

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

AES Redondo Beach, L.L.C.	)	Docket Nos. ER98-2843-005
	)	ER98-2843-006
	)	and ER98-2843-007
AES Huntington Beach, L.L.C.	)	Docket Nos. ER98-2844-005
	)	ER98-2844-006
	)	and ER98-2844-007
AES Alamitos, L.L.C.	)	Docket Nos. ER98-2883-005
	)	ER98-2883-006
	)	and ER98-2883-007
	)	(Not Consolidated)
El Segundo Power, LLC	)	Docket Nos. ER98-2971-006
	)	ER98-2971-007
	)	and ER98-2971-008
Long Beach Generation, LLC	)	Docket Nos. ER98-2972-006
	)	ER98-2972-007
	)	and ER98-2972-008
	)	(Not Consolidated)
Ocean Vista Power Generation, L.L.C.	)	
Mountain Vista Power Generation, L.L.C.	)	Docket Nos. ER98-2977-004
Alta Power Generation, L.L.C.	)	ER98-2977-005
Oeste Power Generation, L.L.C.	)	and ER98-2977-006
Ormond Beach Power Generation, L.L.C.	)	
Williams Energy Services Company	)	Docket Nos. ER98-3106-002
	)	ER98-3106-003
	)	and ER98-3106-004
Duke Energy Oakland, L.L.C.	)	Docket Nos. ER98-3416-004
	)	ER98-3416-005
	)	and ER98-3416-006
Duke Energy Morro Bay, L.L.C.	)	Docket Nos. ER98-3417-004
	)	ER98-3417-005
	)	and ER98-3417-006
Duke Energy Moss Landing, L.L.C.	)	Docket Nos. ER98-3418-004

	)	ER98-3418-005
	)	and ER98-3418-006
	)	(Not Consolidated)
Southern California Edison Company	)	Docket No. EL98-62-003
	)	EL98-62-004
	)	and EL98-62-005
Sempra Energy Trading Corporation	)	Docket No. ER98-4497-002
San Diego Gas & Electric Company	)	Docket No. ER98-4498-002
California Independent System Operator Corporation	) )	Docket No. ER99-1971-000

**CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION'S  
REQUEST FOR REHEARING, MOTION FOR CLARIFICATION  
AND CONDITIONAL MOTION FOR PARTIAL STAY**

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713, the California Independent System Operator ("ISO") submits this Request for Rehearing of two aspects of the order issued by the Commission in the above-captioned dockets on May 26, 1999 (the "May 26 Order").<sup>1</sup> In addition, pursuant to Rule 212 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.212, the ISO seeks clarification of one additional issue addressed in the May 26 Order and conditionally moves for a stay of one of the Commission's directives in that order.

---

<sup>1</sup> *AES Redondo Beach, L.L.C., et al.*, 87 FERC ¶ 61,208 (1999).

## I. INTRODUCTION

On March 1, 1999, the ISO filed Amendment No. 14 to the ISO Tariff.<sup>2</sup> Amendment No. 14 comprises primarily revisions that implement portions of the ISO's comprehensive redesign of its Ancillary Service markets, in compliance with the Commission's October 28, 1998, order in the above-captioned dockets.<sup>3</sup> The proposed revisions were products of an extensive process through which all interested stakeholders were involved in assessing the problems that had arisen in those markets during the first year of the ISO's operation and in developing proposals to address them.

Amendment No. 14 included, among other things, the following elements of the Ancillary Service market redesign proposal:

- Modifications to the ISO's Ancillary Service procurement process to enable the ISO to purchase additional quantities of one Ancillary Service that can substitute for another Ancillary Service, in order to reduce total costs (the "rational buyer" proposal);
- Modifications to the amounts payable to the operators of resources that fail to comply with ISO dispatch instructions, together with a plan to purchase additional quantities of Replacement Reserves to cover any forecast deficiencies in available energy, in order to reduce reliance on out-of-market purchases for that purpose;
- Introduction of separate pricing for the upward and downward components of Regulation service to increase the efficiency of the Regulation market;
- Modifications to permit Scheduling Coordinators to engage in trades of Ancillary Services to provide alternative means for them to fulfill their Ancillary Service obligations; and
- Modifications which the ISO deemed necessary for the implementation of the newly adopted provisions for billing Ancillary Services based on metered

---

<sup>2</sup> Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

<sup>3</sup> *AES Redondo Beach, L.L.C., et al.*, 85 FERC ¶ 61,123 (1998).

Demand. The modifications address a potential gaming opportunity and ensure comparable treatment of Scheduling Coordinators who self-provide the capacity necessary to meet their Ancillary Service obligations and those who purchase capacity for that purpose in the ISO's markets.<sup>4</sup> The modifications would require a Scheduling Coordinator, whose self-provided Ancillary Service capacity has decreased from the Day-Ahead to the Hour-Ahead Market, be charged to replace that capacity at the Hour-Ahead Market price.

Amendment No. 14 also included proposed modifications to the Ancillary Services Requirements Protocol to reflect the ISO's new requirements concerning communications and direct control systems for units providing Regulation service.

In the May 26 Order, the Commission approved all of these proposals, in some cases with reporting or other conditions. In the case of the modification to the proposal to base charges for Ancillary Services on metered Demands (referred to as the "buy-back" proposal), the Commission approved the proposal with regard to self-supplied Ancillary Services voluntarily withdrawn by a Scheduling Coordinator, but rejected its application in circumstances where the withdrawal is involuntary. 87 FERC ¶ 61,208 at 61,814 (1999).

The May 26 Order also confirmed the ISO's authority to impose caps on the prices it would pay for Ancillary Services and Imbalance Energy, but limited the duration of that authority to November 15, 1999. 87 FERC at 61,818-19. The Commission stated that the ISO could file to extend that authority if it found it necessary to do so, based on: a) the summer's experience with the improvements in the Ancillary Service markets implemented by Amendment No.

---

<sup>4</sup> The revisions adopting Ancillary Service billing based on metered Demand were approved by the Commission in its order on Amendment No. 13 to the ISO Tariff. *California Independent System Operator Corp.*, 86 FERC ¶ 61,122 (1999) (the "February 9 Order").

13 and Amendment No. 14, and b) on the October 15, 1999 reports required of the ISO's Market Surveillance Committee ("MSC") and the California Power Exchange Market Monitoring Committee ("MMC") on the effectiveness of the Ancillary Services reforms. *Id.*

## **II. EXECUTIVE SUMMARY**

The ISO seeks rehearing of two aspects of the May 26 Order, moves for clarification on another issue, and seeks a partial, conditional stay of one of the Commission's directives.

**A.** The Commission confirmed the ISO's authority to establish caps on the prices it will pay in markets for Ancillary Services and Imbalance Energy, but specified that this authority will terminate on November 15, 1999, unless extended by the Commission prior to that date. The ISO asks the Commission to reconsider the November 15, 1999 termination date for the ISO's price cap authority. That date gives the ISO too little time to give due consideration to the analyses of the efficacy of the Ancillary Service market reforms that the Commission directed the ISO's Market Surveillance Committee and the California Power Exchange's Market Monitoring Committee to file on October 15, 1999. Those reforms will be in effect for only a portion of the summer peak period, and another important market reform related to Reliability Must-Run generation cannot be implemented until after the summer. There is therefore a strong likelihood that the ISO will seek an extension of price cap authority in some form. The termination date established by the May 26 Order effectively

precludes the ISO from taking the views of the market committees into account when it makes that determination and when it decides the nature of the continued authority that it will seek. The ISO accordingly requests that the Commission extend the termination date for its authority to cap bid prices until February 15, 2000 to afford the ISO adequate time for the consideration of the Committees' reports.

**B.** Under the ISO's proposal to base Ancillary Service charges on metered Demand, a Scheduling Coordinator whose commitment to self-supply Ancillary Service capacity decreases from the Day-Ahead Market to the Hour-Ahead Market must make up for the shortfall at the Hour-Ahead Market price for the service. In its May 26 Order, the Commission approved the ISO's proposal but limited that proposal to the circumstance when the Scheduling Coordinator has voluntarily reduced the Ancillary Service capacity it supplies. This limitation is inconsistent with the obligations of suppliers in the ISO's Ancillary Service and Imbalance Energy markets. In all of those markets, a supplier bears the risk that it will be unable to live up to its supply obligations, whether or not the cause of a failure to do so is subject to its control. The May 26 Order would shift this risk to other Market Participants for Scheduling Coordinators that: a) choose to self-supply Ancillary Service capacity, and b) have that capacity reduced due to events beyond their control. This would shift risks away from a supplier that is in the best position to manage the risk and creates a disincentive for Scheduling Coordinators to participate in the ISO's Ancillary Service markets. Furthermore, in order to comply with the Commission's ruling, the ISO would have to engage in

burdensome manual work-arounds until next year, which is the earliest it could modify its software for the allocation of Ancillary Service costs on the basis of Scheduling Coordinators' actual Demands to reflect the Commission's ruling. The ISO requests the Commission to reconsider and remove this limitation.

**C.** In the May 26 Order, the Commission cautioned the ISO that its exercise of direct digital control over hydroelectric units providing Regulation service cannot preclude the owner of such units from intervening manually to comply with license conditions and Commission orders. The ISO confirms that the owner of a unit providing Regulation can intervene manually for such purposes. The ISO requests clarification from the Commission that this portion of the May 26 Order was not intended to insulate the Generating Unit owner from the consequences under the ISO Tariff of its taking direct control over the unit. Taking direct control would mean the unit would not be supplying Regulation service and, in this circumstance, the Scheduling Coordinator representing the unit might have to forfeit payments and might be exposed to other penalties in accordance with the ISO Tariff.

**D.** In the event the Commission cannot rule on the ISO's request for rehearing of the May 26 Order's limitation on the buy-back proposal by July 20, 1999, the ISO moves for a stay of that portion of the May 26 Order pending the Commission's consideration of the ISO's rehearing request. A stay is in the public interest because it will enable the ISO to implement billing for Ancillary Services based on metered Demand this summer. Absent a stay, this reform, which addresses a significant cause of abnormalities in the California electricity

markets cannot be implemented without burdensome manual work-arounds that would be required until next year, which is the earliest the ISO could modify the software to implement the May 26 Order's limitation on the buy-back proposal.

### **III. SPECIFICATIONS OF ERROR**

In compliance with Rule 713(c)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.7(c)(1), the ISO respectfully submits that the Commission erred in the following respects in the May 26 Order:

1. The termination of the ISO's authority to impose price caps on Ancillary Services bids that leaves insufficient time to consider the efficacy of the Ancillary Service redesign measures during peak load conditions and the analyses of the MSC and MMC. The termination date should be extended to permit sufficient time for that consideration.

2. The prohibition on the use of the buy-back proposal except in cases of voluntary reductions in self-provided Ancillary Services commitments departs from an otherwise consistent market design that places performance risk on the party scheduling a service and inappropriately places that risk on other Market Participants. If this prohibition is not removed or stayed, it threatens to complicate the implementation of billing based on metered Demand, which is an important component of the Ancillary Service market redesign approved by the Commission.



#### IV. REHEARING REQUESTS

##### A. The Commission Should Extend the Authority of the ISO To Cap Bids in Ancillary Service and Imbalance Energy Markets Through February 15, 2000.

In the May 26 Order, the Commission authorized the ISO to continue to impose a purchase price cap on Ancillary Services and Imbalance Energy bids.<sup>5</sup> It directed the ISO, however, to eliminate the price caps by November 15, 1999, absent Commission action extending the authority. The Commission reasoned that the ISO could request an extension of price cap authority based on its consideration of its experience with the Ancillary Service market improvements during the 1999 summer peak season and on its review of the reports of the MSC and MCC on the efficacy of those improvements, which the Commission directed be filed by October 15, 1999. 87 FERC at 61,818.

The ISO remains committed to the elimination of price caps at the earliest practicable date consistent with ensuring the ISO's ability to protect Market Participants against unreasonably high prices that could result from remaining market design flaws and opportunities for the exercise of market power. The ISO agrees entirely with the Commission's conclusion that a purchase price cap is not an ideal approach to operating a competitive market. *Id.* The ISO is concerned, however, that the schedule established by the Commission for the expiration of the ISO's bid price cap authority on November 15, 1999 will not allow for a reasoned decision by the ISO that considers the analyses of the MSC and MMC regarding whether to seek an extension of its authority. That schedule also

---

<sup>5</sup> Currently, those price caps are set at +/- \$250/MW for Ancillary Service capacity and \$250/MWh for Imbalance Energy.

impairs the ISO's ability, if it decides to seek an extension of price cap authority, to fashion an approach to bid price restrictions that gives greater flexibility to suppliers to promote greater entry, while protecting buyers against undue price volatility.

**1. The Scheduled Expiration of the ISO's Price Cap Authority Leaves Inadequate Time for Consideration of the Committees' Reports.**

The MSC and MMC reports evaluating experience under the Ancillary Service market reforms are scheduled for submission on October 15, 1999. *Id.* at 21. The ISO intends and desires to take those reports into consideration in deciding whether to seek an extension of bid price cap authority and the nature of the authority to request. To do so, ISO management must first analyze the reports and prepare a recommended course of action and the ISO Board must act upon the management's recommendations. The ISO must also prepare an appropriate application for filing with the Commission.

It will be extremely difficult for the ISO to give due consideration to the committees' reports, to determine an appropriate course of action, to obtain ISO Governing Board approval, and, if necessary, to prepare a filing with the Commission, all within thirty days. Even if the ISO is able to complete these actions within the limited time provided by the May 26 Order, its consideration of the committees' reports will necessarily be constrained.

Moreover, if the ISO concludes, based in part on consideration of the committees' reports, that continued price cap authority is necessary and appropriate, the factors driving that conclusion will undoubtedly make it

imperative that it act in a manner that avoids a gap in its price cap authority. The ISO would therefore be forced to request the Commission to act on any request for extended price cap authority on an emergency basis, before the November 15 deadline.

**2. Only Limited Experience With Ancillary Service Market Redesign Will Be Available By November 15, 1999.**

The May 26 Order presumes that, by the fall of 1999, the ISO will have a full summer of experience under the Ancillary Service market redesign measures approved in Amendments No. 13 and 14, upon which to base its decision regarding whether to apply for an extension of price cap authority. This, however, will not be the case. Before the May 26 Order was issued, the ISO directed its contractors to begin the development of the software necessary to implement those measures and that work is proceeding. Due to the magnitude and complexity of the software changes required, however, it will not be possible to complete the software necessary to implement all aspects of the Ancillary Service market redesign before the summer peak season. Rather, different elements of the market redesign will be implemented over the course of the summer on a phased basis, as the necessary software is completed and tested. Under the current schedule, most software modifications will be implemented the week of July 26, 1999. The last pieces of the software needed to implement the current components of Ancillary Service market redesign are projected to be ready for use on approximately August 15, 1999.

The Commission's assumption that the MSC, the MMC and the ISO will have a full summer of experience with the Ancillary Service market reforms upon

which to base their analyses of the continued need for some form of price caps is thus mistaken. The ISO therefore will have only limited data available upon which to base its decision regarding an application to extend price cap authority.

**3. There Is a Strong Likelihood That the ISO Will Seek an Extension of Price Cap Authority in Some Form.**

While the ISO is confident that the measures approved in Amendment No. 14 will lead to substantial improvements in the competitiveness of Ancillary Service markets, there is a high probability that the ISO will seek an extension of price cap authority in some form. Not only will the ISO lack a full summer peak season's data upon which to base a determination on the effectiveness of those measures, but one critical measure that was not included in Amendment No. 14 cannot be completed this summer. In its earlier reports on the Ancillary Service markets in California, the MSC concluded that a change in the manner in which Reliability Must-Run generation is dispatched is necessary to address conditions that present opportunities for the exercise of market power.<sup>6</sup> See 87 FERC at 61,801. Consistent with the settlement approved by the Commission in Docket Nos. ER98-441-000, *et al.*, the ISO may not propose such a change until October 1999, after the summer peak season.<sup>7</sup>

The MSC and the MMC have prepared a joint "Memorandum on Maximum Purchase Prices in Energy and Ancillary Services Markets in California," which is attached as Appendix 1. In that memorandum, the MSC and the MMC confirm

---

<sup>6</sup> The California Power Exchange MMC, while noting that it has not conducted as thorough an analysis of the impact of Reliability Must-Run generation on the ISO markets, supports the MSC's recommendations. See March 9, 1999 Second Report on Market Issues in the California Power Exchange Energy Markets at 70-71.

<sup>7</sup> 87 FERC ¶ 61,250 (May 28, 1999).

their views of the importance of this additional reform. There is accordingly a strong likelihood that the ISO will find it necessary to seek an extension of price cap authority in some form. In the face of the November 15 deadline established in the May 26 Order, the ISO will be hard pressed to delay that decision until after the MSC and MMC reports are issued.

**4. The Schedule in the May 26 Order Limits the ISO's Ability To Consider the Views of the MSC and MMC in Fashioning any Proposed Extension of Price Cap Authority.**

The likelihood that the ISO will request some form of continued price cap authority makes it all the more important that the ISO have sufficient time to develop an approach that protects buyers against undue price volatility while minimizing the constraints on suppliers. The ISO is currently working on a proposal that could, after sufficient experience with the Ancillary Service market reforms approved in the May 26 Order, function as a less restrictive alternative to the current bid price caps. At its June 24, 1999 meeting, the ISO Board of Governors directed ISO Management to pursue the development of a proposal that would replace absolute bid price caps with limitations on price volatility in the ISO's Ancillary Service and Imbalance Energy markets. Over the next few months, the ISO will be working with stakeholders on the development of the details of such a proposal, for consideration at the ISO Board's August meeting.

The ISO believes that consideration of the appropriateness of such a price volatility limit mechanism as a replacement for the current bid caps would benefit if the analyses of the MSC and the MMC could be taken into account. In their joint memorandum, the MSC and MMC indicate their intention to continue to

study such mechanisms. The ISO believes that consideration of the views of the MSC and MMC, as presented in their October 15 reports, should form a critical component of the ISO's determination regarding a replacement for the current bid price caps. The schedule established by the May 26 Order, however, will leave the ISO little time to evaluate those reports as part of its decision.<sup>8</sup>

\* \* \* \* \*

For these reasons, the ISO urges the Commission reconsider its November 15, 1999 date for the termination of the ISO's authority to implement Ancillary Service and Imbalance Energy bid price caps. The ISO requests that the Commission extend that authority to February 15, 2000 -- four months after the date for issuance of the MSC and MCC reports -- conditioned on the ISO's filing for any extension of its authority at least 60 days prior to the February 15, 2000, termination date. Absent such an extension, the ISO anticipates that it will find it necessary to seek continued price cap authority sufficiently in advance of November 15, 1999 to ensure that such authority is not interrupted, which would deprive the ISO of an opportunity to review the analyses of the MSC and MMC, as reflected in their October 15 reports, before developing and submitting an extension proposal. The ISO believes that the modest extension it proposes would be preferable to such a sequence of events because it would give both the

---

<sup>8</sup> The ISO does not interpret the May 26 Order to limit the ISO's discretion to modify the price cap mechanism for the period prior to November 15, 1999. Should the ISO Board approve a price volatility limitation mechanism for implementation before November 15, the ISO would implement that mechanism, and would take into consideration the views of the MSC and MMC, based on the limited data then available, in making that decision. The only question presented concerns the ISO's ability to take account of the MMC and the MSC reports in considering the continued appropriateness of the mechanism after November 15, 1999.

ISO and the Commission adequate time to take account of the MSC and MMC reports in considering the need for and form of continued price cap authority.

**B. The Commission Should Not Limit the Buy-Back Proposal for Ancillary Services to Voluntary Reductions in Self-Provided Ancillary Services.**

As noted above, the ISO proposed in Amendment No. 14 to modify its proposal to allocate Ancillary Service obligations and costs on the basis of metered Demand, which had been approved as part of Amendment No. 13. The modification addresses the opportunity created by the initial proposal for a Scheduling Coordinator to withdraw in the Hour-Ahead Market, self-supplied Ancillary Service capacity that was committed in the Day-Ahead Market. The example included in the ISO's transmittal letter to Amendment No. 14 postulated a Scheduling Coordinator voluntarily withdrawing its self-supply commitment, in the hope of reselling at higher Hour-Ahead prices. Under Section 2.5.21 of the ISO Tariff, a Scheduling Coordinator that commits to *sell* Ancillary Service capacity in the Day-Ahead Market must live up to that commitment or buy back the capacity at the Hour-Ahead Market price for the Ancillary Service in question. In Amendment No. 14, the ISO proposed to confirm that the same rule would apply to self-provided Ancillary Service capacity.

The May 26 Order accepted the ISO's proposal to charge Scheduling Coordinators the Hour-Ahead Market price for Ancillary Services capacity that replaces self-provided Ancillary Services capacity that the Scheduling Coordinator had scheduled in the Day-Ahead Market but had voluntarily withdrawn before the Hour-Ahead Market. 87 FERC at 61,814. The

Commission, however, rejected the proposal as it applied to capacity involuntarily withdrawn from the Day-Ahead Market at the direction of the ISO, as in the case of a transmission line derating or a change in generation schedules. *Id.* The Commission reasoned that applying the proposal to involuntary withdrawals would not further the purpose that it believed the ISO to be advancing for the proposal – to reduce gaming by removing the incentive for Scheduling Coordinators to withdraw previously scheduled self-provided capacity from the Day-Ahead Market. *Id.*

The Commission should reconsider and remove this limitation on the ability of the ISO to charge the Hour-Ahead price for a Scheduling Coordinator's replacement of scheduled, but withdrawn, self-provided Ancillary Services capacity. While the Commission was correct in noting that the ISO intended by its proposal to reduce opportunities for gaming, the policies underlying the proposed ISO Tariff amendment are more fundamental, and the Commission's resolution of this issue thus has broad implications. The Commission's ruling inappropriately requires other Market Participants to provide insurance against external events to a Scheduling Coordinator that chooses to self-provide Ancillary Services in the Day-Ahead Market – protection that is unavailable in any of the Ancillary Service and real-time Energy markets administered by the ISO. It thus affords such a Scheduling Coordinator protection that is unavailable to Scheduling Coordinators that supply capacity to the ISO for use in its Ancillary Service markets, biasing suppliers against participating in those markets. Further, the ISO could not modify software currently under development in order



to implement the Commission's ruling until well into the year 2000. In the interim, the ISO would have to rely on onerous manual work-arounds to implement billing based on metered Demand, a key component of the Ancillary Service market redesign.

**1. The Limitation on the Buy-Back Proposal Is Inconsistent With the Rules Applicable to Other ISO Markets and Inappropriately Shifts Risks Among Market Participants.**

The May 26 Order would treat an external event that prevents a Scheduling Coordinator from living up to its self-supply commitment for Day-Ahead Ancillary Service capacity as the equivalent of a *force majeure* event, relieving the Scheduling Coordinator of its obligation to make good on its self-supply commitment. However, the ISO's need to procure Replacement Reserve capacity in the Hour-Ahead Market at the Hour-Ahead price is present regardless of the reason why the capacity committed in the Day-Ahead Market is unavailable. The Scheduling Coordinator's failure to deliver the Ancillary Service capacity causes the ISO to incur additional costs to procure replacement capacity in the Hour-Ahead Market. The ISO's proposal would have imposed these costs on the Scheduling Coordinator who suffered the non-delivery, while the Commission's ruling would spread those costs to other Market Participants. Shifting to other Market Participants the risk of non-performance by a self-providing Scheduling Coordinator, even when limited to external events, is inappropriate for a number of reasons.

First, the limitation that the Commission ruling creates on the obligation of a self-providing Scheduling Coordinator to satisfy the commitment reflected in its Schedule is inconsistent with the design of other ISO markets for Ancillary

Services and Imbalance Energy. In particular, as noted above, a Scheduling Coordinator that bids and is selected to supply Ancillary Service capacity to the ISO is not protected against external events that might prevent the delivery of the capacity it is scheduled in the Day-Ahead Market to supply. To the contrary, under Section 2.5.21 of the ISO Tariff, a Scheduling Coordinator in that position must pay the Hour-Ahead Market price to buy back Ancillary Service capacity that it fails to supply, regardless of whether that failure is voluntary or due to external forces. Similarly, a Scheduling Coordinator that provides balanced Energy schedules in the forward market, but fails to deliver on its commitment due to a transmission outage, must pay for the Energy that was used to serve its Demand at the hourly ex post price. The risk of non-performance in the ISO's markets is thus placed on the supplier, rather than on buyers. The May 26 Order would exempt self-providing Scheduling Coordinators from this rule.

Second, requiring a self-providing Scheduling Coordinator, rather than Ancillary Service market buyers, to bear the risk of external forces that curtail deliveries of Ancillary Service capacity places the risk on the party in the best position to manage it. A self-providing Scheduling Coordinator that cannot live up to its Day-Ahead commitment has numerous options available to it to avoid the imposition of Hour-Ahead charges for replacement capacity. As the Commission noted, a Scheduling Coordinator can choose to meet a portion of its Ancillary Service requirements in the Hour-Ahead Market. In addition, with the provisions in Amendment No. 14 for Inter-Scheduling Coordinator trading of Ancillary Services, the Scheduling Coordinator can negotiate after close of the

Day-Ahead Market to purchase replacement capacity from other suppliers. See Section 2.5.7.4.1. These measures are available to protect a Scheduling Coordinator against buy-back exposure resulting from external events, such as transmission line derates.

The ISO, in contrast, must rely primarily on bids submitted in its markets to make up for the effect on buyers of Ancillary Services of a self-providing supplier's non-performance. It cannot negotiate out-of-market purchases simply to avoid high prices in the Hour-Ahead Market. Neither can the ISO expect to rely on real-time markets to obtain replacement Ancillary Service capacity. Ancillary Service capacity that is not accepted in the Day-Ahead or Hour-Ahead Markets is likely to be committed to an Energy transaction. It therefore may not be available in real time to replace deficiencies in self-provided Ancillary Service capacity. As a result, the Hour-Ahead Market represents the primary mechanism available to the ISO to replace the Ancillary Services capacity that a Scheduling Coordinator fails to provide in accordance with its self-provision commitment.<sup>9</sup>

Third, the Commission's ruling departs from the well-recognized principle that cost responsibility should track cost causation, to the extent feasible.<sup>10</sup> It

---

<sup>9</sup> In the May 26 Order, the Commission urged the ISO to consider market mechanisms to address situations in which it must reduce the amount of Ancillary Services capacity bid or self-provided. Such mechanisms cannot, however, address the circumstance when the ISO continues to require the Ancillary Services capacity but the self-provider cannot deliver. It should be noted that Scheduling Coordinators are not disadvantaged by the requirement that they supply scheduled Ancillary Services even if the amount required is reduced. Amendment No. 14 ensures that a self-provider will be provided a credit for any Ancillary Services capacity provided in excess of its obligations. See Section 2.5.28.

<sup>10</sup> See *Cities of Riverside & Colton. v. FERC*, 765 F.2d 1434, 1439 (9<sup>th</sup> Cir. 1985), citing *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982); *California Independent System Operator Corp.*, 86 FERC ¶ 61,122 at 61,424 (1999) (“...costs should be borne on the basis that they are incurred.”); *California Power Exchange Corp.*, 85 FERC ¶ 63,007, 65,122 (1998).

forces other Market Participants to insure a Scheduling Coordinator that chooses to self-provide its Day-Ahead Ancillary Service requirements against external events that could affect its ability to live up to its obligation. The self-providing Scheduling Coordinator, however, caused the ISO to incur additional costs associated with its failure to provide the committed Ancillary Service capacity. A Scheduling Coordinator in that situation is the most appropriate entity to bear the associated cost.

Fourth, the special treatment afforded self-providers of Ancillary Service capacity serves no market or efficiency objective. In fact, it could be counter-productive. The Commission recognized in the May 26 Order that features of the Ancillary Service market that create the potential for differential compensation between self-suppliers and sellers of Ancillary Services should be minimized. May 26 Order, slip op. at 30-31. Yet, the Commission disregarded its own counsel in the course of modifying the buy-back proposal. Assume, for example, that a transmission line is derated after the close of the Day-Ahead Market, preventing the supply of Ancillary Service capacity from two Generating Units. If one of those generators served as the source of a Scheduling Coordinator's self-supply commitment, while the second was successfully bid into a Day-Ahead Ancillary Service market by a second Scheduling Coordinator, only the second Scheduling Coordinator would bear the costs of replacing its Day-Ahead supply commitment in the Hour-Ahead Market. The costs of replacing the first Scheduling Coordinator's capacity would be borne by all Market Participants purchasing the Ancillary Service in question from the ISO.

In the May 26 order, the Commission postulates a scenario where the weighted-average price for spinning reserve in the Day-Ahead and Hour-Ahead Markets is \$14, while the Hour-Ahead price for Spinning Reserve is \$20. 87 FERC at 61,814. The Commission then states:

If the SC sells into the hour-ahead market rather than self-providing, it receives the \$20 hour-ahead while incurring the \$14 charge -- resulting in net revenue of \$6 from the ISO. We see no reason why capacity should receive different compensation based solely on whether it is self-provided or sold; the capacity would provide the same function and benefit whether self-provided or sold. *The ISO's buy back proposal does not change this feature, and the differential compensation still leaves room for gaming.*

*Id.* (emphasis added). The ISO's proposal is intended precisely to change the feature the Commission describes. In the example postulated by the Commission, the ISO's proposal would allow it to charge the Scheduling Coordinator the \$20 Hour-Ahead price (as opposed to the weighted-average price), irrespective of the reason(s) why the buy-back obligation arose. Thus, it would eliminate the existing difference in the compensation between "bid" and "self-provided" resources in a buy-back scenario.

By relieving self-supplying Scheduling Coordinators of the risk of non-performance that is borne by those supplying Ancillary Service capacity or Imbalance Energy to the ISO, the May 26 Order creates an incentive for Scheduling Coordinators to self-supply Ancillary Service capacity, rather than to supply capacity and Energy to the ISO's markets. As modified by the May 26 Order, the buy-back proposal could increase the frequency of occasions of bid insufficiency in Ancillary Service markets. It would thus be inconsistent with one

of the major thrusts of the ISO's Ancillary Service market redesign initiative – to create incentives for increased supplies of Ancillary Service capacity.

**2. The Limitation on the Buy-Back Proposal Threatens To Complicate the Implementation of a Significant Component of Ancillary Service Market Redesign.**

The Commission's limitation on the applicability of the buy-back policy could significantly complicate the implementation of billing based on metered Demand, as approved in the February 9 Order. In order to implement the components of Ancillary Service market redesign included in Amendment Nos. 13 and 14, the ISO's contractors have been working since the spring to develop the necessary software modifications. The software necessary to implement the allocation of cost responsibility for Ancillary Services based on metered Demand, including the buy-back modification as proposed in Amendment No. 14, is now scheduled to be ready for implementation during the third week of July, 1999.

Limiting the buy-back proposal to voluntary reductions in self-provided capacity would require revisions to the software currently under development, which does not now distinguish between voluntary and involuntary failures to supply self-provided Ancillary Service capacity. Further, in order to ensure that all ISO systems are compliant with Year 2000 software requirements, the ISO's Y2K policy prohibits the introduction of new software between the September 1999 nation-wide testing and January 2, 2000.

As a consequence, to implement billing based on metered Demand this summer, while reflecting the limitation on the buy-back modification ordered by the Commission, the ISO would have to perform manual work-arounds whenever

a transmission outage or other event precluded the delivery of Ancillary Service capacity that is self-provided in the Day-Ahead Market.

Manual work arounds of this nature are onerous and costly and create significant potential for error and disputes. The ISO would use this approach, if necessary, only due to the importance of implementing billing based on metered Demand. In the February 9 Order, the Commission recognized that using metered Demand to allocate costs of Ancillary Service capacity would remove an existing incentive for Scheduling Coordinators to underschedule, which requires the ISO to scramble in real-time operations to serve unanticipated Demand. February 9 Order, 86 FERC at 61,419 . Removing this incentive is a key component of the Ancillary Service market redesign. Creating a need to use manual work-arounds to implement this reform in order to incorporate a limitation that, as shown above, is inconsistent with the nature of a self-providing Scheduling Coordinator's obligation and with the treatment of suppliers in other ISO markets, is inadvisable.

The ISO accordingly urges the Commission to grant rehearing and to reconsider its limitation on the buy-back modification to the adoption of billing for Ancillary Services based on metered Demand. The buy-back proposal should be approved as submitted in Amendment No. 14.

## **V. MOTION FOR CLARIFICATION**

Amendment No. 14 included a proposal to establish new uniform requirements for automatic control and communications systems applicable to

Generating Units supplying Regulation service to the ISO. In the May 26 Order, the Commission approved this proposal, referred to as the Generator Communications Project (“GCP”), but “caution[ed]” the ISO that “the degree of control implied in the . . . proposal cannot conflict with requirements of FERC hydroelectric licenses.” May 26 Order at 35. The Commission found the record to be unclear regarding whether the GCP proposal would permit hydroelectric licensees supplying Regulation service to intervene manually to ensure compliance with their licenses and Commission orders, especially with respect to public safety. *Id.*

The ISO confirms that nothing in the GCP proposal precludes a licensee from intervening manually to comply with the requirements of its license and of Commission orders. As revised by the GCP proposal, the Ancillary Service Requirements Protocol requires the installation of communications and control equipment that *enables* the Generating Unit to respond to the ISO’s digital control signal without manual intervention. It does not, however, preclude manual intervention where necessary for other purposes.

When a Generating Unit’s response to the ISO’s digital control signal is interrupted by manual intervention (whether to ensure a hydro unit’s compliance with license conditions or for any other reason), that Generating Unit is not supplying Regulation service.<sup>11</sup> In those circumstances, the Scheduling Coordinator representing the Generating Unit is not entitled to be paid for the

---

<sup>11</sup> Regulation consists of the response of Generating Units to the direct digital control signal of the ISO to match real-time fluctuations in demand and resources. ISO Tariff, Appendix A (definition of “Regulation”).



Regulation service, and may be subject to other penalties.<sup>12</sup> The ISO requests clarification that the concern expressed in the May 26 Order regarding hydro licensees' ability to control the output of their units manually to comply with license conditions was not intended to suggest that such units should be exempted from the provisions of the ISO Tariff and Protocols that apply to all resources that choose to supply Regulation service.

## **VI. CONDITIONAL MOTION FOR PARTIAL STAY**

As discussed above, the ISO began in the spring the development of software to implement the allocation of Ancillary Service costs on the basis of metered Demand, including the requirement that Scheduling Coordinators who schedule, and later withdraw, self-provided Ancillary Service pay for replacement capacity at Hour-Ahead rates. That software cannot distinguish between voluntary and involuntary withdrawal of capacity. The ISO expects that the software will be ready for implementation by the third week of July, 1999.

As also explained above, revisions to the software that implements billing based on metered Demand will be necessary to reflect the portion of the May 26 Order that requires the ISO to exclude Scheduling Coordinators who are precluded by circumstances beyond their control from meeting their commitments in the Day-Ahead Market to self-supply an Ancillary Service from the Hour-Ahead charges. Such revisions could not be ready before the autumn.

---

<sup>12</sup> Under Sections 2.5.25.1 and 2.5.26 of the ISO Tariff, a Generating Unit that has been selected to supply Regulation and is determined by the ISO not to have followed the ISO's Dispatch instructions is not entitled to payment for Regulation for a period defined in Section 2.5.26.1. ASRP Section 11 provides for sanctions for non-performance that could include, after a warning, disqualification of a Generating Unit from providing the Ancillary Service in question.

Moreover, as also discussed above, implementation of such revisions before the year 2000 would compromise the ISO's Y2K compliance efforts. Thus, unless the Commission modifies the May 26 Order in response to the request for rehearing set forth above, the ISO will only be able to comply with the Commission's Order by using manual work-arounds that are onerous, costly and create the potential for error and disputes.

In these circumstances, the ISO urges the Commission to act on the ISO's request for rehearing of this portion of the May 26 Order by July 20, 1999, if at all possible. If the Commission is unable to do so, the Commission should stay the portion of its May 26 Order that excludes Scheduling Coordinators who are precluded by circumstances beyond their control from meeting their self-provided Ancillary Services commitments in the Day-Ahead Market from the requirement to pay for replacement capacity at Hour-Ahead rates.

The Commission has explained that, in accordance with the standard set forth in the Administrative Procedure Act, a stay will be granted if the Commission finds that "justice so requires."<sup>13</sup> Under this standard:

the Commission generally considers such factors as whether the moving party will suffer irreparable injury without a stay; whether issuance of a stay would substantially harm other parties; and where the public interest lies.<sup>14</sup>

The ISO's request for a conditional and partial stay of the May 26 Order easily satisfies this standard. If the ISO is unable to commence allocating

---

<sup>13</sup> 5 U.S.C. § 705; *see also, e.g., City of Tacoma*, 87 FERC ¶ 61,197 (1999); *Clifton Power Corp.*, 58 FERC ¶ 61,094 (1992).

<sup>14</sup> *City of Tacoma*, 87 FERC at 61,732; *see also, e.g., CMS Midland, Inc.*, 56 FERC ¶ 61,177, at 61,631 (1991), *aff'd sub nom. Michigan Municipal Cooperative Group v. FERC*, 990 F.2d 1377 (D.C. Cir.), *cert denied*, 510 U.S. 990 (1993).

Ancillary Service costs based on metered Demand, as approved in the February 9 Order, due to the need to incorporate manual work-arounds to comply with the May 26 Order, the burdens and costs of implementing billing based on metered Demands will be substantially increased. In addition, as explained above, one of the objectives of the Ancillary Service redesign - eliminating disincentives for supplying Ancillary Service capacity to the ISO - will be partially compromised.

Accordingly, if the Commission is unable to act on the ISO's rehearing request before July 20, 1999, it should stay the May 26 Order's directive that the buy-back proposal be modified pending the Commission's consideration of that request. In that way, the proposal for allocating Ancillary Service costs on the basis of metered Demand, as approved in the February 9 Order, may go into effect with the modification proposed in Amendment No. 14.

## **VII. CONCLUSION**

For the reasons set forth above, the ISO respectfully requests that the Commission (1) defer until February 15, 2000, the termination of the ISO's authority to impose price caps on Ancillary Services bids; (2) revise the May 26 Order to authorize the ISO to require Scheduling Coordinators that schedule self-provided Ancillary Services in the Day-Ahead Market and reduce such self-provision before the Hour-Ahead Market to replace such capacity at Hour-Ahead prices in all cases; (3) clarify that the concern expressed in the May 26 Order regarding hydro licensees' ability to control the output of their units manually to comply with license conditions was not intended to suggest that such units

should be exempted from the provisions of the ISO Tariff and Protocols that apply to all resources that choose to supply Regulation service; and (4) stay the portion of the May 26 Order that excludes Scheduling Coordinators who are precluded by circumstances beyond their control from meeting their self-provided Ancillary Services commitments in the Day-Ahead Market from the requirement to pay for replacement capacity at Hour-Ahead rates in the event that the Commission does not rule on the request for rehearing by the date that the software to implement the charges is available for implementation.

Respectfully submitted,

---

N. Beth Emery  
Vice President and General Counsel  
Roger E. Smith, Regulatory Counsel  
The California Independent  
System Operator Corporation

Edward Berlin  
Kenneth G. Jaffe  
Michael E. Ward  
Sean A. Atkins

Swidler Berlin Shereff Friedman, LLP

Counsel for the California Independent  
System Operator Corporation