

COMM-OPINION-ORDER, 92 FERC ¶61,172, **San Diego Gas & Electric Company (Complainant) v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Docket No. EL00-95-000,** . . ., (Aug. 23, 2000)

**San Diego Gas & Electric Company (Complainant) v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Docket No. EL00-95-000, Investigation of Practices of the California, Independent System Operator and the California Power Exchange (Respondent), Docket No. EL00-98-000**

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**San Diego Gas & Electric Company (Complainant) v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Docket No. EL00-95-000  
Investigation of Practices of the California, Independent System Operator and the California Power Exchange (Respondent), Docket No. EL00-98-000**

**Order Initiating Hearing Proceedings to Investigate Justness and Reasonableness of Rates of Public Utility Sellers in California ISO And PX Markets**

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**and to Investigate ISO and PX Tariffs, Contracts, Institutional Structures and Bylaws; and Providing Further Guidance to California Entities**

**(Issued August 23, 2000)**

**Before Commissioners: James J. Hoecker, Chairman; William L. Massey, Linda Breathitt, and Curt Hébert, Jr.**

On August 2, 2000, San Diego Gas & Electric Company (SDG&E) filed a complaint pursuant to Rule 206 of the Commission's Rules of Practice and Procedure<sup>1</sup> asking the Commission for an emergency order capping at \$250 per MWh the prices at which sellers subject to its jurisdiction may bid energy or ancillary services into the markets operated by the California Independent System Operator (ISO) and the California Power Exchange (PX). SDG&E seeks an amendment to the market-based rate schedules of all sellers into the markets operated by the ISO and PX to restrict their bids into those markets.<sup>2</sup> SDG&E requests that the Commission act as quickly as possible on the merits of its complaint.

In this order, as discussed below, we are denying SDG&E's requested immediate imposition of a price cap on all sellers in California.<sup>3</sup> However, we are instituting consolidated hearing<sup>4</sup> proceedings pursuant to Section 206 of the Federal Power Act to investigate the justness and reasonableness of the rates and charges of public utilities that sell energy and ancillary services to or through the California ISO and PX, and to also investigate whether the tariffs and institutional structures and bylaws of the California ISO and PX are adversely affecting the efficient operation of competitive wholesale electric power markets in California and need to be modified. In light of the fact that many of the same issues raised here are also the subject of a fact finding staff investigation ordered by the Commission on July 26, 2000, we intend to issue a further order after the Commission reviews the outcome of the staff investigation related to California markets to take into account the staff investigation findings, as appropriate, and to address or further refine the issues set for hearing herein, as appropriate.<sup>5</sup>

Our goal in these proceedings is to detect and, to the extent within our jurisdiction, to resolve as expeditiously as possible, any defects in the operation of competitive power markets in California. To the extent market performance issues surface in our staff investigation or the Section 206 investigation that

concern the structure or independence of the ISO, the Commission will also take up these issues to the extent they are present in any RTO proposal that is filed on January 16, 2001, pursuant to [Order No. 2000](#).

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### *SDG&E's Complaint*

SDG&E states in its complaint that since the restructured electric market began operation in California in April 1998, the three large investor-owned utilities in the state transferred operational control of their transmission facilities to the ISO, and began purchasing all of the

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energy needed to serve their retail customers through the PX. SDG&E states further that because it has completed recovery of certain stranded generation costs, the retail rate caps imposed by state statute no longer exist for it, although they are still in place for the other two investor-owned utilities.

SDG&E asserts that since the beginning of June 2000, wholesale electric prices in California have at times exceeded, often by a multiple of three or four, prices seen at comparable load levels in prior years. SDG&E cites to data showing that the PX day-ahead price for Southern California never exceeded \$250 in June and July of 1999, but equaled or exceeded that level in 167 hours in 2000. SDG&E attributes this to “dysfunctional” wholesale markets, particularly at high demand levels, that allow sellers to exact prices considerably above levels that would prevail in a more fully competitive market.

SDG&E is critical of what it calls the “de-centralized” market structure and design in California, stating that the market is not capable of supplying the electricity needs of consumers at competitive prices. SDG&E states that the Commission has already seen fit to intervene when it found that the ISO’s congestion management system is in need of overhaul or replacement.<sup>7</sup> SDG&E argues that although the Commission did not design California’s market, it has a statutory responsibility to lead the effort to fix the problems and protect consumers in the interim until reforms are in place.

SDG&E contends that the Commission’s market-based rate authorizations were based on the necessary premise that the sellers lack market power and that the markets into which they are selling are workably competitive. SDG&E asserts that the energy and ancillary services markets in California are not workably competitive, at least when state-wide demand reaches 33,000 MW, and at such demand levels, wholesale prices are no longer reasonable. SDG&E asks that any seller’s market-based rate authority “should be conditioned to provide that, unless or until the Commission finds that the bulk power markets for energy and ancillary services in California are workably competitive, such seller shall not submit a bid of more than \$250 per MWh to supply energy or ancillary services into markets operated by the ISO or PX.” SDG&E requests that the Commission act as quickly as possible on its complaint.

### *Notice and Pleadings*

Notice of SDG&E’s filing was published in the *Federal Register*, 65 *Fed. Reg.* 48,693 (2000), with comments, protests, and motions to intervene due on or before August 14, 2000.

The Public Utilities Commission of California (California Commission) filed a notice of intervention supporting SDG&E’s request for a \$250 bid cap and asking that such caps remain in place until the Commission finds based on an evidentiary hearing that workable competition exists in California and western energy and capacity markets. Pacific Gas and Electric Company and Southern California Edison Company filed motions to intervene and stated positions in support of the complaint. The Utility Reform Network filed a late motion to intervene in support of the complaint.

Answers in opposition to the complaint were filed by Dynegy Power Marketing, Inc., El Secunda Power, LLC, Long Beach Generation LLC, Cabrillo Power I LLC, and Cabrillo Power II LLC, (jointly); Southern Energy California, L.L.C., Southern Energy Delta, L.L.C., and Southern Energy Potrero, L.L.C.

(jointly); and by Enron Power Marketing, Inc. and Enron Energy Services, Inc. (jointly). Reliant Energy Power Generation, Inc. filed an answer in opposition to the complaint and a motion to file it one day out-of-time. Merrill Lynch Capital Services, Inc. filed a motion to intervene and answer in opposition. New York Mercantile Exchange, Morgan Stanley Capital Group Inc., Duke Energy North America LLC (together with Duke Energy Trading and Marketing, LLC and Duke Energy Merchants, LLC), Williams Energy Marketing & Trading Company, and Independent Energy Producers Association filed motions to intervene and protests.

The ISO filed a motion to intervene, answer, and request for summary rejection of the complaint. The PX filed a motion to intervene with comments noting the existence of its hedging products and disputing that the separation of the ISO and PX is a fundamental impediment to competition. The following filed motions to intervene and stated a position in opposition to the complaint: Electric Power Supply Association; Western Power Trading Forum; Portland General Electric Company; Automated Power Exchange, Inc.; and Northern California Power Agency (agrees with allegations but opposes price cap).

The following filed motions to intervene raising no issues: California Electricity Oversight Board; El Paso Merchant Energy, L.P.; the cities of Redding, Santa Clara, and Palo Alto and the M-S-R Public Power Agency; Arizona

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Districts; PPL EnergyPlus, LLC and PPL Montana, LLC; California Manufacturers and Technology Association; Sacramento Municipal Utility District; Metropolitan Water District of Southern California; California Department of Water Resources; Modesto Irrigation District; and Transmission Agency of Northern California. In addition, a number of individuals filed brief letters of comment on the complaint.

#### *Discussion*

##### *A. Procedural Matters*

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,<sup>8</sup> the notice of intervention and the timely, unopposed motions to intervene serve to make those who filed them parties to this proceeding. In addition, those respondents filing answers to the complaint are parties. We will accept the late-filed pleadings.

##### *B. Rejection of Immediate Seller Price Cap and Institution of Hearing on Seller Rates, ISO and PX Tariffs and Market and Institutional Design*

The Commission is very concerned about the impact of significant increases in retail electricity rates on residents and businesses in San Diego. We note that a number of factors have interacted to lead to these rate increases, and that many of the factors that contributed to these increases fall within the jurisdiction of state regulators and are not within the jurisdiction of the Commission, including: (1) siting of new generation and transmission facilities; (2) lack of demand-side programs that allow consumers and businesses to receive and respond to price signals; (3) rules under which SDG&E provides retail electric service which limit its actions as a purchaser of wholesale power (*e.g.*, requirements that SDG&E make all purchases through a single power exchange and restrictions on SDG&E's ability to enter into wholesale supply or risk management agreements that could protect against excessive volatility in wholesale commodity prices); and (4) retail rate designs that do not offer retail customers of SDG&E the option to arrange for stable, levelized rates. And, of course, the severe weather which has blanketed the West and exacerbated the generation supply shortage that exists in California is beyond the control of any public body.

The Commission does have jurisdiction over wholesale electric prices and a role in determining whether and to what extent factors related to wholesale electric markets might have contributed to the increase in retail electric rates in San Diego. We take seriously volatile price increases during high load periods in

California and allegations that the markets are not functioning properly. According to SDG&E, prices in June and July of 1999 rarely exceeded \$150/MWh, while prices for the same period in 2000 exceeded \$250/MWh in 167 hours and \$500/MWh in 59 hours. SDG&E contends that these higher prices come at a time when load levels for 2000 are below the peak levels of 1999. SDG&E argues that even accounting for this year's higher natural gas prices, energy and ancillary services prices during June and July of 2000 greatly exceed the operating costs of a typical Southern California gas-fired generating unit. SDG&E concludes that the markets cannot be workably competitive if sellers are able to exact prices that are considerably above levels that would prevail in open competition, *i.e.*, sellers are able to bid and receive prices significantly above their marginal costs. SDG&E also argues that the hour-to-hour volatility in imbalance energy prices and the erratic clearing price for ancillary services is an indication that the market is breaking down when it is moderately stressed.

In addition, numerous reports prepared by the independent monitoring bodies of the PX and ISO indicate that the current market in California experiences problems during tight supply/high demand periods such that it may not yield just and reasonable rates. These reports indicate that, despite significant increases in demand, there has been no corresponding increase in the construction of new generation. Given the lack of any meaningful demand response, this means that virtually all bids must be accepted when these shortage conditions arise. In addition, these reports indicate that most of the load in California is being met through spot market wholesale purchases rather than longer-term power sale contracts and hedging arrangements that could provide price certainty and stability. As a result of all these factors, there are periods when all generation must be accepted, regardless of the bid price, and sellers may be in a position to act on this knowledge and raise bids above the level that would be expected solely as a result of scarcity.

For all of these reasons, we conclude that a further formal investigation is appropriate to determine why anomalous prices occur at certain times, whether certain market or institutional factors cause the anomalous prices, and whether the anomalous prices are unjust, unreasonable, unduly discriminatory or preferential. While SDG&E has focused on the performance of sellers in the market, the action of sellers may in part be caused by the current market rules and institutional structures. Accordingly,

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we conclude that it is appropriate to investigate not only the justness and reasonableness of public utility sellers' rates in the PX and ISO markets but also to investigate the tariffs and agreements of the ISO and PX to determine whether market rules or institutional factors embodied in those tariffs and agreements need to be modified.

We note that all of the markets operated by the ISO and PX markets are highly inter-related and largely served by the same generating units. The rules for pricing and bidding for any one market can affect the price and quantity bid into any of the other markets. Consequently, a poorly designed market not only can distort prices for its own participants but can also create high opportunity costs to participants in other markets that may, by themselves, be well-designed and functioning properly.

While we find it appropriate to institute a Section 206 hearing on these issues, we cannot implement an immediate price cap of \$250/MWh as requested by SDG&E because there is no record before us to support such an action. Under the Federal Power Act, upon complaint or on our own motion, the Commission may establish new rates only if it first has a record to determine that the existing rates are unjust, unreasonable, unduly discriminatory or preferential. Further, once such a finding is made as to existing rates, the Commission must have a record to support the new rate it establishes as just and reasonable. While the issues raised by this complaint are important, the Commission has no basis to conclude that SDG&E's proposal to place an immediate, arbitrary \$250/MWh cap on the price that every public utility seller of energy and ancillary services may bid into the PX and ISO markets would satisfy this standard. SDG&E has provided no evidence to demonstrate that all potential sellers are able to exercise market power, has not documented a single instance of a seller exercising market power during times of scarcity, and did not attempt to show that the conditions underlying the Commission's approval of market-based rates for public utility sellers of energy and ancillary services have changed. Nor did it address specific market or

institutional factors that may be causing rates to be unjust or unreasonable. In addition, the ISO's analysis raised concerns that a cap at this level would call into question the ISO's ability to attract sufficient supply to meet the totality of California loads, and SDG&E has not provided any basis for the Commission to evaluate the reliability impacts of adopting a \$250/MWh seller's bid cap. In sum, SDG&E has not met the burden of showing that an immediate, universal bid cap on all potential sellers supplying energy and ancillary services into the PX and ISO markets is justified and in the public interest.

Although we have concluded that immediate seller price caps have not been justified based on the existing record, we have not disturbed the actions taken by the California ISO, in its discretion as a purchaser of imbalance energy and ancillary services, to set its purchase price cap at \$250/MWh. This action addresses SDG&E's concern that pricing volatility be mitigated. While the ISO's authority to implement this cap expires in November 2000, the ISO has recently stated that it will make a timely filing with the Commission to extend its authority. In addition, while only the ISO's markets are directly affected by its recent action, the ISO purchase price caps currently permitted by the Commission will serve to discipline prices in both the ISO and PX. We disagree with SDG&E that the effect of the maximum purchase price that the ISO will pay for energy and ancillary services on prices in the PX market is only indirect. The ISO sets a maximum purchase price at \$250/MWh and the evidence to date indicates that the unconstrained PX clearing price has not exceeded the maximum purchase price set for ISO imbalance energy (currently \$250/MWh) plus the rate for replacement reserves (\$100/MWh) for under-scheduled load. Buyers in the PX submit conditional bids. They offer to purchase energy and ancillary services from the PX at a price at or near the ISO's maximum purchase price because they know that if their bids are not accepted in the PX, they may still buy energy and ancillary services at the maximum purchase price in the ISO's real-time market. Thus, the ISO's maximum purchase price effectively disciplines prices in the PX markets.

### *C. Congestion Management and Market Redesign*

SDG&E asserts that the ISO's congestion management and market structures are flawed and in need of overhaul. In support of its assertion, SDG&E points to an order issued by the Commission on January 7, 2000, in which the Commission directed the ISO to file replacement congestion management and market approaches.<sup>9</sup> Furthermore, SDG&E expresses its concern that, for a number of reasons, the congestion management and market reform efforts being pursued by ISO stakeholders will not produce meaningful results. SDG&E indicates that it is prepared to work with the ISO

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to develop alternative reform proposals;<sup>10</sup> however, SDG&E's complains that the ISO stakeholder process has, in SDG&E's judgment, been ineffective with respect to these issues.

Various interveners contend that SDG&E's arguments are premature. In particular, the ISO notes that in initiating the ISO's market redesign, the Commission stated that it should be pursued with input from all stakeholder groups, and it argues that SDG&E is attempting to circumvent that process.<sup>11</sup>

We agree with Interveners. In *California ISO*, the Commission found the ISO's existing congestion management structure to be flawed, and, on that basis, we directed the ISO to develop and submit to the Commission a comprehensive congestion management and market redesign. Moreover, as noted by the ISO, we stated that such a redesign should be pursued with input from *all* stakeholder groups, as well as from the ISO's Market Surveillance Committee. The reform efforts have been the subject of extensive public review and comment and are nearing completion. Accordingly, we reject SDG&E's arguments at this time. We will defer any consideration on the merits of the ISO's reform efforts until the earlier of the ISO's filing of its reform proposal or the date which the Commission issues a supplemental order in this proceeding.

### *D. Other Available Methods to Reduce Impact of Spot Market Volatility*

SDG&E cites a number of problems that contribute to produce the unsatisfactory results facing its retail customers, including its exposure to spot market price volatility. In its complaint, SDG&E states that under California's restructuring policy it remains a "default" service provider for residential customers that have not chosen other energy service providers. SDG&E states that it will continue until directed otherwise to provide service to these customers by passing through the PX and ISO spot market wholesale price.

According to many of the comments, SDG&E has chosen not to purchase risk management tools that were and are available and that would have provided price certainty during periods of short supply. Furthermore, SDG&E appears to be the only major investor-owned utility in California that had not sought state commission authority to hedge its price risks through forward contracts which are designed to "lock-in" a specific price in advance of spot or real-time market activities. We note that other Interveners argue that the price cap proposal will penalize those market participants that hedged against price volatility relative to those market participants that chose to remain exposed to the spot markets. They argue that SDG&E should not be sheltered for the consequences of its decision not to protect its retail customers and remaining fully exposed in the spot market, when other participants made decisions to hedge their risks.

It is unclear whether SDG&E's failure to purchase hedging instruments for its retail operations is due to state regulatory policies or its business decisions. A retail rate design that exposes consumers to the volatility of commodity prices would be extraordinary, particularly when consumers do not have the ability to receive or respond to price signals. While the Commission has no authority over retail electricity rates nor authority to rule on the prudence of SDG&E's provision of retail electric service, we would expect any responsible retail supplier to rely on a portfolio of resources and to turn to the spot market only to engage in economy transactions or to meet portions of its load that could not be predicted well in advance or which were not anticipated due to resource outages greater than are covered by prudent reserves. We note that responsible hedging in the forward markets will greatly reduce price volatility for SDG&E's retail customers even within the limits established by the California Commission.<sup>12</sup> The Commission has approved a number of recent filings by the Cal PX and its Cal PX Trading Services (CTS) division that enhance and expand wholesale forward market services (*e.g.*, block forward contracts for balance-of-the-month, monthly and multi-year). We encourage SDG&E to discuss with the California Commission the use of all available hedging tools to prudently manage the price risks associated with the retail market.

#### *E. Other Market Reforms*

The record indicates that a current market problem is underscheduling of loads and generation in the Cal PX Day ahead and Hour Ahead markets. In some hours as much as 25 percent of system needs were met in the ISO real-time market. This significant level of under-scheduling is largely attributable to the different market incentives faced by buyers and sellers. We are concerned that this increasing

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level of market activity in the real-time market raises significant reliability and economical concerns. For example, if there is insufficient supply in the ISO markets, then the ISO must procure additional supplies out-of-market (OOM) at the last minute in order to meet its needs for the operating day. Historically, the ISO procures on a daily basis only the resources needed for the operating day. Not only does this procurement practice put pressure on the grid operator to secure needed resources at the last minute, but the practice is uneconomical. Such spot-market purchases are not subject to the ISO's buyer's cap. Furthermore, because the ISO is the supplier of last resort for these services, when OOM calls are made, suppliers realize that the ISO is in a must-buy situation.

In an effort to address this problem, we direct the ISO to immediately institute a more forward approach to procuring the resources necessary to reliably operate the grid. Specifically, the ISO should anticipate the need for such additional resources based on forecasted peak periods. We direct the ISO to factor these reforms into an analysis of the need for and level of purchase price caps and to include this analysis as support for any filing it makes to extend its purchase price cap authority.

#### *F. Refund Effective Date*

In cases where the Commission institutes a proceeding on complaint under Section 206 of the Federal Power Act, Section 206(b) requires that the Commission establish a refund effective date that is no earlier than 60 days after the filing of the complaint, but no later than five months subsequent to the expiration of the 60-day period. In cases where the Commission institutes a Section 206 proceeding on its own motion, Section 206(b) requires that the Commission establish a refund effective date that is no earlier than 60 days after publication of notice of the Commission's intent to institute a proceeding in the *Federal Register*, and no later than five months subsequent to the expiration of the 60-day period. We will establish the refund effective date in Docket Nos. EL00-95-000 and EL00-98-000 60 days from the date on which notice of our initiation of the investigation in Docket No. EL00-98-000 is published in the *Federal Register*.

We note that although the Commission is statutorily required to establish a refund effective date whenever it institutes a proceeding under Section 206 of the FPA, it is not required to order refunds at the end of the proceeding.<sup>13</sup> Refunds are discretionary. Moreover, any attempt to establish a just and reasonable price to serve as the basis for a refund calculation would be extremely difficult to the extent that it would require the Commission to reconstruct economic decisions that would have been made under different circumstances. In addition, in the context of market-based rates and a competitive market, refunds may not be the appropriate remedy to address any competitive problems that may be found. Thus, in establishing a refund effective date in these dockets, we wish to emphasize that, while refunds would ultimately offer some level of restitution to California ratepayers, they may be an inferior remedy from a market perspective and not the fundamental solution to any problems occurring in California markets. Further, we are cognizant of the effect that potential refund liability could have on public utility sellers in the California ISO and PX markets and we emphasize that while we must protect ratepayers, we also do not intend to undermine the financial stability of public utility sellers. We emphasize these points not to prejudge the issue of whether the Commission will find it appropriate to order refunds, but rather to ensure that all parties are aware of the statutory framework and the complexity of the issues raised in this proceeding. Any decision whether or not to impose refund obligations will be based on our findings regarding just and reasonable rates and a balancing of consumer and investor interests.

#### *G. Consolidation and Further Orders*

Because Docket Nos. EL00-95-000 and EL00-98-000 raise common issues of law and fact, we will consolidate them for purposes of hearing and decision. Accordingly, any party who has moved to intervene in Docket No. EL00-95-000 will be considered to be a party to the consolidated proceeding. We shall also issue further orders in this proceeding after we consider information related to California markets to be provided by the staff investigation ordered on July 26, 2000. In our July 26, 2000 Order Directing Staff Investigation, the Commission directed staff to undertake a fact-finding

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investigation of the conditions in electric bulk power markets (including volatile price fluctuations) in various regions of the country and report its findings to the Commission by November 1, 2000. Because of recent events in the ISO and PX markets, we will direct staff to focus on the California and Western region as soon as possible. By having the benefit of the fact-finding results, we will be better able to further narrow the focus of the hearing ordered herein, as appropriate.

*The Commission orders:*

(A) SDG&E's request for the imposition of a price cap on sellers into the California markets is hereby denied as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by Section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly Section 206 thereof, and pursuant to the Commission's Rules of

Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held in [Docket Nos. EL00-95-000](#) and [EL00-98-000](#) concerning the justness and reasonableness of the rates, charges, and practices of public utility sellers of wholesale power into the California ISO and PX markets and of the California ISO and PX tariffs, agreements and institutions, as discussed in the body of this order.

(C) The hearing ordered in Ordering Paragraph (B) above shall be held in abeyance pending a further Commission order, as discussed in the body of this order.

(D) [Docket Nos. EL00-95-000](#) and [EL00-98-000](#) are hereby consolidated for the purposes of hearing and decision.

(E) The Secretary shall promptly publish in the *Federal Register* a notice of the Commission's initiation of Section 206 proceedings in [Docket No. EL00-98-000](#), and we direct the ISO and PX to electronically serve this notice upon their respective list of market participants and to immediately post a copy of this order on their webpages.

(F) The refund effective date in [Docket Nos. EL00-95-000](#) and [EL00-98-000](#), established pursuant to Section 206(b) of the Federal Power Act, will be 60 days following publication in the *Federal Register* of the notice discussed in Ordering Paragraph (E) above.

Commissioner Massey dissented in part with a separate statement attached.

Commissioner Hébert concurred with a separate statement attached.

**William L. MASSEY, Commissioner**, *dissenting in part*:

There is a crisis of confidence in California wholesale electricity markets that threatens to erode the political consensus necessary to sustain a market-based approach to regulation. In these circumstances, the Federal Energy Regulatory Commission must act forcefully and decisively to reassure California market participants, policymakers and consumers that federal regulators will insist that jurisdictional wholesale markets produce consumer benefits and just and reasonable rates. I would grant the relief requested in the complaint and would cap bids into the California ISO and PX markets at \$250/MWh<sup>1</sup> as a temporary stopgap measure pending the outcome of the Section 206 investigation initiated by today's order. I am convinced that such a cap is necessary to ensure just and reasonable rates during our investigation.<sup>2</sup>

In recommending that a price cap be put in place now, I am motivated by a deep concern about the high prices in wholesale markets in California. The Commission has a statutory duty to ensure that wholesale prices are just and reasonable. This is the Commission's fundamental consumer protection responsibility, and the Federal Power Act provides no exception for poorly functioning markets. Indeed, the Commission's primary rationale for promoting market-based policies has been that markets would produce consumer benefits and lower prices compared to cost of service regulation.

There are sufficient indications in this record that California wholesale markets are not producing prices that are just and reasonable. California

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wholesale electricity costs for June 29 of this year were seven times what they were for the same date in 1999 (\$340 million vs. \$45 million) even though energy usage was only about 3% more.<sup>3</sup> Southern California Edison states that during the month of June, 2000, the total cost of electricity (energy and ancillary services combined) charged to the California market was nearly half of California's total electricity cost for all of 1999. In two separate five-day periods in June, 2000 (when demand was at least 3,000 MW to 5,000 MW below the projected annual peak) California's total cost of electricity exceeded \$1 billion, with one of those five day periods reaching \$1.3 billion.<sup>4</sup> SDG&E provides a comparison of final



PX day-ahead prices for the Southern California zone for June and July during 1999 and 2000. During June and July of 1999, prices rarely exceeded \$150/MWh even during the highest load levels. During the same period this year, prices have multiplied to three and four times the levels reached last year whenever load levels exceed 33,000 MW, according to SDG&E.<sup>5</sup> The California Public Utilities Commission states that every analysis of the California markets since their opening has found substantial exercise of market power.<sup>6</sup> In these circumstances, the confidence of California consumers in wholesale markets may quickly erode.

The record supports the conclusion that during periods of high demand in California, generator bid prices are virtually unrestrained by the forces that would apply in competitive markets for other commodities. In other markets besides electricity, when the price is too high, consumers purchase less and this in turn has a substantial dampening effect on price. In the California wholesale electricity markets, the willingness of purchasers is largely unaffected by price, and sellers understand this dynamic. In fact, the ISO's Department of Market Analysis concluded that when demand exceeds 40 GW "there is no constraint on how high [generators] might raise their prices in the absence of price caps."<sup>7</sup>

This lack of demand responsiveness appears to have the strong tendency to influence generator bids sharply higher. In high usage hours where no market forces restrain an unbridled price runup, a large transfer of wealth from purchasers to sellers can occur rapidly because all sellers are paid the highest market clearing price. The high prices that wholesale purchasers pay are ultimately passed through to retail consumers, either immediately or over some period of time.<sup>8</sup>

The complainant and interveners identify other serious problems as well in California wholesale markets. The siting of generation is lagging rather sharp increases in demand, which makes it likely that during peak usage all generator bids, regardless how high, must be accepted. There is limited transfer capacity over high voltage transmission wires into California. There have been very limited hedging and forward contracting by wholesale purchasers who have been required by state policy to make the bulk of their purchases through the ISO and PX spot markets. Serious questions are raised about the wisdom of the somewhat unique California market design, required by state law, that provides for separate ISO and PX markets. In addition, this Commission has already declared that the ISO's current congestion management system must be completely overhauled.

I do not believe that customers must be required to bear the full economic brunt of the poorly functioning market and high prices that these problems create. I am pleased that the Commission is launching a Section 206 investigation, and it is my hope that we will leave no stone unturned in investigating and proposing market-based solutions that will lead to just and reasonable prices.

I must point out, however, that neither the FERC nor state policymakers, acting in isolation from each other, can solve all of these market flaws because our respective jurisdictions are sharply delineated under existing law. State policymakers cannot effectively define or police market power in interstate wholesale markets. They cannot require a wholesale market structure, based upon an efficiently operating interstate transmission grid, that will produce just and reasonable rates. These are federal responsibilities. By the same token, under existing law the FERC cannot site the generation and transmission facilities that are necessary to bring supply and demand into equilibrium, and has no direct authority to require purchasers of power to hedge price volatility risk in forward or financial markets. These are state responsibilities. Both federal

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and state policymakers have a role in pursuing policies that will facilitate an effective and price-dampening demand side response (where, for example, customers bid "negawatts" into the market).

In short, high prices in California may not ultimately be reduced without a joint effort by federal and state policymakers. We must work together to solve the problems at hand, including joint proceedings and hearings as appropriate.

I would not recommend a \$250/MWh bid cap as a long term solution to these market flaws. I am very much aware that the installation of additional generation facilities is a key part of the solution in California, and our policies must not discourage that investment. Nevertheless, I am convinced that this temporary price cap is necessary pending the implementation of measures to ensure that California wholesale markets produce just and reasonable rates.

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

**Curt L. HQEBERT, Jr., Commissioner, concurring:**

I write separately to explain my position on one of the issues raised in today's order. In my opinion, California consumers are not adequately served by the Commission's selection of possible refund relief. If it were up to me, I would refrain from adopting a refund effective date. If a refund effective date were in fact required by the Commission's institution of a proceeding under Section 206, as amended by the Regulatory Fairness Act, I would choose a different refund effective date. Specifically, I would select the latest possible refund effective date (7 months from the date of publication of the investigation in EL00-98-000 in the *Federal Register*) rather than the earliest date (60 days from the date of *Federal Register* publication).

I understand that the selection of a later refund effective date would be contrary to the Commission's standard practice, repeated here, of selecting the earliest possible date. In the present circumstances, however, the interest of California consumers justifies a departure from standard practice. That is because the Commission's investigation of practices of the California ISO and PX is tied to its ongoing investigation of wholesale power practices throughout the United States. The Commission is unlikely to conclude either of its investigations prior to the refund effective date instituted in today's order. That means that in the intervening period--after the refund effective date but before the conclusion of the Commission's investigations--wholesale power suppliers into California markets will not know for certain the price they ultimately will be allowed to recover.

I appreciate the language in today's order, slip op. at 12-13, that indicates that refunds may not represent an appropriate remedy, in the context of market-based rates and competitive markets, to address any identified competitive problems. Nevertheless, the fact remains that a later refund order remains a possibility, no matter how remote. This looming contingency will deter power suppliers from entering capacity-starved California markets. The possibility of a retroactive price adjustment, just like the imposition of price caps, acts to undermine precisely the type of reliability of service and robustness of competitive markets that the Commission (and all market participants) claim to vigorously support.

Consumers are best served by regulatory policies that promote market entry and ensure that electricity supply will be available to meet demand. Directives from regulators and politicians to make refunds or release emergency funds may offer some relief in the short-term. In the long-term, however, electricity consumers can be assured of low prices and reliable service only if entrepreneurs have the motivation to build plants and string wires. Without badly-needed capital investment, capacity-limited regions such as southern California will continue to lurch uncertainly from summer to summer.

In all other respects, I agree with the determinations of the Commission in today's order.

Therefore, I respectfully concur.

-- Footnotes --

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<sup>1</sup> [18 C.F.R. §385.206](#) (2000).

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<sup>2</sup> SDG&E states that it would be impracticable to list all such sellers in its complaint. It states that it served the complaint on all parties to various Commission proceedings involving California pricing and restructuring issues, including [Docket Nos. ER98-2843](#), ER99-4462, EL00-91, ER96-1663, and EC96-19. It states that it also requested the ISO to distribute it electronically to the ISO's list of market participants.

<sup>3</sup> However, we are not disturbing the California ISO's decision to set its purchase price cap at \$250/MWh, *see, Morgan Stanley Capital Group Inc. v. California Independent System Operator Corp.*, [92 FERC ¶61,112](#) (2000).

<sup>4</sup> Hearings under Section 206 may take the form of a proceeding before an Administrative Law Judge or a hearing directly before the Commission. A hearing before the Commission may include written and/or oral presentation of evidence and arguments. We do not in this order determine which type of proceeding that will be required.

<sup>5</sup> The Section 206 proceeding we are initiating here differs from the staff investigation in several respects. A Section 206 investigation initiates a formal evidentiary process where all interested parties are assured an opportunity to present evidence and arguments on the record before the Commission. In addition, it provides a statutory mechanism for the Commission to exercise its remedial powers to change the rates, terms and conditions of jurisdictional services that are determined to be unjust, unreasonable, unduly discriminatory or preferential and, if appropriate, to order refunds. By establishing the proceeding in this order, the Commission ensures that its remedial authorities under Section 206 will be available at the earliest time permitted under the Federal Power Act.

<sup>6</sup> *Regional Transmission Organizations*, [Order No. 2000](#), 65 *Fed. Reg.* 809 (2000), *FERC Statutes and Regulations* [¶31,089](#) (1999), *order on reh'g*, [Order No. 2000-A](#), 65 *Fed. Reg.* 12,088 (2000), *FERC Statutes and Regulations* [¶31,092](#) (2000), *petitions for review pending sub nom. Public Utility District No. 1 of Snohomish County, Washington v. FERC*, Nos. 00-1174, *et al.*

<sup>7</sup> *Citing California Independent System Operator Corp.*, [90 FERC ¶61,006](#) (2000).

<sup>8</sup> [18 C.F.R. §385.214](#) (2000).

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<sup>9</sup> See *California Independent System Operator Corp.*, [90 FERC ¶61,006](#) (2000) (*California ISO*).

<sup>10</sup> Notably, SDG&E indicates its preference that the ISO adopt the market and congestion management structures currently in use by the PJM and New York Independent System Operators. SDG&E at 7.

<sup>11</sup> ISO Answer at 6, *citing California ISO*, [90 FERC at p. 61,014](#).

<sup>12</sup> For example, SDG&E currently has the ability to obtain a hedged position in the wholesale market at a price below \$60/MWh. Morgan Stanley at 4.

<sup>13</sup> Under Section 206, if the Commission finds that any public utility's rates, charges or classification, is unjust, unreasonable, unduly discriminatory or preferential, it shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Section 206 provides that at the conclusion of the proceeding, the Commission may order a public utility to make refunds of any amounts paid for the period subsequent to the refund effective date through a date 15 months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate the Commission orders to be thereafter observed and enforced.

<sup>1</sup> In order to provide the ISO with the flexibility to maintain reliability, I would not apply the bid cap to Out of Market calls to out of state generator resources or to energy payments in the Summer 2000 Demand Relief Program currently in effect.

<sup>2</sup> The majority order notes that the ISO's existing \$250/MWh purchase price cap effectively limits bids into California, and this appears to be true. Rather than rely totally upon the ISO for temporary price relief, however, this Commission must take firm responsibility for prices in jurisdictional wholesale markets. In most other respects, I agree with the conclusions reached by the majority order. In particular, I endorse opening an expedited Section 206 investigation and setting the earliest possible refund effective date, although I disagree with the portion of the text that appears to characterize the

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prospects for refunds as unlikely. In any event, if refunds are unlikely, it is even more incumbent upon the Commission to ensure that unreasonably high prices are mitigated during the pendency of our investigation.

<sup>3</sup> See Attachment B to Notice of Intervention of the Public Utilities Commission of the State of California.

<sup>4</sup> Motion to Intervene and Response of Southern California Edison Company.

<sup>5</sup> Complaint of San Diego Gas & Electric Company.

<sup>6</sup> Notice of Intervention of the Public Utilities Commission of the State of California, at 8.

<sup>7</sup> *Id.*, at 7.

<sup>8</sup> *Narragansett Electric Co. v. Burke*, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).