

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

California Independent System Operator Corporation))))	Docket No. ER01-607-____
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**LIMITED MOTION FOR CLARIFICATION OF THE CALIFORNIA INDEPENDENT
SYSTEM OPERATOR CORPORATION AND ANSWER TO
THE CALIFORNIA POWER EXCHANGE’S MOTION
FOR EMERGENCY EXPEDITED MODIFCATION
OF AMENDMENT NO. 33**

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. §§ 385.212 and 385.213, the California Independent System Operator Corporation (“ISO”) hereby submits the following Limited Motion for Clarification of the Commission’s December 8, 2000 “Order Accepting Tariff Amendment on an Emergency Basis” in this proceeding¹ and its Answer conditionally supporting the Motion for Emergency Expedited Modification of Amendment No. 33 filed in this proceeding by the California Power Exchange (“PX”) on December 11, 2000.

I. INTRODUCTION AND SUMMARY

The ISO recognizes and greatly appreciates the extraordinary efforts the Commission undertook in responding to the ISO’s emergency filing of Amendment No. 33. As described below, the ISO’s implementation of Amendment No. 33, as approved by the Commission, has had the intended effect of improving bid sufficiency in the ISO’s real time

¹ *California Independent System Operator Corp.*, 93 FERC ¶ 61,239 (2000) (“December 8 Order”).

Imbalance Energy market and relieving a significant burden on the ISO's operations staff in their real time interaction with Generation.

REQUEST FOR CLARIFICATION

The December 8 Order does not directly address the ISO's request in Amendment No. 33 that the Commission require sellers submitting bids in excess of \$250 in the ISO's Imbalance Energy Market to provide details of their bids and cost support information to the Commission and other entities. As the Commission recognized in its November 1, 2000 order in Docket Nos. EL00-85 *et al.*,² the provision of such information to the appropriate regulatory and monitoring entities is necessary so that they may adequately monitor the competitiveness of markets and ensure just and reasonable rates. Moreover, in Order No. 2000 FERC stated that market information "will be beneficial to state commissions that protect the interest of retail consumers, especially where they are overseeing the development of a competitive electric retail market." Accordingly, the ISO respectfully requests that the Commission clarify its December 8 Order to confirm that sellers submitting bids above \$250 in the ISO's Imbalance Energy Market are required to report their bids and provide cost information on a weekly basis not only to the Commission, but also to the California Electricity Oversight Board and the ISO. In addition, the ISO requests clarification that the Commission intended to approve the proposed December 12, 2000 effective date for the cost allocation elements of Amendment No. 33.

RESPONSE TO THE PX MOTION

The PX's Motion is based on the premise that the interim \$250 soft cap on the ISO's Imbalance Energy Market implemented pursuant to Amendment No. 33 to the ISO Tariff

² *San Diego Gas & Electric Co. 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

and the December 8 Order has, in conjunction with the existing \$250 “hard cap” on Adjustment Bids in the ISO’s Congestion Management process, created an incentive for Generation in California to reduce bids submitted in the PX forward Energy markets in favor of the ISO’s real time Imbalance Energy market. The PX is therefore requesting that, effective “as soon as possible,” the Commission remove the hard cap on Adjustment Bids and replace it with a floating cap that would track the price of energy in the market. Although the ISO has not fully assessed the impact of the PX proposal on consumers, the ISO is concerned that the PX proposal has the potential to increase energy prices. The ISO believes that it has identified an alternative approach to address the PX’s concerns and one that is preferable to that proposed by the PX. The ISO is concerned that the PX proposal, if implemented, may result in extremely high constrained Zonal market clearing prices in the forward Energy markets and may be subject to the exercise of market power and to gaming. The ISO believes that its proposal will address the PX’s concerns and may result in short-term reliability benefits in California, with less risk of adverse price effects. However, as explained below, as part of its proposal the ISO believes that it is imperative that the PX Market Monitoring Unit (“MMU”) , in concert with the ISO’s Department of Market Analysis (“DMA”), carefully monitor Adjustment Bids and bids submitted in the PX forward Energy markets for evidence of the exercise of market power.

In addition, the ISO recommends that the Commission reconfirm that, consistent with the clarification requested above, all Market Participants that submit Adjustment Bids are required to report their bids on a weekly basis to the Commission, and also to the California Electricity Oversight Board and the ISO.

(2000) (“November 1 Order”).

II. BACKGROUND

On December 8, 2000, the ISO filed Amendment No. 33 in this proceeding to address emergency conditions in California, in which the ISO found itself forced to serve an intolerably large portion of the total Control Area Load through its real-time Imbalance Energy market under conditions that make it increasingly difficult to do so reliably. To address these conditions, Amendment No. 33 modified the ISO Tariff in the following three respects:

- (1) in order to encourage greater participation of Generators in the ISO markets, in which there is severe and persistent bid insufficiency, Amendment No. 33 implemented immediately an interim price mitigation measure in the ISO's Imbalance Energy market based on the "soft" price cap concept that was proposed by the Commission in its November 1, 2000, Order;
- (2) to address the failure of Participating Generators to respond to the ISO's Dispatch instructions, Amendment No. 33 provides for penalties for Participating Generators that fail to respond to a Dispatch instruction from the ISO during a System Emergency or when the ISO is acting to avoid a threatened or imminent System Emergency; and
- (3) to provide an incentive to Loads to purchase Energy in forward markets and to include in their portfolios enough resources to meet their needs, Amendment No. 33 allocates responsibility for amounts paid by the ISO for purchases of Energy from bids above the price cap and through the issuance of out-of-market Dispatch instructions to Scheduling Coordinators whose real-time Demands exceed their real-time Generation.

In its December 8 Order, the Commission approved Amendment No. 33 to go into effect immediately, on an emergency basis. The effect of the December 8 Order on supply sufficiency in the ISO's real time Imbalance Energy market was immediate and beneficial.

Although supply in California is still very tight, after implementation of Amendment No. 33, there were bids available in the ISO's "BEEP Stack" to address California's real time balancing needs for the first time in nearly a week. Immediately after the order was issued 3000 to 5000 MW of Generation internal to California and up to an additional 1990 MW

of imports became available to the ISO. As a consequence of the Commission's quick action to address the ISO's reliability concerns, the following day there was only one hour in which reserves dropped below 6% and one hour in which reserves were as great as 10%. In addition, implementation of Amendment No. 33 has substantially relieved the burden which had previously been placed on the ISO's operators by in-state Generators attempting to negotiate prices in real time in response to ISO Dispatch instructions.

III. MOTION FOR CLARIFICATION

As part of the ISO's proposal in Amendment No. 33 to implement an interim \$250 "soft cap" in the 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. Transmittal Letter at pp. 7-8. This request was modeled on the Commission's proposal in the November 1 Order to establish such a requirement in conjunction with the proposed soft cap in all ISO and PX markets. As with the Commission's proposal, Amendment No. 33 included a request that such reports include the price and amount of MWs covered by the transaction, the hour(s) covered by the transaction, and the incremental generation costs (including fuel costs, emissions allowance costs, and start up costs). The Commission's proposal also provided for the recovery, if appropriate, of opportunity costs. In addition, the ISO in Amendment No. 33 requested that the Commission require sellers to provide this information to the ISO and the California Electricity Oversight Board ("EOB"), so that the ISO and the EOB will be able to review the costs and evaluate whether to seek Commission action regarding any costs that appear to be unjust and unreasonable.

The December 8 Order itself does not address this aspect of the Amendment No. 33 filing. The press release issued by the Commission concerning the December 8 Order

does state, however, that “[t]hose bidding above \$250 will be required to report their bids to the Commission on a weekly basis and provide certain cost information.” The ISO requests clarification that the Commission intended, in its acceptance of Amendment No. 33, to establish a requirement that the requested reports be submitted to the ISO and the EOB in addition to the Commission. Such a clarification will enable the ISO and the State of California to review all bids above the interim Imbalance Energy soft cap and to bring to the Commission’s attention those bids that appear to be unjust and unreasonable. Such a requirement would be consistent with the Commission’s statements in the November 1 Order emphasizing the importance of heightened market monitoring. Such a requirement would also be consistent with the Commission’s statements in the November 1 Order that the issues facing the California electric markets will best be addressed when both the State of California and the Commission work towards a mutual goal.³

The ISO also requests clarification of the effective dates for certain elements of Amendment No. 33. The December 8 Order’s description of Amendment No. 33 suggests that “the ISO requests an effective date of December 10, 2000” for the cost allocation elements of Amendment No. 33. The requested effective date for these elements was actually December 12, 2000. See Transmittal Letter at p. 11. The ISO requests that the Commission confirm that its December 8 Order accepted the proposed effective dates for Amendment No. 33, and that the cost allocation elements of the amendment should properly go into effect on December 12, 2000.

³ The ISO notes that, since sellers would be required to submit bid and cost data directly to the EOB, the restrictions and procedures associated the ISO’s provision of bid and other data to regulatory entities set

IV. ANSWER TO THE CALIFORNIA POWER EXCHANGE'S MOTION FOR EMERGENCY EXPEDITED MODIFICATION OF AMENDMENT NO. 33

The ISO's filing of Amendment No. 33 was necessitated by the need for both increased bidding in the ISO's real time Imbalance Energy market and Generator compliance with ISO emergency Dispatch instructions in order to "keep the lights on in California" during an unprecedented period of supply insufficiency. Although supply is still extremely tight in the State, as it is throughout the West, implementation of Amendment No. 33 has significantly alleviated the real time reliability concerns described in the filing.

In addition, the cost allocation elements of Amendment No. 33 provide an incentive for Load to procure Energy in the forward markets, and remove an incentive for Generation to wait for the ISO to call upon them out-of-market during real time operations, thereby decreasing the reliability and operational problems associated with heavy reliance on the ISO's real time balancing market. The PX's motion suggests that implementation of Amendment No. 33's interim soft cap on the Imbalance Energy market may have created a countervailing incentive with respect to forward scheduling. Specifically, the PX asserts that the fact that the interim soft cap applies only to bids in the ISO's Imbalance Energy market, and not to Adjustment Bids submitted in the ISO's Congestion Management process, creates a disincentive for resources to bid into the forward markets. PX Motion at 5. The PX states that the ISO's proposal creates an incentive for Generation to withhold supply from the forward market and bid into the real-time market, where they can receive effective market prices for their generation. The PX states that generators know that, with the existing \$250 hard cap on Adjustment Bids, they will be unable to protect their schedules (i.e., indicate they value transmission service at a price greater than \$250) at

forth in Section 20.3 of the ISO Tariff would not apply.

prices above \$250, and will therefore choose not to schedule in the forward markets but await the real-time market, where they can sell at uncapped rates (subject to justification). The PX states that the only way to fix this problem is to lift the cap on Adjustment Bids. The PX recommends that the Commission remove the hard cap on Adjustment Bids and replace it with an “energy price equivalent that allows forward buyers and sellers to conduct transactions, with price certainty, ahead of CAISO real-time operations.”

Contrary to the PX’s intimation, the ISO carefully considered whether to propose, as part of Amendment No. 33, to modify the cap on Adjustment Bids. While the ISO agrees that the combination of a hard \$250 cap on Adjustment Bids, the high cost of Energy and a soft cap on prices for real-time Energy can result in a disconnect between unconstrained and constrained market clearing prices in the PX, the ISO does not believe that lifting the cap on Adjustment Bids is the best solution to this problem. In particular, the ISO was and remains concerned about the impact of such a step on forward Energy prices. Unlike the imposition of a soft cap in the ISO’s real-time Energy market, a higher cap on Adjustment Bids may have a greater impact on the cost of Energy in California. Whereas imposition of a soft cap in the ISO’s Imbalance Energy Market may have an impact on the “average” cost of Energy in that market (due to the fact that suppliers will be paid the combination of the market clearing price up to \$250 and “as-bid” over that amount), a higher cap on Adjustment Bids could result in a higher market clearing price for **all** Energy procured in a Zone in the forward market. Therefore, the cost impact on consumers from lifting the cap on Adjustment Bids could be much greater than an increase in cost of Imbalance Energy.

More importantly, at the time the ISO submitted Amendment No. 33, the ISO did not believe that modifying the cap on Adjustment Bids would necessary address the ISO’s

pressing need to encourage suppliers to submit bids in **some** market, rather than withhold their Energy and require the ISO to call them out-of-market. Although the ISO was and is concerned about discouraging bids in the forward markets, its overriding objective was to create incentives for suppliers to bid into a market, even in the form of real-time Supplemental Energy bids. While the ISO was certain as to the need for expeditious action to address the untenable operating conditions under which the ISO operated, the ISO was less certain as to the reliability benefit and cost consequences of lifting the cap on Adjustment Bids, as proposed by the PX.

The ISO has an alternative recommendation that it believes will address the PX's concerns with less risk of adversely affecting forward market Energy prices. As opposed to simply lifting the cap on Adjustment Bids, the ISO proposes that both the PX and ISO implement certain changes to the way they respectively formulate and process Adjustment Bids. These changes, as outlined below, would enable PX Participants to reflect their true value of using constrained transmission facilities, relative to the PX's unconstrained market clearing price. Thus, with minimal changes to both the ISO and PX market rules, the PX can maintain its current pricing mechanism while fully participating in the ISO's Congestion Management process.

While the problems raised by the PX are unique to the PX and are a function of certain of its market rules, we believe that the ISO can accommodate the PX without requiring changes to the ISO's markets that would apply to all Scheduling Coordinators ("SCs").⁴ The PX's existing market rules anchor the PX constrained price to the incremental and decremental bids submitted in the ISO's Congestion Management

⁴ The ISO originally made this proposal to the PX this summer. At that time, the PX was reluctant to undertake or commit to any changes to its market rules.

process, which are currently limited to \$250. Therefore, even when the unconstrained market clearing price in the PX is \$1000, the constrained price is often only \$250. Thus, where most Scheduling Coordinators submit incremental and decremental bids (which together constitute an Adjustment Bid) with the relative price difference reflecting the price they are willing to pay to use the constrained transmission grid, the PX requires its participants to submit incremental and decremental bids that reflect the marginal cost of their resources and then uses those bids to establish the constrained PX market clearing price in a Zone, which can be no greater than the maximum Adjustment Bid or \$250. This creates the problem that is the subject of the PX Motion.

The ISO believes that a simple fix to this problem is for the PX to anchor its Adjustment Bids (incremental and decremental bids) prices to the unconstrained market clearing price, as opposed to absolute Energy bids. Simply put, the PX would establish its constrained market clearing price as the sum of the unconstrained market clearing price and the Usage Charge resulting from the ISO's Congestion Management process. Thus, when the PX unconstrained price is \$1000/MWh, the PX constrained price could be as much as \$1250/MWh. A PX participant could thus reflect that it places a value significantly higher than the unconstrained PX price on its schedule.

In order to effectuate this change, the PX would have to impose a new rule that Adjustment Bids submitted by its participants be within \$125 of the unconstrained market clearing price. The PX would then be required to process the Adjustment Bids prior to passing them on to the ISO. The PX would simply have to subtract the unconstrained market clearing price from each Adjustment Bid prior to submitting it to the ISO. The ISO could then utilize these Adjustment Bids, as well as those submitted by other Scheduling Coordinators, to run its Congestion Management system. After the ISO completes its

Congestion Management process, the ISO would then “post-process” the Adjustment Bids (add back the unconstrained market clearing price) for use by the PX in establishing its constrained Zonal Energy prices and, as needed, by the ISO in real-time Congestion Management. The ISO believes that such an approach will be simple to implement, address the problem posed in the PX Motion and reduce the risk that solving this problem will unnecessarily remove all limits on the difference between unconstrained and constrained market clearing prices in the PX.

While the ISO believes that the proposal outlined above will address the problems raised by the PX, we also recognize that, ultimately, the cost consequences of addressing the concern presented in the PX Motion will be borne by the purchasers in the PX markets, primarily the California investor owned utilities (Pacific Gas & Electric Company, Southern California Edison Company and San Diego Gas & Electric Company). The ISO is cognizant of and concerned about the extreme financial condition in which these companies find themselves. While we believe that the ISO’s proposal would enable the utilities to better utilize and protect their own resources and load through the submission of price-reflective Adjustment Bids, there may be other solutions or alternatives of which we are not aware. The ISO does not intend, by presenting this alternative to the PX’s proposal, to preclude consideration of other solutions that may be presented by one or more of the utilities or by the EOB.

In addition, in light of the potential impact that any proposal to address the problem identified by the PX Motion may have on the price of Energy, we believe that it is imperative that the Commission impose reporting requirements on those entities who submit Adjustment Bids in the ISO’s Congestion Management process. Consistent with the requirements proposed in the Commission’s November 1 Order, the ISO believes that

such a requirement may discipline behavior in the market and provide a necessary disincentive to those who might otherwise attempt to game the Congestion Management market. Therefore, the ISO recommends that the Commission require the submission of all Adjustment Bids to the Commission, the ISO and the EOB. In the same vein, the Commission should direct the PX Market Monitoring Unit (“MMU”), in concert with the ISO’s Department of Market Analysis (“DMA”), to increase its monitoring of Adjustment Bids and bids submitted in the PX forward Energy markets for evidence of the exercise of market power.

V. CONCLUSION

Wherefore, for the foregoing reasons, the ISO respectfully requests that the Commission clarify its December 8 Order to confirm that sellers submitting bids above \$250 in the ISO’s Imbalance Energy market are required to report their bids and provide cost information on a weekly basis not only to the Commission, but also to the Electricity Oversight Board and the ISO and to confirm the December 12 effective date of the cost allocation elements of Amendment No. 33. The ISO also requests that the Commission act on the PX’s motion in accordance with the comments set forth above.

Respectfully submitted,

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Dated: December 12, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding and upon all parties served with Amendment No. 33 to the ISO Tariff.

Dated at Washington, DC, on this 12th day of December, 2000.

Sean A. Atkins

December 12, 2000

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

Re: **California Independent System Operator Corporation**
Docket No. ER01-607-____

Dear Secretary Boergers:

Enclosed for filing are one original and 14 copies of the Limited Motion for Clarification of the California Independent System Operator Corporation and the Answer to the California Power Exchange's Motion for Emergency Expedited Modification of Tariff Amendment No. 33 in the above-referenced proceeding. Two additional copies of the filing are also enclosed. Please stamp the two additional copies with the date and time filed and return them to the messenger.

Thank you for your assistance in this matter.

Respectfully submitted,

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