

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

**California Independent System)
Operator Corporation)** **Docket No. ER00-3673-000**

**ANSWER OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO MOTIONS TO INTERVENE, COMMENTS, AND PROTESTS**

I. INTRODUCTION AND SUMMARY

On September 14, 2000, the California Independent System Operator Corporation (“ISO”)¹ filed Amendment No. 31 to the ISO Tariff in the above-referenced docket. Amendment No. 31 proposed changes to the ISO Tariff to remove the existing termination date of the ISO’s authority to disqualify Imbalance Energy and Ancillary Service bids that exceed levels specified by the ISO, and to confirm the ISO’s ability to establish price caps for all of its markets.

Numerous parties have moved to intervene in the instant proceeding. Some of the motions to intervene include comments on or protests of Amendment No. 31, as well as requests for specific relief. Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213, the ISO submits its Answer to the motions to intervene, comments, and protests submitted in the above-captioned docket. As explained below, the ISO does not

¹ Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

oppose the intervention of the parties that have sought leave to intervene in this proceeding.

A number of parties note their qualified or unqualified support for Amendment No. 31. Other parties request substantial modifications or rejection of the amendment. These requests are unsupported.

The Commission has recognized the authority of the ISO, as a purchaser of capacity and Energy, to set price caps. Thus, the ISO is empowered to extend its price cap authority as described in Amendment No. 31; this amendment was filed after the ISO Governing Board, by a large majority, decided that an extension of price cap authority was required in light of the continued exercise of market power in the ISO's markets. Moreover, it is consistent both with the ISO's role as a purchaser and Commission precedent for the ISO to determine whether price caps are necessary, and if so, what the appropriate levels for the price caps are, based on current market conditions. Once the ISO is able to mitigate market power through a longer-term approach, which will be part of the ISO's Comprehensive Market Redesign proposal to be filed with the Commission later this year, the continued need for and level of price caps will be reevaluated.

II. BACKGROUND

A. Amendment No. 31

At its meeting on September 6-7, 2000, the ISO Governing Board considered options for addressing the problems with the operation of the markets

in California described in a report by the ISO's Department of Market Analysis.² In that report, the DMA concluded that the extension of price cap authority is necessary because of concerns that the California markets are not workably competitive during high-load periods, and that measures to mitigate the resultant high prices of electricity are not yet adequately developed.³ The Commission reached the same conclusion in its recent order concerning a complaint by the San Diego Gas & Electric Company asking the Commission to cap the prices that sellers could bid into the California markets, where the Commission stated:

[N]umerous reports prepared by the independent monitoring bodies of the PX and ISO . . . indicate that, despite significant increases in demand, there has been no corresponding increase in the construction of new generation. Given the lack of any meaningful demand response, this means that virtually all bids must be accepted when these shortage conditions arise. In addition, these reports indicate that most of the load in California is being met through spot market wholesale purchases rather than longer-term power sale contracts and hedging arrangements that could provide price certainty and stability. As a result of all these factors, there are periods when all generation must be accepted, regardless of the bid price, and sellers may be in a position to act on this knowledge and raise bids above the level that would be expected solely as a result of scarcity.⁴

The DMA recommended that the ISO's price cap authority be extended until a comprehensive market reform proposal is implemented to address mitigation measures for global and locational market power.⁵ The Governing Board considered various options for responding to the DMA's concerns. To aid

² *Request to Extend Price Caps* (report of the California ISO Department of Market Analysis) (Aug. 10, 2000) ("DMA Report"). The DMA Report is included in the Amendment No. 31 filing as Attachment C.

³ DMA Report at 3.

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*, 92 FERC ¶ 61,172, at 61,605 (2000), *reh'g pending* ("August 23 Order").

⁵ DMA Report at 3, 10.

in evaluating these options, the Board also referred to a memorandum prepared for the Governing Board's use by the Director of the DMA and the ISO's Senior Regulatory Counsel.⁶ The Governing Board ultimately adopted a resolution that approved the following actions:

- the filing of an amendment to the ISO Tariff to remove the November 15, 2000 date for the termination of the ISO's authority to establish price caps in the ISO's markets;
- the continuation of the provision setting the price cap at \$250 and of the other provisions set forth in the Governing Board's "Price Cap Resolution 8-1" of August 1, 2000 beyond October 15, 2000 until further directed by the Governing Board in a further resolution;⁷ and
- the provision of a report and analysis to the Governing Board by no later than March 31, 2001 that includes an assessment of market competitiveness in Summer 2001, a timetable for the implementation of Congestion Management Reform and other Comprehensive Market Redesign components that could affect the need for price caps, and a recommendation regarding the need for and level of price caps for Summer 2001.⁸

Notably, the first of these actions was approved by an overwhelming vote of 21 in favor, one against, and no absentions; the second and third of the actions were adopted by a similar majority of 19 in favor, two against, and one abstention.⁹

The Governing Board approved these actions to allow the ISO to provide relief from excessively high electricity prices until the ISO is able to mitigate market power through a longer-term approach that will be part of the ISO's Comprehensive Market Redesign proposal to be filed with the Commission in

⁶ See Memorandum Concerning Extension of Price Cap Authority and Levels of Price Caps After October 15, 2000 (Aug. 29, 2000), at 3-4 ("Board Memorandum"). This memorandum was included in the Amendment No. 31 filing as Attachment D.

⁷ A copy of the Board's "Price Cap Resolution 8-1" was included in the Amendment No. 31 filing as Attachment E.

⁸ A copy of the Board's resolution was included in the Amendment No. 31 filing as Attachment F.

⁹ See *id.*

November 2000. Significantly, in the August 23 Order the Commission noted that the ISO's continued ability to establish purchase price caps in its markets addressed concerns "that pricing volatility be mitigated," both in the ISO's markets and in other markets where sellers' bids are disciplined by the maximum prices established for the ISO's markets.¹⁰ The need for price caps will be reevaluated once effective mitigation measures are in place.

B. Interventions

Motions to intervene, comments, and/or protests were filed by numerous parties.¹¹ A notice of intervention was filed by the Public Utilities Commission of the State of California ("CPUC"). Various parties representing diverse interests, including two California regulatory bodies, express support for Amendment No. 31 in whole or in part.¹² Some parties, however, protest Amendment No. 31 and move for modification or rejection of the amendment. As explained below, these requests lack merit.

¹⁰ August 23 Order at 61,606.

¹¹ Motions to intervene, comments, and/or protests were filed by the California Department of Water Resources; California Electricity Oversight Board ("EOB"); California Power Exchange Corporation ("PX"); Cities of Redding, Santa Clara, and Palo Alto, California, and the M-S-R Public Power Agency ("Cities/M-S-R"); City of San Diego; Duke Energy North America, LLC, Duke Energy Trading and Marketing, LLC, and Duke Energy Merchants, LLC ("Duke"); Dynegy Power Marketing, Inc. ("Dynegy"); Enron Power Marketing, Inc. and Enron Energy Services, Inc. ("Enron"); Independent Energy Producers Association ("IEP"); Merrill Lynch Capital Services, Inc. ("Merrill Lynch"); Metropolitan Water District of Southern California ("MWD"); Modesto Irrigation District ("MID"); Morgan Stanley Capital Group Inc. ("Morgan Stanley"); Northern California Power Agency; Pacific Gas and Electric Company ("PG&E"); PPL Montana, LLC and PPL EnergyPlus, LLC ("PPL Parties"); Reliant Energy Power Generation, Inc. ("Reliant"); Sacramento Municipal Utility District ("SMUD"); Southern California Edison Company ("SCE"); Transmission Agency of Northern California ("TANC"); Turlock Irrigation District; Western Power Trading Forum ("WPTF"); and Williams Energy Marketing & Trading Company ("Williams").

¹² These parties include the CPUC, EOB, Cities/M-S-R, MID, PG&E, PX, SCE, SMUD, and TANC.

III. ANSWER TO COMMENTS AND PROTESTS¹³

A. The ISO Has the Authority to Set Price Caps

As described in the transmittal letter for Amendment No. 31, the Commission has recognized that the ISO's authority to establish price caps in its markets derives from the ISO's status as a purchaser of capacity and Energy.¹⁴ Moreover, if a seller does not wish to bid into the ISO's markets, it is free to bid into other markets or to enter into bilateral sales arrangements.¹⁵ Additionally, because the ISO has general authority to establish limits on the prices it pays, it also has the authority to apply the price caps when it declares a System Emergency.¹⁶

¹³ Some of the parties commenting on Amendment No. 31 do so in portions of their pleadings that are variously styled, without differentiation. Parties also request affirmative relief in pleadings styled as comments and protests. There is no prohibition on the ISO's responding to the assertions in these pleadings. The ISO is entitled to respond to these pleadings and requests notwithstanding the labels applied to them. *Florida Power & Light Co.*, 67 FERC ¶ 61,315 (1994). In the event that any portion of this Answer is deemed an Answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. § 385.213) to permit it to make this Answer. Good cause for this waiver exists here given the nature and complexity of this proceeding and the usefulness of this Answer in ensuring the development of a complete record. See, e.g., *Enron Corp.*, 78 FERC ¶ 61,179, at 61,733, 61,741 (1997); *El Paso Electric Co.*, 68 FERC ¶ 61,181, at 61,899 & n.57 (1994).

¹⁴ See Transmittal Letter for Amendment No. 31 filing at 2-3. Thus, the ISO disagrees with parties' assertions that the Commission should set conditions or limits on the duration, permissible levels, or other features of the ISO's price caps. See, e.g., Williams at 25-28.

As explained in the transmittal letter for the Amendment No. 31 filing, the ISO's price cap authority does not derive from an express provision of the ISO Tariff. Nevertheless, the ISO believes that its price cap authority should be detailed in a Tariff provision, for the following reason: The ISO establishes its contractual relationship to sellers in its markets through their execution of Scheduling Coordinator Agreements, which make the Scheduling Coordinators' participation in the ISO's markets subject to the terms of the ISO Tariff. It is important, therefore, that the Tariff leave no ambiguity as to the ISO's ability to establish price caps. Transmittal Letter for Amendment No. 31 filing at 7 n.21. Duke is incorrect in asserting that the Tariff thereby becomes "the locus of [the ISO's] authority to establish and revise price caps in the markets it administers." See Duke at 5. Rather, the ISO's authority derives from the fact that no purchaser may be compelled to buy wholesale power at a price it considers excessive, absent a prior obligation to do so.

¹⁵ *California Independent System Operator Corporation*, 89 FERC ¶ 61,169, at 61,511 (1999) ("Amendment No. 21 Order").

¹⁶ See Enron at 8-10; Reliant at 5 & n.4. Moreover, as the ISO explained in an answer in another proceeding, the ISO's current compensation mechanisms for the curtailment of Exports are reasonable. See generally Answer of the California Independent System Operator

Parties' attempts to show that the ISO does not have the authority to set price caps are unsuccessful. PPL Parties assert that granting the ISO discretion to establish the price cap level would be an impermissible delegation of Commission authority, because then the ISO would be able "to monopsonize California's markets."¹⁷ This argument ignores the fact that, as the Commission has noted, sellers are free to sell into other markets than those of the ISO.¹⁸ Similarly, PPL Parties' argument that the Commission "may not allow the ISO to establish prices"¹⁹ contradicts the Commission's recognition that the ability to set the level of its price caps is in the ISO's discretion.²⁰ Dynegy concedes that "the Commission may arguably have jurisdiction only over" bid caps, not purchaser's caps, but incongruously also claims that purchaser's caps and bid caps "are really just the flip side of the same coin."²¹ Additionally, Dynegy asserts that the Commission left the ISO "with discretion to set the cap at whatever level it deems fit" based on the belief that the ISO-run markets "generally make up only 10% to 15% of sales in the California electricity markets."²² However, Dynegy is able to point to nothing in the July 28 Order – and indeed there is nothing in that order – to support its contention. Morgan Stanley argues that the Commission's statement that the ISO does not establish the prices that sellers may charge, only the price that the ISO is willing to pay, pertains solely to the provision of Ancillary

Corporation to the Complaint and Request for Fast Track Processing of Reliant Energy Power Generation, Inc., Dynegy Power Marketing, Inc., and Southern Energy California, LLC, Docket No. EL00-97-000 (Aug. 14, 2000).

¹⁷ PPL Parties at 15-16.

¹⁸ See Amendment No. 21 Order at 61,511.

¹⁹ PPL Parties at 16-17. See also Merrill Lynch at 5-6.

²⁰ August 23 Order at 61,606.

²¹ Dynegy at 6.

²² *Id.* at 4.

Services.²³ However, Morgan Stanley ignores the fact that, in the July 28 Order, the Commission said that this statement applies to both Imbalance Energy and Ancillary Services.²⁴

Parties' attempts to show that the ISO is not an ordinary buyer are also fruitless. Parties claim that the ISO is not an ordinary buyer because, under the ISO Tariff, the ISO is permitted to call on generators in the event of a System Emergency.²⁵ However, parties do not dispute that the ISO serves as an ordinary buyer at all times except when extraordinary circumstances compel the ISO, in accordance with its Tariff, to fulfill its duty to maintain system reliability (i.e., circumstances involving the risk of cascading outages or violation of minimum operating reliability criteria).²⁶ The Commission is well aware of this fact, and has nevertheless repeatedly affirmed that the ISO may establish limits on the prices it pays at all times.²⁷

B. Whether There Should Be Price Caps, and the Appropriate Levels At Which to Set Them

The parties express in their pleadings strongly divergent views and rationales regarding whether price caps should be continued at all, assuming the ISO's authority to establish such limits. As the ISO explained in the transmittal letter, the Governing Board evaluated various options for addressing this issue, including the following:

- permitting the ISO's price cap authority to expire;

²³ Morgan Stanley at 6.

²⁴ See *Morgan Stanley Capital Group Inc. v. California Independent System Operator Corporation*, 92 FERC ¶ 61,112, at 61,431 (2000) ("July 28 Order").

²⁵ Enron at 8-10; Reliant at 4-5; WPTF at 6-8.

²⁶ See ISO Tariff, Section 4.4; *id.*, Appendix A, definition of "System Emergency."

²⁷ See Transmittal Letter for Amendment No. 31 filing at 1-2.

- asserting continued price cap authority without an amendment to the ISO Tariff; and
- modifying the ISO Tariff to extend the ISO's price cap authority.

The Governing Board weighed the strengths and weaknesses of each option, considered the appropriateness of preserving the ISO's flexibility to place appropriate limits on the prices paid in its markets, and referred to the DMA Report and Board Memorandum. The Governing Board ultimately determined, by an overwhelming margin, that an extension of its price cap authority was required.²⁸

As to the appropriate levels for any price caps that are implemented, Amendment No. 31 "preserves the discretion of the ISO, in accordance with criteria adopted by the ISO Governing Board, to adjust price cap levels as appropriate to respond to changes in market conditions."²⁹ The Commission has noted that market conditions indicate the appropriate levels for price caps: "If the ISO is unable to elicit sufficient supplies at or below its announced price ceiling, it will have to raise its purchase price to the level necessary to meet its needs."³⁰ The ISO will adjust price cap levels accordingly.

Enron is incorrect in stating that the Commission, in the August 23 Order, asserted that price caps are not helpful in addressing issues in the California markets.³¹ In the August 23 Order, the Commission noted that the ISO had "recently stated that it will make a timely filing with the Commission to extend its

²⁸ See *id.* at 3-5; see *id.*, Attachment F.
²⁹ Transmittal Letter for Amendment No. 31 filing at 7.
³⁰ Amendment No. 21 Order at 61,511.
³¹ Enron at 4-5.

[price cap] authority.”³² The Commission did not say that such a filing would be unhelpful. To the contrary, the Commission said that the ISO’s price caps “serve to discipline the ISO’s prices in both the ISO and PX,” and gave the ISO direction on materials to include in its future filing.³³ For similar reasons, Morgan Stanley’s assertion that Amendment No. 31 is premature in light of the investigation established in the August 23 Order is incorrect.³⁴ If the Commission had wished in the August 23 Order to inform the ISO that it would be superfluous to make a price caps filing in the near future, the Commission could easily have done so.

C. The Use of Price Caps Is An Interim Measure That Will Be Reevaluated Once the ISO Is Able to Mitigate Market Power Through a Longer-Term Approach

As the ISO stated in the transmittal letter for Amendment No. 31, the continuation of the ISO’s price cap authority is “intended to allow the ISO to provide relief from excessively high electricity prices until the ISO is able to mitigate market power through a longer-term approach that will be part of the ISO’s Comprehensive Market Redesign proposal to be filed with the Commission in November 2000.”³⁵ Moreover, the ISO stated that it “does not believe that price caps provide the complete answer, or even the preferred answer, to the problem of market power. However, price caps ‘will serve to discipline prices in both the ISO and PX’ in the interim until comprehensive market reform measures have been implemented to address the problem of market power.”³⁶ As a result,

³² August 23 Order at 61,606.

³³ *Id.* at 61,606, 61,608.

³⁴ See Morgan Stanley at 7-8.

³⁵ Transmittal Letter for Amendment No. 31 filing at 5.

³⁶ *Id.* at 5 n.17 (quoting August 23 Order at 61,606). As PG&E correctly observes, “[o]ther programs, such as increasing generation, or demand responsiveness, are still in initial stages of

parties' concerns that these price caps will continue indefinitely are unwarranted.³⁷ However, because the date for the implementation of comprehensive market power reform measures currently can only be estimated rather than known, it would be premature for the ISO to establish a sunset date for the use of price caps.³⁸

development, relatively small in scale, and unable as yet to assure a fully competitive market outcome." PG&E at 3.

Additionally, the ISO notes that the Commission recently issued an order announcing expedited procedures for addressing California market issues. Among other things, the Commission stated that, on November 1, 2000, it plans to hold a special meeting "for purposes of considering the issuance of a proposed order in the captioned dockets that proposes specific remedies to address the issues set for hearing in the August 23 Order and that directs any further procedural steps deemed necessary or appropriate." *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*, 93 FERC ¶ 61,051, slip op. at 2 (Oct. 19, 2000).

³⁷ IEP at 7; Merrill Lynch at 9-12; Morgan Stanley at 7; PPL Parties at 14; Williams at 10-13; WPTF at 8-9.

³⁸ See Duke at 4-8.

IV. CONCLUSION

For the reasons set forth above, the ISO urges the Commission to grant all motions to intervene and to accept Amendment No. 31 without further procedures.

Respectfully submitted,

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