146 FERC ¶ 61,183
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Acting Chairman;
Philip D. Moeller, John R. Norris,
and Tony Clark.

Indicated CAISO Suppliers | Docket No. ER14-1428-000

ORDER DENYING WAIVER

(Issued March 14, 2014)

1. On March 4, 2014, the Indicated CAISO Suppliers (Suppliers)[1] submitted an emergency request for temporary waiver of the California Independent System Operator Corporation (CAISO) tariff in order to require CAISO to reimburse generators for the costs of natural gas procured in response to CAISO dispatch directives. The reimbursement provisions would include the costs of disposing of natural gas when CAISO later elects not to dispatch units for which natural gas was procured. As discussed below, the Commission denies the requested waiver.

I. Background and Details of the Filing

2. Suppliers explain that the CAISO tariff offers two options for calculating start-up and minimum load costs in the day-ahead market, either the "proxy cost option" or the "registered cost option."[2] For resources under the proxy cost option, as part of the

[1] The Indicated CAISO Suppliers are power marketers and generators participating in the California energy market, which include: NRG Companies (NRG Power Marketing LLC, GenOn Energy Management, LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Energy Center LLC, El Segundo Power, LLC, NRG Delta LLC, NRG Marsh Landing LLC, NRG California South LP, High Plains Ranch II, LLC, Long Beach Generation LLC, NRG Solar Alpine LLC, NRG Solar Borrego I LLC, NRG Solar Blythe LLC, and NRG Solar Roadrunner LLC); Dynegy Companies (Dynegy Marketing and Trade, LLC and Dynegy Morro Bay, LLC); CalPeak Entities (CalPeak Power LLC, CalPeak Power-Panoche LLC, CalPeak Power-Vaca Dixon LLC, CalPeak Power-Enterprise LLC, and CalPeak Power-Border LLC); La Paloma Generating Company, LLC; and Shell Energy North America (US).

[2] CAISO tariff section 30.4.

calculation for start-up and minimum load costs, CAISO calculates the natural gas price by using at least two prices from two or more stated natural gas price indexes.[3] Suppliers explain that because, under its tariff, CAISO calculates the gas price using index prices that are published on the day before the gas flow day, there is a lag of at least two days relative to the actual price on the day when the unit will be dispatched. This lag is even greater on intervening days (e.g., weekends) when price indices are not published.[4]

3. Suppliers argue that the proxy cost methodology leaves the generator completely unprotected during times of rapidly rising natural gas prices. During these times, generators are required to make offers with start-up and minimum load costs that are based on a natural gas price that lags at least two days behind the increase. Under these conditions, CAISO's dispatch algorithm sees the generator as having start-up and minimum load costs significantly below its actual costs. According to Suppliers, CAISO will then commit resources at minimum load but is unlikely to dispatch them beyond this level. Suppliers argue that because generators are least efficient at minimum load, CAISO's methodology causes unnecessary stress on California's natural gas system and leaves generators unable to recover all of their fuel costs. Similarly, Suppliers assert that the registered cost option provides no protection against unexpected natural gas price increases of more than 150 percent relative to the resources' registered costs for that 30-day period.[5]

4. Suppliers explain that the lag in the calculated natural gas price described above also can occur when CAISO determines that a transmission constraint is non-competitive and dispatches a generating unit according to its default energy bid. Suppliers assert that during recent gas curtailment events many gas-fired generators were dispatched according to default energy bids that used natural gas price data that was well below their actual natural gas costs.[6]

5. Suppliers further assert that due to simultaneous gas transmission and distribution system operational constraints, California's gas utilities have imposed stringent restrictions on the amount of balancing service available to gas-fired generators and if resources violate these restrictions, they can be liable for penalties of up to $100/MMBtu. Suppliers argue that California generators have been exposed to massive swings in gas prices and have had to procure gas on short notice, without any assurance that they will be paid by CAISO for their actual costs of production. According to Suppliers, increased

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[3] *Id.* section 39.7.1.1.1.3.

[4] Suppliers transmittal at 6-8.

[5] *Id*. at 9.

[6] *Id.*

gas prices have caused California generators to incur millions, likely tens of millions, of dollars in unrecoverable natural gas costs this winter.[7]

6. Moreover, Suppliers note that CAISO's intended tariff waivers are inadequate because they: (1) would not fully eliminate the time lag; and (2) would do nothing to make generators whole when they acquire natural gas after being committed by CAISO in the day-ahead market and are then de-committed by CAISO the following day.[8]

7. Suppliers urge the Commission to grant waiver of the CAISO tariff as necessary to allow gas-fired generators to bill CAISO for make-whole payments to cover shortfalls in cost recovery when their actual natural gas costs is above what the proxy cost or registered cost methodology or default energy bids would permit them to recover (i.e., actual gas costs that are currently un-recoupable under CAISO's tariff). Notably, Suppliers request that any waiver granted by the Commission should provide for make-whole payments when generators procure natural gas in response to CAISO's dispatch instructions but then must dispose of the gas after CAISO de-commits those generators.[9]

8. Suppliers state that their requested waiver is of limited scope, remedies a concrete problem, and does not have undesirable consequences.[10] Suppliers assert that the waiver would only apply from the date of the Commission's order until March 31, 2014 and only seeks relief in the form of permitting make-whole payments. Further, Suppliers assert that the waiver addresses the concrete problem of generators being required to provide services needed to ensure reliability while operating at a loss.[11] They also contend that their requested waiver does not have undesirable consequences, such as harming third parties. They argue that their request is consistent with the Commission's findings in the orders granting tariff waivers for PJM Interconnection, L.L.C. (PJM) and New York

[7] *Id*. at 13-15.

[8] On March 6, 2014, CAISO filed two requests for waivers of its tariff provisions with the Commission to address the effect natural gas price volatility on natural gas-fired generators ability to recover their costs in CAISO's markets. *See* California Independent System Operation Corporation, Petition for Limited Waiver of Tariff Provisions and Request for Next-Day Commission Action, Docket No. ER14-1442-000 and California Independent System Operator Corporation, Petition for Limited Waiver of Tariff Provisions, Request for Shortened Comment Period, and Request for Expedited Commission Action by March 19, 2014, Docket No. ER14-1440-000.

[9] Suppliers transmittal at 16-18.

[10] *Id.* at 19.

[11] *Id.*

Independent System Operator (NYISO). Suppliers argue that in these orders, the Commission granted cost recovery for generators in those respective markets,[12] upon finding that there was no legitimate claim of cognizable harm to customers arises from permitting generators to recover their actual fuel costs, even if such recovery increases the costs borne by customers.[13]

II. Notice and Responsive Pleadings

9. Notice of Suppliers' filing was published in the *Federal Register*, 79 Fed. Reg. 14,243 (2014), with interventions and protests due on or before March 11, 2014. Timely motions to intervene were filed by Calpine Corporations; Northern California Power Agency; California Public Utilities Commission; City of Santa Clara, California; California Department of Water Resources State Water Project; Modesto Irrigation District; Cogeneration Association of California; Powerex Corp.; and; Sunrise Power Company. Comments and protests were filed by Pacific Gas and Electric Company (PG&E); Edison Mission Energy; CAISO; Southern California Edison Company (SoCal Edison); Public Citizen, Inc., Utility Reform Network, and National Consumer Law Center (Public Citizens); NRG Companies and Dynegy Companies (NRG/Dynegy); Morgan Stanley Capital Group Inc. (Morgan Stanley); Electric Power Supply Association and Independent Energy Producers Association (Electric Power Supply/Independent Energy Producers); High Desert Power Project (High Desert); and Western Power Trading Forum (Western Power). A motion for late intervention was submitted by the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (Six Cities).

Comments and Protests

10. Several commenters filed in support of the waiver request. NRG/Dynegy contend that, under this waiver, suppliers would be made whole for the costs of natural gas procured in response to CAISO's dispatch directives, which they argue is similar to the waivers granted by the Commission in *PJM* and *NYISO*. Electric Power Supply/Independent Energy Producers, Edison Mission Energy and High Desert provide similar arguments in support of Suppliers' waiver request.[14]

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[12] *See id*. (citing *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,041, at P 41 (2014) (*PJM*); *New York Independent Operator*, *Inc.*, 146 FERC ¶ 61,061, at P 20 (*NYISO*).

[13] Suppliers transmittal at 19-20.

[14] Electric Power Supply/Independent Energy Producers at 7-10, Edison Mission Energy at 1-2, High Desert at 4.

11. Electric Power Supply/Independent Energy Producers also support the waiver regardless of any waiver that may be granted to CAISO. They contend that CAISO's petitions do little to alleviate the specific problems Suppliers' filing seeks to remedy. They argue that generators should be allowed to recover their costs when market rules and directives to support system reliability force generators to operate at a loss. As such, they argue that the Commission should approve Suppliers' request for individual cost-based make-whole opportunities to both complement the CAISO waivers and to protect against situations that are not addressed at all by the proposal in the CAISO waivers. Electric Power Supply/Independent Energy Producers further argue that while granting the requested waiver will result in temporary relief, the Commission should continue to pursue market-based solutions to ensure price formation and reliability.[15]

12. Morgan Stanley also notes that although the lagging price indices used by CAISO to determine generators' start-up and minimum load costs may reflect a significant price spike in the days following a spike, CAISO is unlikely to commit natural gas-fired generators at the same levels once the price spikes are reflected in those indices. They claim that this would result in incongruence between costs incurred and ultimate compensation for the generators. Morgan Stanley suggests that a revision of CAISO's market rules is the most appropriate solution.[16]

13. Similarly, Western Power asserts that Suppliers' request would assure that, when CAISO makes a decision to commit and run facilities at minimum load, suppliers will not experience a loss of revenue during that commitment period as a result. Western Power argues that the quid pro quo for resource owners turning over commitment decisions to automated commitment processes is that, when CAISO chooses to commit a unit, it guarantees that the unit will not lose money as a result.[17]

14. Several commenters recommend that the Commission reject the waiver request. CAISO, PG&E, and SoCal Edison contend that the waiver request should be rejected because it is overly broad, does not seek waiver of any section of the CAISO tariff, and proposes an undefined process for reimbursing undefined costs.[18]

15. CAISO notes that the CAISO tariff provides for direct recovery of fuel costs associated with fuel actually used in production as well as gas transportation. However, by allowing an open-ended proposal to bill CAISO for any 'gas procurement' expenses,

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[15] Electric Power Supply/Independent Energy Producers at 3-4.

[16] Morgan Stanley at 6-9.

[17] Western Power at 3-4.

[18] CAISO at 14-15, PG&E at 4-5, SoCal Edison at 3.

generators would be permitted to receive guaranteed recovery for types of costs that are not directly related to cost recovery currently allowed in the tariff. CAISO further contends that given the ambiguity of the waiver request, it is not clear exactly what costs could be billed to CAISO, but that presumably these costs would include gas imbalance charges and other costs. Finally, CAISO argues the waivers granted in *PJM* and *NYISO* are distinct from this waiver because they allowed costs already approved under the PJM and NYISO tariffs to be recovered through existing mechanisms, while Suppliers' proposed waiver seeks recovery of costs well beyond the existing CAISO tariff. CAISO states that Suppliers are within their rights to dispute the justness and reasonableness of the CAISO tariff, but assert that it should be done through sections 205 and 206 of the Federal Power Act.[19]

16. SoCal Edison and PG&E contend that the waiver fundamentally changes the question of which parties bear the risk in the unit commitment process. They argue that the waiver results in a non-symmetric remedy because, if a generator, as a result of changing dispatch instructions, purchases gas and then resells it at a profit, there is no mechanism for the generator to refund the CAISO the benefit of the price change.[20] Moreover, CAISO and PG&E note that the waiver would not improve dispatch issues associated with lagged gas price indices.[21] CAISO contends that market distortions and gaming opportunities would be likely present when generators are committed on one set of costs and paid by CAISO for a separate set of costs. CAISO further contends that the current waiver would undermine gas system reliability by allowing generators to recover pipeline penalties.

17. CAISO comments that it has already committed to a stakeholder process to address commitment cost compensation issues for generators, including issues of gas-related costs. The process will begin in April and an interim solution could be implemented as early as this fall.[22]

18. Public Citizens argue that the Commission should reject the waiver request because it inequitably favors certain suppliers while profoundly disadvantaging end use consumers. They further assert that the waiver request shields suppliers from risk associated with rising natural gas prices while concurrently preserving their benefits should prices decline. It notes that the gas price spike on February 6 was immediately followed by a large decrease in gas prices. According to Public Citizens, this unfairly

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[19] CAISO at 14-15.

[20] SoCal Edison at 3, PG&E at 4.

[21] PG&E at 4-5.

[22] CAISO at 6.

shifts risk from suppliers to end consumers while guaranteeing no tangible benefits for end consumers in return. Public Citizens also contends that various affiliates of Suppliers are major gas producers who enjoy stronger profits from increased natural gas prices and participate as sophisticated energy price hedgers.[23]

III. Discussion

A. Procedural Matters

19. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[24] the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure,[25] the Commission will grant Six Cities' late-filed motions to intervene given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

B. Substantive Matters

20. The Commission has previously granted requests for waivers of tariffs in situations where: (1) the waiver is of limited scope; (2) a concrete problem must be remedied; and (3) the waiver does not have undesirable consequences, such as harming third parties.[26] As discussed below, we will deny Suppliers' waiver request because it does not meet the Commission's requirements for granting waiver of a tariff.

21. Suppliers make two requests in their filing. First, they request that the Commission grant waiver of the CAISO tariff to allow generators to apply to CAISO for make-whole payments to cover shortfalls in cost recovery resulting from the application of the proxy cost or registered cost methodology, or default energy bids. Second, they request that the Commission "grant a waiver of the CAISO [t]ariff provisions to allow

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[23] Public Citizen at 2.

[24] 18 C.F.R. § 385.214 (2013).

[25] 18 C.F.R. § 385.214(d) (2013).

[26] *See, e.g.*, *New York Indep. Sys. Operator, Inc.*, 139 FERC ¶ 61,108, at P 14 (2012); *PJM Interconnection, L.L.C.*, 137 FERC ¶ 61,184, at P 13 (2011); *ISO New England Inc.*, 134 FERC ¶ 61,182, at P 8 (2011); *California Indep. Sys. Operator Corp.*, 132 FERC ¶ 61,004, at P 10 (2010); *accord ISO New England Inc. – EnerNOC, Inc.*, 122 FERC ¶ 61,297 (2008); *Central Vermont Public Service Corp.*, 121 FERC ¶ 61,225 (2007); *Waterbury Generation LLC*, 120 FERC ¶ 61,007 (2007); *Acushnet Co.*, 122 FERC ¶ 61,045 (2008).

natural gas-fired generators to bill the CAISO for their actual gas procurement and disposal costs that are currently unrecoupable under the CAISO's existing [t]ariff provisions."[27]

22. We find that Suppliers' proposal is overly broad in scope and does not meet the Commission's requirements for a tariff waiver. Specifically, Suppliers' request does not identify specific provisions of the CAISO tariff for which they seek waiver. Rather, Suppliers' waiver request seeks broad revisions of the CAISO tariff that appears to incorporate significant changes to the CAISO current market rules. Thus, we find that Suppliers' requested waiver is not of limited scope. For these reasons, we find that this waiver request does not comply with the Commission's requirements for granting a waiver.

23. We note that we are issuing concurrently an order granting a limited waiver of the CAISO tariff provisions that is intended to address natural gas pricing spikes on a short-term basis in Docket No. ER14-1442-000. We also note that CAISO has committed to conduct a stakeholder process starting this April that will focus on developing long-term solutions to problems resulting from natural gas price spikes. Many commenters note that part of the recent pricing problems result from inefficient dispatch of units because, as a result of using outdated data to compute natural gas prices that should reflect actual costs, start-up and minimum load costs appear inexpensive relative to energy bids. Other commenters note that the pricing problem could be resolved if CAISO's market allowed generators to bid their gas costs on a daily basis, subject to demonstration of actual costs. We encourage Suppliers, CAISO, and CAISO's stakeholders to consider revisions to the CAISO tariff regarding the issues.

<u>The Commission orders</u>:

Suppliers' request for waiver is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[27] Suppliers transmittal at 16.