UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, Complainant,	)	Docket Nos. EL00-95-001
	)	EL00-95-004
	)	EL00-95-005
v.	)	Docket Nos. EL00-95-006
	)	EL00-95-007
Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents	)	EL00-95-010
	)	EL00-95-010
	)	EL00-95-011
	)	EL00-95-019
	)	EL00-95-039
	)	EL00-95-046
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	EL00-95-047
	)	
	)	
Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council	)	Docket Nos. EL00-98-001
	)	EL00-98-004
	)	EL00-98-005
	)	EL00-98-006
	)	EL00-98-008
	)	EL00-98-010
	)	EL00-98-011
	)	EL00-98-018
	)	EL00-98-037
	)	EL00-98-043
	)	EL00-98-044
Public Meeting in San Diego, California	)	Docket No. EL00-107-002
Reliant Energy Power Generation, Inc., Dynegy Power Marketing, Inc. and Southern Energy California, L.L.C., Complainants,	)	Docket No. EL00-97-001
	)	
	)	
	)	
v.	)	
California Independent System Operator Corporation, Respondent	)	
	)	
	)	

California Electricity Oversight Board, Complainant, v.	)	
All Sellers of Energy and Ancillary Services Into the Energy and Ancillary Services Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents	)	Docket No. EL00-104-001
California Municipal Utilities Association, Complainant, v.	)	
All Jurisdictional Sellers of Energy and Ancillary Services Into Markets Operated by The California Independent System Operator and the California Power Exchange, Respondents	)	Docket No. EL01-1-001
CAlifornians for Renewable Energy, Inc. (CARE), Complainant, v.	)	
Independent Energy Producers, Inc. and All Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange; All Scheduling Coordinators Acting on Behalf of the Above Sellers; California Independent System Operator Corporation; and California Power Exchange Corporation, Respondents	)	Docket No. EL01-2-001
Puget Sound Energy, Inc. Complainant, v.	)	
All Jurisdictional Sellers of Energy and/or Capacity at Wholesale Into Electric Energy and/or Capacity Markets in the Pacific Northwest, Including Parties to the Western Systems Power Pool Agreement, Respondents	)	Docket No. EL01-10-001

California Independent System Operator Corporation	))	Docket Nos. ER01-607-000 ER01-607-001
California Independent System Operator Corporation	))	Docket Nos. RT01-85-002 RT01-85-005
Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council	))))	Docket Nos. EL01-68-002 EL01-68-008
California Power Exchange Corporation	)	Docket no. ER00-3461-001
California Independent System Operator Corporation	))	Docket No. ER00-3673-001
California Independent System Operator Corporation	))	Docket No. ER01-1579-001
Southern California Edison Company and Pacific Gas and Electric Company	))	Docket Nos. EL01-34-000 EL01-34-001
Arizona Public Service Company	)	Docket No. ER01-1444-001
Automated Power Exchange inc.	)	Docket No. ER01-1445-001
Avista Energy, Inc.	)	Docket No. ER01-1446-001
California Power Exchange Corporation	)	Docket No. ER01-1447-001
Duke Energy Trading and Marketing, LLC	)	Docket No. ER01-1448-002
Dynegy Power Marketing, Inc.	)	Docket No. ER01-1449-002
Nevada Power Company	)	Docket No. ER01-1450-001
Portland General Electric Company	)	Docket No. ER01-1451-002
Public Service Company of Colorado	)	Docket No. ER01-1452-001
Reliant Energy Services, Inc.	)	Docket No. ER01-1453-001
Sempra Energy Trading Corporation	)	Docket No. ER01-1454-002

Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC) Docket No. ER01-1455-002

Williams Energy Services Corporation) Docket no. ER01-1456-002

MOTION FOR CLARIFICATION AND REQUEST FOR REHEARING OF THE ORDER ON CLARIFICATION AND REHEARING

The California Independent System Operator Corporation ("ISO")[1] respectfully submits this Request for Rehearing of the Commission's Order On Clarification and Rehearing" in the above-captioned docket, 97 FERC ¶ 61,275 (2001) ("December 19 Order"), pursuant to section 313(a) of the Federal Power Act, 16 U.S.C. § 825l(a) (1994), and sections 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713 (2001).

For the reasons presented below, the Commission should revoke, retract or modify the provisions in the December 19 Order (1) requiring marketers and hydroelectric generators to bid $0/MWh in the ISO real time spot markets; (2) directing the ISO to recalculate the mitigated reserve deficiency Market Clearing Price ("MCP") when Operating Reserves fall below seven percent; (3) stating that the ISO "agreed on" the terms and rates for the sales of power conducted pursuant to Department of Energy section 202(c) orders, (4) requiring that the ISO file by May 1, 2002, a congestion management plan and proposal for a Day Ahead Energy Market; and (5) stating that generators will earn interest on overdue amounts owed by ISO Market Participants.

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

I. INTRODUCTION AND SUMMARY OF POSITION

The Commission has previously concluded in these dockets that the market structures and rules for wholesale sales of electric energy in California are "seriously flawed," and, in conjunction with the imbalance of supply and demand in California, have created the ability of suppliers of electricity in those markets to exercise market power and to charge unjust and unreasonable rates for energy.[2] In its April 26 Order,[3] the Commission issued an order adopting a prospective market monitoring and mitigation plan for real-time wholesale energy markets in California. The market monitoring and mitigation plan, which went into effect on May 29, 2001, specifically included, among other elements:

- a price mitigation mechanism for all sellers bidding into the ISO's real-time Energy market during System Emergencies (*i.e.,* "periods of reserve deficiency," defined as beginning with a Stage 1 System Emergency) under which the Market Clearing Price will be set at a "proxy price," reflecting the highest marginal cost of all of the gas-fired units dispatched, as calculated by the ISO, pursuant to a formula set forth by the Commission. Under the April 26 Order, all sellers were permitted to submit bids greater than this proxy price, subject to refund and justification.

The April 26 Order failed to address a number of important issues, including price mitigation in non-emergency hours and "megawatt laundering." The ISO requested guidance on certain issues in its May 11, 2001 Compliance Filing and in status reports filed with the Commission on May 18 and May 25. On May 25, 2001, the ISO filed a motion for clarification and request for rehearing of the April 26 Order (the "May 25 Rehearing Request"), explaining, *inter alia*, the need for mitigation of the market power

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2 December 15 Order at 61,998-99.

3 *San Diego Gas & Electric Co., et al., 95 FERC ¶ 61,115* ("April 26 Order").

being exercised in all hours and in all wholesale markets and for a mechanism to address the problem of megawatt laundering.

On May 25, 2001, the Commission issued an order confirming certain aspects of the April 26 Order but not addressing price mitigation in non-emergency hours or megawatt laundering.[4] In its June 19 Order, the Commission acted on the requests for rehearing of the April 26 Order and addressed a number of issues related to the May 25 Order. The June 19 Order substantially modified and expanded the market monitoring and mitigation plan adopted in the April 26 Order, establishing price mitigation in all hours and for all "spot markets" throughout the Western interconnection. Specifically, the June 19 Order:

- retained the price mitigation mechanism for all sellers bidding into the ISO's spot market during System Emergencies, but modified the formula for determining the "proxy price" used to determine the Market Clearing Price;

- established a price mitigation mechanism for all sellers bidding into the ISO's spot market during non-System Emergency periods, under which the maximum Market Clearing Price for spot market sales during such hours will be eighty-five percent (85%) of the highest ISO hourly Market Clearing Price established during the hours when the last Stage 1 System Emergency (that was not also a Stage 2 or Stage 3 System Emergency) was in effect;

- mandated that all marketers be "price takers" and not be able to set the Market Clearing Price or be paid as-bid above the mitigated Market Clearing Price;[5]

In the December 19 Order the Commission adopted, rejected and modified aspects of the ISO's compliance filings submitted in response to the orders discussed above. In particular, the Commission:

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[4] *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.*, 95 FERC ¶ 61,275 ("May 25 Order").

[5] Under the June 19 Order, sellers other than marketers will continue to have the opportunity to justify bids or prices above the maximum Market Clearing Prices.

- required hydroelectric generators to be price takers when such resources participated in ISO spot markets;

- required the ISO to modify its Tariff regarding the declaration of System Emergencies to reflect a definition of a Stage 1 System Emergency to occur when operating reserves fall below seven percent, and thus, when a new mitigated reserve deficiency MCP must be calculated;

- stated that the ISO and suppliers agreed to terms and rates for sales made pursuant to section 202(c) of the Federal Power Act during the period December 14, 2000 through February 7, 2001; and

- directed the ISO to file a congestion management plan and proposal for a Day Ahead Energy Market no later than May 1, 2002.

II. SPECIFICATIONS OF ERROR

The ISO respectfully submits that the December 19 Order errs in the following respects:

(1) By requiring marketers to bid $0/MWh in the ISO real time spot markets;

(2) By directing the ISO to recalculate the mitigated reserve deficiency Market Clearing Price ("MCP") when operating reserves fall below seven percent;

(3) In concluding that the ISO and suppliers agreed to terms and rates for sales made pursuant to section 202(c) of the Federal Power Act during the period December 14, 2000 through February 7, 2001;

(4) In failing to account for the Commission's recently-announced process for standardized market design and provide adequate time for the ISO to prepare a congestion management plan and proposal for a Day Ahead Energy Market; and

(5) In implying that the ISO pays default interest to generators when past due amounts are paid for transactions in ISO markets outside of the period from October 2, 2000 through June 20, 2001.

III. ARGUMENT

A. The Commission's Requirement That Marketers bid at $0/MWh Discourages Imports and Affects the ISO's Ability to Purchase Imported Power at Reasonable Prices

In the June 19 Order, the Commission properly ordered that marketers be price-takers to prevent megawatt laundering, wherein power from California generating units is first exported out of California and then imported back into California to escape the price mitigation that is applied specifically to in-state generating units. While the Commission's intent to eliminate megawatt laundering was correct, its implementation of that intent – ordering that marketers could bid no higher than the MCP – has always been problematic because marketers cannot know what the MCP ultimately will be at the time the marketers bid into the ISO real time spot markets. The ISO acknowledged these problems in its implementation of the June 19 Order, wherein marketers could bid into the ISO's Real Time Imbalance Energy Market, but, since they could not set the price, might be dispatched at a price below their bid price.

The Commission sought to correct these flaws in the December 19 Compliance[6] and December 19 Rehearing Orders by directing that marketers must bid at a price of $0/MWh to satisfy their obligation to be price-takers. While the Commission's intent again is correct, the current provision is even more problematic than the Commission's previous requirement.

Energy imported into the ISO Control Area across the interties connecting the ISO Control Area to external Control Areas is, with the exception of Energy from dynamically scheduled resources or where contractual allowances are made for mid-

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[6] "Order Accepting In Part and Rejecting In Part Compliance Filings,: 97 FERC ¶ 61,293 (2001) ("December 19 Compliance Order").

hour intertie adjustments, generally scheduled in static hour-long blocks in accordance with west-wide standard scheduling practices. Consequently, the ISO pre-dispatches imported Energy before the operating hour so the imported Energy can be accounted for in the interchange schedule confirmations that, per Western Systems Coordinating Council ("WSCC") scheduling practices, must be completed thirty minutes prior to the start of the operating hour to assure that Control Areas reflect the correct net interchange value in their control systems. Furthermore, since the generating resources that are providing the imported Energy are in the control of the Control Area operator in the sending Control Area, and not in the control of the ISO, the ISO dispatches these imports for an entire hour since it cannot re-dispatch them during the operating hour and the prevailing practice is to not adjust interchange schedules for non-emergency reasons.

The ISO relies on imported Energy to maintain the reliability of the ISO Control Area. The ISO wants to accommodate out-of-state suppliers' reasonable expectations that they earn a price no lower than their bid price. Even if such suppliers are price-takers, the ISO can strive to provide some assurance of price protection by evaluating how much Energy it can import and how much Energy it must Dispatch from the stack of Imbalance Energy bids to ensure that the BEEP price does not go below the price of the highest price import bid dispatched. The ISO cannot make this evaluation, however, if marketers are all required to bid $0/MWh. If all marketers seeking to import Energy into the ISO Control Area are required to bid $0/MWh, the ISO reasonably would be obligated to Dispatch all of those $0/MWh bids first, but in so doing, would depress the

BEEP price and thereby discourage out-of-state suppliers from offering supply to the ISO. Certainly this is not the Commission's intent.

Moreover, even if marketers are not dissuaded from bidding at $0/MWh into the ISO real time markets, the resulting depression of the BEEP price will encourage generators whose operating costs are higher than the artificially low BEEP price to engage in negative uninstructed deviations (*i.e.,* under-generate). Generators will do this because, compared to the costs to self-generate, it will cheaper to buy from the ISO the supply they need to meet their Load obligations. Such an increase in failure to perform on schedules will decrease operational predictability. Specifically, the ISO will not know, with any degree of certainty, if generators will comply with their schedules and so the ISO will have less operational ability to respond to reliability problems.

Artificially depressed prices also will decrease incentives for Load Serving Entities ("LSEs") to engage in Demand Side Management ("DSM") and forward scheduling and contracting for supply. Given the importance the Commission has placed on encouraging DSM and forward transactions, decreased interest by LSEs is a serious negative consequence of requiring interties and marketers to bid $0/MWh.

Lastly, when faced with a quantity of $0/MWh bids that exceeds demand, the ISO will have to make arbitrary decisions as to which units to Dispatch. The lack of ability to distinguish among resources will create random acceptance of bids and interties and marketers will have even less incentives to bid into the ISO markets since there will not be a way for them to offer bids that distinguish themselves from others and thus be assured of Dispatch.

While the ISO does not wish for the Commission to rescind the directive that marketers must be price-takers, based upon the multiple reasons detailed *supra*, the ISO requests the Commission remove the requirement for marketers to bid $0/MWh so that the ISO can provide some opportunity for the marketers to earn a price at or near their bid price without having the opportunity to set that price. Moreover, as set forth in the ISO's July 10 Compliance Filing in the above-cited dockets, such an approach allows the ISO to Dispatch marketers' bids in merit order through the BEEP stack while paying the bids at the MCP.

B. Recalculation of the Mitigated Market Clearing Price Should Be Triggered By Actual Operating Reserve Deficiencies As Defined By the Western System Coordinating Council and Minimum Operating Reliability Criteria

The December 19 Order provides, that until September 30, 2002, the date the Commission has established as the termination date for the price mitigation plan, a drop in Operating Reserves below seven percent will serve as an automatic trigger for recalculation of the Non-Emergency Clearing Price Limit.[7] In addition, the Order apparently requires that the ISO also is to declare a Stage 1 System Emergency when Operating Reserves drop below seven percent. The Commission's directives specifically are set forth in the December 19 Compliance Order, issued concurrently with the December 19 Order in the above-identified dockets. The ISO, concurrently with the instant filing, is filing a Motion for Clarification and Request for Rehearing of the December 19 Compliance Filing, ("ISO Request for Rehearing of December 19 Compliance Order") which sets forth in greater detail the ISO's concerns about the Commission's requirement that a Stage 1 System Emergency be defined to occur when

operating reserves drop below seven percent, thus triggering an automatic recalculation of the non-emergency MCP. The instant filing is made because the December 19 Order references the specific provision of the December 19 Compliance Order directing the ISO to amend its Tariff respectively.

As detailed in the ISO Request for Rehearing of the December 19 Compliance Order, the Commission has clarified that it was the reserve deficiency, and not the declaration of an emergency, that created the risk of excessive prices. The ISO is concerned that the Commission, while properly linking periods of inadequate operating reserve with the potential for unjust and unreasonable prices, improperly links such a period with what is properly a circumstance of an ISO-declared System Emergency, as further explained below.

In brief, the ISO implements graduated levels of system emergencies. A Stage 1 System Emergency occurs when a potential Operating Reserve shortfall exists and available market and non-market resources potentially will be insufficient to maintain Operating Reserves in compliance with the WSCC Minimum Operating Reliability Criteria ("MORC").[8] The ISO is obligated to take affirmative action to maintain its full reserve obligation and to attempt to *avoid* the occurrence of any emergency, including Stage 1 System Emergencies. Many of the operational actions that the ISO undertakes to avoid an operating reserve deficiency are public and accordingly, sellers often know

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[7] The ISO will address issues associated with the Commission's December 19, 2001 Order revising the West-wide price mitigation methodology (*see* 97 FERC ¶ 61, 294) in a separate rehearing request.

[8] If Operating Reserves are currently or are forecast to be below five percent, a Stage 2 System Emergency is declared. The ISO enters a Stage 3 System Emergency when Operating Reserves are currently or forecast to be below 1.5 percent.

even before a Stage 1 System Emergency is announced that their resources will be required.[9]

The ISO's obligations in this regard arise in part out of its adherence to the FERC-approved WSCC reliability criteria.[10] The ISO is committed to comply with the WSCC RMS by virtue of: (1) its contract with the WSCC,[11] (2) the provisions of the ISO Tariff,[12] and (3) California state law.[13] The WSCC MORC (the underlying standards with which the ISO must comply pursuant to the RMS contract) requires that the ISO maintain Spinning Reserves and Non-Spinning Reserves equal to the sum of five percent of the load responsibility served by hydroelectric generation and seven percent of the load responsibility served by thermal generation.[14] Moreover, previously, the Commission has recognized that the ISO maintains Spinning Reserves and Non-Spinning Reserves equal to the sum of five percent of the load responsibility served by hydroelectric generation and seven percent of the load responsibility served by thermal

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[9] In accordance with ISO Operating Procedure E-508, the ISO may issue Alert and Warning notices, even before issuing System Emergency notices.

[10] In its declaratory order concerning the WSCC's Reliability Management System ("RMS"), under which transmission operators agree, through contracts, to comply with WSCC reliability criteria, the Commission "acknowledg[ed] the longstanding role of WSCC in formulating regional reliability standards" and gave "substantial deference to WSCC in the development of reliability standards." *Western Systems Coordinating Council*, 87 FERC ¶ 61,060, 61,234 (1999).

[11] The ISO agreement is designated by the Commission as WSCC Rate Schedule No. 5.

[12] Section 2.3.1.1.6 of the ISO Tariff states that the ISO should be the WSCC security coordinator for the ISO Controlled Grid. Under Section 2.3.1.3.1, the ISO is to exercise Operational Control over the ISO Controlled Grid "to meet planning and Operating Reserve Criteria no less stringent than those established by WSSC and NERC as those standards may be modified from time to time . . . ." *See also* Section 2.1 of the Dispatch Protocol of the ISO Tariff which provides:

> The ISO shall exercise Operational Control over the ISO Controlled Grid in compliance with all Applicable Reliability Criteria. Applicable Reliability Criteria are defined as the standards established by NERC, WSCC and Local Reliability Criteria and include the requirements of the Nuclear Regulatory Commission (NRC).

[13] Chapter 345 of Assembly Bill 1890 provides:

> "The Independent System Operator shall ensure efficient use and reliable operation of the transmission grid consistent with achievement of planning and operating reserve criteria no less stringent than those established by the Western Systems Coordinating Council and the North American Electric Reliability Council."

[14] WSCC Rate Schedule No. 1 First Revised Sheet No. 27.

generation. See, for example, *Duke Energy Oakland, et a.,* 84 FERC ¶ 61,960, n. 12 (1998) ("[f]or and demand met by hydroelectric resources, the 7% figure is reduced to 5%."; *El Segundo Power, LLC, et al.,* 84 FERC ¶ 61,011, 61,057 n. 9 (1998). In addition, ISO Operating Procedure E-508 specifies that the ISO will declare a Stage 1 System Emergency "any time it is clear that an Operating Reserve shortfall (when Operating Reserve is less than MORC minimum) is unavoidable."

Now the Commission apparently has ordered the ISO to alter the definition of a Stage 1 System Emergency to be coincident with a fixed actual value of reserve margin that does not comport with the WSCC MORC. Beyond the conflict with the WSCC MORC, the declaration of a Stage 1 System Emergency when reserves fall below seven percent is unlikely to coincide with an actual Operating Reserves deficiency since the ISO is not required by WSCC MORC to maintain seven percent Operating Reserves.

It is implicit that, in a redefinition of a Stage 1 System Emergency, there also is a concurrent redefinition of the ISO's minimum Operating Reserve. As the ISO has detailed to the Commission in its concurrently-filed ISO Request for Rehearing of December 19 Compliance Order, in prior filings in the above-cited dockets, and *supra*, the ISO's actual Operating Reserve obligation (based on the limited definition in the ISO Tariff) is *not* simply a fixed seven percent of its Load obligation. Instead, it is a varying function of its Load responsibility, including the variable amount of its Load served by hydroelectric generation and thermal resources, and other reliability requirements as set forth by the WSCC MORC. Such other reliability requirements translate into variable reserve requirements for the ISO, depending on system conditions.

In 2001, the ISO's average Operating Reserve requirement was not seven percent, but 6.2 percent, based on the simple average of the monthly Operating Reserve obligation. If the ISO were to operate using a seven percent Operating Reserve threshold for the duration of the price mitigation period (until September 30, 2002), the ISO will incur a significant additional cost, which must be passed through to Market Participants, for the procurement of unnecessary and excessive Operating Reserve above the MORC requirements. The ISO does not believe that the Commission intended this consequence. As the Commission has emphasized, it is not the declaration of a Stage 1 System Emergency, but rather a reserve deficiency that creates the risk that prices might exceed those charged in a competitive market.

The Commission directs the ISO to use a seven percent reserve margin as the threshold for resetting the Non-Emergency Clearing Price Limit. Given that it is not reasonable to believe that the Commission intends that the ISO maintain excessive operating reserves, the ISO proposes, in its compliance filing responsive to the December 19 Compliance Order, a new Tariff term, "Price Mitigation Reserve Deficiency" which is defined as "Any clock hour in which the ISO's maximum actual reserve margin is below seven (7) percent." The Non-Emergency Clearing Price Limit will be reset whenever a Price Mitigation Reserve Deficiency occurs. This approach is consistent with the Commission's finding that a specific percentage is appropriate and reasonable because it enhances market certainty during the mitigated period and it avoids a temporary redefinition of a Stage 1 System Emergency that would conflict with the ISO's operation of the Control Area and ISO's compliance with the WSCC MORC requirements. The ISO believes that its proposed solution resolves the multiple

problems springing from use of a single and static percentage of reserve for definition of a System Emergency *AND* to trigger recalculation of the Non-Emergency Clearing Price Limit.

However, to best conform with the Commission's intent to link recalculation of the MCP and Non-Emergency Price Clearing Limit with periods in which prices otherwise would exceed those in competitive markets, it is important that the trigger point for a Price Mitigation Reserve Deficiency be set to the correct Operating Reserve obligation. To that end, the ISO specifically requests the Commission modify its order in this particular instance and adopt the ISO proposed Price Mitigation Reserve Deficiency, and order it be set at the level of 6.2 percent maximum actual hourly Operating Reserve.

C. The ISO Did Not Agree To The Rates and Terms Of Transactions Made Pursuant To DOE 202(c) Orders

In its December 19 Order, the Commission not only reiterated that 202(c) transactions were outside the scope of the refund proceeding, but also went one step further, stating that 202(c) "provides no role for the Commission in the event that parties agree on the rates that will apply to the transactions." Slip op. at 56. The Commission explained that because the parties to transactions made pursuant to the DOE Orders had agreed on the terms and rates for those sales, 202(c) "provides for no further adjustments." *Id.* It is with respect to the determination that the parties agreed on rates that would apply to these transactions that the ISO seeks rehearing.

In reaching that determination, the December 19 Order proceeds from a fundamentally flawed premise. In the chaotic environment that prevailed during the period in which the DOE Orders were in effect, the ISO had but one focus: acquiring

sufficient energy to keep the lights on. Declaration of Ms. Ean O'Neill ("O'Neill Decl.") at ¶ 9-11. The discussions between the operators on the ISO floor and the 202(c) respondents focused on volumes, *not on price*, and no one could reasonably have thought otherwise. *Id*. Consideration of the background against which those discussions occurred makes this clear.

In the second half of calendar year 2000 and first quarter of 2001, due to a variety of factors, the ISO had found it increasingly difficult to obtain adequate supplies in order to meet demand, to the extent that during November and December the ISO declared numerous system emergencies and eventually, on January 17, 2001, was forced to involuntarily curtail firm Load (in the form of "rotating outages"). for the first time in its operational history. In this dire situation, the ISO desperately sought any means available to "keep the lights on," a task made especially difficult given the rampant underscheduling and the dearth of available bids in the ISO's real-time Energy market. *See* O'Neill Decl. at ¶ 4. In an attempt to bolster the number of bids into its real-time Energy market, on December 8, 2000, the ISO filed, and the Commission immediately approved,[15] Amendment No. 33 to the ISO Tariff. That amendment imposed a $250/MWh "soft cap," giving Generators the opportunity to submit bids into the ISO's markets above that cap and be paid "as bid," subject to after-the-fact cost review by the Commission.

Amendment No. 33 and the "soft cap" regime that it initiated recognized the reality: the supply crisis, and resulting threat to the continuity of service to Load, was so severe that issues of price above a benchmark level had to be set to the side for resolution *after* the supply imperative was met. The Commission not only endorsed this

approach, it shortly thereafter implemented a lower -- $150 – "soft cap,"[16] with bids accepted above that level still subject to after-the-fact cost review by the Commission.

Although additional supplies were forthcoming, the crisis was not sufficiently abated due largely to growing concerns over the creditworthiness of the California investor-owned utilities. Ultimately, the ISO determined that it had no alternative but to seek relief from the Secretary of Energy pursuant to section 202(c), which was provided by then-Secretary Richardson and later by Secretary Abraham. In all instances, prior to availing itself of the relief provided, the ISO had to certify the continuation of crisis conditions. Relief under section 202(c) was available between December 14, 2000 and February 7, 2001.

Thus, beginning at least as early as December 8, 2000 and continuing throughout the period that the DOE Orders were in effect, there was a general understanding that the prices being demanded by suppliers may not be just and reasonable, that prices in excess of $250/MWh and then $150/MWh required explicit cost justification, and that the pressing issue in real-time was supply availability, the satisfaction of which could not and would not be made to depend on price negotiation. *See* O'Neill Decl. at ¶ 9-10. Instead, the price issue was to be deferred to allow for reasoned consideration outside of the crisis environment that plagued the ISO as its operators struggled to keep the lights on. *See id*. at ¶ 11.

Against this background, the Commission's most recent characterization of the section 202(c) transactions is mistaken. The world was on notice that the ISO *and the Commission* were not accepting – and surely not agreeing to – prices in excess of the

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15 *Order Accepting Tariff Amendment on an Emergency Basis*, 93 FERC ¶ 61,239 (2000).

16 *San Diego Gas & Electric Co.*, et al., 93 FERC ¶ 61,294 (2000).

soft cap. Instead, the focus was on the immediate imperative – acquiring the needed energy – with the price justification (if above the cap) to be adjudicated at a later date.

In these circumstances, it cannot logically be said that there was "agreement" on price. In point of fact, price was *not* negotiated. The ISO told the suppliers the volumes it required, and the suppliers stated their price. This does not equate to a "meeting of the minds."[17] This was an adhesion situation carried to the extreme.[18] As the Commission itself recognized in the July 25 Order[19], because the ISO is the supplier of last resort with respect to the resources necessary to operate the grid, "when OOM calls are made, suppliers realize that the ISO is in a must-buy situation." 96 FERC at 61,515. For this reason, the Commission appropriately subjected those transactions to refund liability. Those purchases made pursuant to section 202(c) are no different, and in fact represent an even greater example of supplier leverage, since the DOE authority represented the ISO's true "last resort" mechanism. *See* O'Neill Decl. at ¶ 5.

In fact, during this period, ISO operations personnel were specifically instructed that they were *not* to negotiate prices with suppliers. Instead, they were to concentrate on their pressing reliability responsibilities. O'Neill Decl. at ¶ 10-11. Moreover, it was unnecessary to resolve or even debate prices – the "soft cap" regime was in place, and all knew that under it, suppliers would be obliged affirmatively to establish the cost justification for above-cap prices. *Id*.

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[17] *See, e.g., Banner Entertainment v. Superior Court*, 62 Cal. App. 4th 348, 359 (Cal. Ct. App. 1998) (noting that "the failure to reach a meeting of the minds on all material points prevents the formation of a contract *even though the parties have orally agreed upon some of the terms, or have taken some action related to the contract*") (emphasis in original).

[18] *C.f., e.g., Gallogan v. Arrovitch*, 219 A.2d 463, 465 (Pa. 1966) (finding an impermissible contract of adhesion where there was no meeting of the minds and one party had no choice but to accept the terms of the other, with no alternative other than to reject the transaction entirely).

[19] "*Order Establishing Evidentiary Hearing Procedures, Granting Rehearing in Part and Denying Rehearing in Part,"* 96 FERC ¶ 61, 120 (2001) ("July 25 Order").

That was the prevailing regime, as was apparent to all parties – the 202(c) respondents as well as the ISO. A conclusion that those respondents should obtain any price they happened to name, when the ISO had made clear it was not negotiating price, cannot be reconciled with 10 C.F.R. 205.376 which, at least by analogy, looks to existing rate regimes to define prices acceptable under 202(c) ("rates and charges contained in approved existing rate schedules"). While the section also refers to "negotiate[d] mutually satisfactory rates," it cannot seriously be maintained that any supplier believed that a price it stated in excess of the soft cap was "acceptable" to the ISO.[20]

The ISO's reliance on the "soft cap" breakpoint is not a post-hoc rationalization. This characterization is supported by the recollection of Ms. Ean O'Neill, who was closely involved in the process of procuring energy pursuant to the DOE Orders. *See* O'Neill Decl. at ¶ 11. Finally, it must be emphasized once again, there was no need for ISO personnel to repeatedly recite the fact that the soft cap was in place when all knew that to be the case. Instead, they focused their time and energy on doing what then was important: keeping the lights on and maintaining reliability.

Even in the abstract, it is not logical to conclude that the soft cap methodology did not apply to DOE sales. If this were the case, suppliers would have had no incentive to bid into the ISO's markets, as they could have skirted the breakpoint methodology by simply characterizing every transaction entered into during this period as a "202(c) transaction." However, only a few suppliers representing a relatively small

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[20] Moreover, the language of section 202(c) and the CFR section both assume that negotiations would be taking place between the real parties in interest. Everyone knows this is not the case in the ISO's markets.

amount of the energy transacted with the ISO during this period explicitly invoked 202(c). What this suggests is that suppliers, as well as the ISO, knew that prices charged over the breakpoint would be subject to cost justification and review by the Commission.

Therefore, because the ISO did not agree, under section 202(c), to the prices being demanded by suppliers for sales made pursuant to the DOE Orders, and because it is illogical to conclude that such transactions were not subject to Commission review, the Commission should reverse its determination in the December 19 Order that the ISO agreed to the rates for sales made pursuant to the DOE Orders.

D. The Commission Should Allow A Schedule That Facilitates ISO Development Of A Robust Market Redesign Proposal And Transition From The Current Price Mitigation Plan To Market Features Necessary To Ensure Market Power Mitigation.

The December 19 Order denied all requests for rehearing of the September 30, 2002, termination date for the price mitigation measures, as established in the June 19 Order. The Commission explained:

> "[t]hat if there is not a sufficient Commission-approved superseding mitigation plan in place after September 30, 2002, all sellers into the ISO market will need to undergo review of their market based rate authority based on the Supply Margin Assessment screen or such other Commission approved market power analysis in place at that time." December 19 Order, slip op. at 61.

The Commission also directed the ISO to file a comprehensive congestion management redesign proposal, and a plan for creation of a day-ahead energy market, by May 1, 2002. Thus, the ISO is to develop and file at the Commission a comprehensive market redesign proposal that: 1) reforms the ISO's congestion management protocols; 2) provides for the creation of a day-ahead energy

market in California; and 3) ensures that a “sufficient” Commission-approved price mitigation plan is in place by September 30, 2002.

The ISO supports those objectives but is concerned, however, about its ability to implement fully effective market power mitigation elements, consistent with its proposed redesign of congestion management and a forward energy market, by the September 30, 2002 expiration of the Commission’s existing market mitigation provisions. At this point, the ISO believes that effective price mitigation measures can only come in two forms: 1) price mitigation measures or mechanisms established as part of the ISO’s redesign proposal; or 2) extension of the Commission’s established price mitigation measures.

Unfortunately, the ISO is unsure whether all of the price mitigation measures developed as part of its market redesign proposal can be effectively implemented by September 30, 2002. For example, in order to prevent physical withholding from the market in the future, the ISO is developing measures to replace the must-offer obligation. Specifically, the ISO is examining the possibility of establishing a capacity reserve obligation on load-serving entities (“LSEs”) in California that would ensure that sufficient capacity is available to serve forecasted load, meet reserve requirements, and provide a margin to ensure competitive behavior in California markets. While such measures are in use in other markets around the country, this would be a new feature in the California market. The ISO is concerned that it cannot fairly apply such a requirement to LSEs effective September 30, 2002, without inappropriately

disadvantaging them in their negotiations with suppliers necessary to satisfy the requirement.

In addition, while the ISO recognizes that it could possibly develop and implement alternative measures to ensure that adequate capacity is made available in the market, the ISO believes that such measures would place the ISO in a position of having to procure such capacity itself – a position that the ISO believes would inappropriately expand its mission by placing the obligation to serve and ensure adequate capacity in the Control Area on the ISO, as opposed to LSEs, where it properly belongs.

Therefore, the ISO requests that the Commission remain flexible as to the possible extension of the September 30, 2002 termination of the price mitigation measures currently in effect. The ISO will, at a minimum, provide regular update the Commission as to the current status of redesign efforts and the potential ramifications of the expiration of the Commission's price mitigation measures as part of its March 26, 2002 report to the Commission.[21]

Finally, the ISO notes its concern that the Commission has established a schedule for the ISO that will not allow the ISO to successfully meet either its

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[21] The ISO believes that adequate provisions are already in place to inform the Commission about the current status of the California markets and the need for mitigation. In particular, in the June 19 Order the Commission required that:

> "…the ISO file a report on market conditions by March 26, 2002 that addresses among other things: a list of all new generating resources that the State of California has announced would be on line by Summer 2002 and which of those facilities are on line; and the continued progress in executing long-term contracts and reducing reliance on the spot market."

In addition, the Commission noted the ongoing requirement that the ISO file quarterly reports, beginning on September 14, 2001, analyzing how the mitigation plan is operating and the progress that has been made in developing new generation and demand response.

market redesign or market power mitigation objectives. Specifically, the Commission has established a schedule for the redesign of the California market that is not in sequence with the Commission's own rulemaking on the creation of a Standard Market Design. As the Commission is aware, it has established a procedural schedule that provides for the issuance of a Notice of Proposed Rulemaking in March, 2002 and the release of a Final Rule in July, 2002. Thus, at the same time that the ISO will be developing its own redesign proposal (January through May), the Commission will be conducting a rulemaking proceeding whose outcome could materially impact the ISO's redesign proposal.

The ISO is will not be able to file its redesign proposal by May 1, 2002, and incorporate direction from the Commission, as is scheduled to be set forth in the Commission's Final Rule on the Standard Market Design, proposed to be issued in July, 2002. More importantly, the ISO may be unable to ensure that the price mitigation measures proposed as part of its redesign package are sufficient to satisfy the Commission's standards – standards that will presumably be established as part of the rulemaking process.

Therefore, the ISO requests the Commission to reconsider the timing requirement to file a market redesign to take into account the Commission's own activities in this regard.

E. The ISO Tariff Does Not Provide For Payments Of Interest On Past Due Accounts

The December 19 Order, slip op. at 82, in denying requests by generators to increase the level of creditworthiness adder, states that "[g]iven the fact that generators will earn interest on amounts eventually paid, we believe that 10 percent is

reasonable for the risk of certain amounts ultimately not being repaid at all." While this statement may be correct for the period from October 2, 2000, through June 20, 2001, due to the Commission's requirement in the July 25 Order that interest be paid both for refunds and amounts past due.[22] It is incorrect when applied to the period from June 21, 2001 forward because the ISO Tariff does not provide for payment of interest to Market Participants owed past due amounts. Specifically, the Settlement and Billing Protocol, a part of the ISO Tariff, provides:

> Section 6.5.2 Other Funds in the ISO Surplus Account
>
> (a) Any amounts paid to the ISO in respect of acts or defaults giving rise to default interest referred to in SAABP 6.10.5 or penalties referred to in SABP 3.1.1 shall be credited to the Surplus Account.
>
> (b) The funds referred to in SABP 6.5.2(a) shall first be applied towards any expenses, loss or costs incurred by the ISO. Any excess will be credited to the Surplus Account pursuant to SABP 6.5.2(a).

On December 28, 2001, the ISO filed, in Docket No.ER02-657-000, Amendment No. 41 to the ISO Tariff, which proposed to modify the ISO Tariff in a number of respects, including changes in the use of interest received by the ISO on payments in default to permit the use of such interest to pay unpaid creditors first and secondly to offset the Grid Management Charge ("GMC"). The specific proposed revised text is as follows, with the proposed revisions in bold:

> Section 6.5.2 Other Funds **Used** in the ISO Surplus Account
>
> (a) Any amounts paid to the ISO in respect of acts or defaults giving rise to default interest referred to in SAABP 6.10.5 or penalties referred to in SABP 3.1.1 shall be credited to the Surplus Account.
>
> (b) The funds referred to in SABP 6.5.2(a) **pertaining to Penalties as provided in SABP 3.1.1** shall first be applied

[22] 96 FERC ¶61,120 at 61, 519.

towards any expenses, loss or costs incurred by the ISO. Any excess will be credited to the Surplus Account pursuant to SABP 6.5.2(a).

(c) **The funds referred to in SABP 6.5.2(a) pertaining to default interest referred to in SABP 6.10.5 shall first be applied towards any unpaid creditor balances for the trade month in which the default interest was assessed and second to any other unpaid creditor balances. Only after all unpaid creditor balances are satisfied in full will any excess funds pertaining to default interest be credited to the Surplus Account pursuant to SABP 6.5.2(a).**

Thus neither the current nor proposed revised Tariff provide for the payment of default interest to creditors as an additional amount beyond the underlying amount owed. Instead, in Amendment No. 41, the ISO has proposed to use default interest to help assure more unpaid debts are paid.

Therefore, because the ISO Tariff does not so provide, and the Commission did not intend, that default interest be paid to generators as additional compensation for past unpaid bills, the ISO asks the Commission to amend that statement to indicate that it applies only to the period October 2, 2000 through June 20, 2001 as directed in the Commission's July 25, Order.

IV. CONCLUSION

Wherefore, for the reasons discussed above, the ISO respectfully requests that the Commission revoke or otherwise revise the December 19 Order as requested above.

Respectfully submitted,

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Dated: January 18, 2002

THE UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, Complainant,	)	
v.	)	**Docket No. EL00-95-045**
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 California Power Exchange	)	**Docket No. EL00-98-042**

DECLARATION OF EAN O'NEILL

1. My name is Ean O'Neill, and I am currently employed by the California Independent System Operator ("ISO") as the Federal Legislative Coordinator. At the beginning of these proceedings, and during the time period relevant to this declaration, my position was Dispatch Support for Operations Support & Training. In that capacity, I was a member of the ISO Emergency Response Team and involved in the implementation of the DOE Order. My time was spent in the ISO Control Room throughout each operating day. As such, I am familiar with the activities in the ISO Control Room leading up to and continuing on throughout the DOE Order, especially as those activities involved the procurement of Out-of-Market ("OOM") energy from entities outside of the ISO's Control Area.

2. On December 14, 2000, then-Secretary of Energy William Richardson issued an order pursuant to section 202(c) of the Federal Power Act, finding that an emergency existed in California because of a shortage of electric energy, and requiring certain entities to make excess energy available to the ISO. This order, along with subsequent amendments, continued in effect until January 11, 2001. On January 11, 2001, Secretary of Energy Spencer Abraham issued a similar order pursuant to section 202(c), which also found that an emergency existed in California because of a shortage of electric energy and required certain entities to make excess energy available to the ISO. This order, as amended, continued in effect until February 7, 2001. Both of these orders ("DOE Orders") required that the ISO file a certification with the Department of Energy that it had been "unable to acquire in the market adequate supplies of energy to meet system demand" prior to invoking the terms of the DOE Orders.

3. The ISO filed its first certification with the Department of Energy certifying that it had been "unable to acquire in the market adequate supplies of energy to meet system demand" on December 20, 2000. Subsequently, the ISO filed 33 such certifications, with the last filed on February 6, 2001.

4. During the period in which the DOE Orders were in effect, approximately 12,000 MWs of load was being underscheduled each operation day. To put this number in perspective, total load in the ISO's Control Area was generally about

30,000 MW. Thus, the ISO was forced to ensure that a significant percentage of the total load in its Control Area was met using real time mechanisms. However, because of the lack of bids into the ISO's Real Time Market, ISO real time operations personnel had to make up significant energy shortfalls in real time, as high as 5,000 MW during this period, with OOM energy obtained from entities outside of the ISO's Control Area, a portion of which the ISO sometimes obtained pursuant to the DOE Order. These shortfalls occurred not just one hour of each day, but during most hours of the day.

5. The ISO encouraged entities to bid energy into the market during this time period. The ISO also made OOM calls to generators with Participating Generator Agreements pursuant to the emergency dispatch authority contained in its Tariff. However, if these mechanisms were not sufficient to meet outstanding load, then the ISO, in real time was forced to procure OOM energy from entities outside of its Control Area as a last resort prior to imposing rolling blackouts. In procuring that energy, it was sometimes necessary for the ISO to call on the energy that certain entities, pursuant to the DOE Order, indicated would be available.

6. ISO real time operations personnel also had to deal with ever-changing conditions in each hour of the operating days during this period including, but not limited to:

- Unexpected loss of generation
- Unexpected increases in load

- Congestion constraints (especially on Path 15)
- Previously negotiated OOM transactions pulled by the supplier at the last minute
- Air quality and environmental issues

7. ISO real time operations personnel did not know how many MWs the ISO Control Area would be short for the upcoming hour until the markets closed, approximately 20 minutes after the current hour. At that time the following information would be known: 1) the number of MWs available in the ISO's Real Time Market (the "BEEP stack") and 2) the number of additional MWs the ISO had to make up through OOM transactions in order to serve its load and maintain an adequate amount of operating reserve as mandated by the WSCC.

8. Once the energy shortage was determined, ISO real time operations personnel, usually consisting of two operators, had approximately half an hour (30 minutes) to contact suppliers and arrange for the necessary energy through OOM transactions. These operators would make up to 20 telephone calls to a list of suppliers (approximately 10) in the 30-minute timeframe. This situation became the norm during this period.

9. Because of the large quantities of energy that had to be made up in real time during most hours of each operating day, and the short time available in which to contact potential suppliers, ISO real time operations personnel were

under tremendous pressure to procure any and all available OOM energy as quickly as possible. They were also aware that the results of their efforts were absolutely critical if the ISO was to avoid blacking out California consumers and maintain the reliability of the ISO Controlled Grid.

10. During the period of the DOE Order, ISO real time operations personnel were only concerned with the quantity of energy needed to keep the lights on, not the price that suppliers were demanding. This was because the ISO needed sufficient quantities of energy above anything else, and real time operations personnel did not have adequate time to negotiate prices with suppliers of OOM energy.

11. Additionally, ISO real time operations personnel were instructed by management not to negotiate price with the belief that the just and reasonable rate referred to in the DOE Order was the price cap in place at that time and any amount over that price would have to be justified to the Federal Energy Regulatory Commission ("Commission") by those suppliers. It was understood by the real time operations personnel that their main focus was to keep the lights on in California, and that prices for DOE sales above the price cap would be sorted out after the fact.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on January 17, 2002.

_____

Ean O'Neill

CALIFORNIA ISO

California Independent
System Operator

January 18, 2002

The Honorable Linwood A. Watson, Jr.
Acting Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange
Docket Nos. EL00-95-000, et al., etc.

Dear Secretary Watson:

Enclosed for electronic filing please find the California Independent System Operator Corporation's Motion for Clarification and Request for Rehearing of the Order on Clarification and Rehearing in the above-referenced dockets.

Thank you for your assistance in this matter.

Respectfully submitted,

Margaret A. Rostker
Counsel for The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned dockets.

Dated at Folsom, California, on this 18th day of January, 2002.

_____

Margaret A. Rostker
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