

March 28, 2005

**Via Electronic Filing**

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. ER05-595-000**

Dear Secretary Salas:

Enclosed please find the Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Motions to Intervene and Protests, submitted in the captioned docket. It has come to our attention that this exact same filing was inadvertently submitted on March 25, 2005 in Docket No. ER03-595-000. We apologize for any confusion that may have resulted.

Feel free to contact the undersigned with any questions. Thank you for your attention to this matter.

Respectfully submitted,

/s/ Bradley R. Miliauskas  
Kenneth G. Jaffe  
Bradley R. Miliauskas

Counsel for the California  
Independent System Operator  
Corporation

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**California Independent System            )     Docket No. ER05-595-000  
Operator Corporation                    )**

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

On February 17, 2005, the California Independent System Operator Corporation (“ISO”)<sup>1</sup> submitted an amendment to the ISO Tariff (“Amendment No. 65”) in the captioned proceeding. The purpose of Amendment No. 65 is to establish an additional criterion governing when the bid-based methodology should be used to calculate decremental reference levels (the “Potomac standard”). The revision proposed in Amendment No. 65 is the exact same revision that the ISO submitted in its compliance filing of May 17, 2004 (“May 17, 2004 Compliance Filing”), in Docket No. ER03-683, the proceeding concerning Amendment No. 50 to the ISO Tariff (“Amendment No. 50”), and which the Commission found to be “necessary to correct a fundamental flaw in the proposed decremental reference bid methodology.” *See California Independent System Operator Corporation*, 107 ¶¶ 61,042, at P 62 (2004) (“April 16, 2004 Order”). In the Commission’s January 6, 2005 Order in that proceeding, the Commission directed the ISO to submit the revision in a stand-alone filing under

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<sup>1</sup> Capitalized terms not otherwise defined herein have the meaning set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff.

Section 205 of the Federal Power Act (“FPA”). *California Independent System Operator Corporation*, 110 FERC ¶ 61,007, at P 31 (“January 6, 2005 Order”).

A number of parties submitted motions to intervene in response to Amendment No. 65, and two parties also submitted protests.<sup>2</sup> Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213, the ISO hereby respectfully requests leave to file an answer, and files its answer, to Coral Power’s protest.<sup>3</sup>

Coral Power is virtually alone in protesting Amendment No. 65.<sup>4</sup> The parties that intervened but that *did not* protest or even comment on Amendment No. 65 constitute a cross-section of the electric industry: municipal agencies, a governmental agency (the CPUC), and generators (Williams and TDM). In fact, TDM declined to protest or comment on Amendment No. 65 even though, like Coral Power, it protested a number of ISO filings throughout the Amendment No.

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<sup>2</sup> Motions to intervene were submitted by: the Cities of Santa Clara and Redding, California, and the M-S-R Public Power Agency; Modesto Irrigation District; Northern California Power Agency; Termoeléctrica de Mexicali de R.L. de C.V. (“TDM”); and Williams Power Company, Inc (“Williams”). The California Public Utilities Commission submitted a notice of intervention (“CPUC”). Coral Power, L.L.C., Energia Azteca X, S. de R.L. de C.V., and Energia de Baja California, S. de R.L. de C.V. (collectively, “Coral Power”) and the California Electricity Oversight Board (“EOB”) submitted motions to intervene and protests.

<sup>3</sup> The ISO requests waiver of Rule 213(a)(2) (18 C.F.R. § 385.213(a)(2)) to permit it to make an answer to Coral Power’s protest. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case. See, e.g., *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Company*, 93 FERC ¶ 61,098, at 61,259 (2000).

<sup>4</sup> The EOB also filed a protest; however, the protest does not address the substance of the ISO’s proposed mechanism for determining decremental reference levels. Rather, the EOB argues that such mechanism should be made effective as of January 20, 2004 and that Amendment No. 65 is unnecessary because the Commission previously found the mechanism to be just and reasonable and the ISO included the mechanism in tariff language in the May 17, 2004 Compliance Filing in the Amendment No. 50 proceeding. For the reasons set forth in the ISO’s February 7, 2005 request for rehearing in Docket No. ER03-683, the ISO agrees with the EOB.

50 proceeding in Docket No. ER03-683. As explained below, the Commission should reject the arguments presented by Coral Power. The Commission has already found the Potomac standard to be necessary and thus to be just and reasonable. Moreover, in Docket No. ER03-683, the Commission has already rejected the very arguments that Coral Power repeats now in opposition to the use of the Potomac standard. Therefore, the Commission should accept Amendment No. 65 as filed and grant the effective date requested by the ISO.

## **I. ANSWER**

### **A. Background<sup>5</sup>**

On January 16, 2004, Potomac Economics (“Potomac”) identified a concern with the methodology used to determine decremental reference prices based on bids during “competitive periods.” Transmittal Letter for Amendment No. 65 at 2-3. To address this concern, on January 20, 2004, Potomac implemented the Potomac standard and the ISO issued a notice to all Market Participants announcing its implementation. *Id.* at 3. On February 2, 2004, Coral Power submitted in the Amendment No. 50 proceeding a “Supplemental Protest” of the Potomac standard, in which Coral Power asked the Commission, *inter alia*, to “issue an emergency order that directs the ISO to cease and desist from further implementation of [the Potomac standard] and further directs the ISO to revert to the pre-Amendment No. 50 procedures for managing congestion . . . .”<sup>6</sup>

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<sup>5</sup> This background section supplements the background section contained in Amendment No. 65, and is included to provide context for the discussion contained in the rest of this answer.

<sup>6</sup> Supplemental Protest of Coral Power to ISO Modification of Compliance Filing Without Request for or Receipt of Commission Authorization, and Request for Emergency Cease and

On February 17, 2004, the ISO submitted an answer to the February 2, 2004 Coral Power Supplemental Protest ("February 17, 2004 ISO Answer"),<sup>7</sup> and on March 3, 2004, Coral Power submitted an answer to the February 17 ISO Answer ("March 3, 2004 Coral Power Answer").

In an order on compliance filing issued on April 16, 2004, the Commission found that

the changes proposed by Potomac Economics were necessary to correct a fundamental flaw in the proposed decremental reference bid methodology and we therefore reject the supplemental protest of [Coral Power]. We will, however, direct the CAISO to incorporate the new test into section 7.2.6.1.1 of its tariff.

April 16, 2004 Order at P 62.

In compliance with this directive, the ISO included, *inter alia*, changes to the ISO Tariff to implement the Potomac standard in the May 17, 2004 Compliance Filing. As mentioned above, the tariff changes contained in the May 17, 2004 Compliance Filing are the same as the changes in Amendment No. 65. In the January 6, 2005 Order, the Commission noted that in the April 16, 2004 Order the Commission "found the standard implemented by Potomac Economics on January 20, 2004 to be necessary to correct a fundamental flaw in the proposed decremental reference bid methodology," and that the ISO "was directed to submit a compliance filing to incorporate the [Potomac standard] into section 7.2.6.1.1." January 6, 2005 Order at P 25. Nowhere in the January 6,

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Desist Order, Docket No. ER03-683-003 (filed Feb. 2, 2004), at 2 ("February 2, 2004 Coral Power Supplemental Protest").

<sup>7</sup> That same day, Potomac submitted its own response to the February 2, 2004 Coral Power Supplemental Protest. For the Commission's convenience and reference, the ISO is including a copy of Potomac's response in Attachment A to the present filing.

2005 Order did the Commission reconsider or modify its finding that the Potomac standard is necessary to correct a fundamental flaw in the decremental reference bid methodology. The Commission found, however, that the Potomac standard “will not become effective until the CAISO makes a section 205 filing and that filing is accepted by the Commission.” *Id.* at P 31.

In response to the directive in the January 6, 2005 Order to submit the Potomac standard in a Section 205 filing, the ISO submitted Amendment No. 65. In its transmittal letter accompanying the proposed tariff changes, the ISO noted that it had sought rehearing of the requirement that the Potomac standard be included in a Section 205 filing. Transmittal Letter for Amendment No. 65 at 1. The ISO stated that by submitting Amendment No. 65, the ISO was not waiving the position taken in its request for rehearing, but that it was submitting Amendment No. 65 “to ensure that the competitiveness standard is included in the ISO Tariff as promptly as possible because it is necessary to protest against the exercise of market power in the decremental bid market.” *Id.* at 3.

**B. The Commission Has Already Found that the Tariff Changes Contained In Amendment No. 65 Meet the Commission’s Just and Reasonable Standard.**

Coral Power erroneously asserts that the tariff changes contained in Amendment No. 65 fail to meet the required burden of proof under Section 205 of the FPA. Coral Power at 4. The Section 205 burden of proof is to show that the proposed change is just and reasonable. 16 U.S.C. § 824d(a). The Commission has already found that the Potomac standard meets the just and reasonable standard. As explained in Section I.A, above, in the April 16, 2004 Order, the

Commission found that the Potomac standard was “necessary to correct a fundamental flaw in the proposed decremental reference bid methodology.” April 16, 2004 Order at P 62. The Commission made this finding based on the support for the Potomac standard provided by the ISO and Potomac. The May 17, 2004 Compliance Filing set out that necessary change in tariff language. The January 6, 2005 Order reiterated the finding in the April 16, 2004 Order that the Potomac standard was necessary. January 6, 2005 Order at PP 25, 31.

The Commission’s finding that the Potomac standard is necessary to the just and reasonable operation of the ISO’s interim Intra-Zonal Congestion Management approach necessarily satisfies the requirement, under Section 205, that the Potomac standard be just and reasonable.<sup>8</sup> The only thing the Commission said the ISO still needed to do with respect to the Potomac standard was submit it pursuant to a Section 205 filing rather than a compliance filing. In submitting Amendment No. 65, the ISO has followed the Commission’s directive (while preserving its position that the Commission was incorrect that the Potomac standard needed to be included in a Section 205 filing). Coral Power’s claim that the ISO failed to satisfy its burden of proof is therefore unfounded.

**C. Coral Power Repeats Arguments that the Commission Has Already Rejected.**

Coral Power presents a bevy of misplaced arguments to support its contention that the Commission should reject the Potomac standard. Coral

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<sup>8</sup> See, e.g., *Transcontinental Gas Pipe Line Corporation*, 106 FERC ¶ 61,299, at P 44 (2004) (approving continued use of bundled gas service (called GSS service) in relevant part because “while it is not Transco’s burden to show that its current bundled GSS service is just and reasonable, Transco has put forth testimony explaining why it is necessary to maintain the existing bundled GSS service . . . .”)

Power at 6-11. In doing so, however, Coral Power simply repeats *verbatim* arguments that the Commission already considered and rejected when Coral Power presented them in Docket No. ER03-683 in its effort to persuade the Commission to reject the Potomac standard on the merits.<sup>9</sup> The Commission should reject those same arguments now for the same reasons it rejected them in Docket No. ER03-683. Coral Power's repetition of its flawed arguments in the present proceeding does not make them any more persuasive.<sup>10</sup>

Moreover, Coral Power's assertion that Amendment No. 65 should be rejected because the ISO has not demonstrated that the bids of frequently decremented units are artificially low amounts to an argument that the ISO (or, for that matter, any independent system operator or regional transmission organization) may not file measures to preclude or deter Market Participants from exploiting flaws in its market design. Not only is that nonsensical, it is plainly not the law. The ISO must be permitted to file preventative measures to head off exploitation of market design flaws, and, conversely, must not be required to wait

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<sup>9</sup> Compare Coral Power at 6-7 with February 2, 2004 Coral Power Supplemental Protest at 10 (containing identical arguments); compare Coral Power at 8 with February 2, 2004 Coral Power Supplemental Protest at 9-10 (same); compare Coral Power at 9-10 with February 2, 2004 Coral Power Supplemental Protest at 11-12 (same); compare Coral Power at 10-11 with February 2, 2004 Coral Power Supplemental Protest at 12-13 (same). To be sure, in its Amendment No. 65 protest, Coral Power has rearranged the order of the arguments presented in the February 2, 2004 Supplemental Protest, but they are the same arguments nonetheless. It appears that Coral Power simply "cut and pasted" parts of the February 2, 2004 Supplemental Protest in order to cobble together arguments for its Amendment No. 65 protest.

<sup>10</sup> In particular, Coral Power argues that is unduly discriminatory not to apply the Potomac standard to imports. Coral Power at 8-10. However, Coral Power ignores the fundamental fact that the ISO's Commission-approved decremental reference price methodology does not apply to imports, and Potomac does not set decremental reference prices for imports. The Commission has already approved this approach in Amendment No. 50 and rejected Coral Power's arguments on this point. See *California Independent System Operator Corporation*, 107 FERC ¶ 61,028, at P 10 (2004). There is no need to revisit the issue here. Coral Power's argument is essentially a collateral attack on the approach approved by the Commission with respect to Amendment No. 50.



until after Market Participants have taken advantage of market design flaws before correcting them.

For example, the ISO notes that the Commission approved the ISO's proposed Enforcement Protocol as part of Amendment No. 55 to the ISO Tariff ("Amendment No. 55"). *California Independent System Operator Corporation*, 106 FERC ¶¶ 61,179 (2004). The Enforcement Protocol established a set of behavioral rules and specified prohibited behavior. In response to the ISO's Amendment No. 55 filing, numerous parties argued that the Commission should reject certain of the behavioral rules because the ISO failed to show that a problem actually existed or was likely to occur in the future. *See id.* at PP 49, 60. Those arguments did not preclude the Commission from approving such behavioral rules. Stated differently, the Commission did not require the ISO to demonstrate that specific types of improper behavior had already occurred (or were likely to occur in the future) before it would approve a behavioral rule(s) prohibiting such behavior. The same reasoning applies here. Potomac identified a flaw in the ISO's market design, and the ISO has filed tariff language to fix that flaw.

**D. Coral Power's Repetitious Arguments Are a Collateral Attack on, and Untimely Request for Rehearing of, the Commission's Directive that the Potomac Standard is Necessary.**

Coral Power's *verbatim* repetition of the arguments it presented unsuccessfully in Docket No. ER03-683 amount to an impermissible collateral attack on the Commission's directive that use of the Potomac standard is necessary to correct a fundamental flaw in the decremental reference bid

methodology. Coral Power did not seek rehearing of that directive in the April 16, 2004 Order, nor did Coral Power seek rehearing after the Commission repeated the directive in the January 6, 2005 Order. Coral Power states that it “respectfully disagree[s]” with the Commission’s finding that the Potomac standard is necessary. Coral Power at 10. The time for Coral Power to have disagreed with the Commission’s finding (respectfully or not) was on rehearing. Coral Power decided not to do so, and it may not take a different tack here.

Coral Power also argues that, in the April 16, 2004 Order, the Commission “credited the ISO’s assertions without scrutiny of the underlying factual predicate . . . when it stated, by way of *dictum*, that the [Potomac standard] was ‘necessary to correct a fundamental flaw in the proposed decremental reference bid methodology . . . .’” Coral Power at 5 (quoting April 16, 2004 Order at P 62). Coral Power should not assume that the Commission made its finding in the April 16, 2004 Order “without scrutiny of the underlying factual predicate.” The “underlying factual predicate” was clearly demonstrated to the Commission’s satisfaction and was scrutinized by the Commission, as shown by the fact that the Commission found the Potomac standard to be necessary. Further, if by “*dictum*” Coral Power means a gratuitous observation,<sup>11</sup> Coral Power misreads the Commission’s finding. The determination that the Potomac standard was “necessary to correct a fundamental flaw” was the Commission’s *central holding* with regard to the Potomac standard, and was the very reason provided by the

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<sup>11</sup> Black’s Law Dictionary states that the word “*dictum*” is “generally used as an abbreviated form of *obiter dictum*, ‘a remark by the way;’ that is, an observation or remark . . . not necessarily involved in the case or essential to its determination . . . .” *Black’s Law Dictionary* 454 (6th ed. 1990).

Commission for rejecting the February 2, 2004 Coral Power Supplemental Protest. Moreover, Coral Power's request that the Commission now "reconsider its *dictum*" (Coral Power at 6) amounts to a collateral attack on, and untimely request for rehearing of, the April 16, 2004 and January 6, 2005 Orders.

**E. No Hearing Is Required Concerning Amendment No. 65.**

Coral Power erroneously argues that that Commission should establish hearing procedures concerning Amendment No. 65. Coral Power at 15-17. As indicated by the same Commission orders that Coral Power cites, the Commission will only order a hearing where provisions have "not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful."<sup>12</sup> In the present proceeding, as explained in Section I.B, above, the Potomac standard has already been shown to be necessary and therefore is just and reasonable. Therefore, no hearing is required concerning Amendment No. 65. Coral Power's request for a hearing violates the Commission's policy against the re-litigation of issues that have already been decided.<sup>13</sup>

In any event, there are no issues of material fact that need to be fleshed out at a hearing. The Commission has issued countless orders on market rules, bidding methodologies, behavioral rules, and reference level methodologies without the need for a hearing. Similarly, there is no need for a hearing here.

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<sup>12</sup> *El Paso Electric Company*, 107 FERC ¶ 61,314, at P 11 (2004); *Trans-Elect NTD Path 15, LLC*, 109 FERC ¶ 61,249, at PP 30-31 (2004).

<sup>13</sup> *See, e.g., Tapoco, Inc.*, 47 FERC ¶ 61,022, at 61,072 (1989).

**F. The Commission Should Grant the ISO's Request for Waiver of the 60-Day Prior Notice Requirement.**

The standard for granting waiver of the 60-day prior notice requirement is contained in Section 35.11 of the Commission's regulations. The section states that the Commission may grant a waiver "[u]pon application and for good cause shown." 18 C.F.R. § 35.11. In order to demonstrate good cause, the applicant must show "(a) how and the extent to which the filing public utility and purchaser(s) under such rate schedule, or part thereof, would be affected if the notice requirement is not waived, and (b) the effects of the waiver, if granted, upon purchasers under other rate schedules." *Id.*

In Amendment No. 65, the ISO stated that good cause existed to grant a waiver of the prior notice requirement to permit the amendment to go into effect the day after filing (*i.e.*, February 18, 2005) or, in the alternative, on January 20, 2004 (the date the Potomac standard was implemented and the ISO provided notice to all Market Participants of its implementation). Transmittal Letter for Amendment No. 65 at 4-5. The ISO explained that making the amendment effective on February 18, 2005 would reduce the amount of time that the fundamental flaw the Commission found in the decremental reference bid methodology would persist, and that good cause existed, for four reasons, for granting the proposed alternative effective date of January 20, 2004. *Id.*<sup>14</sup>

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<sup>14</sup> The four reasons the ISO explained were that: (1) the ISO submitted tariff language establishing that bids during "competitive periods" would be used to establish reference price levels as part of its July 18, 2003 addendum in the Amendment No. 50 proceeding, and since January 20, 2004, all Market Participants have been on notice both that the Potomac standard for determining "competitive periods" would apply and as to the Potomac standard's implementation and specifics; (2) the Potomac standard should be made effective at the point in time it was implemented to correct the fundamental flaw that the Commission identified; (3) the inclusion of the Potomac standard in the May 17, 2004 Compliance Filing constituted "related necessary

Therefore, the ISO satisfied the requirement of Section 35.11 that it explain what the effect would be if the requested waiver were not granted. Moreover, the granting of the requested waiver would not have any effect on “purchasers under other rate schedules.” As a result, the ISO has demonstrated that good cause exists for granting the requested waiver pursuant to Section 35.11.

Coral Power asserts that the ISO has not demonstrated that good cause exists to grant waiver of the 60-day prior notice requirement as requested in Amendment No. 65. Coral Power at 11-14. Coral Power incorrectly describes the circumstances in which the Commission will grant such a waiver. It argues that the Commission has found it is restricted to granting a waiver only when the proposed tariff change “has no impact on rates, results in a rate decrease, or is prescribed by an agreement on file with the Commission . . . .”, or when “extraordinary circumstances” exist. Coral Power at 12-13. But the very case that Coral Power cites for support of its argument states that the Commission has “broad discretion to grant waiver of notice for good cause” and that “[t]he Commission’s authority to waive the requirement of 60-days’ prior notice for good cause rests entirely within its discretion.” *Central Hudson Gas & Electric Corporation*, 61 FERC ¶ 61,089, at 61,357 & n.11 (1992). Indeed, the Commission has approved amendments to the ISO Tariff without making reference to the supposed restrictions on the granting of a waiver that Coral

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changes” that could and should be made effective on the date the standard was implemented; and (4) if the ISO were to not be granted retroactive to January 20, 2004, the ISO would be compelled to undertake the costly, cumbersome, and unnecessary tasks of conducting a rerun process to reproduce the results of the flawed methodology and to make refunds based on that flawed methodology. Transmittal Letter for Amendment No. 65 at 4-5.

Power lists.<sup>15</sup> Therefore, the Commission is not constrained, as Coral Power suggests, as to when it may grant waiver. The Commission should exercise its discretion to grant the requested waiver with regard to Amendment No. 65 because the ISO has shown, pursuant to Section 35.11, that good cause exists for granting the waiver.

Further, even assuming *arguendo* that Coral Power were correct – which it is not – in its description of the circumstances in which the Commission will grant a waiver of the prior notice requirements, the effective date requested in Amendment No. 65 should be granted because of the existence of “extraordinary circumstances.” The Commission has found the Potomac standard to be necessary to correct a flaw in the decremental reference price methodology. For the reasons explained in Amendment No. 65, the Potomac standard should be made effective as soon as possible. Therefore, extraordinary circumstances justify the effective date requested by the ISO.

Notwithstanding the foregoing, the ISO believes that the Commission should grant the request for rehearing the ISO filed on February 7, 2005 in Docket No. ER03-683, which Commission action would mean that Amendment No. 65 would no longer be needed to implement the Potomac standard. Moreover, for the reasons the ISO explained in its request for rehearing, the Commission should approve a January 20, 2004 effective date for the Potomac

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<sup>15</sup> See, e.g., *California Independent System Operator Corporation*, 102 FERC ¶ 61,278, at P 23 (2003) (granting request for waiver to permit Amendment No. 48 to the ISO Tariff to go into effect retroactively); *California Independent System Operator Corporation*, 103 FERC ¶ 61,340, at P 12 (2003) (granting request for waiver to permit Amendment No. 52 to the ISO Tariff to go into effect one day after the issuance of the order approving the amendment, which was issued less than a month after the amendment was filed).

standard. At a minimum, the Potomac standard must be made effective no later than April 16, 2004, *i.e.*, the date on which the Commission issued an order in Docket No. ER03-683 finding the Potomac standard to be necessary and directed the ISO to file appropriate tariff language in a compliance filing. The ISO filed tariff language reflecting the Potomac standard in the May 17, 2004 Compliance Filing in Docket No. ER03-683. There is no lawful or reasonable basis for the Commission to approve a later effective date for the Potomac standard, especially given that the Commission has approved retroactive implementation of a mechanism for the recovery of Start-Up Costs – a mechanism that was filed with the Commission for the first time in the same May 17, 2004 Compliance Filing that included the Potomac standard. Indeed, there is an even stronger basis for making the Potomac standard effective on January 20, 2004 (or April 16, 2004 at the latest) than for making the Start-Up Cost recovery mechanism effective May 30, 2003. In that regard, it was not until January 6, 2005 that the Commission approved the recovery of Start-Up Costs for shut-down units; in contrast, the Commission found the Potomac standard to be necessary in an order issued on April 16, 2004.<sup>16</sup>

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<sup>16</sup> The arguments in the above paragraph concerning the effective date for the Potomac standard are discussed more fully in the ISO's February 7, 2005 request for rehearing at pages 15 to 22. The ISO incorporates those arguments by reference into the present filing.

## II. CONCLUSION

WHEREFORE, for the foregoing reasons, the ISO respectfully requests that the Commission grant leave to file the present answer, deny the relief requested by Coral Power, and accept Amendment No. 65 in its entirety as filed with the requested effective date.

Respectfully submitted,

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Filed: March 28, 2005



## ATTACHMENT A

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Telephone: 703-383-0720  
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February 17, 2004

VIA E-MAIL FOR ELECTRONIC FILING

Hon. Magalie R. Salas, Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, D.C. 20426

**Re: California Independent System Operator Corporation  
Docket No. ER03-683-003**

Dear Ms. Salas:

Potomac Economics Ltd. hereby submits an electronic version for filing of its Comments in Response to the Supplemental Protest of Coral Power, L.L.C. et al. in the above-referenced docket.

Thank you for your assistance.

Sincerely,

David B. Patton  
President  
Potomac Economics, Ltd.

cc: Official Service List of Docket No. ER03-683-000

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System )  
Operator Corporation ) Docket No. ER03-683-003  
)

**COMMENTS OF POTOMAC ECONOMICS LTD.  
TO THE SUPPLEMENTAL PROTEST OF  
CORAL POWER, L.L.C., ENERGIA AZTECA X, S. DE R.L. DE C.V. AND ENERGIA  
DE BAJA CALIFORNIA, S. DE. R.L. DE C.V.**

Potomac Economics Ltd. ("Potomac Economics") hereby submits its comments, pursuant to Rule 212 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.212, on the Supplemental Protest of Coral Power L.L.C., Energia Azteca X, S. De R.L. De C.V. and Energia De Baja California, S. De. R.L. De C.V. ("Coral Power"), filed February 2, 2004, in the above-referenced docket. The Supplemental Protest was filed in response to a change in the California Independent System Operator's ("CAISO") procedures used to determine reference levels, implemented on January 20, 2004.

If this filing is considered an answer under Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, Potomac Economics hereby requests leave to file an answer, and files its answer, to the protest submitted in the above-referenced docket, and requests that the Commission accepts this response as providing useful and pertinent information that aids the Commission.

On March 31, 2003, the CAISO submitted Amendment No. 50 to the CAISO Tariff ("Amendment No. 50") in the above-referenced docket. In 103 FERC ¶ 61,265 (2003) ("May 30

Order”), the Commission authorized the CAISO to dispatch units using a decremental reference price to mitigate Intra-Zonal Congestion and directed the CAISO to submit a compliance filing to further explain the procedure it intended to utilize to dispatch generating units. On June 30, 2003, the CAISO submitted its compliance filing, and an Addendum was submitted to the June 30 Compliance Filing on July 18, 2003 (“Addendum”). The Addendum contained, *inter alia*, details on how the independent entity calculating reference levels, Potomac Economics, would determine decremental reference levels. On January 20, 2004, CAISO issued a Market Notice informing participants that Potomac Economics had adjusted its methodology for determining decremental reference levels.

#### **I. The May 30 Order**

The Commission agreed with the CAISO that intra-zonal congestion can be a problem that needs to be addressed, particularly if market participants engage in gaming strategies that allow them to profit from market dysfunction they intentionally caused.<sup>1</sup> The Commission approved, with modifications, proposed Amendment No. 50, to deal with the potential for abuse through the “dec game,” until the new market design can be implemented. The Commission approved the CAISO's proposal to use mitigated decremental bids to manage intra-zonal congestion and mitigate local market power.<sup>2</sup>

Due to inaccuracies inherent in identifying a generating unit's costs using a cost-based proxy bid, the Commission agreed with intervenors that a reference price is a superior market-based proxy to the CAISO's cost-based proposal. The Commission required that the CAISO use

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<sup>1</sup> May 30 Order at p. 16.

<sup>2</sup> May 30 Order at p. 39-40.

reference levels for dec bids to be administered by an independent entity, and applied to all generators.<sup>3</sup> The Commission directed the independent entity (i.e. Potomac Economics) that determines the reference levels for the Automated Mitigation Procedure (“AMP”) to develop this decremental bid reference price.<sup>4</sup>

## **II. Coral Power’s Assertions**

Potomac Economics takes issue with two assertions made by Coral Power in its supplemental protest. First, Coral Power argues that “the CAISO’s approach violates the basic premise of the May 30 Order, that reference level bid prices should be market-based.”<sup>5</sup> Second, Coral Power asserts that “the CAISO developed its new approach in secret discussions with its outside consultant, Potomac Economics. This undermined Potomac Economics’ independence from the CAISO, in violation of the Commission’s directive that the reference level bid prices should be determined by an independent entity.”<sup>6</sup>

Before discussing the substantive merits of these assertions, we would note that Coral Power’s repeated reference to the approach for calculating decremental reference levels as “CAISO’s approach” or implications that the CAISO developed the approach are false. The approach was developed and implemented by Potomac Economics under its independent mandate to administer the CAISO’s reference levels. The CAISO did not develop the approach, nor compel Potomac Economics to develop or implement the approach.

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<sup>3</sup> May 30 Order at p. 41.

<sup>4</sup> May 30 Order at p. 54.

<sup>5</sup> Supplemental Protest, p. 2.

### III. Reference Levels are Consistent with the May 30 Order

Coral Power's first assertion that the decremental reference approach violates the May 30 order is incorrect. As noted above, a careful reading of the May 30 Order would lead to two conclusions:

1. A reference level is a superior market-based proxy to the CAISO's prior cost-based proposal,  
  
and
2. Potomac Economics was directed to develop and administer this decremental bid reference price.

Reference levels are intended to serve as a competitive benchmark for a units bid prices used to a) determine whether a unit's current bid may warrant mitigation, and b) provide a price level that would replace the current bid price when mitigation is implemented. Reference levels are considered "market-based" because they rely as heavily as possible on a supplier's past conduct when the supplier faces competition and can thus be presumed to approximate competitive behavior. In particular, the first option is to calculate reference levels based on past accepted bids during competitive periods.

Expected behavior by suppliers operating in a competitive market will be to bid close to their perceived marginal costs due to the loss of potential profits from a) excessively high incremental bids or b) low decremental bids. In a competitive market, a low decremental bid can result in the unit operating when its marginal costs exceed the market price, thus losing money by not reducing production and buying lower-cost replacement power to serve any supply obligations. This occurs because other units with similar costs will submit higher dec bids and

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<sup>6</sup> Supplemental Protest, p. 4.

be ramped down or turned off before the under-bidding unit. Therefore, decremental bids during periods when markets are competitive should reflect the unit's marginal costs.

Intra-zonal congestion, unlike inter-zonal congestion, is wholly managed in real-time in the energy imbalance market for supplemental energy. Inter-zonal congestion is managed using adjustment bids to ration available transmission capacity. Forward inter-zonal schedules are limited to the available transmission capacity between each zone, and only feasible schedules are accepted in the CAISO inter-zonal scheduling process. Unlike the inter-zonal schedules, market participants may submit schedules within a zone without regard to the available transmission capacity. If intra-zonal congestion results from these schedules, it must be managed in real time by means of supplemental energy bids (inc and dec bids) which are submitted to the CAISO 45 minutes before the operating hour. Dec bids ration excess generation at a constrained node by choosing more expensive generators to curtail production, and compensating them for the difference between zonal prices and their dec bids. The acceptance of infeasible schedules within a zone creates opportunities and incentives for market participants to submit schedules to create congestion, which they are then paid to relieve in real-time (i.e., the "dec game").

Section 7.2.6.1.1 of the CAISO Tariff, *Decremental Bid Reference Levels*, governs the calculation of decremental bid reference levels. These reference levels are calculated from the "the lower of the mean or the median of a resource's accepted decremental bids if such a resource has more than one accepted decremental bid in competitive periods over the previous 90 days for peak and off-peak periods, . . ." The key term is "competitive periods." The reason for specifying competitive periods is that the only bids that should be eligible for setting reference levels are those that can be expected to reflect competitive behavior.

The term “competitive period” is not defined in the tariff, rather, it is a term of art. Normally, competitive periods are defined as those in which offers are accepted in sequence, that is, units are accepted (or curtailed) in order of their relative cost (across the relevant zone). However, certain units in the CAISO market are routinely decremented out of sequence, and are only periodically decremented in sequence. It is rational for suppliers in this position to incur some lost profit through excessively low decremental bids during hours in which they are decremented in-sequence in order to decrease their reference levels, and thus increase their profits during the hours decremental offers accepted are out of sequence. The loss due to operating at costs above market price in some hours are outweighed by the gain from excessive out-of-sequence decremental payments stemming from below-cost decremental reference levels.

For this reason, the assumption that bids accepted in sequence are adequately disciplined by the competition prevailing in those hours is flawed in this case. In particular, hours in which the limited number of bids accepted in sequence for a unit that is more often accepted out of sequence cannot be deemed to have been submitted in “competitive periods” under the CAISO tariff. To address this concern, we implemented a new test to determine whether the in sequence decremental bids for a unit should be deemed to have been accepted in competitive periods. The test requires that ratio of out-of-sequence decremental MWs to a unit’s total decremental MWs during the prior 90 days be less than 50 percent before the bid-based approach for calculating the unit’s decremental reference levels would be used. This test is applied each day on a rolling 90-day basis as an integrated component of the reference level calculations.

The second alternative for setting reference levels if decremental bids are unavailable, setting the decremental bid reference level in consultation with the Market Participant (§7.2.6.1.1(a)). While this would be a cumbersome procedure to apply system-wide, it is not



onerous to apply in limited cases to ensure that the units' reference levels are relatively close to their unit marginal costs.

The Commission explicitly delegated the authority to develop and administer decremental reference levels to the independent entity. As that independent entity, Potomac Economics developed a decremental reference price methodology, monitored the efficacy of the measure and adjusted that methodology, within the parameters of the CAISO tariff. Potomac Economic has exercised only the discretion to interpret the term, "competitive period," which is undefined in the tariff, in light of its delegated duty to administer dec reference levels. The actions taken by Potomac Economics fall within the confines of the authority delegated by the Commission.

#### **IV. Potomac Economics Objects to Aspersions Cast Upon Its Independence and Objectivity**

Potomac Economics rejects the baseless accusations that Potomac Economics conspired with the CAISO to unfairly impose congestion costs upon the Mexican generators. Coral Power claims that "the ISO was secretly working with Potomac to come up with an approach that imposes yet more burdens on Coral and the La Rosita Generators."<sup>7</sup> ". . .the ISO secretly worked with its 'independent' consultant – Potomac Economics – to devise a plan where by the congestion costs that are paid by the La Rosita Generators and TDM are dramatically increased."<sup>8</sup>

The gist of Coral Power's claim that Potomac Economics is not independent lies in the two mentions by CAISO staff that the CAISO worked with Potomac Economics to develop the

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<sup>7</sup> Supplemental Protest, p. 7.

<sup>8</sup> Supplemental Protest, p. 9.

new reference level methodology. This is based on (1) a reference in the Staff's PowerPoint presentation that states that the CAISO is "committed to working with . . . Potomac Economics to improve the Reference Bid methodology," and (2) a memo to the CAISO Board of Governors in which the CAISO's Staff acknowledged that the CAISO is "working with Potomac Economics . . . to improve the Reference Bid methodology . . ." <sup>9</sup> "Because the ISO is itself not an independent entity, therefore, its collaboration with Potomac to develop the decremental reference level prices inherently taints the Potomac's required independence from market participants."<sup>10</sup> Claims by CAISO staff that they are responsible for any changes in the Reference Bid methodology are groundless. While CAISO raised concerns regarding the level of some of the dec reference prices, Potomac Economics is solely responsible for any changes in the methodology for determining dec reference levels, as delegated by the Commission.

Coral Power states that "at a bare minimum, Potomac should also have solicited the views of the stakeholders, particularly the La Rosita Generators that are the entities most directly affected by the new reference level approach. Its failure to do so belies any suggestion that it was acting independently of the ISO. At a very minimum, the appearance of Potomac's lack of independence from the ISO is manifest."<sup>11</sup> Under Coral Power's definition of independence, an independent entity could not contact or consult with an ISO (or RTO) on any matter, without some sort of formal public process. This reflects some confusion concerning the role of Potomac Economics.

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<sup>9</sup> Supplemental Protest, p. 19.

<sup>10</sup> Supplemental Protest, p. 20.

<sup>11</sup> Supplemental Protest, p. 19.

Although Potomac Economics is not a market monitor in California, it is an independent entity performing a function that is an integral part of the monitoring and mitigation framework, under delegation from the Commission. As such, the policies that the Commission applies to market monitors to ensure their independence are applicable to Potomac Economics in this context. In the SMD NOPR, the Commission noted that it expects the market monitor to be in close contact with the Regional Transmission Operator:

Market monitoring should be conducted on an on-going basis by a market monitoring unit that is autonomous of the Independent Transmission Provider's management and market participants. The market monitoring unit may be located within the offices of the Independent Transmission Provider, *to permit easy access to the market data and operations personnel* (emphasis added), or it may be physically located elsewhere.<sup>12</sup>

Additionally, the monitor is expected to focus on identifying factors that might contribute to economic inefficiency.<sup>13</sup> In its role in California, Potomac Economics is required to consult not only with the CAISO, but also privately with individual market participants. Potomac Economics has had a number of these consultations with Coral Power. If our consultations, either with CAISO or market participants, were presumed to compromise our independence or objectivity, we would have no ability to independently carry out our mandate.

Coral Power has provided no evidence of any conflict of interest or other reason to suspect that the independence of Potomac Economics has been compromised. The sum of their evidence is that Potomac Economics had private conversations with CAISO. Given the Commission's requirements and policies, this evidence does not support Coral Power's assertions.

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<sup>12</sup> SMD NOPR, 100 FERC ¶ 61,138 (2002) at 429.

<sup>13</sup> SMD NOPR at 431.

**V. Conclusion**

The change in the methodology for determining decremental bid reference levels was the responsibility of Potomac Economics, acting in response to a flaw in the initial definition. The purpose of this correction was to limit bid based reference levels to only reflect bids which reflected market competition. Potomac Economics has no interest in any California market participant, and was motivated only by the desire to correct a flaw in the California markets.

Respectfully submitted,

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Dated: February 17, 2004

**CERTIFICATE OF SERVICE**

I hereby certify that I have caused the foregoing document to be served upon each person designated on the official service list compiled by the Secretary for this proceeding, pursuant to Rule 2010(a) of the Commission's Rules of Practice and Procedure.

February 17, 2004

/s/

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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 for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California, on this 28<sup>th</sup> day of March, 2005.

/s/ Anthony Ivancovich  
Anthony Ivancovich