

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation)
Operator Corporation)
Docket No. ER00-555-000)
)

**MOTION FOR CLARIFICATION
OR, IN THE ALTERNATIVE, REQUEST FOR REHEARING,
AND REQUEST FOR EXPEDITED CONSIDERATION
OF THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

Pursuant to Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713, the California Independent System Operator Corporation ("ISO") moves for clarification or, in the alternative, requests rehearing of certain aspects of the order issued by the Commission in the above-captioned docket on January 7, 2000 (the "January 7 Order" or "Order")¹ and requests expedited consideration of its motion.

I. SUMMARY

In its January 7 Order, the Commission described Amendment No. 23 as expanding the ISO's authority to issue out-of-market Dispatch instructions in situations where generators have in fact submitted bids, but in the determination of the ISO, the markets for such bids are not competitive.² The Commission rejected this aspect of Amendment No. 23 and directed the ISO to "reevaluate the problem on a comprehensive, rather than piecemeal, basis." January 7 Order, slip op. at 1. The Commission agreed with the ISO that there is a serious

¹ *California Independent System Operator Corp.*, 90 FERC ¶ 61,006 (January 7, 2000).

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

flaw in the existing Intra-Zonal management scheme, however, it was not convinced the ISO had proposed an appropriate remedy. The Commission stated that the flaw is:

. . . a recognition that a competitive solution may simply not be feasible for intrazonal congestion. This strikes at the heart of the existing approach and calls out for the design of a comprehensive replacement congestion management approach. Moreover, the redesign should be pursued with input from all stakeholder groups, as well as from the Market Surveillance Committee.

Id. at 9-10.

Comprehensive Review of the ISO's Congestion Management Scheme.

The ISO will undertake a comprehensive redesign of its approach to Congestion Management as called for by the Commission in its January 7 Order. This redesign effort will include all stakeholder groups as well as the ISO's Market Surveillance Committee ("MSC"). Based on experience, the ISO anticipates that a stakeholder process of this magnitude will run through this Spring and Summer. As a result, the ISO is targeting a filing with the Commission by October 31, 2000. In addition, a revised approach to Congestion Management will require the development and testing of necessary software revisions prior to implementation. The work required to implement a revised Congestion Management scheme will depend on the scope of the reform. The ISO's objective is to have in place a revised approach to managing Intra-Zonal Congestion as soon as practicable. The ISO will provide an implementation schedule in the filing to be made by October 31, 2000.

Intra-Zonal Congestion Management in the Interim Period Prior to Implementation of Congestion Management Reform

While the Commission ordered a comprehensive review of the ISO's approach to Congestion Management, the January 7 Order is silent as to what measures the ISO can use to manage Intra-Zonal Congestion and to constrain the exercise of market power while the ISO engages in the comprehensive review ordered by the Commission. As set forth herein, the ISO describes its proposed approach to manage Intra-Zonal Congestion in the interim period prior to implementation of the reforms that result from the comprehensive review ordered by the Commission. As explained below, the ISO believes its proposed interim approach is consistent with the January 7 Order and requests clarification of the January 7 Order to confirm this interpretation.

There are a number of approaches the ISO could use to manage Intra-Zonal Congestion during the interim period. At one extreme, the ISO could request that it be allowed to implement Amendment No. 23 as filed for that period. Such a request would be premised on the fact that the Commission agreed that there is a serious flaw in how the ISO manages Intra-Zonal Congestion and that this flaw presents opportunities for the exercise of market power.³ However, this approach would not heed the Commission's statements that the ISO should not reject market bids that are effective in meeting the ISO's needs. At the other extreme, the ISO could take the approach that, in all

³ As noted above, the Commission agreed with the ISO's assessment that a serious flaw existed in the existing Intra-Zonal Congestion Management scheme and postulated that there may not be a competitive market for resolving Intra-Zonal Congestion. January 7 Order, slip op. at 9.

circumstances where Reliability Must-Run ("RMR") Units are not available to manage Intra-Zonal Congestion, the ISO should accept and pay all bids "as-bid." While this approach would accept all bids, it would also countenance the exercise of market power at the expense of California consumers.

The ISO does not believe that implementation of either of the above alternatives for the interim period is consistent with the Commission's intent in the January 7 Order. Rather, the ISO believes that the Commission intended the ISO to apply an approach that gives effect to market bids during normal operating conditions, while protecting against the exercise of market power when unusual system conditions limit the transfer capability of Intra-Zonal facilities. Only in the former situation would the Commission's concern about the need to send appropriate price signals for new transmission and generation investment in areas where there are constraints apply.⁴ An interim approach consistent with the January 7 Order would accordingly distinguish between circumstances where reliance on prices to send locational signals to encourage new investment is appropriate (*i.e.*, the congestion experienced during normal system operations) and those circumstances where reliance on locational price signals for that purpose is not appropriate (*i.e.*, unusual system conditions of an intermittent or unpredictable nature where the price signal for investment would need to be astronomically high to induce investment). The ISO requests clarification that its application of this approach for the interim period, before completion of the

⁴ In discussing the flaw in the ISO's Intra-Zonal Congestion Management scheme, the Commission stated, "The ISO's proposal fails to send price signals to encourage new generators to enter into areas where there are constraints, which could help alleviate any market power that exists." January 7 Order, slip op. at 9.

comprehensive review of the ISO's Congestion Management system and the implementation of resulting reforms, is consistent with the Commission's January 7 Order.

There are two sets of general circumstances that can, and do, lead to Intra-Zonal Congestion but are not appropriate situations in which to rely on price signals to encourage transmission and generation investment. These circumstances involve transmission facility and other equipment outages, and the outage of RMR Units upon which the ISO would otherwise rely to assure local reliability. Such circumstances represent unusual system conditions of an intermittent or unpredictable nature and do not reflect underlying system deficiencies. For these circumstances, and only for the interim period, the ISO is proposing that it be allowed to dispatch units out-of-market as proposed in Amendment No 23.

The identified circumstances are in addition to the ISO's existing authority to call on generating units out-of-market when effective market bids are unavailable. When added together, the ISO would have the authority to dispatch generating units out-of-market in the following four circumstances: (1) System Emergencies and real time system problems; (2) bid insufficiencies; (3) unusual system conditions involving transmission facility and other equipment outages; and (4) the outage of RMR Units.

As noted above, the ISO's interpretation of the January 7 Order for the interim Period also adheres to the Commission's statements that the ISO should not disregard market bids that have the physical ability to meet the ISO's needs.

If none of the four identified sets of circumstances is present, the ISO would pay bidders their bid price to resolve Intra-Zonal Congestion during the interim period, even if there was a non-competitive supply of bids.⁵ Paying resources as-bid in circumstances that remain vulnerable to the exercise of market power will result in additional costs being passed on to California consumers. This presents the possibility that substantial costs for resolving Intra-Zonal Congestion during normal system conditions could be passed on to California consumers during the period before Congestion Management reforms could be implemented. The ISO's preliminary analysis suggests that the cost of paying bidders their bid price to resolve Intra-Zonal Congestion under normal system conditions when there is a non-competitive supply of bids could be over \$10 million for a six-month period. The ISO's reading of the January 7 Order to permit the ISO to rely on Dispatch instructions in lieu of bids submitted in a non-competitive market only to resolve Intra-Zonal Congestion arising from unusual system conditions would address the *additional* costs that consumers would bear during such incidents. The occurrence of such unusual conditions can create an opportunity for a single resource to exercise locational market power where it knows the ISO will be forced to accept its bids. For example, during a single outage event in October 1999, additional Intra-Zonal Congestion costs of approximately \$5.7 million were incurred due to such circumstances.⁶

⁵ If an RMR Unit were available to resolve the Intra-Zonal Congestion, the ISO would use the RMR Unit.

⁶ If all bids during the October outage had been submitted at the applicable price cap of \$750, the additional costs would have been approximately \$7.8 million.

Thus, the ISO seeks clarification on two items for the interim period: (1) that the ISO has the authority to dispatch and compensate resources under the payment options approved in Amendment No. 23 to address Intra-Zonal Congestion arising from unusual system conditions, rather than having to rely on non-competitive bids from resources exercising locational market power; and (2) that the ISO is directed by the January 7 Order to pay resources as-bid when they are called to mitigate Intra-Zonal Congestion under normal conditions, *i.e.*, when Intra-Zonal facilities are operating at their normal capacities, even though such bids may reflect the exercise of locational market power by the bidders.

To the extent that the Commission does not confirm that the ISO's approach for the interim period is consistent with the January 7 Order, the ISO requests that the Commission grant rehearing and modify the Order as necessary to ensure that the ISO can address locational reliability needs and the potential for exercise of market power during the interim period. The ISO notes, consistent with its commitment to implement reforms developed through the review of its Intra-Zonal Congestion Management approach as soon as practicable, that the requested authority is limited in duration. The ISO also requests that the Commission grant either the requested clarification or rehearing on an expedited basis in order to ensure that California consumers do not incur excessive and inappropriate costs during the interim period.

II. BACKGROUND

A. Amendment No. 23

On November 10, 1999, the ISO filed Amendment No. 23 to the ISO Tariff in the above-captioned proceeding. Amendment No. 23 included proposed

modifications to the ISO Tariff to implement a decision by the ISO Board of Governors (“Governing Board”) to address pricing and cost allocation issues related to the ISO's authority to dispatch resources.

Amendment No. 23 included revisions proposed to clarify the circumstances in which the ISO will exercise its Dispatch authority. The ISO normally obtains the Energy it needs to balance Loads and resources in real-time (*i.e.*, Imbalance Energy) from resources that have bid into the ISO's real-time markets or from capacity that has been selected in the Ancillary Services markets. There are circumstances however, where recourse to these markets or to the ISO's authority to dispatch RMR Units under RMR Contracts is not feasible or possible. The ISO Tariff therefore permits the ISO, in certain circumstances, to issue Dispatch orders to Participating Generators, Participating Loads and System Resources⁷ that have not bid into the relevant ISO markets.⁸ The circumstances under which the Tariff authorizes the ISO to exercise such authority include: an imminent or existing real-time system problem or System Emergency; a deficiency of Ancillary Service Energy bids and of Supplemental Energy bids in the Balancing Energy and Ex Post Pricing (“BEEP”) stack; or the absence of Adjustment Bids and Imbalance Energy bids in the BEEP stack that can be effective in resolving adverse system conditions (*e.g.*, due to locational requirements). The revisions proposed in Amendment No. 23 would establish that the ISO would also use its authority to issue Dispatch orders when the ISO

⁷ System Resources are a group of resources located outside the ISO Control Area capable of providing Energy and/or Ancillary Services to the ISO Controlled Grid.

⁸ See, *e.g.*, Sections 5.1.3, 5.6.1, and 7.2.6.2 of the ISO Tariff.

makes an advance determination that a competitive market for such bids is not present.⁹

Amendment No. 23 also modified the Tariff to provide an alternative payment option for resources responding to such Dispatch orders. Prior to Amendment No. 23, a resource dispatched for the reasons discussed above would receive (or pay in the case of decremental Dispatch) the Hourly Ex Post Price. The Hourly Ex Post Price is the weighted average of the BEEP Interval Ex Post Prices during each hour. Amendment No. 23 enabled resources to choose, on an annual basis, whether to continue to receive (or pay) the Hourly Ex Post Price for ISO Dispatch orders or a new payment option that includes, if applicable, a capacity component tied to market indicators, an Energy component tied to market indicators, a component that permits the recovery of fuel-related start-up costs, and a component that would permit recovery of verifiable daily gas imbalance charges incurred solely as a result of the ISO's Dispatch order.¹⁰ This alternative payment option was developed in response to concerns expressed by generation owners that payment for these Dispatch orders at the Hourly Ex Post Price would not always provide adequate compensation for out-of-pocket costs.

⁹ Amendment No. 23 included revisions to Section 7.2.6.2, which governs the ISO's authority to issue Dispatch orders to manage Intra-Zonal Congestion. Section 7.2.6.2 currently authorizes the ISO to exercise its Dispatch authority when no Adjustment Bids or Imbalance Energy bids that are effective in managing Intra-Zonal Congestion are available. The revisions proposed in Amendment No. 23 would have permitted the ISO to exercise this authority if "the market for such bids is not competitive."

¹⁰ Under Amendment No. 23, resources would also be compensated under the payment option chosen through this annual election if dispatched where the ISO has determined in advance that a competitive market for bids is not present.

Amendment No. 23 also modifies provisions that govern the allocation of costs for all ISO Dispatch orders, whether a resource is paid for such Dispatch orders under the current pricing mechanism or the new payment option. As modified, the cost responsibility for these payments will be allocated according to the reason for the Dispatch order. If a resource is dispatched to address transmission outages or the ISO's locational reliability needs, the costs of such calls will be allocated to the Participating Transmission Owner in whose Service Area the transmission facility is located or the location-specific requirement arises. If the Dispatch order is the result of market shortages or any other system-wide requirement, the costs will be allocated to Load. If the ISO needs to procure such services Zonally, the ISO will allocate the costs related to such Dispatch orders to Load within the Zone.

B. The January 7 Order

In the January 7 Order, the Commission accepted those aspects of Amendment No. 23 that would establish an additional payment option to compensate resources for ISO Dispatch orders.¹¹ The Commission also accepted the ISO's proposed allocation of costs resulting from ISO Dispatch

¹¹ Under Amendment No. 23, Scheduling Coordinators were to make an annual election as to the payment option for out-of-market calls by December 31st of each year. Since the Commission's order was issued after December 31, 1999, Scheduling Coordinators have not had the opportunity to choose a payment option for calendar year 2000. The ISO is giving Scheduling Coordinators until March 7, 2000 to choose a payment option for 2000. Consistent with the approved effective date for Amendment No. 23, the ISO will then use the elected payment option to compensate resources for all "out-of-market" ISO Dispatch orders for the period from January 1, 2000 through December 31, 2000. This implementation schedule will, of course, permit any resources already called under the ISO's Dispatch authority since January 1 to determine which of the alternative payment options would be most advantageous to them for the initial period. In the future, the ISO expects the annual election for each year to be made before January 1 of the year in question.

orders. The Commission rejected aspects of Amendment No. 23, however, that would establish the ISO's authority to issue out-of-market ("OOM") Dispatch orders to manage Intra-Zonal Congestion where generators have submitted bids for managing Intra-Zonal Congestion to the ISO, but the ISO has determined that the markets for such bids are not competitive. January 7 Order, slip op. at 4-5.

Specifically, the January 7 Order states that market power problems related to the management of Intra-Zonal Congestion identified by the ISO should not be remedied by extending the ISO's "OOM" authority to Intra-Zonal Congestion Management in circumstances where market bids that could manage the Intra-Zonal Congestion have been submitted to the ISO.¹² *Id.* at 9-10. One market flaw identified by the ISO and discussed by the Commission is the potential for generators to engage in gaming behavior that "create[s] artificial scarcity in order to create congestion revenues that will be paid to them." *Id.* at 9. The Commission stated that the ISO's filings in this proceeding highlight a fundamental flaw in the ISO's Congestion Management scheme -- the fact that the ISO's Intra-Zonal Congestion Management mechanisms were designed to rely on competitive market solutions, while subsequent experience has demonstrated that competitive markets for resolving Intra-Zonal Congestion often are not present. The Commission therefore directed the ISO to undertake a comprehensive review of its Congestion Management approach and its

¹² The January 7 Order makes it clear that the ISO has the authority to issue Dispatch orders to manage Intra-Zonal Congestion where there is a bid insufficiency. In its discussion of the "ISO's pre-existing authority to issue OOM calls," the Commission states "if the output available from generators bidding into the imbalance and ancillary services markets is inadequate to serve load *and manage congestion*, the ISO can direct an idle Participating Generator to start up and deliver energy to meet the ISO's needs." January 7 Order, slip op. at 3-4 (emphasis added).

mechanisms for Intra-Zonal Congestion Management with input from all stakeholder groups and from the MSC. *Id.* at 10.

III. MOTION FOR CLARIFICATION

The January 7 Order confirmed the ISO's exercise of its Dispatch authority to preserve reliability, when resources that could be used for that purpose have not been made available through market bids or RMR contracts. While the Commission agreed with the ISO that there is a serious flaw in the existing Intra-Zonal Congestion Management scheme, it was not convinced the ISO had proposed an appropriate remedy. As a result, the Commission rejected the ISO's use of Dispatch authority (and compensation of dispatched resources under the payment options approved in Amendment No. 23) to manage Intra-Zonal Congestion where bids have been submitted that can physically manage Intra-Zonal Congestion, even if those bids are not the result of a competitive market.

The January 7 Order did not address the scope of the ISO's authority during the interim period before the review of the Intra-Zonal Congestion Management process called for by the Commission is concluded and any resulting reforms are implemented. In addition, the Commission did not distinguish the need for Intra-Zonal Congestion Management arising during "normal" operations, (*i.e.*, when transmission facilities are operating at their normal transfer capabilities, but the scheduled transactions exceed those levels) from the need for Intra-Zonal Congestion Management arising due to unusual system events that create local reliability problems. These circumstances

include reductions in transfer capability due to a scheduled transmission facility outage or system problems, such as the forced outage of a transmission facility.

Such "unusual" system conditions occur infrequently on any given transmission facility but can create Intra-Zonal Congestion that, if left unaddressed, would lead to actual or imminent local reliability problems. When generating units that the ISO can call on under RMR Contracts are not available to address the unexpected reliability problems created by these situations, they represent opportunities for the exercise of market power by the owners of resources that the ISO must call upon to resolve them. While the ISO intends to address these situations in the comprehensive redesign process that it is undertaking, the January 7 Order leaves uncertain the scope of the ISO's authority during the interim period to constrain market power through the use of its Dispatch authority and compensation of dispatched resources under the payment options approved in Amendment No. 23.

A. The ISO Will Undertake a Comprehensive Review of Its Congestion Management System.

Consistent with the January 7 Order, the ISO commits to undertake a comprehensive review and redesign of its Congestion Management system, with a goal of developing new or revised mechanisms for managing Intra-Zonal Congestion.¹³ Although not specifically identified by the Commission as a topic to be included in the redesign process, the ISO will also use this comprehensive

¹³ The ISO notes that it had already planned to consider reforms related to Intra-Zonal Congestion Management as part of its Market Redesign 2000 initiative, but recognizes that the January 7 Order directs a more comprehensive review of the ISO's Congestion Management system.

review to consider, with stakeholder input, how to address Intra-Zonal Congestion arising from abnormal system conditions that create a short-term potential for the exercise of market power. For reasons explained below, there is a substantial need to address these issues in conjunction with the review of the ISO's approach to Congestion Management.

The January 7 Order does not establish a specific timetable for completing the comprehensive review of the ISO's Congestion Management system.¹⁴ The ISO is committed to conducting a review that is thorough, with ample opportunities for input and involvement of stakeholders and the MSC, yet expeditious. The ISO also welcomes the participation of the Commission staff in this process. The ISO intends to structure the process so that any necessary amendments to the ISO Tariff can be filed with the Commission by October 31, 2000.¹⁵ The ISO cannot predict the outcome of the stakeholder process or the scope of any reforms developed therein, but recognizes that a change in the approach to Intra-Zonal Congestion Management could require the development and testing of necessary software revisions prior to implementation. The ISO's objective is to have in place a revised approach to managing Intra-Zonal Congestion as soon as practicable. The ISO will provide an implementation schedule in the filing to be made by October 31, 2000.

¹⁴ The Order does note that the timing of this review is critical in light of the requirement under the Commission's Final Rule on Regional Transmission Organizations ("RTOs"), Order No. 2000, 89 FERC ¶ 61,285 (1999), that the ISO and other public utilities make a filing by January 2001 demonstrating compliance with the Commission's RTO minimum characteristics and functions. January 7 Order, slip op. at 10 n.16.

¹⁵ The ISO is still developing a schedule for the stakeholder meetings and other components of the review process. The ISO will provide the Commission staff with a copy of this schedule when it is developed.

B. The January 7 Order Leaves Unclear Certain Aspects of the ISO's Dispatch Authority Pending the Review of Methods of Managing Intra-Zonal Congestion.

The January 7 Order confirmed the ISO's authority to issue Dispatch instructions to resources that must be adjusted to address System Emergencies and real-time operating problems, including Intra-Zonal Congestion, when bids have not been received from such resources that are effective for this purpose, and RMR contracts are not in place with such resources. As the Commission recognized in the January 7 Order, the ISO's exercise of its Dispatch authority for Intra-Zonal Congestion Management is appropriate in cases of bid insufficiency, since the ISO would not be rejecting bids in such cases. January 7 Order, slip op. at 3-4.

In addition, where the ISO has an RMR Contract in place with a resource that can be adjusted to relieve Intra-Zonal Congestion in what would be a non-competitive market for redispatch bids, the ISO will continue to rely on its authority under that contract.¹⁶ Section 4.1(b) of the *pro forma* RMR Contract approved by the Commission as part of the Offer of Settlement in Docket Nos. ER98-441 *et al.* establishes that the ISO has the right to issue Dispatch Notices for purposes of managing Intra-Zonal Congestion.¹⁷

¹⁶ The ISO notes that the January 7 Order contains a misstatement in its summary of the ISO's December 20, 1999 Answer in this proceeding. The Order suggests that the ISO claimed that "RMR generation can be called upon only if there are insufficient real-time energy bids and cannot be used in circumstances when adjustment bids are deemed not to be competitive." January 7 Order, slip op. at 8-9. In fact, the ISO's Answer discussed the ISO's current practice, as reflected in Operating Procedure M-401, of relying on its authority under RMR Contracts to manage Intra-Zonal Congestion where the ISO has determined in advance that there is not a competitive market for managing such Congestion. See December 20 Answer at 19, 22-23. This practice is consistent with the approach to dispatch of RMR generation by other ISOs in similar circumstances. See *PJM Operating Agreement*, Schedule 1, Section 6.

¹⁷ *California Independent System Operator Corp.*, 87 FERC ¶ 61,250 (1999).

The ISO acknowledges that in circumstances that do not include System Emergencies, bid insufficiencies, or the use of RMR Contracts, the Commission rejected the ISO's use of the Amendment No. 23 Dispatch authority to manage Intra-Zonal Congestion in circumstances where the redispatch market has been found to be non-competitive. Instead, the Commission directed the ISO to undertake a comprehensive review and reform of its Congestion Management procedures – a process to which the ISO is fully committed. In a number of respects, however, the January 7 Order was unclear regarding the intended scope of the ISO's Dispatch authority. The January 7 Order was silent regarding the measures the ISO could use to constrain the exercise of market power prior to implementation of the reforms produced by the comprehensive review ordered by the Commission. The January 7 Order also does not distinguish between the ability of the ISO to rely on its Dispatch authority to address Intra-Zonal Congestion arising when unusual system conditions create locational reliability needs,¹⁸ and use of such authority under normal operating conditions. Where RMR Generation is available, the ISO can address locational needs by exercising its authority under the RMR Contracts. There are situations, however, where RMR Generation is not available to address these locational needs.¹⁹

¹⁸ The January 7 Order's discussion of the ISO's Dispatch authority is limited to "[t]he ISO's proposal to issue OOM calls in circumstances in which the ISO determines that the market bids available to resolve intra-zonal congestion are non-competitive." January 7 Order, slip op. at 3.

¹⁹ For example, one system condition that might require the ISO to call on a specific resource to manage Intra-Zonal Congestion is where a generating unit designated as RMR by the ISO is unavailable due to an outage.

C. The Commission Should Clarify the Authority of the ISO To Dispatch Resources To Address Intra-Zonal Congestion Arising From Unusual System Conditions, Rather Than Requiring It To Rely on Bids From Resources Exercising Locational Market Power, Pending the Reform of Intra-Zonal Congestion Management.

As explained above, the circumstances that require Intra-Zonal Congestion Management, both during normal operations and during unusual system conditions, may give the owner of a single resource the ability to submit bids for the redispatch of that resource that are not subject to effective competition. The ISO does not dispute that a comprehensive review of its approach to addressing these situations is appropriate, and it has committed to undertake such a review. Nevertheless, if the ISO is required to accept bids submitted by a resource with market power in all circumstances, even for an interim period while that review goes forward, it would be forced to pass excessive costs on to California end-use consumers.

The absence of any discussion in the January 7 Order about the period prior to implementation of Congestion reforms that are the result of the comprehensive review order by the Commission suggests that the Commission did not focus on the authority necessary for the ISO to protect consumers during the interim period from Energy prices that result from bids that are not subject to effective competition. In the absence of explicit guidance from the Commission, the ISO has considered a number of possible approaches to guard against the possibility that consumers would bear excessive costs due to the exercise of locational market power during the interim period.

One possible approach would have been for the ISO to request that the Commission permit it, during the interim period, to exercise its Dispatch authority to resolve Intra-Zonal Congestion in *all* circumstances (*i.e.*, to request that the ISO be permitted to exercise the full Dispatch authority proposed in Amendment No. 23). The ISO is not making such a request. The ISO recognizes that the Commission indicated that the ISO should accept market bids that are able to resolve Intra-Zonal Congestion, even if such bids are the result of locational market power, so that price signals can provide incentives for upgrades to transmission or the building of generation that might alleviate Intra-Zonal Congestion in the long-term. However, the same approach, when applied to Intra-Zonal Congestion created by unusual system conditions, would use price signals in inappropriate circumstances and leave California consumers with a large cost exposure for bids that are the result of locational market power.²⁰

The ISO believes that the Commission intended the ISO to apply an approach that gives effect to market bids during normal operating conditions, while protecting against the exercise of market power when unusual system conditions limit the transfer capability of Intra-Zonal facilities. An interim approach consistent with the January 7 Order would accordingly distinguish between circumstances where reliance on prices to send locational signals to encourage new investment is appropriate (*i.e.*, the Congestion experienced

²⁰ For example, if there was a one week planned maintenance outage of a transmission line and the ISO needed to call on a 400MW generator to reliably manage the outage, the ISO would notify the generator in advance of the outage. If the generator then put in Supplemental Energy bids of \$750 for every hour of the outage (168 hours), the cost exposure for these "market bids" would be extremely large. Even if one assumes a 50% average use factor, the cost exposure could be more than \$25 million (200 MWs x 168 hours x \$750 = \$25,200,000).

during normal system operations) and those circumstances where reliance on locational price signals for that purpose is not appropriate (*i.e.*, unusual system conditions of an intermittent or unpredictable nature where the price signal for investment would need to be astronomically high to induce investment).

There are two sets of general circumstances that result in unusual system conditions: (1) circumstances that involve transmission facility and other equipment outages; and (2) the outage of RMR Units upon which the ISO would otherwise rely to assure local reliability. Such circumstances are of an intermittent or unpredictable nature and do not reflect underlying system deficiencies. For these circumstances, and only for the interim period, the ISO is proposing that it be allowed to dispatch units out-of-market as proposed in Amendment No 23.

These circumstances, when added to the ISO's existing authority, would give the ISO the authority to dispatch generating units out-of-market in the following four circumstances: (1) System Emergencies and real-time system problems; (2) bid insufficiencies; (3) unusual system conditions involving transmission facility and other equipment outages; and (4) the outage of RMR Units. The January 7 Order does not, however, address Intra-Zonal Congestion that is the result of reduced transfer capability due to unusual system conditions (*i.e.*, transmission maintenance outages, unplanned facility outages, or the unavailability of RMR Units). Such system conditions occur infrequently on any given transmission facility, but create a short-term opportunity for resources to exercise locational market power. Even though the need for the ISO to address

Intra-Zonal Congestion created by such system conditions is infrequent for any given facility, the potential cost exposure to California consumers from energy prices based on bids from non-competitive markets is great.²¹

The ISO requests clarification that, solely for the period extending until the reforms to be produced by its comprehensive review of the Intra-Zonal Congestion management process are implemented, it is appropriate for the ISO to: (1) exercise its authority to Dispatch a resource out-of-market to address Intra-Zonal Congestion arising from unusual system conditions; and (2) to compensate such a resource under the payment options approved in Amendment No. 23. The ISO views this approach as consistent with the January 7 Order. In the Order, the Commission rejected application of expanded out-of-market Dispatch authority for Intra-Zonal Congestion Management, but did agree that the ISO had identified market flaws that needed to be resolved. The January 7 Order also states that the need for out-of-market Dispatch of generation to address Intra-Zonal Congestion "should be infrequent and temporary."²² Thus, the Commission apparently anticipated that additional Intra-Zonal Congestion Management costs to consumers during the interim period would be minimal.

As noted above, the ISO will consider the mechanisms needed to address the potential for the exercise of market power in connection with locational needs of limited duration as part of the comprehensive review and redesign process directed by the January 7 Order. But nothing in the January 7 Order suggests that the Commission was aware and therefore intended to expose California

²¹ See *infra*, footnote 6.

²² January 7 Order, slip op. at 12.

consumers to excessive costs potentially amounting to millions of dollars during the interim period, while the ISO is working with stakeholders to undertake the redesign process. The ISO does not believe that the January 7 Order can or should be interpreted to compel such a result.

The ISO believes that the application of the ISO's out-of-market Dispatch authority and compensation structure to address such unusual system conditions is consistent with the January 7 Order's discussion of price signals.²³ The ISO shares the Commission's view that market participants should be given price signals that will induce them to make operating and investment decisions that alleviate system problems and reduce opportunities for the exercise of market power. It would be inappropriate, however, to provide generators with monopoly profits simply to send price signals to induce new generators to locate in areas that experience Intra-Zonal Congestion due to conditions that are infrequent and occasionally unpredictable. If, for example, a transmission line must be taken out of service for a few weeks every two years, or might experience a forced outage at unpredictable intervals, the price signals that could induce a new generator to locate in anticipation of earning high profits during these infrequent events would be astronomical, creating an exceedingly high price umbrella, up to which generators with locational market power safely can bid. Building new generation is simply not an appropriate response to such intermittent and sometimes

²³ *Id.* at 9.

unpredictable events, and the ISO does not believe that it is the result the Commission intended in the January 7 Order.²⁴

The proper price signal in the case of short-term locational reliability needs should be directed to Participating Transmission Owners. These are the only entities that can take actions to address such short-term locational needs, for example by transmission system upgrades and additions and/or improved maintenance practices. The Commission recognized this in the January 7 Order, where it approved those aspects of Amendment No. 23 that allocate the costs of ISO Dispatch calls needed to address transmission outages and location-specific requirements to the Participating TOs for the transmission system where the need arises.²⁵ The same rationale applies to the costs necessary to address infrequent system conditions that create a short-term opportunity for the exercise of market power.

The ISO's interpretation of the January 7 Order, for which it requests confirmation in this motion, is consistent with authority the Commission has granted to other independent system operators. In *Atlantic City Electric Company, et al.*, the Commission granted the request of utilities in PJM to sell electric energy and ancillary services at market-based rates.²⁶ The Commission relied in part on the authority of the PJM Office of Interconnection ("PJM-OI"), the PJM independent system operator, to identify situations when, due to

²⁴ Dealing with such events by attempting to encourage new generation to locate where it could mitigate their effects would be like building a new highway bypass whenever it is necessary to close one lane of an existing highway for resurfacing or to clear an accident.

²⁵ *Id.* at 13-14.

²⁶ *Atlantic City Electric Company, et al.*, 86 FERC ¶ 61,248 (1999).

transmission constraints, a generator must be run out of economic merit order to maintain the reliability of service in the control area or on local transmission facilities monitored by a transmission owner.²⁷ When a generation resource is dispatched in this manner, it would receive: (a) the average energy price at the resource's location, during comparable periods determined by PJM-OI; (b) 110% of the resource's incremental operating costs; or (c) an amount determined by an agreement, if any, in place between PJM-OI and the resource owner.²⁸

If anything, the clarified authority that the ISO seeks is less expansive than the authority the Commission granted to the PJM-OI in *Atlantic City Electric*. First, as noted above, the ISO has committed to implement a replacement approach to addressing Intra-Zonal Congestion as soon as practicable; the authority granted to the PJM-OI was indefinite. Second, while both Amendment No. 23 and the PJM approach provide for prices to dispatched resources based on market prices that prevailed in the absence of constraints, the Amendment No. 23 payment option – which the Commission has determined to be reasonable – is less restrictive. It provides compensation both for Energy and for capacity, and also reimburses the resource owner for certain specific costs. Finally, Amendment No. 23 identifies in advance how comparable market conditions will be determined for purposes of compensating resources that elect the payment option; PJM-OI can make that determination on a case-by-case basis.

²⁷ *Id.* at 61,903.

²⁸ *Id.* at 61,899. The resource owner must select a payment option in advance. The provisions implementing this mechanism are located in Schedule 1, Section 6, to the PJM Operating Agreement.

The ISO notes that the potential for exercise of locational market power during periods of transmission maintenance and outages is not taken into account under the selection criteria by which the ISO makes annual designations of RMR Generation. In designating the RMR Units, the ISO takes into account the outage of the single transmission element that has the most adverse impact on the reliability of the local area transmission system. However, the ISO does not account for circumstances where the outage of the single transmission element occurs *during* a planned outage or *following* the unplanned outage of another transmission element in the same area. Also, most maintenance outages on any given transmission facility occur on an infrequent basis. For example, the ISO is aware of one situation where certain transmission facilities must be taken off line for a brief period only once every two years. When those facilities are unavailable during that biennial maintenance period, the ISO will need Energy from a single generator to maintain local reliability. Thus, that generator has the ability to exercise locational market power during a brief window once every two years. It would be inefficient and costly to designate that generator as an RMR Unit, and to pass the associated RMR costs on to end-use customers, in order to address such a limited need. As explained above, however, if the ISO were required to accept bids that reflect the unit owner's ability to exercise locational market power during the biennial maintenance period, excessive costs would also flow through to consumers. In this situation, the ISO believes that the proper approach would be to dispatch the generator in

question "out-of-market" and to compensate the generator under the payment options approved in Amendment No. 23.

In addition, compensation of resources dispatched to address such locational needs under the payment options approved in Amendment No. 23 is consistent with the Commission's finding that these payment options provide fair compensation to resources subject to the ISO's Dispatch authority. The January 7 Order states that "the ISO's proposal is a pragmatic approach to addressing generators' concerns which uses payment methods based, to the extent possible, on market data."²⁹ Therefore, if a resource is dispatched by the ISO to address locational needs during the interim period, it will be assured of compensation at a rate based on market indicators; it simply will not be compensated based on a bid resulting from the exercise of market power.

IV. REQUEST FOR REHEARING

If the Commission does not clarify that the ISO's approach for the interim period is consistent with the January 7 Order, the ISO respectfully requests that the Commission grant rehearing and reconsider the January 7 Order's failure to address that interim period.

As explained above, the Commission agreed with the ISO that resources that were required for Intra-Zonal Congestion Management were in a position to exercise local market power. The Commission also found that, in light of the lack of competitive markets for the redispach of resources to resolve Intra-Zonal Congestion, the approach to Intra-Zonal Congestion Management described in

²⁹ January 7 Order, slip op. at 12.

the ISO Tariff was inadequate. A comprehensive review of options to address the flaws identified by the Commission and the implementation of necessary reforms will take time. Requiring the ISO, during the interim, to accept all redispatch bids from resources that must be adjusted to resolve Intra-Zonal Congestion and to address local reliability needs created by unusual system conditions (except where the ISO has an RMR Contract with the resource) could require California consumers to bear millions of dollars in excessive costs that are demonstrably the product of the ability of resources to exercise market power in these circumstances.

To the extent that the January 7 Order's silence with respect to the interim period is interpreted to preclude the ISO from issuing Dispatch instructions to resources in these circumstances (and precluding payment in accordance with the options approved in the Order), the ISO asks the Commission to give explicit consideration to the interim period and to reconsider this result.

The ISO does not believe that the Commission intended to expose consumers, even for a limited period, to the excessive costs that would result from the ability of resource owners to exploit what the Commission has determined to be a fundamental flaw in the current approach to Intra-Zonal Congestion Management: the lack of the competitive redispatch markets upon which the approach was premised. The Commission recognized in the January 7 Order: (1) this flaw in the current approach to Intra-Zonal Congestion Management; (2) the reasonableness of the pricing option made available to resource owners in Amendment No. 23; and (3) the appropriateness of the

allocation to Participating Transmission Owners of amounts paid to resources redispached to address local transmission-related system problems. The Commission has authorized other independent system operators to exercise even more expansive authority to guard against the exercise of market power in similar circumstances.

In these circumstances, the ISO's proposal to exercise its Dispatch authority to prevent resource owners from taking advantage of this flaw in limited circumstances, at least during an interim period, is manifestly just and reasonable. We understand the Commission's unwillingness to accept long-term reliance on such an approach in the absence of a comprehensive review. We respectfully suggest, however, that it is appropriate to rely on the interim approach described herein to protect consumers while the comprehensive review proceeds.

Accordingly, if the Commission does not grant the ISO's motion for clarification, it should grant rehearing to authorize the ISO to exercise its Dispatch authority to manage Intra-Zonal Congestion created by the system conditions discussed above pending the development and implementation of long-term reforms to the ISO's Intra-Zonal Congestion Management process.

V. REQUEST FOR EXPEDITED CONSIDERATION

As explained above, if the ISO is unable to exercise its Dispatch authority to address Intra-Zonal Congestion and locational reliability needs arising from unusual system conditions on an interim basis, the ISO may be forced to pass excessive costs in the order of millions of dollars on to consumers before it can

develop and implement a redesign of its Congestion Management system and its mechanisms for addressing locational needs. The ISO therefore requests that the Commission act on an expedited basis to grant the clarification requested by the ISO or to grant rehearing of the January 7 Order in order to minimize the harmful consequences that could otherwise result from limitations on the ISO's Dispatch authority during the period that the ISO is undertaking the comprehensive review directed by the Commission.

VI. CONCLUSION

For the reasons set forth above, the ISO respectfully moves that the Commission clarify its January 7 Order to confirm that the ISO is authorized to exercise its Dispatch authority, consistent with the discussion above, for the interim period, pending implementation of the reforms to be developed in the comprehensive review and redesign process. In the alternative, if the Commission does not confirm that the ISO's can use the Dispatch authority as described herein, the ISO respectfully requests that the Commission grant rehearing of the January 7 Order and establish that, in the limited circumstances described above, the ISO may exercise its authority to Dispatch resources and compensate those resources under the payment options approved in Amendment No. 23. In either event, and in recognition of the potential cost impact on consumers, the ISO requests that the Commission act on this motion and request for rehearing on an expedited basis.

Respectfully submitted,

Roger E. Smith
Senior Regulatory Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7135
Fax: (916) 351-4436

Edward Berlin
Kenneth G. Jaffe
Michael E. Ward
Sean A. Atkins
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
Tel: (202) 424-7500
Fax: (202) 424-7643

Dated: February 7, 2000

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 7th day of February, 2000.

Sean A. Atkins