May 11, 2001

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 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*.

Dear Secretary Boergers:

The California Independent System Operator Corporation ("ISO")[1] respectfully submits six copies of this filing in compliance with the Commission's April 26, 2001 "Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale Western Energy Markets" in the above-captioned dockets, 95 FERC ¶ 61,115, ("April 26 Order").

I. BACKGROUND

In its December 15, 2000, Order in this proceeding,[2] the Commission found that the market structures and rules for wholesale sales of Energy in California were seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and Demand in California, have created the opportunity for suppliers of electricity to exercise market power and to charge unjust and unreasonable rates. The December 15 Order mandated various remedies to address these circumstances, including the

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

[2] *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*, *et al.*, 93 FERC ¶ 61,294 (2000) ("December 15 Order").

establishment of a $150/MWh (or $150/MW) "soft cap" or breakpoint in the ISO's Ancillary Services and real-time Imbalance Energy markets. Under this price mitigation mechanism, suppliers whose bids to provide Ancillary Services or Imbalance Energy are above the $150 breakpoint and are accepted by the ISO are paid "as-bid" (*i.e.*, no bid above $150 in any settlement interval can set the Market Clearing Price in the ISO's Ancillary Services and Imbalance Energy markets). Public utility sellers bidding above the breakpoint are required to submit cost support data for these above-cap bids to the Commission, and payment for all such bids accepted by the ISO is subject to refund. Pursuant to the December 15 Order, the soft cap mechanism went into effect on January 1, 2001, and remains in effect to date. The December 15 Order also required the development of a longer term mitigation plan to replace the interim breakpoint methodology.

In the April 26 Order, the Commission reaffirmed its previous findings that there is a potential for the exercise of market power in the California wholesale markets under certain conditions and mandated that a replacement mitigation plan be put into place. As described in further detail below, the mitigation plan adopted in the April 26 Order includes:

- increased coordination, control, and reporting of outages;
- a requirement for all sellers that own or control generation in California to offer all their available power in the ISO's real-time Energy market; and
- a price mitigation mechanism for the ISO's real-time Energy market during System Emergencies.

The Commission directed the ISO to submit Tariff revisions to comply with the Order within fifteen days. The ISO hereby submits changes to the ISO Tariff in compliance with the Commission's directives.[3] In accordance with the Commission's determination, the changes to the ISO Tariff contained herein are proposed to become effective May 29, 2001. April 26 Order, 95 FERC ¶ 61,115, slip op. at 7.[4]

II. OUTAGE COORDINATION

In the April 26 Order, the Commission held that, "[t]he ISO must be provided the authority to achieve greater systematic control over all units (including those of the IOUs) that the ISO must dispatch, *i.e.*, those units that have signed PGAs [Participating Generator Agreements]." April 26 Order, 95 FERC ¶ 61,115, slip op. at 9. Accordingly, the Commission directed the ISO to "make a tariff filing within 15 days of this order

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[3] As noted below, the ISO is submitting this filing strictly to comply with the April 26 Order and reserves the right to seek clarification or rehearing of any aspect of that order, including those aspects of the April 26 Order to be implemented through the attached Tariff revisions.

[4] The ISO is making every effort to implement all of the changes mandated by the April 26 Order by May 29, 2001. A number of factors, including the cooperation of entities that must provide the ISO with information needed to implement the Order, may limit the ISO's ability to fully implement these changes by May 29. To the extent such factors appear to likely to limit full implementation of the proposed changes by that date, the ISO will address these issues in a subsequent filing to the Commission.

proposing a mechanism for coordination and control of outages, including periodic reports to the Commission, consistent with the discussion in this order." *Id.* at 8.

The ISO already has significant authority to approve and modify planned outages for Participating Transmission Owners and Reliability Must-Run ("RMR") Generating Units. In addition, Participating Generators are currently required to submit information regarding their planned outage programs to the ISO on a periodic basis and must seek ISO approval for outages scheduled or modified with less than seven days notice. The ISO's only other current authority to coordinate or control the planned outage of a Participating Generator is its emergency authority "to instruct a Participating Generator to bring its Generating Unit on-line, off-line, or increase or curtail the output of the Generating Unit . . . if such instruction is reasonably necessary to prevent an imminent or threatened System Emergency or to retain Operational Control over the ISO Controlled Grid during an actual System Emergency."[5] The current authority does not permit the ISO to ensure that all Generator outages are coordinated in advance and in a consistent manner that will minimize the reliability impacts on the ISO Controlled Grid and ensure that the minimum necessary level of Generation is available to serve California Load.

In the instant filing, the ISO proposes to apply the outage coordination requirements currently applicable to RMR Units and transmission facilities forming part of the ISO Controlled Grid to all Generating Units owned by any Participating Generator.[6] These revisions will provide the ISO with the authority to approve or deny planned outages for all Participating Generators, on an annual planning basis, which will enable the ISO to coordinate the planning of outages of both generating and transmission facilities. The ISO anticipates that this coordinated approach to Generator outage scheduling will reduce the need for Generator Maintenance Outages to be modified or rescheduled due to System Emergency conditions. The proposed Tariff revisions also make explicit the requirement of Participating Generators to provide the ISO with timely explanations of Forced Outages, so that the ISO can report questionable outages to the Commission, as required by the April 26 Order. The proposed Tariff revisions do not include specific compliance provisions. In the event that the proposed cooperative process proves inadequate to assure the necessary outage coordination, the ISO may file additional Tariff revisions providing for penalties or other measures to ensure compliance with the outage coordination process, and in particular, compliance with the provisions related to Forced Outages.

The ISO notes that the revisions to Section 2.3.3.6.3 will provide Participating Generators with the opportunity, under certain conditions and subject to specified requirements and limitations, to obtain compensation for the direct and verifiable costs

[5] Section 5.6.1 of the ISO Tariff. The ISO notes that issues related to the ISO's current authority with respect to Participating Generator outages are pending in Docket No. EL01-57.

[6] A "Generating Unit" is defined in the ISO Tariff as an electric generator that is located within the ISO Control Area, connected directly or indirectly to the ISO Controlled Grid and capable of producing positive net Energy. ISO Tariff, Appendix A. A "Participating Generator" is defined as an entity that sells Energy or Ancillary Services from a Generating Unit that has undertaken to be bound by the terms of the ISO Tariff through a Participating Generator Agreement. *Id.*

that a Participating Generator incurs due to the ISO's "last-minute" cancellation of an Approved Maintenance Outage. This opportunity is equivalent to that provided to Participating Transmission Owners whose Approved Maintenance Outages are cancelled at the last minute.[7] Although the ISO believes that Participating Generators with market-based rates have a much greater opportunity to protect themselves from the costs of last-minute cancelled outages than do Participating Transmission Owners under a regulated cost-of-service rate structure, the ISO has elected to afford comparable treatment to Participating Generators and Participating Transmission Owners subject to the ISO Tariff's outage coordination requirements.

As the ISO has previously informed the Commission, the State of California is considering legislation that would implement the coordination of outages of all Generating Units in California, both inside and outside the ISO Control Area. The Governor of the State of California has also issued Executive Order D-23 addressing outage maintenance issues. The ISO believes that the Tariff revisions addressing outage coordination proposed in this filing are compatible with the Executive Order D-23 and permit the ISO to comply not only with the Commission's April 26 Order, but also the planned State legislation. Nonetheless, if necessary and appropriate to comply with State law, the ISO may file additional outage coordination Tariff revisions in the future to fulfill any additional obligations imposed upon it by State law.

Black-lined Tariff provisions showing the revisions needed to implement the increased coordination and control of Generator outages are provided as Attachment B to this filing.

III. SELLING OBLIGATION

In the April 26 Order, the Commission established a requirement that all non-hydroelectric Generators in the State of California "offer the ISO all of their capacity in real time during all hours if it is available and not already scheduled to run through bilateral agreements." April 26 Order, 95 FERC ¶ 61,115, slip op. at 10. This requirement applies not only to Participating Generators, but to all "non-public utility sellers that own or control generators in California" as a condition to their participation in the ISO's markets or use of the ISO Controlled Grid. *Id.* The ISO was directed to modify its Tariff to reflect these conditions and this requirement.

The ISO proposes Tariff revisions to make it clear that the selling obligation established by the April 26 Order is applicable to all "Must-Offer Generators," defined as either a Participating Generator or any entity that owns or controls one or more non-hydroelectric Generating Units located in California from which Energy or capacity is either: (i) sold through any market operated by the ISO, or (ii) transmitted over the ISO Controlled Grid.[8] This obligation applies to all available capacity from the Must-Offer Generator for which Energy is not scheduled in the responsible Scheduling

[7] *California Independent System Operator Corp.*, 90 FERC ¶ 61,316 at 62,050-51 (2000).

[8] This would include Generating Units in Control Areas in California other than the ISO Control Area.

Coordinator's Final Hour Ahead Schedule.

In order to implement and monitor compliance with this requirement, the ISO must have certain operating information (*i.e.*, minimum and maximum operating levels, ramp rates, and outage information) from all Generators subject to the requirement. The ISO does not currently receive this information from non-Participating Generators and therefore proposes certain reporting requirements for Must-Offer Generators that are not Participating Generators. The ISO has already issued a market notice requesting such information from the affected Generators.[9]

The ISO anticipates that there may be circumstances where a Generator subject to this requirement has capacity "available," as defined in the April 26 Order, but fails to formally submit a bid for all or part of that available capacity. In such circumstances, the ISO proposes to use the "Proxy Price" calculated by the ISO for real-time price mitigation purposes as a standing bid for the available capacity of all gas-fired Generating Units owned or controlled by a Must-Offer Generator and to use a standing bid to receive the Market Clearing Price for the applicable hour for all other Generating Units owned or controlled by a Must-Offer Generator.

It should be noted that the ISO does not have a contractual relationship with all Must-Offer Generators within and outside of the ISO Control Area. That is, while many of these resources are located in California, they are either: (1) not located within the ISO's Control Area and not required to execute Participating Generator Agreements;[10] or (2) scheduled and dispatched according to agreements that pre-date ISO operations.[11] The Commission should accordingly be aware that the ISO's ability to validate and enforce the requirements of the April 26 Order is limited with respect to those Generators. At most, the ISO can advise the Commission if it appears that any such Generator has failed to comply with the April 26 Order's requirements so that the Commission may take such action as it deems appropriate.[12]

Black-lined Tariff provisions showing the revisions needed to implement the April 26 Order's generator selling obligation are provided as Attachment D to this filing.

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[9] *See* the May 7, 2001, Market Notice addressing "Submission of Generator Performance Data by California Non-Public Utilities," provided as Attachment C to this filing.

[10] Therefore, the ISO does not receive for such resources the information required to be submitted by Participating Generators under Schedule 1 of the Participating Generator Agreement. In addition, such resources are currently not required to comply with the metering and telemetry requirements of the ISO Tariff.

[11] These agreements result in resources being scheduled as an aggregated resource or as a resource representing a net interchange of energy with the scheduling entity, neither of which meet the metering and telemetry requirements of the ISO Tariff.

[12] The ISO also notes that there may be difficulty in determining the available capacity of Qualifying Facility ("QF") resources because such resources are currently scheduled on a "net" basis while their maximum capability is expressed on a "gross" basis. Since the ISO lacks information on the Load being served behind a QF resource's meter, it will be unable to fully determine what capacity from that resource is available.

IV. REAL-TIME PRICE MITIGATION

In the April 26 Order, the Commission adopted a price mitigation plan under which:

> each gas-fired generator in California (both those signing PGAs and covered non-public utility gas-fired generators) will file with the Commission and the ISO (on a confidential basis) the heat rate and emission rate for each generating unit. These heat rates must reflect operational heat rates that do not include start-up and minimum load fuel costs because, in a declared emergency, the market clearing price should reflect the cost to generate at or near maximum outputs. The ISO will use these heat rates to calculate a marginal cost for each generator [the Generator's "Proxy Price"] by using a proxy for the gas costs, emission cost, and a $2.00 adder for operation and maintenance expenses.

April 26 Order, 95 FERC ¶ 61,115, slip op. at 15. These Proxy Prices will form the basis for the April 26 Order's price mitigation plan, which is to apply only in the ISO's real-time market and when there is a reserve deficiency "defined as emergency situations beginning at Stage I (i.e., when reserves are 7.5 percent or less)." *Id.* at 14. During such System Emergencies, bids for Energy from gas-fired Generating Units may be submitted at their Proxy Price, and "[a]ll generators who elect the proxy will be paid a single market clearing price reflecting the highest priced unit dispatched calculated using the proxy prices." *Id.* at 15. Bids for Energy from gas-fired Generating Units that are above the Proxy Price and are accepted by the ISO will be paid as-bid but are subject to refund if the Commission determines that a bid is not cost-justified, following its review of reports that such Generators must submit to the Commission and the ISO. During System Emergencies, Energy from Generating Units that are not gas-fired units and all other resources may be bid into the ISO's markets to be dispatched at the Market Clearing Price determined by the ISO in accordance with this mitigation scheme (the "Marginal Proxy Clearing Price" in the attached Tariff language). Such other resources may also bid Energy above that Market Clearing Price, subject to cost justification before the Commission and refund liability.

The April 26 Order required each entity that owns or controls gas-fired Generation in California to file with the Commission and the ISO (on a confidential basis) the heat rate (not including start-up and minimum load fuel costs) and emission rate for each gas-fired Generating Unit in the State. The ISO issued two market notices providing a format for submission of this information.[13] In these market notices, the ISO requested heat and emission rates for 11 different operating points with the first and last operating points representing the unit's minimum and maximum (or near maximum)

[13] *See* the April 27, 2001, Market Notice addressing "Submission of Generator Heat Rate and Emission Data," provided as Attachment E to this filing and the April 30, 2001, "Supplement To Market Notice - Submission of Generator Heat Rate and Emission Data," provided as Attachment F to this filing.

operating level, respectively. The ISO also requested the minimum and maximum operating levels, and ramp rate for non-PGA units.[14]

Based on this information, the ISO has determined that it will calculate the Proxy Prices for gas-fired Generating Units using the following methodology: The ISO will use the provided average heat rate data to calculate an incremental heat rate step function for each gas-fired Generating Unit. To determine the Proxy Price at each operating level, the ISO will calculate the incremental heat rate cost using the daily gas price index described in the April 26 Order, add the emission cost, and add a $2.00 adder for operation and maintenance expenses.

The April 26 Order does not provide detailed guidance as to how the Market Clearing Price will be calculated during System Emergencies under the mitigation plan established by the April 26 Order. The ISO believes that the April 26 Order requires the ISO to use the highest Proxy Price calculated for a gas-fired Generating Unit dispatched during a System Emergency to set the Market Clearing Price for that settlement interval, even if the bid for the Generating Unit in question is greater than that unit's Proxy Price. To the extent that the bid for the marginal unit selected by the ISO is less than that unit's Proxy Price, however, that unit's actual bid would set the Market Clearing Price. That is, for each settlement interval in which price mitigation applies, the ISO will both dispatch (*i.e.,* establish the merit order stack) and determine the Marginal Proxy Clearing Price based on the lesser of each gas-fired resources' actual bid or its applicable Proxy Price. The ISO believes that this approach is consistent with the Commission's Order and results in an efficient dispatch of resources and an accurate Marginal Proxy Clearing Price or Market Clearing Price. This approach is reflected in the attached Tariff revisions.

The attached Tariff revisions also implement the reporting and cost-justification provisions of the April 26 Order.

The real-time mitigation scheme mandated by the April 26 Order supersedes the $150/MW "soft cap" scheme previously established by the Commission's December 15 Order. Accordingly, in the instant filing the ISO includes Tariff revisions to eliminate the $150 soft cap on Ancillary Services capacity. In implementing the April 26 Order, the ISO will also eliminate the $250 hard cap for Adjustment Bids currently in effect.[15] Consistent with the April 26 Order, there will be no limitation on bids in the ISO's Ancillary Services markets and on Adjustment Bids effective May 29, 2001.

Black-lined Tariff provisions showing the revisions needed to implement the real-time price mitigation mechanism mandated by the April 26 Order are provided as Attachment G to this filing.

[14] While some affected entities have provided the requested data, as of May 10, 2001, the ISO has received no or only partial data from several parties subject to this requirement. Unless all parties comply with this request, the ISO may be unable to calculate the Proxy Prices for all gas-fired resources in California and therefore to fully implement the April 26 Order by May 29. As noted above, in such an event, the ISO may need to submit a subsequent filing addressing implementation issues related to the April 26 Order.

[15] *See* the ISO's January 2, 2001, compliance filing in Docket Nos. EL00-95 *et al.*

V. RESERVATION OF RIGHTS

This filing represents the ISO's best efforts at complying with the Commission's April 26 Order in the short time permitted. In addition, the ISO has already identified a number of issues related to the April 26 Order which will require clarification or modification. The ISO is continuing its evaluation of the impacts of the April 26 Order and will address these issues in a separate motion for clarification and request for rehearing to be filed by May 25, 2001. The ISO reserves all rights to pursue issues on clarification and rehearing, notwithstanding its implementation of the directives of the April 26 Order in this compliance filing.

VI. SUPPORTING DOCUMENTS

The following documents, in addition to this letter, support this filing:

Attachment A	Revised Tariff Sheets, incorporating the compliance changes;
Attachment B	Black-lined Tariff provisions showing revisions related to outage coordination;
Attachment C	May 7, 2001 Market Notice addressing "Submission of Generator Performance Data by California Non-Public Utilities;"
Attachment D	Black-lined Tariff provisions showing revisions related to the generator selling obligation;
Attachment E	April 27, 2001 Market Notice addressing "Submission of Generator Heat Rate and Emission Data;"
Attachment F	April 30, 2001 "Supplement To Market Notice - Submission of Generator Heat Rate and Emission Data;"
Attachment G	Black-lined Tariff provisions showing revisions related to real-time price mitigation; and
Attachment H	A notice of filing, suitable for publication in the Federal Register (also provided in electronic format).

Two additional copies of this filing are enclosed to be date-stamped and returned to our messenger. If there are any questions concerning this filing, please contact the undersigned.

Respectfully submitted,

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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 this proceeding and upon all entities with Participating Generator Agreements with the ISO.

Dated at Washington, DC, this 11th day of May, 2001.

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Sean A. Atkins