

121 FERC ¶ 61,276  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
Philip D. Moeller, and Jon Wellinghoff.

Independent Energy Producers Association

v.

Docket No. EL05-146-004

California Independent System Operator Corporation

ORDER ON REHEARING AND CLARIFICATION

(Issued December 20, 2007)

1. These proceedings arise out of an August 26, 2005 complaint (Complaint) filed by the Independent Energy Producers Association (IEP) against the California Independent System Operator Corporation (CAISO) with respect to the then-existing must-offer obligation under the CAISO Tariff in Docket No. EL05-146. On February 13, 2007, the Commission issued an order on paper hearing to review evidence on whether the rates and cost allocation under the contested Offer of Settlement filed in this proceeding or some other rates and cost allocation are just and reasonable with respect to the must-offer obligation.<sup>1</sup> The Order on Paper Hearing approved the Offer of Settlement as modified therein, finding that, as a result of the additional evidence provided in the paper hearing, the Offer of Settlement presents a just and reasonable outcome. This order addresses requests for clarification and/or rehearing of the Order on Paper Hearing. For the reasons discussed below, we deny the requests for rehearing and grant in part and deny in part the requests for clarification.

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<sup>1</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 (2007) (Order on Paper Hearing).

## I. Background

### A. Procedural History

2. In an order issued on April 26, 2001,<sup>2</sup> the Commission established a prospective mitigation and monitoring plan for the California wholesale electric markets. One of the fundamental elements of the plan was the implementation of a must-offer obligation, pursuant to which most generators serving California markets were required to offer all of their capacity in real time during all hours if it is available and not already scheduled to run through bilateral agreements. The CAISO implemented the must-offer obligation beginning July 20, 2001.

3. In an order issued on June 17, 2004,<sup>3</sup> the Commission recognized the California Public Utilities Commission's (CPUC) plan to phase in resource adequacy requirements and suggested that if the CAISO determines that the resource adequacy requirements are sufficient to meet its operational needs, the resource adequacy requirements and obligations could serve to replace the existing must-offer obligation.<sup>4</sup> Additionally, on July 8, 2004,<sup>5</sup> the Commission advised that if IEP believed the current must-offer obligation to be unjust and unreasonable, it may seek to initiate a section 206 proceeding to challenge the justness and reasonableness of the current method and seek an alternative proposal.<sup>6</sup>

4. On August 26, 2005, IEP filed the Complaint against the CAISO under section 206 of the Federal Power Act (FPA).<sup>7</sup> The Complaint alleged that the existing must-offer

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<sup>2</sup> *San Diego Gas & Electric Co.*, 95 FERC ¶ 61,115, at 61,355-57, *order on reh'g*, 95 FERC ¶ 61,418, *order on reh'g*, 97 FERC ¶ 61,275 (2001), *order on reh'g*, 99 FERC ¶ 61,160 (2002), *pet. granted in part and denied in part sub nom., Public Utils. Comm'n of the State of Cal. v. FERC*, 462 F.3d 1027 (9th Cir. 2006).

<sup>3</sup> *Cal. Indep. Sys. Operator Corp.*, 107 FERC ¶ 61,274 (June 17, 2004 Order), *order on reh'g*, 108 FERC ¶ 61,254 (2004).

<sup>4</sup> *See* June 17, 2004 Order, 107 FERC ¶ 61,274 at P 26-28.

<sup>5</sup> *Cal. Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,022 (July 8, 2004 Order), *order on reh'g*, 109 FERC ¶ 61,097 (2004).

<sup>6</sup> July 8, 2004 Order, 108 FERC ¶ 61,022 at P 111.

<sup>7</sup> 16 U.S.C. § 824e (2000).

obligation under the CAISO Tariff is flawed and no longer just and reasonable. The Complaint also requested that the Commission direct the CAISO to replace the existing must-offer obligation and related minimum load cost compensation tariff provisions with an interim set of tariff provisions to remain in effect until the CAISO's market redesign goes into effect.<sup>8</sup>

5. On March 31, 2006 certain parties (the Settling Parties)<sup>9</sup> filed a contested Offer of Settlement, which proposed the institution of a Reliability Capacity Services Tariff (RCST). The RCST, which was initially proposed by IEP in the Complaint, modified the existing Commission-imposed must-offer obligation under the CAISO Tariff, as well as other market design elements. The RCST provided a backstop capacity procurement mechanism to the CAISO that included provisions establishing: (1) must-offer capacity payment rates; (2) RCST rates due to designation resulting from a Significant Event; (3) RCST rates due to designation resulting from deficiency in Resource Adequacy showings; and (4) payments to frequently mitigated units. In addition, the RCST established cost allocation methodologies and the rules by which the CAISO can procure RCST capacity. Under the terms of the Offer of Settlement, the RCST will expire on December 31, 2007 or on midnight of the date immediately before the Market Redesign and Technology Upgrade (MRTU) becomes effective, whichever is earlier.

6. In a July 20, 2006 Order on Complaint and Offer of Settlement,<sup>10</sup> the Commission found that, under the then-current market design, the compensation to generators under the must-offer obligation was no longer just and reasonable. However, the Commission was unable to find that the rates and cost allocation mechanism under the contested Offer of Settlement were just and reasonable. Accordingly, the July 20, 2006 Order established paper hearing procedures to review evidence on the rates and cost allocation issues presented by the Offer of Settlement.

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<sup>8</sup> The CAISO's market redesign is currently planned to go into effect on April 1, 2008.

<sup>9</sup> The Settling Parties are: IEP; the CAISO; the CPUC; Pacific Gas and Electric Company; San Diego Gas & Electric Company; and Southern California Edison Company (SoCal Edison).

<sup>10</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,069 (2006) (July 20, 2006 Order).

7. On September 27, 2006, the Commission issued an Order on Clarification as to the July 20, 2006 Order.<sup>11</sup> The Commission clarified, among other things, that the July 20, 2006 Order implemented the Offer of Settlement rates on an interim basis, pursuant to Rule 602(h) of our regulations,<sup>12</sup> and subject to refund. Moreover, the Commission clarified that, upon approval of appropriate interim tariff sheets, the CAISO would be authorized to implement all of the terms of the Offer of Settlement relating to the sale of capacity and each potential seller of capacity would be authorized to collect the Offer of Settlement rates, if the seller so elected pursuant to the July 20, 2006 Order. The Commission also stated that the interim tariff sheets should include the cost allocation methodologies and all reporting and procedural requirements set forth in the Offer of Settlement. The Commission stated, however, that it was not authorizing the CAISO to implement the provisions in the Offer of Settlement relating to automatic mitigation procedures (AMP) and ancillary services on an interim basis.

8. On February 13, 2007, in its Order on Paper Hearing, the Commission approved, with modifications, the Offer of Settlement as a just and reasonable outcome for this proceeding. Although the Commission found that the RCST provisions were just and reasonable, the Commission recommended modifying the Offer of Settlement with respect to two secondary provisions relating to AMP and ancillary services. The findings of the Order on Paper Hearing are discussed in greater detail below.

9. On June 11, 2007, the Commission denied requests for rehearing of the July 20, 2006 and September 27, 2006 Orders.<sup>13</sup> The June 11, 2007 Order also denied rehearing of the order accepting CAISO's proposed tariff revisions to implement the 2007 cost allocation methodologies for the costs incurred while making 2007 Local and Significant Event RCST designations in Docket No. ER07-326.<sup>14</sup>

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<sup>11</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,297 (2006) (September 27, 2006 Order).

<sup>12</sup> 18 C.F.R. § 385.602(h) (2007) (Rule 602(h)).

<sup>13</sup> *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,266 (2007) (June 11, 2007 Order), *pet. for review pending sub nom.*, *Cities of Anaheim v. FERC*, Case No. 07-1222, *et al.* (D.C. Cir., filed June 20, 2007).

<sup>14</sup> *Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,097 (2007) (February 13, 2007 Order on 2007 RCST), *order on reh'g*, June 11, 2007 Order, 119 FERC ¶ 61,266 (2007). In the February 13, 2007 Order on 2007 RCST, the Commission accepted, among other

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## **B. Requests for Clarification and/or Rehearing**

10. Timely requests for clarification and/or rehearing of the Order on Paper Hearing were filed by: the California Department of Water Resources State Water Project (SWP); the California Electricity Oversight Board (CEOB); the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, Six Cities); the City of Santa Clara, California d/b/a Silicon Valley Power (SVP); Mirant Energy Trading, LLC, Mirant California, LLC, Mirant Delta, LLC, and Mirant Potero, LLC (collectively, Mirant); and Williams Power Company, Inc. (Williams).<sup>15</sup> The requests for clarification and/or rehearing are discussed in greater detail below.

## **II. Discussion**

### **A. Effective Date**

#### **1. Order on Paper Hearing**

11. The Order on Paper Hearing established prospective implementation of the Offer of Settlement, setting forth an effective date of June 1, 2006.

#### **2. Requests for Clarification and/or Rehearing**

12. Six Cities and SVP argue that the Commission erred by prematurely authorizing sellers of capacity to collect Offer of Settlement rates prior to Commission acceptance of a CAISO compliance filing containing tariff provisions that conform to the Commission's final order in this case. They maintain that the plain language of FPA section 206 and applicable precedent requires a rate increase to become effective only after the Commission accepts a compliant filing after the Commission's final order on a

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things, those amendments which related to the 2007 Local and Significant Event RCST designations, effective January 1, 2007.

<sup>15</sup> On July 20, 2007 and October 31, 2007 Williams filed additional information to supplement its request for rehearing. On November 15, 2007, the CAISO and Six Cities filed answers to Williams' October 31, 2007 pleading. It is our general practice not to accept new evidence in a rehearing request. *See, e.g., N.Y. Indep. Sys. Operator, Inc.*, 112 FERC ¶ 61,283, at P 35, n.20 (2005); *see also Ocean State Power Co.*, 69 FERC ¶ 61,146, at 61,548 (1994); *Philadelphia Elec. Co.*, 58 FERC ¶ 61,060, at 61,133 (1992). Accordingly, we reject Williams' July 20, 2007 and October 31, 2007 pleadings and the CAISO and Six Cities' November 15, 2007 answers.

section 206 complaint.<sup>16</sup> Six Cities and SVP note that they raised this concern in requests for rehearing of the July 20, 2006 and September 27, 2006 Orders but that the Commission failed to act on those requests.

### 3. Commission Determination

13. The Commission finds that the implementation of the Offer of Settlement rates on an interim basis was not in error. For the reasons stated in the June 11, 2007 Order, section 206 permits the Commission to implement an interim rate order if the affected parties have notice of the interim rates.<sup>17</sup> Six Cities and SVP raised this very issue in requests for rehearing of the July 20, 2006 and September 27, 2006 Orders and do not raise any issues in their current requests for rehearing that persuade the Commission otherwise.

#### B. Target Capacity Price

##### 1. Order on Paper Hearing

14. The Offer of Settlement provided for a target capacity price of \$73/kW-yr.<sup>18</sup> This target capacity price is adjusted by monthly shaping factors, peak energy rent, and availability to determine a monthly RCST payment to generators on a per kW basis.<sup>19</sup>

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<sup>16</sup> Six Cities Request for Rehearing at 5-15 (citing, *inter alia*, *Elec. Dist. No. 1 v. FERC*, 744 F.2d 490 (D.C. Cir. 1985); *Pub. Service Co. of N.M. v. FERC*, 832 F.2d 1201 (10th Cir. 1987); *Kan. Gas & Elec. Co.*, 34 FERC ¶ 61,288 (1986)); SVP Request for Rehearing at 10-12 (citing, *inter alia*, *Elec. Dist. No. 1 v. FERC*, 744 F.2d 490 (D.C. Cir. 1985); *Pub. Serv. Co. of N.M. v. FERC*, 832 F.2d 1201 (10th Cir. 1987); *Tarpon Transmission Co.*, 58 FERC ¶ 61,354 (1992); *Trunkline Gas Co.*, 58 FERC ¶ 61,240 (1992); *Enron Power Enterprise Corp.*, 52 FERC ¶ 61,193 (1990)).

<sup>17</sup> June 11, 2007 Order, 119 FERC ¶ 61,266 at P 36-40.

<sup>18</sup> The target capacity price represents the annualized fixed costs of the reference resource. While units designated under RCST receive compensation based on the fixed costs of the reference resource, the monthly RCST payment is adjusted by other factors, such as the monthly energy rents that the reference resource would have likely received.

<sup>19</sup> Monthly shaping factors are intended to weight the value of capacity according to demand. See Offer of Settlement, Art. 6.2. Peak energy rent and availability are discussed in more detail below.

The Order on Paper Hearing found that the target capacity price, as a component of the RCST payment, had been sufficiently justified through submission of supplemental cost data and an analysis of the cost of new entry. Accordingly, the Order on Paper Hearing found that the target capacity price of \$73/kW-yr establishes a just and reasonable rate.<sup>20</sup>

## 2. Requests for Clarification and/or Rehearing

15. Williams requests rehearing of the Commission's finding to adopt a target capacity price of \$73/kW-yr. It argues that this price results in payments to must-offer units only marginally higher than payments received under the former must-offer obligation rate structure, which the Commission had previously found to be unjust and unreasonable for failing to adequately compensate generators for the reliability services they provide.

16. Williams also argues the Settling Parties did not themselves fully support the proposed \$73/kW-yr target capacity price, because: (1) the Order on Paper Hearing rejected the Settling Parties' reliance on \$62/kW-yr as constituting the low end of the range of reasonableness;<sup>21</sup> and (2) the next figure in the range offered by the Settling Parties is \$84/kW-yr. Williams submits that the Order on Paper Hearing instead used the average annual fixed costs of existing non-hydroelectric Reliability Must Run (RMR)<sup>22</sup> units of \$64/kW-yr to serve as the lower end of the reasonable range. Williams further asserts that the CAISO, and not the Settling Parties, provided the \$64/kW-yr figure. This, according to Williams, was contrary to the express procedures established in the July 20 Order, which directed the Settling Parties to fully support the \$73/kW-yr target capacity price.

17. Moreover, Williams argues that the Commission in the Order on Paper Hearing inappropriately examined both the cost of new entry and the costs attributed to *existing* generation. Williams asserts that, as noted by the Settling Parties, the cost of new entry is the correct analysis to use when establishing the range for a just and reasonable target capacity price. Williams submits that the backstop mechanism must send appropriate price signals to create proper incentives to invest, and the appropriate rate must therefore

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<sup>20</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 69-77.

<sup>21</sup> Williams Request for Rehearing at 12 (citing Order on Paper Hearing, 118 FERC ¶ 61,096 at P 70).

<sup>22</sup> RMR units are generators that the CAISO determines are required to be on line to meet reliability requirements.

be the cost of new entry. Williams adds that the Commission's analysis is fundamentally inconsistent with the methodology adopted by the Settling Parties to support the proposed rate, and inconsistent with the finding made in the Order on Paper Hearing that the cost of new entry is the appropriate benchmark for determining the rate in the instant proceeding.<sup>23</sup>

18. Williams further asserts that the Commission failed to consider numerous pieces of evidence that it submitted in the paper hearing process. First, Williams states it provided escalation levels from the Bureau of Reclamation construction cost trends for the years 2000 through 2006. These escalation levels show an average increase in power plant construction costs of approximately 3.1 percent per year, as opposed to the 2.5 percent escalation rate assumed by Settling Parties. Williams also argues that the Commission failed to consider evidence it submitted showing that the Settling Parties omitted in their range of annualized costs the figure of \$99/kW-yr reflected for the area encompassing Southwest Connecticut. Williams maintains that the installation and fixed operation costs for Southwest Connecticut compares more favorably to urban areas in California, and that the Commission did not address why this is not an appropriate benchmark. Finally, Williams maintains that the Commission failed to consider evidence showing that SoCal Edison had estimated an annualized revenue requirement of \$147/kW-yr for 250 megawatts of new black-start, utility-owned peaking turbines.<sup>24</sup>

19. Williams concludes that, based on the capacity costs of a "frame" type combustion turbine unit, a reasonable target capacity price is between \$87/kW-yr and \$99/kW-yr.<sup>25</sup> Williams contends, however, that if a "frame" type resource is used, the methodology for calculating the peak energy rent deduction must be modified. Alternatively, Williams argues that using the capacity costs of an aero-derivative combustion turbine to establish the target capacity price results in a reasonable range of between \$134/kW-yr and \$176/kW-yr.

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<sup>23</sup> Williams Request for Rehearing at 17 (citing Order on Paper Hearing, 118 FERC ¶ 61,096 at P 69).

<sup>24</sup> *Id.* at 24 (citing SoCal Edison Letter to Assigned Commissioner Ruling Addressing Electric Reliability Needs in Southern California for Summer 2007, CPUC Docket Nos. R 05-12-013 and R. 06-02-013 (Aug. 23, 2006)).

<sup>25</sup> *Id.* at 20-25. Williams states that these rates incorporate the Bureau of Reclamation construction cost trends for the years 2000 through 2006, without which a reasonable range for the target capacity price is between \$84/kW-yr and \$99/kW-yr.



20. The CEOB argues that the Commission erred in determining that the RCST capacity payment should be based on the cost of new entry into California's electricity market. The CEOB maintains that "[f]undamentally, the RCST paradigm is a temporary replacement for [the must-offer obligation]" and therefore, "the price of new generation is irrelevant to providing a fair payment to existing generators for the capacity reservation service they have been providing to the CAISO under [the must-offer obligation]."<sup>26</sup>

21. The CEOB also argues that the Commission erred in finding that: (1) the RCST payment must be set high enough to attract new investment in California; and (2) the capacity payment must be high enough so that utilities do not rely on the backstop mechanism to meet their resource adequacy requirements. The CEOB asserts that the premise of both conclusions is faulty because the RCST payment is not about securing more investment in California. The CEOB contends that investors will not commit to fund generation projects based on the notion that RCST capacity payments are available until December 31, 2007. The CEOB further argues that "setting up a payment structure to get new entry at the RCST price as set forth in the Order on Paper Hearing will leave consumers holding expensive resources they cannot use due to the effect of California's strict greenhouse gas legislation."<sup>27</sup>

22. Finally, the CEOB maintains that the record does not establish that basing the RCST payment on the cost of new entry will encourage utilities and generators to engage in longer-term contracts. The CEOB submits that the motivating factor to encourage long-term supply contracts is the fact that California's utilities face severe financial penalties for failure to comply with resource adequacy standards.<sup>28</sup>

### 3. Commission Determination

23. 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

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<sup>26</sup> CEOB Request for Rehearing at 9-10.

<sup>27</sup> *Id.* at 11.

<sup>28</sup> *Id.* (citing CPUC Decision 06-06-064, Opinion on Local Resource Adequacy Requirements (June 29, 2006) (penalty of up to 300 percent of the cost of replacement capacity)).

new entry.<sup>29</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.<sup>30</sup> On the upper end, it is reasonable to expect the target capacity price would be less than the cost of new entry, because 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<sup>31</sup> 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>32</sup>

24. We disagree with the CEOB that financial penalties for failure to comply with resource adequacy standards will encourage load serving entities and generators to engage in longer-term contracts. While the CEOB refers to the financial penalties levied by the CPUC, the CPUC does not have jurisdiction over all load serving entities in the CAISO control area. Further, we disagree that the penalties levied by the CPUC should impact our determination of a reasonable price to pay for backstop capacity. The CPUC assesses penalties to address potential non-compliance of CPUC jurisdictional utilities. As approved by the Commission, the RCST tariff provisions establish a reasonable price for backstop capacity to ensure reliability. The CPUC's non-compliance penalties are designed to deter specific conduct and are not directly related to the jurisdictional service and payment structure we have approved in this proceeding.

25. Williams argues that the Settling Parties did not fully support the Offer of Settlement target capacity price, as required by the July 20 Order, because the Commission had to rely on evidence submitted in the CAISO's reply comments. The Commission established the paper hearing to explore the reasonableness of the proposed service and rates, and was well within its discretion to consider all evidence submitted. The information provided in the CAISO's reply comments is properly part of the record in this proceeding. The fact that the information upon which the Commission relied was not provided in the Settling Parties' initial response to the data requests set forth in the

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<sup>29</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 70.

<sup>30</sup> *Id.* P 71.

<sup>31</sup> July 20, 2006 Order, 116 FERC ¶ 61,069 at P 35-37.

<sup>32</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 74.

July 20, 2006 Order does not mean that the Commission was precluded from making its finding on the justness and reasonableness of the target capacity price. Our decision was based on the substantial evidence in the record.

26. Accordingly, for the reasons stated in the Order on Paper Hearing and further discussed herein, we find that the Offer of Settlement target capacity price of \$73/kW-yr results in capacity payments that are supported by substantial evidence in the record, and are just and reasonable. Regardless of whether the case record may have supported a range of possible just and reasonable results,<sup>33</sup> the proposed target capacity price was shown to be a just and reasonable component of the RCST payment, and thus we approve it.<sup>34</sup>

### C. Peak Energy Rent Deduction

#### 1. Order on Paper Hearing

27. The Offer of Settlement provided for a peak energy rent deduction, which serves to reduce the payment a generator would receive under the RCST. Peak energy rent equals the revenue a hypothetical reference resource would earn in excess of its variable costs from the sale of energy and non-spinning reserves. The reference resource is assumed to be dispatched for energy whenever the energy price during the month is

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<sup>33</sup> See *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.”). This conclusion represents nothing more nor less than a recognition of the general principle that the Commission has broad authority in selecting methods for determining just and reasonable rates or in choosing a rate among a range of just and reasonable rates. *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.”) (internal citations omitted).

<sup>34</sup> *Conway*, 426 U.S. at 278 (finding that “there is no single cost-recovering rate, but a zone of reasonableness”); 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”).

greater than the reference resource's variable cost. The reference resource variable cost is based on multiple operational characteristics, including a 10,500 BTU/kW-hr heat rate. When not dispatched for energy, the reference resource is assumed to provide non-spinning reserves. The Order on Paper Hearing approved the peak energy rent deduction as part of the Offer of Settlement.<sup>35</sup>

## **2. Requests for Clarification and/or Rehearing**

28. Williams argues that the Commission erred in finding that the Settling Parties justified the proposed peak energy rent deduction. Williams submits that the relatively low heat rate and the purported ability to provide non-spinning reserve result in a rate that is neither balanced nor reasonable.

29. As argued in its original comments, Williams reiterates that the studies and documents that Settling Parties relied upon to support the Offer of Settlement rates are based on a "frame" type unit that is unable to provide non-spinning reserve. Williams argues that if the rates proposed in the Offer of Settlement are to be found just and reasonable, those rates must be based on the installed cost, performance and operating characteristics of an actual, proven unit, not a seemingly "impossible" low-cost, high performance reference resource. Williams submits that the inability of a "frame" type unit to provide ten-minute non-spinning reserves has a significant financial impact on the peak energy rent deduction. It estimates that from July 2006 to December 2006, the ten-minute non-spinning reserves component of the peak energy rent deduction amounted to \$9.37/kW-yr. Williams argues that the Commission should therefore strike the non-spinning reserve component of the peak energy rent deduction from the rate formula. In the alternative, Williams asks that the peak energy rent deduction be modified so that it is comparable to that approved in ISO New England Inc. (ISO-NE). Williams contends that in ISO-NE's Forward Capacity Market, the reference resource has a heat rate of 22,000 BTU/kW-hr – resulting in a smaller deduction for sales of energy – and there is no additional deduction for non-spinning reserves.

## **3. Commission Determination**

30. We do not agree with Williams that the target capacity price in the Offer of Settlement corresponds to a reference resource that cannot provide non-spinning reserves. Williams' argument hinges on the premise that the target capacity price should equal the cost of new entry. As discussed above, we find that the just and reasonable target capacity price is lower than the cost of new entry. We find that Williams has not shown

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<sup>35</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 86-89.

that the target capacity price does not correspond to an *existing* unit that reflects the Offer of Settlement heat rate and is able to provide non-spinning reserve. We reiterate that while the case record may have supported a range of possible just and reasonable proposals, the peak energy rent was shown to be a just and reasonable component of the RCST payment based on the evidence provided in the paper hearing, and thus we have approved it.<sup>36</sup> Accordingly, we deny rehearing on this issue.

**D. Target Availability Factor**

**1. Order on Paper Hearing**

31. The Order on Paper Hearing approved the Settling Parties' proposal for a 95 percent target availability. Resources that exceed the target availability will receive an additional payment for their superior availability while resources that fail to meet the 95 percent availability will be penalized. The Commission found the target availability is a reasonable component of the RCST payment calculation and availabilities higher than the target 95 percent warrant additional compensation based on the enhanced reliability that the resources provide.<sup>37</sup>

**2. Requests for Clarification and/or Rehearing**

32. The CEOB argues that the Commission erred in approving additional payments for RCST capacity availability above 95 percent. The CEOB maintains that providing a bonus payment to RCST capacity for availability greater than 95 percent will not necessarily achieve enhanced reliability. The CEOB argues that there is no mechanism that can verify that RCST capacity not listed as an "Authorized Outage"<sup>38</sup> is actually capable of responding to a dispatch order from the CAISO.

33. The CEOB also argues that the benefits from greater than 95 percent availability have not been demonstrated, maintaining that "[n]owhere in the decision does the Commission (or the Settling Parties) provide a cost-benefit analysis to justify their conclusion that bonus payments will provide sufficient enhanced reliability to California

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<sup>36</sup> *See supra* P 26.

<sup>37</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 97-98.

<sup>38</sup> CEOB Request for Rehearing at 4 (citing Offer of Settlement, Att. A2, § 43.7.1).

ratepayers that outweigh the bonus costs.”<sup>39</sup> The CEOB argues that the Commission’s rationale is based on the assumption that RCST units are “properly maintained,”<sup>40</sup> but “the Commission has no evidence before it as to the kind, or cost of maintenance needed to increase availability to, or above, 95 [percent].”<sup>41</sup> The CEOB contends that some generators may be motivated to forego needed maintenance in order to maximize bonus payments in the short run, which could lead to reduced reliability during times of critical need. Moreover, the CEOB argues that the fact that at 100 percent availability the bonus payment equals just over \$83/kW-yr and is within the range of just and reasonable prices discussed by the Commission in the Order on Paper Hearing is irrelevant to deciding whether availability bonus payments are justified. The CEOB argues that ratepayers should not be charged up to \$83/kW-yr for a service that must be provided to the CAISO at \$73/kW-yr or less.

### 3. Commission Determination

34. We deny the CEOB’s request for rehearing on this issue. We disagree with the CEOB that there is no mechanism by which to verify that RCST capacity is capable of responding to a CAISO dispatch order. The CAISO Tariff contains several provisions that require generators to notify the CAISO of any outages or any other reductions in maximum operating levels and that specify enforcement actions for non-compliance.<sup>42</sup>

35. We further disagree with the CEOB that it is irrelevant whether the RCST payment lies within a just and reasonable range. It is the RCST payment, the actual payment for capacity that generators will receive, that we must approve and find just and reasonable, and not merely one component. At 100 percent availability, the RCST payment reaches its theoretical maximum of \$83/kW-yr. Given that this maximum

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<sup>39</sup> *Id.* at 5.

<sup>40</sup> *Id.* (citing Order on Paper Hearing, 118 FERC ¶ 61,096 at P 98).

<sup>41</sup> *Id.*

<sup>42</sup> *See, e.g.*, CAISO Tariff, §§ 37.2.4, 40.6A.3 and 43.5.1.

capacity payment lies within a just and reasonable range, and that there exists a clear link between higher generator availability and enhanced reliability,<sup>43</sup> we find unnecessary the cost benefit study that the CEOB requests.

36. Finally, we dismiss the CEOB's arguments regarding maintenance as speculative. It provided no evidence to support its assertions. Further, we note that section 37.2.3 of the CAISO Tariff requires generators to undertake operating and maintenance practices "as necessary to avoid contributing to a major outage or prolonging response time . . . ."<sup>44</sup>

## **E. Must-Offer Capacity Compensation**

### **1. Order on Paper Hearing**

37. As set forth in the Offer of Settlement, the RCST provides must-offer capacity compensation to units that are dispatched under the must-offer obligation for reliability purposes and are not currently operating under capacity contracts (*i.e.*, resource adequacy).<sup>45</sup>

38. Under the Offer of Settlement, before issuing a must-offer waiver denial, the CAISO must first exhaust the other reliability resources under contract for capacity (*i.e.*, resource adequacy, RMR and units with system or local RCST designations) available to it. Any unit denied a must-offer waiver that is not under contract for capacity will receive a daily capacity payment equal to 1/17th of the monthly RCST capacity charge for each day that the unit receives a must-offer waiver denial. Additionally, if the CAISO issues a must-offer waiver denial on four separate days in any one-year period, the CAISO will evaluate whether a Significant Event has occurred that warrants an RCST designation for that resource.<sup>46</sup>

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<sup>43</sup> See, e.g., FERC, *Electric Power Market Summary Summer 2006*, at 2, available at <http://www.ferc.gov/market-oversight/reports-analyses/overview/electric-report.pdf>; *ISO New England, Inc.*, 111 FERC ¶ 61,185, at P 32, *order on reh'g*, 112 FERC ¶ 61,254, at P 6, 15 (2005), *pet. for review granted on other grounds sub nom.*, *Conn. Dep't of Public Util. Control v. FERC*, 484 F.3d 558 (D.C. Cir. 2007).

<sup>44</sup> CAISO Tariff, § 37.2.3.

<sup>45</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 15.

<sup>46</sup> *Id.* P 18-19.

## **2. Requests for Clarification and/or Rehearing**

39. Mirant asserts that from June 1, 2006 through August 31, 2006, a number of Mirant's units were issued more than four must-offer waiver denials. Mirant states that these units are non-RMR and Non-Resource Adequacy so they are "Eligible Capacity" under the Offer of Settlement. Mirant notes that the CAISO has not provided a report (as required under section 40.15.4 of the CAISO Tariff) or an explanation as to why such must-offer waiver denials did not result in an RCST designation. Mirant seeks clarification that, pursuant to the RCST tariff sheets as approved in the Order on Paper Hearing, the CAISO must conduct a must-offer waiver denial evaluation whenever a must-offer generator receives a must-offer waiver denial on four separate dates in any calendar year, regardless of whether these must-offer waiver denials occurred prior to issuance of the Commission's approval of the Offer of Settlement. Mirant seeks clarification that the CAISO must comply with the RCST designation provisions of the Offer of Settlement dating back to the June 1, 2006 effective date. Mirant also seeks clarification that nothing in the Offer of Settlement precludes the CAISO from designating a must-offer generator as an RCST resource on an after-the-fact basis if the must-offer waiver denial evaluation warrants said designation.

40. Williams argues that the Commission erred in approving the RCST because the rate structure is inadequate to ensure that the capacity secured under the must-offer obligation is appropriately valued and that must-offer generators are adequately compensated for reliability services they provide. Williams argues that the approved rate structure is unjust and unreasonable because it is only marginally higher than the must-offer obligation rate the Commission found unjust and unreasonable.

41. Specifically, Williams asks that the Commission remove the CAISO's discretion to designate a unit as RCST after the issuance of every four must-offer waiver denials to a unit, and reject the zonal carve-out from the RCST designation process. Williams asks that the CAISO be required to make RCST designations from the effective date of the settlement, June 1, 2006. Williams further asks the Commission to clarify that the CAISO's discretion with regard to RCST Designation is not unbounded.

42. Williams also asks that the Commission require CAISO to provide to the Commission the amounts associated with must-offer waiver denials that the CAISO has actually paid or will actually pay under the Offer of Settlement from the effective date of the settlement forward. Williams asks that the CAISO also be required to provide data concerning what these same generators would have been paid under the former must-offer obligation rate structure. Further, Williams asks that, to the extent the CAISO chooses not to award an RCST designation to a particular unit that has received at least



four must-offer obligation rescinded waivers since June 1, 2006, the CAISO should provide data demonstrating the impact that designation would have had on the amounts paid to the generator.

43. Finally, Williams asks that the Commission clarify that it will actively oversee the implementation of the Offer of Settlement to ensure that the rates produced are consistent with the purpose of this proceeding.

### **3. Commission Determination**

44. We grant clarification sought by Mirant and Williams that RCST tariff provisions became effective June 1, 2006, including provisions relating to the designation of RCST resources. However, we will neither modify the terms of the Offer of Settlement affecting must-offer designations, nor require the CAISO to make RCST designation for zonal reasons.

45. We find that the CAISO has complied with its reporting obligation under the Offer of Settlement in its posting of a report titled “Retroactive RCST Significant Event Summary.”<sup>47</sup> We find the CAISO’s report to be compliant with the reporting requirements established in the Offer of Settlement.

46. Further, we find that there is no record before us to indicate that the procurement of RCST capacity for zonal reasons would necessarily result in additional units being designated as RCST resources or that this modification is necessary to ensure that the RCST tariff provisions remain just and reasonable. As previously noted by the Commission, “the Offer of Settlement represents an agreement among the CPUC, the CAISO, the independent generators and the three largest IOUs in California – parties with divergent interests on the issue of compensation to generators under the must-offer obligation.”<sup>48</sup> The Commission found that the Offer of Settlement provided a just and reasonable solution to the problematic compensation structure of the must-offer obligation.<sup>49</sup> We are not persuaded to change our determination, and we will not require

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<sup>47</sup> See CAISO, *Retroactive RCST Significant Event Summary For period 6/1/06 – 2/28/07*, available at <http://www.caiso.com/1c20/1c20e8373c330ex.html>.

<sup>48</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 48.

<sup>49</sup> *Id.*

the CAISO to file the amount of compensation actually provided under the RCST tariff. That said, we clarify that the CAISO must exercise any discretion under its tariff in a reasonable manner.

47. Finally, we note Williams' concern that the Offer of Settlement has provided "only marginally higher" compensation to units operating without a capacity contract. This is not an appropriate standard for determining the reasonableness of the RCST compensation structure. As discussed in previous sections of this order, we based our finding that the Offer of Settlement was just and reasonable on the substantial evidence in the record. The Commission understands that the CAISO and its stakeholders are working on developing a replacement backstop capacity program for implementation under MRTU.<sup>50</sup> If filed with the Commission, it may be relevant to consider the overall performance of the Offer of Settlement when evaluating the merits of the new proposal.

## **F. Duplicative Must-Offer Capacity Compensation**

### **1. Order on Paper Hearing**

48. Under the Offer of Settlement, a generation unit that is not designated under the RCST and is issued a must-offer waiver denial will receive: (1) a daily capacity payment equal to 1/17 of the monthly RCST payment; (2) start-up and minimum load costs compensation (MLCC); and (3) imbalance energy payments. The generator will continue to receive these amounts for each day it receives a must offer waiver denial until the sum reaches the monthly RCST payment. After this cap is reached, the unit will only receive the MLCC and imbalance energy payments when issued any further must-offer waiver

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<sup>50</sup> On November 30, 2007, Dynegy Moss Landing, LLC, Dynegy Morro Bay, LLC, El Segundo Power LLC and Reliant Energy, Inc. filed with the Commission a complaint against the CAISO alleging that, upon termination of the RCST, the filed rate fails to provide generators subject to the must-offer obligation with just and reasonable compensation for providing reliability services; complainants offer an alternative compensation mechanism. That complaint is pending in Docket No. EL08-13-000.

Moreover, on October 12, 2007, IEP filed with the Commission a motion for reconsideration and clarification of the Commission's grant of an extension of time to the CAISO to file CAISO's Interim Capacity Procurement Mechanism. An order on that motion is being issued concurrently in Docket No. EL08-20-000, *et al.*

denials. The Order on Paper Hearing rejected protests from Six Cities that generators would receive duplicative capacity payments consisting of both an RCST payment and payments for imbalance energy and the MLCC.<sup>51</sup>

## 2. Requests for Clarification and/or Rehearing

49. Six Cities argue that the Order on Paper Hearing failed to respond to their argument that the Offer of Settlement will result in duplicative compensation for generating units dispatched under the must-offer obligation. Six Cities argue that the Commission erred in determining that generating units are entitled to receive both capacity payments under the RCST tariff provisions and payments for MLCC and imbalance energy, which the Commission previously stated included compensation for fixed costs. Six Cities argue that the Order on Paper Hearing agreed with Six Cities' description of the payments to which must-offer obligation units are entitled, but failed to address their contention that "through the payments for imbalance energy and MLCC, [must-offer obligation] units are already receiving the functional equivalent of a capacity payment."<sup>52</sup> Six Cities maintain that "this unsupported ruling is inconsistent with the Commission's prior determination that energy charges compensate [must-offer obligation] units issued [must-offer waiver denials] for the units' fixed costs and the costs associated with standing ready to respond to the CAISO's dispatches as necessary for reliability."<sup>53</sup>

## 3. Commission Determination

50. In support of their argument regarding duplicative compensation, Six Cities cite to a prior Commission finding that:

if generators are dispatched under the must offer obligation, unless it is the marginal costs unit that sets the market clearing price, the generator will receive some contribution to fixed costs . . . . Generators who are dissatisfied with this finding regarding cost recovery of only minimum load status costs may propose cost-based rates for their generating units

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<sup>51</sup> *Id.* P 77.

<sup>52</sup> Six Cities Request for Rehearing at 17.

<sup>53</sup> *Id.* at 18 (citing *Cal. Indep. Sys. Operator Corp.*, 111 FERC ¶ 61,207, at P 23 (2005)).

with cost support including a reasonable rate of return on investment that reflects the unique conditions in California.<sup>54]</sup>

51. The July 20, 2006 Order found that the compensation to generators under the must-offer obligation was no longer just and reasonable, *i.e.*, generators under the must-offer obligation were not receiving sufficient compensation through the MLCC and imbalance energy payments for recovery of their fixed costs.<sup>55</sup> Thus, Six Cities' argument is based on a Commission finding that has been superceded in this respect. We find that the daily capacity payment equal to 1/17 of the monthly RCST payment is therefore intended to supplement, not duplicate, the existing and inadequate compensation methodology under the must-offer obligation.

## **G. Frequently Mitigated Unit Bid Adder**

### **1. Order on Paper Hearing**

52. As set forth in the Offer of Settlement, the RCST tariff provisions compensate resources that are needed to meet short-term reliability requirements but are not designated as RCST units. These include non-resource adequacy frequently mitigated units (FMUs) and are not designated as RCST units and are not eligible for the must-offer capacity payment. These units will be eligible for compensation through the implementation of a "bid adder."<sup>56</sup> The Offer of Settlement includes a \$40 bid adder for FMUs units (FMU bid adders) that have had incremental bids mitigated for local area constraints more than four times in a day and are not receiving other capacity payments under RCST (*i.e.*, must-offer, RMR or resource adequacy). The Settling Parties assert that it is appropriate for a unit whose bid is taken out of merit order to receive a payment in lieu of the capacity payments. Under the Offer of Settlement, the total amount of FMU bid adders for any unit shall not exceed the daily capacity payment equal to 1/17th of the

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<sup>54</sup> *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 99 FERC ¶ 61,159, at 61,641 (2002), *order on reh'g*, 105 FERC ¶ 61,065 (2003), *order on reh'g*, 107 FERC ¶ 61,165, *order on reh'g*, 109 FERC ¶ 61,218 (2004), *order on reh'g*, 110 FERC ¶ 61,336, *order on reh'g*, 112 FERC ¶ 61,226 (2005) (internal citations omitted).

<sup>55</sup> July 20, 2006 Order, 116 FERC ¶ 61,069 at P 36-37.

<sup>56</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 15.

monthly RCST capacity payment. Further, FMUs stop accruing adders in a calendar month once the combined total compensation reaches the maximum monthly RCST payment.<sup>57</sup>

## 2. Requests for Clarification and/or Rehearing

53. The CEOB argues that the Commission erred in approving the FMU bid adder. First, the CEOB argues that the Commission erred in finding that a FMU provides a reliability service similar to that provided through RCST, RMR or must-offer obligation. The CEOB notes, in particular, that while “the purpose of RMR is to insure the availability to the CAISO of units that have local market power without allowing those units to actually exercise their market power . . . the FMU bid adder is nothing more than a unit with local market power that *is* allowed to exercise that power.”<sup>58</sup>

54. Second, the CEOB argues that the Commission erred in making its FMU bid adder determination without the historical data on local market power mitigation. Without this data, the CEOB claims that the Commission cannot reasonably provide estimates of either the number of units, or the total cost to California ratepayers. The CEOB maintains that the FMU provisions in the Order on Paper Hearing will apply to far more units than the definition of FMU that the CAISO has used in the MRTU process. The CEOB notes that while the MRTU process requires units to be dispatched out of sequence in at least 80 percent of the hours, under the FMU bid adder provision units can be classified as frequently mitigated after less than an hour of mitigation. The CEOB concludes that a large number of units may be eligible for the FMU bid adder and that this suggests the potential cost associated with the provision is large.<sup>59</sup> The CEOB claims that the facts vitiate the apparent assumptions underlying the Commission’s approval of the FMU bid adder.

55. Third, the CEOB argues that the Commission erred in finding that compensation is consistent with other capacity payments established under the RCST because the FMU

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<sup>57</sup> *Id.* P 20.

<sup>58</sup> CEOB Request for Rehearing at 6-7 (emphasis in original).

<sup>59</sup> The CEOB supports its conclusion by citing data provided by the CAISO during the MRTU public discussion process. See Jeff McDonald and Keith Casey, CAISO Department of Market Analysis, *MRTU Market Power Mitigation Issues for Resolution* (May 18-19, 2005), available at <http://www.caiso.com/docs/2005/05/17/2005051713281812950ex.html>.

bid adder is derived from a bid that was mitigated due to local market power and can receive payment in excess of the mitigated market clearing price due to the bid adder. The CEOB argues there is no economic justification for the FMU, and the adder “effectively circumvents the purpose of the mitigation process and provides an incentive to market participants to game the system.”<sup>60</sup> The CEOB also argues that the Commission simply pointed to the explanations of the Settling Parties in support of the bid adder and failed to articulate its own reasoning for approval.

56. Six Cities argue that the Commission erred in approving the bid adder for FMUs without addressing Six Cities’ argument that the bid adder is unreasonably high and will apply in inappropriate circumstances. Six Cities maintain that “in addition to being excessive and unlikely to result in greater market efficiencies, [the bid adder] is available to generators even when they are not mitigated ‘frequently.’”<sup>61</sup> Six Cities claim that the Commission did not address that the adder would be applied to generators too often under the definition of “Frequently Mitigated,” and that the Commission did not acknowledge its concerns about cost increases.

### **3. Commission Determination**

57. As explained below, we deny rehearing requests challenging the Commission’s approval of the FMU bid adder. The FMU bid adder is an appropriate mechanism in the CAISO’s current market design to compensate units for the portion of their capacity that is needed for reliability services and that is not operating under a capacity contract.

58. We disagree with the CEOB that the FMU bid adder permits units to exercise local market power. The FMU bid adder is applied after an energy offer is mitigated by the CAISO, and it is the mitigation process that prevents units with local market power from exercising their market power in the energy market. However, the mitigation process does not consider whether the unit being mitigated is operating under a capacity contract or whether the unit is eligible for a RCST must-offer capacity payment. If a unit is not otherwise eligible for a capacity contract but is providing similar reliability services as other units with capacity contracts, it would be inappropriate to exclude the uncontracted unit from a compensatory capacity payment. The FMU bid adder is a reasonable mechanism to provide such units with a compensatory capacity payment for the services they provide.

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<sup>60</sup> CEOB Request for Rehearing at 8.

<sup>61</sup> Six Cities Request for Rehearing at 19-20.

59. In its determination, the Commission noted that the application of the bid adder should be limited since units operating under a capacity contract will not be eligible for the FMU bid adder. Ultimately, all the units needed for reliability services should be designated as resource adequacy resources. If the situation arises in which the CAISO needs an additional unit operating without a capacity contract, this does not indicate the FMU bid adder provision is flawed. Instead, it may indicate that resource adequacy requirements may need to be modified.

60. We also disagree with CEOB that the FMU bid adder circumvents the CAISO's mitigation process. As noted above, the mitigation process does not consider whether a particular unit is eligible for capacity compensation under the FMU bid adder provision. Further, there is no relationship between the price level of unmitigated energy offers and the compensation received under the FMU bid adder provision. Instead, as noted in the Order on Paper Hearing, the compensation received under the FMU bid adder "stop[s] accruing in any calendar month once the combined value reaches the level of the monthly RCST capacity payment."<sup>62</sup> By limiting compensation under the FMU bid adder to an amount equal to or less than the compensation received under other capacity related provisions, we find that the compensation received under FMU bid adder is consistent with other RCST capacity payments.

61. Moreover, as noted in the Order on Paper Hearing, the FMU bid adder does not set the market clearing price, and therefore, the compensation provided by the provision is unit specific.<sup>63</sup> In contrast, the MRTU bid adder is eligible to set the clearing price, which will potentially impact the energy revenue received by multiple units, including units that are operating under a capacity contract. Therefore, it is inappropriate to compare the FMU bid adder to the MRTU bid adder and to conclude that the FMU bid adder will be applied too frequently relative to the MRTU bid adder.

## **H. Issues Relating to Participating Load**

### **1. Order on Paper Hearing**

62. The Offer of Settlement included provisions for allocating the costs associated with RCST capacity payments. The Offer of Settlement allocated the cost of RCST capacity designated for LSEs with deficient resource adequacy demonstrations to the LSEs that are deficient. The Offer of Settlement proposed to allocate costs incurred for

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<sup>62</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 177.

<sup>63</sup> *Id.*

local RCST designations triggered by a Significant Event to all Scheduling Coordinators for LSEs in the transmission access charge area in which the Significant Event occurred. The Offer of Settlement proposed to allocate capacity payments associated with units that receive a must-offer waiver denial in a manner consistent with the Commission's decision in the Amendment No. 60 proceeding.<sup>64</sup> The Offer of Settlement proposed to allocate costs associated with FMU bid adders using the grid operations charge methodology.

## 2. Requests for Clarification and/or Rehearing

63. SWP argues that the Commission erred in finding that capacity costs must be allocated in the same manner as energy costs such as start-up and minimum load costs because such a finding failed "to recognize the long-established distinction between capacity or demand charges and energy or volumetric charges."<sup>65</sup> SWP argues that there is a fundamental difference between capacity costs, which are ordinarily allocated to customers based on their contribution to the coincident peak, and energy costs, such as Amendment No. 60 minimum load and must-offer costs. SWP maintains that capacity costs are not allocated using the same methodology as energy costs and argues that the Commission erred in approving use of the Amendment No. 60 method to allocate must-offer capacity costs.

64. SWP argues that:

to the extent that the Order [on Paper Hearing] at P 132 found that all RCST costs, including must-offer capacity costs, were just and reasonable because they were to be allocated on a coincident peak basis, SWP seeks immediate action on rehearing to reverse the contrary finding in P 125. If the Order did not so intend, then as discussed below, it should be reversed on rehearing because, among other things, it failed to address SWP's allegations "that the proposal to socialize

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<sup>64</sup> *Id.* P 27; *see Cal. Indep. Sys. Operator Corp.*, 113 FERC ¶ 63,017 (2005), *aff'd in part and rev'd in part*, 117 FERC ¶ 61,348 (2006), *order on reh'g*, 121 FERC ¶ 61,193 (2007).

<sup>65</sup> SWP Request for Rehearing at 25.



*must-offer capacity costs* across all hours is not just and reasonable because fact, precedent, and policy support a coincident peak cost allocation.”<sup>66]</sup>

65. SWP argues that, assuming the Order on Paper Hearing intended to use Amendment No. 60 to allocate must-offer capacity costs, it ignores the uncontested, overwhelming evidence supporting a coincident peak allocation. According to SWP, this evidence includes: (1) RCST capacity costs are incurred to meet peak loads; (2) time-sensitive cost allocation is necessary for demand to respond to price signals, and reduce the need for reliability generation capacity incentivized through RCST; and (3) the Settling Parties’ own testimony provides substantial evidence supporting time-sensitive – and not socialized – cost allocation.

66. Further, SWP argues that concluding that SWP’s advanced transmission technology, such as curtailable loads and pump-hydro, contribute to RCST capacity payments for other, competing, peak resources was in error. First, SWP argues that this unduly discriminates against SWP’s pump storage generators and curtailable loads by burdening those off-peak pump loads – which provide on-peak capacity and energy to the grid – with RCST capacity payments offered as “economic incentives” to competing generators meeting the same coincident peak needs. Moreover, SWP argues that this violates the Energy Policy Act of 2005’s (EPAAct 2005) mandate that FERC “shall encourage, as appropriate” advanced transmission technologies including curtailable load and pump-hydro.<sup>67</sup>

67. SWP claims that CAISO-specific precedent and practice support distinct allocation of capacity and energy costs. Moreover, SWP states that it is “[c]ommon practice in ISO[s]/RTOs with vibrant demand response programs [to] allocate[] responsibility for reliability capacity costs based on a market participant’s contribution to system peak.”<sup>68</sup> SWP states that the ISOs/RTOs in the east define capacity that account for a load serving entity’s coincident peak loads and allocate energy costs on deviations and/or pro rata load. SWP argues that the Order on Paper Hearing’s failure to give consideration to time-sensitive rates, necessary to send price signals to elicit demand response was in error.

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<sup>66</sup> *Id.* at 41-42 (emphasis in original).

<sup>67</sup> *Id.* at 59-60 (citing EPAAct 2005 at § 1223).

<sup>68</sup> *Id.* at 35.

68. Finally, SWP also argues that the Commission erred in its reliance on the Amendment No. 60 proceeding and not the record in the instant docket. SWP maintains that the Commission failed to satisfy due process and substantial evidence requirements by using the Amendment No. 60 record, while disregarding the record developed in this docket and impermissibly disregarded evidence in this docket indicating that the CAISO is not, in fact, actually applying Amendment No. 60 cost allocation to RCST must-offer capacity costs. SWP states that the Commission's action "leads to the conclusion that the entire evidentiary hearing in this docket has been impermissibly treated as a throw away gesture with respect to the question of RCST capacity cost allocation."<sup>69</sup>

### 3. Commission Determination

69. We deny SWP's request for rehearing on the allocation of RCST must-offer capacity costs. As explained in the Order on Paper Hearing, the cost allocation methodologies established in the Amendment No. 60 proceeding are a reasonable means to allocate RCST costs relating to the dispatch of units under the must-offer obligation. Specifically, we find it reasonable to do so because the same reasons that give rise to the costs considered in the Amendment No. 60 proceeding also give rise to the incurrence of RCST must-offer capacity costs.

70. The Commission recognized the different reasons for incurring RCST capacity procurement costs and accepted each corresponding cost allocation methodology. As explained in the Order on Paper Hearing, RCST capacity costs procured on behalf of LSEs that are short of meeting their resource adequacy requirements and RCST costs procured as a result of a Significant Event are allocated based on a coincident peak.<sup>70</sup> The coincident peak methodology is used to allocate such costs in part because these costs relate to the forward procurement of capacity that is designated to meet ongoing reliability needs. On the other hand, RCST costs related to the must-offer obligation are related to daily operational decisions that result in the dispatch of a particular unit to meet daily reliability needs. It is consistent to allocate these costs based on the methodologies established in the Amendment No. 60 proceeding.

71. For example, the reasons for incurring must-offer capacity costs can be related to system contingencies that can occur at any time during a day and that are not necessarily related to the overall demand on the CAISO's system.<sup>71</sup> In the Amendment No. 60

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<sup>69</sup> *Id.* at 79-80.

<sup>70</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 132.

<sup>71</sup> *See Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,193 at P 89, 100.

proceeding, the Commission found that the CAISO's non-time sensitive rate design is just and reasonable.<sup>72</sup> In this proceeding, we again find that it is reasonable to allocate RCST must-offer costs in a manner consistent with Amendment No. 60.

72. We note that the Commission has previously rejected SWP's argument that allocating costs in a manner consistent with Amendment No. 60 is inappropriate because the resultant price signals do not adequately elicit demand response.<sup>73</sup> We find that SWP has not provided any new support for its proposal, and, therefore, we deny SWP's request for rehearing on this issue.

73. Finally, regarding SWP's claim that the Commission erred in its reliance on the Amendment No. 60 proceeding, we disagree. Our consideration of that proceeding is appropriate because that is the cost allocation methodology proposed by the Settling Parties. Additionally, for reasons stated above, we find that the cost allocation method proposed by the Settling Parties is not in violation of any mandate in EPAct 2005 that the Commission "shall encourage" advanced transmission technologies.

**I. Issues Relating to Existing Transmission Contracts and Metered Subsystem Agreements**

**1. Existing Transmission Contracts**

74. SWP argues that the Order on Paper Hearing approves duplicative allocation of RCST capacity costs to SWP's Existing Transmission Contract (ETC) service, even though SWP's highest priority firm ETC specifically calls for back-up generation redispatch superior to CAISO reliability services. SWP asks that the Commission refrain from allocating any RCST capacity costs to firm ETC service that already specifically calls for back-up generation to firm up transmission service.

75. SWP maintains that the Order on Paper Hearing's allocation of RCST costs to ETC service was in error because it relied on erroneous factual assumptions based on CAISO's misrepresentation of SWP's filed contract rights, neglected to apply or distinguish applicable precedent which prohibits imposition of any RCST costs, including must-offer, Significant Event, or any other capacity costs, upon ETC service, absent

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<sup>72</sup> *Id.* P 100.

<sup>73</sup> *Id.* P 99-101.

contract revision and unduly discriminated against SWP's demand-based reliability services provided under the ETC—which are not compensated with the firm service contracted for—by allocating RCST capacity costs to SWP's ETC service.

## 2. Metered Subsystem Agreements

76. SVP argues that the Commission erred in failing to exclude RCST rates to SVP and other CAISO customers that meet reliability requirements through load-following under Metered Subsystem (MSS) agreements. SVP argues again that it is “an unreasonable double charge to allocate RCST costs to load-following MSS customers, such as SVP.”<sup>74</sup> SVP argues that the Commission erred in making a distinction between scheduling deviations and the need for backstop procurement because the MSS governs advance planning as well as scheduling deviations. SVP also argues that the Commission erred in failing to recognize the additional costs imposed on load-serving MSS agreements by RCST, in addition to MSS penalties. SVP maintains that “[b]ecause of their unique obligations to meet load or face severe financial penalties . . . load-following MSS customers are operating under a higher standard of reliability requirements than non-MSS Load Serving Entities in the ISO.”<sup>75</sup> Accordingly, SVP asks that “no RCST costs shall be allocated to SVP or any other load-following MSS Operator because the MSS agreement governs SVP's reliability responsibilities, and imposes existing reliability costs on SVP.”<sup>76</sup>

## 3. Commission Determination

77. Regarding the potential allocation of RCST costs to ETCs, the Commission denies SWP's rehearing request. As explained in the Commission's Order on Paper Hearing, there are only two types of RCST costs that could apply to load served by ETCs.<sup>77</sup> First, the allocation of costs associated with must-offer capacity payments has been determined by the Amendment No. 60 proceeding. In that proceeding, the Commission found that it is appropriate for ETC customers to be assigned a portion of the costs incurred under the must-offer obligation.<sup>78</sup> The RCST adopts the Amendment No. 60 cost allocation

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<sup>74</sup> SVP Request for Rehearing at 5 (internal citation omitted).

<sup>75</sup> *Id.* at 7.

<sup>76</sup> *Id.* at 10.

<sup>77</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 149.

<sup>78</sup> *Cal. Indep. System Operator Corp.*, 121 FERC ¶ 61,193 at P 39.

methodology for the allocation of RCST must-offer capacity costs because RCST must-offer capacity costs are incurred for the same reasons as costs addressed in the Amendment No. 60 proceeding.<sup>79</sup>

78. Second, RCST costs associated with a Significant Event will be incurred only in the event of an unpredictable change in the CAISO's transmission system. Accordingly, the reliability resources designated prior to a Significant Event may no longer be sufficient to avoid the curtailment of existing transmission rights. The Significant Event provision provides the CAISO with a tool to compensate units that provide reliability services after the occurrence of such an event. The corresponding costs help to permit the continuation of existing transmission rights. Accordingly, in the event that a Significant Event occurs, it is appropriate to allocate a proportion of the costs incurred for maintaining transmission rights to all transmission right holders, because it is the holders of these rights that benefit from the continuation of their transmission service.

79. Finally, as to the allocation of RCST costs to MSS, in the Order on Paper Hearing, the Commission explained that the RCST "alters neither the contractual terms of the MSS agreements nor the financial penalties under the MSS agreements associated with scheduling deviations during real-time operations."<sup>80</sup> To the extent that SVP maintains its resource adequacy requirements established by its own Local Regulatory Authority, SVP will not incur *any* RCST procurement costs relating to resource adequacy deficiencies. To the extent SVP utilizes the CAISO transmission system, the MSS agreement will continue to govern the allocation of reliability-related costs.

The Commission orders:

(A) The requests for rehearing of the Order on Paper Hearing are hereby denied, as discussed in the body of this order.

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<sup>79</sup> Order on Paper Hearing, 118 FERC ¶ 61,096 at P 125.

<sup>80</sup> *Id.* P 158.

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(B) The requests for clarification of the Order on Paper Hearing are granted in part and denied in part, as discussed in the body of this order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.