

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation)
Docket No. ER99-3301-000)
)
)

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

I. INTRODUCTION AND SUMMARY

On June 18, 1999, the California Independent System Operator Corporation ("ISO") filed Amendment No. 18 to the ISO Tariff.¹ Amendment No. 18 modifies the ISO Tariff to expand the market from which the ISO may select resources for the relief of Intra-Zonal Congestion in real-time. The ISO explained that restrictions currently in the ISO Tariff have presented the opportunity for some Market Participants to exercise market power and have led to sharp and substantial increases in the costs of Intra-Zonal Congestion Management. The ISO accordingly asked for expedited consideration of Amendment No. 18 and requested waiver of prior notice requirements to permit the revisions to take effect as of June 20, 1999. In accordance with the Notice of Filing issued June 21, 1999, a number of interventions were filed on July 1, 1999, some of which included comments on or protests of Amendment No. 18.

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

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the ISO submits its Answer to the Motions to Intervene, Comments and Protests submitted in the above-captioned docket. The ISO does not oppose the intervention of any of the parties that have sought leave to intervene in this proceeding. The ISO notes that most intervenors either support Amendment No. 18 or raise issues that do not contest the appropriateness of the proposed modifications to the ISO Tariff.

There is no substance to the few substantive objections raised to the changes proposed in Amendment No. 18. Many of those objections fail to appreciate that the amendment does not change the options available to the ISO to relieve Intra-Zonal Congestion, but only the order in which the ISO may turn to those options. Amendment No. 18 eliminates unnecessarily narrow market definitions and a requirement to use those narrow markets sequentially. Those restrictions have artificially inflated the cost of Intra-Zonal Congestion Management and presented opportunities for the exercise of market power.

Amendment No. 18 treats both resources that submit Adjustment Bids and Imbalance Energy bidders fairly. Both categories of bidders may compete to supply Intra-Zonal Congestion relief. In both cases, the bids normally will have been considered and *not* called based on economic merit order for relief of Inter-Zonal Congestion (for Adjustment Bids) and balancing energy (for Imbalance Energy bids). Only if those bids remain outstanding would they be considered and selected for Intra-Zonal Congestion

Management, based on their effectiveness in relieving Congestion and in economic (merit) order. In other words, Imbalance Energy bidders have been and remain eligible to receive the BEEP Interval Ex-Post Prices (the 10-minute market clearing prices), unless they are called to mitigate Intra-Zonal Congestion *before* having cleared the Imbalance Energy market.² Furthermore, concerns that the amendment will simultaneously reduce the supply of Adjustment Bids and increase the cost of Imbalance Energy are unfounded.

The Commission should accordingly accept Amendment No. 18 without substantive modification. The Commission should also grant the requested waiver to permit Amendment No. 18 to take effect as of June 20, 1999, to avoid extending the period during which Market Participants can take advantage of the unnecessary and undue restrictions in the current market rules.

II. BACKGROUND

A. Amendment No. 18

Section 7.2.6.2 of the ISO Tariff sets forth the market rules under which the ISO is directed to manage Intra-Zonal Congestion in its real-time operations.³ Under Section 7.2.6.2 and section 8.4 of the Dispatch Protocol (“DP”), the ISO is

² Imbalance Energy bids are called for 10-minute BEEP Intervals. A bidder does not necessarily supply energy in all 10-minute periods of the hour. In fact, it might be awarded incremental bids (or “inc’s”) for some periods and decremental bids (or “dec’s”) for others.

³ In contrast, the ISO manages Inter-Zonal Congestion in forward markets, using Adjustments Bids submitted by Scheduling Coordinators to reflect their willingness to adjust the output of their resources. It was originally intended that Intra-Zonal Congestion, too, would be managed in forward markets (and it is for this reason that Adjustment Bids are identified as the primary tool to be used). The software necessary for forward management of Intra-Zonal Congestion is scheduled for implementation in 2000..

required first to attempt to manage Intra-Zonal Congestion using Adjustment Bids that remain available after Inter-Zonal Congestion has been relieved in forward markets. Only when available Adjustment Bids are exhausted before the Congestion is fully relieved may the ISO turn to incremental and decremental bids for real-time Imbalance Energy to direct further adjustments in Market Participants' Schedules. Moreover, the ISO is directed first to use Adjustment Bids and Imbalance Energy bids from resources that are within the Zone experiencing Intra-Zonal Congestion before utilizing other options to manage the Congestion.⁴ Under this ordered hierarchy of resources, if Adjustment Bids within the Zone experiencing Intra-Zonal Congestion are available, the ISO must call upon them, even if less expensive Imbalance Energy bids are available, *even from the same Generating Unit*, and even if less expensive Adjustment Bids or Imbalance Energy bids submitted by Generating Units outside the Zone could be used to relieve the Congestion.

This market rule presents the opportunity for strategic bidding, especially when only one or two units in a Zone can relieve a Congestion problem. For example, the limitations embodied in the Tariff have required the ISO to call on high Adjustment Bids on many occasions, when unused Imbalance Energy bids (sometimes from the same unit for the same capacity) are available at substantially lower prices.⁵ Moreover, recent bids received by the ISO indicate that Market Participants have identified the opportunity that the current market

⁴ Only if no effective bids exist may the ISO call units out-of-market under the Participating Generator Agreements.

⁵ An example illustrating the problem is shown on the diagram contained in Attachment C to the ISO's filing.

rule presents for them to profit from Intra-Zonal Congestion by submitting high-priced Adjustment Bids.⁶ As several intervenors note, this problem has been especially evident on Path 26, which is in the northern portion of the Southern Zone. The ISO estimates that, if all bidders with the ability to exercise market power in this way were to engage in the strategic behavior described above, the ISO would incur additional Intra-Zonal Congestion Management costs of up to \$750,000 each day, compared to the costs it estimates it would incur if it could select the most economical and efficient combination of Adjustment Bids and Imbalance Energy bids to address Intra-Zonal Congestion. These costs are borne by Scheduling Coordinators serving demand within a Zone experiencing Intra-Zonal Congestion and ultimately by California end-use consumers.

To remove these unnecessary limitations and thereby to expand the market for economic bids to relieve Intra-Zonal Congestion, Amendment No. 18 modifies Section 7.2.6.2 (and DP 8.4) to allow the ISO to use Adjustment Bids and Imbalance Energy bids interchangeably and regardless of the location of the resource, to mitigate Intra-Zonal Congestion in real-time. The ISO would select resources based upon their effectiveness (*i.e.*, their ability to mitigate the Intra-Zonal Congestion without increasing Inter-Zonal Congestion) and the prices reflected in their bids.⁷ The ISO would continue to use the same economic resources that it now uses to manage Intra-Zonal Congestion. However, the

⁶ To protect the confidentiality of bid data upon which the ISO's analysis is based, that analysis was submitted under seal pursuant to 18 C.F.R. § 388.112 as Attachment D to the ISO's filing. No intervenor objected to confidential treatment for these data.

⁷ Amendment No. 18 would also make a small number of clarifying changes to the provisions of the ISO Tariff and Protocols that relate to Intra-Zonal Congestion Management. These changes, which are described in the ISO's transmittal letter, did not occasion substantial comment from intervenors.

prescribed *order* in which the ISO must use those resources that have submitted Adjustment Bids and/or Imbalance Energy bids would be removed, expanding the market and minimizing opportunities for exercise of market power.

The unnecessarily narrow market definition for managing Intra-Zonal Congestion and proposed ISO Tariff amendments to permit the use of Adjustment Bids and Imbalance Energy bids within the Zone interchangeably for that purpose were discussed with stakeholders in May and approved at the May 27, 1999 meeting of the ISO Board of Governors. Thereafter, based on the recent experience described above, the ISO expanded the market definition to allow the use of Adjustment Bids and Imbalance Energy bids without regard to the zonal location of the resource, based solely on their effectiveness and price, before filing Amendment No. 18. The final version was reviewed by the ISO Board at its June 23-24 meeting.

B. Interventions

A notice of intervention was filed by the Public Utilities Commission of the State of California ("CPUC") and motions to intervene were filed by a number of parties.⁸

Most intervenors indicated support for Amendment No. 18. Many of the intervenors, however, accompanied their interventions with Comments and/or Protests. In many cases, the intervenor's comments do not indicate

⁸ Timely motions to intervene were filed by California Department of Water Resources ("DWR"); California Power Exchange ("PX"); Duke Energy Trading and Marketing, LLC ("Duke"); Electric Clearinghouse, Inc. ("ECI"); Enron Power Marketing, Inc.; Metropolitan Water District ("MWD"); Modesto Irrigation District ("Modesto"); Northern California Power Agency ("NCPA"); Pacific Gas & Electric Company ("PG&E"); the Cities of Redding and Santa Clara, et al. ("Redding"); Reliant Energy Power Generation, Inc. ("Reliant"); Sacramento Municipal Utility District ("SMUD"); San Diego Gas & Electric Company; Southern California Edison Company ("SCE"); City and County of San Francisco; Southern Energy California, L.L.C., et al.; Transmission Agency of Northern California ("TANC"); and Western Area Power Administration.

opposition to the changes proposed by the amendment, but instead comment on or propose changes to other portions of the ISO Tariff. Only three intervenors oppose the changes proposed by Amendment No. 18 in whole or in part.

The ISO does not oppose the intervention of any of the parties that have sought leave to intervene. The ISO does not believe, however, that any of the substantive challenges to Amendment No. 18 or any of the proposals for further changes to the ISO Tariff has merit.

III. ANSWER TO COMMENTS AND PROTESTS⁹

A. The Expansion of the Market for Intra-Zonal Congestion Relief Is Necessary and Appropriate.

Most intervenors support the expansion of the markets for Intra-Zonal Congestion relief in accordance with Amendment No. 18.¹⁰ Only three intervenors challenge the thrust of Amendment No. 18 in whole or in part.¹¹

⁹ Some of the intervenors commenting substantively on Amendment No. 18 do so in portions of their pleadings variously styled as "Comments" or "Comments and Protest," without differentiation. There is no prohibition on the ISO's responding to the comments in these pleadings. The ISO is entitled to respond to these pleadings and requests notwithstanding the label applied to them. *Florida Power & Light Company*, 67 FERC ¶ 61,315 (1994). In the event that any portion of this answer is deemed an answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. §385.213) to permit it to make this answer. Good cause for this waiver exists here given the nature and complexity of this proceeding and the usefulness of this answer in ensuring the development of a complete record. *See, e.g., Enron Corporation*, 78 FERC ¶ 61,179 at 61,733, 61,741 (1997); *El Paso Electric Company*, 68 FERC ¶ 61,181 at 61,899 & n.57 (1994).

¹⁰ SCE notes that the ISO found it necessary to accept Adjustment Bids and or Imbalance Energy bids near the \$250/MWh cap on the afternoons of June 24 and June 25, notwithstanding the interim implementation of the procedures set forth in Amendment No. 18. SCE at 2. In these instances, the ISO was managing Path 26 congestion and required incremental bids south of the path. Bids were selected based on effectiveness and in price order. Many of the bids in these hours were not effective since they were either bids from resources north of Path 26 or bids from tie-line resources south of Path 26 (that could not be called mid-hour). Skipping these ineffective bids resulted in the selection of higher priced bids (*e.g.*, at or close to \$250/MWh in several hours of these two days).

¹¹ The objections of one of these intervenors, Reliant, are discussed in the following section of this Answer.

1. Amendment No. 18 does not unjustly deprive Imbalance Energy bidders of opportunities to participate in that market.

Duke, which acknowledges that it has profited from the current narrow market for Intra-Zonal Congestion relief due to the location of one of its generating plants, supports the removal of the “within the Zone” limitation on Adjustment Bids for the relief of Intra-Zonal Congestion, but opposes letting the ISO select Imbalance Energy bids for that purpose before all Adjustment Bids are exhausted.¹² Duke argues that it is unfair to pay Imbalance Energy bidders who are selected for Intra-Zonal Congestion Management based on their bids because they may have hoped or expected to receive prices higher than their bids in the Imbalance Energy market. Duke and Reliant further contend that the proposed changes could deter the submission of Adjustment Bids and lead to higher-priced Imbalance Energy bids.¹³

These objections are misplaced. As an initial matter, Amendment No. 18 does not introduce the ISO’s authority to select an Imbalance Energy bid to relieve Intra-Zonal Congestion; the ISO currently has that authority under Section 7.2.6.2 of the ISO Tariff. As noted above, Amendment No. 18 merely eliminates an unnecessarily restrictive rule regarding the *order* in which the ISO now must look to Adjustment Bids and Imbalance Energy bids inside and outside the Zone for Intra-Zonal Congestion Management. Under Amendment No. 18, the ISO is not limited to an artificially narrow market -- all Adjustment Bids within the Zone,

¹² Duke at 6-7.
¹³ *Id.* at 7; Reliant at 4.

regardless of their price – before turning to less costly Imbalance Energy bids or to less costly resources located outside the Zone.

Further, an Imbalance Energy bidder is still eligible to receive the BEEP Interval Ex Post Price if its resource is selected in the ISO's real-time Energy market. Amendment No. 18 simply continues to recognize that a bidder is deemed to have bid into two markets – Intra-Zonal Congestion and Imbalance Energy – and may be called for either. Amendment No. 18 assures an Imbalance Energy bidder that it will receive its bid price (which it can set equal to or above its running cost) for any output it is required to provide for Intra-Zonal Congestion Management, over and above the level for which it is selected in the Imbalance Energy market. It does not promise the bidder the best of both worlds, nor does it need to do so in order to meet the requirements of the Federal Power Act.

Reliant argues that there is one circumstance when an Imbalance Energy bidder could lose an “opportunity” to earn a higher overall price: when (1) a resource's bid in the real-time Energy market is too high to be competitive at the start of the hour; (2) the bid therefore is not expected to be used for Imbalance Energy and is selected to provide Intra-Zonal Congestion relief; and (3) prices in the real-time Energy market unexpectedly increase during the hour, such that the bid would have been selected to supply Imbalance Energy later in the hour if it were not already committed for Congestion Management.¹⁴ Reliant is correct – there is a theoretical “lost opportunity.” “Lost opportunity” or not, this situation is

¹⁴ Reliant at 5-6.

not new; it reflects the operation of the ISO Tariff and Protocols prior to Amendment No. 18. Amendment No. 18 neither creates nor eliminates any such theoretical opportunity.¹⁵ Reliant fails to note, moreover, that there are many other contingencies that could affect what the Hourly Ex Post Price for Imbalance Energy “could have been.” The Imbalance Energy market for sellers is based on six ten-minute BEEP Interval Ex Post Prices each hour. *If* a Generating Unit is called early in the hour *and* keeps running all six intervals during the Settlement Period, there is a theoretical possibility that it would make more (or less) depending on, among other things, whether it was later decremented, what the subsequent market clearing prices were for each BEEP Interval, and what its bid price was.

Amendment No. 18 does not change this aspect of the Imbalance Energy market design; it merely increases the size of the market from which the ISO may select bids to resolve Intra-Zonal Congestion in the first instance. Previously, the ISO had separate, narrowly-defined markets for Intra-Zonal Congestion Management and for Imbalance Energy. Amendment No. 18 changes the design, putting Imbalance Energy bidders on notice that their bids may be selected either for Imbalance Energy or Intra-Zonal Congestion Management, *albeit* with different settlement rules.

¹⁵ Reliant is correct that prior to the effectiveness of Amendment No. 18, the ISO was settling Imbalance Energy bids used for Intra-Zonal Congestion by paying the Hourly Ex Post Price plus, if applicable, amounts to equal the “as bid” price. In most circumstances, this results in paying the applicable bid price, because only bids that were not selected for the Imbalance Energy market (and therefore were receiving the Hourly Ex Post Price) normally remain available for real-time Intra-Zonal Congestion Management. This practice hardly amounted to a commitment to pay sellers selected for Congestion Management the higher of the Imbalance Energy clearing price and their bid prices in all cases.

Reliant and Duke apparently believe they have a property right to a specific market structure under which generators would receive the *higher* of the Market Clearing Price for Imbalance Energy (*i.e.*, the BEEP Interval Ex-Post Prices) or the bid price when “winning” in the Intra-Zonal Congestion market. This is neither a necessary or appropriate market design.

2. Amendment No. 18 does not present a substantial risk that the supply of Adjustment Bids will be reduced or Imbalance Energy prices increased.

Duke’s final points are both unfounded and internally contradictory. The ISO does not expect Amendment No. 18 to reduce the supply of Adjustment Bids. One of the principal economic purposes of Adjustment Bids, from the standpoint of Market Participants, is to enable them to express a value for Inter-Zonal transmission capacity against which the Market Participant is willing to adjust the output of its resources. The current incentives for Market Participants to submit Adjustment Bids for this purpose remain in place.

The ISO concurs, however, that Amendment No. 18 will eliminate *inflated* Adjustment Bids, through which a favorably-situated generator can now seek to take advantage of the artificial market restriction currently reflected in the ISO Tariff. Eliminating the ability of certain generators to exercise market power in this way benefits the public that is ultimately responsible for paying the cost of Intra-Zonal Congestion Management.

Even if generators nevertheless disfavor Adjustment Bids in favor of Imbalance Energy bids, as Duke posits, that increased supply of Imbalance Energy bids cannot be assumed to lead to higher prices for Imbalance Energy. It

is logical to expect that the effect of an increase in the supply of Imbalance Energy bids (as hypothesized by Duke) will be lower prices, not higher prices. Entities submitting Imbalance Energy bids must still compete for selection and run the risk of non-selection if their bids are too high.

3. Speculation over the bidding strategy of one Market Participant does not obviate the need for Amendment No. 18.

ECI identifies a number of “questions” that it urges the Commission to ask before approving Amendment No. 18.¹⁶ None of these questions goes to the heart of Amendment No. 18 -- -- giving the ISO greater flexibility to use the most economic resources, as reflected in the bids submitted by Scheduling Coordinators, to relieve Intra-Zonal Congestion.

ECI first questions whether the problem of expensive Intra-Zonal Congestion relief on Path 26 may be the result of a conscious decision by PG&E to withhold Adjustment Bids from a nuclear generating unit. The ISO is not privy to PG&E’s bidding strategies for Regulatory Must-Take resources. As well, nothing in the ISO’s experience suggests that nuclear generating stations would serve as feasible sources of Instructed Imbalance Energy, Regulating capacity, load following, or Intra-Zonal Congestion mitigation. Even if nuclear generating stations were otherwise capable of providing such real-time services, ECI’s “question” in no way justifies the maintenance of artificial barriers to the ISO’s use of economic resources for the relief of Intra-Zonal Congestion.

¹⁶ ECI at 4-7.

4. Amendment No. 18 is appropriate whether or not a new Zone is created.

ECI also questions whether the problem of excessive Intra-Zonal Congestion Management costs could be dealt with by the creation of a new Zone.¹⁷ As ECI acknowledges, the ISO in fact is evaluating the creation of a new Zone in light of the substantial Intra-Zonal Congestion that has been experienced on Path 26, in accordance with the criteria applicable under the ISO Tariff.¹⁸

Consideration of a new Zone is not, however, a substitute for Amendment No. 18, which is intended to minimize opportunities for the exercise of market power that are present right now. The very conditions on which Amendment No. 18 are predicated demonstrate why creation of a new Zone is problematic as a solution to high Congestion costs on Path 26. Under the ISO Tariff, new Zones may be created if sufficient Congestion has been experienced in a Zone *and* there would be workably competitive markets on both sides of the new Inter-Zonal Interface.¹⁹ If the ISO remains dependent for Adjustment Bids on one Generator, or a small group of Generators, creation of a new Zone will simply convert high Intra-Zonal Congestion costs into high Inter-Zonal Congestion costs. While the ISO is ready to create new Zones, where warranted, the need for new Zones should not be artificially enhanced by Intra-Zonal Congestion costs that are inflated by unduly restrictive market rules.

¹⁷ ECI at 6.

¹⁸ See Sections 7.2.7.2, 7.2.7.3.

¹⁹ *Id.* The latter requirement applies, under Section 7.2.7.3, to the creation of an “Active” Zone. Only Congestion between Active Zones is relieved through Inter-Zonal Congestion Management.

5. *Manual work-arounds are not an option*

Finally, ECI questions whether the ISO's current inability to manage Intra-Zonal Congestion in forward markets, due to the staging of software development, could be remedied by manual work-arounds.²⁰ The short answer is that such an approach is not feasible. Forward market Intra-Zonal Congestion Management involves the iterative evaluation and adjustment of the individual schedules submitted to the ISO, based on Scheduling Coordinators' financial bids, to find the most economical set of adjustments that respects all transmission limits on the ISO Controlled Grid. It simply is not practical to conduct that process manually throughout the Day-Ahead (both Preferred and Revised) and Hour-Ahead markets. In any event, even if it were possible to undertake some forward management of Intra-Zonal Congestion, it would still be appropriate to remove the unnecessary restrictions on the ISO's real-time management of any remaining Intra-Zonal Congestion. The changes effected by Amendment No. 18 would still be necessary and appropriate.

B. The ISO Tariff Provision for Settlement With Resources Used for Intra-Zonal Congestion Management Are Adequate and Appropriate.

Prior to Amendment No. 18, Section 7.3.2 of the ISO Tariff specified that Scheduling Coordinators whose resources are redispached by the ISO for Intra-Zonal Congestion Management will be paid or charged on the basis of the

²⁰ ECI at 7.

Adjustment Bids they have submitted to the ISO. Consistent with the purpose of Amendment No. 18, to enable the ISO to use Adjustment Bids and Imbalance Energy bids interchangeably to relieve Intra-Zonal Congestion, the ISO added “Supplemental Energy bids” to this provision, so that the Tariff makes clear that, regardless of the type of bid submitted, the Scheduling Coordinator will be paid the amount bid for a resource used to manage Intra-Zonal Congestion.²¹ This continues and clarifies the current practice, under which Imbalance Energy bids selected for real-time Intra-Zonal Congestion Management are paid on the basis of the incremental and decremental prices reflected in the bids.²²

Some intervenors argue that settling with Scheduling Coordinators that have submitted bids in the real-time Energy market at the bid price, rather than the market-clearing price for the Imbalance Energy market (*i.e.*, the BEEP Interval Ex Post Prices), is inappropriate.²³ They argue that a Scheduling Coordinator whose Imbalance Energy bid is accepted, whether for Intra-Zonal Congestion Management or any other purpose, should receive a price that is the higher of the bid price or the Hourly Ex Post Price for that Settlement Period (*i.e.*, the weighted average of the six BEEP Interval Ex Post Prices).

As noted above, in response to the “lost opportunity” argument, these objections are misplaced. The Intervenor inappropriately read Section 7.3.2 of the ISO Tariff in isolation, as though it were the only provision applicable to the

²¹ MWD notes that this reference should read “Imbalance Energy” bids, for consistency with other modifications proposed in Amendment No. 18. MWD at 7. The ISO agrees and will make that change in a compliance filing.

²² The costs of redispatch through incremental and decremental Imbalance Energy bids are treated in the same manner as incremental and decremental Adjustment Bids for purposes of Section 7.3.2 and Appendix B of the Settlements and Billing Protocol.

²³ DWR at 3-4; Reliant at 4-6.

pricing of Imbalance Energy. When an Imbalance Energy bid is less than or equal to the applicable BEEP Interval Ex Post Price, it will, where feasible, be selected in the Imbalance Energy auction and the Scheduling Coordinator representing the resource will be compensated based on the BEEP Interval Ex Post Price for the Energy provided, in accordance with Sections 2.5.23.1 and 11.2.4.1 of the ISO Tariff. The market rules reflected in these Tariff provisions are unchanged by Amendment No. 18.

If the real-time dispatch of economic resources can be accommodated without creating or exacerbating Intra-Zonal Congestion, through the acceptance of Imbalance Energy bids that do not exceed the BEEP Interval Ex Post Price, there is no need to resort to Intra-Zonal Congestion Management, and the payment rule set forth in Section 7.3.2 does not come into play. That rule applies only to changes in output from a resource that the ISO requests in order to relieve Intra-Zonal Congestion. Under that rule, if a resource was selected to supply Imbalance Energy because its bid was in the market, but is asked to supply *additional* Energy to relieve Intra-Zonal Congestion, it receives its bid price for only the latter block of Energy.²⁴

²⁴ This may be most easily seen by an example. Assume that, for a particular Settlement Period, the Hourly Ex Post Price for Imbalance Energy is \$30/MWH, which is also the Ex Post Price for each of the BEEP Intervals in the hour. An Adjustment Bid of \$200/MW for up to 50 MW of additional output was submitted for Generating Unit A, while nearby Generating Unit B submitted a Supplemental Energy Bid of \$25/MWH for up to 150 MWH and \$40/MWH for an additional 50 MWH. Unit B normally would be selected to supply 150 MWH in the real-time Energy market and would be paid \$4,500 (150 x \$30) for that Energy. If Intra-Zonal Congestion still existed, which could be relieved by an additional 50 MW of generation from Unit A or Unit B, the current Tariff rules would require the ISO to select 50 MW from Unit A, at a cost of \$1,000 (50 x \$200). Under Amendment No. 18, the ISO could instead call on Unit B to supply the 50 MW of Congestion relief, at a cost of \$200 (50 X \$40). Unit B would receive a total of \$4,700.

Nevertheless, Amendment No. 18 does *not* ensure, and is not intended to ensure, that in every case an Imbalance Energy bidder will get the highest payment possible, had it been able to elect to bid only in the Intra-Zonal Congestion Management market or in the Imbalance Energy market. The ISO is under no obligation to design markets to ensure that sellers get the “best of both worlds.” Bidders choose what to bid and can include in their Imbalance Energy bids any risk premium they believe appropriate to recognize that the bids may be selected in *either* of the two markets. The ISO is under no obligation to design the markets to pay suppliers as though they won in the *higher* priced of the two markets.

The PX argues that Amendment No. 18 lacks sufficient detail to explain how the ISO will pay Scheduling Coordinators to manage Intra-Zonal Congestion.²⁵ Reliant similarly argues that Scheduling Coordinators will not be told the purpose for which their Imbalance Energy bids are accepted, which affects the payments to which they are entitled and that the basis upon which resources will be selected is not specified.²⁶ They contend that more detailed Tariff provisions are required.

The ISO disagrees; the answers to all of the questions raised by the PX and Reliant are clear. As revised by Amendment No. 18, the ISO will pay Scheduling Coordinators for adjustments to resources they represent in accordance with the bids submitted. Where more than one bid is submitted, the bid used to determine the payment to which a Scheduling Coordinator is entitled

²⁵ PX at 3-4.

²⁶ Reliant at 8.

is that applicable to the adjustment called upon by the ISO.²⁷ There is no distinction between bids from supply resources and demand resources, because both may be used, if they would be effective to relieve Intra-Zonal Congestion. Nor is the ISO given unbridled discretion regarding the selection of resources for Congestion relief, as Reliant contends. As revised by Amendment No. 18, Adjustment Bids and Imbalance Energy bids that could effectively relieve Intra-Zonal Congestion would be selected “in merit order,” *i.e.*, based on their respective bid prices.

Amendment No. 18 thus provides a clear description of the ISO’s revised approach to managing Intra-Zonal Congestion. As revised, the ISO Tariff more than satisfies the requirements of the Federal Power Act. While further detail is provided in the ISO’s internal operating procedures, which are publicly available on the ISO Home Page, that is entirely appropriate. These intervenors’ concerns about Amendment No. 18 are simply misplaced.²⁸

C. Tariff Modifications Proposed in Amendment No. 18 Are Sufficiently Clear.

The ISO proposes in Amendment No. 18 to implement the expansion of the markets to which it could turn for economic bids to manage Intra-Zonal

²⁷ For example, if a Scheduling Coordinator submits a bid of \$35/MWH for a generating unit to increase its output from 100 MW to 150 MW and a bid of \$45/MWH for a further increase to 200 MWH, if the ISO selects the unit to increase its output from 100 to 150 MW to relieve Intra-Zonal Congestion, its Scheduling Coordinator will receive \$1,750 (50 x \$35).

²⁸ The PX raises an additional concern about the fact that Section 2.4 of Appendix B to the Scheduling and Billing Protocol does not limit calculations of net ISO redispatch costs to costs incurred “within a Zone.” PX at 4. This omission is intentional (see Attachment B to the ISO’s filing); it reflects the fact that, under Amendment No. 18, resources outside a Zone may be redispatched to relieve Congestion within a Zone. Restoring the stricken phrase, as the PX advocates, would defeat one of the purposes of Amendment No. 18.

Congestion by removing existing limitations from the relevant provisions of the ISO Tariff. Adjustment Bids and Imbalance Energy bids would be selected “based on their effectiveness and in merit order.” The ISO explained that selecting resources based on their “effectiveness” in relieving Intra-Zonal Congestion includes ensuring that the resource will not create or exacerbate Inter-Zonal Congestion.²⁹

Some intervenors argue that this limitation should be clarified or expressly set forth through additional tariff language.³⁰ The ISO believes that additional language is unnecessary. A bid that would create or worsen Inter-Zonal Congestion cannot be “effective” for purposes of Intra-Zonal Congestion Management, since the ISO will, whenever possible, have relieved Inter-Zonal Congestion through adjustments to forward schedules, before it addresses Intra-Zonal Congestion. No further tariff modifications are required to reflect these concepts.

D. The Commission Should Grant the ISO’s Request for Waiver of Prior Notice To Permit the Prompt Implementation of Amendment No. 18.

In filing Amendment No. 18, the ISO reluctantly asked, pursuant to 18 C.F.R. § 385.11, for waiver of the prior notice requirements to permit the amendment to take effect on June 20, 1999. The ISO explained, based on an analysis of bid data for which privileged treatment was requested, the current limitations on the order in which it could turn to resources for Intra-Zonal Congestion relief could cause it to incur excess costs of up to \$750,000 per day.

²⁹ Transmittal Letter at 4-5.

³⁰ DWR at 5-6; ECI at 5; MWD at 6-7.

In light of the magnitude of the additional costs that would otherwise be incurred, and which would ultimately be borne by California end-use customers, and the simplicity of the proposed change, the ISO believed that waiver was appropriate.

Duke nevertheless argues that the request for waiver of notice is unsupported, principally because it is based on bid data for which confidential treatment has been requested.³¹ Notwithstanding Duke's opposition and its acknowledgement that it has benefited from the current market rules, the ISO does not believe it is at liberty to discuss publicly the confidential bid data upon which its request for waiver was based.³² The ISO determined, based on bid data that was submitted to the Commission, that the market rules currently reflected in the ISO Tariff had caused it to incur excessive costs for Intra-Zonal Congestion Management and would continue to do so until they were changed. The costs at issue, which would be borne by other Scheduling Coordinators and, ultimately, by end-use customers, were substantial. The ISO believes that showing is sufficient to justify waiver of notice.

Duke contends that its own opposition to the prompt implementation of Amendment No. 18 "militate[s]" against waiver of notice.³³ Again, the ISO disagrees. To paraphrase Duke's argument, it should come as no surprise that the changes the ISO is seeking to implement are opposed by certain entities whose ability to profit from existing unnecessary limitations on the scope of the market to which the ISO can turn for Intra-Zonal Congestion relief is affected.

³¹ Duke at 8-9.

³² See ISO Tariff, Section 20.3.2.

³³ *Id.* at 9.

The opposition of parties in a position to profit from market imperfections should not deter the Commission from granting the ISO's request for waiver of notice.

E. There Is No Merit to Objections Raised to Tariff Provisions and Practices That Have Not Been Modified by Amendment No. 18.

Some intervenors raise objections to various provisions of the ISO Tariff that the ISO does not propose to modify in Amendment No. 18 or to ISO practices. None of these objections has merit.

1. Amendment No. 18 appropriately leaves unchanged the ISO's authority to direct the redispatch of resources to relieve Intra-Zonal Congestion if no economic bids are available.

Section 7.2.6.2 of the ISO Tariff currently provides that, in the event no Adjustment Bids and no Imbalance Energy bids are available to relieve Intra-Zonal Congestion, "the ISO will exercise its authority to direct the redispatch of resources" for that purpose. Amendment No. 18 left this fall-back authority undisturbed.

A number of intervenors nevertheless challenge this provision, arguing that it could be read to grant the ISO authority over resources that have not been turned over to the ISO's control. They seek clarification or propose tariff language to limit the ISO's authority to redispatch resources.³⁴

The ISO is committed to the "market first" philosophy, under which the resources provided voluntarily by Market Participants will be used, whenever feasible, to maintain and ensure reliability. The ISO Tariff accordingly places

³⁴ Redding at 7-8; SMUD at 7 n.5; TANC at 6-7.

strict limits on the ISO's ability to direct the redispatch of resources in a manner inconsistent with the bids submitted on behalf of a resource owner.³⁵ The ISO cannot, however, be deprived of the ability to preserve reliability when the Market Participants choose not to submit financial bids sufficient to deal with Intra-Zonal Congestion or other adverse system conditions.

The ISO believes that any additional limitations on its authority to redispatch resources to relieve Intra-Zonal Congestion when economic bids are unavailable for that purpose would severely impair the ISO's ability to preserve reliability in accordance with the criteria and Reliability Management System of the WSCC and the standards established by the North American Electric Reliability Council. As the entity responsible for the reliable operation of the ISO Controlled Grid and as the Control Area operator, the ISO must have the ability to direct the operation of facilities within its Control Area when the Market Participants have declined to provide financial bids that would enable it to do so. To secure the ability to direct the operation of these resources, the ISO has entered into agreements with Participating Generators, Scheduling Coordinators, Participating Transmission Owners and Utility Distribution Companies, as well as

³⁵ For example, DP 8.5 specifies that schedules will be adjusted in real-time to mitigate Congestion only if there are insufficient resources that have provided financial bids. Even in that event, schedules that rely on Existing Contracts may be adjusted in real time only in accordance with the operating instructions that have been submitted to the ISO. SMUD's proposed changes to this provision would only sow confusion, thereby promoting disputes. For example, SMUD would add a new sentence governing the circumstances under which facilities "that do not rely on new firm uses of the ISO Controlled Grid" may be redispatched. SMUD would thus have two sentences in a single provision that would apply to schedules that rely on Existing Contracts. Either the two sentences are in conflict or the new sentence that SMUD would add is redundant. In either case, SMUD's unexplained change is inappropriate.

interconnected Control Area operators. The ISO can also exercise the rights of Participating Transmission Owners pursuant to Existing Contracts that remain in effect, as reflected in instructions provided to the ISO with respect to each such contract. In each case, there is a contractual basis for the ISO's issuance of operating instructions to the resource's owner or operator.

The authority of the ISO to direct resource owners to adjust their operations in real time is fundamental to its ability to preserve reliability. The insertion of additional limitations on that authority, beyond those already included in the ISO Tariff, is unwarranted and dangerous. The Intervenor's requests for such limitations should accordingly be denied.

2. The basis for the allocation of Grid Operations Charges should not be disturbed.

Under Section 7.3.2 of the ISO Tariff, the costs of Intra-Zonal Congestion Management are recovered through Grid Operations Charges, which are allocated to Scheduling Coordinators in proportion to their metered Demands within a Zone experiencing Congestion and exports from that Zone to another Control Area. Amendment No. 18 did not propose to change this allocation.

Several intervenors nevertheless propose to alter this basis for allocating Grid Operations Charges, limiting it to Scheduling Coordinators' Demands "using the ISO Controlled Grid," while expanding it to include exports to other Zones.³⁶

These proposed changes are unexplained and, in any event, inappropriate. No explanation is offered regarding how it will be determined whether the Demand served by a Scheduling Coordinator "us[es] the ISO

³⁶ TANC at 7-8; SMUD at 8. Corresponding changes are proposed to DP 7.4.

Controlled Grid.” Applying this amorphous criterion to shift costs among Scheduling Coordinators is likely to prove contentious and time-consuming. Nor is it immediately apparent that such a limitation is appropriate, even if it could be adequately defined. These intervenors fail to explain why it is appropriate to exclude some Demands from responsibility for the charges through which the costs of such Congestion are recovered. Similarly, no explanation is offered as to why responsibility for Intra-Zonal Congestion should be assigned to inter-zonal transfers. An intervenor’s bare request for a change, in the absence of any discussion of the basis for it, cannot suffice.

The further changes to Section 7.3.2 and related provisions proposed by these intervenors should accordingly be rejected.

3. Additional unexplained changes should be rejected.

SMUD proposes modifications to Section 7.4.1 and 7.4.2 of the ISO Tariff -- for which no changes were proposed in Amendment No. 18 -- to modify the manner in which Transmission Losses are allocated to Scheduling Coordinators.³⁷ Like the changes discussed above, SMUD’s proposal would have the determination of a Scheduling Coordinator’s responsibility for Transmission Losses turn on whether its Demand is “on the ISO Controlled Grid” or “using the ISO Controlled Grid.” No explanation is offered for the proposed changes, which do not relate to the modifications proposed in Amendment No. 18. SMUD’s unsupported changes to other ISO Tariff provisions should accordingly be rejected.

³⁷ SMUD at 7 and n. 5.

4. The ISO has not modified payments to generators contrary to Tariff provisions.

Finally, Reliant argues that the ISO improperly changed two aspects of the manner in which payments are calculated for resources called “out-of-sequence” in the Imbalance Energy market, without submitting ISO Tariff modifications to reflect those changes.³⁸ This challenge to a change in an ISO procedure that predated the filing of Amendment No. 18 is beyond the proper scope of this proceeding.³⁹ While the Commission therefore need not consider Reliant’s contentions to rule on the justness and reasonableness of Amendment No. 18, the ISO will briefly explain why Reliant’s insistence that a Tariff amendment was required is unfounded.

Reliant first complains about the ISO’s adoption, effective June 1, 1999, of a practice whereby Imbalance Energy bids selected “out-of-sequence” to supply balancing Energy may set BEEP Interval Ex Post Prices. This change in practice, however, is consistent with the ISO Tariff.

Shortly before the ISO commenced operations in 1998, the ISO determined that operational and software design issues related to the balancing energy (“BEEP”) software required interim changes to the ISO Tariff, which were made as parts of Amendments No. 6 and No. 7.⁴⁰ The ISO explained, among other things, that it was not always feasible for all resources selected by the

³⁸ Reliant at 7-8.

³⁹ See, e.g., *PJM Interconnection, L.L.C.*, 85 FERC ¶ 61,383 at 62,493 (1998); *California Independent System Operator Corp.*, 86 FERC ¶ 61,122 at 61,420, 61,424 (1999); *California Independent System Operator Corp.*, 87 FERC ¶ 61,143 (1999).

⁴⁰ Amendment No. 6 was filed on March 23, 1998 and conditionally accepted in *California Independent System Operator Corp.*, 82 FERC ¶ 61,327 (1998). Amendment No. 7 was filed on March 31, 1998 and conditionally accepted (in relevant part) in *California Independent System Operator Corp.*, 83 FERC ¶ 61,209 (1998).

BEEP software from the merit order stack to be dispatched in real-time operations. When a resource in the merit order stack is skipped, the ISO must select a more expensive resource “out-of-sequence” to meet the need for balancing Energy. Recognizing that, but for these software problems, the out-of-sequence resource would not have been selected for Dispatch, Amendment No. 6 defined the “BEEP Interval Ex Post Price” in such a way that the ISO could exclude certain bids from those “eligible” to set the BEEP Interval Ex Post Price.⁴¹ In a clarification filed in response to the Commission’s order accepting Amendment No. 7, the ISO confirmed that, when a resource called out-of-sequence is excluded from the calculation of the BEEP Interval Ex Post Price, it will receive its bid price, even though the bid exceeds the BEEP Interval Ex Post Price.⁴²

While the ISO Tariff thus *authorized* the ISO to exclude certain resources from the calculation of the BEEP Interval Ex Post Price, it did not *require* the ISO to do so. The ISO determined this Spring that improvements in the BEEP software and in Dispatch operations reduced substantially the frequency of deviations between the actual dispatch and the BEEP merit order stack, as well as the difference in price between out-of-sequence resources and the marginal price bids selected by the BEEP software. In these circumstances, the ISO determined that it was no longer necessary to deem out-of-sequence resources ineligible to set the BEEP Interval Ex Post Price. Including such resources in the

⁴¹ See ISO Tariff, Section 23.2.2.

⁴² *California Independent System Operator Corp.*, Docket Nos. EL96-19-023 and ER96-1663-024, Report on Clarification (filed June 29, 1998).

BEEP Interval Ex Post Price for Imbalance Energy is consistent with the ISO Tariff, as revised in Amendment No. 6. Reliant's assertion that a tariff change was required to implement this return to the original market design is accordingly unfounded.

Reliant's second concern relates to the payments made to out-of-market resources selected from the Imbalance Energy market for real-time Intra-Zonal Congestion Management. Reliant correctly notes that, formerly, when two bids from such a resource were both selected for Congestion Management, it received payments based on the higher bid for the total amount of Energy used for that purpose. Effective at the beginning of June 1999, the ISO began paying for each block of Energy at the applicable bid price.

This change, too, did not require an amendment to the ISO Tariff. As explained above, the ISO Tariff currently specifies that the ISO will pay resources that are incremented and decremented for Intra-Zonal Congestion relief based on the bids supplied to the ISO.⁴³ While paying based on the *highest* Imbalance Energy bid accepted from a resource was a reasonable interpretation of the "as bid" payment rule, it was not the only permissible interpretation. The ISO determined that it would be preferable, as well as consistent with the treatment of Adjustment Bids used for Intra-Zonal Congestion Management, to use the bid applicable to each block of Imbalance Energy accepted for the same purpose. The resources selected for Intra-Zonal Congestion Management would continue to be paid "as bid." Since no provision of the ISO Tariff mandated the previous

⁴³ See ISO Tariff, Section 7.3.2; Settlements and Billing Protocol, Appendix B, Section B 2.

interpretation, the adoption of the current approach did not require an amendment.

In sum, the changes in practice referred to by Reliant were not the subject of filings under Section 205 of the Federal Power Act because the revised practices remain consistent with the ISO Tariff. Even if these practices were a proper subject of this proceeding, which they are not, Reliant's objections to their adoption should nevertheless be denied as groundless.

IV. CONCLUSION

For the foregoing reasons, the Commission should accept Amendment No. 18 to the ISO Tariff without modification.

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Dated: July 9, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, D.C. this 9th day of July, 1999.

Sean A. Atkins