

Pursuant to Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713, the California Independent System Operator Corporation ("ISO") moves for clarification and requests rehearing of certain aspects the order issued by the Commission in the above-captioned dockets on December 15, 2000 (the "December 15 Order" or "Order").¹

I. SUMMARY

The Commission's December 15 Order was a significant step forward in addressing the crisis in the California electric market. One of the major tenets of the Commission's plan of correcting the market problems is a price mitigation proposal designed to reduce reliance on the spot markets and to reduce the impact of high prices. One feature of the Commission's price mitigation proposal is the application of a \$150 breakpoint or "soft cap" to the markets operated by the ISO and the California Power Exchange. While the ISO does not challenge implementation of this measure with regard to its Imbalance Energy market, as demonstrated by its adoption of a modified version in Amendment No. 33 to the ISO Tariff,² the ISO does not consider a soft cap to be appropriate for capacity bids in its Ancillary Services markets (apart from the Regulation market) or as applied to negatively-priced Imbalance Energy bids.³ As discussed below, the ISO seeks rehearing of the December 15 Order with regard to the application of

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 (2000).

² Amendment No. 33 was approved by the Commission in an order issued December 8, 2000. *California Independent System Operator Corp.*, 93 FERC ¶ 61,239 (2000).

³ Capitalized terms that are not defined in this Motion are defined in the Master Definitions Supplement, Appendix A of the ISO Tariff.

soft caps in these circumstances, and authority to impose a hard cap in certain of the ISO's markets.

A second feature of the Commission's price mitigation plan is a penalty on Load that underschedules. As explained in its October 20 Offer of Settlement in this proceeding, the ISO also believes that an underscheduling penalty is appropriate and warranted in light of the functioning of the real-time market this past year. Underscheduling has played a large role in creating the stressful and difficult conditions under which the ISO has operated. The ISO believes very strongly, however, that some form of underscheduling penalty should be applied to both Load and Generation. This belief is grounded in the pragmatic desire to create incentives for all Market Participants to move into forward Energy markets as well as in concerns for fairness. Although the Commission, in the December 15 Order, did not act on calls for a penalty provision that applies to both Generation and Load, the Commission did state that the ISO would be free to propose a modification to the penalty procedures set forth in the December 15 Order. The ISO believes this directive permits the ISO to develop and propose underscheduling penalties for Generation. The ISO seeks clarification of the December 15 Order to confirm this understanding. To the extent that the December 15 Order does not permit the ISO to propose such penalties, the ISO requests rehearing of the asymmetric underscheduling penalties instituted by the December 15 Order.

In both the Commission's November 1⁴ and December 15 Orders in this proceeding, it identified a number of longer-term measures which might address outstanding problems in the California wholesale electric markets and directed the Commission staff to convene a technical conference to consider these measures. Among the measures identified is a review of the existing requirement that Scheduling Coordinators submit balanced schedules to the ISO as well as consideration of the establishment of an integrated day-ahead market for both the ISO and the California Power Exchange ("PX"). While the ISO is open to examination of these issues, elimination of the balanced schedule requirement would fundamentally change many features of both ISO operations and the ISO's markets. The ISO seeks clarification that the Orders did not mandate immediate elimination of the balanced schedule requirement. Insofar as the November 1 and December 15 Orders might possibly be read as requiring the immediate elimination of the ISO's balanced schedule provisions, the ISO believes such a requirement is not supported and requests rehearing on this issue.

The ISO also seeks clarification of the application of the Commission's reporting requirements, to ensure that the entities called Out-of-Market at prices above the breakpoint are required to justify their costs to the Commission.

In this pleading, the ISO addresses certain procedural issues raised by the December 15 Order. As noted above, in the Order, the Commission directs its

⁴ *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 93 FERC ¶ 61,121 (2000) ("November 1 Order").

staff to convene a technical conference to explore long-term measures to address issues facing California's wholesale markets. Although the ISO stands ready to work with the Commission staff on exploring the long-term measures identified in the December 15 Order, the ISO is concerned that during the next few months most of its resources will need to be devoted to other Commission-mandated efforts, including the preparation of a Congestion Management redesign proposal and participation in the Commission's technical conference on market monitoring and mitigation. Accordingly, the ISO requests that the Commission schedule the technical conference on long-term issues no sooner than the second quarter of this year.

Finally, the ISO notes that it is submitting a separate motion for stay and alternative request for rehearing on governance issues raised by the December 15 Order.

II. 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. This investigation and the Commission proceeding related to it culminated in the Commission's November 1 and December 15 Orders.

The ISO appreciates the Commission's extraordinary efforts to address many of the problems plaguing the electric system of California. The ISO seeks rehearing, however, on certain Commission requirements that are potentially problematic or counter-productive. The ISO also seeks confirmation that it has

correctly interpreted several aspects of the December 15 Order, and requests rehearing of certain additional matters if the Commission does not support the ISO's interpretation. As well, the ISO seeks clarification of how some of the Commission's directives in the Order should be implemented.

III. REQUEST FOR REHEARING

A. The Commission Should Allow the ISO to Impose a Hard Cap in the Ancillary Services Markets (Other Than the Regulation Market).

The December 15 Order imposed a \$150 breakpoint or "soft cap" on the Market Clearing Price in the ISO's markets. Prior to this directive, the ISO initially had applied a \$250 hard cap on its Ancillary Services (\$100 on Replacement Reserve) and Imbalance Energy markets. With the implementation of Amendment 33 on December 8, 2000, the ISO established a "soft cap" at \$250 for its Imbalance Energy market. Pursuant to the December 15 Order, the ISO implemented a \$150 soft cap in its Ancillary Services capacity markets, effective January 1, 2001. As discussed further below, the Commission should allow the ISO to reinstate a hard cap in the Ancillary Services markets, other than the Regulation market.

The ISO believes that, with the institution of the \$150 breakpoint in Energy markets in lieu of hard price caps, there can be no cost justification for bids above \$150/MW in the Ancillary Services capacity markets.⁵ Bidders in the Spinning, Non-Spinning, and Replacement Reserve markets submit Energy bids

⁵ Implementation of the \$150 breakpoint on the Ancillary Services markets will require those who bid capacity above this figure to provide cost justification to the Commission, just as those who bid above the breakpoint in the Imbalance Energy market must do.

along with their capacity bids. If the bid is selected for the Ancillary Service, but not dispatched to supply such service, then the bidder receives the capacity payment. When the ISO dispatches capacity selected for one of these Ancillary Services, the bidder is assured of payment in accordance with its Energy bid, which it is now free to set at any level it deems necessary to recoup its costs of providing the Ancillary Service. Since the payment such bidders receive for their Energy bids (apart from those associated with Regulation bids) are no longer subject to a hard price cap, bidders can recover all reasonable costs through their Energy bids and thus cannot justify bids in excess of \$150 in the Ancillary Services capacity markets as necessary to recover their costs.⁶

Moreover, the Ancillary Services markets were not designed in contemplation of a soft cap. Accommodating a soft cap mechanism, through which the “Market Clearing Price” does not represent the highest bid the ISO accepted to procure the necessary quantity of the Ancillary Service capacity, would present novel problems of interpretation and implementation that do not appear to have been considered in the December 15 Order. Among the areas in which these issues will arise with a soft cap on all Ancillary Services are the Rational Buyer protocol and the Ancillary Services “buy back” mechanism.

⁶ The ISO does not request the Commission to revisit its decision to impose a soft cap on the Regulation market because the Regulation market treats Energy bids differently than the other Ancillary Service markets. The providers of Regulation are price takers in the Real Time Imbalance Energy market dispatched out of Regulation capacity (*i.e.*, they do not provide bids, but are paid whatever the Market Clearing Price in the Imbalance Energy market turns out to be), and therefore there can be legitimate justification for Regulation capacity bids, both Regulation Up and Regulation Down, above \$150/MW. Accordingly, the Ancillary Services soft cap would be reasonable if imposed on Regulation.

The ISO's Rational Buyer protocol is designed to minimize the total payment to Ancillary Services providers, represented as the sum of the products of the Market Clearing Prices and quantities procured (MCP*Q) in each market. When the Market Clearing Price represents the highest bid accepted in each market, as it does when a hard price cap is employed, the Rational Buyer protocol thus minimizes the ISO's total cost of procuring the Ancillary Services. *See AES Redondo Beach, LLC, et al.*, 87 FERC ¶ 61,208, 61,808 (1999). Under a soft cap approach, this would no longer be the case, because the sum of the products of the Market Clearing Price and quantities (MCP*Q) in all markets will not represent the total cost of all services procured whenever the ISO must accept bids above the soft cap to obtain enough Ancillary Service capacity. Unless and until the Rational Buyer protocol is modified to consider the costs of purchases above the capped Market Clearing Prices, which would require significant software revisions, the ISO would be able to minimize only the portion of its Ancillary Service procurement that it is able to obtain at bids less than or equal to the level of the soft cap.⁷ Application of a soft cap to all Ancillary Services markets would defeat, in part, the purpose of the ISO's adoption of the Rational Buyer protocol – reducing the overall costs of procuring Ancillary

⁷ With a soft cap on Regulation only, the ISO can first reject all non-Regulation Ancillary Service bids above \$150. The ISO can then continue to use the existing Rational Buyer protocols by minimizing the sum of MCP*Q, temporarily ignoring the cap on Regulation (allowing Regulation Market Clearing Price to exceed \$150 if need be), knowing that the Market Clearing Price in the lower quality Ancillary Services would not exceed \$150. In this manner, it is highly likely that Regulation bids above \$150 would be used only if bids at or below \$150 in other Ancillary Services are inadequate to meet Ancillary Services requirements. The Rational Buyer, minimizing the MCP*Q, temporarily ignoring Ancillary Services caps, would work only if the soft cap applies to Regulation only. If, however, the soft cap is allowed on other Ancillary Services, this approach would not work as it may even increase the total Ancillary Service costs

Services in an incentive compatible framework without unacceptable cost-shifting burdens on any one Ancillary Service.

Similar issues would arise under the Ancillary Services buy back mechanism. Originally proposed in Amendment No. 14 to the ISO Tariff, and modified in response to several Commission Orders through subsequent compliance filings, the ISO's buy back mechanism is designed to address circumstances where Scheduling Coordinators voluntarily withdraw, in the Hour-Ahead market, Ancillary Service capacity that was accepted in the Day-Ahead market. As required by ISO Tariff Section 2.5.21, the price to be paid for this withdrawn capacity is the Market Clearing Price for the Hour-Ahead market. If the ISO is required to apply the soft cap to the Ancillary Services markets, however, the Market Clearing Price will no longer represent the marginal value of the capacity in the Hour-Ahead market whenever the ISO is forced to accept bids above the soft cap in an Ancillary Service market. The Scheduling Coordinator could therefore pay a price for the withdrawn capacity that is lower than the price the ISO must pay to replace the capacity. This would encourage the uneconomic buy back of Ancillary Service capacity.

B. The Commission Should Allow the ISO to Impose a Negative Hard Cap for Imbalance Energy Bids Below Negative \$150.

The ISO has previously exercised its purchase price cap authority in the real-time market by imposing symmetrical price caps in the Imbalance Energy market, *i.e.*, it has imposed a negative hard cap on Energy bids, parallel to the positive bid caps imposed from time to time. Allowing negative Energy prices has helped to alleviate over-generation that sometimes occurs, particularly in the

spring with its high hydroelectric generation runoff conditions.⁸ A hard cap is necessary because negatively-priced bids can represent offers by Generators to be paid not to generate for reliability reasons (e.g., system-wide or local over-generation).

Replacing the hard negative price cap in the Imbalance Energy market with a negative soft cap is inadvisable, as such a mechanism would render cost justifications and cost allocations extremely difficult. Scheduling Coordinators often submit negatively priced bids in order to be certain of being dispatched in merit order, secure in the knowledge that they will receive the Market Clearing Price no matter what they have bid. This negative bid tells the ISO what that Generator is willing to pay to stay on line. With a bid less than a negative \$150, the ISO believes that the December 15 Order would require entities submitting such bids to provide the Commission with cost information that would allow the Commission to determine the justness and reasonableness of such bids. Nothing in the December 15 Order, however, provides any guidance on what sort of information would be appropriate with respect to negative Imbalance Energy bids. It is also far from clear how, or even if, the Commission could review negative Imbalance Energy bids under the procedures set forth in the December 15 Order.

In addition, ISO settlements for negative Imbalance Energy bids below negative \$150 on an as-bid basis would be exceedingly difficult. Since bids

⁸ The Commission accepted the ISO's proposal to allow Market Participants to submit negative Supplemental Energy bids as part of Amendment No. 13 to the ISO Tariff. *California Independent System Operator Corp.*, 86 FERC ¶ 61,122 (1999).

beyond the soft cap are not supposed to be allowed to establish a Market Clearing Price, with a soft cap on negatively-priced bids, the ISO's Target Price mechanism may encounter significant problems if there are incremental bids priced below negative \$150. The Target Price is, in fact, a surrogate Market Clearing Price for overlapping incremental and decremental bids, and is used in lieu of incremental bids offered below the Target Price (or decremental bids offered above the Target Price).

For these reasons, ISO requests that the Commission grant it the authority to impose a hard cap on negative Imbalance Energy bids, tracking the level of the breakpoint on positive bids.

C. The Commission Should Confirm That the ISO is Permitted to Propose an Underscheduling Penalty That Would Apply to Generation as well as to Load.

In the December 15 Order, the Commission declined to apply an underscheduling penalty on Generation as it had done with regard to Load. The ISO believes this asymmetrical approach fails to provide the proper incentives to lessen underscheduling and also presents problems of equity. As noted in the ISO's November 22 Comments on the November 1 Order, as well as in its Offer of Settlement filed in this proceeding on October 20, 2000, penalizing only unscheduled Loads means that, when Load-serving Scheduling Coordinators seek to negotiate forward purchase arrangements, they will have to take into account their exposure to the penalty if the negotiations fail, while the suppliers with which they are negotiating will not. "The penalty must apply to both load and supply if the negotiating leverage is to remain in balance." November 22

Comments at 18-19. *See also* October 20 Offer of Settlement, Transmittal Letter at 7-8.

While the Commission chose not to act on comments urging it to adopt an underscheduling penalty provision that applies to both Load and Generation in the December 15 Order, noting that there would be complexities involved in developing such penalty provisions for Generation, the Commission did state that the ISO “is free to propose a modification to [the] penalty procedures.”⁹ The ISO believes this statement leaves the ISO the option to propose additional measures to address underscheduling, including penalties for Generation that could address the concerns raised in the December 15 Order. The ISO is currently examining such options and hopes to develop a proposal in the near future.

If the December 15 Order does not leave such an option open to the ISO, all of the concerns raised in the ISO’s October 20 Offer of Settlement and November 22 Comments would still apply. The ISO accordingly requests clarification that it is authorized to submit such a proposal. If this is not the case, the ISO requests that the Commission modify the December 15 Order in order to permit the development and implementation of a penalty on Scheduling Coordinators that fail to schedule available Generation in forward Energy markets. Failure to permit implementation of such a penalty for Generation will result in a failure to fully address the underscheduling problem discussed in the December 15 Order.

⁹ December 15 Order, 93 FERC ¶ 61,294, slip op. at p. 44, n.57.

D. The Commission Should Confirm That the December 15 Order Does Not Mandate Elimination of the Balanced Schedule Requirement.

In the summary of the Commission's November 1 Order in this proceeding, it identified "elimination of the balanced schedule requirement" as a proposed structural reform to be addressed.¹⁰ In the November 1 Order's discussion of "balanced schedules" under the heading of longer-term reforms to be addressed, the Commission clarified that:

We are also concerned that some of the underscheduling problems may be a result of the existence of many individual scheduling coordinators that are required to submit balanced schedules to the ISO. We therefore direct the ISO and the PX to pursue establishing an integrated day ahead market in which all demand and supply bids are addressed in one venue.¹¹

The Commission revisited this issue in the December 15 Order, indicating that in the November 1 Order "while we stated that we were not dictating any particular revision, we instituted the following longer-term measures: . . . (3) directing the ISO and PX to pursue establishing an integrated day ahead market in which all demand and supply bids are addressed in one venue"¹² The Commission went on to state in the December 15 Order that "we will decline at this time to issue more prescriptive direction for our long-term measures than that already stated in our November 1 Order."¹³

In light of the Commission's explicit acknowledgement that it did not dictate any particular longer-term revision in the November 1 Order and that it did

¹⁰ November 1 Order, 93 FERC ¶ 61,121, slip op. at 5.

¹¹ *Id.*, slip op. at p. 33.

¹² December 15 Order, 93 FERC ¶ 61,294, slip op. at 67.

¹³ *Id.*, slip op. at 69.

not issue any more prescriptive direction in the December 15 Order, the ISO believes that it is only required to examine the issues related to the balanced schedule requirement. The ISO will consider these issues with the PX, Commission staff and other interested parties. The ISO believes that this is the only requirement imposed by the Commission with respect to balanced schedules and that the summary section of the November 1 Order was not intended to expand on the discussion in the body of that order. The ISO requests clarification that this understanding is correct.

The Commission must understand that elimination of the balanced schedule requirement would require sweeping changes in how the ISO operates and conducts its markets. If the summary portion of the November 1 Order were intended to mandate the immediate elimination of the balanced schedule requirement, the ISO believes there is nothing in either Order that supports such a mandate. A simple statement that the Commission is concerned that the balanced schedule requirement might have added to the underscheduling problems experienced by the ISO in the past year, without any findings or evidence to serve as a basis for such a concern, is insufficient to justify such an action. Accordingly, the ISO requests that the Commission confirm that the December 15 Order does not mandate elimination of the balanced schedule requirement, or, in the alternative, requests rehearing on this issue.

IV. POINTS OF ERROR

- A. The Commission erred in applying a breakpoint or “soft cap” to the ISO’s Ancillary Service Markets other than Regulation, rather than allowing the continuance of a hard cap.
- B. The Commission erred in failing to authorize the ISO to continue to apply a negative hard cap to the ISO’s Imbalance Energy market.
- C. If the December 15 Order prohibits the ISO from proposing underscheduling penalties on Generation, the Commission erred in applying an underscheduling penalty to Load alone, and precluding the application of an underscheduling penalty to Generation.
- D. If the December 15 Order requires the ISO to eliminate the requirement that Scheduling Coordinators submit balanced schedules, the Commission erred in mandating the elimination of the balanced schedule requirement.

V. MOTION FOR CLARIFICATION

The Commission Should Clarify that Reporting Requirements and Cost Justification for Out-of-Market Transactions are the Same as those for Above-Breakpoint Bids.

In the December 15 Order, the Commission required those entities whose bids above the \$150 breakpoint are accepted by the ISO to provide information regarding the above-breakpoint transactions to the Commission on a weekly basis so that the Commission can determine whether the bids are just and reasonable. The information to be submitted to the Commission includes cost

data such as operating costs, fuel quantity and cost, and NOx emissions costs.¹⁴ The ISO seeks clarification from the Commission that it intended these same reporting and cost justification requirements to be imposed on Out-of-Market (“OOM”) transactions with suppliers from outside the ISO’s Control Area.

The ISO frequently procures Energy through OOM calls. When OOM calls are made on in-state resources that are obliged to respond to the ISO’s Dispatch instructions, the Scheduling Coordinator is paid in accordance with Section 11.2.4.2 of the ISO Tariff, at either the Market Clearing Price for Imbalance Energy or based on a calculated price determined using certain market indicia and cost elements. When the ISO procures Energy Out-of-Market from resources that are not in its Control Area, it does so through negotiated transactions at agreed-upon prices. The negotiated price can exceed the \$150 breakpoint by a considerable margin.

OOM transactions with suppliers of Energy from outside the ISO’s Control Area should be subject to the same reporting and cost justification requirements that apply to suppliers whose accepted Energy bids are above the breakpoint. Otherwise, in-state suppliers could seek to avoid both the OOM payment provisions in the ISO Tariff and the reporting and justification requirements of the December 15 Order by arranging exports to third parties outside the ISO’s Control Area. These parties could then refrain from submitting market or Imbalance Energy bids and could resell the Energy to the ISO through an OOM transaction thus avoiding the reporting and cost justification requirements (“ricochet scheduling”). Furthermore, even in the absence of ricochet

¹⁴ December 15 Order, 93 FERC ¶ 61,294, slip op. at pp. 58-59.

transactions with in-state suppliers, if suppliers outside the ISO's Control Area are not subject to the reporting and justification requirements of the December 15 Order, they will have an incentive to withhold bids from the ISO markets and wait for OOM negotiations in order to avoid those requirements. In short, if OOM transactions with suppliers outside the ISO Control Area are not subject to the reporting and cost justification requirements, it will increase the burden on the ISO to negotiate Out-of-Market purchases in real time. This would be contrary to one of the principal purposes of the reforms prescribed in the December 15 Order. Clearly, increasing the real-time negotiating burdens on the ISO's operators and creating new opportunities for gaming the system was not the Commission's intent in crafting its cost reporting and justification requirements.

To avoid such gaming opportunities, the Commission should clarify that it intends its reporting and cost justification requirements to apply to all transactions in the ISO's markets, including all OOM transactions with entities outside the ISO's Control Area delivered at prices in excess of \$150.

VI. REQUEST FOR COMMISSION CONSIDERATION OF PROCEDURAL ISSUES

Lastly, the ISO wishes to raise for the Commission's attention certain procedural issues which are of concern to the ISO. While we recognize that the Commission has not yet scheduled the technical conference to address certain long-term measures identified in the Commission's December 15 Order, we urge the Commission to postpone such conference until at least the second quarter of this year. As required by the Commission's December 15 Order, the ISO is in the midst of preparing its January 31 Congestion Management filing and

preparing for the Commission's January 23 technical conference regarding market power monitoring and mitigation. Both of these matters require the dedication of significant ISO personnel and resources. In addition, not only is the technical conference on market power issues scheduled for January 23, but the Commission also intends that the market monitoring and mitigation plan developed in that process be implemented by May 1 of this year. The ISO is concerned that, should the Commission schedule the long-term issues technical conference for any time within the next month or two, the ISO would be unable to dedicate the resources required to properly develop our thoughts and positions on these weighty issues. Therefore, the ISO requests that the Commission schedule the long-term issues technical conference to occur no earlier than May 1, 2001.

VII. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Commission grant rehearing of the December 15 Order with regard to its rulings on the issues described in parts III and IV above, clarify its December 15 Order with regard to the issue described above in part V, and schedule the technical conference on long-term issues in accordance with the discussion in part VI.

Respectfully submitted,

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Dated: January 16, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned 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 Washington, DC this 16th day of January, 2001.

Sean A. Atkins

