

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

<b>California Independent System Operator Corporation</b>	) ) ) ) )	<b>Docket No. ER08-760-000</b>
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**MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

On March 28, 2008, in accordance with the Commission’s December 20, 2007 Order,<sup>1</sup> the California Independent System Operator Corporation (“CAISO”)<sup>2</sup> submitted a proposed Transitional Capacity Procurement Mechanism (“TCPM”), 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.

The TCPM is meant to serve as a bridge between the currently effective Reliability Capacity Services Tariff (“RCST”) and the Interim Capacity Procurement Mechanism (“ICPM”) proposed in Docket Nos. ER06-615 and ER08-556, which will be implemented as part of the CAISO’s Market Redesign and Technology Upgrade (“MRTU”). The TCPM adopts certain of the improvements to the RCST program developed in the ICPM. However, given the very short duration anticipated for the TCPM’s effective period and the need to

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<sup>1</sup> *Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,281 (2007) at P 38.

<sup>2</sup> Capitalized terms not otherwise defined herein have the meaning set forth in the Master Definition Supplement, Appendix A to the ISO Tariff.

work with the existing CAISO systems and market design, including the existing Must Offer Obligation (“MOO”), the TCPM continues and updates other aspects of the RCST.

In response to the filing, a number of parties submitted motions to intervene, comments, or protests.<sup>3</sup> 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 April 18, 2008, and pursuant to Rule 213, 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 TCPM amendments, without modification.

## **I. 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

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<sup>3</sup> The following parties filed interventions: the California Public Utilities Commission (“CPUC”), California Department of Water Resources State Water Project; Modesto Irrigation District (“Modesto”); and NRG Companies (“NRG”). The following parties filed interventions with comments and/or protests: Western Area Power Administration (“WAPA”); Alliance for Retail Energy Markets (“AReM Comments”); California Municipal Utilities Association (“CMUA Protest”); the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (“Six Cities Protest”); City of Santa Clara, California, doing business as Silicon Valley Power (“SVP”) and the M-S-R Public Power Agency (“SVP/M-S-R Protest”); Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (“Constellation Protest”); Dynegy Moss Landing, LLC, Dynegy Morro Bay, LLC, El Segundo Power, LLC, and Reliant Energy, Inc. (“California Generators TCPM Protest”); Independent Energy Producers Association (“IEP TCPM Protest”); Northern California Power Agency (“NCPA Comments”); Pacific Gas and Electric Company (“PG&E Comments”); and Southern California Edison Company (“SCE Comments”).

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.<sup>4</sup>

## II. ANSWER

The TCPM is to be effective for a brief period of time between June 1, 2008 and the commencement of MRTU, which the CAISO and stakeholder are working diligently to have in place during the Fall of 2008. The TCPM is based on the RCST, a backstop procurement program that the Commission found, and as recently as December 2007 reaffirmed, to be just and reasonable.<sup>5</sup> The CAISO has proposed to update the RCST rates to account for inflation and other factors that potentially affect the costs of *existing* Generating Units. The proposed rate is between the two bookends established by the Commission as a zone of reasonableness for the CAISO's backstop procurement<sup>6</sup> - it is higher than the fixed costs of existing generation and lower than the cost of new entry ("CONE").<sup>7</sup>

As the proponent of a rate design, the CAISO does not have to demonstrate that the TCPM is perfect or even the best backstop mechanism.<sup>8</sup>

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<sup>4</sup> 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).

<sup>5</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 (2007) at P 69, order on reh'g, 121 FERC ¶ 61,276 (2007) at P 26.

<sup>6</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 at PP 70-72.

<sup>7</sup> *Id.*

<sup>8</sup> *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).

The CAISO is only required to show that the TCPM, like the RCST before it, is just and reasonable, and this the CAISO has done. The CAISO need not show that its proposal is the only conceivable just and reasonable rate design or that its proposal is more reasonable than other proposals.<sup>9</sup>

In developing the TCPM, as was the situation with the proposed ICPM, the CAISO tried to negotiate the difficult waters of strongly-held, divergent stakeholder positions and arrive at a fair outcome. The CAISO does not suggest that ratemaking should necessarily follow a “Goldilocks” approach of trying to find the middle ground between being either too hot or too cold, or in this case, either paying too much or too little for needed backstop capacity. The CAISO hoped for more of a consensus on the issue of the target capacity price. However, in the absence of agreement and given the direction of the Commission’s December 20, 2007 order, the CAISO has sought to craft a balanced, updated proposal that will serve as a useful transition from the RCST to the ICPM. The CAISO respectfully requests that the Commission find that the TCPM represents a reasonable and equitable approach.

**A. IEP’S ATTEMPT TO INCORPORATE ITS ARGUMENTS BY REFERENCE IS INCONSISTENT WITH COMMISSION POLICY**

Before addressing the substantive issues raised in the comments and protests, the CAISO notes an important procedural deficiency in IEP’s pleading.

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<sup>9</sup> *New York Independent System Operator, Inc.*, 122 FERC 61,064 at n.12. See also *Louisville Gas & Elec. Co.*, 114 FERC ¶ 61,282, at P 29, *order on reh’g sub nom., E.ON U.S. LLC*, 116 FERC ¶ 61,020 (2006) (“[T]he just and reasonable standard under the FPA is not so rigid as to limit rates to a ‘best rate’ or ‘most efficient rate’ standard. Rather, a range of alternative approaches often may be just and reasonable.”). *FPC v. Conway Corp.*, 426 U.S. 271, 278-79 (1976) (*Conway*); *Permian Basin Area Rate Cases*, 390 U.S. 747, at 791-92 (1968); *Colo. Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945) (Allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science).

While IEP makes certain general arguments in its protest, the primary support for its contentions is based on an attempt to incorporate by reference two prior pleadings: (1) IEP's Comments in Docket No. EL08-20 and (2) IEP's Motion to Intervene and Protest in Docket No. ER08-556.<sup>10</sup> The Commission has stated that reliance on incorporation by reference is not an appropriate means to develop arguments for a protest,

Incorporation by reference of arguments from prior pleadings in other proceedings is not sufficient to warrant a Commission response to those arguments... We must decide each case on the record in that case, and here what is before us is simply an unexplained and unsupported claim.... A party has an obligation to clearly articulate and substantiate the basis for its requested action..., and not simply make an unsupported claim.<sup>11</sup>

Docket No. EL08-20 concerns the extension of the CAISO's use of the RCST past the expiration date of December 31, 2007. Docket No. ER08-556 involves the CAISO's ICPM proposal. While the CAISO recognizes that there are similarities of issues between the proceedings, there are significant differences, including, but not limited to, the proposed prices the CAISO would pay for backstop capacity; the voluntary obligation to supply under the ICPM; and the designation process for Significant Events. In Docket No. ER08-556, IEP's proposed remedy was a settlement conference.<sup>12</sup> In its protest in this proceeding, IEP appears to request a paper hearing.<sup>13</sup> As discussed below, the CAISO believes that neither of IEP's proposals has merit and that a fully

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<sup>10</sup> See IEP TCPM Protest at 5, 6, and 7.

<sup>11</sup> *ISO New England*, 119 FERC ¶ 61,161 at P 16 (2007). See also, e.g., *Pub. Serv. Elec. and Gas v. FERC*, No. 05-1325, slip op. at 13-14 (D.C. Cir. Apr. 13, 2007) ("it is not 'the court's duty to identify, articulate, and substantiate a claim for the petitioner'" in regard to "petitioners' one-sentence cry of protest.").

<sup>12</sup> Docket No. ER08-556-000, "Motion to Intervene and Protest of Independent Energy Producers, Inc.," at 2-3, Feb. 29, 2008 ("IEP ICPM Protest" or "IEP attached ICPM Protest").

<sup>13</sup> IEP TCPM Protest at 2.

sufficient record exists for the Commission to make the policy determinations with respect to both the TCPM and the ICPM. Nevertheless, it is because of the uncertainty in how to relate arguments made in one context to another proceeding that the Commission has rejected the use of incorporation by reference.

In the following sections, the CAISO will explain why its pricing proposal is reasonable and why the arguments made by IEP and the California Generators lack substantive merit. Nevertheless, IEP's use of incorporation by reference constitutes a separate and sufficient basis for rejection of the protest.

## **B. THE CAISO'S PROPOSED TARGET ANNUAL CAPACITY PRICE AND DAILY MOO CAPACITY PAYMENT ARE REASONABLE**

In developing the target capacity price for the TCPM, the CAISO began with the Commission's statements in the two December 20, 2007 orders. First, the Commission reaffirmed the bookends that establish the zone or reasonableness<sup>14</sup> for the CAISO's backstop procurement.

As an initial matter, we disagree with Williams' and the CEOB's contentions that the Commission approved the target capacity price based on the cost of new entry. To the contrary, the Commission found that a just and reasonable target capacity price should be no less than the fixed costs of existing generation but no more than the cost of new entry.<sup>15</sup> The data provided in the paper hearing process established these limits as \$64/kW-yr and \$88/kW-yr, respectively. On the lower end, the Commission found that the target capacity price should be greater than the fixed costs of existing generation in order to encourage longer-term bilateral contracting. On the upper end, it is reasonable to expect the target capacity price would be less than the cost of new entry, because

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<sup>14</sup> *Conway*, 426 U.S. at 278; *see also Am. Elec. Power Serv. Corp.*, 44 FERC ¶ 61,206, at 61,749, *order on reh'g*, 45 FERC ¶ 61,408 (1988), *order on reh'g*, 46 FERC ¶ 61,382 (1989) ("The Commission's task is to determine whether [a rate] is just and reasonable. It is not required to find that the [rate] is the 'best,' or 'superior' to all others, in order to adopt it").

<sup>15</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 70.

the shorter term nature of RCST does not provide the long-term incentive required to attract new investment. Instead, this transitional price for capacity serves as a bridge to help ensure that existing generators remain available and are adequately compensated until new resources can be built in conjunction with the market-oriented mechanisms and incentives of the CAISO's MRTU.<sup>16</sup>

Second, the Commission noted if MRTU implementation were postponed until after March 31, 2008, it would "heighten concerns we may have regarding prolonged extension of the RCST" and that the CAISO was to "follow through with its commitment to initiate a new stakeholder process and modify the RCST accordingly."<sup>17</sup>

Thus, the CAISO initiated a stakeholder process to update the RCST rate. Because of the short-term nature of the program and speculative need for any backstop procurement, the Commission recognized that any transitional mechanism was not meant to serve as a means of attracting new investment. Accordingly, the CAISO focused on the need to revise the RCST rate based on costs for existing facilities. It was important that during the stakeholder process, no suppliers came forward with data indicating that there had been a significant increase in the operating costs of their facilities. Indeed, in their protests, the generators do not cite any evidence that the costs of existing Generating Units eligible to receive a TCPM designation or MOO waiver denial have increased from \$73 to a level where \$86 is inadequate. The generators do not challenge the Generating Units that the CAISO has used for the floor of the zone of reasonableness, and instead improperly rely on CONE, which does not reflect

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<sup>16</sup> 121 FERC ¶ 61,276 at P 23.

<sup>17</sup> 121 FERC ¶ 61,281 at P 38.

the costs of existing Generating Units. As explained below, the generators' position is without merit and the CAISO's Target Annual Capacity Price, based on an escalation of the approved RCST price, is reasonable.

**1. The CAISO Has Justified the Proposed Target Annual Capacity Price of \$86/kW-year**

**a. The CAISO's Proposed Target Annual Capacity Price Is Not Too High**

SCE, PG&E, CMUA, Six Cities, NCPA, and AReM<sup>18</sup> protest the increase in the Annual Target Capacity Price proposed in the TCPM. Importantly, these parties do not appear to object to the CAISO's proposed escalation of the RCST rate based on indexed data for 2006 and 2007. They do, however, oppose the additional ten percent adder, claiming it is not sufficiently supported. For example,

SCE agrees with the initial steps of the CAISO's proposal, i.e. calculating a circa 2008 capacity payment by applying two years of inflation to the FERC approved circa 2006 capacity value. As discussed in the CAISO's TCPM filing, applying the National Consumer Price Index for all Urban Consumers ("CPI-U") values for 2006 and 2007 to the FERC approved \$73/kw-yr value result is a capacity payment value of \$77.89/kw-yr.

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The CAISO has not specifically provided evidence that TCPM designated generators receiving a capacity payment based upon \$77.89/kW-yr will not be able to recover their costs. SCE recommends that the Commission not approve the proposed 10% adder.<sup>19</sup>

In the filing letter, the CAISO explained that the ten percent adder:

(1) recognized that the CPI-U is only a general inflation factor that may not

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<sup>18</sup> SCE Comments at 3-4; PG&E Comments at 5; CMUA Protest at 9, Six Cities Protest at 6-7; NCPA Comments at 4, AReM Comments at 4.

<sup>19</sup> SCE Comments at 3-4.

capture all of the appropriate costs and considerations that should be taken into account in determining the appropriate target TCPM Capacity payment;

(2) provided a “margin for error” in recognition of the fact that the CAISO does not have comprehensive cost information regarding the fixed costs of all existing Generating Units; and (3) attempted to balance the positions taken by the representatives of LSEs and generators.<sup>20</sup> Moreover, the protestors have agreed that it is reasonable to make annual adjustments to the target capacity price based on CPI-U data. The ten percent adder also, in part, recognized that it would be appropriate, at a minimum, to include an additional CPI-U adjustment for 2008.

The U.S. Supreme Court has stated that “there is no single cost-recovering rate, but a zone of reasonableness.”<sup>21</sup> The CAISO’s proposed target price of \$86/kW-year represents a material increase from the \$73/kW-year price that was affirmed in December.<sup>22</sup> Nevertheless, as the Commission noted in December, the case record may have supported a range of possible just and reasonable results.<sup>23</sup> The CAISO submits that the proposed rate represents a just and reasonable payment for a product whose need may be infrequent or, at least, highly uncertain.

**b. The CAISO’s Proposed Target Annual Capacity Price Is Not Too Low**

The California Generators and IEP strenuously argue that the \$86/kW year price is unreasonably low. As noted previously, the basis of their argument

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<sup>20</sup> TCPM Filing Letter at 5-6.  
<sup>21</sup> *Conway*, 426 U.S. at 278.  
<sup>22</sup> 121 FERC ¶ 61,276 at P 26.  
<sup>23</sup> *Id.*

is not that their own costs have escalated at rates greater than those reflected in the CPI data, but rather that the cost of new entry has increased. In essence, their argument is not based on their own cost recovery needs, but a perceived under-valuing of their capacity relative to the costs of new entrants. However, as will be discussed, new entry is not needed over the next few months in most of the local areas in the CAISO footprint and even if it was, a short-term program with uncertain revenues, such as the TCPM, is unlikely to be considered by any investor as a relevant source of market revenue.

**(1) In Evaluating the Protests of the California Generators and IEP Some Perspective Is Important**

In evaluating the arguments made by the California Generators and IEP, it is important to recognize why there is a MOO, what purpose the target capacity payment addresses, and how the backstop procurement interrelates with other state resource adequacy and CAISO procurement programs.

First, the MOO originated as a market power mitigation measure as a result of the 2000-2001 California energy crisis. In an attempt to prevent physical withholding, the Commission recognized that existing facilities should be willing to bid available and uncommitted supply at the unit's marginal cost. After the crisis subsided, there were delays in developing and implementing a revised market structure. A concern was expressed that, without a capacity purchase obligation, LSEs could "lean" on the MOO and not procure the necessary capacity to serve their loads.

This concern about a lack of state-mandated capacity procurement was addressed by passage of California Assembly Bill 380,<sup>24</sup> which directed the CPUC to establish, in consultation with the CAISO, new Resource Adequacy (“RA”) requirements for LSEs that are under the jurisdiction of the CPUC and for Local Publicly Owned Utilities to establish their own separate RA programs. As described in A.B. 380, a RA program must,

Ensure that adequate physical generating capacity dedicated to serving all load requirements is available to meet peak demand and planning and operating reserves, at or deliverable to locations and at times as may be necessary to ensure local area reliability and system reliability, at just and reasonable rates.<sup>25</sup>

On October 27, 2005, the CPUC issued decision 05-10-42 reaffirming and clarifying that entities under its jurisdiction would be required, by June 2006, to demonstrate that they have acquired capacity sufficient to serve their forecast retail customer load and a 15-17% reserve margin by June 2006. Local Publicly Owned Utilities have also implement RA programs with varying reserve margin requirements. Thus, there are now RA programs in place to support needed capacity procurement. While the California Generators have criticized elements of the RA programs, such as the manner in which demand side resources are counted by the CPUC, the California Generators also admit there has been compliance with the RA requirements.<sup>26</sup> These RA programs have also been

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<sup>24</sup> Cal. Pub. Util. Code §§ 380 and 9620 (2006).

<sup>25</sup> *Id.*

<sup>26</sup> California Generators ICPM Protest at 9. See *a/so* IEP ICPM Protest at 5-6.

effective in supporting the development of new resources. Even IEP recognizes that over 5,000 MWs of additional capacity have been brought on line.<sup>27</sup>

Second, as explained in more detail below, there is no discrimination between old and new resources as alleged by IEP.<sup>28</sup> There are many existing resources that receive capacity payments having executed contracts with LSEs to serve as Resource Adequacy Resources.<sup>29</sup> Moreover, while IEP wants existing Generating Units to be paid the same as new Generating Units, those new Generating Units are merely recovering their costs via rate base cost of service rates or long-term contracts. IEP wants Generating Units with potentially significantly lower costs to be paid an amount significantly in excess of their costs. Alternatively, IEP could have its members file for cost based rates if they want to be treated in a similar manner to the newer Generating Units they reference. There is currently no centralized capacity market in California, and the Commission has determined that it is reasonable for an independent system operator to operate based on a bilateral market structure.<sup>30</sup> Concerns about rate basing of new Generating Units or long-term contracts should not be “corrected” via TCPM.

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<sup>27</sup> IEP ICPM Protest at 4.

<sup>28</sup> IEP TCPM Protest at 7-8.

<sup>29</sup> For example, in July 2007 there were 474 generators within the CAISO Control Area under an RA obligation that provided Resource Adequacy Capacity totaling 35,565 MW, which was more than 75% of the total Net Qualifying Capacity (“NQC”) of 46,828 for that month potentially available from all resources on the CAISO’s RA NQC Report. Similarly in August 2007, there were 475 generators within the CAISO Control Area under an RA obligation that provided Resource Adequacy Capacity totaling 36,894 MW, which was more than 79% of the total NQC of 46,686 MW for that month potentially available from all resources on the CAISO’s RA NQC Report. This substantial participation in the RA program demonstrates that Resource Adequacy Capacity is not being supplied merely by utility-owned or recently constructed Generating Units.

<sup>30</sup> *Midwest Indep. Transmission Sys. Operator, Inc.*, 122 FERC ¶ 61,283 at P 354 (2008).

Third, the TCPM and the MOO are not substitutes for RMR contracts, which are contracts entered into by the CAISO to address a known long-term local reliability need not addressed through RA contracts.<sup>31</sup> In other words, the CAISO needs a particular unit, in a particular location on a long-term basis to maintain reliability.<sup>32</sup> Also, MOO is not a substitute for RA. RA is to meet a resource and planning reserve requirement imposed by the CPUC or LRA. Daily MOO is not used to meet a resource requirement imposed by the CPUC or LRA. It reflects the need for a unit on a given day. It is a daily product.

Fourth, the TCPM backstop program, and in particular backstop procurement for TCPM Significant Events is not designed to provide economic signals for construction of new generation. By definition, TCPM Significant Events are random and unexpected and may not be reoccurring such that additional resources are necessary. Repeated designations are to signal that

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<sup>31</sup> Moreover, the CAISO should not be required to use RMR to procure generic capacity that can be provided by a number of Generating Units. System wide and in most local areas there is surplus capacity where the Generating Units are similarly effective. 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 already under an RA contract or an RMR Contract. Generating Units procured under RMR are Generating Units that are needed on a long-term basis in that location. On the other hand, TCPM procurement would generally be more short-term or transitory in nature. In particular, TCPM Significant Event procurement will arise following unforeseen or unplanned events. Typically these will be events that only require capacity for a short period of time and will not be indicative of a long-term need for capacity in the area of the TCPM Significant Event. RMR-type contracts and pricing is not appropriate under these circumstances.

<sup>32</sup> The California Generators claim that it is “ironic” that “the CAISO does not determine RMR “need” in the same manner that it defines “need” under TCPM.” California Generators TCPM Protest at 6. This statement is incorrect in two respects. First, with respect to forward TCPM procurement in the event an LSE fails to comply with Local Capacity Obligations, the CAISO does evaluate the need for RMR and backstop procurement on a similar basis. Second, with respect to TCPM Significant Event designations, these are random, potentially short-term events outside the planning scope and serve a different purpose than RMR generation (which is based on a forward-identified, long-term need of the CAISO).

modifications are necessary to the RA program which is the primary facilitator of new construction.

Fifth, the TCPM is not to serve as a guaranteed source of payments for resources that have not secured RA or RMR contracts. As the Commission recognized,

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 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.<sup>33</sup>

Simply stated, the TCPM is designed to utilize Generating Units that have 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. The TCPM represents an opportunity for a resource to earn unanticipated, additional revenues if CAISO determines that an unexpected event has occurred that creates a need for capacity procurement in order to maintain reliability.

## **(2) IEP's Request to Set the Target Capacity Price at CONE Is Inappropriate**

IEP argues that the proposed ICPM pricing is unsupported by economic principles, unduly discriminatory, and undervalues capacity.<sup>34</sup> IEP also argues

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<sup>33</sup> *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,211 (2008) at P 38.  
<sup>34</sup> IEP TCPM Protest at 6-8. See also, IEP attached ICPM Protest at 12.

that the price of the TCPM should promote new investment.<sup>35</sup> IEP is asking that the Target Annual Capacity Price be set at CONE. Using CONE for the capacity payment under TCPM 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 CONE. It approved a target price less than CONE and expressly recognized that it was doing so in its order.<sup>36</sup> The Commission should not depart from this determination and should reject IEP's request.<sup>37</sup>

The foundation of IEP's argument is flawed. The TCPM is not a capacity market and is not intended to incent new generation. TCPM is proposed as a transitional administrative mechanism that will permit the CAISO to procure capacity from existing Generating Units to fill gaps in LSE procurement or respond to unexpected TCPM Significant Events. The short term mechanism is intended to be in place until the ICPM and even the ICPM is intended to remain effective only until the CAISO develops a more permanent capacity pricing mechanism (which the CAISO will begin to assess with stakeholders some time after the conclusion of the CPUC's long-term RA proceeding, the appropriate forum to address long-term capacity pricing issues). In other words, the TCPM represents a temporary and potentially infrequent and uncertain backstop procurement mechanism. New entry cannot provide this service and will not

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<sup>35</sup> IEP attached comments on RCST Extension at 2.

<sup>36</sup> *Indep. Energy Producers Association v. California Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 (2007) at P 72.

<sup>37</sup> CMUA urges the Commission to not be distracted by arguments made by generators regarding infrastructure investment and incentives for new entry. Those issues are for long-term RA policy. TCPM is merely a very short term fail-safe mechanism to backstop the existing RA program. TCPM is designed to meet short-term and/or unanticipated reliability needs only, not to provide a revenue stream to support new generation. CMUA Protest at 5.

compete to provide this service. New entry price signals, therefore, are not needed for the TCPM service. Rather, the pertinent issue here is whether existing resources are being adequately compensated for the TCPM service they provide and CONE is not relevant to this discussion.

In addition to being contrary to specific Commission precedent regarding the CAISO's backstop procurement,<sup>38</sup> there is no evidence that the fixed costs of existing suppliers have increased beyond those recognized by the CAISO's use of the CPI index with the ten percent adder. To the contrary, the limited data from RMR facilities that the CAISO has available indicates that the proposed price, if considered on an annualized basis, will not only cover going forward costs for the existing facilities, but also provide for a return on investment in most cases.<sup>39</sup> The CAISO notes, however, that like RCST, the short-term nature of most TCPM payments (i.e., daily, monthly) are not intended to provide guaranteed coverage of annual fixed costs for any particular unit. Moreover, the target capacity price (even allowing for the peak energy rent reduction) is at the high-end of the range of RA prices that are being paid as the result of competitive solicitations.<sup>40</sup>

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<sup>38</sup> *Indep. Energy Producers Association v. California Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,276 at P 23 (2008).

<sup>39</sup> This is demonstrated by the data provided in Attachments D and E to the Filing Letter.

<sup>40</sup> See Attachment H to ICPM Filing Letter in Docket No. ER08-556 which contain a copy of the Notice of Intervention and Comments of the CPUC in Docket No. EL08-20 filed on January 9, 2008. These comments state "CPUC staff observations of CPUC jurisdictional LSE capacity procurement indicate that Local RA capacity is generally transacting in a \$20 to \$45 per kW year price range depending on the economics of the specific local area; while capacity used to fulfill system-wide RA requirements is generally transacting in the \$15 to \$25 per kW year price range." *Id.* at 6.

As the CAISO explained in its filing letter,<sup>41</sup> the use of CONE or a multiple of CONE (net of peak energy rents) is generally justified in a capacity market design as an incentive for new generation in areas where it is needed. Unlike a multi-year capacity market, the TCPM is a short-term, administrative, backstop procurement mechanism that permits the CAISO to procure capacity from existing Generating Units and does not guarantee a stream of revenues to any resource.<sup>42</sup> The CAISO also noted that 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. CONE should be considered as a possible backstop price only when there is a capacity deficiency in a local area or system zone. The CAISO included a Table with data from the 2008 Local Requirements Study showing that 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 Technical Analysis suggesting that only few locations on the CAISO Controlled Grid would even warrant high backstop prices if a CONE approach were to be applied. The data for the recently released 2009 study<sup>43</sup> show a similar pattern, which are reflected in the following table. As can be seen by the table, one of the previously deficient areas now has sufficient capacity and of the existing deficient areas, the deficiency has narrowed in all but one load pocket.

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<sup>41</sup> See TCPM Filing Letter at 18-23.

<sup>42</sup> IEP states that the new generation that has been built is being compensated through cost-based rates or long-term contracts. IEP attached ICPM Protest at 7-8. If that is the case, these Generating Units will not benefit from cost of new entry pricing, only existing Generating Units will.

<sup>43</sup> The full study, including details as to the methodology and results, is available on the CAISO's website at <http://www.caiso.com/1fba/1fbace9b2d170.pdf>.

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

Local Area Name	Qualifying Capacity			2009 LCR Need Based on Category C with operating procedure		
	QF/ Muni (MW)	Market (MW)	Total (MW)	Existing Capacity Needed	Deficiency	Total (MW)
Humboldt	48	135	183	177	0	177
North Coast / North Bay	217	728	945	766	0	766
Sierra	1012	768	1780	1617	703	2320
Stockton	276	265	541	541	185	726
Greater Bay	1111	5662	6773	4791	0	4791
Greater Fresno	510	2319	2829	2680	0	2680
Kern	646	31	677	417	5	422
LA Basin	3942	8222	12164	9728	0	9728
Big Creek/ Ventura	931	4201	5132	3178	0	3178
San Diego	201	3442	3663	3113	14	3127
<b>Total</b>	<b>8894</b>	<b>25773</b>	<b>34687</b>	<b>27008</b>	<b>907</b>	<b>27915</b>

The Commission found that prices should be significantly below CONE in situations where there is excess supply.<sup>44</sup> That is generally the case here, and the CAISO’s pricing proposal is more reasonable under these conditions than is IEP’s proposal.

Finally, as to the pricing of backstop capacity for TCPM Significant Events, payments for unplanned, unanticipated, short-term procurement should not be based on the CONE because the purpose of this type of procurement is to utilize those existing Generating Units that are available to address short-term contingencies or reliability needs, not to provide incentives for new generation.<sup>45</sup>

<sup>44</sup> *NY Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211 at P 35 (2008).

<sup>45</sup> See Attachment F to the TCPM Filing Letter in which the Market Surveillance Committee (“MSC”) writes with respect to “Type 2” ICPM Significant Events,

Accordingly, there is no reasonable basis to pay a price based on CONE to existing Generating Units under these types of circumstances.

Contrary to IEP's statement that the proposed price "will do nothing to provide proper procurement incentives on the part of LSE,"<sup>46</sup> the LSEs have every incentive to engage in the required procurement, particularly given the nature of the CPUC program. Even the California Generators recognize that the IOUs will not fail to comply with their RA procurement responsibilities.<sup>47</sup> 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, this proceeding is not a proper venue to pursue those concerns.

In summary, as with the RCST, the TCPM is not intended to provide either new or existing Generating Units with guaranteed full fixed cost recovery. The fact that new construction costs have increased does not affect the costs of existing Generating Units. If the TCPM price is increased to account for a recent rise in the costs of constructing new power plants, such an increase would merely result in windfall payments for existing Generating Units. As such, use of CONE does not present sound policy in this situation. In fact, based on the level

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[t]he primary rationale for Type 2 procurement is to ensure that the generation capacity purchased continues to bid in the short-term market. Receipt of the ICPM capacity payment is conditional on the un owner being willing to subject its unit to the ISO's must-offer obligation. For this reason, the price and duration of payment for Type 2 does not provide a signal for new generation investment.

*Id* at 3. Thus, the MSC supported capacity prices "significantly below CONE" for Significant Event procurement. *Id.* at 4.

<sup>46</sup> IEP attached ICPM Protest at 2. See also IEP TCPM Protest at 6.

<sup>47</sup> Docket No. ER08-556. *et al.*, "Motion to Intervene and Protest of Dynegy Moss Landing, LLC, Dynegy Morro Bay, LLC, El Segundo Power LLC, and Reliant Energy, Inc.," at 8, Feb. 29, 2008 ("California Generators ICPM Protest").

of bilateral contract prices and RMR contracts, a price based on CONE would result in most existing Generating Units being paid a significant multiple of their total fixed costs. Further, unlike the CPUC proceeding establishing a long-term RA framework, 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.

IEP and California Generators continue to fail to provide specific cost data for their facilities despite all the objections made regarding the proposed TCPM price. There have been no protests with data demonstrating that IEP and California Generators' value of their capacity higher than the \$86/kW-year target price proposed by the CAISO. The CAISO's rate accounted for inflation plus an additional ten percent. In light of such silence, the far more reasonable course is to recognize that the \$86/kW-year price in tandem with the higher daily payment will provide a reasonable contribution towards fixed cost recovery for existing resources that have not already negotiated RA contracts.

**(3) California Generators Proposed Price of \$115/kW-Year Should be Rejected**

For the California Generators, the CAISO's purportedly "*ad hoc*" approach to escalating the level of the target annual capacity price should be replaced with "a fully updated application of the RCST "methodology," based on the current CONE in California.<sup>48</sup> California Generators maintain that if the RCST rate approach had been utilized for TCPM purposes, then the new CONE reference price would yield a higher target capacity price than the \$73/kW-year target

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<sup>48</sup> California Generator's TCPM Protest at 3. The California Generators claim that the CAISO has "abandoned the RCST pricing model" and has instead, proposed an unjustified new method of price escalation that deviates from the principled basis upon which the RCST settlement price was justified. *Id.* at 12.

capacity price. Specifically, the price would yield a rate of \$115/kW, which would be almost sixty percent higher than the RCST figure.<sup>49</sup> IEP also challenges the CONE price used in the RCST rate. Specifically, IEP states that aero-derivative peaking capacity costs \$148/kW-year and a simple cycle peaking combustion turbine costs \$120/kW-year from a recent CEC cost study.<sup>50</sup> IEP also notes that the New York Independent System Operator (“NYISO”) had a recent unit come in at \$216/kW-year with CONE estimates at \$160-189/kW on an annual levelized basis.<sup>51</sup> IEP also asserts that newly installed peaking Generating Units in the Los Angeles Basin have an estimated nominal annualized value of \$218/kW-Yr.<sup>52</sup>

As the CAISO explained in the Filing Letter in response to a similar argument made by Dynegy during the stakeholder process, the California Generators’ proposal is not just and reasonable.<sup>53</sup> It is not justifiable to increase the RCST price by such a substantial amount simply because the CONE has increased since the prior CEC cost study. The existing Generating Units that have been eligible to receive the just and reasonable \$73/kW-year RCST payment, *affirmed in December 2007*, are the same Generating Units that would now be eligible to receive a \$115/kW-year payment under California Generators’ proposal. However, the increased CONE does not affect these Generating Units’ costs. Accordingly, the sole result of California Generators’ proposal would be a revenue windfall for existing Generating Units, as discussed above.

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<sup>49</sup> *Id.* at 3. The CAISO notes that during the stakeholder process, Dynegy stated the rate should be \$117/kW-year.

<sup>50</sup> IEP attached ICPM protest at 20.

<sup>51</sup> *Id.* at 20-21.

<sup>52</sup> IEP attached ICPM Protest, Cavicchi Aff. at ¶ 27.

<sup>53</sup> See TCEM Filing Letter at 23-24.

Using the costs of 2006 and 2008 RMR Generating Units and the prices of bilateral RA contracts as a proxy for the costs of existing Generating Units, California Generators' proposal would result in existing Generating Units being paid many times their actual full fixed costs, even though there are surplus conditions in most local areas.<sup>54</sup> Notably, the California Generators did not dispute this data or claim that it was inconsistent with their own operating experience.

The California Generators attempt to utilize a pricing framework that resulted from a settlement which, although the Commission found was just and reasonable, was not agreed to by all the parties. Moreover, the Commission did not approve a specific formulaic methodology, but rather a black box amount that was between two bookends establishing a zone of reasonableness. How close the number was to the identified bookend rate was not a basis for the decision.<sup>55</sup>

Second, California Generators have not justified the floor or ceiling prices used to reach the \$115 price. They simply retain the \$64/kW-year price from the RCST (which was based on the Annual Fixed Revenue Requirements of 2006

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<sup>54</sup> As explained in the filing letter these Generating Units have averaged \$64/kW-year in 2006 and \$32.44/Kw year in 2008. TCPM Filing Letter at 24.

<sup>55</sup> The CAISO disagrees with the statement in the California Generators' pleading, "The RCST settlement methodology approved by the Commission set a price between the unrecovered fixed cost of existing generation and the estimated cost of new generation, i.e., CONE. Those two values established a range of potential capacity compensation under RCST between \$64/kW-year and \$89/kW-year. The RCST settlement price of \$73/kW-year was, in percentage terms, 36% higher than the lower value, reflecting the dynamics of settlement but a principled criterion for choosing a value within the appropriate price range." California Generator's TCPM Protest at 12. The RCST settlement did not apply a formula to pick a point 36% between two ends. Moreover, if it was a true formula the California Generators would need to update both endpoints. This they have not done. In addition, the criteria for the endpoints would have needed to be established. For example should it be based on the most extreme Generating Unit at each end or some representative sample of Generating Units. The California Generators seem to be adjusting only one end of their "formula" based on a limited set of facilities.

RMR Generating Units) without providing any current information regarding the fixed costs of existing Generating Units, information which is entirely within their control. Stated differently, the California Generators have updated the high bookend without considering potential changes to the low-end.<sup>56</sup> In addition, they have updated the high end based on a limited sample that does not necessarily reflect an accurate CONE value. It is more appropriate that any CONE price be based on a representative sample of Generating Units such as that reflected in the comprehensive generation cost study conducted by the CEC.

The California Generators state that a just and reasonable price for backstop capacity should encourage LSEs and generators to engage in longer-term contracting<sup>57</sup> and not rely on the CAISO backstop mechanism to meet their RA requirements.<sup>58</sup> Yet these are the same California Generators who admit that LSEs have been in compliance with their RA procurement responsibilities.<sup>59</sup>

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<sup>56</sup> Using the Annual Fixed Revenue Requirements of RMR Generating Units for 2008, as reflected in Attachment E to the filing letter, as a proxy for the fixed costs of existing Generating Units would yield an average price of \$31.71, substantially lower than the floor used to justify the RCST rate.

<sup>57</sup> The California Generators cite the CAISO's Department of Market Monitoring's [2007 Annual Report on Market Issues and Performance](#) to demonstrate that costs of new generation have increased. California Generators at 17-18. The CAISO is not disputing that the costs of new generation in California have risen over the past years. The Annual Report points out that a new entrant in California, under the current pre-MRTU market structure, would need additional forward contracts for energy and capacity to cover its fixed costs, and could not rely entirely on wholesale market revenues. That is, it would be risky to enter the California market on a spot market only basis.. The expectation is that the MRTU market, with its higher offer caps and locational marginal pricing, among other features, will provide enhanced market revenues, but an RA contract will likely continue to be required for fixed cost recovery. In the short-term, given that TCPM will not attract entry, using the cost of new entry to pay existing resources will not achieve the goal of inducing investment.

<sup>58</sup> California Generators TCPM Protest at 13.

<sup>59</sup> California Generators ICPM Protest at 8.

There is simply no evidence that a higher CAISO backstop procurement price is necessary to ensure compliance with RA obligations on the part of LSEs.<sup>60</sup>

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 reap windfall benefits under the TCPM.

**c. IEP Price Discrimination Argument Is Misplaced**

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.<sup>61</sup> Further, IEP asserts that in a competitive market, suppliers should be compensated on equal terms

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<sup>60</sup> The CAISO's 2007 Annual Report on Market Issues and Performance for the proposition that states:

The finding that estimated spot market revenues do not provide for fixed cost recovery [for a new combustion turbine unit] underscores the critical importance of long-term contracting as the primary means for facilitating new generation investment. It also suggests that there are deficiencies in the current spot market design that are limiting market revenue opportunities – although it could be alternatively argued that the spot market design is adequate and sending the right investment signal for the current market year (i.e., the generation level from a market efficiency standpoint was adequate in 2007) but the net revenues earned in 2007 are not indicative of future market revenue opportunities, which are the primary driver for new investment.

The California Generators cite this report for the proposition that “[a]pparently the CAISO has never considered that one of the ‘deficiencies in the current spot market design’ is that the payments provided under its various capacity backstop proposals, including TCPM, neither encourage the adoption of RA requirements that actually provide the CAISO with the capacity it really requires to reliably operate the grid nor significantly contribute to fixed cost recovery for generating units.” California Generators TCPM Protest at 17-18. The California Generators also claim “the CAISO’s access to backstop insurance it clearly and correctly views as ‘cheap’ will provide no incentive to ensure the RA requirements reflect real operating requirements.” *Id.* at 14. The Commission’s orders require the CAISO to defer to the local regulatory authorities determination of the reserve margin. As stated previously, California law (A.B. 380) requires that these margins be set at levels that “ensure that adequate physical generating capacity dedicated to serving all load requirements is available.” The California Generators should not be permitted to distort the reasonableness of the TCPM prices in order to effectuate modifications to the state RA program.

<sup>61</sup> IEP attached ICPM Protest at 6.

within identified geographic locations.<sup>62</sup> IEP's complaint is based on the fact that SCE 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.<sup>63</sup>

IEP's comparison with new generation is inapt. The existence of unduly discriminatory TCPM compensation cannot be 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.<sup>64</sup> 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 clients 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 TCPM proposal is unduly discriminatory is the TCPM compensation and that compensation uniformly applies to all Generating Units. The CAISO has no obligation to ensure through its rates for an interim capacity procurement mechanism the financial success of any particular unit; its only

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<sup>62</sup> IEP attached ICPM Protest at 8; Cavicchi Aff. at ¶¶ 24, 29.

<sup>63</sup> IEP attached ICPM Protest at 7.

<sup>64</sup> It is the CAISO's understanding that the generation being built by load serving entities 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.

obligation is to provide just and reasonable and non-discriminatory compensation for the services provided under its tariff, and the TCPM achieves that objective.

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,<sup>65</sup> and that the circumstances are worse for existing Generating Units,<sup>66</sup> 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.

In reading IEP's protest, one is left with the impression that the only facilities that can receive payments providing a return on investment are either utility-owned facilities or new Generating Units that have secured long-term resource adequacy contracts. However, many *existing, non-utility-owned* facilities are participating as Resource Adequacy Resources under either short or long-term contracts that provide for payments for capacity.<sup>67</sup>

IEP does not focus on these facilities for the simple reason that they undermine its claim of discrimination. It is not discrimination for LSEs to cover their "net short" positions, the difference between the utility's self-generation and their peak load demand, with other existing, independent resources that have offered to supply the capacity at a lower price. Accordingly, IEP's discrimination claim is without merit and should be rejected.

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<sup>65</sup> IEP ICPM Protest, Cavicchi Aff. at ¶ 4.

<sup>66</sup> *Id.* at ¶ 5.

<sup>67</sup> See discussion *supra* note 29.

**2. The CAISO's Proposal To Increase the Daily MOO Capacity Payment From a Factor of 1/17 of the Target Annual Capacity Price to a Factor of 1/8 Is Reasonable**

SCE, PG&E, NCPA, Six Cities, and CMUA state that the CAISO has not adequately supported the proposed increase in the daily MOO capacity payment from a factor of 1/17 of the Target Annual Capacity Price to a factor of 1/8.<sup>68</sup> As the CAISO explained in its Filing Letter, the proposed increase from 1/17 to 1/8 attempted to recognize the reliability services being procured. In short, the TCPM implicitly accepts that it is reasonable to pay a unit the equivalent of a monthly payment if it was called on eight separate times during the month to meet reliability needs. The CAISO further noted in the Filing Letter that the higher payment will provide further inducement for availability during the summer period when capacity is likely to be needed most.

The CAISO notes that in the Order on Paper Hearing conditionally approving the RCST settlement, the Commission accepted a \$40 adder for resources that were not receiving capacity payments through RCST, the must-offer obligation, RMR, or RA contracts that had their bids mitigated for local constraints more than four times in one day.<sup>69</sup> In response to protests that there was “no economic justification” for the adder or that there was “no supporting explanation,”<sup>70</sup> the Commission concluded that the payment was “consistent with other capacity payments established under the RCST,” was capped at the monthly RCST capacity payment amount, and was “commensurate with the

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<sup>68</sup> SCE Comments at 2; PG&E Comments at 5-6, NCPA Comments at 5, Six Cities Comments at 8, CMUA Protest at 6-7.

<sup>69</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 at P 178.

<sup>70</sup> *Id.* at P 171 and P 172.

reliability service [these resources] provide”.<sup>71</sup> The CAISO submits that similar reasoning supports the 1/8 daily payment. It is consistent with and capped at the TCPM monthly payment amount. Most importantly, it fairly values the reliability services being provided and encourages resources to be available during the peak summer period.

**C. THE CAISO’S PROPOSED DEFINITION OF TCPM SIGNIFICANT EVENT, TCPM SIGNIFICANT EVENT DESIGNATION PROCESS, AND TCPM SIGNIFICANT EVENT MINIMUM DESIGNATION PERIODS ARE REASONABLE.**

The CAISO has proposed to utilize the TCPM 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 does not cure the deficiency when it is identified in its Annual or Monthly Plan; and (4) in the case of an TCPM Significant Event. The primary focus of the protests involves the proposal for TCPM Significant Events.

As the CAISO explained in the transmittal letter and in the ICPM proceeding,<sup>72</sup> the CAISO modified the definition of Significant Event and the minimum term for Significant Event designations in order to provide it with more

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<sup>71</sup> *Id.* at P 176-178.

<sup>72</sup> See TCPM Filing Letter at 25; see also Docket No. ER08-556, “California Independent System Operator Corporation Interim Capacity Procurement Mechanism,” at 25, Feb. 8, 2008 (“ICPM Filing Letter”).

flexibility to make additional designations as needed to meet Reliability Criteria. This additional flexibility was balanced by enhanced reporting requirements to ensure that any TCPM Significant Event Designation was sufficiently transparent. None of the protests provide a sufficient basis to reject the CAISO's proposal, which provides a balanced approach that navigates between the generators' complaints, which would result in excess capacity being designated and the arguments of the LSEs and Constellation, which could result in insufficient capacity being designated.

**1. Constellation's Contention that the CAISO Should Not Be Able to Procure for Significant Events Should be Rejected.**

Constellation argues that the CAISO's ability to designate resources as a result of an ICPM Significant Event should be eliminated.<sup>73</sup> Constellation states 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 in the next planning cycle.<sup>74</sup> Finally, Constellation contends that if there are short term issues, the proper course to respond to the emergency is by purchasing energy, not capacity.<sup>75</sup>

Constellation raised similar issues with regard to the ICPM Tariff filing.<sup>76</sup> In response, the CAISO explained that 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

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<sup>73</sup> Constellation Protest at 5 and 7.

<sup>74</sup> *Id.* at 8.

<sup>75</sup> *Id.* at 9.

<sup>76</sup> Docket No. ER08-556, "Motion to Intervene, Protest and Comments of the Constellation Parties and the Mirant Parties," at 5-8, Feb. 29, 2008 ("Constellation ICPM Protest").

Event.<sup>77</sup> Thus, 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.”<sup>78</sup> The Commission found that RCST was neither unnecessary nor duplicative; rather, the Commission found that it augments both market design and reliability initiatives.<sup>79</sup> The same rationale supports the need for the TCPM. 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 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.<sup>80</sup>

Constellation does not attempt to distinguish or even discuss this clear precedent.

With regard to the ICPM, 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

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<sup>77</sup> Docket No. ER08-556, “Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation,” at 22, Mar. 17, 2008 (“CAISO ICPM Answer”).

<sup>78</sup> *Indep. Energy Producers Association v. California Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 at P 49 (2007).

<sup>79</sup> *Id.*

<sup>80</sup> *California Indep. Sys. Operator Corp., et al.*, 122 FERC ¶ 61,017 (2008) at P 63-64.

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.”<sup>81</sup> The same rationale applies to potential TCPM Significant Event designations.

Constellation appears to be suggesting that the CAISO must engage in short-term (i.e. daily or hourly) energy procurement rather than forward capacity procurement to ensure that sufficient resources will be available when needed to ensure that Reliability Criteria are satisfied. If Constellation’s view is followed through to its logical conclusion, in the short-term, the CAISO should simply allow the reliability problem to occur and utilize the existing MOO authority to commit the resource throughout the period of the TCPM Significant Event to ensure the CAISO can comply with mandatory NERC Reliability Standards. While this approach may or may not result in any difference in procurement costs, it has the disadvantage of not mitigating a known problem in advance and thereby putting unnecessary and unwarranted stress on the CAISO operators.

Constellation states that if procurement for TCPM 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.<sup>82</sup> SCE supports the CAISO’s authority to make a TCPM designation for a Significant Event. However, SCE does not support the proposed definition which it alleges is vague

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<sup>81</sup> See Attachment F to the ICPM Filing Letter, Opinion on “Interim Capacity Payment Mechanism Under MRTU”, Market Surveillance Committee of the California ISO dated November 21, 2007 (“MSC Opinion”) at 3-4.

<sup>82</sup> Constellation Protest at 5 and 10.

and overbroad.<sup>83</sup> For SCE, a Significant Event should be limited to a physical change to the electrical grid.<sup>84</sup>

With respect to TCPM Significant Event designations, “TCPM 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.<sup>85</sup>

As the CAISO explained in its answer to similar protests in the ICPM proceeding, 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.<sup>86</sup> The CAISO should be accorded the ability to act when conditions *threaten* to cause non-compliance. Good Utility Practice requires the CAISO to act in order 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 Generating Units in advance of an actual emergency. For example, the RCST permits the CAISO to make a Significant

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<sup>83</sup> SCE Comments at 2. See also SVP/M-S-R Protest at 7 (the Commission should reject CAISO’s broad discretion in designating Significant Event and return to RCST provision).

<sup>84</sup> 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 or is absent the recurring use of a non-RA resource(s) on a prospective basis. SCE Comments at 5-6.

<sup>85</sup> ICPM Filing Letter at 23.

<sup>86</sup> CAISO ICPM Answer at 24.

Event designation where an event “threatens to cause a failure to meet Applicable Reliability Criteria” (see definition of Significant Event). 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.” 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 TCPM will ensure that the already heavily-scrutinized CAISO backstop procurement practices will be monitored on an enhanced basis by interested Market Participants.

With regard to SCE’s suggestion that TCPM Significant Event declarations be restricted to physical system changes, the CAISO stresses that it needs to meet Reliability Criteria no matter the cause of the “problem.” SCE’s proposal would unduly limit the CAISO’s ability to respond to all circumstances. The CAISO recognizes that while most TCPM 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 such as modifications to reliability requirements or RA requirements could compel designations. Under the tariff

and the Transmission Control Agreement, the CAISO must operate CAISO Controlled Grid in accordance with Reliability Criteria. If a TCPM 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 TCPM Designations Is Misplaced**

California Generators and IEP object to the discretion that the CAISO has in determining whether to make TCPM Significant Event designations.<sup>87</sup> Both IEP and California Generators express concern that the CAISO will not designate Generating Units under the TCPM 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 Generating Units on 525 separate occurrences.<sup>88</sup> As an alternative, California Generators propose that the first MOO Waiver Denial should trigger a minimum three-month TCPM designation.<sup>89</sup> IEP concurs, stating that the proposed reduction in the designation period from three months to one month runs counter to the economic arguments IEP has been making.<sup>90</sup>

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 here because the CAISO is proposing a new definition of

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<sup>87</sup> California Generators TCPM Protest at 8; IEP attached ICPM Protest at 14.

<sup>88</sup> California Generators TCPM Protest at 7; IEP TCPM Protest at 4-5.

<sup>89</sup> California Generators TCPM Protest at 3.

<sup>90</sup> IEP TCPM Protest at 5.

Significant Event under the TCPM which materially differs from the definition of Significant Event under RCST and which gives the CAISO broader authority than existed under RCST to make capacity designations.<sup>91</sup> Further, the CAISO's ability to make designations to address short-term reliability needs will be enhanced by the fact that TCPM designations have a minimum term of one month as opposed to the three-month minimum term under RCST.

The Commission should reject the continued complaints about the lack of RCST designations. 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 in the numerous pleadings they have filed on this subject and, importantly, do not provide evidence to the contrary in their comments on the TCPM. IEP and California Generators simply *assume* that the CAISO must have abused its discretion because only one RCST designation resulted from the 525 MOO

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<sup>91</sup> 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 Generating Units and can only designate capacity that 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 resources.

Waver Denials issued between June 1, 2006 and December 31, 2007.<sup>92</sup> 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, as the CAISO has explained in previous filings, the RCST Settlement and the Commission-approved tariff provisions implementing the RCST establish specific requirements before the CAISO can exercise its discretion to designate a unit; there 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, is 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 is “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 MOO waiver denials or any number of MOO Waiver Denial'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

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<sup>92</sup> IEP ICPM Protest at 6.

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 MOO waiver denials is irrelevant to this determination.

As the CAISO indicated in its ICPM transmittal letter<sup>93</sup> the CAISO has modified the definition of Significant Event to give it broader authority to make designations than was permitted under the RCST definition of Significant Event, and the CAISO has continued this approach in the TCPM. IEP and California Generators inappropriately rely on the lack of designations under the RCST's different, more prescriptive standard to claim that the CAISO should not have discretion to make TCPM 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.<sup>94</sup> This has been problematic from a designation standpoint because the CAISO, in determining whether to make a designation, was 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.

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<sup>93</sup> ICPM Filing Letter at 23-27.

<sup>94</sup> Under the Significant Event/Repeat MOO waiver denial evaluation process, the CAISO is also required to indicate whether any RA resources or RMR Generating 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.

The TCPM 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, incorporated into the TCPM, will make it easier for the CAISO to make designations to meet short-term reliability needs. Instead, they continue to insist on a minimum designation term of three-months, which is wholly inappropriate for the reasons discussed elsewhere.

The CAISO applied each of the aforementioned criteria required by the RCST to each of the MOO waiver denials 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.<sup>95</sup> IEP and California Generators have not identified (in their TCPM 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 MOO waiver denials – which is the entire basis of IEP’s and California Generators’ contention – means nothing without a showing that there were MOO

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<sup>95</sup> See November 15 2007 *CAISO Answer to Williams Power Company LLC* at 6-9 in Docket No. EL05-146. 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 Generating 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 a RCST designation.

waiver denials that satisfied these criteria, 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 Generating Units that are committed for one MOO Waiver Denial, regardless of whether they are needed on a long-term basis.<sup>96</sup>

IEP's and California Generators' reliance on the raw number of MOO waiver denials since June 1, 2006 is misleading and incomplete. Of the 525 MOO waiver denials, 264 were MOO Waiver Denials in Real-Time under the CAISO's Real Time Commitment ("RTC") software which commits effective Generating Units in economic order.<sup>97</sup> Thus, with respect to RTC commitments non-RA Generating Units, other RA or RMR Generating Units are generally available for commitment,<sup>98</sup> but the Commission-approved RTC methodology requires that a more economic FERC Must Offer unit be committed before an RA or RMR Generating Unit.<sup>99</sup> The CAISO reasonably determined that there was no

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<sup>96</sup> The California Generators state that while the CAISO understands that it is obtaining capacity services in the context of RMR and RA, but without justification, refuses to recognize that, when Generating Units are denied MOO waivers, they are providing comparable capacity services to the CAISO. California Generators TCPM Protest at 7. Such an argument is simply wrong. The RA program is designed to ensure that sufficient resources are available when and where needed throughout the year. Similarly, RMR resources fill specific needs on a regularly-occurring basis. In contrast, a MOO waiver denial can be of extremely limited duration. Moreover, as demonstrated by experience under the RCST, Significant Event can be far less than three months in duration.

<sup>97</sup> Retroactive RCST Significant Event Summary at 3-4, July 2007.

<http://www.caiso.com/1c20/1c20e8373c330.pdf>.

<sup>98</sup> In only 4 of the 264 instances of RTC commitments were RA or RMR Generating Units not available for commitment.

<sup>99</sup> Real Time commitments are divided into two categories – Manual commitments and RTC (computer driven) commitments. Manual commitments are reviewed just like day-ahead commitments. See, e.g., Report for week ending 8/4/07: <http://www.caiso.com/1c44/1c44b81030fd0.pdf>. When a unit is committed by RTC, the CAISO first determines whether RA Generating Units were available. If RA Generating Units were available, the CAISO has concluded that there was no Significant Event requiring a designation of

Significant Events related to these real-time system MOO waiver denials because on all of these days other Generating Units were available for commitment.<sup>100</sup>

The CAISO has recently reviewed the data for 2008 and determined that *all* of the 77 MOO waiver denials for 2008 have been the result of the RTC software and not due to the unavailability of other resources. It is precisely to address this concern and reduce the number of MOO waiver denials due to the current RTC commitment process that the CAISO has proposed tariff changes to section 34.3 of the ISO Tariff as part of the TCPM proposal.

Another 33 of the 525 MOO waiver denials 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 MOO waiver denials should not have happened in the first place).<sup>101</sup> A total of 112 MOO waiver denials were for zonal reasons and, as the Commission has recognized,<sup>102</sup> neither the RCST Settlement nor the tariff permits designations for zonal reasons. Thus, of the 525 MOO waiver denials issued from June 1, 2006 through December 22, 2007, only 116 potentially could

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capacity, because there was no real shortage of capacity. See, e.g., Report for week ending 12/22/07: <http://www.caiso.com/1cc5/1cc59404446c0.pdf>. If RA resources were not available, the review is conducted as with day-ahead commitments. See, e.g. Report for week ending 9/9/06: <http://www.caiso.com/1c6c/1c6cddf9dbe0.pdf>.

<sup>100</sup> The CAISO's MOO waiver denials 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 MOO waiver denials 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 MOO waiver denials are issued when other Generating 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.

<sup>101</sup> Obviously erroneous MOO waiver denials should not be "counted" for purposes of arguing that more RCST designations should have been made.

<sup>102</sup> California Indep. Sys. Operator Corp., 121FERC 61,276 at P 46 (2007).

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 MOO waiver denials were, *inter alia*, due to short-term events that either did not satisfy the definition of Significant Event or were of such a short duration that a minimum three-month designation of capacity could not be justified in accordance with the tariff.

The CAISO also notes that certain actions taken by the CPUC under its RA program are intended to reduce the need for MOO Waiver Denial-type commitments of non-RA, non-RMR Generating Units in the future. First, effective January 1, 2008, the CPUC included in its RA program restrictions on procurement that recognize Path 26 transfer limitations and thereby ensure that Resource Adequacy Resources will be appropriately balanced on either side of the zonal constraint. Second, the percentage of non-resource specific liquidated damages contracts permissible in an LSE's portfolio for RA compliance purposes is reduced from 50% to 25% for 2008, excluding the existing long-term contracts of the California Department of Water Resources. This should result in increased physical capacity being subscribed under RA contracts, increase the capacity contract opportunities for California Generators, and further reduce the need for MOO Waiver Denial-type commitments of non-RA Generating Units.

**3. IEP's And California Generators' Proposals For Automatic Three-Month TCPM Designations After A Single Exceptional MOO Waiver Denial Is 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 under an TCPM Significant Event is an automatic designation if the unit is committed just once, on a single day pursuant to a MOO waiver denial. They propose that the term of the designation would be for three months.<sup>103</sup>

Any type of "hard" trigger that results in an automatic three month TCPM designation, no matter what the circumstances are, is inappropriate, depending on where the designated unit is located. IEP and California Generators do not offer a sufficient basis as to why an automatic trigger is reasonable. The California Generators state that: (1) it is expected that a generating unit that has incurred fixed and going-forward costs by remaining available to the CAISO and that is most likely to be denied a MOO waiver (e.g., a high rate, low capacity factor unit) would not expect to recover its fixed costs through the CAISO's energy markets in the non-peak seasons and that a three-month designation would recover these fixed costs incurred during months when the unit is not operating in the CAISO's energy markets; (2) a three-month designation period is a compromise between a one-month RA requirement and the five-month RA season and (3) a three-month designation is consistent with the approved terms

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<sup>103</sup> California Generators TCPM Protest at 3; IEP TCPM Protest at 5.

of RCST.<sup>104</sup> IEP contends that allowing for designations of one month contradicts a generation capacity owner's need to establish fixed operations and maintenance budgets ahead of time and to plan to complete capital investments that will ensure reliable operations.<sup>105</sup> These justifications do not withstand scrutiny.

As discussed above, the RCST involved an entirely different set of standards and processes than the TCPM, and the experience under the RCST cannot serve in any way as a legitimate basis to require some form of "hard" trigger for TCPM designations. 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.<sup>106</sup> To the extent the CAISO does not, parties are able to file a complaint at FERC.

It is manifestly improper for the California Generators to attempt to rely on the minimum period of the RCST settlement without recognizing the other terms of that same settlement – namely that any designations would have to consider where in fact there would be a need for three months and the overall costs of the designation. It is wrong to enforce only one condition of the settlement and not all aspects of the agreement.

The CAISO does not disagree that the RCST process can and should be improved, but the improvements must be balanced and reasonable. Neither IEP

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<sup>104</sup> California Generators TCPM Protest at 10.

<sup>105</sup> IEP ICPM Protest at 14.

<sup>106</sup> *Indep. Energy Producers Association v. California Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,276 at P 41 (2007).

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 -- cannot serve as the basis for adopting an automatic trigger mechanism under the TCPM 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 TCPM 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 issued a MOO waiver denial on a given day, even though on a prospective basis other RA, RMR or cheaper non-RA Generating Units available to meet the reliability need prospectively. Moreover, the circumstances (e.g., the nature of the event that led to the MOO waiver denial or the expected duration of the event) may not justify a one-month prospective designation of capacity. These are needs based on circumstances that exist on a given day and may not support a month or longer TCPM Significant Event designation unless they result from an event that will continue into the future and will require the use of non-RA Generating Units to meet such future need. IEP and California Generators have not explained why such uses of

MOO waiver denials warrant a three month TCPM designation in the absence of any evidence of long-term reliability need. The purpose of the TCPM 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 MOO waiver denial would only impose an unjust and unreasonable burden on ratepayers. As such, “hardwiring” of designations is inappropriate.

It is untenable for IEP to suggest that a resource’s need to establish fixed operations and maintenance budgets ahead of time and to plan to complete capital investments is dependent on the mere potential of a TCPM Significant Event designation. Given that these designations are for unplanned occurrences, the resource owners’ plan of operation cannot count on the possibility of designation.

Under the TCPM, 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. IEP’s and California Generators’ proposal essentially amounts to forced contracting for Generating 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.

There is no reasonable basis for a minimum TCPM Significant Event designation term of three-months. 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 issues a MOO waiver denial or if the unit is only needed on a prospective basis for a very short period of time. 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 TCPM 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 TCPM 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 TCPM Significant Event -- than is an automatic three-month or longer minimum designation term. It is inherently reasonable that TCPM designations be limited, as proposed by the CAISO, to situations where the CAISO determines a TCPM designation is

necessary on a prospective basis following a TCPM Significant Event to maintain compliance with reliability criteria and taking into account the duration of the TCPM 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.

Furthermore, the significant increase in the daily capacity payment from 1/17 of the target annual capacity price to 1/8 of the capacity price means that resources will be significantly compensated for any need to utilize their capacity on a short-term basis. Moreover, this increase provides a check on the CAISO’s discretion to make designations – a point not recognized by either the California Generators or IEP. If the CAISO is going to have more than seven days with MOO waiver denials in a given month, it would be prudent to designate the resource under the TCPM for that month. In other words, the increase in the daily price should also make the CAISO more willing to designate resources under the TCPM if they will be needed repeatedly in any given month.

The intent of California Generators’ proposal is essentially to increase the contracting opportunities for Generating 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 TCPM procurement. The TCPM is intended as a backstop mechanism for the CAISO to “fill” any short-term capacity needs. The TCPM 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.

#### **4. The CAISO's Proposed Designation Process Is Reasonable**

SCE proposes an alternative definition for TCPM 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.<sup>107</sup> Additionally, SCE suggests a CAISO officer should report any instance in which a unit is designated more than once in a year due to a TCPM Significant Event.<sup>108</sup>

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 TCPM process. The CAISO does not believe that it is appropriate or necessary for CAISO management to take TCPM 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

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<sup>107</sup> SCE Comments at 5-6.

<sup>108</sup> *Id.*

believes that the Board needs to be notified of a TCPM 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. 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.

**D. WAPA'S PROTEST OF THE TCPM COST ALLOCATION SHOULD BE REJECTED**

In the TCPM, the CAISO proposed to follow the ICPM methodology for allocating costs in connection with two types of capacity designations: (1) for collective local capacity shortfall designations (as set forth in proposed new Section 43.8(4)); and (2) for TCPM Significant Event designations, as set forth in Section 43.8 (5)). The CAISO noted that both of these allocation methodologies resulted from the lengthy ICPM stakeholder process and were generally supported by stakeholders.<sup>109</sup> One party, WAPA, protests these proposed allocations, arguing that costs should be determined based on the LSEs share in the locally constrained area and not the TAC Area.<sup>110</sup> WAPA states that the CAISO's methodology results in an inequitable burden to entities, such as WAPA, who have proportionately a small percentage of their overall load in the locally constrained area.<sup>111</sup>

The CAISO based the TCPM cost allocations on the ICPM proposal, in part, because no Market Participant, including WAPA, protested the more

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<sup>109</sup> TCPM Filing Letter at 35.

<sup>110</sup> WAPA Protest at 4.

<sup>111</sup> *Id.*

enduring ICPM allocation methodology. Further, consistent with the implicit acceptance of the ICPM methodology, no party indicated during the TCPM stakeholder process that costs should or could be allocated on a more granular basis. More importantly, and in response to similar concerns raised in another proceeding, the CAISO explained that it currently does not have the data available to allocate the cost of local capacity with greater granularity.<sup>112</sup> One of the concerns in developing the TCPM given a June 2008 effective date and the short-term nature of the program was to utilize existing CAISO systems.

The CAISO has also expressed the concern that failing to aggregate local capacity area minimum requirements at some level would require small LSEs to buy impractically small or fractional MW quantities in each local capacity area, which might lead to high transaction costs or market power.<sup>113</sup> Nevertheless, the CAISO has stated it would reconsider the TAC Area cost allocation methodology if actual experience demonstrates that the proposed approach leads to insufficient aggregate LSE portfolios in load pockets so as to trigger a concomitant need for the CAISO backstop procurement or, alternatively, upon the implementation of a capacity market that would facilitate procurement by small LSEs.<sup>114</sup>

The Commission, recognizing the reasonableness of the CAISO's arguments, has endorsed the use of allocating backstop procurement costs on a TAC Area basis:

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<sup>112</sup> Docket No. ER06-615, *et al.*, "Reply Comments of the California Independent System Operator Corporation," at 22, Oct. 5, 2007.

<sup>113</sup> *Id.* at 23.

<sup>114</sup> *Id.*

The Commission finds that allocating procurement obligations according to an LSE's contribution to TAC area peak load is a just and reasonable method of allocation. While the Commission recognizes that this may not result in a perfectly precise allocation of capacity procurement obligations, any method of allocation will result in similar imperfections and distortions, as the CAISO illustrates with its example of the small LSEs. A method that allocates procurement obligations according to an LSE's contribution to TAC area peak load results in easily quantifiable obligations for each LSE. It also fits well into the current market design of the CAISO, as many provisions in the tariff already use the TAC area to determine charges, such as the high voltage access charge.<sup>115</sup>

There is no reason to deviate from this recent precedent.

Perhaps in recognition that the Commission has already found allocation of costs based on TAC Areas to be reasonable, WAPA makes a secondary argument that it would be appropriate for a Local Regulatory Authority "to have the discretion to set its own local requirement."<sup>116</sup> WAPA cites the Commission's September 2006 Order conditionally accepting the MRTU market design as support for the proposition that "the CAISO would defer to Local Regulatory Authorities regarding allocation of local capacity."<sup>117</sup> WAPA's analysis of the September 2006 Order fails to withstand scrutiny. WAPA's reference is to the Commission recognition that,

The CAISO also states that it will defer to the Local Regulatory Authority to the extent consistent with meeting applicable reliability criteria and commits to clarifying this in the MRTU Tariff in a compliance filing. The CAISO argues that the CPUC and other Local Regulatory Authorities will be able to select or reject these

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<sup>115</sup> *California Indep. Sys. Operator Corp.*, 122 FERC ¶ 61,017 at P 55. CAISO FERC Electric Tariff Third Replacement Volume No. II at First Revised Sheet No. 531.

<sup>116</sup> WAPA Protest at 7.

<sup>117</sup> *Id.* at 6 (citing *California Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 at P 1162 (2006)).

operating solutions in determining acceptable levels of end-use customer service reliability.<sup>118</sup>

As the Commission determined,

We find, however, that the CAISO must play a greater role in setting local RA requirements because it is uniquely situated to assess capacity needs in constrained areas and load pockets. In this manner, the CAISO's role is similar to the role it plays today in assessing RMR requirements. The CAISO will perform an annual technical study to determine the minimum amount of capacity that must be available to the CAISO within each local capacity area. The CAISO will then work with Local Regulatory Authorities to set local capacity area requirements.<sup>119</sup>

WAPA does not argue that it was denied an ability to have input into any of the CAISO's annual studies, nor does WAPA contend that those studies used inappropriate criteria. WAPA has not indicated that it would curtail its load under specified circumstances. While the CAISO must respect the input of LRAs, such as WAPA in the development of the study, the CAISO must also comply with Reliability Criteria. It would be inappropriate for WAPA or any other LRA to adopt its own local capacity requirements that would be inconsistent with the CAISO's responsibilities as the Balancing Authority Area Operator. WAPA's argument, therefore, is either a collateral attack on the Commission's determinations as to the scope of the CAISO's responsibility in implementing Local Capacity Area requirements or a complaint against the CAISO's implementation of its responsibility. This latter attack can be done only by means of a separate Section 206 application.

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<sup>118</sup> *California Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 at P 1162.

<sup>119</sup> *Id.* at P 1119.

**E. RA CREDITS SHOULD BE NOT BE PROVIDED FOR PROCUREMENT FOR SIGNIFICANT EVENTS**

In the TCPM proposal, the CAISO agreed that, consistent with the approach taken under the ICPM and to prevent potential over-procurement, the capacity procured under specific TCPM scenarios should be credited to Scheduling Coordinators towards satisfying their general RA obligations. Thus, the proposed TCPM Section 43.9 would provide credit:

- To the extent the cost of a CAISO designation is the result of a failure of a Scheduling Coordinator on behalf of an LSE to demonstrate sufficient Local Capacity Area Resources and is allocated to such Scheduling Coordinator, the CAISO proposes to provide the Scheduling Coordinator on behalf of the LSE, credit towards the LSE's Local Capacity Area Resource obligation.
- To the extent the cost of CAISO designation is a result of a collective deficiency in local capacity area resources and is allocated to a Scheduling Coordinator on behalf of an LSE, the CAISO will provide the Scheduling Coordinator on behalf of the LSE credit towards the LSE's Demand and Reserve Margin requirements for purposes of any subsequent CAISO backstop procurement cost allocations; and
- To the extent the cost of a CAISO designation is the result of the failure of a Scheduling Coordinator on behalf of an LSE to demonstrate sufficient RA resources to meet annual and monthly Demand and Reserve Margin requirements and is allocated to such Scheduling Coordinator, and the designation is for greater than one month, the CAISO will provide the Scheduling Coordinator on behalf of the LSE credit towards the LSE's Demand and Reserve Margin requirements for purposes of any subsequent CAISO backstop procurement cost allocations.

As was the case with the ICPM proposal, the CAISO did not support allowing TCPM Significant Event designations to count toward RA showings.

AReM and Constellation disagree with the CAISO's failure to provide RA credits for Significant Events longer than 30 days.<sup>120</sup> AReM believes that, in the

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<sup>120</sup> AReM Protest at 5. Constellation Protest at 5 and 11-12.

vast majority of the cases, CAISO TCPM procurement without associated RA credits would result in consumers overpaying for reliability.<sup>121</sup> AReM's ignores the fundamental preconditions for TCPM Significant Event Procurements.

A TCPM Significant Event results from a material difference from what was assumed in the RA program for determining the RA capacity requirements or will prevent compliance with Reliability Criteria absent the recurring use of non-RA resources. In other words, in a TCPM Significant Event situation, there has been full compliance by LSEs with their annual and monthly planning Reserve Margin requirements. Nevertheless, a situation has arisen that requires *additional* capacity in order to ensure reliable system operations. Therefore, allowing LSEs to include TCPM Significant Event procurement in subsequent RA showings would result in a decrease of the available RA capacity, which was already determined to be insufficient to address the Significant Event. This would only exacerbate the conditions that led to the TCPM Significant Event, thereby potentially resulting in a cycle of additional TCPM procurement. The purpose of a TCPM Significant Event designation is to provide capacity for a situation unanticipated and unaddressed by the prior procurement conducted during the RA process. Accordingly, the protests of AReM and Constellation should be rejected and the CAISO's proposed crediting program in section 43.9 should be accepted without modification.

**F. There Is No Need for a Paper Hearing**

IEP requests that the Commission establish paper hearings to determine the justness and reasonableness of the TCPM.<sup>122</sup> The CAISO does not believe

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<sup>121</sup> AReM Protest at 5.

that such a hearing is advisable or necessary. The CAISO already conducted a stakeholder process for the TCPM and the Commission has provided an opportunity for comment and protest.

Parties remain committed to their positions. The TCPM proposal is ripe for a decision. The CAISO has provided supporting cost information. IEP, the California Generators, and the other intervenors have had the opportunity to respond. The Commission also has available to it the fixed revenue requirements of RMR Generating Units for 2006 and for the lesser pool of RMR resources in 2008. In order to provide the necessary certainty to the market, the Commission should make the policy decision regarding the TCPM as proposed by the CAISO.

### III. CONCLUSION

For the reasons discussed above, the CAISO requests that the Commission accept the TCPM Tariff Amendment without modification.

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Dated: May 5, 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 Washington, D.C. this 5<sup>th</sup> day of May, 2008.

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