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NEWS RELEASE

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COMMISSION EXTENDS CALIFORNIA PRICE MITIGATION PLAN FOR SPOT MARKETS TO ALL HOURS, ALL STATES IN ENTIRE WESTERN REGION

The Federal Energy Regulatory Commission today expanded its price mitigation plan for the California spot market sales to 24 hours a day, seven days a week. The curbs on prices in the spot electric markets were also broadened to cover the entire 11-state western region. Spot markets cover sales that are 24 hours or less and that are entered into the day of, or day prior to, delivery.

Chairman Curt L. Hébert, Jr. said: "The Commission's price mitigation plan works. Today, the Commission adopts additional measures, based on its original mitigation plan and which continue to employ market-oriented principles, that will ensure that the plan works even better."

Today's order retains the use of a single price auction and must-offer and marginal cost bidding requirements when reserves are below 7 percent in the California Independent System Operator (ISO) spot markets, as outlined in the April 26, 2001 price mitigation and monitoring order. The California ISO market clearing price will also serve to constrain prices in all other spot market sales in the Western Systems Coordinating Council (WSCC) during reserve deficiencies in California. Sellers in other spot markets in WSCC will receive up to the clearing price without further justification. Sellers other than marketers will have the opportunity to justify prices above the market clearing price during reserve deficiency hours.

The California ISO market clearing price for reserve deficiency hours will also be adapted for use in all western spot markets when reserves are above 7 percent. Prices during non-reserve deficiency hours cannot, absent justification, exceed 85 percent of the highest hourly clearing price that was in effect during the most recent Stage 1 reserve deficiency period called by the ISO.

Building on the success of its price mitigation and monitoring plan, the Commission said that the key to bringing down prices in California still lies with signing a portfolio of longer term contracts and relying less on the more volatile spot markets, and attracting additional investment in badly needed supply and delivery infrastructure.

Today's actions will ensure that wholesale rates in spot markets in California and the rest of the WSCC will fall within a zone of reasonableness. In rejecting a return to cost-of-service rates, the Commission said that cost-based ratemaking may penalize more efficient generators and does not provide proper incentives for generators to become more efficient. The Commission, in this order, as it has done in all its previous orders related to the California markets, has put procedures in place to prevent possible abuses that could lead to unjust and unreasonable rates.

The Commission made clear that the abuse of market power will not be tolerated and sellers may lose their market-based rates if they engage in anti-competitive behavior.

In adopting market-based rates for the Western energy markets, the Commission's use of a monitoring program is key to ensuring that rates are just and reasonable. The revisions made in this order are designed to provide a structure that will minimize potential abuses, ensuring reasonable rates for consumers, while also encouraging adequate supply in the market.

Other elements of today's order are:

- all public utilities and non-public utilities selling into the markets run by the California ISO or using Commission-jurisdictional transmission facilities, who own or control generation in California, must offer power in the California ISO's spot markets. This applies to any non-hydroelectric resource to the extent its output is not committed for use (energy or minimum operating reserves) or sale in the hour.
- the same requirement will apply to sellers throughout the rest of the WSCC, except that they may offer their power in the spot market of their choosing.
- power marketers will not be permitted to sell above the mitigated prices.

- generators' bids during reserve deficiencies must reflect the marginal cost to replace gas used for generation, determined by the average of the mid-point of the monthly bid week prices as reported in Gas Daily for three spot market prices reported for California.
- bidders will be allowed to invoice the California ISO for the costs of complying with Nox and other emissions standards and for fuel used for start-up. The ISO is required to file a rate mechanism to bill those costs over the entire load on the ISO system.
- the price mitigation will end September 30, 2002.

Chairman Hébert commented: "This is a plan that is good for California, good for the Pacific Northwest, and good for the entire West. It is a balanced plan that respects market forces and that attempts to restrain prices, while at the same time offering incentives for investment in supply and delivery that is the only real solution to the West's immediate energy problems. It represents an effort to provide some relief now, while making sure that mitigation is short-lived. The Commission's goal remains to fix dysfunctional markets and to ensure that markets regain their competitive footing as quickly as possible."

Commissioner Linda K. Breathitt said: "I support the mitigation approach adopted through this order because it contains the market features that I believe are critical to helping remedy the market design flaws while still encouraging new investment in infrastructure and protecting consumers."

Commissioner Nora Mead Brownell commented: "It is my hope that this order lays out a road map which will bring certainty and stability to the citizens in the West and encourage the desperately needed investment in infrastructure."

Commissioner William L. Massey said: "This order provides price protection in the entire Western interconnection 24 hours a day, seven days a week, it absolutely prohibits gaming and so-called megawatt laundering, and will last 2 summers. I have been advocating this comprehensive approach for quite some time, and am generally pleased with this order."

Commissioner Pat Wood, III commented: "What we do today is about more than California. It is about the future of competition and about our resolve to make it a better world for energy customers in our country."

In a comprehensive December 15, 2000 order addressing problems in the

California wholesale markets, the Commission found that the market structure and rules for wholesale sale of electric power in California were flawed and that, in combination with an imbalance of supply and demand, led to unjust and unreasonable rates for short-term energy during certain periods and under certain conditions. The December order provided a number of remedies for the California markets including elimination of the Power Exchange's (PX) mandatory buy-sell requirement price and establishment of penalties for under scheduling load.

Following the December order and a series of related refund and investigation orders issued earlier this year, the Commission announced its prospective price mitigation
and monitoring plan for California in an April 26 order. The Commission noted that the plan, which took effect May 29, has already produced results with western power prices dropping in both the spot and long term markets. California's reliance on the spot market has dropped from near 100 percent to about 20 percent during peak hours since the Commission's December order.

The Commission also announced today that it will hold a settlement conference before a FERC administrative law judge later this month. All parties in the California ISO investigation proceeding are directed to participate in the settlement discussions in order to resolve refund issues for past periods and help structure new arrangements for California's energy future.

Key Questions and Answers About the Federal Energy Regulatory Commission's June 18, 2001 Order Addressing Price Mitigation in California and the Western United States

Question 1: *Does the Commission's order put price caps on all California wholesale electricity prices?*

Answer: No. The Commission's order does not impose cost-based caps in any markets or on any prices. Rather, it establishes price mitigation, based on market-oriented principles, that will apply to all wholesale sales of energy in *spot markets* in the United States portion of the Western Systems Coordinating Council (WSCC). Spot market sales are wholesale sales that last no longer than 24 hours and that are entered into the day of, or the day prior to, the power being delivered.

Question 2: *What is the "price mitigation" that is being adopted?*

Answer: There are two types of price mitigation being put in place for spot market sales, depending upon how low generation operating reserves are at any particular time:

(1) When generation operating reserves fall below 7% in California (called a reserve deficiency), a market clearing price will apply to all spot market sales in California and in the rest of the WSCC. All bidders in the ISO spot markets will receive the market clearing price without further price justification. All sellers in other spot markets in the WSCC will receive up to the clearing price without further price justification. The market clearing price will be based on the bid of the highest cost gas-fired unit located in California that is needed to serve the California Independent System Operator's load on any day in which a reserve deficiency is called. The bid will reflect a published gas cost plus an adder for operating and maintenance expenses. Sellers other than marketers will have the opportunity to individually cost justify prices above the market clearing price. Marketers must be price takers, i.e., they cannot charge more than the market clearing price.

(2) When a reserve deficiency period ends and generation operating reserves rise to 7% (a non-reserve deficiency period), the maximum price that can be charged for spot market sales in California and the rest of the WSCC during the non-reserve deficiency period, absent cost justification, will be 85 % of the highest hourly price that was in effect during the most recent Stage 1 reserve deficiency period called by the California ISO. An uplift charge for fuel used for start up of generators will not be included in the market clearing price, but instead, will be recovered through ISO charges to all California load on the ISO's transmission system.

Question 3: *How does the above price mitigation differ from that in the Commission's April 26, 2001 order?*

Answer: It differs in three major ways:

(1) The market clearing price formula is changed in three ways: it adjusts the gas component to reflect the marginal cost to replace gas used for generation, determined by the average of the mid-point of the monthly bid week prices as reported in Gas Daily for three spot market prices reported for California; it adjusts the O&M expense from $2 to $6; and it eliminates emission costs from the formula. Emission costs will be recovered separately from the ISO and, ultimately, the ISO's customers.

(2) The prior order did not provide for mitigation of spot sales prices in non-reserve deficiency periods. As described in the answer to Question 2, today's order does provide for such mitigation.

(3) The prior order did not provide for mitigation of spot prices in the WSCC, other than the spot prices in the ISO's centralized markets, but sought comment on whether and what mitigation to adopt outside the ISO markets. Today's order applies price mitigation rules in California and all

of the WSCC's spot markets, including to individual bilateral contract spot market sales in California and the remainder of the WSCC.

Question 4: *Do the above price mitigation rules apply to all sellers in the West?*

Answer: Yes. The same rules that apply to FERC-regulated public utilities (such as traditional investor-owned utilities, individual power generators and power marketers) that make spot market sales in the WSCC also apply to any non-public utility (such as Federal power marketing agencies, municipal utilities and electric power cooperative utilities) that chooses to sell in FERC-regulated power markets or that use FERC-regulated interstate transmission facilities.

Question 5: *How does the Commission's order apply to power marketers and potential market power abuse such as "megawatt laundering"?*

Answer: "Megawatt laundering" refers to selling from California to other states, and later reselling into California in order to avoid price mitigation that may be in effect. Incentives for this will now be eliminated because uniform price mitigation rules will apply in California and in the remainder of the WSCC for both reserve deficiency periods and non-reserve deficiency periods. Further, power marketers (unlike other suppliers) will not be permitted to justify prices above the prescribed mitigated prices. Finally, all public utility sellers' market-based rate authorizations are conditioned on sellers agreeing to refund overcharges resulting from anti-competitive conduct and to potential revocation of their market rate authority.

Question 6: *Does the new mitigation adopted in the order apply retroactively? What about refunds for past periods?*

Answer: The mitigation in today's order takes effect the day after issuance of the order. The Commission will address refunds for past periods, if not resolved by settlement, in future orders. The Commission has directed public utility sellers and buyers in the California ISO markets to participate in settlement efforts before a Commission administrative law judge, with such efforts to begin by June 25 and to be completed within 15 days thereafter. Among the many issues presented by these proceedings, the parties may address refund issues during the settlement proceedings.

Question 7: *Why hasn't the Commission imposed cost-based caps? Isn't the Commission required by the Federal Power Act to impose cost-based rates if competitive markets aren't working the way they are supposed to?*

Answer: The Commission has broad discretion in setting rates, and is not required to use cost-based rates or any other specific method so long as the end result is within a zone of reasonableness. The Commission must balance two statutory goals: protecting customers against unreasonable rates and encouraging adequate supplies to meet those customers' power supply needs. Cost-based rates would squelch development of new supplies in the West and thus perpetuate the problems we are trying to solve. Thus, the price mitigation adopted by the Commission ensures that rates are not unreasonable for customers but also encourages new supplies needed in the West.

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