UNITED STATES OF AMERICA
BEFORE THE
FEDERAL REGULATORY ENERGY COMMISSION

San Diego Gas & Electric Company,	**) Docket Nos. EL00-95-058,**
et al.	**) EL00-98-050, EL00-107-009,**
	) EL00-97-003, EL00-104-008,
	) EL01-1-009, EL01-2-003 and
	) EL01-68-011

Answer of the California Independent System Operator Corporation to Motions to Intervene, Requests for Clarification, Comments and Protests to the January 25, 2002 Compliance Filing

On January 25, 2002, the California Independent System Operator Corporation ("ISO")[1] submitted a compliance filing and proposed Tariff revisions ("January 25 Compliance Filing") as directed in the Commission's December 19, 2001 "Order Accepting In Part And Rejecting In Part Compliance Filings," 97 FERC ¶ 61,293 (2001) ("December 19 Compliance Order"); the December 19, 2001 "Order on Clarification and Rehearing," 97 FERC ¶61,275 (2001) ("December 19 Rehearing Order"); and the December 19, 2001 "Order Temporarily Modifying The West-Wide Price Mitigation Methodology," 97 FERC ¶61,294 (2001) ("December 19 Winter Price Order") in the above-captioned dockets. In the January 25 Compliance Filing,[2] the ISO submitted the Tariff revisions needed to comply with the several December 19 orders, and described the ISO's implementation procedures for:

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

[2] On January 17, 2002, the ISO filed a Motion For Extension Of Time to permit the ISO to tender its compliance filing on January 25, 2002 instead of January 18, 2002 as provided for in the December 19 Compliance Order.

(1) the exemption (or waiver) procedures and payment of start-up and minimum load costs relating to the must-offer obligation,

(2) recalculation of the Market Clearing Price under the West-Wide Winter Season Methodology,

(3) application of a new operating reserve percentage threshold as a trigger for recalculation of the mitigated Market Clearing Price for non-operating reserve deficiency periods,

(4) use of proxy prices only to establish the mitigated reserve deficiency Market Clearing Price,

(5) removal of the requirement that bids, even if not accepted, if over the mitigated Market Clearing Price, must be cost-justified,

(6) temporary removal of the penalty for failure to respond to ISO Dispatch instructions,

(7) calculation of price limits on Ancillary Services based upon prices at the time such transactions are entered into as opposed to when delivery actually occurs,

(8) requirements for resources outside the ISO Control Area to be eligible to set the Market Clearing Price,

(9) specifications as to how emissions and start-up fuel costs should be documented,

(10) addition of a ten percent credit risk adder to bids above the mitigated Market Clearing Price that are accepted and cost-justified,

(11) inclusion of a termination date of September 30, 2002 for the market mitigation measures,

(12) adoption of a requirement that marketers must bid $0/MWh in the ISO Real Time Markets, and

(13) elimination of the ability of hydroelectric generation units within the ISO Control Area to set the Market Clearing Price during non-operating reserve deficiency periods.

The Commission's February 6, 2002, Notice of Filing directed parties to comment on the ISO's Compliance Filing on or before February 15, 2002.

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the ISO submits its Answer to the motions to intervene, requests for clarification, comments and protests concerning the January 25 Compliance Filing in the above-captioned dockets. The ISO does not oppose the intervention of any party that sought leave to intervene in this proceeding. As explained below, however, the comments and protests that seek the rejection or substantive modification of the ISO's January 25 Compliance Filing are without merit with the exception of the several modifications the ISO details below. Accordingly, the ISO urges that the Commission accept the ISO's proposed Tariff revisions without condition and with only such modifications as the ISO agrees to below.

I. BACKGROUND

In its December 15, 2000, order[3] the Commission found that the market structures and rules for wholesale markets in California were seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and Demand in California, had created the opportunity for suppliers of electricity to exercise market power and to charge unjust and unreasonable rates. The December 15 Order mandated various remedies to address these circumstances that included: (1) eliminating the mandatory California Power Exchange ("PX") Buy-Sell requirement; (2) adopting an advisory benchmark for assessing long-term bilateral contract prices; (3) establishing penalties for underscheduling with the ISO; and (4) requiring that the ISO stakeholder governing board resign and be replaced by a board independent of market participants. In addition, the Commission established an interim modification of the single price auction as proposed in its November 1 Order[4] and reporting requirements for transactions and/or bids over $150/MWh. On January 2, 2001, the ISO submitted a compliance filing and proposed Tariff revisions in response to the December 15 Order ("January 2 Compliance Filing").

On April 26, 2001, the Commission issued its "Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale Western Energy Markets" in the above-captioned dockets ("April 26 Order").[5] In

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[3] 93 FERC ¶ 61,294 (2000) ("December 15 Order").
[4] 95 FERC ¶ 61,121 (2000) ("November 1 Order").
[5] 95 FERC ¶ 61,115 (2001)

the April 26 Order, the Commission reaffirmed its previous findings that there is a potential for the exercise of market power in the California wholesale markets under certain conditions and mandated that a replacement mitigation plan be put into place. The primary elements of the April 26 Order's mitigation plan included: (1) increased coordination, control and reporting of outages by the ISO; (2) a requirement that all sellers, including non-public utilities, that voluntarily make sales through the ISO's market or use the ISO's interstate transmission grid, to offer all of their available power in real time during reserve deficiencies; (3) a provision for refund liability and conditions on public utility sellers' market-based rate authority to prevent anti-competitive bidding behavior; and (4) a price mitigation mechanism for the ISO's real time Energy Market during System Emergencies. In compliance with the April 26 Order, the ISO filed, on May 11, 2001, Tariff revisions that included: (1) proxy price calculation, reporting and cost-justification provisions; (2) data requirements for the ISO's implementation of generators' must-offer obligation; and (3) expanded outage coordination procedures ("May 11 Compliance Filing").

On rehearing of the April 26 Order, the Commission issued an order on June 19, 2001,[6] in which, in explicit recognition that the Western region is "a single market which is at once inextricably interrelated, yet characterized by important differences" the Commission prescribed price mitigation for wholesale spot markets throughout the Western Systems Coordinating Council ("WSCC").[7]

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[6] *San Diego Gas & Electric Company, et. al,* 95 FERC ¶61,418(2001) ("June 19 Order").

[7] June 19 Order, slip op. at 2. References to the WSCC are limited to that portion of the WSCC in the United States and the terms "spot markets" and "spot market sales" are defined to mean sales that are 24 hours or less and that are entered into the day of or day prior to delivery.

Among its provisions, the June 19 Order: (1) modified the formula for determining the marginal cost-based proxy price for sales in the ISO's spot markets in operating reserve deficiency hours in California; (2) established a mitigated-reserve deficiency Market Clearing Price ("MCP") in the ISO's spot markets in operating reserve deficiency hours in California; (3) established a mitigated non-reserve deficiency MCP for spot market sales in all non-reserve deficiency hours that is 85 percent of the highest ISO mitigated reserve deficiency MCP established during the hours when the last ISO-declared Stage 1 System Emergency was in effect; (4) instructed bidders to invoice the ISO directly for the cost to comply with emissions requirements and for start-up fuel costs; and (5) required all utilities who own or control generation in California to offer power in the ISO's spot markets.

The June 19 Order also allowed sellers other than marketers to justify prices higher than the market clearing price, subject to review and refund, and restricted marketers from bidding above the market clearing price. On July 10, 2001, the ISO submitted a compliance filing and proposed Tariff revisions, as directed by the June 19 Order ("July 10 Compliance Filing"). In addition to submitting revised Tariff sheets in response to the June 19 Order, the ISO also included in its July 10 Compliance Filing a revised Tariff sheet to reflect the Commission's rejection of Amendment No. 31 in Docket ER00-3673-000, in response to the November 1 Order. The Commission, in the December 19 Compliance Order, accepted the revised Tariff sheet rejecting Amendment No. 31. On July 30, 2001, the ISO filed, as an errata amendment to its May 11 and

July 10 Compliance Filings, revised Tariff sheets that substituted Hourly Ex Post Price for the ten-minute mitigated reserve deficiency MCP for hourly Ancillary Service Prices during System Emergencies.

Noting that there are several aspects of the December 19 orders that perpetuate the potential for unjust and unreasonable rates and a number of open questions relating to the market power mitigation plan established by the Commission, the ISO specifically requested modification and clarification of the December 19 orders with respect to the following issues:

December 19 Rehearing Order:

- the requirement that marketers must bid $0/MWh in the ISO spot markets;
- the requirement that the ISO recalculate the mitigated reserve deficiency Market Clearing Price ("MCP") when operating reserves fall below seven percent;
- the conclusion that the ISO and suppliers agreed to terms and rates for sales made pursuant to section 202(c) of the Federal Power Act during the period of December 14, 2000 through February 7, 2001;
- the failure to account for the Commission's recently-announced process for standardized market design and provide for adequate time for the ISO to prepare a congestion management plan and proposal for a Day Ahead Energy Market;
- the incorrect implication that the ISO pays default interest to generators when past due amounts are paid for transactions in ISO markets outside the period from October 2, 2000 through June 20, 2001;

December 19 Compliance Order:

- the requirement that the ISO must declare a Stage 1 System Emergency when operating reserves drop below seven percent;
- the implementation of the must-offer obligation;
- the requirement that out-of-control area resources (interties) are eligible to set the MCP without entering into a Participating Generator Agreement;

December 19 Winter Price Order:

- the determination that historic differences in peak demand warrant a modification to the existing market power mitigation methodology;
- the requirement to use $108/MWh as the winter season price limit; and

- the limitation that the $108/MWh price limit can be increased based on changes in gas prices but not decreased.

Critically, many of these same issues identified by the ISO are the subject of rehearing and clarification requests made by other parties. Additionally, many of the comments and protests filed by other parties in response to the ISO's January 25 Compliance Filing focus upon these same issues as well. As noted below, to the extent that comments and protests on the January 25 Compliance Filing take issue not with the ISO's implementation of the December 19 orders but instead with the requirements of the several orders themselves, such issues should have been raised within the statutory deadline for seeking rehearing of the underlying orders and not as protests of the ISO's implementation of those issues in compliance with the Commission's orders.

As explained below, the comments and protests of those parties in opposition to the ISO's January 25 Compliance Filing are without merit and should be rejected.

II. PARTIES FILING INTERVENTIONS, COMMENTS AND PROTESTS

A number of parties have filed comments or protests.[8] A number of parties filing comments and protests plainly are complaining about the provisions of the December 19 orders and not the ISO's implementation of the provisions in

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[8] Parties include: Transmission Agency of Northern California ("TANC"); Modesto Irrigation District ("MID"); Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc. ("Reliant"); The Cities of Redding, Santa Clara and Palo Alto, California and the M-S-R- Public Power Agency ("Cities/M-S-R"); Northern California Power Agency ("NCPA"); Dynegy Power Marketing, Inc., El Segundo Power LLC, Long Beach Generation LLC, Cabrillo Power I LLC, and Cabrillo Power II LLC ("Dynegy"); Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC ("Duke"); Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC and Mirant Potrero, LLC ("Mirant"); Southern California Edison Company ("SCE"); and Williams Energy Marketing & Trading Company ("Williams").

those orders. For example, the excessive concerns expressed regarding implementation of the must-offer obligation and especially including the reimbursement of minimum load costs, and the concerns for the ISO's compliance with the directive to recalculate all non-reserve deficiency hours back to May 29, 2001 based upon a trigger of operating reserves below seven percent belie a misunderstanding of the Commission's intent.

It is clear that the Commission has determined that the provisions in the December 19 orders, and the June 19 and April 26 Orders preceding them, are necessary to address the dysfunctional markets. The ISO's January 25 Compliance Filing implements those measures that the Commission has mandated in order to ensure just and reasonable prices in the California wholesale electricity markets. As the Commission noted in its June 19 Order, to the extent that Market Participants are dissatisfied with the terms of the market power mitigation plan, they may engage in forward contracting or apply for cost of service rates to avoid the market mitigation provisions.

Accordingly, to the extent that comments and protests raise substantive concerns about the ISO's implementation of the must-offer obligation, market mitigation plan and other provisions of the December 19 orders, the ISO answers such concerns in the following section. To the extent that parties express dissatisfaction with the December 19 orders, parties were required to raise such issues within the statutory deadline for requests for rehearing of those several orders. It is inappropriate and contrary to the Commission's regulations for parties to raise or repeat any such issues now in response to the January 25

Compliance Filing. The Commission will act on these issues in response to the requests for rehearing of its December 19 orders.

III. ANSWER TO COMMENTS AND PROTESTS[9]

A. The ISO Has Properly Implemented the Commission's Must-Offer Obligation.

In the December 19 Compliance Order, the Commission clarified when the ISO should compensate a generator for Minimum Load Costs incurred during compliance with the must-offer obligation. The Commission also stated that the ISO's proposal to grant a waiver to the must-offer obligation under certain conditions is reasonable and that a generator will not qualify for Minimum Load Costs during the period the waiver is in effect. The Commission specifically noted that its procedure for payment of Minimum Load Costs will allow the ISO "to make reasoned decisions about its generation requirements in order to maximize economic and reliable operations. . .." *Id.* Having set forth that generators should recover their minimum load costs, the Commission prescribed a set formula for determining fuel costs for units running at their minimum load, thus leaving the need only for information on time (or BEEP intervals) for which a generating unit is eligible for recovery of such costs.

[9] Some of the Intervenors commenting substantively on the ISO's filing do so in portions of their pleadings variously styled as "Requests for Clarification" or "Comments" without differentiation. There is no prohibition on the ISO's responding to the comments in these pleadings. The ISO is entitled to respond to these pleadings and requests notwithstanding the label applied to them. *Florida Power & Light Company*, 67 FERC ¶ 61,315 (1994). In the event 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 of this proceeding and the usefulness of this answer in ensuring the development of a complete record. See, e.g., *Enron Corporation*, 78 FERC ¶ 61, 179 at 61, 733, 61, 741 (1997); *El Paso Electric Company*, 68 FERC ¶ 61, 181 at 61, 899 and n. 57 (1994).

In its January 25 Compliance Filing the ISO sought to implement the Commission's direction that: (1) generators are to invoice the ISO for their actual costs during each hour and (2) the ISO is to use a heat rate calculation for calaculation of the fuel costs for units running at their minnnimum load. January 25 Compliance Filing at 12.

Several of the generators protest aspects of the ISO's proposed implementation of the must-offer obligation. They contend that the ISO has not complied with the Commission's direction that a generator must be compensated for its actual costs during each hour when that generator is; (1) not scheduled to run under a bilateral agreement; (2) not on a planned or forced outage; and (3) running in compliance with the must-offer obligation but not dispatched by the ISO. See e.g. Duke at 3 and Reliant at 5-12. As explained below, this critisim is without merit. To the contrary, it is the positions advocated by the generators that will lead to the imposition of unjust and unreasonable costs on consumers and which are inconsistent with the Commission's orders implementing the must offer reguirement.

1. Netting Revenues Is Appropriate To Prevent Over-Payment To Generators Running At Minimum Load

When generators run in accordance with the must offer obligation, they are producing power at least to the minimum load level for the unit. The ISO pays for this output at the Instructed Energy Price. For example, a 100 MW generator with a 10 MW minimum load will be producing at least 10 MW and be paid for this output. Alternatively, the generator may engage in other bilateral transactions or produce at a level above its schedule or ISO Dispatch instruction and receive Uninstructed Energy payments. The Commission clearly understands that the ISO does not know the payments associated with bilateral transactions. Further, the Commisison's cannot intend to have the compensation for minimum load costs subsidize a generator's bilateral transaction. The Commssion similarly prevented the improper subsidization of market transactions when it ordered the ISO to compensate generators for Minimum Load Costs when their units were "running in compliance with the Must-Offer obligation *but not dispatched by the ISO*". December 19 Compliance Order slip op at 8 (emphasis added). In the January 25 Compliance Filing, the ISO proposed to recognize these identifiable payments from market transactions and any other identifiable revenues in calculating what additional compensation is necessary to ensure that generators receive full compensation for their minimum load costs up to the amount authorized by the Commission. To avoid over-payment, the ISO proposes to pay for the unit's Energy output at the Instructed Imbalance Energy price, then net the difference between the unit's operating costs and those payments in all hours that the unit ran at minimum load in compliance with the must-offer obligation (the Waiver Denial Period) against the unit's minimum load costs for the same period. To the extent that the unit's Minimum Load Costs incurred during the Waiver Denial Period still remain unpaid, the generator would be compensated for these costs. The end result is the generator is made whole for its Minimum Load Costs, as set forth in the Commission's express formula, and ISO Market Participants do not subsidize other market activity or otherwise pay twice for the same energy.

Williams, Duke, Dynegy and Reliant protest the ISO proposal to offset revenues from certain hours against costs incurred in other hours before reimbursing actual generation costs. Williams at 7, Duke at 5, Dynegy at 3, Reliant at 8. Duke argues that "[c]ross-subsidizing minimum load costs in one hour, out of revenues in another is unjust and unreasonable because it violates the principle of cost causation." Duke at 6. Reliant, while protesting the netting of revenues, acknowledges that the Commission accepted the ISO's waiver plan, which specifically included such netting. Reliant at 4.

Such protests are an impermissible collateral attack on the Commission's December 19 order adopting the ISO's waiver proposal[10], as noticed in a Market Notice on July 20, 2001, and as filed with the Commission on December 3, 2001, in the above-referenced dockets,[11] and as such, should be dismissed. Specifically, the ISO noted that generators' desire both to receive full payment for Minimum Load Costs and be free to participate in bilateral agreements, keeping all profits by selling their remaining economic capacity through their market-based rates, would seriously distort ISO markets. Status Report at 7-8. Moreover, no other market, for example, NYISO, NEISO, or PJM permit such unconditional compensation for Minimum Load Costs. Instead these markets provide uplifts for Minimum Load Costs *only to the extent they are not recovered*

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[10] December 19 Compliance Order, *slip op.* at 8.

[11] Status Report of the California Independent System Operator Corporation on the Must-Offer Obligation, filed December 3, 2001, in EL00-95-OOO, *et al.* ("Status Report").

from market revenues over 24 hours. Status Report, FN 10.

The protests are over-reaching and thinly disguised attempts to cost-shift costs most appropriately recovered under bilateral contracts to ISO Market Participants. Neither the ISO, nor any other independent system operator, nor the Commission, as it has already ruled in this proceeding regarding start-up and emissions costs,[12] should grant such a request.

2. Bilateral Transactions Should Not Free Ride On Market Participant Payment Of Start-Up and Minimum Load Costs

The ISO proposes to deny Minimum Load Cost recovery for an entire Waiver Denial Period to any unit that, while running at minimum load in compliance with the must-offer obligation or during a period beyond the Waiver Denial Period that is within the end of the last self-committed period preceeding the Waiver Denial Period plus the unit's minimum down time: (1) submits an Hour-Ahead Energy Schedule, (2) self-provides or is awarded Hour-Ahead Ancillary Services Capacity, or (3) engages in uninstructed deviations over an entire hour that are outside a tolerance band of five MW or three percent of the unit's maximum output.

Reliant protests that the ISO proposal "punishes generators ordered to operate at minimum load if they are later able to participate in any market, including bilateral sales, imbalance energy and ancillary services." Reliant at 9. Dynegy argues the "ISO has no authority to look forward forward or backward

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[12] December 19 Compliance Order, *slip op.* at 20 ("We reject parties claims that they should by the ISO for all emissions and start-up costs including those costs associated with bilateral transactions.")

during the ‘Waiver Denial Period’ to determine what other revenues a generator may receive. . ..” Dynegy at 5-6. Williams and Dynegy argue that the Waiver Denial Period and resultant conditions on ISO payment of Minimum Load Costs is directly counter to the Commission’s directive. Williams at 6, Dynegy at 2-3.

The protests over denial of cost recovery based upon submittal of a bid or schedule are clearly an attempt to make the ISO subsidize start-up costs and minimum load costs for generators which, when freed of such costs, they can also recover such costs in bilateral contracts (where they are most appropriately recovered), and thus reap excessive profits. Mirant presents an example of a potential result wherein power purchasers, rather than enter into the Hour-Ahead or Day-Ahead Markets because of the start-up and ramping costs that a generator would factor into the bilateral agreement, would elect to buy Energy from the ISO Imbalance Energy Market instead. Mirant at 4 – 5. Mirant appears to believe it is entitled to complete compensation by the ISO for start-up costs, Minimum Load Costs and operation and maintenance costs, even for such costs incurred as a necessary part of Mirant’s performance under voluntary bilateral agreements. This is wholly contrary to the Commission’s intentions for the must-offer obligation and payment of minimum load costs. Under no circumstances should any generator be able to shift costs incurred through performance under a bilateral agreement to the ISO Market Participants in general. This is the very antithesis of a competitive market outcome.

Duke, Dynegy and Reliant propose that, should Minimum Load Costs be denied recovery, if ever, it should be on the basis of submission of an actual

Schedule to the ISO as opposed to merely submitting a bid. Duke at 3-4; Dynegy at 5-6; Reliant at 10. The ISO agrees that submission of bids for Ancillary Services into either the Day-Ahead or Hour-Ahead Markets should not cause the generator to forego Minimum Load Cost recovery for the Waiver Denial Period, and agrees to amend the Tariff accordingly. Additionally, the ISO agrees to modify the Tariff so that a generator that is awarded Ancillary Services in an hour in the Hour-Ahead market shall forfeit minimum load cost recovery only for that hour. The ISO maintains, however, that a generator that self-provides Ancillary Services or is awarded Ancillary Services in the ISO's Day-Ahead markets is self-committed and therefore not entitled to subsidized recovery of its Minimum Load Costs.[13] Moreover, generators must bid available capacity into the ISO Supplemental Energy Markets, inasmuch as this is the intent of the must-offer obligation. To the extent that generators do not bid available capacity into the Supplemental markets, the ISO will create and insert proxy bids for such capacity. Only Supplemental Energy bids that are accepted and Dispatched will affect Minimum Load Cost recovery, and the affect is limited to an offset of market revenues, thus again ensuring complete recovery of Minimum Load Costs while preventing double or over-payments.

In contrast to the ISO's proposed treatment Supplemental Energy bids, generators who submit Schedules for bilateral agreements while running at

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[13] See e.g. ISO Tariff Section 2.5.15, which reads, in part, "The ISO's [Spinning Reserve] auction does not compensate a Scheduling Coordinator for the minimum Energy output of Generating Units, System Units or System Resources bidding to provide Spinning Reserve. Therefore, any minimum Energy output associated with Spinning Reserve selected in the ISO's auction is the responsibility of the Scheduling Coordinator selling the Spinning Reserve."

Minimum Load in compliance with the must-offer obligation, should forefeit all Minimum Load Cost recovery for the entire Waiver Denial Period. This is consistent with the Commission's oft-stated position that costs associated with performance of bilateral contracts, *e.g.,* start-up and ramping costs, should be included in the contracts themselves and not cost-shifted to Market Participants under the must-offer obligation. Moreover, the ISO, not privy to the terms of bilateral contracts, lacks a mechanism to offset such market revenues against Minumum Load Costs and thus lacks a means to guard against double-payments.

Lastly, for generators who do not have Supplemental Energy bids accepted and Dispatched or a Schedule submitted for a bilateral agreement and who engage in uninstructed deviations, beyond a reasonable tolerance band provided to account for operational flexibility, the ISO will eliminate payment of Minimum Load Costs for the Waiver Denial Period. As discussed *infra*, the ISO acknowledges that this remedy appears harsh but believes it is essential to discourage generators who would prefer the certainty of the ISO paying their Minimum Load Costs from withholding from other market opportunities (again, where those costs should be recovered) in the hopes of getting the ISO to guarantee those costs.

Dynegy suggests the ISO may engage in gaming the Ancillary Services market by using its wavier denial authority to "lean on must-offer units for reserves, rather than pay for such services in the market. . . ." Dynegy at 6. The ISO believes that Dynegy is concerned that the ISO may reduce its purchases of Ancillary Services in the Day-Ahead and Hour-Ahead Markets and rely upon committed capacity for operating reserves without actually compensating generators for such capacity. Dynegy's unsupported allegation is unfounded. The ISO does not reduce the amount of Ancillary Services it procures by the amount of committed but unloaded capacity. Stated differently, the ISO does not construe unloaded capacity as Ancillary Services unless such capacity is self-provided or purchased through an ISO auction. Moreover, inasmuch as the ISO publishes its procurement quantities, Dynegy, or any other party, would have evidence to support allegations of gaming.

Mirant argues, contrary to other generators, that Energy produced by units running at Minimum Load should be Scheduled and not treated any differently than pre-Dispatched Regulatory Must-Run units. Mirant at 7-8.   The ISO cannot distinguish between a Schedule for a bilateral agreement and a Schedule for compliance with the must-offer obligation. Therefore, the ISO lacks a means to calculate which hours the resource ran in compliance with the must-offer obligation, and is thereby eligible for Minimum Load Cost recovery, versus hours the resources was self-committed under a bilateral contract. Moreover, as discussed *supra,* the ISO pays generators operating at minimum load in compliance with the Commission's must-offer obligation the instructed imbalance energy price to ensure adequate, but not unwarranted, cost recovery. These payments would not be made to generators with forward Schedules.

3. The Proposed Waiver Denial Period Appropriately Includes Operational and Economic Considerations Consistent With the Commission's Orders

To the extent that protests assert that the ISO should not take economic considerations into account, the ISO notes the Commission authorized the ISO to "make reasoned decisions about its generation requirements in order to maximize economic and reliable operations. . . ." December 19 Compliance Order, slip op. at 8. Any such protests to the January 25 Compliance Filing arguing against use of economic considerations to identify which units should run at minimum load and which may be granted waivers are inappropriate collateral attacks on the underlying order.

Duke protests that the Waiver Denial Period is vague and contains objectionable procedures, including granting to the ISO the ability to deny waivers arbitrarily and capriciously. Duke at 7-8. Moreover, Duke believes that the first criterion for consideration of a waiver, *i.e.,* minimization of start-up and Minimum Load Costs to the ISO, discriminates against the more efficient generating units and discourages the construction of more efficient generation in California. *Id.* This argument is hard to understand, since more efficient generating units, by definition, have reduced costs and thus are more attractive units for bilateral transactions under any circumstances. It is not clear why Duke, counter to sound business principles, would want to forego operation of such cost-effective units and elect instead to run them at Minimum Load only. To the extent that Duke believes it would suffer uncompensated wear-and-tear and thermal stress from operating at Minimum Load, Duke can avoid such circumstances by engaging in forward contracts. Nonetheless, the ISO has modified its procedures for granting waivers to consider a resource's operating costs in addition to the resource's start-up and minimum load costs. Lastly, the market mitigation measures already provide a generous operating and maintenance adder, currently set at $6.00/MWh, to defray such wear-and-tear for units operating in the ISO Control Area, and this would be applied to the minimum load as well. Duke, in objecting to the third criterion for waivers, namely to provide for a reasonable assurance of competitive market outcomes, is re-arguing a settled Commission order accepting the waiver principles proposed in the Status Reports, and so this argument is without merit and needs no further response.

Reliant complains that the ISO should base the grant or denial of a waiver on specific criteria and inform a generator that a waiver has been granted or denied. Reliant at 6-7. Williams expresses a related concern. Williams at 4. The ISO, as set forth in the January 25 Compliance Filing, will consider the four criteria enumerated therein, but, must also give paramount weight to reliability considerations. Nevertheless, the ISO will employ a form of a unit commitment computer program and will issue information as the software is implemented and tested. The ISO wants to ensure that its pays the minimum load costs only for those units that the ISO determines must operate to comply with reliability criteria. To that end, generators are assumed to be under an ISO waiver of the must-offer obligation, and therefore not eligible to recover their minimum load costs, unless the ISO expressly revokes their waiver and requires them to be operating in accordance with the must-offer obligation. Generators must not assume that the mere act of operating at minimum load with no forward schedules will qualify them to recover their Minimum Load Costs from the ISO. If the ISO requires units that are not operating to operate, it will notify them to revoke their waiver so that the unit must start-up so as to operate in compliance with the must-offer obligation. If units that are operating want to shut down, they must notify the ISO before shutting down, and the ISO shall either grant the waiver (i.e., confirm the generator *is not* required) or revoke the waiver (i.e., confirm the unit *is* required). In summary, only those units that the ISO has confirmed are required to operate by expressly revoking the waiver of compliance with the must-offer obligation are eligible to have their Minimum Load Costs paid by the ISO.

4. The Tolerance Band is a Reasonable Means To Assure Generating Units Are Running At Minimum Load To Be Available For ISO Dispatch In Real Time and Not Engaged In Bilateral Contracts

Duke opposes use of a tolerance band which, if exceeded, acts to deny Minimum Load Cost recovery for units. Duke at 4-5. Dynegy argues that such a tolerance band is tantamount to a penalty and that generators could suffer as a result of production imbalances within a particular hour. Dynegy at 7. The tolerance band allows for operational flexibility and is a specific acknowledgement that certain generating units may not be able to match Dispatch instructions perfectly. On the other hand, ISO Market Participants should not be required to pay Minimum Load Costs for generating units that are unresponsive or undertake uninstructed deviations. Moreover, positive uninstructed deviations in real time may be evidence of a bilateral transaction, for which the Commission has ruled no Minimum Load Cost recovery is permissible.[14] Ultimately, the tolerance band allows for realistic operational flexibility while protecting ISO Market Participants from payments for Energy and products not delivered.

5. Disincentives To Schedule Into the Day-Ahead Market May Be An Unavoidable Consequence Of the Must-Offer Obligation

Mirant protests that the ISO proposed implementation of the must-offer obligation endangers system reliability by shifting load from forward markets to real time spot markets. The ISO noted in its January 25 Compliance Filing that the Commission's directive to pay minimum load costs "may create a gaming opportunity by providing suppliers with a disincentive to schedule in the Day-Ahead market and withhold schedules in order to have the ISO subsidize their minimum load costs during a Waiver Denial Period." This is the reason the ISO proposes a set period of time through which a unit may not self-commit to assure there is no such improper subsidization of minimum load costs. As clarified in section A(2) *supra*, generators may bid for Ancillary Services and Supplemental Energy while running at Minimum Load in compliance with the must-offer obligation. If such bids are accepted and Dispatched, the resulting market revenues will be netted against Minimum Load Costs for the Waiver Denial Period to ensure full but not excessive payment. As will other bids, it remains incumbent upon the generator or Scheduling Coordinator to incorporate operating costs of performance into any such bids.

6. Heat Rate

Dynegy argues that the ISO should use minimum point on the unit's

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[14] December 19 Order slip op at 20.

heat rate curve instead of the unit's average heat rate for purposes of calculating Minimum Load Costs. Dynegy at 8-9. Dynegy appears to imply that only one heat rate curve – an incremental heat rate curve – exists. In fact multiple heat rate curves, all derived from the basic input-output curve, exist. The incremental heat rate curve, for example, shows the additional fuel that must be consumed to produce an additional MW. Since the average heat rate curve shows the average fuel consumed at that operating point, the total fuel consumed at that operating point can be determined by multiplying the average heat by the output. The most appropriate curve for Minimum Load Cost recovery, therefore is the average heat rate curve, in contrast to the incremental heat rate curve which is the appropriate curve to use for determining the marginal price of energy.

7. Other Issues Related to Must Offer Payments

Duke argues that the ISO should not net out any emissions cost recovery against Minimum Load Cost recovery. Duke at 6. Dynegy claims the ISO should add the ten percent credit adder to Minimum Load Cost payments along emissions cost reimbursement. Dynegy at 9, 11. The ISO has proposed to follow the Commission's directions regarding what costs to consider in the calculation of Minimum Load Costs and these costs do not include emission costs, which are recovered through a separate mechanism. Moreover, compliance with the must-offer obligation is a condition of participation in the ISO markets and not a transaction entered into between the ISO and the Generator. As such, Minimum Load Cost recovery, calculated accordingly to a specific formula set forth by the Commission, properly excludes the ten percent credit adder.

8. Retroactive Calculation of Minimum Load Costs

Dynegy is concerned that the ISO may seek to apply the Waiver Denial Period procedure retroactively to prior period when generators could not have known its terms and conditions and thus comply. Dynegy at 5. Reliant expresses a similar concern. Reliant at 11 –12. The ISO is reviewing the extensive record of must-offer obligation transactions to determine how to most fairly, equitably and reasonably compensate generators for prior compliance with the must-offer obligation. As noted in the January 25 Compliance Filing, the ISO will file with the Commission a status report within eight weeks of the compliance filing set forth a proposed retroactive calculation of Minimum Load Costs.

9. Minimum Load Cost Template

The ISO has not yet completed the Minimum Load Template for generators to use to provide data to the ISO and thus the template is not yet posted on the ISO web site. Thus, the ISO agrees with Mirant and Dynegy that additional time will be needed for generators to comply with the required submittal of required data. Mirant at 9, Dynegy at 10.

10. Required Data For Waiver Denial Period Computer Program

Reliant protests that the ISO should be required to work with generators to specify a fair method for determining the values for such parameters of start-up time, minimum up time, minimum down time and others as set forth in the January 25 Compliance Filing and Market Notice posted on February 13, 2002.

Reliant also argues that the ISO should not automatically use, for settlement of Minimum Load Costs the shorter time period as may be contained in either of the ISO or a generator's records for a particular transaction period, but instead should employ a predictable standard. Reliant at 13.

As to the first issue, the data the ISO has required for each generating unit in order for that unit to be included in the Waiver Denial Period computer program are basic and standard parameters of generating units.

As to the later issue, the ISO agrees to use its own records, which are set forth under its Tariff as the data of first resort. To the extent that any generator believes the ISO records are incorrect, the ISO Tariff at Section 13 provides for a dispute resolution process to address the generators concerns.

B. Implementation of the 7% Reserve Criterion Back To May 29 For Resetting the Mitigated MCP

Reliant states that the ISO should not undertake the extensive, and expensive, recalculations of prior transactions until the Commission has acted on the rehearing requests concerning the December 19 orders and, in particular, application of the seven percent criterion for resetting the mitigated market clearing price. Reliant at 13-15. The ISO agrees that such recalculations should not take place until the Commission has issued a final ruling on the pending requests for rehearing.

C. Start-up and Emissions Cost Recovery From ISO Total Gross Load

Several California governmental entities protest the proposed revisions to Sections 2.5.23.3.6.3 and 2.5.23.3.7.3 of the ISO Tariff that the rates for

Emissions Costs and Start-up Fuel Costs should be based on the sum of the "Control Area Gross Load and the projected Demand with California outside the ISO Control Area that is served by exports from the ISO Control Area." *See, e.g.,* Modesto at 4, Cities/M-S-R at 3, TANC at 6-9 and NCPA at 3. According to the governmental entities, nothing in the December 19 Compliance Order warranted a modification of these Tariff provisions. TANC at 8-9, Modesto at 8. Such an assertion is without merit. The December 19 Compliance Order states unequivocally:

> "In response to PG&E's request for clarification regarding whether the ISO will assess the emissions and start-up costs on a gross or net load basis, the ISO commits to modify its Tariff to assess these charges 'to all ISO Control Area Gross Load within the ISO's Control Area and to "all Load exported from the ISO Control Area to another Control Area in California."
>
> ***
>
> We agree with the ISO that total gross load is the most appropriate method to assess these costs."

December 19 Compliance Order at 62,370. Contrary to the assertion of the governmental entities, the ISO's compliance filing contains the precise language proposed to and accepted by the Commission.

TANC also faults the ISO for "propos[ing] to assess such costs to all Load in the ISO control area, including Load that does not require the use of the ISO Controlled Grid." TANC at 6. TANC does not identify the Load in the Control Area that does not benefit from the ISO Controlled Grid. Indeed, the definition of Control Area Gross Load excludes Load that is electrically isolated from the ISO Controlled Grid. Thus, the ISO proposal is entirely consistent with the Commission's express order and the protests amount to collateral attacks on the underlying order.

SCE identifies that the ISO failed to make corresponding changes to Sections 2.5.23.6.1 and 2.5.23.3.7.1 of the ISO Tariff containing the provisions regarding payment of the Emissions and Start-up Costs. SCE at 3. This creates the problem for the potential underrecovery of these costs if the obligation to pay the rate is based on metered Demand for a charge developed on Control Area Gross Load. The ISO agrees that these sections should have been modified as well. Consistent with the ISO's billing of the Control Area Service component of its Grid Management Charge to Control Area Gross Load, pursuant to Section 8.3.1 and SABP 3.1 of the ISO Tariff, the obligation to pay for Emission and Start-up Costs should be billed to Scheduling Coordinators and Other Appropriate Parties based on the Control Area Gross Load and Demand within California outside the ISO Control Area that is served by exports from the ISO Control Area multiplied by the rates developed in accordance with Sections 2.5.23.3.6.3 and 2.5.23.7.3.

D. Credit Risk Adder

Reliant argues that the ten percent credit adder should be applied retroactively to January 5, 2001. Reliant at 16. Dynegy asserts that the ten percent credit adder should be applied only retroactively to June 21, 2001. Dynegy at 15. Reliant's attempt to extend the creditworthiness adder retroactively to January 5, 2001 is patently unreasonable. The

Commission adopted the requirement in its June 19 Order. The ISO agrees with Dynegy that the requirement should be effective as of June 21, 2001, and not as of December 20, 2001, as mistakenly was provided for in the January 25 Compliance Filing.

Both Reliant and Dynegy argue that the ten percent adder should be applied to uninstructed deviations in which generator produce power above and beyond their Schedules or what has been instructed by the ISO. Reliant at 15-16, Dynegy at 11-12.

The Commission should not countenance such overreaching. Uninstructed Imbalance Energy is not the subject of an agreed-upon transaction with the ISO, but only a consequence of generator's unilateral, voluntary decision to produce additional output or an operator's loss or lack of control.

E. Calculation of the Market Clearing Price For Ancillary Services Was Modified In the December 19 Rehearing Order and Is Prospective Only

Duke argues that the December 19 orders require the ISO to recalculate the Market Clearing Price for Ancillary Services retroactively to June 21, 2001. Duke at 9-10. Dynegy protests that the ISO should apply it retroactively to June 20, 2001. Dynegy at 15-16. First, the ISO notes that Dynegy's proposed date of June 20, 2001, is clearly mistaken since the Commission set all other applicable implementation dates associated with the June 19 Order effective as of June 21, 2001. Second, both the Duke and Dynegy assertions that implementation of the new methodology for calculation of the marginal clearing price for Ancillary Services should be retroactive at all is rebutted by the Commission's statement,

> We agree with Enron and Reliant that the price for the hour a transaction is entered into, and not the hour of delivery is relevant for establishing the market clearing price for Ancillary Services. We will grant rehearing of our prior orders on this point, to the extent needed to allow this *modification.*

December 19 Rehearing Order, slip op. at 94. Emphasis added. The Commission modified its prior order, directed the ISO to use a new method, and did not provide for retroactive application to change the way the ISO implemented the pricing for Ancillary Services prices prior to the December 19 Rehearing Order. Thus, the ISO properly proposed to apply the new pricing method prospectively only, beginning with the first day of compliance with the December 19 Rehearing and Compliance Orders, *i.e.,* December 20, 2001.

F. Use of Proxy Price Only To Establish the Mitigated Reserve Deficiency Market Clearing Price

The ISO agrees with Reliant and Dynegy that use of the proxy price alone should be used to establish the mitigated reserve deficiency MCP beginning on May 29, 2001 and not, as was inadvertently indicated, May 20, 2001. Reliant at 17; Dynegy at 15-16. This is consistent with the Commission's express directive set forth in the December 19 Compliance Order, slip op. at 11.

G. Visibility Is a Legitimate and Reasonable Requirement For Resources Seeking to Set the Mitigated Reserve Deficiency Market Clearing Price in ISO Markets

In the Compliance filing, the ISO, in accordance with the Commission's direction, removed the requirement that out-of state generators execute a Participating Generator Agreement in order to be eligible to set the Market Clearing Price. Three in-state generators, Reliant, Mirant, and Dynegy protest that the compliance filing did not go far enough. They contest the ISO's proposal to require real time telemetry for outside of ISO Control Area resources as a prerequisite to be eligible to set the ISO's MCP. Reliant at 17-18; Mirant at 10-11; Dynegy at 13.

By removing the requirement that the out-of-state suppliers enter a PGA, the ISO addressed the Commission's concern that out-of-state suppliers should not "cede control of their generating units". December 19 Compliance Order Slip op at 18. The Commission, however, recognized the need to provide the ISO with appropriate meter and interchange data. *Id.*

The ISO notes that the protests that the ISO should not require real time visibility are misplaced and fail to acknowledge the real danger of market power abuses and portfolio substitution should a resource be permitted to influence the ISO Real Time Market price under a scheme of bait and switch.

Indeed, Commission staff have filed rebuttal testimony in the refund proceeding, Docket Nos. EL00-95-045 and EL00-98-042[15] indicating an understanding that because the ISO Market Clearing Price is based on a specific unit Dispatched by the ISO, and because, interties, like other non-Participating Generator resources, have their offers inserted into the BEEP stack as intertie Schedules and not specific unit bids, some adjustment must be made to ensure a specific unit responded to a Dispatch and is therefore eligible to set the Market Clearing Price. The ISO has not been able to determine any other way besides real time visibility to verify compliance with ISO Dispatch Notices and eligibility to set MCP.

H. Effective Date For Elimination of Fines For Failure To Report A Forced Outage Or Respond To An ISO Dispatch Instruction

In the December 19 Compliance Order, the Commission stated "[I]n light of the mitigation plan instituted in the April 26 Order, including the must-offer obligation, we find there is no need for the ISO to impose any penalty either for a failure to report a forced outage or a failure to respond to a dispatch request." December 19 Order, Slip Op at 15. The ISO complied with this directive by proposing a new Section 5.6.3.2.1 suspending application of the penalty for the period June 20, 2001 through September 30, 2002 – the period coincident with the mitigation program. Indeed, the ISO also proposed a new Section 31 that

[15] Exhibit No. S-26, Prepared Rebuttal Testimony of John K. Sammon, witness for the staff of the Federal Energy Regulatory Commission, at 54.

specifically sunsets the must-offer obligation and the other elements of the mitigation program.

Dynegy argues that the ISO must remove the generator fine provision from the ISO Tariff in its entirety. Dynegy at 14. Dynegy's position should be rejected. The Commission did not find the previously-approved penalties to be unjust and unreasonable. Rather, the Commission stated that the penalties were unnecessary during the time the must-offer and other mitigation elements were in place. Inasmuch as these several market power abuse mitigation provisions are to sunset on September 30, 2002, it is proper to waive application of the generator fine provision until September 30, 2002, only. The Commission has not ordered the ISO not to re-impose such fines after that time. The ISO agrees with Reliant, however, that the January 25 Compliance Filing inadvertently proposed an effective date of June 20, 2001, instead of the correct date of June 21, 2001, to remove the penalty for failure to report a forced outage or to respond to an ISO Dispatch request.

I. Gas Portfolio Data To Support Recovery Of Costs Above The Formulaic Gas Proxy Price

Dynegy contends that the ISO should be required to remove all reference to submission of gas portfolio data from the Tariff because the Commission only requires such data from sellers seeking to justify gas costs in excess of the price calculated through a Commission-set formula. Dynegy at 16. Dynegy is mistaken because the Commission specifically does require submission of portfolio data expressly to support such requests for cost recovery above the calculated gas proxy price.

IV. CONCLUSION

For the foregoing reasons, the Commission should accept the ISO's January 25 Compliance Filing in this proceeding without modification except as set forth in this filing.

Respectfully submitted,

____
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Dated: March 4, 2002

CALIFORNIA ISO

California Independent
System Operator

March 4, 2002

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

Re: San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange Docket No. EL00-95-058;

Investigation of Practices of the California Independent System Operator and the California Power Exchange Docket No. EL00-98-050;

Public Meeting in San Diego, California Docket No. EL00-107-009;

Reliant Energy Power Generation, Inc., Dynegy Power Marketing, Inc., and Southern Energy California, L.L.C. v. California Independent System Operator Corporation Docket No. EL00-97-003;

California Electricity Oversight Board v. All Sellers of Energy and Ancillary Services Into the Energy and Ancillary Services Markets Operated by the California Independent System Operator Corporation and the California Power Exchange Docket No. EL00-104-008;

California Municipal Utilities Association v. All Jurisdictional Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange Docket No. EL01-1-009;

Californians for Renewable Energy, Inc. (CARE) v. Independent Energy Producers, Inc., and All Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange; All Scheduling Coordinators Acting on Behalf of the Above Sellers; California Independent System Operator Corporation; and California Power Exchange Corporation Docket No. EL01-2-003;

Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western System Coordinating Council Docket No. EL01-68-001

Dear Secretary Salas:

Enclosed for electronic filing, please find the Answer of the California Independent Operator System Corporation to Motions to Intervene, Requests for Clarification, Comments and Protests to the January 25, 2002 Compliance Filing and Proposed Tariff Amendments in the above-captioned dockets.

Thank you for your assistance in this matter.

Respectfully submitted,

Margaret A. Rostker
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(916) 608-7147

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the Answer of the California Independent System Operator Corporation to Motions to Intervene, Requests for Clarification, Comments and Protests to the January 25, 2002 Compliance Filing and Proposed Tariff Amendments upon each person designated on the official service list compiled by the Secretary in the above-captioned dockets.

Dated at Folsom, California, on this 4th day of March, 2002.

____

Margaret A. Rostker
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