UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket No. ER15-15-000**

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO COMMENTS AND LIMITED PROTEST

The California Independent System Operator Corporation ("CAISO")[1] files this answer to the comments and limited protest submitted in the above-captioned proceeding[2] in response to the CAISO's October 1, 2014, tariff amendment to modify the provisions regarding recovery of start-up and minimum load costs ("October 1 tariff filing").[3]

The Commission should accept the October 1 tariff filing as submitted by the CAISO and without imposing directives concerning the outcome or timing of future tariff amendments in the area of start-up and minimum load cost recovery.

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1 Capitalized terms not otherwise defined herein have the meanings set forth in appendix A to the CAISO tariff.

2 The following entities filed motions to intervene in the proceeding: the California Department of Water Resources State Water Project; Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, "Six Cities"); Dynegy Moss Landing, LLC, Dynegy Oakland, LLC, and Dynegy Marketing and Trade, LLC; Exelon Corporation; Modesto Irrigation District; Northern California Power Agency; NRG Power Marketing LLC and GenOn Energy Management, LLC (together, "NRG"); Pacific Gas and Electric Company ("PG&E"); Powerex Corp.; Southern California Edison Company ("SCE"); and Western Power Trading Forum ("WPTF"). In addition, NRG, PG&E, SCE, and Six Cities filed comments, and WPTF filed a limited protest.

3 The CAISO files this answer pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213. The CAISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to WPTF's limited protest. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in the case. *See, e.g.*, *Equitrans, L.P.*, 134 FERC ¶ 61,250, at P 6 (2011); *California Independent System Operator Corp.*, 132 FERC ¶ 61,023, at P 16 (2010); *Xcel Energy Services, Inc.*, 124 FERC ¶ 61,011, at P 20 (2008).

In their comments, PG&E and Six Cities request that the Commission require the CAISO to use updated natural gas price data not only in the event of a significant gas price increase, which the CAISO has proposed, but also in the event that gas prices decrease significantly overnight. The Commission should reject that request. The two situations are not symmetrical. The purpose of the CAISO's amendment is to reduce the risk that sellers will be unable to recover their costs in the event gas prices significantly increase overnight. In addition to such relief, the CAISO is also proposing greater flexibility in daily proxy cost bidding of up to 125 percent of proxy costs. In the event of a significant overnight decrease in gas prices -- with all else being equal -- it is reasonable to expect that most generators will lower their proxy cost bids in order to remain competitive and not risk pricing themselves out of the market. Also, PG&E fails to convincingly demonstrate that generator bids were excessive on the one day it analyzed when gas prices declined significantly.

WPTF and NRG support Commission acceptance of the October 1 tariff filing as a near-term solution but also request that the Commission require the CAISO to make a further filing in 2015 to address concerns they have regarding greater bidding flexibility and recovery of intra-day gas costs. Although the CAISO plans to commence a stakeholder process in the near future to consider providing further flexibility in bidding commitment costs, WPTF's and NRG's requests that the Commission direct the content or timing of a filing by a date certain are both premature and beyond the scope of this proceeding. WPTF and

NRG will have the opportunity to provide their input on these issues in the upcoming stakeholder initiative.

I. Background

In the October 1 tariff filing, the CAISO proposed to: (1) eliminate the registered cost option for generating resources other than use-limited resources; (2) increase the daily proxy cost bid cap from 100 percent to 125 percent; and (3) add provisions to allow the CAISO to use updated natural gas price data in its day-ahead market when a daily gas price reported by the Intercontinental Exchange ("ICE") on the morning of a day-ahead market run exceeds 125 percent of any natural gas price index calculated for the day-ahead market during the previous night. The CAISO requested that the Commission accept the proposed tariff revisions effective as of December 1, 2014.

II. Answer

A. The Commission Should Not Require the CAISO to Use Updated Natural Gas Price Data in the Event of a Significant Gas Price Decrease

PG&E and Six Cities generally support Commission acceptance of the October 1 tariff filing, subject to one further requested change: that the CAISO also use a manual process to update natural gas price data in its day-ahead market when a daily gas price reported on the morning of a day-ahead market run *decreases* by more than 25 percent from a natural gas price index calculated for the day-ahead market during the previous night.[4] PG&E argues that its

[4] PG&E at 3; Six Cities at 1-3. Six Cities ask the Commission to require this change pursuant to the discussion in PG&E's comments. Six Cities at 3.

requested change is necessary because resources do not always bid below the start-up and minimum load cost cap that the CAISO calculates when prices decline. Specifically, PG&E asserts that, on February 7, 2014, use of a gas price input pursuant to the CAISO's tariff calculations that was higher than the actual gas price inflated day-ahead energy prices, produced inefficient dispatches, and caused excess costs to CAISO load.[5]

The Commission should not require the CAISO to make PG&E's requested change. The CAISO proposed to use updated natural gas price data when natural gas prices increase by more than 25 percent from the previous night in order to provide resources a reasonable opportunity to recover their costs. This is consistent with the Commission's longstanding principle that in a competitive marketplace suppliers should be provided the opportunity for cost recovery.[6] In contrast, a significant price decline does not pose the same concerns. To the extent PG&E is concerned about potential cost over-recovery, the CAISO notes that its proposed 125-percent proxy cost bid cap acts as a ceiling, not a floor, so generators are free to bid below the cap. The CAISO believes that resources will have sufficient incentive to lower their bids to remain competitive in the event of a large overnight decrease in natural gas prices.[7] In other words, should the gas price significantly decrease overnight, it is reasonable to also expect an overall decrease in commitment cost bids.

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[5] PG&E at 3-5.

[6] *See California Independent System Operator Corp.*, 123 FERC ¶ 61,288, at P 29 (2008); *California Independent System Operator Corp.*, 145 FERC ¶ 61,082, at PP 23-24 (2013).

[7] Transmittal letter for October 1 tariff filing at 21-22.

Resources that do not lower their start-up and minimum load bids risk pricing themselves out of the market.

In addition, as PG&E acknowledges, an overnight decrease in gas prices of 25 percent or greater has only occurred three times since the CAISO's current market structure went into effect over five years ago. Based on the rarity of these occurrences, the incentives for generators to lower their bids in response to lower gas prices, and the overall success of the CAISO's proxy cost bid cap in mitigating the exercise of market power,[8] the CAISO believes that the risk of a sudden drop in gas prices resulting in start-up and minimum load bids significantly in excess of actual costs on a particular day causing a substantial increase in energy prices is de minimis. On the other hand, manually recalculating gas prices is inefficient and disruptive to the running of the day-ahead market, and the CAISO therefore wishes to minimize the situations in which such manual recalculations are required. Given the minimal risk that an overnight gas price drop would create an unacceptable opportunity for the exercise of market power, requiring the CAISO to manually recalculate the gas index is not warranted under these circumstances.

Further, PG&E's analysis to support the claim that load overpaid on February 7, 2014 is oversimplified and unconvincing. First, PG&E's analysis conflates the system heat rate, which drives prices for energy above minimum load, with minimum load costs. As PG&E notes, the implied heat rate is the ratio

[8] Generally, the CAISO's Department of Market Monitoring has been much more concerned with the exercise of market power by resources under the registered cost option where start-up and minimum load costs may be bid at levels much higher, currently up to 150 percent, of proxy costs on a day-to-day basis.

of locational marginal prices and gas-related costs.[9] The locational marginal prices reflect the incremental energy bids in the CAISO market, not commitment costs. There are many factors that could have caused prices on February 7, 2014 to be higher than PG&E believes they theoretically should have been. These include differences in congestion patterns, conditions in neighboring balancing areas affecting demand for imports and exports, and various factors affecting market participants' bidding behavior. PG&E's analysis fails to account or control for any of these factors.

PG&E also suggests that default energy bids may have been inflated on that day because the gas price index calculated the evening before would have included the higher gas prices of the previous day, thereby increasing above-cost payments to generators on that day. In fact, even if the default energy bids were inflated on February 7, 2014, they would have had no impact on prices. Information publicly available on the CAISO's Open Access Same-time Information System (OASIS) shows that there were no non-competitive internal constraints and thus the CAISO did not apply local market power mitigation and, therefore, did not and would not have mitigated any bids on February 7, 2014.[10] The only constraint that was binding was for the Palo Verde intertie and the CAISO does not mitigate interties. This suggests that prices experienced on that date were caused by factors other than the gas price index.

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9 PG&E at 4 n.3.

10 For enforced constraints, see http://oasis.caiso.com at the links for "Prices" and then "Nomogram/Branch Shadow Prices" with data sorted for February 7, 2014 in the day-ahead market (DAM). For mitigated bids, see the same website at the links for "Energy" and then "Market Power Mitigation Status," with the data sorted for February 7, 2014, in the day-ahead market (DAM).

For these reasons, the Commission should not require the CAISO to implement a manual process in the event of a significant price decrease.

B. The Commission Should Reject WPTF's and NRG's Requests for an Additional CAISO Filing by a Date Certain as Beyond the Scope of this Proceeding

WPTF supports Commission acceptance of the October 1 tariff filing without further amendment as a near-term solution.[11] WPTF also quotes the explanation in the October 1 tariff filing that the CAISO plans to begin a more comprehensive bidding rules initiative later in 2014 that will include "discussion regarding greater bidding flexibility and recovery of intra-day gas costs, based on more comprehensive data than has been provided or assessed so far."[12] However, WPTF asks the Commission to direct the CAISO to submit a compliance filing by June 2015 that contains a proposal based on the upcoming bidding rules stakeholder process and addresses topics listed by WPTF.[13] Similarly, NRG states that it supports the October 1 tariff filing as an interim approach but requests that the Commission direct the CAISO to file a more permanent bidding solution by September 1, 2015 that allows for a November 1, 2015 effective date.[14]

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[11] WPTF at 3, 5.

[12] *Id.* at 3 (quoting transmittal letter for October 1 tariff filing at 20).

[13] *Id.* at 4-5. Specifically, WPTF states that the compliance-filing proposal should encompass new mechanisms, including: (1) daily bidding with updating or changes, at a minimum; (2) ensuring that suppliers are kept whole for any costs incurred due to CAISO rules prohibiting them from updating their bids to reflect changing actual costs for start-up; and (3) minimum load requirements. *Id.*

[14] NRG at 5-7.

The Commission should reject WPTF's and NRG's requests to require the CAISO to make a future filing by a date certain or direct the CAISO to implement unfettered daily bidding. The October 1 tariff filing is the latest (and, as discussed therein, not the last) in a series of incremental improvements to the CAISO's tariff mechanisms providing for the recovery of costs by resources participating in its markets.[15] The applicable standard of review is whether the modifications proposed in the October 1 filing are just and reasonable. As the CAISO demonstrated in that filing, they are just and reasonable because they provide resources in the CAISO's markets adequate opportunities for cost recovery over a reasonable time horizon.[16]

WPTF's and NRG's requests are outside of the scope of this proceeding.[17] Further, any filing the CAISO would make would be in the form of a Section 205

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[15] *See California Independent System Operator Corp.*, 128 FERC ¶ 61,282, at PP 26-30 (2009) (accepting various tariff revisions to "provide resource owners the needed flexibility to choose the option that best enables recovery of their start-up and minimum load costs"); *California Independent System Operator Corp.*, 134 FERC ¶ 61,257, at PP 4, 23-24, 26 (2011) (accepting tariff revisions to "further increase resource owners' flexibility in choosing between the options available to recover start-up and minimum load costs by allowing a resource to select a different recovery option for each type of cost and by introducing a daily bid option"); *California Independent System Operator Corp.*, 141 FERC ¶ 61,237 (2012) (conditionally accepting tariff revisions that allow resources to recover greenhouse gas compliance costs in their commitment costs, default energy bids, and generated bids); *California Independent System Operator Corp.*, 145 FERC ¶ 61,082 (2013) (accepting tariff revisions to include additional categories of costs eligible for inclusion in proxy cost calculations for start-up and minimum load costs, default energy bids, and generated bids).

[16] *See California Independent System Operator Corp.*, 123 FERC ¶ 61,288, at P 29; *California Independent System Operator Corp.*, 145 FERC ¶ 61,082, at PP 23-24.

[17] *See, e.g.*, *California Independent System Operator Corp.*, 132 FERC ¶ 61,045, at P 93 (2010) (citation omitted) ("We note that the CAISO continues in its efforts to resolve issues regarding Participating Load in its stakeholder process. The arguments raised by SWP regarding Participating Load . . . are outside the scope of this proceeding, and will be better addressed when the CAISO files tariff language to amend its Participating Load program."); *California Independent System Operator Corp.*, 132 FERC ¶ 61,269, at P 18 (2010) ("[W]e find that the modifications requested by Dynegy regarding CAISO's market issues process are premature and beyond the scope of this proceeding. Dynegy's concerns appear to be more appropriately

tariff amendment; it would not be a compliance filing. They seek additional, new market rule changes that are not the subject of the instant tariff amendment. WPTF and NRG have not carried their burden of demonstrating that specific action under Section 206 of the Federal Power Act is necessary at this time.

In any event, the CAISO appreciates the concerns of WPTF and NRG regarding greater bidding flexibility and recovery of intra-day gas costs.[18] The CAISO urges WPTF and NRG to raise those concerns and participate fully in the bidding rules stakeholder process scheduled to begin in the next few months.[19] As the CAISO explained in the October 1 tariff filing, the discussion in that stakeholder process will be informed by more comprehensive data than has been provided or assessed so far. It would be premature, however, to attempt to predetermine the scope or nature of any tariff provisions to come out of the

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addressed in CAISO's stakeholder process regarding the BPM [business practice manual] modification to finalize CAISO's market issues process."); *California Independent System Operator Corp.*, 142 FERC ¶ 61,072, at P 42 (2013) ("WTPF and Powerex's objections to CAISO's handling of multiple scheduling coordinator circular schedules fall outside the scope of this proceeding. . . . Since CAISO does not propose new tariff revisions for multiple scheduling coordinator circular schedules, the issue is not before the Commission.").

[18] With regard to greater bidding flexibility, the Department of Market Monitoring has explained that one potential long-term refinement is to allow higher start-up and minimum load bidding limits and only apply tighter limits when resources are found to have market power. However, designing and implementing additional market power mitigation for commitment costs would be a complex undertaking and should not be a high priority relative to other market initiatives and enhancements that would be competing for the same resources. *See* Department of Market Monitoring memorandum to CAISO Governing Board at 6 (Sept. 11, 2014), which is available on the CAISO website at http://www.caiso.com/informed/Pages/BoardCommittees/Default.aspx. The memorandum was also cited in footnote 29 of the transmittal letter for the October 1 tariff filing.

[19] The CAISO is currently performing scoping activities for this initiative. The CAISO's most recent draft stakeholder initiatives catalog states that the bidding rules stakeholder process is non-discretionary. See page 41 of the draft 2015 stakeholder initiatives catalog available on the CAISO website at http://www.caiso.com/Documents/Draft_2015StakeholderInitiativeCatalog.pdf. Thus, there is no risk that the bidding rules stakeholder process will not take place.

stakeholder process, or to set a deadline for submittal of such tariff provisions for Commission acceptance.

III. Conclusion

For the foregoing reasons, the Commission should accept the October 1 tariff filing as submitted in the captioned proceeding without condition or modification.

Respectfully submitted,

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Dated: October 31, 2014

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service list for the above-referenced proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, CA this 31st day of October, 2014.

/s/ Sarah M. Garcia
Sarah M. Garcia