UNITED STATES OF AMERICA 111 FERC ¶ 61,138
FEDERAL ENERGY REGULATORY COMMISSION

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

California Independent System Operator Corporation — Docket No. EL04-108-000 and EL04-108-001

ORDER ON REHEARING, PROVIDING CLARIFICATION AND GRANTING MOTIONS TO DISMISS SELLER'S CHOICE CONTRACTS

(Issued May 3, 2005)

1. In this order, we respond to requests for clarification and rehearing of our findings in the June 17, 2004 Order[1] relating to the seller's choice contracts. This order also addresses numerous motions to dismiss possible seller's choice contracts[2] from the Federal Power Act section 206[3] proceeding established pursuant to the June 17 Order. That order identified possible seller's choice contracts signed by the California Energy Resources Scheduling Division (CERS) of the California Department of Water Resources (CDWR) on behalf of retail customers during the 2000-2001 energy crisis. The June 17 Order also instituted a section 206 proceeding before an administrative law judge (ALJ) to investigate the feasibility of both upholding the CERS contracts without modification and implementing the Locational Marginal Price (LMP) market design.

2. During the course of the section 206 proceeding, a Data Acquisition Committee (DAC) was formed to gather applicable information on potential seller's choice contracts. Settlement judge procedures were also established to provide a

[1] *California Independent System Operator*, 107 FERC ¶ 61,274 (2004) (June 17 Order).

[2] A seller's choice contract allows a seller of power to designate the point of delivery on the California Independent System Operator Corporation's (CAISO's) system.

[3] 16 U.S.C. § 825e (2004).

forum for parties to renegotiate the terms of their seller's choice contracts prior to a formal hearing. The contracts identified by the DAC as potential seller's choice contracts (DAC List) included not only those CERS contracts identified by the Commission in its June 17 Order, but, also, contracts executed by various other parties participating in the California energy market. Numerous parties filed motions to dismiss their contracts from the section 206 proceeding.

3. In this order, we clarify that the scope of the section 206 proceeding is limited to the contracts included in Attachment B to the June 17 Order. Accordingly, we grant all motions to dismiss, including those motions which contain certain CERS contracts because our examination of those CERS contracts indicates that they are: (1) not seller's choice contracts, (2) will have expired upon the implementation of LMP, or (3) the parties to the contract have mutually agreed to resolve the issues outside the scope of the section 206 proceeding.

4. This order benefits customers by clarifying aspects of the June 17 Order relating to seller's choice contracts and by removing uncertainty surrounding the investigation into seller's choice contracts and removing impediments to the CAISO's transition to a LMP market design.

Background

5. In January 2000, the Commission found that the CAISO's congestion management method was fundamentally flawed, and directed it to design a comprehensive replacement congestion management approach.[4] The CAISO began a stakeholder process to do this, but the subsequent upheaval in the CAISO power markets in 2000 and 2001 delayed the CAISO's efforts. The Commission then directed the CAISO to propose a plan by May 1, 2002, to implement a day-ahead market, to be integrated with the revised congestion management plan that was directed in January 2000.[5] The CAISO then filed its Market Redesign and Technology Upgrade (Market Redesign) proposal.[6] The Commission issued an order

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[4] *California Independent System Operator Corporation*, 90 FERC ¶ 61,006, *reh'g denied*, 91 FERC ¶ 61,026 (2000) (January 2000 Order).

[5] *San Diego Gas & Electric Company*, 97 FERC ¶ 61,275 at 62,245 (2001).

[6] Formerly referred to as the CAISO's Comprehensive Market Design 2002 (MD02).

accepting in part, rejecting in part and directing modifications to the CAISO's Market Redesign proposal.[7]

6. In July 2003, the CAISO filed a revised conceptual proposal to develop design elements of its prior proposal. In response, the Commission issued a guidance order[8] approving, in principle, many of the conceptual design elements submitted by the CAISO. One of the issues discussed in the Guidance Order was the concern raised by CERS relating to the possible effect of the CAISO's proposed Market Redesign on its long-term bilateral contracts. Specifically, the CERS raised concerns that the implementation of an LMP-based market design would undermine the long-term contracts entered into by the CERS on behalf of retail customers during the 2000-2001 energy crisis.

7. In the June 17 Order, the Commission instituted a section 206 proceeding before an ALJ to investigate the feasibility of upholding the CERS contracts without modification, while implementing the CAISO's proposed Market Redesign, including the degree to which these types of contracts create market inefficiencies and are not operationally and economically compatible with the CAISO's proposed Market Redesign, and the options for resolving issues surrounding the seller's choice contracts.[9] Attachment B to the June 17 Order contained a list of 32 long-term power contracts executed by the CERS, as identified at that time on the CERS website. The June 17 Order directed the ALJ to determine which of these contracts was a seller's choice contract and to gather information on the universe of implicated contracts.[10] Also, the ALJ was instructed to "explore . . . the viability of creating a trading hub or other commercial solution as a means of addressing the issues presented by the seller's choice contracts."[11]

[7] *California Independent System Operator Corporation*, 100 FERC ¶ 61,060 (2002).

[8] *California Independent System Operator Corporation*, 105 FERC ¶ 61,140 (2003) (Guidance Order).

[9] *See* June 17 Order at P 166.

[10] *Id*.

[11] *Id*.

8. Certain parties[12] filed requests for clarification and rehearing of the Commission ruling in the June 17 Order regarding seller's choice contracts. Specifically, they challenge the scope of the instant proceeding and raise various other issues regarding seller's choice contracts.

9. During the course of the section 206 proceeding, the Chief Judge established a DAC to compile an inventory of seller's choice contracts that could be subject to investigation in this proceeding.[13] As a result of the inventory, the DAC identified an additional 260 contracts executed by various parties participating in the California energy market that may be characterized as seller's choice contracts. Additionally, the Chief Judge established settlement judge procedures to provide a forum for parties to renegotiate their seller's choice contracts prior to a formal hearing.

10. Twenty-eight motions to dismiss have been filed in this proceeding seeking to dismiss nearly 300 contracts identified as possible seller's choice contracts.[14] Some motions were filed in response to the June 17 Order, where parties argue that certain contracts listed in Attachment B are not seller's choice contracts. Other motions to dismiss were filed after the DAC List was established, seeking removal of certain contracts from the DAC List and the proceeding. Additionally, certain motions seek to dismiss contracts not captured in either Attachment B to the June 17 Order or in the DAC List. The motion to dismiss filed by El Paso Merchant Energy, L.P (El Paso) also seeks clarification of the scope of this proceeding. El Paso requests the Commission clarify that it did not intend to set for hearing contracts other than those included in Attachment B to the June 17 Order. In addition, several movants seek permission to remain parties to this proceeding even if their contracts are dismissed from the proceeding.

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[12] The following parties seek clarification: CERS; Calpine Corporation (Calpine); Coral Power, LLC and Sempra Energy Resources (Indicated Sellers); Northern California Power Agency (NCPA); El Paso; Constellation Power Sources, Inc., High Desert Power Project, LLC, and Morgan Stanley Capital Group Inc. (Constellation); Williams Power Company, Inc. (Williams); J. Aron & Company and Power Receivables Finance, LLC (J. Aron); Duke Energy North America LLC and Duke Energy Trading and Marketing L.L.C. (Duke).

[13] The DAC consisted of representatives from the CAISO, CDWR, and the legal representatives of other interested parties.

[14] The motions to dismiss are listed on Appendix A to this order.

Commission Determination

A. **Clarification on the Scope of the Section 206 Proceeding**

11. Attachment B to the June 17 Order identified 32 contracts signed by the CERS during the California energy crisis which may contain seller's choice terms. However, as the result of the inventory conducted by the DAC, approximately 300 contracts, including contracts between various other parties, have been identified as possible seller's choice contracts and are currently part of the section 206 proceeding. J. Aron, El Paso, Duke, Williams, and NCPA request that the Commission clarify the scope of the section 206 proceeding. Duke and NCPA ask the Commission to limit the scope of the hearing to exclude the contracts that specify a single delivery point, such as Palo Verde or the California-Oregon Border. While El Paso requests clarification that the scope of the hearing is limited to contracts included in Attachment B to the June 17 Order, J. Aron, Constellation, and Indicated Sellers argue that the hearing should also include all other seller's choice contracts because there is no basis to distinguish or single out the CERS contracts referenced in Attachment B to the June 17 Order and other existing seller's choice contracts.

12. In this order, we clarify that the scope of the hearing is limited to the contracts included in Attachment B of the June 17 Order. We believe that the confusion regarding the scope of the section 206 proceeding was caused by the directive in the June 17 Order for the ALJ to "gather applicable information on the universe of implicated contracts."[15] We clarify that the phrase "universe of contracts" refers to the contracts listed in Attachment B to the June 17 Order. Attachment B to the June 17 Order was compiled on the basis of the data available on the CERS website, and some of the contracts listed on that website did not appear to be seller's choice contracts.[16] For this reason, we directed the ALJ to determine which of the implicated CERS contracts was a seller's choice contract.[17] Accordingly, we directed the ALJ to explore the *universe* of implicated contracts from the contracts listed in Attachment B.

13. We also note that our decision to set for hearing only the CERS contracts was based on the CERS representation that its long-term bilateral contracts may not be operationally and economically compatible with the CAISO's proposed Market Redesign. According to CERS, these contracts involve large amounts of energy to be delivered and may have greater potential to impact the operation of the CAISO's market. For this reason, we concluded that the CERS contracts should be evaluated

[15] June 17 Order at P 166.

[16] *See id.* n. 100.

[17] *See supra* n. 16.

prior to the implementation of LMP. Accordingly, we deny J. Aron's, Constellation's and Indicated Sellers' requests for clarification.

B. Motions to Dismiss

14. Consistent with our clarification of the scope of the instant proceeding, all contracts not listed in Attachment B to the June 17 Order are hereby dismissed from the proceeding. This includes contracts contained in the motions to dismiss (as discussed below), as well as contracts for which parties have not sought dismissal from the proceeding.

15. Accordingly, we grant 28 motions to dismiss pending before us in this proceeding. Specifically, we grant motions to dismiss which contain contracts not listed in Attachment B to the June 17 Order. In addition, we grant motions seeking to dismiss certain CERS contracts listed in Attachment B to the June 17 Order. Our review of these motions to dismiss indicates that the CERS contracts identified therein are : (1) not seller's choice contracts because they do not permit the seller to unilaterally select the delivery point by establishing defined delivery points for energy or by providing for mutually agreeable designated delivery point(s) if the existing delivery point is changed or eliminated; (2) have expired or will expire before the implementation of LMP, scheduled for February 2007; or (3) the parties to the contract have mutually agreed to resolve possible seller's choice issues outside the scope of the section 206 proceeding.[18]

C. Clarification of Other Issues

16. J. Aron, Indicated Sellers, Calpine, El Paso, and Constellation challenge the Commission's decision to set the issue of seller's choice contracts for hearing. They believe that the hearing was not warranted because the Commission acknowledged that seller's choice contracts represent commercial matters best left to resolution by parties and because there was no material fact in dispute. According to J. Aron and Constellation, the Commission's finding that "seller's choice contracts appear to stand in the way of needed reform to the reliable operation of the CAISO grid and may therefore be unjust and unreasonable" is factually unsupported.

17. We disagree. The Commission concluded as early as January 2000 that the CAISO's congestion management system was fundamentally flawed and directed the CAISO to design a comprehensive replacement congestion management approach.[19]

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[18] Appendix A of this order denotes which motions to dismiss contain the CERS contracts.

[19] *See* January 2000 Order.

As a result, the CAISO has proposed an LMP market design to address the flawed system currently in operation. Because seller's choice contracts executed by the CERS could stand in the way of needed reform and thus the reliable operation of the CAISO grid, our decision to institute a section 206 proceeding before the ALJ to investigate the feasibility of upholding these contracts without modification and implementing the CAISO's proposed Market Redesign is appropriate. Specifically, we found in our initial review of the CERS contracts that a significant percentage of the contracts provided for large volumes of megawatts per hour; contained must-take or take-or-pay provisions; and allowed the seller of power to designate, at its sole discretion, the point of delivery thereby impeding the ability of the buyer to hedge its congestion costs under LMP.

18. J. Aron, Williams, and Indicated Sellers also request that the Commission clarify that the *Mobile-Sierra* public interest standard of review[20] will apply to the implicated contracts and the Commission will not abrogate any of the terms of the contracts unless it is proven that modification is compelled by the public interest.

19. The issue of the applicable standard of review is raised prematurely. We established the section 206 proceeding to investigate the feasibility of both upholding the seller's choice contracts [executed by the CERS] *without modification* and implementing the CAISO's proposed redesign.[21] For this reason, we deny these requests for clarification and rehearing.

20. CERS also requests clarification that the section 206 proceeding was not established for the purpose of interpreting individual contracts or to resolve any existing or potential contract interpretation disputes.

21. The June 17 Order clearly identifies the CERS contract terms to be examined by the ALJ in process of the hearing.[22] For this reason, we believe that no further clarification is needed.

22. CERS also seeks clarification that the scope of this proceeding also includes an examination of the financial effect the CAISO's marginal loss methodology on seller's choice contracts.

23. In the Guidance Order, the June 17 Order, and the September 20, 2004 Order,[23] the Commission approved the CAISO's proposal to use marginal losses in calculation

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[20] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power*, 350 U.S. 348 (1956).

[21] *See* June 17 Order at P 166.

[22] *See id.*

of LMPs because pricing losses on a marginal basis reflects more accurately the cost of supplying additional load at each location and, therefore, assures least-cost dispatch.[24] As a result, nodal prices under LMP will be calculated using a marginal loss methodology. In the September 20 Order, the Commission rejected requests by various parties to require a complete analysis of the cost and benefits associated with the implementation of the CAISO's marginal loss methodology. Accordingly, the CERS request for clarification is denied.

D. <u>Procedural Matters</u>

24. Parties listed in Appendix B to this order filed timely motions to intervene in this proceeding. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the filing of a timely motion to intervene that has not been opposed makes the movant a party to the proceeding.

25. In addition, certain parties seek permission to remain parties to this proceeding even if their contracts are dismissed from the proceeding. Pursuant to Rule 102(c) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.102(c) (2004), a party means, with respect to a proceeding, any respondent to a proceeding or any person whose motion to intervene has been granted. An entity whose contracts have been dismissed is no longer a respondent in the instant proceeding and thus loses its party status unless it has filed a motion to intervene which has been granted.

<u>The Commission orders</u>:

(A) Clarification of the scope of the section 206 proceeding is hereby given, as discussed in the body of this order; other requests for clarification and rehearing are hereby denied for the reasons stated in the body of this order.

(B) All motions to dismiss are hereby granted, as discussed in the body of this order.

(C) All other contracts not listed in Attachment B to the June 17 Order are hereby dismissed from the instant proceeding, as discussed in the body of this order.

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[23] *California Independent System Operator*, 108 FERC ¶ 61,254 (2004) (September 20 Order).

[24] *See id*. at P 142 and September 20 Order at P 60.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Deputy Secretary.

Appendix A

List of Motions to Dismiss

California Energy Resources Scheduling Division, California Department of Water Resources (re: Clearwood Electric Company, *et al*.) December 1, 2004*
California Energy Resources Scheduling Division, California Department of Water Resources (re: High Desert Power Project) February 16, 2005*
California Energy Resources Scheduling Division, California Department of Water Resources (re: Calpine Energy Services, L.P.) April 8, 2005*
California Energy Resources Scheduling Division, California Department of Water Resources (re: Coral Power LLC) April 11, 2005*
CalPeak Power Midway, LLC, *et al*. September 10, 2004*
Calpine Energy Services, L.P, *et al*. November 16, 2004**
Calpine Energy Services, L.P. (re: Northern California Power Agency) December 20, 2004
Calpine Energy Services, L.P. (re: Duke Energy Trading and Marketing, LLC) February 22, 2005
Calpine Energy Services, L.P. (re: SoCal Edison Company) March 4, 2005
Calpine Energy Services, L.P. (re: Strategic Energy, LLC) March 25, 2005
City of Alameda, *et al.* April 8, 2005
Colton Power, L.P., August 20, 2004*
El Paso Merchant Energy, L.P., August 31, 2004*
El Paso Merchant Energy, L.P., *et al*., November 17, 2004
GWF Energy, LLC., August 20, 2004*
Morgan Stanley Capital Group, Inc. , April 8, 2005
Pacific Gas and Electric Company (re: Maderia Power, L.L.C.) November 8, 2004
Pacific Gas and Electric Company (re: Community Renewable Energy Services Inc.) November 8, 2004
Pacific Gas and Electric Company (re: Wheelbrator Shasta Energy Company, Inc.) November 8, 2004
Pacific Gas and Electric Company, *et al*. (re: Sierra Power Corporation) November 8, 2004
Pacific Gas and Electric Company, *et al*. (re: Metropolitan Water District) December 2, 2004
Pacific Gas and Electric Company (re: California Energy Resources Scheduling Division, California Department of Water Resources), December 3, 2004 *
PPM Energy, Inc., *et al*. (re: City of Klamath Falls) November 24, 2004
PPM Energy, Inc., *et al* (re: Modesto Irrigation District) December 3, 2004
PPM Energy, Inc., *et al* (re: California Energy Resources Scheduling Division, California Department of Water Resources), February 22, 2005*

Shell WindEnergy, Inc., *et al*. August 12, 2004*
Wellhead Power Panoche, LLC, *et al*., August 13, 2004*
Williams Energy Marketing and Trading, October 29, 2004*

* Motion to Dismiss containing CERS contracts
** Motion to Dismiss containing one CERS contract

Appendix B

Motions to Intervene
Docket No. EL04-108-000

Avista Energy, Inc.
California Electricity Oversight Board
California Department of Water Resources California Energy Resources Scheduling Division
California Independent System Operator
California Public Utilities Commission
Calpeak Parties
Calpine Corporation
Cities of Redding, Santa Clara and Paolo Alto, California
City of Klamath Falls, Oregon
City of Roseville
Colton Power L.P.
Constellation
Coral Power, L.L.C.
Duke Energy Trading and Marketing L.L.C.
El Paso Merchant energy, L.P.
FPL Energy, LLC
GWF Energy LLC
High Desert Power Project
Independent Energy Producers
J. Aron
Modesto Irrigation District
M-S-R Public Power Agency
Mirant Corporation
Morgan Stanley Capital Group Inc.
Northern California Power Agency
Pacific Gas and electric Company
Power Receivable Finance, LLC
Powerex Corp.
PPM Energy, Inc.
Sacramento Municipal Utility District
San Diego Gas & Electric Company
Sempra Energy Resources
Shellwind Energy Inc.
Southern California Edison Company
Williams Power Company, Inc.