97 FERC ¶ 61, 294
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council — Docket No. EL01-68-000

ORDER TEMPORARILY MODIFYING THE WEST-WIDE
PRICE MITIGATION METHODOLOGY

(Issued December 19, 2001)

On October 29, 2001, the Commission convened a technical conference to address possible modifications to the current West-wide price mitigation methodology for the winter season.[1] After taking into consideration all filed comments, including the comments arising out of this technical conference, we have decided to require the CA ISO to recalculate the price mitigation for spot market transactions when the average of the three gas indices increases 10 percent from the level last used for calculating the mitigated price. This order serves the public interest and will benefit electricity customers because it encourages competitive markets while helping to maintain a reliable power supply.

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[1]The Commission accommodated requests to speak at the technical conference from the following parties: California Congressional Democrats; California Public Utilities Commission (California Commission); Dynegy Power Marketing, Inc. (Dynegy); Southern California Edison (SoCal Edison); Transaction Finality Group (TFG); Duke Energy NA and Duke Energy Trading and Marketing (collectively, Duke); City of Tacoma, Washington (Tacoma); Enron Power Marketing (Enron); Portland General Electric (Portland GE); Electric Power Research Institute (EPRI); PacifiCorp and PacifiCorp Power Marketing (collectively, PacifiCorp); California Independent System Operator (CA ISO); and Pacific Gas & Electric (PG&E).

Background

Since December 15, 2000, the Commission has issued a series of mitigation directives to correct dysfunctions in wholesale power markets in California and the West.[2] In one of these directives, issued on June 19, 2001, the Commission adopted a mitigation plan for CA ISO organized spot market sales during all hours, as well as for bilateral spot market sales throughout the Western Systems Coordinating Council (WSCC) from June 20, 2001 through September 30, 2002.[3] In that order, the Commission also invited interested parties to file with the Commission comments and proposals for the purpose of revisiting the mitigation methodology for future periods.

Following the presentations at the October 29, 2001 technical conference, the discussion centered on two possible modifications to the current price mitigation methodology: (1) whether to eliminate the 10 percent credit adder for sales into California; and (2) whether to require the CA ISO to recalculate the price for spot market transactions when the average of the three gas indices increases by 10 percent from the level last used for calculating the mitigated price.

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[2]See San Diego Gas & Electric Company et al., 93 FERC ¶ 61,294 (2000), reh'g pending on some issues (December 15 Order); San Diego Gas & Electric Company et al., 94 FERC ¶ 61,245 (2001), (March 9 Order); San Diego Gas & Electric Company et al., 95 FERC ¶ 61,418 (2001), reh'g pending on some issues (June 19 Order); and San Diego Gas & Electric Company et al., 96 FERC ¶ 61,120 (2001), reh'g pending on some issues (July 25 Order). An Order on Rehearing resolving a number of issues in the December 15 Order, June 19 Order and July 25 Order and all of the issues in the March 9 Order is being issued contemporaneously with this order.

[3]The June 19 Order retained the use of a single price auction and must-offer and marginal cost bidding requirements when reserves are below 7 percent in the CA ISO spot markets. Under the price mitigation plan, the CA ISO market clearing price also serves as a limit on prices in all other spot market sales in the WSCC during reserve deficiencies in California. Sellers in all spot markets in the WSCC receive up to the clearing price without further justification. The June 19 Order allowed sellers other than marketers the opportunity to justify prices above the market clearing price. The CA ISO market clearing price for reserve deficiency hours was also adapted for use in all Western spot markets for non-reserve deficiency hours, e.g. when reserves are above 7 percent. Prices during subsequent non-reserve deficiency hours cannot, absent justification, exceed 85 percent of the highest hourly clearing price that was in effect during the most recent Stage 1 reserve deficiency period (i.e., when reserves are below 7 percent) called by the CA ISO.

Comments

The California Congressional Democrats, SoCal Edison, PG&E, EPRI, PacifiCorp, TFG, Duke, the CA ISO, Portland GE, Dynegy, the California Commission, Enron, Tacoma, Colorado Association of Municipal Utilities (CAMU); Utah Associated Municipal Power Systems (UAMPS); California Electricity Oversight Board (CEOB); Dr. Jian-zhong Zhong; the California State Assembly; Reliant Energy Services, Inc. and Reliant Energy Power Generation, Inc. (collectively, Reliant); Public Service Company of Colorado (PS Colorado); Avista Energy, Inc (Avista); Puget Sound Energy, Inc. (Puget Sound); American Enterprise Institute (AEI); Mirant Americas Energy Marketing, LP, Mirant Delta, LLC, Mirant Potrero, LLC, Mirant California, LLC (collectively, Mirant) and the Western Power Trading Forum (WPTF) filed comments in this proceeding following the Commission's Notice of the Technical Conference.

The 10 Percent Credit Adder

The following parties submitted written comments in favor of removing the 10 percent credit adder for energy sales made in California: the California Congressional Democrats, SoCal Edison, PG&E, CA ISO, UAMPS, California State Assembly, and CEOB. Generally, these parties state that the 10 percent adder to reflect credit uncertainty is unnecessary for two reasons: (1) the California Department of Water Resources (CDWR) is a third-party, creditworthy guarantor of the buyers; and (2) the adder indiscriminately punishes all load serving entities regardless of their credit risk.

Dynegy opposes the removal of the 10 percent adder because it contends that PG&E and SoCal Edison remain non-creditworthy entities and, despite CDWR's promise to act as a third-party guarantor, "no ISO market payments have been received." While TFG favors prospective elimination of the Commission's price mitigation measures, it does not support dropping the 10 percent adder if the Commission chooses to continue the price mitigation measures. Duke and Reliant state that removal of the 10 percent adder should be conditioned on the CA ISO's payment for all transactions entered into for energy and ancillary services provided to serve the loads of SoCal Edison and PG&E. Similarly, Mirant and Reliant state that, until the CA ISO complies with Commission orders and ensures a creditworthy counter-party, generators should continue to receive the 10 percent adder to compensate them for having to take the continuing risk of non-payment. PS Colorado suggests that, in the event that the Commission maintains price mitigation throughout the WSCC, the Commission should apply the 10 percent credit adder to transactions in the WSCC to ensure that adequate supplies are equally available throughout the WSCC.

Revising Price Mitigation Measures Based on Gas Prices

PG&E, SoCal Edison, Duke, CA ISO, and the California State Assembly submitted comments in favor of the Commission revising its price mitigation measures to be based on gas prices fluctuating both up and down. Mirant and Reliant do not support a recalculation that responds to a drop in the average of the monthly gas indices. The CEOB warns that if the mitigation price is allowed to float with fluctuating gas prices, the Commission must ensure that gaming of the natural gas market does not occur. The CAMU has concerns that recalculation of the mitigation price for the entire Western region will be based only upon changes in natural gas indices in California.

Additional Comments

The Commission received a large variety of additional comments and suggestions concerning West-wide price mitigation. Many of the commenters request that the Commission largely maintain the current mitigation plan since it served to help stabilize the 2001 California electricity market. While some commenters suggest maintaining the must-offer requirement, many of the commenters suggest changes to the bid process, including the following: eliminate the must-offer requirement; clarify the must-offer obligation concerning "available" generating units with long start-up times; expand the must-offer obligation to include decremental bids; modify the must-offer requirement to apply only during reserve deficiency periods, provide adequate compensation to units that are required to remain on-line when such operation is not economically justified or, in the alternative, develop a day-ahead unit commitment market; revise the must-offer requirement to reflect competitive market principles, through the use of a day-ahead unit commitment mechanism and an hour-ahead market, and remain in place until September 2002; excuse small generators, particularly small "non-jurisdictional" generators outside the Pacific Northwest, from must-offer obligations; implement "Layered Auction and Pricing" for power generation where the daily load area will be divided into "G-areas" that generators will be allowed to bid for on a daily basis, rather than on an hourly basis; and consider uniform price mitigation throughout the West, consisting of a "bid-cap".

Several of the commenters propose modifications to the CA ISO's operations. These proposals include the following: not allow the CA ISO to determine pricing in the WSCC; modify market practices or modify the physical operation of the underlying power grid to exploit substantial unused grid capacity; raise the efficiency of grid monitoring and grid control; and change the current mitigation measures on the occasions when a security coordinator other than the CA ISO issues energy alerts.

Many of the commenters suggest changes to the way in which certain parties are treated in the mitigation plan. These comments include the following suggestions: exempt electric peaking facilities from price mitigation measures; not "punish" resellers of power by subjecting their prices to mitigation; hold generators responsible for unjustifiably high charges that exceed the mitigated price; require CDWR to obtain adequate real-time load data from SoCal Edison and PG&E to allow it to schedule and balance those entities' net short load like any other Scheduling Coordinator in the ISO markets; exempt resales of power purchased under forward contracts entered into before June 19, 2001; permit generators located outside of California to recover environmental and start-up costs on the same bases as California generators; and limit the prohibition of cost-based prices above the mitigation price to exclude load-serving entities, particularly those that are of modest size and that are outside of California and the Commission's jurisdiction.

While several parties suggest that the Commission avoid implementing regional proxy prices, various commenters propose regional alternatives to the current mitigation plan, including the following: reflect regional differences in gas costs and demand for energy; recognize all variable costs of production; "decouple" any mitigated price measures for the California market from the other WSCC markets to encourage adequate supplies during the winter season through, among other things, elimination of the 85 percent cap on the mitigated price during non-emergency hours in order to recognize the actual mitigated price based on the gas indices; lift mitigation measures for sales into WSCC markets during the winter season, with the possible exception of loads within the CA ISO control area, to allow market signals to attract supplies during peak demand periods, or alternatively, implement a "circuit breaker" similar to those that ERCOT, the NY ISO and PJM utilize, along with a hard cap of $500; utilize a single electric proxy price incorporating the highest regional gas price and a fixed peaking resource heat rate; and modify the basis for any price mitigation to reflect more region-wide, independent and verifiable prices (such as published natural gas prices across the region or within subregions).

Other miscellaneous comments submitted to the Commission include the following: encourage demand response measures; expand cooperation with state authorities on market power issues; base mitigation measures on winter peaking; avoid retroactive application of the rules; implement a "soft cap" or remove price mitigation entirely; eliminate the use of the "85 percent rate multiplier" on prices in California and the West; expeditiously resolve matters concerning California and the West; track bilateral transactions more closely; implement an effective alternative mitigation plan before the current mitigation plan expires; and consider "circuit breaker" rules that are set at levels reflecting the opportunity cost of hydroelectric power.

Discussion

As many of the commenters point out, the Commission's price mitigation measures of 2001 were a significant factor in helping to stabilize the California electricity market. These commenters request that the Commission keep the current methodology largely intact. However, several other commenters suggest significant changes to, and in some cases an overhaul of the current price mitigation measures. The Commission has carefully considered all of these comments and concludes that it would be unwise at this time to make major changes to the current price mitigation measures. Major changes could disrupt the recently achieved stability in the California market. However, because the area the ISO serves is a summer peaking system and significant portions of the WSCC, especially the Northwest, are winter peaking systems, some changes to the mitigation plan are necessary for continued stability.

The changes we choose to implement in this order are only temporary measures intended to help the West through the winter season (until May 1, 2002). Because of the current stability in the California electricity market, more significant changes to the current mitigation measures are simply not needed at this time. Indicators of the recent market stability include the following: (1) record high working gas amounts in the region's storage facilities;[4] (2) favorable weather conditions contributing to a steady increase in the region's hydroelectric reserves; (3) a reduction in peak demand due to conservation programs and other factors;[5] and (4) spot prices for electricity at the major trading hubs (California Oregon Border, Mid-Columbia, Palo Verde) consistently below $40/Mwh and well below the current $92/MWh mitigated price. Accordingly, we will not address the merits of suggestions seeking major changes to the current mitigation measures.[6] Furthermore, to the extent that any comments concern pending rehearing issues on the December 15 Order, March 9 Order, June 19 Order, or July 25 Order, and

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[4]See Energy Information Administration, U.S. Natural Gas Storage By State, available at http://www.eia.doe.gov/pub/oil_gas/natural_gas/data_publications/natural_gas_monthly/current/pdf/table_14.pdf.

[5]California Energy Commission, Reduction in 2001 Monthly Peak Demand, at http://www.energy.ca.gov/electricity/peak_demand_reduction.html; and, Press Release, Office of the California Governor, October Electricity Use During Peak Times Down Nearly Nine Percent from Last Year, (November 6, 2001), available at http://www.energy.ca.gov/releases/2001_releases/2001-11-06_gov_demand.html.

[6]See e.g., comments of Duke, Dynegy, EPRI, Enron, Dr. Zhong, Mirant, PacfiCorp, Portland GE, PS Colorado, Puget Sound, Reliant, TFG, WPTF, and UAMPS.

to the extent that the Commission's actions in its July 25 Order superseded earlier filed comments, we will not address those comments.

We find the comments the parties[7] raise requesting removal of the 10 percent adder for energy sales made in the California market to be unpersuasive. As indicated in the Order on Rehearing being issued concurrently with this order,[8] we continue to receive complaints that suppliers are not being paid for services rendered, despite the Commission's repeated instructions to the ISO to ensure that there is a creditworthy party to back each transaction.[9] As a result, we find it necessary to retain the adder until the CA ISO enforces the creditworthiness requirement under the ISO Tariff, and CDWR, as the creditworthy guarantor, satisfies its past due financial obligations to generators for energy sold through the CA ISO. Once the CA ISO has fully complied with the implementation of the creditworthiness requirement and suppliers have received payments due to them, the Commission will consider the removal of the 10 percent credit adder.

With regard to PS Colorado's suggestion that the Commission apply the 10 percent credit adder to all transactions in the WSCC, we find that the proposal is unnecessary. The Commission imposed the creditworthiness adder on market participants in California because there has been a history of nonpayment risk in the California market. We note that entities in other regions of the WSCC have not indicated to the Commission that any legitimate risk of nonpayment or a record of untimely payments exists sufficient to justify the imposition of the 10 percent adder across the entire WSCC. Accordingly, we will not apply the 10 percent credit adder to transactions in areas outside of California.

In order to address the seasonal diversity of the Northwest (a winter peaking region), we will no longer make adjustments to the mitigated price for the 2001-2002 winter period dependent on the occurrence of a reserve deficiency in California (a summer peaking region). The current mitigation plan relies on the CA ISO's single

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[7] See e.g., comments of So Cal Edison, PG&E, CAISO, UAMPS, California Congressional Democrats, California State Assembly, TFG and CEOB.

[8] Order on Rehearing of the December 15 Order, March 9 Order, June 19 Order, and July 25 Order.

[9] See California Independent System Operator Corporation, 97 FERC ¶ 61,151 (2001) (November 7 Order). On November 21, 2001, the CA ISO submitted a compliance report pursuant to the Commission's instructions in the November 7 Order.

control area and its centralized market to determine when there exists a reserve deficiency to formulate the mitigated price. Unlike the CA ISO, the area of the WSCC outside of California is composed of numerous control areas with no centralized market, making it virtually impossible to adapt the current reserve deficiency model for winter use outside of California with the necessary accuracy to the entire WSCC. For this reason, we will not continue the use of the reserve deficiency model to formulate a new mitigated price for the winter period.

The technical conference record supports the continued reliance on a gas fired unit as the marginal unit in our mitigation methodology for the winter season. For this reason, incremental changes in the cost of gas will be used to calculate a new mitigated price for the winter period. We note that we first proposed this change to the mitigation plan in the October 12, 2001 Notice of Technical Conference Concerning West-wide Price Mitigation for the Winter Season and Procedures for Seeking Participation.[10] No party has raised serious concerns regarding this proposal.

We will require the CA ISO to recalculate the mitigated market clearing price when the average of the three gas indices currently used increases at least 10 percent above the level last used for calculating the mitigated price. Only a change in the gas indices last used for the summer period will trigger a recalculation of the mitigated price.

Effective on the trading day following the date of this order, through April 30, 2002, we will suspend the methodology used to calculate the current mitigated price and substitute the following West-wide winter season methodology. As a starting point, the mitigated price will be set at $108/MWh. This is the actual mitigated price set using the current methodology during the last reserve deficiency on May 31, 2001, based on a gas index of $6.641/MMBtu, a generating unit with a heat rate of approximately 15,360 Btu/MWh and $6.00 for the O&M adder. The new interim mitigated price will supersede the existing mitigated price (approximately $92/MWh), which was set at eighty-five percent of the originally calculated $108/MWh mitigated price for application during non-reserve deficiency hours. We find this adjustment necessary to set the price for the winter period and to track changes in the gas indices.

The winter formula will maintain the current heat rate and O&M adder. The one variable in the formula will be tied to the current average of the mid-point for the monthly bid-week index prices reported for SoCal Gas (large packages), Malin and PG&E city-gate. Under the winter season formula, the mitigated price will be

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[10] 66 Fed. Reg. 52, 912 (Oct. 18, 2001).

recalculated when the average gas price rises by a minimum factor of 10 percent (e.g., to $7.305/MMBtu) effective for the following trading day. The formula will also track subsequent cumulative changes of at least 10 percent (including reductions of 10 percent, but not less than a floor of $108/Mwh). Effective on May 1, 2002, the summer methodology will be reinstated along with the current mitigated price of approximately $92/Mwh for non-emergency periods.

We will now address a few of the additional comments that we find warrant discussion. Several commenters contend that a party other than the CA ISO should perform the price calculation. Their concerns appear to question the independence of the CA ISO. We note that the temporary methodology for the winter period is straightforward and easy to independently verify. Parties are now familiar with accessing the current price data from the CA ISO's web page. Moreover, in the absence of an independent regional entity, such as an RTO, a superior alternate entity to perform the calculation and posting does not exist. Accordingly, we will require the CA ISO to calculate and post the interim mitigation for the winter period.

Several commenters request that the Commission exempt new peaking generating resources from the mitigation plan in order to provide incentives for investment or, in the alternative, to utilize a higher hard price cap (e.g., $500/MWh). We note that there is no evidence in the record indicating that the current methodology is affecting investment decisions. To the contrary, we note that the market price for sales in the spot markets at the major western trading hubs has consistently been well below the current mitigated price. Thus, there is no evidence to support the need to abandon our current market oriented methodology in order to utilize an arbitrary hard price cap that does not reflect changes in the market.

With respect to the request to set a price that reflects the opportunity cost of hydroelectric power, we note that such resources are exempt from the requirement to offer available capacity in the spot markets. In addition, the record evidence indicates that calculating the future value of hydroelectric power is difficult and, because it is generally valued on a seasonal basis, is inappropriate for an interim winter period. Finally, we note that, in an order issued concurrently with this order, we have lifted the must-offer requirement and the price mitigation measures for governmental entities and RUS-financed cooperatives, unless they choose to participate in the ISO spot markets.[11]

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[11] See note 2 supra.

<u>The Commission orders:</u>

(A) Sellers of energy in the WSCC are hereby subject to the winter mitigation plan as discussed in the body of this order.

(B) The winter mitigation plan shall become effective on the trading day following the date of this order and shall remain in effect through April 30, 2002, as discussed in the body of this order.

By the Commission. Commissioner Massey dissented with a
separate statement attached.

(S E A L)

Linwood A. Watson, Jr.,
Acting Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Westerns Systems Coordinating Council — Docket No. EL01-68-000

(Issued December 19, 2001)

MASSEY, Commissioner, dissenting:

Today's order makes significant changes to our Western market mitigation program. The mitigation program the Commission adopted in our June 19, 2001 order was carefully thought out.[1] Since the program was put in place, the Western markets have behaved well. I cannot support making these changes to that program for two reasons.

First, I am not convinced that the changes are necessary. If the concern is that gas prices will rise sharply, above the current formula ceiling such that fossil generators will not offer into the market, I would not expect that problem to arise. Gas prices are reasonable now and the Energy Information Administration projects that they will trend even lower over the next year. Today, for example, spot prices in the West ranged from $2.43 MMBtu to $2.93 MMBtu. The existing mitigation formula is based upon $6.60 MMBtu gas.

If the concern is that a California reserve deficiency will trigger a lowering of the west wide mitigated price due to the current low gas prices, and that the new price will be insufficient to ensure that hydro plant operators will sell into the market, it's not clear to me why they would not sell. Prices over the west generally rise and fall together. Thus, I cannot conclude that the current mitigation price method will cause a significant problem in the market.

Second, our June 19, 2001 mitigation plan restored the Commission's credibility as a tough but reasonable cop on the beat. Unfortunately, tinkering with the formula may also tinker with our credibility. The order unplugs recalculation of the mitigated price from a reserve deficiency in California. One of our concerns with the dysfunctional

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[1] San Diego Gas & Electric Co., et al., 95 FERC ¶ 61, 418 (2001).

California market was the ability of sellers to exercise market power, especially when supplies are tight. If shortages occur in California, under this order sellers will be able to drive prices up to $108, which under current conditions is probably a multiple of their costs. This invites non-competitive prices.

Today's order places a $108 ceiling on the market with possible adjustments upward. Our June 19 mitigation order calls for a ceiling that's only 85% of that, or $92, when there has been no reserve deficiency. There has been no reserve deficiency to trigger the higher price. The 85% factor was a careful compromise in our June order, and I am not willing to depart from it without a very compelling reason. I find no such reason here.

The current mitigated price of $92 reflects gas costs that were double what they are now. As a result, the current mitigated price is much higher than that which would result from current gas prices. I believe this has provided a strong incentive for sellers to do all they can to offer power to the market to avoid a reserve deficiency declaration and to avoid the consequent recalculation downward of the generous mitigated price. The order unfortunately removes that rather positive incentive to offer power.

A final concern of mine is that today's order applies an asymmetric approach. Under the order, the mitigated price will increase above $108 with higher gas prices, but it will not decrease with lower gas prices. The mitigated price will not fall below $108 as gas prices trend lower. I fail to see the logic in this. The existing approach is symmetrical and, if a reserve deficiency is called, the mitigated price can either increase or decrease with gas prices. The existing approach is better.

My conclusion is that there is no crisis now that requires a change in the methodology. I do not expect such problems to arise. However, if actual problems do arise over the next few months, the Commission can act quickly to resolve them and to change the mitigated price formula as necessary.

For these reasons, I must respectfully dissent from this order.

William L. Massey
Commissioner