

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

AES Redondo Beach, L.L.C.	)	Docket Nos. ER98-2843-001
	)	and ER98-2843-002
AES Huntington Beach, L.L.C.	)	Docket Nos. ER98-2844-001
	)	and ER98-2844-002
AES Alamitos, L.L.C.	)	Docket Nos. ER98-2883-001
	)	and ER98-2883-002
	)	(Not Consolidated)
El Segundo Power, LLC	)	Docket Nos. ER98-2971-001
	)	and ER98-2971-002
Long Beach Generation, LLC	)	Docket Nos. ER98-2972-002
	)	and ER98-2972-002
	)	(Not Consolidated)
Ocean Vista Power Generation, L.L.C.)	
Mountain Vista Power Generation, L.L.C.	)	Docket Nos. ER98-2977-001
Alta Power Generation, L.L.C.	)	and ER98-2977-002
Oeste Power Generation, L.L.C.)	
Ormond Beach Power Generation, L.L.C.)	
Williams Energy Service Company	)	Docket No. ER98-3106-001
Duke Energy Oakland, L.L.C.	)	Docket No. ER98-3146-001
Duke Energy Morro Bay, L.L.C.	)	Docket No. ER98-3147-001
Duke Energy Moss Landing, L.L.C.	)	Docket No. ER98-3148-001
	)	(Not Consolidated)
Southern California Edison Company	)	Docket No. EL98-62-000

**THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION'S
REQUEST FOR REHEARING OR, IN THE ALTERNATIVE,
MOTION FOR CLARIFICATION**

Pursuant to Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713 (1998), the California Independent System Operator Corporation ("ISO") hereby requests rehearing of

the Commission's October 28, 1998 Order ("October 28 Order") in the above-captioned proceedings insofar as the October 28 Order limits the ISO's ability to implement price caps as authorized by the Commission's July 17, 1998 Order in these proceedings ("July 17 Order"). In the alternative, the ISO asks the Commission to clarify that the July 17 Order does not preclude the ISO from treating Ancillary Services and Replacement Reserve bids submitted above the price cap during periods of bid insufficiency in July and August of 1998 as bids to provide those services at the applicable price cap level.

I. BACKGROUND

The circumstances under which the Commission granted the ISO interim authority to establish price caps and later extended that authority have been described at great length in numerous other filings and orders in the above-captioned proceedings.¹ Relevant highlights of this background will be repeated here to provide the necessary context for the ISO's instant filing.

By orders issued on June 30 and July 10, 1998, the Commission accepted for filing, without suspension or hearing, proposed market-based rates for certain Ancillary Services submitted by a number of California Market Participants. AES Redondo Beach, L.L.C., et al., 83 FERC ¶ 61,358 (1998) (the "June 30 Order"); Long Beach Generation, L.L.C., et al., 84 FERC ¶ 61,011 (1998) and Ocean Vista Power Generation, L.L.C., et al., 84 FERC ¶ 61,013 (1998) (together, the

¹ See, e.g., October 28 Order, 85 FERC ¶ 61,123, slip op. at 2-16; July 17 Order, 84 FERC ¶ 61,046 at 61,197-99; see also California Independent System Operator's Emergency Motion for Stay, Notice of Action Taken, Request for Rehearing, and Motion for Clarification filed on July 13, 1998 at pp. 9-17.

“July 10 Orders”). Prior to issuance of those orders, the ISO had requested that parties seeking to sell Ancillary Services at market-based rates be required to demonstrate that they lacked market power through time-differentiated market studies. The ISO had also requested that the Commission permit the ISO to cap these rates at a level that was high enough to provide an incentive to bid into the Ancillary Service markets but would ensure that generators could not charge excessive prices. The Commission rejected these requests, expressing concerns that price caps would reduce the supply of available Ancillary Services to the detriment of the market, and permitted the proposed market-based rates for Ancillary Services to go into effect immediately.²

In the first two weeks of July, after the Commission’s June 30 and July 10 Orders, the California market witnessed dramatic spikes in the price for Replacement Reserves, with prices reaching as high as \$5,000/MW and even \$9,999/MW for certain hours. During this period, the ISO exercised its discretion to refrain from purchasing Replacement Reserves when possible to avoid passing such exorbitant costs on to consumers. On certain days, however, reliability concerns related to the high demand summer months prevented the ISO from exercising such discretion. The ISO determined that it needed to take other measures to protect the interests of energy consumers.

² In the June 30 and July 10 Orders, the Commission also concluded that Replacement Reserves were not an ancillary service within the meaning of Order No. 888. See June 30 Order, 83 FERC ¶ 61,358 at 62,446. For the purposes of this filing, the term “Ancillary Services” is used as defined in the Master Definitions Supplement, Appendix A to the ISO Tariff, and includes Replacement Reserves. Except as noted, all other capitalized terms in this filing are used as defined in the Master Definitions Supplement.

On Monday, July 13, 1998, the ISO filed an Emergency Motion for Stay, Notice of Action Taken, Request for Rehearing, and Motion for Clarification (“Emergency Motion”) in the above-captioned proceedings requesting a stay of the Commission orders granting market-based rate authority for Ancillary Services in the California market. The ISO also notified the Commission that, “beginning with Trading Day July 14th, it will cap the prices that it will pay to those bidders that have been granted market-based rate authority . . . at \$500/MW.” Emergency Motion at p. 6. If the Commission did not stay or rescind its orders granting market-based rate authority for certain sellers of Ancillary Services, the ISO requested that it be permitted to cap Ancillary Service bids at \$500/MW.

On July 13, 1998, the same day the Emergency Motion was filed, the ISO sent the following notice (the “July 13 Notice”) to all Market Participants:

The ISO has implemented interim emergency measures pending FERC action in the form of caps on all Ancillary Service bids – including Replacement Reserves – of \$500/MW and seeks FERC approval of that action in the [Emergency Motion]. Bids were adjusted in some hours in today’s Day Ahead Market and will continue to be adjusted to \$500/MW pending a FERC order.

In the July 17 Order, the Commission recognized that the ISO needed to take emergency measures to address the unprecedented conditions in the California electricity market and found that the ISO’s interim establishment of price caps for Ancillary Services was reasonable. “Consistent with the ISO’s proposal, we will direct the ISO to provide advance notice to all market participants . . . of any adjustment in the price at which it will accept bids for these services.” 84 FERC ¶ 61,046 at 61,199.

One week after this order was issued, the ISO informed Market Participants of a resolution regarding the FERC-authorized Ancillary Service price caps that was passed at the July 23 meeting of the ISO Governing Board.

The price cap for all ancillary services (spin, non-spin, regulation, and replacement) will be \$250 beginning with the day ahead market Saturday, July 25 for Trade Day Sunday, July 26. As a reminder any bids over the price cap will be adjusted down to the price cap. . . The Board resolution is consistent with the authority to set caps granted by FERC in the July 17 order.³

Notwithstanding the July 17 Order and the July 13 and July 24 Notices, the ISO continued to receive numerous bids above the \$250/MW price cap in the markets for all Ancillary Services. In many cases these bids exceeded the caps by 400 percent or more. On August 18, 1998 there were bids in the Spinning Reserve market of \$25,000/MW, or 100 times the applicable cap. Consistent with the ISO's July 13 and July 24 Notices and in reliance on the authority granted by the July 17 Order, the ISO treated such bids above the cap level as bids to provide those services at the applicable price cap. This approach was necessary to address the continued bid insufficiencies and shortages in available capacity in the Ancillary Services markets that have been well documented in this proceeding.⁴ The ISO continued to adjust above-cap bids to the cap level as needed due to bid insufficiency through August 28, 1998. Since that date, the ISO has received sufficient bids to supply Ancillary Services at levels at or below

³ As with the July 13 Notice, this message (the "July 24 Notice") was part of a memorandum distributed by e-mail to all Market Participants. This is the primary method by which the ISO communicates with Market Participants. The July 24 Notice was submitted for Commission review as an attachment to the Supplement to Request for Reconsideration of Houston Industries Power Generation, Inc. filed in these proceedings on August 4, 1998.

⁴ See the Reports of the California Power Exchange Corporation Market Monitoring Committee and the ISO Market Surveillance Committee, filed on August 17, 1998 and August 19, 1998 respectively.

the price caps to enable it to reject all bids for Ancillary Services above the price cap.

Numerous parties submitted requests for rehearing or other motions concerning the Commission's July 17 Order. The Commission rejected most of these requests and motions in the October 28 Order. In a pleading submitted on August 17, 1998, the AES Companies and Williams Energy Service Company ("AES/Williams") requested clarification that the ISO's interim Ancillary Services price capping authority was limited to the automatic disqualification of all above-cap bids. In the October 28 Order, the Commission granted this request, relying in part on language from the July 17 Order authorizing "the ISO's rejection of bids in excess of whatever price levels it believes are appropriate" 85 FERC ¶ 61,123, slip op. at 24, citing 84 FERC ¶ 61,046 at 61,199. The Commission felt that this was not a serious problem, since it was "unclear" why any generator would submit a bid above the ISO's "purchasing cap," when the ISO was required to provide advance notice of any changes in the level of the cap. Id.

II. SPECIFICATION OF ERRORS

In accordance with Rule 713(c) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c) (1998), the ISO urges the Commission to grant rehearing to correct the following error in the October 28 Order:

The Commission should find that the ISO's interim authority to establish price caps for Ancillary Services bids includes the authority to adjust bids

submitted above the price cap to the applicable cap level where Market Participants are given notice that above-cap bids will be so treated.

III. REQUEST FOR REHEARING

A. Adjustment of Above-Cap Bids to the Price Cap Level Is Consistent With the July 17 Order

The authority granted to the ISO by the Commission's explicit language in the July 17 Order to cap prices at which it would purchase Ancillary Services was broad enough to include the ability to accept above-cap bids and adjust them to the applicable price level. While the July 17 Order did discuss the price capping authority in terms of "rejection" of bids exceeding the cap, the Commission's further discussion supports an authority beyond automatic disqualification of above-cap bids. Specifically, the Commission directed "the ISO to provide advance notice to all market participants . . . of any adjustment in the price at which it will accept bids for these services" and permitted the ISO to make "necessary adjustments in the appropriate level that the ISO will accept, based on the recommendations of the market surveillance committee." 84 FERC ¶ 61,046 at 61,199.

The ISO's authority to establish Ancillary Services price caps under the July 17 Order therefore includes the authority to establish the level at which it will accept bids, provided it gives advance notice to Market Participants. Where the ISO provides advance notice to Market Participants that it will treat all Ancillary Services bids submitted above the cap as bids to provide those services at the

applicable cap level, as discussed above, it is acting within the scope of this authority.

Furthermore, in its June 30 and July 10 Orders in this proceeding, the Commission expressed concerns that automatic rejection of all bids above a specific price cap level might limit the availability of Ancillary Services. In fact, it was this precise concern that led the ISO during the summer to adjust bids that exceeded the published price cap to the level of the cap, in accordance with the July 13 and July 24 Notices. Since the July 17 Order was issued in response to supply shortages in the Ancillary Services markets, the ISO acted reasonably in interpreting the price capping authority flowing from that order as broad enough so that the ISO would not have to disqualify automatically bids for scarce Ancillary Services when such bids exceeded applicable price caps.

B. Adjustment of Above-Cap Bids to the Price Cap Level Was a Reasonable and Appropriate Exercise of the ISO's Ancillary Services Price Capping Authority

The ISO's treatment of bids for Ancillary Services submitted above the price cap as bids to supply those services at the cap was a proper and necessary exercise of the price capping authority granted in the July 17 Order as applied to the unique circumstances of the ISO's Ancillary Services markets. First, participants were given specific and timely notice in the July 13 and July 24 Notices that any bids above the price cap level would be treated as bids to supply service at the cap level. Market Participants that chose to submit bids in the ISO's Ancillary Service auctions were on notice that above-cap bids would be treated in this manner and that, in any case, the price caps published by the ISO

would serve as ceilings on the market clearing prices that would be paid to all successful bidders. Accordingly, no bidder could have a legitimate expectation that it would receive any price above the published price cap for capacity bid and selected in the ISO's Ancillary Service auctions. Further, because the price caps were set at levels that exceeded the highest cost-based rates accepted by the Commission, no bidder could argue that it was forced to supply any Ancillary Service capacity at below-cost prices. Market participants submitting bids above the cap were improperly attempting to profit during this period of bid insufficiency, subverting the Commission's authorization to the ISO to limit the prices it paid for Ancillary Services.

1. All Potential Bidders in the ISO's Ancillary Services Markets Were On Notice That Bids Submitted Above the Price Cap Would Be Treated As Bids To Supply Services at the Cap Level

Potential bidders into the ISO's Ancillary Services markets were given unambiguous notice that any bids that exceeded the published price caps would be reduced to the level of the applicable cap. In its July 13, 1998 Emergency Motion, the ISO stated that, "beginning with Trading Day July 14th, it will cap the prices that it will pay to those bidders that have been granted market-based rate authority . . . at \$500/MW." Emergency Motion at p. 6. That same day, the ISO notified Market Participants in the July 13 Notice that Ancillary Service bids exceeding \$500/MW would continue to be adjusted to \$500/MW pending a Commission order. After the Commission authorized the ISO to cap the prices it paid for Ancillary Services in the July 17 Order, the ISO similarly issued the July 24 Notice

to put prospective suppliers of Ancillary Services on notice of a change in the level of the price cap to \$250/MW and to remind them that “any bids over the price cap will be adjusted down to the price cap.”

No Market Participant submitting an Ancillary Service bid above the applicable price cap can therefore argue that there was any ambiguity concerning how the ISO would treat such a bid. Every Market Participant was aware that, in implementing the authority granted by the Commission to limit prices paid for Ancillary Services during periods when insufficient bids were received below the price cap level, the ISO would treat above-cap bids as bids at the maximum price level. If that price was not acceptable to a Market Participant during any hour, it had a clear alternative available to it: it could refrain from submitting an Ancillary Service bid to the ISO.

2. The Ancillary Services Price Cap Limits the Market Clearing Price Received by Successful Bidders in the Ancillary Services Markets

The reasonableness of the ISO’s implementation of the authority confirmed by the July 17 Order is further apparent when viewed in the context of the operation of the ISO’s Ancillary Service markets. Under the ISO Tariff, all successful bidders in the ISO’s Ancillary Services markets that are authorized to sell Ancillary Services at market-based rates receive the applicable market clearing price for the capacity they provide. See ISO Tariff, §§ 2.5.7.3, 2.5.14 – 2.5.17. Under the authority granted in the July 17 Order, the ISO will not accept any bid higher than the level of the published price cap. The price cap thus acts

as a ceiling on the market clearing prices that will be paid to suppliers of Ancillary Services selected in the ISO's auctions. The market clearing prices will be less than or equal to the published price cap and all bidders know that the market clearing price they will receive will not exceed the level of the price cap. By submitting a bid in an Ancillary Service auction, a Market Participant thus signifies its readiness to accept a price for capacity for the Ancillary Service in question that is no higher than the published price cap applicable during the period, especially in light of the notice provided in the July 13 and July 24 Notices. If a Market Participant was not ready to accept that price, then it could simply refrain from submitting a bid.

The design of the ISO's Ancillary Service markets thus reinforces the reasonableness of the approach the ISO took to implementing the price cap authority confirmed by the July 17 Order. Every successful bidder in the ISO's Ancillary Services markets received the applicable market clearing price, constrained by the published price cap. No Market Participant had any legitimate expectation of receiving a price for Ancillary Services that exceeded the level of the published price cap.

3. All Bidders With Bids Accepted at the Price Cap Level Received Prices in Excess of the Highest Cost-Based Rate Approved by the Commission

The price caps established by the ISO pursuant to the authority granted in the July 17 Order were initially \$500/MW, later reduced to \$250/MW. The highest cost-based rate accepted by the Commission for the sale of Ancillary Services to the ISO was \$244.60/MW. See Long Beach Generation, LLC, 83

FERC ¶ 61,277 (1998). The ISO took care to be sure that the Ancillary Service price caps were set at levels that exceeded the cost of supplying capacity for Ancillary Services so as not to discourage bidding. By the same token, adjusting above-cap bids to the level of the published price cap, in accordance with the July 13 and July 24 Notices, did not deprive any supplier of Ancillary Services of the ability to recover its legitimate costs. In any event, as explained above, the price cap operated as a ceiling on the market clearing prices that the ISO would pay in its Ancillary Service auctions; no supplier could expect payment above the level of the price cap, even if its costs exceeded that level.

4. Market Participants Submitting Bids Above the Price Cap Are Improperly Attempting To Profit at the Expense of the Ancillary Services Markets and the ISO's Ability to Maintain System Reliability

Since Market Participants have no justifiable expectation that bids for Ancillary Services might be accepted at prices in excess of the published price cap, the Commission understandably reasoned that there was no reason for them to submit bids at levels exceeding the price cap. October 28 Order, slip op. at 24. The ISO's experience, however, belies that expectation: Market Participants submitted numerous bids at levels above the price caps. In some cases, the bids were as much as 100 times greater than the applicable price cap. There must be a reason why some of them continue to submit above-cap bids after the Commission's authorization of price caps in the July 17 Order. As described in greater detail below, it seems that some bidders were hoping, in misplaced reliance on a Commission order addressing the ISO's price capping

authority for imbalance energy bids, to maneuver the ISO into a position in which it would have to pay the above-cap bids, notwithstanding the July 17 Order.

As part of Amendment No. 7 to the ISO Tariff, the ISO proposed a temporary rule disqualifying imbalance energy bids above an established price cap. The ISO's proposal explicitly limited the ISO's authority to the ability to reject or disqualify automatically all bids submitted above the cap level. The Commission accepted this limitation and incorporated it into its authorization of price caps on imbalance energy bids. See California Independent System Operator Corporation, 83 FERC ¶ 61,209 at 61,923 (1998) (the "Amendment No. 7 Order"). In response to a request for clarification, the Commission further declared that the imbalance energy bid price cap should not "prevent a unit that is actually called upon from receiving a price at least equal to its bid price . . . for any deliveries it actually makes." Id.⁵

Market Participants submitting above-cap bids in Ancillary Service auctions apparently hope to apply this ruling in Ancillary Services markets, as well, enabling them to receive payments that are uncapped. Those hopes are completely unfounded. First, on its face the Amendment No. 7 Order is limited to the imbalance energy price cap and does not apply to the Ancillary Services price cap, which had not even been proposed at the time that order was issued. The July 17 Order contains no similar restrictions or caveats on the ISO's authority to implement price caps for Ancillary Services.

Moreover, the situations addressed by each order are quite different. The relevant portion of Amendment No. 7 was designed to address a shortcoming in

the software used by the ISO to calculate the market clearing price for imbalance energy, not a shortage of bids. In that case, automatic disqualification of bids submitted above the price cap was sufficient to address the problem being addressed so there was no need for the ISO to accept adjusted above-cap bids. The specification that a generator called upon to run should receive its applicable bid price addressed the situation in which the ISO found it necessary to call upon a generator that was not selected to supply imbalance energy to operate out-of-sequence or out-of-market to maintain system reliability. In the case of the constrained Ancillary Services markets, the problem was a shortage of bids, creating the opportunity for some Market Participants to exercise market power if prices paid in the ISO's auctions were not capped. The appropriate price capping authority to address this situation properly includes the authority to accept all available bids at a price no greater than the cap level, particularly when bidders have been notified in advance that above-cap bids will be adjusted to the level of the caps.

Second, if the ISO were unable to adjust above-cap bids to the level of the published price cap, the purpose of the Commission's grant of authority to the ISO in the October 28 Order would be substantially vitiated. If the ISO's price capping authority in Ancillary Services markets were limited in this manner, whenever the ISO did not receive sufficient bids at or below the level of the applicable price cap, it would be left with two unacceptable alternatives. If it rejected all above-cap bids (as it does in the imbalance energy market) it would be left with insufficient resources to obtain the Ancillary Services required to

⁵ Rehearing of the Amendment No. 7 Order, 83 FERC ¶ 61,209, is currently pending.

preserve reliability. It would have to increase its reliance on generators with Regulatory Must Run (“RMR”) contracts to address the shortfall.⁶ Alternatively, if it paid the bidders that submitted above-cap bids in accordance with their bids, the price caps would plainly be ineffective to limit the prices paid for Ancillary Services and to curtail bidders’ opportunities to exercise market power. Such a result would clearly be contrary to the Commission’s July 17 Order.

Third, these bidders are misinterpreting the Commission’s ruling on Amendment No. 7. As the ISO stated in its June 29, 1998 response to the Commission’s requested clarification on Amendment No. 7, the ISO will pay all “applicable” bids (i.e. those bids below the price cap) at either the BEEP Interval Ex Post Price, or, if a unit is called out-of-sequence, the unit’s applicable bid price. Consistent with the express provisions of the ISO Tariff as modified by Amendment No. 7, Generators that submit bids for supplemental energy above that price cap will have those bids rejected and therefore are out-of-market and not “applicable”.⁷

Bidders who intentionally submit above-cap bids and who seek any compensation above the level of the applicable market clearing price, as constrained by the published price cap, are attempting to circumvent the

⁶ To the extent a Market Participant submitting above-cap Ancillary Service bids is the owner of RMR generation, the creation of increased demand for Ancillary Services under its RMR contracts may have been another motivation for an above-cap bidding strategy.

⁷ If necessary to avoid an intervention in market operations, or to prevent or respond to a System Emergency, the ISO may dispatch a resource which has not submitted a qualified bid. Section 11.2.4.2 of the ISO Tariff provides that for resources “which have not bid into the Imbalance Energy markets but which have been dispatched by the ISO to avoid an intervention in market operations or to prevent a System Emergency, the ISO shall settle. . . by way of the Uninstructed Imbalance Energy charge.” Resources with bids rejected pursuant to section 2.5.22.6 of the ISO Tariff are treated in accordance with section 11.2.4.2.

Commission-authorized price cap. They know that the ISO must accept such bids during periods of bid insufficiency in order to ensure system reliability. They also know that, at minimum, any above-cap bids accepted by the ISO will be treated as bids at the cap level, establishing the market clearing price at that level. To the extent they seek compensation beyond that level, they are attempting to side-step caps established to enable the ISO to secure the Ancillary Service capacity it needs to maintain system reliability without facilitating the exercise of market power. The Commission should not permit these parties to profit from such efforts. By confirming the authority of the ISO to treat above-cap bids as bids at the cap level, the Commission will enable the ISO to maintain the Ancillary Services price cap for its intended purpose and to thwart attempts to profit at the expense of system reliability.

C. Adjustment of Above-Cap Bids to the Price Cap Level Does Not Represent an Improper Exercise of “Unilateral Authority To Set Rates or To Reduce Bids”

The AES/Williams clarification request suggests that the ISO’s adjustment of above-cap bids to the cap level represents an attempt to impose prices on sellers “unilaterally” in violation of the FPA. The Commission is apparently responding to this concern when it states in the October 28 Order that the ISO “as a purchaser, has the discretion to reject bids that are excessive; [but] it does not have unilateral authority to set rates or to reduce bids.” 85 FERC ¶ 61,123, slip op. at 24. In general, the ISO agrees with this statement. It is important to recognize, however, that the ISO’s exercise of its price capping authority to

adjust bids to the cap level does not constitute an attempt unilaterally to set prices or arbitrarily to reduce bids.

As a purchaser, the ISO does have the authority to accept or reject bids. During periods of bid insufficiency, the ISO has notified Market Participants that it will exercise its authority to accept bids in conjunction with its authority under the July 17 Order to establish price caps. Market Participants are on notice that the ISO will not pay prices for Ancillary Services in excess of the cap level and that bids submitted above the cap level will only be accepted insofar as they are adjusted to the applicable cap level.

This practice is certainly not a unilateral attempt to set rates in contravention of the FPA. Sellers are free to continue to submit market-based bids for Ancillary Services under their approved rate schedules. They do so with the prior knowledge that bids exceeding the published price cap will be adjusted in accordance with the July 24 Notice. The ISO does not attempt to dictate whether or at what price such bids are made. Nor does the ISO arbitrarily impose reductions on these bids. The ISO does not reduce the prices for these bids, it merely treats certain bids -- those that are submitted above the cap level with no expectation that they'll be accepted at that price -- as if they were bids to provide those services at the applicable cap level.

For all the foregoing reasons, the ISO requests that the Commission grant rehearing of its October 28 Order and confirm that the ISO's interim authority to establish the price level at which it will accept Ancillary Services Bids includes the authority to adjust bids submitted above the price cap to the applicable cap

level when Market Participants are given notice that above-cap bids will be so treated.

IV. MOTION FOR CLARIFICATION

In the event the Commission does not grant the ISO's request for rehearing, it should at least clarify that the ISO acted properly in treating above-cap Ancillary Services bids submitted during periods of bid insufficiency in July and August of 1998 as bids to provide those services at the applicable price cap level.

A. The ISO's Acceptance of Above-Cap Bids at the Applicable Cap Level Was Necessary Due to Supply Shortages in the Ancillary Services Markets and Continued Above-Cap Bidding by Market Participants

As described above, the ISO has only adjusted above-cap Ancillary Services bids to the applicable cap level during certain periods from July 14, 1998 to August 28, 1998. The ISO did not adjust every bid submitted above the cap level during this time. It only accepted above-cap bids (at the adjusted price level) when there were insufficient bids available at or below the cap level. The shortages of Ancillary Services in the California market during July 1998 are described at length in the ISO's July 13 Emergency Motion. The reports of the ISO Market Surveillance Committee and PX Market Monitoring Committee described how these shortages continued into August.⁸

⁸ See the Reports of the California Power Exchange Corporation Market Monitoring Committee and the ISO Market Surveillance Committee, filed on August 17, 1998 and August 19, 1998 respectively.

This situation was only exacerbated by the fact that certain sellers of Ancillary Services continued to submit bids significantly in excess of applicable price caps long after the Commission authorized such caps in the July 17 Order. In the October 28 Order, the Commission expressed the belief that such bidding behavior would be rare.⁹ In reality, the ISO received many bids for each type of Ancillary Service at levels above the price cap.

Attached to this filing as Appendix A are tables for each of the Ancillary Services markets (Regulation, Spinning Reserve, Non-Spinning Reserve, and Replacement Reserves) summarizing all above-cap bids accepted by the ISO (and adjusted down to the applicable cap level) for July and August 1998. Appendix A provides information on only those above-cap bids which the ISO accepted due to insufficient bids submitted at or below the applicable price level and does not list the many above-cap bids rejected by the ISO during July and August. These tables show that certain Market Participants continued to bid thousands of megawatts of Ancillary Services at prices as great as 100 times the applicable price cap. Such bidding practices continued for more than a month after the Commission issued the July 17 Order.

Because so many Ancillary Services continued to be bid at above-cap levels into tight markets, the ISO was faced with a dilemma. Had the ISO rejected all the above-cap bids identified in Appendix A, it is unclear whether it would have been able to maintain the integrity of the ISO Controlled Grid. Instead, where bids were otherwise insufficient the ISO accepted the above-cap

⁹ "It is unclear why generators would bid at levels above the ISO's purchasing cap when the ISO is required to provide advance notice to all market participants of any adjustments in the price at

bids and adjusted them to the applicable price cap level, as it had stated it would in the July 13 and July 24 Notices to the Market Participants. This step was taken in order to protect energy consumers from bearing the costs of bids submitted in excess of the Commission-authorized and ISO-established price cap. The ISO believes its actions both in accepting above-cap bids and adjusting them down to the applicable cap level were absolutely necessary for the ISO to meet its responsibilities during the unique circumstances of its first summer of operation.

In addition, the ISO conducted its procurement of Ancillary Services for the latter part of July and August 1998 with the understanding that the price capping authority granted by the Commission's July 17 Order included the authority to accept above-cap bids and adjust them to the applicable cap level. The Commission should clarify that this procurement was an appropriate and justified response to market conditions and bidding patterns during July and August.

C. The ISO Cannot Re-Run the Markets for July and August 1998

The requested clarification is appropriate in light of the fact that the ISO cannot re-run the Ancillary Services procurement process for those periods in July and August when it accepted and adjusted above-cap bids. If the ISO had exercised its price capping authority under the limitations provided for in the October 28 Order during those periods, it would have been forced to reject all of the above-cap bids listed in Appendix A. Since above-cap bids were only

which it will accept bids for these services." 85 FERC ¶ 61,123, slip op. at 24.

accepted during periods of bid insufficiency, the ISO most likely would have called on RMR resources to provide the services necessary to maintain system reliability. The many variables that would have affected this procurement process cannot accurately be recreated. It is impossible retroactively to determine how the Ancillary Services markets would have turned out during those periods if the ISO had not accepted above-cap bids.

Moreover, the generation dispatched during those periods cannot now be retracted. Even if it were possible, for example, to identify RMR units that would have been called had above-cap bids been rejected, that information is now of no practical use. Units which did not actually provide services cannot claim a stake in some hypothetical retroactive market. Under the circumstances, the Commission should make clear that the ISO's procurement of Ancillary Services during July and August cannot now be revisited.

V. CONCLUSION

For the foregoing reasons, the ISO respectfully requests that the Commission grant the request for rehearing as described above or, in the alternative, clarify that the ISO properly implemented its price capping authority during periods of bid insufficiency in July and August of 1998, as described above.

Respectfully submitted,

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Date: November 27, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned dockets, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (1998).

Dated at Washington, D.C. on this 27th day of November, 1998.

Sean A. Atkins

November 27, 1998

David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

**Re: AES Redondo Beach, L.L.C.
Docket Nos. ER98-2843-001, et al.**

Dear Secretary Boergers:

Enclosed for filing is one original and 14 copies of the California Independent System Operator Corporation's Request for Rehearing or, In the Alternative, Motion for Clarification in the above-captioned dockets. An additional copy of the filing is also enclosed.. Please stamp the additional copy with the date and time filed and return it to the messenger.

Thank you for your assistance in this matter.

Respectfully submitted,

Kenneth G. Jaffe
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