

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation))))	Docket No. ER99-826-000
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**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION TO MOTIONS TO INTERVENE
AND RESPONSE TO COMMENTS AND PROTESTS**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (1997), the California Independent System Operator Corporation ("ISO") submits this Answer to the motions to intervene and response to comments and protests submitted in this docket.¹ As stated herein, the ISO does not oppose any of the interventions. The ISO also provides its

¹ To the extent this Answer responds to protests, the Commission has accepted answers to protests, notwithstanding Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), that assist the Commission's understanding and resolution of the issues raised in a protest, *Long Island Lighting Co.*, 82 FERC ¶ 61,129 (1998), clarify matters under consideration, *Arizona Public Service Co.*, 82 FERC ¶ 61,132 (1998); *Tennessee Gas Pipeline Co.*, 82 FERC ¶ 61,045 (1998), or materially aid the Commission's disposition of a matter, *El Paso Natural Gas Co.*, 82 FERC ¶ 61,052 (1998). The ISO's Answer will clarify matters under consideration, aid the Commission's understanding and resolution of the issues and help the Commission to achieve a more accurate and complete record, on which all parties are afforded the opportunity to respond to one another's concerns. *Northern Border Pipeline Co.*, 81 FERC ¶ 61,402 (1997); *Hopkinton LNG Corp.*, 81 FERC ¶ 61,291 (1997). The Commission should accordingly accept this Answer.

responses to the issues raised in the comments and protests of certain of the parties.

BACKGROUND

On December 4, 1998, the ISO submitted an amendment to Section 28 of the ISO Tariff, extending the authority of the ISO to disqualify Energy bids that exceed a certain level (the "BEEP Cap").² Under the proposed amendment, the ISO would initially maintain the price cap on Energy bids at the current level, \$250/MWh. In the filing letter accompanying the proposed amendment, the ISO explained that the ISO Board of Governors ("ISO Board") planned to raise the level of the price cap to \$750/MWh after the implementation of certain improvements to ensure that the Energy and Ancillary Service markets are functioning effectively.³ Although the ISO currently intends to make these changes by May 31, 1999, no fixed deadline for raising the cap to \$750/MWh was included in the proposed amendment because the timing of the implementation of these changes is uncertain at present. In addition, the

² Capitalized terms used herein and not defined are used with the meanings given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

³ These improvements include the following items or substantially equivalent actions as determined by the ISO Board: (a) implementation of Rational Buyer Protocols, and (b) modification of Reliability Must-Run (RMR) agreements to eliminate or substantially reduce potential incentives for withholding of capacity from the Ancillary Service and other markets.

amendment would establish a floor for the price cap of \$2,500/MWh subsequent to October 1, 1999, without respect to the status of these changes.

The Commission noticed the ISO's filing on December 9, 1998, with interventions and protests due on or before December 28, 1998. Timely interventions were filed by seventeen parties, and a motion to intervene out of time was filed by one. Five parties included comments expressing support for the amendment in its entirety;⁴ five parties took no position on the merits of the amendment;⁵ and eight parties filed protests or comments that supported the extension of the ISO's authority to cap Imbalance Energy prices, but opposed some aspect of the proposal to increase the cap above \$250.⁶

DISCUSSION

The ISO does not oppose the intervention of any of the parties that have moved to intervene in this proceeding. The ISO would also note, as an initial

⁴ The Public Utilities Commission of the State of California; Electric Clearinghouse, Inc.; Pacific Gas & Electric Company; San Diego Gas & Electric Co.; and the Utility Reform Network and Utility Consumer Action Network.

⁵ Bonneville Power Administration; Duke Energy Trading and Marketing, L.L.C.; Houston Industries Power Generation, Inc.; the Northern California Power Agency; and PSEG Resources, Inc.

⁶ The Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California; Los Angeles Department of Water and Power; the Metropolitan Water District of Southern California; Modesto Irrigation District; the Cities of Redding and Santa Clara, California and the M-S-R Power Agency; the Sacramento Municipal Utility District; Southern California Edison Company; and the Transmission Agency of Northern California.

matter, that no party has expressed opposition to the extension of the authority to cap Imbalance Energy prices. The only issues raised concern the ISO's authority to determine the level of the BEEP Cap and the raising of the BEEP Cap to a level no lower than \$2500/MWh effective October 1, 1999.

The opposition takes three forms. First, a number of parties argue that granting the ISO authority to determine the level of the BEEP Cap is beyond the Commission's authority under the Federal Power Act ("FPA").⁷ Second, some of the same parties also argue that the ISO's filing is deficient in that the criteria used to raise the BEEP Cap are undefined.⁸ Third, certain parties object to the automatic raising of the BEEP Cap to a level no lower than \$2500/MWh effective October 1, 1999.⁹

I. The Commission Has the Authority Under the FPA to Grant the ISO Discretion to Determine the Appropriate Level of the BEEP Cap.

⁷ The Metropolitan Water District of Southern California; Modesto Irrigation District; the Cities of Redding and Santa Clara, California and the M-S-R Power Agency; and the Transmission Agency of Northern California.

⁸ The Metropolitan Water District of Southern California; Modesto Irrigation District; the Cities of Redding and Santa Clara, California and the M-S-R Power Agency; the Sacramento Municipal Utility District; and the Transmission Agency of Northern California.

⁹ The Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California; Los Angeles Department of Water and Power; Modesto Irrigation District; the Cities of Redding and Santa Clara, California and the M-S-R Power Agency; the Sacramento Municipal Utility District; and Southern California Edison Company.

A number of parties argue that the Commission lacks the authority under the FPA to permit the ISO to determine the appropriate level of the BEEP Cap. They contend that only the Commission can determine just and reasonable rates, and that allowing the ISO to raise the BEEP Cap above the existing \$250 level would be an impermissible delegation of the Commission's authority. Such arguments, however, have already been made to the Commission, and were rejected. In *AES Redondo Beach, L.L.C.*, 85 FERC ¶ 61,123 (1998), the Commission responded to an argument that its order allowing the ISO to set caps on Ancillary Services and Replacement Reserve bids was "contrary to law because the Commission has no authority to delegate ratemaking to the ISO." *Id.* at 61,455. The Commission stated:

The Order simply acknowledged that, as the purchaser of Ancillary Services and Replacement Reserves, the ISO has the discretion to reject excessive bids. Accordingly, while we agree with [the parties] that under the FPA, the ISO may not change the price in another party's rate schedule, that is not what the . . . Order allowed the ISO to do."

Id. at 61,463.

Only one of the parties challenging the legality of the ISO's authority to impose caps acknowledges the existence of the Commission's statements quoted above.¹⁰ That party nonetheless argues that the ISO is such a massive purchaser of Ancillary Services and Replacement Reserves that the imposition of

¹⁰ Motion to Intervene and Protest of The Cities of Redding and Santa Clara, California and the M-S-R Power Agency at 8.

a price cap effectively and impermissibly establishes the rate.¹¹ This argument misses the mark. Regardless of the volume of electricity a buyer purchases at wholesale, the buyer can determine a price above which it will decline to transact. There is thus no reason for the Commission to reverse its position regarding the legality of its grant of authority to the ISO to determine the appropriate level of Commission-granted price caps.

II. The Proposed Amendment to Section 28 Constrains the ISO's BEEP Price Cap Authority Appropriately.

Many of the same parties who contest the Commission's authority under the FPA also argue that the ISO's discretion to raise the BEEP Cap is improper because the Tariff does not include criteria according to which that discretion will be exercised. They cite the Commission's direction to the ISO in *AES Redondo Beach* regarding the Ancillary Services Market Redesign that the Commission has directed be completed by March 1, 1999:

[W]e will direct the ISO in its March 1st filing to indicate whether it intends to continue or to eliminate its discretion to use a purchase price cap. If the ISO proposes to retain such discretion, it must in its filing propose objective criteria that it will use to exercise this discretion. Moreover, the ISO must propose a formula for specific level for any cap.

85 FERC at 61,464. The Commission issued this direction because it was "mindful of concerns . . . that the ISO's discretion to use a purchase price cap should not be in place any longer than is absolutely necessary." *Id.* The BEEP

¹¹ *Id.*

Cap extension, however, addresses those concerns directly. Subsequent to October 1, 1999, the proposed amendment establishes severe constraints on the ISO's discretion to establish a price cap for Energy bids. After that date, the proposed Section 28 would require the ISO to set the BEEP Cap at a level no lower than \$2500/MWh. Under current market conditions, such a cap would only come into play during periods of *extreme* price deviation. If further experience indicates that the BEEP Cap needs to be maintained or lowered to a level below \$2500/MWh after October 1, 1999, the ISO would have to submit a subsequent filing with the Commission floor setting forth the need for such a lower cap. The Commission's concerns about the ISO's long-term retention of the ability to impose restrictive price caps are therefore addressed by the proposed BEEP Cap extension, which severely constrains the ISO's discretion (absent further Commission order) as of October 1, 1999.

III. The October 1, 1999 \$2500/MWh Floor for the BEEP Cap is the Reasonable Product of a Stakeholder Process That Still Permits the ISO and Other Parties to React to Market Conditions.

Finally, certain parties object to the October 1, 1999, \$2500 floor for the BEEP Cap because of a concern that market conditions may not have improved sufficiently by that date to justify such limits on the ISO's authority. In essence, the dispute in this regard is between those who favor an indefinite unconstrained price cap, with the burden on those who would to eliminate it, and those who favor a "sunset" on the unconstrained price cap, with the burden on those who would continue it. As one of the objecting parties notes, the timing of and

conditions for the elimination of the BEEP Cap were the subject of debate during the stakeholder process leading up to the proposed amendment.¹² A number of parties nonetheless contend that the ISO should not propose a floor on the level of the BEEP Cap until further information, such as data on the market for the summer of 1999, is available.

While opinions may reasonably differ regarding the appropriate duration of an unconstrained Imbalance Energy price cap, the current proposal represents a compromise. It maintains the ISO's discretion to determine the appropriate level of the BEEP Cap through the summer of 1999 while demonstrating the ISO's commitment to keep lower caps in place no longer than necessary. Moreover, it reflects the Commission's concerns, as expressed in *AES Redondo Beach*, that price caps be so structured as to allow room for the development of competitive markets. See 85 FERC at 61,464.

While concerns about the state of the market are reasonable, the proposal provides adequate opportunity to address any untoward developments. Should market conditions during the summer indicate the necessity of continued authority to impose price caps below \$2500, the ISO has the ability to request that a lower floor be established or to request that it retain its current authority to determine the appropriate level of the cap, if necessary. In its response to the distortions of the Ancillary Service market last summer, the ISO has already

¹² The stakeholder process is described in the ISO's December 4, 1998, filing letter in this proceeding.

demonstrated its readiness to take action to prevent abuses of market power. Moreover, other parties retain the ability under section 206 of the FPA to request an extension of price caps if they disagree with the ISO's decision. In light of the expressed desire of the Commission and all parties to limit reliance on price caps, these options provide adequate opportunity to adjust further the future level of the BEEP Cap if necessary.

The Commission has recognized that one of the important functions of an ISO is to provide a forum for stakeholders to debate and resolve policy questions in a fair and nondiscriminatory manner.¹³ The need for an extension of the BEEP Cap and the terms of an extension were considered through an open stakeholder process, and the present amendment was the product of that process.¹⁴ Consistent with the importance that the Commission has placed on the California stakeholder process, *AES Redondo Beach*, 85 FERC at 61,463; *California Independent System Operator Corporation*, 84 FERC ¶ 61,217 (1998), and in light of the reasonableness of the result, the Commission should not overturn the

¹³ *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540, 21,596 (May 10, 1996), FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,036 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), III FERC Stats. & Regs. ¶ 30,048 (1996), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *appeals pending*.

¹⁴ See the discussion of that process in the ISO's December 4, 1998, filing letter at 5-6.

outcome. The Commission should accordingly accept the proposed amendment as a just and reasonable basis for the extension of the BEEP Cap.

CONCLUSION

Wherefore, for the reasons stated herein, the ISO respectfully requests that the motions to intervene be granted and that the Commission accept, without modification, the proposed amendment to the ISO Tariff.

Respectfully submitted,

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Dated: January 11, 1999

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, D.C. this 11th day of January, 1999.

Sean A. Atkins