not obligated to supply these services to the California ISO, and the Commission already had authorized them to sell at market-based rates, thereby allowing them to receive whatever competitive price a buyer was willing to pay. Therefore, the Commission accepted the tariff revisions for an additional 12 months during which the California ISO market redesign would be completed.²

Requests for Rehearing

5. On December 10, 1999, Williams Energy Marketing & Trading Company (Williams) filed a request for rehearing of the November Order. Williams argues that the Commission erred by: (1) finding that the California ISO's purchase price cap is not a cap on what a seller of ancillary services and imbalance energy may charge, because the California ISO is simply a purchaser of ancillary service and imbalance energy, with no more or less discretion than any other purchaser; (2) finding that California generators are not obligated to supply

¹89 FERC at 61,511.

²Id.

ancillary services and imbalance energy to the California ISO but can choose to sell these services in the PX or bilateral markets; and (3) departing from its well-established price cap policy, which limits price caps to markets in which significant market design flaws exist. Williams states that the Commission should find that the California ISO has failed to satisfy its burden of demonstrating that remaining market flaws justify continued reliance on price caps, and asks that the Commission order an immediate end to the California ISO's price cap authority. Alternatively, Williams asks that, if the Commission should find that the California ISO has met the foregoing burden, the Commission should nevertheless provide the California ISO only a reasonable period to correct such design flaws, and forbid the California ISO from reducing its price caps below \$750 between now and such date. Lastly, Williams asks that the Commission clearly reaffirm the California ISO's burden of justifying any continued reliance on price caps at any future time.

6. On December 13, 1999, Southern Energy California, L.L.C., Southern Energy Delta, L.L.C., and Southern Energy Potrero, L.L.C. (Southern Energy) filed a request for rehearing arguing that the Commission erred: (1) by failing to engage in reasoned decisionmaking by abandoning its prior orders that required the California ISO to demonstrate that "significant market design flaws" exist in order to support its request for extended price cap authority; (2) by basing its November Order on an erroneous belief that markets, other than those in which the California ISO is the primary, if not exclusive buyer, exist for imbalance energy and ancillary services; and (3) by failing to address the competitive problems resulting from the California ISO acting as both a price regulator and the primary, if not exclusive, purchaser of imbalance energy and ancillary services.

7. On December 13, 1999, Duke Energy North America, L.L.C., (Duke) filed a request for rehearing arguing that the Commission's decision was based upon inaccurate assumptions about the California ancillary services market. Specifically, Duke states that these incorrect assumptions are that: (1) the California ISO is just another buyer, exercising no greater influence over the relevant markets than any other purchaser; and (2) the purchase price cap is not a cap on what suppliers can sell because suppliers impacted by the cap can sell in other markets. Duke argues that the California ISO is effectively a monopsony buyer of ancillary services, and its purchase price cap is not only a cap on what the California ISO will pay, but also on what suppliers will receive.

8. On December 13, 1999, Southern California Edison Company (Edison) filed a motion to consolidate (or, in the alternative, for clarification or rehearing). Edison claims that the Commission reached the correct result in the November Order, but requests that the Commission consolidate Docket No. ER99-4462-000 with Docket Nos. ER98-2843-000, *et al.*, so that the California ISO's Market Surveillance Committee (MSC) Report and comments filed on the report are part of the record. Alternatively, Edison asks that if the Commission declines to grant Edison's motion to consolidate, Edison seeks rehearing of that portion of the November Order that rejected these answers.

9. On December 13, 1999, Dynegy Power Marketing, Inc. (Dynegy) filed a motion to intervene and protest, and a separate request for rehearing. In its request for rehearing, Dynegy asserts that it does not seek to overturn the California ISO's purchase price cap authority, but would agree to a temporary \$750 purchase price cap if the Commission: (1) rejects the conditions attached to reducing the level of the purchase price cap from \$750 to \$500 or lower; (2) provides an incentive to fix the California market by establishing a date certain for terminating price caps; and (3) initiates a process that will achieve that result. In addition, Dynegy contends that the Commission erred: (1) by failing to consider whether the California ISO complied with past orders and to demonstrate, based on the experience during Summer of 1999, that significant market design flaws remain; (2) in assuming that the California ISO has no more or less discretion than any other buyer of ancillary services; and (3) in allowing the California ISO to implement a purchase price cap that contained flawed, arbitrary provisions.

10. On December 13, 1999, Sacramento Municipal Utility District (SMUD) filed a motion for clarification, or, in the alternative, request for rehearing. SMUD asks the Commission to clarify that the November Order was based on the conclusion that the ancillary services markets are not workably competitive, and that the California ISO's price cap authority is limited by the parameters set forth in its Amendment No. 21 filing. Alternatively, SMUD seeks rehearing of the Commission's reasoning in the November Order authorizing the extension of the California ISO's price cap authority.

Discussion

11. We find that the requests for rehearing are now moot given subsequent Commission decisions, particularly the Commission's decision in San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al., 93 FERC ¶ 61,121 (2000), order on clarification and rehearing, 97 FERC ¶ 61,275 (2001), order on rehearing and clarification, 99 FERC ¶ 61,160 (2002) (California ISO Order),³ where the Commission addressed problems in the California market, and also eliminated the California ISO's purchase price cap authority, as discussed below, effective January 1, 2001.⁴

12. Among other things, in the California ISO Order, the Commission stated that after analyzing the staff investigation report,⁵ as well as other submissions, and in light of the

³These orders were appealed and are pending a decision by the United States Court of Appeals for the Ninth Circuit. See Public Utilities Commission of the State of California, et al. v. FERC, Nos. 01-71051, et al. (9th Cir. June 29, 2001).

⁴93 FERC at 61,367-71.

⁵In the California ISO Order, the Commission noted that we had responded to San

Commission's experience in dealing with evolving California issues since the restructured California markets began operation in 1998, as well as market dysfunctions and pricing abnormalities in California, the Commission proposed specific remedies to ensure just and reasonable wholesale power rates by public utility sellers in California.⁶

Diego Gas & Electric Company's request in Docket No. EL00-95-000, et al., that the Commission impose a \$250 price cap. The Commission stated that we had denied the request because the company had not provided sufficient evidence to support an immediate seller's price cap. However, we noted that the Commission instituted hearing proceedings under section 206 of the FPA to address matters affecting bulk power markets and wholesale energy prices in California, but held the hearing in abeyance pending the results of a separate staff fact-finding investigation ordered by the Commission on July 26, 2000, of the conditions in electric bulk power markets (including price fluctuations) in various regions of the country. See San Diego Gas & Electric Company, et al., 92 FERC ¶ 61,172 (2000), reh'g pending, 95 FERC ¶ 61,115 (2001).

⁶93 FERC at 61,349.

13. Specifically, the Commission found that the market structure and market rules for wholesale sales of electric energy in California were flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California caused, and had the potential to cause, unjust and unreasonable rates for short-term energy (day-ahead, ancillary services and real-time energy sales) under certain circumstances.⁷ Therefore, the Commission proposed fundamental modifications to the market structure and rules currently in place in California. The Commission also proposed price mitigation measures (e.g., modification of the single price auction so that bids above \$150/MWh could not set the market clearing price that is paid to all bidders) to ensure that wholesale rates remain just and reasonable during the period it would take to effectuate the market structure and market rule changes being proposed.⁸

14. In addition, the California ISO Order addressed the California ISO's Tariff Amendment No. 31 in Docket No. ER00-3673-000, which proposed to extend the California ISO's purchase price cap authority beyond November 15, 2000, and to allow the California ISO to establish caps for all of its markets. The California ISO Order also addressed the PX's tariff amendment that proposed to impose prices for bids in its day-ahead and day-of markets of \$350/MWh in Docket No. ER00-3461-000.⁹

⁷Id.

⁸Id. at 61,350-51.

⁹Id. at 61,355.

15. In rejecting the California ISO's proposal in Docket No. ER00-3673-000, the Commission discussed the California ISO's purchase price cap authority in light of the problems in the California market at issue in this proceeding, *i.e.*, Docket No. ER99-4462-000. The Commission explained that while the California ISO's purchase price cap had served to mitigate price volatility in both the California ISO and PX markets, it also had served to disrupt the market by encouraging sellers to stay out of the PX's auction and wait for the California ISO to make the needed purchase on an out-of-market basis at the last minute. The Commission noted that we proposed modifying the single price auctions so that bids above \$150/MWh could not set the market clearing price that is paid to all bidders, and that this modification was intended to establish uniform pricing and remove incentives for the load and resources to participate in one market over another. For this reason, the Commission stated that we would not allow either the California ISO or the PX to implement changes that would disrupt this uniformity or to introduce new incentives in the markets.¹⁰ On rehearing, we reiterated that the Commission remained committed to establishing market-driven price mitigation measures, and the California ISO's and PX's proposals would have disrupted efforts to move in that direction. Accordingly, we denied requests for rehearing to reinstate the California ISO's discretion to set price caps.¹¹

16. Thus the California ISO Order: (1) confirmed that market design flaws existed during the effective period of the purchase price cap; (2) terminated the California ISO's purchase price cap authority; and (3) provided a replacement price mitigation method going forward. The arguments on rehearing that the California ISO failed to demonstrate that the markets were flawed are moot given the first point above; price mitigation was necessary during the locked-in period of the purchase price cap (November 15, 1999 through January 1, 2001). While the Commission put in place an interim price mitigation scheme, that scheme could only be put in place, and was put in place, prospectively by the California ISO Order. Thus, despite whatever flaws, as the only price mitigation scheme available for the locked-in period, the purchase price cap accepted by the November Order will be upheld for that period.

17. Therefore, as discussed above, in light of our decisions issued subsequent to the November Order, particularly, the California ISO Order, we find that the requests for rehearing

¹⁰*Id.* at 61,371. We added that we were attempting to provide a period of stability in the market in order to encourage supply to enter the market. Therefore, although we rejected the California ISO's and PX's proposals filed in Docket Nos. ER00-3473-000 and ER00-3461-000, in the interest of maintaining stability in the markets during the transition prior to imposing the instant market reforms, we stated that the current \$250 California ISO purchase cap would remain in place at that level but only until 60 days after the date of the California ISO Order (*i.e.*, January 1, 2001). *Id.*

¹¹97 FERC at 62,237.

filed in Docket No. ER99-4462-001 have since been addressed and are now moot and we will dismiss them.¹²

The Commission orders:

The requests for rehearing filed in Docket No. ER99-4462-001 are hereby dismissed, as discussed in the body of this order.

By the Commission.

(S E A L)

¹²We find that Edison's motion to consolidate Docket No. ER99-4462-000 with Docket Nos. ER98-2843-000, et al. is moot as well. Edison asked for consolidation so that the California ISO's MSC Report and comments filed on the report would become part of the record in ER99-4462-000. We note that in the California ISO Order, the Commission incorporated the analysis of the MSC Committee in its decisionmaking (see 93 FERC at 61,354 at, 61,366 n.81). In addition, we note that after the November Order was issued, the Commission issued a decision in Docket Nos. ER98-2843-008, et al. See AES Redondo Beach, L.L.C., et al., 90 FERC ¶ 61,036 (2000), petition for review denied, El Segundo Power, LLC, et al. v. FERC, No. 00-1093 (D.C. Cir. May 22, 2001).

Linwood A. Watson, Jr.,
Deputy Secretary.