107 FERC ¶ 61, 118

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher,

California Independent System Operator Corporation — Docket No. ER03-1102-002

ORDER ON REHEARING

(Issued May 6, 2004)

1. In an order issued on February 20, 2004,[1] the Commission directed the California Independent System Operator Corporation (CAISO or ISO) to modify the behavior rules proposed in Amendment No. 55 to be consistent with the Commission's market-based rate behavior rules in the MBR Tariff Order.[2] The Commission accepted, subject to the Commission's acceptance of a CAISO filing that demonstrates that the CAISO has established an independent Governing Board in compliance with Commission orders,[3] the CAISO's proposal to charge pre-defined penalties for certain objectively identifiable behavior. The Commission directed modification of Amendment No. 55 to conform it to the Commission's MBR Tariff Order and otherwise provided direction to the CAISO. In this order, we grant, in part, and deny, in part, the requests for rehearing of the February 20 Order and respond to the requests for clarification. This order applies the Commission's recently adopted behavior rules and benefits customers in the CAISO markets by providing a reasonable approach to investigating and sanctioning anti-competitive behavior.

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[1] California Independent System Operator Corp., 106 FERC ¶ 61,179 (2004) (February 20 Order).

[2] Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003) (MBR Tariff Order).

[3] Mirant Delta, LLC, et al. v. California Independent System Operator Corp., 100 FERC ¶ 61,059 (2002) (Mirant I), reh'g granted in part, 100 FERC ¶ 61,271 (Mirant II), reh'g denied, 101 FERC ¶ 61,078 (2002).

I. Background

2. On July 22, 2003, the CAISO filed its proposed Oversight and Investigations Program (O&I Program) as Amendment No. 55 to the CAISO's Open Access Transmission Tariff (ISO Tariff).[4] The CAISO proposed to implement the O&I Program in three parts: (1) adding an Enforcement Protocol as a stand-alone Attachment to the ISO Tariff, (2) incorporating additional conduct rules in the main body of the ISO Tariff to address specific bidding and scheduling behavior, and (3) revising the ISO Market Monitoring and Information Protocol (MMIP) under the ISO Tariff to complement the Enforcement Protocol and to correct various outdated provisions of the MMIP.

3. The proposed Enforcement Protocol was composed of seven parts: (1) Objectives, Definitions, and Scope (EP 1); (2) Rules of Conduct (EP 2); (3) Process for Investigation and Enforcement (EP 3); (4) Process for Prohibiting Detrimental Practices and Market Manipulation (EP 4); (5) Administration of Penalties (EP 5); (6) No Limitations on Other Rights of ISO (EP 6); and (7) Amendments (EP 7). The CAISO proposed to monitor, investigate and enforce nine Rules of Conduct.[5] For each of its nine Rules of Conduct, the CAISO provided a General Rule, ascribed a maximum fixed Standard Penalty amount per event for rule violations and listed any Special Penalties, Exceptions or Limitations to the rule. In addition to the maximum fixed Standard Penalty, for five of the nine Rules of Conduct, the ISO proposed to impose a variable penalty for violations.

4. On September 22, 2003, the Commission issued an order accepting and suspending Amendment No. 55 for five months, to be effective February 21, 2004, subject to refund and further Commission order.[6] In the February 20 Order, the Commission directed the ISO to modify proposed Amendment No. 55.

5. Requests for rehearing and/or motions for clarification were filed by the CAISO;

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[4] The CAISO stated that its O&I Program consisted of five elements, only four of which the ISO requested the Commission to approve.

[5] The nine Rules of Conduct set forth in EP 2.2 through EP 2.10 were as follows: (1) comply with operating orders; (2) submit feasible energy and ancillary service bids and schedules; (3) no physical withholding; (4) no economic withholding; (5) comply with availability reporting requirements; (6) provide factually accurate information; (7) provide information required by the ISO Tariff; (8) no detrimental practices; and (9) no market manipulation.

[6] See California Independent System Operator Corp., 104 FERC ¶ 61,308 (2003).

the City of Santa Clara, California, Silicon Valley Power (Santa Clara); the Modesto Irrigation District (Modesto); the Indicated Generators;[7] Sempra Energy (Sempra); Southern California Edison Company (SoCal Edison); Powerex Corp. (Powerex); the California Public Utilities Commission (CPUC); and the Automated Power Exchange, Inc. (APX).

II. Discussion

A. ISO Governance

6. In the February 20 Order, the Commission accepted the ISO's proposal subject to, among other things, the Commission's acceptance of a CAISO filing that demonstrates that the ISO has established an independent Governing Board in compliance with Commission orders.

7. The ISO and the CPUC argue that the Commission does not have statutory authority under the Federal Power Act (FPA) to affect the corporate governance structure of the CAISO because the issue falls within an area of traditional state concern and regulation. The ISO and the CPUC assert that the only provision of the FPA which relates to corporate structure, section 305, 16 U.S.C. § 825d, is not applicable here. The ISO and the CPUC add that section 206 of the FPA, 16 U.S.C. § 824e(a), does not address corporate governance; they argue that governance is not a "practice" under that section of the statute. The ISO contends that, even if section 206 did apply, the Commission has not made the necessary finding that the composition of the ISO's Governing Board is presently "unjust, unreasonable, unduly discriminatory or preferential." The CPUC also argues that Order No. 888 does not provide the Commission with authority over the ISO's Governing Board because Order No. 888 cannot trump the FPA and does not require a specific form of corporate governance. The Commission has addressed all of these issues in the Commission's orders concerning governance of the CAISO.[8] For the reasons stated in those orders, we deny these requests for rehearing.

8. SoCal Edison argues that, to ensure that California ratepayers and market participants are adequately protected from gaming and anti-competitive behavior in the

[7] The Indicated Generators include Reliant Energy Power Generation, Inc.; Reliant Energy Services, Inc.; Mirant Americas Energy Marketing, LP; Mirant California, LLC; Mirant Delta, LLC; Mirant Potrero, LLC; Dynegy Power Marketing, Inc.; El Segundo Power LLC; Long Beach Generation LLC; Cabrillo Power I LLC; Cabrillo Power II LLC; and Williams Energy Marketing & Trading Co.

[8] Mirant I, 100 FERC ¶ 61,059; Mirant II, 100 FERC ¶ 61,271.

future, it is essential that oversight and enforcement of market behavior is handled at the ISO, notwithstanding concerns over the ISO's governance. SoCal Edison asks the Commission to indicate that the ISO will ensure compliance with Amendment No. 55. As indicated in the February 20 Order, the ISO's marketing monitoring unit (MMU) will have authority to ensure compliance with certain portions of proposed Amendment No. 55, subject to modification and our approval of the ISO's compliance filing,[9] once the CAISO has established an independent Governing Board in compliance with Commission orders.[10] Until the Commission determines that the CAISO is independent, the Commission will enforce those Rules of Conduct accepted in the February 20 Order which are both objectively identifiable and which require subjective evaluation.[11] Contrary to SoCal Edison's assertion, the independence of the ISO's Governing Board is an essential element in assuring that California markets function competitively.[12]

B. Commission Assumption of ISO Enforcement Activities

9. In the February 20 Order, the Commission stated that, in its filing establishing Governing Board independence, the CAISO must demonstrate that the MMU possesses the ability to independently administer the behavior-related tariff provisions and assess penalty charges as discussed therein and must make any necessary revisions to the MMIP in that respect.[13] In the interim, the Commission directed the ISO to modify the Enforcement Protocol to indicate that it will be enforced by the Commission. It stated that, until it determines that the CAISO is independent, the Commission will enforce those Rules of Conduct accepted which are both objectively identifiable and which

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[9] The CAISO has requested an extension of time until May 20, 2004 to submit the compliance filing with the modifications to Amendment No. 55 that the Commission directed in the February 20 Order. It explains that the numerous tariff modifications ordered by the Commission will require a major overhaul of the Enforcement Protocol. The CAISO also seeks the delay because of the limited availability of certain key personnel. Although the Commission is reluctant to grant extensions of time for compliance filings unless good cause exists, given the volume, scope and importance of the directed tariff revisions, we will grant the CAISO's motion.

[10] February 20 Order at P 1, 40, 46, 154 and 167.

[11] Id. at 154.

[12] See Mirant I, 100 FERC ¶ 61,059; Mirant II, 100 FERC ¶ 61,271.

[13] February 20 Order at P 154.

require subjective evaluation.

10. The ISO asserts that the Commission has not provided a reason or justification for concluding that the lack of independence of the ISO Governing Board would affect the ISO's investigation and enforcement functions. The ISO argues that, since the Commission has eliminated any discretion the ISO might having in administering the proposed Rules of Conduct and penalties set forth in the Enforcement Protocol, there is no justification for the Commission to assume the enforcement activities allocated to the Department of Market Analysis (DMA) until the ISO makes a filing demonstrating the ISO Governing Board's independence. The ISO adds that the fact that the Commission will be the ultimate arbiter of any dispute concerning the ISO's exercise of the authority apportioned to it underscores its point. The ISO claims that the Commission has given other independent system operators the authority to exercise the same functions that the Commission has withheld from the CAISO.

11. We continue to believe, as a matter of policy,[14] that independence is paramount to the proper function of any independent system operator, even where discretion is limited. This need for independence extends to a function within the ISO to monitor markets and assess penalties. Markets need certainty and unbiased rules and enforcement of those rules, especially with respect to those rules where the ISO may be perceived as intervening in market outcomes. Market operations, including tariff rules and administration, must foster trust by market participants and customers. The 2000-01 energy crisis compromised confidence and trust in the CAISO energy markets. The Commission believes that confidence and trust in these markets by participants and customers starts with clear and fair tariff/market rules coupled with independent implementation and enforcement of them. Accordingly, we deny this request for rehearing.

C. CAISO's Market Monitoring Structure

12. References to the "DMA" in the Commission's February 20 Order were expressly intended to cover all individuals who have MMU responsibilities, including the Compliance Unit.[15] The Commission did not require the ISO to make any changes in its organizational structure but directed the ISO to inform the Commission of the duties and responsibilities of its Compliance Unit, including any dual functions shared by the DMA and the Compliance Unit.[16] Moreover, to ensure that the MMU is adequately

[14] See 18 C.F.R. § 35.34 (2003).

[15] February 20 Order at n.8.

[16] February 20 Order at P 155.

independent to be able to carry out its activities associated with the Enforcement Protocol without interference or instruction from other ISO/RTO personnel or non-MMU supervisors, the Commission directed that, in its filing establishing Governing Board independence, the ISO demonstrate that the MMU possesses the ability to independently administer the behavior-related tariff provisions and assess penalty charges as discussed in the order and make any necessary revisions to the MMIP in that respect.[17]

13. The ISO explains that the function of the DMA is to monitor activity in the ISO's markets and to identify and report instances of manipulative or anomalous behavior in those markets. It states that the Compliance Department is responsible for monitoring compliance with the ISO Tariff and administering any penalties that are based on objective criteria, as specified in the ISO Tariff, including the Enforcement Protocol. Both of these departments report to the ISO's General Counsel.

14. The ISO claims that the Commission required the Enforcement Protocol to be administered solely by the DMA and that the DMA be independent of ISO management. The ISO argues that the Commission does not have the authority to dictate the internal corporate/departmental structure of the ISO. The ISO states that it will need to reorganize its existing market monitoring structure in response to the February 20 Order. The ISO argues that these changes are not necessary to ensure just and reasonable market monitoring and would result in unjust and unreasonable outcomes. The ISO argues that the changes would create an irreconcilable conflict of interest for those employees who would be paid by the ISO but report to the ISO's regulator and expose the ISO to liability for the actions of employees without the ability to influence or impact those actions. The ISO contends also that separating the DMA or the Compliance Department from ISO management would severely inhibit management's ability to develop supportable section 205 filings and section 206 complaints. The ISO asserts that the separation of the MMU from management is not necessary because: (1) pursuant to the February 20 Order, the ISO will not have any discretion in the application of penalty amounts, (2) the ISO commits to documenting processes and controls to provide assurances that the

administration of the penalty authority set forth in the Enforcement Protocol will be just and reasonable, and (3) the Commission will review actions taken by the ISO. The ISO adds that the penalty authority that the Commission has granted to other independent system operators is applied directly by those operators, not by MMUs independent from those entities.[18]

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[17] February 20 Order at P 154.

[18] Citing NEPOOL Market Rules and Procedures, Section 13.3.1 ("The ISO may

15. The ISO states that these management changes will require it to hire additional staff to perform a number of functions for the ISO as a corporation currently provided by DMA and Compliance Department staff. The ISO suggests that the public would be better served if the Commission retains and pays its own staff to monitor market performance and serve as a "check" on the analysis performed by the regulated entity.

16. We are persuaded that for the purposes of administering objective, enumerated tariff provisions, there need not be a further demonstration of the Compliance Department's independence or the DMA's independence from ISO management. The authority to administer such penalty charges stems from the Commission-approved ISO Tariff, not from a delegation of authority. Therefore, we grant rehearing and will not require that the Compliance Department and the DMA demonstrate independence from the ISO for purposes of this enforcement protocol. However, consistent with our requirement in the previous section, the ISO Governing Board must be found to be independent before the Compliance Department and the DMA may implement the Enforcement Protocol.

17. This is a separate issue from the Compliance Department's role or the DMA's role in market oversight, which prior orders have consistently required to be performed independent of ISO management. For example, these entities must be able to go directly to the ISO Governing Board or to the Commission with issues relating to market design, ISO operations, and market participant behavior not enumerated in the Commission-approved ISO Tariff.

D. Proposed Enforcement Protocol

1. EP 1.6: Scope

18. In the February 20 Order, the Commission required the ISO to revise EP 1, which delineates the objectives, definitions and scope of the Enforcement Protocol, to reflect the demarcation of enforcement responsibilities set forth in the MBR Tariff Order. The

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impose sanction on any Participant that directly engages in Sanctionable Behavior."); New York Independent System Operator, FERC Electric Tariff, Attachment H.

Commission also, among other things, rejected APX's proposed revision to the scope of the Enforcement Protocol in EP 1.6 which would have required the ISO to issue sanctions and penalties to market participants directly, and not to their Scheduling Coordinators. The Commission rejected this change because Scheduling Coordinators are jointly and severally liable for refund liabilities associated with energy scheduled by them that cannot be apportioned to a specific entity.

19. APX argues that the Commission's finding that the Scheduling Coordinators will be jointly and severally liable for a seller's action is improper because the Commission does not have the authority to order APX to disgorge profits because it is not a "public utility" under the FPA. APX adds that this liability standard conflicts with the Commission's holding in the MBR Tariff Order that sellers alone are responsible for complying with the market rules.[19] APX argues that the imposition of liability on the scheduling coordinator is also contrary to Commission precedent which states that the use of a scheduling intermediary does not relieve the seller from its obligations under the FPA.[20]

20. APX also argues that the Commission's reliance on the California Refund Order of October 16, 2003[21] to support the liability standard is misplaced because in that order the Commission relied upon language in the Scheduling Coordinator Agreement to find Scheduling Coordinators jointly and severally liable for any refund to the extent the Scheduling Coordinator cannot apportion the refund to a participant. APX asserts that the Commission cannot conclude from the Scheduling Coordinator Agreement that

Scheduling Coordinators agreed to be responsible for a seller's illegal activity related to sales in the CAISO. APX contends that such a conclusion would be contrary also to the Commission's holding that it will not excuse a seller from Commission oversight simply because it hires a scheduling intermediary.

21. We grant rehearing to the extent of stating that we will not hold a Scheduling Coordinator responsible for a tariff violation or manipulative conduct attributable solely to one of its market participants. (A specific example of action APX or other Scheduling

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[19] Citing MBR Tariff Order at P 66.

[20] Citing Washington Water Power Co., 74 FERC ¶ 61,033 at 61,083-84 (1996); Idaho Power Co., 74 FERC ¶ 61,149 (1996).

[21] San Diego Gas & Elec. Co. v. Seller of Energy and Ancillary Services, 105 FERC ¶ 61,066 (2003) (Refund Order).

Coordinators may take to limit its responsibility is discussed below in P 37-38). However, if it is not possible to distinguish whether APX or its Market Participants created a harm in violation of the Enforcement Protocol and there is no reasonable basis for determining the contribution of each in the resulting harm, then APX and its Market Participants will be jointly and severally liable for the harm and will be assessed penalties accordingly.[22] The Commission's holding in the MBR Tariff Order does not contradict this determination. The MBR Tariff Order is narrower in scope than the Enforcement Protocol because the former only addresses the behavior rules imposed upon sellers who have market-based rate authority and therefore only considers the liability of those sellers.[23] The MBR Tariff Order did not limit the liability of other entities which may be subject to penalties due to the violation of other market behavior rules, such as those set forth in the ISO's Enforcement Protocol.

22. APX asserts that imposing penalties and sanctions on a market participant's Scheduling Coordinator is not a meaningful deterrent and thus not just and reasonable because neither the Commission nor the ISO may require APX to pay a refund or penalty that exceeds the revenue that it earned for a given transaction.[24] APX contends that the proposed penalties are exorbitant in relation to the small amount of money it earns on each MW of power it schedules. This argument is misplaced "where activity of multiple parties creates harms that cannot be distinguished from one another and there is no reasonable basis for determining the contribution of each in the resulting harm."[25] We also reject APX's assertion that this liability may operate as a chill on the market because it is mere speculation.

23. APX seeks clarification that, even if a market participant submits its schedules and bids to the ISO through a Scheduling Coordinator, (1) the market participant that is the source of a bid, schedule or improper action (such as not running its generating unit) is not relieved of the obligations under the ISO Tariff, protocols or procedures by transacting through a Scheduling Coordinator; (2) the ISO will "look through" the Scheduling Coordinator when investigating and imposing penalties on a market participant; and (3) all penalties are the responsibility of the market participant who has

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[22] Refund Order at P 170 (citing Restatement (Second) of Torts, § 433A (1965)).

[23] MBR Tariff Order at P 66.

[24] Citing Idaho Power Co., 63 FERC ¶ 61,182 at P 14 (2003).

[25] Refund Order at P 170 (citing Restatement (Second) of Torts, § 433A (1965)).

acted improperly and will not be automatically imposed on the Scheduling Coordinator who submitted the schedule for the bad actor. We grant this clarification only to the extent stated above. However, the Scheduling Coordinator will be jointly and severally liable if the harm created is not distinguishable and the contribution of each party cannot be reasonably determined.

24. Finally, while APX is correct that some Scheduling Coordinators may not be public utilities, APX itself is in fact a public utility.[26]

2. EP 2.2: Comply with Operating Orders

25. In the February 20 Order, the Commission approved the General Rule proposed by the ISO in EP 2.2(a), which requires market participants to "comply with operating orders issued by the ISO." These operating orders include communications to Scheduling Coordinators through means other than the ISO's automated dispatch system. The Commission also directed the ISO to include, in its compliance filing, specific provisions: (1) to ensure that market participants are not penalized for the CAISO's flawed market design and software that accepts infeasible schedules, and (2) to clarify that the Enforcement Protocol does not modify the terms of any ISO agreements or the relationship of those agreements to the ISO Tariff.

26. Santa Clara alleges that the Commission erred and failed to engage in reasoned decision-making by not recognizing the inappropriateness of, and by not suspending enforcement of, any assessment of penalties for noncompliance with the ISO's dispatch orders, so long as the ISO's dispatch procedures and automated dispatch systems cause generation to be dispatched without regard to: (a) operator safety; (b) the condition of the dispatched equipment; (c) operating limits applicable to constrained resources; (d) environmental regulations; or (e) the provisions of existing contracts between the ISO and the owners of the dispatched equipment. Santa Clara further states that it cannot support a blanket rule requiring compliance in all instances with ISO dispatch instructions when, for example, these instructions ignore force majeure events or waste energy-limited resources or could result in harm, or the threat of harm, to equipment and personnel, especially if a market participant has a legitimate reason for noncompliance

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[26] Automated Power Exchange, Inc., 82 FERC ¶ 61,287, reh'g denied, 84 FERC ¶ 61,020 (1998), aff'd, Automated Power Exchange, Inc. v. FERC, 204 F.3d 1144 (2000). APX referred to this fact in its February 13, 2004 filing in Docket No. ER04-556-000. In a recent order, the Commission rejected APX's termination of its electricity market tariff for the CAISO without prejudice to APX refiling its notice after the date on which APX has settled all amounts owed and owing as part of the California refund proceeding. Automated Power Exchange, Inc., 107 FERC ¶ 61,014 (2004).

and so notifies the ISO. Santa Clara concludes that compliance with dispatch instructions, whether directly communicated to Scheduling Coordinators or automated, should be subject to certain exclusions that take into consideration "the reasonable and prudent judgment of operating management." Moreover, Santa Clara argues that the only way to remedy the ISO's inappropriate dispatching is through a complete overhaul of the ISO's automated and manual dispatching procedures and resource planning. Until such a solution is proposed by the ISO and approved by the Commission, Santa Clara supports requiring the ISO to observe the contingency flags posted by generators for constrained generating units.

27. We deny rehearing of our acceptance of EP 2.2, as directed to be modified.[27] As stated in the February 20 Order, we view compliance with instructions given to market participants by the ISO to be a fundamental requirement that should be adhered to by all market participants.[28] We further stated in the February 20 Order that the General Rule and penalties under EP 2.2 pertain to "non-automated" dispatch instructions.[29] The CAISO did not propose, and the February 20 Order did not authorize, a penalty structure for automated dispatch instructions. Moreover, this problematic feature of the CAISO's market design is appropriately being address in the context of the on-going MD02 proceeding. With respect to the ISO observing contingency flags posted by generators, the Commission stated in the February 20 Order that "market participants should notify the CAISO as soon as they become aware of a unit's inability to perform."[30] We direct the CAISO to consider this type of information and all other relevant generator conditions before communicating a dispatch instruction to a market participant.

Furthermore, notwithstanding Santa Clara's concern, we note that any penalty structure for the Enforcement Protocol which is ultimately accepted by the Commission will allow for an appeal process before fines are imposed, during which time, mitigating circumstances may be presented.

3. Penalties under EP 2.2: Comply with Operating Orders and EP 2.3: Submit Feasible Energy and Ancillary Service Bids and Schedules

[27] February 20 Order at P 56-57.

[28] Id. at 56.

[29] Id. at 57.

[30] Id. at P 56.

28. In the February 20 Order, the Commission accepted the General Rule under EP 2.2(a), which requires market participants to comply with operating orders issued by the ISO, directed the ISO to reflect a penalty range not to exceed $10,000 per day for violations of EP 2.2, and provided additional guidance. In the February 20 Order, the Commission also accepted the General Rule under EP 2.3(a), which requires market participants to bid and schedule energy and ancillary services from resources that are available and capable of performing at the levels specified in the bid and/or schedule. The Commission stated that the proposed maximum fixed Standard Penalty of $10,000 for this particular rule appeared reasonable, with the stipulation that the proposed penalty be assessed per day rather than per event and in keeping with other guidance provided in the February 20 Order concerning the administration of penalties.

29. The CPUC challenges the Commission's determination that the maximum daily Standard Penalty for violations of proposed EP 2.2 and EP 2.3 is $10,000 and the Commission's rejection of the Special Penalties in EP 2.2(c). The CPUC argues that the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) and the ISO New England Inc.'s (ISO New England) market rules allow for the assessment of penalties per violation and do not require a maximum standard penalty regardless of the number of violations that occur during the day. The CPUC adds that there is no basis to conclude that a $10,000 penalty that may be appropriate in the Midwest ISO is a sufficient deterrent in the Western markets which experienced an electricity crisis. The CPUC claims that the February 20 Order does not explain why a $30,000 penalty, the approved Standard Penalty of $10,000 trebled under EP 5.3, is just and reasonable, commensurate with the targeted conduct and likely to discourage violations in the Western markets.

30. The ISO requests that, after the Commission reviews the ISO's Amendment No. 55 compliance filing, the Commission clarify that it does not necessarily prohibit penalties under EP 2.2 and EP 2.3 that exceed $10,000 per day if an entity engages in multiple violation "events" during a day. The ISO seeks clarification that the ISO has the same authority the Commission granted to the Midwest ISO in this respect. The ISO suggests that the Commission defer clarification on this issue until the ISO files its revised penalty structure pursuant to the February 20 Order.

31. The Commission based its determinations in the February 20 Order on the particulars of the CAISO and its current markets. We have previously found that the CAISO lacks the requisite independence and that its current market design suffers from fairly substantial flaws. Thus, it would be unreasonable for us to blindly apply sanctionable events and penalty levels from other ISOs to the CAISO. The Commission

exercised its judgment in denying certain penalties based upon the CAISO's filing, which in large part did not materially support the requested penalty levels. In the February 20 Order, the Commission found that "many of the proposed penalties [in the Enforcement Protocol] are not commensurate with the conduct to be deterred."[31] To the extent that the ISO now wants to support its proposal on compliance based upon the CAISO markets and operations, we withhold judgment on the issue until the Commission has had the opportunity to evaluate the CAISO's compliance filing. Thus, we will not grant the requested clarification that the CAISO is entitled to the same penalty authorization approved for the Midwest ISO market.

32. With regard to the CPUC's claim that the February 20 Order did not explain why a $30,000 penalty is just and reasonable, the CAISO (and not the Commission) has the burden under section 205 of the FPA to support its requested sanctions and penalties. As to concerns raised over possible differences in sanctions and penalties among ISOs/RTOs, the February 20 Order was the first application of the market behavior rules in the MBR Tariff Order. To the extent that other ISOs/RTOs do not seek to amend their tariffs, as necessary, to conform with the MBR Tariff Order, in due course, we will review such tariffs and, if necessary, consider directing that amendments be made so that the tariffs of each ISO/RTO are consistent with the MBR Tariff Order.

4. EP 2.4: No Physical Withholding and EP 2.5: No Economic Withholding

33. In the February 20 Order, the Commission denied the imposition of sanctions for physical and economic withholding via the Enforcement Protocol and, accordingly, directed the CAISO to delete EP 2.4 and EP 2.5.[32] The Commission found that these sections of the Enforcement Protocol were redundant since the CAISO already had measures at its disposal to address withholding. Specifically, the CAISO has in place a must-offer obligation, automatic market power mitigation, $250 per MWh bid cap, and local market power mitigation in the form of Reliability Must-Run agreements. Moreover, the Commission found that EP 2.4 and EP 2.5 were far too broad and were addressing behavior that was not objectively identifiable in contravention of the MBR Tariff Order. The Commission noted that, if physical and/or economic withholding occurs in CAISO Markets, such behavior will be subject to investigation and enforcement by this Commission under the anti-manipulation provisions of Market Behavior Rule 2 of the MBR Tariff Order.

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[31] Id. at P 29.

[32] Violations of these rules would have been subject to a maximum fixed Standard Penalty of $25,000 per event and a variable penalty.

34. The ISO believes that EP 2.4 and 2.5 should be retained and suggests that the Commission, in ordering the ISO to delete EP 2.4 and EP 2.5, did not sufficiently consider the usefulness of the sanctions for physical and economic withholding as a "safety net" that catches actions not addressed by current market measures. The ISO argues that, to whatever extent the sanctions turn out to be redundant, they will not need to be employed. Thus, the ISO concludes that their inclusion does not detract from, and can only improve, the ability to prevent and correct for physical and economic withholding. In addition, the ISO states that both the New York Independent System Operator and ISO New England have similar rules in their tariffs in addition to other measures in place in those markets (e.g., local market mitigation on a temporary basis). The CAISO asserts that, absent a justification for treating the CAISO differently, the Commission's departure from past precedent is discriminatory, unfair, and not the product of reasoned decision-making.

35. We deny rehearing of our direction to remove EP 2.4 and EP 2.5. Each ISO/RTO's tariff is unique as necessitated by its particular market situation and each proposed amendment to a tariff must be reviewed by the Commission in the context of the entire tariff. Accordingly, when the Commission reviewed EP 2.4 and EP 2.5, it found those proposed revisions unnecessary and redundant due to other measures the CAISO currently has available under its ISO Tariff to address withholding,[33] some of which are not included in other ISO/RTO tariffs. Moreover, as the proposed language was drafted, the behavior addressed by EP 2.4 and 2.5 is covered by Market Rule 2 of the MBR Tariff Order.[34]

5. EP 2.7: Provide Accurate Information

36. In the February 20 Order, the Commission accepted the General Rule under EP 2.7(a) which requires all applications, schedules, reports and other communications by a market participant (or its agent) to be submitted by a "responsible company official" who is knowledgeable of the facts submitted. All such information submitted must be true, complete and consistent with the operational plans of the company to the best knowledge of the person submitting the information. In addition, the Commission found that the proposed penalties (generally, $10,000 per event) under EP 2.7, in conjunction with the modifications required to be made to EP 5 (Administration of Penalties), may be reasonable for applications, routine reports and other communications. However, the

[33] February 20 Order at P 78.

[34] Id.

Commission directed the ISO to clarify the meaning of "event" under this rule. Three Special Penalties are also assessed under EP 2.7, one which is applied to Scheduling Coordinators that overschedule load. This Special Penalty is the maximum penalty (up to $10,000 per event) equal to the Net Excess Load multiplied by the applicable Market Clearing Price.

37. Indicated Generators argue that, consistent with Commission precedent,[35] the Commission should condition the application of special penalties under proposed EP 2.7(a) for the overscheduling of load by sellers on the provision of symmetrical penalties for underscheduling of load by buyers. Indicated Generators assert that, given the causal link between under- and overscheduling, there is no basis for exempting buyers from punishment for underscheduling while punishing sellers for overscheduling. In addition, Indicated Generators contend that, in the Commission's investigation of allegations of manipulation in the California markets, the Commission affirmed that underscheduling is a violation of the ISO Tariff that "caused a demonstrable detriment to the efficiency of the market."[36] Accordingly, Indicated Generators challenge what they view as a discriminatory penalty structure.

38. We will grant Indicated Generators' request for rehearing. After thorough review of the dysfunctions that led to the 2000-2001 California electricity crisis, the Commission determined that chronic underscheduling was one of a variety of factors that converged to drastically skew wholesale prices.[37] The Commission found that underscheduling of load jeopardized reliable system operations by forcing the ISO to satisfy far more load in real-time than the market was intended to supply (i.e., approximately five percent).[38] We reaffirm that underscheduling of load by market participants may threaten reliability in California electricity markets. Therefore, prior to imposing penalties for overscheduling load pursuant to EP 2.7, we direct the ISO to propose a similar, symmetrical penalty for underscheduling load.

39. APX requests clarification that the requirement that APX ensure the submission of correct data does not mean that APX must police against and ferret out improper

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[35] Citing San Diego Gas & Elec. Co., 93 FERC ¶ 61,294 at 62,003-4 (2000); American Elec. Power Serv. Corp., 103 FERC ¶ 61,345 at P 58, 60 (2003).

[36] Id.

[37] San Diego Gas & Elec. Co., 93 FERC ¶ 61,294, reh'g, 97 FERC ¶ 61,275 (2001).

[38] Id.

behavior. APX seeks clarification that, as long as APX implements data verification procedures, it will satisfy the obligation that scheduling coordinators verify the accuracy of the market participant's data and that all sanctions and penalties for any underlying transaction would be imposed on the market participant engaged in the improper behavior. The data verification procedures that APX proposes are as follows:

> (1) requiring buyers and sellers that hire APX to represent each time they submit a schedule or bid to APX that the submissions are in compliance with the ISO's rules;
>
> (2) having software that does not permit (a) a generator to submit a schedule that exceeds its output, (b) a participant to submit a bid for service to any party that would result in a schedule that exceeds the generator's output, (c) a buyer to submit a schedule that exceeds the buyer's registered load maximum, and (d) a participant to submit a bid for service to any party that would result in a schedule that exceeds the load's registered maximum delivery;
>
> (3) if the submission of schedules results in schedule transfers among scheduling coordinators, verifying that the schedules APX forwards match the schedules submitted by other scheduling coordinators under the ISO's Phase II validation process;
>
> (4) requiring participants to submit a copy of the power transmission tag for imports and exports in order to address any inconsistencies identified by the ISO;
>
> (5) receiving meter data daily from its participants' Meter Data Management Agents (MDMA), generating reports that compare the MDMA data to check consistency, reviewing the meter data to identify differences with the prior submissions, and addressing any deviation outside the bandwidth with the participant to determine if an error in the data exists; and
>
> (6) hiring an independent auditor annually to audit the meter data that APX submitted to the ISO consistent with the ISO's audit requirements and requiring its load service participants to comply with the ISO's audit requirements for meter data.

If the listed steps are not sufficient, APX requests that the Commission indicate the additional steps which are necessary.

40. We find that the verification process proposed by APX is sufficient for the purposes addressed in this order.

6. EP 2.9: No Detrimental Practices

41. The proposed General Rule under EP 2.9(a) prohibited market participants from engaging in "detrimental practices," which the CAISO defined as: (1) behavior that takes unfair advantage of the rules and procedures set forth in or pursuant to the ISO Tariff to the detriment of system reliability, other market participants, or the efficiency of the ISO market; and (2) such behavior or behavior substantially similar to it has been proscribed in a Final Market Notice [issued by the ISO] in accordance with the procedures outlined in EP 4.6 [Final Market Notice]. The maximum proposed penalty for violation of this rule was $25,000 per event plus a variable penalty.

42. In the February 20 Order, the Commission required the ISO to replace the proposed language in EP 2.9(a) with Market Rule 2 of the MBR Tariff Order. The ISO argues that the proposed language in the first bullet of EP 2.9(a) (i.e., "such behavior takes unfair advantage of the rules and procedures set forth in or pursuant to the ISO Tariff to the detriment of System Reliability, other Market Participants, or the efficiency the ISO Market") should be retained because the scope of Market Behavior Rule 2 is, on its face, more limited with respect to practices that detrimentally affect system reliability. The ISO contends that, while EP 2.9(a) encompasses practices that detrimentally affect market efficiency, other market participants and system reliability, Market Behavior Rule 2 appears only to cover behavior affecting "market prices, market conditions, or market rules." According to the ISO, the behaviors enumerated in that portion of EP 2.9(a) may not be subject to sanction under Market Behavior Rule 2 by either the ISO or the Commission.

43. We deny this request for rehearing. The Commission's goal in instituting industry-wide standards for market behavior is to deter manipulative market conduct in all its forms. In granting limited approvals under the Enforcement Protocol, where appropriate, we have allowed the MMU's use of enforcement tools to ensure the reliability of system operations (e.g., by approving EP 2.2: Comply with Operating Orders and EP 2.3: Submit Feasible Energy and Ancillary Services Bids and Schedules). Additionally, we note that the primary objective in establishing market rules Commission-wide and on the ISO level is to address market abuse. Market Behavior Rule 2 of the MBR Tariff Order has been tailored to address detrimental practices that could potentially lead to anomalous market conditions. For these reasons, we find that it is not necessary to retain the language in the first bullet of EP 2.9(a). We reiterate that the Commission, and not the ISO, has enforcement responsibility for EP 2.9.

7. EP 3: Process for Investigation and Enforcement Generally

44. In EP 3, the ISO proposed the process for investigation and enforcement of the Rules of Conduct in EP 2. The ISO stated that it may adopt alternative or additional procedures for undertaking preliminary or initial review of potential violations and that EP 3 would not apply to violations for which the ISO had developed automated algorithms to detect violations and assess penalties, if those violations were subject to review under the ISO's current settlement and dispute resolution processes.

45. In the February 20 Order, the Commission directed the ISO to modify EP 3 to reflect the reporting relationship between MMUs and the Commission adopted in the MBR Tariff Order. The Commission also required the MMU to continue to include a process for market participants to respond to allegations against them before the MMU makes a decision and allow appeal to the Commission after a decision is made by the MMU. The Commission also required the MMU to notify both the Scheduling Coordinator and the market participant it represents of alleged violations and required the Scheduling Coordinator, in turn, to immediately notify the alleged offenders they represent through revised internal processes.

46. Modesto argues that the use of automated algorithms to detect violations and assess penalties violates market participants' due process rights because it allows the ISO to levy penalties before deciding whether those penalties are warranted. Modesto argues that EP 5.1(r) which states that inadvertent errors or omissions are a mitigating factor to the assessment of penalties is not useful in preventing the assessment of an unwarranted automated penalty. Modesto also complains that EP 3.1 would allow the CAISO to deviate from the procedures set out in EP 3 for levying penalties in a deliberate manner. Modesto requests that the Commission reject the automated assessment of penalties and clarify that fines will not be paid until market participants have had an opportunity to respond to allegations against them and the DMA has made a decision.

47. We deny Modesto's request that we reject the automated assessment of penalties because those automated algorithms have not yet been submitted to the Commission for approval. The ISO must submit those algorithms to the Commission for approval prior to using them. We clarify, however, that ISO must modify EP 3.1 to indicate that a market participant will not be required to pay any assessed penalty, even if it is based upon an automated algorithm, until the market participant has had an opportunity to respond to the allegations against it and the MMU has made a decision. Subsequent to the MMU's finding, EP 3 must allow for appeal to the Commission. Furthermore, we clarify that the MMU may not adopt alternative or additional procedures other than the process that is approved in EP 3[39] because such action could lead to discriminatory results; we direct the

[39] Pursuant to the February 20 Order, EP 3 will be modified and refiled as part of the ISO's compliance filing. February 20 Order at P 109.

ISO to modify EP 3.1 accordingly.

48. Modesto seeks clarification that any market participant, not only Scheduling Coordinators, may appeal DMA determinations to the Commission. Modesto contends that this appeal right should be expanded because Scheduling Coordinators do not have an explicit duty or incentive to advocate on behalf of client market participants when penalties are billed directly to the market participant. We clarify that any market participant may appeal the MMU's determinations to the Commission and direct the ISO to modify EP 3 accordingly.

49. SoCal Edison argues that the Commission should create an expedited process through which market participants can present evidence of an ISO mistake to the MMU to correct conduct, stop financial harm to the market participant and avoid potential penalties. SoCal Edison states that these mistakes may include mistakes in market operations, in following the ISO own procedures, and in interpreting and administering the ISO Tariff. We deny this request. The request is incongruous because the MMU independently, not the ISO in general, will be assessing penalties once governance is addressed. Furthermore, SoCal Edison's concern has already been addressed. In the February 20 Order, the Commission required the MMU to continue to include in EP 3 a process for market participants to respond to allegations against them before the MMU makes a decision and allow for appeal to the Commission after a decision has been made by the MMU.[40]

8. EP 5.2: Administration of Penalties - Excuse

50. In EP 5.2, the ISO proposed that a violation of the Rules of Conduct may be excused due to uncontrollable force; safety, licensing or other requirements; emergencies; and conflicting directives. Modesto claims that this list is too restrictive. Modesto argues that the CAISO should not reject in advance any plausible reason why a transaction should not be subject to penalties. We do not want the process to be judgmental and discretionary and find it more appropriate to set the boundaries at this time. Modesto has raised no specific defenses to include in EP 5.2, so we will not require the ISO to modify that provision.

9. EP 5.4: Administration of Penalties - Settlement

51. In EP 5.4, the ISO proposed that penalties assessed under the Enforcement Protocol would be administered through Preliminary and Final Settlement Statements that

[40] Id.

would be issued to the responsible Scheduling Coordinator by the ISO. APX seeks clarification that under EP 5.4 a market participant may use its Scheduling Coordinator to pay a penalty but that the market participant, not the Scheduling Coordinator, is ultimately responsible for the market participant's payment of the penalty. We clarify that, if the ISO determines that the market participant is solely responsible for the payment of a penalty,[41] then, even if the market participant uses its Scheduling Coordinator to pay that penalty, the market participant, not the Scheduling Coordinator, is ultimately responsible for the market participant's payment of the penalty.

10. EP 5.6: Administration of Penalties – Time Limitation

52. In the February 20 Order, the Commission found that the time limitation for the assessment of penalties proposed under EP 5.6 was not reasonable. The Commission directed the ISO to revise this provision to state that the MMU may assess a penalty under the Enforcement Protocol up to a year after discovery of a violation but no later than three years after the date of a violation.

53. Sempra argues that the Commission erred by permitting the assessment of penalties up to three years after the alleged violation occurred. Sempra requests that the Commission require the DMA to initiate any enforcement action within ninety (90) days after the close of the calendar quarter in which the alleged violation occurred and assess any associated penalty within one year after the discovery of the violation. Sempra argues that the ninety (90) day time period is consistent with the market behavior rules now included by the Commission in market-based rate tariffs, thus creating a uniform industry, time standard for reviewing disputed transactions.

54. We grant Sempra's request to the extent that we will require the MMU to initiate an investigation of a potential violation within 90 days from the date the MMU knew of an alleged violation of the sections of the Enforcement Protocol under its enforcement authority. This limitation is consistent with the one the Commission imposed upon itself in the MBR Tariff Order.[42] We deny Sempra's request to limit the amount of time within which the MMU must assess a penalty. The February 20 Order is more restrictive in this regard than the MBR Tariff Order which does not limit the amount of time within which the Commission must assess a penalty. Sempra has not convinced us that the time period

[41] See supra P 20 for the circumstance under which joint and several liability will apply.

[42] MBR Tariff Order at 148.

set forth in the February 20 Order is unreasonable.

55. The ISO seeks clarification that the Commission will entertain requests for extensions of the one year limitation on assessing penalties after the discovery of a violation upon a proper showing by the ISO that good cause exists for such an extension in a specific instance. The ISO asserts that such an extension may be necessary if, for example, a market participant fails to cooperate with an investigation of an under-reported load. We clarify that the Commission will entertain requests for extensions of the time limitation on assessing penalties, as modified above, upon a proper showing by the ISO that good cause exists. We find that allowing such an extension of time is reasonable because it creates the appropriate balance between providing market certainty through a uniform industry, time standard for responding to improper conduct and the need to properly determine whether a penalty is necessary.

11. Allocation of Penalty Proceeds

56. In the February 20 Order, the Commission found that only Scheduling Coordinators "that have not been found to be in violation of the Rules of Conduct under the ISO Tariff should be allocated penalty proceeds at the end of each calendar year as a credit against their portion of the [Grid Management Charge]."[43]

57. APX seeks clarification that a Scheduling Coordinator who acts for multiple market participants is not automatically prevented from receiving penalty payments because of the improper actions of one of its participants.[44] APX requests that the Commission direct that, if a Scheduling Coordinator acts for multiple market participants, no penalty payments transferred to such a Scheduling Coordinator may be passed on to the market participant that was responsible for the improper behavior. APX's request is reasonable; therefore, we grant this clarification and direct the ISO to modify the Enforcement Protocol accordingly.

12. Equitable Remedies

58. The CPUC seeks clarification, or in the alternative rehearing, that, to the extent that violation of the ISO Tariff due to physical or economic withholding, detrimental

[43] February 20 Order at P 40.

[44] See also CAISO Request for Rehearing at 26.

practices and market manipulation are enforced by the Commission, equitable remedies, including a "make the market whole remedy" may be imposed. The CPUC argues that there is no authority allowing the Commission to prematurely and arbitrarily limit the scope of its remedies for tariff violations, including a "make the market whole remedy," without knowledge of the particular circumstances. It cites to Commission precedent that states that the Commission has broad authority to remedy tariff violations, including through "make the market whole remedies." We deny the CPUC's request. In accord with prior Commission orders, we find that the appropriate remedy for the tariff violations, if found to exist, would be the disgorgement of any unjust profits attributable to these tariff violations and may also include additional, appropriate non-monetary remedies as allowed under the FPA.[45] These remedies will provide a sufficient inducement for market participants to comply with these rules. Our primary focus, in this regard, is on encouraging appropriate market behavior and deterring inappropriate market behavior.

59. Modesto requests that the Commission reserve the authority and opportunity to make market participants whole if the ISO acts improperly (e.g., the ISO misreports information regarding a market participant which causes harm to reputation and finances). We deny this request as outside the scope of this proceeding, which focuses on the actions of market participants in ISO markets. This issue may be raised in a separate proceeding in an appropriate forum.

13. Implementation Details

60. SoCal Edison asserts that the Rules of Conduct are vague. SoCal Edison argues that the following terms are undefined: "operating order" in EP 2.2 and throughout; "unjustifiably high" in EP 2.5(a); "immediately" in EP 2.6(a); and "event" in EP 2.7(c). In the February 20 Order, we directed the ISO to define the term "event,"[46] and we expect the ISO to do so in its compliance filing. The definition of "unjustifiably high" in EP 2.5(a) is not relevant because we have directed the ISO to remove this provision from the Enforcement Protocol.[47] We clarify that the ISO must define the terms "operating

[45] American Elec. Power Serv. Corp., 103 FERC ¶ 61,345; Enron Power Marketing, Inc., 103 FERC ¶ 61,346 (2003); Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, 103 FERC ¶ 61,347 at P 2 (2003); Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 103 FERC ¶ 61,349 at P 6, 16 (2003); MBR Tariff Order at P 151;

[46] February 20 Order at P 91.

[47] Id. at P 78.

order" and "immediately" in its compliance filing.

61. SoCal Edison also argues that the Rules of Conduct are overly broad and burdensome. First, SoCal Edison complains that a market participant could be subject to a penalty for not submitting factually accurate information per EP 2.7 without a method for distinguishing between actual deceit and legitimate error, other than the manual investigation process in EP 3. SoCal Edison has raised no specific process that the MMU should provide in addition to the manual process in EP 3; therefore, we will not require a modification to the Enforcement Protocol in this regard.

62. Second, SoCal Edison complains that under EP 2.8, which requires market participants to provide information, market participants will be required to respond to non-specific requests for information, data, analysis and reports in an unspecified timely manner. Contrary to SoCal Edison's assertion, EP 2.8 does specify which information will be requested: "[a]ll information that is required to be submitted to the ISO under the ISO Tariff, its protocols, or jurisdictional contracts." We believe that EP 2.8 provides enough specificity in this regard. It would be unreasonable to expect the ISO to list in EP 2.8 all the instances when the ISO will request information when those instances are already set forth in other ISO Tariff provisions or jurisdictional contracts. SoCal Edison requests that the Enforcement Protocol describe how the ISO will constrain its requests for data. This request is misplaced because the ISO will be requesting information that has already been approved and therefore does not need to be constrained. Finally, in the February 20 Order, the Commission declined to require the ISO to specify a particular time period to submit requested data pursuant to EP 2.8 because the breadth of such information will differ for each case,[48] and we have not been convinced otherwise.

63. SoCal Edison also claims that the Enforcement Protocol incorrectly assumes that market participants have the physical ability or the contractual rights to submit information as required under EP 2.7 and that resources that are inherently unpredictable or affected by ambient conditions will be able to comply with the availability reporting requirements under EP 2.6. We reiterate that, under EP 3, the MMU will provide a process for market participants to respond to allegations against them before the MMU make a decision. Part of that process would be the submission of information. These and other anomalous circumstances can be raised in that forum, and, after a decision has been made by DMA, the process in EP 3 will allow for appeal to the Commission.

[48] Id. at P 96.

64. SoCal Edison argues that neither the ISO nor the Commission has provided clarity as to which screening mechanisms for catching potential rule violations will be applied prospectively or retroactively, which will be applied automatically or manually, and which will provide for corrective action on the part of market participants. We will deny this request. SoCal Edison's request is too broad and lacks the specificity for the Commission to be able to give the ISO meaningful direction to address SoCal Edison's concerns. However, we do clarify that application of the O&I Program, once approved by the Commission and conditions are met, will be prospective. The CAISO does not have the authority to implement Amendment No. 55 in full or in part without meeting the conditions set forth by the Commission and without having received Commission approval to implement it.

E. Proposed Amendment to ISO Tariff Section 7.3.1.5.2: Elimination of Usage Payments for Undelivered Counter-Flow

65. The ISO argues that counter-flow schedules that are cut in real-time and never materialize can increase the risk of real-time congestion and create gaming opportunities and settlement inequalities. The ISO claims that the Commission failed to acknowledge that a deviation results on either side of the path of a cut counter-flow schedule over an inter-tie and, because those deviations are charged and paid the same price in real-time, there is no zonal price differential in real-time, creating a potential incentive to cut counter-flow schedules in inter-ties. The ISO contends that it is appropriate to eliminate such payments, even if the Scheduling Coordinator was not engaging in gaming, because the Scheduling Coordinator will receive a windfall. The ISO requests that the Commission accept its revision to ISO Tariff Section 7.3.1.5.2 to remedy this market design flaw.

66. In the February 20 Order, the Commission found that the existing tariff provision in Section 7.3.1.5.2 of the ISO Tariff provided an appropriate mechanism for ensuring that the ISO is not adversely impacted financially from counter-flow schedules that are cut in real-time.[49] In addition, the Commission was hesitant to hold Scheduling Coordinators responsible for circumstances "unforeseeable and beyond the Scheduling Coordinator's control," given the CAISO's acknowledgement that most counter-flows are not the product of gaming, especially absent a demonstration that the CAISO itself would incur financial harm.[50] The CAISO has not met its burden in demonstrating that it is incurring or will incur financial harm as a result of the existing tariff provision. In addition, the CAISO does not seek to prevent market manipulation with this modification

[49] Id. at P 129.

[50] Id.

but rather correct a market design flaw. The appropriate venue to address this market redesign issue is in the on-going MD02 proceeding.

F. Proposed Amendment to ISO Tariff Sheets[51] Regarding Buy-Back of Ancillary Services in the Hour-Ahead Market

67. SoCal Edison argues that repurchases of ancillary services in the Hour-Ahead Market should be the greater of the Day-Ahead or Hour-Ahead price. The SoCal Edison claims that the CAISO's main method of verifying the legitimacy of ancillary services from imports is to call on energy from the imports during real-time. Thus, SoCal Edison concludes that, if importers sell ancillary services day-ahead and then repurchase the ancillary services hour-ahead, the CAISO has no effective means of ensuring that such sales were in fact legitimate. SoCal Edison argues further that, currently, if ancillary services in the Day-Ahead Market reach the $250/MWh bid cap, importers have no disincentive to sell fictitious services to the ISO in the Day-Ahead Market, because the same services can be bought back hour-ahead at prices that are limited to the cap. Thus, SoCal Edison asserts that, if these same services bought back hour-ahead also reach the cap, importers break even; and, if prices in the Hour-Ahead Market are below the cap, importers profit from the buy-back of fictitious services. Moreover, SoCal asserts that high prices in the Day-Ahead Market equates to limited supply and challenging operating conditions. During these times, when the CAISO must procure reliable reserves in order to maintain grid reliability, SoCal Edison contends that importers have an incentive to sell the CAISO fictional ancillary services as part of an arbitrage scheme. Accordingly, SoCal Edison argues that the Commission should accept the CAISO's proposal to cap the price of ancillary services at the higher of the Day-Ahead or Hour-Ahead price or, in the alternative, allow the CAISO to apply its proposal to importers that repurchase ancillary services.

68. We deny rehearing. As stated in the February 20 Order, the Commission views legitimate arbitrage favorably, as long as the generating unit that submits a bid or schedule is backed by a physical resource.[52] In the February 20 Order, the Commission addressed the underlying problem here: the CAISO has not developed a mechanism to track imports. Therefore, the ISO has no way of knowing if imports are in fact backed by

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[51] ISO Tariff Section 2.5.21 (Scheduling of Units to Provide Ancillary Services); SP 9.1 (Bid Evaluation and Scheduling Principles); SP 9.3 (Scheduling Ancillary Services Resources); ISO Tariff Section 2.3.1.2.1 (Comply with Operating Orders Issued) under Changes Concerning Schedules and Bids Being Binding Obligations; and SBP 5.3 (Buy Back of Ancillary Services).

[52] February 20 Order at P 136.

a physical resource. In the February 20 Order, the Commission noted that "the CAISO also has the option of requiring imports to specify a physical resource when submitting bids."[53] The entire market should not be stymied because the ISO has not addressed this reporting issue or the lack thereof. Additionally, if the CAISO should decide to impose a reporting requirement on importers and those importers deliberately supply false information to the ISO, this type of market manipulation is covered under Market Behavior Rule 2(b) of the MBR Tariff Order.[54]

69. Powerex notes that, in its Answer, the ISO recognized that it did not intend ISO Tariff Section 2.3.1.2.1 to prohibit Day-Ahead and Hour-Ahead Schedule changes for System Resources or buying back energy in the Hour-Ahead Market. In its Answer, the ISO agreed to revise Section 2.3.1.2.1 by adding that the section "does not prohibit a Scheduling Coordinator from modifying its Schedule or re-purchasing Energy in the Hour-Ahead Market."[55] Powerex notes that the Commission has recognized that changing schedules and buying back energy in the Hour-Ahead Market is a legitimate activity[56] and requests that the Commission require the ISO to make this clarification. We direct the ISO to make this modification.

G. Proposed ISO Tariff Prohibition on Circular Schedules

70. APX seeks clarification of the definition of "circular schedule."[57] APX notes that, in its Answer, the ISO agreed that APX should not be treated as having submitted a "circular schedule" if it submits a schedule that is an amalgam of a number of market participants' separate but simultaneously submitted schedules. APX requests that the Commission direct the ISO to exclude such a schedule from the definition of "circular schedule." We direct the ISO to make this modification.

The Commission orders:

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[53] Id.

[54] MBR Tariff Order at P 64-69.

[55] CAISO Answer at 70.

[56] Citing American Elec. Power Serv. Corp., 103 FERC ¶ 61,345 at P 64; California Independent System Operator Corp., 106 FERC ¶ 61,179 at P 136.

[57] The definition of "Circular Schedule" is set forth in Appendix A of the ISO Tariff.

(A) The requests for rehearing are hereby granted in part and denied in part, as discussed in the body of this order.

(B) The requests for clarification are hereby granted in part and denied in part, as discussed in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.