

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

California Independent System Operator Corporation Docket No. ER05-718-003

ORDER ON TARIFF FILING

(Issued September 30, 2005)

1. In this order, the Commission accepts a tariff filing by the California Independent System Operator Corporation (CAISO) to continue an interim solution to a problem associated with the manner in which import and export bids from System Resources¹ are cleared and settled.

I. Background

A. Previous Orders

1. The Commission's April 7 Order

2. Under the tariff provisions in effect prior to April 7, 2005, System Resources submitting bids to sell energy to the California system (increment bids), or to “buy” energy through reducing generation (decrement bids) would submit bids for each hour which might ultimately be higher or lower than the market clearing price for that hour. The CAISO would determine, ahead of each hour, which of these external resources’ bids would be taken. In order to provide an incentive for external resources to bid into the California market, the CAISO’s tariff provided that each resource would receive (or pay) a price for its energy that was determined by a “bid or better” rule. That is, a resource that made an increment bid would receive either the market clearing price or its own bid, whichever was higher, and a resource that made a decrement bid would pay either the market clearing price or its own bid, whichever was lower. In situations where the resource's bid, rather than the market clearing price, was the better price, the CAISO would make an uplift payment to that resource for the difference.

¹ The CAISO tariff defines System Resources as a group of resources located outside of the CAISO control area capable of providing energy and/or ancillary services to the CAISO-controlled grid.

3. On March 23, 2005, the CAISO made an emergency filing (Amendment No. 66) to revise these provisions of its tariff. It stated that the combination of the pre-dispatching of import/export bids and the "bid or better" settlement rule had created an incentive for the bidding of external resources in a manner that increased the uplift costs incurred by the CAISO. It stated that this was occurring because of the lack of convergence between real-time market clearing prices and the prices at which external bids are pre-dispatched, and the fact that resources had an incentive to bid quantities of offsetting incremental and decremental energy (which to a significant extent offset one another, in which case no energy was actually received by or provided to the system). The CAISO asserted that California load was being charged significant amounts for the ensuing uplift costs without receiving any concomitant benefits.² To protect customers from being charged unnecessary uplift costs, the CAISO stated that it had begun exploring, with its market participants, several alternative long-term solutions to the problem of clearing intertie bids. As an interim solution, however, the CAISO proposed to move to an "as bid" rule, under which System Resources, if dispatched, would be paid their original bid price.

4. On April 7, 2005, the Commission accepted the CAISO's filing for an interim period, effective March 24, 2005. The Commission specified, however, that Amendment No. 66 tariff provisions would remain in effect until the earlier of September 30, 2005, or the effective date of a tariff filing providing a long-term solution filed by the CAISO and accepted by the Commission.³ The Commission stated that "[i]f no proposed tariff amendment has been filed to become effective by September 30, 2005, then on October 1, 2005, the tariff provisions accepted here will sunset, and those tariff sections will revert to their current version."⁴

² In Docket No. IN05-8-000, the Commission investigated allegations of manipulative bidding at interties in the CAISO's supplemental energy market by Powerex Corporation (Powerex). On September 26, 2005, the Commission issued an order disclosing the results of the investigation, which found that Powerex's overlapping bids at different interties did not constitute manipulation in violation of Market Behavior Rule 2 or section 7.1 of the CAISO Enforcement Protocol. *See, Intertie Bidding in the California Independent System Operator's Supplemental Energy Market*, 112 FERC ¶ 61,333 (2005).

³ *California Independent System Operator Corporation*, 111 FERC ¶ 61,008 (2005) (April 7 Order).

⁴ *Id.* at P 15.

2. The Commission's May 20 Order

5. The CAISO sought rehearing and clarification of the April 7 Order. It asked the Commission to grant rehearing of the requirement that the CAISO reinstate the "bid or better" methodology for settling intertie transactions by October 1, 2005, if no better solution is found, and also to clarify that the CAISO is not precluded from proposing, as its preferred "long-term solution" to the problem of clearing overlapping intertie bids, retention of the current "as bid" payment methodology.

6. In an order issued on May 20, 2005,⁵ the Commission denied the CAISO's rehearing request, refusing to eliminate its previous requirement that Amendment No. 66 would sunset on October 1, 2005. However, it clarified that the CAISO is not precluded from proposing, as its preferred "long-term solution" to the problem of clearing overlapping intertie bids, retention of the current "as bid" payment methodology. The Commission stated that when the CAISO makes that filing, it will consider it on its own merits.⁶

B. CAISO's July 26 Filing

7. The CAISO states that since the approval of Amendment No. 66, the CAISO has conducted an extensive stakeholder process in order to determine the best longer-term solution to the problem of settling import and export bids from System Resources for the period between October 1, 2005 and implementation of the CAISO's new locational marginal pricing (LMP) market design, its Market Redesign and Technology Upgrade (MRTU). It states that, in light of the effectiveness of the "as bid" solution, and the need to focus its resources on development and implementation of MRTU Release 1, the CAISO has concluded that the best option available to it is to continue the "as bid" methodology until implementation of MRTU Release 1. It also states that it will "include as part of its November 2005 MRTU Tariff filing a long-term methodology for settling intertie bids in the Hour Ahead Scheduling Process (HASP), which under the current MRTU timeline would become effective as of February 2007."⁷

⁵ *California Independent System Operator Corporation*, 111 FERC ¶ 61,235 (2005) (May 20 Order).

⁶ *Id.* at P 15. Also in the May 20 Order, the Commission accepted Amendment No. 69 to the tariff, filed by the CAISO on April 22, 2005 as a further tariff revision necessary for full and complete implementation of Amendment No. 66.

⁷ Transmittal letter, July 26 filing, at 2.

8. The CAISO asserts that through this stakeholder process, the CAISO and market participants considered a number of potential longer-term solution options. Of these various options, the CAISO asserts that two in particular received the most support from market participants, the CAISO, and the Market Surveillance Committee: (1) setting a pre-dispatch market clearing price that all import and export bids from System Resources would be settled against; or (2) retaining the "as bid" methodology, under which System Resources that are dispatched are paid their bid price. The CAISO asserts four reasons why it believes that of these two, retaining the "as bid" methodology would be the most appropriate longer-term solution to remain in place until February 2007.

9. First, the CAISO states that the "as bid" methodology implemented in Amendment No. 66 has worked extremely well in curbing the excessive uplift costs that resulted from the "bid or better" settlement rule, and that the amount of overlapping increment and decrement bids cleared by the CAISO dropped dramatically as soon as the CAISO moved from the "bid or better" settlement rule to the "as bid" settlement rule. Additionally, the CAISO points out that the weekly Division of Market Analysis (DMA) reports that it filed with the Commission show that the costs incurred by the CAISO associated with clearing the market by dispatching overlapping increment and decrement bids from System Resources have been essentially eliminated under the "as bid" settlement rule.

10. Second, the CAISO believes that the "as bid" rule shares the most important features of a pre-dispatch market clearing price solution. The CAISO asserts that both options are effective in preventing the occurrence of uplift costs that would be allocated to CAISO ratepayers under the "bid or better" settlement rules. In addition, the CAISO states that both the "as bid" and "pre-dispatch market clearing price" methodologies would ensure that System Resources recover the full bid price of any incremental energy bids pre-dispatched by the CAISO. Thus, the CAISO argues that both of these methodologies ensure that System Resources will be able to cover their operating costs. Moreover, the CAISO states that both settlement solutions would provide the opportunity for System Resources to receive prices in excess of their costs.

11. Third, the CAISO believes that the weekly DMA reports show that none of the concerns expressed with respect to the "as bid" methodology have materialized. The CAISO believes there have not been any problems in terms of bid sufficiency or liquidity of incremental or decremental energy import bids since the switch to an "as bid" settlement rule.

12. The CAISO does not anticipate that the potential downsides of the "as bid" methodology will present a significant problem going forward. The CAISO believes the possible inefficiencies introduced by the "as bid" methodology are not particularly significant because the amount of net imports that are pre-dispatched by the CAISO before the start of the real-time market is but a small fraction of the total CAISO system

load. Therefore, the CAISO states, any possible inefficiencies resulting from System Resources bidding in an effort to predict real-time market clearing prices would constitute only a fraction of total production costs on a small fraction of total supply.

13. Additionally, the CAISO states that although the experience with the "as bid" methodology, and the stakeholder process in the present proceeding, will be instructive in developing the methodology to be used under the MRTU tariff revisions, the substantial market and operational changes introduced by MRTU Release 1, including the move to a Locational Marginal Price (LMP) congestion management approach, the creation of an integrated forward market, and the integration of intertie pre-dispatch into the HASP, will necessitate the development and implementation of a new solution for settling intertie bids. Therefore, potential inefficiencies resulting from the application of the "as bid" settlement rule are not likely to be of significant duration, because the CAISO intends to implement a new optimal methodology for settling intertie bids by including that methodology as part of its MRTU Release 1 filing, which it intends to put into effect in February 2007.

14. The CAISO also puts forth that the pre-dispatching of imports is based on the CAISO's desire to accommodate the timing of import practices within real-time system operations in a manner that encourages imports. To the extent that importers are able to dynamically schedule their imports to respond to CAISO real-time dispatch instructions, their supply will be unaffected by the "as bid" rule because those supplies will settle in the same manner as internal resources and be paid the real-time market clearing price. Therefore, the CAISO argues that importers have the option to mitigate any potential downside to the "as bid" settlement rule by taking advantage of the ability to schedule dynamically by entering into an agreement to do so with the CAISO. Thus, the CAISO believes that the "as bid" settlement rule also has the benefit of encouraging importers to pursue dynamic scheduling arrangements with the CAISO, which both the CAISO and the Market Surveillance Committee believe will enhance the long-term efficiency of the CAISO markets.

15. Finally, the CAISO points out that because it is already operating under the "as bid" methodology, continuing to operate under this methodology after September 30, 2005 will not involve any additional implementation costs or allocation of resources. In contrast, the CAISO estimates that implementing a pre-dispatch market clearing option would take at least 6-8 months, and would require a budget of approximately \$600,000 in addition to the use of internal CAISO resources. Additionally, implementing alternative

options would require the extensive utilization of internal CAISO staff time and resources that are currently scheduled to be used for settlement conversion projects and, most importantly, the implementation of MRTU Release 1 by February 2007.⁸

C. Issues Raised by Protesters

16. The California Electricity Oversight Board (CEOB) supports the CAISO's filing and states that it is the only solution that would address the issue in an easily-implemented manner for the period prior to implementation of MRTU Release 1. Additionally, Powerex states that it will not oppose the continuation of the "as bid" settlement process until MRTU is implemented. However, Powerex asserts that the "as bid" settlement process should be viewed as an inferior solution whose shortcomings can be tolerated only for a limited period until MRTU is implemented. Powerex argues that if the schedule for MRTU changes in any material way, the Commission should require the CAISO to reconsider implementation of the pre-dispatch clearing price option to be applied to the current market design.

17. Bonneville Power Administration (Bonneville) asserts that the CAISO has focused on the uplift cost of clearing the pre-dispatch market, and not on the cost of paying importers pre-dispatched to meet CAISO system needs for the value of the energy they provided. Bonneville believes that by ignoring this distinction, the CAISO is pursuing a non-competitive solution applied to all pre-dispatch bids that undermines import participation in the market and punishes import bidders for the adverse consequences of dispatch decisions made solely by the CAISO.

18. Bonneville believes that accurate price forecasts would result in a close match between the pre-dispatch and real-time prices, and thus create little or no resulting uplift. Bonneville notes that the CAISO has made adjustments in price forecasting that were adopted at about the same time as the interim "as bid" settlement, and these adjustments have reduced the price disparity and thus the CAISO's exposure to uplift payments. Additionally, Bonneville asserts that alternative solutions would be to cease clearing pre-

⁸ Transmittal letter, July 26 filing, at 13 ("Additionally, implementing alternative options would require the extensive utilization of internal CAISO staff time and resources that are currently scheduled to work on settlement conversion projects and, most importantly, the implementation of MRTU Release 1 by February 2007. Thus, implementation of alternative options would result in the incurrence of significant opportunity costs in terms of having to delay work on these other projects. . . . Given the February 2007 MRTU Release 1 implementation date, neither of these options is desirable").

dispatch bids after determining pre-dispatch for CAISO system needs or to continue to clear pre-dispatch bids, but to pay and charge only the price at which the bids were cleared, without paying uplift to adjust to the eventual real-time price.

19. Bonneville contends that the CAISO has rejected all of its proposed solutions and insists that the only practical remedy is to continue "as bid" settlements until MRTU implementation. Bonneville believes, however, that the relationship between pre-dispatch and the real-time market price is such that, within the total requirement for real-time energy, there is little risk to the CAISO of pre-dispatching more intertie energy than necessary. Bonneville argues that the "as bid" settlement strengthens the incentive for the CAISO to engage in excessive intertie pre-dispatch by reducing the cost of the intertie energy to bid prices.

20. Bonneville states that, although the CAISO filing suggests that Bonneville could shift its real-time bidding to the 5-minute market, there are specific impediments to Bonneville's participation in 5-minute dispatch, including the volatility of real-time prices and the resulting complications for hydro generation operations to provide energy dispatched, inefficient use of network and intertie transmission due to erratic dispatch of energy, and potential exposure to uninstructed deviation penalties.

21. Bonneville argues that the market inefficiency of "as bid" settlement is well established. Bonneville asserts that rather than submit cost-based bids and receive market prices, under pay-as-bid settlements market participants will tend to design their bids to meet their expectations from the market. Bonneville believes that with the relative complexity of the CAISO market, if prices in simpler alternative markets are comparable to bid prices, those simpler markets are administratively preferable, and the CAISO pre-dispatch market becomes an expansion market of last resort. Powerex argues that the CAISO is in need of adequate price signals, and supports Bonneville's arguments.

22. Bonneville contends that the CAISO's weekly reports omit important information.⁹ Powerex believes that the CAISO's weekly reports have provided important information and that the Commission should require the CAISO to continue to submit the reports. In addition, Powerex believes that the Commission should require the CAISO to include in its weekly reports the additional analyses contained in Tables 1 and 2 and Figures 6 and 7 of Attachment C to the instant filing. Powerex also believes

⁹ For example, Bonneville explains that the weekly reports state that the volume of incremental energy bids has not declined and bid prices have not increased. However, Bonneville believes that the reports do not account for the impact of seasonal hydro generation from snow melt and spring rains that occurred around the time the "as bid" settlement was implemented. Bonneville protest at 9.

Figures 6 and 7 should include separate curves for each month starting October 2004. Powerex believes that these weekly reports, including the additional analyses would assist the Commission and market participants in their continuing evaluation of the intertie bidding problems and in working with the CAISO to develop a workable long-term solution.

II. Discussion

A. Procedural Matters

23. The CAISO's July 25 filing was noticed in the *Federal Register*, with protests, comments and motions for intervention due on August 16, 2005.¹⁰ A timely motion to intervene and comments were submitted by the CEOB, and timely comments were submitted by Powerex and Bonneville. CEOB, Powerex and Bonneville are already intervenors in this docket.

24. The CAISO submitted a motion to file an answer to the intervenors' comments, and an answer. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2005), prohibits an answer to a protest unless otherwise permitted by the decisional authority. We are not persuaded to accept the CAISO's answer, and will therefore reject it.

B. Commission Determination

25. The Commission accepts the CAISO's filing to extend the "as bid" settlement rules as a temporary solution to the problem of settling intertie bids to be effective starting October 1, 2005. The CAISO has demonstrated that the "as bid" settlement rules have not adversely affected the quantity of intertie supply offers to date.¹¹ The weekly reports indicate that the volume of incremental energy bids has consistently been higher this year than during the comparable period in 2004.

26. While we have continuing concerns with the potential inefficiencies and difficulties associated with the "as bid" approach, as described by Bonneville and Powerex, we also take note of the CAISO estimates that implementing a pre-dispatch market clearing option (as would be preferred by Bonneville) would take at least 6-8 months and would divert needed resources from implementation of the long-term solution to this problem, the release of MRTU. As stated in our April 7 Order, we expect

¹⁰ 70 Fed. Reg. 46502 (2005).

¹¹ See Twenty-Fourth Weekly DMA Report on Market Impacts of Amendment No. 66, submitted to the Commission in Docket No. ER05-718 on September 23, 2005, at Figure #6.

that the CAISO will be vigilant in monitoring for any unintended consequences that the “as bid” approach may have on its markets.¹²

27. We believe the current weekly reports are sufficient to indicate that the primary concerns associated with the “as bid” approach have not materialized to date.¹³ Nevertheless, we agree with Bonneville and Powerex that the weekly reports, required by the Commission in our April 7 Order,¹⁴ do not provide as complete an analysis of the effects of the “as bid” settlement rules as will be necessary to permit effective monitoring of those effects over the extended period that the CAISO requests. Continuation of the reports, with additional information, will increase the transparency of the CAISO’s implementation of the “as bid” settlement rules. We believe additional transparency of the pre-dispatch costs under the “as bid” settlement rules will provide useful information to market participants forward of real time settlement and be useful in the ongoing monitoring and assessment of market outcomes. The Commission directs the CAISO to make available and publish on its website the average incremental bid price accepted and the average decremental bid price accepted for each hour and applicable zone along with the associated average hourly ex-post price. Additionally, we direct the CAISO to include an expanded analysis in its weekly reports filed with the Commission, as requested by Powerex, beginning with the next weekly report that it files after the date of this order.

28. Lastly, we find that, rather than leaving its current tariff sheets in effect, the CAISO must refile its tariff sheets within 30 days of the date of this order, and state that the “as bid” settlement rules will sunset on the date on which the long-term solution for settling intertie bids is implemented.

The Commission orders:

(A) The CAISO's tariff filing is accepted, as discussed above, effective October 1, 2005.

(B) Within 30 days of the date of this order, the CAISO must refile tariff sheets as discussed above.

¹² See April 7 Order at P 21.

¹³ See, *Id.* at P 21 where the Commission stated that potential unintended consequences, raised by intervenors, might include “(a) whether liquidity of bids at the interties will be diminished, (b) the extent to which the “as bid” policy may cause bidders to change the level of their bids to the expected clearing price, and the resulting effect on the overall costs to customers from both of these possible problems.”

¹⁴ See April 7 Order at P 21.

(C) The CAISO is directed to make available and publish on its website the average incremental bid price accepted and the average decremental bid price accepted for each hour and applicable zone along with the associated average hourly ex-post price.

(D) The CAISO must include an expanded analysis in its weekly reports filed with the Commission, as requested by Powerex, beginning with the next weekly report that it files after the date of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.