

114 FERC ¶ 61, 135
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly

California Independent System Operator Docket No. EL06-44-000

ORDER ON SECTION 206 INVESTIGATION INTO WECC-WIDE PRICE CAP AND
THE CAISO ANCILLARY SERVICE CAPACITY BID CAP

(Issued February 13, 2006)

1. On January 13, 2006, the Commission issued an order¹ in which we instituted, under section 206 of the Federal Power Act (FPA),² an investigation into the price cap in the Western Electricity Coordinating Council (WECC) outside of the California Independent System Operator Corporation (CAISO). The Commission also instituted a section 206 investigation into the CAISO's ancillary service capacity bid cap, in order to consider whether any incentives that distort a supplier's choice between offering energy or ancillary services will result from the rise in gas prices and the increase in the CAISO energy bid cap. The January 13 Order established a refund effective date pursuant to the provisions of section 206. In this order, the Commission modifies the price cap on spot market sales in the WECC outside of the CAISO to a \$400/MWh "soft" cap, effective upon issuance of this order. This order also raises the ancillary service capacity bid cap in the CAISO to a \$400/MWh "soft" cap, effective upon issuance of this order.

Background

2. On December 21, 2005, the CAISO filed a tariff amendment (Amendment No. 73) proposing to change its current "soft" \$250/MWh bid cap for real-time energy bids and adjustment bids to a "hard" \$400/MWh bid cap, effective January 1, 2006 or as soon thereafter as possible.³

¹ *California Independent System Operator Corp.*, 114 FERC ¶ 61,026 (2006) (January 13 Order).

² 16 U.S.C. § 824e (2000).

³ A "soft" cap is one where market participants may submit bids above the bid cap with adequate justification, but without setting the market clearing price. A "hard" cap is one where market participants' bids are not permitted to exceed the cap, regardless of the
(...continued)

3. On January 13, 2006, the Commission issued an order⁴ accepting the CAISO's proposal to adjust its bid cap for real-time energy bids and adjustment bids to \$400/MWh. However, the January 13 Order rejected the CAISO's proposal to change the current "soft" cap to a "hard" cap during the interim period prior to the implementation of MRTU and a resource adequacy mechanism.

4. The January 13 Order also instituted an investigation into the price cap in the WECC outside the CAISO and the ancillary service capacity bid cap in the CAISO. Specifically, the Commission proposed to change the price cap in the WECC outside the CAISO to a \$400/MWh "soft" cap, and requested comments on the appropriate level of the CAISO ancillary service capacity bid cap. The Commission gave entities 10 days from issuance of the January 13 Order to comment. The refund effective date established pursuant to section 206(b) of the FPA, as amended by section 1285 of the Energy Policy Act of 2005, is the date upon which the January 13 Order was published in the *Federal Register*.

Bid Cap Background

5. In July 2002, the Commission established a bid cap of \$250/MWh for the California real-time energy and ancillary services markets.⁵ Additionally, the Commission applied this bid cap to day-ahead markets when implemented by the CAISO. The July 2002 Order also imposed a price cap of \$250/MWh for all spot market sales in the WECC.⁶

6. On October 11, 2002, the Commission issued an order on rehearing and compliance filing.⁷ The October 2002 Order clarified that sellers may continue to submit bids above the bid cap with the understanding that such bids cannot set the market clearing price and that these bids above the cap will be subject to justification and refund.⁸

seller's costs.

⁴ January 13 Order, 114 FERC ¶ 61,026.

⁵ See *California Independent System Operator Corp.*, 100 FERC ¶ 61,060 (July 2002 Order), *order on reh'g*, 101 FERC ¶ 61,061 (2002).

⁶ *Id.*

⁷ *California Independent System Operator Corp.*, 101 FERC ¶ 61,061 (2002) (October 2002 Order).

⁸ *Id.* at P 17.

7. On July 1, 2005, the Commission issued an order finding that the bid cap for California market energy bids should be increased to a “hard” \$500/MWh cap on day one of MRTU implementation.⁹ The July 2005 Order reaffirmed that the bid cap for ancillary services and Residual Unit Commitment (RUC) availability should remain at \$250/MWh.¹⁰

Notice of Filing and Responsive Pleadings

8. Notice of the Commission’s institution of this FPA section 206 investigation was published in the *Federal Register*, 71 Fed. Reg. 6063 (2006), with interventions and protests due on or before January 23, 2006. Modesto Irrigation District (MID) filed a motion to intervene. California Public Utilities Commission (CPUC) filed a notice of intervention in Docket No. EL06-44-000.¹¹ California Electricity Oversight Board (CEOB), Indicated Parties,¹² the Northern California Power Agency (NCPA), Portland General Electric Company (Portland), Powerex Corp. (Powerex), Public Service Company of New Mexico (PSNM), and Williams Power Company, Inc. (Williams) filed motions to intervene and comments. Southern California Edison Company (SCE), Pacific Gas and Electric Company (PG&E), and CPUC jointly filed comments. The City of Takoma, Washington (Takoma) filed comments.

⁹ *California Independent System Operator Corp.*, 112 FERC ¶ 61,013 at P 104 (2005) (July 2005 Order)..

¹⁰ *Id.* at P 111 (reaffirming the Commission’s October 2003 and June 2004 Orders which determined that the bid caps for ancillary services and RUC availability should be \$250/MWh. *See California Independent System Operator Corp.*, 105 FERC ¶ 61,140, *reh’g denied*, 105 FERC ¶ 61,278 (2003); *California Independent System Operator Corp.*, 107 FERC ¶ 61,274, *order on reh’g*, 108 FERC ¶ 61,254 (2004)).

¹¹ CPUC’s pleading also included a motion to intervene out-of-time in Docket No. ER06-354-000. The Commission will address this motion in that docket.

¹² The Indicated Parties consist of Avista Energy, Inc., Puget Sound Energy, Inc., Coral Power, L.L.C., Sempra Global, and Constellation Energy Commodities Group, Inc. (CCG). Indicated Parties’ pleading also included a motion to intervene out-of-time in Docket No. ER06-354-000 for CCG and Sempra Global. The Commission will address this motion in that docket.

Discussion

Procedural Matters

9. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to these proceedings.

Price Cap in the WECC Outside the CAISO

Comment Summary

10. The CEOB, CPUC, SCE, PG&E, Indicated Parties, and Williams argue that the price-cap level for spot market sales in the WECC outside the CAISO should be changed to a \$400/MWh “soft” cap in order to mirror the CAISO \$400/MWh bid cap established by the Commission’s January 13, 2006 Order. The CEOB, CPUC, SCE, and PG&E argue that this is necessary to avoid creating an energy bid cap differential between California and WECC that could set the stage for non-competitive behavior of the type seen during the California energy crisis. Commenters note that the entire WECC market, including California, has faced the same changes in market conditions since the bid cap was introduced in 2002, and accordingly, concerns over high and volatile natural gas prices are equally applicable to the non-CAISO WECC markets. Commenters assert that maintaining different price caps in physically connected markets could lead to reduced supply options available to WECC purchasers, and argue that such market distortions can be alleviated by raising the WECC price cap outside of the CAISO to \$400/MWh.

11. Many commenters note that Commission precedent and market realities support setting the CAISO bid cap and the non-CAISO WECC price cap at the same level. As argued by PSNM, “so long as price caps remain in place, the price cap applicable to spot market sales in the WECC outside of the CAISO must mirror that CAISO bid cap, to avoid artificial market distortions that could result from restraining prices in one region below those applicable to an adjoining region. . . .By so acting, the Commission will ensure a level playing field for sellers and buyers throughout the WECC, and will help to ensure that supply adequacy in the WECC will not be affected adversely by inconsistent [market power] mitigation provisions.”¹³

12. Takoma states that it neither supports nor opposes the Commission’s proposal to increase the price cap in the WECC outside the CAISO, but states that the Commission

¹³ PSNM comments at 6-7.

may not implement a change to the price cap in the WECC without first finding that the existing rate or practice is unjust, unreasonable, unduly discriminatory or preferential.

13. No intervenor opposes modifying the current price cap on spot market sales in the non-CAISO WECC to a \$400/MWh “soft” cap.

Commission Determination

14. As the Commission has noted in prior orders, “California is an integral part of a trade and reliability region in the West. Because of this interdependency of market and infrastructure, conditions in and changes to the California market affect the entire region.”¹⁴ Given this interdependency, we find that it is unjust and unreasonable to have inconsistent bid caps in the CAISO and the rest of the WECC. Accordingly, pursuant to our authority under section 206 of the FPA, we hereby find that the price cap for spot market sales in the non-CAISO WECC¹⁵ established by the July 2002 Order is no longer just and reasonable, and find that the just and reasonable price cap is a \$400/MWh “soft” cap. Therefore, we establish a \$400/MWh “soft” price cap in the WECC outside the CAISO, effective upon issuance of this order.

Requested Clarification on Documentation

Comment Summaries

15. Indicated Parties also request that the Commission clarify the type of documentation that must be provided by a seller seeking to justify prices above the applicable “soft” cap established in the Commission’s October 2002 Order. Indicated Parties argue that more certainty about the types of documentation required to make such a showing would help expedite future filings.

¹⁴ July 2002 Order, 100 FERC ¶ 61,060 at P 2.

¹⁵ As defined in our June 19, 2001 Order, spot market sales in the WECC are sales that are 24 hours or less and are entered into the day of or day prior to delivery. *See 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*, 95 FERC ¶ 61,418 at n. 3 (2001) (June 2001 Order).

Commission Determination

16. We deny the Indicated Parties' request for clarification of the specific type of documentation that must be provided by a seller to justify prices above the cap. Because we cannot anticipate all of the possible justifications, we decline to delineate the specific types of documentation a seller might provide, and would consider any such filing on a case-by-case basis.

CAISO Ancillary Service Capacity Bid Cap

Comment Summary

17. The CPUC, PG&E, SCE, and PSNM provide no comment on the CAISO ancillary services capacity bid cap.

18. Portland asserts that the Commission should raise the CAISO's ancillary service capacity bid cap. Powerex (whose comments are supported by Indicated Parties) argues that retaining a \$250/MWh bid cap on ancillary services capacity while raising the energy bid cap to \$400/MWh would create an economic incentive for a resource to sell energy rather than provide contingency capacity to the CAISO if energy prices rise above the \$250/MWh ancillary service capacity bid cap. Powerex asserts that such an outcome would most likely occur during peak load periods when the CAISO has the greatest demand for ancillary services, but would offer no incentive to suppliers to provide capacity. Powerex argues that the "soft" nature of the cap does not justify retaining the \$250/MWh bid cap on capacity because it does not factor in the costly administrative burden, as well as the uncertainty, of the cost justification process. Powerex argues that bid caps should be the same for both the CAISO energy and ancillary service capacity markets.

19. Williams notes the Commission's concern that under the current CAISO market design, which does not co-optimize energy and ancillary services, the price of energy could have an impact on the price of ancillary services. Thus if the ancillary service capacity bid cap is below the opportunity cost a seller could incur, the suppliers may choose to provide energy instead of ancillary services. Williams argues that making the CAISO ancillary service capacity bid cap equal to the energy bid cap is the simplest way to eliminate the Commission's concern.

20. Williams also suggests that the CAISO misses the mark by suggesting that PJM's energy cap of \$1,000/MWh and ancillary services cap of \$100/MWh support the

CAISO's proposal to leave the CAISO ancillary services cap at \$250/MWh.¹⁶ Williams states that ancillary services offered in PJM, such as regulation and spinning reserves, receive not only the capacity payment, but also an additional payment for the lost energy opportunity costs associated with providing the ancillary service. Williams points out that this is not true of the CAISO's current market settlement process for ancillary services, and thus, reference to PJM's bid cap structure is not appropriate. Williams

further states that increasing the ancillary service capacity bid cap would help to alleviate the CAISO's prior-stated concerns¹⁷ over increasing participation in the CAISO's ancillary services markets.

21. The CEOB is the only intervenor who currently opposes raising the ancillary service capacity bid cap. It argues that (1) the Commission does not have an adequate record before it at this time, and thus, any decisions made will be based on conjecture and not analysis; and (2) the increase in the energy market bid cap under Amendment 73 was driven by rising natural gas prices which are largely avoided in the ancillary services market. The CEOB asserts that the rising cost of natural gas is not a direct issue in analyzing the CAISO's ancillary service bid cap. The CEOB submits that a more grounded approach would be to set the ancillary service capacity bid cap in relation to the underlying costs of producing the service, just as the energy bid cap is set in relation to the cost of providing energy, rather than equating the bid caps in absolute terms. According to the CEOB, a generator should then be profit-indifferent, and thus have an equal incentive to participate in both the energy and ancillary services markets. The CEOB further notes that although the Commission rejected a motion¹⁸ filed by several California parties to extend the comment period, the CEOB anticipates a settlement proposal will be forthcoming that may address the CAISO's ancillary service capacity bid cap. Lastly, CEOB argues that Powerex's worst-case scenario is most likely to occur during peak demand months, thus there appears to be no reason that the Commission

¹⁶ Williams attributed these comments to the CAISO's December filing, but they are found in the CAISO's January 5, 2006 Answer in Docket No. ER06-354-000 at 8.

¹⁷ Williams notes that the CAISO cited ancillary service bid insufficiency in its Amendment No. 60 filing in Docket No. ER04-835, May 11, 2004 transmittal letter at 28.

¹⁸ Joint Motion for Extension of Time to Comment and for Expedited Consideration, filed by SCE, PG&E, SDG&E, the CPUC, and the CAISO (Joint Parties), January 17, 2006, wherein the Joint Parties requested an additional 31 days to comment, noting that they are currently in settlement negotiations in Docket EL05-147 concerning unspecified issues "that directly relate to the issues raised in the Commission's section 206 investigation."

could not convene a proceeding to develop an evidentiary record to support the Commission's ultimate decision on that issue.

Commission Determination

22. We find that the existing bid cap for ancillary services in California is no longer just and reasonable, and that it is just and reasonable to raise the cap to \$400/MWh as a "soft" cap. As we noted in the January 13 Order, a generator may incur energy opportunity costs in providing ancillary services. Specifically, in periods when the energy price exceeds the generator's incremental cost of producing energy, the generator could have earned profits by selling energy, but gives up those profits to the extent that it provides ancillary services instead. By raising the energy bid cap to \$400/MWh, the profits from selling energy – and thus, the opportunity costs to provide ancillary services – may increase for at least some generators, especially those that do not use natural gas. If the ancillary service capacity bid cap is below the opportunity cost of providing ancillary services, the generator may choose to provide energy rather than ancillary services. We agree with Williams that the simplest way to alleviate this concern, given the CAISO's other market design rules, is to raise the ancillary service capacity bid cap to the level of the energy bid cap, *i.e.*, to \$400/MWh.

23. In opposing an increase in the ancillary service capacity bid cap, the CEOB argues that this cap should be set in relation to the underlying costs of providing the service, and that the recent increases in natural gas prices have not increased the underlying cost of providing ancillary services. However, the CEOB fails to consider the fact that sellers providing ancillary services may incur opportunity costs, and that higher energy costs may increase those opportunity costs.

24. We agree with Williams that the CAISO's comments in its December filing regarding PJM's bid cap for regulation service fail to support a policy of setting the California ancillary service capacity bid cap below the energy bid cap. As Williams observes, PJM's market design is different from the CAISO's market design. In particular, PJM's market rules automatically pay generators for opportunity costs (calculated as the difference between the applicable Locational Marginal Pricing (LMP) and the generator's energy bid). In addition, PJM allows each generator to submit a bid to recover other costs (in excess of these opportunity costs) associated with providing regulation service; PJM's regulation service bid cap only limits this latter bid. Thus, the compensation received for providing regulation service in PJM can include both opportunity costs and an additional amount based on regulation service bids. By contrast, the current CAISO market rules do not automatically pay opportunity costs to ancillary service providers; so sellers must factor opportunity costs into their ancillary service bids. We note that under the CAISO's MRTU, proposed to be implemented in 2007, ancillary service prices will automatically reflect the opportunity cost of providing reserves and, therefore, unlike today's market design, market participants will not need to incorporate opportunity costs into their ancillary service capacity bids.

25. Based on these facts, the Commission finds that the CAISO ancillary service capacity bid cap should be raised to a \$400/MWh “soft” cap, effective upon issuance of this order. The Commission directs the CAISO to make a compliance filing within 20 days of the date of issuance of this order modifying its tariff to incorporate this \$400/MWh “soft” bid cap for ancillary services.

The Commission orders:

(A) The Commission hereby establishes a \$400/MWh “soft” price cap in the WECC outside the CAISO, effective upon issuance of this order.

(B) The Commission hereby directs the CAISO to implement a \$400/MWh “soft” cap for ancillary service capacity bids, effective upon issuance of this order. The Commission hereby also directs the CAISO to make a compliance filing within 20 days of the date of issuance of this order revising its tariff to incorporate this \$400/MWh “soft” bid cap for ancillary services.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.