



NEWS RELEASE

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California ISO Board of Governors Approves Market Redesign Plan *Tariff Amendment Targeted to Meet March 1st FERC filing deadline*

(Folsom, CA) Following months of extensive reviews and stakeholder involvement, the California Independent Systems Operator (Cal-ISO) Board of Governors voted today, Thursday, February 25, 1999, to approve a comprehensive redesign of the California Ancillary Services Markets. The vote was made in preparation for a March 1, 1999 tariff amendment filing required by the Federal Energy Regulatory Commission (FERC).

The primary objectives of the market redesign are to address problems in the market and to increase workable competition to the degree that price caps now in place may be raised later this year. In the first year the Cal-ISO has been operational, several structural deficiencies in the markets have contributed to inefficient operation. In particular, the markets have exhibited excessive price volatility and prices for "lower quality" services such as Replacement Reserves have often exceeded prices for "high quality" services such as Regulation. These conditions led to the imposition of price caps last summer and have prevented the Cal-ISO from lifting them in the time since.

The following market conditions have been identified by the Cal-ISO, its independent market surveillance committee as well as market participants:

- Demand for Ancillary Services has been higher than anticipated.
- Available supply of Ancillary Services is too small.
- Existing markets have some inefficiencies.

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MARKET REDESIGN 2-2-2

Believing that the elimination of these problems would directly reduce the potential for exercise of market power and increase the likelihood of workable competition, the Board voted to approve a market redesign package that included the following elements:

- **Ancillary Service auction design changes** that allow the ISO to lower costs by substituting higher-quality services for lower-quality services, when doing so reduces total costs;
- **Removal of economic incentives for Scheduling Coordinators and generators** to ignore ISO dispatch instructions for capacity bid into the market and accepted by the ISO;
- **Purchase of additional replacement reserves** (that could be called on if needed), to reduce the need for high-cost emergency deals with other control areas;
- **Automation of dispatch instructions to generating units** to improve generator response times (compared to current phone call system) and make sure that no capacity bids are skipped;
- **Pricing of “regulation upward” service separately from “regulation downward” service**, to reduce costs (now, the most expensive service sets the price for both) and eliminate gaming opportunities between the two services that inflate prices; and
- **Implementation of software to allow ancillary services trades between Scheduling Coordinators** so they can protect themselves (and their customers) from price fluctuations and other features of the Cal-ISO's markets.

If the software changes required by the market redesign are done in time, the appropriate Reliability Must Run contract design changes are implemented on schedule, and the markets respond as expected to the redesign efforts, the Cal-ISO will continue on course to consider raising price caps in both the ancillary services and the real-time markets from the current \$250 per megawatt to \$750 per megawatt later this year.

For more details on today's presentation to the Cal-ISO Board of Governors, please visit the Cal-ISO Web Site at www.caiso.com/pubinfo/BOG/documents/market.

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