

July 27, 1998

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

**Re: The California Independent System Operator Corporation,
Amendment to ISO Tariff To Implement Firm Transmission
Rights**

Dear Secretary Boergers:

Pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d, and Section 35.13 of the Commission's Regulations, 18 C.F.R. § 35.13, the California Independent System Operator Corporation ("ISO") submits six copies of an amendment, Amendment No. 10, to the ISO Tariff and Protocols, which are the ISO's FERC Electric Tariff, Original Volume No. 1.

The enclosed amendment pertains to Ancillary Services. First, it makes necessary revisions to various sections of the Tariff and Protocols to allow Scheduling Coordinators to bid and self-supply certain ancillary services from resources outside the ISO Control Area. These provisions are proposed to be effective immediately upon the availability of the software to accommodate such resources. As explained below, the ISO has for some time sought to implement software modifications that will enable Scheduling Coordinators to bid or self-provide certain ancillary services from out-of-area resources. That software is now in the testing stage and expected to be available for production use imminently. In addition, the proposed amendment provides clarifying language regarding the circumstances under which certain penalties for a generating unit's failure to pass an availability test will be waived. In view of the urgent need to expand the pool of resources upon which the ISO can draw for its ancillary service requirements, the ISO respectfully asks that the Commission waive the notice requirements of its regulations to permit the enclosed amendment to take effect immediately.

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COMMUNICATIONS AND NOTICE

Communications regarding this filing should be directed to the following representatives of the ISO, whose names should be placed on the official service list established by the Secretary for this proceeding:

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Pursuant to Commission Regulations, the ISO is also enclosing a form of Notice of Filing, in hard copy and in electronic form, suitable for publication in the Federal Register. The ISO has also posted this filing on the ISO Home Page and electronically notified all Market Participants of the filing.

BACKGROUND AND REASONS FOR FILING

Under the ISO Tariff and Protocols, Scheduling Coordinators may bid, and self-provide, Ancillary Services solely from resources within the ISO Control Area.¹ The only exception is for Ancillary Services provided from external sources through Existing Contracts. This limitation was imposed, and approved by the Commission, because of the inability of the ISO's software to accommodate the scheduling of such external imports upon the ISO's Operations Date. See *California Independent System Operators Corporation*, 81 FERC ¶ 61,320. This functionality has been a high priority, but due to its complexity, it has been delayed several times.² Once this software becomes functional, it is necessary to amend the Tariff and Protocols in a variety of places.

The ISO now has the software modifications in testing. The ISO expects to complete the testing of the software modifications imminently and to be ready to load them on the production computers. The ISO therefore is proposing

¹ Capitalized terms used in this letter that are not defined herein are used in the sense given in the ISO Tariff, Master Definitions Supplement.

² Refer to current and most recent Staging Plan item #'s.

amendments to eliminate from external imports restrictions in the ISO Tariff and Protocols on the bidding and self-provision of Spinning, Non-Spinning, and Replacement reserves. The exact date on which the software will be loaded is not, however, certain at this time. To allow for this functionality as soon as it is available, the ISO requests that the amendments be made effective as of the date on which the ISO gives Notice that it will begin to accept bids of external imports for the particular Ancillary Service. In the case of each Ancillary Service, the ISO will provide at least one day's advance notice of its acceptance of external import bids to the Commission and, via posting on the ISO's Home Page, to Market Participants.

The acceptance of external imports of these Ancillary Services is an important step in enhancing the robustness of the markets for these products. As the ISO noted in a recent filing with the Commission, during a significant number of hours each day, the demand for Ancillary Services exceeds the supply bid into the ISO's Ancillary Services market. See *AES Redondo Beach, et al.*, Order Denying Motions for Stay, Authorizing the ISO to Take Interim Action, Requiring Market Monitoring Reports, and Providing Opportunity to Comment, 82 FERC ¶ 61,046, slip op. at 3. As a result, certain suppliers with market-based rate authority for sales of Ancillary Services have been able to demand exorbitant prices. For example, on July 19, 1998, prices for Replacement Reserves reached \$5,000/MW. The total cost for such reserves during five hours of the day was \$9.1 million, compared to \$3,300 for the same hours on June 25, 1998. *Id.* at 2.

In response to these developments, the Commission has provided the ISO with interim authority to place caps on bids for Ancillary Services, including for Replacement Reserves. *Id.* at 7. This authority, however, can only serve as a stop-gap measure. The ultimate resolution of these market conditions must lie in the development of a robust, competitive market for Ancillary Services. The inclusion of external resources in these markets will increase the number of eligible suppliers and should help create a more competitive market. In its Order granting the ISO authority to impose price caps, the Commission noted that it was "particularly interested in how the Ancillary Services and Replacement Reserves markets respond to the inclusion of out-of-control area suppliers, whether inside or outside California, when the ISO remedies its existing limitations" *Id.* at 7-8. The ISO shares the Commission's interest and believes that it is in the interest of the Market Participants and their customers that the ISO begin to accept bids and self-provision from external imports as soon as possible.

Proposed Revision to Section 26 of the Tariff.

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Amendment No. 6 to the Tariff, in order to encourage greater participation in the Ancillary Services markets, limited the applicability of certain penalties that apply to Scheduling Coordinators for non-performance with respect to the provision of Ancillary Services (ISO Tariff Section 2.5.26). The ISO had determined that, because of the increased emphasis on submitting adequate Adjustment Bids and the process in which the ISO's software sequentially evaluates Congestion Management and Ancillary Services, the penalties could dissuade Scheduling Coordinators from participating in the ISO's Ancillary Services markets.

As the ISO explained in the transmittal letter to Amendment No.6, the ISO's Congestion Management Software (CONG) and Ancillary Services management (ASM) processes run sequentially in the ISO's scheduling system. In the event of Congestion, some resources may be adjusted to the point at which their Revised Schedules conflict with their offered Ancillary Services. For example, a 100MW Generator, with an initial Preferred Schedule of 75 MW, may also bid to supply 25 MW of Spinning Reserve. As a result of Congestion, the Generator may be adjusted to 80 MW. The ISO's Ancillary Services evaluation, as currently configured in the scheduling system, will not take the adjustment into account, but will instead assume that the whole of the 25 MW bid to supply Spinning Reserves is available. If this Generator is selected by the ISO to provide the full 25 MW of Spinning Reserve, the Scheduling Coordinator will not be in a position to respond fully and may be subject to penalties.

The ISO had expected the modifications to its ASM software to be functional by or shortly after the ISO Operations Date. As an interim solution, the ISO proposed in Amendment No. 6 to waive temporarily any penalty associated with this problem (See Section 26 of the ISO Tariff). However, there have been delays in this software development. These software changes are currently scheduled to be completed by August 29, 1998.²

As the result of the ISO's experiences with the above-referenced price-spikes and with unit operators resisting ISO operator directions, the ISO became aware that some Market Participants have interpreted Section 26.2 as waiving all penalties associated with a resource's failure to pass an availability test under any circumstance, rather than solely when the failure resulted from the ISO's CONG/ASM software limitations. As the transmittal letter to Amendment No. 6 made clear, this was not the ISO's intent. As a result of the recent developments in the ISO's Ancillary Services markets and concerns raised with respect to the availability of Ancillary Services resources discussed above, the ISO issued a statement on July 17, 1998, to all Market Participants, clarifying that the ISO intends to pursue any and all penalties associated with the non-provision of Ancillary Services selected in the ISO's Ancillary Services auctions except where the non-provision is directly attributable to a unit whose output was adjusted by the ISO's CONG software to a level that conflicts with the unit's Ancillary Service commitments.

To eliminate any perceived ambiguity, the ISO proposes to modify Section 26.2 of the ISO Tariff to clarify what was originally expressed in the transmittal letter and in the ISO Board's approval--the ISO will waive only those penalties

² See Revised Staging Plan No. 4 – Exhibit A, filed July 22, 1998.

incurred by a Scheduling Coordinator as a result of the limitations on the ISO's CONG and ASM software.

REQUESTS FOR WAIVERS

Waiver of Notice Requirement and Effective Date: Pursuant to Rule 35.11 of the Commission rules and regulations (18 CFR § 35.11), the ISO requests waiver of the Commission's notice requirements. Good cause exists to grant this waiver. As noted above, it is in the interest of the ISO's Market Participants and their customers that the ISO commence the acceptance of bids and self-provision of Spinning, Non-Spinning, and Replacement reserves from external imports of System Resources as soon as possible. These changes are not unexpected, having been in the ISO Staging Plans, and, in fact, delayed from the projected functionality date. The ISO therefore requests an effective date for all changes, other than the revision to Section 26.2, as of the date that the ISO indicates, by Notice to the Commission and on the ISO Home Page, that bids from external imports will be accepted in the ISO action for a specified Ancillary Service. The ISO will provide that Notice at least 24 hours in advance of accepting such bids. The ISO anticipates providing such notice with respect to Spinning Reserves, Non-Spinning Reserves, and Replacement Reserves within a week from this filing. Regulation presents unique challenges and will be further delayed.

The ISO respectfully requests that the clarification to Section 26.2 because it does no more than make clear what was the original intent of that section, be accepted as of the original effective date of Section 26.

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General Waiver: The information submitted with this filing substantially complies with the requirements of Part 35 of the Commission's rules and regulations applicable to a filing of this type. The ISO requests waiver of any applicable requirement of that Part, if necessary, in order to permit Amendment No. 10 to become effective as proposed.

Respectfully submitted,

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