

BPA response to California ISO study

BPA Fact Sheet

April 13, 2001

This fact sheet addresses statements in a recent *L.A. Times* article asserting that BPA, among others, manipulated prices on the California electricity market. For additional information, contact Steve Oliver at (503) 230-3295.

Background

An April 11, 2001 article in the *L.A. Times* reported that the California Independent System Operator (Cal ISO) had performed a study accusing numerous marketers, including BPA and three other government agencies, of “consistently trying to inflate prices.” The article further states that, according to the study, BPA “. . . reaped millions more in alleged excessive profits, apparently because it supplied greater amounts of power during the period studied. Bonneville was in the top five accused of taking excessive profits.”

The article adds that the California spot market was designed so that all suppliers offering power received the same price, which equaled the highest bid accepted by the California ISO in any hour.

Summary:

BPA had neither the ability nor the motivation to manipulate the California market and did not in fact manipulate prices. On the contrary, BPA is suffering severe financial impacts from the California market breakdown and would benefit from lower prices. BPA frequently bought power from California and elsewhere along the West Coast last year to cover periodic Northwest power shortages. In fact for the May-Nov. 2000 period, BPA actually purchased about \$730 million of power including about \$60 million from the California PX and ISO. BPA continues to face large future purchase obligations in an inflated power market. As a matter of policy, BPA’s practice has been to price its offers into the California market at well below the prevailing market prices. This practice has often reduced, not increased, the California market-clearing prices. Further, BPA literally kept the lights on in California on several days over the last year by taking extraordinary measures in the operation of its hydro system.

(See citations beginning on page four from letters thanking BPA for its efforts from Cal ISO president Terry Winter, California Governor Gray Davis, and Senator Dianne Feinstein.)

Key Facts

- BPA consistently bid its surplus energy into the Power Exchange (PX) and ISO markets at prices well below the market-clearing price. The effect of this was to *lower* the overall cost of electricity to California consumers by bringing down the market-clearing price. BPA’s bids effectively supplanted bids from higher-priced sources. *(For the exception to this, see question 4 below.)*

- In the period May through October 2000, BPA was buying power from the California market to cover hydro shortages and nuclear plant outages almost as often as it was selling power. As a frequent buyer, BPA had no interest in driving prices up. Over the period, BPA bought roughly 550,000 MWh and sold roughly 850,000 MWh.
- Astronomical California power prices and power shortages are impairing BPA's ability to conduct normal hydro operations to benefit migrating salmon. BPA is having difficulty finding and affording the power purchases needed to maintain normal hydro operations for fish. Clearly, BPA's interest lies in lower market prices.
- The high prices in the California market are *hurting* BPA and are a major factor in a potential BPA wholesale rate increase of more than 100 percent. It is *not* in BPA's interest to drive prices up.
- During the past summer, BPA's power sales into the California market helped keep the lights on and air conditioners running. In fact, during the summer and fall of 2000, Terry Winter, the CEO of the California ISO twice wrote letters to BPA thanking BPA for keeping the state's lights on. BPA took extraordinary steps, at the urging of California officials, to help California avoid power blackouts – including temporary modification of operations intended to save threatened and endangered Columbia River salmon and high-priced power purchases to replace energy we provided to the ISO during their emergencies.
- Throughout the period reviewed by the Cal ISO study, BPA had very limited surplus to sell, and BPA's hydro system limitations gave it virtually no ability to decide when to put that surplus on the market. BPA was forced to sell when it had surplus and to buy when it was deficit, with little control over the timing of either. This made the CAL ISO hour-ahead market more attractive than the day-ahead California PX market. The decision to sell in the ISO versus PX was not an attempt to withhold power from the market. This physical reality left BPA with no ability to drive market prices up, even if it wanted to.
- BPA's sales account for less than 2 percent of the California market annually, reaching as much as 4 percent during high-runoff (and low-price) months.

Questions and answers

1. What benefits does California gain by having BPA buy and sell power in its markets?

1. As a direct result of BPA's assistance in providing power during system emergencies, the California ISO has been able to avoid Stage 3 rolling blackouts across the state on many occasions.
2. When there is surplus power in the Pacific Northwest, BPA's participation has increased California's power supply. When there's more power in the market, prices for that power are generally lower. During the relatively good water years of 1998 and 1999, the restructured California market worked smoothly, and prices were lower than expected, as

BPA and other Northwest parties bid large amounts of power into the PX and ISO markets.

3. BPA's participation in the California market has provided operating reserves and other ancillary services that have enabled California to operate its system reliably.
4. BPA also has provided capacity and balancing energy to California especially during its system emergencies. These two products have allowed California to meet spikes or peaks in demand throughout the course of an emergency.

2. When BPA purchases energy in the California market, it purchases large amounts. Is this a factor in causing electricity prices to rise?

BPA does not believe its participation significantly affects the price. BPA's ability to buy or sell to California is limited by transmission resources, availability of surplus and regional preference. When we participate in a large way in California we are talking about volumes of about 1,000-2000 MW per hour. The California market is a 50,000 MW market. In addition, BPA is just one of many participants in the California markets, providing less than 2 percent of the energy sold, and at other times buying a smaller percentage of the energy purchased. Whether BPA is selling or buying (or in the market at all), prices become the most volatile when the total demand is close to the maximum the system can supply. Prices are at their highest during the peak hours of the day. That's why, during the power shortage in June of last year, BPA purchased power from California during light load (or off-peak) hours so BPA's purchases would not impact the heavy load (on-peak) hours. Because of BPA's buying strategy, our purchases did not increase the upward pressure on peak-hour prices during California's June 2000 shortage.

3. Besides purchasing power from BPA in the hour-ahead spot market, did the Cal ISO seek to purchase power from BPA in out-of-market transactions?

Yes. At various times when it was facing a power emergency (more frequently as the crisis deepened), the Cal ISO would invoke emergency provisions in its tariff which allowed it to make out-of-market purchases. It would do this by calling BPA and other power suppliers when a shortage was imminent and attempt to arrange an emergency purchase for power to be supplied later in the day. These transactions, initiated by the Cal ISO, did not include a bid process and had no effect on the market clearing price. When the ISO requested this kind of help from BPA, the agency would often attempt to reshape its generation in order to provide the ISO as much help as possible. BPA would accept the price the ISO offered, typically based on the cost of energy to replace what BPA delivered. The Cal ISO study referenced in the *L.A. Times* article inappropriately and inaccurately included these types of sales in its analysis, resulting in apples and oranges comparisons.

4. Did BPA at any time bid higher energy prices?

Yes. In an effort to provide California as much help as possible during power emergencies, BPA would sell capacity in a form that included spinning and non-spinning reserves even when we had no energy to spare. These reserves are not supposed to be called upon for supply of base-load energy as they are intended to be used in the event of an outage. To

minimize the incentive to use BPA's capacity reserves for energy use, BPA would bid the capacity low but the potential energy component extremely high. Nevertheless, the ISO had the right to take the energy that BPA did not wish to sell, and at times it used this energy portion of the ancillary reserve service for meeting load rather than for assuring reliability, even in the absence of an outage. BPA repeatedly warned the ISO that using the reserves as a normal energy product is an improper use of such ancillary services that could threaten reliability and put BPA in the position of having to make expensive market purchases to replace the energy.

5. If BPA didn't manipulate the market, why would the California ISO allege BPA did so?

California is constantly examining the reasons for its present circumstances. It is looking at both market design as well as participation. While many experts believe the problem is due more to participation than design, it is still a matter of debate.

The ISO's motivations for accusing BPA of market manipulation are a mystery to us. After all the help BPA has rendered the ISO, it is difficult to understand what would drive the ISO to do this. We would prefer to think that, give the huge workload the ISO faces, it simply made a mistake. Clearly, the study is mistaken.

The ISO's study is based on a methodology that looks at sales made in the hourly market by sellers that did not bid power for sale the day before (in the day-ahead market), and assumed that this is an indication of market power abuse. BPA has large capacity contract obligations to utilities in the Pacific Northwest that have us standing ready to back up these utilities' generators on short (hour-ahead) notice. Therefore, while BPA frequently could not offer firm energy on a day-ahead basis, we nevertheless frequently could offer balance energy to the ISO in their hour-ahead market and even respond to an emergency (out-of-market) appeal which would have us alter river operations in order to help California avert the public health and safety threat of blackouts. The California governor, senators and ISO chief executive have all commended BPA for its approach to the California system and its problems. It is grossly misleading and unfair of the ISO at this point to report its data in a manner that so distorts the record of BPA's operation.

In an Aug. 11, 2000 letter, Cal ISO president and CEO Terry Winter said:

. . . the CAISO greatly appreciates the outstanding effort put forth by BPA staffs to help minimize the impact to our customers.

Four out of the five days of the week of July 31st to August 4th the CAISO faced emergency conditions that caused us to declare Stage 2 emergencies. Specifically, on August 3rd, BPA's last minute energy transactions prevented us from dropping firm load in order to maintain operating reserves. On the succeeding day we hovered on the brink of State 3 firm load interruption again and it was avoided due to real time transactions with your staffs.

California governor Gray Davis, in a Dec. 14, 2000 letter to BPA acting administrator Steve Wright said:

I am writing to express my gratitude to Bonneville Power Administration for selling power to California yesterday. As you know, eleven energy generators, marketers and utilities, mostly located outside of California, contact the California ISO yesterday and indicated their reluctance to sell electricity into California without letters of credit from California's investor owned utilities.

Your cooperation came at a critical time and helped California to avert a rolling blackout. Thank you very much.

Senator Dianne Feinstein (D-Calif.), in a Dec. 14, said:

I am writing to express my gratitude to Bonneville Power Administration for selling power to California yesterday.

Yesterday my State nearly had an energy catastrophe. In a meeting at my office yesterday to discuss California's energy situation with Governor Davis, Secretary Richardson from the Department of Energy, and Federal Energy Regulatory Commission Chairman Hoecker, calls came into my office that within the hour, a rolling blackout could hit California and that the California Independent System Operator (ISO) would not be able to purchase the power necessary to "keep the lights on."

(Sen. Feinstein then cites the reluctance to sell power to California of the out-of-state energy generators and marketers mentioned in Gov. Davis' letter.)

I am grateful for BPA's cooperation! THANK YOU!