

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

San Diego Gas & Electric Company,)	
)	
Complainant,)	
)	
v.)	
)	Docket No. EL00-95-000
)	
Sellers of Energy and Ancillary Services)	
Into Markets Operated by the California)	
Independent System Operator and the)	
California Power Exchange,)	
)	
Respondents.)	
)	
Investigation of Practices of the California)	
Independent System Operator and the)	Docket No. EL00-98-000
California Power Exchange)	
)	
California Independent System Operator)	Docket No. ER01-607-000
Corporation)	

**MOTION FOR ISSUANCE OF REFUND NOTICE TO SELLERS, REQUEST FOR
DATA, REQUEST FOR HEARING, AND REQUEST FOR EXPEDITED ACTION OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION AND THE
CALIFORNIA ELECTRICITY OVERSIGHT BOARD**

Pursuant to Rule 212 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.212, the California Independent System Operator Corporation (“ISO”) and the California Electricity Oversight Board (“EOB”) file this motion with the Commission to issue a Notice to Market Participants that wholesale sales pursuant to bids above the \$150 breakpoint continue to be subject to review beyond the 60-day period, in keeping with the requirements of the order issued by the Commission in the

above-captioned docket on December 15, 2000.¹ The ISO and the EOB also request that the Commission: (1) require generators to provide the ISO and California state officials with cost data provided to the Commission; and (2) institute a hearing regarding the justness and reasonableness of sales by public utility sellers in the California Power Exchange ("PX") and ISO markets since December 8, 2000.

I. BACKGROUND

In response to concerns regarding the functioning of the California electricity markets, and to address issues raised by Market Participants in several ongoing proceedings, the Commission instituted an investigation into the California bulk power markets.² In its August 23, 2000 Order initiating the investigation, the Commission stated that sales pursuant to bids submitted to the ISO or the PX markets from October 29, 2000 forward would be subject to refund.³

On November 1, 2000, the Commission issued the report of its Staff investigation and an order proposing remedies for the California Wholesale Electric Market. In the November 1 Order, the Commission proposed: (1) to eliminate the requirement that the California investor owned utilities sell all of their generation into and purchase all of their energy requirements from the PX; (2) to institute a penalty for underscheduled load;

¹ *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 ¶ 61,294 (December 15, 2000) ("December 15 Order").

² Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, Appendix A to the ISO Tariff.

³ *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.*, 92 FERC ¶ 61,172, 61,608 (2000) ("August 23 Order"). The August 23 Order sets a refund effective date of 60 days after notice of the initiation of the investigation is published in the Federal Register. Such notice was published on August 30, 2000 (65 FR 52726). In the November 1, 2000 Order, FERC granted the rehearing requests of Southern California Edison Company and Pacific Gas and Electric Company and advanced the refund effective date to October 2, 2000. 93 FERC ¶ 61,121 at 61,370 (2000) ("November 1 Order").

(3) to institute a soft price cap at \$150/MWh; and (4) to replace the ISO and PX Governing Boards.⁴ The Commission also proposed to require the PX and the ISO to report confidentially to the Commission on a monthly basis regarding bids above the \$150 breakpoint and for individual public utility sellers to provide on a weekly basis the cost support for their successful bids above that level. *Id.* at 61,368.

In response to emergency conditions in its Control Area, the ISO filed Amendment No. 33 on December 8, 2000. This filing proposed to implement immediately an interim price mitigation proposal based on the soft cap concept from the November 1 Order except that the breakpoint level was set at \$250/MWh. In its Transmittal Letter, the ISO requested that the Commission impose similar reporting requirements on sellers bidding above \$250 in the ISO's Imbalance Energy Market as those discussed in the November 1 Order. Filing letter at 7-8. The ISO also requested that the Commission require that sellers provide cost information to the ISO and the EOB, so that they could review the costs and evaluate whether to seek Commission action regarding any sales that appear to be unjust and unreasonable. *Id.* In recognition of the exigent circumstances, the Commission accepted Amendment No. 33 that same day. *California Independent System Operator Corporation*, 93 FERC ¶ 61,239 (2000). The Order did not discuss the ISO's proposed reporting requirements.

On December 15, 2000, the Commission issued its Order Directing Remedies of the California Wholesale Electric Markets, *San Diego Gas & Electric Company, et al.*, 93 FERC ¶ 61,294 (2000). Among the major elements of the December 15 Order were: prohibiting the California investor owned utilities from buying and selling through the PX; replacement of the stakeholder Governing Boards of the PX and the ISO; and providing a penalty for underscheduling by Load (that is, failing to schedule ahead of real time).

⁴ 93 FERC at 61,360. The Commission also required the ISO to file interconnection procedures and identified additional longer-term structural reforms that needed to be addressed. *Id.* at 61,364-65.

The December 15 Order also required that public utility sellers whose bids above a \$150 “breakpoint” were accepted by the ISO file weekly transaction reports providing cost justification for such bids above the breakpoint. December 15 Order at 62,011. The Commission reaffirmed its “responsibility under the FPA to monitor markets to ensure that rates in the markets remain within a zone of reasonableness.” *Id.* at 61,996. In order to satisfy this obligation, the Commission stated that bids above the \$150 breakpoint would be subject to review to ascertain whether they are above the breakpoint due to legitimate costs or due to an exercise of market power by the bidder. The information to be submitted to the Commission includes specific transaction cost data, such as MWs sold, fuel quantity and cost, NOx emissions costs, and information on other input costs. *Id.* at 62,08-10.

In order to promote price certainty, the Commission stated its intention “to close our review of as-bid transactions within 60 days after the transaction report is filed with us.” *Id.* at 61,997. The Commission added that if it did not issue written notification within the 60-day period, any refund liability on the part of the seller would end automatically. *Id.*

II. SIGNIFICANT MARKET POWER IN THE CALIFORNIA MARKET HAS RESULTED IN UNREASONABLE PRICES

In his concurrence on the December 15 Order, Commission Massey referred to the “apocalypse occurring in the California power markets” and the “staggering” transfer of wealth from purchasers of power to sellers. Unfortunately, the available information suggests that this situation persists and that the Commission's price mitigation measures have not had the desired effect on prices in the California market.⁵ The ISO

⁵ The ISO and the EOB understand that one of the most significant mitigation measures proposed in the Commission's December 15th Order was the use of long term contracts at reasonable rates to mitigate the amount of Load exposed to spot market prices. The State of California has been undertaking extraordinary efforts to secure such contracts. In order to accomplish this goal the State has expeditiously passed legislation authorizing the California Department of Water Resources (“CDWR”) to enter into such agreements and enabling CDWR to issue bonds to fund the purchases. CDWR has issued two requests for bids and is in active negotiations. Nevertheless, it was not possible to have these

estimates that Energy and Ancillary Service Costs for December 2000 totaled \$6.15 billion and for January 2001 totaled \$5.34 billion, or over \$11 billion for two months.⁶ This compares to estimated costs of \$7.43 billion *for the entire year* of calendar 1999. On a dollar per MW basis, costs in 1999 ranged between monthly averages of about \$20 to \$50 with a yearly average of \$31. The comparable figures for December 2000 and January 2001 were \$294 and \$265, respectively -- nearly ten times the prices during the previous year.

Since December 8, 2000, the ISO has operated under a "soft cap". As noted above, all bids less than the applicable breakpoint continue to be treated under the single price auction design, with bidders receiving the market clearing price ("MCP") set by the highest accepted bid within this threshold. Bids above the soft cap are paid as bid, and since January 1, 2001, have been subject to the additional reporting requirements of the December 15 Order.

Provided as Attachment B to this pleading is a report prepared by the ISO's Department of Market Analysis ("DMA") that provides a preliminary cost review of accepted bids and out-of-market (OOM) purchases by the ISO to meet demand for real time Imbalance Energy during the period from December 8, 2000 to January 31, 2001. The DMA report compares purchases of Energy at prices over the \$250 and \$150 thresholds in the ISO's Imbalance Energy Market to estimated costs, including a reasonable margin above estimated costs (calculated as 10 percent of production costs or \$25, whichever is less). For natural gas-fired plants within the ISO Control Area owned or operated by major non-utility owners, the costs were estimated based on actual unit operating levels, combined with estimated heat rates, spot market gas

long term contracts in place for December and January and it may not be possible to implement this remedy for some additional period of time. Accordingly, a critical component of the Commission's program of ensuring just and reasonable rates for this period is not in place.

⁶ See Attachment A, Cost Summary Through January 29, 2001.

prices, and, where applicable, estimated NOx emission rates and emission credit costs. For imports into the ISO Control Area, costs were estimated based on daily spot market gas prices and an average 12,000 Btu/kWh heat rate.⁷

The central conclusion of the DMA Report is that numerous sellers were able to establish prices at levels substantially above levels that may be considered just and reasonable based on a detailed analysis of supply costs, current market conditions, and revenues earned over the last year as a result of the uncompetitive conditions and outcomes in California's marketplace. Report at i. DMA estimates that as much as \$247 million or 21% of the real time Energy costs during December 2000 and \$315 million or 63% of the real time Energy costs for January 2001 represent charges that may exceed just and reasonable levels. *Id.*

The DMA Report explicitly accounts for the high price of natural gas that some suppliers may need to purchase in the daily spot market.⁸ Similarly, DMA also considered the potential cost of NOx emission credits costs for units within the South Coast Air Quality Management District ("AQMD") that needed to buy emission credits. While the cost of natural gas on the spot market and NOx emission credits may have been relatively high for some units in recent months, these potential costs do not explain the high overall prices for real time Energy being demanded by suppliers.⁹

⁷ Since most of the imports into the ISO Control Area during this period were from hydroelectric resources, the ISO based its estimates on the opportunity cost for such hydroelectric resources, that of the cost of the inefficient thermal unit. The heat rate estimate was conservative in that it represents a relatively inefficient thermal unit.

⁸ The report notes that spot market gas prices rose gradually from about \$5 to \$20/MMBtu over the month of November, spiked sharply in the first week of December to nearly \$60, and then fell sharply starting in the second week of December to remain below \$20 for both the remainder of the month and throughout January 2001.

⁹ NOx emission prices rose up to about \$42/lb during the month of December 2000. Actions by the AQMD Governing Board to modify the emissions trading market and to help stabilize credit prices, however, lowered NOx credit prices to approximately \$18/lb in mid-January 2001. These initiatives include new AQMD rules to create a pilot program through 2003 where certain companies could obtain additional NOx credits by paying \$7.50/lb. AQMD is also working on reviewing the market structure.

The DMA analysis included in this filing demonstrates that in December, even with the expensive spot market gas and NOx emission prices that some generators may have incurred, the operating costs of most thermal capacity owned by the major non-utility owners within the ISO Control Area were significantly below December's \$250 breakpoint. Approximately two-thirds of all real time Energy procured during December, however, was procured at prices above the \$250 threshold, with the total amount of potential payments in excess of the \$250 threshold representing approximately \$422 million.

Similarly, after the \$150 soft cap took effect on January 1, 2001, approximately two-thirds of real-time Energy was purchased at prices above this threshold, with the total amount of potential payments in excess of the \$150 threshold representing approximately \$370 million, even though the bulk of thermal generation within the ISO Control Area appeared to have operating costs below this level as a result of the decreases in gas prices and NOx emission credit prices.

The ISO has developed the analysis presented in the attached report in order to provide an indication of the reasonableness of overall costs and the magnitude of potential refunds until more complete cost information can be obtained and fully reviewed by the ISO. Pursuant to the ISO's emergency filing for Amendment 33, the ISO's Department of Market Analysis previously directed all Scheduling Coordinators supplying at prices over the \$250 breakpoint in effect from December 8-31, 2000 to submit supporting cost data to the ISO by January 31, 2001. To date, numerous suppliers have either not responded to this request, or have responded by indicating they do not believe they are subject to any cost reporting requirements under the ISO's Amendment 33 filing. In addition, data provided by many suppliers was typically insufficiently documented to allow cost information to be verified. Nevertheless, analysis of cost data submitted by numerous suppliers pursuant to Amendment 33 is highly consistent with general findings of this report, in that total self-reported costs are

significantly lower than sales costs to the ISO, and indicate that unjust and unreasonable profit margins continue to result due to the current non-competitive condition of California's wholesale energy market. Summary results of the ISO's analysis of cost data submitted pursuant to Amendment 33 is provided in the confidential Appendix C to the DMA report.

The record profits earned by the sellers in the California markets have been well documented.¹⁰ In a comparison of net income for the third quarter of 2000 against the third quarter of 1999, AES Corporation had an increase of 131 percent from \$58 million to \$134 million; Williams Energy Marketing & Trading had an increase of 342 percent from \$1.9 million to \$8.4 million; Duke Energy Corporation had an increase of 75.7 percent from \$436 million to \$766 million; Dynegy Power Marketing had an increase of 82.9 percent from \$96.5 million to \$176.5 million; and Reliant Energy had an increase of 37.5 percent from \$283 million to \$398 million.

While these corporate earnings reflect operations beyond those conducted in California, previous analyses submitted to the Commission by the ISO indicate that prices received by these entities in the California market during the summer and fall months of 2000 were significantly inflated above competitive levels.¹¹ The Commission itself found in its November 1 Order that:

the electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy [and Ancillary Services] under certain market conditions.¹²

¹⁰ The figures listed in this pleading are taken from a January 7, 2001 Article in the *Sacramento Bee*, a copy of which is provided as Attachment C.

¹¹ See, e.g., Comments of the California Independent System Operator Corporation, Docket No. EL00-95-00, *et al.*, November 22, 2000, Attachment A.

¹² November 1 Order at 61,349.

The Commission's December 15 Order reaffirmed its finding that "that unjust and unreasonable rates were charged and could continue to be charged unless remedies are implemented."¹³

The additional analysis by DMA submitted with this filing provides further evidence that many sellers have continued to benefit improperly from noncompetitive market conditions by bidding significantly above costs (including a reasonable contribution to fixed costs) for a prolonged period in the California electricity market.¹⁴

III. REQUESTS FOR RELIEF

The ISO and the EOB believe that the data presented in the DMA Report constitutes a *prima facie* case that prices in the California market have exceeded competitive levels, are unjust and unreasonable, and warrant further Commission investigation and refunds. Based on the information developed to date, the ISO and the EOB respectfully request that the Commission take the following immediate actions:

- Notify sellers that their transactions are subject to further review;
- Require generators to provide the ISO and California state officials with cost data provided to the Commission; and
- Set issues related to the exercise of market power by public utility sellers into the PX and ISO markets and the appropriateness of refunds for hearing.

Each of these requests is discussed below.

¹³ December 15 Order. at 61,999.

¹⁴ The November 22, 2000 Comments of the Pacific Gas & Electric Company submitted in response to the November 1 Order contained the testimony of Dr. Carolyn Berry of National Economic Research Associates, Inc. Dr. Berry's analysis indicates that the new plant owners had recovered all or a substantial portion of their acquisition costs from sales into the ISO and the PX markets during the period between April 1, 2000 and October 31, 2000.

A. The Commission Should Notify Sellers That Their Transactions Are Subject To Further Review.

As discussed above, in the December 15 Order, the Commission required public utility sellers to submit weekly reports on costs incurred to make all sales into the ISO and PX spot markets that exceed the \$150/MWh soft Cap. December 15 Order at 62,011. Reports are due the Wednesday following the transaction week. *Id.* at 62,012. “[U]nless the Commission issues some form of notification to a seller that its transaction is still under review, refund potential on a particular transaction will close 60 days after the initial report is filed with the Commission.” *Id.* at 62,011.

The first reports provided in accordance with the December 15 Order were due on Wednesday January 10, 2001. The sixty-day period with regard to these initial transaction reports will expire on March 11, 2001. Based on the significant evidence suggesting that bids above the \$150/MWh level reflect the exercise of market power and result in unjust and unreasonable costs to consumers, the ISO and the EOB request that the Commission issue the necessary notifications preserving the potential for a subsequent finding that refunds are warranted.

B. The Commission Should Require Generators to Provide the ISO and California State Officials With Cost Data Provided to the Commission.

As part of the ISO’s proposal in Amendment No. 33 to implement an interim \$250 soft cap in its Imbalance Energy Market, the ISO requested that the Commission condition sellers’ market-based rate authority by requiring each seller to file on a weekly basis a report detailing each transaction that exceeded the soft cap. Amendment No. 33, Transmittal Letter at 1. This request was modeled after the proposals contained in the Commission’s November 1 Order. The ISO requested, however, that in addition to supplying this data to the Commission, public utility sellers also should be required to provide it to the ISO and the California Electricity Oversight Board, to permit an assessment of the costs and enable a determination as to whether or not to seek

Commission mitigation of bids that appeared to be unjust and unreasonable. The Commission's Order approving Amendment No. 33 did not directly address this request.¹⁴

Previously, the ISO had requested that all Scheduling Coordinators with accepted bids over the \$250 breakpoint (for the period from December 8 through December 31) provide supporting cost data to the ISO. In order to facilitate the provision of such information, the ISO provided Scheduling Coordinators with electronic files that included their individual BEEP and OOM bid/dispatch data for Energy supplied at prices over \$250/MWh during this time period. The ISO believed that the provision of such information would make the task of matching cost data to specific hourly transactions easier for both the ISO and Market Participants. The ISO also developed, and provided to Market Participants, suggested guidelines for reporting cost data and supporting documentation associated with specific hourly transactions. The ISO requested that data supporting bids over \$250 be submitted to the ISO by January 31, 2001. As noted above, to date, numerous suppliers providing real time Energy at prices over \$250 during the December 8-31 period have either not responded to this request, or have responded by indicating they do not believe they are subject to any cost reporting requirements under the ISO's Amendment 33 filing.

The ISO is preparing a second request to obtain this information. Section 4.5.1 of the Market Monitoring and Information Protocol ("MMIP") of the ISO Tariff permits the DMA to "request the submission of any information determined by [the DMA] to be potentially relevant by ISO participants, the PX or other entities whose activities may affect the operation of the ISO market." The ISO and the EOB are concerned, however, that given the inadequate response to the ISO's previous request, this vital data will not be forthcoming.¹⁵

¹⁴ The ISO has filed a limited motion for clarification on this issue in Docket No. ER01-607.

¹⁵ To the extent that the ISO once again receives an inadequate response to this legitimate

As noted above, in the December 15 Order, the Commission required sellers to provide extensive data on their transactions above the current soft cap level of \$150/MWh. The ISO and the EOB renew the ISO's request that this information be provided to the ISO's DMA at the same time it is provided to the Commission. The information should also be provided to California officials including the EOB, the California Public Utilities Commission, and the Attorney General.

The goal of the MMIP is to:

adequately inform regulatory agencies, ISO Participants and others of the state of the ISO Markets, especially their competitiveness and efficiency. This function is designed to facilitate efficient corrective actions to be taken by the appropriate body or bodies when required.

MMIP at Section 1.2.1. In furtherance of this objective, the DMA must scrutinize market behavior to identify anomalous market behavior defined as a departure "from normal competitive markets that do not require continuing regulation." *Id.* at Section 2.1.1. In order to carry out its responsibilities effectively, the DMA must be given access to sellers' actual costs consistent with the data the Commission has required be provided on a weekly basis.

C. The Commission Should Set Issues Related to the Exercise of Market Power and the Appropriateness of Refunds for Hearing.

The ISO and the EOB request the Commission to set the justness and reasonableness of the sales submitted in the California markets by public utility sellers in the PX and the ISO markets since December 8, 2000 for hearing.¹⁶ The unprecedented massive transfer of wealth in the California electric market and the

information request, the ISO will pursue all available remedies. As the Commission has already initiated an investigation into sales during this period and has notified jurisdictional sellers that all sales into the ISO's markets are subject to refund, the ISO and the EOB request that the Commission reaffirm the ISO's ability to request and obtain such information.

¹⁶ The ISO is continuing its efforts at analyzing bidding behavior in prior periods and expressly reserves the right to seek hearings for sales made prior to December 8, 2000, as well.

strong suggestion of the improper exercise of market power from both the Commission's own investigations as well as the DMA Report mandate that a full and fair airing of the matter. Hearing procedures are necessary to allow full discovery of the cost information supporting the bids to be had, and to allow Market Participants to present evidence regarding the existence of market power. The ISO has conducted an internal analysis of the bidding behavior based on the data available to it as described above. Hearing procedures would allow the ISO (and other parties) to obtain additional data and to present testimony further explaining its experience with the exercise of market power in its markets.

Moreover, if the public utility sellers in the California markets have at their disposal evidence that their bids have not been based on the exercise of market power, this, too, could be presented in a hearing context. It would allow other Market Participants to understand better that no abuse of market power has taken place. At the current time, the ISO and the EOB are aware of no such evidence. Finally, once bids have been examined fully and justified to the extent possible, the Commission can make a final determination as to their justness and reasonableness, and order refunds where warranted.

IV. REQUEST FOR EXPEDITED ACTION

Total costs for Energy and Ancillary Services averaged approximately \$169 million *per day* during January 2001.¹⁷ These astronomical prices cannot continue. In order for California state officials to be in a position properly to plan and execute bond financing and other market reforms they need to know what are the just and reasonable rates. Accordingly, the ISO and the EOB respectfully request that the Commission issue an order shortening the period for responding to this pleading and to act expeditiously on this request.

¹⁷ See Attachment A.

V. CONCLUSION

For the reasons set forth above, the ISO and the EOB respectfully request that the Commission: (1) issue written notice that above-breakpoint bids submitted in the California markets since January 1 are still under review, (2) require public utility sellers to provide the ISO and California state officials with cost data provided to the Commission; and (3) set for evidentiary hearing the issue of the justness and reasonableness of the sales of the public utility sellers in the PX and ISO markets.

Respectfully submitted,

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