UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER03-683-000**

MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTIONS TO INTERVENE, COMMENTS, PROTESTS, REQUEST FOR SUSPENSION, AND REQUEST FOR A TECHNICAL CONFERENCE

I. INTRODUCTION AND SUMMARY

On March 31, 2003, the California Independent System Operator Corporation ("ISO")[1] submitted Amendment No. 50 to the ISO Tariff ("Amendment No. 50") in the above-referenced docket. As the ISO explained, Amendment No. 50 has two purposes: (1) to make market-related changes to the ISO Tariff to provide a means to improve current management of Intra-Zonal Congestion; and (2) to make data sharing changes to the ISO Tariff to allow the ISO to share Generator Outage information with entities operating transmission and distribution systems affected by the Outage.[2] In response to the filing of Amendment No. 50, a number of parties submitted motions to intervene, comments, and/or protests.[3]

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

[2] *See* Transmittal Letter for Amendment No. 50 at 2.

[3] Motions to intervene, comments, and/or protests concerning Amendment No. 50 were submitted by the following entities: the American Wind Energy Association ("AWEA"); California Department of Water Resources State Water Project; California Electricity Oversight Board ("CEOB"); California Municipal Utilities Association ("CMUA"); Calpine Corporation ("Calpine"); Cities of Anaheim, Azusa, Banning, and Colton, California; Cities of Redding and Santa Clara, California, and the M-S-R Public Power Agency; City and County of San Francisco; City of Santa Clara, California ("Santa Clara"); Cogeneration Association of California and the Energy Producers and Users Coalition ("CAC/EPUC"); Coral Power, L.L.C., Energiz Azteca X, S. de R.L. de C.V., and Energia de Baja California, S. de R.L. de C.V. ("Coral Power"); Duke Energy North

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213, the ISO hereby requests leave to file an answer, and files its answer, to the comments, protests, request for suspension, and request for a technical conference submitted in the above-referenced docket.[4] The ISO does not oppose the intervention of any of the parties that have sought leave to intervene in this proceeding. As explained below, however, the ISO believes that Amendment No. 50 should be accepted as submitted to the Commission, except as described herein, and that the relief requested in filings submitted in opposition to the filing of Amendment No. 50 should be denied. The ISO notes that a number of parties, including the CPUC, CEOB, PG&E, and SCE, variously state that they support Amendment No. 50 in whole or in part.

America LLC and Duke Energy Trading and Marketing L.L.C. (collectively, "Duke"); Dynegy Power Marketing, Inc., El Segundo Power, LLC, Long Beach Generation LLC, Cabrillo Power I LLC and Cabrillo Power II LLC (collectively, "Dynegy"); Independent Energy Producers Association ("IEP"); Mesquite Investors, L.L.C.; The Metropolitan Water District of Southern California ("MWD"); Modesto Irrigation District; Northern California Power Agency ("NCPA"); Pacific Gas and Electric Company ("PG&E"); Reliant Energy Power Generation, Inc., Reliant Energy Services, Inc., Mirant Americas Energy Marketing, L.P., Mirant California, LLC, Mirant Delta, LLC and Mirant Potrero, LLC (collectively, "Reliant/Mirant"); Public Utilities Commission of the State of California ("CPUC"); Southern California Edison Company ("SCE"); Sempra Energy ("Sempra"); Transmission Agency of Northern California ("TANC"); and Williams Energy Marketing & Trading Company ("Williams"). In addition, Santa Clara submitted a request for suspension and TANC submitted a request for a technical conference, and the CPUC submitted a notice of intervention.

[4] Some of the parties commenting on Amendment No. 50 do so in portions of their pleadings that are variously styled, without differentiation. Parties also request affirmative relief in pleadings styled as comments and protests. There is no prohibition on the ISO's responding to the assertions in these pleadings. The ISO is entitled to respond to these pleadings and requests for relief notwithstanding the labels applied to them. *Florida Power & Light Co.*, 67 FERC ¶ 61,315 (1994). To the extent that any portion of this Answer is deemed an Answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. § 385.213) to permit it to make this Answer. Good cause for this waiver exists here given the nature and complexity of this proceeding and the usefulness of this Answer in ensuring the development of a complete record. *See, e.g., Enron Corp.*, 78 FERC ¶ 61,179, at 61,733, 61,741 (1997); *El Paso Electric Co.*, 68 FERC ¶ 61,181, at 61,899 & n.57 (1994).

II. ANSWER

A. The Proposed Interim Solution to the Problems of Intra- Zonal Congestion and the Exercise of Locational Market Power Is Just and Reasonable

A number of parties argue that Amendment No. 50 represents a piecemeal solution to the problem of Intra-Zonal Congestion, and a remedy that is not necessary if the ISO implements Locational Marginal Pricing ("LMP") as part of its Market Redesign 2002 ("MD02"). Coral Power at 12; Duke at 4; Dynegy at 3; Reliant/Mirant at 15-16; Williams at 14.

The fact that the ISO is actively pursuing a longer-term redesign of its markets should not deter the Commission from approving interim corrective actions that are not only just and reasonable, but are necessary **now** to facilitate reliable operation of the grid. The ISO should not be required to wait for a solution (*i.e.*, LMP) to a current problem that will not be implemented until the Fall 2004 at the earliest. As the ISO has repeatedly argued, the current locational market power provisions in the Tariff do not provide sufficient safeguards against local market power (in particular, the "DEC" game) and stronger measures are needed on an interim basis to ensure just and reasonable prices until the ISO can implement MD02.

The ISO recognizes that LMP could significantly reduce the "DEC" game because Market Participants would not be able to submit infeasible Schedules in the forward market.[5] However, implementing LMP would not negate the need for

[5] There would still be opportunities for DEC gaming under LMP when transmission derates occur after the Day-Ahead Market.

local market power mitigation.[6] Indeed, all of the Eastern independent system operators that utilize LMP also have strong local market power mitigation measures in place.

More significantly, the proper legal standard for evaluating Amendment No. 50 is whether the amendment is just and reasonable under Section 205 of the Federal Power Act ("FPA").[7] In other words, the appropriate question to be answered is not whether the solution proposed in Amendment No. 50 will produce the ideal result, but whether the solution proposed in Amendment No. 50 will produce a just and reasonable result. If it does, the fact that there may be another equally reasonable solution – or even a better solution – does not mean that Amendment No. 50 is unacceptable. The Commission has made clear that there is a zone of reasonableness within which a proposal appropriately may fall.[8]

B. Approving the Interim Proposed Solution in Amendment No. 50 Would Not Delay Implementation of LMP

Some parties also suggest that the implementation of the Intra-Zonal Congestion solution proposed in Amendment No. 50 will result in the

[6] Even a long-term solution such as LMP would need to include measures for bid mitigation, similar to the measures contained in Amendment No. 50. LMP addresses the current reliability problem of having to address Intra-Zonal Congestion in real time, but does not solve the problem of locational market power. For example, PJM, which uses LMP, also employs very strong local market power mitigation rules. If LMP alone were sufficient to resolve locational market power, no such bid-mitigation measures would be needed. Further, because bid-mitigation measures are employed in PJM and other independent system operators. Dynegy is incorrect to argue that it is unlawful and unduly discriminatory for the ISO to "suspend market-based pricing of any in-area generator whenever it . . . deems an intrazonal constraint to be binding." Dynegy at 3-4.

[7] 16 U.S.C. § 824d (1994).

[8] *See, e.g., New England Power Co.,* 52 FERC ¶ 61,090, at 61,336 (1990), *aff'd, Town of Norwood v. FERC,* 962 F.2d 20 (D.C. Cir. 1992) (rate design proposed need not be perfect, it merely needs to be just and reasonable), *citing Cities of Bethany*, *et al. v. FERC,* 727 F.2d 1131, 1136 (D.C. Cir.), *cert. denied*, 469 U.S. 917 (1984) (utility needs to establish that its proposed rate design is reasonable, not that it is superior to all alternatives).

implementation of LMP being delayed or put off indefinitely. Duke at 3-4; IEP at 2-3; Williams at 15-16. These parties are incorrect; in fact, the opposite may prove to be true. In that regard, not providing the effective interim Intra-Zonal Congestion Management and local market power mitigation measures proposed in Amendment No. 50 will only serve further to erode the confidence of consumers and major policy makers in California (and other parts of the country) that the Commission will provide adequate and effective safeguards against the exercise of market power under any market design (and in particular upon implementation of a brand new LMP market design). Consequently, this could delay any further market reform efforts. Moreover, the measures proposed by the ISO in Amendment No. 50 are intended to minimize the changes required to existing ISO systems (because the ISO expects that those systems will be superseded by the systems needed to implement the MD02 design) and will not significantly divert resources from the intensive MD02 development effort currently underway. Therefore, the implementation of Amendment No. 50 should not have any discernable adverse effect on the ISO's timetable for submitting to the Commission a MD02 proposal.

In addition, IEP states that Intra-Zonal Congestion management under Amendment No. 50 may not be just an interim program because the program does not have a "sunset" provision. IEP at 11. This statement ignores the fact that the ISO cannot possibly know exactly when MD02 will be put into effect. The implementation of the MD02 Congestion Management system depends on a myriad of factors, including the time for Commission approval, vendor

development time, and the results of testing by Market Participants – all factors that are beyond the ISO's control. Therefore, it is not practicable to have a date-specific sunset provision for the measures proposed in Amendment No. 50.

C. The Existing Provisions in the Tariff Are Insufficient to Effectively Mitigate Locational Market Power and to Efficiently Manage Intra-Zonal Congestion

Some parties argue that the existing provisions in the Tariff are sufficient to prevent the exercise of locational market power and, thus, Amendment No. 50 is not required. Calpine at 3; Duke at 4-5; Dynegy at 10-11; IEP at 4-5; Williams at 21-22. These parties incorrectly assert that the ISO's Automatic Mitigation Procedure ("AMP") and the current -$30/MWh negative decremental cap are sufficient to prevent the exercise of market power.[9] This position does not withstand scrutiny.

First, as the ISO explained in the transmittal letter for Amendment No. 50, locational market power modifications to AMP and the -$30/MWh negative decremental bid cap loosely bound, but do not prevent, the exercise of locational market power. In particular, these measures do not address the "DEC" game because suppliers with locational market power essentially can force the ISO to

[9] IEP also argues that the ISO has or will have Reliability Must-Run ("RMR") Units, the must-offer obligation, and Residual Unit Commitment ("RUC") as tools sufficient to allow the ISO to address the problem of locational market power. IEP at 5. IEP is incorrect on all counts. RMR Units are made available pursuant to individual contractual agreements based on very narrowly defined reliability criteria and thus do not sufficiently cover all potential local market power situations. Because local market power can arise anywhere in the ISO Control Area under varying system conditions, relying solely on RMR Contracts to address local market power would mean the ISO would have to sign a RMR Contract with every Generating Unit in the control area, which is clearly not a reasonable solution. Moreover, the must-offer obligation and the Day-Ahead must-offer waiver process, which IEP incorrectly describes as RUC, do not address local market power. These measures only address physical withholding; the owners of Generating Units can still exercise local market power through economic withholding and engaging in the "DEC" game.

pay them $30/MWh not to produce energy.[10] That is wholly unacceptable. Second, while the AMP provisions may partially address the issue of locational market power, they do not satisfy the ISO's operational need for a process to manage Intra-Zonal Congestion in the *forward* markets. Transmittal Letter for Amendment No. 50 at 4-6. Therefore, measures are needed in addition to the existing provisions in the ISO Tariff.[11]

Parties also make the related argument that the ISO has not shown that market power is being exercised to such a degree that the proposed solution in Amendment No. 50 is required. Duke at 5; Dynegy at 7-9; IEP at 4-5, 8-9; Santa Clara at 4; TANC at 10. The ISO has described in a number of filings, including this Amendment No. 50 as well as Amendment Nos. 42 and 44, the various and extensive ways in which locational market power is being exercised in the ISO's markets. In his affidavits submitted herein and in Amendment No. 44, Dr. Eric Hildebrandt identified numerous examples of suppliers engaging in the "INC" and "DEC" games.[12] No party challenges – nor can they challenge – the factual basis for Dr. Hildebrandt's affidavit. The undeniable fact is that locational market power is being exercised in the CAISO markets, and the existing mitigation measures

[10] The Amendment No. 50 Transmittal Letter discusses how the existing Tariff fails to address the "DEC" game. There is no need to repeat those arguments here.

[11] Reliant/Mirant argues that if the Commission "determines that circumstances require the modification of the current -$30 cap on decremental bids, it should reject the Cal ISO's proposed cost-based proxy bid scheme in favor of a market-based mechanism." Reliant/Mirant at 18-19. However, the existing market-based mechanisms under the Tariff are insufficient to prevent the exercise of market power.

[12] The ISO notes that in Docket No. EL02-51 the California EOB filed a complaint against numerous generators alleging that such generators were exercising market power by submitting anticompetitive negative "Dec" bids. The EOB complaint identified instances of suppliers submitting anticompetitive "Dec" bids. The Commission dismissed the EOB complaint without prejudice finding that it was premature to undertake a piecemeal modification to the ISO's market design given that the filing of a revised market design was imminent. *California Independent System Operator Corporation, et al.*, 98 FERC ¶61,327 (2002).

are inadequate to prevent it from occurring. Even assuming, *arguendo*, that these examples fail to demonstrate the rampant exercise of locational market power, that would not serve as a legitimate basis for rejecting the ISO's proposed measures for dealing with locational market power. Under those circumstances Amendment No. 50 would serve as a preemptive and preventative measure, which the ISO would be prudent to employ even in the absence of a current crisis caused by the exercise locational market power.[13] To the extent that market power currently is being exercised, Amendment No. 50 will help to deter such occurrences in the future. If, on the other hand, market power is not being exercised, then the ISO will never have to employ the measures in Amendment No. 50 (though the measures will serve as a deterrent even in that case).

In any event, arguing that the ISO has not presented any justification for implementing measures designed to prevent the exercise of locational market power is akin to saying that it would not be reasonable to maintain fire extinguishers in a public building because the building has not recently caught fire. As demonstrated by the widespread opposition to electricity market reform in California, it is difficult to convince current tenants to move back into a building, and to entice new tenants to move into the building, after the building has already burned down once, unless the landlord can convincingly demonstrate that superior fire detection and suppression tools have been added.

[13] According to the faulty logic of the parties who assert that Amendment No. 50 is premature, there was no reason to be concerned about the dysfunctional market design in California prior to the crisis of that led to the Commission's proceedings in Docket Nos. EL00-95, *et al.*, and it would not have been desirable to take preventative action, if possible, to address the market design problems before the crisis began.

D. The ISO Included Stakeholders in the Development of Amendment No. 50

Some parties assert that the ISO did not engage in a proper stakeholder process with regard to Amendment No. 50. Coral Power at 5-6; Duke at 4; Santa Clara at 5; TANC at 10; Williams at 14-15. These parties ignore the fact that the ISO has been engaged in discussions with stakeholders on measures to address locational market power arising from Intra-Zonal Congestion for a long time, including the measures proposed in Amendment No. 50. *See* Board Documents from Meetings of ISO Board of Governors held on August 1, September 19, October 24, and November 21, 2002 (available on the ISO's Web site, <www.caiso.com>); Transmittal Letter for Amendment No. 42, Docket No. ER02-992-000 (filed Jan. 31, 2002), at 8-9. Indeed, in connection with MD02, technical conferences were held in San Francisco and numerous stakeholder meetings and conference calls were held dealing solely with the Intra-Zonal Congestion issue. Indeed, the ISO removed its interim Intra-Zonal Congestion measure from the May 1, 2002 MD02 filing because of the then- ongoing stakeholder process that was addressing the issue. Market participants could not come to any type of agreement on the appropriate measures that should be implemented to address Intra-Zonal Congestion. Accordingly, after giving much thought to the subject, the ISO is now proposing the measures contained in Amendment No. 50. Under these circumstances market participants cannot credibly claim that there has not been any stakeholder discussion of Intra-Zonal Congestion management issues.

Further, the proposal reflected in Amendment No. 50 was developed by the ISO's independent Market Surveillance Committee ("MSC") and was

presented publicly at the MSC's meeting on August 20, 2002. The proposal was presented to and approved by the ISO Board at the Board's October 24, 2002 meeting, and presented to stakeholders again to the ISO's Market Issues Forum meeting on November 12, 2002. The parties were therefore well aware of the ISO's proposals and had opportunities to comment on them. Thus, there is no reason for the parties to complain that they did not have sufficient participation in the discussion of the ISO's proposals.

E. The Market Power Mitigation in Amendment No. 50 Does Not Expose Generators to Potential Allegations of Collusion

Duke asserts that proposed Section 2.2.10.7 of the ISO Tariff is vague and may expose Generators to potential allegations of collusion. Duke at 4-5.[14] The ISO clarifies that Section 2.2.10.7 applies to the maximum or minimum allowable output for the entire group of Generators; this obviates Duke's concerns about vagueness. Moreover, there is no basis for Duke's assertion that Generators providing data to one another in order to allow the ISO to forecast Congestion (and determine if proxy Energy bids are required) may be deemed to have improperly colluded with one another. Collusion generally does not arise simply from the sharing of data, but instead from the sharing of data for the purpose of achieving some unlawful end.[15] (Notably, Duke fails to mention any

[14] Duke's filing refers to "Section 2.2.10.8," but it is clear from the context and the language quoted in the filing that Duke means Section 2.2.10.7. IEP (at 9) makes an argument similar to Duke's with regard to collusion.

[15] *See, e.g., El Paso Natural Gas Company*, 88 FERC ¶ 61,139, at 61,408 n.22 (1999) ("What is prohibited is collusion or practices designed to restrict output in a manner that results in significant non-transitory price increases"); *New England Power Pool*, 85 FERC ¶ 61,379, at 62,480 (1998) ("NEPOOL's monitoring plan includes collusion by stating that monitors should focus on behavior that is consistent with an intentional effort to raise prices"). As described in *Black's Law Dictionary*, collusion means in relevant part "[a]n agreement between two or more persons to . . . obtain an object forbidden by law." BLACK'S LAW DICTIONARY 264 (6th ed. 1990).

of the lawful types of information sharing, such as occurs in connection with Inter-Scheduling Coordinator Energy and Ancillary Service Trades.) Under Amendment No. 50, data would be shared solely for the *lawful* purpose of submitting Schedules that comply with the ISO's published limits. Thus, sharing data pursuant to Amendment No. 50 would not be collusion but rather would constitute collaboration for the purposes of self-management of Congestion.

F. The Market Power Mitigation in Amendment No. 50 Does Not Detract from Efforts to Create Proper Price Signals

Several parties argue that implementing Intra-Zonal Congestion Management pursuant to Amendment No. 50 will not send correct price signals. These parties suggest that certain actions to send such price signals should be taken instead (*e.g.*, the transmission grid should be expanded and generation should be sited where Congestion exists). Reliant/Mirant at 16; TANC at 8-9; Williams at 19-21. These parties are mistaken in their belief that excessive locational prices that reflect the exercise of local market power will necessarily prompt infrastructure improvements, and will do so in a timely fashion. Moreover, the fact that a supplier has local market power does not necessarily imply that there is insufficient infrastructure at that location. There may in fact be adequate generation and transmission, but the local generation is all owned by the same supplier (or there has been a temporary outage). That is the case today in numerous locations in California. For load pockets that do require infrastructure improvements to serve load reliably, building new fossil-fueled generation in such areas is often extremely difficult because of community opposition, making transmission expansions, conservation, and renewable

energy the preferred alternatives. Because the load serving entity for such areas has an obligation to serve load, it also has a regulatory obligation to ensure that adequate infrastructure is in place to meet current and future demands. Imposing excessive prices in such areas that reflect the exercise of local market power will only serve to unfairly transfer wealth from consumers to suppliers.

The ISO believes the appropriate locational price signal is the marginal cost of the highest cost unit needed to serve load, because is what would occur in a competitive setting. Further, the concept of price signals – *i.e.*, prices that encourage infrastructure investment and technology improvements – cannot and must not be separated from the Commission's statutory obligation to maintain just and reasonable rates. The exercise of local market power can be considered a "price signal," but it cannot be considered a just and reasonable rate.[16] Because the Commission has directed suppliers to look to forward contracts, not spot markets, for the bulk of their fixed cost recovery,[17] the belief that spot prices should be relied on to encourage investment is suspect. Such price signals actually may create perverse incentives for suppliers. Specifically, a supplier relying on Congestion rents to recover its fixed costs will be in serious trouble if the price signals those Congestion rents send actually provoke the investment that relieves the Congestion. Further, the ISO's real time imbalance market has shrunk to the point where only one-to-two percent of load is covered

[16] *See, e.g.*, *State of California, ex rel. Bill Lockyer, Attorney General of the State of California, et al.*, 100 FERC ¶ 61,295, at P 16 (2002) ("Quarterly reports provide a means for examining whether a utility continues to lack market power and, thus, that its rates remain just and reasonable").

[17] *See Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,280 at P 47 (2003); *San Diego Gas & Electric Co., et al.*, 97 FERC ¶ 61,275, at 62,229 (2001); *San Diego Gas & Electric Co., et al.*, 95 FERC ¶ 61,418, at 62,547 (2001).

by purchases in such market. No one can credibly argue that that significant investment decisions that depend on a reasonable opportunity to recover fixed costs will be driven by the prices in the ISO's *de minimis* real time market. Moreover, such argument ignores the fact prices would be mitigated only when Intra-Zonal Congestion occurs and suppliers are in a position to exercise local market power. In all other instances, real time prices will not be mitigated for local market power reasons.

G. The Market Power Mitigation in Amendment No. 50 Does Not Create Opportunities for Generators to Create or Benefit from Congestion

Santa Clara and TANC assert that Amendment No. 50 may create opportunities for Generators to create Congestion and benefit from such Congestion based on their re-Dispatch priority. Santa Clara at 3; TANC at 8. Their concerns, while important, are misplaced. Any incentives for Generators to create Congestion are ones that already exist; Amendment No. 50 actually should produce a *disincentive* to create Congestion. If a Generator creates Congestion and such congestion is not relieved, under Amendment No. 50 that Generator will receive a cost-based amount (rather than a market-based amount) for its power. While Amendment No. 50 may not eliminate any profit a supplier may receive by submitting a forward Schedule that causes Congestion, Amendment No. 50 *does* prevent a supplier from profiting from any adjustment needed to move its unit to an operating point that relieves the Congestion. The only way to prevent a supplier from profiting from the submission of an infeasible forward Schedule is to account for all constraints in the forward markets; while

LMP will do so, the current zonal market model does not. By removing any opportunity to profit from the re-Dispatch instruction by directing that the re-Dispatch takes place at a Generator's cost, Amendment No. 50 greatly decreases the incentive to submit forward Schedules that cause Congestion.

H. The Market Power Mitigation in Amendment No. 50 Does Not Put Unreasonable Restrictions on Market Participants that Cause Congestion

Santa Clara and TANC argue that Amendment No. 50 does not give sufficient consideration to LSEs that are submitting Schedules in operating their systems that are feasible and reasonable but which happen to cause Congestion, and thus that the amendment will impose unreasonable restrictions on Market Participants. Santa Clara at 5; TANC at 10-11. The ISO is puzzled by the notion that a forward Schedule that causes Congestion is a feasible and reasonable Schedule. If that were true, the ISO would have no need to perform Congestion Management.

I. No Basis Exists for Granting Special Treatment to Hydroelectric Units Under the Market Power Mitigation in Amendment No. 50

MWD argues that the transmittal letter for Amendment No. 50 "appears to suggest that only those Participating Generators that submitted schedules contributing to the Congestion" might be subject to Intra-Zonal Congestion Management pursuant to proposed Section 7.2.6.1, and that hydroelectric units that have not submitted Schedules should not be subject to the section. MWD at 8-9. MWD misconstrues the language of the transmittal letter. Section 7.2.6.1 is

intended to apply – and by its terms does apply – to dispatchable units, which include hydroelectric units that have not submitted Schedules.

MWD's belief that hydroelectric units should receive special treatment under Amendment No. 50 leads it to propose that such units should be subject to Adjustment Bids, as opposed to proxy Energy bids, for Intra-Zonal Congestion Management. Alternatively, MWD suggests that involuntary dispatch of hydroelectric units for resolution of Intra-Zonal Congestion should be prohibited unless a reference price is mutually agreed upon by the ISO and the hydroelectric unit owner. MWD at 9-10. Presumably, MWD would express its preference not to be re-dispatched for Intra-Zonal Congestion by submitting an Adjustment Bid with a very high price. If the ISO needed to use that bid to mitigate Intra-Zonal Congestion, that high-priced bid would have the same adverse effect as a bid seeking to exercise local market power because there generally are only a few units controlled by a few suppliers that can mitigate the Congestion (and there likely would be no other effective alternatives.[18] The ISO would consider the effects of curtailing the output of a unit operating to provide for vital water delivery just as it proposed to consider the effects of other externalities such as energy limitations or environmental concerns. Yet, if a hydroelectric unit is the only unit that can effectively mitigate Intra-Zonal Congestion, there is no valid reason to treat hydroelectric units differently from other dispatchable units under Amendment No. 50. A hydro-electric unit can exercise local market power just like a thermal unit. With respect to MWD's

[18] However, in presenting its arguments above, the ISO is in no way accusing MWD of seeking to exercise local market power or suggesting that MWD has done so in the past.

alternative proposal, any discussions the operator of a hydroelectric unit might want to have concerning the reference price should be directed to Potomac Economics, Ltd., the independent entity that determines the reference price. *See* Transmittal Letter for Amendment No. 50 at 8.

J. The Proxy Price Formula In Amendment No. 50 Provides Just and Reasonable Compensation to Generators

A number of parties argue that the proxy price formula proposed by the ISO does not sufficiently compensate Generators. Calpine at 7-8; Coral Power at 9-10; Dynegy at 11-12; IEP at 5-6, 10; Reliant/Mirant at 13-14; Sempra at 5-6. In making this argument, the parties ignore the fact that the ISO has modeled its proxy price formula on the formula the Commission required with regard to price mitigation in the California wholesale power market proceedings in Docket Nos. EL00-95, *et al. See San Diego Gas & Electric Co., et al.*, 95 FERC ¶ 61,418, 62,559-64 (2001). The Commission has rejected arguments that such pricing mechanism does not permit adequate cost recovery. Id. at 62,560-65. In prior mitigation orders, the Commission sought to provide prices that emulate those that would result in a competitive market (*i.e.* marginal costs) and provide generators with a reasonable opportunity to recover their costs. *Id.* at 62,563-64. By using the marginal cost of the last unit dispatched to establish the market clearing price, more efficient generators will be reimbursed for more than their marginal costs, *i.e*. they will have an opportunity to recover capital costs and essentially receive scarcity rents (because they will receive the price of the last amount dispatched). *Id.* at 62,563-64; *see also San Diego Gas and 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 ¶ 61,115 at 61,363 (2001). Because generators such as Duke, Dynegy and Reliant have a portfolio of generating capacity, they will have units that are more efficient than the unit setting the market price. The amounts earned on the more efficient plants will cover the investment in the marginal plant.

Under these circumstances, the Commission should find the ISO's formula, to be just and reasonable.[19]

K. There Can Be No Opportunity Cost Associated With the Sale of a Product That Cannot Be Delivered

Calpine argues that it should be permitted to recover opportunity costs associated with foregone Ancillary Services sales. Calpine at 8. This argument is without merit. When the ISO instructs a unit to an operating point to mitigate Congestion any additional output from that unit – such as energy from Ancillary Services capacity – above that operating point cannot be delivered. To ensure that the energy from Ancillary Services capacity can be delivered, the ISO would have to dispatch a unit to an operating point where that capacity would be held available. The ISO does not consider it prudent to decrement a unit's output on a cost-based bid for the sole purpose of holding available capacity that may or may not be dispatched as energy from that Ancillary Services capacity. The ISO will therefore re-Dispatch a unit to a point that relieves the Congestion, but will not allow the unit to operate above that point. Because any output above that point

[19] Additionally, SCE, in contrast to other parties on this issue, argues that one component under the ISO's proxy price formula – the O&M adder – should be *reduced*. SCE at 7-9. However, the O&M adder the ISO proposes to use is the same as the one the Commission has required, and should therefore not be changed.

would re-create the Congestion and is not deliverable, there necessarily cannot be any opportunity for the power to be sold. Therefore, there can be no Ancillary Services opportunity costs associated with a Generating Unit re-dispatched to an operating point that mitigates Congestion.

L. There Is No Reason for the ISO to Create a New, Inactive Zone

Reliant/Mirant argue that the ISO is obligated by Section 7.2.7.2.1 of the Tariff to investigate whether it ought to create a new Zone rather than implement Intra-Zonal Congestion Management under Amendment No. 50. Reliant/Mirant at 13, 18. Reliant/Mirant would have the ISO engage in a pointless exercise. As the ISO pointed out in its Amendment No. 50 transmittal letter, Intra-Zonal Congestion almost always involves a very limited number of suppliers. Without a sufficient number of suppliers, workable competition does not exist. If the ISO were to create a new Zone where Intra-Zonal Congestion is significant, the new Zone would contain a limited number of suppliers and, as such, would be a non-competitive Inactive Zone. There would be no justifiable reason to create such an Inactive Zone. Moreover, creating a new Zone would constitute a step backward from the nodal Congestion Management reforms proposed in MD02.

M. The Commission Should Not Adopt the Changes to Amendment No. 50 Proposed By Sempra

The changes to Amendment No. 50 proposed by Sempra should be rejected by the Commission. The ISO explained in the Amendment No. 50 transmittal letter the rationale for the ISO's proposed modifications to the Tariff, and those modifications are just and reasonable. Sempra asserts that the Commission should find that the ISO is allowed to exercise its protocols only to

manage real Intra-Zonal Congestion, not "phantom" Congestion. Sempra at 6-7. Sempra's assertion is inapposite; phantom Congestion is not at issue in this proceeding. Moreover, Sempra's proposal that the ISO be directed to use "an AC power flow analysis in order to ensure a reasonably efficient redispatch solution" (Sempra at 8) ignores the fact that the ISO does not have a real-time power flow tool available to its operators. The ISO's operators can account for varying effectiveness factors using information from off-line studies, but, without a real-time power flow tool, some measure of operator judgment is necessary. Moreover, a power flow cannot by itself serve as a substitute for other factors that an operator must consider, such as Energy or environmental limitations, when re-dispatching units to mitigate Congestion. The ISO agrees that a real-time power flow tool would help its operators optimally re-Dispatch units to manage Congestion, and the ISO intends to implement such a tool in its MD02 re-design. However, the ISO cannot implement such tool immediately. As authorized by the Commission, the ISO is currently working to develop the full network model that could serve as the foundation for a real-time operator power flow tool.

N. Parties' Suggested Topics for Discussion at the Technical Conference Requested by the ISO Have Been Rendered Moot

In Amendment No. 50, the ISO requested that the Commission convene a technical conference to allow a discussion among the ISO, the Commission, and the Market Participants of other alternatives -- beyond the ones the ISO has proposed -- to deal with the problem of Intra-Zonal Congestion until an LMP-based Congestion Management or some other long-term solution is

implemented. Transmittal Letter for Amendment No. 50 at 14-15. This technical conference took place on May 1, 2003.

The fact that the technical conference has already occurred renders moot the arguments made by various parties that certain topics should be addressed or not addressed at the technical conference (to the extent they were not actually made subject to discussion at the conference). *See* CEOB at 2; CMUA at 3-5; Dynegy at 3; NCPA at 6-7; SCE at 9-10; TANC at 12-13. The ISO looks forward to addressing, in its initial and reply comments, the subjects the Commission required to be considered pursuant to the technical conference.[20]

O. The ISO Agrees That Intermittent Resources, Qualifying Facilities, and Must-Take Resources Should, Under Most Circumstances, Be Exempt From the Provisions of Amendment No. 50

The ISO agrees with the argument of several parties that certain kinds of resources, including Regulatory Must-Take Generation, Intermittent Resources, and Qualifying Facilities ("QFs") should generally be exempted from the provisions of Amendment No. 50. *See* AWEA at 2-4; CAC/EPUC at 2-4; IEP at 11-12. At the very least, these resources should be the very last resources the ISO would re-Dispatch to manage Intra-Zonal Congestion. This was the intent of the ISO's proposed Tariff language in Section 7.2.6.1, which indicated the ISO would consider "other relevant factors such as Energy limitations, existing contractual restrictions, and Regulatory Must-Run or Regulatory Must-Take

[20] These topics include the appropriate treatment of the Miguel substation. Therefore, the ISO will provide discussion on the subject of the Miguel substation in its comments submitted pursuant to the technical conference. The present filing is not the appropriate place for the ISO to address comments submitted by certain parties on the subject. *See* Dynegy at 5-7; Santa Clara at 3; Williams at 23-24.

status" when re-dispatching units to alleviate Intra-Zonal Congestion. To clarify this intent, the ISO commits to adding language to Section 7.2.6.1, in a compliance filing on Amendment No. 50, that would read as follows: "The ISO shall only re-Dispatch Regulatory Must-Take or Regulatory Must-Run Generation, Intermittent Resources or Qualifying Facilities to manage Intra-Zonal Congestion after fully re-dispatching all other available and effective generating resources, including Reliability Must-Run Units."

P. Newly Constructed Generation Should Be Subject to Mitigation Measures

Calpine argues that it paid for transmission upgrades needed to ensure the delivery of energy from a new power plant and therefore should be exempted from the provisions of Amendment No. 50. Calpine at 3-5. However, the premise of Calpine's argument is faulty: it is impossible to "ensure" the delivery of Energy from a power plant under all conditions. Assuming, as Calpine notes, that Calpine, PG&E, and the ISO made a good faith effort to identify a reasonable set of transmission upgrades that would allow Calpine to deliver the Energy from its new power plant, those upgrades did not reflect all possible combinations of contingencies that might impinge on the delivery of power from that plant. Calpine likely would have balked at incurring the cost of upgrades necessary to ensure the delivery of Energy from its plant under all possible conditions.

Power delivery systems are neither designed nor built to ensure continuity of service under all conditions, but are built to reasonable standards that provide for reliable service under most conditions. Thus, no supplier can be guaranteed

delivery under all conditions. Moreover, no supplier would pay the prohibitive costs of upgrading the system to be able to achieve such guarantees (even if the guarantee could be made). From time to time, problems above and beyond those that it is reasonable and prudent to anticipate, can and do happen., When such problems occur, it is unfair to provide a guarantee of delivery to any supplier, even one that has responsibly taken steps to minimize – but not eliminate – the possibility of curtailment.

Moreover, new generation has an inherent advantage under Amendment No. 50. Because Amendment No. 50 re-Dispatches generation using cost-based proxy bids, and settles generation at the cost-based price or the market price, whichever is more favorable, new efficient generation should be the last generation curtailed based on its low proxy price. For these reasons, Calpine's request for an exemption from Amendment No. 50 should be rejected.

Q. The ISO's Proposal to Provide Generator Outage Information, with Certain Modifications Proposed by Parties, Should Be Accepted by the Commission

The ISO is at a loss to explain how Williams can claim the ISO has provided no justification for its proposal to share Generator Outage information. *See* Williams at 27-28. The ISO has explained at length the reasons for its proposal. *See* Transmittal Letter for Amendment No. 50 at 16-20. In order to allow for effective coordination of Generator Outages, the ISO must be able to exchange information with entities as described in the Amendment No. 50 filing. Given that other suppliers generally do not oppose the ISO's proposal –indeed many generators connected to the ISO-controlled grid have similar information

sharing requirements in their contracts with transmission owners (although such provisions are not always being followed)—there is no reasonable basis for Williams to claim that such provisions are unnecessary.

MWD and SCE recommend that language in proposed Section 20.3.4(c) be modified to change the phrase "significantly affected" to "affected." MWD at 10-11; SCE at 12. The ISO agrees that this change should be made. MWD is incorrect, though, in its argument that the section should be changed to apply to "the electric transmission systems" rather than to "the electric supply system." *See id.*[21] The effect described under Section 20.3.4(c) could be on a sub-transmission or distribution system, not just a transmission system or systems.

Duke proposes that the Commission require the ISO to maintain on its Web site a current list of all entities that have signed the WECC Confidentiality Agreement. Duke at 7. The ISO is willing to post a list of such entities on its Web site.[22] However, the ISO should not be required also to post the names of all persons the entities have authorized to receive Generator Outage information. *See id.* The ISO must rely on the entities themselves to ensure that only authorized persons receive the information; it cannot police the entities. Hence, requiring the ISO to publish the names of the persons would not, as Duke believes, "enable market participants to know who is, and is not, receiving generator outage information from the CAISO."

[21] SCE proposes a similar change. *See* SCE at 11-12.
[22] The ISO's willingness to post the names of the entities should address the concern expressed by TANC that the ISO "fails to describe clearly the entities with which the ISO will share information." TANC at 11.

CEOB asserts that the Commission should direct the ISO to provide reports at specified intervals that assess the effect of allowing the limited communication of Generator Outage information. CEOB at 8-9. The ISO questions the usefulness of ongoing reports that purport to assess the effects of providing Generator Outage information. The benefits of providing this information – namely, a more efficient Outage Coordination process – will be difficult, if not impossible, to quantify. Devoting staff time to develop a means to quantify these benefits – and then devoting additional staff time to prepare an ongoing report - will only serve to detract from the efficiencies that these proposed changes hope to provide.

Finally, all of the entities that express concern about the possible release of confidential information have a number of possible actions they can take if they believe that an entity has improperly divulged information. They can seek recourse pursuant to the terms of the WECC Confidentiality Agreement or can bring a complaint under Section 206 of the FPA. Especially in light of these possible courses of action, the ISO should not be made responsible for keeping such information confidential and, thus, Section 20.3.4(c) of the Tariff should not be modified to provide for such ISO responsibility.

III. CONCLUSION

For the foregoing reasons, the ISO respectfully requests that the Commission accept Amendment No. 50 as submitted to the Commission, except as described herein.

Respectfully submitted,

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Date: May 6, 2003

CALIFORNIA ISO

California Independent
System Operator

May 6, 2003

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: California Independent System Operator Corporation
Docket No. ER03-683-000

Dear Secretary Salas:

Enclosed for electronic filing please find Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Motions to Intervene, Comments, Protests, Request for Suspension, and Request for a Technical Conference in the above-referenced docket.

Thank you for your assistance in this matter.

Respectfully submitted,

Anthony J. Ivancovich
Counsel for The California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned docket.

Dated at Folsom, California, on this 6th day of May, 2003.

_____

Anthony J. Ivancovich