

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

<b>Duke Energy Oakland LLC</b>	<b>)</b>	<b>Docket No. ER98-3416-000</b>
<b>Duke Energy Morro Bay LLC</b>	<b>)</b>	<b>Docket No. ER98-3417-000</b>
<b>Duke Energy Moss Landing LLC</b>	<b>)</b>	<b>Docket No. ER98-3418-000</b>

**PROTEST OF  
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to Rule 211 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.211, and the Commission's June 23, 1998, Notice, the California Independent System Operator Corporation ("ISO"), hereby files its Protest in the above-entitled proceedings.

The ISO submitted its Motions to Intervene in the above-entitled proceedings on July 8, 1998,<sup>1</sup> reiterating concerns expressed with respect to requests by other companies for market-based rate authority for sales of Ancillary Services: that the thinness of the market for Regulation and Reserve Services during certain hours would allow sellers to command exorbitant prices, necessitating a time-differentiated market-power study. The ISO also recognized, however, that the Commission had recently rejected the ISO's argument that a time-differentiated study is necessary. See *AES Redondo Beach, L.L.C., et al.*, 83 FERC ¶61,358 (June 30, 1998) ("June 30<sup>th</sup> Order"). Therefore, the ISO informed the Commission that it would continue to monitor the market, apprise the Commission of any concerns and, if necessary, request relief.

The purpose of this Protest is to bring to the Commission's attention the fact that the unconditional grant of market-based rate authority to other sellers has had extremely serious consequences in the ISO's Ancillary Services

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<sup>1</sup> The Motion to Intervene in Duke Energy Morro Bay was submitted one day out of time.

markets, permitting the exercise of market power, and producing extraordinarily high market clearing prices in some hours. The ISO urges the Commission, in the strongest possible terms, to take these consequences into account in ruling on the instant applications. The Commission should defer granting the requested authorizations, which are not supported by the type of analyses that are required to demonstrate the absence of market power in the discrete markets for Ancillary Services – i.e., time-differentiated studies. Alternatively, the Commission should condition its approvals upon confirmation of the authority of the ISO to impose price caps or to take other appropriate action to mitigate any exercise of market power.

**PROTESTA. The Results of the Commission’s Grant of Market Rate Authority for Sales of Ancillary Services to the ISO Demonstrate That Sellers Can Exercise Market Power in Some Hours, Producing Exorbitant Prices.**

In the above-entitled dockets, Duke Energy Morro Bay LLC, Duke Energy Moss Landing LLC, and Duke Energy Oakland LLC (collectively, “Duke”) seek market rate authorization for sales of four Ancillary Services -- Regulation, Spinning Reserve, Non-spinning Reserve, and Replacement Reserve, each as defined in the ISO Tariff (collectively, the Regulation and Reserve Services). Duke seeks such authority during times when it is not obligated to sell that particular Ancillary Service under its Must-Run Agreements. (Duke Energy Morro Bay is not a party to a Must Run Agreement.)

In the June 30<sup>th</sup> Order, the Commission accepted applications to sell into the markets for Regulation, Spinning Reserves, and Non-Spinning Reserves at market-based rates. In addition, 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 30<sup>th</sup> Order, Slip op. at 5. On July 10, 1998, the Commission issued further orders authorizing additional entities to sell the same Ancillary Services to the ISO at market-based rates. *El Segundo Power, LLC et al.*, 84 FERC ¶ 61,011 (1998); *Ocean Vista Power Generation, LLC et al.*, 84 FERC ¶ 61,013 (1998). In so doing, the Commission rejected the ISO's contention that, to account for different market conditions, a time-differentiated market power study was required. The Commission dismissed the ISO's concern that, in a substantial number of hours, the Ancillary Service markets would be "thin," i.e., there would be insufficient sellers, giving the ISO no choice but to accept any bid submitted by a seller with market-based rate authority. June 30<sup>th</sup> 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. Although only a short period of time has passed since the June 30<sup>th</sup> and July 10<sup>th</sup> Orders were issued, events in the ISO's Ancillary Service markets have borne out the ISO's greatest fears. For example, On Thursday, July 9, 1998, in the Southern Zone (south of Path 15,<sup>1</sup> "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 \$9.1 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 enormous impact on California consumers of the market-based rate authority that the Commission granted in the June 30<sup>th</sup> and July 10<sup>th</sup> Orders, and the market forces that have engendered this market distortion, are described in the ISO's Emergency Motion for Stay, Notice of

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<sup>1</sup> Path 15 is a major transmission line separating the Northern and Southern Zones.

Action Taken, Request for Rehearing, And Motion for Clarification regarding those Orders, a copy of which is attached and incorporated into this Protest.

These results make clear that sellers authorized to sell at market-based rates already have imposed significant financial burdens on the market. If it is to obtain similar authority, it is incumbent upon Duke to demonstrate that it could not similarly exercise market power. As explained below, Duke has failed to do so.

**B. Duke Has Failed To Demonstrate That It Would Be Unable To Exercise Market Power If Its Applications Were Granted.**

Because of its concerns regarding the “thinness” of the Regulation and Reserve Services market, the ISO would support Duke’s application if granting it would facilitate competitive and robust markets in those Ancillary Services. The California restructuring is based on the concept that the market can provide all services necessary for reliability and desired by marketplace participants. Development of competitive Regulation and Reserve Services markets therefore is of prime importance to the ISO, which is charged with the responsibility to procure those services from the market. Toward this end, the ISO firmly believes that it is in the best interest of all Market Participants to facilitate the development of an open, robust market where all are free to compete on a market-oriented basis.

As the Commission has recognized, however, the benefits of market-based pricing could be thwarted by the exercise of market power. Accordingly, the Commission has determined that it will permit the sale of an Ancillary Service at market-based rates only if the seller supports its request with an analysis demonstrating that it would lack the ability to exercise market power in the discrete service. See *Ocean Vista Power Generation, et al.*, 82 FERC ¶ 61,114

(1998).

Duke has not done so. It has presented only a traditional “dominance study,” which focuses broadly on the markets for Regulation and Reserve Services without recognition of the critical fact that each of those are sold in *hourly* markets. As recent events demonstrate, this type of analysis obscures the fact that market conditions permit sellers, in a number of hourly auctions, to exercise market power, command an unduly high premium, and significantly and adversely influence the clearing price for a service. The ability to exercise that influence is masked by the type of study upon which Duke would have the Commission rely.

The ISO currently receives insufficient bids in the Regulation and Reserves Services markets many hours of the day. The deficiency in bids typically occurs during the early morning and late evening hours (i.e., the steep ramping periods). This situation is not likely to end soon. In these circumstances, and in view of the prejudice already being experienced by the market, the Commission should be loathe to exacerbate the situation by granting Duke’s applications on the basis of its inadequate market analysis.

**C. If the Commission Does Not Deny Duke’s Applications as Unsupported, It Should Condition Its Approval of Those Applications by Confirming the ISO’s Authority To Cap Bids and to Take Other Appropriate Actions To Mitigate the Exercise of Market Power in Ancillary Services.**

The markets for Ancillary Services in the ISO control area are evolving. When the market is fully competitive, the ISO is confident that it will provide the required services at appropriate prices. But while this market is still under development, protections should be instituted to ensure (1) the sufficiency of bids and, (2) that customers who are dependent on the ISO for the procurement of Ancillary Services, are not subjected to unjust and unreasonable charges.

To protect the realization of these objectives, the ISO respectfully requests

that the Commission, if it does not defer Duke's request for market-based rate authority, condition any authority that it grants upon confirmation of the authority of the ISO to cap Ancillary Service bids above \$500/MW and to take other action necessary to mitigate the exercise of market power in thin Ancillary Service markets. The need for bid caps is described in the ISO's Emergency Motion for Stay, Notice of Action Taken, Request for Rehearing, And Motion for Clarification regarding the June 30<sup>th</sup> and July 10<sup>th</sup> Orders (attached). Absent a further filing with the Commission by a generator seeking to justify bids 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, *reh’g denied*, 68 FERC ¶ 61,041 (1994). Authorizing the ISO to cap bids at \$500/MW reduces significantly the exposure of customers to potential market power abuse 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 markets such basic protections clearly are warranted.

The ISO must emphasize that this alternative solution is not a preferred approach. 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.

## CONCLUSION

WHEREFORE, the ISO respectfully requests that the Commission (1) defer granting Duke's requested market-based rate authority for Regulation and Reserve Services until such time as Duke provides a time-differentiated market power study; and (2) if the Commission grants such authority, confirm the authority of the ISO to impose a \$500/MW cap on bids for such Services.

Respectfully submitted,

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Date: July 16, 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. ER98-3416-000, ER98-3417-000, and ER98-3418, 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 16<sup>th</sup> day of July, 1998.

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