

143 FERC ¶ 61,211
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony Clark.

California Independent System
Operator Corporation

Docket No. EL12-73-000

ORDER CONDITIONALLY GRANTING PETITION FOR DECLARATORY ORDER

(Issued June 5, 2013)

1. On June 8, 2012, the California Independent System Operator Corporation (CAISO) filed a petition for declaratory order seeking approval for the resettlement of bid cost recovery payments from April 1, 2009 through March 25, 2011. In this order, we find that the resettlements are appropriate and conditionally grant approval, subject to CAISO filing a detailed report of the resettlements.

I. Background

2. The CAISO tariff provides for “bid cost recovery” to ensure that resources committed by CAISO will recover their bid costs, including start-up and minimum load costs. When a resource’s market revenues are insufficient to cover those bid costs, the bid cost recovery mechanism provides resources with a make-whole payment. The Commission’s original acceptance of the bid cost recovery mechanism specified that CAISO must calculate bid cost recovery payments based on actual delivered amounts of energy.¹ To calculate actual delivered amounts of energy, CAISO developed and implemented through its business practice manuals a formula to apply in the day-ahead and real-time markets.²

3. CAISO subsequently discovered that, in application, the business practice manual formula did not fully account for market revenues associated with delivered energy when

¹ *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274, at PP 491-539 (2006), *order on reh’g*, 119 FERC ¶ 61,076 (2007), *aff’d*, *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520 (D.C. Cir. 2010).

² *Cal. Indep. Sys. Operator Corp.*, 137 FERC ¶ 61,180, at P 2 (2011) (December 2, 2011 Order).

a generator provided less energy in real-time than it was scheduled to provide in the day-ahead market. CAISO also discovered that a certain bidding practice was exacerbating this flaw in the formula. To remedy the problem, CAISO filed tariff revisions with the Commission to eliminate the flaw and prevent the bidding practice at issue.³

4. After filing its tariff revisions with the Commission in March 2011, but before the Commission issued an order in the proceeding, CAISO issued a technical bulletin to its market participants that announced CAISO's intention to recalculate previously settled bid cost recovery payments "to account for energy market revenue associated with all delivered energy associated with the day-ahead schedule as required by the tariff."⁴ In its May 4, 2011 order accepting the tariff revisions, the Commission took notice of the April 5 Technical Bulletin, but made no findings with regard to the resettlements.⁵ The Commission stated that, to the extent CAISO determined that resettlements were necessary, it "must file with the Commission prior to any action to request authority and explain its proposal with amounts and details."⁶

5. On rehearing, the Commission clarified that, while not all resettlements require prior Commission authority, the automatic resettlement authority that independent system operators have under the filed rate doctrine is limited to corrections of administrative errors, such as data input errors, or software malfunctions. The Commission distinguished those types of computational errors from the situation at hand, in which CAISO sought to reinterpret the application of its tariff and confirmed that CAISO's proposed resettlements went beyond the correction of administrative errors. The Commission explained that, "while the proposed change and resettlement may, in fact, be a reasonable interpretation of the tariff in effect at the time, it is different from the way in which the terms of the tariff were previously applied through the business practice manual."⁷ The Commission held that the determination of whether CAISO's proposed tariff interpretation and corresponding resettlement methodology were reasonable would

³ See *id.* P 3. For a detailed discussion of the business practice manual formula and the calculation method under the revised tariff, see *Cal. Indep. Sys. Operator Corp.*, 135 FERC ¶ 61,110 (2011) (May 4, 2011 Order).

⁴ CAISO April 5, 2011 Bid Cost Recovery and Accounting Technical Bulletin (April 5 Technical Bulletin).

⁵ May 4, 2011 Order, 135 FERC ¶ 61,110 at P 27.

⁶ *Id.*

⁷ December 2, 2011 Order, 137 FERC ¶ 61,180 at P 22.

be the subject of the subsequent CAISO filing, which would be required if CAISO wished to follow through with the resettlements.⁸

II. CAISO Petition

6. In its petition, CAISO seeks approval for resettlement of bid cost recovery payments from April 1, 2009 (the date CAISO implemented the bid cost recovery mechanism) through March 25, 2011 (the day before the effective date of the tariff revision to fix the flaw). CAISO asserts that its prior application of the business practice manual formula was inconsistent with the only reasonable reading of the then-effective CAISO tariff, which required CAISO to account for all revenues associated with a resource's delivered energy. CAISO contends that its bid cost recovery provisions have always been intended to make payments only for energy actually delivered and only to the extent that costs are unrecovered. To achieve this result, CAISO states that it must net bid costs against all payments made for delivered energy.⁹

7. CAISO states that the prior business practice manual formula was flawed and inconsistent with the tariff because it failed to fully account for market revenues, resulting in overpayments to resources for bid cost recovery. CAISO asserts that the resettlement method is more consistent with the fundamental design of the bid cost recovery mechanism, and the tariff, to calculate the bid cost recovery payment by netting any market revenues received by the resource against its bid costs. Further, CAISO contends that, to the extent that the business practice manual formula conflicted with its tariff, the tariff provision must take precedence as the filed rate. Thus, CAISO argues that resettlements are appropriate in order to correctly apply the filed rate.¹⁰

8. CAISO argues that when it discovered the flaw in the business practice manual formula, it sought to resettle the market in an efficient and expeditious manner. CAISO asserts that when it issued the April 5 Technical Bulletin, it believed that it was necessary to immediately proceed with resettlements to correctly apply its filed rate. Thus, CAISO states that it began recalculating settlement statements for the eight month period from August 1, 2010 through March 25, 2011, prior to the Commission's May 4, 2011 Order. CAISO states that upon receiving the Commission's December 2, 2011 Order it

⁸ *Id.* n.33.

⁹ CAISO June 8, 2011 Petition for Declaratory Order, Docket No. EL12-73-000 at 2, 8-9 (CAISO Petition).

¹⁰ *Id.* at 12-19.

evaluated its next steps and planned to seek a declaratory order in early 2012.¹¹ CAISO contends that immediately reversing the resettlements it had already completed and ceasing the resettlement process, while waiting for Commission action on this petition, would have resulted in confusion and unnecessary administrative burden. CAISO claims that if the Commission rejects this petition, it can easily undo the completed resettlements to restore the prior recalculated statements for the resettled months. CAISO notes that because interest will apply to any resettlements the delay will not harm or unjustly enrich any market participants.¹²

9. CAISO states that it completed the resettlements of bid cost recovery payments from August 1, 2010 through March 25, 2011 using an accounting method consistent with the intent of the then-effective tariff (i.e., accounts for all market revenues for delivered energy), resulting in a reallocation back to load of approximately \$35.3 million. CAISO states that it has not yet resettled the period from April 1, 2009 to July 31, 2010 and expects such resettlements to amount to an additional \$16.7 million in payments returned to load. CAISO notes that its tariff prevents it from issuing corrected settlement statements beyond 36 months from the applicable trading day, unless authorized by the Commission. Accordingly, CAISO requests that the Commission grant CAISO authority to re-run settlements back to April 1, 2009. Further, if the Commission denies the petition, CAISO asks that the Commission find that CAISO should reverse the already-completed resettlements.¹³

III. Notice and Responsive Pleadings

10. Notice of CAISO's petition was published in the *Federal Register*, 77 Fed. Reg. 38,050 (2012), with interventions or protests due on or before July 9, 2012. Timely motions to intervene were filed by Calpine Corporation; the Northern California Power Agency; the City of Santa Clara, California and the M-S-R Power Agency; the California Department of Water Resources State Water Project; Pacific Gas and Electric Company (PG&E); and JP Morgan Ventures Energy Corp. (JP Morgan). PG&E filed comments in support of CAISO's petition. JP Morgan filed a protest. CAISO filed an answer to JP Morgan's protest and JP Morgan filed an answer to CAISO's answer.

¹¹ CAISO notes that, due to a number of intervening matters, the filing was delayed. *Id.* at 22.

¹² *Id.* at 20-23.

¹³ *Id.* at 23-26.

11. As an initial matter, JP Morgan argues that the Commission should reject CAISO's petition because CAISO violated two Commission orders by resettling past bid cost recovery payments without prior Commission approval. JP Morgan states that in the May 4, 2011 Order, the Commission found that CAISO must file with the Commission prior to any action to request authority to undertake the resettlements.¹⁴ JP Morgan states that in the December 2, 2011 Order, the Commission again informed CAISO that it must seek authorization prior to making resettlements.¹⁵ JP Morgan states that CAISO has ignored these unambiguous orders by continuing to resettle bid cost recovery payments without seeking Commission authorization. JP Morgan argues that the Commission should reject the Petition on this basis alone, and order CAISO to refund, with interest, the unlawful resettlements made over the past 15 months.

12. JP Morgan also argues that the Petition should be rejected because, contrary to CAISO's claims, the bid cost recovery formula in the business practice manual was consistent with the effective CAISO tariff. First, JP Morgan contends that the business practice manual formula was consistent with the plain language in section 11.8.2.2 of the CAISO tariff requiring market revenues to be based on "delivered" energy. JP Morgan argues that since the business practice manual formula expressly states that its purpose is to determine energy that is "actually delivered," it is implausible for CAISO to argue that the use of the formula was inconsistent with tariff language requiring market revenues to be based on energy that is "delivered."¹⁶ JP Morgan asserts that the business practice manual formula does not have to be a perfect, or even the best, method for determining the amount of energy that is "delivered" to be consistent with the language of the effective tariff.¹⁷

13. JP Morgan argues that CAISO's claim that the business practice manual formula was inconsistent with the tariff is contradicted by previous interpretations by CAISO and CAISO's independent auditor, and by the course of CAISO's performance. JP Morgan states that CAISO's tariff defines business practice manuals to mean rules, policies, procedures or guidelines that are consistent with the CAISO tariff.¹⁸ JP Morgan contends that CAISO cannot simply walk away from its previous statements that the business

¹⁴ JP Morgan July 9, 2012 Protest at 16-17 (citing May 4, 2011 Order, 135 FERC ¶ 61,110 at P 27) (JP Morgan Protest).

¹⁵ *Id.* at 17 (citing December 2, 2011 Order, 137 FERC ¶ 61,180 at PP 21-24).

¹⁶ *Id.* at 19-20.

¹⁷ *Id.* at 20.

¹⁸ *Id.* at 21 (citing to CAISO Tariff, App. A – Definitions).

practice manual was consistent with the tariff simply because it seeks to reinterpret the tariff.¹⁹ JP Morgan argues that CAISO's claim is contradicted by a March 2009 filing²⁰ in which CAISO added the word "delivered" to section 11.8.2.2 of the tariff specifically to ensure that the language of section 11.8.2.2 was consistent with the business practice manual, and made representations to the Commission that the language was consistent.²¹ JP Morgan also contends that CAISO's claim is contradicted by an audit by Price Waterhouse Coopers just prior to the implementation of the bid cost recovery mechanism that concluded that the business practice manual formula was consistent with the tariff, and argues that audit report is "prima facie proof" that the original settlements based on that software are also consistent with the tariff.²² JP Morgan further argues that CAISO's claim is contradicted by CAISO's consistent application of the business practice manual formula from its inception in April 2009 until early 2011, without ever suggesting that the tariff mandated a different method.²³ JP Morgan also notes that CAISO defended the formula as consistent with the tariff in pleadings before the Commission in July 2010 in an unrelated proceeding.²⁴

14. JP Morgan argues that even if CAISO could establish that the business practice manual formula was inconsistent with the tariff, CAISO's petition for resettlement should be denied. JP Morgan contends that the Commission has denied resettlements in cases where business practice manuals applied market rules that were found to be inconsistent with the tariff, because such resettlements would be unfair to market participants that relied on the manuals in making economic decisions in the market, and would undermine confidence in the markets and create regulatory uncertainty.²⁵ JP Morgan cites to

¹⁹ *Id.* at 22.

²⁰ *Cal. Indep. Sys. Operator Corp.*, Docket No. ER09-918-000 (accepted by unpublished letter order dated May 27, 2009).

²¹ JP Morgan Protest at 23-24.

²² *Id.* at 24-26.

²³ *Id.* at 26.

²⁴ *Id.* at 8-9 (citing CAISO July 6, 2010 Answer, Docket No. ER10-1360-000 (addressing concerns of Southern California Edison Company that the formula results in overpayment to generators. In its answer, CAISO stated that the concerns lie with existing bid cost recovery rules, which were not part of that proceeding)).

²⁵ *Id.* at 27-28.

Midwest Independent Transmission System Operator, Inc.,²⁶ where the Commission found that the Midwest Independent Transmission System Operator, Inc. (MISO) violated its tariff by not charging virtual supply offers for revenue sufficiency guarantee costs and directed MISO to make resettlements. JP Morgan states that on rehearing, the Commission upheld its conclusion that MISO's business practice manuals were inconsistent with its tariff, but reversed itself on resettlements. JP Morgan argues that CAISO should not have the authority to change bid cost recovery payments that were based on the business practice manual, even if they are found to be inconsistent with the tariff.

IV. Discussion

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2012), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2012), prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We are not persuaded to accept the answers filed by CAISO and JP Morgan and will, therefore, reject them.

B. Commission Determination

16. We will grant the petition, thereby authorizing CAISO to resettle bid cost recovery payments for the period of April 1, 2009 through March 25, 2011. We find that the resettlements are necessary to give effect to CAISO's filed rate, which has required CAISO, since April 1, 2009, to account for all revenues earned by a resource for energy actually delivered when it calculates a bid cost recovery payment. The purpose of the bid cost recovery mechanism is to make resources whole by permitting a resource to recover bid costs that were not fully recovered through market revenues. In order to effectuate this result, CAISO had to determine and net out all market revenues earned for delivered energy by a resource. We find that the flawed formula in the business practice manuals led to the overpayments by failing to fully account for revenues earned for delivered energy in that portion of a resource's schedule that was below that resource's minimum load. Thus, the business practice manual formula led to a result that was inconsistent with the express language and intent of CAISO's tariff. Accordingly, we find the resettlements lead to an equitable result that provides for full recovery by resources of their bid costs.

²⁶ 115 FERC ¶ 61,108 (2006); *order on reh'g*, 117 FERC ¶ 61,113 (2006); *order on reh'g*, 118 FERC ¶ 61,212 (2007) (*Midwest ISO*).

17. We are not persuaded by JP Morgan's assertion that we should reject the petition as a violation of the May 4, 2011 Order and the December 2, 2011 Order. JP Morgan contends that CAISO's delay in seeking Commission authorization for its resettlement, even after the Commission made clear that it was required to do so, should lead to the rejection of CAISO's petition. JP Morgan's argument regarding the timing of the resettlements does not demonstrate harm and relies solely on process. We recognize that the resettlements initiated by CAISO may have been premature and our finding here is not an endorsement of that process. However, we also understand that the process involved in CAISO reversing resettlements that predated the May 4, 2011 Order and reinstating subsequent resettlements could have resulted in multiple iterations of settlement statements and could have created additional confusion and unwarranted administrative burden. As discussed herein, we find that the resettlements are consistent with CAISO's tariff, and the issue of timing does not affect that finding nor does the premature resettlement affect the due process rights of the parties.²⁷ Therefore, we conclude that, while the timing of the resettlements was less than ideal, a rejection of the petition on the basis of timing is excessive and unwarranted and we reject the argument.

18. We find no merit in JP Morgan's arguments that the business practice manual formula was consistent with the result required by CAISO's tariff. The fact that the stated purpose of the business practice manual formula was to determine market revenues associated with delivered energy does not mean necessarily that the formula actually resulted in an accurate calculation of those revenues. CAISO has provided ample evidence that the business practice manual formula did not account for revenues associated with delivered energy at or below minimum load.²⁸ Although JP Morgan correctly notes that there may be more than one way to determine the revenues associated with delivered energy, the fact remains that any such method must achieve the result required by the tariff, i.e., the formula must net out all market revenues for delivered energy. In this case, the business practice manual formula did not calculate market revenues correctly, which led to the over-recovery of bid costs.

19. JP Morgan relies on the independent auditor's conclusions and CAISO's failure to identify that the business practice manual formula was inconsistent with the tariff to demonstrate consistency between the business practice manuals and the tariff. We find

²⁷ We note that CAISO filed its Petition on June 8, 2012, more than six months after the December 2, 2011 Order. CAISO does not offer any justification for the delay, other than to state that ". . . due to a number of intervening matters, the filing was delayed." CAISO Petition at 22. We remind CAISO that disregard of the Commission's direction and untimely filings may result in appropriate remedies, including penalties. *Midwest ISO*, 118 FERC ¶ 61,212, at P 91 (2007).

²⁸ CAISO Petition, Ex. No. 1 at 5-14.

this argument to be misplaced. As discussed above, the stated purpose of the business practice manual formula does not override actual results achieved in practice. Thus, the fact that CAISO, in March 2009, added the word “delivered” to section 11.8.2.2 of its tariff demonstrates only the fact that CAISO intended to capture all revenues from energy that was actually delivered. This tariff revision does not obviate the need to employ an accurate formula for calculating revenues from delivered energy. Although neither CAISO nor the independent auditor’s report identified a flaw in the business practice manual formula, these facts do not discount that CAISO did discover that the formula led to a flawed and unanticipated result. In addition, we find that the evidence presented by CAISO, including evidence of the bidding behavior that exacerbated the flaw, regarding the effect of the flawed formula is sufficient to overcome any presumption that may have been created by the independent auditor’s report. We find that the length of time it took for CAISO to discover the flaw is not relevant regarding the question of whether the flaw existed.

20. Finally, we find that permitting the resettlements is consistent with Commission precedent. We find that, while both the instant case and *Midwest ISO* involve a discrepancy between the business practice manuals and the tariff, the result in *Midwest ISO* is distinguishable from the facts presented here. In *Midwest ISO*, the Commission initially authorized refunds on the basis of the tariff language. The Commission reversed on rehearing, but did not disturb its earlier finding that the tariff language, and not the business practice manuals, dictated the result. Rather, the Commission found that refunds would be inequitable because they would render previous transactions uneconomic.²⁹ Authorizing resettlements in this proceeding results in no such occurrence. Although resettlements will reduce payments to resources, they will not cause any resource to have operated at a loss because the bid cost recovery mechanism allows for make whole payments of unrecovered bid costs. Further, authorizing the resettlements will not create uncertainty in the markets or undermine confidence in them because resources should not have expected to receive bid cost recovery payments for costs that were already recovered through market revenues.

21. For the reasons stated above, we authorize the bid cost recovery resettlements already completed by CAISO and direct CAISO to complete resettlements for the remainder of the period between April 1, 2009 and July 31, 2010. We direct CAISO to file a report with the Commission showing the detailed calculations of the resettlements from April 1, 2009 through March 25, 2011 within 30 days after completion of the resettlements.³⁰

²⁹ *Midwest ISO*, 117 FERC ¶ 61,113 at P 95.

³⁰ We note that this report is for informational purposes only and will neither be noticed nor require Commission action.

The Commission orders:

(A) CAISO's petition for declaratory order requesting authority to resettle bid cost recovery payments for the period from April 1, 2009 through March 25, 2011 is hereby granted, as discussed in the body of this order.

(B) CAISO is hereby directed to file a report with the Commission showing the detailed calculations of the resettlements, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.