

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

Williams Energy Services Company) Docket No. ER98- 3106- 000

**MOTION TO INTERVENE AND PROTEST OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to Rules 211 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.211 and 214, and the Commission's May 28, 1998, Notice, the California Independent System Operator Corporation ("ISO"), hereby moves to intervene and protests in the above-entitled proceedings.

I. MOTION TO INTERVENE

The ISO is a non-profit public benefit corporation organized and existing under the laws of the State of California, and authorized to do business therein. The ISO operates a grid comprising the transmission systems of Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas and Electric Company. The ISO is responsible for maintaining the reliability of electric transmission scheduled into and through the ISO control area. To support reliability, the ISO is also responsible for procurement of Ancillary Services, to the extent that they are not self-provided, at a competitive price. The activities of the ISO are subject to the jurisdiction of the Commission.

In the above-entitled docket, Williams Energy Service Company ("Williams") seeks, inter alia, blanket market-based rate authorization for sales of four Ancillary Services -- Regulation, Spinning Reserve, Non-Spinning Reserve, and Replacement Reserve, each as defined in the ISO Tariff (collectively, the Regulation and Reserve Services). The ISO currently operates the principal market for Regulation and Reserve Services in California. The ISO has a direct and substantial interest in this proceeding because of the ISO's responsibility for procuring Regulation and Reserve Services to meet the reliability of the ISO control area in accordance with Western Systems Coordinating Council and

North American Electric Reliability Council standards. Moreover, the ISO's interests cannot be adequately represented by any other party. Accordingly, the ISO respectfully requests that it be permitted to intervene herein with full rights of a party.

II. COMMUNICATIONS

Please address communications concerning this filing to the following persons:

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III. PROTEST

The purpose of this Protest is to bring to the Commission's attention the fact that the unconditional grant of market-based rate authority to other sellers has had extremely serious consequences in the ISO's Regulation and Reserve Services markets, permitting the exercise of market power, and producing extraordinarily high market clearing prices in some hours. The ISO urges the Commission, in the strongest possible terms, to take these consequences into account in ruling on the instant application. The Commission should defer granting the requested authorizations, which are not supported by the type of analyses that are required to demonstrate the absence of market power in the discrete markets for Regulation and Reserve Services – i.e., time-differentiated studies. Alternatively, the Commission should condition its approvals upon confirmation of the authority of the ISO to impose price caps or to take other appropriate action to mitigate any exercise of market power.

A. The Results of the Commission's Grant of Market Rate Authority for Sales of Regulation and Reserve Services to the ISO Demonstrate That Sellers Can Exercise Market Power in Some Hours, Producing Exorbitant Prices.

On June 30, 1998, the Commission issued its first grant of authority for the sale of Regulation and Reserve Services at market-based rates. See *AES Redondo Beach, L.L.C., et al.*, 83 FERC 61, 358, (June 30th Order).¹ Subsequently, the Commission has granted such authority to additional applicants. *El Segundo Power, LLC et al.*, 84 FERC ¶ 61,011 (1998); *Ocean Vista Power Generation, LLC et al.*, 84 FERC ¶ 61,013 (1998) (July 10th Orders).

¹ The units for which the Commission granted market-based rate authority in the June 30th Order are the same units from which Williams proposes to market Regulation and Reserve Services.

In the June 30th and July 10th Orders, the Commission also reached a broader conclusion with respect to Replacement Reserves, stating, Replacement Reserve Service, however, is not an ancillary service under Order No. 888. Thus, the Applicants may sell Replacement Reserve Service under their previously-authorized market-based rates and do not require separate authorization here.

June 30th Order, Slip op. at 5. In granting these authorizations, the Commission rejected the ISO's contention that, to account for different market conditions, a time-differentiated market power study was required. The Commission dismissed the ISO's concern that, in a substantial number of hours, the Ancillary Service markets would be "thin," i.e., there would be insufficient sellers, giving the ISO no choice but to accept *any* bid submitted by a seller with market-based rate authority, no matter how high. June 30th Order, Slip op. at 10; *El Segundo Power, LLC et al.*, Slip op. at 10; *Ocean Vista Power Generation, LLC et al.*, Slip op at 9.

Although only a short period of time has passed since the June 30th and July 10th Orders were issued, events in the ISO's Ancillary Service markets have borne out the ISO's greatest fears. For example, On Thursday, July 9, 1998, in the Southern Zone (south of Path 15,¹ "SP15"), prices for Replacement Reserves reached \$5,000/MW in three hours and \$2,500/MW and \$750/MW in two other hours. The total cost of Replacement Reserves for SP15 in these hours was \$9.1 million. In comparison, the costs for Replacement Reserves in those same hours and for the same amount of capacity in SP15 was \$3,300 on June 25, 1998. The enormous impact on California consumers of the market-based rate authority that the Commission granted in the June 30th and July 10th Orders, and the market forces that have engendered this market distortion, are

¹ Path 15 is a major transmission line separating the Northern and Southern Zones.

described in the ISO's Emergency Motion for Stay, Notice of Action Taken, Request for Rehearing, And Motion for Clarification regarding those Orders, a copy of which is attached and incorporated into this Protest.

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

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

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

As the Commission has recognized, however, the benefits of market-based pricing could be thwarted by the exercise of market power. Accordingly, the Commission has determined that it will permit the sale of an Ancillary Service at market-based rates only if the seller supports its request with an analysis demonstrating that it would lack the ability to exercise market power in the

discrete service. See *Ocean Vista Power Generation, et al.*, 82 FERC ¶ 61,114 (1998).

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

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

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

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

To protect the realization of these objectives, the ISO respectfully requests that the Commission, if it does not defer Williams’s request for market-based rate authority, condition any authority that it grants upon confirmation of the authority of the ISO to cap Ancillary Service bids above \$500/MW and to take other action necessary to mitigate the exercise of market power in thin Ancillary Service markets. The need for bid caps is described in the attached Emergency Motion for Stay, Notice of Action Taken, Request for Rehearing, And Motion for Clarification. Absent a further filing with the Commission by a generator seeking to justify bids above this level, bids above \$500/MW would be deemed to be unjust and unreasonable.

The Commission has a statutory responsibility to protect consumers. *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414 at 418 (1952) (“A major purpose of the whole Act is to protect power consumers against excessive prices.”); *see also*, *Atlantic Refining Co. v. Public Service Comm’n of N.Y.*, 360 U.S. 378 at 388 (1959); *Northeast Utilities Service Co. (Re: Public Service Co. of N.H.)*, 66 FERC ¶ 61,332 at 62,081-82, *reh’g denied*, 68 FERC ¶ 61,041 (1994). Authorizing the ISO to cap bids at \$500/MW reduces significantly the exposure of customers to potential market power abuse, while leaving generators with prices significantly in excess of the cost-based limits. Given the infancy and evolving

nature of the California Ancillary Service markets such basic protections clearly are warranted.

The ISO must emphasize that this alternative solution is not a preferred approach. To implement this approach, the ISO must manually reject bids prior to running congestion management. Doing so is estimated to take up to an additional hour. This could delay the publishing of initial preferred schedules beyond the deadline that allows for the congestion iteration to occur. It is not clear yet how long it would take to design and implement software changes to allow an automatic rejection of bids, as can be done with supplemental energy bids above \$250.

CONCLUSION

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

Respectfully submitted,

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Date: July 17, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the forgoing document upon each person designated on the official service list compiled by the Secretary in this Docket No. ER98-3106-000 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.2010 (1997).

Dated at Washington, D.C. on this 17th day of July, 1998.

Michael E. Ward