UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Reliant Energy Power Generation, Inc.,	**)**	
Dynegy Power Marketing, Inc., and	**)**	
Southern Energy California, LLC	**)**	
	)	
v.	**)**	**Docket No. EL00-97-000**
	)	
California Independent System	**)**	
Operator Corporation	**)**	

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATON TO THE COMPLAINT OF RELIANT ENERGY POWER GENERATION, INC., DYNEGY POWER MARKETING, INC., AND SOUTHERN ENERGY CALIFORNIA, LLC

Pursuant to Rules 206(f) and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.206(f) and 385.213, and the Notice of Filing issued on August 4, 2000, the California Independent System Operator Corporation ("ISO") submits this Answer in response to the "Complaint and Request for Fast Track Processing" ("Complaint") of Reliant Energy Power Generation, Inc., Dynegy Power Marketing, Inc., and Southern Energy California, LLC (collectively "Complainants") filed on August 3, 2000.

I. INTRODUCTION AND SUMMARY

This Complaint and request for "Fast Track Processing"[1], is addressed to a fact situation that never has occurred any time since the ISO began operations, and

---

[1] Complainants request expedited processing of its Complaint. Complaint at 4. The Commission has stated that expedited processing should be employed only in limited circumstances and only in the most unusual cases. *See, e.g., Amoco Energy Trading Corporation, et al., v. El Paso*

if it were to occur in the future, would do so rarely. Specifically, the Complainants contend that the ISO's Tariff[2] must specify the payments to be made to Scheduling Coordinators whose Export schedules are curtailed in response to a severe System Emergency threatening the reliability of the ISO Controlled Grid and that of interconnected control areas. They urge adoption of language that they represent – incorrectly – to be that which had been offered by the New England Power Pool ("NEPOOL") and accepted by the Commission. The language they offer goes far beyond the NEPOOL submission, however; indeed, it includes cost recovery components explicitly excluded in that proposal. In sharp contrast to the support that the NEPOOL submission received from stakeholders in New England, Complainants' proposal is lacking in support among members of the ISO Governing Board and is addressed to circumstances in which Generators would be in a position to exercise market power in the markets operated by the ISO, a concern neither evident in the NEPOOL filing nor in the Commission orders that preceded or followed it.

Moreover, under the California model, notwithstanding Complainants' contrary claim, compensation for the curtailment of Exports already is provided. The Commission explicitly approved the reasonableness of the ISO Tariff's current compensation mechanisms. This Complaint is a collateral attack on the Commission's order on Amendment No. 23 to the ISO Tariff, *California Independent System Operator Corporation,* 90 FERC ¶ 61,006 (2000), in which FERC considered

---

Natural Gas Company, 89 FERC ¶ 61,165 (1999), *reh'g denied*, 90 FERC ¶ 61,354 (2000). Complainants have made no showing that such treatment is justified.

The ISO, for its part, requests waiver of any Commission provisions (*e.g.,* 18 C.F.R. § 385.206(c)(4)) which would view this Answer as inadequate, in light of the extremely brief period in which the ISO was required to prepare its response.

[2] Capitalized terms are references to terms defined in the ISO Tariff.

and rejected claims that the current ISO Tariff mechanisms provide inadequate compensation.[3]

For these reasons, developed more fully below, the Commission should decline to entertain the Complaint.

II. COMMUNICATIONS

Communications regarding this matter should be directed to the following individuals, whose names should be entered on the official service list maintained by the Secretary in this docket:

Charles F. Robinson
General Counsel
Roger E. Smith
Senior Regulatory Counsel
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tele: (916) 351-2334
Fax: (916) 351-2350

Edward Berlin
Kenneth G. Jaffe
David B. Rubin
Julia Moore
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W.
Suite 3000
Washington, DC 20007-3851
Tele: (202) 424-7500
Fax: (202) 424-7643

III. DISCUSSION

A. The Complaint is Addressed to a Limited and Unlikely Circumstance

It is important that the Commission appreciate that the Complaint is addressed to an unlikely, indeed an unprecedented, occurrence. While it is true that

[3] This collateral attack is all the more objectionable in light of the Commission's rejection of a "tariff" filing made by El Segundo Power, LLC (a Dynegy affiliate) as a collateral attack on the same order. *See El Segundo Power, LLC*, 91 FERC ¶ 61,110 (2000), *reh'g pending*. Complaints reference the *El Segundo* order in their complaint under the heading "18 C.F.R. § 385.206(b)(6)", the Commission rule which deals with whether issues similar to those in the complaint are pending in another Commission proceeding. Complaint at 19-20.

under the ISO's operating procedures, interruptible Exports are subject to curtailment after a Stage 1 System Emergency[4] has been declared and during times when interruptible loads within the ISO Controlled Grid are being curtailed, firm Exports are subject to curtailment only when a Stage 3 Emergency has been declared. At that point, the only tool that would remain available to the ISO by which to maintain the integrity of the interconnected grid would be the curtailment of firm load, whether it had been intended to serve control area needs or for export.

As Complainants acknowledge (Complaint at 17), curtailment of firm loads and Exports would be preceded by a series of actions by the ISO, including: procuring additional Replacement Reserves, procuring all available energy out of market under the ISO's price cap, implementing demand relief programs, curtailing UDC interruptible loads, procuring additional out-of-market energy from other control areas (at prices potentially above the ISO's purchase price cap), and requesting emergency assistance from neighboring control areas. This list of actions only

---

[4] A System Emergency is called

> When, in the judgment of the ISO, the System Reliability of the ISO Controlled Grid is in danger of instability, voltage collapse or under-frequency caused by transmission or Generation trouble in the ISO Control Area, or events outside of the ISO Control Area that could result in a cascade of events throughout the WSCC grid ….

Dispatch Protocol 10.1.3

A Stage 1 System Emergency is called when operating reserves are less than minimum operating reliability criteria. In response, public appeals for conservation are initiated and available resources acquired. A Stage 2 Emergency is called when operating reserves are less than 5%. In response, interruptible loads are curtailed. A Stage 3 Emergency would be called if operating reserves were less than 1.5%. In response, firm load would be curtailed.

serves to highlight the point that curtailing firm load and Exports would be a last resort for the ISO.

In the case of curtailments of firm Exports, moreover, the ISO would expect to work with neighboring control area operators to manage the emergency conditions, as it has done to date. Typically, when one control area is in danger of curtailing firm load, neighboring control areas will offer assistance. If a control area and its neighboring control area were both in danger of curtailing firm load, the control area operators would work cooperatively to determine the best way to manage the need. If at all possible, the actions taken by control area operators would be mutually agreed to and would be aimed at keeping the interconnection up and avoiding the curtailment of firm load and Exports in both control areas.

Fortunately, to date the ISO has never had to declare a system-wide Stage 3 Emergency. Accordingly, the ISO never has curtailed firm Exports. The possibility for which Complainants seek extraordinary "Fast Track" relief is thus exceedingly unlikely.

Nonetheless, the possibility of curtailment should be no less evident in the case of firm Exports than it is for interruptible Exports.[5] The ISO Tariff is explicit that, in response to System Emergencies,

> 5.6.1 All Generating Units and System Resources that are owned or controlled by a Participating Generator are (without limitation to the ISO's other rights under this ISO Tariff) subject to control by the ISO

[5] We do not construe the Complaint to be addressed to curtailment of interruptible exports. Those sales, after all, explicitly assume the possibility of curtailment, and the parties presumably factor that risk into the price and other terms of their arrangements.

> during a System Emergency and in circumstances in which the ISO considers that a System Emergency is imminent or threatened. The ISO shall, subject to Section 5.6.2, have the 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 and to alter scheduled deliveries of Energy and Ancillary Services into or out of the ISO Controlled Grid, if such an 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.

Tariff, 5.6.1 (emphasis added).

Thus, under the ISO's operating procedures, interruptible Exports are accorded the same treatment as indigenous interruptible load, and firm Exports are treated in a manner equivalent to indigenous firm load.

In light of this, the issue of financial exposure (although as noted in C, below, the Tariff does provide compensation for curtailed Exports), is one of risk allocation, and the situation that would give rise to the risk is the equivalent of a *force majeure* event. As with similar occurrences, this risk is best dealt with contractually by the parties to the Export transaction. Just as parties to interruptible Export contracts must factor the risk of interruption of an Export contract into their transactions, so must parties to firm Export contracts, to a lesser degree. That the more likely cause of firm Export interruptions is equipment malfunction, as Complainants admit (Complaint at 18-19), rather than intentional curtailment only serves to underscore the logic of dealing with the remote Stage 3 Emergency contractually.

B. During Times When Exports Might Be Curtailed, Generators Are in a Position to Exercise Market Power

The circumstances to which the Complaint is addressed are precisely the times when the markets administered by the ISO are apt not to be workably competitive and thus when Generators are likely to enjoy market power.

For much of the year the markets administered by the ISO are workably competitive. At times of high load, however, the opportunity to exercise market power exists. This has been the judgment both of the ISO's Department of Market Analysis ("DMA") and of the independent Market Surveillance Committee ("MSC").

As reported by DMA,

> *While the markets are workably competitive during most hours, there is clearly market power during hours in which system loads are the highest. Historical prices suggest that market power is most significant when ISO system loads exceed 40GW. This occurred in 121 hours in 1998 (approximately 1.4% of the total hours per year) and in 57 hours in 1999 (less than 1% of the total hours per year). In these hours, individual suppliers run little or no risk of not being called if their bid prices are too high, and thus there is no constraint on how high they might raise their prices in the absence of price caps.*

Price Cap Policy for Summer 2000.[6] The MSC has reached a similar conclusion. *See The Competitiveness of the California Energy and Ancillary Services Markets*, March 9, 2000 at 1-2.[7]

Assuming, therefore, the presence of market power, the need for mitigation is apparent. The question is what payment level would compensate fairly the Generator for a curtailed sale while mitigating the potential for the exercise of market power. In Part C, below, we discuss the compensation already provided by the ISO Tariff and demonstrate its reasonableness. We anticipate that Complainants' response will be twofold. First, that the Exports that may be curtailed are sales

---

[6] Prepared by the Department of Market Analysis, California ISO, March 2000, at 2 (emphasis in original). This Report is included herewith as Attachment A.

[7] Attachment B.

made competitively[8] and, therefore, that "full" cost recovery would be consistent with mitigation objectives. Second, as Complainants already contend, that the end-result of the ISO's refusal to accept their proposal amounts to circumvention of the Commission's ruling in *Morgan Stanley Capital Group, Inc. v. California Independent System Operator Corporation*, 92 FERC ¶ 61,112 (2000). Neither response has merit.

First, there simply is no feasible way to monitor the consistency of prices negotiated in connection with Exports with the objective of market power mitigation. Apart from the fact that the absence of workable competition is likely to spread to contiguous states when the precipitating factor is high demand, the dollar compensation that actually changes hands may be influenced by circumstances apart from the discrete transaction. In the case of affiliates, the "policing" function would be difficult enough; in the absence of affiliation, it would be daunting, indeed.[9]

Nor is it true that adoption of Complainants' proposal is necessary to avoid circumvention of *Morgan Stanley*. To be sure, the Commission held therein that Generators are free to pick the markets in which they choose to do business; that they cannot be forced to <u>bid</u> into the ISO's markets and accept its purchase price caps to the exclusion of other market opportunities. We do not, however, understand *Morgan Stanley* to be addressed at all to the rare scenario that would give rise to the need to curtail firm transactions (including both service for load within the ISO Controlled Grid as well as Exports) in response to System Emergencies that

[8] At times this might be the case. It would not always be the case, however, as the circumstances that give rise to high demands in California do not typically respect state boundaries. Therefore, a lucrative export might well be the product of an exercise of market power outside the ISO Control Area.

[9] For example, in the case of companion transactions that bear no direct linkage but provide mutual consideration.

threaten interconnected operations. There is no dispute that in those emergency circumstances curtailment would be appropriate. Complaint at 5-6. The only question is one of compensation, and as we now show there already is provision for fair, non-discriminatory compensation in the Tariff.

C. The Tariff Already Provides Appropriate Compensation

Complainants suggest that absent adoption of their proposal, Exports might be curtailed without the payment of fair compensation. Complaint at 5. That is not the case. Section 11.2.4.2 of the Tariff describes the compensation applicable to such curtailments. Curtailed Exports would be compensated by payment either of the Hourly Ex Post Price or a calculated price containing (1) a capacity component based on certain market indices, (2) an Energy component based on certain market indices, (3) verifiable start-up fuel costs, and (4) verifiable gas imbalance charges (if any). The payment option is based upon an election made on a yearly basis by the Scheduling Coordinator concerned. Thus, if an Export were curtailed in an actual or threatened Emergency the payment would be either a high or capped Market Clearing Price ("MCP") for the Imbalance Energy market (*i.e.*, the Hourly Ex Post Price) or the calculated price. These payment options were approved as reasonable as part of the order on Amendment No. 23. 90 FERC at 61,015.

Dissatisfied with the payment options available, Complainants challenge the applicability §11.2.4.2 on two purported bases: the failure to reference curtailed Exports explicitly and the fact that firm Exports would not be curtailed until the ISO

exhausts all other opportunities for the avoidance of the System Emergency. Complaint at 16-17.

With respect to the applicability of §11.2.4.2, by its clear terms it applies broadly to actions taken by the ISO that result in the alteration of operations of resources that have not bid into the ISO's markets. Exports clearly fit that definition. When the ISO curtails an Export the *de facto* effect is to make the curtailed power available to the ISO Controlled Grid, on a basis that would be precisely analogous to an out-of-market ("OOM") call. Complainants acknowledge that §11.2.4.2 explicitly covers such calls (Complaint at 16), while denying that it could apply to curtailed Exports, as well. The Commission's approval of the reasonableness of those payment options in this circumstance is equally applicable for Exports.

Complainants distinguish curtailed Exports from OOM calls by referencing the Exports' "high curtailment priority". Complaint at 17. That the ISO would exhaust all available avenues of relief before curtailing Exports, including procuring out-of-market resources, is a curious basis for denying applicability of §11.2.4.2. Rather, it goes to the point made previously, that the "risk", which the Complainants express a purported need for extraordinary relief to guard against, is a most unlikely one, better safeguarded in the contractual negotiations between the sophisticated parties to the Export transaction.

D. The New England and New York Precedents Offered by Complainants Support Rejection of the Complaint

Citing filings proposed by NEPOOL and by the New York Independent System Operator ("NYISO"), Complainants contend that Commission precedent

requires the payment of "opportunity costs" where Exports are curtailed. The cited authority is inapposite; indeed, it is supportive of the current California approach.

The NEPOOL filing was the conclusion of a series of actions that began with elimination of its Operable Capacity market. In response to that effort, a generator complained that the elimination would deprive it of a source of revenues that served as a hedge against financial exposure suffered when Exports are curtailed in response to certain emergency conditions (known as "OP4" conditions). *New England Power Pool,* 90 FERC ¶ 61,168, 61,536 (2000). The Commission rejected that objection but did express sympathy with the notion that some measure of compensation would be appropriate, and it directed:

> the ISO and NEPOOL to address the issue of how generators should be paid when exports are curtailed due to OP4 conditions to assure that generators are adequately compensated for the services they provide. If there is the need for a hedge against or a guarantee of recovery of such lost opportunity costs, it should be considered through an appropriate market-based mechanism.

90 FERC at 61,540, emphasis added. The Commission stopped far short of imposing a requirement for compensation that includes recovery of "opportunity costs." Indeed, it invited a submission "if there is the need."[10] Subsequently, when a compensation mechanism was filed, it was accepted with the routine caveat that acceptance "does not constitute approval of any service, rate, charge, classification, or any rule, regulation, contract, or practice affecting such rate or service provided

[10] This is quite different from how it is characterized in the Complaint. Complainants allege that the Commission "specifically noted the need for an appropriate mechanism to serve as 'a hedge against or guarantee of recovery of [ ] lost opportunity costs.'" Complaint at 11. As noted above, the Commission's actual statement was "If there is the need for a hedge…." 90 FERC at 61,540.

for in the filed documents." *New England Power Pool*, 91 FERC ¶ 61,303, 62,034 (2000).

Moreover, the Operable Capacity market was part of the original design of the market in New England and it was the elimination of that market that Generators argued removed an existing hedging opportunity from the market design in New England. In contrast, there has been no change in either the ability to hedge or the various hedging options available to Market Participants in California. First, the market design in California never included a product or market similar to the Operable Capacity market in New England. Second and more importantly, the ISO's option to curtail firm load and Exports during a Stage 3 Emergency has been part of market design in California since start up. Thus, unlike the situation in New England, nothing has occurred that eliminates the existing options or ability of exporters to hedge the identified risk (*i.e.*, the risk that during a Stage 3 Emergency firm Exports may be curtailed). While the ability to hedge has not changed, the Complainants argue that the need (as opposed to the ability) to hedge has increased with the reduction in the ISO's purchase price cap to $250. The possibility that the ISO's purchase price cap could change with Governing Board approval, however, is also something Market Participants have known for over two years, and something which already should have been included in any Market Participant's contracting strategy.

Furthermore, the NEPOOL filing enjoyed, according to the transmittal letter, "broad consensus." While there were a number of abstentions among the NEPOOL

participants, the proposed compensation mechanism was "unanimously approved." *New England Power Pool*, Docket No. ER00-2735-000, Transmittal Letter, June 5, 2000 at 3-4. In sharp contrast, as the Complaint here acknowledges, the proposal now advanced was rejected by the Governing Board of the ISO by a nearly unanimous vote. Complaint at 15.

Even if the NEPOOL Order were of precedential significance, Complainants' characterization of its proposal as paralleling that submitted by NEPOOL is highly inaccurate. *See* Complaint at 14, n. 10. While the Complainants' over-broad proposal would obligate the ISO, without limitation, to reimbursement of the seller for "any penalties or other charges incurred by a seller for non-delivery" (Complaint, Attachment 5), the NEPOOL filing made clear that "in no event should such [replacement] price include any penalties, ratcheted demand or similar charges." *New England Power Pool*, Docket No. ER00-2735-000, Transmittal Letter, June 7, 2000, Attachment 1.

Finally, there is absolutely no indication that market power mitigation had any bearing in consideration of the NEPOOL proposal.

The cited NYISO action offers even less support for Complainants; if anything, it confirms the propriety of the approach taken in California. *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 (2000). The issue there was whether, in the context of mandatory bids that were subject to a cap, suppliers selected to provide non-spinning reserves should be made whole for the opportunity costs of lost sales in connection with market-clearing bids submitted in the NYISO

energy market. Compensation for spinning reserves already included such lost opportunity costs. 91 FERC at 61,802. Apart from the fact that at issue were services routinely provided, as opposed to those required in circumstances of *extremis*, the compensation was a market clearing price in the market administered by the NYISO, directly analogous to the Hourly Ex Post Price option of ISO Tariff §11.2.4.2.

Another important point to take from the *NYISO* case cited by Complainants is that different procedures are appropriate for different ISOs. In the New York order the Commission noted, without criticism, the fact that the California ISO provided for no opportunity cost reimbursement in its non-spinning reserves market. The Commission distinguished the cases in part by observing that non-spinning reserve suppliers in California, aware that they would receive no opportunity costs otherwise, factor such costs into their bids (while still coming in under the cap). 91 FERC at 61,802. The Commission thus clearly realizes that ISOs need not operate in lock step with their colleagues in order to achieve a fair and appropriate result.

IV. CONCLUSION

The authorities relied upon by Complainants are inapplicable and, if anything, support the reasonableness of the payment provision already in the ISO Tariff. Moreover, the Complaint is addressed to an extremely unlikely occurrence but one which, if it occurs, amply justifies restraining compensation to clearing prices within the ISO-administered market.

The Complaint should be rejected.

Respectfully submitted,

____
Charles F. Robinson
General Counsel
Roger E. Smith
Senior Regulatory Counsel
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630

____
Edward Berlin
Kenneth G. Jaffe
David B. Rubin
Julia Moore
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W.
Suite 300
Washington, DC 20007-3851

Counsel for the California Independent System
Operator Corporation

Dated: August 14, 2000