

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

102 FERC ¶ 61,050

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

California Independent System Operator Corporation Docket Nos. ER02-1656-010
ER02-1656-011
ER02-1656-012

California Independent System Operator Corporation Docket No. ER02-2576-002

Investigation of Wholesale Rates of Docket No. EL01-68-025
Public Utility Sellers of Energy and
Ancillary Services in the Western
Electricity Coordinating Council

ORDER ON REHEARING

(Issued January 17, 2003)

1. In this order, we are addressing the rehearing requests of orders issued on October 11, 2002¹ and October 25, 2002² concerning the California Independent System Operator Corporation's (CAISO) Comprehensive Market Redesign Proposal (MD02).³ This order benefits customers by clarifying aspects of MD02, which will result in

¹See California Independent System Operator Corporation, et al., 101 FERC ¶ 61,061 (2002) (October 11 Order).

²See California Independent System Operator Corporation, 101 FERC ¶ 61,084 (2002) (October 25 Order). On December 26, 2002, the Commission issued an order in which we granted rehearing of the October 25 Order for the limited purpose of further consideration and so that timely-filed rehearing requests would not be deemed denied by operation of law.

³See California Independent System Operator Corporation, 100 FERC ¶ 61,060 (2002) (July 17 Order).

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enhanced electricity reliability for California and help provide power at just and reasonable prices.

Background

2. The CAISO, Southern California Edison Company (SoCal Edison), Powerex Corp. (Powerex), Independent Energy Producers Association (IEPA), Williams Energy Marketing and Trading Company (Williams), and the Bonneville Power Administration (BPA) filed requests for rehearing of the October 11 Order. In a November 27, 2002 order, the Commission addressed rehearing requests concerning one aspect of the October 11 Order, and stated that we would address the remaining issues raised on rehearing at a later time.⁴ On November 25, 2002, Mirant Parties (Mirant) and SoCal Edison filed requests for rehearing of the October 25 Order.

Discussion

Zero-Bid Requirement

3. The CAISO, Powerex, BPA, and IEPA submitted comments concerning the Commission's decision in the October 11 Order to continue to require that bidders outside of the CAISO control area be "price-takers," i.e., bidders must continue to submit zero bids into CAISO markets and receive the lower of the lowest available proxy bid or the clearing price of feasible incremental and decremental bids available. Generally, these parties, including the CAISO, argue that the Commission should allow bidders outside of California to bid prices other than \$0/MWh because the zero-bid requirement will create a disincentive for resources outside of California to submit bids into CAISO markets once the CAISO implements new economic dispatch software to establish a single price in each 10-minute interval.

4. In the July 17 Order, the Commission directed the CAISO to implement software as part of MD02 that resolves what the CAISO referred to as the "price overlap"

⁴See California Independent System Operator Corporation, 101 FERC ¶ 61,266 (2002) (November 27 Order). On December 9, 2002, the Commission issued an order in which we granted rehearing of the October 11 Order for the limited purpose of further consideration of issues that were not addressed in the November 27 Order and so that timely-filed rehearing requests would not be deemed denied by operation of law.

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problem.⁵ The "price overlap" condition occurs when scheduling coordinators are willing to buy real-time energy or reduce their generator output (by submitting decremental bids) at prices higher than the prices at which other scheduling coordinators are willing to sell real-time energy or increase their generator output (by submitting incremental bids). A "price overlap" can occur because the CAISO's current "market separation rule" requires scheduling coordinators to maintain balanced schedules, *i.e.*, scheduling coordinators are not currently permitted to trade schedules with each other. To resolve this "price overlap" problem, the CAISO will eliminate the "market separation rule" and allow scheduling coordinators' separate incremental and decremental bids to converge to a more efficient single market clearing price for each ten-minute interval.

5. The parties, including the CAISO, state that, if bids from outside of the CAISO control area are required to bid \$0/MWh in order to be price takers, import bids will likely clear at \$0/MWh when any decremental bid is greater than \$0/MWh. Because bidders outside of the CAISO control area in this scenario will be paid \$0/MWh for their energy, these parties, contend that the zero bid requirement in conjunction with the implementation of the new economic dispatch software will result in a loss of participants and supply in the CAISO markets.

6. The CAISO requests that the Commission allow bidders outside of the CAISO control area to submit a bid into CAISO markets other than \$0/MWh and be paid the market clearing price, but not allow that bid to set the market clearing price. The CAISO states that by restricting the setting of the market clearing price to bids made from resources inside its control area will eliminate the incentive for "megawatt laundering."

7. While the Commission remains concerned, as we stated in the October 11 Order, with the possibility of "megawatt laundering" if the zero-bid requirement is removed, we find that eliminating a strong disincentive to suppliers outside of the CAISO control area to bid into the CAISO markets through the removal of the zero-bid requirement outweighs current concerns regarding the possibility of "megawatt laundering." Furthermore, once the CAISO has implemented a financially binding day-ahead market, concerns about "megawatt laundering" will be greatly diminished. Given the potential disincentive for resources outside of the CAISO control area to bid into CAISO markets under the current zero-bid requirement as described above, we will accept the CAISO proposal to prevent this potential supply problem. Accordingly, effective on the date of implementation of the new economic dispatch software discussed above, we will allow

⁵The CAISO estimates that it will implement this economic dispatch software in mid-2003.

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bidders outside the CAISO control area to submit a bid into CAISO markets other than \$0/MWh and be paid the market clearing price, but not allow that bid to set the market clearing price. Until such time, the \$0/MWh bid requirement will remain in effect.

Expiration of Creditworthiness Adder

8. Williams requests that the Commission reinstate the ten percent creditworthiness adder for all transactions in California. Williams states that two requirements the Commission imposed to remove the credit adder have not been satisfied: (1) that suppliers be paid in full; and (2) that the CAISO has fully complied with the Commission's directives concerning creditworthiness.⁶ Furthermore, Williams states that the Commission's finding in the October 11 Order, that a supplier may choose to include a credit risk premium in its bid price, does not take into account all types of transactions, such as when a bid is subject to AMP or when the CAISO denies a supplier a waiver from the must-offer obligation. Williams requests that the Commission, at a minimum, direct the CAISO to add at least ten percent to the market clearing price any time AMP mitigation is imposed and to the minimum load costs a supplier incurred while operating in compliance with the must-offer obligation.

9. In the October 11 Order, the Commission found that the ten percent creditworthiness adder would be unnecessary as of October 31, 2002, when the initial elements of the MD02 redesign went into effect. The Commission pointed out in the October 11 Order that the ten percent charge was added to the market clearing price paid to generators when proxy bids were used. Since the market-oriented rules approved in the July 17 Order and implemented on October 31, 2002 removed the ability of the CAISO to impose proxy prices to replace a supplier's bids and a supplier retains the option of including a credit risk premium in its bid price, the Commission removed the mandatory credit adder.⁷ Because a supplier has the option to include a credit adder in its bid price, we find no merit to Williams' allegation regarding the requirements necessary for removal of the mandatory credit adder.

10. We also find that Williams is incorrect when it states that a supplier's option to include a credit risk premium in its bid price does not take into account all types of

⁶See Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council, 97 FERC ¶ 61,294 (2001).

⁷A supplier will have to evaluate market conditions to determine if including a credit premium as part of its bid adversely affects the likelihood of it being dispatched.

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transactions, such as when a bid is subject to AMP or when the CAISO denies a supplier a waiver from the must-offer obligation. By giving a supplier the option to incorporate a credit adder, the Commission created a more efficient market-based mechanism than if it had continued to impose a fixed credit adder amount. Each supplier can evaluate how much of a credit adder, if any, to include in its bid price based on that supplier's assessment of overall credit risk. If a supplier believes that credit uncertainty exists for specific transactions, it may adjust its bid price to cover these costs of doing business. For this reason, we will deny Williams' requests that the Commission direct the CAISO to add at least ten percent to the market clearing price any time AMP mitigation is imposed and to the minimum load costs incurred by a supplier while operating in compliance with the must-offer obligation.

Hour-ahead Market Timeline

11. SoCal Edison opposes the change to the hour-ahead market timeline from T-120 to T-135 minutes because it hampers its ability to procure energy. SoCal Edison contends that the change will increase the number of schedule deviations in real-time, and runs counter to the CAISO's MD02 goal of bringing the hour-ahead timeline closer to real-time. Finally, SoCal Edison disputes Mirant's statement that these changes to the timeline do not allow Mirant sufficient time for submitting bids. SoCal Edison states that if the CAISO is late in submitting the final hour-ahead schedules, the solution is not to modify the timeline but to enforce it.

12. SoCal Edison fails to give any explanation as to how the change to the hour-ahead timeline will hamper its ability to procure energy and it has not demonstrated how the change will increase the number of schedule deviations in real-time. In fact, Mirant states that accepting the CAISO's proposal without modification would lead to a greater incidence of incorrect schedules being submitted to the CAISO due to the insufficient amount of time a scheduling coordinator would have to evaluate what capacity is uncommitted. Specifically, Mirant states that the CAISO's initial proposal allowed a scheduling coordinator only 15 to 30 minutes to evaluate how much uncommitted capacity is available to bid in the supplemental energy market. According to Mirant, this would be an unreasonably short amount of time, especially given that the current timeline is already "extremely" tight and barely achievable, particularly if the CAISO runs late in publishing hour-ahead final schedules. Because SoCal Edison has not provided an explanation to support its arguments against changing the hour-ahead timeline to T-135 and we find Mirant's proposal to advance by 15 minutes the deadline for submitting bids in the hour-ahead market to be reasonable, we will deny SoCal Edison's request for rehearing on this issue.

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13. The CAISO has acknowledged that due to scheduling difficulties and late filings by market participants, it occasionally publishes final hour-ahead schedules after the deadline required by its tariff. However, the CAISO has recently implemented new procedures to encourage timely closing of its markets.⁸ Beginning on November 1, 2002, should any entity, including the CAISO itself, delay timely closing of any of the CAISO markets, the CAISO will send a message to all scheduling coordinators (SCs) indicating whether the late closing was due to CAISO system problems or late validated SC schedules. If the cause for late closing is due to late validated schedules, the CAISO will also identify the SCs who caused the delay. We recognize the CAISO's efforts in this regard and encourage it to continue to improve its performance in publishing the hour-ahead final schedules in a timely manner.

Determining Reference Prices: Use of Monthly vs. Daily Gas Prices

14. Mirant states that the Commission failed to address its comments concerning the CAISO's request to update the AMP reference prices daily using monthly changes in gas proxy costs. Mirant states that this process represents an improper matching of daily reference prices with monthly gas prices. Mirant contends that during periods of unstable gas prices, using the change in monthly gas prices would result in incorrect reference prices, possibly to levels below the actual cost of production for gas-fired generating units. Mirant requests that the Commission direct the CAISO to adjust the daily AMP reference prices with changes in daily gas costs.

15. While we agree with Mirant that using daily gas prices for the daily calculation of reference prices has some advantages over using monthly gas prices, Mirant has not demonstrated that the use of a monthly gas price adjustment has resulted in unreasonable reference prices. In addition, we note that Commission staff is currently investigating the possible manipulation of gas prices. Because our concern over the possible manipulation of gas prices outweighs our concern over the proper matching of data in calculating reference prices, we will deny Mirant's request for rehearing on this issue, but invite Mirant to raise any concerns it may have once the Commission has completed its investigation.

⁸See CAISO Market Notices dated September 23 and October 25, 2002.

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Interties and Uninstructed Deviation Penalties

16. The CAISO requests that the Commission clarify that uninstructed deviation penalties will apply to intertie schedules if a pre-dispatch instruction is declined or not delivered. We clarify that intertie schedules that the CAISO has pre-dispatched (i.e., issued a dispatch instruction for the next hour, regardless of successive 10-minute dispatches) will not be subject to a deviation penalty if the CAISO then makes an intra-hour change. However, if the CAISO pre-dispatched an intertie bid for the next hour, and the pre-dispatch instruction is declined or the energy is not delivered, an uninstructed deviation penalty will apply.

17. Powerex requests that the Commission direct the CAISO to file proposed tariff language allowing for all interconnection resources to be exempt from uninstructed deviation penalties when a force majeure event (e.g., forced outage of a generating or transmission facility) makes them incapable of delivering the energy. Powerex argues that all interconnection resources should have the same right to be exempt from deviation penalties in the event the interconnection resource is physically incapable of delivering the expected energy to satisfy its final hour-ahead schedule and real-time dispatch instruction due to a force majeure-type event. Powerex contends that the CAISO provides this exemption only for "dispatchable" interconnection resources. We direct the CAISO to file either proposed tariff language incorporating Powerex' request, or an explanation why such a change would be inappropriate.

Proxy bids and the Must-Offer Obligation

18. The CAISO requests that the Commission clarify that, in instances where a supplier is subject to the must-offer obligation but fails to submit a bid, the CAISO is permitted to impose a proxy bid. We so clarify. We note that the CAISO is not permitted to replace a submitted bid with a proxy bid, but if a supplier fails to submit a bid under the must-offer requirement, the CAISO may impose a proxy bid as a default.

Automatic Mitigation Procedures (AMP)

19. SoCal Edison also requests clarification on the application of AMP to power marketers that do not own generating plants since their bids are not resource-specific. In May 2002, the Commission issued revised reporting requirements that require

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transaction-specific data from power marketers.⁹ Since sufficient data are now available to identify resources associated with bids, the independent entity should be able to calculate AMP reference prices for power marketers.

AMP Reference Prices

20. Regarding the development of reference prices, SoCal Edison maintains that the metrics and standards that the independent entity considers should be made public and that the Commission should adopt procedures to allow third parties to examine and challenge negotiated reference prices. We reiterate our confidence in the independent entity to properly and fairly determine reference prices. We further note that the CAISO's proposed market monitoring plan provides that a third party may avail itself of the CAISO's dispute resolution process if that party believes that any mitigation measure has been improperly applied or withheld.¹⁰

21. Williams seeks clarification as to whether the AMP thresholds provide a "safe harbor" for individual bids that do not exceed the thresholds. Specifically, Williams suggests that a bid that does not exceed the price screen should not be subject to any further testing.

22. We clarify that the price screen is not a "safe harbor" for bids. As stated in paragraph 26 of the October 11 Order, "For the price screen, if the market clearing price for all zones is \$91.87/MWh or below, AMP will not be applied. Therefore, if the market-clearing price is projected to be above \$91.87/MWh in any zone, an examination of bids through AMP will occur in all zones." Since the price screen applies to market clearing prices, not to individual bids, all bids are subject to scrutiny through AMP when the market clearing price in any zone exceeds \$91.87/MWh.

Reliability-Must-Run (RMR) Contracts

23. The CAISO submits that the Commission erred in making the determination that suppliers can seek to enter into RMR contracts with the CAISO if they believe that AMP will not permit them to recover their costs. The CAISO maintains that units can qualify for RMR status only if they are required to satisfy applicable reliability criteria. We

⁹See Revised Public Utility Filing Requirements, 99 FERC ¶ 61,107 at Attachment C (2002).

¹⁰See CAISO Proposed Market Mitigation Measures, Appendix A, Section 6 - Dispute Resolution.

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agree with the CAISO that RMR status is not appropriate for every unit and clarify that this provision was meant to apply only to cases in which a unit has been repeatedly called upon to relieve local reliability problems.

AMP for Local Market Power Mitigation

24. Williams requests rehearing on the application of AMP for local market power mitigation. Williams maintains that RMR units should be sufficient for local market power mitigation and objects to the use of AMP, especially without a price screen, for this purpose. Williams refers to AMP as a "cost-based" mitigation scheme and argues that the \$91.87/MWh price screen threshold may be too low to allow for recovery of fixed and variable costs at less than full load operating points and/or during high natural gas price situations. We have previously addressed the question of the use of RMR contracts as the sole mitigation tool to prevent the exercise of local market power.¹¹ As before, we find that the use of RMR contracts alone is not a sufficient tool to cover every situation and must be supplemented by the use of AMP. We disagree with the characterization of AMP as cost-based and note that AMP relies first on market-based measures, resorting to cost data only if a unit has no accepted bids in last 90 days. Finally, we note that reference prices are adjusted for changes in the price of natural gas.

25. IEP requests clarification regarding the specific mechanics of AMP implementation under circumstances where a bid is taken out-of-merit order. Under the October 11 Order, when a bid is taken out-of-merit order, the price screen is removed for all bids in the relevant zone and all bids are then examined under AMP. IEP argues that in cases where a bid is taken out-of-merit order, those bids that were accepted in merit order and below the level of the price screen should not be examined for the exercise of market power under AMP. We will deny IEP's request. When bids must be taken out-of-merit order, all bids must be examined through AMP to determine that market power is not being exercised.

¹¹See October 11 Order at paragraph 41.

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The Commission orders:

The Commission hereby denies in part and grants rehearing in part of the October 11 Order and the October 25 Order, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.