

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

San Diego Gas & Electric Company,)	
Complainant,)	
)	
v.)	Docket No. EL00-95-018
)	
Sellers of Energy and Ancillary Services)	
Into Markets Operated by the California)	
Independent System Operator and the)	
California Power Exchange, Respondents.)	
)	
Investigation of Practices of the California)	
Independent System Operator and the)	Docket No. EL00-98-017
California Power Exchange)	
)	
Duke Energy Trading and Marketing, LLC)	Docket No. ER01-1448-001
)	
Dynegy Power Marketing, Inc.)	Docket No. ER01-1449-001
)	
Portland General Electric Company)	Docket No. ER01-1451-001
)	
Reliant Energy Services, Inc.)	Docket No. ER01-1453-001
)	
Mirant California, LLC, Mirant Delta, LLC, and)	Docket No. ER01-1455-001
Mirant Potrero, LLC)	
)	
Williams Energy Services Corporation)	Docket No. ER01-1456-001

**REQUEST FOR REHEARING OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
OF THE COMMISSION'S MARCH 16, 2001 NOTICE OF PROXY
PRICE FOR FEBUARY WHOLESALE TRANSACTIONS IN THE
CALIFORNIA ELECTRICITY MARKET**

Pursuant to section 313(a) of the Federal Power Act ("FPA" or "Act"), 16 U.S.C. § 825l(a) (1994), and section 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2000), the California Independent System

Operator Corporation (“ISO”)¹ respectfully submits this request for rehearing of the Commission’s Notice of Proxy Price for February Wholesale Transactions in the California Wholesale Electric Market issued March 16, 2001 in the above-captioned dockets (“March 16 Notice”).

I. BACKGROUND

On December 15, 2000, the Commission issued its Order Directing Remedies for the California Wholesale Electric Markets. *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange, et al.*, 94 FERC ¶ 61,294 (2000), *reh’g pending* (“December 15 Order”). As part of the mitigation measures adopted in that order, the Commission established a \$150/MWh breakpoint methodology – only sellers whose bids below \$150/MWh that are accepted by the ISO would be eligible for the Market Clearing Price. December 15 Order at 61,983. The Commission also committed to analyze individual bids above the breakpoint and required public utility sellers to submit on a weekly basis detailed data, including information on their marginal costs (fuel quantity, fuel costs, NOx emissions rates, NOx costs, variable operations, and maintenance expenses). *Id.* at 62,011. The intent behind the soft cap approach was clear: “[b]y establishing a \$150 breakpoint and not pricing every MWh at the clearing price, spot prices will no longer be magnified.” *Id.* at 61,996. The Commission took this action to “give

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

purchasers the assurance that these cost factors have contributed to the higher spot prices rather than the exercise of market power." *Id.*

On March 1, 2001, the ISO and the California Electricity Oversight Board filed a Motion for Issuance of Refund Notice to Sellers, Request for Data, Request for Hearing, and Request for Expedited Action in Docket No. EL00-95-000, *et al.* Provided with the motion was a report prepared by the ISO's Department of Market Analysis ("DMA") that provided a preliminary cost review of accepted bids and out-of-market ("OOM") purchases by the ISO to meet demand for real time Imbalance Energy during the period December 8, 2000 to January 31, 2001. The central conclusion of the DMA Report was that numerous sellers were able to charge prices substantially above levels that may be considered just and reasonable based on a detailed analysis of supply costs and market conditions. DMA Report at i. DMA estimated that as much as \$247 million or 21% of the real time Energy costs during December 2000 and \$315 million or 63% of the real time Energy costs for January 2001 represent charges that may exceed just and reasonable levels. *Id.* The DMA Report attempted to account for the high price of natural gas that some suppliers may have needed to purchase in the daily spot market. Similarly, DMA also considered the potential cost of NOx emission credits costs for units within the South Coast Air Quality Management District ("SCAQMD") that needed to buy emission credits. The ISO argued that the data presented in the DMA Report constituted a *prima facie* case that prices in the California market have exceeded competitive levels, were unjust and unreasonable, and warranted further

Commission investigation and refunds. March 1 Motion at 9. The ISO requested that the Commission: (1) notify sellers that their transactions are subject to further review;² (2) require generators to provide the ISO and California state officials with cost data submitted to the Commission; and (3) set issues related to the exercise of market power by public utility sellers into the PX and ISO markets and the appropriateness of refunds for hearing. *Id.*

On March 9, 2001, the Commission issued its Order Directing Sellers To Provide Refunds of Excess Amounts Charged for Certain Electric Energy Sales During January 2001 or, Alternately, To Provide Further Cost or Other Justification for Such Charges. *San Diego Gas & Electric, Co. et al.*, 94 FERC ¶ 61,245 (2001) ("March 9 Order"). In the March 9 Order, the Commission departed from the December 15 Order's methodology. The Commission established "a just and reasonable 'rate screen' above which refunds will either be required or further investigation will be undertaken." March 9 Order at 61,862. This rate screen was not at \$150/MWh but at \$273/MWh. *Id.* at 61,862-63. The Commission stated that it developed this screen by "establishing the market clearing price that would have occurred had the sellers bid their variable costs into a single price auction." *Id.* at 61,862. The screen was based on the weighted average of the *least efficient* gas turbine for each of the three California IOUs. *Id.* at 61,863 (emphasis added). The Commission only applied this screen during periods when the ISO was experiencing Stage 3 emergencies. *Id.* at 61,862-63. The proxy price of \$273/MWh was based upon a hypothetical

² In the December 15 Order, the Commission stated that unless the Commission issues some form of notification to a seller that its transaction is under review, refund potential on a

simple-cycle combustion turbine unit with a heat rate of 18,073 Btu/kWh. *Id.* at 61,862-63. The Commission used a natural gas rate of \$12/mmBtu based on the average reported January midpoint prices for "Southern California Gas Company large package" transactions as reported in Financial Times Energy's "Gas Daily" publication, average January NOx allowance costs from the SCAQMD NOx auction of \$22.50/lb. as reported by Cantor Fitzgerald Environmental Brokerage Services, an average NOX emissions rate of 2 lbs./MWh and variable operations and maintenance costs of \$2/MWh. *Id.* at 61,863. The Commission stated that it would use these indices to establish proxy market clearing prices for each month through April 2001. *Id.* at 61,864.

In its March 16 Notice, the Commission applied the methodology proposed in the March 9 Order. The Commission noted that the average reported February midpoint price of \$19.11/mmBtu for "Southern California Gas Company large package" transactions as reported in Financial Times Energy's "Gas Daily" publication was an increase of 53 percent. March 16 Notice, Slip op at 2. The Commission also stated that February NOx allowance costs from the SCAQMD NOx auction of \$41.720/lb. as reported by Cantor Fitzgerald Environmental Brokerage Services represented an 85 percent increase. *Id.* As a result, the Commission set the proxy price for February at \$430/MWh. *Id.* Again, this screen was only applied to transactions that occurred during Stage 3 conditions. *Id.*

On April 9, 2001, the ISO filed its request for rehearing of the March 9 Order. The ISO argued that the March 9 Order represented an unexplained and

particular transaction will close 60 days after its cost report is filed.

unreasonable departure from the mitigation measures adopted in the December 15 Order and that, even if it were appropriate for the Commission to utilize a "rate screen," the Commission's implementation of this surrogate market clearing price in the March 9 Order was fundamentally flawed -- (1) limitation of refund exposure to Stage 3 emergencies was arbitrary and capricious³ and (2) the reasonableness of the indices used in determining the Commission's proxy price lacks foundation in the established record of this proceeding.⁴ The ISO called on the Commission to work to ensure that sales by sister federal agencies were made at just and reasonable rates. The ISO also renewed its requests for access to the cost data provided to the Commission by supplier and its request for a hearing to fully investigate these vital issues.⁵

³ The ISO noted: (1) that past studies have found that suppliers routinely exercise market power outside of Stage 3 conditions; (2) that recent studies by DMA have found the rampant exercise of market power under *all* system conditions; (3) that the limitation of refunds to Stage 3 emergencies is directly contrary to the ISO's responsibility under Commission-approved contracts, the ISO Tariff, and state law to maintain specific reserve levels (i.e. the ISO must purchase supplies to attempt to prevent conditions deteriorating to Stage 1 and Stage 2 emergencies, not just Stage 3) and (4) that the Commission's exclusive focus on Stage 3 sends incorrect price signals, purporting to mitigate or lower prices at the times of highest needs.

⁴ In particular, the March 9 Order fails to recognize that the need for NOx credits only relates to facilities in certain locations within California and fails to take into account actions that state officials have taken to lower the prices Generating Units pay for NOx credits. In addition, the Commission's gas price may overstate what a prudent generator's actual production costs should be.

⁵ With regard to the Commission's statement that its proxy price should serve as an incentive for new supply (March 9 Order at 61,863), the ISO noted that the prices were far above the level needed to attract new generation. See April 9, Request for Rehearing at 24. Moreover, in its March 30, 2001 Comments in Docket No. EL01-47-000, the California Energy Commission ("CEC") noted that as of March 21, 2001, the CEC had already licensed 8,464 MW of new central station generation which is in various stages of construction and anticipated to be operational by 2003; that an additional 5,000 MW were currently under siting consideration; and that applicants for another approximately 8,000 MW have indicated they will be seeking operating certificates during the next year. March 30, 2001 Comments at 2-3. The CEC notes that the state is negotiating long-term contracts to encourage continued power plant construction and that "[c]ontinued or increasing high prices beyond any reasonable level, instead of causing more power plant applications this year, will simply aggravate a burden-of-payment and credit crisis that increasingly clouds the financial outlook for both existing and new projects." *Id.* at 4.

II. SPECIFICATIONS OF ERROR

The ISO respectfully submits that the March 16 Notice errs in the following respects:

1. The Commission's use of a "rate screen" to establish a surrogate Market Clearing Price represents an unsupported departure from prior Commission findings with respect to the current crisis facing the wholesale California electricity market and an unwarranted retreat from the obligation assumed by the Commission in its December 15 Order to implement the generator-specific mitigation measures reflected in that Order.
2. Even if the Commission finds that use of a rate screen is appropriate, it is arbitrary, capricious, an abuse of discretion, and contrary to the law for the Commission to limit refunds to Stage 3 emergency conditions.
3. The Commission has failed to provide a reasoned basis for its proxy price. Use of the proxy price reflected in the March 16 Notice results in unjust and unreasonable rates for sales for resale in interstate commerce.
4. It is unjust and unreasonable and contrary to the Commission's prior approval of the Market Monitoring and Information Protocol ("MMIP") of the ISO Tariff for the Commission not to order

generators to supply their cost data to the ISO and appropriate State officials.

5. Given the dysfunctional California wholesale electric market, it is arbitrary and capricious and an abuse of discretion for the Commission to fail to establish hearings to determine just and reasonable rates based on the actual cost of service.

III. ARGUMENT

Provided with this Request for Rehearing are two documents. The first is the ISO's April 9 Request for Rehearing of the March 9 Order.⁶ As the March 16 Notice implements the methodology first proposed in the March 9, 2001 Order, the ISO incorporates by reference the arguments contained in the prior rehearing request.

The Second document is DMA's preliminary cost review of accepted bids and out-of-market ("OOM") purchases by the ISO to meet demand for real time Imbalance Energy during February 2001.⁷ The April 14 DMA Report provides a comparison to the Commission's rate screen methodology based on two different approaches.

First, the April 14 DMA Report includes analysis of potential charges in excess of just and reasonable levels based on the same methodology as was utilized in the report for December 2000 and January 2001 submitted as part of

⁶ See, Attachment A.

⁷ See, Attachment B ("April 14 DMA Report").

the March 1 Motion filed by the ISO and EOB. As described in that filing, this analysis is based on estimated costs, plus a margin of 10% or \$25/MWh, whichever is less.

Second, the April 14 DMA Report includes an analysis of excess revenues earned from sales in the real time energy market relative to an hourly competitive baseline price developed by DMA and utilized in previous analyses submitted to the Commission.⁸ The hourly competitive baseline price used in this analysis is specifically designed to represent the standard proposed in the Commission's March 9 Order and March 16 Notice for setting the proxy price to be used in refunds -- "the market clearing price that would have occurred had the sellers bid their variable costs into a single price auction." However, unlike the specific proxy used in the Commission's decisions, the hourly competitive baseline price used in the DMA report is based on actual hourly load and supply conditions, combined with spot market gas prices, unit-specific heat rates, and, where applicable, estimates of unit-specific NOx emission rates and emission credit costs. Again, the central conclusion of this analysis is that numerous sellers were able to charge prices substantially above levels that may be considered just and reasonable based on a detailed analysis of each suppliers costs, as well as what each supplier would have earned under competitive market conditions.

⁸ See, *Further Analyses of the Exercise and Cost Impacts of Market Power In California's Wholesale Energy Market*, March 2001, Prepared by Eric Hildebrandt, Department of Market Analysis, submitted as Attachment B to the ISO's *Comments on FERC Staff's Recommendations on Prospective Market Monitoring and Mitigation for the California Wholesale Market*, March 22, 2001. See also, the additional data provided in response to the Commission's March 30, 2001 letter from Daniel Larcamp.

The Commission's March 16 Notice identified approximately \$51 million in potential refunds for sales of real time energy directly by public utility sellers under Commission-authorized tariffs granting market-based rate authority. Under the cost-based standard used in the April 14 DMA Report to screen sales, refunds from these same sellers would total approximately \$128 million. Based on the competitive baseline price methodology, refunds from these same transactions would total approximately \$108 million.

When all non-utility sellers are included in the analysis, DMA estimates that as much as \$380 million or over 38% of the real time Energy costs from non-utility sources during February 2001 represent charges that may exceed just and reasonable levels relative to estimated supply costs. When compared to prices that would result in a single-price auction under competitive market conditions, DMA estimates that as much as \$347 million or about 34% of the real time Energy costs for non-utility sources during the same period represent charges in excess of prices that result under competitive market conditions.

IV. CONCLUSION

WHEREFORE, for the above-stated reasons and in its request for rehearing of the March 9, 2001 Order, the ISO respectfully requests that the Commission grant rehearing of its March 16, 2001 Notice, and that the Commission further find, determine and order:

- (1) That sellers be ordered to immediately refund all amounts above the rate screen (subject to the provision of additional data) for all

hours and not just those hours for which Stage 3 emergencies have been declared;

- (2) That the Commission suspend payment of all amounts owing to generators based on bids below the rate screen but above the \$150 soft cap for the period from January 1, 2001 forward, until a final resolution of the issues set for hearing;
- (3) That the Commission work with its sister agencies to facilitate the achievement of just and reasonable rates for sales from these federal entities.
- (4) That the Commission require generators to provide to the ISO and to the EOB their unit-specific cost data (subject to appropriate confidentiality protections);
- (5) That the Commission immediately establish hearings to develop the appropriate record to establish unit specific reasonable rates for this period of market dysfunction; and

- (6) That the Commission vacate that part of its December 15 Order providing a 60-day limitation on review of amounts bid into the California markets.

Respectfully submitted,

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

Edward Berlin
Kenneth G. Jaffe
David B. Rubin
Bradley R. Miliauskas
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007
Tel: (202) 424-7500

Dated: April 16, 2001