From: Woertz, Byron
Sent: Sunday, May 27, 2001 12:16 AM
To: ISO Market Participants
Subject: CAISO Emergency Notice - May 25, 2001 FERC Order On Implementation of the Price Mitigation Plan in April 26 Order

ISO Market Participants:

On Friday, May 25, 2001, the Federal Energy Regulatory Commission (FERC) issued an "Order Providing Clarification and Preliminary Guidance On Implementation Of Mitigation and Monitoring Plan For The California Wholesale Electric Markets." (May 25 Order). The FERC clarified four issues for purposes of implementing the mitigation plan outlined in FERC's April 26, 2001 Order.

Please see the attached notice for a discussion of FERC's May 25 Order.

Byron B. Woertz, Jr.
Director, Client Relations
(916) 608-7066
(800) 481-7037 - Pager

EMERGENCY MARKET NOTICE

May 25, 2001 FERC Order On Implementation of the Price Mitigation Plan in April 26 Order

On Friday, May 25, 2001, the Federal Energy Regulatory Commission (FERC) issued an "Order Providing Clarification and Preliminary Guidance On Implementation Of Mitigation and Monitoring Plan For The California Wholesale Electric Markets." (May 25 Order). The FERC clarified four issues for purposes of implementing the mitigation plan outlined in FERC's April 26, 2001 Order:

- Treatment of Generators Who Did Not Supply Heat & Emission Rates;
- Calculation of a Natural Gas Proxy Price;
- Creditworthiness; and
- Price Mitigation in the ISO's Spot Markets Other Than Imbalance Energy.

Treatment of Generators Who Did Not Supply Heat & Emission Rates

The FERC accepts the ISO's proposal, as outlined in the ISO's status report filed with the FERC on May 18, 2001 (May 18 Status Report), to substitute a $0/MWh bid for all available capacity that is not bid into the ISO's Imbalance Energy market and for which either the ISO has not received heat and emission rate information or the information is not complete.

Calculation of a Natural Gas Proxy Price

The FERC directs the ISO to calculate the natural gas proxy price as per the April 26 Order. That is, the ISO is to calculate the proxy price for natural gas using all California Delivery Points published in *Gas Daily* (*i.e.*, Malin, PG&E CityGate, Southern California Border (Kern River Station), SoCalGas large packages, and PG&E large packages).[1] Thus, beginning on May 28, 2001, the ISO will publish a natural gas proxy price for these delivery points based on an average of the gas prices published in Gas Daily. The proxy price will be applicable in the ISO's Imbalance Energy and Ancillary Service (discussed below) markets effective May 29, 2001.

Creditworthiness

The FERC granted a request for clarification from the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (Southern Cities) and stated that the "must-offer" obligation, as outlined in the April 26 Order, should be applied to publicly owned generators only if they are assured of a creditworthy buyer. FERC stated that, as of May 29, 2001, they expect the ISO to ensure the presence of a creditworthy buyer for all transactions made with all generators who offer power in compliance with the must-offer requirement specified in the April 26 Order. The ISO explained in its response to Southern Cities' request that the arrangements currently in place provide all suppliers with assurances that they will receive payment for Energy under the must-offer requirement. See, ISO's Answer to the Southern Cities filed with FERC on May 25, 2001. In addition, the ISO issued Supplemental Market Notice on May 25, 2001 reiterating that it will

[1] In its May 18 Status Report, the ISO noted that the two large package prices do not necessarily pertain to individual delivery points and that Malin, while not in California, is a pricing point for delivery to California. Thus, the ISO had recommended that the gas price index reflect the price of deliveries at Malin, Kern River Station and PG&E CityGate only.

continue to comply with the FERC's orders regarding creditworthiness and offering a further explanation as to the consequences of the ISO's compliance.

Price Mitigation in the ISO's Spot Markets Other Than Imbalance Energy

The FERC stated that the ISO erred in its interpretation of the April 26 Order. The ISO had interpreted the April 26 Order as not providing price mitigation in the ISO's Ancillary Services (A/S) markets and the Adjustment Bid market. FERC indicated that price mitigation does apply in those markets: "*Therefore the ISO must replace the $150/MWh breakpoint methodology in the [Ancillary Services] markets with the superseding methodology adopted in the April 26, Order. Further, we clarify that the April 26 Order did not replace the ISO's current methodology for mitigating Adjustment Bid prices.*" Slip.Op. at 5.

1. Adjustment Bid Market. The ISO will continue to enforce a $250 hard cap on Adjustment Bids.

2. A/S Markets. With regard to the market clearing price (MCP) for A/S, the FERC directed the ISO to:

> *use each relevant average hourly mitigated Imbalance Energy price. If the Ancillary Services markets clear below the average hourly mitigated Imbalance Energy price for that hour, then the ISO will pay the Ancillary Services clearing price for that market. If the Ancillary Services markets clear above the average hourly mitigated Imbalance Energy price, then the ISO will use that price to clear the market and will pay as bid for all Ancillary Services that are needed above the mitigated price. Bids accepted above the mitigated price will be subject to refund and justification*

Slip.Op. at 5 (emphasis added).

According to Order, the price mitigation in the forward A/S markets will apply *ex post* or after those markets have cleared and the mitigation will apply only in those hours in which there was a reserve deficiency. For each hour of the Day-Ahead A/S markets, if there is subsequently no reserve deficiency in real time for that hour, there will be no price cap, no subject to refund requirement, and no cost justification required of suppliers under the Order. If there is a reserve deficiency in real time for that hour, the proxy MCP for imbalance energy will apply to the A/S capacity markets and any accepted A/S bid above the proxy MCP will be paid "as bid" and will be subject to refund and justification. For purposes of implementing FERC's April 26 Order (effective May 28, 2001, for Trading Day May 29, 2001), the ISO will implement FERC's price mitigation measures as clarified above.

Furthermore, since FERC did not clarify all aspects of the ISO's proposed implementation plan, as outlined in its May 18 and May 25 Status Reports to FERC, the ISO will treat, until directed otherwise, emissions costs as outlined in those reports. Thus, beginning on May 28, for purposes of implementing FERC's price mitigation measures effective trading day May 29, the ISO will publish a "$0" proxy price for emissions costs.