UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER13-2296-000**

ANSWER TO MOTIONS TO INTERVENE AND COMMENTS, MOTION TO FILE ANSWER, AND ANSWER TO PROTEST, OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

The California Independent System Operator Corporation ("ISO")[1] files this answer to the motions to intervene and comments submitted in response to its August 30, 2013 tariff amendment fling to include additional categories of costs eligible for inclusion in proxy cost calculations for start-up and minimum load, generated bids, and variable cost default energy bids ("August 30 tariff amendment").[2] The ISO also requests leave to answer and answers the protest submitted by NRG.[3]

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[1] Capitalized terms not otherwise defined herein have the meanings set forth in Appendix A to the ISO tariff, as revised by the proposed tariff changes contained in the tariff amendment submitted in this proceeding. Except where otherwise specified, references to section numbers are references to sections of the ISO tariff as revised by the proposals in the tariff amendment. The ISO is sometimes referred to as the CAISO.

[2] The following entities filed motions to intervene in the proceeding: the California Department of Water Resources State Water Project; Calpine Corporation; City of Santa Clara, California, d/b/a Silicon Valley Power; Cogeneration Association of California & Energy Producers and Users Coalition; Exelon Corporation; Northern California Power Agency ("NCPA"); NRG Power Marketing LLC, GenOn Energy Management, LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, High Plains Ranch II, LLC, Long Beach Generation LLC, NRG California South LP, NRG Delta LLC, NRG Marsh Landing LLC, NRG Solar Alpine LLC, NRG Solar Borrego I LLC, NRG Solar Blythe LLC, NRG Solar Roadrunner LLC, and Avenal Solar Holdings LLC (collectively, "NRG"); Pacific Gas and Electric Company ("PG&E"); Southern California Edison Company ("SCE"); and Western Power Trading Forum. NCPA, PG&E, and SCE also filed comments, and NRG also filed a protest.

[3] The ISO submits this answer pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213. The ISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to NRG's protest. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the

The Commission should accept the August 30 tariff amendment as just and reasonable. NRG protests that the proposed reduction of the registered cost cap from 200 percent to 150 percent of the projected proxy cost is not just and reasonable because on two different five-day periods in the last 21-month period, NRG was not able to manage its gas imbalance charges at one of its generation plants, incurring costs that were 165 percent and 157 percent of projected proxy costs, respectively. NRG's protest should be rejected for the following reasons: (1) NRG did not take into account that the 150-percent cost cap implemented by this tariff amendment will result in a higher cost cap than one based on projected proxy costs in the prior 12-month period because it will include major maintenance and grid management charge costs; (2) the fact that NRG can point to only two instances in which its costs might have slightly exceeded the 150-percent cap demonstrates that the cap allows for "adequate" cost recovery, and therefore complies with Commission precedent. In all the other instances over this twelve-month period NRG's costs would have been lower than the cap, allowing sufficient recovery of costs for the two times they may have exceeded the cap; and (3) the ISO never intended to include gas imbalance charges in proxy cost calculations and, consequently, the registered cost cap. Market participants should be responsible for managing gas imbalances, although the registered cost option provides more than adequate headroom to reflect gas

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decision-making process, and help to ensure a complete and accurate record in the case. *See, e.g.*, *Equitrans, L.P.*, 134 FERC ¶ 61,250, at P 6 (2011); *California Independent System Operator Corp.*, 132 FERC ¶ 61,023, at P 16 (2010); *Xcel Energy Services, Inc.*, 124 FERC ¶ 61,011, at P 20 (2008).

imbalance charge risk and the ISO intends to provide for bid cost recovery under certain circumstances where the penalty is unavoidable.

NCPA requests that the Commission direct the ISO to produce a study after one year to assess whether the 150 percent cost cap can be reduced. In addition, SCE requests the Commission to direct the ISO to produce a study after one year regarding the efficacy of the process for major maintenance cost adders. The ISO urges the Commission to reject these suggestions. The ISO has limited resources and needs to dedicate those resources based on the highest and best uses of those resources. Neither NCPA nor SCE provide a compelling reason for dedicating the ISO's limited resources to conducting two very different studies in the absence of any actual harm. If issues of concern arise, the ISO, and its Department of Market Monitoring, will address them. In addition, stakeholders are free to raise concerns or proposals for new initiatives.

Finally, the Commission should reject PG&E's request to require the ISO to establish an implementation plan regarding the inclusion of major maintenance costs associated with transitions of multi-stage generating resources in proxy cost calculations. It is premature to establish such an implementation plan at this point. Stakeholder consensus during the development of this initiative was that this issue be deferred until more experience is gained with multi-stage generating resource functionality, and thus it will be identified in the ISO's soon to be published Stakeholder Initiatives Catalog.

I. Answer

A. It Is Just and Reasonable to Reduce the Registered Cost Cap to 150 Percent.

NRG argues that the ISO's proposal to reduce the level of the registered cost cap from 200 percent to 150 percent of the projected proxy cost is not just and reasonable on the grounds that it would not allow generators to recover all of their fuel costs in circumstances where the generators have incurred natural gas imbalance charges or penalties.[4] NRG asserts that, based on a review of its gas procurement data for the past 12 months, NRG discovered a single five-day period during which its Cabrillo Power I plant incurred gas imbalance charges that caused the plant's fuel costs to be 165 percent of its projected proxy cost, and a single five-day period during which its Cabrillo Power II plant incurred gas imbalance charges that caused the plant's fuel costs to be 157 percent of its projected proxy cost.[5]

NRG's argument is flawed in several respects. First, NRG ignores the context of the ISO's proposal to reduce the registered cost cap from 200 percent to 150 percent. The registered cost cap is a percentage of the projected proxy costs. The ISO's proposal to add major maintenance costs and grid management charges into the proxy cost calculations will increase generators'

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[4] NRG at 1, 4.

[5] NRG at 4-5. NRG also argues that the fuel costs would not be covered under a proposal the ISO and stakeholders will develop in a future stakeholder process to allow recovery of penalty costs for violating natural gas pipeline balancing orders as part of the bid cost recovery mechanism under the ISO tariff. NRG at 6, 7, 8. The Commission should disregard those NRG arguments. The recovery of penalty costs for violating natural gas pipeline balancing orders is beyond the scope of the instant proceeding. *See* transmittal letter for August 30 tariff amendment at 5.

projected proxy costs, thereby increasing their registered cost cap as well. Thus, 150% of projected proxy costs after the effective date of this tariff amendment will be a larger number than 150 percent of projected proxy costs prior to the effective date of this tariff amendment. NRG appears to be basing its calculation of 150 percent of the registered cost cap on the proxy costs in effect during the previous 12 months, without considering the fact that the inclusion of additional proxy costs will create a higher 150-percent registered cost cap.

Second, NRG premises its argument on the assumption that the registered cost cap is not just and reasonable if it is reduced to a level that does not guarantee that generators choosing the registered cost option will recover *all* their fuel costs for every five-day period, including fuel costs that result from incurring gas imbalance charges and penalties. This assumption is not supported by Commission precedent.

As the Commission has explained, the ISO tariff includes "both a cost-based (proxy cost) and a market-based (registered cost) option to allow each resource to evaluate the risks associated with recovery of its start-up and minimum load costs and make a business decision about which cost recovery method best suits its risk profile."[6] For generators that choose the registered cost option, "the fuel cost component of the projected proxy cost is not intended to be a precise quantification of gas prices on a forward-looking basis, but instead

[6] *California Independent System Operator Corp.*, 134 FERC ¶ 61,257, at P 25 (2011). *See also id.* at P 24 (explaining that "the registered cost option is a market-based recovery mechanism which, by definition, involves taking a risk that market prices will change in ways that increase a resource's costs").

serves as a prospective benchmark approximation of California-area gas costs."[7] Further, the level of the cap under the registered cost option is just and reasonable if it "provides a reasonable balance between preventing the exercise of market power and enabling recovery of supplier costs."[8]

The Commission has also explained that cost recovery under the proxy cost option need only be "adequate," because generators choosing that option "will be able to earn revenues in excess of start-up and minimum load costs," including revenues from being dispatched to provide energy and ancillary services.[9] A similar concept is true for generators that choose the registered cost option. The registered cost option does not reflect specific gas costs, but rather incorporates a general gas price estimate designed to cover most gas costs, as a trade-off for allowing generators to register other costs which exceed the cost estimates included in the projected proxy cost.[10]

These Commission directives make it clear that the premise of NRG's argument -- that the level of the registered cost cap must guarantee generators' recovery of all their actual fuel costs for every five-day period -- is incorrect. Instead, the level of the registered cost cap is just and reasonable if it permits adequate cost recovery while also preventing the exercise of market power.

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[7] *California Independent System Operator Corp.*, 126 FERC ¶ 61,165, at P 23 (2009).

[8] *California Independent System Operator Corp.*, 128 FERC ¶ 61,282, at P 30 (2009).

[9] *California Independent System Operator Corp.*, 123 FERC ¶ 61,288, at P 29 (2008).

[10] Further, "in the event a resource becomes concerned that the capped registered cost option is preventing its recovery of actual start-up and minimum load costs, it has the option to switch to the proxy cost option." *California Independent System Operator Corp.*, 126 FERC ¶ 61,165, at P 23.

NRG fails to show that reducing the registered cost cap to 150 percent will prevent adequate cost recovery especially when the registered cost cap will reflect higher proxy costs. The gas imbalance charges incurred by the two plants caused the gas costs for the plants to be only marginally above 150 percent of their projected proxy cost – 15 percent above that level for the Cabrillo Power I plant and 7 percent above that level for the Cabrillo Power II plant, and only for two five-day periods.[11] Also, the capacity represented by the two Cabrillo plants represents a relatively small portion of the total generating capacity owned by NRG in California.[12] Thus, NRG's own evidence shows that the 150-percent cost cap is sufficiently compensatory, even without the inclusion of the additional proxy costs reflected in the August 30 tariff amendment.

Third, the ISO never intended for gas balancing costs or gas pipeline penalties to be included in start-up and minimum load costs. These costs are not costs associated with specific start-ups or minimum load dispatches, but rather, are infrequent in nature. Such costs should not be reflected in the daily proxy costs calculations and, therefore, should not be expressly included in the registered cost cap.[13]

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[11] It is reasonable to assume that during the other five-day periods during which these plants operated their gas balancing costs were less than the proposed 150-percent cap, although NRG does not indicate by what amount the 150-percent cap would have exceeded their costs.

[12] NRG explains in its motion to intervene in this proceeding that it owns, operates, or is developing over 8,500 megawatts of power generation facilities in California of which Cabrillo Power I and II plants make up only 965 megawatts of the NRG generating fleet. *See* http://www.nrgenergy.com/about/assets.html (at NRG's asset listing for Encina, *i.e.*, the Cabrillo Power I and II plants).

[13] Of course, the registered cost cap is designed to provide head room for costs not included in the proxy costs, which can include gas cost risk.

The ISO expects market participants to manage their gas imbalance risk and it appears that NRG has done just that with the exception of two instances. Apart from standard gas imbalance charges and with respect to gas pipeline penalties that market participants incur as a result of an ISO dispatch, the ISO board has authorized such costs to be recovered through the bid cost recovery mechanism. As explained in the ISO's August 30 tariff amendment filing in this proceeding, the ISO determined that it required additional time to develop the tariff language before filing with the Commission. Some of the costs cited by NRG might potentially be eligible for recovery under this mechanism.[14] Regardless, these costs are clearly not daily costs, and therefore, are not appropriately accounted for in proxy costs of the registered cost cap.

In sum, reducing the registered cost cap to 150 percent will result in sufficient cost recovery for generators – even NRG's Cabrillo Power I and II plants, despite any occasions on which they may incur gas imbalance charges.[15] Reducing the registered cost cap to 150 percent will also help to prevent the

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[14] One of the principles guiding the ISO's development of a mechanism to allow generators to recover certain gas pipeline penalty charges is to ensure that such a mechanism does not undermine the behavioral incentives that underlie those penalties. NRG's argument that the ISO's cost recovery mechanisms should effectively hold generators harmless against the financial impacts of such penalties is contrary to this principle.

[15] NRG argues that reducing the registered cost cap to 150 percent "does not meet the standard set by the Commission in *Dominion Energy Marketing, Inc.*" NRG at 7 (citing *Dominion Energy Marketing, Inc.*, 143 FERC ¶ 61,233, at P 25 (2013)). NRG is incorrect. In *Dominion*, a complaint proceeding under section 206 of the Federal Power Act, the Commission found that provisions regarding cost recovery set forth in the ISO New England Inc. ("ISO-NE") tariff were unjust and unreasonable because they did not "provide resources an adequate opportunity to recover costs" and thus "resources could suffer significant financial loss in unrecovered costs." 143 FERC ¶ 61,233, at P 25. In contrast, as explained above, the use of a 150-percent registered cost cap will provide resources an adequate opportunity to recover costs and will not result in resources suffering significant financial loss in unrecovered costs. Therefore, NRG's argument as to *Dominion* is inapposite.

exercise of market power. As the ISO explained in the August 30 tariff amendment, use of a 150-percent registered cost cap will provide an additional safeguard against the exercise of market power by preventing strategies that generators may use to receive inflated bid cost recovery uplift payments.[16]

For the reasons explained above and in the August 30 tariff amendment, it is just and reasonable to reduce the registered cost cap to 150 percent of the projected proxy cost.

B. There Is No Need for the ISO to Produce a Study on the Level of the Registered Cost Cap or a Study on the Major Maintenance Expense Process.

NCPA requests that the Commission direct the ISO to produce and file a study in a year after the 150-percent registered cost cap goes into effect that assesses whether the cap should be further reduced to 125 percent of the projected proxy cost. NCPA asserts that reevaluating the registered cost cap will help maintain the balance between protecting against abuse of market power and enabling reasonable cost recovery for generators.[17]

The Commission should not require the ISO to produce and file such a study. Such a study is not necessary because the ISO continually monitors bidding practices and if it observes evidence that the 150-percent registered cost cap is causing inappropriate bidding practices, it will take appropriate action. Developing a separate study as requested by NCPA would not be a worthwhile

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[16] See transmittal letter for August 30 tariff amendment at 10-11. The ISO's initial proposal was to reduce the cost cap for the registered cost option to 125% of projected proxy costs, but in response to stakeholder comments this was modified to the final proposed 150% level. The 150% level is the level that best reflects stakeholder interests in ensuring that generators receive adequate cost recovery while preventing the exercise of market power.

[17] NCPA at 4.

use of the ISO's limited resources, which can be better allocated to some other purpose.

Similarly, SCE also requests that the Commission order the ISO to produce and file a study in a year regarding a different subject: the efficacy of the major maintenance data submission process. Although it urges the Commission to accept the ISO's filing, SCE states that if the process should prove to be problematic, modifications to it should be considered, such as the "safe-harbor" maximum values for cost submissions that SCE suggested in the stakeholder process.[18]

The Commission should not require such a study. The process for submitting major maintenance costs is very similar to the negotiated default energy bid process. The negotiated default energy bid process has been in place since April 2009 and has worked smoothly for over five years. Again, it would be inappropriate to direct the future use of scarce ISO resources when no problem may emerge. Further, the ISO made a deliberate decision not to propose a "safe-harbor" maximum value because of the incentives such a provision would create for market participants to simply submit the "safe-harbor" value instead of their actual major maintenance costs. The ISO and scheduling coordinators (including SCE) will gain experience with the efficacy of the data submission process after it begins. If the ISO or a stakeholder believes the process has proven to be problematic, it can propose this area as a topic for a new policy initiative.

[18] SCE at 3-4.

C. It Would Be Premature for the ISO to Establish an Implementation Plan for Inclusion of Costs Associated with Transitions of Multi-Stage Generating Resources in Proxy Cost Calculations.

PG&E states that it supports the August 30 tariff amendment. However, PG&E requests that the Commission encourage the ISO to establish an implementation plan for including major maintenance costs associated with transitions of multi-stage generating resources in proxy cost calculations.[19]

It would be premature for the ISO to establish an implementation plan regarding the multi-stage generating resource issue referenced by PG&E. The ISO removed this issue from the stakeholder initiative for the August 30 tariff amendment due to a lack of sufficient stakeholder interest and the potential complications involved in developing an approach for enhancing the proxy cost calculations. The stakeholder consensus was that these refinements should be deferred until more experience is gained with the multi-stage generating resource functionality. The ISO anticipates that the issue will generate more interest as more resources participate in its markets as multi-stage generating resources in the future.[20]

This issue will be identified in the soon to be published Stakeholder Initiatives Catalog. The ISO and stakeholders will determine the appropriate priority and delegation of limited resources to the multi-stage generator issue as part of the regular process of prioritizing the proposed initiatives described in the Stakeholder Initiatives Catalog. PG&E provides no reason why this issue

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[19] PG&E at 3.

[20] Transmittal letter for August 30 tariff amendment at 4, 9.

requires special priority. Therefore, the ISO's regular process for determining stakeholder prioritization of initiatives should be permitted to go forward without interruption or Commission intervention.

Finally, as the ISO discussed in the transmittal letter accompanying the August 30 tariff amendment filing, MSG resources will have the ability to include major maintenance costs in start-pup and minimum load proxy costs and, thus, these costs will also reflected in higher caps on transition costs.

II. Conclusion

For the reasons explained above and in the August 30 tariff amendment, the Commission should accept the tariff amendment as just and reasonable, and approve it without any of the modifications or additional requirements requested by intervenors.

Respectfully submitted,

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Dated: October 2, 2013

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 above-referenced proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, DC this 2nd day of October, 2013.

/s/ Michael Kunselman
Michael Kunselman