

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Midway Sunset Cogeneration Company) Docket No. ER21-998-000

**MOTION TO INTERVENE AND PROTEST OF THE CALIFORNIA
INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”), 18 C.F.R. §§ 385.212 and 385.214, the California Independent System Operator Corporation (“CAISO”) hereby submits a motion to intervene and protest in response to the January 29, 2021 filing by Midway Sunset Cogeneration Company (“MSCC”) of an unexecuted Reliability Must-Run Service Agreement between MSCC and the CAISO (“Agreement”). MSCC made a further errata filing on February 3, 2021.¹ This submission responds to both filings. The CAISO asks the Commission to accept the Agreement for filing, permit it to become effective on February 1, 2021, the date requested by MSCC, subject to refund, and set the filing for hearing and settlement procedures.

I. MOTION TO INTERVENE

The CAISO is a non-profit public benefit corporation organized under the laws of the State of California. The CAISO is the balancing authority responsible for the reliable operation of the electric grid comprising the transmission systems of a number

¹ The February 3, 2021 errata filing made changes that affected the filed rate reflected in the January 29, 2021 filing. The Commission set February 24, 2021 as the response date.

of utilities. As part of its mandate to operate the electric grid, the CAISO's Tariff contains provisions that give it the authority to designate units as necessary for reliability purposes and enter into reliability must-run agreements. Therefore, the CAISO has an interest in this proceeding that cannot be represented adequately by any other party, and it requests that the Commission permit it to intervene in this proceeding.

The CAISO requests that communications and notices concerning this motion and these proceedings be provided to:²

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II. BACKGROUND AND DESCRIPTION OF PROCEEDING

The CAISO is responsible for the reliability of the CAISO controlled grid. One tool the CAISO has to ensure reliability is reliability must-run agreements ("RMR Agreements"), typically used for generating plants that cannot compete in the market because of their high costs but that are nevertheless necessary to maintain the reliability

² These individuals are designated to receive service pursuant to Rule 203(b) (3) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.203(b)(3).

of the CAISO grid. The Commission approved the current *pro forma* RMR Agreement at the end of 2019.³

On January 29, 2021, MSCC submitted, pursuant to Section 205 of the Federal Power Act,⁴ the unexecuted Agreement for MSCC's 248 MW natural-gas fired facility,⁵ comprising three combustion turbines of the same size and design (Turbines A, B and C) that had historically operated as an integrated cogeneration facility located in the Midway Sunset oilfield in Kern County, California (the "Facility"). The power purchase agreements under which the Facility had been operating terminated on September 30, 2020 (Turbine C) and December 31, 2020 (Turbines A and B). In response, the CAISO Board of Governors authorized CAISO management to designate the Facility as an RMR unit on December 16, 2020.⁶ In deciding to designate the Facility for RMR service, the CAISO followed the procedures specified in its Tariff, which involved conducting studies to confirm whether absence of the Facility would create unacceptable reliability impacts. The CAISO found the Facility is required to meet 2021 system-wide reliability needs. Specifically, the Facility is needed in order to maintain BAL-002-WECC-2a contingency reserve requirements and unloaded capacity to meet operational needs pursuant to BAL-001-2 and BAL-003-2.⁷

³ See *California Independent System Operator Corp.*, 168 FERC ¶61,199 (2019) (order accepting tariff revisions).

⁴ 16 U.S.C. § 824d.

⁵ As discussed in Section III.A below, one of the points of disagreement between CAISO and MSCC that is relevant to this Protest is the capacity of the Facility. At MSCC's request, the Facility is listed in the CAISO's Master File as a 248 MW facility. MSCC seeks to have it treated as a 240/230 MW facility, based on seasonal adjustments.

⁶ See Attachments G and H to MSCC's January 29 filing in this docket (December 8, 2020 Memorandum to CAISO Board of Governors and December 16, 2020 briefing on the Motion to Designate).

⁷ *Id.*

Given the need for the Facility to begin RMR service on February 1, 2021, and because the performance requirements are all clearly established elements of the *pro forma* RMR Agreement, the CAISO supports MSCC's filing of the unexecuted Agreement so that service could commence on February 1, 2021. There was, however, insufficient time between the RMR designation date and MSCC's filing date for the CAISO and MSCC to reach agreement on MSCC's rates for providing RMR service. Additionally, the RMR Agreement provides a role for the California Public Utilities Commission (CPUC) to review proposed capital projects under Schedule L-1, and there are several capital projects at issue here. Finally, the RMR Agreement, whether executed or not, allows interested parties to comment or protest. Accordingly, MSCC filed the unexecuted Agreement, on January 29, 2020, requesting that it be made effective February 1, 2021, subject to refund. The CAISO supports that request, recognizing that rates are in dispute and will be determined at a later date.

III. PROTEST

As noted above, the CAISO has determined continued operation of the Facility is required to meet system-wide reliability requirements, and there are no available alternatives for meeting these requirements. As such, the CAISO supports Commission acceptance of an agreement for the Facility to provide RMR service to support the reliability of the CAISO-controlled grid. However, because the parties could not agree on the rate and all of the terms of service proposed by MSCC, and because of the role of the CPUC and load-serving entities responsible for bearing the costs of this facility, the CAISO requests the Commission set MSCC's filing for hearing and establish

settlement procedures so the parties can attempt to reach a final resolution on just and reasonable rates and terms for MSCC's provision of RMR service.

The CAISO supports MSCC's right to recover in rates the prudently incurred, reasonable costs of providing service under the Agreement. As explained by MSCC in its filing, the CAISO: (1) does not object to MSCC's filing of the unexecuted Agreement; (2) supports the proposed February 1, 2021 effective date for the Agreement; (3) subject to additional documentation as to the need for and the scope of work, supports MSCC's proposed schedule for planned outages to conduct major maintenance on Turbines A, B, and C and the combustion system conversion on Turbine C; and (4) does not oppose including contingent RMR rates for 2022 in the filed RMR Agreement, subject to a CAISO determination of continuing RMR need for the Facility,⁸ to provide certainty regarding the two-year plan of major maintenance covering Turbines A, B, and C and a required combustion system conversion on Turbine C to allow it to operate in single-cycle rather than co-generation mode.

On the other hand, the CAISO disagrees with MSCC's characterization of its RMR designation as unique, which MSCC appears to offer as justification for significant departures from the Commission-approved RMR *pro forma* Agreement. None of the thirteen circumstances MSCC labels as unique justify such a label or the special treatment MSCC seeks.⁹ These are circumstances that, in general terms, have

⁸ The CAISO has not made a final determination whether MSCC is needed for Contract Year 2022. It expects to make a decision prior to October 1, 2021, the standard renewal date for RMR agreements.

⁹ MSCC Filing Statement (Filing Statement) at 2-3 (January 29, 2021). For example, MSCC suggests that the CAISO's designation of MSCC for a Contract Year that is not coincident with the calendar year is unique and justifies its request for transition costs. In fact, the CAISO Tariff provides for the designation of new RMR resources "at any time." Tariff, Section 41.2.

applied to multiple prior RMR Agreements with the CAISO – without the special treatment MSCC seeks here.

As described in greater detail below, the CAISO believes that MSCC has unjustly and unreasonably departed from the Commission approved RMR *pro forma* in multiple ways. Specifically, it has failed to justify its treatment of: (1) facility availability; (2) multiple cost elements; (3) depreciation; and (4) capital items.¹⁰ MSCC has also failed to adhere to the structure of an RMR rate filing in numerous ways that are either unexplained or unjustified, and it has not provided the necessary support for many of its cost elements. Thus, significant additional information will be required for the CAISO to fully evaluate the MSCC proposed rates. The CAISO takes no position regarding MSCC’s proposed capital structure or rate of return, although it disagrees with MSCC’s claim the RMR Agreement presents a high risk to its owners.

A. The CAISO Disagrees with MSCC’s Description of and Approach to the Availability of the Facility, Which MSCC Has Not Shown Is Just and Reasonable

The CAISO has two concerns about MSCC’s proposed treatment of the availability of the Facility. It fails to accurately describe the actual capability of the Facility to provide RMR service, and it seeks an unjustified departure from the CAISO’s method of addressing ambient derates gas plants may require in hot weather. Essentially MSCC seeks a free pass from the consequences other RMR generators face under the *pro forma* RMR agreement and Resource Adequacy (RA) contract holders

¹⁰ The CAISO’s review of the MSCC filing is ongoing, and the CAISO reserves its right to raise additional issues as they come to light, including as to the reasonableness of particular cost items MSCC has included in the rate it filed.

face under the CAISO Tariff when they fail to make contracted capacity fully available to CAISO markets for dispatch.

1. Availability of Unit C

MSCC asserts “Turbine C is available and capable of providing RMR service during the Contract Year prior to completion of the combustion system conversion.”¹¹ This statement is, at best, misleading. It suggests that Turbine C can provide service similar to Turbines A and B. This is not true. As discussed in more detail below, the current expectation is that, through the first part of 2022, Turbine C would only be available to operate under an emergency order issued by the Secretary of Energy under Section 202(c) of the Federal Power Act (FPA).

As MSCC explains elsewhere in its filing, to meet the air quality standards that apply when Turbine C operates in simple-cycle mode, rather than in its currently licensed cogeneration mode, MSCC must undertake a significant capital project, a combustion system conversion. This is a long-lead time project that will not be completed until the first half of 2022. MSCC obtained a temporary variance from the local air district for Turbine C to operate, which the CAISO understood would allow it to provide service under the RMR Agreement for some limited number of hours in 2021. However, the temporary variance does not excuse MSCC from meeting federal Clean Air Act standards. Thus, although the CAISO had anticipated Turbine C would be available to operate under the variance, MSCC has informed the CAISO that it is

¹¹ Filing Statement at 12.

unwilling to rely solely on the local variance. As a result, Turbine C is not “available and capable of providing RMR service during the Contract Year.”

Rather, as MSCC explains, “Turbine C is available for emergency dispatch in 2021, prior to undertaking the combustion system conversion, only if the CAISO were to obtain an order from the U.S. Secretary of Energy (“the Secretary”) under FPA section 202(c) authorizing the CAISO to direct the MSCC Facility to operate.”¹² The CAISO has experience obtaining emergency orders from the Secretary of Energy under Section 202(c),¹³ but it has sought such authority only twice in more than twenty years, and it views Section 202(c) authorizations as far different from, and more limited than, RMR arrangements.

Nevertheless, the CAISO acknowledges Turbine C could not be made available to the CAISO under a Section 202(c) emergency order unless it were also under contract to the CAISO under an RMR Agreement, given that MSCC had announced the intention to mothball Turbine C before it received the CAISO’s RMR designation. In response to the RMR designation, MSCC completed a necessary repair, which means the plant can provide service if it receives a Section 202(c) order. Because Unit C is under an RMR Agreement, the parties can process the proposed capital project for the combustion system improvement in accordance with Schedule L of the RMR Agreement. This capital project will enable Turbine C to provide the kind of peaker service that Turbines A and B provide, but not until sometime in 2022. Although the

¹² *Id.*, fn. 24 (emphasis added).

¹³ 16 U.S.C. § 824a(c).

combustion turbine conversion project is a long-lead item, that will always be true, and unless it gets underway, Turbine C will be permanently lost to the grid.

2. Facility Capacity

MSCC also has not demonstrated its proposed approach to the potential need for the Facility to undertake ambient derates is just and reasonable. The *pro forma* RMR Agreement bases its capacity determinations and associated “must-offer” obligation on a generator’s Pmax, or maximum generating capacity. The generator owner registers the Pmax in the CAISO master file, which is required to reflect the physical capability of the unit, subject to certain environmental limitations, or limitations required to maintain the reliability of the CAISO grid. MSCC accurately states its Pmax at 248 MW in its Schedule A. However, it also specifies two lower capacity levels in Schedule A that cover the entire year – 240 MW (winter) and 230 MW (summer) – describing the lower capacities as its seasonal derate capacities. MSCC seeks to have its performance evaluated against these derated capacity levels, not its Pmax level. It also proposes in Schedule A, Section 1, an alternative to the RAAIM performance penalty included in Section 8.5 of the *pro forma* RMR Agreement that would allow it to base its must offer obligation on these self-selected seasonal derate capabilities, not its Pmax value.

MSCC’s acknowledged objective in making these proposals is to avoid any potential penalty under the CAISO Tariff’s Resource Adequacy Availability Incentive Mechanism (RAAIM). This CAISO Tariff mechanism provides both penalties and incentive payments calculated on the basis of the availability of RMR unit compared to the unit’s must-offer capacity. The purpose of RAAIM is to provide an economic

incentive to maximize the must-offer capacity availability. The MSCC proposal removes this incentive mechanism for a portion of its capacity.

The CAISO recognizes thermal units like the MSCC Facility may be unable to operate at Pmax under all weather conditions. Indeed, because of this, RAAIM penalties do not apply unless the bidding availability is below 94.5% of Pmax over an entire month, and incentives apply for performance at 98.5% of Pmax or greater measured over an entire month.¹⁴ MSCC has not adequately justified its proposed alternative, which all but ensures it will incur no penalties for under-performance and gives MSCC no incentive to seek out substitute resources when it cannot perform. MSCC's proposed approach risks leaving the CAISO grid short of the capacity it sought when it designated MSCC for RMR service based on the Pmax capacity value MSCC established for itself. Other RMR and RA thermal units operate within these parameters, and MSCC has not made the case that it faces any special circumstances that warrant different treatment.

MSCC's own actions demonstrate the approach MSCC proposes is not justified by the facts. Resource owners submit requests to establish the net qualifying capacity (NQC) values each year to establish the capacity eligible for purchase under RA contracts. Following the mothballing of Turbine C, MSCC requested monthly NQC values for the 2021 calendar year. NQC values are subject to CAISO review and approval to ensure the values align with interconnection limitations and performance testing. The NQC values accepted and posted on the CAISO website for the resource

¹⁴ CAISO Tariff Section 40.9.

with only Turbines A and B for the 2021 contract year represent two thirds of the capacity of all three turbines subject to the RMR Contract because all three resources have the same rating. The capacity values submitted varied over each month of 2021 for Turbines A and B, ranging from a minimum of 165 MW registered for the month of July to maximum of 178 MW for the month of January. Turbine C has the same rating as Turbines A and B, and thus the total capacity of the three together should be a 1.5 multiple of the range requested and approved for the combination of only Turbines A and B. Using this multiple to reflect the capacity of the Facility with Turbine C included provides an expected potential capacity range for the combination of Turbines A, B and C together from a minimum of 248 MW of the month of July to 268 MW for the month of January. Given that the interconnection capacity for the Facility is limited to 248 MW, the NQC value may not exceed 248 MW. By contrast, MSCC proposes values of 240 MW (winter) and 230 (MW) summer.

In short, the data MSCC submitted as capacity it was willing to supply for purchase under the RA program exceeds the capacity reflected in the RMR Agreement. MSCC overlooks this history when it suggests that the Pmax was “historically set” with something other than RAAIM in mind.¹⁵ Thus, based on the record MSCC itself has made, in the language of Section 8.5 of the *pro forma* RMR Agreement that MSCC purports to rely upon, the CAISO has not “determine[d] the default availability incentive mechanism is inadequate with respect to reliability needs and the performance characteristics of the Unit” that would cause it to offer “an alternative

¹⁵ Filing Letter at 10.

availability incentive.”¹⁶ The 248 MW represents the true maximum output rating of the resource, which is the required RMR capacity value under Schedule A – and what the CAISO is paying for when it contracts for the entire unit. Accordingly, the derated summer and winter capacities MSCC proposes in its filing here are not just and reasonable.¹⁷

B. MSCC Transition Cost Claims Are Not Just and Reasonable

The CAISO has not yet been able to fully evaluate the reasonableness of the amounts MSCC claims as costs.¹⁸ But it believes, whatever amounts might be justified for certain elements of cost, MSCC’s proposed treatment of many of the claimed costs is contrary both to the terms of the *pro forma* RMR Agreement and applicable precedent, and has not been shown to be just and reasonable. MSCC’s claim for “transition costs” seeks to accelerate recovery of costs to 2021 that, under the RMR Agreement, would be properly recoverable in 2022. Specific elements of the claimed transition costs suffer from additional flaws as well. Among the unjustified elements of the transition costs are: (i) plant costs for January 2021, (ii) permitting costs that will

¹⁶ The circumstances envisioned for when “an alternate availability incentive” would be required were “extremely idiosyncratic scenarios” where a generator was needed outside the 17 hours a day, seven days a week to which RAAIM penalties apply. <http://www.caiso.com/Documents/Apr22-2019-TariffAmendment-RMR-CPMEnhancements-ER19-1641.pdf>. The CAISO further notes that establishing the RAAIM penalty based on a generator’s Pmax is so thoroughly integrated into the CAISO settlement process that it cannot be readily adjusted. To do so would be a time-consuming and difficult process that the present situation clearly does not justify.

¹⁷ Perhaps associated with its effort to understate its availability, but perhaps unrelated, in its Schedule A, Section 6, Unit Performance Characteristics, MSCC also included configuration tables for the Facility, showing transition parameters and configuration heat rates that conflict with the 248 MW contract capacity and the values registered in the Master File. Schedule A specifies that these values will be accurately reflected in CAISO systems, including the Master File, with changes reviewed and approved by the CAISO in accordance with applicable business practice manuals. MSCC cannot simply rewrite the RMR Agreement schedules in this way to suit its preferences.

¹⁸ The CAISO will be seeking documentation to support MSCC cost claims.

not support RMR operations, and (iii) stack repair costs that should be treated as capital repairs.

On August 19, 2020, MSCC notified the CAISO of its intention to mothball Unit C of the Facility effective September 30, 2020.¹⁹ On September 28, 2020, MSCC notified the CAISO it would mothball Units A and B as well when their power purchase agreement expired at the end of 2020. Upon receipt of the September notice, the CAISO undertook the reliability studies necessary to determine whether there was a continuing reliability need for the Facility. The CAISO concluded there was a need, denied the mothball notice, and as noted above, designated the Facility for RMR service on December 16, 2020.²⁰

The earliest date by which MSCC could make the required Section 205 filing with the Commission was January 29, 2021, for service to commence on February 1, 2021. MSCC seeks to recover in 2021 rates approximately \$3.4 million in “transition costs” comprised of plant costs for the one month between the termination of the prior cogeneration contract and the commencement of RMR service, stack repair costs for Turbine C, and legal and regulatory costs.²¹

Under the RMR Agreement, cost recovery operates based on a historic cost year, July 1 to June 30 of the immediately prior year. Reasonable plant costs and legal

¹⁹ MSCC failed to provide the required 90-day notice for its Turbine C mothball plans under Section 3.2.2 of the Participating Generator Agreement between CAISO and MSCC.

²⁰ See discussion *supra* at 3.

²¹ MSCC proposes to treat these most of these costs under a Daily Surcharge Transition Cost under Schedule B to the filed RMR Agreement. MSCC Filing Statement at 13. MSCC explains, however, that, for the month of January, when the Facility was not operating, “the transition costs also include 1/12 of A&G, other taxes, and return of and on capital costs included in Schedule F.” *Id.* at 14.

and regulatory costs associated with providing RMR service are recoverable under the Agreement, but because the costs MSCC puts into this transition category were or will be incurred after the end of this test year, they are not recoverable until 2022 under the *pro forma* RMR Agreement.

MSCC argues it should recover these costs in 2021 because the CAISO may not designate the Facility for RMR service in 2022.²² If MSCC is not extended for 2022 and the Facility does not re-enter the market, the CAISO is prepared to consider treating the costs MSCC designates as transition costs in accordance with Section 2.5 of the RMR Agreement. However, there is no justification under the *pro forma* RMR Agreement for recovery of those costs in 2021.

Regarding the plant costs for which MSCC seeks to accelerate recovery, the test year underlying MSCC's rate proposal is based on the 12 months of plant costs for July 1, 2019 to June 30, 2020. There is no justification for adding January 2021 plants costs, a month well outside the historic cost year, to current rates by putting them in a "transition costs" category of MSCC's devising. It would add an extra month of plant costs during this Contract Year.

The legal and regulatory costs MSCC seeks to recover as transition costs are presented as a single cost of \$1,250,000. The RMR formula rate provides for recovery of legal and regulatory costs associated with providing RMR service. MSCC provides insufficient detail for the CAISO to determine whether this additional transition cost

²² MSCC Filing Statement at 13.

item duplicates costs already covered elsewhere in its proposed rates. This requires further documentation from MSCC and analysis by the CAISO.²³

Apart from that issue, MSCC includes an unspecified amount in its legal and regulatory costs associated with obtaining a permit waiver for Unit C from the local air quality district. As explained above, MSCC has informed the CAISO that, because it has no comparable waiver from EPA, it will not rely on the waiver. The CAISO does not take issue with that regulatory judgment by MSCC, but the result is RMR ratepayers will receive no benefit from the waiver. Thus, the associated costs are not properly charged under the RMR Agreement.

MSCC argues the waiver could support emergency operations pursuant to an order under Section 202(c) of the Federal Power Act.²⁴ However, Section 202(c) specifically provides an automatic waiver of air quality standards to support emergency operations.²⁵ Thus, if the CAISO were to experience a grid emergency requiring it to seek such authority, the local air quality waiver would be unnecessary. In short, there is no justification for recovery of permitting costs for a waiver that will not be used under the RMR Agreement.

²³ Legal and regulatory costs are not the only cost category where a potential for duplicative recovery seems possible. Duplicative charges are impermissible and must be rejected. In the information exchanges that will follow, the CAISO will further explore if there are any duplicative costs included in the MSCC rates.

²⁴ Filing Statement at 11.

²⁵ 16 U.S.C. § 824a(c)(3) (“To the extent any omission or action taken by a party, that is necessary to comply with an order issued under this subsection, including any omission or action taken to voluntarily comply with such order, results in noncompliance with, or causes such party to not comply with, any Federal, State, or local environmental law or regulation, such omission or action shall not be considered a violation of such environmental law or regulation, or subject such party to any requirement, civil or criminal liability, or a citizen suit under such environmental law or regulation.”).

MSCC also seeks to recover as transition costs the stack repair costs for Turbine C, which MSCC states were \$475,000.²⁶ The stack repair costs are likewise unrecoverable as transition costs, but for a different reason. Such repair costs are recoverable as capital costs under Schedule L of the RMR Agreement, but only after MSCC complies with the procedures for approval of capital items provided for in Section 7.4 of the Agreement. And, as discussed below, pursuant to Section 7.4(b) of the RMR Agreement, as a capital item costing less than \$500,000, the stack repair must be depreciated over ten years, not in a single year, as MSCC seeks to accomplish by labeling it a transition cost.²⁷

In short, none of the “transition costs” MSCC seeks to recover in 2021 are appropriate for special treatment. Some of those costs are not recoverable at all, and those that are shown to be just and reasonable in amount should be treated either as historic cost year costs recoverable in 2022 or as capital costs.

C. MSCC’s Accelerated Depreciation of Previously Incurred Capital Costs Is Unsupported

MSCC correctly includes in its depreciation expense its undepreciated plant balance for the combustion conversion projects it undertook on Turbines A and B in 2014-2015. MSCC indicates the undepreciated balance is \$ 6,815,344. The CAISO agrees depreciation is a cost category recoverable under the RMR Agreement. However, MSCC seeks to accelerate the recovery so the costs are entirely recovered by

²⁶ Attachment C, Lovinger Testimony at 29.

²⁷ See discussion *infra* at Section III.E.

the end of 2022, based on the speculation that the Facility will cease operations at the end of 2022.²⁸

The FERC Uniform System of Accounts provides for depreciation to occur over the useful life of an investment.²⁹ The workpapers accompanying the MSCC filing indicate the remaining depreciable life on prior investments is five years or more.³⁰ Moreover, the undepreciated plant costs are sunk costs that MSCC incurred when it had no reason to expect RMR designation. Accelerating the depreciation schedule to recover all remaining undepreciated investment in the expected remaining RMR contractual period would constitute a wholly unjustified burden on ratepayers and a windfall to MSCC – taking profits for non-cash expense items that would have been written off entirely if MSCC had retired the resource.

There is never guarantee a plant in which a capital investment is made will operate for the entire useful life of the investment, but that does not justify accelerating cost recovery to a speculative end-date of operations, as MSCC attempts here. The depreciation schedule must continue on the same basis MSCC assumed when it made the investment in 2014-2015 (*i.e.*, five-six years before the RMR designation), rather than shifting all remaining past plant investment to ratepayers under the RMR Agreement.

²⁸ As noted *supra* at 10, to justify its collection of “transition costs,” MSCC assumes Facility operation only until the end of 2021, by contrast to the 2022 termination date it assumes for purposes of items it acknowledges are capital costs. Both end dates are supported by little more than MSCC’s speculation and the desire to maximize its revenue under the Agreement.

²⁹ FERC Uniform System of Accounts, General Instructions ¶ 22.

³⁰ Attachment J – Work Papers and Cost-of-Service Model, Statement 6, page 1 of 2.

D. MSCC Is Not Entitled to Include an Asset Retirement Obligation in RMR Rates

As should be expected, MSCC has accumulated funds to cover the retirement of the plant. MSCC indicates those funds, which previously secured a letter of credit required under its power purchase agreement, have now been re-designated as an Asset Retirement Obligation (ARO) account, and total \$11,869,332. Assuming RMR service through 2022, MSCC argues that an ARO liability of \$12,264,126 should be included in the rate base as working capital. MSCC also seeks to recover \$384,688, the amount by which it estimates its retirement costs will increase between now and 2023. Finally, MSCC proposes to treat the ARO as working capital in order to earn a return on that capital from ratepayers. Neither the RMR Agreement nor any preceding RMR unit retirements within the CAISO support this approach to asset retirement.

First and foremost, the suggested treatment of the asset retirement funds as working capital flatly contrary to the FERC rules. The Commission has specifically rejected the inclusion of ARO in rate base. In a rulemaking focused specifically on the treatment of ARO, the Commission observed:³¹

Although the proposed accounting rules require the recording of an asset retirement cost, the Commission recognizes that no actual cash expenditures are made or required until the long-lived assets are retired from service.... Therefore, it would be inappropriate for public utilities, licensees, and natural gas companies to include these asset retirement costs in rate base and collect a rate of return allowance and related income taxes on these amounts in jurisdictional rates.

³¹ *Accounting, Fin. Reporting, & Rate Filing Requirements for Asset Ret. Obligations*, 101 FERC ¶ 61,102 at P 42-44 (2002).

Experts on utility accounting reinforce the conclusion the Commission reached.³² Fundamentally, working capital is the money available to meet short-term expenses. By contrast, the very purpose of an asset retirement account is to meet retirement costs at some future time.

Additionally, Schedule F of the RMR Agreement has a very specific definition of working capital that does not include asset retirement costs.³³ MSCC does not explain why it should be permitted to depart from that definition. MSCC purports to rely on *Trans-Elect NTD Path 15, LLC*, and 117 FERC ¶ 61,214 (2006).³⁴ However, *Trans-elect* is not relevant. The decision is noteworthy for the Commission’s repeated emphasis of the presumption in favor of the convention of including in working capital 45 days of O&M costs – a convention embodied in Schedule F of the *pro forma* RMR Agreement. The Commission rejected *Trans-elect*’s efforts to rely on a lender’s requirement of a much higher amount. There was no discussion of treating ARO funds as working capital.³⁵

Finally, MSCC’s effort to charge RMR ratepayers for presumed increases in retirement costs occurring between now and 2023, is likewise impermissible. The

³² Hahne and Aliff, “Accounting for Public Utilities,” explains: “The financial analyst’s perspective of working capital reflects a measure of financial liquidity (i.e., the availability of cash on hand and other current assets that are readily convertible to cash that may be used to meet liabilities that must be paid in the current business cycle).” Hahne and Aliff go on to explain that, “For ratemaking purposes, working capital is a measure of the amount of funding needed to satisfy the level of the daily operating expenditures and a variety of non-plant investments that are necessary to sustain ongoing operations of the utility.” <https://store.lexisnexis.com/products/accounting-for-public-utilities-skuusSku10154>. The approach MSCC argues for serves neither of these perspectives: retirement obligations have nothing to do with “meeting liabilities of the current business cycle,” nor amounts needed “to sustain ongoing operations of the utility.”

³³ RMR Agreement, Schedule F, Article II, Section 4.F.

³⁴ Attachment C, Lovinger Testimony at 14-15.

³⁵ 117 FERC at PP 39-43.

RMR Agreement does not allow recovery of asset retirement costs. The FERC Uniform System of Accounts recognizes this type of cost for standard utility rates. However, the RMR rate formula specifically narrows the cost categories to only those associated with providing RMR service. The ARO is not associated with RMR service because the costs of plant retirement would have been incurred had the Facility never become an RMR unit. And MSCC merely speculates the Facility's retirement will occur in 2023. At the end of 2020, MSCC itself indicated an intent to mothball the Facility; it did not assert it would retire the Facility. There is no reason for the Commission to assume the Facility will not return to the market at the conclusion of whatever period of RMR service the Facility provides.

MSCC can appropriately set aside the ARO funds it has accumulated in an investment account, along with any earnings that accrue on those funds, but it has failed to identify any authority that would justify charging RMR ratepayers for additions to or a return on those funds.

E. MSCC's Treatment of the Needed Capital Repairs and Improvements to the Facility Is Unsupported, Unjust and Unreasonable

As noted above, to provide RMR Service, MSCC has indicated it must undertake four capital projects: Turbine C requires a combustion conversion to allow it to operate in single-cycle mode; it also required the stack repair described above, which the CAISO understands has been completed. Turbines A and B each require scheduled major maintenance. Although the CAISO will require additional documentation from MSCC to support these projects, the CAISO acknowledges this work is likely necessary for the plants to provide the needed reliability services, and it

is the type of work eligible for cost recovery. However, as provided in Section 7.4 and Schedule L of the RMR Agreement, the CAISO has established practices and protocols for approving such projects and providing for cost recovery of such capital investments. MSCC seeks to depart sharply from those protocols, but it has presented no arguments sufficient to support those departures.

As discussed above, MSCC seeks to recover the Turbine C stack repair as a “transition cost” through a Daily Transition Cost Surcharge. Such a repair, which MSCC indicates cost \$475,000, is a capital item, and accordingly it must be submitted for approval through a Schedule L-1 submission. Once the costs are approved and the project is in service, the stack repair costs should be capitalized over a period of ten years, the period specified in Section 7.4(b) for repairs costing less than \$500,000.³⁶ If RMR service terminates and the Facility is retired before cost recovery is complete, as discussed below, Section 2.5 of the RMR Agreement allows for cost recovery of any remaining undepreciated costs, provided the plant retires at the conclusion of RMR service.

MSCC’s effort to instead recover these costs in a Daily Transition Costs Surcharge violates the established principle under the FERC Uniform System of Accounts that cost recovery should not commence until a capital item is placed in service.³⁷ If Turbine C does not provide service until 2022, as is expected, depreciation for the Turbine C stack repair would commence in 2022. These principles are embodied in the RMR Agreement, Section 7.4 and Schedule L. The CAISO and other

³⁶ RMR Agreement, Schedule F, Article II, Section 4.F.

³⁷ FERC Uniform System of Accounts, General Instructions ¶ 36.

RMR unit owners routinely follow those procedures, and MSCC offers inadequate justification to skirt them.

MSCC's proposed approach to recovering the costs of the combustion conversion upgrade to Turbine C and the major maintenance on Turbines A and B is similarly unsupported. MSCC acknowledges that, under the FERC Uniform System of Accounts, MSCC may not begin recovering the costs for these investments until the upgrades are placed in service.³⁸ However, MSCC seeks to depreciate these major capital investments entirely by the end of 2022. These capital improvements must be depreciated on a schedule that is based on the useful life of the projects.³⁹

The improvements to Turbine C will not go into service until 2022, and they likely have useful lives of ten years or more. The major maintenance projects for Turbines A and B will be completed later in 2021, and the useful lives will vary depending on the nature of the work. For example, the major inspection work for these turbines is recommended at 48,000 operating hours or 2,400 starts. Based on expected service of the Facility, such inspections would occur after six to ten years of service. Each maintenance activity has an expected service interval recommended by the manufacturer, and that would be a reasonable basis for determining the depreciation schedule.

MSCC argues instead that cost recovery should be complete by the end of 2022 because that is end of the period MSCC expects to be under an RMR Agreement, and

³⁸ Filing Statement at 22.

³⁹ FERC Uniform System of Accounts, General Instructions ¶ 36.

it has no guarantee of any further operation.⁴⁰ That is a speculative and insufficient justification.

As a matter of course, RMR designations are for one Contract Year at a time, but the CAISO does not assume, nor can MSCC assume, there will be no RMR designation for further years. Nor does the CAISO assume the Facility will not return to market status, particularly following the kind of significant capital improvements that MSCC proposes to make. Furthermore, the RMR Agreement is designed to ensure an RMR owner that undertakes a capital investment to provide RMR service will be made whole if its facility is not re-designated and instead retires before the capital investment is fully amortized.

Specifically, if a unit ceases to operate within six months of termination of an RMR Agreement, Section 2.5 of the Agreement provides for the payment to the owner of a termination fee equal to the undepreciated cost of approved capital items and approved cost of any construction work in progress, less salvage value. This ensures the RMR unit owner is not left with unrecovered costs of an approved capital improvement that it made to provide RMR service. However, this structure is also designed to avoid the speculative assumptions MSCC asks the Commission to adopt, *i.e.*, that RMR service will end in 2022 and that will be the end of the Facility's useful life. The termination fee provision of the RMR Agreement has served well to protect RMR unit owners from stranded investment. MSCC is entitled to no different or greater protection.

⁴⁰ Filing Statement at 21-22.

Likewise, Commission precedent does not support the kind of accelerated depreciation period MSCC seeks. In the rare instance where the Commission has provided for accelerated depreciation of capital assets, it has done so by rulemaking and held parties who sought to take advantage of the rule to a high standard of proof of how ratepayers would benefit.⁴¹ MSCC has made no showing of benefit to ratepayers for its proposed depreciation schedule, nor can it.

MSCC argues that recovery of its capital investments over a period of less than two years is warranted because, as a matter of policy, California is moving away from fossil fuel generation. Although California is gradually moving away from fossil fuel generation, the announced time frame is 2035, with an interim goal of 2030, not 2023.⁴² On this record, there is no reason to treat major capital investments as current expenses, to be recovered over a period of less than two years for Turbines A and B, and over a period of less than one year in the case of Turbine C. Such an outcome is patently unwarranted.

⁴¹ In 18 C.F.R. § 35.34, the Commission authorized utilities building new transmission to employ an accelerated depreciation schedule to those facilities, provided the new facilities satisfied certain standards. Recognizing the significant advantage to the transmission owner of accelerated depreciation, the Commission rigorously evaluated whether the transmission facilities provided the benefits for which the special rule was created. See, e.g., *Westar Energy, Inc.*, 122 FERC ¶ 61,268 (2008); *Pacific Gas & Electric Co.*, 106 FERC ¶ 61,242 (2004). Here, of course, there is no special rule allowing accelerated depreciation, and the acceleration MSCC seeks is far beyond the kind of acceleration that rule envisioned.

⁴² Compare Filing Statement at 16 with <https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M365/K316/365316643.PDF> (noting that the GHG target for the electric sector for 2030 is 46 million metric tons). This recognizes natural gas fired units like MSCC will continue to play an important role in the reliability of the California grid for some time to come.

F. MSCC’s Rewrite of Schedule F of the RMR Agreement Is Unjust and Unreasonable

Schedule F of the RMR Agreement provides detailed instructions concerning the fixed costs recoverable under the RMR Agreement, including extensive references to the specific FERC Form 1 accounts for inclusion in RMR rates. At best, MSCC seems to have treated the Schedule F instructions as a suggestion, and it freely departs from the principles Schedule F embodies, which are designed to ensure an RMR owner recovers its costs of providing RMR service, but not other costs.

MSCC also fails to provide the required documentary support for costs that are allowable in nature. The CAISO’s analysis of Schedule F is ongoing,⁴³ but it has been made more difficult by MSCC’s failure to map its costs to the FERC Uniform System of Accounts, as Schedule F directs. The paragraphs that follow describe the impermissible items MSCC has included in its Schedule F costs that the CAISO has identified to date.

Schedule F, at Article II, Part B, Section 4 (C), provides for the identification of costs for Construction Work in Progress (CWIP). The FERC Form 1 reference for the line item in question is defined as follows: “‘CWIP’ is the amount of construction work in progress, as properly recorded in Account 107 for construction projects associated with the Subject Resource related solely and directly to pollution control for the Subject Resource.” MSCC added to that line on its Schedule F “plus: Special Deposits for Salvage and Restoration.” This is where MSCC included ARO and other

⁴³ For example, the CAISO does not understand how MSCC’s treatment of Accumulated Deferred Income Taxes (ADIT) is consistent with the principles underlying the RMR Agreement. *See Attachment C, Lovinger Testimony* at 15-16. The CAISO requires additional information to evaluate MSCC’s representation of ADIT.

retirement costs. As described above, these costs are not recoverable under the RMR Agreement.⁴⁴

Schedule F, in Article II, Part B, Section 4 (D), calls for Plant Held for Future Use (PHFU). Inexplicably, MSCC added to this line “plus: Materials and Supplies and Prepayments,” and it included costs for materials and supplies in this line item. FERC Form 1 includes in PHFU “the cost of plant held for future use, as properly recorded in Account 105 that is reasonably assignable or allocable to the Subject Resource.” The Schedule F formula includes separate provisions for i) Plant Materials and Supplies and ii) Prepayments under Schedule F, Article II, Part B, Section 4 (F) Working Capital as follows: “Plant Materials and Supplies, consisting of the value of plant materials and supplies reasonably assignable or allocable to the Subject Resource, as properly recorded in Accounts 154 and 163 and (3) Prepayments, consisting of the amount, if any, of prepayments reasonably assignable or allocable to the Subject Resource, as properly recorded in Account 165.” MSCC does not explain its accounting choice here, nor does it provide documents to support the values submitted. Without additional explanation, these costs are not justified. At a minimum, they should be properly recorded.

The testimony of Mr. Lovinger also indicates the amount MSCC uses for the plant investment, \$204,690,312, is from MSCC’s balance sheet as of December 31, 2020.⁴⁵ As described above, under the RMR Agreement, costs are based on the prior

⁴⁴ See discussion *supra* at Section III.D.

⁴⁵ Attachment C, Lovinger Testimony, page 12, lines 22-23.

cost year, July 1 to June 30. Thus, the plant investment value should reflect MSCC's balance sheet as of June 30, 2020, not December 31, 2020. In its errata, MSCC made some adjustments to this item, but it remains unclear the accounting is correct. The CAISO needs additional information and analysis to determine from whether MSCC used the correct cost period for other Schedule F values.

MSCC requests approval of rates for a two-year period, contingent on the CAISO extending the RMR Agreement for 2022. Without explanation or justification, MSCC proposes for 2022 a 2.5% adder to its Schedule F 2021 fixed revenue requirement. Particularly given current low inflation levels, MSCC's unexplained 2.5% rate adder is not just and reasonable and should be rejected.

IV. CONCLUSION

For the foregoing reasons, the CAISO requests that the Commission grant CAISO's motion to intervene, accept the Midway Sunset RMR Agreement for filing, effective February 1, 2021, subject to refund, and set the matter for hearing and settlement procedures.

Respectfully submitted,

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Dated: February 24, 2021

CERTIFICATE OF SERVICE

I hereby certify that I have this 24th day of February 2021, caused to be served a copy of the forgoing Motion to intervene and Comments upon all parties listed on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

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