UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company	)	
v.	)	Docket Nos. EL00-95-___ and EL00-98-___ *et al.*
Sellers of Energy and Ancillary Services,	)	
et al.	)	

MOTION FOR ESTABLISHMENT OF A CAPACITY MARKET IN CALIFORNIA WITH ASSOCIATED MUST OFFER OBLIGATIONS AND PRICE MITIGATION MEASURES

PURSUANT TO RULE 212 OF THE COMMISSION'S RULES OF PRACTICE AND PROCEDURE, 18 C.F.R. § 385.212 (2001), RELIANT ENERGY POWER GENERATION, INC. ("REPG") AND RELIANT ENERGY SERVICES, INC. ("RES") (COLLECTIVELY, THE "RELIANT COMPANIES") HEREBY MOVE THAT THE COMMISSION REQUIRE ESTABLISHMENT OF A CAPACITY COMMITMENT MARKET AND ASSOCIATED MUST OFFER OBLIGATIONS AND PRICE MITIGATION MEASURES IN THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION'S ("CAISO") MARKET UPON EXPIRATION OF EXISTING MITIGATION AND FOR THE LONG TERM.

I. INTRODUCTION AND SUMMARY

The capacity market proposal outlined below meets the needs of California through market-based mechanisms with the following characteristics:

1. Establishment of an interim monthly ACAP market that begins in October 2002 and ends in December 2004, that will impose obligations on supply and load market participants and will ensure that the CAISO will have adequate supply for the short-term;

2. Incorporation of market power mitigation measures for the interim period, including a two part "must offer" requirement and acceptance of a maximum payment amount for real time Energy/Ancillary Services from monthly ACAP providers, a damage control offer cap for all non-ACAP providers selling into the CAISO real time or Ancillary Services markets, and transitional mitigation or refund obligations outside of reasonable safe harbor standards; and

3. Creation of a forward capacity market in the form of an annual Regional Reliability Commitment ("RRC") with delivery beginning January 1, 2005, that will provide sufficient lead-time for construction of new generation and maintenance or upgrades to existing generation, and will provide load resources an opportunity to make any necessary changes to their operating configuration.

The ACAP/RRC are mechanisms for ensuring that adequate capacity reserves are available to meet loads in future years by providing the missing price signals needed for development of new generation. They accomplish this objective by requiring forward commitments for capacity resources equal to projected system load plus a reserve margin, thereby assuring generators of the opportunity to recover the fixed costs of providing capacity even if actual energy needs are minimal or non-existent. The ACAP/RRC capacity markets function as a regional resource plan by identifying the loads that are forecast to occur in future periods and then explicitly identifying the capacity resources that will be relied upon to serve that load. To the extent that the ACAP/RRC mechanisms identify any shortfall in future periods, a market-based auction process is used to secure additional capacity resources.

The ACAP/RRC proposal is an adaptation of existing capacity markets in other transmission systems and of the RRC proposal advanced by the Reliant Companies in Docket No. RM01-12 designed specifically to meet the following needs of the California market:

1. Assurance that the CAISO has sufficient capacity available to serve peak load on a month-to-month and long-term basis;

2. Assurance that adequate resources will be committed to "must offer" to the CAISO system through a market mechanism;

3. Assurance that the resources committed to supply capacity needs will not be paid more than a maximum price as described herein;

4. Assurance that there are long-term price signals for generation capacity that will encourage new generation development, allow existing owners to make decisions on required new environmental investments and major repairs and encourage load response to enter the market; and

5. Provision of adequate mitigation mechanisms in the CAISO market until market restructuring is completed.

Ideally, these problems would be addressed through a capacity obligation component and other facets of the standard market design proceeding. However, it will be some time before the Commission's standard market design is finalized and takes effect. The CAISO cannot afford to delay implementation of market reform and a capacity market. California needs both a short-term and a long-term capacity market structure that is consistent with the Commission's goals for the nationwide market and that will address California's needs.

II. MOTION FOR CONSIDERATION OF ACAP/RRC PROPOSAL WITH ASSOCIATED MUST OFFER OBLIGATIONS AND PRICE MITIGATION MEASURES

The Commission has held repeatedly that the short-term wholesale electricity market in California – the market operated by the CAISO – is dysfunctional. Among the problems identified by the Commission are scarcity of supply in comparison to demand, an excessive portion of load in the real time market, price volatility and high prices in the real time market, the need for forward (*i.e.*, other than real time) markets, and lack of meaningful demand response. The following proposal argues for an ACAP market for the CAISO that will address these issues in the immediate term (*i.e.*, upon expiration of the Commission's existing mitigation September 30, 2002), and an RRC market that will provide a mechanism to foster long-term development of competitive markets and optimal supply and demand conditions in California consistent with the Commission's goals.

The CAISO's existing market mechanisms do not facilitate any significant commitments prior to real time. This energy only market perpetuates volatile spot markets and continued uncertainty for all market participants.[12] Current mitigation, combined with the CAISO's apparent intent to ignore the Commission's instructions for market development through a substantive May 1 filing, threatens to perpetuate and increase the existing problems. The CAISO presently uses the must offer obligation as a mechanism to require numerous generators to run at minimum load levels at all times, regardless of the market needs at the time. The result is that the market receives an availability benefit for which generators are not compensated and generators frequently are required to operate in a manner that is inefficient. The current combination of real time price mitigation and this implementation of the must offer obligation creates a situation where the CAISO receives free operating reserves, the Ancillary Services markets have ceased to function in any meaningful form, and there are no accurate price signals or incentives for development of demand response or new supply. The result is a serious lack of progress toward a functioning, competitive market.

The present application of the must offer obligation, along with cost-based limits that prohibit recovery for major capital expenditures necessary to keep a unit in the market, presents suppliers with a situation where they have to make decisions on maintaining generating units that may be contrary to the actual market values for such units. For example, proposed new State environmental restrictions require expensive emissions upgrades for parts of the California supply portfolio. Generators, however, cannot plan these upgrades with any reasonable expectation that they will be able to recover the expenditure. Therefore, the generator is faced with the option of retiring a unit without full information as to whether that unit still may be needed by the market. If a capacity market were available, however, the generator would have the opportunity to bid the unit at its long-term value including the cost of upgrades to determine

[12] A study commissioned by the CAISO and released recently on the CASIO website pointed out the inherent dysfunction that results from an energy-only market and the reasons that a capacity commitment market is needed in the CAISO. *See* Background Paper: Comparison of Capacity Obligations and Markets, prepared by Power Economics, Inc. (April 15, 2002), available at http://www.caiso.com, Market Design 2002 link.

whether it is economic to make the investment or whether the unit should be mothballed or retired.

Presently, many generators are providing a valuable service to the market (reserves) for which they do not receive any compensation. As a result, risks are not evenly balanced between supply and demand. For generators operating under must offer obligations and cost-based price restrictions in the CAISO market, provision of system reserve margins and reliability will become a worthwhile long-term investment activity only if capacity payments are available. In the present structure, the generator who provides the reserve margin without running is not usually compensated and will not want to continue providing this benefit; but, by paying a compensatory reliability payment to the generators who do not run, but stand ready to run, the optimal level of reliability can be maintained.

The Commission has ordered a redesign of the CAISO market to correct the structural shortcomings in the CAISO's current market. Many aspects of this redesign were to be included in a submission from the CAISO due for filing on May 1, 2002. However, it has become apparent that the CAISO's May 1 filing is not likely to include key provisions needed to improve market conditions in California. In fact, it appears that the CAISO will not propose actual changes, but rather will make "hypothetical" observations about possible market redesign. In light of the apparent lack of initiative from the CAISO Board to improve market conditions in California, the Reliant Companies submit this Motion requesting that the Commission consider together with the CAISO's May 1 filing an alternative, market-based proposal that will enhance market stability through development of a capacity market combined with retention of certain must offer and price mitigation mechanisms to protect market participants until market redesign can be implemented fully.[13] The details of this proposal follow.

III. BENEFITS OF THE ACAP/RRC PROPOSAL

The ACAP and the RRC can ensure generation adequacy necessary for system reliability by providing stronger price signals for entry and an assurance of generation availability for load. In addition, the ACAP and the RRC auctions present enhanced opportunities for demand to participate in determination of market prices. The ACAP/RRC proposal also is significantly superior to existing market conditions because the increase in a fixed (capacity) payment decreases the need for high variable (energy) payments, thereby moving resources out of the energy-only spot market and decreasing price volatility.

The ACAP/RRC proposal is consistent with the Commission's guiding principles for a standard market design, as formulated thus far. The Commission's working paper on standard market design recognizes that, in order for an electric power system to be reliable and for markets to function efficiently, there must be adequate generation resources. The Commission working paper does not specify the form that a generation adequacy market should take, but does recognize certain principles that support the need for such a market. For example, the working paper mentions that a capacity market should be forward-looking enough to allow significant new entry bidding and flexible enough to accommodate changing load conditions without disadvantaging new load-serving entities. The ACAP/RRC proposal meets these needs for California.

The ACAP/RRC also is a good solution because it relies to a large extent on existing CAISO market mechanisms and is supported by a straightforward implementation

[13] The price mitigation aspects of the Interim ACAP proposal are illustrated on the chart included as Attachment 1.

structure. For example, the interim ACAP will make use of existing Ancillary Services markets (especially Replacement Reserves) to serve as a temporary alternative to a day-ahead unit commitment market, instead of requiring development of a new and entirely cost-based residual unit commitment requirement for generators to be proposed by the CAISO's "hypothetical" May 1 filing.[14] In addition, the interim ACAP retains components of the Commission's mitigation and the CAISO's proposed going-forward market design.

The ACAP mechanism can be implemented by October 1, 2002 (the date on which the current West-wide mitigation measures are scheduled to expire). Implementation by this time is necessary if California is to avoid a recurrence of the capacity shortages and reliability challenges (as evidenced by system emergency declarations) that occurred in 2000 and 2001. Initial RRC auctions beginning in November 2002 will allow implementation of the RRC for delivery beginning January 2005.[15]

A. IV. KEY DEFINITIONS

The following definitions apply to the ACAP proposal described herein:

Interim ACAP – The CAISO shall forecast peak load and Reserve Margins and shall purchase capacity through a monthly auction to meet the net short between the CAISO's forecast and the amount of capacity Self-arranged or purchased in advance by the LSEs in the CAISO Control Area. The ACAP is interim in nature and shall apply only for the period while development of the redesigned CAISO market proceeds and prior to full implementation of the Regional Reliability Commitment.

Regional Reliability Commitment (RRC) – The CAISO shall forecast peak load and Reserve Margins and shall purchase capacity through an annual auction to meet the net short between the CAISO's forecast and the amount of capacity Self-arranged or purchased in advance by the LSEs in the CAISO Control Area. The RRC is implemented on a three-year forward-looking basis.

Capacity Product – The ACAP or RRC product is defined by a capacity payment at a price arranged in advance through bilateral negotiations or the single clearing price derived from the ACAP or RRC auction and dependent upon verification of actual availability. This payment obligates the ACAP or RRC Resource to offer committed capacity by bidding into the existing Day-Ahead Ancillary Services markets (including Replacement Reserves, Spin and Regulation Up for units capable of providing Regulation Energy) or the Day-Ahead energy market once it is implemented, then to offer all available energy from on-line units into the real time energy market. Compensation for energy provided in association with an ACAP obligation is limited to a $250/MWh or a proxy incremental heat rate times the applicable gas index. Compensation for Energy provided in association with an RRC obligation is limited to a maximum

[14] The residual unit commitment proposal is nothing more than a continuation of the must offer obligation under a different name – an energy-only market for all units and all hours without providing any capacity compensation.

[15] For illustration of the implementation timeline, see the chart included as Attachment 2.

energy payment price established by the CAISO at the time of the applicable RRC auction.

Eligible ACAP or RRC Resource – Generation and load resources (LSEs) are eligible on a whole-unit basis (discounted to reflect an equivalent forced outage rate of 7 percent) to participate in the ACAP or RRC market, both bilaterally and through the auction, as long as they certify their ability to provide capacity. For existing resources, such eligibility may be demonstrated by either (1) providing to the CAISO verification of testing to determine operating capability, or (2) demonstrating to the CAISO that the resource has, within the last twelve months, generated energy at the level being offered as capacity. For new resources that have not completed construction, eligibility may be demonstrated by showing a feasible construction timeline consistent with the capacity being offered for the future year, including a demonstration of the status of necessary permits, interconnection agreements, and other critical path milestones. LSEs choosing to meet their capacity forecasts through bilateral commitments must certify their capacity according to the same guidelines.

ACAP or RRC Resource – Any supplier selected to provide capacity either through the CAISO auction or through a bilateral commitment to an LSE shall be designated an ACAP or RRC Resource and shall incur all of the obligations associated with such designation, including those obligations inherent in the provision of a capacity product as described herein.

Reserve Margin – The CAISO shall determine the appropriate level of reserves based on a study of regional factors affecting reserve margins, including the types and sizes of individual generators, historical forced and planned outage rates, available transmission capacity and import capability from other regions during peak periods, and load forecast error.

Self-arranged Capacity – LSEs may meet their ACAP or RRC capacity levels with Self-arranged capacity acquired through self-provision or bilateral arrangements. LSEs that choose to do so must demonstrate to the CAISO the identity of the unit(s) providing capacity, provide confirmation to the CAISO on the eligibility of such resources, and provide such capacity according to the obligations imposed on ACAP or RRC Resources, including the applicable must offer obligations and price mitigation measures.

Capacity Compliance Report – All ACAP and RRC Resources, including those that are Self-arranged and those committed through a CAISO auction, must verify to the CAISO their actual availability on a monthly basis through submission of a Capacity Compliance Report. This Report shall consist of a template, filled out by the ACAP or RRC Resource, and utilized by the CAISO in disbursement of ACAP payments. The Capacity Compliance Report shall indicate availability for each hour of the month and shall demonstrate compliance with the must offer obligation by reporting submission of bids on an hourly basis into each applicable market.

V. CHARACTERISTICS OF THE INTERIM ACAP

The Interim ACAP mechanism is a monthly measure intended to fill the immediate need for a unit commitment market in the CAISO and to implement price mitigation and must offer provisions needed in the period prior to full redesign of the CAISO market and implementation of the RRC.

A. The Auction Process

The Interim ACAP gives LSEs two options: they may Self-arrange their capacity or allow the CAISO to acquire capacity for them. Under the Self-arrange option, LSEs must purchase or supply from their own generation some or all of the capacity required to meet their forecast load requirement plus the Reserve Margin set by the CAISO. For those that opt to purchase their capacity reserves from the CAISO, and for the net difference between the CAISO's forecasts and Self-arranged capacity, the Interim ACAP auction would work as follows:

(1) The CAISO shall forecast the projected peak load for the month plus a Reserve Margin. Monthly projected peak load shall be determined by the CAISO using advisory information provided by the LSEs for the upcoming months.

(2) Each LSE shall certify to the CAISO by a date certain the amount of Self-arranged capacity that it has available to meet its established ACAP obligation.

(3) The CAISO shall compare the amount of Self-arranged capacity against the forecasted needs and procure any net short amount through a single clearing price auction in which Eligible ACAP Resources may bid on a whole-unit basis and load may submit demand bids. The cost of procurement through the auction is allocated to each LSE in MWs based on actual monthly peak demand in proportion to its share of the net short position.

B. Proposed Timeline

The CAISO shall inform LSEs of the monthly forecast peak load plus the Reserve Margin by the first day of each auction month. LSEs shall certify to the CAISO any Self-arranged capacity by the 8th day of each auction month. Bids from Eligible ACAP Resources shall be accepted by the CAISO from the 9th through the 15th of each auction month, and ACAP Resources selected through the auction process shall be informed of their ACAP obligation by the 18th day of each auction month. The initial Monthly ACAP auction shall occur in September 2002 for services to be provided in October 2002. Subsequent monthly ACAP auctions shall be conducted to assure adequate capacity on a monthly basis for the period October 2002 through December 2004.

C. Must Offer Obligations

Suppliers in the CAISO market will be obligated to a multi-part must offer requirement so that there can be an assurance that suppliers will not exercise physical withholding in the ACAP auction process or in the CAISO spot markets.

(1) First, all generators that have executed a Participating Generator Agreement ("PGA") shall have the obligation of offering all available and otherwise uncommitted capacity in the ACAP auction. Generators may satisfy this obligation by bidding on a whole unit basis a number of megawatts equal to full capacity, discounted by an equivalent forced outage rate of up to 7 percent, minus the number of megawatts equivalent to their largest unit (for unit contingency reserve).

(2) Second, generators that are selected as ACAP Resources shall have an obligation to submit bids for the committed capacity in the CAISO's existing Day-Ahead Ancillary

Services markets (including Replacement Reserves, Spin, and Regulation for those units capable of providing Regulation Energy). Upon development of a Day-Ahead energy market, the ACAP Resources will be obligated to offer their capacity in this market.

(3) Third, any ACAP Resource that is committed to run by the obligation of CAISO Day-Ahead markets or through bilateral transactions shall have the additional bidding any remaining energy in the real time market.

The CAISO will be able to verify compliance with the bidding component of the must offer obligation through review of the Capacity Compliance Report.

(1) D. Price Mitigation Measures

The Interim ACAP imposes price mitigation measures temporarily in each of the CAISO's capacity and energy markets. These price mitigation measures are structured to ensure reasonable prices during the CAISO's transition to a redesigned, competitive market, while at the same time maintaining market-based mechanisms that will provide some degree of price certainty for sellers and will generate price signals to encourage development of adequate supply and meaningful demand response.

(1) Cap on ACAP Prices – For the period October through December 2002, the monthly ACAP price cap shall be set equal to a fixed price of $6/kW-month (a representation of the approximate cost of a new simple cycle CT unit). Beginning with the auction for January 2003 deliveries, the cap on monthly ACAP auction prices shall be set equal to the clearing price established in the RRC auction for 2007 delivery and shaped monthly to reflect the relative monthly Loss of Load Probability during the relevant period. This price cap is appropriate since it reflects new entry costs at a point sufficiently forward to enable new generation supply to compete with incumbent suppliers, thereby eliminating market power concerns.

(2) Cap on Payment to ACAP Resources – A cap on Energy and Ancillary Services payments for ACAP Resources shall be set equal to the higher of $250/MWh or an index price set by a high heat rate unit and a gas index (*i.e.*, 20,000 Btu/kWh x gas index). Under this mechanism, the maximum total price that can be received by an ACAP Resource selling Ancillary Services and Energy is the higher of the index price or $250/MWh, exclusive of any ACAP payment received.

(3) Cap on non-ACAP Resources – Suppliers that are not selected as ACAP Resources by the CAISO or Self-arranged by LSEs, and therefore do not receive any capacity payments, may submit bid prices for Energy and Ancillary Services up to a damage control cap, but do not have a must offer obligation. The damage control cap shall be set at a minimum of $1,000/MWh and, in the event that index gas prices exceed $30/mmBtu, the cap will be raised in a proportion equal to the percent that gas prices exceed the $30/mmBtu level.

The ACAP proposal balances the above short-term price mitigation measures with the following safe harbor provisions to ensure that prices for non-ACAP Resources remain reasonable: (1) there is no after-the-fact mitigation for all accepted bids to the CAISO at prices of $250/MWh or less, and (2) there is no after-the-fact mitigation for accepted bids that are within 300 percent of a 90-day rolling average of a resource's bidding history calculated as $/MWh. If the 90-day bidding history is inadequate for a particular resource, then the last 90-day period that is adequate is used. For example, the last 90 days of operation may be appropriate for a peaker unit.

Transaction prices on sales from non-ACAP Resources to the CAISO outside of both safe harbors will remain subject to mitigation and refund if the Commission determines that there has been an exercise of market power. But, the safe harbor provisions will provide certainty of reasonable and final transaction prices. Such certainty is necessary to maintain incentives for adequate supply to enter and/or continue to participate in the CAISO market. All Energy and Ancillary Services bids from ACAP Resources are capped and therefore are not subject to after-the-fact mitigation.

(2) E. Availability Standards

Payments for the Interim ACAP are based upon actual availability during the delivery month, as measured hourly, and shall take into account whether the capacity resource was offered into the Day-Ahead Energy or Ancillary Services markets in compliance with the must offer obligation. Accordingly, suppliers providing ACAP (whether through an auction award or Self-arranged commitments) shall have the obligation of certifying the availability of each ACAP resource to the CAISO. Both aspects of compliance shall be demonstrated through submission of the Capacity Compliance Report described above. In this way, the CAISO and market participants can be certain that ACAP Resources are performing consistent with their capacity commitments.

(3) F. Performance Incentives

The ACAP proposal recognizes that an essential part of the ACAP process is the ability of LSEs to rely on ACAP Resources to perform according to their agreed-upon obligations and at capped prices for the associated Energy and Ancillary Services payment. This issue comes into play both with respect to new market entrants who must provide reasonable assurance that the new capacity will be constructed and available, and with respect to existing market participants that must maintain capacity in an available and reliable manner. The following process should ensure that ACAP Resources are accountable for their obligations:

(1) Resources committed to ACAP through Self-arranged bilateral agreements and resources that participate in the monthly ACAP auction or the RRC auction must meet the requirements for an Eligible ACAP Resource.

(2) ACAP Resources must report their actual availability and compliance with the must offer obligation to the CAISO on a monthly basis through the Capacity Compliance Report mechanism, and will be compensated only for capacity that is certified as available and offered in the applicable delivery month. As explained above, availability will be evaluated on an hourly basis using the bids of individual suppliers and payment by LSEs does not occur until after the ACAP service is provided in the designated future period.

(3) ACAP Resources will be required to post a credit in an amount equal to 10 percent of the monthly contract value in the form generally required by the CAISO. If the resource is unable to provide the committed capacity, it will lose a part of its ACAP/RRC payment in proportion to its level of non-performance for the relevant

period and also forfeit as a penalty a *pro rata* portion of the 10 percent credit posted.[16] Such penalty shall be netted against any capacity payments to be received or shall be charged directly to the ACAP provider if the penalty is in excess of the capacity payment amount.

In this way, suppliers will be able to offer capacity only if they actually demonstrate their availability to meet their obligations, they will be paid only if the promised capacity is actually made available, and they will be penalized for unavailability. As a result, ACAP Resources have appropriate incentives to perform.

VI. CHARACTERISTICS OF THE REGIONAL RELIABILITY COMMITMENT

The RRC mechanism is structured in a manner similar to the Interim ACAP, but it operates on a three-year forward-looking basis. This time horizon provides sufficient lead-time for additional generation construction and for load resources to make any necessary changes to their operating configurations. As such, some aspects of the must offer obligations and price mitigation measures that are part of the Interim ACAP are no longer needed once the RRC is fully implemented. However, a must offer obligation for the RRC auction, a maximum energy payment amount, and availability standards and performance incentives remain.

(4) A. The Auction Process

The RRC gives LSEs two options: LSEs can Self-arrange their capacity or purchase it from the CAISO through a single clearing price auction. Under the Self-arrange option, LSEs will purchase or supply from their own generation enough capacity to meet their forecast load requirements plus a Reserve Margin set by the CAISO. For those that opt to purchase their capacity reserves from the CAISO, the capacity auction will operate as follows:

(1) The CAISO shall determine the amount of capacity necessary to ensure generation adequacy. This amount shall be calculated based on a load forecast for an annual period beginning three years from the present period. The three-year forward load forecast shall be increased by a Reserve Margin to be determined by the CAISO. The CAISO then shall assign load obligations to each LSE on a pro rata basis.

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[16] For example, if an ACAP Resource is to receive $30,000 in ACAP payments for a 30-day month, but is unable to provide the committed capacity for five of those days, the ACAP Resource will forfeit $5,500 of its capacity payment.

(2) Each LSE shall be provided a reasonable time to report any Self-arranged capacity to the CAISO, then the CAISO shall deduct from the capacity amount determined in (1) above the amount of Self-arranged capacity committed to by LSEs.

(3) The CAISO shall conduct a single clearing price auction to secure the residual capacity. The CAISO will supply a maximum energy payment amount associated with the RRC auction, and that price shall become the maximum amount an RRC Resource selected in the auction will be allowed to bid.

(4) The annual cost of capacity purchased in the auction for a given year shall be allocated to each of the months in the year and colleted from the LSEs as a part of their monthly bills based on their load ratio share for that month, taking into account the capacity that they did not Self-arrange and actually make available.

(5) B. Proposed Timeline

In order to allow for a transition to the RRC, the auctions for calendar years 2005-2007 must take place in the near term. For example, the auction for calendar year 2005 should occur in November 2002 (26 months forward), and the auction for calendar year 2006 should occur in May 2003 (31 months forward). Beginning with calendar year 2007, the RRC can operate on a 36-month forward basis, with the auction taking place in December 2003. As with the Interim ACAP, the CAISO will determine the net short capacity for each annual RRC period by comparing the forecasted peak load for that future year plus the Reserve Margin.

To provide adequate flexibility to take into account changes in availability that may occur in the time between the RRC auction and the delivery period, the RRC allows for substitution or trading of an RRC obligation. For example, consider an instance where a new market entrant is selected as an RRC Resource, but is not able to complete construction in a timely manner or has to cancel construction altogether. The RRC Resource will have the option of substituting an alternative provider through a bilateral purchase, so long as the substitute meets the eligibility requirements and the same needs identified by the CAISO or the affected LSE.

(6) C. Must Offer Obligations

Generators that have executed a Participating Generator Agreement ("PGA") shall have the obligation of offering all available and otherwise uncommitted capacity in the annual RRC auction. Generators that are selected as RRC Resources shall have an obligation to submit offers in the Day-Ahead and/or Ancillary Services markets as described in the Interim ACAP section above. In addition, any RRC Resource that is committed to run in the Day-Ahead and/or Ancillary Services market shall have the obligation of bidding all remaining capacity in the real time market as described in the Interim ACAP section above.

(7) D. Price Mitigation Measures

Energy bids from RRC Resources will be limited to a maximum energy payment level specified by the CAISO at the time of the auction. However, the more elaborate price mitigation measures contemplated for the Interim ACAP proposal should not be necessary by the time the RRC is implemented. In particular, since new entrants can bid into the RRC auction and new plants can be constructed within three years (by merchant generators or by the LSEs themselves), there should be no market power concerns for the three-year auctions. However, if market participants believe conditions in the CAISO market become anti-competitive in the future, they still will have the option of bringing their claims to the Commission for consideration.

(8) E. Availability Standards

Payments for RRC Resources are based upon actual availability during the delivery month, and availability shall be determined through submission of Capacity Compliance Reports in the same manner set out in the Interim ACAP section above.

(9) F. Performance Incentives

RRC Resources committed in the annual RRC auction will face the same performance obligations and will be compensated in the same manner set forth above for ACAP Resources. They will confirm their availability on a monthly basis and show that bids have been submitted consistent with the must offer obligations, and will receive capacity payments on a monthly basis following verification. The credit showing described above will be assessed for each RRC Resource at 10 percent of its annual contract value (instead of monthly value as proposed in the Interim ACAP section). Penalties will be assessed on a monthly basis in the same manner described for the Interim ACAP.

B. VII. COMMISSION INVOLVEMENT IN CAISO MARKET REDESIGN

As has been noted repeatedly, the stakeholder process for development of the CAISO market redesign has broken down.[17] In addition, in yet another indication that the governance of the CAISO needs total replacement to be independent and effective, the CAISO Board has indicated that its market redesign filing will ignore not only input from its stakeholders, but also input from its own staff and consultants.[18] As a result, Commission involvement in the CAISO market redesign is absolutely essential. Approval of the ACAP/RRC proposal would go a long way toward correcting market dysfunctions in California. However, there is much more to be done. The Commission should continue to foster and participate in a real stakeholder process to help develop the total market redesign with the CAISO staff.

The Commission also should make an immediate decision on a market replacement for the must offer obligation that is presently creating disincentives for market

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[17] *See* Letter Submitted by Dynegy Power Marketing, Inc., Docket No. EL00-95-000 (filed Apr. 12, 2002) (expressing appreciation for FERC Staff participation in CAISO market redesign technical conference and belief that such participation enhanced the level of the discussion); Letter submitted by Williams Energy Marketing & Trading Co., Docket No. EL00-95-000 (filed Apr. 18, 2002) (same); Letter Submitted by Calpine, Docket No. EL00-95-000 (filed Apr. 19, 2002) (same).

[18] On April 9 and April 25, 2002, the Board of Governors of the CAISO met to consider proposals for filing on May 1, 2002, as required by the Commission's December 19, 2001 Order. Per the Commission's instructions, the purpose of the CAISO's filing was to provide "adequate market structures to be in place when the price mitigation ends on September 30, 2002." At the April meetings, however, the CAISO Board determined that, instead of proposing a new market solution, it would argue that the existing Commission-imposed mitigation must be extended "until there is a workably competitive market in California." Any substance in the May 1 filing is to couched as "hypothetical" and "information-only" measures. The CAISO took this step despite the obvious need for market reform – a need evidenced by months of stakeholder discussion on this topic along with independent market analysis and CAISO Staff work to develop the proposals.

participation and entry and facilitating manipulation of the CAISO's markets by the CAISO. As discussed above, the best interim proxy for the existing must offer obligation is a capacity market where suppliers will receive compensation when they maintain their resources to meet load and where load shares market risks through a forward planning system. It is essential that this capacity mechanism include a payment basis for units serving the CAISO markets that will ensure adequate cost recovery. A unit commitment requirement without a capacity payment would fail utterly to correct existing imbalances of market risks. In addition, the Commission must ensure that the CAISO constructs a day-ahead energy market and adequate congestion management as directed in previous Commission Orders. Finally, the Commission should ensure that any California market developments stay focused on the central goal of maintaining market signals needed to encourage entry of supply and demand response.

CONCLUSION

A commitment market is needed in California. The ACAP/RRC proposal will benefit the California wholesale market by ensuring that existing and new generation has incentives to participate in the CAISO, presenting opportunities for demand to participate in a market-based mechanism, ensuring that capacity is available when needed by load and by the CAISO system, and ensuring that consumers are not forced to pay for unnecessary reserves. This proposal address both the short-term and the long-term needs of the California market by including price mitigation and must offer obligations along with signals for development and commitment of adequate resources to ensure much-needed system reliability. Finally, the ACAP will moderate price volatility by moving load from variable energy markets into fixed payment capacity markets. The ACAP and RRC markets should be adopted without delay so that they can be implemented in a timely manner in California.

WHEREFORE, for the foregoing reasons, the Reliant Companies request that the Commission order the development of a capacity market in California, as described herein.

Respectfully submitted,

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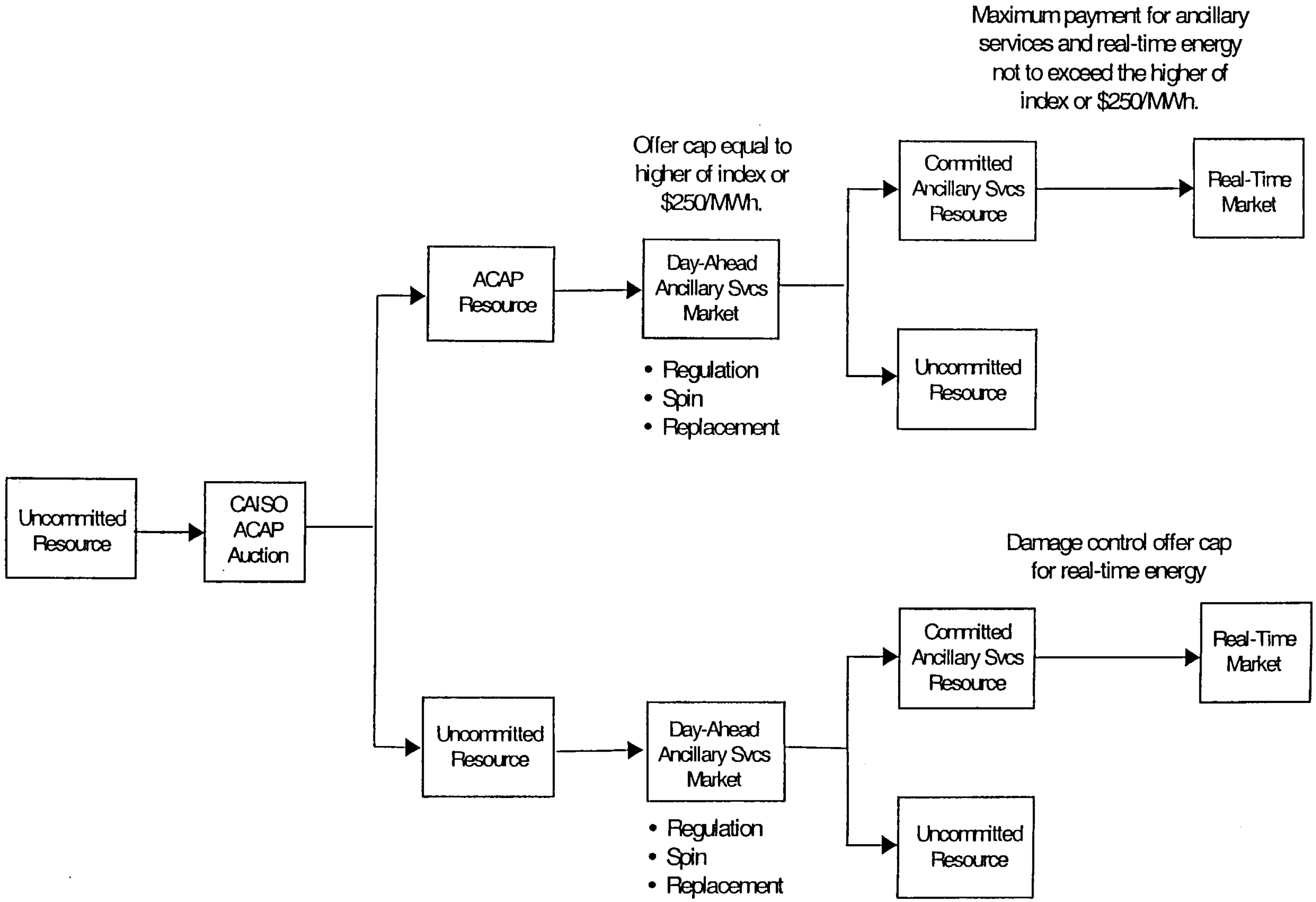
Dated: April 30, 2002

ACAP Proposal for CAISO Market

Attachment 1



California Capacity Market Implementation Timeline