UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Williams Energy Marketing &	**)**	
Trading Company	**)**	**Docket No. ER99-1722-004**

MOTION TO INTERVENE AND PROTEST OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rules 211 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211 and 214, and the Commission's March 15, 2001, Notice, the California Independent System Operator Corporation ("ISO"),[1] hereby moves to intervene and protest in the above-entitled proceedings. These proceedings concern the compliance of Williams Energy Marketing & Trading Company ("Williams") with the Commission's requirement that it provide an update of the market power analysis supporting its market-based rate authority every three years. As discussed below, there is overwhelming evidence that Williams has exercised market power and collected rates well in excess of those that are just and reasonable. Williams' continued ability to due so can only exacerbate conditions in California markets. Williams has failed to supply the updated market analysis on which the Commission conditioned its earlier grants of market-based rate authority to Williams, despite the clear changes in market conditions. In light of Williams' noncompliance with the Commission's clear mandate, the ISO submits that the Commission should terminate summarily Williams' market-based rate authority in California or, if it is not prepared to do so, set the matter for hearing and limit Williams' to cost-based rates in the interim.

[1] Capitalized terms, not otherwise defined, are used with the meanings given in the Master Definitions Supplment, Appendix A to the ISO Tariff.

I. MOTION TO INTERVENE

The ISO is a non-profit public benefit corporation organized and existing under the laws of the State of California, and authorized to do business therein. The ISO operates a grid comprising the transmission systems of Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas and Electric Company. The ISO is responsible for maintaining the reliability of electric transmission scheduled into and through the ISO Control Area. To support reliability, the ISO is also responsible for procurement of Ancillary Services, to the extent that they are not self-provided, at least cost.

In the above-entitled docket, Williams seeks to extend its market-based rate authorization for sales in California of Energy and Ancillary Services. The ISO currently operates the principal markets for Ancillary Services and Imbalance Energy in California. The ISO has a direct and substantial interest in this proceeding because of the ISO's responsibility for maintaining the reliability of the ISO Control Area in accordance with Western Systems Coordinating Council and North American Electric Reliability Council standards. For these reasons, the ISO's participation is in the public interest. Moreover, the ISO's interests cannot be adequately represented by any other party. Accordingly, the ISO respectfully requests that it be permitted to intervene herein with full rights of a party.

II. COMMUNICATIONS

Please address communications concerning this filing to the following persons:

Charles F. Robinson
Vice President and General Counsel
Roger E. Smith, Regulatory Counsel
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: 916-351-4400
Fax: 916-351-2350

Edward Berlin
Kenneth G. Jaffe
Michael E. Ward
Swidler Berlin Shereff Friedman, LLP
3000 K St., NW #300
Washington, DC 20007
Tel: 202-424-7588
Fax: 202-424-7645

III. PROTEST

A. Background

In March 1998, three subsidiaries of AES Corporation submitted market-based rate applications for Energy sales for Generating Units at three plants in Southern California: AES Huntington Beach, AES Alamitos, and AES Redondo Beach. The filing was supported by a Generation market dominance analysis that evaluated the Units' share of uncommitted capacity in the relevant geographic market. On April 30, 1998, the Commission granted the market-based rate authority with respect to these Units. *AES Huntington Beach, et al.*, 83 FERC ¶ 61,100 (1998).

In May 1998, AES sought market-based rate authority for the sale of Ancillary Services from these Units, relying upon a Generation market

dominance analysis that evaluated the Units' share of total uncommitted Ancillary Services capacity. The ISO argued to the Commission that such an analysis was inadequate in light of the hourly nature of the ISO's markets, and that a time-differentiated analysis was appropriate. Rather than recommending rejection of the market-based rate authority, the ISO suggested that the Commission grant the authority subject to a rate cap. On June 10, 1998, the Commission granted the requested authority, finding a time-differentiated study unnecessary and a rate cap undesirable. The Commission promised to revisit the need for a time-differentiated analysis if the ISO's market monitoring indicated that such a reexamination was necessary. *AES Redondo Beach, L.L.C., et al.*, 83 FERC 61, 358 (1998).[2]

Soon after Generators began to exercise their newly granted market-based rate authority, the ISO experienced dramatic spikes in the prices for replacement reserves. Between July 9, 1998, and July 13, 1998, for Replacement Reserves of $5,000/MW and even $9,999/MW resulted in millions of dollars in customer costs, even though other sellers, such as the investor-owned utilities, were still limited to cost-based rates. In response to this emergency, the ISO filed for authorization to impose price caps.

In late May, 1998, Williams filed notice of a change of facts regarding its existing market-based rate authority, seeking to extend that authority to the sales of Energy and Ancillary Services for the AES Units, from which Williams had

[2] The Commission also concluded that Replacement Reserves were not Ancillary Services, and that entities with market-based rate authority for Energy could therefore sell Replacement Reserves at market rates. Subsequently, the Commission granted market-based rate authority to additional applicants. *El Segundo Power, LLC et al.*, 84 FERC ¶ 61,011 (1998); *Ocean Vista Power Generation, LLC et al.*, 84 FERC ¶ 61,013 (1998).

obtained the right to market and dispatch the Energy and capacity. Williams supported its request with two market power studies by J. Stephen Henderson (the "1998 Market Power Analysis"), which paralleled the studies submitted by AES. In light of the price spikes that had followed the Commission's previous grants of market-based rate authority for Ancillary Services, the ISO protested, requesting that the Commission require a time-differentiated market analysis or, in the alternative, allow the ISO to impose a price cap.

Subsequent to the ISO's protest, the Commission authorized the ISO to impose price caps on Ancillary Services. *California Independent System Operator Corporation*, 84 FERC ¶ 61,046 (1998). On July 24, 1998, the Commission granted Williams' requested market-based rate authority. It rejected the ISO's request for a time-differentiated study, noting that the ISO had been granted its alternative requested relief – price cap authority. *Williams Energy Services Company*, 84 FERC ¶ 61,072 (1998).

The current proceeding concerns Williams' most recent "update" of its market power analysis in support of its continued market-based rate authority. With regard to the AES units, Williams merely states, "[B]ecause the Commission has recently granted [Williams] market-based rate authority to make these sales, which remain subject to Commission review, there are no market power concerns with respect to [Williams'] sales from these units." (Footnotes omitted.)

B. Williams Has Failed to Comply with the Commission's Requirement for an Updated Market Power Analysis

In recognition that markets are not static, and showing that a seller lacks market power cannot be presumed valid despite the passage of time, the Commission requires sellers to whom it grants market-based rate authority to file updated market power analyses every three years. *See, e.g., Entergy Services, Inc.*, 58 FERC ¶ 61,234 (1992). Although the Commission applied this requirement to Williams, Williams provides *no* analysis whatsoever with regard to the California markets. That failure, in itself, means that Williams has failed to comply with the most basic requirement of the Commission's 1998 orders. This omission alone is a sufficient basis from which to conclude that Williams has failed to comply with the Commissions orders.

Williams' failure is even the more egregious, however, because fundamental facts upon which its 1998 Market Power Analysis relied are no longer valid. Williams' 1998 Market Power Analysis presumed that all capacity available to California's investor-owned utilities is uncommitted because California law required it to be sold through the California Power Exchange. Not only is the California Power Exchange no longer operating, but the Commission has ordered that the investor-owned utilities be permitted to use all capacity available to them to serve native load. *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, 93 FERC ¶ 61,294 (2000) ("December 15th Order"). As the 1998 Market Power Analysis recognizes, resources dedicated to native load must be considered committed.

The Demand data from Williams 1998 study are also significantly outdated. These data were derived from the 106th Edition of Electric World's Directory of Electric Power producers, which used data from fiscal years 1995 and 1996. The 1998 analysis upon which Williams continues to rely also presumes that the ISO's Southern Zone, SP15, is the smallest relevant geographic market because congestion costs are uniform throughout the Zone. The Southern Zone, however, has since been divided into two Zones, ZP26 and SP15.

In light of these events, the need for an updated analysis is overwhelming. The Commission should not tolerate or excuse Williams' noncompliance with its orders and, on this basis alone, should terminate Williams's market-based rate authority or, at the very least, set the matter for hearing.

C. The Commission Should Revise Its Methodology for Evaluating Market Power in California Markets for the Purposes of Market-Based Rate Authority

As described above, in 1998, in response to the ISO's request that the Commission require time-differentiated market-power analyses in connection with the grant of market-based rate authority for Ancillary Services, the Commission stated that it could "revisit the issue at any time that the ISO's market monitoring identifies concerns that require the Commission's attention."

83 FERC at 62,449. The ISO submits that events since 1998 forcefully demonstrate the need for the Commission to require time-differentiated, in depth, market-power analysis as a condition precedent for sellers' continued market-based rate authority for either Energy or Ancillary Services in California markets.

One significant intervening event is the termination of the ISO's price cap authority. As described above, in denying the ISO's request that the Commission require Williams to submit a time-differentiated market power analysis in support of its market-based rates for Ancillary Service, the Commission pointed to the ISO price cap authority. The Commission, however, has refused to extend that authority. *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.*, 93 FERC ¶ 61,121 (2000). That fact, in itself, is sufficient to justify revisiting the issue of a need for time-differentiated studies.

Even more important, however, is a recognition that the Commission's traditional benchmark for the ability to exercise market power – 20 percent of uncommitted generating capacity, *see, e.g., Louisiana Energy and Power Authority v. FERC*, 141 F.3d 364 (D.C. Cir. 1998) – has proven not an effective gauge of Williams' ability to exercise market power in California markets. Reliance on a "generation dominance" standard that does not assess the underlying competitiveness of properly defined electricity markets, simply fails to detect significant opportunities to exercise market power. A market share

threshold, such as 20 percent, can represent very low market power in an hour with a great amount of surplus Generation; when, however, the level of Demand has risen to approach available Generation, a supplier with a 20 percent market share can be pivotal in setting the price because its supply is needed to meet system load and reserve requirements.

The determinative relevant issue must be whether a Generator controls sufficient generating capacity in the relevant markets to increase prices significantly over a substantial period of time. Under current market conditions in California, a Generator's share of total uncommitted capacity is not determinative of that issue. More significant is a comparison of the Generator's available generating capacity with the difference between the ISO's total requirements (Demand plus reserves) and the total resources available to the ISO in particular time periods. For example, in an hour when there are 40,000 MW of total available capacity, and the ISO's total requirements are 38,000 MW, a Generator controlling 3,000 MW can affect prices by withholding capacity, even if that 3,000 MW represents only 15 percent of uncommitted capacity. The Generator can effect that result by physically withholding the capacity or, more subtly, by bidding the capacity at prices well above the clearing price.

The ISO's Department of Market Analysis ("DMA") has identified compelling evidence of the exercise of such market power by Williams in a significant number of hours. Attachment A is an analysis of Williams' market behavior prepared by the ISO's DMA and not previously provided to the Commission. This analysis contains information that may be confidential under

the ISO Tariff. The ISO therefore requests that the Commission treat this analysis as confidential and not release it except to Williams. The analysis shows that Williams has engaged in and profited from the exercise of market power since at least May 2000. DMA calculated that Williams earned nearly $8 million in excess profits between May 2000 and November 2000, exclusive of excess profits in the California Power Exchange markets. Indeed, the DMA was not able to identify any hours during the period from May 2000 through November 2000 in which Williams did not engage in physical or economic withholding. The DMA also determined that, subsequent to the termination of the ISO's price cap authority, Williams exercise of market power was even more profitable. The DMA estimates Williams' real-time market revenues for the months of December 2000 through March 2001 were almost twice (173%) its estimated operating costs, resulting in excess profits of approximately $114 million.

The data analyzed in the DMA study shows that Williams is in a position to exercise market power, under established Commission criteria. In the context of pipeline regulation, the Commission has stated, "if a company can sustain an increase in its rates of 10 percent or more without losing significant market share, the company is in a position to exercise market power to the determent of the public interest." *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076 at 61,232 (January 31, 1996). Under such a standard, Williams has certainly exercised market power. Further, the Commission has itself identified evidence of instances in which Williams has

been a party to the exercise of locational market power. In its Order to Show Cause in Docket No. IN01-3-00, the Commission found evidence that Williams had manipulated outages in order to circumvent the mitigation by the ISO's RMR Contracts of the locational market power of the AES Units. The Commission indicated that this evidence raised questions regarding Williams' compliance with

the terms of its market-based rate authority. *AES Southland, Inc., et al.*, 94 FERC ¶ 61,248 (2001).

The data concerning Williams are consistent with evidence previously submitted to the Commission that showed that there have been a significant number of hours in which Generators that have been granted market-based rate authority under the Commission's standards, even prior to the termination of the ISO's price cap authority and the December 15th Order authorizing and directing the investor-owned utilities to devote their resources to native Load, have exercised market power.[3] The ISO is including that evidence with this Protest. Attachment B is a study prepared by Dr. Eric Hildebrandt, entitled *Further Analyses of the Exercise and Cost Impacts of Market Power in California's Wholesale Energy Market* that has been provided to the Commission in Docket No. EL01-10. Using a "system price cost markup" methodology which compares energy prices to the variable cost of the marginal unit in the market in each hour

[3] The Commission has already implicitly found the exercise of market power by Generators, including Williams, in hours of peak imbalances between resources and Demand. *See 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 ¶ 61,245 (2001). The ISO's evidence, however, goes well beyond that evidence.

to meet demand,[4] Dr. Hildebrandt demonstrates that 30 percent of the wholesale energy prices over the last year can be attributed to the exercise of market power (*i.e.*, that wholesale energy costs were about 30 percent higher than they would have been in the absence of market power). His analyses show, moreover, that prices exceed the competitive market benchmark in all hours under a variety of system conditions.

Provided as Attachment C is an analysis recently completed by Dr. Anjali Sheffrin, entitled *Empirical Evidence of Strategic Bidding in California ISO Real Time Market,* that examines the bidding behavior in the ISO's Real Time Market of five large in-state non-IOU suppliers and 16 importers and was also submitted to the Commission in Docket No. EL01-10. Dr. Sheffrin examined two types of bidding strategies exhibited by suppliers: (1) economic withholding – bidding substantially above their units marginal costs and (2) physical withholding – not bidding or scheduling available resources in the market. The study found that withholding, especially economic withholding, plagued the market for most hours from May to November 2000.[5] The study provides direct evidence that many large suppliers actively have engaged in strategic bidding efforts that are consistent with oligopoly pricing behavior, with a direct and substantial impact on market prices.

Dr. Sheffrin's study concludes that, from the period of May to November 2000, as a direct consequence of the exercise of market power, large suppliers

[4] As such, this methodology represents the price that would have occurred under workably competitive conditions. It attempts to account for variations in gas prices, costs of emission credits, and even appropriate scarcity rents.

[5] Of the 25,000 hourly biding profiles studied, less than 2% displayed the absence of a clear pattern of withholding.

earned excess profits of more than $500 million over competitive price benchmarks in the ISO's real-time energy market. The overall impact (i.e., including smaller suppliers) of the exercise of market power on the ISO's Real Time Market during the same period is estimated at $1.19 billion. This study represents substantial evidence that individual suppliers successfully inflated market prices in the California ISO Real Time Market. This represents, however, only 10% of the total market costs incurred. To gain a more complete understanding of the prejudice that has been imposed on California ratepayers and on the California economy, it would be necessary to apply this methodology to transactions in the PX markets.

This evidence presented by the ISO and identified by the Commission establishes overwhelmingly that Williams and other Generators serving California markets, each of whom has survived a traditional generation market power analysis (albeit, using data as much as three years out of date), have exercised extensive market power. It further demonstrates that the traditional analysis obscures the fact that current California market conditions permit sellers to exercise market power in a substantial number of hours and thereby command an unduly high premium, and significantly and adversely influence the clearing price for a service. As Commissioner Massey recently commented about the traditional "hub-and spoke" analysis:

> This is a back of the envelope approach more or less. It takes little or no account of the important factors that determine the scope of electricity markets, such as physical constraints, prices, costs, transmission rates, and variance of supply and demand over time.

Sithe Edgar, L.L.C., et al., 93 FERC ¶ 61,193 at 61,637 (2000).

Under such circumstances, even if Williams had submitted an updated Generation market dominance analysis meeting the Commission's traditoinal standards, the Commission could not reasonably extend Williams' market-based rate authority of Williams. The Commission has a statutory responsibility to protect consumers. *Pennsylvania Water & Power Co. v. FPC,* 343 U.S. 414 at 418 (1952)("A major purpose of the whole Act is to protect power consumers against excessive prices."); *see also, Atlantic Refining Co. v. Public Service Comm'n of N.Y.*, 360 U.S. 378 at 388 (1959); *Northeast Utilities Service Co. (Re: Public Service Co. of N.H.)*, 66 FERC ¶ 61,332 at 62,081-82, *reh'g denied,* 68 FERC ¶ 61,041 (1994). As the U.S. Court of Appeals for the District of Columbia Circuit held in rejecting an attempt by the Commission to depart from the cost standard in its regulation of oil pipelines under the Interstate Commerce Act, "Departures from cost-based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods *ensure* that the resulting rate levels are justified by those factors." *Farmers Union Cent. Exch., Inc. v. FERC,* 734 F.2d 1486, 1530 (D.C. Cir.), *cert. denied sub nom., Williams Pipe Line Co. v. Farmers Union Cent. Exch., Inc.,* 469 U.S. 1034 (1984) (emphasis added). Market-based rates can satisfy the statutory standard "when there is a competitive market," i.e., where FERC has "specifically found that [the relevant] markets are sufficiently competitive to preclude [a jurisdictional seller] from exercising significant market power in its merchant function." *Elizabethtown Gas Co. v. FERC,* 10 F.3d 866, 870-71 (D.C.

Cir. 1993) (citations omitted). In those circumstances, "competition in [the] relevant markets will operate as a meaningful constraint" on sellers' prices. *Buckeye Pipe Line Co.,* 44 FERC ¶ 61,066 at 61,186 (1988). It is thus incumbent upon the Commission to reexamine and revise its standards for granting market-based rate authority, and to require Williams to justify continuation of its market-based rate authority under the revised standards.[6]

D. Even Under a Traditional Market Power Analysis, Williams' Update Must Be Rejected

As discussed above, Williams' failure to provide an updated generation dominance analysis for California is inexcusable in light of the dramatic changes in the structure of the California electricity market that have occurred since the completion of the earlier analysis. Had Williams updated its 1998 analysis in compliance with the Commission's orders, however, Williams would have been unable, even under the Commission's established methodologies for evaluating market power, to justify continued market-based rate authority in the California markets.

Exhibit No. 4 (JSH-4) to Williams 1998 Market Power Analysis was a "hub-and-spoke" generation market analysis. It identified 44,653 MW of uncommitted capacity in the Southern California Edison service territory or available through first tier interconnections. The analysis assumes that all capacity available to California's investor-owned utilities is uncommitted. As noted above, however, under the Commission's December 15th Order, that capacity can be used to serve native load. Capacity used to serve native load must, as Williams' 1998 analysis concedes, be considered committed. Thus, the total uncommitted capacity under an updated analysis is only a fraction of that

[6] An alternative method for evaluating going-forward market power would be a Residual Supply Index, such as that suggested in the DMA's Annual Report on Market Issues and Performance, June 1999, which was previously provided to the Commission.

included in Williams' 1998 analysis. In addition, Williams' 1998 analysis used Demand data from the 106th Edition of Electric World's Directory of Electric Power producers. These data were from fiscal years 1995 and 1996, and are significantly outdated.

As shown in Attachment D, updating the data to for those resources that were shown as uncommitted capacity in Williams 1998 analysis, which are now committed to serve utilities' native load, and correcting the Demand data for Los Angeles yields a total uncommitted capacity of [19,824 MW] in the first tier analysis. Williams' capacity of 3,956 MW constitutes 20.5% percent of that uncommitted capacity, which exceeds the Commission's threshold, requiring further analyses to assess the Generator's ability to exercise market power.

Recognizing the potential transmission constraints in the ISO Control Area, Williams' 1998 Market Power Analysis also included in Exh. 5 (JSH-5) an examination of generation in the ISO's Southern Zone ("SP15," south of Path 15). The analysis argued that this was the smallest geographic market because congestion costs would be uniform throughout that area. Subsequently, however, the ISO has specified a new Zone, ZP26, that comprises certain areas (and Generators) formerly within SP15. If this change and the commitment of Southern California Edison's and San Diego Gas & Electric Company's capacity to its native load are taken into account, Williams share of uncommitted capacity is approximately 36 percent.

Such an analysis could be seen as overstating Williams' market share, however, in that it fails to take into account any import capability. As shown in Attachment E, the DMA has modified that analysis to take into account import capability. This analysis yields [19,214 MW] of uncommitted capacity and a Williams market share of [20.6%]. Under this alternative analysis, Williams market share remains in excess of the Commission's threshold for the existence of market power. Moreover, this analysis is based on the full available

transmission capability of the major transmission paths connected to SP15. The *actual* average scheduled imports on these paths during the peak hours of summer 2000 is much less. When one calculates market shares using these average flows, Williams' market share is 27.7 percent. This is significantly in excess of the 20 percent threshold.

Even if the Commission does not share the ISO's belief that these updates to Williams's 1998 Market Power Analyses demonstrates Williams' ability to exercise market power, it must at least find that Generation market share levels above the traditional "safe harbor" levels demonstrates a need for further investigation, especially in light of Williams' failure to submit an updated analysis and the other studies and evidence discussed above. The Commission should therefore terminate Williams market-based wholesale rate authority until Williams establishes, through a fully-supported analysis, that it lacks market power. At the very least, the Commission should set this matter for hearing to determine whether Williams' market-based rate authority should be restored. Should the Commission set the matter for hearing, it also should, in light of this evidence, and Williams failure to submit *any* analysis to support market-based rate authority, limit Williams to cost-based wholesale rates in the interim.

CONCLUSION

WHEREFORE, the ISO respectfully requests that the Commission terminate Williams's market-based wholesale rate authority for sales of Energy and Ancillary Services in California pending Williams submission of a fully supported analysis demonstrating that it lacks market power. In the alternative, the Commission should set the matter for hearing and limit Williams to cost-based wholesale rates in the interim.

Respectfully submitted,

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Charles F. Robinson
Vice President and General Counsel
Roger E. Smith, Regulatory Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: 916-351-4400
Fax: 916-351-2350

Edward Berlin
Kenneth G. Jaffe
Michael E. Ward
Swidler Berlin Shereff Friedman, LLP
3000 K St., NW Suite 300
Washington, D.C. 20007
Tel: 202-424-7588
Fax: 202-424-7645

Date: April 2, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the forgoing document upon each person designated on the official service list compiled by the Secretary in this Docket No. ER99-1722-004 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.2010 (1997).

Dated at Washington, D.C. on this 2nd day of April, 2001.

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Michael E. Ward