

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

AES Redondo Beach, L.L.C.)

Docket No. ER98-2843-000

**MOTION TO INTERVENE 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 in the above captioned proceeding.

I. SERVICE

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

N. Beth Emery
Vice President and General Counsel
Roger Smith
Regulatory Counsel
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: 916-351-2334
Fax: 916-351-2350

Fiona Woolf
Bridget E. R. Shahan
Cameron McKenna LLP
2000 Pennsylvania Ave. NW, Ste. 8550
Washington, D.C. 20006
Tel: 202-466-0060
Fax: 202 466-0070

Brian Theaker
The California Independent System
Operator Corporation
1000 S. Fremont A-13
Alhambra, CA 91802
Tel: 626-537-2746
Fax: 626-537-2350

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 the ISO controlled grid initially composed of 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”), (collectively referred to as the “Companies”). 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

AES Redondo Beach L.L.C., AES Huntington Beach L.L.C. and AES Alamos L.L.C. (“AES”) each operates units designated by the ISO as Reliability Must-Run (“RMR”) by the ISO, which units are obligated to provide energy and Ancillary Services to the ISO under an RMR Agreement filed with the Commission in Docket No. ER98-441 and assigned by Edison to AES pursuant to approval given in Dockets No. ER98-986-000, ER98-984-000 and ER98-985-000. On May 1, 1998, AES tendered separate applications for “Authority to Sell Four Ancillary Services at Market-based Rates, Request for Waivers, and Request for Expedited Consideration” for, respectively, AES Redondo Beach L.L.C., AES Huntington Beach L.L.C. and AES Alamos L.L.C. These filings are Section 205 applications requesting blanket authority to enable AES to charge market-based rates for four Ancillary Services – regulation, spinning reserve, non-spinning reserve, and replacement reserve – during periods other than when the ISO has called on these units for

RMR services. AES wishes to sell these Ancillary Services subject to rates, terms and conditions to be negotiated with buyers in the market.

The ISO is the operator of the 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. Accordingly, the ISO respectfully requests that it be permitted to intervene herein with full rights of a party.

IV. STATEMENT OF SUPPORT OF THE ISO

The ISO is concerned about the lack of participation in the Ancillary Services market. Presently, only cost-based Ancillary Service 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 had to utilize RMR contracts a great deal during the initial start-up period at costs significantly above the costs the ISO believes would result from market-based bids. Consequently, the ISO wishes to encourage greater participation in the Ancillary Services market to allow the ISO to obtain the required Ancillary Services from sources other than RMR facilities. Accordingly, the ISO supports the application of AES to the extent it facilitates a competitive and robust Ancillary Services market, which at this time we believe would require the Commission to impose some type of cap on AES's bids.

V. BACKGROUND

As the ISO explained in its Tariff Amendment No. 8, filed May 19, 1998, Docket Nos. EC96-19-___ and ER96-1663-___¹, 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 100% deficient). This results in a significant reliability concern for the ISO. As the Commission is aware, Regulation is a significant Ancillary Service that is essential to the reliability of the grid in every hour of operation. In response to this concern, the ISO has proposed in 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

¹ The Commission has not yet issued a subdocket number for Tariff Amendment No. 8.

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. AES has chosen the second approach.

A. The AES Study is Limited to a Dominance Study

AES has submitted a detailed study that concludes that AES does not control a significant percentage of any Ancillary Service market (*i.e.*, a dominance study). AES defines the relevant geographic market for each Ancillary Service as restricted to the generation owned, or previously owned, by the IOUs.² AES states that this is an appropriate definition since these are the only units currently authorized to sell Ancillary Services to the ISO.³ In addition, since the ISO software currently cannot accept Ancillary Services bids from outside the control area, AES did not include utilities outside the ISO.⁴ During times when transmission service between the Northern and Southern Active Zones is constrained, AES appropriately defines the relevant market as the Southern Zone, in which it is located.⁵ In order to compute AES's market share for each Ancillary Service market, the AES study sums the capacity of each unit in the relevant geographic market

² Affidavit of J. Steven Henderson at 6.

³ Id.

⁴ Id. at 7.

⁵ Id.

capable of providing the relevant Ancillary Service. ⁶ Based on this study, AES alleges that it controls: 1) 16.2% of Regulating capacity ISO-wide (without congestion) and 21.4% in the Southern Zone (with congestion); 2) 7.3% of Spinning Reserve capacity ISO-wide (without congestion) and 14.9% in the Southern Zone (with congestion); 3) 7.8% of Non-Spinning Reserve capacity ISO-wide (without congestion) and 15.8% in the Southern Zone (with congestion); and 4) 14.1% of Replacement Reserve capacity ISO-wide (without congestion) and 22.6% in the Southern Zone (with congestion). ⁷

AES states 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 relevant market. ⁸ As noted above, the AES study purportedly demonstrates that with respect to Spinning reserve and Non-Spinning Reserve capacity, AES's share of the market is below 20 percent and therefore acceptable. With respect to Regulating capacity and Replacement Reserve capacity, AES admits that its market share is above 20 percent. AES argues that while its market share for these two services is above the Commission's threshold 20 percent level, there is ease of entry into the markets indicating that AES would be unable to sustain a significant increase in the price of these service (*i.e.*, exercise market power). ⁹ In addition, AES states that during the peak hour there is enough excess capacity capable of supplying 161.6 percent of the ISO's Regulation requirements and 423.9percent of the ISO's Replacement Reserve requirements.¹⁰ AES also states that its share of the excess capacity market (the amount of capacity available beyond that required by the ISO) is a relevant indicator of its ability to exert market power. AES states that

⁶ Id. at 8.

⁷ Id. at 12-24.

⁸ Id. at 8.

⁹ Id. at 13-14 and 25.

¹⁰ Id. at 15 and 26.

AES's supply will be 41.7 percent of the excess capacity in the Regulation market and 27.6 percent of the excess capacity in the Replacement Reserve market.¹¹

B. AES Has 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 AES's 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.

AES has 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 AES may represent only a small fraction of the market for a given service during certain hours of the day, AES may well 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, AES should not have the unlimited authority to collect market-based rates for Ancillary Services.

Thus, the ISO believes that AES must demonstrate that it does 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 AES clearly demonstrates that it cannot exercise market power in most hours of the day, AES should be subject to a capped rate as discussed below.

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

¹¹ Id.

Commission consider an alternative to outright approval or rejection of AES's request. The ISO proposes that the Commission permit AES (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 and higher cap.

The ISO believes that the appropriate basis for such a cap would be cost of the alternative supply options available to the ISO for procuring Ancillary Services – the RMR units. 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. In order to encourage active participation in the Ancillary Service auctions, the ISO believes that it would be appropriate to establish a sufficiently high cap on Ancillary Services prices that would: 1) encourage entry into the market and active participation in the Ancillary Service auctions during all hours of the day; and 2) permit the ISO to procure the necessary Ancillary Services at a cost that is less than the cost of securing these services from the higher-cost RMR units. If the cap is not established at a high enough level, RMR units will not have any incentive to bid into the market. We have not had the time to analyze and propose a specific cap that would accomplish these objectives. However, we believe the Commission should consider establishing an alternative cap rather than outright reject the AES filing.

VII. SUPPORT OF THE ISO FOR WAIVER OF NOTICE AND EXPEDITED ACTION

AES has requested that the Commission waive its notice requirement and order the rate schedule authorizing AES to charge market-based rates into effect as of the date that AES acquired the Redondo Beach, Huntington Beach and Alamitos plants. AES also has requested that the Commission grant expedited consideration to its application. If the Commission does take

expeditious positive action on the application of AES, and decides to grant the waiver of the 60-day filing requirement and the 120 filing requirement, 18 C.F.R. §§ 35.2(e) and 35.3(a), AES will be able to participate in the Ancillary Services market and receive payment at market-based rates. The ISO supports the request for expedited action and a waiver to facilitate greater participation in the Ancillary Services market; but in a limited fashion.

First, there is no practicable means for the ISO to recalculate Ancillary Services bids that have been accepted (or to award previously-rejected bids). When AES sought to bid in the Ancillary Services market, the ISO was faced with a dilemma. It needed as many bids as possible, but was aware in fact that AES had no tariff on file with the Commission allowing it to sell Ancillary Services in the market at cost-based or market-based rates. On the other hand, prior to its transfer to AES, the unit was bid into the market by its utility owner (SCE) at FERC-approved Ancillary Service rates. The ISO thus concluded that it would allow any RMR unit owner with an assigned RMR Agreement to continue to bid up to the previous utility owner's capped rate on the assumption that FERC would eventually agree to sales effective from the date of assignment at least at that rate. The ISO rejected bids above that cap.

Thus, the ISO supports approval to sell up to the previous owner's cap retroactive to the date of assignment; and requests expedited action to allow the interim higher cap to be effective on a *prospective* basis from the date of the order. The ISO simply cannot accommodate any recalculation of accepted bids for prior transactions. The ISO has made this clear to AES and conditioned its support of expedited action on a higher cap to AES agreeing to limit bids to the previous owner's cap in the interim.

VIII. CONCLUSION

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

Respectfully submitted,

N. Beth Emery
Vice President and General Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: 916-351-2334
Fax: 916-351-2350

Fiona Woolf
Bridget E. R. Shahan
Gunnar Birgisson
Cameron McKenna LLP
2000 Pennsylvania Ave., N.W.
Suite 8550
Washington, D.C. 20006
Tel: 202-466-0060
Fax: 202-466-0077

Date: May 21, 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. ER98-2843-000, 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 21st day of May, 1998.

Harry Dupre

\\CM411\SYS\General Office\Gunnar\Reliability Must Run\BETH RB.doc