



California Independent
System Operator Corporation

March 17, 2008

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

**Re: Motion for Leave to File Answer and Answer of the California Independent
System Operator Corporation
Docket Nos. ER08-556-000 and ER06-615-020**

Dear Ms. Bose:

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213 (2007), the CAISO respectfully submits a motion for leave to file an answer ("Answer") to the protests filed in this proceeding on February 29, 2008, and pursuant to Rule 313, the CAISO also files its answer to the comments submitted on the same date.

If there are any questions concerning this filing, please contact the undersigned.

Respectfully Submitted,

/s/ Anthony J. Ivancovich

Anthony J. Ivancovich
Counsel for the California Independent
System Operator Corporation

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

California Independent System)	Docket No. ER08-556-000
Operator Corporation)	Docket No. ER06-615-020
)	

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

On February 8, 2008, the California Independent System Operator Corporation (“CAISO”) ¹ submitted a proposed amendment to its Market Redesign and Technology Upgrade Tariff (“MRTU Tariff”) in the above-referenced docket. ² As the CAISO explained, the amendment was submitted to implement the Interim Capacity Procurement Mechanism (“ICPM”) which provides the CAISO with an administratively straightforward and efficient tariff-based mechanism to permit the CAISO to engage in backstop capacity procurement under a defined set of circumstances when necessary to meet Reliability Criteria and maintain system operations. In response to the filing, a number of parties submitted motions to intervene, comments, or protests. ³ Requests for clarification and for a settlement conference were also submitted.

¹ Capitalized terms not otherwise defined herein have the meaning set forth in the Master Definition Supplement, Appendix A to the CAISO Tariff.

² Docket Nos. ER06-615-000, ER08-556-000, California Independent System Operator Corporation Interim Capacity Procurement Mechanism, Feb. 8, 2008.

³ The following parties filed interventions: California Department of Water Resources State Water Project (“CDWR”); Electric Power Supply Association (“EPSA”); Metropolitan Water District of Southern California (“Metropolitan”); Modesto Irrigation District (“Modesto”); NRG Companies (“NRG”); and Western Area Power Administration (“WAPA”). The following parties filed interventions with comments and/or protests: Alliance for Retail Energy Markets (“AREM Comments”); California Municipal Utilities Association (“CMUA Comments”); California Public Utilities Commission (“CPUC Comments”) Calpine Corporation (“Calpine Protest”); the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (“Six Cities Comments”); City of Santa Clara, California and the M-S-R Public Power Agency (“Santa Clara/M-S-R Protest”); Constellation Parties and Mirant Parties (“Constellation/Mirant Protest”); Dynegy Moss Landing, LLC, Dynegy Morro Bay, LLC, El Segundo Power, LLC, and Reliant Energy, Inc.

Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213 (2007), the CAISO respectfully requests leave to file an answer (“Answer”) to the protests filed in this proceeding on February 29, 2008, and pursuant to Rule 313, the CAISO also files its answer to the comments submitted on the same date. For the reasons explained below, the CAISO respectfully requests that the Commission accept the proposed ICPM amendments, without modification, other than the limited clarifications and refinements provided in this Answer.

I. SUMMARY

The ICPM is a necessary and appropriate mechanism to complement the MRTU market design. It will enable the CAISO to maintain reliable grid operations in the unlikely event Load Serving Entities (“LSEs”) do not meet resource adequacy (“RA”) requirements established by the California Public Utility Commission (“CPUC”) and other Local Regulatory Authorities; procured Resource Adequacy Resources do not meet specific local reliability criteria; or unexpected conditions or events occur during the operating year that create a need for the CAISO to procure additional capacity on a short-term basis in order to maintain and sustain reliable operations.⁴ The ICPM replaces the Reliability Capacity Services Tariff (“RCST”) and provides the CAISO with the means to engage in backstop procurement, when necessary, to ensure the reliability of the CAISO Controlled Grid in accordance with Reliability Criteria.

(“California Generators Protest”); Independent Energy Producers Association (“IEP Protest”); Northern California Power Agency (“NCPA Comments”); Pacific Gas and Electric Company (“PG&E Protest”); Southern California Edison Company (“SCE Comments”); and the Utility Reform Network (“TURN Comments”);

⁴ Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definition Supplement, Appendix A to the CAISO Tariff.

The CAISO notes that a number of parties submitted comments in overall support of the CAISO's ICPM proposal, including: TURN, CPUC, SCE, PG&E, Six Cities, NCPA, and CMUA. A handful of parties, objected to the CAISO's proposal, namely IEP, the California Generators, Calpine and Mirant/Constellation. In response to those parties who have protested or objected to the filing, CAISO reiterates a few important points that seem to have been lost in the debate. First, the CAISO is not attempting to create a centralized capacity market with the ICPM. Second, the ICPM is not intended as a mechanism to incent new generation. Third, the ICPM is not intended to be a referendum on the state RA program or to modify the RA program. The ICPM is merely an interim, administrative mechanism that will permit the CAISO to efficiently procure backstop capacity on a short-term basis from existing resources that have capacity available and which are willing to make that capacity available to the CAISO via a forward ICPM designation in order for the CAISO to meet reliability needs that arise. Further, designations under the ICPM are voluntary; units owners are not required to accept them. Given the interim nature of the ICPM (the ICPM will automatically sunset on December 31, 2010), the uncertainty as to whether (or when) there will even be any ICPM procurement, and the fact that the ICPM is merely intended to "fill" any gaps in LSE procurement or permit the CAISO to undertake short-term procurement in response to unplanned, unexpected Significant Events, the ICPM clearly will not -- and cannot reasonably be expected to -- "drive" new investment or repowering of existing units.

To the extent protesting parties take issue with the state's RA program, then they should raise their issues with the CPUC. Concerns with the RA program should not be addressed within the context of this proceeding. Indeed, issues regarding the appropriate

long-term RA framework applicable to CPUC-jurisdictional utilities are being addressed before the CPUC in Docket No R-04-04-003. That proceeding is considering issues associated with long-term capacity procurement, including centralized capacity market options. The parties that have protested the CAISO's ICPM proposal have been actively participating in that proceeding urging the CPUC to consider recommending implementation of a centralized capacity market approach. The CAISO has also been actively involved in the proceeding, in particular, to evaluate centralized capacity market alternatives and recommend a preferred approach. As the CAISO indicated in its ICPM transmittal letter, following the conclusion of the CPUC's long-term RA proceeding, the CAISO will work with stakeholders to evaluate designs for more permanent capacity pricing mechanisms that provide appropriate long-term investment signals and prices that comport with the long-term need for capacity and which can effectively complement the state's long-term resource adequacy framework, and which includes carefully crafted mitigation measures. That is why the CAISO has proposed that the ICPM automatically sunset on December 31, 2010, *i.e.*, so that it can be replaced by a long-term capacity pricing mechanism at that time. The CAISO has designed its ICPM proposal so that, among other things, it does not unduly "interfere" with the existing RA program (*e.g.*, by unduly influencing RA prices upwards or downwards) or pre-judge the issues that the CAISO soon will be discussing with stakeholders regarding a long-term capacity procurement mechanism. The CAISO urges the Commission not to "put the cart before the horse" by adopting the multi-year ahead capacity market-type features recommended by IEP and others, but should instead direct that those issues be fully vetted in the context of a CAISO stakeholder process to develop a more permanent

capacity procurement/pricing mechanism to function in conjunction with the long-term RA design.

In any event, the CAISO believes that the proposed ICPM sufficiently meets its goal of enabling the CAISO to supplement or backstop LSE-based RA capacity procurement from existing resources as needed for reliability grid operations using a transparent and efficient tariff-based mechanism, and the Commission should find it to be just and reasonable.⁵ In addition, the pricing of the ICPM is both just and reasonable and consistent with rate principles previously adopted by the Commission. The proposal essentially permits the procurement of capacity from existing resources that either (a) have voluntarily decided to participate in the forward time frame (*i.e.* prior to the RA showing for the compliance year) based on the CAISO's ICPM price offer, or (b) after the forward showing for resources, have decided to remain in operation during the year without having an RMR or RA contract, with the expectation of only making market or off-system sales. Commission precedent states that a program such as the ICPM:

would promote order and transparency in the market by clearly telling sellers of the maximum price the ISO was willing to pay and allowing sellers to make informed economic choices on whether to sell [to the CAISO] or to sell elsewhere ...[W]e did not allow the ISO to establish the prices that sellers may charge, only the price that the ISO is willing to pay. Because sellers are not required to sell to the ISO, the ISO cannot dictate their price.

⁵ *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984), *cert denied*, 469 U.S. 917 (1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to all alternatives).

Currently, notwithstanding the maximum purchase price at what the ISO as purchaser is willing to pay, the ISO has no more or less ability to procure capacity and energy than any other buyer of these services....[I]f the ISO is unable to elicit sufficient supplies at or below its announced purchase price ceiling (because generators are free to sell elsewhere if they choose), it will have to raise its purchase price to the level necessary to meet its needs.⁶

Participation in the ICPM is *voluntary*. Sellers are free to decline CAISO designations. As the Commission noted in *Morgan Stanley*, if the program fails to meet the CAISO's procurement needs, the CAISO will need to make adjustments. The CAISO believes this should not be necessary because the proposal will, *at a minimum*, cover a resource's going forward costs (plus 10%) -- and in most instances should cover an even larger portion (or even the entirety) of the total fixed costs (including recovery of and return on capital) for many resources for the period of designation-- while allowing resources to retain all market revenues (*i.e.*, there is no peak energy rent deduction for ICPM capacity). Thus, the ICPM appropriately values any energy required from the unit by enabling it to retain the market price, including scarcity payments. The CAISO understands, based on the CPUC pleading filed in Docket Nos. EL08-20 (Exhibit H to the ICPM filing), that the proposed minimum capacity price to be paid to designated units under the ICPM falls at the high end of the range of prices paid to RA resources under bilateral RA contracts. This will encourage both suppliers and LSEs to enter into RA contracts and not rely instead on the backstop. As discussed in detail herein and in the ICPM transmittal letter, there is no logical, economic or legal basis for the uniform

⁶ *Morgan Stanley Capital Group Inc. v. California Independent System Operator Corporation*, 92 FERC ¶ 61,112 (2000) at 61,431.

application cost of new entry pricing (“CONE”) for ICCPM capacity (as proposed by IEP) given the following facts: (1) the interim nature of the ICPM and the fact that new entry cannot compete with existing resources to provide ICPM service because the ICPM is not a multi-year forward capacity market; (2) the fact that ICPM procurement is not intended to and will not incent new generation given the uncertain and short-term nature of ICPM procurement; (3) the adoption of CONE pricing will result in payments to ICPM resources that are significantly higher than the prices that are being paid to RA and RMR resources and would likely interfere with the existing RA program and attempts to design a more permanent long-term RA framework and capacity pricing mechanism; (4) for 2008 a capacity surplus exists systemwide in seven of the ten local capacity areas and, for 2009, a capacity surplus exists in eight of ten local capacity areas, and in those areas of deficiency most of the capacity is either owned by the investor-owned utilities or is under long-term contract, *i.e.*, CONE pricing will not benefit the California generators for the short period of time that ICPM will be in effect; (5) CONE pricing will allow resource owners in local areas where ownership is concentrated to increase prices even though there is a surplus of capacity and new entry is not needed in those areas; and (6) CONE pricing is wholly inappropriate for short-term ICPM designations due to unexpected and transitory Significant Events where new generation cannot provide the service and there is no indication that new resources should even enter the market at that particular location in the long-term due to the transient nature of the event.

The CAISO also submits that the designation process is reasonable. The ICPM provides the CAISO with broader authority and more flexibility to designate resources than the criteria provided under the RCST. In its ICPM transmittal letter, the CAISO

identified the deficiencies in the RCST designation process and criteria and how those deficiencies have been remedied in the ICPM. For example, when needing to meet a short-term reliability need, the CAISO will be more likely to designate a resource for one month than the three month minimum required under the RCST. Proposals for “hard” triggers that result in automatic designations or for minimum designation terms ranging from three months to the balance of the a year for Significant Events, and for one-year designation terms if there is an RA deficiency (even if the deficiency is only for a month or two) will result in unnecessary procurement, over-procurement, and designations unrelated to actual need, create perverse incentives to stay out of the market in order to earn automatic multi-month designations, and will unduly burden ratepayers with unjust, unreasonable and excessive costs.

In essence, the Commission is being asked to choose between two alternatives. On one hand, the CAISO, supported by the CPUC, municipal entities, the IOUs, consumer interest groups, and end-use customers, seeks to implement a targeted capacity backstop program, with a sunset date in December 2010, that will fairly compensate existing resources for voluntarily committing their unreserved capacity to the CAISO’s use for a short period of time while allowing them to retain all market revenues. In contrast, IEP and California Generators seek “hard” triggers that will result in automatic designations of capacity for a minimum term of three months or the balance of year at prices based on CONE. Their proposals would result in significant over-procurement of capacity due both to amount of capacity required to be procured and to the duration of the designation (which would be wholly unrelated to the period of time that the capacity is actually needed or expected to be needed) at prices that far exceed the total fixed costs

of most existing units (oftentimes by many multiples). Moreover, IEP's and California Generators' proposed pricing does not consider the existing surplus in the sub-markets of the RA program (*i.e.*, the local area RA requirements), and in particular the local areas where there is a surplus of capacity, but ownership of units is concentrated. In these circumstances, IEP's and California Generators' proposals would only serve to substantially increase forward RA prices without incenting new entry. As such, IEP's and California Generators' proposals essentially become an insurance policy for resources that have failed to secure RA contracts and would unfairly and unreasonably burden ratepayers and should be rejected by the Commission.

II. BACKGROUND

The background for the ICPM filing is detailed in the CAISO's ICPM transmittal letter submitted February 8, 2008. Over the past nine months, CAISO staff has collaborated with stakeholders to develop an interim, tariff-based, capacity procurement mechanism to be implemented coincident with start-up of MRTU. As the culmination of a lengthy and rigorous stakeholder process, the ICPM proposal effectively meets the CAISO's objectives for an interim backstop mechanism, is compatible with both the MRTU market design and, in the interim, the State of California's existing RA program, will not interfere with the CPUC's and CAISO's efforts to design a long-term RA framework and a more permanent capacity procurement mechanism, and attempts to strike a reasonable balance between the divergent views of stakeholders. Importantly, the ICPM Proposal supports reliability while not interfering with the efficiency of the markets, both CAISO and bilateral.

III. MOTION TO FILE ANSWER

The CAISO does not object to any of the interventions filed in this proceeding. The CAISO recognizes that, unless authorized by the Commission, the Commission's Rules of Practice and Procedures preclude an answer to protests. The CAISO hereby respectfully requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an Answer to the protests. Good cause for this waiver exists here because the 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 to ensure a complete and accurate record in this case.⁷

IV. ANSWER

- A. This Proceeding Is About the CAISO's Limited Backstop Procurement Authority; It Is Not a Referendum on the State of California Resource Adequacy Program**
- 1. The Commission Has Found that State Authorities Have the Responsibility To Establish Planning Reserve Margins and Determine Resource Qualifications.**

In its September 21, 2006 Order conditionally accepting the MRTU Tariff, the Commission determined that state authorities have the responsibility to establish Reserve Margins and determine the qualifications of resources to meet those margins.⁸ The Commission expressly rejected the CAISO's proposal to establish minimum criteria, permitting the CAISO's proposed standards to be utilized only in the absence of action by

⁷ See, e.g., *Entergy Services, Inc.*, 116 FERC ¶ 61,286 at P 6 (2006); *Midwest Independent Transmission System 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).

⁸ *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 (2006) (September 21 Order), *order on reh'g*, 119 FERC ¶ 61,076 (2007) ("April 2007 Order") (stating, "California or the region may determine in the first instance the appropriate level of planning reserves by balancing reliability and cost considerations") 119 FERC ¶ 61,076 at P 558.

the appropriate local regulatory authority.⁹ Accordingly, the protests of the ICPM which express dissatisfaction with California's RA program must be dismissed as being beyond the scope of this proceeding. They constitute an impermissible collateral attack on prior Commission Orders.¹⁰ The CAISO's proposal merely seeks authorization for an interim and targeted backstop capacity procurement mechanism, and is not intended to be a substitute for the state RA program, which is the primary means for ensuring that resources are available when and where needed and serves as the mechanism for ensuring generation adequacy and incenting the development of new generation.

The attacks on the state RA program are both general and specific. For example, Calpine asks the Commission to reject the ICPM proposal and initiate a proceeding to develop a market-based structure for capacity procurement in California that "comprehensively addresses the limitations of the RA program."¹¹ IEP states that the time has come "to repair the reliability flaws inherent in the RA process,"¹² and for the California Generators, the time has come to require parties to buy reliability insurance in the form of excess infrastructure capacity to cover outages above an "optimal" level of planning Reserve Margin.¹³ Specific complaints include Calpine's contention that IOUs are permitted to procure capacity through "discriminatory solicitations."¹⁴ The California

⁹ September 21 Order at PP1117-1118.

¹⁰ See *supra* note 7.

¹¹ Calpine Protest at 2. Calpine complains that California lacks a robust centralized capacity market and relies on a RA program that does not produce price signals that reasonably value a generator's commitment to capacity. Calpine Protest at 1-2. Calpine also boldly claims, without providing any supporting evidence, that the RA program and resulting prices are not presumptively just and reasonable. Calpine Protest at 10. Calpine requests that as part of this proceeding that the Commission should initiate to examine comprehensively the California capacity procurement mechanisms (including RA) and direct the CAISO to develop a straw proposal for a uniform set of availability obligations (with performance measures and targets and penalties and bonuses) that would apply to both CAISO-procured capacity or RA or other bilaterally procured capacity. Calpine Protest at 13.

¹² IEP Protest at 2.

¹³ California Generators at 8.

¹⁴ Calpine Protest at 5.

Generators, Calpine, and IEP also fault the CPUC's methodology for counting demand response as meeting the Reserve Margin.¹⁵

These issues are clearly beyond the scope of this proceeding. The Commission has stated, "the MRTU Tariff gives Local Regulatory Authorities the authority to do their own system RA planning in the first instance."¹⁶ It is inappropriate for Calpine, IEP and the California Generators to attempt to circumvent current state requirements and ongoing state proceedings by having the Commission establish its own RA mandate either by expanding the scope of the CAISO's limited Section 205 filing or by fundamentally altering the terms and conditions of the CAISO's limited backstop procurement mechanism.

2. Refinements to the State Program Are Ongoing

As noted in ICPM transmittal letter, the CAISO has recognized that the ICPM should not unnecessarily interfere with the CPUC's ongoing proceeding regarding the appropriate long-term RA program for the utilities within its jurisdiction.¹⁷ In particular, the CAISO does not want to prejudge the state's or its own consideration of the development of a capacity market. The CAISO has further recognized that there have been significant refinements to the state RA program, and further efforts are ongoing.

Specifically, the state program is phasing out the use of liquidated damage contracts in meeting RA obligations. Accordingly, no new liquidated damage contracts can count for RA purposes, other than the contracts entered into by the CDWR during

¹⁵ California Generators Protest at 9; Calpine Protest at 4; IEP Protest at 17. If the Commission were to order the CAISO to adjust its use of demand response as a resource adequacy tool as requested by IEP (IEP at 17; Cavicchi at P 46), it would make a mockery of the deference accorded to the state program in the MRTU order. If the CAISO could engage in ICPM designations simply because it considered the established Reserve Margin to be too low, the CAISO would in effect be establishing its own Reserve Margin, a practice the Commission has prohibited.

¹⁶ September 21 Order at P 555.

¹⁷ ICPM Transmittal Letter at 17.

the California Energy Crisis, liquidated contracts will not “count” toward meeting RA requirements after December 31, 2008. Moreover, the CDWR contracts are gradually expiring.

In addition, the state RA program has adopted more stringent local capacity procurement requirements. For example, the 2008 study added another load pocket – the Big Creek / Ventura area, and effective January 1, 2008, the CPUC adopted a Path 26 procurement constraint under its RA program which should reduce zonal congestion because more RA units should be addressing these needs. Both of these requirements will result in more capacity being procured on a forward basis to meet local needs and should reduce the need for the CAISO to commit non-RA units to meet such needs.

Also, as the CAISO stressed in its ICPM transmittal letter, following the completion of the CPUC’s long-term RA proceeding, the CAISO will begin evaluating long-term capacity pricing mechanisms, including centralized capacity market options. Indeed, in 2007, the CAISO conducted a stakeholder process in conjunction with the CPUC’s long-term RA proceeding, to evaluate high-level capacity market designs. The long-term capacity pricing issues raised by Calpine, IEP and the California Generators are more appropriately addressed in the stakeholder processes that will occur following the CPUC’s decision. They are not appropriate for consideration in the context of an interim capacity backstop mechanism such as the ICPM that is intended solely to enable the CAISO to efficiently procure capacity from existing units on a short-term basis in order to fill gaps in LSE procurement or address reliability needs caused by unanticipated Significant Events.

IEP offers the seemingly contradictory statement that “despite planned capacity

additions California's wholesale market prices indicate that no new planned capacity is needed.¹⁸ IEP also notes that California has added over 5,000 MW of generation since 2004.¹⁹ Moreover, significant new generation is expected to come on line in the next year including the Island Empire project in Riverside rated at 800 MW.²⁰ The California Generators state that ICPM will not be needed because the IOUs will not fail to comply with their RA requirements, including meeting the Planning Reserve margin established by the CPUC.²¹ The CAISO also believes this will be the case, and thus, the need for backstop procurement will be minimal. However, the only way for this statement to be true is if the California IOUs are undertaking the necessary procurement activities by either self-producing or contracting for the required supply. The stream of revenue from long-term contracts can fund new generation. An investor's decision whether to build new generation will not be based on the pricing parameters of a two-year backstop capacity procurement mechanism in which it will be uncertain whether there will even be any procurement, what locations any capacity will be needed, and the fact that any procurement that does occur will be for a short-term basis.

The CAISO is in agreement with the statement by the California Generators that the need for ICPM is inversely proportional to the robustness of the RA requirements. The CAISO noted in its Transmittal Letter that a significant volume of ICPM designations would signal that modifications to the RA program are necessary.²² It does not follow, however, that even before MRTU has commenced, even before the CAISO

¹⁸ IEP Protest at 16; Cavicci at P 8.

¹⁹ IEP Protest at 4.

²⁰ In addition, the 590 MW Otay-Mesa plant located in the San Diego load pocket is expected to come on-line in 2009. Also, the California Energy Commission ("CEC") recently approved the construction of a 500 MW peaker to be constructed in Los Angeles County by Edison Mission Energy that is targeted to be on-line in the summer of 2009. *See* Electric Power Daily at 4 (Feb. 28, 2008).

²¹ California Generators Protest at 8.

²² ICPM Transmittal Letter at 51-52.

has had to maintain reliability without the Commission-required Must Offer Obligation (“MOO”); and even before a voluntary ICPM designation request, that the ICPM program can or should be found to be inadequate.

3. Complaints About the CAISO’s Present and Future Energy Markets Are Similarly Beyond the Scope of This Proceeding.

The California Generators make reference to the “highly mitigated” CAISO Markets.²³ The Commission’s authorization of MRTU, including the approved provisions protecting against the exercise of market power, are similarly beyond-the scope of this proceeding. MRTU removes the MOO, provides for locational marginal pricing, increases the damage control bid cap, provides for the possibility to earn a RUC Availability payment, and includes higher prices in times of overall scarcity of supply.²⁴ Also, a year after MRTU implementation, the CAISO is required to implement a more formal scarcity pricing scheme.

The Commission has found the CAISO’s MRTU pricing provisions to be just and reasonable; so, complaints about MRTU pricing amount to nothing more than collateral attacks on prior Commission orders on MRTU. Thus, IEP’s statement that the CAISO’s spot market energy prices have not been “at high enough levels to support investment in new capacity”²⁵ misses the mark because the offer caps are increasing under MRTU, and there are opportunities for suppliers to earn increased revenues in local areas where their energy is needed. Given that the Commission has already found the MRTU pricing scheme to be just and reasonable, any revenues earned through ICPM designations are

²³ California Generators Protest at 10.

²⁴ On day one, MRTU includes a form of scarcity pricing – namely if there is a reserve shortage due to an overall scarcity of resources the market clearing price goes to the price cap. The Commission has also required the CAISO to file a more formal scarcity pricing regime to be effective one-year after MRTU implementation.

²⁵ IEP Protest at 4.

either part of the forward decision that suppliers would take into consideration in determining to accept a voluntary designation or “gravy” on top of the already just and reasonable MRTU prices that suppliers determined were sufficient to continue to run their facility even without RA or RMR contracts. Moreover, resources are not required to accept ICPM designations, for example if they believe they can receive higher prices elsewhere for their capacity or if they opt to earn revenues solely through the ISO markets. As discussed in the ICPM transmittal letter, the price for ICPM capacity should incent resources to accept a designation because, at a minimum, the CAISO will pay a resources its going forward costs, plus 10%, and in most instances units will be receiving an even greater contribution toward their fixed costs. In any event, as the Commission has previously recognized, it is bilateral contracting that should stimulate new investment not spot market prices.²⁶ Stated differently, it is LSE compliance with the Reserve Margin that provides the primary impetus for the development of new generation. Projects will not be financed based on the speculative chance that a unit might receive a short-term ICPM designation. The ICPM cannot be seen as a mechanism to raise forward RA prices or provide scarcity payments that are not available otherwise through the energy and ancillary service markets; it is designed to serve as a backstop to support CAISO’s ability to reliably operate the grid using existing resources.

²⁶ For example, the Commission has stated with respect to the CAISO’s use of Default Bids that it is the default bid options, *in conjunction with the forward contracting imposed under the CPUC’s resource adequacy program*, will provide generators with a reasonable opportunity to become revenue sufficient. Therefore, the likelihood of over-mitigation is low and, contrary to Williams’ assessment, local market power mitigation should not deter future investment in California. *California Indep. Sys. Operator*, 119 FERC ¶ 61,076 at P 493 (2007) (emphasis added). The Commission has recognized elsewhere that bilateral contracts should be the principal means by which generators recover their total fixed costs. *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 95 FERC ¶ 61.115 at 61,364 (2001).

B. The Nature of the ICPM Product Is Reasonable

As discussed in the ICPM filing letter, CAISO proposes to procure a “capacity only” product.²⁷ The California Generators protest the nature of the product by arguing that the ICPM term of service is not consistent with year-ahead RA requirements (5 months), local RA (one year) or RMR (one year).²⁸ Further, the Generators assert that ICPM compensation is only provided when the unit is required to operate under CAISO’s discretion, and does not provide for recovery of capital costs.²⁹

These contentions are without merit. The ICPM is designed to utilize units that have *voluntarily* accepted the offer of designation either in the forward time-frame, or during the year, when they have elected to remain in operation even without RA contracts, and thus, can respond to the CAISO’s offer during a Significant Event. ICPM represents a voluntary opportunity for a resource to be on call if CAISO determines that LSEs have not properly responded to RA requirements or an unexpected event has occurred that creates a need for capacity procurement in order to maintain reliability. Given its brief time-frame until 2010, the ICPM is not sufficient to serve as an entry market for capacity. No generator that has entered the California market in the past few years, nor that is planning to enter during the period ICPM will be in effect, can legitimately claim that they need ICPM payments to cover capital costs. Such generators chose to enter the California market either based on other sources of revenue through bilateral agreements or without guarantees of capital cost recovery, and it is inappropriate to now require ICPM to provide guarantees of additional capital cost recovery for the brief period that it will be in place. If ICPM were to provide capital cost recovery it

²⁷ ICPM Transmittal Letter at 19.

²⁸ Generators Protest at 5.

²⁹ Generators Protest at 15.

could be sending a false signal to the market that there is a centralized capacity market in California when clearly the future RA market design remains a work in process. Rather, the ICPM designation should be interpreted as essentially a forward call option on existing facilities that have previously-decided that it was in their economic interest to be in operation to facilitate sales into the CAISO energy and Ancillary Services Markets or to provide bilateral sales of capacity or energy to LSEs in California or outside the state.

Also, the ICPM is also not a substitute for RMR, which are annual contracts entered into to address a known long-term local reliability need not addressed through RA contracts. In other words, the CAISO needs a particular unit, in a particular location on a long-term basis to maintain reliability.

Moreover, the California Generators are incorrect when they claim that a designation cannot be as long as the period of an RA requirement. Under proposed Section 43.2.1, a proposed designation can be for as long as one year, depending on the period(s) of any deficiency based on the CAISO's evaluation of the submitted Resource Adequacy Plans. Similarly, under Section 43.2.4, the CAISO can procure ICPM capacity to fill any deficiency in the procurement of annual demand and reserve margin requirements for a minimum term of one month and a maximum term equal to the maximum annual procurement period established by the applicable regulatory authority, *i.e.*, currently five months for the CPUC, based on the period of the actual deficiency. It is inherently reasonable for the CAISO to procure ICPM capacity only for the period of the actual deficiency; to do otherwise would result in over-procurement or a duplication of RA procurement, that would impose unnecessary and excessive costs on ratepayers. California Generators also ignore the fact that the RA program provides that LSEs must

procure 100% of their requirements (demand plus planning reserve) on a month-ahead basis. In other words, RA contemplates the possibility of monthly procurement, and the CAISO can procure capacity to fill any deficiency in meeting monthly RA requirements (*see* Section 43.2.4). Moreover, designations for ICPM Significant Events are not designed to track the period of an RA contract, but rather reflect the expected duration of the event for which the procured capacity is intended to address.

The Commission has recognized the CAISO's "has no more or less ability to procure capacity and energy than any other buyer of these services."³⁰ The CAISO should be permitted to operate as any rational buyer would in seeking to purchase only the capacity it needs to meet its reliability requirements and obligations and not an excessive amount. Similarly, rational sellers should welcome the additional revenues for their capacity that is not previously under contract. As the CAISO stated in the transmittal letter,³¹ the ICPM is not a substitute for other existing programs, including RMR and Extraordinary Dispatch. It is a replacement for the RCST and an implementation of the backstop procurement authority that has existed in some form in the tariff since the commencement of CAISO operations. While the CAISO could have reverted to its original authority to negotiate individual contracts when needed to support reliable operations, it has pursued the ICPM because of a recognition that a more simple, efficient, tariff-based, forward, transparent process that was consistent with a redesigned market with numerous changes to the pricing of energy and ancillary services was a benefit to both Market Participants and CAISO staff. One lesson learned from the California Energy Crisis was that contract solicitation by the CAISO during times of

³⁰ Morgan Stanley Capital Group Inc. v. California Independent System Operator Corporation, 92 FERC ¶ 61,112 (2000) at 61,431.

³¹ ICPM Transmittal Letter at 16.

significant challenges to system operations was incompatible with its fundamental mission of reliable system operation. The ICPM appropriately fills a need not met by other programs and products and will allow the CAISO to effectively and efficiently meet its reliability needs.

C. The Designation Process is Just and Reasonable

The CAISO has proposed to utilize the ICPM to designate capacity in four situations: (1) if an LSE fails to procure its share of Local Capacity Requirements and other LSEs in the same area have not over-procured to make up the deficiency; (2) if all the LSEs in a Local Capacity Area have met their requirements but there is still a shortfall that prevents the CAISO from meeting Reliability Criteria and the “collective deficiency” is not cured; (3) if an LSE does not meet the Reserve Margin established by the CPUC or other Local Regulatory Authority and there is an overall shortfall, and the LSE does not cure the deficiency; and (4) in the case of an ICPM Significant Event. In each of the four situations, the CAISO has sought to procure capacity in an amount equal to the amount of the deficiency (or the amount of capacity needed to address the Significant Event) and for the period of the capacity deficiency (or expected duration of the Significant Event).

1. Constellation and Mirant’s Contention that the CAISO Should Not Be Able to Procure for Significant Events Should be Rejected.

Constellation and Mirant argue that the CAISO’s ability to designate resources as a result of an ICPM Significant Event should be eliminated.³² They state that the loss of a generating facility or transmission facility are the types of transitory events for which a planning Reserve Margin exists and that changes in laws or forecasts should be reflected

³² Constellation/Mirant Protest at 7.

in the next planning cycle.³³ Finally, they contend that if there are short term issues, the proper course to respond to the emergency is by purchasing energy not capacity.³⁴ While the CAISO agrees that Reserve Margins should be set at levels sufficient to respond to a prudent level of contingencies, it is not prudent to rely on procurement of energy-only to maintain system reliability and it would be cost-prohibitive and not required by Good Utility Practice to set reserve margins at levels that would be sufficient to respond to each and every conceivable contingency.

In approving the RCST, the Commission has already made the determination that it is appropriate for the CAISO to have authority to procure capacity from non-RA resources to address a Significant Event. Mirant's/Constellation's protest is essentially a collateral attack on that prior finding. Indeed, the Commission expressly rejected claims that the RCST was an "unnecessary mechanism."³⁵ The Commission found that RCST was neither unnecessary nor duplicative; rather, the Commission found that it augments both market design and reliability initiatives.³⁶ The same rationale supports the need for the ICPM. Elsewhere the Commission has also recognized that the CAISO needs the authority to engage in backstop procurement to meet its responsibilities as the Balancing Authority Area operator:

We find it reasonable to allow the CAISO the flexibility to engage in backstop procurement activities even though LSEs have adequately met their immediate local capacity obligation. We believe this flexibility is appropriate for those unforeseen circumstances where the CAISO must act in response to a system contingency (e.g. transmission outage) that prevents an LSE from meeting its local procurement obligation in its applicable TAC area location. We also emphasize the necessity of this

³³ *Id.* at 7.

³⁴ *Id.* at 9.

³⁵ Independent Energy Producers Association v. California Independent System Operator Corporation, 118 FERC ¶ 61,096 at P 49 (2007).

³⁶ *Id.*

approach because the CAISO is responsible for maintaining the efficiency and reliable operation of the transmission grid consistent with the NERC planning standards. In addition, we note that the CAISO is under an obligation to meet other applicable reliability criteria under its Transmission Control Agreement.³⁷

Similarly, the Market Surveillance Committee (“MSC”) “support[ed] giving the ISO Operators considerable discretion to declare a Significant Event whenever they determine that additional RA capacity is necessary to maintain grid reliability....because the potential reliability consequences of limiting the set of circumstances when the ISO can declare a significant event are simply too great to ignore.”³⁸

Mirant and Constellation appear to suggest that the CAISO should operate the system only with RA units. If that approach is followed through to its logical conclusion, in the short-term, the CAISO should simply allow the reliability problem to occur. That ignores the fact that there are non-RA units available to meet the reliability need. It also ignores the intent of EPAct and the NERC Reliability Standards. Such a practice would be patently imprudent and inconsistent with Good Utility Practice.

Constellation and Mirant state that if procurement for ICPM Significant Events is not eliminated, it should be restricted to occur only when the available capacity is reduced to a level below the authorized minimum reserve level.³⁹ SCE supports the CAISO’s authority to make an ICPM designation for a significant event. However, SCE does not support the proposed definition which it alleges is “vague and overbroad.”⁴⁰ For SCE, a Significant Event should only be the result of a physical change to the electrical

³⁷ California Indep. Sys. Operator Corp., et. al., 122 FERC ¶ 61,017 (2008) at P 63-64.

³⁸ Opinion on “Interim Capacity Payment Mechanism Under MRTU”, Market Surveillance Committee of the California ISO dated November 21, 2007 (“MSC Opinion”) at 3-4.

³⁹ Constellation/Mirant Protest at 11-12.

⁴⁰ SCE Comments at 3-4. *See also* SVP/M-S-R (the Commission should reject CAISO’s broad discretion in designating Significant Event and return to RCST provision). SVP/M-S-R at 6-7.

grid.⁴¹ CMUA does not ask the Commission to make modifications to the CAISO's proposal but submits comments to make sure Commission is aware of its concern about CAISO discretion.⁴²

With respect to ICPM Significant Event designations, "ICPM Significant Event" is defined as:

A substantial event, or a combination of events, that is determined by the CAISO to either result in a material difference from what was assumed in the resource adequacy program for purposes of determining the Resource Adequacy Capacity requirements, or produce a material change in system conditions or in CAISO Controlled Grid operations, that causes, or threatens to cause, a failure to meet Reliability Criteria absent the recurring use of a non-Resource Adequacy Resource(s) on a prospective basis.⁴³

The CAISO strongly disagrees with the suggestion that it should be required to wait until it is in *actual* non-compliance with Reliability Criteria before taking affirmative action to secure needed capacity on a forward basis. The CAISO should be accorded the ability to act when conditions *threaten* to cause non-compliance. Good Utility Practice, as well as common sense, requires the CAISO to act in advance to avoid emergency situations, not just to respond once an emergency is upon it. Such authority is consistent with authorizations the Commission has previously granted the CAISO. In that regard, the RCST, the CAISO's existing tariff, and the MRTU Tariff all authorize the CAISO to commit units in advance of an actual emergency. For example, the RCST permits the CAISO to make a Significant Event designation where an event "threatens to cause a failure to meet Applicable Reliability Criteria" (*see* definition of Significant Event).

⁴¹ *Id.* at 5. SCE proposes the following definition: An event that either (1) poses a credible threat that could result in a significant physical change to the CAISO grid or (2) has resulted in a significant physical change to the CAISO grid that causes, or threatens to cause, a failure to meet are absent the recurring use of a non-RA resource(s) on a prospective basis. SCE Comments at 5.

⁴² CMUA Comments at 6.

⁴³ ICPM Transmittal Letter at 23.

Under Section 42.1 of the existing Tariff, the CAISO can procure capacity if forecasts show that Reliability Criteria cannot be met during peak Demand periods or if the CAISO concludes it may be unable to comply with Applicable Reliability Criteria. The Exceptional Dispatch provisions of the MRTU Tariff (Section 34.9.1) permit the CAISO to dispatch a unit “to prevent an imminent System Emergency or a situation that threatens System Reliability.” Mirant’s/Constellation’s proposal is contrary the concepts embodied in these, and other, tariff provisions that the Commission has previously approved, as well as Good Utility Practice. In any event, as discussed below, the CAISO has been criticized (unfairly) for making too few designations for Significant Events under the RCST. The simple truth is that the enhanced reporting obligations proposed with the ICPM will ensure that the already heavily-scrutinized CAISO backstop procurement practices will be monitored on an enhanced basis by interested Market Participants.⁴⁴

With regard to SCE’s suggestion that ICPM Significant Event declarations be restricted to physical system changes, the CAISO stresses that it needs to meet Reliability Criteria no matter what the cause of the “problem” is. SCE’s proposal would unduly limit the CAISO’s ability to do that in all circumstances. The CAISO recognizes that while most ICPM Significant Events are likely to be needed for such physical changes, the CAISO and the tariff must protect against the possibility that non-physical changes. Non-physical changes that could necessitate designation include, *inter alia*, modifications to reliability requirements or RA requirements and changes in CEC load forecasts upon which the CAISO’s local capacity studies are based. Under the tariff and the Transmission Control Agreement, the CAISO must operate CAISO Controlled Grid in

⁴⁴ Six Cities is also concerned about the CAISO discretion to designate for ICPM Significant Events, but notes that its concern is mitigate somewhat by the reporting obligations. Six Cities at 5. *See also*, CMUC at 7

accordance with Reliability Criteria. If an ICPM Significant Event declaration is necessary to achieve compliance as a result of a non-physical issue, the CAISO should not be precluded from using this option. Again, the reporting obligation will ensure transparency as to the CAISO's actions.

2. IEP's And California Generators' Reliance On The Lack Of Designations Under RCST As A Reason For Removing The CAISO's Discretion To Make ICPM Designations Is Misplaced

California Generators and IEP object to the discretion that the CAISO has in determining whether to make ICPM Significant Event designations. California Generators state that, absent designation under ICPM, there is no explicit identifiable fixed cost recovery provided to non-RA units.⁴⁵ IEP claims that the ICPM designation process gives the CAISO too much flexibility to establish the term of the designation.⁴⁶ Both IEP and California Generators express concern that the CAISO will not designate units under the ICPM because the actual experience with RCST shows that, during the period June 1, 2006 through December 31, 2007, the CAISO only made one three-month designation despite denying Must Offer waivers to 31 different units on 525 separate occurrences.⁴⁷ As an alternative, California Generators propose that the first Exceptional Dispatch for reliability purposes of a non-RA resource (1) should trigger a balance of the year ICPM designation if the unit is located within one of the ten local reliability areas which have CAISO-defined local area requirements, or (2) should trigger a three-month ICPM designation if it is not located within one of those reliability areas.⁴⁸ IEP concurs, stating that "if a generating unit receives a single Must Offer Waiver Denial ("MOWD"),

⁴⁵ California Generators Protest at 23.

⁴⁶ IEP Protest at 14.

⁴⁷ California Generators Protest at 24; IEP Protest at 21.

⁴⁸ California Generators Protest at 24.

it should be designated on that basis alone.”⁴⁹ IEP also states that “[i]t would be just and reasonable to designate such units to a term of one full year (or until the end of RA demonstration period if a Significant Event results in an offer of designation).”⁵⁰ As discussed elsewhere, both IEP and California Generators propose paying the existing unit providing this ICPM service a capacity payment based on CONE.

IEP and California Generators continue to complain about the lack of designations under the RCST. Their reliance on what occurred under the RCST is wholly irrelevant to ICPM because the CAISO is proposing a new definition of Significant Event under the ICPM which is vastly different than the definition of Significant Event under RCST. The ICPM definition of Significant Event gives the CAISO broader authority to make capacity designations than existed under RCST. In addition, the CAISO is proposing different designation criteria than existed under the RCST. For example, the CAISO is proposing that it be allowed to designate partial units under the ICPM, which will allow it to capacity designations that would not have been allowed under RCST.⁵¹ Further, the CAISO’s ability to make designations to address short-term reliability needs will be enhanced by the fact that ICPM designations have a minimum term of one month as opposed to the three-month minimum term under RCST. In any event, the Commission should not countenance the continued complaints about the lack of RCST designations, especially given that IEP and California Generators have failed to

⁴⁹ IEP Protest at 21. There is no Must Offer Obligation under MRTU and no MOWD process; so, it is not clear, how any unit could receive a designation after one MOWD.

⁵⁰ IEP Protest at 14.

⁵¹ IEP and California Generators fail to mention that the CAISO would have made a second three month designation of capacity under the RCST, but was prohibited from doing so by the requirement under the RCST Settlement that the CAISO can only designate whole units and then can only make a designation if the unit’s capacity is slightly more or slightly less than the amount of the deficiency that needs to be remedied. Thus, under RCST, if the capacity of the unit is greater than “slightly more” than the amount of the deficiency, the CAISO is unable to procure under RCST. That limitation is eliminated under ICPM which provides the CAISO with the ability to designate partial units.

show, in the numerous pleadings that they have filed on this subject, that the CAISO has incorrectly applied the RCST designation criteria specified in the tariff. Under these circumstances, IEP's and California Generators' complaints amount to nothing more than an objection to the very criteria they agreed to and supported as part of the RCST Settlement.

As the CAISO thoroughly explained in its December 20, 2007 Answer to Energy Companies' complaint in Docket No. EL08-13, in its November 15, 2007 Answer to Williams' *Motion to Supplement Motion for Clarification* filed in Docket No. EL05-146, and in its *Reply Comments* filed on January 24, 2008 in Docket No. EL08-20, the CAISO has *not* abused its discretion with respect to RCST designations: the CAISO's implementation of RCST has been entirely consistent with the terms of the tariff and the RCST settlement. IEP and California Generators have not shown otherwise and, importantly, do not provide one iota of evidence to the contrary in their comments on the ICPM. IEP and California Generators simply *assume* that the CAISO must have abused its discretion because only one RCST designation resulted from the 525 MOWDs issued between June 1, 2006 and December 31, 2007.⁵² The lack of RCST designations, however, has been due to the CAISO's conscientious application of the prerequisites for such designations that were included in the RCST Settlement – prerequisites that were agreed to by IEP and the California Generators as part of the RCST Settlement -- and the CAISO's adherence to the designation criteria and standards set forth in the tariff.

IEP and California Generators ignore the fact that the RCST Settlement and the Commission-approved tariff provisions implementing the RCST establish specific requirements before the CAISO can even exercise its discretion to designate a unit; there

⁵² IEP at 6.

are no hard triggers for multi-month RCST designations, nor are such hard triggers appropriate. First, there must be a Significant Event – which, for 2006, was defined as an event “that results in a material difference in ISO-Controlled Grid operations relative to what was assumed in developing the LARN Report for 2006 that causes or threatens to cause a failure to meet Applicable Reliability Criteria.” For 2007, it was “an event that results in a material difference in ISO Controlled Grid operations relative to what was assumed by the CPUC and Local Regulatory Authorities in developing Local Resource Adequacy Requirements for 2007 that causes, or threatens to cause, a failure to meet Applicable Reliability Criteria.” Thus, the issuance of an MOWD or any number of MOWD’s does not – and cannot – establish that a Significant Event occurred. Second, under Section 43.4, the CAISO may designate capacity to provide service under the RCST following a Significant Event only *if* such an RCST designation is *necessary to remedy any resulting material difference* in ISO Controlled Grid operations relative to the assumptions in the LARN Report. Again, the number of MOWDs is irrelevant to this determination.

As the CAISO indicated in its ICPM transmittal letter⁵³ the CAISO has modified the definition of ICPM Significant Event under ICPM to give it broader authority to make designations than was permitted under the RCST definition of Significant Event. Indeed, the CAISO specifically acknowledged (at page 25 of the ICPM transmittal letter) that the RCST definition of Significant Event under RCST was too prescriptive and unduly limited the CAISO’s ability to make designations. IEP and California Generators do not offer any evidence to dispute that fact, yet, they inappropriately rely on the lack of

⁵³ ICPM Transmittal Letter at 23-27.

designations under the RCST's different, more prescriptive standard to claim that the CAISO should not have discretion to make ICPM designations.

Further, under RCST, because Significant Event designations have a minimum term of three months (and will be paid monthly capacity payments for every month that they are designated), Section 43.4 requires the CAISO to take into account the expected duration of the Significant Event in determining whether or not to make an RCST designation.⁵⁴ As the CAISO indicated in its transmittal letter,⁵⁵ this is problematic from a designation standpoint because the CAISO, in determining whether to make a designation, is required to compare the expected duration of the Significant Event to the three-month minimum term for a Significant Event designation. This made it difficult for the CAISO to make RCST designations for shorter-term events which are more likely to occur than a longer-term, more drastic event. The ICPM proposal addresses this limitation by allowing the CAISO to make a one-month designation (and then extend the designation for two months if the Significant Event will go beyond a month). This provides the CAISO with greater flexibility to make designations to meet shorter term needs without having to balance the cost impacts of a minimum three-month designation. IEP and California Generators fail to recognize that the ICPM proposal will make it easier for the CAISO to make designations to meet short-term reliability needs, but instead they continue to insist on minimum designation terms of one-year or three-months, which are wholly inappropriate for the reasons discussed elsewhere,

⁵⁴ Under the Significant Event/Repeat MOWD evaluation process, the CAISO is also required to indicate whether any RA resources or RMR units were available and called by the CAISO before it denied a FERC must-offer Generator's waiver request. Finally, the CAISO must explain why Non-Generation Solutions were insufficient to prevent the use of denials of must offer waivers for local reasons.

⁵⁵ ICPM Transmittal Letter at 27.

The CAISO emphasizes that it applied each of the aforementioned criteria required by the RCST to each of the MOWDs that it issued since June 1, 2006, as required by the RCST Settlement and the RCST Tariff. By doing so, it determined that only two events would have warranted Significant Event designations under the RCST.⁵⁶ IEP and California Generators have not identified (in their ICPM comments or in the other pleadings they have filed on this subject) a single instance in which the CAISO failed to apply the specified criteria or applied them incorrectly. The fact that those criteria were applied to a 525 MOWDs – which is the entire basis of IEP’s and California Generators’ contention – means nothing without a showing that there were MOWDs that satisfied these criteria and require a RCST designation, but upon which the CAISO nevertheless refused to make an RCST designation. IEP’s and California Generators’ argument amounts to nothing more than a red-herring in an attempt to gain support for their proposal that would automatically give long-term designations to units that are committed for only one-day regardless of whether they are needed on a long-term basis.

In any event, IEP’s and California Generators’ reliance on the raw number of MOWDs since June 1, 2006 does not tell the whole story. First, of those 525 MOWDs, 264 were MOWDs in Real-Time under the CAISO’s Real Time Commitment (“RTC”) software which commits effective units in economic order.⁵⁷ Thus, with respect to

⁵⁶ See *CAISO Answer to Williams Power Company LLC* at 6-9. As the CAISO has previously noted, the CAISO was unable to make a Significant Event RCST designation for one of the events -- the CEC’s upward revision to its Summer 2006 Demand outlook -- because of the requirements that the CAISO can only designate whole units whose capacity is slightly more or slightly less than the identified deficiency. See *Answer to Williams* at 7-8; *Answer to Energy Companies* at fn. 24. Because the capacity of the only unit that was available to satisfy the deficiency was more than four times the amount of the deficiency, the CAISO was unable to make an RCST designation.

⁵⁷ Retroactive RCST Significant Event Summary at 3-4, July 2007.
<http://www.aiso.com/1c20/1c20e8373c330.pdf>.

RTC commitments other RA, RMR units or non-RA units are generally available for commitment,⁵⁸ but the Commission-approved RTC methodology requires that the most economic unit be committed, even if that means committing a more economic FERC Must Offer before an RA or RMR unit. The CAISO reasonably determined that there was no Significant Events related to these real-time system MOWDs because on all of these days other units were available for commitment.⁵⁹ Another 33 MOWDs were due to operator error in which the operator mistakenly believed that a FERC Must Offer Unit was an RA unit (in other words those MOWDs should not have happened in the first place).⁶⁰ Third, 112 MOWDs were for zonal reasons and, as the Commission has recognized,⁶¹ neither the RCST Settlement nor the tariff permits designations for zonal reasons. Thus, of the 525 MOWDs issued from June 1, 2006 through December 22, 2007, only 116 potentially could have supported Significant Event Designations. As indicated above, the CAISO proposed to make two designations, but was only permitted to make one due to the general designation criteria in the tariff, criteria that were supported by IEP and the California Generators. The remainder of the MOWDs were, *inter alia*, due to short-term events that did either did not satisfy the definition of Significant Event or were of such a short duration that a minimum three-month

⁵⁸ In only 4 of the 264 instances of RTC commitments were RA or RMR units not available for commitment in addition to the FERC Must Offer Unit that was committed.

⁵⁹ The CAISO's MOWDs pursuant to the RTC software are discussed in greater detail in the CAISO's Reply Comments filed on January 24, 2008 in Docket No. EL08-20. It is not surprising that RTC MOWDs do not result in designations because one of the factors the CAISO is required by Section 43.4 of the tariff to consider is the expected duration of the Significant Event. Because RTC MOWDs are issued when other units are available for commitment (*i.e.*, there is no resource shortage of RA or RMR generation and, as such, there is not likely to be any material change in assumptions from what was assumed in establishing local capacity requirements), based on economic criteria, and to address events that typically are of a very short-term (*i.e.*, intra-day) nature, they will unlikely constitute a Significant Event that necessitates the multi-month procurement of capacity.

⁶⁰ Obviously erroneous MOWDs should not be "counted" for purposes of arguing that more RCST designations should have been made.

⁶¹ California Independent System Operator Corporation, 121FERC 61,276 at P 46 (2007).

designation of capacity could not be justified in accordance with the tariff. As indicated above, however, that limitation is remedied by the ICPM proposal which permits one-month designations of capacity and which will provide the CAISO with greater flexibility to make designations to address shorter-term reliability needs.

The CAISO also notes that certain actions taken by the CPUC under its RA program will reduce the need for MOWD-type commitments of non-RA, non-RMR units in the future. First, effective January 1, 2008, the CPUC adopted a Path 26 procurement constraint under its RA program which should reduce the number of MOWDs for zonal reasons because the units needed to address these needs should now have RA contracts. Second, 2008 is the last year that liquidated damages contracts can count under the RA program, except for the CDWR contracts. Because this will result in increased physical capacity being subscribed under RA contracts, it will increase the capacity contract opportunities for California Generators and further reduce the need for MOWD-type commitments of non-RA units.

In any event, IEP and California Generators have not presented *any* evidence showing that the CAISO should have made additional RCST designations under the tariff. IEP and California Generators do not identify any deficiency in the CAISO's analysis of whether the events included in the reports constituted Significant Events that would have necessitated a designation of capacity, consistent with the criteria identified above. IEP and California Generators do not explain why it would have been *necessary* - a prerequisite under the RCST tariff -- to designate any of the units that were denied MOWDs under the RCST in response to a Significant Event. In particular, IEP and California Generators do not even attempt to explain why the CAISO would have been

required to give RCST designations to a particular unit. Also, IEP and California Generators do not show that the CAISO has improperly implemented the RCST Settlement or improperly applied the RCST tariff language with respect to the designation of RCST Units for Significant Events. In short, IEP and California Generators do not provide one iota of evidence that the CAISO has failed to fulfill its obligations under the RCST Settlement and the Tariff with respect to the designation of units. Accordingly, the Commission should not countenance these baseless allegations or permit them to serve as the basis for denying the CAISO the discretion to make Significant Event designations under ICPM.

Finally, the CAISO notes that designations are essentially contracts between two parties that typically require the voluntary consent of both parties. If CAISO were to adopt IEP's and California Generators' suggestion, the process would be akin to forced contracting. In that regard, IEP and California generators would make hard trigger designations mandatory for the CAISO in contrast to the voluntary nature of ICPM as proposed by the CAISO. However, suppliers do not have a right to a long-term contract if they are unable to negotiate an RA contract or are not needed for RMR service.

3. IEP's And California Generators' Proposals For Automatic Balance-of-Year Or Three-Month ICPM Designations (Based On Cost Of New Entry Pricing) After A Single Exceptional Dispatch Commitment On One-Day Are Patently Indefensible

IEP's and California Generators' proposed alternative to the CAISO exercising its prudent judgment, consistent with Good Utility Practice, to determine whether monthly or longer-term designations are appropriate to meet reliability needs as the result of an ICPM Significant Event is an automatic designation if the unit is committed just once, on a single day, pursuant to the CAISO's Exceptional Dispatch procedures. California

Generators propose that the term of the designation would be for the balance of the year if the unit is located within one of the ten local reliability areas which have CAISO-defined local area requirements, or for three-months if the unit is not located within one of those reliability areas. In fact, the California Generators go so far as to recommend that a single selection of a resource in the CAISO's Residual Unit Commitment ("RUC") process for reliability service if it could not be provided by a Resource Adequacy Resource, result in a fixed three month designation.⁶² In addition, as discussed below, IEP and California Generators would pay the designated unit a capacity payment based on the cost of new entry.

IEP's and California Generators' alternative proposal is not a legitimate and acceptable option. Based on the costs of existing generation in California (as reflected in the prices of bilateral RA contacts – which range from \$15-\$45/kW-year according to the CPUC (*see* Exhibit H to the ICPM filing letter) -- and the annual fixed revenue requirement ("AFRR") of RMR units⁶³), a single Exceptional Dispatch commitment or RUC dispatch would result in most units being paid a multiple of their annual total fixed

⁶² California Generators Protest at 27.

⁶³ Exhibit B to the CAISO's Reply Comments in Docket No. EI05-146, filed on May 1, 2006, showed the Annual Fixed Revenue Requirements ("AFRR") of the RMR units for 2006. The CAISO is attaching that document as Attachment A to the instant filing. The AFRR amounts of the overwhelming majority of those units are significantly below the cost of new entry prices proposed by IEP and the California Generators. Indeed, more than two-thirds of the units have AFRRs (including return of and on capital to the extent they are not fully depreciated) that are less than the *minimum* \$41/kW-year target capacity price that the CAISO is proposing under ICPM. The percentage is even higher when one looks at the Fixed Option Payment ("FOP") which is the amount that the CAISO actually pays these RMR units after taking into account the expected revenues that the RMR unit might earn in the market (*i.e.*, it functions like a peak energy rent deduction). In other words, the CAISO does not pay an RMR 1 unit its total AFRR in recognition that the unit will earn revenues in the market to contribute toward fixed cost recovery. On the other hand, the proposed \$41/kW-year ICPM price does not have a PER deduction, so unit owners keep all market revenues. The \$41/kW-year price is higher than approximately 80% of the FOP price being paid to RMR units. Attachment B hereto contains the AFRRs of 2008 RMR units. The average of the \$/KW-year of these 18 units is \$32.44/kW-year. If these prices are representative of the costs of existing generation in California that would be eligible for ICPM designations, it is clear that IEP's and California Generators' proposal would result in most designated units being paid a multiple of their total fixed costs, albeit based on a single Exceptional Dispatch. It also shows the inherent reasonableness of the CAISO's 41/kW-year minimum ICPM payment, with no deduction for market revenues.

costs (including recovery of and on capital). This is significantly more money than is being paid to RA and RMR units under *annual* contracts for service, let alone a one-day Exceptional dispatch commitment. Needless to say, IEP's and California Generators' proposal is patently indefensible.

Any type of “hard” trigger that results in an automatic ICPM designation, no matter what the circumstances are, is inappropriate, as is any requirement that an ICPM Significant Event designation have a minimum three-month term, or balance of year term, depending on where the designated unit is located. IEP and California Generators do not offer a single reason why an automatic trigger is appropriate other than their concern that the CAISO may not designate units based on experience under the RCST. As discussed above, the RCST involved an entirely different set of standards and processes than the ICPM, and the experience under the RCST cannot serve in any way as a legitimate basis to require some form of “hard” trigger for ICPM designations. The ICPM Transmittal Letter⁶⁴ discussed why a “hard” trigger is inappropriate. Neither IEP nor California Generators acknowledge this discussion nor attempt to rebut it. It is appropriate that the CAISO be permitted to exercise reasonable and prudent judgment as to whether a designation is appropriate. As the Commission has indicated previously, the CAISO is required to exercise this discretion in a reasonable manner.⁶⁵ To the extent the CAISO does not, parties are able to file a complaint at FERC. However, neither IEP nor California Generators have made any showing that the CAISO is incapable of exercising its discretion in a reasonable manner. Their baseless claims about the lack of designations under RCST -- while offering no facts whatsoever to support their claims --

⁶⁴ ICPM Transmittal Letter at 25.

⁶⁵ Independent Energy Producers Association v. California Independent System Operator Corporation, 121 FERC ¶ 61,276 at P 41 (2007).

cannot serve as the basis for adopting an automatic trigger mechanism under the ICPM which employs an entirely different designation standard than the RCST.

In any event, “hard” triggers are inappropriate because they could result in prospective designations of capacity even though the capacity is not needed (*e.g.*, because the ICPM Significant Event has ended, RA or RMR capacity is available to meet the reliability need on a prospective basis, or the reliability need will only last for a very short period of time that does not justify a one-month designation of capacity), *i.e.*, is not deemed significant. A “hard” trigger such as that proposed by IEP and California Generators could result in a unit being designated as the result of it being Exceptionally Dispatched or selected in RUC on a given day, even though on a prospective basis other RA, RMR or cheaper non-RA units available to meet the reliability need prospectively. Moreover, the circumstances that permit the CAISO to Exceptionally Dispatch a unit on a given day may not justify a one-month prospective designation of capacity. For example, under Section 34.9.2, the CAISO can Exceptionally Dispatch a unit on a particular day to mitigate Overgeneration, provide Blackstart, or accommodate ETC/TOR schedule changes after the market closes. Exceptional Dispatch can also be used when it is necessary to decrement a unit’s output. IEP’s and California Generators’ proposals would require three month or balance of year designations for a single Exceptional Dispatch even if the CAISO was required to DEC the resource. Obviously, that is illogical and unwarranted. These are needs based on circumstances that exist on a given day and may not support a month or longer Significant Event Designation unless they result from an event that will continue into the future and will requires the use of non-RA on a to meet such future need. IEP and California Generators have not explained why

such uses of Exceptional Dispatch warrant a monthly, multi-month or year-long ICPM designation in the absence of any evidence of long-term reliability need.

In any event, the purpose of the ICPM Significant Event designation provisions is to enable the CAISO to procure capacity that is needed to meet prospective reliability needs based on an event that has occurred and will continue to occur in the future. “Hard” triggers could result in unnecessary procurement or over-procurement. Designations following a single Exceptional Dispatch or RUC commitment (after the non-RA resource had made a voluntary bid) would only impose an unjust and unreasonable burden on ratepayers. As such, “hardwiring” of designations is inappropriate.

Under the ICPM, the CAISO is establishing an administrative mechanism that will essentially enable it to contract for capacity in an efficient manner on a short-term forward basis if it determines that such capacity is needed on a prospective and recurring basis to meet Reliability Criteria. However, contracting is a two-way street; the CAISO must determine that it needs to procure capacity on a forward basis, and a resource must determine that it wants to accept the designation. IEP’s and California Generators’ proposal essentially amounts to forced contracting for units that do not have RA or RMR contracts, without the CAISO having any say in the matter. That is unjustifiable and is contrary to any reasonable construct of bilateral capacity procurement.

IEP’s and California Generator’s proposed “hard trigger” and accompanying automatic multi-month capacity designations would also create improper incentives in the marketplace. In that regard, non-RA units that anticipate they might be needed on a given day (e.g., due to a noticed transmission or generation outage) might be inclined either to submit unreasonably high bids in the CAISO’s spot market or simply withhold

their energy from the market, in order to increase their chances of being dispatched under the Exceptional Dispatched out-of-sequence or out-of-market-type commitment provisions and thereby automatically receive a three-month or balance of year capacity designation. A properly designed market should not encourage this type of behavior. The ICPM proposal does not create these perverse market incentives.

Likewise, there is no reasonable basis for a minimum ICPM Significant Event designation term of three-months or the balance of the year. It would essentially require the CAISO to contract for three or more months of capacity even if there is no need for the capacity beyond the day on which a unit was Exceptionally Dispatched or if the unit is only needed on a prospective basis for a very short period of time (*e.g.*, that might justify a one-month designation of capacity but not a three-month or longer designation of capacity). Any requirement for an automatic three-month or longer designation of capacity would be wholly unrelated to, and would completely disregard, the nature or the expected duration of such event. In other words, the CAISO would be paying for capacity for every day during a three-month or longer period whether it needs the capacity or not. This will result in unnecessary procurement and over-procurement, thereby imposing an unjust and unreasonable burden on ratepayers.

The CAISO's ICPM proposal, which permits the CAISO to make an initial one-month designation of capacity reasonably provides the CAISO with flexibility to make designations to meet shorter-term reliability needs without being required to take into consideration the potentially burdensome cost impacts of a three-month or longer designation. Moreover, to the extent an ICPM Significant Event is expected to last longer than a month, the CAISO has the ability to extend the designation for an additional

60 days. Certainly this is more rational -- and more tailored to the scope and duration of the ICPM Significant Event -- than is an automatic three-month or longer minimum designation term. It is inherently reasonable that ICPM designations be limited, as proposed by the CAISO, to situations where the CAISO determines an ICPM designation is necessary on a prospective basis following an ICPM Significant Event to maintain compliance with reliability criteria and taking into account the duration of the ICPM Significant Event. Some limitations on the extent of CAISO forward procurement are not unreasonable. Capacity should be procured on a forward basis only to meet a specific future need or requirement; forward capacity procurement should not be a “reward” for having been available on a given day or days in the past. In contrast to Significant Event designations, Exceptional Dispatches are for a single day and are based on whether Commission-approved circumstances exist on that particular day or whether the CAISO needs a unit to be available *on that day*. Specifically, Exceptional Dispatch permits the CAISO, *on a given day*, to dispatch units, whether they are RA, non-RA, RMR or ICPM, out-of-merit order or out-of-market in order, *inter alia*, to prevent a situation that threatens System Reliability and which cannot be addressed by the CAISO’s Real Time Market optimization and system modeling. In other words, Exceptional Dispatch is a daily product and specified criteria must be met each and every day in order for it to be used; whereas, ICPM involves the forward procurement of capacity that will be needed for the CAISO to maintain reliability for a longer period of time.

California Generators also suggest that the proposed ICPM Significant Event procurement is flawed because the CAISO will procure capacity following an ICPM Significant Event; whereas, RA capacity is procured in advance of the “projected need

for service.⁶⁶” This argument does not make sense. ICPM Significant Events are unanticipated, uncertain and unplanned events and not reflected in the contingency analysis that supports determination of the RA requirements or the CAISO’s local capacity study requirements. The CAISO cannot contract in advance for these events because the CAISO does not know whether, where, or to the extent these events will even occur. These are the type of events that are not typically planned for and would be economically prohibitive to plan for them year-round by requiring long-term capacity contracts. Unlike RA, there is no “projected need for service” so the CAISO cannot procure in advance for it. The “projected need for service” arises only after the ICPM Significant Event has occurred, and the ICPM provides the CAISO with the ability to procure ICPM capacity to meet the continued future need for such capacity. The intent of California Generators’ proposal is essentially to increase the contracting opportunities for units that do not have RA contracts. Again, this amounts to a collateral attack on the state RA program as it would expand the state-required Reserve Margin levels by ICPM procurement. ICPM is intended as a backstop mechanism for the CAISO to “fill” any short-term capacity needs. ICPM is not intended to be, and should not be used as, a tool to simply expand the RA program; yet, that would be the end result of California Generators’ proposal. California Generators’ arguments are also inherently inconsistent. They recognize that RA capacity is procured in advance to meet a “projected need for service;” yet, they propose “hard” triggers that would result in automatic multi-month designations of capacity whether the capacity is needed to provide service for that period of time or not.

⁶⁶ California Generators Protest at 13.

4. The CAISO's Proposed Designation Process Is Reasonable

The CPUC argues that CAISO should begin dialogue with market participants during the initial 30 day designation period to determine whether an ICPM Significant Event is expected to last more than the initial 30 day designation and whether operational solutions outside of designation may address the need in full or in part after the initial 30 day designation.⁶⁷ SCE proposes an alternative definition for ICPM Significant Event, and requests that if this definition is not accepted, then prior to extending a designation, a CAISO officer should be required to advise the Board if an initial designation is to be extended beyond 30 days and preferably request/receive approval for the extension.⁶⁸ Additionally, SCE suggests a CAISO officer should report any instance in which a unit is designated more than once in a year due to an ICPM Significant Event.⁶⁹

While CAISO appreciates such suggestions, it believes that the designation periods as proposed provide more than adequate notice and sufficient opportunity for Market Participants to be involved in the ICPM process. With respect to the CPUC's argument, the CAISO does not believe 30 days offers sufficient time to fully evaluate and implement alternatives to the ICPM designation. In particular, it will place additional burdens, responsibilities, and inappropriate time constraints on CAISO staff, in addition to their ongoing responsibilities. During that initial 30-day period, the CAISO may not even know how long the Significant Event will last. The CAISO will first need to evaluate and assess the duration of the Significant Event. Also, the CAISO is not an expert on field equipment. The CAISO needs to rely on options provided by the PTOs in most instances, and will then need to assess those options and how they "fit" into CAISO

⁶⁷ CPUC Comments at 7.

⁶⁸ SCE Comments at 5.

⁶⁹ *Id.*

operations. To the extent the CAISO can undertake a dialogue within the initial 30-day designation period and implement any operational solutions, it will attempt to do so, but such a requirement should not be “hardwired” into the tariff. That is why the CAISO has proposed that this process be completed during the 60-days following the initial 30-day designation, to the extent the CAISO expects a Significant Event to continue.

With respect to SCE’s arguments, the CAISO does not believe that it is appropriate or necessary for CAISO management to take ICPM Significant Event designations to the CAISO Governing Board or seek the approval of the Board to make or extend such designations. CAISO management and staff are responsible for maintaining reliable grid operations on a daily basis, not the CAISO Governing Board. If SCE believes that the Board needs to be notified of an ICPM designation or if SCE feels the CAISO is making inappropriate designations, SCE is free to raise the issue at one of the Governing Board’s public meetings or to contact the Board members between meetings. In any event, the CAISO believes that the proposed robust reporting requirements should alleviate concerns raised by SCE with regarding to how often a unit is designated within a year.

5. The CAISO Should Be Able to Designate Less than a Unit’s Full Output

Certain commenters have raised some concerns regarding partial unit procurement under ICPM. For instance, Calpine argues that CAISO has broad discretion in deciding from whom it will procure capacity to fill in for RA deficiencies or shortfalls due to ICPM Significant Events.⁷⁰ Calpine takes issue with CAISO’s discretion in the procurement process because CAISO determines the conditions of need, the time of need,

⁷⁰ Calpine Protest at 9.

and the amount of capacity it needs, and that these needs may be only a sliver of a unit's full capacity.⁷¹ Further, Calpine states that the "capacity only" product consists of an entire unit's commitment to be available to the CAISO.⁷² Such commitment is obtained typically on an annual basis, and not on an "as needed, event-by-event" basis.⁷³ Moreover, Calpine asserts, the capacity costs -- both the full fixed costs, and even the going forward fixed costs -- are indivisibly associated with the entire unit and are not incurred on an incremental basis.

IEP also raises objections to partial unit designation, arguing that such a concept defies actual plant operation.⁷⁴ IEP argues that all systems must be operated and maintained regardless of expected operating range, and that providing payment for only part of the fixed costs when the owner must maintain the entire unit is not reasonable.⁷⁵ Further, IEP states "partial unit designation is completely inconsistent with the basis upon which generating unit owners must allocate capital to operate and maintain generating units year-by-year."⁷⁶ IEP claims that providing payment for only part of a unit's fixed costs when the unit owner must operate and maintain the entire unit is unjust and unreasonable.⁷⁷ IEP states to be reliable, a unit owner must plan for investments for the entire plant and that investments are based on a whole unit not a portion of a unit.⁷⁸ The California Generators also take issue with ICPM partial unit designation, arguing that such designation ignores the indivisibility of a "call option" on the capacity of a

⁷¹ Calpine Protest at 9.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ IEP Protest at 15.

⁷⁵ *Id.*

⁷⁶ *Id.* at 22.

⁷⁷ *Id.* at 15.

⁷⁸ *Id.* at 16; Cavicchi at PP 47-48.

resource.⁷⁹ According to the California Generators, this “call option” effectively requires the entire resource to be available, even if the CAISO identifies a reliability need that is less than the capacity of an available unit. As a solution, California Generators assert that compensation under the ICPM should be based on the entire qualifying Eligible Capacity of a resource procured (*i.e.*, designated) by the CAISO, and not on arbitrarily designated slices of partial unit capacity.⁸⁰ Moreover they assert that under RMR contracts, the MOO and RCST, availability obligations should be based on the full unit.⁸¹

The arguments against the CAISO’s partial designation of units are the proverbial “red herring,” are based on faulty premises, overlook the fact that these are facilities that have voluntarily chosen to remain in operation and engage in market transactions without an RA contract, and ignore the fact that many generators have already entered into partial unit contracts for RA capacity (thereby undercutting the generators’ arguments against the feasibility of partial ICPM unit designations). Indeed, in a recent order on the New York ISO’s capacity market framework, the Commission rejected arguments by generation unit owners who requested that the Commission require that the entire capacity of a unit be procured (or that the owner be paid for the entire capacity of the unit) rather than just the portion of the capacity that cleared in the market. As the Commission recognized in rejecting this request,

Regarding KeySpan’s request to alter NYISO’s proposal to require that all capacity of a unit be purchased (or that a unit be paid for all of its capacity) if any capacity of that unit clears in the market, the Commission disagrees. The Commission sees no justifiable reason to guarantee payments to a supplier for all of its capacity if all of its capacity does not clear the market. KeySpan merely describes the risk that all suppliers face, *i.e.*, that in certain market conditions, all of their capacity may not be

⁷⁹ California Generators Protest at 30.

⁸⁰ *Id.*

⁸¹ California Generators Protest at 31.

purchased. KeySpan's request would result in discriminatory treatment of the DGOs vis-à-vis other market participants by guaranteeing the DGOs sales of all of their capacity, regardless of whether it clears, but not providing the same guarantee for other suppliers. KeySpan and other in-City capacity suppliers should be subject to this market risk, not insulated from it.⁸²

For similar reasons, the Commission should reject IEP's, Calpine's and California Generators' arguments that the CAISO be required to procure whole units under ICPM. Their proposal amounts to nothing more than forced overprocurement of capacity (and payment for an entire unit) even if the capacity of the entire unit is not needed to meet the deficiency or address the Significant Event.

Claims that unit owners base investment and capital improvement decisions on the basis of whole units not partial units and that therefore the CAISO should therefore be required to designate only whole units under ICPM are misplaced. No rational unit owner is going to base an investment or capital improvement decision on the *possibility* that in the future the unit might get a short-term ICPM designation. Stated differently, prudent owners will not be basing investment decisions with long-term ramifications on the uncertainty of getting a short-term designation pursuant to an interim backstop capacity procurement mechanism that will only be in place for two years. The arguments of Calpine, IEP and California Generators also fail to recognize that the units eligible for ICPM designations are units that have either voluntarily elected to participate in the ICPM on a forward basis or voluntarily elected to remain available during the year without an RA contract. The CAISO's designation is an additional benefit that they could not otherwise have been counted on (i.e., the supplier could not have relied on the

⁸² New York Independent System Operator, Inc., 122 FERC ¶ 61,211 (2008) at P 38.

occurrence of an ICPM Significant Event in making determinations as to the operability of the facility.)

The claims that whole-unit designations are required and partial unit designations are inappropriate are belied by the fact that generators in California have executed RA contracts for partial units. Even the California Generators own proposal recognizes the feasibility of partial unit designations and the possibility of partial unit RA contracts. If the unit has some RA capacity sold, the California Generators maintain that the Eligible Capacity should equal the Net Qualifying Capacity minus RA capacity.⁸³ In essence, it was permissible to sell part of a unit as RA capacity and sell the remaining portion of the unit in the market. If partial unit contracts are acceptable and feasible under RA, there is no reason why they cannot be acceptable and feasible under ICPM. In any event, the decision whether to accept an ICPM designation is entirely voluntary on the part of a unit owner. If the unit owner does not want to accept a designation for part of the unit's capacity, it is not required to do so.⁸⁴

⁸³ California Generators Protest at 5.

⁸⁴ Arguments that the Must-Offer Obligation and the RCST are based on whole unit designations, and therefore ICPM should be based on whole-unit designations, are misplaced. First, the Must Offer Obligation was intended as a remedy to address physical withholding. As such, it necessarily must apply to the entire capacity of a unit (*i.e.*, the Commission could not permit partial unit withholding. However, in practice and as designed by the Commission, the Must Offer Obligation does not require the commitment of whole units. The Commission and Section 40.7.4 of the CAISO Tariff only require that a unit offer its Available Generation into the Real-Time Imbalance Energy Market. That Available Generation can be the capacity of the entire unit or only part of the unit, depending on what the Available Generation of the unit is on any given day. Second, the requirement for whole unit designations under RCST was a negotiated element of the Settlement that was not litigated in the paper hearing before the Commission. As such, it cannot serve as precedent that dictates what should occur under the entirely different ICPM proposal. Third, a partial unit designation that is not for the balance of the unit's capacity cannot be accommodated under the existing pre-MRTU design because the pre-MRTU system has a MOO requirement that applies to the balance of a unit's capacity (*i.e.*, that part of the generator's total capacity that qualifies as Available Generation under Section 40.7.2) This presents conflicts between the MOO proxy bid process, which ensures that a resource has bids between its Pmin and Pmax, and a partial designation. If a resource were to be partially designated under RCST and dispatched through proxy bids to a level above its designation, it might be eligible for additional compensation, which could be proposed as a partial daily payment for the capacity not covered by the RCST designation. If the Settling Parties would have agreed to partial unit designations under the RCST, the CAISO would have had to make significant changes to its market and

The California Generators also assert that if, on a given day, the CAISO requires the designated unit to operate at an operating level greater than the amount of designated ICPM capacity for reliability reasons, then the CAISO should be required to designate ICPM capacity for that term equal to the level the CAISO required the unit to operate to maintain reliability.⁸⁵ The California Generators are mixing capacity procurement with Energy Dispatches. A generator would be operating at a level greater than the amount of designated capacity either (1) if it is participating in the market or (2) it is Exceptionally Dispatched in accordance with the Exceptional Dispatch provisions of the tariff. If the unit is voluntarily participating in the market at a higher level, it clearly should not be entitled to an additional capacity payment. To the extent the unit is Exceptionally Dispatched for Energy, it will be paid pursuant to the Exceptional Dispatch payment provisions approved by the tariff. In any event, the CAISO would be evaluating the situation to determine whether the dispatch was a one-day issue, an issue unrelated to the reason why the unit was given a Significant Event designation, or whether additional capacity is needed to be designated to address the Significant Event on a future basis above and beyond the amount initially designated by the CAISO. If the latter, the CAISO would then be able to designate additional capacity under the ICPM.

As a final point, the CAISO notes that RCST's requirement for whole unit designations resulted in fewer designations than would have occurred if the CAISO were permitted to designate partial units. If the CAISO is permitted to procure only whole units that will probably result in fewer designations of capacity under the ICPM because

settlement systems to be able to calculate and pay resources that were due both an RCST payment and a partial daily payment, including identifying these situations after the fact and calculating a pro-rata amount for the daily payment. Because there is no MOO under MRTU, the problems with partial unit designations that exist today under RCST will not exist under MRTU. .

⁸⁵ California Generators Protest at 5, 34.

the CAISO will only be permitted to procure whole units whose capacity is slightly more or slightly less than the amount of the deficiency (based on the existing RCST language). That does not benefit the California Generators' or IEP's members and does not help the CAISO to more efficiently meet its reliability needs. Absent such language, the possibility would exist for significant over-procurement. Accordingly, the CAISO proposes to take a "middle-ground" approach by proposing that it can make partial unit designations. That will better enable the CAISO to meet its reliability needs in a cost-effective manner. If a unit owner does not want a partial unit designation, it can decline the designation.

6. The CAISO Has Properly Considered Procurement By Other LSEs Before Engaging in Backstop Procurement.

The CPUC states that the CAISO should only procure for net system deficiencies rather than for system deficiencies by individual LSEs.⁸⁶ Specifically, the CPUC contends that Section 43.1.3 does not contain a provision preventing ICPM designation where there is no collective system deficiency considering capacity procurement effected by all LSEs within the control area.⁸⁷ The CAISO agrees that any backstop procurement under the ICPM should take into consideration the collective purchasing of Resource Adequacy Resources by LSEs, *i.e.*, over-procurement by one LSE could offset a similar amount of under-procurement. The CAISO would commit to making this change in a compliance filing.

⁸⁶ CPUC Comments at 5.

⁸⁷ *Id.*

7. ICPM Procurement Does Not Eliminate the Need for RMR

Constellation and Mirant argue that if the ICPM procurement is approved, then the CAISO should be directed to eliminate any new RMR designations and consolidate backstop authority into a single mechanism.⁸⁸ Calpine also contends that ICPM is a substitute for RMR, stating that it is discriminatory “to deny non-RA units a ‘similar capacity payment’ to that available to Reliability Must-Run (“RMR”) or RA units, if non-RA units are providing on-call commitments to the CAISO in the event that ‘system conditions arise that require additional supply from non-[RA] units.’”⁸⁹ These contentions do not withstand scrutiny. ICPM procurement does not eliminate the need for RMR, and as such, the two designations processes will need to remain as separate mechanisms.

As stated previously, RMR contracts are annual contracts for the purpose of addressing specific long-term local reliability needs not addressed through RA contracts. These are forward contracts because the CAISO needs a particular unit, in a particular location on a *long-term* basis to maintain reliability. Also, RMR is a market power mitigation tool for units that might have local market power. The ICPM is not intended as a market power mitigation mechanism. The CAISO retains the ability to enter into RMR contracts to the extent the aforementioned criteria are satisfied; however, it is inappropriate to require RMR designations for units that do not meet these criteria, especially when the CAISO is designating capacity to meet a short-term system need.

⁸⁸ Constellation/Mirant at 5, 12-13.

⁸⁹ Calpine Protest at 8.

Moreover, the CAISO should not be required to use RMR to procure generic capacity that can be provided by a number of units. System wide and in most local areas there is surplus capacity where the units are similarly effective and deliverable. In other words, the CAISO could designate any unit; it is not required to select a specific unit. The competitive nature of these circumstances should not guarantee the recovery of full fixed costs of a unit, *i.e.*, capital and return, as well as annual designations. Further, in the areas where there currently is not a surplus, or only a slight surplus, there is either extremely little or no capacity over the RA requirement, indicating that the existing capacity is already under an RA contract or an RMR Contract.

Units procured under RMR are units that are needed on a long-term basis in that location, and the CAISO needs these units to remain in service to meet long-term reliability needs. On the other hand, ICPM procurement will generally be more short-term or transitory in nature, *i.e.*, filling gaps in LSE procurement or responding to unexpected Significant Events. In particular, ICPM Significant Event procurement will arise following unforeseen or unplanned events. Typically these are transitory events that only require capacity for a short period of time and are not indicative of a long-term need for capacity in the area of the ICPM Significant Event. Annual RMR-type contracts and pricing is not appropriate for Significant Event designations under these circumstances.

Calpine's proposal is also flawed because it would require the CAISO to procure a unit for one-year to backstop a local RA deficiency, even if the deficiency does not exist for the entire year. This would result in unnecessary over-procurement. On the other hand, the CAISO proposes to procure capacity for the period of the deficiency, *i.e.*,

when the capacity is needed to address the deficiency. This will meet the CAISO's reliability needs while avoiding unnecessary over-procurement. In summary, Calpine is essentially seeking RMR type treatment for ICPM designations. There is no basis for that and the Commission should reject the request.

Finally, the CAISO stresses that it retains the ability to make RMR designations where circumstances so require. Calpine and Mirant/Constellation are essentially trying to force the CAISO give longer-term capacity payments to units that did not receive RA contracts, irrespective of whether the CAISO needs the capacity for the term of the commitment period they are seeking.

E. Acceptance of Designations Should Be Voluntary

The CAISO received a number of comments regarding the voluntary nature of ICPM designation. Specifically, the CPUC is concerned with the voluntary nature of ICPM and argues that generators may economically or physically withhold capacity in order to elevate prices.⁹⁰ PG&E states that the voluntary nature of ICPM could encourage attempts at gaming.⁹¹

Neither the CPUC nor PG&E demonstrate how the voluntary nature of the ICPM -- as opposed to some other reason -- enables suppliers to engage in gaming or withhold capacity for purposes of increasing energy prices. The CPUC suggests (and PG&E implies) that if a unit declines an ICPM designation, the CAISO may have to Exceptionally Dispatch the unit, and the unit will therefore be able to earn higher prices absent mitigation of Exceptional Dispatches. Whether an ICPM designation is

⁹⁰ CPUC Comments at 4.

⁹¹ PG&E Protest at 7.

mandatory or voluntary had no impact whatsoever on Exceptional Dispatch pricing. Under the Exceptional Dispatch provisions, a unit that accepts an ICPM designation is treated in exactly the same manner as a unit that declines an ICPM designation. Stated differently, the unit will receive the same Exceptional Dispatch price whether it has accepted an ICPM designation or not. Because ICPM designations are irrelevant to the pricing of Exceptional Dispatches, no incentive exists for a unit owner to decline an ICPM designation because it cannot earn a higher energy price via Exceptional Dispatch. Even assuming *arguendo* that the CPUC was correct, it does not seem patently unjust and unreasonable for a unit to decline an ICPM designation and instead accept an Energy price that the Commission has found to be just and reasonable. The CAISO notes that it is conducting a stakeholder process regarding the pricing of Exceptional Dispatches.

PG&E expresses concern that suppliers may decline ICPM designations, and that might create reliability problems for the CAISO. Suffice it to say that the CAISO would not have supported a voluntary designation process if it believed that reliability would be threatened. The CAISO has sufficient tools to ensure that reliability is maintained on a daily basis and to address imminent emergencies or threats to meeting Reliability Criteria.

PG&E also states that declining ICPM designations might result in distortions in the Residual Unit Commitment Process (“RUC”). However, the Commission has already found the RUC process and pricing to be just and reasonable. It does not seem inherently unreasonable that a unit should be permitted to decline an ICPM designation and try to earn revenues through the RUC mechanism and pricing scheme that the Commission has

found to be just and reasonable. As the CAISO indicated in its transmittal letter (p. 28), the CAISO's Department of Market Monitoring will be monitoring the market for any signs of withholding. There is no reason for the Commission to act now without any evidence of clear gaps in the market design or improprieties.

In any event, at pages 27-28 of the ICPM transmittal letter, the CAISO stated why it believed a voluntary approach was appropriate. Those reasons remain valid, and no party has identified a legitimate reason why ICPM designations should be made mandatory.

The California Generators assert that the "choice" to accept or decline ICPM service not, in fact, a choice,⁹² Calpine asserts that under the MOO, the CAISO has routinely denied its generating facilities requests for planned maintenance during the summer through persistent denials of waiver requests.⁹³ The CAISO disagrees that Generators do not have a choice. The fact that participation is based on a certain set of proposed parameters, including the proposed payment price, rather than other proposals favored by the generators does not render the program involuntary. California Generators' claim amounts to nothing more than a desire to be paid more than the proposed ICPM price. In particular, they claim that ICPM units ought to be paid RA-like compensation. Contrary to California Generators' claims, they are being paid RA-like compensation. ICPM units will be paid a minimum of \$41/kW-year; according to the CPUC, RA units are being paid capacity prices that range from \$15/kW-year to \$45/kW-year (*see* Exhibit H to the ICPM Tariff Amendment Filing). Thus, the ICPM target capacity price is at the high end of the RA range. With the elimination of the MOO

⁹² California Generators Protest at 29-30.

⁹³ Calpine Protest at 4.

under MRTU and a voluntary ICPM designation process, Calpine's concern over the CAISO's denial of waivers for its facility will be moot.

F. The CAISO's Proposed ICPM Pricing Proposal Is Reasonable

1. It Is Appropriate To Base Minimum ICPM Payments On The Going Forward Costs of the Highest Cost Gas Unit in the CEC Cost Study

IEP argues that the proposed ICPM pricing is not supported by economic principles, is unduly discriminatory and undervalues capacity. IEP also argues that the price of ICPM should promote new investment.⁹⁴ IEP further claims that the going forward costs of a new peaker, which is the marginal unit in California, is not a suitable basis for establishing a capacity price. California Generators object to the ICPM pricing because it abandons the RCST approach which they claim was based on CONE.⁹⁵ They also claim that the \$41/kW-year target capacity price is unjust and unreasonable because it does not reflect the recent run up in the costs of building new capacity.⁹⁶ Calpine argues that the formula is arbitrarily limited to going forward costs and does not reflect stakeholder consensus.⁹⁷

IEP starts from a faulty premise. The ICPM is not a capacity market, is not intended to incent new generation, and will not incent new generation given, *inter alia*, the interim nature of the program, the uncertain and short-term nature of any procurement and the surplus conditions that exist in most local capacity areas. ICPM is merely a transitional administrative mechanism that will permit the CAISO to procure capacity from existing units to fill gaps in LSE procurement or respond to unexpected Significant

⁹⁴ *Id.* at 12.

⁹⁵ California Generators Protest at 19.

⁹⁶ *Id.*

⁹⁷ Calpine Protest at 7.

Events, until the CAISO develops a more permanent capacity procurement and pricing mechanism. In other words, ICPM is short-term, uncertain backstop procurement. New entry cannot provide this ICPM service; nor can it compete to provide the service. Accordingly, uniform cost of new entry price signals are not needed or appropriate for the ICPM. As the CAISO has indicated previously, following the conclusion of the CPUC's long-term RA proceeding, the CAISO will undertake a stakeholder process to evaluate long-term capacity pricing issues and mechanisms that can be implemented in connection with, and complement, the long-term RA framework.⁹⁸ That is the appropriate forum to address long-term capacity pricing issues. The relevant issue here is whether existing resources are being adequately compensated for the ICPM service they provide pending implementation of a long term capacity procurement mechanism. As the CAISO demonstrated in its Transmittal Letter and the CAISO Market Surveillance Committee concluded in its opinion on the ICPM proposal, the answer to this question is an emphatic YES!

Claims that ICPM undervalues capacity are based solely on the basis that the price is not based on CONE. As discussed *infra* and in the ICPM transmittal letter, uniform CONE pricing is wholly inappropriate for the ICPM product. The argument that ICPM pricing is undervalued is not sustainable given that the \$41/kW-year price is at the high-end of the range of RA prices that are being paid as the result of competitive solicitations. Also, as indicated above, based on the 2006 and 2008 RMR data, as reflected in Exhibits A and B hereto, the \$41/kW-year price is higher than the full fixed

⁹⁸ The CAISO has explained why the ICPM is not intended to be an incentive to build new generation, but rather, the proposal functions as an interim backstop procurement method. While it may be appropriate to adjust capacity payments in the future in conjunction with implementation of the state's long-term RA framework designed to elicit such investment in generation, that issue is currently before the CPUC at this time, and is not the purpose of the ICPM.

cost revenue requirement (including return of and on capital) of approximately two-thirds of the units that were RMR in 2006 and more than 80 percent of the RMR units in 2008. Further, the CAISO is not proposing any PER deduction from the ICPM capacity payment which will allow resource owners to retain all market revenues. On the other hand, under an RMR 1 contract, the fixed option payment (“FOP”) takes into account the revenues that the RMR unit would earn in the market and serves to reduce the CAISO’s payment to the unit, *i.e.*, the RMR price essentially reflects a PER surrogate. Based on the FOP levels in Exhibit A, the minimum ICPM capacity payment of \$41/kW-year exceeds the prices being paid to an even larger percentage of RMR units. The CAISO also notes that ICPM payments will be made to existing resources that have elected to remain available to participate in the markets without an RA contract. Paying for a resource’s going forward costs -- which are the costs a resource needs to recover to remain available -- is economically justifiable and reasonable under these circumstances and supported by the CAISO Market Surveillance Committee.⁹⁹ Further, it must be recognized that the CAISO is not paying unit-specific going forward costs (unless those costs exceed \$41/kW-year), it is paying a price based on the going forward costs of the highest-priced type of gas-fired unit in the CEC study, plus a 10% adder. Because the CAISO used the going forward costs of the highest cost unit, and included a 10% adder, the minimum \$41/kW-year price will provide additional contribution toward fixed cost recovery above and beyond most units’ going forward costs. This conclusion is also

⁹⁹ The CAISO notes that in the recent NYISO order evaluating the appropriate components of going forward costs, the Commission concluded that costs such as property taxes are only appropriate for a unit that wishes to retire because such costs are not avoided if a unit is merely mothballed. *New York Independent System Operator Corporation, Inc.*, 122 FERC ¶ 6,61,211 at P81 (2007). The CAISO, on the other hand, proposes to include property taxes in the going forward cost calculation for *all* resources. Thus, the CAISO is providing more cost recovery to resources than might otherwise be necessary. This fact further supports the justness and reasonableness of the CAISO’s proposal.

supported by the total revenue requirements of RMR units, as reflected in Exhibits A and B hereto, which can serve as a proxy for the costs of existing generation units. For units that might have going forward costs in excess of \$41/kW-year, the ICPM will pay them based on their actual going forward costs plus 10%. The proposed ICPM price is also just and reasonable given that there is a surplus systemwide and in the majority of local capacity areas.

It is significant that for all the objections IEP and California Generators raise to the proposed ICPM price, there is an unnatural silence when it comes to providing specific cost data for their facilities, although they alone control such data. However, even if unit owners can demonstrate higher going forward costs than \$41/kW-year, the CAISO proposal offers every supplier the opportunity to recover going forward costs in excess of \$41/kW-year, plus an additional ten percent, as part of a unit-specific cost justification. In light of such silence, the far more reasonable course is to recognize that the \$41/kW-year price will permit most existing suppliers to earn revenues above and beyond their going forward costs. This conclusion is also supported by the fact that the \$41/kW-year price is based on the highest cost gas unit studied by the CEC, the level of RA bilateral contract prices (with the ICPM price being at the high end of the range), and the prices paid to RMR units (with the minimum ICPM price being in excess of the full fixed costs and the prices being paid to the majority of the RMR units). Moreover, the ICPM and MRTU offer suppliers additional revenues through the market payments which they are permitted to keep in their entirety with no PER deduction.

IEP's claim that ICPM pricing is unduly discriminatory is likewise misplaced. According to IEP, price discrimination occurs when a buyer or seller can profitably

obtain different prices for an identical good.¹⁰⁰ Further, IEP asserts that in a competitive market, suppliers should be compensated on equal terms within identified geographic locations.¹⁰¹ IEP's complaint is based on the fact that Southern California Edison Company has added new peakers and that the cost of the new peakers (which are being recovered pursuant to cost-of-service rates approved by the CPUC) exceeds the price being paid to existing generation units under RA contracts and the ICPM.¹⁰²

IEP's comparison with this new generation is inapt. The existence of unduly discriminatory ICPM compensation is not determined by comparing the compensation that new Generating Units receive from bilateral contracts or cost-of-service based rates approved by a state commission with the compensation that existing Generating Units receive from bilateral contracts or the market-based rates that they have chosen. The generation built by SCE is being priced on a cost-of-service basis. On the other hand, the generators represented by IEP have opted for market based rates, not cost-based rates for their generation. Thus, the two are not similarly situated. To the extent IEP's members want to receive the same rate treatment that SCE is receiving, they should file for cost-based rates. In any event, the only relevant compensation for purposes of determining whether the ICPM proposal is unduly discriminatory is the ICPM compensation and that is determined by applying the same methodology for all units. The CAISO has no obligation to ensure through its rates for an interim capacity backstop the financial success of any unit; its only obligation is to provide just and reasonable and non-discriminatory compensation for the services provided under its tariff, and the ICPM achieves that objective.

¹⁰⁰ IEP Protest at 6.

¹⁰¹ IEP Protest at 8; Cavicchi Aff. at ¶¶ 24, 29.

¹⁰² IEP Protest at 7.

Moreover, although Mr. Cavicchi asserts that inadequate revenues (for total fixed cost recovery) can be expected from CAISO markets if investment in new capacity is undertaken,¹⁰³ and that circumstances are worse for existing Generating Units,¹⁰⁴ it is not the Commission's responsibility under a market-based rate pricing system to ensure that Generators recover their "total fixed costs." The only cost recovery that is required is cost recovery proportional to the service provided. The ICPM accomplishes that, and allows resources to keep all of their market revenues.

Finally, IEP argues that basing the ICPM price on the going forward costs of a new peaker bears no relationship to the going forward costs of the existing fleet of generators because existing units could require capital investments.¹⁰⁵ IEP also argues that if it were appropriate to use going forward costs to price ICPM capacity, the CAISO should use the going forward costs of the marginal unit relied on to ensure system reliability.¹⁰⁶

These arguments too are without merit. First, with respect to IEP's claim that if it were appropriate to use going forward costs, the CAISO should use the going forward costs of the marginal unit, the CAISO reminds IEP that ICPM is not a capacity market and that acceptance of designations is voluntary. ICPM is more akin to a contracting process where the CAISO is indicating up front the price it is willing to pay for forward procurement of backstop capacity. IEP's proposal simply constitutes another attempt to pay existing resources more money than (1) is justified by the surplus conditions that exist, or (2) appropriate for Significant Event designations which will be made to units

¹⁰³ Cavicchi Aff. at ¶ 4.

¹⁰⁴ *Id.* at ¶ 5.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

that have elected to remain available without an RA contract. Basing the ICPM price on the going forward costs of the unit with the highest going forward costs would not be sufficient to incent new generation; so, it is not certain what purpose such an approach would serve other than to raise the prices paid to existing units. IEP's approach would also unduly "interfere" with bilateral RA procurement and the RA prices (by putting upward pressure on such prices) prior to the implementation of a long-term RA framework and a more permanent capacity pricing mechanism. An argument could be made that under a non-multi year ahead centralized capacity market, units designated under the ICPM should only be permitted to recover their unit-specific going forward costs --- which in most instances will be less than \$41/kW-year (especially if property taxes are not included). However, the CAISO is paying units the higher of \$41/kW-year or their actual going forward costs, plus 10%, and this price includes the recovery of amounts for property taxes even if a unit is not retiring. This is clearly just and reasonable under the circumstances and will provide an additional contribution toward the total fixed costs of most units above and beyond just their going forward costs.

Second, IEP provides no evidence that the going forward costs of the existing fleet are generally higher than the going forward costs of the new, highest cost gas-fired unit that the CAISO used as the baseline for deriving the ICPM price. Even assuming *arguendo* that existing units generally had higher going forward costs than the new peaker used by the CAISO, the ICPM proposal would accommodate that by allowing them to make a cost justification filing at the Commission to receive a price higher than \$41/kW-year.

Third, IEP's claim that existing units have higher going forward costs than new units because they might require capital investments is misplaced. Capital investments are not an appropriate component of going forward costs.¹⁰⁷ In any event, resource owners are not going to be undertaking capital investments for their units based on the *possibility* that they *might* get a short-term designation under a backstop capacity program that will only be in place for two years.

Fourth, available evidence seems to suggest that the going forward costs of existing gas-fired units generally are not higher than the going forward costs of the peaker unit used by the CAISO to establish the minimum ICPM capacity rate of \$41/kW-year. The CEC study was based on the costs of 34 gas-fired units constructed from 2001 to 2006. The CAISO used the going forward costs of the highest cost type of unit (as constructed by a merchant generator which had higher costs than a comparable unit constructed by an IOU or POU). Also, a review of RMR data in Exhibits A and B shows that the \$41/kW-year price is higher than the total fixed costs (including return of an on capital) for approximately two-thirds of the 2006 units and more than 80% of the 2008 units.¹⁰⁸ Further, the fact that the \$41/kW-year price is at the high-end of RA prices also supports a conclusion that the going forward costs of existing units generally are lower than the minimum ICPM price.

Fifth, notwithstanding the fact that the ICPM is not a capacity market, the CAISO has essentially based the minimum ICPM price on a marginal unit by using the going forward costs of highest cost gas unit identified in the CEC's comprehensive study

¹⁰⁷ New York Independent System Operator Corporation, Inc., 122 FERC ¶ 61,211 at P 79 (2008).

¹⁰⁸ Based on the limited data the CAISO has reviewed from 2008 RMR filings containing AFRR data, the CAISO notes the following going forward costs for gas-fired units: (1) the Oakland CTs (ER08-124)--\$25.90/kW-year (units fully depreciated); (2) Cabrillo Power II units (ER08-177) -- \$28.32/kW-year (units fully depreciated); (3) South Bay (ER08-126) --\$30.11/kW-year.

of generation costs in California. In addition, the CAISO has included a 10% adder (and counted property taxes as going forward costs in all instances). IEP has not identified any other “marginal” unit that should be used; nor have IEP or California generators filed any cost information in their filings. To implement IEP’s proposal every generator in the CAISO balancing area would need to file its going forward costs for review to determine the marginal cost unit. This would be a burdensome, inappropriate and unnecessary task, because the ICPM pricing scheme is already just and reasonable for the reasons described herein and in the ICPM filing letter.

IEP’s statement that the proposed price “will do nothing to provide proper procurement incentives on the part of LSE”¹⁰⁹ is also without merit. Even the California Generators recognize that the IOUs will not fail to comply with their RA procurement responsibilities.¹¹⁰ Given the structure of the CPUC program, including the steep penalties for non-compliance, as well as the fact that the \$41/kW-year ICPM price is at the high end of the range of RA prices (and could be higher for units that cost justify or have increased availability during the period of designation), LSEs, have every incentive to engage in the required procurement. There have not been any instances of non-compliance to date, and the CAISO has no reason to expect that there will be any in the future. If their attack is on the structure of the CPUC’s RA program itself, the CAISO has already explained that this proceeding is not a proper venue to pursue those concerns.

California Generators’ claim that the ICPM price is unjust and unreasonable because it is not based on CONE which the Commission purportedly used to determine the appropriate capacity price under RCST. This argument lacks a factual or legal basis.

¹⁰⁹ IEP Protest at 2.

¹¹⁰ California Generators Protest at 8.

In its RCST rehearing order, the Commission expressly rejected the claim that it approved the RCST capacity price based on CONE.¹¹¹ In any event, the RCST capacity price was a negotiated settlement price. It should not serve as the basis for the new ICPM product which is a voluntary product (as opposed to RCST and MOO which are mandatory). Also, the RCST capacity payment involves a PER deduction; whereas, ICPM permit unit owners to retain all market revenues.

California Generator's claim that the ICPM price is outdated because it fails to reflect recent increases in the costs of building power plants is likewise misplaced. First, the ICPM is not intended to provide units with guaranteed full fixed cost recovery, and capital costs are not going forward costs. Second, this argument is inconsistent with the argument elsewhere that the new units being built (and which would be incurring these increased construction costs) either have bilateral contracts or CPUC cost-based rate recovery. In other words, these units will not be receiving ICPM designations. Third, the vast number of units that will be eligible for ICPM designations are existing units. The fact that new construction costs have increased in the last year does not affect the costs of these existing units which are not under construction. Increasing the ICPM price to account for recent increases in the costs of constructing new power plants would merely result in windfall payments for the large number of existing units, without incenting new generation.

¹¹¹ Independent Energy Producers Association v. California Independent System Operator Corporation, 121 FERC ¶ 61,276 at P 23 (2008).

2. Uniform CONE Pricing Is Inappropriate for the ICPM

In their protests, a number of the suppliers ask the Commission to reject the CAISO's pricing proposal and set the ICPM capacity charge at CONE.¹¹² Using CONE for the capacity payment under ICPM would be inappropriate and would impose an unnecessary burden on California ratepayers. In determining that the rate for capacity payments under the RCST was just and reasonable, the Commission *did not* use the CONE price. It approved a target price less than CONE and expressly recognized that it was doing so in its order.¹¹³ The Commission should not depart from this determination and should reject the supplier's request for uniform application of CONE pricing.

The use of the CONE (net of peak energy rents) is generally acceptable in a multi-year forward capacity market design as an incentive for new generation in areas where it is needed and where new generation can compete with existing generation to provide the service. While the CAISO agrees that it may be appropriate to adjust capacity payments in the future in conjunction with implementation of a long-term RA framework designed to elicit investment in generation (or other means to achieve RA) in locations where new infrastructure is needed -- an issue that is currently being addressed in the long-term RA framework proceeding at the CPUC -- the ICPM does not constitute such a situation. Unlike a multi-year capacity market, the ICPM is a short-term, administrative, backstop procurement mechanism that permits the CAISO to procure capacity from existing units and does not guarantee a stream of revenues to any

¹¹² IEP argues that “[t]he time has come for generating capacity suppliers to be compensated for such services fully for the value of the reliability services they provide, and be compensated on par with new capacity resources.” IEP at 2. For the California Generators, pricing of ICPM at CONE prevents underpricing the product and undermining primary reliance on forward RA commitments. California Generators at 12.

¹¹³ Settlement Order at P 72.

resource. New entry cannot compete to provide the service only existing units can. Hence, ICPM is not a proper mechanism to support new investment, nor is it appropriate to make the ICPM the mechanism to guarantee a particular level of fixed cost recovery to recent entrants that made the investment decisions prior to the establishment of the ICPM or to resources that have decided to remain available absent an RA contract. The purpose of the ICPM is to provide the CAISO with the ability to call on *existing* units not under RA or RMR contracts if the CAISO need them on a particular day. Thus, it will only produce revenues for existing resources; the cost of new entry is significantly higher than the fixed costs of existing generation.¹¹⁴

Furthermore, even assuming *arguendo* that CONE pricing was appropriate under an interim program, it would not be appropriate to apply such pricing in a uniform manner as proposed by IEP. In particular, CONE should be considered as a possible backstop price only when there is a capacity deficiency in a local area or system zone and the intent of the mechanism is to incent new generation (which is not the case with a backstop mechanism that will only be in place for a limited duration). RA requirements are currently set on both a local area and system basis. Many of the local areas are small relative to total CAISO capacity MW (as shown in the Table below) and have a concentration of ownership. If the backstop mechanism were to be designed to send investment price signals, CONE should be considered as a possible backstop price only when there is a capacity deficiency in a local area or system zone. Furthermore, regardless of the timeframes being considered (*i.e.*, whether the objective is to incent investment), a uniform application of CONE without additional market power mitigation

¹¹⁴ IEP states that the new generation that has been built is being compensated through cost-based rates or long-term contracts. IEP Protest at 7-8. If that is the case, these units will not benefit from cost of new entry pricing for an ICPM product only existing units without RA contracts will.

rules would create competitiveness issues. IEP has not proposed any market power mitigation measures, and a further process would be required to determine such appropriate measures.

The Table below shows the 2008 evaluation of the deficiency or surplus in the 10 local capacity areas that the CAISO has defined for the CAISO grid. Only three of these local areas are deficient relative to the RA requirement and one is just above the RA requirement, based on the reliability needs defined in the CAISO's local capacity studies. This assessment suggests that only few locations on the CAISO Controlled Grid would even warrant high backstop prices if a CONE approach were to be applied. However, most of the capacity in those tight areas is either owned by investor owned utilities or is under multi-year RA contract, thereby indicating that even if a CONE approach were to be applied, it would provide no near-term benefits to IEP's members or to the California Generators. In the remaining load pockets, where there is a surplus of capacity, additional investment does not seem to be needed in the near term; so using CONE pricing to spur additional investment in these areas is neither needed nor justifiable for the period under which the ICPM will be in effect. Using CONE as the backstop price in these circumstances could only serve to increase the forward RA prices in these areas to the extent ownership of resources is concentrated in the hands of a few owners.¹¹⁵

¹¹⁵ For example, consider a hypothetical scenario in which there is a load pocket with 50% additional capacity (MW) than is needed to fulfill the local RA requirement. There is also substantial concentration of ownership of that capacity because only one or two sellers exist. In that situation, the cost of new entry backstop price would be used not to incent new generation but to provide sellers with a bargaining tool in bilateral RA negotiations with buyers. This occurs because sellers would know that if buyers did not accept the offered forward RA prices, they could rely on the CAISO to procure that capacity through the backstop and at a price at cost of new entry. To mitigate this market power, there would need to be additional rules for backstop capacity pricing, such as an administrative demand curve for capacity that lowers the backstop price in relation to the surplus market supply condition. Such rules have not been proposed by the Energy Companies.

**Table -- Comparison of 2008 Locational Capacity Requirement Need and
Qualifying Capacity**

Local Area Name ^{1/}	Total '2008 LCR Need based on Category C with Operating Procedure ^{1/} (MW)	Total Qualifying Capacity ^{1/} (MW)	Surplus or (Deficit) (MW)	Surplus or (Deficit) (%)
Humbolt	175	180	5	3%
North Coast/North Bay	676	883	207	
Sierra	2092	1780	(312.00) ^{2/}	(15%) ^{2/}
Stockton	786	536	(250.00) ^{2/}	(32%) ^{2/}
Greater Bay	4688	6214	1526	33%
Greater Fresno	2382	2991	609	26%
Kern	486	646	160	33%
LA Basin	10130	12093	1963	19%
Big Creek/Ventura	3658	5396	1738	48%
San Diego	3033	2919	(114.00) ^{2/}	(4%) ^{2/}
Total	28106	33638		

^{1/} Source: CAISO "2008 Local Capacity Technical Analysis Report and Study Results," Updated April 3, 2007, table on page 4 of 85 pages. Data for San Diego local area is from "Report and Study Results Update for San Diego, Updated June 19, 2007, which was filed with the CPUC.

^{2/} Generation deficient Local Capacity Area (or with sub-area that are deficient) – deficiency included in LCR. Generator deficient area implies that in order to comply with the criteria, at summer peak, load must be shed immediately after the first contingency.

The CAISO recently released draft results for 2009. These are reflected in the following table. As can be seen by the table, in eight of the ten Local Capacity Areas the difference between the amount of Qualifying Capacity has increased versus the amount needed based on compliance with NERC Category C and one of the areas that was deficient in 2008 is no longer deficient.

**Table -- Comparison of 2009 Locational Capacity Requirement Need and
Qualifying Capacity**

Local Area Name ^{1/}	Total '2009 LCR Need based on Category C with Operating Procedure (MW)	Total Qualifying Capacity (MW)	Surplus or (Deficit) (MW)	Surplus or (Deficit) (%)
Humbolt	155	211	56	36%
North Coast/North Bay	839	883	44	
Sierra	1895	1780	(115)	5% (6%)
Stockton	726	541	(185)	(25%)
Greater Bay	4791	6331	1540	32%
Greater Fresno	2692	3132	440	16%
Kern	424	646	222	52%
LA Basin	10225	12282	2057	20%
Big Creek/Ventura	3116	5444	2328	74%
San Diego	3453	3612	159	4%
Total	28316	34862	6546	

The Commission has recently recognized,

While a capacity market may produce market clearing prices equal to or in excess of net CONE in certain market conditions, the NYC capacity market is currently enjoying a surplus of capacity.¹¹⁶ This surplus should translate into market clearing prices that are below net CONE, and therefore we would expect that any just and reasonable proposal would produce market clearing prices that are below net CONE, as NYISO's proposal does. Market-clearing prices under the proposed mitigation will likely fall significantly below new entry costs in the short-run, but this is to be expected given the significant excess supply that currently exists.¹¹⁷

¹¹⁶ Potomac Economics, Ltd., *NYISO State of the Market Report* (2006).

¹¹⁷ *New York Independent System Operator, Inc.* 122 FERC ¶ 61,211 at P 35.

Thus, the Commission found that prices should be significantly below CONE in situations where there is excess supply. That is the case here, and the CAISO's pricing proposal is more reasonable under these conditions than is IEP's proposal for uniform CONE pricing.

Again, as stated above in its ICPM Transmittal Letter, the CAISO is not in principle opposed to the use of CONE in the context of a well-designed, multi-year centralized capacity market. However, a centralized capacity market design is a complex and complicated matter and would require an extended inquiry into the appropriate technology and other factors to be used to set CONE and the shape of any demand curve, as well as determining appropriate market power mitigation measures. However, the IEP and California Generators argue for use of particular estimates of CONE in the context of a mechanism that is simply not designed appropriately -- or intended -- to send a new entry price signals and not needlessly distort the existing RA market. First, as stated above, most load pockets in California can meet their local RA requirements (Demand plus a Planning Reserve margin) and still have a substantial capacity surplus. The uniform introduction of CONE into that setting will not support new entry but will simply enhance the market power of existing units in the bilateral RA market. Stated another way, a uniform CONE backstop price is not appropriate when the RA market is subdivided into multiple submarkets with concentration of ownership. If the IEP and California Generators had taken their argument to the next level of market design, they would have proposed a market power mitigation method along with their proposal of CONE, but they did not. If they had done that, they would have encountered

the design issues that CAISO encountered in the ICPM stakeholder process and which were reviewed above, namely that using known methods of capacity market design and market power mitigation, at best any backstop capacity procurement in surplus load pockets should be paid a price substantially less than CONE. A price equal to the higher of \$41/kW-year or actual going forward costs plus 10%, which is at the high end of the range of prices being paid to RA units is more than just and reasonable for backstop capacity in locations with surplus; for the few load pockets in deficiency (which account for only a small portion of the total MW of capacity in all local areas), the ICPM price will not incent entry but will guarantee a contribution to total fixed costs while the MRTU design will provide enhanced market revenues through locational marginal prices. This is not inappropriate given that the capacity in these areas is either owned by the IOUs or under long-term RA contract. Following the CPUC's long-term RA proceeding, the CAISO will be able to undertake a process to evaluate a more permanent capacity backstop pricing mechanism that complements the long-term RA program.

Another policy consideration concerns whether, even if a CONE were appropriate under an interim program, a uniform price based on cost of new entry would be appropriate for all types of capacity commitments (*e.g.*, system, local, zonal, ICPM Significant Event, RA deficiency). With respect to the pricing of backstop capacity for ICPM Significant Events, it is particularly inappropriate to base payments for unplanned, unanticipated, short-term procurement on the CONE because the purpose of this type of procurement is to employ existing units that have available capacity to address short-term contingencies or reliability needs, not to provide incentives for new generation. There is no legitimate basis to pay a price based on CONE to existing units under these

types of circumstances. Even ignoring the fact that new entry could not enter the market in the necessary timeframe to provide the service, there is no indication that new units should even enter the market at that particular location in the long-term. Thus, CONE pricing serves no legitimate purpose and will only produce excessive revenues for existing resources.

Moreover, there are no good policy reasons for using CONE at this time. No other reliability generation in the CAISO service model is paid CONE. Further, a multi-year forward capacity market, a backstop mechanism that will be in place only for a limited duration is not intended to, and cannot be expected to, incent new generation. Rather, it will only produce windfall revenues for existing resources. Indeed, based on the level of bilateral RA contract prices and RMR contract prices, a price based on CONE would result in most existing units being paid a significant multiple of their total fixed costs (including a return of and on capital), with efficient units being able to earn revenues in excess of the PER deduction as well. Finally, even if the Commission were to mandate CONE, it might be appropriate to phase in CONE over several years, as was done in some of the eastern ISOs, in order to allow buyers time to make appropriate investment decisions. That has not occurred here.

3. California Generators Proposed Price of \$117/kW-Year Should be Rejected

The California Generators propose a \$117/kW-year price for capacity procured under the ICPM with a monthly payment shaped to reflect the higher reliability needs of the summer months.¹¹⁸ California Generators argue that CAISO should not have abandoned the approach used to establish the target capacity price for RCST, one which

¹¹⁸ California Generators Protest at 4.

fell between the fixed costs of existing generation and the CONE at that time.¹¹⁹

California Generators maintain that if the RCST rate approach had been utilized for ICPM purposes, then the new CONE reference price would yield a higher target capacity price than the \$73/kW-year target capacity price. Specifically, the price would yield a rate of \$117/kw, which would be sixty percent higher than the RCST figure.¹²⁰

Similarly, IEP asserts that the RCST provides a sound economic basis that should be used to value reliability capacity until the RA issues have been resolved, and the ICPM can provide the basis for such change.¹²¹

California Generators' proposal is not just and reasonable. First and foremost, it is not justifiable to increase the RCST price by 60% simply because the Cost of New Entry has dramatically increased since the prior CEC cost study. The same existing units that have been eligible to receive the just and reasonable \$73/kW-year RCST payment are the same units that would be eligible to receive a \$117/kW-year payment under California Generators' proposal. However, the increased cost of new entry does not affect these existing units' costs. The sole result of California Generators' proposal would be a revenue windfall for existing units. Based on the costs of 2006 and 2008 RMR units and the prices of bilateral RA contracts as a proxy for the costs of existing units, California Generators' proposal would result in existing units being paid a multiple of their actual total fixed costs (including return on and of capital) and upward pressures being placed on RA prices, even though there are surplus conditions in most local areas, and ICPM will not incent new generation. The arguments above with respect to the inappropriateness of CONE pricing for ICPM apply with similar force to California Generators' proposal.

¹¹⁹ California Generators Protest at 17.

¹²⁰ *Id.*

¹²¹ IEP Protest at 19-20.

There are other reasons why it is inappropriate to use the \$117/kW-year price proposed by California Generators. First, it utilizes a pricing framework that resulted from a settlement which, although the Commission found was just and reasonable, was not negotiated and agreed to by all the parties. Second, the RCST price and pricing scheme was approved in the context of a pre-MRTU environment with a mandatory Must Offer Obligation, a \$400 bid cap, and no locational marginal pricing. On the other hand, ICPM will be implemented under MRTU where there will be higher bid caps (reaching \$1,000), locational marginal pricing (which will enable units providing locational benefits to earn higher revenues, and scarcity pricing.. In addition, ICPM is a voluntary designation process, whereas RCST and MOO were mandatory. The higher price is not justifiable under these circumstances. Third, California Generators have not justified the floor or ceiling prices used to reach the \$117 price. They simply retain the \$64/kW-year price from RCST (which was based on the Annual Fixed Revenue Requirements of 2006 RMR units) without providing any current information regarding the fixed costs of existing units, information which is entirely within their control. Using the Annual Fixed Revenue Requirements of the 2008 RMR units is \$32.44/KW-year. Further, California Generators do not rely on the comprehensive CEC cost study as the basis for determining CONE ceiling price. Instead, they set the ceiling price (\$205/kW-year) based on the cost of peakers installed by Southern California Edison Company on an expedited basis under special circumstances. It is inappropriate to based the CONE price on a single data point without knowing all of the circumstances that led to the cost of the particular unit installation. It is more appropriate that any CONE price be based on a representative sample of units such as that reflected in the comprehensive generation

cost study conducted by the CEC. As IEP indicates in its comments, the CONE of a CT is approximately \$148/kW-year, as reflected in the CEC cost study.

Another flaw in California Generators' proposal (and IEP's proposal) is their treatment of the PER. They propose retention of an RCST-style approach to ICPM pricing. RCST uses an *ex post* PER that is calculated on a zonal basis; however, pricing under MRTU will be on a LMP basis. This could result in a disparity of prices. Specifically, prices could rise in local areas, but because the PER would be calculated on a zonal basis, it would not reflect the more granular prices in local areas. This suggests that a nodal *ex post* PER might be necessary under MRTU or some form of *ex ante* PER that reflects LMP pricing, but IEP and California Generators simply retain the *ex post* PER mechanism that was utilized in a pre-MRTU zonal market design -- without any supporting discussion as to its appropriateness given the changed MRTU market design. Their use of an *ex post* PER based on the pre-MRTU market design is a further reason why their proposals are defective and not just and reasonable. The CAISO also notes that the record contains no discussion about how an appropriate nodal *ex post* PER or an *ex ante* would be established under ICPM and MRTU.

California Generators' proposal is not just and reasonable for all of the reasons discussed herein. Given that very few MW will likely ever be procured under this backstop, their proposal amounts to nothing more than an attempt to indirectly raise all RA prices. In any event, California Generators they have failed to demonstrate that the CAISO's ICPM -- which is entirely voluntary -- is unjust and unreasonable.

H. Calpine's Proposal Is Not Appropriate

Calpine argues that RA compensation as represented by the CAISO and CPUC staff does not cover the going-forward fixed costs of existing capacity.¹²² In its protest, Calpine renews its proposal that generators should be permitted to elect to opt out of the forward capacity market and be permitted to seek and receive capacity compensation under a cost-of-service based mechanism.¹²³ Calpine also argues that CAISO initially rejected Calpine's proposal because of a preconceived view that ICPM is a piecemeal backstop procurement mechanism to be used rarely and only for short periods of time, but it is in fact a uniform capacity only product.¹²⁴

Calpine's claim that the CAISO's proposal will not permit existing units to recover their going forward costs is baseless. The very essence of the CAISO's proposal is that, at a minimum, units will be permitted to recover their going forward costs, plus 10%. Units whose going forward costs plus 10% exceed \$41/kW-year will be permitted to make a cost justification filing at the Commission to recover the higher amount. Thus, in no instance will a unit not be able to recover its going forward costs. Indeed, as

¹²² Calpine Protest at 5.

¹²³ Calpine Protest at 2. As set forth in the Calpine Protest at 12, Calpine's proposal is as follows:

1. A uniform definition of the capacity-only product would "trigger" capacity compensation when generators are "on call" to the CAISO and are subject to the availability obligations associated with RA capacity. Generators can voluntarily commit or be subject under CAISO procurement mechanisms to such availability obligations.
2. Generation providing the capacity-only product would be entitled to elect a capacity payment for an annual term, based on annualized full fixed cost recovery, taking into account expected net energy market revenues. Monthly or seasonal shaping and application of availability targets (with penalties or bonuses) could be included.
3. To achieve the just and reasonable level of compensation, generation providing reliability, capacity only service, should be allowed to elect to receive (i) a "safeharbor" formula rate capacity payment, reflective of a proxy unit's fixed investment costs (including recovery of and return on capital), or (ii) a full cost of service capacity payment, that reflects all-in capital costs, similar to Schedule F of the RMR Agreements, with an ex ante deduction for energy rents that would be projected to be earned by the individual unit, had it been subject to a tolling agreement, i.e. based on a reference unit's fuel costs and indexed electricity prices.

¹²⁴ Calpine Protest at 12.

discussed above, the CAISO's definition of going forward costs is "richer" than other definitions because it includes coverage of property taxes, where the Commission has found that property taxes should be included only for units that might otherwise retire. As the CAISO explained in the filing letter (pages 42-44), Calpine's proposal is flawed, *inter alia*, because it would require the CAISO to procure a unit for one-year, even if the deficiency does not exist for the entire year, and that this would result in unnecessary over-procurement. In essence, Calpine is essentially seeking RMR type treatment for ICPM designations. There is no basis for that.

What Calpine characterizes as "piecemeal" the CAISO views as prudent utility practice – utilizing existing resources to procure the amount of capacity needed over the time period it is needed. The CAISO also believes that its proposal is more appropriate under a market-based rate regime. The suppliers that operate in the CAISO's market place have not opted for cost-based rate recovery, they have opted for market-based rates. The CAISO does not believe that it is appropriate to guarantee full cost recovery to units under these circumstances especially where the CAISO has not identified the unit as one that is needed on a long-term basis to meet reliability needs. RMR-type pricing certainly is not appropriate in surplus conditions where generic capacity can be provided by a number of units or in local areas where multiple units may be similarly effective in resolving a constraint. The competitive nature of these circumstances should not guarantee the recovery of the full fixed costs of a unit. Likewise RMR pricing is not appropriate for short-term Significant Event procurement where the CAISO is procuring capacity from existing units that have chosen to remain available without a bilateral contract and where there is not a long-term need for capacity in the area of the Significant

Event , only a need for enough capacity to address the transitory Significant Event for the duration of the event. This is consistent with the Commission’s recent order on the New York ICAP market and other orders.¹²⁵ As indicated above, the CAISO still remains the ability to make RMR designations in instances where a particular unit is needed on a long-term basis to maintain reliability. RMR pricing is not appropriate in other instances.

The CAISO’s proposal will, at a minimum, guarantee units recovery of their going forward costs (the costs necessary to keep a unit operating) for the period of their designation and will permit resources to retain all revenues they earn in the Energy and Ancillary Services markets. As indicated above, in many instances the minimum ICPM Capacity payment will likely provide an additional contribution toward a resource’s full cost of service (including capital and return). The ICPM proposal is consistent with that expectation because it permits those units to retain all market revenues, plus it provides them, at a minimum, with going forward cost recovery which are the costs necessary to keep their resource available, as well as an additional amount to contribute to fixed cost recovery.

I. RA Credits Should be Not Be Provided for Procurement for Significant Events

In accordance with CAISO’s original proposal, RA credits should not be provided for procurement for Significant Events.¹²⁶ AReM argues that CAISO ICPM procurement will add local RA megawatts and reliability, and an associated RA credit would afford the LSE with opportunity to reduce its monthly system RA procurement with no

¹²⁵ See, New York Independent System Operator, Inc. 122 FERC ¶ 61,211 at P 38; *Bridgeport Energy LLC*, 113 FERC 61,311 at 62,263 (2005).

¹²⁶ ICPM Transmittal Letter at 54.

reduction in overall reliability.¹²⁷ The CAISO disagrees. Allowing LSEs to include ICPM Significant Event procurement in subsequent RA showings would result in a decrease of the available RA capacity, which was already insufficient (to address the Significant Event, and this would only exacerbate the conditions that led to the ICPM Significant Event, thereby potentially resulting in additional ICPM procurement. Accordingly, the CAISO believes that the credit provided under Section 43.8 should be used solely for determining the need for the additional designation of ICPM Capacity under Section 43.1 and for allocation of ICPM costs under Section 43.7.

J. Requirement to Bid A/S

Some parties commented on CAISO’s proposed section 43.4.1, which defines the availability obligations of resources designated under the ICPM. Specifically, CMUA requested clarification of the last sentence of section 43.4.1, which reads, “in addition to Energy Bids, resources designated under the ICPM shall submit Ancillary Services bids for their ICPM capacity to the extent that resource is certified to provide the Ancillary Service.”¹²⁸ The CAISO clarifies that units designated as ICPM must bid Energy and Ancillary Services and permit the MRTU market software to optimize the two. The CAISO is not imposing a requirement to buy Ancillary Services certified resources, but only that, if a unit is certified to provide Ancillary Services, its must bid both Energy and Ancillary Services.

California Generators also request modification of this section, seeking to add the following phrase: “and to the extent that the unit is not already self-scheduled in the

¹²⁷ AREM Protest at 8-9. *See also*, Constellation/Mirant Protest at 5 and 16-17 (Commission order should provide capacity credit for LSEs for ICPM procurement with a duration longer than 30 days).

¹²⁸ CMUA Comments at 8.

IFM.”¹²⁹ The California Generators believe that the CAISO ostensibly means in Section 43.4.1 that a resource designated under ICPM must submit Economic Bids or Self-Schedules for its *ICPM* capacity, not its *Resource Adequacy* capacity. Further, given that a resource could satisfy its offering obligation by fully self-scheduling its ICPM capacity, submitting a bid for the resource’s certified AS capacity for ICPM capacity already self-scheduled in the IFM could either cause the unit to be over-bid in the IFM or require that the unit bid capacity that is not designated under ICPM into the AS markets.¹³⁰

The Commission should not adopt California Generators’ modification. For example, if too much Energy has been self-scheduled, it could be problematic and the CAISO might need to optimize with Ancillary Services. In other words, the CAISO could be forced to accept Energy that it does not need, when what the CAISO really needs are Ancillary Services offers. Under these circumstances, the CAISO would not be getting the “service” for when it procured the unit and agreed to pay it a monthly capacity payment.

K. Effective date and Settlement Procedures

The California Generators request that the Commission designate a settlement judge to oversee a renewed stakeholder process to develop an alternative backstop capacity procurement mechanism prior to MRTU start-up that will be fully compensatory to non-RA capacity.¹³¹ California Generators assert that in the meantime, the Commission should ensure in 2008 a just and reasonable capacity procurement mechanism effective March 31.¹³²

¹²⁹ California Generators Protest at 5.

¹³⁰ *Id.* at 34.

¹³¹ California Generators Protest at 3.

¹³² *Id.*

These requests are beyond the scope of this proceeding because the ICPM proposal is designed to function under MRTU and be implemented coincident with MRTU; it is not designed to function under the pre-MRTU market design. The CAISO is proposing a transitional backstop procurement mechanism until MRTU -- the TCPM -- that it will file with the Commission at the end of March. The CAISO will seek a June 1, 2008 effective date for the TCPM. California Generators' request also constitutes a collateral attack on the Commission's December 20, 2007 Order in Docket Nos. EL08-20, *et al.* There the Commission (1) rejected IEP's request to require the CAISO to implement ICPM prior to MRTU, (2) extended the RCST effective January 1, 2007 until the earlier of MRTU implementation or implementation of an alternative backstop capacity procurement mechanism (subject to the outcome of a Section 206 proceeding initiated by the Commission to determine the justness and reasonableness of extending the RCST).¹³³ The TCPM proposal is that alternative backstop procurement mechanism.

To the extent California Generators are suggesting that the Commission establish settlement procedures to address ICPM, the CAISO does not believe that such settlement procedures are advisable nor necessary. The CAISO already conducted a nine-month stakeholder process for the ICPM. Since the start of that process, parties have been deeply divided on the key issues and have not moved off of their positions. CAISO management had intended to take ICPM to the Board of Governors at the December 2007 meeting but removed it from the agenda so that one last attempt could be made to reach some sort of compromise or consensus among the parties. Those attempts too "hit a brick wall." Similarly, in the limited stakeholder process that has occurred in February and March with respect to the TCPM proposal, parties again remain committed to their

¹³³ California Independent System Operator Corporation, Inc., et al., 121 FERC ¶ 61,281 (2007).

positions, showing little or no willingness to compromise or attempt to reach a consensus position. Under these circumstances, the CAISO does not believe that additional settlement processes would be productive. Further, a decision in the CPUC's long-term RA proceeding is expected in May. The CAISO believes that resources and efforts would better be spent focusing on the development of a long-term capacity procurement mechanism to replace the ICPM mechanism following the CPUC's decision.

The ICPM proposal is ripe for a decision. It has been through nine months of stakeholdering. The CAISO has provided supporting cost information in the form of the comprehensive CEC cost study which shows the going forward costs and new entry costs for six types of gas-fired units. The Commission also has available to it the fixed revenue requirements of and Fixed Option Payments to RMR units for 2006 and the annual revenue requirements for the lesser pool of 2008 RMR resources. These can serve as a reasonable proxy for the costs of existing generation. The MSC has provided a formal opinion supporting the ICPM proposal. IEP and the California Generators have also provided some additional cost information. In order to provide the necessary certainty to the market at the start of MRTU, the Commission should issue an order now and make the policy decision regarding the appropriate pricing for a voluntary, interim, tariff-based backstop capacity procurement mechanism that is designed to enable the CAISO to procure capacity from existing resources on a short-term basis to "fill-in" gaps in LSE procurement and respond to unexpected events.

L. Sunset Date and Commencement of Stakeholder Process

California Generators argue that there should not be a sunset date for the ICPM, but if a sunset date is accepted, then the Commission should require the CAISO to

commence the stakeholder process to replace ICPM no later than December 1, 2009.¹³⁴ The CAISO included a sunset date because ICPM is an interim mechanism that will be replaced with a more permanent backstop capacity mechanism. As the CAISO has previously explained, the CPUC is currently conducting a proceeding regarding the long-term RA framework for the LSEs subject to its jurisdiction. Following a decision in that proceeding, the CAISO will undertake a process to evaluate long-term capacity pricing mechanisms that will complement the long-term RA framework. It is not appropriate for the CAISO to design and implement a permanent backstop procurement program at this time, while the outcome of that proceeding is pending. With experience under MRTU and the determinations by the CPUC as to their view of the appropriate nature and structure of long-term RA procurement activities, the CAISO will be in a better position to work with stakeholders in developing a more permanent capacity procurement mechanism. The CAISO does not believe it is necessary or appropriate to establish a hard deadline in the tariff for commencement of the stakeholder process on the replacement for the ICPM.

M. Reporting Requirements

With regard to reporting requirements, SVP/M-S-R argues that Section 43.5.1 should be changed to allow two days notice to Market Participants for designations other than just ICPM Significant Event designations.¹³⁵ For example, SVP/M-S-R argues that the CAISO should provide two days notice that it will make an ICPM designation because an LSE is deficient in meeting its RA requirements. The CAISO notes that during the stakeholder process SVP/M-S-R did not submit any comments on the various

¹³⁴ California Generators Protest at 4; 27-29.

¹³⁵ SVP/M-S-R Comments at 7.

whitepapers the CAISO posted which included proposed reporting requirements. Likewise, they did not submit any comments on the proposed ICPM tariff language that was posted for comment. However, the CAISO is not opposed to making modification proposed by SVP/M-S-R if the Commission finds it to be appropriate.

SVP/M-S-R also asserts that Section 43.5.2 should be changed to require a designation report to be posted on or before earlier of 10 days after the end of the month or 30 days after the designation has occurred.¹³⁶ SVP/M-S-R states that this time frame is consistent with the time frame for similar reports that the Commission approved in a January 9, 2008 Order. The CAISO does not object to making this modification to the extent the Commission finds it to be appropriate.

N. Definition of PMin

Section 43.3 of the proposed ICPM tariff language provides that the CAISO may not designate less than a unit's PMin. The previously-approved MRTU tariff defines PMin as "The minimum normal capability of the Generating Unit." California Generators assert that it is unclear from the definition what PMin is intended to mean. They assert that it could mean the unit's minimum stable operating point under manual control, a point from which the unit typically cannot be dispatched to provide energy and respond in the same dispatch interval. On the other hand, it could mean the unit's minimum stable operating point from which the unit could be dispatched and respond in the same dispatch interval – a level which is higher than the unit's manual minimum load.

The California Generators request that, if the Commission approves the CAISO's proposal to allow partial unit designation under ICPM, that it require the CAISO to designate capacity up to at least the unit's dispatchable minimum load amount. Although

¹³⁶ SVP/M-S-R Comments at 7.

the California Generators believe partial unit designation to be an unjust and unreasonable if the Commission permits such designation, they argue that the CAISO should be directed to give recognition to the fact that this is the operating level at which the unit can respond to CAISO dispatch instructions in real time as required.¹³⁷

The CAISO disagrees with this proposal. The CAISO is procuring capacity not energy under the ICPM. While the CAISO would generally expect to be designating an amount of capacity above a resource's PMin level, the CAISO is procuring a capacity product and should procure as close to the actual amount of capacity needed as possible, and not more. Moreover, once the CAISO has designated a resource at the PMin level, nothing would prevent the Scheduling Coordinator for the resource from bidding the resource's full energy output into the CAISO market and receiving the LMP. To the extent a unit does not submit a bid above its Pmin, and the CAISO needs to Exceptionally Dispatch a unit above its Pmin on a given day, the unit will be paid for that additional amount of Energy under the Exceptional Dispatch provisions of the tariff. The CAISO will monitor any Significant Event situation to assess whether the designation of additional is appropriate in order to address the Significant Event on a prospective basis..

¹³⁷ California Generators Protest at 33.

V. CONCLUSION

For the reasons discussed above, the CAISO requests that the Commission accept the ICPM Tariff Amendment without change except for the clarifications provided by the CAISO in this Answer.

Respectfully submitted,

/s/ **Anthony J. Ivancovich**

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Dated: March 17, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service list for the captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 17th day of March, 2008.

/s/Susan L. Montanna
Susan L. Montanna

EXHIBIT A

2006 RMR Fixed Cost per Kw-Yr (Sorted by AFRR/Kw-Yr)

Trans Owner	Unit	Capacity (MW)	Fixed Option		RMR Rate (FOP/KW-Yr)	RMR Rate (AFRR/KW-Yr)	Docket No.
			AFRR or AFRC	Payment \$ (FOP)			
SDG&E	Palomar EC 2x1	541	\$86,630,665	\$17,320,000	\$32.01	\$160.13	ER06-577-000
SDG&E	South Bay 1	145	\$10,525,748	\$10,525,748	\$72.59	\$72.59	ER06-115-000
SDG&E	South Bay 2	149	\$10,461,586	\$10,461,566	\$70.21	\$70.21	ER06-115-000
SDG&E	Encina 5	330	\$17,343,963	\$9,400,428	\$28.49	\$52.56	ER06-426-000
SDG&E	Encina 4	300	\$14,857,119	\$8,052,558	\$26.84	\$49.52	ER06-426-000
SDG&E	South Bay 3	174	\$8,151,036	\$8,151,036	\$46.85	\$46.85	ER06-115-000
SDG&E	Cab 2, Miramar	34	\$1,348,880	\$1,348,880	\$39.67	\$39.67	ER06-197-000
SDG&E	Encina 3	110	\$4,318,525	\$4,318,525	\$39.26	\$39.26	ER06-426-000
SDG&E	Cab 2, Kearney 2	55	\$1,712,457	\$1,712,457	\$31.14	\$31.14	ER06-197-000
SDG&E	Cab 2, Kearney 1	17	\$515,452	\$515,452	\$30.32	\$30.32	ER06-197-000
SDG&E	Cab 2, Kearney 3	57	\$1,566,704	\$1,566,704	\$27.49	\$27.49	ER06-197-000
SDG&E	Encina,2	104	\$2,599,810	\$2,599,810	\$25.00	\$25.00	ER06-426-000
SDG&E	South Bay 4	221	\$5,454,353	\$5,454,353	\$24.68	\$24.68	ER06-115-000
SDG&E	South Bay CT	14	\$320,907	\$320,907	\$22.92	\$22.92	ER06-115-000
SDG&E	Encina 1	107	\$2,311,248	\$2,311,248	\$21.60	\$21.60	ER06-426-000
SDG&E	Cab 2, El Cajon	17	\$356,507	\$356,507	\$20.97	\$20.97	ER06-197-000
SDG&E	Calpeak, Border	42	\$414,400	\$414,400	\$9.87	\$9.87	ER06-91-000
SDG&E	Calpeak, El Cajon	42	\$414,400	\$414,400	\$9.87	\$9.87	ER06-90-000
SDG&E	Calpeak, Escondido	42	\$414,400	\$414,400	\$9.87	\$9.87	ER06-92-000
SDG&E	Miramar EX	47	\$416,190	\$416,190	\$8.93	\$8.93	ER06-108-000
SDG&E	Calpeak, Vaca Dixon	42	\$331,520	\$331,520	\$7.89	\$7.89	ER06-93-000X
SDG&E	Encina CT	16	\$69,333	\$20,800	\$1.30	\$4.33	ER06-426-000
					Average \$33 /MW	Average \$65 /MW	
SCE	Huntington Beach 2	215	\$8,280,000	\$2,898,000	\$13.48	\$38.51	ER05-406-000
SCE	Huntington Beach 1	215	\$8,280,000	\$103,500	\$0.48	\$38.51	ER05-406-000
SCE	Alamitos 3	320	\$9,225,000	\$4,151,250	\$12.97	\$28.83	ER05-406-000
							ER05-138
SCE	Etiwanda 3	320	\$8,284,020	\$0	\$0.00	\$25.89	ER06-113-000
							ER05-138
SCE	Etiwanda 4	320	\$7,515,679	\$0	\$0.00	\$23.49	ER06-113-000
					Average \$5 /MW	Average \$30 /MW	
PG&E	Los Esteros 1-4	180	\$44,463,794	\$33,347,846	\$185.27	\$247.02	ER06-288-000
PG&E	Geysers 7	38	\$6,757,876	\$3,378,938	\$88.92	\$177.84	ER06-217-00X
PG&E	Geysers 12	40	\$6,529,236	\$3,264,618	\$81.62	\$163.23	ER06-217-00X
PG&E	Geysers 6	40	\$6,243,311	\$3,121,658	\$78.04	\$156.08	ER06-217-00X
PG&E	Geysers 17	51	\$7,255,435	\$3,627,718	\$71.13	\$142.26	ER06-217-00X
PG&E	DEC	845	\$103,752,212	\$51,876,106	\$61.39	\$122.78	ER06-261-000
PG&E	Geysers 18	60	\$7,291,947	\$3,645,974	\$60.77	\$121.53	ER06-217-00X
PG&E	Geysers 11	60	\$7,285,837	\$3,642,919	\$60.72	\$121.43	ER06-217-00X
							ER05-343-000
PG&E	Potrero 3	206	\$17,908,424	\$8,954,212	\$43.47	\$86.93	ER06-111-000
							ER05-113
							ER06-99-000
PG&E	Hunters Point 4	160	\$6,122,425	\$6,122,425	\$38.27	\$38.27	ER06-341-000
							ER04-227-000
							ER05-343-000
PG&E	Contra Costa 7	345	\$22,237,027	\$11,118,514	\$32.23	\$64.46	ER06-110-000
PG&E	Pittsburg 5	312	\$15,157,190	\$7,578,595	\$24.29	\$48.58	ER05-343-000
PG&E	Pittsburg 6	317	\$15,157,190	\$7,578,595	\$23.91	\$47.81	ER05-343-000
PG&E	Oakland 1	55	\$1,450,000	\$1,087,500	\$19.77	\$26.36	ER06-266-000
PG&E	Oakland 2	55	\$1,450,000	\$1,087,500	\$19.77	\$26.36	ER06-266-000
PG&E	Oakland 3	55	\$1,450,000	\$1,087,500	\$19.77	\$26.36	ER06-266-000
PG&E	Creed	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-101-000
PG&E	Gilroy Peakers 1-2	90	\$600,000	\$600,000	\$6.67	\$6.67	ER06-98-000
PG&E	Gilroy Peakers 3-4	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-98-000
PG&E	Gilroy, Feather River	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-98-000
PG&E	Gilroy, Lambie	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-98-000
PG&E	Gilroy, Riverview	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-98-000
PG&E	Gilroy, Yuba City	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-98-000
PG&E	Gilroy, Wolfskill	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-98-000
PG&E	Goosehaven	45	\$300,000	\$300,000	\$6.67	\$6.67	ER06-112-000
							ER05-113
							ER06-99-000
PG&E	Hunters Point 1	52	\$308,337	\$308,337	\$5.93	\$5.93	ER06-341-000
PG&E	San Joaquin Watershed	215	\$1,263,160	\$1,263,160	\$5.88	\$5.88	ER06-99-000
PG&E	Humboldt Bay Mobiles	30	\$157,895	\$157,895	\$5.26	\$5.26	ER06-341-000
							ER05-343-000
PG&E	Potrero 6	52	\$461,284	\$230,642	\$4.44	\$8.87	ER06-111-000
							ER05-343-000
PG&E	Potrero 5	52	\$451,175	\$225,588	\$4.34	\$8.68	ER06-111-000
							ER05-343-000
PG&E	Potrero 4	52	\$338,285	\$169,143	\$3.25	\$6.51	ER06-111-000
							ER06-99-000
PG&E	Humboldt Bay 1	52	\$157,895	\$157,895	\$3.04	\$3.04	ER06-341-000
							ER06-99-000
PG&E	Humboldt Bay 2	53	\$157,895	\$157,895	\$2.98	\$2.98	ER06-341-000
							ER06-99-000
PG&E	Kings River Watershed	336	\$947,370	\$947,370	\$2.82	\$2.82	ER06-341-000
							ER06-99-000
PG&E	Helms 1	404	\$157,895	\$157,895	\$0.39	\$0.39	ER06-341-000
							ER06-99-000
PG&E	Helms 2	404	\$157,895	\$157,895	\$0.39	\$0.39	ER06-341-000
							ER06-99-000
PG&E	Helms 3	404	\$157,895	\$157,895	\$0.39	\$0.39	ER06-341-000
					Average \$29 /MW	Average \$52 /MW	

State Average \$27 /MW State Average \$52 /MW

EXHIBIT B

RMR Units 2008

Units		2008 RMR MW	AFRC	2008 RMR	AFRR	\$/kW-year
PG&E						
	Feather River	45	\$ 1,250,000			27.78
	*Geysers 6	40		\$ 5,905,834		147.65
	Gilroy Peakers 1-2	90	\$ 2,500,000			27.78
	LMEC	556	\$ -			
	Oakland 1	55		\$ 1,424,666		25.90
	Oakland 2	55		\$ 1,424,666		25.90
	Oakland 3	55		\$ 1,424,666		25.90
	**Potrero 3	206		\$ 17,908,519		86.93
	**Portrero 4	52		\$ 338,267		6.51
	**Potrero 5	52		\$ 451,143		8.68
	**Portrero 6	52		\$ 461,272		8.87
	Yuba City	45	\$ 1,250,000			27.78
Total		1303				
SDG&E						
	Enterprise	42	\$ 434,949.27			10.36
	Border	42	\$ 434,949.27			10.36
	El Cajon	42	\$ 434,949.27			10.36
	Kearney 2A, B, C & D	55		\$ 1,557,804		28.32
	Kearney 3A, B, C & D	57		\$ 1,614,451		28.32
	Mramar 1A & 1B	33		\$ 934,682		28.32
	South Bay	702		\$ 33,775,023		48.11
Total		973				

Average \$/kW-year 32.44

* Geothermal Unit

** Settlement with PG&E Wrap Agreement