UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket No. ER02-1656-000**
Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council	)	**Docket No. EL01-68-017**

MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO COMMENTS AND PROTESTS

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. §§ 385.212 and 385.213, the California Independent System Operator Corporation ("ISO")[1] hereby requests leave to file an answer, and files its answer, to the comments and protests filed by certain parties in response to the compliance filings submitted by the ISO in the captioned proceedings on August 16 and August 21, 2002 (respectively, the "August 16 Compliance Filing" and the "August 21 Compliance Filing," and, collectively, the "Compliance Filings").

In support hereof, the ISO respectfully states as follows:

I. MOTION FOR LEAVE TO FILE ANSWER

Rule 213(a)(2) of the Commission's Rules of Practice and Procedure provides that answers to protests generally are not allowed "unless otherwise

[1] Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, Appendix A to the ISO Tariff, as filed on August 15, 1997, and subsequently revised.

ordered by the decisional authority." In the past, the Commission has allowed the filing of answers to protests for various reasons demonstrating good cause. The Commission has found that good cause exists when an answer will facilitate the decisional process, help resolve complex issues, clarify the issues in dispute or a party's position on the issues, lead to a more accurate and complete record, or provide useful and relevant information that will assist in the decision-making process.[2]

The ISO submits that good cause exists to grant the ISO leave to respond to the various protests filed in these proceedings. The ISO's Answer will lead to a more accurate and complete record and will assist the Commission in understanding and resolving the issues in these proceedings. For these reasons, the ISO respectfully requests that the Commission accept the following Answer.

II. ANSWER

Procedural Background

The ISO submitted the Compliance Filings to comply with the Commission's July 17, 2002 "Order On the California Comprehensive Market Redesign Proposal," 100 FERC ¶ 61,060 (2002) ("July 17 Order"). In response to the Commission's August 21, August 27, and August 29, 2002 notices concerning the Compliance Filings, the following parties submitted comments or protests: the California Department of Water Resources State Water Project

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[2] *East Tennessee Natural Gas Company*, 79 FERC ¶ 61,124, at 61,569 (1997); *Great Lakes Gas Transmission, L.P.*, 66 FERC ¶ 61,115, at 61,194 (1994); *Tennessee Gas Pipeline Company*, 55 FERC ¶ 61,437, at 62,306 n.7 (1994); *Transwestern Pipeline Company*, 50 FERC ¶ 61,362, at 62,090 n.19 (1980); *Transwestern Pipeline Company*, 50 FERC ¶ 61,211, at 61,672 n.5 (1980).

("SWP"); California Electricity Oversight Board ("EOB"); Duke Energy North America, LLC and Duke Energy Trading and Marketing, L.L.C. (collectively, "Duke"); Dynegy Power Marketing, Inc., El Segundo Power, LLC, Long Beach Generation LLC, Cabrillo Power I LLC and Cabrillo Power II LLC (collectively, "Dynegy"); Independent Energy Producers Association ("IEP"); Powerex Corp. ("Powerex"); Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc. (collectively, "Reliant"); and Williams Energy Marketing & Trading Company ("Williams").

A. Ten-Percent Credit Adder

Among the measures adopted by the Commission in its June 19, 2001 order[3] in Docket Nos. EL00-95, *et al.* was the requirement that the ISO add a ten-percent credit risk adder to the market clearing price paid to Market Participants to reflect the then-current uncertainty of payment for prospective sales in ISO markets. This provision, adopted along with other extraordinary market power mitigation provisions, was designed to encourage generator participation in ISO Markets by providing a business risk premium for transactions in ISO Markets that were previously damaged by the bankruptcies of Pacific Gas and Electric Company and the California Power Exchange and the insolvency of Southern California Edison Company. Thus, by simultaneously seeking to stem megawatt laundering, physical capacity withholding and other forms of market power, the Commission also required the ten-percent credit risk adder to help shore-up and even increase the amount of electricity traded in ISO Markets. The total set of measures adopted in the June 19 Order was designed

[3] 95 FERC ¶ 61,418 (2001) ("June 19 Order").

to resolve the then serious crisis in California's electricity markets. As such, the ten-percent credit risk adder, along with the other mitigation measures adopted in the June 19 Order, is set to expire on September 30, 2002. In its July 17 Order, the Commission refused to continue beyond September 30 any market power mitigation provisions except the Must Offer Obligation and a west-wide bid cap. Accordingly, in its August 16 and 21 Compliance Filings, the ISO filed revised Tariff sheets reflecting the expiration of all the other provisions adopted in the June 19 Order, including the ten-percent credit risk adder.

A number of generators protested that the ten-percent credit risk adder should be continued because they are still owed for transactions in ISO markets and because, given that the authority to purchase power granted to the Department of Water Resources ("DWR") by state of California is scheduled to expire on January 1, 2003, the risk of not being paid in the future remains high.[4] In the alternative, the EOB agrees that the ten-percent credit risk adder expires on October 1, 2002.[5]

The generators' argument that there remain past-due debts in ISO markets is misleading. The Commission has stated "[t]he adder is not instituted to compensate generators for past unpaid bills" but to reflect credit uncertainty for 'prospective sales.'" June 19 Order at 62,564. The great majority of all such debts are due to the bankruptcies of the California Power Exchange and Pacific Gas and Electric Company ("PG&E"). Moreover, as the generators well know, they have filed claims for their debts with the relevant bankruptcy courts and thus

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[4] Williams Protest at 5-7, Dynegy Protest at 5, Reliant at 1, IEP Protest at 6-7.
[5] EOB Comments at 2-3.

these debts are on track for payment through the bankruptcy proceedings. Moreover, these debts still outstanding are not those that will be paid through funds that the ISO collects from Market Participants through its normal settlements and billing process. Thus, there is no relationship between upaid debts due to bankrupt entities and the ten-percent credit risk adder.

Some of the generators also argue that they are owed for transactions after January 17, 2001, the date upon which the state of California assumed financial responsibility for the net short energy positions of Southern California Edison Company and PG&E (collectively, the investor-owned utilities ("IOUs")). This argument also fails. Since DWR began paying for third-party transactions in the ISO on behalf of the IOUs, the vast majority of debts in ISO markets have been paid on time and in full. Indeed, most of the small amount of remaining unpaid debts in ISO markets are due to re-statements of transactions that occurred prior to January 17, 2001 that are directly related to obligations of the two bankrupt entities. Again, upon conclusion of the bankruptcy proceedings, all such debts will be addressed through the respective creditor committees. The ISO has no control over or responsibilities for these unpaid debts.

The ISO does have a very small amount of unpaid debts for several months in 2001, due to defaults by Market Participants who are not in bankruptcy. As these several Market Participants make payments on past due amounts or become creditors, allowing the ISO to offset against their prior debts, such past due unpaid debts will be settled.

More importantly, there are *no* past due debts in the ISO Markets for any

Trade Day or Trade Month after September 2001. Therefore, since that time, in accordance with the ISO Payment Calendar, there has been full payment for all transactions in ISO Markets. Finally, the ISO is working with the IOUs and state entities, including DWR and the California Public Utilities Commission, to develop a transition of Scheduling Coordinator responsibilities away from DWR and to the IOUs, beginning with Southern California Edison. The State is also developing a plan for continued creditworthiness backing of the IOUs to assure ISO Market Participants, as well as generators in contracts with the State, of continued payments for all Energy transactions. Given the need for the ISO to comply with the Commission's requirements for creditworthy parties for prospective sales, the fact that DWR's current authority to financially guarantee the IOUs net short transactions is set to end on January 1, 2003 should not have any bearing on the retention of the ten-percent credit risk adder. There is neither reason nor rationale for a continued credit risk adder automatically applied by the ISO settlements and billing process.

Lastly, the EOB is correct that the Commission's July 17 Order makes the ten-percent credit risk adder superfluous by setting both bid caps and the automated mitigated price thresholds so high that the generators can incorporate their own credit risk premium of up to 200 percent above their reference price and still avoid any potential price mitigation. Thus, generators are set to enjoy a credit risk adder well in excess of the expiring ten-percent credit risk adder the Commission authorized for the market power mitigation period. Therefore, to the extent that generators consider themselves at risk, from one another or from the

IOUs, they are free to add their own credit risk adders, up to 200 percent, to their prices.

Accordingly, the Commission should dismiss the protests about the credit risk adder and adopt the ISO's proposed Tariff text deleting this provision effective October 1, 2002.

B. Real Time Economic Dispatch and Uninstructed Deviation Penalties

The July 17 Order makes the ISO's implementation of the Uninstructed Deviation Penalty contingent upon new software programs that incorporate communications on outages, derates, operating problems in Real Time and more accurate representations of ramp rates at various operating points of a unit.[6] Reliant, at 15-16, protests that the ISO should consider such unit-specific constraints as minimum up and down times. Reliant's concern is without merit as the ISO already takes such factors into consideration under the Must Offer Obligation. Nevertheless, the ISO does intend to improve its Dispatch instruction by considering incorporation of resource operating constraints, including physically-dictated operating ranges and associated hold periods and minimum operating range times. IEP argues that the unit-specific dynamic nature of generating units' capabilities may impact the determination of Reference Level bid segments (ISO Tariff Market Monitoring and Information Protocol Section 3.1.1.1(a)(1)) and the Energy bid requirements (ISO Tariff Section 5.13.1). IEP Protest at 7-8. The ISO believes that because the mandatory Energy bid requirement set forth in Section 5.13.1 is based upon "Available Generation," this requirement adequately will reflect a specific unit's current capabilities at the start

[6] July 17 Order at ¶ 141.

of an operating hour. In addition, the ISO considers that Reference Level bid segments should be based on the minimum and maximum capabilities of the unit because these parameters reflect the full range of output that unit potentially could provide. The ISO does not agree with IEP's assertion that a requirement of a monotonically increasing Energy bid curve potentially is inappropriate because it may be inconsistent with some thermal units' cost structure. As explained *infra*, IEP appears to base its assertion on the incorrect premise that a unit's Energy bid curve should reflect its average heat rate rather than its incremental heat rate.

The ISO Imbalance Energy Market is a balancing market where generators should bid in only their remaining capacity and Energy after they have made all possible forward transactions. The clearing price nature of the Imbalance Energy Market guarantees a generator bidding at its incremental cost will not lose money and, except for the marginal unit, all other units will enjoy profits in excess of the incremental costs. Bids based upon average heat rate curves include costs that properly should be recovered in bilateral transactions or through a formal unit commitment process, such as the RUC process proposed by the ISO. By allowing average cost-based bids, which include costs for running at Minimum Load, to be factored into the ISO Imbalance Energy Market, a result will be an artificial increase in the price of Imbalance Energy during low Load periods.

Finally, as the Commission and Market Participants are aware, the ISO is working with stakeholders to identify critical operating constraints that must be included in the new software for feasible Schedule Dispatch instructions. All such software will be fully tested prior to implementation. Given the complexity of the effort, as set forth in the ISO's August 16 Compliance Filing, the ISO fully agrees with the EOB comment that the ISO must be given sufficient time to ensure the software accurately incorporates critical operating constraints. EOB Comments at 4-5. As required by the Commission, the ISO must develop software to include consideration of multiple ramp rates and other unit operating constraints into Dispatch instructions and also implement a new version of SLIC prior to the ISO implementing the single Energy bid curve. These efforts are underway, and the ISO will inform both the Commission and Market Participants of the schedule for implementation of all such new software.

C. Must Offer Obligation

Reliant argues that the ISO should not be considering economic criteria in making Waiver decisions under the Must Offer Obligation (which, in fact, the ISO is not) and supports this argument with an assertion that the Commission's direction in this matter has been unambiguous. Reliant Protest at 17. Reliant also complains about the ISO's use of the "first-come-first served" Waiver procedure, even though this procedure does not consider economic outcomes. Finally, Reliant argues that the ISO should incorporate economic considerations in the Waiver decision process by making use of individual generation units' reference prices. Reliant Protest at 17-18.

As a first matter, the ISO notes that it has removed all consideration of economics from its Waiver procedure, and in so doing has been reduced to using the very simple first-come-first served criterion, tempered by reliability considerations of specific units' operational parameters, locational needs and system conditions, as the most equitable and transparent method to identify which units may be granted Waivers. Moreover, as noted below, the Commission's directions to the ISO regarding economic considerations have not been totally unambiguous.

In its December 19, 2001 Order, the Commission endorsed the ISO's proposal to use a Waiver process and expressly noted that the ISO should "make reasoned decisions about its generation requirements in order to maximize economic and reliable operations. . .." 97 FERC ¶61,273, 62,363 (2001) ("December 19 Order"). The ISO interpreted the Commission's direction to mean it should incorporate economic criteria (*i.e.,* cost impacts) into its Waiver process. Therefore, in compliance with the December 19 Order, on January 25, 2002, the ISO filed a Must Offer Obligation implementation process that included consideration of the collective costs to Market Participants for reimbursement for start-up fuel costs, emission fees and the minimum load operating costs. ISO January 25, 2002 Compliance Filing Transmittal Letter at 16-18.

In its May 15, 2002 Order,[7] however, the Commission rejected the ISO's proposal to include cost considerations in the Waiver process, apparently either reversing its prior provision that the ISO consider the collective costs to Market Participants as set forth in the December 19 order or disagreeing with the ISO's January 25 compliance filing interpretation of this specific provision.

[7] 99 FERC ¶61,158 at 61,630 (2002) ("May 15 Order").

In response to the May 15 Order, on June 24, 2002 the ISO submitted a compliance filing removing use of economic considerations in implementing the Must Offer Obligation. On July 17, 2002, the Commission issued its order on the ISO's comprehensive market design. Critically, the July 17 Order inaccurately stated that the ISO does use a Transmission Constrained Unit Commitment ("TCUC") algorithm in making Waiver decisions under the Must Offer Obligation. July 17 Order at ¶ 65. (As detailed *infra*, any such algorithm will, by design and of necessity, incorporate consideration of the costs associated with committing various units). The basis for this statement by the Commission in the July 17 Order apparently was the ISO's discussion in its May 1 market design filing in which the ISO described the relationship between the Must Offer Obligation and the proposed Residual Unit Commitment ("RUC") process and the ISO's intention to use TCUC for either the Waiver process or the RUC process. It appears that in its July 17 Order's characterization of this issue the Commission overlooked the impact of its May 15 Compliance Order, issued *after* the ISO's May 1 market design filing, in which the ISO was denied the use of cost considerations in the Waiver procedure. Moreover, subsequent to the May 15 Compliance Order, the ISO June 24 compliance filing removed all cost factors from the proposed implementation of the Must Offer Obligation. In fact, as a direct result of the May 15 Compliance Order, the ISO abandoned the development of TCUC for the Waiver process.

Compounding the error in the July 17 Order regarding use of TCUC, the Commission then erroneously assumed that because the ISO was using economic considerations in making decisions about which units must run in compliance with the Must Offer Obligation, the ISO had no need for a true RUC process, including a full software program for unit commitment that considers costs (*i.e.,* TCUC). As the ISO previously has explained to the Commission in the ISO's August 16 compliance filing to the July 17 Order, the ISO's August 16 Request for Rehearing of the July 17 Order, and the ISO's June 9 Request for Rehearing of the May 15 Compliance Order, the ISO does not consider cost minimization in making Must Offer Obligation Waiver decision, but, in fact, should be permitted to do. Specifically, as a result of the Commission's May 15 Order, the ISO has not developed a true unit commitment software program and therefore, the ISO cannot implement *either* RUC or the Automatic Mitigation Procedure ("AMP") as proposed after the close of either the proposed Day-Ahead Energy Market or the existing Hour-Ahead Market.

Despite the misleading insistence by Reliant that there is no confusion on this critical issue, the foregoing recitation of the record before the Commission demonstrates the inconsistencies and disconnection between and among the several orders and filings regarding the use of TCUC for the Must Offer Obligation, RUC and AMP. There is a real and urgent need for Commission clarification and comprehensive guidance on this issue.

In conclusion, the ISO continues to believe that the most fair, transparent and efficient way to make Waiver decisions and the only way to implement a RUC process is through use of a TCUC algorithm, which of necessity considers the costs of committing various units, along with transmission and operating constraints, to optimize the set of resources committed for the following operating day. As the ISO pointed out in its August 16, 2002 Request for Rehearing of the July 17 Order, every other independent system operator is authorized to commit units in this manner. The Commission should grant the ISO the same authority so that it can commit units in a rational manner. The record makes perfectly clear, however, that the ISO currently is fully compliant with the Commission's May 15 Order by making Waiver decisions on a first-come-first served basis only, without regard to cost impacts. Lastly, the ISO simply does not understand, given Reliant's extreme concern that the ISO not consider costs in the Must Offer Obligation, how Reliant can responsibly or credibly file its illogical proposal that the ISO *should* consider costs via reference prices in making Waiver decisions. In light of the plain record before the Commission, Reliant's protest is not factual, lacks merit and should be dismissed as moot.

D. Automated Mitigation Procedures

In its May 1 Filing, the ISO proposed implementing AMP, based on the AMP developed and implemented by the New York Independent System Operator ("NYISO"), on October 1, 2002. In its July 17 Order, the Commission adopted the ISO's AMP proposal with some modifications:

1. The Commission increased the threshold for the conduct test from the lesser of a $50/MWh increase or a 100 percent increase in the bid above its reference level to the lesser of a $100/MWh or 200 percent increase.
2. The Commission increased the threshold for the market impact test from the lesser of a $50/MWh increase or a 100 percent increase in the bid

above its reference level to the lesser of a $50/MWh or 200 percent increase.

3. The Commission directed that AMP will not be applied if the market clearing price in all zones is less than $91.87/MWh.
4. The Commission included AMP conduct and impact tests to mitigate local market power.

Some interveners protest the ISO is not applying the $91.87/MWh price screen as directed by the Commission. IEP and Williams oppose the ISO's intention to adjust all bids that fail the conduct test both above and below the $91.87/MWh price screen to their reference level to determine if those bids fail the impact test. IEP Protest at 4. Williams Protest at 2-3. These parties assert that the Commission intended that AMP should not mitigate any bid if that bid's price was below the price screen of $91.87/MWh.

The July 17 Order did not establish the $91.87 level as a "safe harbor" below which no bid, no matter where it was in relation to its reference price, would be mitigated. Instead, the Commission directed that "if the market clearing price for all zones is $91.87 or below, AMP will not be applied." July 17 Order at ¶ 67. The price screen is intended to be a threshold condition for determining whether AMP should be applied, not a safe harbor for bids in hours where the price screen is violated. Thus, if a price of $91.87 is projected for any or all zones, the ISO would run AMP and mitigate any bid, including a bid that was below $91.87 if it fails the conduct and impact tests. The ISO's implementation of the $91.87 price screen is completely consistent with the NYISO's implementation of its “voluntary” $150 price screen, as confirmed by the Commission:

> “Presently, SCUC determines if there are zones and hours where the LBMP surpasses $150. If so, the bids of generating resources that **exceed the conduct threshold** - *not the bids of generating resources that exceed $150* ***and*** *exceed the conduct threshold* – are replaced by their reference prices.”[8]

In contrast, the Commission clearly intended that bids below $25/MWh would not be subject to AMP. *See* July 17 Order at ¶ 73. Had the Commission intended that no bid below $91.87 would ever be mitigated, there would be no need for the explicit exemption of bids below $25/MWh.

Several interveners protest that because the Commission has directed the ISO to use the services of an independent entity to calculate reference prices, the ISO should not be permitted to include the criteria by which reference prices would be determined in its Tariff. Reliant Protest at 6; Duke Protest at 3-4. These parties assert Section 3.1.1.1 of Appendix A to the Market Monitoring and Information Protocol should be stricken.

The EOB, on the other hand, indicates that nothing in the July 17 Order rejects the ISO’s proposed criteria for determining reference prices. EOB Comments at 4. The ISO agrees with the EOB. The Commission accepted the ISO’s AMP proposal except for: (1) making specific, express changes to the

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8 *New York Independent System Operator, Inc.* 99 FERC ¶ 61,246, at 62,039 (2002) (emphasis added). This statement is also completely consistent with the NYISO’s description of how the “voluntary” $150 price screen is applied in the NYISO AMP:

> “The SCUC determines whether there are zones and hours in which the LBMP exceeds $150 based on the first run of the SCUC. If so, the bids of any generating resource that exceeds the applicable conduct threshold in these zones is replaced by its reference price.”

Compliance Filing of the New York Independent System Operator, Inc. Regarding Comprehensive Market Mitigation Measures and Request for Interim Extension of Existing Automated Mitigation Procedure at 29.

market and conduct thresholds, (2) including the $91.87 price screen, (3) exempting bids below $25/MWh, and (4) directing the ISO to hire an independent entity to calculate reference prices. The Commission ordered no other changes. The July 17 Order further notes that the ISO's proposed criteria generally reflect the criteria used in the NYISO AMP already approved by the Commission. *See* July 17 Order at ¶ 57. Had the Commission wished to reject the criteria proposed by the ISO for determining reference prices, it would have done so. The Commission did not and the parties' attempt to remove the criteria maintained in the compliance filing represent an impermissible collateral attack on the Commission's order because this argument should have been addressed in a request for rehearing and is not permitted in a protest of a compliance filing.

The timing directed by the Commission in the July 17 Order further supports the conclusion that while the Commission directed the ISO to enlist the services of an independent part to calculate reference prices, the Commission did not reject the ISO's proposed criteria for actual calculation of such prices. The Commission directed the ISO to notify it by September 15, 2002, of the entity selected to begin calculating reference prices. The Commission also indicated that the ISO should begin running AMP on October 1, 2002, subject to certain modifications. The Commission could hardly have expected that an entity, selected with as little as 15 days advance notice to calculate reference prices beginning October 1, 2002, to also be required to establish and file for Commission approval reference price calculation criteria separate from the ones proposed by the ISO in its May 1, 2002 filing.

Lastly, the criteria for calculating reference prices constitutes a practice affecting rates. As such, criteria properly are included in the ISO's Tariff. The independent entity selected by the ISO to calculate reference prices is not a public utility and has no rights under Section 205 of the Federal Power Act to dictate the criteria that the ISO, a public utility, should use to calculate such prices. That right resides solely with the ISO.

IEP and Dynegy protest the ISO's use of the proxy figure for natural gas costs comprised of the average of the monthly bid week gas prices for determining the reference level for gas-fired units that do not have sufficient bid histories. IEP Protest at 5; Dynegy Protest at 2. The ISO notes that the Commission approved this proxy figure for natural gas costs for use in the current price mitigation. Moreover, the Commission has rejected the use of a daily index (rather than a monthly index) on several occasions and should again reject such arguments.[9] The Commission expressly found that use of a monthly gas price methodology "will not impede suppliers' recovery of operating costs."[10] The Commission has also found that the average pricing formula "represents a reasonable price for the marginal costs that generators will incur since they can pre-buy their gas requirement for the month at this price."[11] June 19 Order at 62,561. Moreover, the average monthly gas price has consistently been within a

[9] *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 Corporation, Docket No. EL00-95 et al., "Order on Rehearing and Clarification," slip op. at 11-12 (May 15, 2002). 95 FERC ¶ 61,418 at 62,561; Order Accepting in Part and Rejecting in Part Compliance Filings 97 FERC ¶ 61,293 (2001) at 62,204.

[10] December 19 Order at 62,204.

[11] The Commission has noted correctly that the use of the average gas price is reasonable because generators generally pre-buy their monthly gas requirement rather than purchase gas on the daily spot market. May 15 Order, slip op at 11. Reliant's suggestion that generators purchase spot gas for their generation units that operate on a regular basis is unfounded and illogical.

reasonable range of the daily spot market price. *See* May 15 Order. In light of the allegations of manipulation of daily spot gas prices, and the Commission's on-going investigation[12] and the recently-announced new investigations[13] into those prices, using the monthly bid-week prices will further ensure these proxy figures are just and reasonable. The ISO also notes that proxy figures are only used if the resource's reference level cannot be established by its recent bid history.

Dynegy and Reliant protest that the reference price for gas-fired generators does not include all marginal costs, such as the ISO's Grid Management Charge and the ISO's neutrality charge. Dynegy Protest at 2; Reliant Protest at 8. The proxy price proposed by the ISO mirrors the proxy price approved by the Commission for the price mitigation, including a very generous $6.00/MWh allowance for variable operations and maintenance that should help offset, if not completely offset, these charges. Moreover, in its May 15 Order, the Commission denied similar protests by generators that compensation for Minimum Load costs incurred by running in compliance with the Must Offer Obligation should include recovery of a panoply of additional costs such as intrastate transportation costs, franchise fees and taxes. May 15 Order, slip op. at 12. In rejecting such similar requests for compensation, the Commission noted that while such costs may be paid for on an Energy basis, they are, by definition, demand-related costs and if generators believe they are not being

[12] Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, 98 FERC 61,165 (2002).

[13] *See, e.g.,* Order Initiating Investigation, and Establishing Hearing Procedures and Refund Effective Date, 100 FERC ¶ 61,188 (2002).

adequately compensated for their actual costs, they are free to file for costs-of-service rates. *Id.*

Reliant noted that Section 3.2.3 of Appendix A to the ISO's Market Monitoring and Information Protocol was not included in the May 1, 2002 filing and should be rejected. Reliant Protest at 10. The ISO respectfully disagrees. Section 3.2.3 was part of the May 1, 2002 filing.

Dynegy contends that because the ISO proposes to run AMP based on projected dispatch before real-time, the ISO should be required to re-run AMP based on actual conditions after real-time to ensure that no bid is mitigated unnecessarily. Dynegy Protest at 4. While Dynegy is clearly concerned about applying mitigation when it may not be required, and the lower market clearing price that would result under those conditions, it is equally likely, since the mitigation is applied on projected dispatch, that mitigation would not be applied when it was required and applying AMP after real-time would result in additional, not just reduced, mitigation. Notably, Dynegy does not seek to apply AMP after real-time in situations where mitigation should have been applied but was not. The Commission has sought to use AMP because it is a prospective and not after-the-fact mitigation tool. Accordingly, Dynegy's protest should be rejected.

Reliant asserts that the ISO has provided no detail on how it will project the Dispatch of the Real Time Imbalance Energy stack. Reliant Protest at 2. The ISO projects how much Energy it will dispatch from the Imbalance Energy stack each hour by comparing the total Load indicated in Final Hour-Ahead Schedules with the ISO's most recent Load forecast for that hour. The ISO proposes to include this description in Appendix A to the Market Monitoring and Information Protocol in an upcoming filing.

Reliant also contends that the ISO has not described how it will apply AMP to System Resources and non-gas-fired generators. Reliant Protest at 3. To the contrary, Section 3.1.1.1 of Appendix A to the Market Monitoring and Information Protocol clearly delineates how reference prices for these resources will be determined, and Sections 3.1.1 and 3.2.1 set forth the conduct and impact thresholds, respectively, that, if violated, will cause bids to be reset to their reference levels.

Reliant states that the ISO should not be permitted to implement AMP without first testing the software with Market Participants. The ISO agrees that market participant testing must be completed before AMP is placed in service. The current AMP implementation schedule calls for market participant testing on September 18 and 19, 2002. The ISO also notes that the current price mitigation expires on October 1, 2002, and the ISO strongly opposes allowing the current price mitigation to expire until the AMP can be placed in service. If Market Participants require additional testing, the ISO urges the Commission to retain the current price mitigation as needed beyond October 1 to accommodate such additional AMP testing.

Reliant opposes the use of accepted bids rather than submitted bids in the AMP, alleging that using accepted bids does not account for current demand conditions. Reliant Protest at 8. In using accepted bids, the ISO again is being completely consistent with the manner in which the NYISO determines AMP reference prices.[14] Establishing reference prices using unaccepted bids merely encourages suppliers to submit bids which are intended to ratchet up their reference prices, rather than to submit bids to actually provide service – a form of the exercise of market power by means of economic withholding. Moreover, the generous conduct and impact thresholds mandated by the Commission provide sufficient opportunity for suppliers to set and earn prices well above their reference levels under scarcity conditions.

SWP protests that the ISO should not apply the AMP to its Participating Load[15] and dedicated purpose hydro generation (i.e., generation dedicated for use to the California State Water Project) until the ISO and the Commission can articulate how and why the AMP would apply to those resources. SWP Protest at 1. Appendix A to the Market and Monitoring Protocol already sets forth how the AMP apply. Bids that violate the conduct and market impact thresholds when the AMP are applied (after a market clearing price exceeds the price screen) are mitigated to their reference levels, which are established as set forth in Section 3.1.1.1 of that document. The reason why these resources should be subject to AMP is clear – because these resources can, by virtue of their voluntary participation in the ISO's markets, set a market clearing price. Accordingly, these resources should be subject to the AMP. Again, this is not an issue associated with the compliance filing but one that can and should only be taken up on rehearing of the original order.

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[14] See New York System Operator, Inc. FERC Electric Tariff, Section 3.1.4 (a)(1) at Original Sheet 470B.

[15] The ISO Tariff defines a Participating Load as "An entity providing Curtailable Demand, which has undertaken in writing to comply with all applicable provisions of the ISO Tariff, as they may be amended from time to time."

E. Single Energy Bid Curve

Dynegy protests that the ISO's inclusion of a requirement that a resource must bid an Energy curve for at least as much Energy as the Ancillary Services capacity it was awarded in the Day-Ahead Energy Market should be rejected because it was not included in the May 1, 2002 filing. Dynegy is incorrect: the ISO did fill such a requirement in the May 1 Filing.

At present, Scheduling Coordinators are required to submit an Energy bid when they bid to provide Ancillary Services.[16] Energy from Ancillary Services capacity is dispatched as Imbalance Energy in merit order as needed, unless the Scheduling Coordinator indicates that its Energy Bid is to be dispatched only following a contingency. Under the RUC proposal contained in the May 1 Filing, Scheduling Coordinators would have been required to submit resources, including an Energy bid for each resource, into the RUC process. The May 1 Filing proposed to eliminate the requirement to submit Energy bids associated with Ancillary Services capacity, since Scheduling Coordinators would have been required to submit these Energy bids into the RUC process. Consistent with the Single Energy Bid Curve proposal accepted by the Commission,[17] the Energy bids submitted in the RUC process would have been used for that process and for all subsequent markets, and would have served as the default bids had no other bids been submitted. When the Commission rejected RUC, the ISO was

[16] *See, e.g.,* ISO Tariff Schedules and Bids Protocol Section 5.1.2.1 (j).

[17] The Commission accepted the Single Energy Bid Curve in the July 17 Order at ¶ 131 and FN.71. Moreover, given that the Commission rejected RUC, the only way the ISO can implement the Single Energy Bid Curve is through the Supplement Energy template for the Real Time Imbalance Energy Market.

forced to clarify this requirement to ensure, as is currently required, that an Energy bid is associated with awarded Ancillary Services capacity.

Reliant protests that the ISO's requirement to submit an Energy bid for awarded Ancillary Services capacity is an attempt to extend the single Energy bid curve to the Day-Ahead Market. Reliant Protest at 4-5. The ISO's proposal is not so intended, but rather intended to ensure that Ancillary Services capacity has an Energy price associated with it so the ISO can dispatch the Energy in merit order in the Real Time Imbalance Energy stack.

Reliant protests that the ISO should use a resource's reference price as a default bid if no such bid is submitted rather using a proxy bid. Reliant Protest at 5. The Commission previously approved the use of the proxy bid for capacity that is not bid as required under the price mitigation provisions. Furthermore, suppliers that believe the proxy bid price is not compensatory have a remedy completely under their control, namely, to comply with the bidding requirements.

SWP calls for the ISO to revise the provisions of ISO Tariff Section 5.13 to "accommodate true provision of Ancillary Services outside the Ancillary Services markets" and "to accommodate resources that may be able to provide reserve capacity with the type [of] flexibility previously afforded in Amendment No. 38." SWP Protest at 1. Amendment No. 38, approved by the Commission on May 16, 2001, allowed the ISO to "split" the Imbalance Energy stack into two groups: 1) resources that could be dispatched for any reason and 2) resources that were to be dispatched only following a contingency. Prior to Amendment No. 38, the Energy bids associated with Ancillary Services were aggregated with

Supplemental Energy bids in the Imbalance Energy stack. SWP further asserts that the requirement to submit an Energy bid for awarded Ancillary Services capacity turns Ancillary Services self-provision under the control of the Scheduling Coordinator into market Ancillary Services under the control of the ISO. SWP Protest at 3.

The ISO's May 1 filing treats self-provided Ancillary Services no differently than such services are currently treated. Section 2.5.22.3.2 of the ISO Tariff indicates that:

> "For all other Ancillary Services *(i.e., for Ancillary Services other than those provided to cover interruptible imports)* which are being self-provided the Energy Bid shall be used to determine the position of the Generating Unit, System Unit or System Resource in the merit order for real-time Dispatch, subject to the limitation on the Dispatch of Spinning and Non-Spinning Reserve set forth in Section 2.5.22.3." (italics added)

The new Section 5.13.3 proposed in the ISO's August 16 Compliance Filing does not affect this section. Nor does it affect a Scheduling Coordinator's ability to designate the Energy associated with its Ancillary Services as Energy that may be dispatched only following a contingency rather than Energy available for general merit order Dispatch in the Imbalance Energy stack, as provided for in Amendment No. 38.[18] Tariff Section 5.13.3 merely requires a Scheduling Coordinator to provide an Energy bid associated with Ancillary Services capacity awarded in an ISO market or self-provided so the ISO can Dispatch that Energy in accordance with existing Tariff Section 2.5.22.3.2. While SWP may disagree

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[18] SWP also argued for separate treatment of Load and dedicated purpose generation in the ISO's Imbalance Energy stack in their protest to Amendment No. 38 – an argument rejected by the Commission. *See* "Order Accepting In Part and Rejecting In Part ISO Tariff Amendment," 95 FERC 61,199 at 61,695 (2001).

with provisions of the ISO Tariff not amended in either the May 1 Filing or the August 16 or August 21 Compliance Filings, such disagreement cannot be raised in the context of these compliance filings.

Dynegy alleges that the ISO's proposal to allocate Ancillary Services capacity to the high end of the resource's operating range is an attempt to manage price and that the ISO is free to re-file this proposal in accordance with Section 205 of the Federal Power Act. The ISO notes that this proposal was filed under Section 205 of the Federal Power Act on May 1, 2002,[19] and, moreover, accepted by the Commission in the July 17, 2002 Order.[20]

F. Only the ISO Can Make A 205 Filing

IEP uses its protest of the compliance filing to make a gratuitous criticism of the ISO's Reply Comments concerning the ongoing stakeholder process regarding additional Market Redesign 2002 elements. IEP faults the ISO for creating a "hardened litigation stance" by citing its authority to make filings under Section 205. IEP Protest at 2-3.

In response, the ISO notes first that IEP's criticism is beyond the scope of the compliance filing. Second, while the ISO remains fully committed to the ongoing stakeholder efforts, the ISO must reserve solely to itself the right to make further Section 205 filings. The ongoing reform efforts cannot be held hostage if a complete consensus among stakeholders is not reached on an issue. Moreover, the Commission has established strict timetables for further submissions. *See* July 17 Order at ¶ 131, requiring the submission of further

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19 *See* May 1 Filing, Attachment H, Section 5.13.2.3.

20 *See* July 17 Order at ¶131.

tariff revisions by October 21, 2002. Finally, the ISO has the same basic rights under the Federal Power Act as any other Electric Utility – to propose for Commission consideration the tariff conditions under which it will operate. *Atlantic City Electric Company, et al. v. FERC*, 295 F. 3d 1 (D.C. Cir. 2002).

III. CONCLUSION

Wherefore, for the foregoing reasons and the reasons set forth in the Compliance Filings, the ISO requests that the Commission approve the Compliance Filings as filed.

Respectfully submitted,

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Operator Corporation
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Dated: September 18, 2002

CALIFORNIA ISO

California Independent
System Operator

September 18, 2002

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation, Docket No. ER02-1656-000

Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council, Docket No. EL01-68-017

Dear Secretary Salas:

Enclosed for electronic filing, please find the Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Comments and Protests.

Thank you for your assistance in this matter.

Respectfully submitted,

Charles F. Robinson
Margaret A. Rostker
Counsel for the California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, California 95630

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Comments and Protests 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 September, 2002.

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Margaret A. Rostker
Counsel for The California Independent
System Operator Corporation