

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

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

**ANSWER OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION  
TO MOTIONS TO REJECT AND STRIKE COMMENTS ON STAFF'S  
RECOMMENDATION ON PROSPECTIVE MARKET MONITORING  
AND MITIGATION FOR THE CALIFORNIA WHOLESALE  
ELECTRIC POWER MARKET**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2000), the California Independent System Operator Corporation ("ISO") hereby submits this Answer to the Motion to Reject and Strike Comments of Williams Energy Marketing & Trading Company ("Williams") and the Motion for Summary Rejection of Comments of Coral Power, LLC ("Coral") and Enron Power Marketing, Inc. ("Enron") (together, Williams, Coral and Enron are referred to as the "Marketers"). Both motions (the "Motions") were filed with the Commission on April 6, 2001 in Docket No. EL00-95-012.<sup>1</sup>

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<sup>1</sup> Williams subsequently re-filed its Motion to Reject and Strike in its market based rate authority proceeding, Docket No. ER99-1722, on April 16, 2001. Enron and Coral filed a Motion for Summary Rejection of the ISO's Amendment No. 38 filing in Docket No. ER01-1579 on April 10, 2001. The ISO will file separate Answers in those dockets.

In the Motions, Marketers claim that the ISO's Comments on the Commission Staff's March 9, 2001 Market Monitoring and Mitigation Plan, and the Reports which support the ISO's Comments, should be stricken from the record due to the composition of the ISO's Governing Board. Williams also argues that submitting such comments and reports is beyond the scope of the ISO's authority. The Motions reflect a degree of *chutzpah* that is unprecedented in the ISO's experience before this Commission. Far from being in any way inappropriate, the submission by the ISO of analyses demonstrating the pervasive exercise of market power by certain generators and importers was absolutely required in the discharge by the ISO of its Commission-mandated market-monitoring responsibilities. Without challenging their substance in any way, the Marketers attempt to shield themselves from the ISO's analyses, thereby conceding their probity and relevance. The Motions to Strike are inappropriate and should be denied.

## **I. Background**

In the December 15 Order in this docket,<sup>2</sup> the Commission directed its Staff to provide the Commission with a written market monitoring and mitigation recommendation. On March 9, 2001, Staff submitted its recommendation, which included proposals relating to outage coordination, selling obligations, price mitigation, market clearing price, and conditions for invoking mitigation. On the same day, the Commission posted a notice inviting parties to the EL00-95 proceeding to submit comments on the Staff recommendation by March 22, 2001. The ISO submitted its

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<sup>2</sup> *San Diego Gas & Electric Co. 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) ("December 15 Order").

comments on March 22, together with reports on market conditions prepared by the ISO's Department of Market Analysis.<sup>3</sup> The Reports, "Further Analyses of the Exercise and Cost Impacts of Market Power In California's Wholesale Energy Market" by Dr. Eric Hildebrandt and "Empirical Evidence of Strategic Bidding in California ISO Real Time Market" by Dr. Anjali Sheffrin, describe the exercise of market power by sellers in the California markets since May of 2000, including seller-specific information.

## **II. Argument**

The Marketers seek to avoid the implications of the Reports, not by taking issue with their substance, but by denying access to them as part of the decisional record. The Commission must not permit this arrogant attempted diversion in any way to inhibit full consideration of the exercise of market power that has been so rampant in California electricity markets, and as to which the Reports are directly relevant. It would be ludicrous to design a mitigation regime in ignorance of the abuses that exist and that must be addressed. Yet this is precisely what the Marketers seek to achieve by their shallow ruse.

### **A. The Commission Should Recognize That Marketers' Motions Are A Diversionary Tactic**

The Marketers' filings are patently an effort to distract the Commission from fulfilling its statutory mandate – protecting consumers from wholesale rates that are not just and reasonable. The DMA Reports present overwhelming evidence of the exercise of market power leading to persistently distorted wholesale rates that translate into

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<sup>3</sup> The ISO's DMA is an internal staff unit dedicated to monitoring and analyzing market performance and developing market design modifications to improve performance.

billions of dollars of excessive costs imposed on California consumers. Marketers are apparently unable to challenge the substance of the DMA Reports or to defend the actions of the generators, importers, and marketers that have exercised that market power. Instead, they “blame the messenger,” arguing that the Commission should reject the ISO’s Comments and the appended DMA Reports not because the analyses are incorrect or misleading, but because, in Marketers’ view, the ISO is not fit to present comments to the Commission. Perhaps Marketers are influenced by the adage that “the best defense is a good offense”. In this case, however, an irrelevant offense is no defense at all.

Williams contends that it was inappropriate for the ISO to submit its comments and reports on market power to the Commission, since the Commission found in its November 1<sup>4</sup> and December 15 Orders that “the record does not support allegations of specific exercises of market power or market abuse.” Williams at 9. While Marketers would like the record to remain incomplete, under the terms of the Commission-approved ISO Tariff, the ISO is under an obligation to analyze and report on all instances of market power abuse. Ever since the Commission first authorized operation of the ISO, and as further emphasized in the Commission’s Order Nos. 888 and 2000, the Commission necessarily and appropriately relies on the ISO for effective market monitoring. Absent such an approach, the Commission would be forced to dedicate substantial resources to performing similar functions; functions that are best performed, in the first instance, by those most familiar with the markets involved. In addition, had

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<sup>4</sup> *San Diego Gas & Electric Co. 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 ¶ 61,61,121 (2000).

the Commission not intended further development of the record in this proceeding, the Commission would not have noticed and asked for comments in this docket. To fulfill its statutory responsibilities, the Commission must develop a full record upon which to base its ultimate determinations. The Marketers' attempt to short-circuit that process is inappropriate and self-serving.

In fact, Williams is misstating the Commission's Orders. What the Commission actually said in the November 1 and December 15 Orders was that the "Staff Report noted evidence suggesting that sellers had the potential to exercise market power, although there were *insufficient data* to make a determination about the exercise of market power by individual sellers."<sup>5</sup> The Commission stated further that Staff lacked the time and resources to do a more thorough examination, and that "because of the expedited nature of [Staff's examination of bulk power markets leading to the November 1 and December 15 Orders], staff was not able to address all of the issues in depth..." December 15 Order at 62,014, and that "the Staff report was an informal investigation and that in some instances, the Staff did not have time to conduct detailed analyses of certain anomalies..." *Id.* Finally, the Commission noted that "[w]hile this record does not support findings of specific exercises of market power, and while *we are not able to reach definite conclusions about the actions of individual sellers*, there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight..." December 15 Order at 61,984, citing November 1 Order at 61,350 (emphasis added).

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<sup>5</sup> December 15 Order at 61,984 (emphasis added). The Commission also noted that the "Staff report indicated some attempted exercise of market power, if the standard of bidding above marginal cost is used." *Id.* at 61,984, n. 4.

This demonstrates that far from exonerating sellers in the California markets from charges of exercising market power, the Commission found that there was not *yet* enough evidence in the record and enough time to analyze precisely to whom accountability should be assigned. It is indeed wishful thinking for Williams to treat the Commission's inability to assign blame, on the record as it then stood, as justification for erecting a bar against the introduction of the data and analyses necessary to make a substantive and final determination in this proceeding. Rather than foreclosing that opportunity, the Commission plainly expected parties to submit additional data and analyses to support their views of the merits and deficiencies of Staff's market mitigation proposal. Directly pertinent to that effort is evidence of specific, abusive market behavior. That, precisely, was the subject of the DMA analyses, and to deny their consideration is to deprive the Commission of the opportunity for reasoned decision-making. That may serve the objectives of the Marketers; it cannot, however, be reconciled with the discharge by the Commission of its responsibility to protect the public interest.

**B. The Composition of the ISO's Board Is Irrelevant to this Proceeding and, in particular, to the ISO's Continued Fulfillment of Its Market-Monitoring Responsibility**

Marketers argue that the March 22 filing by the ISO should be rejected by the Commission due to the composition of the ISO Board of Governors. The Marketers claim that the current ISO Board was seated "in blatant and complete defiance of the Commission's December 15 Order".<sup>6</sup>

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<sup>6</sup> Williams at 2. Williams also states that the Commission disbanded the previous ISO Board because of "market interference and command and control tactics". Williams at 6. In fact, the Commission's stated reason for disbanding the ISO Board was that the Board had become ineffective

It is clear that, unable to attack the message itself, the Marketers seek to attack the legitimacy of the messenger.

The timing of Marketers' objection is telling. Since the new Board was appointed on January 25, 2001, the ISO has made numerous filings. Marketers did not object to any of the previous filings on legitimacy of governance structure grounds. Moreover, Marketers have continued to take active part in the ISO's markets and to benefit from the structures facilitated by the ISO in spite of what they now claim to be the complete "illegitimacy" of the ISO's actions. It is only now, when the ISO has presented such compelling evidence of the exercise of market power by suppliers in California, that the Marketers protest the ISO's actions.

As Marketers are well aware, the composition of the ISO's Board does not affect the validity of the evidence submitted. The Reports of Dr. Hildebrandt and Dr. Sheffrin are probative because of their authors' expertise, their familiarity with California electricity markets, the extensive data they present and the well-founded analytical techniques they employ (analytical techniques endorsed by the Commission, *see Public Service Company of New Mexico*, 25 FERC ¶ 61,469, 62,042 (1983)), none of which Marketers criticize. The involvement of the Governor of California in appointing members of the ISO Board of Governors simply has nothing to do with the relevance of the DMA Reports or to the weight the Commission should give to their analyses in reaching decisions in these dockets.

Coral and Enron argue that the ISO's current Board is akin to direct state control of the ISO. They state that "Commission precedent is to summarily reject filings by

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due to its inability "to reach decisions on complex and divisive issues." December 15 Order at 62,012. There has been no recent complaint of indecisiveness.

otherwise independent public utilities that are made at the specific direction of state authorities,” citing *Western Massachusetts Electric Company*, 23 FERC ¶ 61,345 (1983) (“*WMECO*”). In fact, this situation is nothing like that in *WMECO*. In that case, the state commission had ordered a utility to make a section 205 rate filing against its will, while it was challenging the order giving rise to the requirement. *Id.* at 61,757, n. 1. The Commission found that *WMECO* had made the filing under duress, and that it was thus contrary to the Commerce Clause and the Federal Power Act. 23 FERC at 61,757.

Here, in contrast, the Marketers’ motions do not concern a rate filing but the submission of information that is central to the discharge, by the Commission, of its own responsibilities. It is, moreover, a submission which both the management and the Board of the ISO feel compelled to place before the Commission. The cases simply are not parallel.

In any event, this is not the proper occasion to consider the conformity of the new Board with Commission requirements lawfully imposed. That debate, if it is to occur at all, must await the Commission’s consideration of the recently amended ISO Bylaws, to be filed with the Commission shortly.

### **C. Market Analysis is an Appropriate Role for the ISO**

Williams argues that in submitting reports on market conditions to the Commission, the ISO has exceeded the scope of its authority. Williams at 4. This is simply not the case. The ISO is required to monitor markets under its Tariff, under the



Commission's October 1997 Order authorizing limited operation of the ISO,<sup>7</sup> and pursuant to guidance by the Commission in the December 15 Order.<sup>8</sup>

In the October 1997 Order, the Commission stated that the ISO should provide the Commission with market monitoring information, and stated that “[i]n particular, the ISO and PX should submit to us descriptions of any observed pattern of market power abuse that is not easily remedied with the tools at the disposal of the ISO and PX.” October 1997 Order at 61,533.

The ISO's Market Monitoring and Information Protocol (“MMIP”), part of its FERC-approved tariff, requires the ISO to address “gaming” in its review of markets. “Gaming” is defined as taking unfair advantage of the rules and procedures set forth in the ISO Tariff, protocols or Activity Rules, or of transmission constraints in periods in which there exists substantial congestion, to the detriment of the efficiency of, and consumers in, ISO Markets. “Gaming” may also include taking undue advantage of other conditions that may affect the availability of transmission and generation capacity, such as loop flow, facility outages, level of hydropower output or seasonal limits on energy imports from out-of-state, or actions or behaviors that may otherwise render the ISO markets vulnerable to price manipulation to the detriment of their efficiency. MMIP section 2.1.3.

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<sup>7</sup> *Pacific Gas and Electric Company, et al.*, 81 FERC ¶ 61,122 (1997) (“October 1997 Order”).

<sup>8</sup> Even if the ISO were responsible solely for reliability, and not for market monitoring in and of itself, as Williams seems to believe (Williams at 7), the proper functioning of markets, including the minimization of market power, is essential to promoting reliability. For example, the rapacious prices allowed by the exercise of market power in the California markets have rendered several entities uncreditworthy. Since these uncreditworthy entities can no longer secure power to meet their load, reliability is threatened.

More recently, in the December 15 Order the Commission instructed the ISO to provide it with market behavior data in the form of monthly reports on bids above the \$150 breakpoint to help the Commission evaluate the California markets. *See, e.g.*, December 15 Order at 62,011-12.

Further, one of the eight functions of a Regional Transmission Organization (“RTO”), as described by the Commission in Order No. 2000,<sup>9</sup> is Market Monitoring. Order 2000 stated that “Reports on opportunities for efficiency improvement, market design flaws and *market power abuses* in the markets the RTO operates and administers also must be filed with the Commission...”<sup>10</sup>

Finally, the Commission specifically directed the ISO to become involved in the Commission Staff’s Market Mitigation proposal: “We expect the input of all interested market participants and *are particularly interested in the views of the ISO’s market monitoring unit* both in assisting our staff in developing this program and in implementing it.” December 15 Order at 31 [emphasis added]. For Williams now to claim the ISO has no appropriate role in the development of the Market Mitigation Plan, or in market monitoring and analysis in general, is thus insupportable.

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<sup>9</sup> *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs., Regs. Preambles ¶ 31,089 (Dec. 20, 1999), *order on reh’g*, Order No. 2000-A, 65 Fed. Reg. 12088 (Mar. 8, 2000), FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (Feb. 25, 2000) (“Order No. 2000”).

<sup>10</sup> Order No. 2000 at 31,156 (emphasis added). In the RTO Notice of Proposed Rulemaking (“NOPR”) leading up to Order No. 2000, the Commission explicitly acknowledged that the ISO already had committed to producing annual public reports on market power abuses and market design flaws. NOPR, FERC Stats. & Regs., Prop. Regs. Preambles ¶ 32,541 at 33,751 (May 13, 2001). The Commission did not consider these activities beyond the scope of the ISO’s authority.

#### IV. CONCLUSION

For these reasons, the ISO requests that the Commission deny the motions of the Marketers and accept the Comments of the ISO on Staff's Market Mitigation Plan, together with the Reports supporting them.

Respectfully submitted,

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Charles F. Robinson  
General Counsel  
Roger E. Smith  
Senior Regulatory Counsel  
The California Independent  
System Operator Corporation  
151 Blue Ravine Road  
Folsom, CA 95630  
Tel: (916) 608-7135

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Edward Berlin  
Kenneth G. Jaffe  
Michael E. Ward  
Julia Moore  
Swidler Berlin Shereff Friedman, LLP  
3000 K Street, N.W., Suite 300  
Washington, DC 20007  
Tel: (202) 424-7500

April 23, 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 23<sup>rd</sup> day of April, 2001.

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Julia Moore  
(202) 295-8357

April 23, 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 Response of the California Independent System Operator Corporation to Motions to Reject and Strike Comments on the Staff's Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market. 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,

Julia Moore  
(202) 295-8357

Counsel for the California  
Independent System Operator Corporation