UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER13-550-000**

MOTION FOR LEAVE TO ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

On December 12, 2012, the California Independent System Operator Corporation ("ISO") submitted a proposed tariff amendment in this proceeding to implement the Flexible Capacity and Local Reliability Resource Retention ("FLRR") mechanism. The FLRR mechanism is an interim measure that provides a financial lifeline to a resource that is uneconomic and at risk of retirement as an incentive for that resource to remain available because it will be needed by the ISO for flexible capacity or local reliability at some time within a two- to five-year period, but not in the first year.

Pursuant to the Commission's December 14, 2012 Errata Notice Extending Comment Period, 23 entities submitted motions to intervene by the January 23, 2013 due date, many with comments or protests with regard to the ISO's FLRR filing.[1] The

[1] Interventions without comments or protests were filed by City and County of San Francisco, Cogeneration Association of California and the Energy Producers and Users Coalition, Edison Mission Energy, Independent Energy Producers Association, J.P. Morgan Ventures Energy Corp. and BE CA LLC, Modesto Irrigation District, M-S-R Public Power Agency, Powerex Corp., Sacramento Municipal Utility District, and San Diego Gas & Electric Company.

Interventions with comments or protests were filed by Alliance for Retail Energy Markets ("AReM"), California Department of Water Resources State Water Project ("SWP"), California Municipal Utilities Association and The Utility Reform Network (together "CMUA/TURN"), California Public Utilities Commission ("CPUC"), Calpine Corporation ("Calpine"), Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively "Six Cities"), City of Santa Clara, California ("Santa Clara"), Northern California Power Agency ("NCPA"), NRG Companies and Dynegy Companies (together "NRG/Dynegy"), Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and Western Power Trading Forum ("WPTF").

ISO does not object to any of the interventions filed in this proceeding, but in this answer will respond to the comments and protests, and explain why they provide no valid basis for the commission to reject or significantly modify the ISO's proposal.

I. MOTION TO FILE ANSWER TO PROTESTS

The ISO recognizes that, unless authorized by the Commission, the Commission's Rules of Practice and Procedure preclude an answer to protests. Accordingly, the ISO requests leave to file its answer to the protests filed in this proceeding. [2]

The ISO submits that good cause for the requested waiver exists because this answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help ensure a complete and accurate record in the case.[3] The comments and protests in some cases reflect a misunderstanding of the nature, purpose, and operation of the FLRR mechanism and in others raise issues that the ISO was unable to anticipate, and therefore did not fully address, in the transmittal letter. The ISO believes that this answer will aid the Commission's understanding and inform its decision-making process by providing additional explanation and support for the essential provisions in the ISO's proposal, in particular, the need for the FLRR mechanism and the compensation and cost allocation of an FLRR designation, which were the focus of the comments and

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[2] The ISO submits this filing pursuant to Rules 212 and 213 of the Commission Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213 (2011). Capitalized terms not otherwise defined herein have the same meaning as set forth in the ISO Tariff, Appendix A, Definitions.

[3] *See, e.g.*, *Entergy Services, Inc.*, 116 FERC ¶ 61,286 at P 6 (2006); *Midwest Indep. Transmission Sys. Operator, Inc.*, 116 FERC ¶ 61,124 at P 11 (2006); *High Island Offshore System, L.L.C.*, 113 FERC ¶ 61,202 at P 8 (2005); *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corp.*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Co.*, 93 FERC ¶ 61,098, at 61,259 (2000).

protests. The ISO will also provide clarification in response to misstatements and mischaracterizations made in the comments and protests.

The ISO also requests leave to file this answer two days after the time applicable for permissible answers. At the ISO's request, the Commission granted parties an additional month in which to file protests and comments. The ISO wishes to provide the Commission a complete response to the comments and protests filed and was not able to finish that effort in 15 days. Because the requested effective date is not until April 1, allowing this additional time for the ISO to file this answer should not impose a hardship on the Commission, its staff, or intervenors.

For these reasons, the ISO respectfully requests that the Commission accept this answer to the comments and protests.

II. ANSWER

A. Approval of the FLRR Mechanism Is an Appropriate Exercise of the Commission's Jurisdiction

The CPUC, NCPA, and SWP argue that the Commission should reject the FLRR mechanism because it intrudes on state or local regulatory authority over resource adequacy and long-term planning. The CPUC presents a number of arguments for the proposition that the Commission's approval of the FLRR mechanism would exceed its jurisdiction under the Federal Power Act. The underlying theme of these arguments is the Commission's approval of the FLRR mechanism would allow the ISO to establish a reliability requirement that "will likely" conflict with the state's resource adequacy requirements, long-term planning process decisions, and authority over resource planning. In support of this argument, the CPUC cites to the ISO's statement that it will determine the need for resources at risk of retirement using NERC and WECC and local

reliability criteria, and asserts that this means that the ISO would effectively transform these standards into reliability requirements, in conflict with CPUC's authority to set resource adequacy requirements.[4]

The ISO is committed to work collaboratively with the state of California in setting the desired levels of resource adequacy and is actively and cooperatively engaged in the CPUC proceedings underway to achieve this goal. In particular, the ISO appreciates the extensive collaboration between the CPUC and the ISO to ensure that California has adequate flexible and local resources in the short- and long-term and intends to continue to participate in that effort. The FLRR mechanism, which only ensures that resources at risk of retirement but needed in the future remain in the market, does not interfere with those efforts or usurp the CPUC's authority in any manner. The FLRR mechanism, like other mechanisms already approved by the Commission for the ISO, is simply a necessary tool through which the ISO can fulfill its responsibility to maintain grid reliability, while the ISO, CPUC, local regulatory authorities, and stakeholders develop a longer-term solution.

1. The FLRR Mechanism Is Designed to Ensure Compliance with Existing Reliability Criteria, Not a New Reliability Requirement

The CPUC's opposition to the Commission's approval of the FLRR mechanism is premised on its contention that the Commission would be imposing a new reliability requirement. To the contrary, approval of the FLRR mechanism would not direct, or even authorize, the ISO to establish a reliability requirement. Rather, it would authorize the ISO to make payments to resources that must remain available to the markets if the ISO is to comply with existing WECC and NERC reliability requirements, but that would

[4] CPUC at 19-20.

be forced to retire absent those payments. Thus, through the FLRR mechanism, the ISO is only proposing to take action to ensure that it is able to meet existing reliability standards.[5] The issuance of an FLRR designation would be pursuant to the ISO's independent responsibility as a transmission provider subject to federal jurisdiction to ensure grid reliability, which the Commission has previously recognized.[6] The FLRR mechanism is not a reliability "requirement" because neither the Commission nor the ISO would be requiring any local regulatory authority or load serving entity to take any procurement actions or requiring any designated resource to offer its capacity or energy into the market during the designation year.

2. The FLRR Mechanism Is Not a Capacity Procurement Requirement, and Therefore Does Not Affect the CPUC's Jurisdiction to Issue Resource Adequacy Requirements

The FLRR mechanism cannot be a resource adequacy requirement reserved for CPUC jurisdiction because it does not result in the procurement of capacity. The California Public Utilities Code describes resource adequacy requirements as follows:

> Each load-serving entity shall maintain *physical generating capacity* adequate to meet its load requirements, including, but not limited

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[5] The U.S. Court of Appeals for the District of Columbia Circuit has recognized the distinction between the Commission imposition of a reliability requirement pursuant to section 215 of the Federal Power Act and its determination, under section 205 of the Federal Power Act, of whether a regional transmission organization's proposed action to ensure grid reliability is just and reasonable. *See Conn. Dep't of Pub. Util. Control v. FERC,* 569 F.3d 477, 483 (D.C. Cir. 2009). For this reason, and others, such as the fact that the Commission would not be pre-empting any state action, sections 215(i)(2) and 215(i)(3) do not prohibit approval of the FLRR mechanism, as the CPUC argues. The Commission's statements in Order No. 747 about potential limits on its jurisdiction with regard to resource adequacy requirements, which the CPUC cites, are not relevant here because in Order No. 747 the Commission was acting under section 215; here it would be acting under section 205. CPUC at 22, citing Order No. 727, Planning Resource Adequacy Assessment Reliability Standard, 134 FERC ¶ 61,212 (2011).

[6] *See Cal. Indep. Sys. Operator Corp.*, 134 FERC ¶ 61,211 at P 124 (2011) ("[ISO] is responsible for ensuring the reliable operation of the transmission system under its control, it must have adequate resources. . . [including] resources at risk of retirement"); *Cal. Indep. Sys. Operator Corp.*, 141 FERC ¶ 61,135 at P 38 (2012) (It is appropriate for a balancing area authority to guard against potential reliability problems, especially reliability problems that occur unexpectedly).[6] California law also charges the ISO with a responsibility, separate and distinct from that of state authorities such as the CPUC, for maintaining operational reliability of the grid.[6] *See, e.g.,* Cal. Pub. Util. Code § 345.5.

> to, peak demand and planning and operating reserves. The generating capacity shall be deliverable to locations and at times as may be necessary to provide reliable electric service.[7]

FLRR designations do not procure physical generating capacity; the resource has no obligation to produce energy. Indeed, the CPUC acknowledges that the ISO is not seeking to require the procurement of capacity through the FLRR mechanism.[8]

Moreover, to the extent that the FLRR mechanism is a form of procurement, it is not procurement by ratepayers or load-serving entities. That ratepayers bear the costs of a FLRR designation does not mean that they are "procuring" the service (if forbearance of retirement can be considered a service) any more than ratepayers are procuring every piece of equipment that a public utility purchases. The CPUC's argument that the FLRR mechanism impermissibly requires load-serving entities to fund investments in generation resources of amortized costs up to $2 million per year[9] fails for similar reasons. Allocating these costs to load-serving entities is not the equivalent of requiring the load-serving entities to invest in the generating resource.

3. The FLRR Mechanism Is an Interim Mechanism To Fulfill a Need Until State Regulation Can Address that Need

The CPUC argues that the FLRR mechanism is impermissible because the Commission has not determined that there is a conflict between a state action and any Commission-approved reliability standards and the ISO has not alleged such a conflict exists.[10] According to the CPUC, the ISO has only identified a concern that might arise

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[7] Cal. Pub. Util. Code § 380(c) (emphasis added).

[8] CPUC at 33.

[9] CPUC at 24.

[10] The CPUC's argument that a prerequisite to approval of the FLRR mechanism is a determination that state action is inconsistent with a reliability standard is a misunderstanding of section 215(i)(3) of the Federal Power Act. As explained above, paragraph (3) of section 215(i) simply provides that reliability standards do not ordinarily preempt state regulation. A determination of a conflict is only a prerequisite to

if resources that are currently uneconomic seek to retire and other resources cannot satisfy the ISO's future operational needs to maintain NERC reliability criteria.[11] In a related argument, SWP suggests that the ISO's sole concern is with overriding decisions by the CPUC, CEC, and other local reliability authorities with which it disagrees. According to SWP, the ISO has shown no basis for why it should be allowed to intrude on the jurisdiction of state agencies and local reliability authorities, or second-guess their flexible capacity procurement determinations.[12]

The FLRR mechanism, however, is not a tool to overrule a state law or regulation. Rather, the ISO is responding to a need that arises because California does not have a multi-year forward capacity procurement obligation for flexible and local resources that would avoid that need. The ISO has determined that the availability of flexible and local reliability capacity is required for reliable operation of the grid and that the availability of such capacity may be at risk over a five-year horizon. While the FLRR mechanism does not provide a multi-year forward capacity procurement mechanism, it does address the unfortunate consequence of the absence of such a mechanism -- existing resources may retire due to the unavailability of sufficient payments to keep them online to meet future needs two to five years into the future. The ISO will only make FLRR designations when, after an extensive public and transparent process, it determines the designation is necessary to ensure such availability. Moreover, the FLRR mechanism specifically terminates upon the successful implementation of a multi-year forward capacity procurement obligation for flexible and local resources.

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a determination that the reliability standard preempts state action. It is not a prerequisite for Commission action in this proceeding.

[11] CPUC at 24-27.

[12] SWP at 8-9.

4. Commission Precedent Supports the Authority of the Commission To Approve the FLRR

That the Commission has found it within its jurisdiction under section 205 of the Federal Power Act to approve mechanisms in which the ISO procures capacity or requires compliance with capacity standards demonstrates that this much more modest proposal is consistent with the Commission's statutory authority. The Commission has previously specifically authorized the ISO to take actions to ensure the availability of sufficient capacity to meet reliability needs that the CPUC has not yet identified and provided for. When the ISO first proposed its resource adequacy program, it deferred to the CPUC's determination of system resource adequacy needs, for which a program was in place. Much as the CPUC has currently promulgated no standards regarding the need for flexible capacity, the CPUC had not at that time promulgated standards for local capacity requirements. The ISO therefore proposed to develop and enforce local capacity requirements itself. In ruling on the resource adequacy proposal, the Commission approved the ISO's proposal of local capacity requirements, noting:

> [T]he [ISO] has the responsibility to ensure the reliability of the transmission system under its control. We find that, without an adequate resource adequacy program, the [ISO] cannot fulfill that responsibility. The . . . resource adequacy requirements will therefore help the CAISO to operate its grid, in a reliable manner, consistent with the requirements of AB 1890 and WECC/NERC obligations.[13]

Nothing in the Federal Power Act precludes the ISO from implementing a program to address reliability needs where the state has not yet acted, nor does it preclude or

[13] *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 at P 1115 (2006).

reduce the Commission's authority to approve such a program under section 205 of the Federal Power Act.[14]

In addition, the Commission has approved the ISO's capacity procurement mechanism, whereby the ISO procures capacity in order to ensure compliance with reliability requirements, including resources at risk-of-retirement that are needed for reliability in the next year.[15] The ISO also procures capacity through reliability must run contracts to ensure compliance with reliability requirements.[16] The CPUC makes no effort to explain or distinguish why the Commission's approval of these procurement mechanisms – which, unlike the FLRR, entail the procurement of physical capacity – is not prohibited by the Federal Power Act while the FLRR mechanism is prohibited.[17]

NRG/Dynegy, on the other hand, argue that the ISO's proposal is inconsistent with Commission precedent. According to NRG/Dynegy, the FLRR proposal is a

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[14] The CPUC acknowledges that the Commission has approved centralized capacity markets in other regions, but attempts to distinguish these mechanisms. CPUC at 32-33. It is not clear that their attempts aid their fundamental argument that the Commission's acceptance of the FLRR mechanism would be an inappropriate expansion of the Commission's authority. In particular, the CPUC notes that these markets do not impose capacity obligations five years in the future. The FLRR mechanism, however, does not impose obligations five years in the future. It authorizes a one-year commitment. It is only the study horizon that extends five years. More importantly, the CPUC does not explain why the study horizon has any relevance to the applicability of section 215 or any other jurisdictional matters. There is no logical reason why it should.

[15] *See* ISO Tariff § 43. Tariff section 43.2.6 expressly provides that the capacity to be procured cannot be under a resource adequacy contract (for use to meet state resource adequacy requirements).

[16] *Id.* § 41.

[17] The CPUC does, however, attempt to distinguish these mechanisms in support of an argument that it is not clear that the FLRR mechanism is a Commission jurisdictional tariff.[17] The CPUC relies upon essentially the same distinctions that it tries to make with regard to capacity markets. For the reasons discussed above, these distinctions are irrelevant to the issue of the Commission's jurisdiction.

The CPUC's suggestion that the FLRR mechanism may not be a Commission-jurisdictional tariff is a separate issue. The ISO believes, and is confident that the Commission will concur, that the allocation to demand of the costs of a mechanism to ensure reliable transmission service is a "charge[ ] made, demanded, or received by [a] public utility for or in connection with the transmission . . . of electric energy," 16 U.S.C. § 824d(a) (2006), and thus subject to regulation by the Commission. If the CPUC were correct, however, it would not serve the CPUC's purpose. In that case, the FLRR mechanism would be unregulated, and the ISO would be free to institute the program pursuant to its corporate charter.

collateral attack on the Commission's order on the capacity procurement mechanism because the ISO seeks authority to look forward for a period of 2 to 5 years rather than the 1-year outlook set forth in existing Tariff Section 43.2.6, but the order on the capacity procurement mechanism expressly rejected NRG/Dynegy's suggestions that the ISO should provide for a minimum of a 3-year forward CPM designation.[18] Actually, the Commission did not rule on NRG/Dynegy's suggestion in that order, but merely recited the ISO's assertion that the capacity procurement mechanism is not a multi-year procurement. Even if the Commission had so ruled, however, NRG/Dynegy's argument would be a *non sequitur.* The FLRR mechanism is not a multi-year designation; although it considers multi-year needs, it is a designation for only one year. Moreover, as the ISO has noted, it is not a procurement of capacity.

B. The Demonstrated Need for the FLRR Mechanism Remains Unrebutted

A number of parties contend that the FLRR mechanism is not necessary. Significantly, none of these arguments challenges the studies that the ISO presented in its transmittal letter or the accuracy of the ISO's conclusions. Rather, some parties assert that other mechanisms exist or are being developed to address the needs identified. Others argue that the ISO fails to address the root cause of the concern. As discussed below, none of these arguments provide a basis for rejecting an interim mechanism to address – pending the development of an adequate mechanism to provide a longer-term solution – the very real possibility and strong likelihood that resources that will be necessary to respond to these needs may be forced into retirement.

[18] NRG/Dynegy at 19-20.

1. Existing CPUC Mechanisms and Undertakings Cannot Address the Immediate Need for a Mechanism To Avoid the Retirement of Resources that Will Be Needed in a Two- to Five-Year Horizon

The CPUC argues that the FLRR mechanism is unnecessary because the CPUC actively and continuously addresses resource planning for California's system and local capacity needs through its resource adequacy program, which has a one-year look-ahead, and the long-term procurement plan, which addresses the need for new infrastructure up to 10 years in the future.[19] Other parties make a similar argument.[20] The ISO's appreciates the CPUC's work in this regard and cooperates with the CPUC in these efforts. These efforts are important, but they do not address the intermediate-term needs for flexible capacity and local reliability. The CPUC does not have *any* mechanism in place for considering the need for flexible capacity, whether for a one-year or a five-year horizon. Moreover, although the long-term procurement plan process looks ahead ten years, it assumes that the existing generation fleet remains intact, with the exception of some anticipated generation retirements. It does not take into account that retirement might be the most economic option for a resource whose power purchase agreement or resource adequacy contract expires in the middle of the 10-year period. In addition, as WPTF explains, resource adequacy only looks ahead one year and the long-term procurement plan process looks only to a 5-to-10-year time horizon and, as the ISO's Market Surveillance Committee has recognized, there is a significant gap in forward procurement mechanisms for resources needed for the

[19] CPUC at 8-9.

[20] CMUA/TURN at 15-16; Six Cities at 7.

medium-term (1-to-5-year) planning horizon.[21] No intervenors have challenged the conclusion of the Market Surveillance Committee. At this time, the ISO is only proposing an interim mechanism to ensure that resources are available when they are needed during that period.

The CPUC also notes that it expects to issue final decisions in January 2013 addressing long-term procurement needs in transmission-constrained areas of southern California.[22] The ISO submits that the possibility a solution may be in place at some indefinite time in the future is not a reason to reject the FLRR mechanism now. Any measures the CPUC includes in the long-term procurement plan to address long-term procurement needs for flexible capacity in the 10-year forward timeframe will likely not show significant results until well after the FLRR mechanism has expired.

The CPUC stresses that it is working in consultation with the ISO to determine flexible capacity resource needs, but that these needs have not yet been determined and this issue will go through several iterations before a policy framework around the procurement of flexible capacity is adopted.[23] The ISO commends these efforts, but until they are complete, and appropriate policies are implemented, an interim measure to address these needs in the intermediate five-year period is necessary. This is particularly true because the CPUC's current efforts are only considering a one-year outlook for the flexible capacity need. There is no indication that the CPUC will address flexible capacity needs two to five years in the future.

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21 WPTF at 3-4.

22 CPUC at 9-10.

23 CPUC at 11-12.

The CPUC states that because it has not completed its determinations, it is premature to deem a lack of flexibility as a reliability risk. That the CPUC has not finished evaluating a risk, however, does not mean it does not exist. As noted, the ISO's studies, presented with its transmittal letter, demonstrate that the risk of inadequate flexible capacity and local reliability capacity is quite real. The fact that the ISO has not yet fully defined the parameters of a flexible capacity product[24] does not diminish the need for a backstop to avoid the premature retirement of resources that have are capable of providing flexible capacity.

The CPUC notes that, to date, only one operator (Calpine) has provided notice of an intent to retire a resource under the ISO's capacity procurement mechanism (which is limited to a one-year-out assessment of the need for a resource at risk of retirement). The CPUC states that the ISO has not demonstrated that California's current regulatory scheme will fail to provide sufficient supply in future years.[25] The ISO has not provided an analysis of specific resource retirements because it does not have the information on specific units' finances or future power purchase agreements. Such an analysis, however, is not necessary for implementation of the FLRR mechanism. If indeed no resources that are needed in the future seek to retire, then there will be no FLRR designations. What the ISO has demonstrated is that the existing regulatory structure creates a probability that some resources that are needed in two to five years will find it uneconomic to operate in the interim. Calpine's notice of the intent to retire the Sutter unit demonstrates that the potential is real, not theoretical. The report of the Brattle Group on Resource Adequacy in California, submitted with Calpine's protest, makes a

[24] CPUC at 12-13.

[25] CPUC at 29.

compelling demonstration that the current regulatory scheme is not capable of a protecting against such losses of needed capacity – that it is, to use the CPUC's words, "broken."

The FLRR mechanism is simply a prudent insurance policy against such events that will impose no costs unless a needed resource plans to retire. As the old adage goes, it's better to be safe than sorry. Absent the FLRR mechanism, there would be no means to stop the retirement of resources that the ISO has identified will be needed in the intermediate future. As the ISO discussed in the transmittal letter, other regional transmission organizations and independent system operators have provisions in place to avoid such retirements. There is no valid reason why the ISO should not have a similar mechanism available to it if the need arises.

The CPUC further argues that the ISO fails to take into account that (1) the CPUC can use existing authority in its Operating Standards of General Order 167 to address reliability risks if more generators assert near-term revenue inadequacy,[26] and (2) the investor-owned load-serving entities manage their net open positions in future years by entering into forward energy and capacity contracts.[27] The Commission has already rejected arguments that the General Order 167 standards are sufficient to prevent retirements in approving the ISO's use of the capacity procurement mechanism to avoid a risk of retirement.[28] In this instance, because the CPUC has no mechanism for identifying the needs for flexible capacity in a two- to five-year horizon, it has no

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[26] CPUC at 30-31.

[27] CPUC at 29-30.

[28] *Cal. Indep. Sys. Operator Corp.*, 134 FERC ¶ 61,211 at P 125 (2011).

basis to use its authority under General Order 167 to prevent the retirement of resources that are needed to meet those needs.

Although load-serving entities may manage their net open positions, the existence of net open positions means that they have future needs for which they have not procured energy and capacity. Moreover, even if the load-serving entities had procured future energy and capacity to meet their full future needs, that would not ensure the procurement of sufficient flexible capacity or local reliability resources, because the CPUC has not established adequacy standards for such resources.

Finally, the CPUC argues that the FLRR mechanism is distinguishable from circumstances in which the Commission has exercised authority over longer-term capacity markets and that the Commission has never authorized an independent system operator to impose capacity obligations on load-serving entities five years into the future. This argument ignores the fact that the FLRR mechanism imposes no capacity obligation and makes only a one year designation – for the year following the request. As for the showing of need, no party has identified any flaws in the ISO's studies demonstrating the need for the FLRR mechanism or offered any contrary study results or other substantive evidence to support their claims.

2. The Absence of Current Requirements for Procuring Flexible Capacity and Local Reliability Resources Based on Two- To Five-Year Needs Analysis Is Not Cause To Reject the FLRR Mechanism

Some parties contend that there cannot be a need for a backstop authority when there are no requirements in place under which load serving entities must identify or procure flexible capacity or local reliability resources on a forward basis.[29] Whether the

[29] CMUA/TURN at 6-7; Six Cities at 3-4.

FLRR mechanism is properly called a backstop is a question of semantics, not of substance. The ISO proposed the FLRR mechanism as a backstop in case current market conditions under the current regulatory structure are insufficient to prevent the retirement of needed resources. That some parties might not consider this a backstop function does not affect the need, or the prudence of having the mechanism in place.

Indeed, it is the lack of existing requirements that creates the need for the FLRR mechanism as an interim measure. Once those requirements are in place, it will be appropriate to consider whether some type of backstop capacity procurement mechanism is necessary in case load-serving entities do not comply with the requirements, but that is not the issue here. The ISO is not seeking authority to procure the capacity that will be needed in two to five years. The issue here is instead preserving the availability of resources that the load-serving entities will need to have available in order to meet future longer-term flexible capacity and local reliability capacity requirements when they are in place. Arguments, such as those raised by Six Cities, that the Commission should direct the ISO consider to the backstop authority in the context of current stakeholder processes to address anticipated needs for operating flexibility ignore the fact that those processes will take time, and even then may not provide a full solution to the longer term needs. An interim "backstop" is both necessary and prudent under these circumstances.

Six Cities argues that the lack of established resource adequacy requirements for forward demonstration of flexible and local resources means that load-serving entities have no clear guidance for shaping their resource procurement policies to meet the ISO's reliability needs and thereby avoid backstop procurement by the ISO. According

to Six Cities, local regulatory authorities should have the opportunity to address the operational challenges that will result from increasing reliance on variable energy resources in the first instance through their resource procurement policies and plans.[30] The ISO does not disagree with these contentions. The ISO disagrees, however, with Six Cities contention that the FLRR proposal seeks to "hijack" the procurement process before state and local regulatory authorities have had a chance to respond to defined reliability needs.[31] As the ISO has repeatedly stressed, the FLRR mechanism is designed so as not to interfere with bi-lateral procurement. A resource requesting a designation must have submitted an offer in response to at least one request for offers of resource adequacy capacity during the current calendar year and, if designated, the resource will be required to submit bids in response to all requests for offers of resource adequacy capacity for which it is eligible during the designation year. If it obtains a contract, the FLRR designation ends.

The ISO cannot "hijack" the procurement process with the FLRR mechanism because, the ISO reiterates, the ISO is not procuring capacity. The ISO is proposing a backstop mechanism. The ISO is not seeking to displace the resource adequacy requirement or the long-term procurement plan. To use Six Cities' analogy, the ISO is not "request[ing] authority to break the glass, at potentially considerable expense to [load-serving entities] and their customers, in anticipation of a possible emergency two

30 Six Cities at 4-5.

31 *Id.* at 5. The ISO notes that nothing in the FLRR mechanism would preclude local regulatory authorities from implementing longer-term flexible capacity and local reliability resource adequacy requirements. To the extent that load-serving entities procure capacity to meet such requirements, the ISO's need to use the FLRR mechanism will diminish.

to five years hence."[32] Rather, the ISO is merely seeking authority to takes steps to ensure that the fire extinguisher is there, behind the glass, when it is needed.

3. The Need To Address Market Flaws and To Develop a Long-Term Solution Does Not Provide a Basis for Rejecting the FLRR Mechanism

Several parties urge rejection of the FLRR mechanism because it purportedly does not address the root causes of market conditions that could lead to the retirement of needed resources. These parties call for the implementation of various measures to address these causes, either a long-term non-discriminatory capacity procurement process (whether conducted by the ISO or the CPUC) or a centralized capacity market.[33] The ISO agrees with these sentiments. As discussed in section II.C.2, however, given the realistic timeline for implementing these types of solutions, they can not address the more immediate need to keep resources in place now that can provide the type of capacity that will be necessary to meet future reliability needs.

Only two parties make arguments that an interim mechanism would be detrimental. AReM contends that approval of the FLRR mechanism would reduce the urgency with which the ISO, working in collaboration with the CPUC and other local regulatory authorities, will complete the work necessary to define appropriate multi-year forward capacity obligations and implement enhancements to its ancillary service markets.[34] There is no basis for this conclusion. If anything, the sunset provision in the FLRR mechanism will increase the urgency to put in place a long-term solution. The ISO is "on record" in support of developing mechanisms to address these issues.

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[32] Six Cities at 7.

[33] *See, e.g.,* AReM at 4; Calpine, Attachment A at 3-4, NRG/Dynegy at 11-15, WPTF at 4, 6, 9-10, SCE at 10.

[34] AReM at 4.

AReM also contends that a mechanism that allows any entity, whether the ISO or the investor-owned utilities, to conduct "on-behalf-of" procurement of resources for load that they do not serve will undermine the ability of load-serving entities to manage their supply portfolios in ways that meet the needs of their customers. According to AReM, this is especially detrimental for the competitive energy service providers that AReM represents, because when they are required to accept procurement made on their behalf, they have less "bandwidth" to provide value-added service to their customers and their costs increase, as they must recover from their customers the socialized procurement costs as well as the costs of their own procurement.[35] This argument is misplaced. First, the FLRR mechanism does not involve the procurement of capacity and thus does not interfere with any entities' procurement decisions. Second, because the ISO is not making a designation on behalf of any particular load-serving entity and would allocate the costs to all load-serving entities in the relevant TAC areas based on demand, it does not impose any discriminatory burdens. Third, any shortfalls in flexible capacity will affect the system as a whole, and consequently all end-use customers, so there is no basis for AReM's contention that their supply portfolios can be managed to "meet the needs of their customers."

Dynegy/NRG contends that retaining non-competitive units in the market through preferential payments will destroy what is left of the competitive market in California.[36] This is an erroneous assumption. Designation does not mean that the units are not competitive in the longer term; only that they cannot earn sufficient revenues in the following year to stay available. The resources eligible for an FLRR designation will be

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[35] *Id.* at 5/

[36] Dynegy at 16-18.

those that the ISO has determined will be needed in the future and that are uniquely able to do so because no new resource or transmission facility is projected by the ISO to be in operation by the start of the year in which the need will arise.

Under the current construct, there is no forward price signal for flexible capacity. Therefore, resources that will be needed in the future have no way of knowing what their value will be. Until an intermediate-term procurement mechanism is in place, the FLRR mechanism is needed to keep resources that are uneconomic today from retiring prematurely. Retaining these resources until the need arises and while mechanisms are developed to assign a value to the resources' flexible or local reliability attributes will enhance the likelihood of improvement in the competitiveness of California markets.

Parties that advocate a different solution to the reliability needs fundamentally misapprehends the nature of the Commission's review under Section 205 of the Federal Power Act. *Cities of Bethany v. FERC*[37] firmly establishes the principle that the Commission's review of a proposed rate, term, or condition need only be just and reasonable. The Commission does not consider whether a proposal is the best possible proposal. As the Commission has explained:

> [t]he courts and this Commission have recognized that there is not a single just and reasonable rate. Instead, we evaluate [proposals under Section 205] to determine whether they fall into a zone of reasonableness. So long as the end result is just and reasonable, the [proposal] will satisfy the statutory standard.[38]

The ISO's proposal falls well within the zone of reasonableness for the reasons just discussed.

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[37] 727 F.2d 1131 (D.C. Cir. 1984).

[38] *Id.* at 1136.

C. The Timing of the FLRR Mechanism Implementation Is Appropriate

Some parties suggest that the Commission should delay approval of the ISO's proposed tariff amendments and instead either schedule the matter for hearing and settlement proceedings or direct the ISO to work with stakeholders to develop the market-based solution to the need for forward, multi-year capacity procurement. These suggestions would interfere with the ISO's ability to respond in a timely manner to the reliability concerns raised by the potential retirement of necessary resources.

1. The Commission Should Not Delay Implementation of the FLRR Mechanism

The CPUC urges the Commission reject the ISO's proposal as unnecessary or unlawful, or set it for hearing to determine if the FLRR mechanism is just and reasonable and not unduly discriminatory.[39] Similarly, Calpine's protest takes issue with nearly every aspect of the ISO's proposal and urges its rejection or that the Commission direct hearings and settlement proceedings before an Administrative Law Judge.[40]

The ISO acknowledges that hearings may sometimes be necessary to identify and address factual differences, just as settlement discussions may be a very effective and successful means to resolve differences between parties, as occurred with the settlement agreement reached on the appropriate administrative price for the ISO's capacity procurement mechanism. In this instance, however, the ISO submits that the CPUC and Calpine have failed to justify the need for hearings. The legal and jurisdictional issues they have raised are not the types of issues that the Commission usually sets for hearing, nor do their arguments rest on factual issues pertaining to the

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[39] CPUC at 47-50.

[40] Calpine at 41.

exact rate to be charged by a supplier, which the Commission may set for hearing. Further, the protests leave little room for the settlement discussions that they request to lead to modifications to the proposed FLRR mechanism that would be acceptable to both these parties and the ISO.

The ISO is concerned that hearings or settlement discussions would only serve to cause protracted delay in implementing the FLRR mechanism.[41] That delay could have an irreversible impact on grid reliability if uneconomic resources that would otherwise be eligible to receive an FLRR designation could not sustain viability through the length of the discussions and would retire before the new mechanism becomes effective. As the ISO explained in the transmittal letter, California's energy portfolio is already undergoing significant change.[42] The need for flexible resources and local capacity to counterbalance the variability and unpredictability of the large amount of renewable and distributed energy resources that are coming on line is increasing as existing flexible capacity resources with once-through-cooling technology retire. The FLRR proposal is an interim backstop measure in response to these urgent circumstances that is necessary while the ISO works with the CPUC, other local regulatory authorities, and stakeholders to develop and implement a long-term solution.

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[41] The ISO recognizes that the Commission could allow the FLRR mechanism to become effective subject to refund, but the ISO does not believe this would be practicable for a number of reasons. For example, it would call upon the Commission to rule upon compensation filings when the Commission has not determined that the underlying process is just and reasonable. Also, the FLRR mechanism entails designations, not just compensation issues, "undoing" the designations and delayed retirements following the final Commission ruling would be highly complicated, if not impossible.

[42] *See* FLRR transmittal letter at 1-3 and 6-14.

2. The Commission Should Not Defer or Reject the FLRR Mechanism in Order To Advance Development and Implementation of Multi-Year Market-Based Capacity Procurement

Calpine and NRG/Dynegy recognize the impending reliability risks, but argue that the Commission could address the issues by skipping the interim step and moving directly to the long-term solution. They urge the Commission to reject the FLRR proposal and to direct the ISO to develop a market-based mechanism for the forward, multi-year procurement of capacity to address the ISO's reliability needs and retention of existing flexible generation resources. Calpine suggests that the Commission should require the ISO to submit the proposal by October 1, 2013, for implementation by October 1, 2014.[43] NRG/Dynegy would have the ISO develop and submit a centralized capacity market proposal within the next 180 days.[44]

These suggestions, on their face, are unreasonable, impractical, and fail to address the need that exists now to avoid premature retirement of resources needed for reliability two to five years from now. They contemplate delaying the implementation of *any* solution to address the rapidly changing composition of California's energy portfolio and its impact on grid reliability. Again, the ISO is concerned that such delay would lead currently uneconomic resources with flexibility attributes or locational benefit to retire during the interval when the long-term solution is under development. The loss of this capacity would exacerbate the operational difficulties confronting the ISO in integrating the growing number of renewable resources.

The possibility for adverse consequences to occur during the delay is even more

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[43] Calpine at 11.

[44] NRG/Dynegy at 27-29.

acute when an achievable schedule for developing the long-term solution is taken into account. It is wildly unrealistic to expect that the effort could be completed within a few months, as Calpine and NRG/Dynegy pose. Rather, the ISO anticipates that development and implementation will be a multi-year endeavor. That length of time is necessary for the ISO to (1) design a comprehensive, multi-year forward, market-based, capacity procurement proposal, (2) undertake an initiative to thoroughly review the proposal with stakeholders and obtain their input, (3) engage in the CPUC's regulatory approval process and any related litigation, and (4) design, test, and deploy the complex changes to ISO systems and software that will be required to implement such a proposal. As the Commission is well aware, the eastern regional transmission organizations and independent system operators took years to develop and implement their capacity mechanisms. Any capacity market proposal the ISO files may similarly be subject to protracted litigation that could further delay the final decision and implementation. For all of these reasons, the suggestion that the ISO could develop and file a capacity market proposal in a matter of months is overly ambitious.

While the ISO intends to actively pursue a more permanent solution, as evidenced by inclusion of a sunset provision in the proposed tariff amendments, this will take time, and the backstop authority provided by the FLRR mechanism is critical to reliable grid operations in the meantime. The FLRR mechanism is an interim measure that will bridge the gap between today's need to retain flexible resources and local capacity and the future development and implementation of the long-term, market-based solution.

D. The Process for Determining Flexible Capacity And Local Reliability Needs Is Just and Reasonable

1. The Assessment and Determination of FLRR Flexible Capacity and Local Reliability Needs Are Not Vague and Employ a Robust and Transparent Stakeholder Review Process

Several parties raised issues with aspects of the assessment and determination of FLRR flexible capacity and local reliability needs as being vague and lacking stakeholder oversight. The CPUC argues that the Commission should reject the FLRR mechanism because it is it is unreasonably vague as to the planning assumptions, reliability standards, and criteria that the ISO will use to develop forecasts and determine if a resource is projected to be needed during the 2-5 year FLRR forward period. The CPUC claims that FERC has consistently limited ISO discretion and required transparent and objective assumptions, as opposed to discretionary standards, for ISO action.[45]

The ISO disagrees that the planning assumptions and standards for determining if a resource is needed are vague or that they require rejection. Proposed Tariff Section 44.3.1 requires the ISO to conduct fleet flexibility assessments each spring, which will consider the most recent CPUC standard planning assumptions used for the long-term procurement plan. The provision allows the ISO to exercise its discretion to adjust the assumptions in the studies for load forecast, energy efficiency, and demand response programs, and to perform additional studies. The ISO must to post its proposed assumptions, and include an explanation of any material differences in key planning assumptions from the most recent CPUC long-term procurement plan process As a result, the assumptions the ISO proposes and actually uses to perform its assessments

[45] CPUC protest at 35-36. 41-44.

will be made public and will be subject to extensive stakeholder review, as discussed below. The ISO submits that this transparency will fully inform stakeholders about the study assumptions, while affording the ISO needed discretion to update an analysis for changed conditions or to use the most recent data.

NCPA and SWP assert that, without a definition and quantification of flexible generator attributes, the ISO's determination of the need for a retiring unit suffers from imprecision, which raises serious concerns that the FLRR mechanism will replace market solutions with generation choices made by the centralized mandatory market and transmission operator.[46] To the contrary, proposed section 44.2 does provide the flexibility attributes that the ISO would consider. That provision states that the ISO's determination of the system flexibility need will consider multi-hour ramping, load-following, and regulation capabilities, and any additional flexibility attributes the ISO considers appropriate. With regard to the concern about the FLRR mechanism replacing market solutions, the ISO reiterates that the FLRR mechanism is a backstop measure that will be used only when all other potential solutions, including market-based procurement, fail.

SCE's comments claim that the ISO has not adequately explained how it will define or quantify future flexibility need. It views the language in proposed section 44 as overly vague and ambiguous and failing to adequately describe the process the ISO will use, other than perform proprietary simulations, to determine if a unit is needed.[47] The ISO submits that SCE's claims are contrary to the plain language of several provisions in Section 44. In sum, proposed Section 44.2 lists the flexibility attributes the ISO must

[46] NCPA at 7-8; SWP at 9-10.

[47] SCE at 4-5.

use in determining the flexibility need. Proposed Section 44.5 describes how the ISO will determine whether the resource is needed in the FLRR forward period. The assessment results will be used to determine whether the resource requesting an FLRR designation is needed by removing that resource from the forecasted fleet and examining whether the remaining fleet is able to supply the relevant system flexibility need or local capacity need such that forecasted load, operating reserve, and ramping requirements for system energy are addressed.

SCE additionally argues that the process for determining if the unit is needed lacks input or oversight from affected market participants. SCE recommends that the needs assessment process should be modified to put in place more formal checks and balances to ensure prudent and efficient levels of procurement rather than leaving the choice to the ISO's discretion.[48] SWP refers to the FLRR designation process as a black box unless the Commission assures that the designations are associated with a defined capacity need.[49] Similarly, SWP claims that the FLRR analysis of need for a retiring generator would vest the ISO with a huge amount of discretion to identify needed resources, with little ability for market participants to review or validate its claims.

These parties have not challenged the ISO's arguments on this point in the transmittal letter or attempted to rebut them. Moreover, their claims are contrary to the plain language of the tariff. The ISO will conduct an open and transparent stakeholder process. The FLRR provisions require that each step of the ISO's assessment and determination process be transparent and thoroughly vetted with stakeholders.

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[48] SCE at 5-6.

[49] SWP at 15.

Proposed Sections 44.3.1 and 44.3.2 describe a robust stakeholder process in which the ISO will make its proposed assumptions, actual inputs, and study results public, review each of them with stakeholders, and provide multiple opportunities for stakeholders to provide input. Under proposed Section 44.4, if the ISO determines that a resource is eligible to receive an FLRR designation, it will again engage stakeholders to discuss that evaluation and obtain their input. Under proposed Section 44.7, if the ISO proposes to designate the resource, it must prepare and post a detailed report, and conduct a stakeholder process regarding that tentative decision. If the ISO proceeds with the designation, it will present its proposed designation to the ISO Board of Governors for consideration and approval, which will offer another public opportunity for stakeholders to express their views.

2. The Determination of FLRR Flexible Capacity and Local Reliability Needs Will Not Impinge on CPUC Long-Term Planning Assumptions

The CPUC and CMUA/TURN argue that the proposed tariff amendments will allow the ISO too much discretion in developing the assumptions that will be used in the ISO's studies to determine reliability needs in the FLRR forward period. The CPUC contends that the tariff language would give the ISO open-ended discretion. The CPUC is concerned that the ISO will use this discretion to ignore the CPUC's decisions on input assumptions or replace the CPUC-adopted long-term resource planning assumptions with its own preferred assumptions or forecasts.[50] CMUA/TURN claim that the ISO's process for determining need is moving away from a collaborative process with the CPUC because the ISO disagrees with the analysis performed at the state level

[50] CPUC at 37-41.

and wants to make more conservative assumptions when assessing reliability needs.

At the outset, the ISO confirms that it remains committed to working collaboratively with the CPUC in the areas of resource adequacy and long-term planning, and to continuing to actively participate in the current proceedings related to these areas. The concerns of the CPUC and CMUA/TURN that the FLRR assessment will ignore or undercut CPUC decisions are not supported by the proposed tariff language. The FLRR assessment process is designed not to impinge on the CPUC's resource adequacy program and long-term planning process. In fact, proposed Tariff Section 44.3.1 expressly requires that the ISO consider the most recent CPUC standard planning assumptions in conducting its analysis. In addition, Section 44.3.1 calls the results of the assessments *advisory* system flexibility requirements.

The ISO's FLRR assessments will be performed for a different time period and for a different purpose than the CPUC's scenarios. The FLRR assessments will focus on the years in the FLRR forward period, which exist in the gap between the CPUC's one-year outlook for setting the resource adequacy requirement and the CPUC's eight- to ten-year outlook in the long-term procurement planning process. The FLRR assessments will forecast ISO system flexibility needs and the local capacity needs for operational purposes in the FLRR forward period. The assessment results will then be used to determine whether the forecasted fleet, without the resource requesting an FLRR designation, can supply the relevant system flexibility need or local capacity need to meet forecasted load, operating reserve, and ramping requirements for system energy. There is nothing in the FLRR process that suggests that either the inputs into the ISO's assessments or the study results will supplant or replace the CPUC's standing

planning assumptions used in the long-term procurement plan process.

3. The Determination of System Flexibility Requirements for the FLRR Forward Period Is Advisory

Several parties speculate that the ISO's assumptions, if different than the CPUC's, may affect other resources. In their joint protest, CMUA/TURN contend that the ISO's use of assumptions in assessing future reliability needs will undercut demand response and energy efficiency investment if meaningful reliance on these programs in demand forecasting cannot be achieved.[51] WPTF is concerned that if the ISO procures capacity using criteria inconsistent with the CPUC, market participants will have virtually no ability to make informed procurement and investment decisions, which will institutionalize the need for the FLRR mechanism to the detriment of competitive wholesale and retail markets.[52] SCE claims that the use of improper assumptions has the potential to create a subsidy to incumbent resources, thereby harming competition. SCE explains that, by offering a designation to existing resources, the ISO will cause the incumbent's costs of doing business to be lower, whereas new entrants will have to bear market risk that has been reduced, if not eliminated, for FLRR resources.[53]

The flaw in each argument is that it ignores the fact that the ISO's determination of the system flexibility requirement and the local reliability requirement during the FLRR forward period is only *advisory*. It is not intended to replace or supplant the CPUC long-term procurement plan. In addition, it should not harm competition from new resources because the eligibility of a resource to receive a designation includes a requirement that no new resource or transmission facility is projected by the ISO to be in operation by the

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[51] CMUA/TURN at 13-14.

[52] WPTF at 5.

[53] SCE at 5.

start of the year in which the resource will be needed that will meet the identified flexible capacity or local reliability need. It does not impose a must offer requirement on the designated resource to participate in the market or require to remain available during the designation year. If the designated resource does participate in the market, 90 percent of the monthly ISO net market revenues it receives and 100 percent of the monthly CPM or bilateral contractual capacity revenues will be netted from its payment.

E. The Process for Determining FLRR Designations Is Just and Reasonable

1. The Proposed Criteria for Determining Resource Eligibility for an FLRR Designation Are Reasonable and Sufficiently Detailed

Proposed Tariff Section 44.2.1 lists the criteria a resource must meet to be eligible to receive an FLRR designation. In brief, those criteria are: (1) the resource does not have a resource adequacy contract or obligation for all or part of the FLRR designation year or a subsequent year; (2) ISO technical assessments project the resource will first be needed for reliability during any year within the FLRR forward period; (3) the resource is projected to be unable to recover its going-forward costs during the designation year and will retire because it will be uneconomic to remain in service; (4) ISO assessments project no new resource or transmission facility will be in service to address the identified need; (5) the resource either submitted a conforming offer in at least one request for offers of resource adequacy capacity for which it was eligible for the requested FLRR designation year or submits sufficient justification why it did not submit such an offer; and (6) if the resource is an intertie resource, it must be either dynamically scheduled or be a pseudo-tie resource.

In its protest, NCPA claims that the eligibility criteria lack necessary detail about baseline assumptions regarding resource eligibility and the amount and characteristics

of flexible capacity that is currently available or projected to come on line. The ISO disagrees with NCPA.[54] The ISO has followed the Commission's rule of reason in drafting proposed Tariff Section 44.2.1.[55] That is the appropriate standard to apply in evaluating the extent to which rules, standards, and business practices should be included in tariff provisions rather than a business practice manual. That standard does not require that all rules, standards, and business practices be included in the tariff, but rather seeks a balance between allowing the utility sufficient flexibility to manage its affairs and the need for full disclosure.[56]

In prior cases, the Commission has applied its rule of reason to determine that the following documents need not be included in a Commission-approved tariff:

- Procedures from a business practice manual for requests for information and challenges to confidentiality designations;[57]
- Procedures to ensure that pass-through charges are not assessed to Load that does not use the transmission grid;[58]

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[54] NCPA at 10-12.

[55] As described in *Town of Easton v. Delmarva Power and Light Co. et al.*, 24 FERC ¶ 61,251 at 61,531 (1983), under the rule of reason the Commission "balance[s] [its] desire not to deprive utilities or groups of utilities of the flexibility they need to manage their own affairs by introducing substantial delay and layered decision-making into their operations . . . with the need for the full disclosure that furthers the purpose of having filing and posting requirements which provide real benefits to existing and potential customers or users of the services in question." In its Prior Notice and Filing Requirements Under Part II of the Federal Power Act, 64 FERC ¶ 61,139 at 61,988 (1993), the Commission adopted the description offered by the U.S. Court of Appeals for the District of Columbia Circuit in *City of Cleveland v. FERC*:

> [T]here is an infinitude of practices affecting rates and service. The statutory directive must reasonably be read to require the recitation of only those practices that affect rates and service significantly, that are realistically susceptible of specification, and that are not so generally understood in any contractual arrangement as to make recitation superfluous. It is obviously left to the Commission, within broad bounds of discretion, to give concrete application to this amorphous directive.

773 F.2d 1368, 1376 (D.C. Cir. 1985) (emphasis in original).

[56] "The Commission disagrees with parties arguing that all of a transmission provider's rules, standards, and practices should be incorporated into its OATT. We believe that requiring transmission providers to file all of their rules, standards and practices in their OATTs would be impractical and potentially administratively burdensome." Order No.890 at P 1651.

[57] *Midwest Indep. Transmission Sys. Operator, Inc.*, 113 FERC ¶ 61,081, at P 118 (2005)

- Criteria according to which the utility determined the availability of economy energy, the arrangement of sales of that energy, and the termination of such sales;[59] and

- Information that must be submitted by the owner of a resource seeking a capacity procurement mechanism risk of retirement designation from the ISO.[60]

The Commission has also rejected arguments that the ISO should be required to describe in the Tariff the supporting information for exercising the negotiated rate option for default energy bids, finding "that the criteria for this rate may require frequent updates in order to capture the potential change in costs or market conditions, and therefore, is best suited for inclusion in the business practice manual."[61]

The ISO believes that the level of detail included in proposed Section 44.2.1 is generally comparable to the Commission's prior application of the rule of reason. Baseline assumptions about the eligibility of a resource for an FLRR designation and the flexible characteristics of the existing fleet and future resources will change over time. It would be impractical and administratively burdensome for the ISO to modify the tariff each time it updates its assumptions. Further, the ISO will include further detail about the resource eligibility criteria in the business practice manual. Under ISO Tariff Section 22.11.1.6, any market participant that submits a proposed business practice manual revision may appeal the decision regarding the business practice manual to a business practice manual appeal committee. If dissatisfied with the decision of the committee, the party may further appeal to the ISO Board of Governors. If NCPA

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58 *Cal. Indep. Sys. Operator Corp.*, 95 FERC ¶ 61,195 (2001).

59 *Commonwealth Edison Co.*, 21 FERC ¶ 61,096 (1982).

60 *Cal. Indep. Sys. Operator Corp.*, 134 FERC ¶ 61,211, at P 134 (2011)

61 *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,313, at P 344.

believes that the ISO has not included sufficient information about resource eligibility criteria in the business practice manual, it may avail itself of this process.

PG&E and SCE suggest that proposed Section 44.2.1(5) be modified to require not only that the resource submit at least one offer in response to a request for offer, but that the offer also be competitive or made in good-faith.[62] PG&E is concerned that unless this modification is made, a resource could meet the requirement by simply providing a non-conforming bid. The ISO considered this suggestion during the stakeholder initiative and decided not to accept it. The ISO is concerned that evaluating whether an offer made in a bilateral, commercial transaction was competitive or made in good faith is so subjective that it would be very difficult to apply such a standard and would interject more controversy than benefit into the eligibility determination. The ISO believes that the currently proposed requirement for the resource to have submitted at least one offer is sufficient objective evidence that it had taken steps to obtain a capacity contract before requesting an FLRR designation.

PG&E also requests revision of the eligibility criteria to exclude the once-through-cooling resources scheduled for retirement or retrofit from eligibility to receive an FLRR designation. PG&E asserts that in these circumstances it does not make sense to provide compensation to the unit to keep it from retiring. The ISO has considered this point and agrees that some clarification of the tariff language is warranted. It is the ISO's intent that an FLRR designation be used to prevent *early* retirement of a once-through-cooling resource but not to extend the scheduled retirement date mandated by state law if retrofit is not undertaken. If directed by the Commission, the ISO will submit

62 PG&E at 7-8; SCE at 8.

a compliance filing to clarify that a once-through-cooling resource would be eligible to receive an FLRR designation if the identified need for the resource arises prior to its scheduled retirement date but that the ISO will not issue an FLRR designation to meet an identified need beyond the resource's scheduled retirement date or to retain the resource in service beyond the scheduled retirement date.

SCE requests that the eligibility criteria be revised in several respects: to limit eligibility to resources physically located within the ISO's balancing authority area; to require non-ISO resources to compete with other non-ISO resources to provide a market-based outcome for ISO imports; and to exclude dynamic resources and pseudo-ties from being eligible to receive an FLRR designation.[63]

The ISO declines to make these modifications. The changes SCE suggests, as the ISO understands them, conflict with each other – on one hand SCE recommends that eligibility for an FLRR designation be limited to internal ISO resources while on the other hand they seek to have non-ISO resources compete with other non-ISO resources. Further, the suggested modifications are not well-explained or supported. It is also possible that a dynamic resource or pseudo-tie could be needed to meet future flexibility needs.

2. The Proposed Process for Assessing Requests for an FLRR Designation Is Reasonable and Transparent

In its protest, Calpine claims that the proposed FLRR designation process lacks a definite schedule and end-date for the ISO's determination of whether to issue the requested designation. Calpine is concerned that a resource may in effect be treading water without the needed financial lifeline for a number of months into the FLRR

63 SCE at 7-8.

designation year. Calpine suggests that the designation process is a "practice" that significantly affects the feasibility of FLRR participation and that the schedule or timeline for completing each step in the process must be set forth in the ISO tariff, not in the business practice manual as the ISO proposes.[64]

Calpine's claim is misplaced. As discussed above, the ISO has followed the rule of reason in drafting the proposed tariff language with sufficient context for the steps and order of the process to be fully disclosed without imposing definitive dates to complete each step, which if missed would be a technical violation of the tariff. The ISO intends to follow the schedule outlined in the draft final proposal and include it in the business practice manual, but needs some flexibility in the schedule to accommodate the unique circumstances that will undoubtedly arise in processing each individual request without triggering a tariff violation.

Calpine claims that the FLRR designation process is excessively complex. It disagrees with the ISO that the extended stakeholder process is analogous to the ISO's transmission planning process. According to Calpine, the transmission planning process tends to weed out, rather than select, economically high-risk projects, and the transmission provider does not invest substantial resources prior to project approval.[65] Calpine misunderstands the analogy the ISO was making in the transmittal letter between the transmission planning process and the FLRR designation process. The ISO was not referring to the substance of the matters to be considered in the process. Rather, the ISO was identifying the similarities between the transparency, development and discussion of study assumptions and results, process steps, and ample opportunity

[64] Calpine at 14-18.

[65] Calpine at 18-19.

for input that both processes afford stakeholders. That open dialog with stakeholders has been successful in the transmission planning process, and the ISO expects the same outcome with the FLRR designation process.

Calpine further argues that the Commission should reject the proposed review of the economic viability of the applicant resource by the independent evaluator. In Calpine's view, the independent evaluator's unchecked authority to second-guess an officer's certification of economic viability is unjust and unreasonable.[66] The ISO does not share Calpine's view. While the ISO appreciates the importance of an officer's certification, the ISO believes that it is nonetheless necessary for the ISO, through the independent evaluator, to conduct reasonable due diligence to confirm that there are evidentiary records and financial projections that support the inability of the resource to recover its going-forward costs and its decision to retire.

NRG/Dynegy claim that the FLRR rules require a generator submitting an FLRR request to divulge a complete picture of the resource's expenses and operational characteristics to full public view. According to NRG/Dynegy, disclosing this competitively sensitive information would harm the generator and the market. [67]

Proposed Section 44.2.2.2 requires the owner of the resource requesting an FLRR designation to provide financial information specified in the business practice manual to the ISO and the ISO's Department of Market Monitoring as part of its designation request. Proposed Section 44.2.3 requires the resource owner to make available to the ISO, the Department of Market Monitoring, and the independent evaluator, financial information regarding the expected going-forward costs and revenue

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66 Calpine at 19-21.

67 NRG/Dynegy at 26-27; Stoddard Affidavit at PP. 39-40.

streams for the resource, and any subsequent information or documentation that the ISO, the Department of Market Monitoring, or the independent evaluator requests. There is no language in these provisions that requires public disclosure of such information. The ISO will treat any confidential information it receives under these provisions consistent with the requirements of Tariff Section 20.

NRG/Dynegy additionally claim that the requirement that the resource owner commit to retiring the resource in order to receive an FLRR designation will discourage participation in the FLRR.[68] NRG/Dynegy support this claim only with a concern that committing to retirement will foreclose options if circumstances may change.

The ISO designed the FLRR mechanism to limit eligibility for a designation to only those resources that are truly uneconomic. The Commission-approved capacity procurement mechanism's risk of retirement provision, also includes as an eligibility requirement that it is not economic for the resource to remain in service the following year. Further, if the resource owner believes that circumstances could change radically enough to reverse the resource's financial plight or that other options may still be available, then it may be premature for that resource to seek an FLRR designation. The FLRR designation is an avenue of last resort.

NCPA is concerned that the FLRR provisions lack detail about the information that a potentially retiring resource must provide to demonstrate that it is no longer financially viable and proposed Section 44.2.3 states that a resource seeking an FLRR designation must supply financial information and documentation listed in a business

[68] NRG/Dynegy at 26-27; Stoddard Affidavit at PP. 39-40.

practice manual that does not yet exist.[69] As the ISO explained above, it is appropriate and consistent with the rule of reason to include in the business practice manual specifics about the documents and financial information that a resource must provide in support of a request for an FLRR designation. Although the ISO has not yet submitted the business practice manual modifications attendant to the FLRR mechanism into the ISO's business practice manual change management process, NCPA and other market participants can participate in that process so that the ISO can consider their concerns and suggestions about document and data details.

3. An FLRR Resource Should Not Be Subject to Performance Obligations During the Designation Year

Six Cities and CMUA/TURN protest the absence of a requirement that the resource receiving an FLRR designation must participate in the ISO's markets during the designation year or have an obligation to remain in service and available through the year in which the need occurs. These parties are concerned that a resource could receive compensation under the FLRR designation and then retire before it is actually needed. The parties recommend that the Commission direct the ISO to modify its proposed tariff language to impose a performance obligation in order that the load serving entities that pay the costs receive actual value for their payments.[70]

SCE objects to the FLRR proposal on similar grounds. SCE contends that it is unjust and unreasonable to make payments to a designated resource without imposing appropriate requirements for performance. SCE contends that if a unit is not required to perform the function for which the designation is issued, then the ISO cannot be certain

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[69] NCPA at 12.

[70] CMUA/TURN at14-15; Six Cities at 11.

that the unit will be available to perform when and how required. To prevent an unjust and unreasonable outcome, SCE offers several possible solutions: (1) require the designated resource to provide assurance for performance in the year of need; (2) provide the ISO a unilateral right, once a resource has accepted an initial designation, to renew the designation for subsequent years until reaching the year of need; and (3) require the resource to forfeit all previous payments if it refuses a future designation request. SCE contends that forfeiture upon non-performance or refusal is just and reasonable because it implies that the generator planned to retire anyway or is competitive in the market, neither of which warrant FLRR compensation.[71]

PG&E does not argue in favor of a performance obligation. Instead it argues that units whose going-forward costs are calculated to be above $24/kW-year should hold the same must-offer obligation as resource adequacy resources.[72] PG&E points out that this $24 figure, which it refers to as the "guardrail price," is the median price paid for capacity in California, as reflected in a CPUC report. PG&E argues that if a FLRR unit receives the compensation a unit receives for capacity, the unit in turn should have an obligation to provide capacity.

The ISO does not support the imposition of performance obligations on FLRR resources. The critical factor justifying this position is that, under the FLRR mechanism, the ISO is neither reserving nor paying for capacity. The sole purpose of an FLRR designation is to ensure that resources that the ISO determines are needed to meet certain reliability needs within the FLRR forward period and that are otherwise at risk of retirement will remain available for another year and do not retire. Because the ISO is

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[71] SCE at 3-7.

[72] PG&E at 5-6.

only providing a limited financial lifeline and not procuring a capacity product, it is not appropriate to impose on the designated resource any performance obligations or must-offer requirements in the ISO markets. For the same reason, it is not appropriate to compel the resource to remain available beyond the designation year, and possibly for multiple years into the future, until the year it is needed. Resources receiving an FLRR designation will be under no additional obligations following the conclusion of the designation year. The resource must, however, submit bids in response to any request for offers for capacity issued under resource adequacy and long-term procurement planning requirements for which it is eligible.

For several reasons, PG&E's suggestion should similarly be rejected. Importantly, PG&E ignores the fundamental purpose of the FLRR provision – ensuring that the needed resource at risk of retirement earns sufficient revenues to cover its going-forward costs so it can remain viable. Setting the FLRR price at the median resource adequacy price would not ensure that outcome. There is no guarantee that a single price applicable to the resource fleet will be sufficient for any particular at-risk resource to cover its going-forward costs. Cost recovery is a generator-specific matter; it cannot be absolutely addressed by a generic slide rule calculation. In this instance, one size does not fit all. Finally, a hybrid approach, where some FLRR units would have a must-offer obligation and some would not, would require significant additional alterations to the ISO proposal. For example, the ISO would have to revisit how to apply the net market revenue offset for FLRR units that hold a must-offer obligation. The ISO does not believe that PG&E's concern justifies a fundamental shift in the ISO proposal.

F. The ISO's Proposed Individualized Going-Forward Fixed Costs Compensation Methodology Is Just and Reasonable and Not Unduly Discriminatory

Calpine, NRG/Dynegy, WPTF, SCE, and PG&E all protest or comment on the ISO's proposed compensation methodology. Calpine, NRG/Dynegy, and WPTF argue that the individualized compensation approach will be too protracted in application and that the proposed methodology will yield inappropriately low compensation. SCE, on the other hand, expresses concerns regarding over-recovery of costs. SCE identifies what it considers to be a potential market gaming opportunity with the compensation methodology and identifies several other ways in which a generator receiving an FLRR designation could receive undue compensation. PG&E, Calpine, NRG/Dynegy, and WPTF offer several proposed clarifications regarding the specific costs that the independent evaluator must take into account. While some of these comments warrant additional clarification from the ISO, none of them raises legitimate questions regarding the fundamentally just and reasonable nature of the ISO's proposed compensation methodology. The FLRR mechanism serves a specific purpose and the compensation provides targeted cost recovery for the costs incurred from meeting that purpose.

1. The Process for Determining FLRR Compensation Is Appropriate and Does Not Abrogate Commission Authority

a. The Timeline for Determining Compensation Is as Streamlined as Practicable

Calpine, NRG/Dynegy, and WPTF argue that the process for determining a specific resource's FLRR compensation will be too protracted, which in turn will create a range of alleged harm. Calpine and WPTF argue that because the process could extend into the FLRR designation year, the unit owner will face substantial risk as to

whether it will receive an amount that it believes would justify continued operations.[73] WPTF claims that this degree of uncertainty runs counter to the objective of preventing resource retirements.[74] To remedy this problem, Calpine argues that the Commission should direct the ISO to include in the tariff a predetermined administrative price rather than authorize unit-specific rate filings.

One of the foundational decisions that the ISO reached in developing the FLRR proposal was that units would receive an individually-calculated cost-based payment, rather than a one-size-fits-all administrative price. Through the stakeholder process, the ISO considered the possibility of using an administrative price. The ISO ultimately concluded, however, that an individualized payment was more appropriate because unlike, *e.g.*, the capacity procurement mechanism, the ISO is not procuring a product that carries with it standardized responsibilities and obligations. As explained multiple times throughout the FLRR transmittal letter, an FLRR unit has no must-offer obligation in the ISO's energy, ancillary services, or residual unit capacity markets. For that reason, there is less justification for creating a standardized level of compensation. Moreover, a standardized price could lead to a default capacity price floor, which could undermine the existing bilateral capacity market and result in higher resource adequacy costs. Finally, units at risk of retirement would not all have the same costs or need the same level of revenues to avoid retirement. An administrative price could thus lead either to over- or under-compensation, depending on a unit's financial situation.

In arguing against the cost-based approach, Calpine, NRG/Dynegy, and WPTF do nothing but state the obvious in noting that it will be faster to use an administrative

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[73] Calpine at 21-26.

[74] WPTF at 6-7.

price than to make individualized calculations. The convenience of having a pre-determined price is, of course, a benefit, but that benefit must be weighed against the greater benefits of pursuing a unit-specific cost-based approach. Merely pointing out one drawback of the ISO proposal does nothing to establish that the ISO proposal is unjust and unreasonable.

It would be remarkable for the Commission to find that cost-based compensation was unjust and unreasonable and order it replaced with a one-size-fits-all payment that bears no direct relationship to the costs incurred. Yet that is precisely what Calpine, NRG/Dynegy, and WPTF would have the Commission do. The sole purpose of the FLRR mechanism is to keep a unit financially afloat until it is needed for system flexibility or local reliability. As each unit receiving an FLRR designation will face different cost structures and varying financial responsibilities, the optimal approach is a unit-specific cost calculation. In the end, because the FLRR is such a narrowly-tailored garment, a one-size payment could never possibly fit all units equally.

b. The Process for Posting Security Does Not Expose Generators to Unreasonable Risk

Calpine and NRG/Dynegy argue that the process surrounding the required posting of security creates too much risk and uncertainty. Under the ISO proposal, a unit receiving an FLRR designation must post security in the amount of the anticipated FLRR payments for the one-year designation term. If the unit retires during that designation term, then the security is forfeited. Calpine characterizes this as posing an unlimited risk of security forfeiture and claims it is unjust and unreasonable. According to Calpine, a generator should receive its security deposit back if the final approved compensation is deemed insufficient by the generator for going-forward operations or if

there are materially changed circumstances that make retirement necessary in the designation year.[75] Additionally, Calpine argues that the amount of the deposit that is forfeited should be pro-rated to exclude going-forward costs that already were incurred in that designation year.[76] NRG/Dynegy claim that the ISO would require an FLRR-designated unit to pay back any revenues received if the resource retires prior to the end of what it claims is the five-year designation term. According to NRG/Dynegy, this inflates the risk profile of accepting an FLRR designation, effectively rendering the program an unacceptably risky proposition for a resource.[77]

In considering any claims about the risks of FLRR, a critical factor to consider is that it is the resource that seeks an FLRR designation and a resource's acceptance of an FLRR designation is purely voluntary. Under the proposal, the ISO cannot force an FLRR designation on a unit. For that reason, if a unit finds the procedures too risky, it simply can choose not to seek or accept a designation. That issue aside, the posting of security is a simple and important safeguard in the FLRR proposal. Without it, the unit owner simply could pocket the money and immediately retire. The security requirement is an important safeguard to keep the unit from retiring during its designation period.

Framing the posting requirement as holding unlimited risk or holding the risk of losing five years' worth of market payments misrepresents the ISO proposal. Under proposed Section 44.8, there is limited risk of losing one year (not five) of FLRR payments held as security. Furthermore, terming this as a "risk" is itself misleading, as the unit owner is entirely in control of whether or not it retires.

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75 Calpine at 37-38.

76 Calpine at 37-38.

77 NRG/Dynegy at 25.

If the security were forfeited, the ISO does not view pro-rating the forfeiture as appropriate because of the nature of the FLRR designation. Where a resource is contracted to provide a service for a defined period of time and only performs for part of that time, some type of pro-rated payment may be reasonable. Because an FLRR-designated unit is not providing a service, however, that same logic does not apply.

The intent of the ISO proposal is to reach a set level of FLRR compensation prospectively. For that reason, the ISO views the possibility of deviations between the projected going-forward costs calculated by the independent evaluator and the actual going-forward costs incurred by the unit as an inherent part of the proposal. The possibility of such a deviation is an issue that a unit owner must weigh as it considers whether or not to accept an FLRR designation. For that reason, the ISO does not believe that changed circumstances would justify return of the posted security if a unit were to retire mid-designation. The ISO does note, however, that a unit owner may request a tariff waiver from the Commission if it believes it has a unique circumstance that could not have been foreseen at the time the independent evaluator made its cost assessment.

c. The Use of the Independent Evaluator Represents a Reasonable Approach to Determining Costs and Does Not Represent Delegation of Commission Authority or Waiver of Generators' Right To Seek Commission Redress

Under the ISO proposal, once the independent evaluator provides its calculation of the compensation that would be due to a unit if it were to receive an FLRR designation, the unit owner must then decide whether to accept the designation (and the stated compensation). Both Calpine and WPTF argue that because a unit owner must either accept or reject the independent evaluator's calculation, the ISO's proposal

requires a unit owner to waive its rights under section 205 of the Federal Power Act. Calpine claims that such approval of this procedure vests impermissible authority in the independent evaluator and that neither the ISO nor the Commission can require suppliers to waive their Section 205 filing rights.[78] Additionally, because the independent evaluator would have authority under proposed Tariff Section 44.11.1(11) to allow recovery of "other costs . . . that would not otherwise be incurred if the resource were retired," Calpine asserts that the ISO proposal would involve impermissible delegation of Commission authority to the independent evaluator.[79] WPTF asserts that a resource owner must have the ability to challenge an unreasonable revenue limit imposed by the independent evaluator.[80] At the same time, WPTF claims that if such ability were granted, then the timeline for receiving finality as to FLRR compensation would be extended further.

The allegation that the ISO is forcing generators to waive their rights under the Federal Power Act simply is not borne out by the details of the ISO proposal. Proposed Section 44.2.2.2(4) provides that a unit voluntarily accepting an FLRR designation must agree that it will file going-forward costs not to exceed the costs determined by the independent evaluator. In no meaningful way does this provision constitute a waiver of Federal Power Act rights. Again, an FLRR designation is voluntary and initiated at the request of a generator. All proposed Section 44.2.2.2(4) does is commit a unit that voluntarily accepts an FLRR designation to also accept the tariff-defined compensation methodology. There is no right to be paid a different rate for an ISO tariff-defined status

78 Calpine at 26-27.

79 Calpine at 36-37.

80 WPTF at 5, 8-9.

than that specified under the ISO tariff. That the ISO proposes to rely upon an independent evaluator to determine the compensation offered does not change that fact. The ISO does not have a core competency to evaluate the cost structure of individual generating units, whereas there are outside consultants and experts who do hold that expertise. The use of the term "independent evaluator" in the proposed tariff language merely represents a commitment by the ISO that the costs will be calculated by personnel holding special expertise in that area. Further, the ISO's reliance on the independent evaluator is comparable to a purchase-price cap in which the ISO will not procure a specific product if the price exceeds a specified level. This is an internal mechanism that will help ensure that the ISO will not be required to pay excessive prices for FLRR.

If a unit seeking an FLRR designation believes that the independent evaluator misapplied the terms of Section 44.11.1 by excluding costs defined in the tariff, then nothing in the ISO proposal would purport to bar that generator from raising an allegation through a Commission complaint that there was a misapplication of the tariff provisions. The section 205 argument is comparable to arguing that a resource that has accepted a capacity procurement mechanism designation should be permitted to receive a rate different than the capacity procument mechanism rate established in the tariff. Obviously, there is no such right.[81] Similarly, a resource they should not have a right to base is FLRR rate on a formula different from that established in the tariff. To

[81] *El Segundo Power, LLC,* 91 FERC ¶ 61,110 at 61,390 (2000) (rejecting a single generator's attempt to file a tariff under Section 205 of the Federal Power Act that would alter the terms of payments that the generator would receive under the ISO tariff for a defined service).

the extent a resource owner wishes to receive a cost-of-service-based rate outside the confines of the FLRR designation, it are free to file such a rate with the Commission.

The ISO is confused by Calpine's specific objection to the "other costs" provision of proposed Section 44.11.1(11). The purpose of proposed Section 44.11.1 is to capture a unit's going-forward costs during the period of designation that would not be incurred if the unit were to retire. Granting the independent evaluator the authority to consider costs meeting that principle seems entirely appropriate due to the wide range of commercial arrangements that are in place with different generators. Failing to include this authority would almost certainly result in the failure of units to recover all appropriate costs under the FLRR mechanism.

2. The ISO Proposal Provides Adequate Cost Recovery for the Obligations Corresponding to Acceptance of an FLRR Designation

WPTF, Calpine, and NRG/Dynegy all argue in one form or another that the specifics of the proposed going-forward costs methodology do not provide adequate opportunity for cost recovery. The ISO disagrees with these contentions.

a. The Net Market Revenue Offset Is an Appropriate Part of the Overall Compensation Methodology

Calpine and NRG/Dynegy both object to the ISO's proposal to offset 90 per cent of net market revenue from units during the term of their FLRR designation, arguing that doing so fails to create proper market incentives for units needed for reliability.[82] NRG/Dynegy additionally argue that the ISO proposal is inconsistent with deactivation

[82] Calpine at 38-39; NRG/Dynegy at 21-22, Stoddard Aff. at P 44.

avoidable cost credit under the tariff of PJM Interconnection, which provides a fixed cost recovery adder that the FLRR proposal does not contain.[83]

In its transmittal letter, the ISO explained that its proposal is modeled on PJM' Interconnection's deactivation avoidable cost credit and contains many similar provisions.[84] The instant proposal is not, however, meant to recreate that mechanism, which was designed to address PJM Interconnection's own unique circumstances. In particular, the resources that receive deactivation avoidable cost credit payments are needed for reliability in the year of designation and must remain available at least until they are no longer needed. FLRR resources, on the other hand, are not needed for flexibility or local reliability needs at the time of designation and are not required to remain available after the designation expires even if they may still be needed in future years. Thus, highlighting a point of distinction between the FLRR mechanism and the deactivation avoidable cost credit is an interesting but irrelevant exercise without providing the critical context. As explained in the transmittal letter, the FLRR proposal is meant to cover a more limited range of investment expenses than PJM Interconnection's mechanism[85] and the FLRR proposal permits retention of a portion of market revenues.[86]

b. The Cap on Annualized Maintenance Cost Recovery Is an Important Safeguard

The ISO proposal would cap annualized major maintenance project investment costs at $2 million for projects initiated after the FLRR designation. WPTF, Calpine, and

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83 NRG/Dynegy at 21-22, Stoddard Aff. at P 44.

84 Transmittal letter at 29.

85 Transmittal letter at 31.

86 Transmittal letter at 33.

NRG/Dynegy assert that this ceiling on recovery is inappropriate and creates the risk of insufficient compensation.[87] They argue that the ISO did not provide a sufficient basis to justify the $2 million figure.[88] NRG/Dynegy states that any analogy to the Commission-approved $2 million cap included in PJM's deactivation avoidable cost credit is inapposite because "[i]n PJM, the investment cap only applies to generators seeking the [deactivation avoidable cost credit]."[89] In the PJM Interconnection, units have alternatives, such as filing "a full cost of service rate at the Commission."[90] These parties also argue that the $2 million amount is inappropriately low. NRG/Dynegy states that major maintenance costs for a large generator can run into the tens of millions of dollars.[91]

The purpose of the limitation on investment return is consistent with the limited scope of the FLRR compensation.[92] Without a cap, a resource would have the incentive both to delay an expensive maintenance project until the designation period and to initiate a non-urgent maintenance project during the FLRR designation period so as to receive guaranteed recovery of the annualized cost of that investment. To prevent such incentive, the ISO found it prudent to create a limitation on such recovery. As NRG/Dynegy correctly points out, the ISO drew the $2 million cap from PJM Interconnection's Commission-approved tariff. The ISO proposed this figure during the

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87 WPTF at 5, 8-9.

88 Calpine at 34-35; WPTF at 7-8; NRG/Dynegy at 22-25.

89 NRG/Dynegy at 23.

90 *Id.*

91 NRG/Dynegy at 22-25.

92 As discussed above, the limited scope is driven by the fact that an FLRR unit is not needed for reliability during the period of designation, the unit has no obligation to remain available after the designation, and the units hold no must-offer obligation.

stakeholder process and no evidence was presented during that process to suggest that the maintenance costs of existing resources in the ISO's footprint differ in any substantial way from those for such resources in the PJM Interconnection. Again, the FLRR mechanism is wholly voluntary. If a unit wants a cost-of-service-based rate, then it can request it from the Commission but that does not entitle the unit to a FLRR designation.

NRG/Dynegy's comment that units have no alternatives to the FLRR mechanism ignores the nature of the FLRR mechanism. As explained above, the FLRR proposal does not require a resource to accept a designation. The FLRR mechanism offers uneconomic resources an opportunity to avoid retirement. Because accepting an FLRR designation is optional, the proposal does not need to offer alternatives.

c. The Amortization Schedule Appropriately Extends to the Life of the Investment

In addition to objecting to the $2 million cap itself, WPTF and Calpine object to the amortization schedule. Both suggest that the amortization should not extend beyond the FLRR designation period. According to WPTF, it would be economically irrational for a resource facing a retirement decision to invest in a facility with no assurance of recovery beyond the designation period.[93] Calpine states that failing to amortize the costs over the expected FLRR term would unreasonably defer cost recovery to future years.[94]

The ISO's rationale for amortizing the project cost over the useful life of the project is simple. A major maintenance project would provide benefit to a resource for

[93] WPTF at 7-8.

[94] Calpine at 35.

many years. In those later years, when the resource is needed for reliability purposes, it will almost certainly have a resource adequacy contract and will have the ability to pay the proportional cost of the project through those revenues. Permitting the resource to recover the full cost of the investment during the FLRR designation period, on the other hand, would go beyond providing going-forward costs and would provide the resource an unwarranted windfall.

3. The FLRR Mechanism Is Distinguishable from the Capacity Procurement Mechanism, Thus Justifying Differing Compensation Methodologies

Calpine, NRG/Dynegy, and WPTF all question why FLRR compensation should differ from capacity procurement mechanism compensation and claim that it is unjust and unreasonable and unduly discriminatory to offer differing levels of compensation.[95] According to NRG/Dynegy, the alleged decrease in compensation relative to a capacity procurement mechanism designation would be counterproductive because it likely would decrease the willingness of generators to provide capacity.[96] Calpine disagrees with the ISO rationale that FLRR is different from the capacity procurement mechanism by virtue of it being a financial "lifeline" to keep existing generators from retiring.[97] In Calpine's view, an FLRR-designated resource that remains available until the year when it is "needed" is providing reliability services no less than a capacity procurement mechanism-designated resource. To Calpine, the only distinction between FLRR and the capacity procurement mechanism is the timing of when the ISO determines that it

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[95] Calpine at 27-33; NRG/Dynegy at 21; WTPF at 4-5.

[96] NRG/Dynegy at 21.

[97] Calpine at 27-28.

needs the resource and Calpine finds this distinction non-compelling.[98] In Calpine's view, the lack of a must-offer obligation for FLRR resources is not a meaningful point of distinction because the lack of a must-offer obligation does not transform the nature of reliability services sought or obtained by the ISO under the FLRR mechanism.[99]

The comparison to the capacity procurement mechanism is disingenuous. There are fundamental differences between the FLRR mechanism and the capacity procurement mechanism. An FLRR-designated resource is not providing capacity. Instead, such a unit is being provided a financial life-line. The absence of a must-offer requirement is a critical point of distinction that marks a dramatic point of distinction between the two mechanisms. Resources procured under the capacity procurement mechanism are subject to all the availability requirements of Section 40.6 of the ISO tariff, which includes requirements to submit energy bids for all of the CPM capacity and for all ancillary services for which the capacity is certified in all hours the resource is physically capable of operating. These resources are also required to submit ancillary services bids for all ancillary services the resource is certified to provide. These bids must be submitted to both the day-ahead market and, for short-start units, to the real-time market. This is a significantly greater obligation than what would be imposed on a resource designated under the FLRR mechanism. These greater obligations are driven by the different purposes of the capacity procurement mechanism. The FLRR mechanism is for a resource that is not needed now but may be needed in several years, whereas the capacity procurement mechanism risk of retirement provision is for a

98 Calpine at 28-29.

99 Calpine at 31-33.

resource the need for which is imminent. It would be counterintuitive to pay a unit that is not needed now the same compensation as a unit that is.

4. The ISO Proposal Does Not Pose Risk of Excessive Cost Recovery for FLRR Units

In its comments, SCE expresses several concerns regarding potential over-recovery of costs by FLRR-designated resources. Under the ISO proposal, FLRR payments will be offset by any additional resource adequacy contract revenue earned during the period of designation. While SCE does not expressly object to the principle of a resource adequacy revenue offset, it is concerned about what it sees as a potential gaming opportunity.[100] Specifically, it notes that an FLRR unit could sell resource adequacy capacity to an affiliate at a below-market price. The unit would still receive cost recovery through the FLRR payment and its affiliate would receive artificially inexpensive resource adequacy capacity. To remedy this circumstance, SCE suggests that the ISO should develop a market-based proxy for payments made via affiliate or non-arm's length transactions.

The ISO proposal permits recovery of interest on debt incurred prior to receiving an FLRR designation. SCE also requests limiting this recovery to incremental debt incurred solely for the purpose of continued operations. SCE views this as necessary to prevent recovery of debt that was incurred unnecessarily immediately prior to a request for a designation for the sole purpose of recovering it through the FLRR mechanism once designated.[101] SCE also comments that the FLRR payments should be pro-rated

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100 SCE at 9.

101 SCE at 9.

for the period the unit is under contract.[102] As SCE views the ISO proposal, a unit will only be under contract for nine months but will receive 12 months of cost recovery.

In response to SCE's general concern about affiliate transactions, the ISO notes that proposed Section 44.11.3 calculates the net market revenues based on default energy bids rather than actual bids. Regarding the specific concern about below-market resource adequacy sales, the ISO believes that such a concern is more appropriately addressed by the CPUC, which has authority over such contracts. Proposed Section 44.11.1(9) allows for recovery of interest on debts incurred before the FLRR designation. Notably, this is limited to the interest and does not extend to the principal. For that reason, the ISO does not believe there is excessive reason for concern that a unit would incur a debt immediately prior to an FLRR request for the sole purpose of recovering it through the FLRR mechanism once designated. Finally, SCE's concern about over-payment is misplaced. The intent of the FLRR mechanism is to cover a full year of expenses because the designation involves the resource not retiring in the year.

5. The ISO's Proposal Is Sufficiently Clear Regarding Costs that Are Eligible and Ineligible for Recovery

Several commenters requested greater clarity regarding the specific costs that the independent evaluator would and would not consider in the cost calculations. PG&E expresses general concern regarding whether the listed recoverable costs comprise the only acceptable costs. Calpine, NRG/Dynegy, and WPTF seek clarification as to the recoverability of certain specific costs.

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[102] SCE at 10.

a. The Enumerated List of Recoverable Costs in Section 44.11.1 Comprises the Only Recoverable Costs

While not expressing a view on whether the methodology will necessarily lead to over- or under-recovery, PG&E expresses concern in its comments that proposed Section 44.11.1 is not sufficiently clear.[103] Proposed Section 44.11.1 lists the costs that are recoverable through the FLRR mechanism as going-forward costs; the section does not explicitly identify costs that are not recoverable. PG&E believes that the tariff should identify explicitly those costs that do not qualify as going-forward costs and should make clear that only major maintenance projects needed to keep an FLRR resource operational during the FLRR designation year will be considered recoverable.

With the exception of proposed Section 44.11.1(11), the items listed in proposed section 44.11.1 are meant to comprise the only recoverable costs. Any cost not identified is not recoverable. An attempt to identify all nonrecoverable costs would undoubtedly miss some such costs and lead to ambiguity. The ISO notes that costs listed in its proposed tariff are similar to what PJM and MISO included in their respective Commission-approved tariffs. The Commission found these other tariffs to have sufficient specificity. There is no reason for a different conclusion here.

b. Costs of Posting Security Are Recoverable

Aside from objections to the fact that FLRR units must post security, two parties object to the lack of cost recovery for the costs associated with posting the required security. NRG/Dynegy believe that the costs of posting security could be covered under proposed Section 44.11.1(11), but that would be a discretionary decision left to the

[103] PG&E at 6-7 and Appendix.

independent evaluator.[104] WPTF raises a similar concern, stating that the cost to provide the financial security should be recoverable in the determination of the resource's compensation.[105]

If a resource owner can demonstrate that it incurred costs associated with posting security, then the independent evaluator could consider it under proposed Section 44.11.1(11). The specific costs, however, would have to be reviewed and considered in the appropriate context. Reimbursing the resource for the amount of the security itself, however, would never be appropriate because doing so effectively would nullify the requirement to post security.

c. The Contract Value of Variable Costs Does Not Represent a Cap on Recovery

Calpine states that the proposed tariff provisions should clarify that a resource is allowed to recover its actual costs, even if such amounts exceed stated contract costs.[106] Calpine's concern relates to the circumstance where a variable operating cost is included in a multi-year contract, even though the actual cost incurred may vary from the contractually stated cost.

The intent of FLRR mechanism is to compensate a unit for its anticipated going-forward costs. For that reason, cost recovery should not automatically be limited to a contractually-stated value if that contract value would not represent the actual costs. The ISO believes this is the natural reading of the proposed tariff language. The independent evaluator would be free to consider evidence that a contract value does not represent the actual costs.

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104 NRG/Dynegy at 25-26.

105 WPTF at 8.

106 Calpine at 36.

d. Environmental Permitting Costs are Recoverable

Calpine states that the ISO should clarify that recovery is allowed for environmental permitting expenses.[107] Additionally, it contends that environmental and efficiency upgrade costs should also be included in the allowable compensation.[108]

Under the proposal, both types of costs are recoverable if they otherwise meet the requirements for recovery. Environmental permitting costs are mentioned explicitly is proposed Section 44.11.1(5). Environmental and efficiency upgrade costs would be covered under proposed Section 44.11.1(8).

e. The Independent Evaluator Will Determine Whether Debt Service Costs Are Recoverable

Calpine requests that the ISO clarify what it means to say that interest on debt that "could have been avoided by retirement" is recoverable, as stated in proposed Section 44.11.1(9).[109] Calpine expresses concern that there is no standard for determining which debts could be avoided by retirement. While the ISO understands Calpine's desire for certainty, this is inherently a fact-specific matter that will be left for the independent evaluator to assess.

G. The Proposed Allocation of the FLRR Cost Is Consistent with Cost Causation Principles

The ISO proposes to allocate the cost of FLRR designations to load-serving entities in the TAC area in which the need for the FLRR designation arose, based on the ratio of metered demand of each load-serving entity to total metered demand in the TAC area. Because the flexible capacity needs are system-wide, the ISO will allocate

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107 Calpine at 37.

108 Calpine at 37.

109 Calpine at 36.

the cost to all TAC areas. For local reliability needs, the ISO will allocate the costs to the specific TAC area with the local reliability need. Several parties object to the ISO's proposal as inconsistent with cost allocation principles. The objections are misplaced.

1. The Proposed Allocation of the FLRR Costs Based on Future Benefits Is Consistent with Cost Causation Principles.

Some parties contend many load-serving entities have planned their resource portfolios to minimize the need for flexibility and to include the resources that are necessary to provide flexibility and should bear less of the costs for this reason.[110] The premise of all these arguments is that cost causation requires the allocation of costs to those that create the need for the cost incurrence. This is not the case. Cost causation principles require the allocation of costs *either* to those that create the need for the incurrence of the cost *or* those that benefit from the expenditure. The Commission has described "cost causation and received benefits as alternate means of expressing the same concept."[111] As the Seventh Circuit has explained, the Commission's duty is to "compar[e] the costs assessed against a party to the burdens imposed *or* benefits drawn by that party."[112]

The cases cited by Six Cities are not to the contrary. In *KN Energy v. FERC*, [113] after setting out the cost causation principle in terms of rates reflecting the costs caused by a customer, the D.C. Circuit approved a cost-spreading allocation based on allocating costs to those that benefit:

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110 *See* CMUA/TURN at 8-10; NCPA at 13; Six Cities at 9. SWP makes similar arguments, but states that the proposed cost allocation is acceptable if the FLRR mechanism is truly an interim measure. SWP at 17-18. The sunset provision guarantees the interim nature of the FLRR mechanism.

111 *Cal. Indep. Sys. Operator Corp.,* 103 FERC ¶ 61,114 (2003) at P 26.

112 *Ill. Commerce Comm'n v. FERC, 576 F.3d 470, 476 (7th Cir. 2009)* (emphasis added).

113 968 F.2d 1295 (D.C. Cir. 1992).

> [T]he benefit principle may simply prove to be another prism through which to view the question of cost causation — one that admittedly extends the chain of causation further than [the Commission] has done traditionally. That is, rather than focusing us on the most immediate and proximate cause of the cost incurred, the benefit principle may only ask us to look at a host of contributing causes for the cost incurred (as ascertained by a review of those who benefit from the incurrence of the cost) and assign them liability too. Simply, it may be a proxy for an extension of the chain of causation.[114]

The formulation in the other two cases cited by Six Cities, "[C]osts should be recovered in the rates of those customers that utilize the facilities and thus cause the cost to be incurred,"[115] is as much a description of the benefits approach to cost causation as a cost-incurrence approach. This formulation describes the conclusion of the Commission in the ISO transmission access charge proceeding, where the Commission approved a cost allocation based on demand, *i.e.,* usage, despite arguments that the transmission facilities were planned for, and thus caused by, peak demand.[116]

2. Allocating the Costs of FLRR Designations Based on Benefits Is Preferable to Allocation Based on Responsibility for the Creation of the Need

In developing its proposal, the ISO concluded that a benefits-based allocation was preferable to a "cause"-based allocation because of the difficulty in assigning responsibility for the creation of the need to make a designation. Six Cities and CMUA/TURN argue that this reasoning is improper, citing the court's statement in *Illinois Commerce Commission v. FERC* that "figuring out who benefits from a new

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114 *Id.* at 1302.

115 *Mansfield Muni. Elec. Co. v. New England Power Co.*, 97 FERC ¶ 61,134 at 61,615 (2001); *No. States Power Co.,* 64 FERC ¶ 61,324 at 63,379 (1993). (In *Northern States Power Co.*, this formulation was not actually offered by the Commission, but appeared in a quotation of the utilities position. The Commission specifically endorsed this language in the *Mansfield* order.)

116 *Cal. Indep. Sys. Operator Corp.,* 103 FERC ¶ 61,114 (2003) at P 26.

transmission facility and by how much" is an inadequate basis to approve, absent evidence that the difficulty exceeds the benefits to particular utilities, a cost allocation methodology that allocates costs to all utilities on a pro rata basis.[117] The ISO, however, is not relying on difficulty to avoid allocating costs in a manner that is roughly commensurate to estimated benefits, which is the central requirement of *Illinois Commerce Commission*.[118] Rather, the ISO is using the difficulty in measuring responsibility/causation for the needs as a basis for relying on benefits and has concluded that system-wide and TAC Area-wide allocations are "roughly commensurate" with estimated benefits. The fact is that electricity does not flow on a path basis. The grid is wholly integrated and operates to provide reliable service to all. flexible capacity procured on a system basis benefits the entire system and allows the entire system to operate more reliably. This benefits everyone. Six Cities and CMUA/TURN fail to recognize this.

In the case of FLRR designations, the proximate cause of the need is the imminent retirement of a resource that the ISO has concluded will be needed for flexible capacity in the longer-term. No particular market participants can be held responsible for the fact that the resource requesting an FLRR designation will be uneconomic during the designation year. The problem is that, in the absence of flexible capacity procurement requirements, the market assigns no value to the resource's flexibility or location, which is the attribute that could make the unit valuable and economically viable in the longer-term.

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[117] Six Cities at 10, citing *Ill. Commerce Comm'n,* 576 F.3d 479 (7th Cir. 2009) at 475; CMUA/TURN at 10, citing the same.

[118] 526 F.3d at 476.

The indirect cause of the FLRR designation is the long-term flexibility need itself. As discussed above, the ISO has concluded that, absent FLRR designations, there is a significant probability that there will be system deficiencies of flexible capacity. Because these deficiencies will arise two to five years into the future, the ISO does not have the ability to assign responsibility for the deficiencies to particular load-serving entities with any degree of certainty. CMUA/TURN, NCPA, Six Cities, and SWP suggest that the ISO should take into account the degree of flexibility in the load-serving entities' portfolio.[119] NCPA and SWP point out that one of the cost allocations being considered in the stakeholder process on flexible resource adequacy requirement would include this factor.[120] The ISO agrees that consideration of existing portfolios would be consistent with cost causation principles – and is worthy of consideration – in the context of deficiencies that arise when there are specific flexible capacity resource adequacy requirements, applicable to the year in which the deficiency occurs (although other allocations may also be consistent in the case of system-wide deficiencies). Although existing portfolios may be indicative of future portfolios, they are subject to revision. The load projections for the load-serving entities are also just that – projections. These longer-term conditions are insufficiently certain to be used for cost allocation purposes. An effort to true-up allocations at a later point based on the conditions that in fact occur would just add another layer of complexity.

In contrast, determining the benefits of flexible capacity FLRR designations is relatively straight forward. The resources will remain available for procurement by any load-serving entity. The flexibility that the resources will provide is a system-wide

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[119] CMUA/TURN at 9-10; NCPA at 14-19, Six Cities at 9; SWP at 16-20.

[120] NCPA at 15-16; SWP at 18-20.

benefit, because the operational issues that a lack of flexible capacity will present are system-wide. Accordingly, a system-wide allocation is "roughly commensurate" to the benefits provided.

The considerations are similar in the case of FLRR designations for local reliability. The proximate cause of the need is the imminent retirement of a resource that the ISO has concluded will be needed for local reliability in the longer-term. The imminent retirement arises from the failure of the market, in the absence of a long-term procurement requirement, to place a value on the long-term value of the resources in providing local reliability. The indirect cause is the likelihood of local reliability needs in the future and, again, the ISO cannot predict with any certainty which portfolios, five years into the future, may have inadequate local reliability capacity.

On the benefits side, there is more information about the particular load-serving entities that will benefit. The fact of matter is that avoiding the retirement of resources that can provide local reliability in these areas will benefit load in these areas as well as the system. By addressing the future need in the local area, the resource will provide stability and reliability that extends to system-wide grid and benefits to loads outside the local reliability area. In light of these factors, the ISO concluded that assignment to load in the directly benefiting TAC area was sufficiently proportionate to benefits to be consistent with cost causation principles.

3. The ISO's Proposed Allocation of the Cost of FLRR Designations Is Consistent with the ISO's Cost Allocation Principles

SWP asks that the ISO discuss the cost allocation in terms of the ISO's principles of cost allocation. There are seven:

- Causation: Costs will be charged to resources that benefit from the service being procured or to resources that drive the procurement decision.

- Comparable treatment: Market participants with similarly situated resources should receive similar allocation of costs and not be unduly discriminated against.

- Accurate price signals: The cost allocation design supports the economically efficient achievement of state and federal policy goals by providing accurate price signals from the ISO market.

- Incentivize behavior: Cost allocation design should provide appropriate incentives for market participants to take action to reduce costs

- Manageable: Market participants should have the ability to manage exposure to the cost allocation.

- Synchronized: Cost allocation is aligned with the timing and quantity of the service procured.

- Rational: Implementation costs and complexity should not exceed the benefits that are intended to be achieved by allocating costs.[121]

The most important of these is cost causation, with which, as the ISO has discussed at length above, the proposal is consistent. Comparable treatment is related to cost causation, but intended to preclude discriminatory allocations. The proposal applies the cost causation principles equally to all market participants.

Rationality is particularly important in this instance, because of the difficulty of assigning responsibility for the incurrence of the costs. The ISO decided to assign costs according to benefits because of this principle.

The accuracy of price signals and the provision of incentives are related. The proposal does not provide price signals to direct market behavior because it is the absence of long-term flexible capacity and local reliability requirements, not market behavior, that drives the need for FLRR designations. The system-wide and TAC-area

[121] May 9, 2012 Memorandum from Keith Casey to ISO Board of Governors, posted at: http://www.caiso.com/Documents/BriefingCostAllocationGuidingPrinciples-Memo-May2012.pdf.

wide allocation of the cost of FLRR designations should provide incentives for market participants to work with their regulatory agencies to develop such requirements, the implementation of which will cause the FLRR mechanism to terminate.

CMUA/TURN and Six Cities, however, argue that the ISO's proposal has a perverse incentive. They note that the ISO has identified increased distributed generation as a cause of increased flexibility needs, and suggest that load-serving entities will have an incentive to increase distributed generation in order to reduce metered demand and, according, the allocation of FLRR costs.[122] The ISO did not propose the FLRR mechanism, however, in order to discourage distributed generation any more than it proposed the mechanism to discourage the development of intermittent renewable resources. As explained in the transmittal letter, increased use of distributed generation and renewable resources is a California policy goal. The ISO intends the FLRR mechanism as an interim step to manage the integration of such resources, pending development of long-term capacity procurement mechanisms.

The ISO acknowledges that the cost allocation of the FLRR mechanism does not provide market participants with the opportunity to manage their exposure to the costs while the mechanism is in place. As noted, however, it does provide an incentive for the development of replacement mechanisms.

Finally, the proposal is consistent with the synchronization principle. FLRR designations are based on projected system conditions in the long term. The proposal allocates cost based on long-term benefits. The suggestion that the ISO allocate costs

[122] CMUA/TURN at 10-11; Six Cities at 10.

according to current conditions – such a current portfolios – would be inconsistent with this factor.

4. PG&E's and SCE's Proposed Modifications to the Allocation of the Costs of FLRR Designations Lack Merit

PGE asks that for modification of the proposal such that the ISO will allocate the costs of all FLRR designations to meet local reliability requirements to the load-serving entities in the TAC areas in which the need for a FLRR designation arose before any allocation system-wide based on flexibility needs. PG&E notes that the ISO has identified an incremental long-term need for local reliability resources in southern California in order to maintain existing local reliability standards and no incremental local need in northern California within the long-term time frame that the ISO evaluated. According to PG&E, the ISO's FLRR proposal is inconsistent with the CPUC's allocation of the cost of local resources and could effectively allocate a portion of southern California's local reliability responsibility to northern California[123]

The ISO wishes to clarify this point. If there is one 200 MW resource eligible for a FLRR designation, then we designate that resource and it provides benefits to the whole system, thus all costs are allocated to the system (this is consistent with how the TAC works for LTPP). If there are two resources, one of 50 MW and one of 150 MW, then the 150 would go to local only, while the 50 would go to system.

SCE contends that the ISO should allocate the costs to both load and generation that create the need for flexibility.[124] The ISO has explained why it has chosen to allocate the costs based on benefits, rather than creation of the need and that this is

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123 PG&E at 8-9.

124 SCE at 10.

fully consistent with cost allocation. Because the ISO has determined that the benefits are system- and TAC area-wide, there is no purpose served in allocation costs to generation. Generation would simply pass those costs to load if the contracts so provides, and the inability of some generation to pass the costs to long would distort the market.

H. SUNSET PROVISION

1. The Sunset Provision is Reasonable and Should Not be Shortened

Proposed ISO Tariff Section 44.1 establishes a sunset provision under which the FLRR mechanism will expire upon implementation of the multi-year forward capacity procurement obligation (provided that an FLRR designation is not issued during 24 consecutive months after its implementation). If those conditions are not met within five years after the FLRR mechanism becomes effective, the FLRR mechanism nonetheless expires.

In its protest, the CPUC contends that the FLRR provisions should expire after two designation cycles, unless the ISO seeks and receives an extension of the expiration date from the Commission. The CPUC is concerned that the FLRR designations will cause load-serving entities to bear "unknown and unchecked" costs for up to five years, which the CPUC believes is too long, without any cost caps or ratepayer protections.[125]

The ISO disagrees with the CPUC characterizations of the sunset provision. The length of the period that FLRR mechanism will be in effect before it expires is not unduly long. The period proposed by the ISO is commensurate with the multi-year effort that

[125] CPUC at 51.

the ISO anticipates will be necessary to develop the more permanent solution to address the need for multi-year forward, market-based capacity procurement. Further, the ISO believes that having a dual sunset provision, with a firm five-year end date in place for those efforts, will serve as an incentive for the ISO and stakeholders to progress toward development of the long-term solution sooner, so that the successor provisions can be submitted for FERC approval and become effective well in advance of FLRR mechanism's expiration.

The CPUC's portrayal of the FLRR costs as "unknown and unchecked" is also not accurate. The ISO's proposal includes several cost containment provisions. For example, (1) the resource receiving an FLRR designation will be limited to receiving at a maximum compensation for its going-forward costs, (2) those costs will be determined by an independent evaluator, (3) cost categories eligible for inclusion in the calculation of going-forward costs are set forth in the proposed Tariff Section 44.11.1 and the further detail about eligible and non-eligible costs will be included in the business practice manual; and (4) the resource will be permitted to retain at most 10 percent of its ISO net market revenues, with the remainder of those revenues used to offset the annual going-forward costs approved by the Commission and bourn by the load-serving entities. The compensation is structured to offer only a financial lifeline to an uneconomic resource that covers its going-forward costs and enables the resource to remain viable during the designation year, so it is available to meet the future need.

Further, the CPUC's characterization ignores the fact that the FLRR mechanism is essentially backstop procurement. The ISO will exercise this backstop authority only when there is an identified operational need for the resource in the future and when all

other avenues of procurement have failed and the resource is on the verge of retiring because it has not been procured under a resource adequacy contract or through the bi-lateral market. There is a finite amount of capacity that meets these criteria, not all of which are uneconomic. Accordingly, the exposure of the load-serving entities to FLRR costs is not unlimited, as the CPUC suggests, and is not grounds to shorten the sunset period.

I. LONG-TERM STANDBY OR MOTHBALLING OPTION

1. Adding a Long-Term Standby or Mothballing Alternative to the FLRR Mechanism is Unwarranted

The transmittal letter in this matter describes at length the ISO's decision not to include a long-term standby or mothballing alternative in the FLRR proposal.[126] In sum, the ISO concluded that such an option would likely be more costly than compensation based on going-forward costs and could create costly environmental issues for the resource under the new source review provisions of the Clean Air Act.

SCE submitted the only comments on whether a long-term standby option should be included in FLRR mechanism. SCE recommends that the Commission require the ISO to include such an option in the FLRR provisions. In support of its recommendation, SCE claims that long-term standby could be less costly than an FLRR designation and that the resource should be required to demonstrate the feasibility and cost of that alternative so the ISO would have the means to determine whether that would be the least-cost solution. SCE offered no evidence to substantiate this claim.

Significantly, SCE's comments do not challenge the ISO's specific arguments against including a mothballing option and do not even address the complications and

[126] FLRR Transmittal Letter, pp. 39-43.

costs associated with new source review. The ISO's arguments, therefore, stand un-rebutted on the record. Further, there is no record evidence that would support a decision to require the ISO to offer long-term standby status or mothballing as an option for a resource seeking an FLRR designation. For these reasons, SCE's recommendation lacks foundation and should be rejected by the Commission.

III. CONCLUSION

For the foregoing reasons and those provided in the transmittal letter, the ISO respectfully requests that the Commission accept the FLRR amendment without change, except for the clarifications provided by the ISO in this Answer.

Respectfully submitted,

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Dated: February 11, 2013

CERTIFICATE OF SERVICE

I hereby certify that copies of this filing have been served on all of the parties listed on the official service list for the above-referenced proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010 (2012)).

Dated at Washington, D.C. this 11th day of February, 2013.

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