

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

California Independent System Operator

Docket No. ER06-354-000
EL06-44-000

ORDER ACCEPTING AND MODIFYING TARIFF FILING AND
INSTITUTING A SECTION 206 PROCEEDING

(Issued January 13, 2006)

1. On December 21, 2005, the California Independent System Operator Corporation (CAISO) filed a tariff amendment (Amendment No. 73) proposing to change its current “soft” \$250/MWh bid cap for real-time energy bids and adjustment bids to a “hard” \$400/MWh bid cap, effective January 1, 2006 or as soon thereafter as possible. The CAISO asked the Commission to review its application on an expedited basis with a shortened comment period. In this order, the Commission accepts with modification, as described below, the CAISO’s proposed tariff amendment, effective upon issuance of this order.

2. To remove any opportunity for market distortions created by the Commission’s approval of an increase in the CAISO bid cap, we will institute, under section 206 of the Federal Power Act (FPA),¹ an investigation into the price cap in the WECC outside the CAISO. We also institute a section 206 investigation into the CAISO ancillary service capacity bid cap, in order to consider whether any incentives that distort a supplier’s choice between offering energy or ancillary services will result from the rise in gas prices and the increase in the CAISO energy bid cap. We hereby establish a refund effective date pursuant to the provisions of section 206.

¹ 16 U.S.C. § 824e (2000).

Background

The CAISO's Filing

3. The CAISO filed Amendment No. 73 requesting that the Commission accept its tariff revision altering the CAISO's current bid cap. Section 28 of the CAISO tariff establishes a bid cap that sets a limit on the level of bids submitted for the CAISO's energy and ancillary service capacity markets. According to the CAISO, this bid cap also applies to adjustment bids used in the day-ahead and hour-ahead congestion management markets. Amendment No. 73 proposes to modify section 28.1.2 to replace the current "soft" bid cap² of \$250/MWh for real-time energy bids and adjustment bids with a "hard" bid cap of \$400/MWh.³ The CAISO states that its proposal to change its bid cap from "soft" to "hard" is consistent with the Commission's directive that it change its bid cap to a "hard" cap when it implements the Market Redesign and Technology Upgrade (MRTU).⁴ It does not propose to change the bid cap for ancillary services markets from the current "soft" \$250/MWh cap.

4. The CAISO states that on November 9, 2005, in response to a request from its Department of Market Monitoring (DMM), the CAISO's Market Surveillance Committee (MSC)⁵ recommended that the bid cap on the real-time energy market be increased prior to this winter, because "the likelihood of substantially higher natural gas prices during the winter of [2006] is sufficiently high to justify raising the bid cap at this time" in order to avoid "the risk of generation unit-level variable costs approaching or rising above the

² Section 28.1.1 of the CAISO's tariff currently permits market participants to submit bids above the cap, but any accepted bids above the cap are not eligible to set the market clearing price and are subject to cost justification and refund. A "soft" cap is one where market participants may submit bids above the bid cap with adequate justification, but without setting the market clearing price.

³ A "hard" cap is one where market participants' bids are not permitted to exceed the cap, regardless of the seller's costs.

⁴ *California Independent System Operator Corp.*, 112 FERC ¶ 61,013 at P 104 (2005) (July 2005 Order), *reh'g pending*.

⁵ The CAISO's website notes that the MSC is an independent advisory group of industry experts who can suggest changes in rules and protocols to the CAISO Governing Board, MSC Description, *available at* <http://www.aiso.com/docs/2005/10/04/200510041051301081.html> (last visited Jan. 9, 2006).

[current \$250/MWh] cap level.” The MSC recommended a new level of \$400/MWh, based on its analysis of average values of Henry Hub futures prices for the upcoming winter.⁶ The CAISO further notes that the DMM prepared a memorandum supporting the MSC’s recommendation, citing changed market conditions and the significant benefits to the California energy markets that would result from raising the real-time energy bid cap under current market conditions.⁷ The CAISO asserts that the DMM further recommended that the bid cap for adjustment bids used in day-ahead and hour-ahead congestion management markets be increased to \$400/MWh, with the bid cap for ancillary services remaining at \$250/MWh.⁸

5. The CAISO requested that, pursuant to section 35.11 of the Commission’s regulations,⁹ the Commission waive its notice requirements for Amendment No. 73. The CAISO states that good cause exists for this waiver because acceptance of a January 1, 2006 effective date will permit the California energy markets to realize the benefits

⁶ See *Raising the Level of the Bid Cap on the Real-Time Energy Market in California*, Market Surveillance Committee, Nov. 9, 2005 (MSC Recommendation Paper). According to the CAISO, the MSC also notes that gaining some experience with the current market design and a higher bid cap would be a preferred strategy for transitioning in the future to a \$500/MWh bid cap. MSC Recommendation Paper at 5-6.

⁷ See *Memorandum of Keith Casey*, Department of Market Monitoring, Dec. 9, 2005 (DMM Memorandum). According to the CAISO, the DMM Memorandum enumerates a number of reasons for raising the bid cap, including: (1) promoting reliability by providing greater fixed-cost recovery for generating units during high demand periods when supply margins are tight and prices are at or near the bid cap; (2) providing greater incentives for load-servicing entities (LSEs) to continue to minimize their spot market exposure for signing additional long-term power contracts; (3) providing greater incentives for generation owners to maintain their units at a high level of availability; (4) providing greater incentives for further development of demand response programs such as real-time pricing; (5) if gas prices escalate over the winter months, a higher bid cap will not discourage suppliers from selling into the California real-time energy markets since such suppliers would be assured of bid cost recovery for accepted bids above \$250/MWh; and (6) providing a measured transition to the \$500/MWh energy bid cap scheduled to be implemented with the CAISO’s new market design in 2007.

⁸ The CAISO Amendment No. 73 Filing, Dec. 21, 2005 (citing DMM Memorandum at 5) (The CAISO Amendment No. 73 Filing).

⁹ 18 C.F.R. § 35.11 (2005).

described above as quickly as possible to address the substantial increase in natural gas prices that may potentially occur in the winter 2006. It also states that the January 1 date will assist in implementation of the bid-cap change in the CAISO settlements process and will permit interested stakeholders time to comment on this proposal on an expedited basis.

6. The CAISO requested expedited tariff revision procedures under the Commission's Expedited Tariff Revisions Guidance Order.¹⁰ It asserts that Amendment No. 73 satisfies the requirements of the Expedited Tariff Revisions Guidance Order because the amendment is intended to remedy the risk that the CAISO real-time energy market may not be able to attract sufficient supply bids to maintain system reliability, particularly from resources outside of the CAISO Control Area due to significant increases in variable operation costs. The CAISO states that it has posted the filing on its website and sent an email notification to each market participant as is required by the Expedited Tariff Revisions Guidance Order.

7. Finally, the CAISO requested a shortened comment period of December 28, 2005 for Amendment No. 73. It states that this shorter comment period will allow the Commission to issue an order prior to the requested January 1, 2006 effective date.

Bid Cap Background

8. In a July 2002 Order,¹¹ the Commission established a bid cap of \$250/MWh for the California real-time energy and ancillary services markets, to become effective on October 1, 2002, as recommended by the CAISO's MSC. The Commission also applied this bid cap to day-ahead markets when implemented by the CAISO. The July 2002 Order also imposed a price cap of \$250/MWh for all spot market sales in the Western Electricity Coordinating Council (WECC), beginning October 1, 2002.¹²

¹⁰ *Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,009 (2005).

¹¹ *California Independent System Operator Corp.*, 100 FERC ¶ 61,060 (July 2002 Order), *order on reh'g*, 101 FERC ¶ 61,061 (2002).

¹² *Id.* The Commission extended the October 1, 2002 deadline to October 30, 2002 in a subsequent order. *California Independent System Operator Corp.*, 100 FERC ¶ 61,351 (2002).

9. On October 11, 2002, the Commission issued an order on rehearing and compliance filing.¹³ The October 2002 Order clarified that sellers may continue to submit bids above the bid cap with the understanding that such bids cannot set the market clearing price and that these bids above the cap will be subject to justification and refund.¹⁴

10. On July 1, 2005, the Commission issued an order finding that the bid cap for California market energy bids should be increased to a hard \$500/MWh cap on day one of MRTU implementation.¹⁵ The July 2005 Order reaffirmed that the bid cap for ancillary services and Residual Unit Commitment (RUC) availability should remain at \$250/MWh.¹⁶

Notice of Filing and Responsive Pleadings

11. Notice of the CAISO's December 21, 2005 filing was published in the *Federal Register*, 71 Fed. Reg. 98 (2006), with interventions and protests due on or before January 3, 2006. Southern California Edison Company (SCE), Sacramento Municipal Utility District (SMUD), the Northern California Power Agency (NCPA), Modesto Irrigation District (MID), the Mirant Parties,¹⁷ and the California Department of Water Resources State Water Project filed motions to intervene. Williams Power Company, Inc. (Williams), Powerex Corp. (Powerex), Portland General Electric Company (Portland), Pacific Gas and Electric Company (PG&E), the Indicated Parties,¹⁸ and Alliance for Retail Energy Markets (AREM) filed motions to intervene and comments.

¹³ *California Independent System Operator Corp.*, 101 FERC ¶ 61,061 (2002) (October 2002 Order).

¹⁴ *Id.* at P 17.

¹⁵ July 2005 Order, 112 FERC ¶ 61,013 at P 104.

¹⁶ *Id.* at 111 (reaffirming the Commission's October 2003 and June 2004 orders which determined that the bid caps for ancillary services and RUC availability should be \$250/MWh. See *California Independent System Operator Corp.*, 105 FERC ¶ 61,140, *reh'g denied*, 105 FERC ¶ 61,278 (2003); *California Independent System Operator Corp.*, 107 FERC ¶ 61,274, *order on reh'g*, 108 FERC ¶ 61,254 (2004)).

¹⁷ The Mirant Parties consist of Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC.

¹⁸ The Indicated Parties consist of Avista Energy, Inc., Puget Sound Energy, Inc., Coral Power, L.L.C., and Sempra Energy.

California Electricity Oversight Board (CEOB) filed a motion to intervene with comments supporting the CAISO's filing but made no other comments. Independent Energy Producers Association (IEP) filed a motion to intervene out-of-time and comments. City of Santa Clara, California (SVP) and Public Service Company of New Mexico (PSNM) filed motions to intervene and protests. The CAISO filed an answer on January 5, 2006.

Raising CAISO Bid Cap

12. PG&E, AReM, and Powerex generally support the CAISO's proposal. AReM states that the CAISO's proposal is rational and reasonable and has been sufficiently justified by the CAISO. AReM notes that the risk of electricity supply shortfalls in California remains high, particularly during the summer of 2006, and that given the dramatic increases in natural gas costs that have occurred over the past year, the current \$250/MWh bid cap raises the risk of generator bid costs exceeding the current bid cap level. AReM cautions that this interim increase in the cap by the CAISO, however, should not be perceived to mitigate the necessity for the further "hard" bid cap increases mandated by the Commission.¹⁹ Powerex cautions that it is important for the CAISO and the Commission to continue to give careful consideration in determining the bid cap levels associated with the various markets so that (1) there is a demonstrated need for the mitigation, and (2) the mitigation levels do not negatively impact the efficient operation of the market or the reliable operation of the grid both in California and West-wide. PSNM, SVP, Portland, and Williams support or do not oppose²⁰ the CAISO's proposal to raise the bid cap to \$400/MWh. No intervenor opposed the CAISO's proposal to raise the bid cap level.

"Hard" vs. "Soft" Bid Cap

13. PSNM, SVP, Portland, and Williams oppose changing the CAISO's bid cap from a "soft" to a "hard" cap.

¹⁹ See July 2005 Order, 112 FERC ¶ 61,013 at P 104.

²⁰ PSNM states it takes no explicit position regarding whether the \$400/MWh bid cap selected by the CAISO is optimal or constitutes a sufficiently high price to eliminate risks of supply shortfalls, but agrees in principle with the CAISO's conclusion that higher natural gas prices necessitate an increase in the existing \$250/MWh bid cap. Williams cautions that its comments in support of the CAISO's proposal should not be construed as an endorsement of price caps as it remains opposed to price caps for a number of reasons.

14. PSNM argues that although the Commission has directed the CAISO to replace the existing “soft” cap with an escalating “hard” cap starting in 2007, concurrent with implementation of the CAISO’s MRTU, it would be unjust and unreasonable to implement a “hard” cap, particularly on such short notice, while still retaining the current market design structure. PSNM notes that, in our July 2005 Order, the Commission did not authorize adoption of a “hard” cap as part of the current market structure or otherwise suggest that the CAISO needs to or should adopt a “hard” bid cap prior to adoption of the MRTU in 2007. PSNM contends that implementing a “hard” cap now, at the proposed \$400/MWh level, would limit suppliers’ ability to recover their substantiated costs if congestion costs and natural gas prices cause the competitive market price to exceed \$400/MWh, thereby creating a risk of supply curtailments. PSNM points out that if, as the CAISO claims, the \$400/MWh price it has selected is unlikely to be exceeded during the one year period prior to adoption of the MRTU, then retention of the “soft” cap should be of little concern. By contrast, PSNM argues, if the CAISO’s estimation of the market price produced by higher natural gas prices is incorrect, and actual prices exceed the \$400/MWh level, the effect on California markets could be severe.

15. SVP argues that the CAISO’s proposal to change from a “soft” cap to a “hard” cap is not supportable. They assert that the three CAISO departmental reports attached to the filing in support of the proposal recommended an increase to a \$400/MWh “soft” cap, not a “hard” cap. SVP argues that the CAISO’s studies conclude that, with current gas prices projected between \$10 and \$12 per Mcf, a “soft” cap of \$400/MWh is roughly equivalent to the \$250/MWh “soft” cap implemented when gas costs were approximately three to four dollars per Mcf. SVP contends that the CAISO studies do not provide any rationale to support a change from a “soft” cap to a “hard” cap, and in fact, assert that a \$400/MWh “soft” cap is necessary to maintain the *status quo*. According to SVP, the CAISO’s Board of Governors’ resolution changed the CAISO’s departmental recommendations to a “hard” cap without explanation or analysis. SVP points out that the CAISO’s only comment on the change is that the Commission required the CAISO to change to a “hard” cap once MRTU is implemented, and that implementing a “hard” cap now will ease the transition to a \$500/MWh “hard” cap when MRTU is implemented in 2007. According to SVP, without the structural changes MRTU is expected to bring about, there is no justification for the change to a “hard” cap, and the CAISO fails to justify any present need for a “hard” cap versus a “soft” cap and does not address the potential consequences of the change. SVP further argues that the escalation in natural gas prices and the recent bankruptcy filing of Calpine Corporation further strain the market and risk contributing to a shortfall of energy in California.

16. Portland argues that the “hard” nature of the new bid cap proposal does not adequately promote a transparent and workable market with the appropriate application of constraints and oversight. Specifically, Portland argues that a hard cap would force the CAISO to resort to out-of-market (OOM) purchases to acquire capacity resources when market prices within the CAISO market exceed the cap. By definition, according to

Portland, such OOM purchases would involve capacity and associated pricing that would not be offered to all market participants in real time, and thus do not promote an efficient, transparent, and workable market. In contrast, Portland argues that a “soft” cap would achieve that goal because the current “soft” cap methodology provides a ceiling that market participants may not exceed without: (1) demonstrating that their costs justify a higher bid; and (2) being subject to refund.

17. Williams similarly requests that the Commission reject the proposal to change the bid cap from a “soft” to a “hard” cap. Williams submits that the same concerns that resulted in the current “soft” cap continue to exist. Specifically, Williams expresses the concern that should fuel prices continue to rise, its operating costs may exceed \$400/MWh, and with the must-offer obligation still in place, it may be required to operate at a loss. Williams states that the CAISO seems to base its proposal for a “hard” cap on the Commission’s directive in a separate proceeding to replace the current “soft” bid cap with a “hard” bid cap when the CAISO’s MRTU market design is implemented.²¹ However, Williams argues, the environment under which a generator will operate when MRTU is implemented will be significantly different than today’s environment,²² and accordingly the CAISO’s attempt to justify the imposition of a “hard” cap at this time, by comparing the proposed cap with the initial MRTU “hard” cap of \$500/MWh, is misplaced.

Price Cap in the WECC Outside the CAISO

18. Powerex and Indicated Parties contend that the CAISO-proposed bid cap increase should be applied throughout the West in order to prevent artificial distortions in the electricity markets that could result from different price caps between regions. They note that the expected increases in natural gas prices in the winter of 2006 will affect not only the CAISO markets, but all electricity markets in the West. As Indicated Parties further state, the West-wide market power mitigation program was established to meet the same

²¹ See The CAISO Amendment No. 73 Filing at 5 (citing July 2005 Order, 112 FERC ¶ 61,013 at P 104 (2005)).

²² Williams notes that the “hard” cap directed by the Commission under MRTU is initially set at \$500/MWh and ultimately increases to \$1,000/MWh (a structure that Williams points out was approved by the Commission prior to the recent run-up in fuel prices), the must-offer obligation will not exist under MRTU as it does today, and the California Public Utility Commission’s (CPUC) resource adequacy requirement should be in place when MRTU is implemented, resulting in less reliance by load on the CAISO’s real-time market.

goals as the CAISO market power mitigation, namely to address market power concerns without undermining incentives for new entry and long-term adequacy. Therefore, according to Indicated Parties, until the Commission releases the western markets from the temporary mitigation program, the West-wide price cap should be no less than the bid cap for the CAISO market. Indicated Parties request that the Commission take action under FPA section 206 to ensure that any elevation in the bid cap applicable to the CAISO markets is matched by an identical elevation in the price cap applicable to the remainder of the WECC. Powerex and Indicated Parties support the increase of the West-wide price cap to \$400/MWh.

19. The Indicated Parties further assert that the Commission should hold that the bid cap in the non-California portion of the WECC will be a “soft” cap that permits cost justifications for sales above the level of the cap, and not a “hard” cap as the CAISO has proposed for its markets. They argue that if natural gas prices move even higher than their current levels, a “hard” cap of \$400/MWh may not be sufficient to ensure full cost recovery for some generators. They assert that a “soft” cap at least permits generators to sell at prices above the cap as long as they can justify their elevated prices. Indicated Parties also request that the Commission clarify the type of documentation that sellers need to supply to justify prices above the applicable bid cap. According to Indicated Parties, this clarification will reduce the possibility of artificial constraints by making it easier for sellers with incremental costs above the level of the cap to decide whether to contribute their output into the market.

Ancillary Services

20. Powerex states that the cap on ancillary service capacity bids should be increased to \$400/MWh. It asserts that neither the CAISO nor MSC has offered any reason for the failure to raise this bid cap. According to Powerex, different bid caps for energy and ancillary services could potentially distort electricity markets since not all possible markets scenarios can be foreseen.

Effective Date

21. SVP asserts that the CAISO violated the FPA by making an unauthorized tariff change. SVP states that the CAISO filed its proposed Amendment 73 on December 21, 2005, and requested expedited consideration in order to implement the proposal on January 1, 2006.²³ SVP notes that on December 22, 2005, the Commission established a

²³ See CAISO Amendment No. 73 Filing.

comment date of January 3, 2006, for protests and interventions, and did not authorize a January 1, 2006 effective date.²⁴ According to SVP, despite the Commission's absence of approval, the CAISO announced its intention to make the proposed "hard" cap effective on January 1, 2006.²⁵ SVP states that the CAISO has no authority to unilaterally implement tariff changes before the Commission approves the changes. It states that the Commission should not tolerate such actions which violate the filed rate doctrine.²⁶ SVP states that the CAISO's unauthorized change in the tariff could cause bids to be rejected or could cause sellers to choose not to bid.

Discussion

Procedural Matters

22. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to these proceedings. We will accept IEP's motion to intervene because it will not be prejudicial at this early stage in the proceeding.

23. 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 ordered by the decisional authority. We will accept the CAISO's answer because it has provided information that assisted us in our decision-making process.

²⁴ *California Independent System Operator Corp.*, Notice of Filing, Docket No. ER06-354-000, Dec. 22, 2005.

²⁵ See CAISO Market Notice, Dec. 27, 2005.

²⁶ See FPA sections 205(c), 16 U.S.C. § 824d(c) (2000), and 206 (a), 16 U.S.C. § 824e(a) (2000); see also *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 581 (1981) (explaining that "under the filed rate doctrine, the Commission alone is empowered to [accept proposed rate filings], and until it has done so, no rate other than the one on file may be charged."); *Williams Power Co. v. California Independent System Operator Corp.*, 110 FERC ¶ 61,231 at P 18, *clarification denied*, 111 FERC ¶ 61,348 (2005) (explaining that "[i]f the CAISO believes that additional tariff provisions are necessary to maintain operational control of its system and to minimize operating costs, it must request prior Commission authorization of the proposed tariff changes.").

24. IEP failed to file a timely Statement of Issues as required by Order No. 663.²⁷ Order No. 663 applies to all pleadings, including protests and comments,²⁸ and requires that any issues that a movant wishes the Commission to address must be specifically identified in a section entitled “Statement of Issues” that must list each issue presented to the Commission in a separately enumerated paragraph that includes representative Commission and court precedent on which the party is relying. Any issues not so listed in a separate section will be deemed to have been waived. Order No. 663 became effective September 23, 2005. IEP’s late motion to intervene and comments, filed on January 4, 2006, omitted the Statement of Issues. For this reason, we deem IEP to have waived the issues in its comments. While Indicated Parties did include a “Statement of Issues,” any issue not specifically identified by Indicated Parties in their “Statement of Issues” is deemed waived.

Commission Determination

CAISO Bid Cap

25. The current \$250/MWh “soft” bid cap in the CAISO’s energy market was established in October 2002 when natural gas prices were between \$3 and \$4/MMBtu. As the CAISO noted in its filing, in recent months, concerns over tight natural gas supplies have resulted in high and volatile natural gas prices throughout the country. Natural gas spot prices in California recently reached as high as \$14/MMBtu.²⁹ Since natural gas is the fuel source for a significant portion of generation used to meet California load, this price rise and volatility led the CAISO to have concerns that the current level of the bid cap may constrain the CAISO’s ability to acquire sufficient power in real time. Given the current market design, which includes a must-offer obligation and a \$250/MWh cap on energy, the Commission is concerned that generators may not have the opportunity to adequately recover their costs. We note that no intervenor has opposed the increase, and find that raising the bid cap is justified by the well-documented rise in

²⁷ *Revision of Rules of Practice and Procedure Regarding Issue Identification*, Order No. 663, 70 Fed. Reg. 55,723 (Sept. 23, 2005), FERC Stats. & Regs. ¶ 31,193 (2005).

²⁸ Order No. 663 does not apply to comments on rulemakings or comments on offers of settlement. However, that exception does not apply here because IEP is commenting on a tariff filing. *See* Order No. 663.

²⁹ *See Daily price survey (\$/MMBtu)*, PLATTS GAS DAILY, Dec. 14, 2005, at p. 2 (listing the midpoint for “PG&E city-gate” at \$14.325).

gas prices. Accordingly, the Commission accepts the CAISO's proposal to raise the current bid cap from \$250/MWh to \$400/MWh.

26. The Commission rejects, however, the CAISO's proposal to change the current "soft" nature of the cap to a "hard" cap during this interim period prior to the implementation of MRTU and a resource adequacy mechanism. Neither the MSC nor DMM recommended changing the cap from a "soft" to a "hard" cap, and the CAISO has not adequately supported such a change. A "hard" cap, in combination with the CAISO's current must-offer obligation,³⁰ could result in confiscatory rates because it would raise the possibility that sellers could be forced to operate at a loss. Based on the current circumstances of rising and volatile gas prices, we will retain the cap as a "soft" cap during this interim period. The CAISO has filed an emergency request in response to an unusual situation of rapidly rising natural gas prices, and the Commission believes the importance of ensuring a market design that is both reliable and non-confiscatory outweighs the CAISO's desire to transition towards a "hard" cap directed by the Commission to begin at the implementation of MRTU in 2007.

Price Cap in the WECC Outside the CAISO

27. Our preliminary judgment is that the maximum price for spot market sales in the WECC outside the CAISO, as established by the Commission in our July 2002 Order, should also be raised to a \$400/MWh "soft" cap. As we stated in that order, "California is an integral part of a trade and reliability region in the West. Because of this interdependency of market and infrastructure, conditions in and changes to the California market affect the entire region."³¹ Accordingly, pursuant to our authority under section 206 of the FPA, we propose to increase the cap to a \$400/MWh "soft" cap for all spot market sales in the WECC outside the CAISO, defined in our June 19, 2001 Order as sales in the WECC that are 24 hours or less and are entered into the day of or day prior to delivery.³²

³⁰We note that the current must-offer obligation in California (and the WECC), which lacks a separate capacity payment, is different from a must-offer obligation where sellers, as part of a resource adequacy program, voluntarily accept a must-offer obligation in exchange for receiving a capacity payment.

³¹ July 2002 Order at P 2.

³² See *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 95 FERC ¶ 61,418 at n. 3 (2001).

28. In light of issues raised by entities in this proceeding and the Commission's above proposal, we hereby institute, under section 206 of the FPA, 16 U.S.C. § 824e (2000), an investigation into the price cap on spot market sales in the WECC outside the CAISO. We recognize the interest of entities regarding this investigation and, therefore, the Commission invites interested persons to submit comments on this issue within 10 days from the date of issuance of this order. We note that implementing a \$400/MWh bid cap in the CAISO while the remainder of the WECC retains a \$250/MWh cap could cause the non-CAISO WECC to have difficulties in attracting imbalance energy if gas prices were to rise substantially prior to Commission action. Because gas prices have leveled off since the CAISO's filing, we believe the potential for this to occur in the near term is small, however, the Commission intends to act expeditiously to address this WECC cap upon the expiration of the comment period.

29. In cases where the Commission institutes an investigation on its own motion, section 206(b) of the FPA, as amended by section 1285 of the Energy Policy Act of 2005,³³ requires that the Commission establish a refund effective date and that date must be no earlier than the publication date of the Commission's notice that it intends to initiate such proceeding but no later than five months after the publication date. Therefore, we find that the refund effective date, pursuant to section 206(b) of the FPA, as amended by section 1285 of the Energy Policy Act of 2005, is the date on which this order is published in the *Federal Register*.

Ancillary Services

30. Powerex argues that the bid caps should be the same for both the CAISO energy and ancillary services markets. Powerex asserts that neither the CAISO nor MSC has offered a rationale for not raising the ancillary services bid cap from its current \$250/MWh level, and cites potential market distortions without giving details of how they might occur. In its answer, the CAISO dismisses this concern, pointing out that PJM has a \$1,000/MWh energy bid cap and a \$100/MWh regulation bid cap, and asserting that ancillary service capacity is a fixed cost and that gas prices do not affect the cost of ancillary services. The CAISO argues that to the extent the CAISO accepts an ancillary services capacity bid from a supplier, and then calls on the unit to provide energy, the supplier will be able to reflect any increased gas costs in its energy bid. Finally, the CAISO argues that the ancillary service capacity bid cap will continue to be a "soft" cap, thus allowing suppliers to submit bids in excess of \$250/MWh, provided they can provide cost justification for such bids.

³³ Pub. L. No. 109-58, § 1285, 119 Stat. 594, 980-81 (2005).

31. The Commission recognizes that until the implementation of MRTU in 2007, the current CAISO market design does not have a day-ahead market that co-optimizes energy and ancillary services. The CAISO relies on ancillary service capacity being offered by sellers directly to the CAISO for various categories of reserves. Sellers must make the decision to sell either energy or ancillary services. To the extent a seller chooses to make its capacity available for selling an ancillary service like spinning reserves, it could incur an opportunity cost by not selling energy. Thus, under the current market design, the price of energy could have an impact on the price of ancillary services and suppliers may thus choose to provide energy instead of ancillary services if the ancillary service capacity bid cap is below this opportunity cost.

32. Given these concerns, we will address the issue of the appropriate level of the CAISO ancillary service capacity bid cap in the section 206 investigation instituted in this proceeding. We recognize the interest of entities regarding this issue, therefore, the Commission invites interested persons to submit comments on the appropriate level of the CAISO's ancillary service capacity bid cap within 10 days from the date of issuance of this order. As discussed above, we find that the refund effective date, pursuant to section 206(b) of the FPA, as amended by section 1285 of the Energy Policy Act of 2005, is the date on which this order is published in the *Federal Register*.

Effective Date

33. We note that in its answer, the CAISO states that it has not implemented Amendment No. 73 and it does not intend to make the \$400/MWh bid cap effective until approved by the Commission. In fact, the CAISO asserts that it made repeated statements in its transmittal letter and market notice that it requested the amendment be made effective on January 1, 2006 or as soon thereafter as possible. As noted above, the Commission accepts the CAISO's proposal, as modified, effective as of the date of this order.

The Commission orders:

(A) The Commission accepts and modifies the CAISO's proposal to adjust its bid cap for real-time energy bids and adjustment bids to \$400/MWh, as discussed within the body of the order, effective upon issuance of this order.

(B) Pursuant to the authority conferred upon the Commission by the FPA, particularly section 206 thereof, the Commission institutes an investigation into the price cap in the WECC outside the CAISO and the ancillary service capacity bid cap in the CAISO, as discussed in the body of this order. Entities may submit comments regarding these issues within 10 days from the date of issuance of this order.

(C) The refund effective date established pursuant to section 206(b) of the FPA, as amended by section 1285 of the Energy Policy Act of 2005, as discussed in the body of this order, is the date upon which this order is published in the *Federal Register*.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.