

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;  
Vicky A. Bailey, William L. Nasse, Jr.,  
Linda Breathitt, and Curt Hebert Jr.

AES Redondo Beach, L.L.C.	)	Docket No. ER98-2843-001
	)	
AES Huntington Beach, L.L.C.	)	Docket No. ER98-2844-001
	)	
AES Alamitos, L.L.C.	)	Docket No. ER98-2883-001
	)	
	)	(Not Consolidated)
El Segundo Power, LLC	)	Docket No. ER98-2971-001
	)	
Long Beach Generation, LLC	)	Docket No. ER98-2972001
	)	
	)	(Not Consolidated)
Ocean Vista Power Generation, L.L.C.	)	
Mountain Vista Power Generation L.L.C.	)	
Alta Power Generation, L.L.C.	)	
Oeste Power Generation, L.L.C.	)	Docket No. ER98-2977-001
Ormond Beach Power Generation, L.L.C.	)	
Southern California Edison Company	)	Docket No. EL98-62-000

ORDER DENYING MOTIONS FOR STAY,  
AUTHORIZING THE ISO TO TAKE INTERIM ACTION,  
REQUIRING MARKET MONITORING REPORTS AND  
PROVIDING OPPORTUNITY TO COMMENT

(Issued July 17, 1998)

On July 13, 1998, as corrected on July 16, 1998, the California Independent System Operator Corporation (ISO) filed an Emergency Motion for Stay, Notice of Action Taken, Request for Rehearing, and Motion for Clarification of the Commission's orders in these proceedings. Also on June 13, 1998, Southern California Edison Company (SoCal Edison) filed an Emergency Request for a Stay, Complaint Requesting Suspension of Market-Based Pricing for Ancillary Services and Replacement Reserves, and Request for Rehearing. In this order, we will address only the requests for stay of the Commission's orders and the ISO's notice of action taken. As discussed below, we accept the ISO's proposal to limit the prices it will pay to those bidders that have been granted market-based rate authority for Regulation, Spinning, Non-Spinning and Replacement Reserves until such time

as the Commission has an opportunity to gather additional information. In addition, we deny the requests for stay, direct the ISO and PX market surveillance staffs to conduct further studies and file reports with us

## Background

### June 30 and July 10 Orders

On June 30, 1998, the Commission accepted for filing without suspension or hearing, the proposed market-based rates for certain ancillary services filed by AES Redondo Beach, L.L.C., AES Alamitos, L.L.C., and AES Huntington Beach, L.L.C. (AES). 1/

On July 10, 1998, the Commission issued two orders accepting for filing, without suspension or hearing the proposed market-based rates for certain ancillary services filed by Long Beach Generation, LLC (Long Beach) and El Segundo Power, LLC (El Segundo); 2/ and Ocean Vista Power Generation, L.L.C., Mountain Vista Power Generation, L.L.C., Alta Power Generation, L.L.C., Oeste Power Generation, L.L.C., and Ormond Beach Power Generation, L.L.C. 3/

### ISO and SoCal Edison Filings

In support of their motions for stay and the ISO's Notice of Action Taken, the ISO and SoCal Edison state that subsequent to the Commission's June 30 and July 10, 1998 Orders, the ISO witnessed dramatic spikes in the price for Replacement Reserve capacity.

Specifically, on July 1, 1998, the ISO began to procure ancillary services on a zonal basis, due to congestion problems. On July 9, 1998, for the Southern Zone, prices for Replacement Reserves reached \$5,000/MW for three hours, and were at \$2,500 and \$750/MW during two other hours. As a result, the total cost for Replacement Reserves during these hours was \$9.125 million.

4/ In response to this price spike, the ISO decided not to purchase any Replacement Reserves for July 10, 1998. However,

1/ AES Redondo Beach, L.L.C., et al., 83 FERC ¶ 61,358 (1998).

2/ Long Beach Generation, L.L.C. et al., 84 FERC ¶ 61,011 (1998).

3/ Ocean Vista Power Generation, L.L.C., et al., 84 FERC ¶ 61,013 (1998).

4/ In contrast, the ISO states that the total price for replacement Reserves during the same hours on June 25, 1998 was \$3,300.

the ISO states that had it chosen to purchase Replacement Reserves on July 10, the market clearing price would have been \$9,999/MW, with total costs in the Southern Zone of \$17.2 million. Moreover, the ISO states that in view of weather predictions, it does not have the flexibility to decline to accept bids for Replacement Reserves on a daily basis.

The ISO states that it received sufficient bids for Replacement Reserves on July 11 and 12, 1998; however, the ISO notes that on those days it did not receive sufficient bids for Operating Reserves. The ISO contends that because the ancillary services and Replacement Reserves auctions are run sequentially, with Replacement Reserves in the last auction, bidders seeking market prices may withhold bids from the other three markets to ensure sufficient capacity to win the Replacement Reserve auction. On July 14, 1998, the ISO did not receive sufficient bids for Replacement Reserves during hours 14 to 18, and experienced a market clearing price of \$9,999/MW for Replacement Reserves during those hours. 5/

The ISO is concerned about the potential for dramatic price spikes to occur in the other three Ancillary Services Markets which also regularly experience insufficient bids during certain hours. The ISO considers this to be of particular concern while there are still few market participants with market-based rate authority.

Similarly, SoCal Edison contends that there is insufficient supply to permit market-based pricing for ancillary services. Like the ISO, SoCal Edison believes that the price spikes are the result of market power caused by thinness in the ancillary services and Replacement Reserve markets. SoCal Edison contends that only 3400 MW of generation is available for ancillary services in the Southern Zone, a level that is barely above the ISO's recent demands for ancillary services. SoCal Edison contends that where, as here, the total inelastic demand in the market is such that supply from every seller is required; then every seller has market power.

This market condition is, according to SoCal Edison, caused by several factors, including the ISO's action splitting the ancillary services market into two zones due to congestion, and

5/ \$9,999/MW is the highest price that can be entered in to the ISO's bidding software, which only provides space for a bid price of up to four digits. When the ISO receives insufficient bids for a given ancillary service, it first accepts all bids received in the auction for that service and, if necessary obtains the remainder of its requirement for the service by calling upon its reliability must run units.

the fact that only in-control area generation is permitted to supply ancillary and Replacement Reserve service to the ISO due to software limitations. Finally, SoCal Edison points out that 1,000 MW of its must-take hydroelectric generation is committed to energy production due to high run-offs and spill Conditions. Therefore, this capacity is unavailable for ancillary services.

SoCal Edison also agrees with the ISO that the problem is not limited to the Replacement Reserves market. SoCal Edison states that the potential for such market power abuse is even greater in the markets for regulation, spinning reserve, and non-spinning reserve, where supplies are even more limited and the ISO has little discretion regarding the amount it must purchase. In addition, SoCal Edison is concerned that the problems will be exacerbated during the summer peak period.

Pending Commission action on the ISO's motions, the ISO states that commencing on July 14, 1998, trading day, it will cap the prices that it will pay to bidders with market-based rate authority at \$500/MW, until such time as the Commission has an opportunity to act on its requests for relief. <sup>6/</sup> The ISO states that its market surveillance committee will monitor market performances and, if bidding conditions indicate that an adjustment in this level is appropriate, the ISO will take action and will notify the Commission and the market participants at the earliest practicable time. The ISO states that all market participants have been notified on its electronic bulletin board (WEnet) of this procedure.

The ISO and SoCal Edison request a stay of the Commission's June 20 and July 10, 1998 Orders until their concerns about the Commission's classification of Replacement Reserves can be addressed and until the Commission can consider a time-differentiated market-power study for the ancillary services.

If the Commission declines to stay its Orders, the ISO requests the Commission to authorize it to cap all bids above a specified level, as described above. SoCal Edison alternatively requests the Commission to initiate a complaint proceeding under section 206 of the FPA, and immediately suspend market-based pricing authority for ancillary services and Replacement Reserves in the California ISO markets. In addition, the ISO requests clarification as to whether the Commission's intended that the ISO pay all sellers the market clearing price for Replacement Reserves. As noted above, the ISO and SoCal Edison also request rehearing of the Commission's June 30, 1998 and July 10, 1998 Orders. We will address SoCal Edison's complaint, the ISO's

<sup>6/</sup> The ISO considers \$500 high enough to stimulate sufficient bids.

request for clarification, and the rehearing requests at a later date.

### Additional Filings

On July 14, 1998, the California Electricity Oversight Board (Oversight Board) filed a motion to intervene and comments in support of the ISO's July 13, 1998 filing. The Oversight Board states that the events of July 9 through July 13, 1998 constitute an urgent indication of a market dysfunction and threaten immediate harm to consumers and will undermine consumer confidence in the market. The Oversight Board believes that the magnitude of the price spikes and the resulting harm to ISO customers justify the grant of a stay. In addition, the Oversight Board states that the ISO acted prudently in imposing a purchase price cap of \$500/MW and urges the Commission to ratify this measure.

Also on July 14, 1998, the Public Utilities Commission of the State of California (California Commission) filed an answer in support of the ISO's Motion for Stay and Motion for Clarification. According to the California Commission, staying the June 30, 1998 and July 10, 1998 Orders will foreclose the possibility that California consumers will pay exorbitant prices in markets it believes are not yet workably competitive. The California Commission also supports the ISO'S alternative request for authorization to reject all bids above a specified level, if a stay is not granted. The California Commission considers this proposal to be similar to the ISO's current authority to reject bids for supplemental energy in excess of \$250/MW. <sup>7/</sup> Finally, the California Commission supports the ISO's request for clarification.

Also on July 14, 1998, SoCal Edison filed an answer opposing the ISO's proposed \$500 cap, contending that this level is too high and will result in excessive prices to the severe detriment of SoCal Edison and other buyers. SoCal Edison Prefers adoption of an interim price cap based on each supplier's cost, because, it claims, adoption of an interim price cap that greatly exceeds cost would simply permit the exercise of market power up to the level of the cap. However, if an interim, non-cost based cap is to be adopted SoCal Edison requests that the cap not be so high

<sup>7/</sup> Although the California Commission acknowledges that it opposed bid caps in its June 8, 1998 comments in these Proceedings, it also stated in that filing that if the ISO's market monitoring indicates problems, the need for a cap can be reconsidered. The California Commission believes that bids as high as \$10,000/MW of replacement reserves raises a legitimate and pressing concern that the structure of the market is allowing the exercise of market power.

as to exploit consumers. SoCal Edison states that it would be willing in these circumstances to accept the \$25/MW price cap that the ISO has previously proposed in these proceedings. 8/

On July 16, 1998, San Diego Gas & Electric Company (SDG&E) filed a Request for Rehearing and Answer in Support of the Motions for Stay. In addition, SDG&E requests leave to intervene in these proceedings out of time, asserting that the grant of the applications in these proceedings has proven in fact to have a direct, significant, and adverse effect on SDG&E. SDG&E states that the price spikes of July 9 and July 13, 1998 result in \$2.8 million in additional ancillary service costs to SDG&E alone. Furthermore, SDG&E states that the \$500/MW price levels for certain hours in the Southern Zone on July 14, 1998 are astronomical in comparison with the price for the Northern Zone during those hours of less than \$8/MW. Therefore, SDG&E contends that the ISO's alternative proposal of a \$500/MW price cap is not an adequate solution, and that the Commission should immediately stay its June 30 and July 10 orders.

## Discussion

### Opportunity to Comment on Filings

We will grant all of the motions to intervene and will afford an opportunity to comment on the ISO's proposals in Docket Nos. ER98-2843-001, ER98-2844-001, ER98-2883-001, ER98-2977-001, ER98-2971-001, and ER98-2972-001 and on SoCal Edison's complaint proceeding in Docket No. EL98-62-000.

Any person desiring to be heard or to protest these filings should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 or 214 of the Commission's Rules of Practice and Procedure (18 CFR §§ 385.211, 385.214 (1998)). Motions to intervene, protests, or comments in each proceeding should be filed within 30 days of the date of this order.

Protests filed with the Commission will be considered by it in determining the appropriate action to be taken but will not serve to make the protestants parties to the proceeding. Any person wishing to become a party must file a motion to intervene. Copies of this filing are on file with the Commission and are available for public inspection.

8/ See June 1, 1998 Motion to Intervene and Comments of the ISO in Docket No. ER98-2971-000, at 8-10.

## Request for Stay and ISO's Notice of Action Taken

In the June 30 and July 10, 1998 Orders, the Commission found that a price cap on market-based rates is undesirable because it creates the very problem which the ISO reports is occurring under cost-based rate caps, *i.e.*, supply is reduced when the cap is set below the appropriate market level. However, the Commission stated that if the ISO's market monitoring indicates problems, the need for a price cap can be reconsidered.

In view of the serious concerns raised by these parties, we believe that further fact finding is necessary. In the interim, the ISO's rejection of bids in excess of whatever price levels it believes are appropriate for Regulation, Spinning Reserve, Non-Spinning Reserve, and Replacement Reserve are authorized as reasonable. The price levels could be based on costs, market or any factor the ISO determines will attract sufficient bids into the markets. Moreover, we accept the ISO's proposal to have its market surveillance committee monitor the market, and to take action to implement necessary adjustments in the appropriate level that the ISO will accept, based on the recommendation of its market surveillance committee. Consistent with the ISO's proposal, we will direct the ISO to provide advance notice to all market participants in compliance with its Ancillary Services Requirements Protocol of any adjustments in the price at which it will accept bids for these services. We are confident that the ISO's notice and posting procedures will ensure nondiscriminatory treatment of all sellers. In view of our authorization of the ISO's proposed interim actions, we will deny the requests for stay of our June 30, 1998 and July 10, 1998 Orders.

## Additional Market Surveillance Committee Report

As noted above, the Commission has indicated its reliance on the continued activity of the ISO's market surveillance committee to ensure the proper operation of the markets for Regulation, Spinning Reserve, Non-Spinning Reserve, and Replacement Reserve. Accordingly, to further the Commission's review, we will direct both the ISO and PX market surveillance committees to each conduct an independent study of the bidding behaviors and structural characteristics of the markets that they each administer and to further clarify the causes of the perceived market concerns raised in the pleadings. We note that the ISO has identified factors that must be considered, such as the divestiture of generation, evaluation of the ISO's software and market structure, the increased experience of Scheduling Coordinators, and the insufficiency of bids. "We are also interested in how the workings of the California market and activity in the generation market affected the prices in the Ancillary Service and Replacement Reserves markets." We also are particularly interested in how the Ancillary Services and

Replacement Reserves markets respond to the inclusion of out-of-control area suppliers, whether inside or outside California, when the ISO remedies its existing limitations later this month. The ISO market surveillance committee study should, at a minimum, compare the market activity for each of the iterative auctions for the period prior to the orders at issue, the period after the June 30, 1998 Order was issued through the commencement of the ISO's action rejecting bids in excess of specified levels, and the period after the ISO implemented its action rejecting bids in excess of specified levels. In addition the ISO and PX should address how their phase-in plans implementing new procedures such as the hour-ahead market will affect the interrelated markets.

The ISO and PX studies should be completed and reports filed with the Commission within 30 days of the date of this order. Parties may file comments on these reports with the Commission within 15 days thereafter.

The Commission orders;

(A) The ISO's and SoCal Edison's Motions for Stay are hereby denied.

(B) The ISO is authorized to implement interim actions, with the conditions discussed in the body of this order.

(C) The ISO and PX market surveillance committees shall each conduct a study and file a report with the Commission within 30 days of the date of this order, as discussed in the body of this order.

(D) Motions to intervene, protests or comments in each proceeding should be filed within 30 days of the date of this order -

By the Commission.

(SEAL)

Original Signed by)  
Linwood A. Watson, Jr.  
Acting Secretary.