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FEDERAL ENERGY
REGULATORY COMMISSION

April 24, 2001

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

Re: ***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,*** **Docket No. EL00-95-012**

Dear Secretary Boergers:

Enclosed please find an original and fourteen copies of the California Independent System Operator Corporation's Response to the Comments of the California Department of Water Resources filed in the above-captioned proceeding on April 23, 2001. Also enclosed are two extra copies of the filing to be time/date stamped and returned to us by the messenger. Thank you for your assistance.

Respectfully submitted,

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Enclosures

cc: Service List

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company	)	
	)	Docket No. EL00-95-012
v.	)	
	)	
Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange	)	

RESPONSE OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO THE COMMENTS OF THE CALIFORNIA DEPARTMENT OF WATER RESOURCES

I. Introduction.

On April 23, 2001, the California Department of Water Resources ("DWR") filed comments on the recommendation of the Federal Energy Regulatory Commission Staff on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Market ("Staff Proposal"). The California Independent System Operator ("ISO") herein submits its comments on the comments filed by DWR in the above-captioned proceeding.

II. Background: the Market Stabilization Plan & Resource-Specific Cost-Based Bid Caps.

Prior to the comments filed by DWR in this proceeding, the ISO filed a proposed Market Stabilization Plan ("MSP") in response to the Staff Proposal.[1]

[1] The ISO filed its MSP on April 6, 2001 in response to a March 30, 2001 letter order from the Director of the Commission's Office of Markets, Tariffs and Rates which indicated that any alternative proposal to the Staff Proposal needed to be filed by April 6, 2001 in order to allow the Commission time to consider the proposal prior to making a determination as to the permanent market mitigation measures for California.

The MSP is designed to mitigate the market power of suppliers in California's wholesale electricity markets and thereby to facilitate just and reasonable prices in those markets. In addition, the MSP is designed to reduce the volume of system load served by real-time transactions by providing the ISO with the ability to commit and dispatch resources on a forward basis.[2]

The MSP's central market-power mitigation measures include: (1) the use of Resource-Specific Cost-Based Bid Caps ("RCBCs") and (2) an availability payment for all Participating Resources[3] that ensures full cost recovery and that such resources will be available to serve California load. Though the ISO will utilize the standing bids (RCBCs) of Participating Resources to satisfy California load, infra-marginal resources will have the opportunity to collect the Market Clearing Price ("MCP") set by the highest–cost Participating Resource.[4]

Under the MSP, all Participating Resources (*i.e.*, those resources that would be subject to RCBCs and must-bid requirements in return for the availability payment) would receive the price of the highest bid-capped resource for awarded Ancillary Service ("AS") capacity and dispatched Energy.[5] Imported

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[2] Under the MSP, there would be forward markets through which the ISO would optimize the procurement of Energy, the procurement of Ancillary Services, and the management of congestion.

[3] The ISO defines "Participating Resources" as all Participating Generating Units and any other resource that makes itself available, in return for an Availability Payment, to serve California load. Such other resources will be offered an availability payment equivalent to the payment made to Participating Generators within the ISO Controlled Grid, and the capacity so contracted will be available in the forward markets at an agreed-upon standing bid price.

[4] One should not infer that use of the term "market clearing price" or "MCP" indicates something other than a cost-based proposal.

[5] The price for AS capacity will be based on the opportunity cost of the ISO reserving that capacity for AS instead of scheduling it as Energy. The opportunity cost will be the difference between the highest dispatched RCBC for Energy (i.e., the so-called "zonal MCP") and the individual resource's RCBC. This foregone revenue will be what is paid for the AS capacity. For further details, see the ISO's filed MSP at 33.

resources that do not want to commit capacity to the ISO's control still may bid in the proposed Day-Ahead and Hour-Ahead Energy markets. However, if such resources are selected and their bids exceed the price of the highest bid-capped resource dispatched by the ISO, they will be paid as-bid and will not be able to set the zonal MCP.

III. ISO Response to DWR's Comments.

In its comments, DWR recommends that the Commission: (1) abandon the single market clearing price auction and employ an "as bid" pricing mechanism until the current imbalance between supply and demand is eliminated, (2) apply unit-specific cost-based pricing to all timeframes, not merely to Stage 3 emergencies, and (3) ensure that destabilizing spot markets are not more attractive to sellers than the forward markets the Commission seeks to promote.[6] While DWR did not mention the ISO's MSP in its comments, the factual underpinnings of DWR's comments and the ISO's MSP are the same, *i.e*, the existing wholesale market in California is not competitive and the mitigation of market power through resource-specific, cost-based bids is both necessary and appropriate.[7]

The ISO believes that market power mitigation measures of the type proposed in its MSP and in the DWR Comments are necessary in order to

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6 DWR Comments at 2.

7 The Commission can depart from cost-of-service ratemaking and rely on market based rates but only if competition can ensure just and reasonable rates and can preclude the exercise of market power. See, e.g. *Farmers Union Cent. Exch., Inc. v. FERC,* 734 F.2d 1486, 1530 (D.C. Cir.), *cert. denied sub nom., Williams Pipe Line Co. v. Farmers Union Cent. Exch., Inc.*, 469 U.S. 1034 (1984); and *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 at 870-71 (D.C. Cir. 1993).

alleviate the intolerable conditions in California and improve the operational stability of the ISO Controlled Grid in the near term. The primary difference between DWR's recommendation and the ISO's MSP is that DWR does not recommend using a market clearing price mechanism within its cost-based proposal; rather, DWR would have all resources subject to cost-based pricing and paid "as bid." The appeal of the ISO's MSP is that it builds upon market power mitigation tools and market structures that the Commission has proposed for California or approved in other restructured electric markets. However, if the Commission were to decline to adopt the ISO's MSP, the Commission should adopt the proposal put forth by DWR. The cost-based regime proposed by DWR would mitigate market power during all periods and operating conditions in recognition of the tight supply conditions prevailing *at all times* in California, and therefore would be superior to the Staff Proposal which only mitigates market power during periods in which the ISO has announced an extreme supply deficiency (*i.e.*, Stage 3 System Emergency).[8]

[8] The ISO notes that if the Commission were to adopt the DWR proposal, the Commission should still address the problem of MW laundering. Cost-based bid caps will not be effective to address the conditions in California unless they are coupled with a requirement to serve California load. In addition, if the Commission were to adopt the DWR proposal, settlement details would lengthen the time for implementation. For example, the current settlement regime uses MCPs to both pay and charge Scheduling Coordinators for the generation and load they schedule. Payment on an "as bid" basis would require development of average weighted zonal charges. Also congestion charges would need to be calculated in a different manner under an "as bid" system.

IV. Conclusion.

For the reasons expressed herein and in its April 6 filing in this proceeding, the ISO believes the changes contained in its MSP are necessary in order to mitigate the market power in California's wholesale markets and to improve operational stability this summer. However, if the Commission were to decline to adopt the ISO's MSP, the Commission should not implement the Staff Proposal but should adopt the proposal put forth by DWR.

Respectfully submitted,

Roger Smith/SAA

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Dated: April 24, 2001

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.

Dated at Washington, DC, this 24th day of April, 2001.

Sean A. Atkins