UNITED STATES OF AMERICA105 FERC ¶ 61, 065
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

San Diego Gas & Electric Company,
Complainant,

v. Docket Nos. EL00-95-062

Sellers of Energy and Ancillary Service Into
Markets Operated by the California
Independent System Operator Corporation
and the California Power Exchange Corporation,
Respondents

Investigation of Practices of the California
Independent System Operator and the
California Power Exchange Docket No. EL00-98-051

Public Meeting in San Diego, California Docket No. EL00-107-010

Reliant Energy Power Generation, Inc.,
Dynegy Power Marketing, Inc., and
Southern Energy California, L.L.C.,
Complainants,
v.
California Independent System Operator
Corporation,
Respondent
Docket No. EL00-97-004

California Electricity Oversight Board
Complainant,
v.
All Sellers of Energy and Ancillary Services Into the Energy and Ancillary Services Markets Operated by the California Independent System Operator and the California Power Exchange,
Respondents

Docket No. EL00-104-009

California Municipal Utilities Association,
Complainant,
v.
All Jurisdictional Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange,
Respondents

Docket No. EL01-1-010

Californians for Renewable Energy, Inc. (CARE),
Complainant,
v.
Independent Energy Producers, Inc., and All Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator 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,
Respondents

Docket No. EL01-2-004

Puget Sound Energy, Inc., Complainant, v. All Jurisdictional Sellers of Energy and/or Capacity at Wholesale Into Electric Energy and /or Capacity Markets in the Pacific Northwest, Including Parties to the Western Systems Power Pool Agreement, Respondents	Docket No. EL01-10-004
California Independent System Operator Corporation	Docket No. ER01-607-003
California Independent System Operator Corporation	Docket No. RT01-85-009
Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council	Docket No. EL01-68-014
California Power Exchange Corporation	Docket No. ER00-3461-004
California Independent System Operator Corporation	Docket No. ER00-3673-003
California Independent System Operator Corporation	Docket No. ER01-1579-004
Southern California Edison Company and Pacific Gas and Electric Company	Docket No. EL01-34-003
Arizona Public Service Company	Docket No. ER01-1444-004
Automated Power Exchange, Inc.	Docket No. ER01-1445-004
Avista Energy, Inc.	Docket No. ER01-1446-006
California Power Exchange Corporation	Docket No. ER01-1447-004

Duke Energy Trading and Marketing, LLC	Docket No. ER01-1448-006
Dynegy Power Marketing, Inc.	Docket No. ER01-1449-007
Nevada Power Company	Docket No. ER01-1450-004
Portland General Electric Company	Docket No. ER01-1451-007
Public Service Company of Colorado	Docket No. ER01-1452-004
Reliant Energy Services, Inc.	Docket No. ER01-1453-008
Sempra Energy Trading Corporation	Docket No. ER01-1454-004
Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC	Docket No. ER01-1455-010
Williams Energy Services Corporation	Docket No. ER01-1456-011

ORDER ON REHEARING AND CLARIFICATION

(Issued October 16, 2003)

1. In this order, the Commission acts on petitions for rehearing and clarification of two orders issued on May 15, 2002.[1] The Commission denies rehearing of the May 15 Orders and grants clarification on one issue. This order brings further clarity to the operation of the Western markets and thereby promotes just and reasonable rates in these markets.

[1] San Diego Gas and Electric Co., et al., 99 FERC & 61,160 (2002) (May 15 Order); San Diego Gas and Electric Co., et al., 99 FERC & 61,159 (2002) (Compliance Rehearing order).

Background

2. The May 15 Order addressed rehearing of the Commission's order issued on December 19, 2001 (December 19 Order),[2] which in turn addressed rehearing of earlier orders related to the mitigation of prices for power sold at wholesale through centralized, single price auction spot markets operated by the California Independent System Operator Corporation (ISO) and California Power Exchange Corporation (PX), as well as mitigation of prices for power sold at wholesale in bilateral (contractual) markets in the former Western System Coordinating Council (WSCC), which has now merged into Western Electricity Coordinating Council (WECC).[3]

3. The Compliance Rehearing order, 99 FERC & 61,159, addressed rehearing of an earlier order accepting in part and rejecting in part the ISO's January 2, May 11, and July 10, 2001 compliance filings.

4. The parties listed in the appendix filed timely motions for rehearing and/or clarification.

Discussion

I. May 15 Rehearing Order

A. Calculation of Mitigation Prices

1. Whether Out of State Generators May Set the Mitigated Prices During the Refund Period

5. The May 15 Order clarified that, if out of state generators bid into the Imbalance Energy market during the refund period and they can provide the heat rate information to the ISO for the unit used to supply the power, that unit should be eligible to set the mitigated market clearing price (MMCP) during the refund period.[4]

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[2] San Diego Gas and Electric Co., et al., 97 FERC & 61,275 (2001).

[3] The December 19 Order, 97 FERC at 62,172-78 includes a detailed background section that summarizes the Commission's orders that relate to the mitigation of prices in the Western markets and other actions to correct dysfunctions and possible exercises of market power in those markets.

[4] May 15 Order, 99 FERC & 61,160 at 61,654.

6. California Parties request clarification or, in the alternative, rehearing that, to the extent that out of state generators are used to set the MMCP, the appropriate gas price input is not the daily spot market average index price for northern or southern California, but instead is the comparable price that reasonably approximates the daily spot market average delivered price that the out of state generator would experience in its geographic location.

Commission Response

7. In our order addressing the proposed findings of Judge Birchman in the refund proceeding, the Commission adopted a Staff recommendation to modify the MMCP formula to use producing-area prices plus a tariff rate transportation allowance instead of California spot gas prices.[5] The order also made clear that the modification applies to out of state generators that are used to set the MMCP. No further clarification is needed.[6]

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[5] San Diego Gas & Electric Company, et al., 102 FERC & 61,317 at P 59 (2003).

[6] Id., at P 51. PG&E requests that, in light of new evidence regarding alleged ISO and PX Tariff violations by marketers, the Commission consider (1) ordering refunds for PX/ISO transactions prior to October 2, 2000; (2) revise the refund methodology by adopting the use of economic dispatch as the competitive benchmark; and (3) reconsider the use of the daily spot gas price indices for determining the MMCP under the refund methodology. PG&E requests a hearing process, if necessary, to develop evidence of tariff violations. The Commission denies PG&E's motion for reconsideration because, as discussed above, we have already conducted a proceeding to review the appropriate gas prices to be used in the refund methodology. Further, the Commission provided parties in the California refund proceeding the opportunity to develop further evidence of tariff violations and market manipulation in the "100-day discovery" proceeding. San Diego Gas & Electric Co., 101 FERC & 61,186 (2002). Finally, as an outgrowth of the Staff investigation in Docket No. PA02-2-000 and the 100-day discovery proceeding, the Commission has initiated formal investigations and show cause proceedings related to specific allegations regarding violations by market participants. Thus, reconsideration of the issues in the current proceeding, as requested by PG&E, would duplicate the Commission's other efforts.

2. Mitigated Market Clearing Prices as Cap During Refund Period

a. May 15 Order

8. The May 15 Order clarified that the "ceiling price" approach should be used to determine the just and reasonable rate for the refund period.[7] Under the ceiling price approach, refunds for each hour would be computed using the lower of the MMCP or the actual clearing price. The May 15 Order explained

> [o]ur concern throughout the course of this proceeding has been that buyers may have paid rates that are above levels that are just and reasonable. [footnote omitted.] The Commission has repeatedly found that due to dysfunctions in the California markets, the buyers may have paid unjust and unreasonable prices in certain circumstances. [footnote omitted.] It would be inconsistent with these concerns to adopt a refund methodology that would have the effect of increasing some actual prices. The ceiling approach is fully consistent with our long-standing concerns. Use of an hourly refund calculation is consistent with our earlier ruling to determine "refunds owed for sales above the hourly price." [footnote omitted.] [[8]]

It also stated that the ceiling price approach to calculating refunds is consistent with the MMCP approach to price mitigation.

9. Further, the May 15 Order clarified that, during periods when there was no single market clearing price because breakpoints were triggered, "for accepted bids above the breakpoint, the refund methodology should use the lower of the bid or the MMCP" and "for accepted bids at or below the breakpoint, the refund methodology should use the lower of the auction price or the MMCP."[9] When the breakpoints were not triggered, the lower of the single market clearing price or the MMCP should be used for determining refunds.

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[7] May 15 Order, 99 FERC & 61,160 at 61,655.

[8] Id. at 61,655-56.

[9] Id. at 61,656.

b. Requests for rehearing

10. California Generators seek rehearing, claiming that the Commission's adoption of the ceiling price approach represented a complete change in direction on the issue, and that the Commission's rationale for the change does not constitute reasoned decision-making. They argue that the Commission erred in assuming that the ceiling price approach would raise prices for purchasers. California Generators contend that they went to great lengths in their earlier pleadings to explain that their proposal would not require any party to put more money back in the market, yet their position was not addressed by the May 15 Order. They also challenge the Commission's finding that the ceiling price is most consistent with the prospective mitigation plan. They argue that the clearing price approach is, in fact, more consistent because, under the prospective plan, new prices are calculated and extended as a uniform clearing price to all transactions. They argue that, at a minimum, it would be more consistent to use a uniform, single clearing price whenever emergency conditions were present. More fundamentally, they claim that the May 15 Order's clarification actually reversed its prior holding in this case without any explanation for the reversal.

11. California Generators argue that reversal of the clearing price approach contradicts the underlying framework of both the refund methodology and prospective mitigation plan. They claim that the thrust of both methodologies is to replicate the price that would be paid in a competitive market; and the development of a single market clearing price, based on running costs of the highest price unit, is the best way to simulate a competitive market.[10] They contend that the fundamental purpose of this approach is to mimic the outcome of the ISO's BEEP Stack market, and that there is no reason to replicate new competitive auction prices if the result is simply to create a "supplemental" price cap. Nor is the use of MMCP as a ceiling consistent with the decision in the May 15 Order that only transactions eligible to set the clearing price can make a unit eligible to be the marginal unit, and thereby exclude out of market (OOM) calls from setting the MMCP. They also contend that the Commission's reasoning for excluding scarcity rents or fixed cost return for peaking units - because generators could recoup such margins by subsidizing their peakers with other units in their portfolio - is now undercut since the non-peaking units will not receive the benefits of a single clearing price set at the new mitigated level and thereby materially diminishing generators' "infra-marginal" rents.

[10] Citing San Diego Gas and Electric Co., et al., 95 FERC & 61,115 at 61,362 (2001) (April 26 Order).

12. Further, California Generators argue that the May 15 Order departs, without explanation, from precedent providing that a refund period must be viewed as a whole, and cannot be sub-divided into segments thereby forcing the regulated entity to absorb undercollections during some periods but pay refunds in other periods.[11] According to California Generators, the May 15 Order subdivided the refund period into over 37,000 separate 10-minute intervals. They contend that such subdividing of refund periods to inflate refunds is inconsistent with DOMAC.

13. Moreover, California Generators argue that the ceiling price approach produces unreasonable and unfair results. They contend that, despite the claims of some parties, refunds are substantial under the clearing price approach. They also argue that soft caps have already mitigated wholesale power costs. According to California Generators, use of a clearing price approach will mitigate down to the just and reasonable level, but no more; and there is no basis for ordering refunds that reduce rates below such level.

14. CSG argues on rehearing that the ceiling price approach is not only a departure from prior rulings in this proceeding, but is bad policy and violates the filed rate doctrine.[12] It contends that the Commission, in the May 15 Order, cited to one vague sentence in the June 19 Order to justify that it had previously accepted the ceiling price approach and was now only clarifying its position. It argues that, to the contrary, the June 19 Order clearly stated that the mitigation plan was intended to replicate prices in a competitive market, the reserve deficiency MCP was based on a single price, and "all more efficient units will receive the same price . . ."[13] According to CSG, if the MMCP operates as a price cap, more efficient units will not be paid the same as inefficient units. It cites, as an example, "when the MMCP is $250/MWh, an efficient unit that was capable of generating power at the time for, say, $100/MWh, will be paid less than an inefficient unit that could do so for $250/MWh, who will be paid $250/MWh." CSG argues that this outcome, which pays both efficient and inefficient units their marginal cost, will reduce incentives for upgrading and replacing aging units. It also claims that the May 15 Order retroactively altered the rate regime under which the market operated

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[11] Citing Distrigas of Massachusetts Corp. v. FERC, 751 F.2d 20, 21-23 (1st Cir. 1984) (DOMAC); Panhandle Eastern Pipe Line Company, 73 FERC & 61,287 at 61,789 (1995); and Louisiana Power & Light Company, 57 FERC & 61,101 at 61,391 (1991).

[12] PacifiCorp filed a request for rehearing that adopts the arguments of CSG.

[13] Citing San Diego Gas and Electric Co., et al., 95 FERC & 61,418 at 62,560 (2001) (June 19 Order); December 19 Order, 97 FERC & 61,275 at 62,212.

during the refund period. This, CSG argues, deprived market participants of the opportunity to manage their portfolios with advance knowledge of the market rules, violating the "predictability" principle of the filed rate doctrine.

15. CSG also argues that the "asymmetrical" treatment of the MMCPs as a cap rather than a clearing price is arbitrary and capricious because it revises transactions in a one-sided manner with the sole design of increasing the amount of refunds. The approach unjustifiably forces sellers to relinquish amounts above the MMCP while requiring that they under-recover on sales made at prices below the MMCP. To illustrate this asymmetry, CSG uses an example of a four-hour block transaction in which the negotiated rate exceeded the reconstructed MMCP for the first two hours and fell below the MMCP for the last two hours. Although both parties agreed to accept the risk that the negotiated price may be higher or lower than the market price, under the ceiling price approach, the seller's rate is reduced to the MMCP for the first two hours. However, during the last hours, the MMCP is inapplicable and the seller receives no upward adjustment. Thus, the seller is unable to recover the loss (of the first two hours) through consistent application of the methodology to the last two hours when the negotiated rate was below market. According to CSG, similar unfairness results from OOM sales for multiple intervals and schedule deviations. It further claims that the ceiling price methodology runs afoul of the Supreme Court's statement in Duquesne Light Co. v. Barasch, 488 U.S. 299, 315 (1988) (Duquesne), and more recently in Verizon Communications, Inc. v. FCC, 535 U.S. 467 (May 13, 2002) (Verizon), a procedure that "arbitrarily switch[es] back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions."

16. Further, CSG argues that the Commission's use of the breakpoint price to establish a Asub-ceiling@ below the clearing price is an unexplained departure from prior orders that established the breakpoint as a Afirewall@ or "safety net" to stabilize the market while the Commission determined an appropriate mitigation plan to determine just and reasonable prices.[14] It claims that the breakpoint was not intended to set the final just and reasonable rate or act as a price cap but, rather, was "established ad hoc at largely arbitrarily levels to act as markers, not final prices."[15] CSG also argues that the May 15 Order contradicts

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[14] Citing San Diego Gas & Electric Co., et al., 93 FERC & 61,121 at 61,367 (2000) (November 2000 Order); and San Diego Gas & Electric Co., et al., 93 FERC & 61,294 at 61,966 (2000) (December 15 Order).

[15] CSG at 18. Citing December 15 Order, 93 FERC at 61,966, 62,004 and 62,008.

earlier orders in this proceeding stating that the breakpoint had been superceded and is now moot.[16] It also contends that use of the breakpoint as a Asub cap@ is at odds with the underlying theory of a single price auction market because it penalizes sellers for bidding at their marginal cost, and instead encourages sellers to bid at what they believe is the market clearing price.

c. Commission Response

17. The May 15 Order explained that the ceiling price approach is consistent with the Commission's primary concern throughout the EL00-95 et al. proceeding - - that buyers may have paid rates above just and reasonable levels.[17] The Commission found, and has repeatedly affirmed with regard to the refund period, that the "electric market structure and market rules for wholesale sales of electric energy in California were seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy . . . under certain conditions."[18]

18. The Commission established a refund effective date and, to calculate appropriate refunds, established a methodology to determine just and reasonable rates in the California ISO and PX markets for the period October 1, 2000 through June 20, 2001. To apply this methodology, the Commission established a hearing before an administrative law judge to determine MMCPs during the refund period. In doing so, the Commission anticipated - and articulated - that the MMCP would establish a ceiling or maximum price, over which spot prices would considered to be unjust and unreasonable. This is clear from the Commission's statement in the July 2001 Order, clarifying that "spot market OOM transactions are subject to refund and subject to the hourly mitigated price established in the ordered hearing. The hourly price will establish the maximum price with refunds for transactions over this level."[19] Likewise, the Commission's intent to establish a maximum price is evident from the December 19 Order, explaining that "[i]n the July 2001 Order, the Commission found that all sales priced above certain levels in

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[16] Citing e.g., December 19 Order, 93 FERC & 61,275 at 62,200 and 62,232.

[17] May 15 Order, 99 FERC & 61,160 at 61,655 and fn 36.

[18] San Diego Gas & Electric Co., 96 FERC & 61,120 at 61,500 (2001) (July 2001 Order), quoting November 2000 Order, 93 FERC & 61,121 at 61,349-350.

[19] July 2001 Order, 96 FERC & 61,120 at 61,515-56 (emphasis added).

the ISO and PX spot markets were unjust and unreasonable, and ordered refunds to remedy receipt of amounts above the just and reasonable level."[20] Consistent with the above, the May 15 Order clarified that the ceiling price approach was to be applied in the refund methodology.

19. The Commission's methodology does not allow the upward adjustment of prices during periods when the MMCP exceeded actual clearing prices. Allowing such an upward adjustment in price is inconsistent with the Commission orders cited above and contrary to the fundamental purpose of the refund proceeding of determining the just and reasonable rate during periods when prices were unreasonably high. The MMCP is a proxy calculation of the highest price level that would be bid in a competitive market; it does not infer that entities will always bid that level. No demonstration has been made - nor has any serious argument been presented - that prices in the California spot market were unreasonably low at any time during the refund period. Indeed, in all periods where the clearing price was lower than the MMCP, sellers (and buyers) receive exactly the price they expected (the market clearing price), and thus have no claim that this price was somehow too low. Thus, no justification has been provided for an upward adjustment in prices.

20. California Generators contend that their alternative, clearing price, approach is reasonable because (as they propose) it would not require any party to put money back in the market. This argument, however, misses the main point: that no justification has been presented for implementing a refund methodology - designed to address unreasonably high prices - that would result in raising prices above what sellers expected to receive during some hours of the refund period, i.e., a seller's expectation would be to receive no more than its bid.

21. Further, contrary to the position of California Generators and CSG, there is no inconsistency between the ceiling price approach and the Commission's stated goal in both the refund and mitigation proceedings of developing a methodology that replicates the maximum prices that would have been bid in a competitive market. Nor does the ceiling price approach mitigate prices to below a just and reasonable level, as argued by California Generators. As the parties note, the MMCP represents an attempt to replicate the maximum price that would have been bid in a competitive market. The underlying factual predicate is that, because of flaws in the California market design and the ability of sellers to exercise market power during times of scarcity, actual clearing prices exceeded the rate that would have been paid under competitive conditions. However, if

[20] December 19 Order, 97 FERC & 61,275 at 62,187 (emphasis added).

the MMCP turns out to be higher than the bid that sets the actual clearing price during some intervals during the refund period, it does not necessarily follow that the sellers are entitled to the effective benefit of the higher price reflected in the MMCP. Rather, in such circumstances, the bid price is in the zone of reasonableness for purposes of determining a just and reasonable rate.[21]

22. Further, the refund methodology designed by the Commission has a "safety valve" mechanism to assure that no seller's "bottom line" is jeopardized by application of the ceiling price approach. Specifically, the May 15 Order extended to all sellers an opportunity at the conclusion of the refund rehearing to "submit evidence as to whether the refund methodology results in an overall revenue shortfall for their transactions in the ISO and PX spot markets during the refund period."[22] This additional procedure is designed to assure that any refunds will not result in confiscatory rates for any seller due to the application of the ceiling price approach. This procedure will also assure that sellers do not suffer a confiscatory loss from OOM calls and block trades that occurred over multiple intervals, as discussed in CSG's brief.

23. The ceiling price approach neither "arbitrarily switches back and forth" nor "requires investors to bear the risk of bad investments" as claimed by CSG, quoting Duquesne.[23] What CSG terms as "switching back and forth" is really a consistent approach in that each seller could not have expected to receive more than a just and reasonable bid price. The MMCP is the benchmark tool to distinguish unjust and unreasonable prices from just and reasonableness prices during the period under investigation, and is only employed for refund purposes. The Commission is not attempting to specify what price sellers should have bid during each interval of the period under investigation. Rather, the Commission's purpose in calculating the MMCP is to

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[21]This explains also why each hourly interval is treated separately for refund calculations. First, the market actually required separate prices for each interval, so this approach replicates how the market operates. Second, the California Generators are asking, in effect, that possible overcharges in one period be used to offset non-existent "losses" (where the actual bid prices were lower than the MMCP) in other periods. But sellers did not suffer any "losses" because they received the bid price they expected, and thus have no grounds for obtaining an offset.

[22]May 15 Order, 99 FERC & 61,160 at 61,656.

[23]CSG also refers to Verizon, where the Supreme Court dismissed an allegation of arbitrary switching back and forth, and referred to the language in Duquesne as "dicta."

identify those bids that exceeded a just and reasonable level. In such circumstances, the MMCP provides an appropriate surrogate for the upper end of the zone of a just and reasonable market price. An actual bid that fell below the MMCP for a particular interval represents a price within the zone of reasonableness. Therefore, no upward adjustment of those prices is warranted.

24. In Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968) (Permian Basin), the Supreme Court explained that the "zone of reasonableness" rule allows the Commission the flexibility to fulfill its broad responsibilities: "it must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests." In this proceeding, we have attempted to reconcile the competing goals of holding overall rates to levels that approximate competitive market levels and inducing sufficient investment in capacity to ensure adequate service.[24] Both of these are ultimately in the best interests of customers. In addition, the Commission has provided sellers an opportunity to recover their costs and a reasonable return in keeping with FPC v. Hope Natural Gas.[25] The Commission has concluded that the ceiling price approach, coupled with the opportunity for sellers to submit evidence as to whether the refund methodology results in revenue shortfalls on an aggregate basis and for the Commission to make necessary adjustments as a result of such demonstration, strikes the most reasonable balance among these competing interests.

25. Nor does the ceiling price approach force sellers to absorb undercollections during some intervals of the refund period as alleged by California Generators. As stated, the market actually operated in intervals with each interval constituting a separate market in terms of energy needs and prices. In DOMAC, 751 F.2d at 22-23, the court found that the Commission unlawfully subdivided a refund period because it required the regulated entity (a natural gas utility) to refund more money than its rate change brought it. DOMAC concluded that such a refund violated the principle in FPC v. Sunray DX Oil Co., 391 U.S. 9, 21-25 (1968), that the pre-existing lawful rate provides a refund floor in

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[24] See, e.g., November 2000 Order, 93 FERC & 61,121 at 61,350.

[25] 320 U.S. 591, 602-603 (1944). Likewise, the Commission's need to take action in the public interest in light of high prices in the California markets, as well as its careful balancing of interests to develop a refund formula that will result in just and reasonable rates falls within the latitude allowed by the Court to "make the pragmatic adjustments which may be called for by particular circumstances." Permian Basin, 390 U.S. at 777, quoting FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 585 (1942).

a NGA Section 4 proceeding. Here, California Generators and CSG attempt to turn the holding in DOMAC on its head by arguing that the Commission' refusal to increase prices above the actual rate, i.e., clearing price is unlawful. The floor here is, as in all market-based rate situations, however, a just and reasonable market price, not necessarily whatever price was reached, although an agreed-upon price in a competitive market situation would normally be just and reasonable. DOMAC is further distinguished because the instant proceeding is not a Section 205 rate case (the equivalent of a Section 4 proceeding under the NGA). Further, having found that the prices in the California spot market during the refund period were not just and reasonable, there is no "pre-existing lawful rate" to set a refund floor like that in DOMAC/Sunray.

26. We are not persuaded by CSG's argument that the ceiling price approach produces inefficient results in some scenarios and that this will reduce incentives for upgrading and replacing aging units. Different rules apply during the mitigation period (June 21, 2001 through September 2002) and going forward. Nor has the Commission retroactively altered the rate regime under which the market operated during the refund period in violation of the predictability principle, as alleged by CSG. In the November 2000 Order, 93 FERC & 61,121 at 61,367, the Commission established a refund effective date of October 2, 2000, thereby putting sellers on notice that their transactions were subject to adjustment if the Commission determined that a lower rate was the just and reasonable rate for a particular sale. In the May 15 Order, the Commission simply clarified how it would determine the just and reasonable rate. Moreover, the example provided by CSG to demonstrate such alleged inefficiency (see P 14 above) is difficult to understand because it does not indicate the actual clearing price for the hypothetical interval. Regardless, however, CSG's example does not accurately depict the results under the ceiling price methodology. Under that approach, both units in CSG's example would be paid the same for that bid interval - both would receive either the MMCP or the actual clearing price, depending on which is lower for the interval.

27. Further, we reject CSG's arguments regarding the breakpoint. The breakpoint did not set the just and reasonable rate, and instead was used to create two distinct classes in those markets. One class consisted of those who bid below the established breakpoint benchmark without need to justify their bids. These sellers could be paid a price higher than their bids (up to the breakpoint) if other sellers bid a higher price than theirs. The second class consisted of sellers who bid above the breakpoint and expected to receive their bid price if their bid was accepted. Sellers in this second class did not expect to receive a higher price if another sellers' higher price bid was accepted. Further, both classes expected that the price they received would be subject to reduction based on the

Commission's future determination of just and reasonable prices during the refund period.[26]

28. The Commission required that those bidding above the breakpoint further justify their bid price on a cost basis.[27] However, the Commission did not require any seller to bid either above or below the breakpoint. Each seller decided what price to bid, possessing full knowledge of the possible effects of that bid. Thus, use of the ceiling price approach does not disrupt the expectations of either class of sellers. If the MMCP is higher than a sellers' bid price, the seller will receive exactly what it originally bid for: sellers bidding below the breakpoint will receive the price that cleared sales for that class, while sellers bidding above the breakpoint will receive their as-bid price. During intervals when the MMCP is lower than the "auction" price, i.e., the highest bid at or below the breakpoint price, that rate will be deemed the just and reasonable rate under the ceiling price approach. In such circumstances, all sellers in both classes will have their prices reduced to the refund MMCP level, a result reached even under the clearing price approach advocated by CSG.

29. Further, the ceiling price approach does not resurrect the use of breakpoints. As mentioned above, the breakpoint did not set the just and reasonable rate. In the ceiling price approach as well the breakpoint is not used to set the just and reasonable rate. However, the ceiling price approach takes into account that there was no actual clearing price during periods when the breakpoint was triggered. Use of the breakpoint, both initially and as an element of the refund formula, is fully justified given the critical events occurring in the California spot markets during 2000-2001. The creation of the two classes was a necessary first step to put a break on the high prices in the dysfunctional California markets. Use of a breakpoint prevented speculative bidding from controlling the entire market. Given that a large proportion of all sales involved sellers who were price takers, the breakpoint provided a degree of stability to a substantial portion of all sales. While the breakpoint did not establish a just and reasonable rate, it did allow the Commission to employ an initial presumption that bids below the breakpoint required no further justification while those above it required full cost justification. As discussed above, sellers in both classes understood that the Commission would subsequently determine the just and reasonable rate, which may ultimately be lower than the

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[26] November 2000 Order, 93 FERC & 61,121 at 61,370.

[27] Id. at 61,367-68.

breakpoint. The bifurcation was justified under the circumstances, similar to the area pricing methodology found acceptable by the court in Permian Basin.[28]

3. Out of Market Calls

30. The May 15 Order clarified that OOM calls are not eligible to set the MMCP during the refund period.[29] The order explained that, if generators chose not to participate in the Imbalance Energy market during the refund period, they are not eligible to set the MMCP.

31. California Generators argue that, while they see "some logic" to excluding OOM calls under the clearing price methodology, OOM transactions should be eligible to set the MMCP during the refund period under the ceiling price approach. They contend that there is no reason to exclude OOM transactions based on the fact that they were not part of the ISO's process for calculating the single price auction results, if the Commission is not creating a single price auction outcome.

Commission Response

32. Application of the ceiling price approach does not change the fact that it is inappropriate to have sellers that did not participate in the Imbalance Energy market set the clearing price for that market.[30] Further, as we have previously recognized, "because the ISO is the supplier of last resort for [last minute resources], when OOM calls are made, suppliers realize that the ISO is in a must-buy situation."[31] Thus, the opportunity for sellers to exercise market power when supply is tight is "most true with respect to the

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[28] 390 U.S. at 774-777. Cf. In Re California Power Exchange Corporation, 245 F.3d 1110, 1123-24 (9th Cir. 2001) (in rejecting a stay of the breakpoint, the court found that "the formulation of this remedy, considering the competing interests involved, is neither arbitrary nor discriminatory").

[29] May 15 Order, 99 FERC & 61,160 at 61,654.

[30] In San Diego Gas & Electric Company, et al., 102 FERC & 61,317 at PP 21, 32, the Commission adopted Judge Birchman finding that eligibility to set the MMCP is contingent on having bid into the ISO market ("BEEP" stack).

[31] July 2001 Order, 96 FERC & 61,120 at 61,515.

ISO's daily OOM purchases and can result in unjust and unreasonable rates . . ."[32] From a pragmatic stand-point, it is unreasonable to allow the same players that had the greatest opportunity to exercise market power and cause the unjust and unreasonable rates at issue to be given the opportunity to set the MMCP. Accordingly, we deny California Generators' request for rehearing on this issue.

B. Marketers that Own Generation

33. The December 19 Order, 97 FERC & 61,275 at 61,193, stated that "the Commission will require marketing affiliates of generators to be price takers." The May 15 Order clarified that "when the marketing and generation activities of an organization are clearly segregated into separate corporate entities, the marketing division will be treated as a marketer (price taker) and the generation division will be treated as a generator for purposes of price mitigation."[33]

34. Williams asks for further clarification (or, alternatively, rehearing) whether it should continue to be treated as a generator (as opposed to a marketer) for output produced from three specific units owned and operated by AES Southland, Inc (AES). Williams explains that it has the exclusive right to market and dispatch the electrical output of these generating units located at three southern California electric generating stations formerly owned by Southern California Edison Co. Williams states that it should be treated as a generator because it is able to trace transactions to the three AES units.[34] Further, Williams contends that it has been viewed as a generator for purposes of the refund proceeding, and has participated as a generator with regard to such issues as fuel costs, heat rates, etc. It also states that the ISO has treated Williams as a generator. For example, the ISO has viewed Williams as subject to the must-offer obligation but has not required or requested Williams to submit $0/MWh bids with respect to generation from the three AES units. It also states that the only Scheduling Coordinator ID for the units belong to Williams, not AES.

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[32] Id.

[33] May 15 Order, 99 FERC & 61,160 at 61,653.

[34] Williams Rehearing Request at 4-5.

Commission Response

35. In the December 19 Order, we explained that "entities that are able to trace a transaction to a specific generating unit will be treated as generators."[35] Williams represents that such is the case with respect to the three AES units. Moreover, based on the specific circumstances described in the filing, it appears that pursuant to the exclusive output arrangement Williams has effectively stepped into AES's shoes and is performing the operations and functions of a generator with regard to the three AES units. Accordingly, we clarify that Williams should continue to be treated as a generator with respect to transactions that can be traced directly to the three AES generation units.

II. May 15 Compliance Rehearing Order

Use of Incremental Heat Rates to Calculate the Mitigated Reserve Deficiency MCP

36. The Compliance Rehearing order, also issued on May 15, 2002, clarified that the incremental heat rate curve should be used to calculate the mitigated reserve deficiency MCP during the prospective period, from June 20, 2001 forward.[36] The Commission noted that this clarification was consistent with earlier findings in the June 19 Order that, by collecting eleven different operating points, the ISO will be able to approximate the actual incremental cost curve of each generating unit.[37] The clarification was also consistent with the April 26 Order, which required heat rates to reflect operational heat rates that did not include start-up or minimum load fuel costs because, in a declared emergency, the market clearing price should reflect the cost to generate at or near maximum outputs.[38]

37. California Generators argue that the Commission incorrectly assumes that reserve deficiency emergencies only occur during peak demand hours and therefore units are generating or near maximum outputs. They contend that, during reserve deficiency emergencies, some units will be operating at minimum load as a result of the must offer

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[35] December 19 order, 97 FERC & 61,275 at 61,193.

[36] 99 FERC & 61,159 at 61,646.

[37] June 19 order, 95 FERC & 61,418 at 62,563.

[38] April 26 order, 95 FERC & 61,115 at 61,359.

obligation, and other units will be dispatched at higher than minimum load but less than full output. They argue that, for such units dispatched by the ISO but not eligible for minimum load fuel payments, incremental heat rates do not reflect their actual running costs. Rather, according to California Generators, average heat rates more properly reflect how units operating only in the real time market would bid because, in a competitive market, the bid of the marginal unit dispatched exclusively to meet real time load would include the units' minimum load costs, even if the unit is not running at minimum load. Thus, they ask that the Commission grant rehearing and order the use of average heat rates.

Commission Response

38. The Commission denies California Generators' request for rehearing on this issue and reaffirm that the use of the incremental heat rate curve for use in calculating the market clearing price is appropriate. While the California Generators are correct that in certain limited circumstances where the generating unit's output has not been partially contracted for under bilateral agreements but rather has been in minimum load status consistent with the Commission's must-offer obligation, and the dispatch of that unit results in that unit setting the market clearing price, an incremental heat rate will not provide for full recovery of actual fuel costs. However, as we have previously stated, our mitigation plan is predicated on the use of marginal cost of the last unit dispatched to set the market clearing price and that the market clearing price should reflect, in a declared emergency, the cost of a unit to generate at or near maximum output. Accordingly, the use of incremental heat rate is the appropriate heat rate to use to compute this market clearing price. Additionally, under most conditions, the generators will receive full recovery of actual fuel costs. Specifically, if the unit is operating at some level of output because of bilateral arrangements, the incremental heat rate is compensatory with incremental additional output. Furthermore, there may be any number of generating units dispatched by the ISO from minimum load status and, at most, only one of these generating units would be the unit setting the market clearing price. In all probability, the other generating units will recover all of their fuel costs because the market clearing price will be above their marginal costs including actual fuel costs.

III. Mirant Bankruptcy

39. On September 12, 2003, the Bankruptcy Court for the Northern District of Texas issued a "Temporary Restraining Order Against the Federal Energy Regulatory Commission" ("TRO") in In Re Mirant Corp. (Mirant Corp. v. FERC), Adversary Proceeding No. 03-4355, which enjoins the Commission "from taking any action, directly or indirectly, to require or coerce the [Mirant] Debtors to abide by the terms of any

Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the Court unless FERC shall have provided the Debtors with ten (10) days' written notice setting forth in detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this paragraph."

40. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Commission will appeal that order. Despite the Commission's disagreement with the validity of the TRO and its expectation that the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days' written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this Order requires Mirant to act in a manner proscribed by the TRO, the Order will provide written notice to Mirant of the action that FERC will take with respect to a covered Mirant Wholesale Contract, which action will not become effective until ten (10) days after issuance of this Order. In all other respects, this Order is effective immediately.

The Commission orders:

The requests for rehearing are hereby denied, and 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 Massey dissenting in part with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

APPENDIX

Requests for Rehearing and/or Clarification

California Generators (Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC, Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc., Dynegy Power Marketing, Inc., El Segundo Power LLC, Long Beach Generation LLC, Cabrillo Power I LLC and Cabrillo Power II LLC, Williams Energy Marketing & Trading Company, Mirant Americas Energy Marketing, LP, and Mirant California, LLC)

California Parties (The People of the State of California ex rel. Bill Lockyer, Attorney General, the California Electricity Oversight Board, the California Public Utilities Commission, San Diego Gas & Electric Company, and Southern California Edison Company)

Competitive Supplier Group (CSG) (Avista Energy, Inc., BP Energy Company, Coral Power, L.L.C., El Paso Merchant Energy, L.P., Exelon Corporation, on behalf of Exelon Generation Company, LLC, PECO Energy Company and Commonwealth Edison Company, IDACORP Energy, L.P., Powerex Corp., Puget Sound Energy, Inc., PPL Montana, LLC, PPL EnergyPlus, LLC, PPL Southwest Generation Holdings, LLC, Public Service Company of New Mexico, Sempra Energy Trading Corp., Tractebel Power Inc., and Tucson Electric Power Company)

Pacific Gas and Electric Company (PG&E)

PacifiCorp

Williams Energy Marketing & Trading Company (Williams).

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, Complainant, v. Sellers of Energy and Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange Corporation, Respondents	Docket Nos. EL00-95-062
Investigation of Practices of the California Independent System Operator and the California Power Exchange	Docket No. EL00-98-051
Public Meeting in San Diego, California	Docket No. EL00-107-010
Reliant Energy Power Generation, Inc., Dynegy Power Marketing, Inc., and Southern Energy California, L.L.C., Complainants, v. California Independent System Operator Corporation, Respondent	Docket No. EL00-97-004
California Electricity Oversight Board Complainant, v. All Sellers of Energy and Ancillary Services Into the Energy and Ancillary Services Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents	Docket No. EL00-104-009

California Municipal Utilities Association, Complainant, v. All Jurisdictional Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents — Docket No. EL01-1-010

Californians for Renewable Energy, Inc. (CARE), Complainant, v. Independent Energy Producers, Inc., and All Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator 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, Respondents — Docket No. EL01-2-004

Puget Sound Energy, Inc., Complainant, v. All Jurisdictional Sellers of Energy and/or Capacity at Wholesale Into Electric Energy and /or Capacity Markets in the Pacific Northwest, Including Parties to the Western Systems Power Pool Agreement, Respondents — Docket No. EL01-10-004

California Independent System Operator Corporation — Docket No. ER01-607-003

California Independent System Operator Corporation — Docket No. RT01-85-009

Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council — Docket No. EL01-68-014

California Power Exchange Corporation	Docket No. ER00-3461-004
California Independent System Operator Corporation	Docket No. ER00-3673-003
California Independent System Operator Corporation	Docket No. ER01-1579-004
Southern California Edison Company and Pacific Gas and Electric Company	Docket No. EL01-34-003
Arizona Public Service Company	Docket No. ER01-1444-004
Automated Power Exchange, Inc.	Docket No. ER01-1445-004
Avista Energy, Inc.	Docket No. ER01-1446-006
California Power Exchange Corporation	Docket No. ER01-1447-004
Duke Energy Trading and Marketing, LLC	Docket No. ER01-1448-006
Dynegy Power Marketing, Inc.	Docket No. ER01-1449-007
Nevada Power Company	Docket No. ER01-1450-004
Portland General Electric Company	Docket No. ER01-1451-007
Public Service Company of Colorado	Docket No. ER01-1452-004
Reliant Energy Services, Inc.	Docket No. ER01-1453-008
Sempra Energy Trading Corporation	Docket No. ER01-1454-004
Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC	Docket No. ER01-1455-010
Williams Energy Services Corporation	Docket No. ER01-1456-011

(Issued October 16, 2003)

MASSEY, Commissioner, dissenting in part:

I am in general agreement with this order. In footnote 6, however, the Commission refuses to consider the effect of behavior that violated the PX and ISO tariffs on the refund competitive benchmark. I would do so. Such behavior, especially withholding, would have affected market prices during the refund period and the MMCP should be adjusted accordingly. This issue should be pursued in the refund proceeding where affected parties may present their arguments and have appeal rights.

For these reasons, I dissent in part from today's order.

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William L. Massey
Commissioner