(ATTACHMENT C)

UNITED STATES OF AMERICA 89 FERC ¶ 61,169
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;
Vicky A. Bailey, William L. Massey,
Linda Breathitt, and Curt Hébert, Jr.

California Independent System Operator Corporation — Docket No. ER99-4462-000

ORDER ACCEPTING TARIFF REVISIONS AND
GRANTING WAIVER OF NOTICE

(Issued November 12, 1999)

In this order, we accept for filing proposed tariff revisions filed by the California Independent System Operator Corporation (ISO) as Tariff Amendment No. 21. Through these revisions, the ISO seeks authorization to specify for an additional year the maximum price at which it is willing to buy Imbalance Energy and Ancillary Services.

Background

On July 17, 1998, we issued an order authorizing the ISO to reject bids in excess of whatever price levels it believed were appropriate for Regulation, Spinning Reserve, Non-Spinning Reserve, and Replacement Reserve. [1] On rehearing, we explained that, as a purchaser, the ISO has the discretion to reject excessive bids. We also stated that a purchase price cap is not an ideal approach to operating a market and that we did not expect the cap to remain in place on a long-term basis. [2] In addition, we directed the ISO to develop a proposal to redesign its Ancillary Services markets. We later authorized the

ISO to adopt a purchase price cap for its Imbalance Energy market at whatever level it deemed necessary and appropriate. [3]

---

[1]AES Redondo Beach, L.L.C., et al., 84 FERC ¶ 61,046, reh'g denied, 85 FERC ¶ 61,123 (1998) (October 28, 1998 Order), reh'g denied, 87 FERC ¶ 61,208 (1999) (May 26 Order), reh'g pending.

[2]October 28, 1998 Order at 61,463.

[3]California Independent System Operator Corporation, 86 FERC ¶ 61,059 (1999).

Docket No. ER99-4462-000

In our order approving the ISO's Ancillary Services market redesign proposal, we allowed the ISO to retain its authority to specify purchase price caps for Ancillary Services and Imbalance Energy until November 15, 1999. The ISO had proposed to raise and eventually eliminate existing price caps on Ancillary Services and Imbalance Energy upon the implementation of several redesign elements, but in the interim, it planned to maintain the current $250/MWh price caps. The ISO had also proposed a safety net in which it would continue to monitor the markets, and if it identified market failures or supply insufficiencies, it would lower price caps in the affected markets. We directed the ISO to eliminate the price caps by November 15, 1999 with the caveat that the ISO could file for an extension of its price cap authority if its experience with the market reforms over the summer indicated serious market design flaws still exist. The determination whether to file for an extension would be aided by reports that we required the ISO's Market Surveillance Committee (MSC) and the California Power Exchange's Market Monitoring Committee (MMC) to file with the Commission by October 15, 1999.

The ISO sought clarification of this aspect of the May 26 Order, requesting that the termination date be extended until February 15, 2000, to permit analysis of the MSC and MMC reports. Two other parties also sought rehearing of the May 26 Order's determination to end the price cap authority as of November 15, 1999. The Commission has not yet acted on these requests.

On September 17, 1999, the ISO filed under Docket No. ER99-4462-000 proposed tariff revisions to extend for one year, until November 15, 2000, its authority to cap Imbalance Energy and Ancillary Services prices. In this filing, the ISO notes that, absent favorable action on its rehearing request or approval of this proposal, its authority to cap prices will expire on November 15, 1999. Further, the ISO explains that its need to ensure that there is no gap in its authority to cap prices necessitates its filing Amendment No. 21 before the MSC and MMC reports have been completed.

By direction of the ISO's Governing Board, the price caps were raised from $250 to $750 per MW or MWh (depending on the service), effective September 30, 1999. If the Commission approves the proposed amendment, the ISO states that it would lower the price caps to $500 effective June 1, 2000, if the ISO Governing Board determines that any of the three following conditions are met: (1) the markets are not workably competitive; (2) there are no practicable demand side management options in place; or (3) the IOU Utility Distribution Companies have sought and not obtained practicable options to self-provide Ancillary Services and applicable hedging products in the

California Power Exchange consistent with certain decisions of the Public Utilities Commission of the State of California (California Commission).[4]

The proposal also gives the ISO discretion to lower the price caps by an unspecified amount in the event that it determines that the markets are not workably competitive. After the summer of 2000, the ISO will recommend to the Governing Board an implementation plan to eliminate the price caps. The ISO maintains that the critical element of the price cap plan is its ability to lower the caps in order to provide a "safety net." The ISO requests an effective date for these changes of November 15, 1999.

The ISO considered four options regarding price caps in these markets: (1) eliminating price caps; (2) instituting "damage control" caps of $2500; (3) raising the existing price caps in predetermined increments that are functions of the degree of progress in reforming the Ancillary Service markets and Reliability Must-Run (RMR) contracts; and (4) maintaining the existing $250 price caps for at least an additional year. The ISO states that the proposed amendment is a "middle ground" allowing market rule corrections to be tested without inflicting significant damage on buyers.

The ISO cites the recommendations of the MSC and the MMC not to remove the price caps until the market reforms have been tested under summer peak conditions, along with the uncertainty of insuring just and reasonable rates in the two markets during the summer, in justifying the proposed price cap extension.

The ISO also proposes one additional tariff change, the elimination of section 4.6 of the Settlements and Bids Protocol (SBP). SBP 4.6 describes the method by which the ISO's software assigns Upward and Downward Adjustment Bid values. The ISO explains that changing the level of permissible bids into the Ancillary Service and Imbalance Energy Markets through the implementation of its price cap proposal would affect the values set forth in SBP 4.6.

The ISO states that Adjustment Bid values will soon be assigned automatically by software revisions proposed in Tariff Amendment 22 [5] and that there will be no need for Scheduling Coordinators to submit these values. Accordingly, it asserts that SBP 4.6 is no longer necessary and should be removed. In addition, the ISO argues that the section represents "'operating guidelines' that simply add details or procedures necessary to implement tariff provisions," which it states the Commission has previously invited the

[4] Transmittal Letter at 6.

[5]This filing has been designated Docket No. ER99-4545-000.

ISO to remove from its tariff. [6] The ISO submits that eliminating SBP 4.6 will not affect the relative priorities of transmission service under existing contracts or priorities associated with Reliability Must-Run contracts. The ISO requests waiver of notice so that this proposed revision may become effective on September 30, 1999.

Notice, Interventions and Responsive Documents

Notice of the ISO's filing was published in the Federal Register, 64 Fed. Reg. 52,783 (1999), with motions to intervene and protests due on or before October 14, 1999. A notice of intervention was filed by the California Commission. Timely motions to intervene, comments, and protests were filed by the California Department of Water Resources (DWR); the California Electricity Oversight Board (Oversight Board); the California Municipal Utilities Association (Municipal Utilities); Cities of Redding and Santa Clara, California and M-S-R Public Power Agency (Cities/M-S-R); Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (California Cities); Coral Power, L.L.C.; City and County of San Francisco, California; Duke Energy North America (DENA); Duke Energy Trading and Marketing, L.L.C. (DETM); Dynegy Power Marketing, Inc. (Dynegy); Electric Power Supply Association (EPSA); Engage Energy US, L.P. (Engage); Metropolitan Water District of Southern California (Metropolitan); Modesto Irrigation District (Modesto); Northern California Power Agency (NCPA); Pacific Gas and Electric Company (PG&E); Reliant Energy Power Generation, Inc. (Reliant); Sacramento Municipal Utility District (SMUD); San Diego Gas & Electric Company (SDG&E); Southern California Edison Company (SoCal Edison); Southern Energy California, L.L.C., Southern Energy Delta, L.L.C., and Southern Energy Potrero, L.L.C. (jointly, Southern Energy); Statoil Energy, Inc. (Statoil); Transmission Agency of Northern California (TANC); Turlock Irrigation District (Turlock); Western Area Power Administration (WAPA); Western Power Trading Forum (WPTF); and Williams Energy Marketing & Trading Company (Williams).

On October 28, 1999, SoCal Edison filed a response to the protests in this proceeding. The filing includes a copy of the Report on Redesign of California Real-Time Energy and Ancillary Services Markets prepared by the MSC and filed on October 19, 1999, in Docket No. ER98-2843-009, et al. (MSC Report).On October 29, 1999, the ISO filed an answer, addressing the various protests, which also includes a copy of the MSC Report. On November 5, 1999, Reliant filed a motion to strike SoCal Edison's response.

Positions of the Parties

[6]Transmittal Letter at 8, quoting Pacific Gas and Electric Co. et al., 81 FERC ¶ 61,320 at 62,471 (1997).

Docket No. ER99-4462-000

Williams opposes the ISO's proposal to extend the price caps and questions the ISO's commitment to eventually remove price caps altogether. Williams contends that the ISO has failed to meet its burden of showing that its markets are not "workably competitive" in order to extend price cap authority. It rejects the ISO's claim that price cap authority should be maintained long enough to analyze the results of the changes in the market software and reforms to RMR contracts because the ISO has not shown any ability to definitively show whether or not markets are workably competitive. Williams also protests the proposed continued ability of the ISO to lower price caps at its own discretion by whatever amount it deems necessary.

DETM contends that the proposed price cap of $750, and possibly $500, for the summer of 2000 is too low, especially when compared to price caps in place for other ISOs. It cites the $1000/MWh price cap in the PJM ISO and ISO New England's operable capacity price cap of five times the average price in 30 previous days. In addition, DETM asserts that bidders would have to assume that the cap would indeed be the lower of the two ($500) in planning for the next peak season.

A number of commenters assert that the ISO has shown no evidence of market imperfection. DENA contends that the only evidence offered by the ISO is Ancillary Service prices reaching the price cap prior to the implementation of market reforms. Citing the ISO's own contention that high prices are not necessarily evidence of market power, DENA dismisses the existence of high prices as evidence of market imperfection. Reliant cites ten market design initiatives implemented by the ISO since it began operation and claims the ISO has failed to show that these initiatives have not worked. EPSA contends that high prices are simply a result of increased demand during periods of exceptional conditions. Engage and EPSA argue that the extension of price caps would impede entry into the California market and thus reduce the market's ability to stabilize prices. They claim that the ISO has not sufficiently justified extending its price cap authority until November 15, 2000, and they suggest that the Commission adhere to the February 15, 2000 date sought in the ISO's request for rehearing.

Dynegy expresses similar concerns. Initially, Dynegy claims the ISO has not shown any specific design flaws that would warrant the renewal of its price cap authority. Dynegy further contends that the ISO offers no objective criteria in determining whether to lower its price cap and no criteria for the size of the increment. It claims the criteria the ISO does offer are all ill-defined. Along with other intervenors, Dynegy notes the lack of a definition of "workably competitive" markets, as well as ambiguity in the criterion that there be no practicable demand-side management options in place. Finally, it claims that the third criterion, that "the IOU Utility Distribution companies have sought and not obtained practicable options to self-provide ancillary services from the power exchange," is also ambiguous, and asks whether this means that

the PX must have an auction in place or must simply allow bilateral transactions. Due to these ambiguities, Dynegy contends that the Commission should reject the ISO's conditions for lowering the price cap and recommends that the Commission impose a sunset date on the ISO's price cap authority.

A number of interveners expressed the view that the ISO's price cap authority and proposed use of that authority infringes on both the California Commission's and this Commission's authority. TANC asserts that granting the ISO the authority to institute price caps in itself represents "an improper delegation to the ISO of the Commission's ratemaking authority under the FPA." Reliant asserts that allowing the ISO to maintain price cap authority based on its own assessment of the functioning of the market makes the ISO both a regulated entity and a de facto regulator, thus usurping the Commission's authority. Southern raises the issue that the level of discretion sought by the ISO encourages it to function as a market participant rather than a market facilitator.

Metropolitan, on the other hand, believes that the ISO's proposal does not offer enough protection to market participants, and it does not want to see the caps raised above $250. Metropolitan complains that the ISO offered little explanation to support its decision, and no evidence regarding the efficacy of its market reforms. It asserts that the caps should be raised only when data demonstrate that there are workably competitive markets and recommends directing the ISO to develop empirical support for cap levels and to propose criteria for what constitutes a "workably competitive" market.

SMUD also supports extending the ISO's price cap authority to November 15, 2000, but does not agree with the level of the caps. SMUD contends there has not been an appropriate demonstration that the caps should be raised above $250. It considers the ISO's proposed caps to be arbitrary and claims the ISO has not provided any specific analysis or justification for the levels of the price caps.

The California Commission supports the ISO's proposal to retain its price cap authority, although it states that the price cap should not be lifted above the current $250 level. It contends that the caps should not be raised until after Phase I of the Ancillary Services redesign is fully implemented.

Both PG&E and California Cities support the proposed price cap extension. PG&E notes the redesign of the market implementation software, intended to correct some market flaws, was not ready in time to be tested under severe market conditions, leaving little data with which to assess its effectiveness. In addition, it cites other evidence of market power, market design flaws or non-compliance, all of which it concludes necessitates the continuation of price caps. Citing reports from the MMC and

the ISO's MSC and Division of Market Analysis, California Cities support the maintenance of price caps until it is clear the California markets are workably competitive.

SoCal Edison asserts that this Commission must approve the ISO's proposal, first, to ensure that wholesale rates in California are just and reasonable, and second, "to protect the integrity of the restructuring process nationwide." [7] SoCal Edison notes that even mature and well functioning exchange markets have the right to stop trading if conditions warrant. If the Commission decides against extending the ISO's price cap authority, SoCal Edison urges the Commission to provide some other type of protection, such as a price volatility limit mechanism. In its October 28, 1999 response, SoCal Edison highlights evidence of market power and market flaws documented in the MSC Report.

Other parties supporting the ISO's price cap proposal include the Oversight Board, Modesto, and Cities/M-S-R.

The ISO 's Answer incorporates a copy of the MSC Report and argues that the purchase price caps continue to be necessary. In addition, the ISO asserts that intervenors' attempts "to erect obstacles in the way of an extension of the ISO's price cap authority" [8] would be inconsistent with the FPA and "would convert the ISO into an involuntary purchaser, at prices it considers excessive." [9]

PG&E protests the proposed removal of SBP 4.6, disagreeing that the tariff language constitutes "truly operational guidelines." [10] SMUD similarly contends that the section contains "substantive information regarding the assignment of priorities, and not simply operating procedures." [11] SMUD concludes that deletion of this section could compromise the priorities of existing transmission contracts. TANC agrees and also adds that the ISO does not adequately describe how the software actually performs the function previously assigned to Scheduling Coordinators.

---

[7]SoCal Edison at 4.

[8]ISO' Answer at 14.

[9]Id. at 15.

[10]PG&E at 3.

[11]SMUD at 5.

Docket No. ER99-4462-000

Municipal Utilities request assurance from the ISO that the removal of the section will not allow it to alter transmission scheduling priorities without prior approval from the Commission, and they raise the point that the increase of the price cap from $250 to $750 would seem to require the ISO to alter the provisions of SBP 4.6 rather than remove it. Cities/M-S-R request that, if the Commission approves the proposal, the order state that relative priorities or other provisions of existing contracts, tariff language or protocols related to existing contracts are not affected by the deletion. Metropolitan requests that the Commission defer action on the ISO's proposal to delete SBP 4.6 until it has had time to review the ISO's proposed tariff changes regarding existing contracts and FTRs in Tariff Amendment No. 22.

In its Answer, the ISO reiterates that elimination of SBP 4.6 would not affect the relative priorities under existing contracts, and points out that another tariff section, specifically section 2.4.4.1, requires the ISO to honor existing contracts.

Discussion

Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, [12] the notice of intervention and the timely, unopposed motions to intervene serve to make the above-listed intervenors parties to this proceeding. We will reject the ISO's and SoCal Edison's answers to the extent that they represent impermissible answers to protests. See 18 C.F.R. § 385.213(a)(2) (1999). Because we have rejected SoCal Edison's answer, Reliant's motion to strike is moot.

Extension of the Price Caps

The ISO is a provider of Ancillary Services, which we have concluded are subject to our jurisdiction. While the ISO's sales of Ancillary Services are not directly at issue in this case, this case does involve the price at which the ISO will purchase Ancillary Services, which at some future time, it will seek to recover in its rates for sales of Ancillary Services. Unlike traditional utilities, the ISO does not own generation or transmission facilities with which it can provide Ancillary Services. Thus, it must procure these services from other entities and resell them to its customers. At issue is whether the ISO should be permitted to specify (until November 15, 2000) the purchase price it is willing to pay for these services.

[12] 18 C.F.R. § 385.214 (1999).

Docket No. ER99-4462-000

We note that intervenors have referred to the ISO's authority to decline to purchase where it concludes that bids are excessive as a "price cap" and have argued or implied that this is an inappropriate cap on sellers' rates. We further recognize that in our prior orders we expressed concerns about the ISO retaining a purchase price cap and stated that a purchase price cap is not the ideal way to operate a competitive market. Upon further reflection, however, we conclude that the purchase price cap at issue in this particular case is acceptable for an additional 12 months, as the ISO requests. The proposed cap is not a cap on what a seller of Ancillary Services may charge to the ISO but rather is a cap on what the ISO as purchaser is willing to pay. The ISO has no more, or less, discretion than any other buyer of services. If the ISO is unable to elicit sufficient supplies at or below its announced purchase price ceiling, it will have to raise its purchase price to the level necessary to meet its needs. Further, on the facts of this case, as discussed below, the ISO's purchase price cap does not serve to set the seller's rate.

Intervenors' concerns about the ISO retaining excessive discretion are unsupported. Sellers of Ancillary Services and Imbalance Energy who are dissatisfied with the ISO's purchase price cap can choose instead to sell these services in the California Power Exchange or the bilateral markets. They are not required to sell to the ISO, and thus the ISO cannot dictate their prices. Finally, assertions that the purchase price cap infringes on the Commission's ratemaking authority are without merit. The ISO is not establishing the prices that sellers may charge because generators are not obligated to supply these services to the ISO, and the Commission has already authorized them to sell at market-based rates, thereby allowing them to receive whatever competitive price a buyer is willing to pay. If sellers were required to bid into these markets, the ISO's purchase price cap would have the effect of setting the maximum selling price. However, that is not the case here.

Accordingly, we will accept these tariff revisions for an additional 12 months, during which the market redesign can be completed. We will grant waiver of the 60-day prior notice requirement to permit these revisions to become effective on November 15, 1999.

Deletion of SBP 4.6

We will accept the ISO's proposed tariff revisions to remove SBP 4.6. The section simply describes the ISO's process of factoring Adjustment Bids into the scheduling priorities and, as the ISO has already stated, does not impact the ISO's obligation to honor priorities. The ISO's curtailment priorities are instead defined elsewhere in the tariff, specifically in SBP section 3.3.2, Curtailment under Non-Emergency Conditions.

Docket No. ER99-4462-000

We will grant waiver of the 60-day prior notice requirement to permit this revision to become effective on September 30, 1999, as requested.

The Commission orders:

(A) The ISO's proposed tariff revisions are hereby accepted for filing, to become effective as discussed in the body of this order.

(B) The ISO is hereby informed that the rate schedule designations will be supplied in a future order.

By the Commission. Commissioners Bailey and Hébert dissented with separate statements attached.

(S E A L)

Linwood A. Watson, Jr.,
Acting Secretary.

Docket No. ER99-4462-000
California Independent System Operator Corporation

Docket No. ER99-4462-000

(Issued November 12, 1999)

BAILEY, Commissioner, dissenting

I dissent from today's order. I do not support continuation of the ISO purchase price cap for another 12 months.

Today's order represents a sharp departure from the Commission's consideration of the issue in three earlier orders. [1] In those orders, dating back to last summer, the Commission reluctantly authorized the ISO to reject bids in excess of whatever price levels it believes are appropriate for various types of ancillary services. The orders consistently have referred to this type of extraordinary authorization as a purchase price cap.

The Commission granted the requested purchase price cap authorization with considerable hesitation. The orders explained that a purchase price cap is not an ideal approach to operating a market and that the Commission did not expect the cap to remain in place on a long-term basis. Specifically, the Commission directed the ISO to eliminate the price cap by November 15, 1999, with the caveat that the ISO could file for an extension of its price cap authority if its experience – especially during the summer months – indicated that serious market design flaws remained.

This brings us to today's order on the ISO's request for an extension of its price capping authority. Responding to the Commission's explicit caveat, the ISO argues that serious market design flaws remain that require extension of the purchase price cap through November 15, 2000. Certain intervenors support the ISO's arguments. Numerous other intervenors vigorously oppose continuation of the price caps, invoking the

[1] See AES Redondo Beach, L.L.C., et al., 84 FERC ¶ 61,046, reh'g denied, 85 FERC ¶ 61,123 (1998), reh'g denied, 87 FERC ¶ 61,208 (1999), reh'g pending.

Commission's earlier hesitation and arguing that market imperfection or manipulation has not been demonstrated.

In my judgment, today's order does not respond directly to these concerns. Nor does it address the limited grounds for continuation of the purchase price cap – a

demonstration that a price cap is necessary to overcome lingering market design flaws – that the Commission identified in its earlier orders.

Rather, today's order states simply that the Commission has changed its mind. It explains that "upon further reflection," an extension of the purchase price cap is now "acceptable." I, however, perceive no compelling reason to change my mind. Despite much "further reflection," I do not see valid grounds for continuation of the purchase price cap in today's order.

I might have been willing to cast a different vote if the majority had done precisely what the Commission promised to do in earlier orders – determine whether market design imperfections remain that justify continuation of the price cap. But today's order sidesteps the issue; it does not rest to any extent on any findings or conclusions as to market design or market power.

This omission confounds me. Did we not direct the ISO's Market Surveillance Committee and the Power Exchange's Market Monitoring Committee to report back to us by October 15, 1999, as to whether market design flaws justify continuation of the price caps? Why are those reports suddenly irrelevant to today's decision?

I would view those reports to be exceedingly relevant. In particular, I would be willing to entertain a request for extension of the purchase price caps if the Commission, relying on the reports, were to conclude that market design flaws remain and that market participants have actually taken advantage of those flaws to recover a price for ancillary services that is not justified by conventional market forces. But the discussion section of today's order omits any reference to the market monitoring and surveillance reports that were intended to educate the Commission as to the presence or absence of market design flaws.

Instead, for the first time, the Commission now disavows interest in the price cap issue. This is because, today's order reasons, the price cap applies only to purchasers, and not to sellers. The order's reasoning is that the purchase price cap is simply that – not a seller cap within the Commission's jurisdictional interest and authority.

Even if I were to engage in this analysis, rather than focus on indicia of market design flaws and market manipulation, I would not support the conclusion of today's order. I do not view the ISO as just like any purchaser of utility services, without the ability to affect the prices a supplier of ancillary services may charge. To the contrary, the ISO is a unique, quasi-governmental super-structure that both sets the rules of the market and then (hopefully) follow those rules. Even if the supplier has other options –

as the order notes, it can sell into the PX or engage in bilateral transactions – clearly the actions of the ISO will have a serious impact on available product offerings and prices.

In my opinion, the purchase price cap, in these particular circumstances, may operate as a seller price cap. If it does not, the purchase price cap, at the very least, and by intentional design, acts to significantly depress the prices that ancillary service providers can charge.

That is why so many ancillary service providers in California, actual or potential, are not indifferent to the ISO's proposal. They perceive the price cap as seriously inhibiting entry into or participation in California markets. This is a serious problem that, in my judgment, begs for a longer-term structural solution – not simply another short-term bandage that masks the underlying problem.

As I previously have explained, I generally do not favor price caps in competitive markets. [1] I believe it is necessary to tolerate short-term market imperfections in order to assure the transmission of price signals that will dictate efficient longer-term solutions – such as those that promote entry into competitive markets and additional investment in generation and transmission capital.

---

[1] See ISO New England, Inc., 88 FERC ¶ 61,316 at 61,972-73 (1999) (dissenting statement).

But I am not inalterably opposed to price caps or other extraordinary or emergency procedures in all circumstances. I have voted for such measures on a number of occasions, including those allowing for the commencement of ISO operations in New England, New York, and, yes, California. [2]

I previously have voted for 16 months of purchase price cap authority for the California ISO. I decline to vote for 12 more months of similar authority unless that vote rests on a strong showing that market design flaws and actual market manipulation activity compel such a continuation. As explained above, today's order does not rest on any such showing.

On a side note, I note that the ISO in June of this year asked for an extension of purchase price cap authority only for an additional three months, to February 15, 2000. Yet three months later, in September of this year, the ISO asked for a full 12 months of additional price capping authority, to take it through the summer of next year. I do not understand the ISO's rationale for changing its mind and asking for a much lengthier extension. A three-month extension, in light of the Commission's earlier hesitation, would have been much easier to justify.

For all of these reasons, I dissent from the decision to allow for a 12-month extension of the ISO purchase price cap – which, when aggregated with earlier authority, would provide for a total of two years and four months of price capping authority.

Vicky A. Bailey

[2] See supra note 1 (citing earlier orders in this proceeding approving temporary purchase price caps in California). See also New York Independent System Operator, Inc., et al., 88 FERC ¶ 61,228 (1999); New England Power Pool, et al., 87 FERC ¶ 61,055 (1999).

Commissioner

Docket No. ER99-4462-000

California Independent System Operator Corporation Docket No. ER99-4462-000

(Issued November 12, 1999)

HÉBERT, Commissioner, *dissenting*:

I dissent. Today's order tries -- unsuccessfully, in my opinion -- to straddle the fence on the issue of price caps for ancillary services in California. The Independent System Operator (ISO) and its supporters argue on the merits that the ceilings must stay for at least a further "temporary" period – next November, though in a filing a few months ago "temporary" meant February – until the market becomes "workably competitive," whatever that means. Opponents, with whom I agree, claim that the shoe rests on the other foot. The California markets must operate freely until the ISO shows otherwise. The ISO has made an insufficient showing here. Supporters and opponents all understand, however, that this question lies within our sphere of interest. With the ISO as a buyer, seller and writer of the rules, we must regard even *purchase* price caps as sellers' price caps.

The majority finds a third way. The Commission neither endorses price caps nor dismisses the filing as outside our jurisdiction. The order points out, "on the facts of this case, as discussed below, the ISO's price cap does not serve to set the seller's rate." Slip op. at 10. That sounds as if we disclaim jurisdiction. The Federal Power Act gives us authority over sellers and sales, not purchasers or purchases. Yet, the majority accepts the filing and grants a waiver to allow an early effective date. I submit the Commission cannot have it both ways. Either the price caps fall under our jurisdiction and we must decide, on the merits, whether to discard them or we dismiss the case. I favor us deciding on the merits.

It puzzles me that the same agency that, in *Automated Power Exchange, Inc.* (*APX*), *82 FERC* ¶61,287, *rehearing denied*, 84 FERC ¶61,020 (1998), *appeal pending* (No. 98-1415, D.C. Cir.) reached out for jurisdiction over a third party's computer algorithm that bound neither the seller nor the buyer reaches a contrary result here. The majority looks the other way at the ISO's activity that has a direct influence on rates. To me, one cannot reconcile this case and *APX*. I also remain puzzled that in looking the other way, the majority ignores reality, both in the operation of the market and the multiple roles the ISO plays in it, under the California legislation and in actual practice.

Docket No. ER99-4462-000 2

Why We Should Care

In *APX*, I wrote that, in contrast to an entrepreneur's computer algorithm, we did have jurisdiction over California's official market apparatus. We acknowledged in the cases involving one institution, the Power Exchange, that the entire structure California created, including the ISO, operates as a machine with moving parts. The ISO/Power Exchange selects sellers and buyers and establishes rates in the State's wholesale markets. "The P[ower] [Exchange] for all practical purposes operates as an arm of the ISO, which, as the controller of the grid, operates jurisdictional facilities." 82 FERC at 62,113 (Hébert, Commissioner *dissenting*).

The ISO in the ancillary services market acts in the same way as the Power Exchange in the energy market. As a purchaser, it determines who will sell ancillary services. In writing the rules of the auction, including price caps, the ISO fixes the rate at which the market (to the extent California allows one to function) clears. Like the Power Exchange, the ISO acts as a the intermediary to resell electricity to the buyers, who sell to customers.

The order here states, "Unlike traditional utilities, the ISO does not own generation or transmission facilities with which it can provide Ancillary Services. Thus, it must procure these services from other entities and resell them to its customers." Slip op. at 9. In practice, the ISO establishes the sellers' prices – its own and those of generators – for ancillary services. Yet, the majority approaches this case as if the ISO, like a the company in a company town, stood only as a large consumer that decided how much to pay for the town's electricity.

Moreover, treating the ISO in isolation would allow the Power Exchange to claim it, too, stood outside our purview as a large buyer. The majority does seek to distinguish this price cap from all others. I find the attempt unconvincing.

The majority says, slip op. at 10, that sellers need not sell into the ancillary service market and should favor the energy market instead. I find that unrealistic. The three investor-owned utilities, to the extent they have stranded costs, must sell to the ISO. Even though they support price caps (because under California law, retail consumers operate under a rate freeze and shareholders suffer the cost of ancillary services the ISO purchases from marketers), and I oppose them, the issue here has to do with whether the caps establish a sales price. They do. The caps also establish the resale price to wholesale customers, when the ISO resells the electricity.

Second, an article in the current issue of the *Electricity Journal* states, "Unlike . . . other [ISO's and] power pools, generators receive no capacity payments for startup costs. Consequently, generators must recover their fixed and capital costs through direct payments for energy on P[ower Exchange] sales, as well as through the energy and capacity charges in the ISO ancillary service markets." R. L. Earle, *et al.,* "Lessons from the First Year of Competition in the California Electricity Markets," 12 *Electricity Journal* (October 1999) 57, 58. Legally, sellers may stay out of the market, but not in practice. The rules of the ISO/Power Exchange establish that the generators must participate in order to recover their capital costs.

Finally, the order assumes that the generators supplying ancillary services may also participate in the energy market. If true, rather than endorse price caps for ancillary services, we should order the ISO to procure those at issue here in the energy market. In one fell swoop, we would eliminate any justification for price caps and, by reducing the ISO's costs of operating a separate market, save the consumers in California a considerable amount of money.

We also could save ourselves and the industry a lot of time. When generators seek market-based rates for ancillary services, we require a separate analysis. In *Avista Energy, Inc., order on clarification,* 89 FERC ¶61,136 (1999) we required Internet postings for generators unable to provide a market analysis for ancillary service markets. Today, the majority makes a complete turn. We should dispense with the separate analysis and the cost of creating an Internet site. We should allow anyone, anywhere, with market-based rates for energy to apply them in markets for the ancillary services at issue here. I doubt that if we received such a filing the majority would loosen the requirements for market-based rates in ancillary services.

Why The Price Caps Must Go

I expressed my antipathy toward price caps my recent dissent in *ISO New England,* 88 FERC ¶61,136 (1999). I rest on those views. I will write here about facts particular to this case.

I find instructive the October Report of the Market Surveillance Committee of the ISO, a document the majority rejects as an impermissible filing, slip op. at 9. It demolishes any claim in favor of price caps. According to the Committee, competition occurs in a market when price equals marginal cost *all the time*. I find this conclusion

astonishing, in theory, let alone the real world. Even the textbook version of competition allows -- indeed, encourages -- prices above marginal costs during periods of low supply or high demand. Economists call this condition scarcity. As I wrote in *ISO New*

England, 88 FERC at _____ (Hébert, Commissioner, *dissenting*), high prices at those times show capitalism at its best. The resulting profits encourage investment. Or, the pain of extra expense brings on conservation. In short, prices above marginal costs create more efficiency. With no evidence of collusion, we should allow the market to work. In any event, the Committee agrees that, for the winter months last year, until June, prices fell at or below marginal costs and the market operated properly. Under the Committee's unrealistic standards, we should reject the caps for the next seven months.

I would also reject the caps for the summer. The record shows only one incident of high prices after the ISO installed the software it needed to make the market reforms we ordered. As Statoil points out in its filing, at 5, prices above marginal cost coincided with hot weather and reduced capacity on September 30 of this year. Prices still fell below the cap and remained high for that day only. Hot weather and outages do not equal market manipulation. No evidence exists that on that day, the best example of an alleged monopolistic market, manipulation occurred. Rather, the market operated as it should.

The filings of two intervenors supporting the price caps, Northern California Power Agency (NCPA) and Transmission Agency of Northern California (TANC) show the crumbling foundation on which the case for caps rests.

NCPA states, at page 3 of its filing:

> Admittedly, there were factors besides market gamesmanship contributing to the spikes [of September 30]. It was a hot day, and PG&E's Diablo Canyon nuclear plant was off line. Congestion was serious. Notwithstanding these other factors, however, gaming of market bids was clearly at work.

The sellers must have so "clearly" manipulated the market that the intervenor could avoid supporting that claim with facts. NCPA offers none.

TANC's filing, at 9, recites the following as the entire justification for price caps:

17. It is beyond peradventure that the lack of a competitive market is still a problem in California. Were it not an issue, the ISO would have no basis upon which to request an extension of its authority to set price caps.

Calling something "beyond peradventure" falls short of the demonstration we required in our earlier order to extend beyond November 15 the deadline for restoring the California ancillary services market to normal operation.

Finally, today, in another docket, we set for hearing and settlement procedures a complaint that the California ISO established unreasonable and discriminatory criteria for municipal generators within its control area to participate in the market. *Turlock Irrigation District, et al. v. California Independent System Operator Corp.*, Docket No. EL99-93. As I have argued all along, if we give an ISO the crutch of price caps, as we did in New England and California today, we remove the impetus for making tough decisions. In New England, the ISO sought to avoid training its personnel to reduce operators' error. California can succumb to whatever ulterior motive it may have to gain control over generators belonging to entities not members of the organization, irrespective of the needs of the market, and, ultimately, of consumers in efficiency.

How ironic.

I respectfully dissent.

Curt L. Hébert, Jr.
Commissioner