UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

AES Redondo Beach, LLC	)	**Docket No. ER98-2843-000**
	)	
AES Huntington Beach, LLC	)	**Docket No. ER98-2844-000**
		)
AES Alamitos, LLC	)	**Docket No. ER98-2883-000**
)		
	)	**(Not Consolidated)**
Long Beach Generation, LLC	)	**Docket No. ER98-2972-000**
	)	
El Segundo Power, LLC	)	**Docket No. ER98-2971-000**
	)	
	)	**(Not Consolidated)**
Ocean Vista Power Generation, LLC	)	
Mountain Vista Power Generation, LLC	)	
Alta Power Generation, LLC	)	**Docket No. ER98-2977-000**
Oeste Power Generation, LLC	)	
Ormond Beach Power Generation, LLC	)	

EMERGENCY MOTION FOR STAY, NOTICE OF ACTION TAKEN,
REQUEST FOR REHEARING,
AND MOTION FOR CLARIFICATION OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Section 313(a) of the Federal Power Act ("FPA"), 16 U.S.C. § 825l(a) (1997) and Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713 (1997), the California Independent System Operator Corporation ("ISO"), hereby moves the Commission for an order immediately staying its Orders of June 30, 1998 (the "June 30th Order"), in the above-entitled AES proceedings, and July 10, 1998 (the "July 10th Orders") in the balance of the above-entitled proceedings. The ISO seeks a stay pending resolution of its requests for rehearing and clarification contained herein.

In the June 30th Order, the Commission granted authorization to the AES companies to sell Regulation, Spinning Reserve and Non-Spinning Reserve Ancillary Services at market-based rates based on a "dominance study" finding that the companies did not generally control a significant percentage of the market for each particular service. The Commission also granted AES authorization to bid Replacement Reserves at market-based rates, but based on a finding applicable to a much broader class of market participants. Specifically, although Replacement Reserves are identified as an Ancillary Service under the ISO Tariff, the June 30th Order nevertheless concluded that Replacement Reserves are not an ancillary service under Order No. 888[1] and, therefore, do not require a specific showing of a lack of market power in order to sell at market-based rates. Thus, the Commission has held that a general authorization to sell capacity or energy at market-based rates suffices to allow bidders to bid uncapped prices in the Replacement Reserve markets of the ISO. This broadly applicable holding was not immediately recognized by many market participants, although a limited number of bidders did, in fact, realize that the order had been issued. The ISO infers this because certain bidders submitted bids substantially in excess of their cost-based caps on July 8, 1998 for the July 9, 1998 Trading Day.

As a consequence of the June 30th Order, the ISO has witnessed a dramatic spike in the price for Replacement Reserve capacity. The implication of the June 30th and July 10th Orders is of even greater concern given the potential for these dramatic price spikes to occur in all four ISO Ancillary Services Markets.

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[1] Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21540 (1996), Order on Reh'g, Order No. 888-A, 62 Fed. Reg. 12274, Order on Reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), Order on Reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

On July 1, 1998, because of congestion problems, the ISO began procuring Ancillary Services on a zonal basis. On Thursday, July 9, 1998, in the Southern Zone (south of Path 15,[2] "SP15"), prices for Replacement Reserves reached $5,000/MW in three hours and $2,500/MW and $750/MW in two other hours. The total cost of Replacement Reserves for SP15 in these hours was $9.125 Million. (In comparison, the costs for Replacement Reserves in those same hours and for the same amount of capacity in SP15 was $3,300 on June 25, 1998.) The following day, the ISO exercised its discretion to eliminate any purchase of Replacement Reserves. This "circuit breaker" allowed time to get full information of the June 30th Order to all market participants. If the market had been allowed to run, bids of $9,999/MW for Replacement Reserves, which had been received, would have resulted in costs of $7.2 Million to the market in the SP15 zone.

The ISO advised market participants of its intent to purchase 500 MW of Replacement Reserves (250 MW for the Southern zone and 250 MW for the Northern zone) for Trading Day July 11, 1998 in anticipation that the market would self-correct.

For both Trading Days July 11 and 12, 1998, sufficient bids were submitted for Replacement Reserves. Significantly, however, there were insufficient bids for Operating Reserves both days. This demonstrates one of the complexities of lifting caps in only one of the four ISO Ancillary Services markets. Because the markets are run sequentially and Replacement Reserves is the last of the four to run, bidders seeking market prices may withhold bids from the other three markets to ensure sufficient capacity to win in the Replacement Reserve auction.

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[2] Path 15 is a major transmission line separating the Northern and Southern Zones.

Although the market self-corrected for two days, for Trading Day July 13, 1998 the ISO once again had insufficient bids for Replacement Reserves in certain hours. Bids of $9,999/MW set the market clearing price in the SP15 zone in hour 14 to18. The balance of capacity was obtained through Reliability Must-Run units. Unlike July 10, 1998, the ISO did not have the flexibility to decline to purchase Replacement Reserves this time; neither will it have that flexibility on a regular basis. Thus, it is clear that in certain hours there is still market power being exercised, as demonstrated by extremely high bid prices.

Continued insufficiency of bids ("thin" markets) is of potentially greater concern in the three other Ancillary Services markets, now that the Commission has authorized market-based rates for all of the purchasers of the Southern California Edison Company ("Edison") units, <u>but not for other market participants</u>. Although high market clearing prices have not been experienced in the three other Ancillary Services markets, these markets experience regular insufficiency of bids in certain hours. Thus, there is no guarantee that the market clearing prices will not soar for all markets in some hours.[3]

This situation is untenable. In an energy market of approximately $63 million daily, consumers should not be asked to pay exorbitant prices -- of $9 million or more daily for Ancillary Service market prices in markets not yet workably competitive. To remedy this situation, the ISO is filing this Motion for Stay and Request for Rehearing and Clarification of the June 30th Order and the July 10th Orders and pending Commission action of its request, is taking action necessary to guard against market abuse.

I. NOTICE OF ACTION TAKEN

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[3] As noted infra at n. 3, in the auction held today for Regulation service, a bid of $2,500/MW already has been submitted.

The ISO urges that the Commission grant the requested stay at the earliest possible time. In the interim, to help ameliorate the prejudicial consequences that would flow from the exercise of market power, the ISO believes that it must take the action that is currently available to it.

Accordingly, the ISO has announced today that it will not be purchasing Replacement Reserves for Trading Day July 14th. However, the ISO will not thereafter be able to rely on the suspension of that service to protect against market abuse. It is anticipated that the California market may soon experience a significant heat wave and that demand may reach peak conditions. Accordingly, the ISO has also announced that beginning with Trading Day July 14th, it will cap the prices that it will pay to those bidders that have been granted market-based rate authority for Regulation, Spinning, Non-Spinning and Replacement Reserves at $500/MW until such time as the Commission has had an opportunity to act on this request for extraordinary relief. The cap is being set at $500/MW to ensure adequate market participation during what could be a high load period.[4] The ISO's Market Surveillance Committee will monitor market performance and if bidding conditions indicate that an adjustment in the cap-price is appropriate, the ISO will take action and will notify the Commission and the market participants at the earliest practicable time. The ISO believes that it has the authority and responsibility under its Tariff and Protocols to adjust its purchases of Ancillary Services in this fashion to guard against the potential for market power abuse.

[4] The $500/MW cap, while it should be high enough to stimulate market interest, will also serve to protect against abusive prices. In today's auction for Regulation service, a bid of $2,500/MW was submitted.

By this filing, which is being provided to all Scheduling Coordinators, and noticed on WEnet, the ISO is notifying both the Commission and market participants of the procedure that will be in place until further action by the Commission.

II. INTRODUCTION AND SUMMARY

The ISO is mindful of the extraordinary nature of certain portions of its request. Were it not absolutely convinced that the June 30th and July 10th Orders have the potential, already demonstrated, to visit considerable prejudice upon consumers, it would be loathe to seek a stay. But the reality is that the market has been impacted, prejudicially so, as a direct consequence of the June 30th Order, and there is every reason to believe that the July 10th Orders will have further adverse consequences.

Although it appeared on July 10th that the market for Replacement Reserves would self-correct, events over the weekend confirm that even when all market participants have uncapped rates, the markets are not yet workably competitive in all hours in all zones. Prudence dictates a "time out" by the Commission and a rethinking of the orders thus far granted.

The ISO therefore requests that the Commission immediately stay its June 30th and July 10th Orders until the ISO's concerns about the Commission's classification of Replacement Reserves can be reheard and until the Commission can consider, based on a time-differentiated market power study, the propriety of granting any seller market-based rate authority for the services at issue. In seeking a stay, the ISO recognizes the burden it bears. It is convinced, however, that the circumstances amply satisfy the governing "when justice so requires" test. Boston Edison Co., 81 FERC ¶ 61,102, 61,104 (1997) (quoting 5 U.S.C. § 705).

If, notwithstanding the potential for the exercise of market power -- including in the markets for Ancillary Services -- the Commission is unwilling to stay its Order, the ISO requests relief that at least will help ameliorate the prejudice that could be imposed on consumers. Specifically, the ISO seeks, in the alternative, that the Commission authorize the ISO to cap all bids above a specified level.

Finally, the ISO seeks clarification of the intended import of the June 30th and July 10th Orders. Notwithstanding that under the ISO Tariff market participants who lack market-based rate authority are limited to cost-based rates for Replacement Reserve service, all bidders are taking the position that they now are entitled to recover the market clearing price. Given these Orders, the ISO does not believe it can refuse to pay all sellers, including Pacific Gas & Electric Company ("PG&E"), Edison, and San Diego Gas & Electric Company ("SDG&E") the market clearing price. The ISO seeks clarification that this is the Commission's intent.

The ISO is committed to a competitive model for the provision of all power supply services, including those classified as Ancillary Service. It is doing all that it can to bring that about at the earliest possible time, including by supporting applications for market-based rate authority where the absence of market power has been demonstrated and by suggesting a temporary increase in the cost-based caps. But when a request for that authority has the potential to introduce serious market distortions, caution must be counseled and a deliberative analysis pursued. The June 30th and July 10th Orders present the opportunity for those prejudices to flow. The ISO respectfully urges a stay of the June 30th and July 10th Orders (granted without hearing and on a notational basis) as soon as possible, until this rehearing request can be given the level of consideration that the evidence presented herein and the economic harm already suffered clearly warrant.

III. BACKGROUND

A. Ancillary Services Under the ISO Tariff as Accepted by the Commission's October 30, 1997 Order

The ISO is a non-profit public benefit corporation that operates a grid initially composed of the transmission systems of PG&E, Edison, and SDG&E. Consistent with its Commission-approved tariff, the ISO is responsible for maintaining the reliability of transmission in its control area and for overseeing the market for the Ancillary Services necessary to ensure that reliability.

As proposed, the ISO Tariff included six Ancillary Services: Regulation, Spinning Reserve, Non-Spinning Reserve, Replacement Reserve, Voltage Support, and Black Start capability.[5] The Commission recognized that the ISO's Ancillary Services "are not simple one-to-one matches with those identified under Order No. 888." Pacific Gas & Electric Co. et al., 81 FERC ¶ 61,122, 61,490 (1997) (the "October 30, 1997 Order"). Nevertheless, the Commission concluded that the tariff proposal "generally conforms with its ancillary services requirements" and that it would "accept the proposed ISO Ancillary Services because the actions required by the ISO and the obligations under the tariff indicate it will provide all necessary services."[6]

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[5] ISO Tariff at § 2.5 and Appendix A. The combination of Spinning and Non-Spinning Reserve required to meet Western Systems Coordinating Council ("WSCC") and North American Electric Reliability Council ("NERC") requirements is referred to as the Operating Reserve.

[6] Id. The example the Commission cited as a deviation from the list of Ancillary Services in Order No. 888 was not Replacement Reserves but rather a lack of a distinct Ancillary Service for Scheduling, System Control and Dispatch Service. Id. at n. 282. The Commission recognized that the ISO Tariff does provide for "comparable service with the costs allocated to the Scheduling Coordinators in proportion to the energy they schedule each month." Id.

Under the ISO Tariff, Regulation is the service provided by generating units equipped and operating with Automatic Generation Control capability and therefore able to match on a real time basis changes in load and generation. ISO Tariff at § 2.5.3.1 and Appendix A. The percentage amount of Regulation to be obtained (between one and five percent of load) is determined by the ISO based upon its need to meet WSCC and NERC control performance criteria. Id. at Appendix L, Ancillary Service Requirements Protocol ("ASRP") 4.1.2.

Spinning Reserve is the portion of unloaded synchronized generating capacity that is immediately responsive to system frequency and is capable of being loaded in ten minutes. Id. at Appendix A. The ISO is required to maintain Spinning Reserves equal to at least one-half of the daily Operating Reserve requirement where such requirement is the greater of the single largest contingency or seven percent of demand, except demand met by hydroelectric generators in which case the seven percent figure is reduced to five percent. Id. at Appendix L, ASRP 5.

Non-Spinning Reserve is off-line generating capacity that is capable of being started, synchronized, and available to meet load within ten minutes. Id. at Appendix A. Replacement Reserve is off-line generation capable of starting and being synchronized within sixty minutes. Id. at Appendix A. The ISO makes its determination of the required quantity of Replacement Reserve based several factors including: (1) analysis of the historical deviations between the Day-Ahead forecast and actual Demand, (2) patterns of unplanned Generating Unit and transmission outages, and (3) any other factor influencing the ISO's ability to ensure grid reliability. Id. at § 2.5.3.3 and Appendix L, ASRP 6.1.2.

To provide the required supplies of Regulation, Spinning Reserves, Non-Spinning Reserves, and Replacement Reserves, the ISO operates Day-Ahead and Hour-Ahead Markets. Scheduling Coordinators may bid the same capacity into each market. The ISO evaluates bids sequentially.[7] The price paid to bidders is the zonal market clearing price for that service (Id. at §§ 2.5.14 to 2.5.17) unless the bid is submitted by a public utility that is limited, under the FPA, to cost-based rates. Id. at § 2.5.7.3.

B. The Various Applications and the ISO's Comments

On May 1, 1998, AES filed three separate applications (one for each company) requesting that the Commission grant each company market-based rate authority for four Ancillary Services, Regulation, Spinning Reserve, Non-Spinning Reserve, and Replacement Reserve, during times when it is not obligated to sell those particular services to the ISO under its reliability must-run agreements. On May 21, 1998 as supplemented on June 8, 1998, the ISO filed a motion to intervene, and comments, in each proceeding. The ISO stated that it generally supported market-based rates for the provision of Ancillary Services to the ISO, but protested that AES had not demonstrated that it lacked market power in the Ancillary Service markets. The ISO noted that the markets for Ancillary Service were Day-Ahead Market and Hour-Ahead, and that the demonstration that a seller lacked market power required a time-differentiated market study. The ISO asked that the Commission cap AES' rates at a level that would be high enough to provide an incentive to bid into the Ancillary Service markets, but that would ensure that generators did not receive excessive prices.

On May 12, 1998, Long Beach Generation LLC ("Long Beach") and El Segundo Power, LLC ("El Segundo") filed separate applications for "Market-Based Ancillary Services Rates" for Regulation, Spinning Reserve, Non-Spinning Reserve, and

[7] The bids are evaluated in the following order: Regulation, Spinning Reserves, Non-Spinning Reserves, and Replacement Reserves. ISO Tariff at § 2.5.13.

Replacement Reserve. On May 13, 1998, Ocean Vista Power Generation, L.L.C., ("Ocean Vista"), Mountain Vista Power Generation, L.L.C. ("Mountain Vista"), Alta Power Generation L.L.C. ("Alta Power"), Oeste Power Generation L.L.C., ("Oeste Power"), and Ormond Beach Power Generation, L.L.C ("Ormond Beach") filed an "Application for Authority to Sell Specific Ancillary Services at Market–Based Rates and Request for Expedited Consideration". The ISO filed a Motion to Intervene and Comment in all of the above-referenced proceedings. The ISO motions were similar to the motions filed in the AES proceeding.

The ISO recommended a specific cap for all participants of $25/MW. The ISO determined that at $25/MW, there would be a sufficient number of RMR and non-RMR units that could reasonably be expected to enter the Ancillary Services market. See, e.g., ISO's June 2, 1997 motion to intervene in <u>Ocean Vista, et al.</u>, at p. 8-12. The ISO believed that the higher cap would provide an incentive for currently unloaded and RMR capacity to bid into the Ancillary Services markets, thereby facilitating the creation of a viable and robust market.

C. <u>The June 30th and July 10th Orders</u>

In its June 30, 1998, "Order Accepting for Filing Proposed Market-Based Rates for Certain Ancillary Services," 83 FERC ¶ 61,358 (1998), the Commission made three primary determinations. First, the Commission accepted AES's applications to sell into the markets for Regulation, Spinning Reserves, and Non-Spinning Reserves at market-based rates. AES's market power study divided the market geographically, but not on a time-differentiated basis. The ISO had protested the AES applications, noting insufficiency of bids in certain hours, asking that a more specific time-differentiated market power analysis be required, and suggesting that in the interim <u>all</u> bidders' cost-based caps be raised to $25/MW based on the ISO's analysis of the amount of capacity available in the market that could be expected to bid at those levels.

Significantly, the Commission appeared to reach a broader conclusion with respect to Replacement Reserves stating,

> Replacement Reserve Service, however, is not an ancillary service under Order No. 888. Thus, the Applicants may sell Replacement Reserve Service under their previously-authorized market-based rates and do not require separate authorization here.

June 30th Order, Slip op. at 5. Finally, the Commission recognized that it could "revisit this issue at any time that the ISO's market monitoring identifies concerns that require the Commission's attention." Id. Slip op. at 10.

The Commission did not place the June 30th Order on its agenda for issuance after a public meeting. Moreover, the Commission not only granted AES's requests for market-based rate authorization without suspension, but also waived the sixty-day notice requirement to permit those authorizations to be effective retroactive to May 2, 1998. Id. Slip op. at 12.

On July 10, 1998, the Commission issued its Orders involving Long Beach, El Segundo, Ocean Vista, Mountain Vista, Alta Power, Oeste Power, and Ormond Beach. The July 10th Orders reached the same determinations expressed in the June 30th Order and indeed cited the pervious decision. With respect to Replacement Reserves, the Commission stated in the July 10th Orders:

> As Indicated in AES Redondo Beach L.L.C., et al., 83 FERC ¶ 61,358 (1998), there is no requirement for any public utility with market-based rate authority to seek separate approval to sell "replacement reserves" at market-based rates.

See, El Segundo Power, LLC et al., 84 FERC ¶ 61,011 (1998), Slip op. at 5.

D. Events Subsequent To the June 30th Order

From the start of ISO grid operations to the beginning of June, bid prices in the Ancillary Services markets ranged at levels between $4.47/MW and $12.00/MW. On June 10, 1998, the Commission issued an Order in Long Beach Generation, LLC, et al., 83 FERC ¶ 61,277 (1998) (the "June 10th Order") accepting, subject to refund, "cost-based" rates proposed by El Segundo Power, LLC ("El Segundo"). Those were rates based on the "Dispatch Rate" contained in Southern California Edison's ("Edison") Reliability Must-Run Agreement ("RMR Agreement") with the ISO.[8] Immediately after the June 10th Order accepting El Segundo's proposed rates, the ISO began receiving bids as high as $244.60/MW for Ancillary Service capacity. In some hours, those bids have established the market-clearing price for Ancillary Service capacity. The ISO's request for rehearing of the June 10th Order is pending.

Following, the June 30th Order, however, the Ancillary Service market, and in particular the market for Replacement Reserves, experienced a dramatic increase in price. For the July 9, 1998 Trading Day, the market clearing price was $5,000/MW for Replacement Reserves for three hours. This price was applicable in the SP15 Zone.[9] The situation deteriorated the following day, when the ISO was projecting a market clearing price for Replacement Reserves during certain hours of $9,999/MW.

The ISO took a number of actions. First, consistent with its authority under the ISO Tariff, the ISO reevaluated its need for Replacement Reserves. Section 2.5.3.3 of

[8] The RMR Agreement was assigned by Edison to El Segundo as part of Edison's divestiture process, and is pending before the Commission in Docket No. ER98-441. The Dispatch Rate is an energy rate, determined by a formula incorporating three components: (a) a Reliability Payment, based on the product of the unit's energy output during the hour and a Reliability Payment Rate that equals $244.70/MWh for El Segundo's Units 1 and 2 and $33.30 for Units 3 and 4; (b) a Variable Cost payment; and (c) a Start-Up payment, if applicable.

[9] Beginning on July 1, 1998, the ISO has split the zones for procurement of Ancillary Services. This has been required for reliability needs.

the ISO Tariff and Section 6.1.2 of the ASRP permit the ISO to exercise its discretion in determining the required quantity of Replacement Reserves. The ISO operators determined, based on system and weather conditions, that the system could ensure reliability based on its Operating Reserves, without the need for any additional Replacement Reserves.

Second, the ISO issued a number of releases to its market participants disseminating information concerning the Commission's June 30th Order. The ISO also announced a forecasted need for 500 MW of Replacement Reserves (250 MW each in the Northern and Southern Zones) for Trading Day July 11, 1998.

Prices for Trading Day July 11, 1998 returned to significantly lower levels. Attachment A contains Market Summary Reports showing the market clearing prices for Regulation, Spinning Reserves, Non-Spinning Reserves, and Replacement Reserves for each hour of each day from June 28, 1998 through July 12, 1998 for both the Northern and Southern Zones. The ISO issued another notice to market participants on July 10, noting that the Replacement Reserve market appeared to be self-correcting. This notice advised of expected orders granting market-based rate authority to additional units (which, in fact, were issued notationally (the July 10th Orders) but not available on the Commission's system throughout the weekend). The ISO encouraged Scheduling Coordinators to bid all available capacity into all four Ancillary Service markets to avoid bid insufficiency and the danger that high bids could lead to price spikes in the other markets.

For Trading Day July 13th, another significant price hike was experienced when there were insufficient bids in the Replacement Reserve market for hours 14 through 18 and the market clearing price was set at $9,999/MW. Reliability conditions did not allow the ISO to reduce planned purchases; therefore the SP15 loads incurred costs of approximately $12.5 million in just those five hours. The ISO issued another notice to the market, restating the need for Scheduling Coordinators to bid all available capacity into the Ancillary Services markets.

IV. EMERGENCY MOTION FOR A STAY

The ISO requests that the Commission stay its June 30th and July 10th Orders both with respect to its determination that bidders with general authorization to sell power at market- based rates need not demonstrate a specific lack of market power in the Replacement Reserve markets and its blanket authorization for the subject sellers to bid at market-based rates in the Regulation, Spinning Reserve, and Non-Spinning Reserve markets. The Commission may stay its action "when justice so requires." Boston Edison Co., 81 FERC at 61,104, quoting 5 U.S.C. § 705. In deciding whether to grant a stay, the Commission generally considers such factors as the balance of interests between the party seeking the stay and the public interest generally, whether the movant will suffer irreparable harm in the absence of the stay, and whether a stay would substantially harm other parties. Western System Power Pool, 55 FERC ¶ 61,154, 61,492 (1991). Applying the balancing test, the Commission has granted stays when necessary to protect consumers from paying exorbitant rates pending clarification and rehearing of a Commission order. Id.

A stay is necessary of the June 30th and July 10th Orders:

- To permit the ISO to evaluate and report on the recent bidding activity in its Ancillary Service markets;
- To enable the ISO to implement software modifications that allow Ancillary Services bids from outside the ISO Control Area;
- To enable the ISO, discussed at page 25, infra, to implement software modifications that would allow a Scheduling Coordinator to receive both market clearing prices and capped prices for individual ancillary services;
- To permit the Commission time to evaluate the significant and complex issues associated with unconstrained market-based rate bidding in the California markets for Ancillary Services;
- To permit market participants, other than those subject to the June 30th and July 10th orders, to seek the necessary regulatory authorizations to broaden the number of bidders with market-based rate authority; and

- To eliminate the significant potential that ratepayers in California would pay excessive amounts for electricity due to prices for Ancillary Services that reflect the exercise of market power.

In a typical stay request, the movant seeks to prevent its own economic injury. Here, however, the ISO is acting, as required by its tariff, to protect the interests of the participating Schedule Coordinators and their customers. For Scheduling Coordinators who do not self-supply, the ISO operates competitive Day-Ahead and Hour-Ahead markets to ensure that Ancillary Services are provided "at least cost to End-Use Customers consistent with maintaining system reliability." ISO Tariff § 2.5.8. In making this request, the ISO does not seek to harm the subject sellers. To the contrary, the ISO encourages full participation in the Ancillary Services markets. But if consumers are to be protected from the potential for market power abuse, it is necessary that bids into the markets for Ancillary Services, including the auction for Replacement Reserves, be limited to previously-approved cost-based levels until a better demonstration is made that viable markets will be functioning at all times. Balancing of the public interest clearly supports the ISO's stay request. Absent a stay, End-Use Customers potentially will be required to pay excessive amounts for Ancillary Services, <u>without the possibility of refunds</u>.

V. SPECIFICATION OF ERRORS

In accordance with Rule 713(c)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c)(1), the ISO urges the Commission to grant rehearing to correct the following errors in the June 30th and July 10th Orders:

1. The Commission should reverse its determinations that Replacement Reserve is not an Ancillary Service and that a supplier need not demonstrate a specific lack of market power in the market for that service in order to bid at non-cost based rates.
2. The Commission should have required each seller in the above-referenced dockets to conduct a time-differentiated study before granting authorization to sell Regulation, Spinning Reserves, Non-Spinning Reserves, and Replacement Reserves at market-based rates.

3. Absent a time-differentiated study, the Commission should permit the ISO to cap bids above $500/MW.

VI. REQUEST FOR REHEARING

A. In Finding that Replacement Reserves Are Not an Ancillary Service and Relieving Suppliers of the Need To Demonstrate Lack of Market Power for that Discrete Service Before Being Able To Supply Replacement Reserves at Market-based Rates, the Commission Has Departed From Its Own Precedent

In the June 30th and July 10th Orders, the Commission summarily concluded that the Applicants may sell Replacement Reserve service under their previously-authorized market-based rates and do not require separate authorization. See, for example, the June 30th Order, Slip op. at 5. The predicate was the assumption that Replacement Reserve service "is not an ancillary service" designated as such under Order No. 888. Id.

The ISO contests this interpretation of Order No. 888. While the term "replacement reserves" may not be among the enumeration of the services that must be offered by a transmission provider, the nature of the service that it represents is. Under the ISO approved tariff, "Replacement Reserve" is:

> [g]enerating capacity that is dedicated to the ISO, capable of starting up if not already operating, being synchronized to the ISO Controlled Grid, and ramping to a specified load point within a sixty (60) minute period, the output of which can be continuously maintained for a two hour period. Also, curtailable demand that is capable of being curtailed within sixty minutes and that can remain curtailed for two hours.

ISO Tariff at Appendix A, p. 345.[10]

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[10] Replacement Reserve is not analogous to the "Backup Supply" service discussed in Order No. 888. Backup Supply is not considered an ancillary service under Order No. 888 and was described as a long term service that could last "for hours, weeks, or longer." FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 ¶ 31,036 at 31,710-711 (1996).

As such, the ISO designation of “Replacement Reserve” is analogous to the Order No. 888 designation of “Supplemental Reserve” which, in the language of that Order:

> . . . is also generating capacity that can be used to respond to contingency situations. Supplemental reserve, however, is not available instantaneously, but rather within a short period (usually ten minutes). Supplemental operating reserve is provided by generating units that are on-line but unloaded, by quick-start generation, and by customer interrupted load i.e., curtailing load by negotiated agreement with a customer to correct an imbalance between generation and load rather than increasing generation output.

61 Fed. Reg. at 21582-83.

Thus, Replacement Reserves under the ISO Tariff is functionally indistinguishable from Supplemental Reserves required by Order No. 888 to be made available by transmission providers. There is admittedly one definitional distinction: under the ISO Tariff the lead-time associated with the availability to the grid of Replacement Reserves may be as long as sixty minutes, while Supplemental Reserves, according to Order No. 888, are capable of synchronization “within a short period (usually ten minutes).” Id. at 21582-83. That distinction should not, however, be controlling. First, Order No. 888 itself describes the ten minute characteristic as the situation that pertains “usually,” not as a limitation. This is appropriate. As regions across the country embark on ISO transmission experiments, it inevitably will be the case that local circumstances will dictate regional approaches to the assurance of reliability. It is far too early in this experiment to conclude confidently that "one size fits all."[11]

Moreover, the Commission itself, both in its Order No. 888 characterization ("usually") and in its response to regional initiatives, has recognized the need for flexible interpretation. In its Order accepting the restructured NEPOOL ISO Tariff, the Commission noted that:

> Under the NEPOOL Tariff, there are three types of Operating Reserves: 10-Minute Spinning Reserve Service, 10-Minute Non-Spinning Reserve Service, and 30 Minute Reserve Service.

New England Power Pool et al., 83 FERC ¶ 61,045, 61,250 (1998).

The first two of those services have parallels in the California ISO Tariff. The third, "30 Minute Reserve Service," like the California ISO's "Replacement Reserve Service," is not among the Order No. 888 enumerated Ancillary Services. Yet, like Replacement Reserves, it is functionally equivalent to Supplemental Reserve Service. The Commission, undoubtedly cognizant that it is critical to allow for regional variations, accepted NEPOOL's "30 Minute Reserve Service" notwithstanding the 10 minute "usual" time-span referenced by Order No. 888. The Commission Staff, in testimony filed in Niagara Mohawk Power Corporation, Docket No. OA96-194-000, also supported 30 minute reserves as an Ancillary Service. Exhibit No. S-9, Direct Testimony of Visweswararao V. Tekumalla at 32.

The ISO Tariff does not provide for a 30 Minute Reserve Service. Based on the characteristics of the California interconnected grid, the judgment was made (and as the ISO discusses presently, accepted by the Commission) that at this point in time 60 minute service is more appropriate. The Commission, in the June 30th Order, offers no explanation why 60 minute service, but not 30 minute service, runs afoul of Order No. 888. To the extent that consistency with the enumeration of Ancillary Services in

[11] Thus, under its Tariff, the ISO, in setting standards to govern the provision of Ancillary Services, is to base those standards "on WSCC Minimum Operating Reliability Criteria ("MORC") and ISO Controlled Grid reliability requirements." Tariff, § 2.5.2.1.

Order No. 888 was considered dispositive in the June 30th Order, the Commission should reverse its conclusion and find that "Replacement Reserve service" is functionally equivalent to "Supplemental Reserve service."

But even accepting that Replacement Reserves is not among the Order No. 888 enumerated Ancillary Services that a transmission provider must make available under its Open Access Tariff, nowhere in Order No. 888 is it suggested that the required listing must remain the exclusive enumeration. To the contrary, while characterizing the designated services as required offerings,[12] Order No. 888 makes clear that either the Commission[13] or transmission providers and their customers, may expand the list:We will not require other interconnected operations services as part of an open access transmission tariff. If a transmission provider supplies such services voluntarily, they may be added to a customer's service agreement with the transmission provider.

Id. at 21581.

If the Commission is disinclined to accept Replacement Reserve service as an Order No. 888-type Ancillary Service, it should at a minimum accept it as an appropriate expansion by the ISO of its required Ancillary Service offerings. Indeed, this is what the Commission previously has done.

In its November 26, 1996 Order conditionally authorizing the establishment of the ISO, the Commission observed:

D. Ancillary Services

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[12] ". . .we identify some of these as ancillary services that must be offered with basic transmission service under an open access transmission tariff." 61 Fed. Reg. at 21581.

[13] In a footnote to the statement quoted in n. 8, the Commission noted that the NERC list of ancillary services, upon which the Commission relied, "is a work in progress and therefore may not be a complete list." The Commission explicitly "encouraged" the efforts of a NERC working group considering modifications to the list and stated that it "will consider future changes to the list of ancillary services . . . ." Id. at n.353.

> Under the proposal, the ISO would provide a range of ancillary services, which the Companies state are consistent with Order No. 888. The Companies propose that system protection, replacement reserves, load following (regulation), energy imbalance, and loss compensation ancillary services be priced through an ancillary services auction at market-based rates.

Pacific Gas & Electric Co. et al., 77 FERC ¶ 61,204, 61,833 (1996) (emphasis added). The Commission explicitly found that ". . . [t]he Companies' proposed list of ancillary services appears reasonable and consistent with those outlined in Order No. 888 . . . ." Id. The Commission held, however, that an adequate showing had not been made to support market-based rates for those Ancillary Services. Id. Significantly, the Commission noted that, in order to make an acceptable showing of a lack of market power in the ISO's Ancillary Service markets (including the markets for Replacement Reserves), an applicant would have to meet the criteria for selling Ancillary Services at market-based rates under Order No. 888, the precise criteria that the June 30th and July 10th Orders finds to be inapplicable.[14] The Commission did not exempt Replacement Reserves from the need to "analyze each separate ancillary service market."

[14] The Commission stated,

> the Companies have failed to provide a market analysis to support their request for market-based ancillary service rates. In Order No. 888, the Commission decided to consider ancillary service rate proposals on a case-by-case basis. We also included some general guidance on ancillary service pricing principles. With respect to pricing these services at market-based rates, Order No. 888 states the following: The fact that we have authorized a utility to sell wholesale power at market-based rates does not mean that we have authorized the utility to sell ancillary services at market-based rates. . .Therefore, the Phase II filing should define and analyze each separate ancillary service market with respect to the potential market power of each Company.

77 FERC at 61,833.

The ISO's enumeration of its Ancillary Services was repeated in the Commission's October 30, 1997 Order authorizing operation of the ISO[15] without any suggestion that Replacement Reserve service was improperly characterized as an Ancillary Service by the ISO. And, as the Commission-approved ISO Tariff stands currently,For purposes of [that] Tariff, Ancillary Services are: (i) Regulation, (ii) Spinning Reserve, (iii) Non-Spinning Reserve, (iv) Replacement Reserve, (v) Voltage Support, and (vi) Black Start Capability.

ISO Tariff § 2.5.1.

Whether or not Replacement Reserve service falls within the Order No. 888 enumeration of Ancillary Services, and as indicated it would appear to, it certainly is an Ancillary Service under the currently effective ISO Tariff, and properly so under the permissive expansion of Ancillary Services contemplated, indeed encouraged, by Order No. 888. Nothing in the June 30th or July 10th Orders suggests an intent to reverse this consistent history of Commission action with respect to the ISO Tariff. Particularly because the ISO's inclusion of Replacement Reserves represents a reasoned judgment of the Ancillary Services required for the reliable operation of the California interconnected grid, the ISO respectfully urges that the Commission reconsider and reverse its conclusions: (1) that Replacement Reserve service is not an Ancillary Service and, (2) whether or not it is, that Replacement Reserves may be sold at market-based rates, presumably by any entity that is authorized to make capacity or energy sales on that basis.

Finally, allowing market-based rates for Replacement Reserves means that a Scheduling Coordinator could be paid a market clearing price for Replacement Reserves while being paid "as bid" prices in the other Ancillary Services. The ISO's software currently is unable to pay sellers "as bid" in one of the Ancillary Services

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[15] October 30, 1997 Order, 81 FERC at 61,489-90.

markets and the market clearing price in another. In other words, the software allows a Scheduling Coordinator to receive all market clearing prices in all four services or to receive only "as bid" (i.e., its cost-based cap), in all four services but not a mixture of the two. Yet this mixture is exactly what the Commission's orders requires. Even utilities with cost-based caps under their Transmission Owner Tariffs are now apparently entitled to market clearing prices for the latter. To implement the Commission's directive, the ISO will be required to undertake significant manual computations until software can be modified.

B. A Time-Differentiated Study Is Necessary To Demonstrate an Absence of Market Power For All Services Identified as Ancillary Services in the ISO Tariff

1. A Time-Differentiated Study Is Necessary to Recognize the Nature of the Discrete Ancillary Service Markets

At the outset, the ISO reiterates the position that it consistently has advocated: the market for Ancillary Services should be driven by competition with market participants free to bid market-based rates. That is the paradigm toward which the ISO strives. But a fundamental prerequisite to that paradigm is that no market participant be able to exercise market power. Thus, while the Commission has recognized the propriety of introducing market-based rates to govern the sale of Ancillary Services, it also has recognized that it is first incumbent upon the market participant to demonstrate that it lacks the ability to exercise market power as to the discrete service for which market-based rate authorization is sought. See Ocean Vista Power Generation, et al., 82 FERC ¶61,114, 61,406 (1998). While the absence of market power always is an important pre-condition to the efficient functioning of markets, the monopoly harms visited on consumers is particularly severe where the exercise of market power establishes an artificially high market clearing price that must then be paid to others. This is precisely the harm that could flow if the June 30th and July 10th Orders are not reversed. In those Orders, the Commission found that the applicants had shown that they lacked market power based on studies comparing the total regulation capacity the controlled with the total regulation capacity available in the ISO's Southern zone, its Northern Zone, and its total control area. Slip op. at 8. The Commission similarly analyzed Spinning Reserve capacity and Non-Spinning Reserve capacity. The Commission rejected the contention of the ISO that the analysis of market power should be analyzed with a "time differentiated" study of the applicants' ability to influence prices during particular hours of the day. Id., at 9-10.

In so doing, the Commission failed to recognize the "discrete markets" for which the applicants sought market-based rate authority. It is an hourly market. Each and every hour constitutes a separate market. This is the reality that the ISO must confront. As such, it is critical to recognize that a market participant might easily satisfy the Commission's safe harbor thresholds when measured on a non-time differentiated basis across a broad geographical zone, yet be in a position to exercise significant market power during discrete hours. This is not idle speculation. It has occurred. This fact is borne out by the information provided in Attachment B to this pleading. For example, if one looks at the hourly data for Regulation service on June 28, 1998, it is clear that, averaged over the course of the day, the ISO received bids for 149% of its Regulation requirements. However, this daily bid sufficiency ignores the fact that the ISO had insufficient bids in 6 hours of the day (the insufficiencies ranged from 12 to 32%).

The nature of the ISO auction process further compounds the prejudice potentially flowing from the June 30th and July 10th Orders. What the Commission may not have fully appreciated is that the market already is "thin" at times, even for those services that the Commission would characterize as ancillary. As shown in Table 1, it already is the case that the ISO currently receives insufficient bids in the Regulation, Spinning Reserve, and Non-Spinning Reserve Ancillary Service markets many hours of the day. The data in the table are based on Day-Ahead Market results from June 24, 1998 to July 13, 1998. An hour was deemed deficient if the total market bids available for an Ancillary Service type was less than the ISO's market requirements.[16]

Table 1

[16] Supporting data for Table 1 is provided in Attachment B.

Ancillary Service Type	Percentage of Hours Deficient
Regulation	32%
Spinning Reserves	57%
Non-Spinning Reserves	61%
Replacement Reserves	15%

The deficiency in bids typically occurs during the early morning and late evening hours (i.e., the steep ramping periods). The thin market conditions during these hours results in all available bids being accepted. Therefore, during these hours, entities that have the authority to submit market-based bids have an unrestrained ability to establish the market clearing price. This situation is not likely to end soon. The ISO previously anticipated that it would be able to accept Ancillary Services bids from resources outside of the ISO Control Area around July 1, 1998. It now appears that, due to necessary software modifications, that will not be possible at least until late July. Yet, even after generators outside the control area are permitted to bid in the Ancillary Service markets, there will be times when transmission constraints limit their participation. In order to maintain reliability and follow prudent operating practice, the ISO has been required to procure Ancillary Services on a zonal basis. For example, if all of the available bids for Regulation come from resources South of Path 15, the ISO would be unable properly to regulate the system North of Path 15 in the event of a contingency. Procuring Ancillary Services on a zonal basis, however, necessarily restricts the number of resources that can bid into the markets.

Moreover, the Ancillary Services markets already are depressed by the bidding rules that govern the Utility Distribution Companies. They must first bid their available generation into the Power Exchange. They are not free to hold it out for the Ancillary Services auctions and can participate in those auctions only if and to the extent that their bids are not accepted by the Power Exchange.

The June 30th and July 10th Orders have the potential to exacerbate further this situation. Indeed, if the market responds rationally to those Orders, as must be presumed, it is likely that capacity that otherwise would be bid into the Non-Spinning auction, for example, might be kept out so that it thereafter can be bid into the Replacement Reserve auction. This certainly would be a logical response by a market participant that remains limited to cost-based rates for its sales of Non-Spinning Reserves. It therefore is reasonable to presume that a foreseeable consequence of the Orders will be to increase the occurrence of bid insufficiency in the markets for Ancillary Services increasing yet further the potential for the exercise of market power.[17]

For all of these reasons, the ISO urges a cautious response to the applications for market-based rates, befitting the consequences that granting them has the potential to visit on consumers. Again, the ISO supports competitive markets. Therefore, it does not lightly resist requests for market-based authorization. But it must be sensitive to the nature of the markets and to the potential that yet exist for abuse. The market for Ancillary Services is an hour-by-hour market, as it is for Replacement Reserve service, however that offering be characterized. As such, the Commission can confidently conclude that the sellers are not in a position to exercise market power <u>only</u> by examining that market (and requiring the seller to make the showing) on that basis.[18]

The ISO asks for no less than the Commission has elsewhere recognized as appropriate. In its Merger Policy Statement, the Commission recognized the existence of "products differentiated by time" and "strongly encouraged" applicants "to analyze

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[17] The ISO cannot avoid the potential by reversing the way its sequential auction is conducted. Apart from the fact that the Tariff requires the bidding to proceed sequentially in the following order, "Regulation, Spinning Reserve, Non-Spinning Reserve and Replacement Reserve," the ISO's software will not accommodate the auction of Replacement Reserves first.

[18] The data presented in Attachment B demonstrates that, while bids may appear sufficient when examined on a daily or even on an on-peak and off-peak basis, there are still discrete hours during the day when deficiencies exist.

short-lived periods of high concentration," particularly when the firm in question had market-based pricing authority. FERC Statutes & Regs. ¶ 31,044 at 31,030. It also directed that when concentration thresholds were exceeded, "including instances where short-lived periods of high concentration are indicated to be problematic," analysis of the "potential for adverse competitive effects" should be presented. Id., at 30,134-35.

The ISO urges the Commission to apply that reasoning here and to direct that AES and the other companies support their applications with a market power analysis that is product and time-differentiated.

2. Even if the Commission Does Not Recognize Replacement Reserves as an Ancillary Service, a Time-Differentiated Study Should Be Required for Market-Based Rate Authority for Replacement Reserves

It should be noted that the propriety of granting market-based authority to participants in the Replacement Reserve markets does not turn on whether that service properly should be classified as an Order No. 888 Ancillary Service. Whatever its characterization, as a function of the auction regime, it is a discrete set of markets warranting a market power analysis discrete from that associated with capacity or energy sales generally. Thus, even if the Commission declines to consider Replacement Reserves as an Ancillary Service, a market participant must nevertheless be obliged to establish its inability to exercise market power with respect to that service. Because the energy and Replacement Reserve markets are distinct, the Commission should not assume that a market power analysis addressed to the former suffices.

On July 9, 1998, the bid in the Replacement Reserve auction in the SP15 Zone that established the market clearing price jumped from $4.35/MW bid during the same hour two days previously and $244.60/MW in the prior day to $5,000/MW.[19] In the Replacement Reserve auction for the following day, the market clearing price would

[19] See the Market Report provided in Attachment A.

have been established at $9,999 MW for certain hours had the ISO not exercised its discretion to decline the purchase of Replacement Reserves. In the future, if Replacement Reserves are bid at prices that appear to reflect the exercise of market power, the ISO will continue to exercise the discretion accorded it by Section 2.5.3.3 of the ISO Tariff to limit its purchases of that service, including not purchasing any at all where doing so would be consistent with maintenance of the ISO's primary responsibility for system reliability. But reliability considerations may not always provide the ISO with that flexibility, particularly as the loads rise and there is less energy available from supplemental energy bids. Hence, the ISO may find itself helpless but to accept bids that represent the exercise of market power, and to have those bids establish the market clearing price.

The consequences to consumers can be quite severe. The ISO does not believe that it is authorized to refuse to pay the market clearing price to any market participant that claims an entitlement to that price. As a result of the June 30th Order, the ISO has been advised that entities that previously have been authorized to sell capacity and energy (albeit not Ancillary Services) at market-based rates, now are entitled to the market clearing rate established for Replacement Reserve service. In effect, notwithstanding that the ISO Tariff specifies Replacement Reserves as an Ancillary Service, and notwithstanding the limitations in Section 2.5.7.3 of that Tariff that "Public utilities under the FPA which have not been approved to bid at market-based rates, will not be paid above their cost-based bid for the Ancillary Service concerned even if the relevant market clearing price is higher," as a consequence of the June 30th Order the market clearing price for Replacement Reserve service is now available to public utilities authorized to sell capacity and energy at market-based rates. If this is not the intended consequence of the Order, the ISO urges the Commission to clarify its directive. If this is the intent of that Order, it underscores the impact that could be visited on consumers if the market clearing price is allowed to be set in any hour by a market participant that is able to exercise market power during that hour. It heightens the imperative that the Commission go the extra-mile in satisfying itself that the ability to exercise market power will not be likely.

C. If Market-Based Rates Are Permitted Without A Time Differentiated Study, Protections Should Be Required. Specifically, the ISO Should Be Permitted To Cap Bids Above $500/MW.

The Ancillary Services in the ISO Tariff are required to maintain the reliability of electric power deliveries throughout the control area. The purpose of a competitive Ancillary Service market is to permit the procurement of these necessary services at the lowest possible cost. While this market is under development, however, protections should be instituted to ensure: (1) a sufficiency of bids and, (2) that End Use Customers, dependent on the ISO Controlled Grid for their power supply, are not subjected to unjust and unreasonable charges.

The Commission is aware of and has taken certain actions to address the ISO's concerns with respect to the "thinness" of the Ancillary Service market. California Independent System Operator Corp., 83 FERC ¶ 61, 209 (June 24, 1998) (accepting interim Regulation Energy Payment Adjustment due to insufficient Regulation Service bids).

In the above-referenced dockets, the ISO proposed that the Commission raise the cost-based caps to $25/MW for all market participants to facilitate the creation of a viable and robust Ancillary Service market. The ISO believed that this cap would have provided sufficient incentive for additional generation to bid into the Ancillary Service market and ensure that generators would not reap windfall profits. The June 30th and July 10th Orders rejected this approach. June 30th Order, Slip op. at 10; El Segundo

Power, LLC et al., Slip op. at 10; Ocean Vista Power Generation, LLC et al., Slip op at 9.

The creation of the Ancillary Service market is a new and iterative process. For example, the ISO's software will not readily allow sellers to be paid "as bid" in one of the Ancillary Services markets and the market clearing price in another. In other words, the software allows a Scheduling Coordinator to receive all market clearing prices in all four auctions or to receive only "as bid" (*i.e.,* its cost-based cap), but not a mixture of the two. Yet this mixture is exactly what the Commission's orders requires. Even utilities with cost-based caps for all but Replacement Reserves are now apparently entitled to market clearing prices for the latter. To implement the Commission's directive, the ISO will be required to undertake significant manual computations until software can be modified.

Divestiture of generating units, evolutions in the ISO's software, and the increased experience of Scheduling Coordinators are among the factors that must be evaluated. Based on recent events, the ISO is concerned that a participant will be able to exercise market power, albeit for limited periods, and be able to charge monopoly prices that, under the Commission's Orders and the ISO tariff, must be paid to all generators entitled to compensation at the market clearing price without the potential for refunds.

The ISO's market surveillance unit conducted a preliminary analysis of the potential impact of the exercise of market power in bidding in the ISO's Ancillary Service markets. As noted above, such market power exists when the ISO has insufficient bids to meet it full requirement of certain Ancillary Services. For example, during the period of June 24, 1998 to July 13, 1998, the Non-Spinning Reserve market experienced 15 hours a day of shortage on average. The average amount of shortage during these hours was about 400 MW. In the worst case scenario and assuming a bid as high as $10,000/MW (which the ISO experienced in the Replacement Reserve market) the total cost for Non-Spinning reserve service can be approximately $60 million in a day. This calculation assumes that the entire 400 MW deficit will be supplied by market-based participants and that all these suppliers will earn the market clearing price of $10,000. Table 2 shows for the same June 24, 1998 to July 13, 1998 period the average number of hours with deficits and the average amount in MH of the deficit for the four Ancillary Services.

Table 2

Category	Average Deficit (MW)	Average Number of Hours With Deficit
Regulation	559	8
Spinning Reserves	235	14
Non-Spinning Reserves	400	15
Replacement Reserves	521	4

To minimize the potential effect of such an occurrence, the ISO respectfully requests that if an absolute stay is not granted, that the Commission authorize it to cap Ancillary Service bids above $500/MW. Absent a further filing with the Commission by a generator seeking to justify bids at above this level, bids above $500/MW would be deemed to be unjust and unreasonable.

The Commission has a statutory responsibility to protect consumers. Pennsylvania Water & Power Co. v. FPC, 343 U.S. 414 at 418 (1952)("A major purpose of the whole Act is to protect power consumers against excessive prices."); see also, Atlantic Refining Co. v. Public Service Comm'n of N.Y., 360 U.S. 378 at 388 (1959); Northeast Utilities Service Co. (Re: Public Service Co. of N.H.), 66 FERC ¶ 61,332 at 62,081-82, aff'd, 68 FERC ¶ 61,041 (1994). Authorizing the ISO to cap bids above the $500/MW reduces significantly the potential exposure of customers to potential market power abuses while still leaving generators with prices significantly in excess of the cost-based limits that applied pre-divestiture. Given the infancy and evolving nature of the California Ancillary Service market such basic protections clearly are warranted.

Even this solution is not desirable. To implement this approach, the ISO must manually reject bids prior to running congestion management. Doing so is estimated to take up to an additional hour. This could delay the publishing of initial preferred schedules beyond the deadline that allows for the congestion iteration to occur. It is not clear yet how long it would take to design and implement software changes to allow an automatic rejection of bids, as can be done with supplemental energy bids above $250.

VII. MOTION FOR CLARIFICATION

Section 2.5.7.3 of the ISO Tariff limits public utilities to cost-based rates for Ancillary Services absent Commission approval of different pricing. It further provides that public utilities, without authority to sell Ancillary Services at market-based rates, will be paid no more than their cost-based bid for Ancillary Services even if the market clearing price exceeds the cost-based bid. In addition, the Transmission Owner Tariff of each of the Participating Transmission Owners established cost-based ceilings on rates for Ancillary Services. The Commission's conclusion that Replacement Reserve service is not an Ancillary Service under Order No. 888, and that the companies may sell Replacement Reserve service under its previous authorized market-based rates, appears to remove these cost-based limitations.

Regardless of whether the Commission grants the relief sought by the ISO in its stay and rehearing requests, the ISO urges the Commission to clarify the intended impact of the June 30th and July 10th Orders on Section 2.5.7.3 of the ISO Tariff and on the cost-based rate restrictions included in the Transmission Owner Tariffs. In particular, the ISO asks the Commission to clarify that any public utility with market-based rate authority for the sale of energy and capacity may submit bids for Replacement Reserve services that exceed costs, and that all such public utilities may receive the market clearing price for Replacement Reserve service even if that market clearing price exceeds cost-based bids.

VIII. CONCLUSION

Based on the foregoing, the ISO respectfully requests that the Commission: (1) immediately stay the effectiveness of the June 30th Order and the July 10th Orders; (2) grant rehearing of its determinations that Replacement Reserves are not an Ancillary Service and whether or not they are, that providers of that service need not demonstrate a specific absence of market power; (3) grant rehearing and defer the companies requests for market-based rate authority to sell Ancillary Services (including Replacement Reserve service) at market- based rates until they provide time-differentiated studies demonstrating a lack of market power; (4) authorize the ISO to cap all Ancillary Service bids over $500/MW; and (5) clarify the current status of Section 2.5.7.3 of the ISO Tariff.

Respectfully submitted,

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Date: July 13, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the forgoing document upon each person designated on the official service list compiled by the Secretary in this Docket Nos. ER98-2843-000, ER98-2844-000, ER98-2883-000, ER98-2972-000, ER98-2971-000, and ER98-2977-000 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.2010 (1997).

Dated at Washington, D.C. on this 13th day of July, 1998.