

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

California Independent System Operator
Corporation

Docket No. ER03-1102-005

ORDER DENYING REHEARING

(Issued October 28, 2004)

1. In an order issued on May 6, 2004,¹ the Commission granted, in part, and denied, in part, the requests for rehearing of the Commission's February 20, 2004 Order,² which directed the California Independent System Operator Corporation (CAISO) to modify the behavior rules proposed in Amendment No. 55 to be consistent with the Commission's market-based rate behavior rules.³ The Commission also responded to requests for clarification. In this order, we deny a request for rehearing of the May 6 Order regarding the CAISO's market monitoring structure. This order benefits customers in the CAISO markets by providing a reasonable approach to investigating and sanctioning anti-competitive behavior.

I. Background

2. On July 22, 2003, the CAISO filed its proposed Oversight and Investigations Program (O&I Program) as Amendment No. 55 to the CAISO's Open Access Transmission Tariff (ISO Tariff). The CAISO proposed to implement the O&I Program in three parts: (1) adding an Enforcement Protocol as a stand-alone attachment to the ISO Tariff, (2) incorporating additional conduct rules in the main body of the ISO Tariff

¹ *California Indep. Sys. Operator Corp.*, 107 FERC ¶ 61,118 (2004) (May 6 Order).

² *California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,179 (2004) (February 20 Order).

³ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 (2003) (MBR Tariff Order); *order on reh'g*, 107 FERC ¶ 61,175 (2004).

to address specific bidding and scheduling behavior, and (3) revising the ISO Market Monitoring and Information Protocol (MMIP) under the ISO Tariff to complement the Enforcement Protocol and to correct various outdated provisions of the MMIP.

3. The proposed Enforcement Protocol was composed of seven parts: (1) Objectives, Definitions, and Scope (EP 1); (2) Rules of Conduct (EP 2); (3) Process for Investigation and Enforcement (EP 3); (4) Process for Prohibiting Detrimental Practices and Market Manipulation (EP 4); (5) Administration of Penalties (EP 5); (6) No Limitations on Other Rights of ISO (EP 6); and (7) Amendments (EP 7). The CAISO proposed to monitor, investigate and enforce nine Rules of Conduct.⁴ For each of its nine Rules of Conduct, the CAISO provided a General Rule, ascribed a maximum fixed Standard Penalty amount per event for rule violations and listed any Special Penalties, Exceptions or Limitations to the rule. In addition to the maximum fixed Standard Penalty, for five of the nine Rules of Conduct, the CAISO proposed to impose a variable penalty for violations.

4. On September 22, 2003, the Commission issued an order accepting and suspending Amendment No. 55 for five months, to be effective February 21, 2004, subject to refund and further Commission order.⁵ In the February 20 Order, the Commission directed the CAISO to modify proposed Amendment No. 55. In the May 6 Order, the Commission granted, in part, and denied, in part, the requests for rehearing of the February 20 Order and responded to requests for clarification.

5. A request for rehearing of the May 6 Order was filed by Dynegy Power Marketing, Inc.; El Segundo Power LLC; Long Beach Generation LLC; Cabrillo Power I LLC; Cabrillo Power II LLC; and Williams Power Company, Inc. (collectively, Dynegy/Williams).

⁴ The nine Rules of Conduct set forth in EP 2.2 through EP 2.10 were as follows: (1) comply with operating orders; (2) submit feasible energy and ancillary service bids and schedules; (3) no physical withholding; (4) no economic withholding; (5) comply with availability reporting requirements; (6) provide factually accurate information; (7) provide information required by the ISO Tariff; (8) no detrimental practices; and (9) no market manipulation.

⁵ See *California Indep. Sys. Operator Corp.*, 104 FERC ¶ 61,308 (2003).

II. Discussion

A. CAISO's Market Monitoring Structure

6. With respect to the CAISO's market monitoring structure, in the February 20 Order, the Commission did not require the CAISO to make any changes in its organizational structure but directed the CAISO to inform the Commission of the duties and responsibilities of its Compliance Department, including any dual functions shared by the Department of Market Analysis (DMA) and the Compliance Department.⁶ To ensure that the Market Monitoring Unit (MMU) was adequately independent to be able to carry out its activities associated with the Enforcement Protocol without interference or instruction from other Independent Transmission System Operator (ISO) and Regional Transmission Organization (RTO) personnel or non-MMU supervisors, the Commission directed that the CAISO demonstrate that the MMU possessed the ability to independently administer the behavior-related ISO Tariff provisions and assess penalty charges as discussed in the order and make any necessary revisions to the MMIP in that respect.⁷

7. On rehearing, the CAISO claimed that the Commission required the Enforcement Protocol to be administered solely by the DMA and that the DMA be independent of CAISO management. The CAISO argued that the Commission did not have the authority to dictate the internal corporate/departmental structure of the CAISO. The CAISO stated that it would need to reorganize its existing market monitoring structure in response to the February 20 Order. The CAISO argued that these changes were not necessary to ensure just and reasonable market monitoring and would result in unjust and unreasonable outcomes. The CAISO argued that the changes would create an irreconcilable conflict of interest for those employees who would be paid by the CAISO but report to the ISO's regulator and expose the it to liability for the actions of employees without the ability to influence or impact those actions. The CAISO contended also that separating the DMA or the Compliance Department from CAISO management would severely inhibit management's ability to develop supportable section 205 filings and section 206 complaints. The CAISO asserted that the separation of the MMU from management was not necessary because: (1) pursuant to the February 20 Order, the CAISO would not have any discretion in the application of penalty amounts for objectively identifiable behavior, (2) the CAISO committed to documenting processes

⁶ February 20 Order at P 155. The Commission referred to the Compliance Unit in its directive; in its rehearing request, the CAISO clarified that the unit's name is the Compliance Department; therefore, it is referred to as such in this order.

⁷ *Id.* at P 154.

and controls to provide assurances that the administration of the penalty authority set forth in the Enforcement Protocol would be just and reasonable, and (3) the Commission would review actions taken by the CAISO. The CAISO added that the penalty authority that the Commission had granted to other independent system operators was applied directly by those operators, not by MMUs independent from those entities.⁸

8. The CAISO further stated that these management changes would require it to hire additional staff to perform a number of functions for the ISO as a corporation currently provided by DMA and Compliance Department staff. The CAISO suggested that the public would be better served if the Commission retained and paid its own staff to monitor market performance and serve as a “check” on the analysis performed by the regulated entity.

9. In the May 6 Order, the Commission stated that it was persuaded that for the purposes of administering objective, enumerated tariff provisions, there need not be a further demonstration of the Compliance Department's independence or the DMA's independence from CAISO management.⁹ It stated that the authority to administer such penalty charges stemmed from the Commission-approved ISO Tariff, not from a delegation of authority. Therefore, the Commission granted rehearing and did not require that the Compliance Department and the DMA demonstrate independence from the CAISO for purposes of the Enforcement Protocol.

10. However, the Commission clarified that this issue was separate from the Compliance Department's role or the DMA's role in market oversight, which prior orders had consistently required to be performed independent of CAISO management. For example, the Commission noted that these entities must be able to go directly to the ISO Governing Board or to the Commission with issues relating to market design, CAISO operations, and market participant behavior not enumerated in the Commission-approved ISO Tariff.¹⁰

⁸ See NEPOOL Market Rules and Procedures, section 13.3.1 (“The ISO may impose sanction on any Participant that directly engages in Sanctionable Behavior.”); New York Independent System Operator, FERC Electric Tariff, Attachment H.

⁹ May 6 Order at P 16.

¹⁰ *Id.* at P 17.

B. Request for Rehearing

11. On rehearing, Dynegy/Williams argue that the Commission erred in finding that, for purposes of administering tariff provisions regarding market monitoring and enforcement, there need not be a demonstration that the Compliance Department or the DMA is independent from ISO management. Dynegy/Williams state that, in light of the findings in the February 20 Order and the MBR Tariff Order,¹¹ the Commission's explanation fails to justify relieving the ISO of the requirement to demonstrate the independence of its MMU. They believe that the MMU's independence will accomplish the MBR Tariff Order's stated goal of forging a close working relationship with Commission staff and MMUs so that Commission staff is apprised at all times of the status of the markets and activities of market participants.¹² Therefore, they conclude that, as contemplated in the MBR Tariff Order, MMU employees should be independent of CAISO management, as had been required in the February 20 Order. Dynegy/Williams assert that, without justification, the Commission's decision in the May 6 Order affords special treatment to the CAISO's MMU which the MBR Tariff Order does not contemplate for other ISOs/RTOs. Dynegy/Williams add that it is inconsistent and contradictory to require MMU independence regarding market oversight matters but not to require independence for enforcement matters.

C. Commission Determination

12. In general, it is important for an MMU to act independently of ISO/RTO management. For example, it should not withhold a report on design flaws and inefficiencies in the market operated by the ISO/RTO based on management's position on the topic. However, this case involves an MMU undertaking the ministerial function of enforcing clear ISO Tariff requirements which do not require the exercise of discretion to administer. In such a case, the MMU does not need to be decisionally independent from others in the ISO/RTO management. This limited finding does not undermine the Commission's goal of forging a close working relationship between Commission staff and MMUs so that Commission staff is apprised at all times of the status of the markets and activities of market participants.¹³ Since Dynegy/Williams have failed to convince us otherwise, we deny their request for rehearing.

¹¹ February 20 Order at P 16, 19, 28, 154, n.15; MBR Tariff Order at P 180-184.

¹² MBR Tariff Order at P 184.

¹³ *See id.*

The Commission orders:

The request for rehearing is hereby denied, as discussed in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Acting Secretary.