UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Long Beach Generation LLC	**)**	**Docket No. ER98-2972-000**

MOTION TO INTERVENE OUT OF TIME AND COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.214, the California Independent System Operator Corporation ("ISO"), hereby moves to intervene out of time and comment in the above captioned proceedings.

I. SERVICE

The names and addresses of the persons to whom communications concerning this filing are to be addressed are as follows:

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II. DESCRIPTION OF THE PARTY

The ISO is a non-profit public benefit corporation organized and existing under the laws of the State of California, in which it is authorized to do business. The ISO operates a grid comprising the transmission systems of Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("Edison") and San Diego Gas and Electric Company ("SDG&E"). The ISO is responsible for maintaining the reliability of electric transmission scheduled into and through the ISO control area. To support reliability, the ISO is also responsible for procurement of ancillary services, to the extent that they are not self-provided, at a competitive price. The activities of the ISO are subject to the jurisdiction of the Commission.

III. MOTION TO INTERVENE OUT OF TIME

On May 12, 1998, Long Beach Generation LLC and El Segundo Power, LLC (together, "the Applicants") tendered separate applications for "Market-Based Ancillary Services Rates" for their facilities in California. These are Section 205 applications requesting authority to enable the Applicants to charge market-based rates for four ancillary services – regulation/automatic generation control, spinning reserve, non-spinning reserve, and replacement reserve – (collectively the "Ancillary Services").

The ISO respectfully moves for leave to intervene one day out of time with full rights of a party. The ISO submits that it meets the Commission's requirements for late interventions under 18 C.F.R. §385.214(d) and that its participation in this proceeding is in the public interest. Presently, the ISO operates the principal ISO Ancillary Service market in California. As such, the ISO has a direct and substantial interest in this proceeding because of the ISO's role of procuring Ancillary Services to meet the reliability of the ISO control area in accordance with Western

Systems Coordinating Council and North American Electric Reliability Council standards. Moreover, the ISO's interests cannot be adequately represented by any other party.

Good cause exists for granting this motion. As the Commission is aware, the ISO filed on June 1 its compliance filing that was due 60 days after the start of ISO operations. The ISO devoted considerable resources to prepare a timely compliance filing. As a result the ISO was unable to also complete the instant intervention for filing on the same day. Given the fact this motion is being submitted but one day late, the intervention will not cause undue delay or disruption to the proceeding. In addition, accepting this motion will also not cause Long Beach prejudice or additional burden, as consideration of the arguments made herein by the ISO will help resolve issues regarding the sale of Ancillary Services at market-based rates.

IV. STATEMENT OF SUPPORT OF THE ISO

At present, all FERC-regulated bidders are limited to the cost-based capacity rates contained in the PG&E's, Edison's, and SDG&E's *pro forma* tariffs. [1] Because the ISO's software does not yet allow Ancillary Services bids from outside the ISO control area, the utility-owned or recently divested units comprise the bulk of the market. Thus, in most cases, only the utilities' cost-based bids are being submitted in the Ancillary Services auctions each day and, depending on the type of service, those bids are either somewhat insufficient or grossly insufficient to meet the ISO's reliability needs. As a result of the insufficient number of bids, the ISO has relied on Reliability Must-Run ("RMR") units to provide a significant portion of the Ancillary Services during the initial start- up period and continues to rely on RMR units for certain services – all at costs significantly above the costs the ISO believes would result from market-based bids because (1) the

[1] See Docket Nos. ER97-2358-000, ER97-2355-000 and ER97-2358-000.

ISO is unable to call on lower-cost non-RMR units that are not bidding and (2) the pricing structure in the RMR contracts. [2]

The RMR units were designated as such to ensure the availability of resources to meet local voltage support and some reactive power needs. Ancillary Services are available from RMR units, but these services are not the primary basis on which RMR units were designated, and the pricing structure and annual energy limits on ISO dispatch do not contemplate the heavy use of these units for Ancillary Services. Unless the Ancillary Services markets are made more robust, the ISO will continue to rely on RMR units, increasing the cost and degrading reliability by reducing the number of hours the RMR units may be called on later when local voltage support is required. Accordingly, the ISO supports the applicants' application to the extent it facilitates a competitive and robust Ancillary Services market.[3]

V. BACKGROUND

As the ISO explained in its Tariff Amendment No. 8, filed May 19, 1998, Docket Nos. EC96-19-027 and ER96-1663-028, the ISO has been concerned about the "thinness" of the Ancillary Services markets since pre-operation tests. While these markets had insufficient bids in a number of hours in the early days of ISO operation, recently the bids for spinning reserve, non-spinning reserve and replacement reserve have been adequate for most of the hours in each day. (The ISO receives insufficient bids in the spinning and non-spinning reserve markets for only one or two hours each day). However, in nearly all of the hours for each operating day, the results of the Ancillary Services auction have left the ISO with insufficient regulation (in the range of 60 to

[2] The ISO Tariff requires that all market bids be utilized prior to dispatching any RMR unit, regardless of economics.
[3] Long Beach also has a pending application in Docket No. ER98-2537-000 to sell ancillary services at cost-based rates. The ISO has previously submitted comments in support of that application. El Segundo also has a pending

100% deficient). This results in a significant reliability concern for the ISO. As the Commission is aware, regulation is a significant component of Ancillary Services that is essential to the reliability of the grid in every hour of operation. In response to this concern, the ISO has proposed in its Amendment No. 8 a payment mechanism that the ISO firmly believes will facilitate greater participation in the Regulation market.

VI. STATEMENT OF POSITION

The California restructuring is based on the concept that the market can provide all services necessary for reliability and desired by marketplace participants. The ISO must procure and deliver the necessary Ancillary Services to fulfill its obligation to provide open and non-discriminatory access over the ISO Controlled Grid. As such, the ISO is very interested in the development of a competitive Ancillary Services market whereby it can procure these services on behalf of market participants at the lowest possible cost. The ISO firmly believes that it is in the best interest of all Market Participants to facilitate the development of a competitive market for Ancillary Services whereby competitors can collect market-based rates for their services.

The ISO believes there are two basic approaches to achieving this aim. First, the ISO or any Market Participant could demonstrate that a competitive market presently exists for each Ancillary Service (*i.e.,* regulation, spinning reserves, non-spinning reserves, and replacement reserves). Alternatively, an individual market participant could demonstrate that, while it has not evaluated the competitiveness of the entire market, individually, it does not control a significant segment of the market at issue and therefore could not exercise market power. Applicants have chosen the second approach.

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application in Docket No. ER98-2550-000 to sell ancillary services at cost-based rates. The ISO has previously submitted comments protesting that application, objecting to the cost-basis for the rates proposed by El Segundo.

A. The Applicants' Study is Limited to a Dominance Study

Applicants have submitted a detailed study that concludes that the Applicants do not control a significant percentage of any Ancillary Service market (*i.e.*, a dominance study). The Applicants define the relevant geographic market for each Ancillary Service as restricted to the generation owned, or previously owned, by the IOUs.[4] The Applicants state that this is an appropriate definition since these are the only units currently authorized to sell Ancillary Services to the ISO.[5] In addition, since the ISO software currently cannot accept Ancillary Services bids from outside the control area, the Applicants did not include utilities outside the ISO.[6] During times when transmission service between the Northern and Southern Active Zones is constrained, the Applicants appropriately define the relevant market as the Southern Zone, in which it is located.[7] In order to compute the Applicants' market share for each Ancillary Service market, the Applicants' study sums the capacity of each unit in the relevant geographic market capable of providing the relevant Ancillary Service.[8] Based on this study, the Applicants allege that they control: 1) 6.1% of regulating capacity ISO-wide (without congestion) and 10.4% in the Southern Zone (with congestion); 2) 3.2% of spinning reserve capacity ISO-wide (without congestion) and 6.2% in the Southern Zone and 0.3% in the Northern Zone (with congestion); 3) 3.1% of non-spinning reserve capacity ISO-wide (without congestion) and 5.9% in the Southern Zone and 0.3% in the Northern Zone (with congestion); and 4) 7.3% of replacement reserve capacity ISO-wide (without congestion) and 11.0% in the Southern Zone and 1.0% in the Northern Zone (with congestion).[9]

The Applicants state that the Commission has used a 20 percent share of a relevant market as a safe-harbor indicator that an applicant does not have the potential for dominating the

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4 Affidavit of J. Steven Henderson at 7.
5 Id.
6 Id. at 8.
7 Id.

relevant market.[10] As noted above, the Applicants' study purportedly demonstrates that with respect to regulation, spinning reserve, non-spinning reserve and replacement capacity, the Applicants' share of the market is below 20 percent and therefore acceptable.

B. Applicants Have Failed to Show Lack of Market Power in a Time-Differentiated Study

While this analysis is a necessary element of any market power study, the ISO believes that the Applicants' showing is insufficient. The ISO believes that applicants for market-based rates for Ancillary Services must demonstrate that they do not control a significant share of the market for each Ancillary Service *and* that they cannot significantly influence the clearing price of each market for a considerable number of hours in each day.

The Applicants have failed to analyze and demonstrate that there is an adequate supply of each Ancillary Service in *most* hours of the day *(i.e.,* a time-differentiated study). For example, while the Applicants may represent only a small fraction of the market for a given service during certain hours of the day, the Applicants could comprise a significant portion of the market during certain hours when potentially competing resources are unable or unwilling to bid into the Ancillary Services market. Absent a showing that there is an adequate supply in *most* hours, the Applicants should not have the unlimited authority to collect market-based rates for Ancillary Services.

Thus, the ISO believes that the Applicants must demonstrate that they do not control a significant share of each Ancillary Service market for *most* (*albeit* not all) hours of the day to warrant the ability to charge unlimited market-based rates for Ancillary Services. Until such time as the Applicants clearly demonstrate that they cannot exercise market power in most hours of the day, the Applicants should be subject to a capped rate as discussed below.

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8 Id. at 9.
9 Id. at 13,16, 19-20 and 23.
10 Id. at 8.

C. The Commission Should Allow Interim Relief Pending a Full Showing

Consistent with the ISO's desire to facilitate the development of a competitive market for Ancillary Services and to attract additional resources into the market, the ISO requests that the Commission consider an alternative to outright approval or rejection of Applicants' request. The ISO proposes that the Commission permit Applicants' (and any other market participant otherwise subject to a cost-based cap) to collect market-based rates for the four Ancillary Services proposed up to an appropriately established cap that is higher than the current transmission owners' tariff rates.

The ISO believes that such a cap should be established at a level that provides sufficient incentive for additional generation (both RMR and non-RMR) to bid into the ISO's Ancillary Services markets, while ensuring that generators would not be able to reap windfall profits. Ideally, the higher cap would incent currently unloaded and RMR capacity into the Ancillary Services markets, thereby facilitating the creation of a viable and robust market. To the extent a greater number of generators participated in the Ancillary Services markets, generators would be under competitive pressure to submit bids lower than the price cap in order to ensure that they were selected in the auction. However, to the extent that the cap is established at too low of a level, a more robust market would not develop and the ISO would continue to be subject to potentially severe reliability problems. In addition, absent a sufficient number of bids in the Ancillary Services auctions, it will be necessary for the ISO to dispatch the RMR units and pay them the high cost-based rates provided for under the agreements. The average RMR reliability payment (service-weighted basis) is $60.03/MWh.

The ISO's threshold analysis indicates that a bid-cap established at approximately $25/MWh would provide sufficient incentive for additional generation to bid into the Ancillary Services markets. The ISO's analysis is based on an examination of RMR unit cost characteristics. As shown on Table 1 below, reliability payment rates under the larger capacity RMR Agreements for the selected units range from $10.20 to $244.70**.** The ISO examined the RMR unit rates but believes there are units with similar cost characteristics that could be incented to bid into the ancillary services market at a set price. The alternately shaded sections in Table 1 denote RMR units that have similar prices. The purpose of this analysis is to determine the price at which a sufficient number of RMR and non-RMR units could reasonably expected to enter the Ancillary Services market.

Table 1

	Capacity Reservation				Energy
Plant Unit/ Owner	Spinning Reserve $/MW/hour	Non-Spinning Reserve $/MW/hour	Replacement Reserve $/MW/hour	Regulation $/MW/hour	Reliability Pmt Rate[11] $/MWH
Huntington Beach 1&2/AES	**9.22**	**4.47**	**4.47**	**9.55**	**10.20**
Moss Landing 7	**7.40**	**7.90**	**7.40**	**7.70**	**12.58**
Mandalay 1&2/HIPG	**9.22**	**4.47**	**4.47**	**9.55**	**12.60**
Alamitos 5&6/ AES	**9.22**	**4.47**	**4.47**	**9.55**	**13.60**
Redondo Beach 3&4/AES	**9.22**	**4.47**	**4.47**	**9.55**	**14.00**
Etiwanda 3&4/HIPG	**9.22**	**4.47**	**4.47**	**9.55**	**15.60**
Moss Landing 6	**7.40**	**7.90**	**7.40**	**7.70**	**15.83**
Alamitos 3&4/ AES	**9.22**	**4.47**	**4.47**	**9.55**	**24.60**
El Segundo 3&4/NRG-Destec	9.22	4.47	4.47	9.55	33.30
Contra Costa 6	7.40	7.90	7.40	7.70	36.46
Contra Costa 7	7.40	7.90	7.40	7.70	44.59
Redondo Beach 1&2/AES	**9.22**	**4.47**	**4.47**	**9.55**	**62.30**
Alamitos 1&2/ AES	**9.22**	**4.47**	**4.47**	**9.55**	**89.90**
Etiwanda 1&2/HIPG	9.22	4.47	4.47	9.55	115.60
El Segundo 1&2/NRG-Destec	9.22	4.47	4.47	9.55	244.70

11 Reliability payment is based on Allocated Costs which equal that portion of the Annual Fixed Costs attributed to the amount of Energy reserved, divided by the Maximum MWH which is the sum of the maximum monthly generation commitments.

The ISO has completed a preliminary cost analysis based on the Reliability payment included in the RMR Agreement A. Table 2 below indicates the amount of RMR capacity that can be expected to bid into the Ancillary Services market for every $5 increase in the cost-based rate cap. For each value of the price cap in the first column the RMR Capacity column indicates the amount of RMR capacity for which the cap exceeds the Reliability Payment Rate in the RMR Agreement. As shown in Table 2, at a bid-cap of $25, the ISO expects that 7,300 MW of RMR capacity will become available in, or bid into, the Ancillary Services market. In addition to the expected RMR capacity participation, the ISO currently has anywhere from 4,000 to 6,000 MW of unloaded non-RMR capacity, a significant portion of which is available to be bid into the Ancillary Services market. [12] The ISO believes that at a bid-cap of $25, this unloaded capacity will also bid into the Ancillary Services market. In order to reliably satisfy its maximum summer peak demand <u>and</u> sustain a competitive market for ancillary services through the summer peak period, the ISO maintains that it must incent at least 10,000 MW of additional generation into its ancillary services markets. The ISO anticipates that a bid cap of $25 should provide the necessary incentive for additional generation to participate in the ancillary services markets. While the ISO fully expects that a $25 bid cap will provide sufficient incentive for generation to bid into the Ancillary Services auction, the ISO recognizes that the determination of an appropriate bid cap is difficult and may involve an iterative process. Therefore, the ISO requests that the Commission approve an initial $25 ancillary services bid cap and consider future changes to the cap as more information becomes available.

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[12] The ISO has in its balancing energy stack approximately 4,000-6,000 of incremental Supplemental Energy bids every day. This means that there is approximately that much capacity potentially available, for the Ancillary Services markets that has not bid.

Table 2

RMR Capacity Available At Each Price Cap

Ancillary Services Capacity Price Cap	MW
<10	0
10	740
15	5,000
20	5,400
25	7,300
30	7,700
35	8,500
40	9,000
45	9,300
50	9,700
55	10,000
60	10,200
65	10,600
70	10,700
80	10,700
90	11,500
95	11,800

VII. SUPPORT OF THE ISO FOR WAIVER OF NOTICE

Applicants have requested that the effective date for the market-based ancillary services rates contemplated by their application be made concurrent with the effective date to be assigned by the Commission to Applicants' request for cost-based ancillary services. Alternatively, Applicants request that the rates be made effective as of May 12, 1998, and thereby requests a waiver of the 60-day notice rule. If the Commission does take positive action on the applications of Applicants, and decides to grant the waiver of the 60-day notice rule, Applicants will be able to participate in the Ancillary Services market and receive payment at market-based rates. The ISO supports the request for a waiver to facilitate greater participation in the Ancillary Services market, consistent with its concerns as set forth above.

III. CONCLUSION

Based on the foregoing, the ISO respectfully requests that the Commission permit it to intervene one day out of time and be treated as a party to this proceeding; defer Applicants' request for unlimited market-based rates until a time-differentiated study supports Applicants' position that they lack market power; but that the Commission grant Applicants interim authority to sell into the ISO Ancillary Services market at the capped rates discussed herein pending further showing by Applicants on market power.

Respectfully submitted,

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Date: June 2, 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 No. ER98-2972-000, 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 2nd day of June, 1998.

Harry Dupre

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