

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

<b>California Independent System Operator Corporation</b>	)	
	)	<b>Docket No. ER04-835-000</b>
<b>Pacific Gas and Electric Company</b>	)	
	)	
<b>v.</b>	)	<b>Docket No. EL04-103-000</b>
	)	<b>(consolidated)</b>
<b>California Independent System Operator Corporation</b>	)	
	)	

**REQUEST FOR REHEARING AND CLARIFICATION OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 251 (a) (2001), and Rules 212 and 713 of the Commission’s Rules of Practice and Procedure 18 C.F.R. §§ 385.212 and 385.713 (2006), the California Independent System Operator Corporation (“CAISO”)<sup>1</sup> hereby submits this Request for Rehearing and Clarification of the Commission’s Opinion No. 492 issued on December 27, 2006, *California Independent System Operator Corp.*, 117 FERC ¶ 61,348 (2006) (“Opinion No. 492”), concerning Amendment No. 60 to the ISO Tariff. The CAISO generally supports the Commission’s findings in Opinion No. 492 but seeks rehearing on one issue that has the potential to limit the scope and effectiveness of the must-offer obligation so substantially as to turn the Commission-imposed “must-offer” obligation – an obligation

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<sup>1</sup> Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

imposed on generators – into a “must-waive” obligation on the CAISO. Narrowing the must-offer obligation to only those resources needed for Energy in real-time is inconsistent with the scope of the must-offer requirement and the ISO Tariff language, which allows the CAISO the discretion to grant waivers to resources that are not needed to provide sufficient on-line capacity to meet operating reserve requirements. To the extent Opinion No. 492 was not intended to prevent the CAISO from denying must-offer waiver requests as needed to provide sufficient on-line capacity to meet operating reserve requirements, the CAISO requests clarification that the CAISO can continue to exercise its discretion to deny must-offer waiver requests to meet these requirements.

The CAISO also seeks clarification, or in the alternative rehearing, that the CAISO may use estimated Start-Up and Emissions Costs related to must-offer waiver denials in allocating such costs to Market Participants.

#### **I. REQUESTS FOR CLARIFICATION AND SPECIFICATION OF ERROR**

The CAISO respectfully submits that Opinion No. 492 erred in the following respects:

- The Commission erred in making arbitrary and contradictory findings that: (1) the CAISO has “sole discretion” to grant exemptions from the must-offer requirement and that approved ISO Tariff language provides that such “exemptions will be granted so as to provide sufficient on-line generating capacity to meet operating reserve requirements,” but (2) the CAISO does not have “the authority to deny exemption from the must-offer obligation in anticipation of a shortage of ancillary services or otherwise commit any generating unit to provide ancillary services.”

- The Commission erred in substantially narrowing the scope of the must-offer obligation under the ISO Tariff by requiring, without explanation, that the CAISO must grant exemptions from the must-offer obligation in all circumstances except when the CAISO anticipates that Energy from a generator subject to the obligation will be needed in real-time.
- The Commission erred in rejecting the CAISO’s authority under previously-approved ISO Tariff language to deny exemptions from the must-offer obligation to provide sufficient on-line generating capacity to meet operating reserve requirements without finding that the previously-approved Tariff language is unjust and unreasonable.
- To the extent the Commission does not grant the clarification requested herein, the Commission erred in finding that the allocation of Emissions and Start-Up Costs associated with Must-Offer Waiver Denials may not be based on cost estimates rather than actual costs.

## II. BACKGROUND

The Commission imposed the must-offer obligation in 2001 “to ensure that all units that are able to run but are not already scheduled to run (with the exception of hydroelectric power . . .) are in fact made available to the ISO in the real-time market.” *San Diego Gas & Elec. Co. v. Sellers of Ancillary Services*, 95 FERC ¶ 61,115 at 61,357 (2001) (“April 26, 2001 Order”).

The Commission subsequently approved, in relevant part, the CAISO’s January 25, 2002 compliance filing of ISO Tariff provisions to implement the process by which Generators can request waiver of the must-offer obligation.<sup>2</sup> Specifically, the Commission approved provisions originally set forth in Section 5.11.6 of the ISO Tariff which remain in the ISO Tariff today:

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<sup>2</sup> The terms “waiver” of the must-offer obligation and “exemption” from the must-offer obligation are used interchangeably in the Commission’s orders and in this filing.

The Commission's April 26 Order set forth that the purpose of the Must-Offer Obligation is to ensure that all units that are able to run but are not already scheduled to run are made available to the ISO in the real-time market. The Must-Offer Obligation is designed to ensure that the ISO will be able to call upon available resources in the real-time market to the extent energy is needed. A generator that has available energy in real time should be willing to sell that energy since it has no alternative purchaser. Additionally, the Commission noted that the Must-Offer Obligation should provide the ISO adequate capacity to help meet operating requirements.

In conditionally approving the ISO's proposed exemption procedures from the Must-Offer Obligation, the Commission intended to assist generators with long start-up times and high Minimum Load Costs and to provide flexibility to the ISO regarding the balancing of load and resources. Therefore, we find the ISO's proposal that exemptions will be granted so as to (1) provide sufficient on-line generating capacity to meet operating reserve requirements; and (2) to account for other physical operating constraints of generating units reasonable.

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With respect to the ISO's Tariff provision that such exemptions be granted by the ISO at its sole discretion, we find this provision not unreasonable as such discretion is reviewable by the Commission. Generators can file complaints if they believe the ISO has used its discretion in an arbitrary or discriminatory manner.

*San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.*, 99 FERC ¶ 61,158 at 61,630 (2002) (footnotes omitted) (“May 15, 2002 Order”).

On May 11, 2004, the CAISO filed Amendment No. 60 to the ISO Tariff in Docket No. ER04-835-000. In Amendment No. 60, the CAISO proposed modifications to provisions of its Tariff related to the implementation of the must-offer obligation, including certain modifications to the process for granting or denying waivers of the must-offer obligation, modifications to the CAISO's allocation of must-offer costs, and the establishment of conditions under which Condition 2 Reliability Must Run (“RMR”) units could be compelled to provide energy-related products and services other than pursuant to the RMR Contract. On May 18, 2004, Pacific Gas and Electric Company (“PG&E”) filed a complaint in Docket No. EL04-103-000 against the

CAISO alleging that the CAISO's methodology for allocating must-offer obligation costs to PG&E was unjust, unreasonable, and unduly discriminatory.

Long Start Generators that request, and are denied, a waiver of the must-offer obligation are paid Minimum Load Cost Compensation ("MLCC"). *California Independent System Operator Corp.*, 108 FERC ¶ 61,022 at P 82 (2004). In Amendment No. 60, the CAISO proposed to amend its Tariff to allocate the costs in three buckets, according to the nature of the reason for the denial of the waiver: local, zonal, or system.<sup>3</sup> Two of the criteria for assigning waiver denials to particular buckets concern the allocation of MLCC costs when the CAISO denied waivers because of an anticipated shortage of Ancillary Services. If the CAISO were procuring Ancillary Services zonally at that time, the MLCC costs would be allocated zonally; if the procurement were on a system basis, the allocation would be on a system basis.

The additions to the ISO Tariff proposed in Amendment No. 60 resulted in the following ISO Tariff language concerning the grant and denial of must-offer waivers being moved from Section 5.11.6 of the ISO Tariff to a new Section 5.11.6.2:

The ISO shall grant waivers so as to: (1) provide sufficient on-line generating capacity to meet operating reserve requirements; and (2) account for other physical operating constraints, including Generating Unit minimum up and down times.

This Tariff language, which was previously approved in the Commission's May 15, 2002 Order was not modified in Amendment No. 60.<sup>4</sup>

On July 8, 2004, the Commission issued orders consolidating the two dockets, accepting Amendment No. 60 subject to modification, and setting the issue of the allocation must-offer obligation costs for hearing. *See California Independent System Operator Corp.*, 108 FERC

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<sup>3</sup> See Transmittal Letter for Amendment No. 60, at 31-36.

<sup>4</sup> Since Amendment No. 60 was filed, this language has been moved to another location in the current ISO Tariff – Section 40.9 – without substantive modification.

¶ 61,017 (2005) and *California Independent System Operator Corp.*, 108 FERC ¶ 61,022 (2005).

With two exceptions unrelated to the must-offer provisions concerning operating reserves, the Commission accepted the other ISO Tariff revisions in Amendment No. 60. 108 FERC ¶ 61,022 at Ordering Paragraph A.

The hearing took place in the consolidated proceedings from June 28 through July 19, 2005. Presiding Administrative Law Judge H. Peter Young issued his Initial Decision on October 31, 2005.<sup>5</sup> The Initial Decision generally upheld the CAISO's proposed cost allocation but found, however, that the CAISO lacked the authority to deny waivers because of an anticipated lack of ancillary services. The abbreviated discussion can be reproduced in whole:

I find and conclude that ISO has “utterly” failed to establish that it has any authority whatsoever to commit must-offer generation to provide ancillary services. Despite ISO's assertions, I find no such authority in the tariff. ISO merely cites Amendment No. 60 itself, apparently taking the position that proposing to grant itself authority to commit must-offer generation to provide ancillary services actually confers that authority. Such claims merit no discussion. ISO should not be permitted to circumvent and expand the ancillary services market by abusing the must-offer obligation to force generators into a position where they have no rational choice but to offer into that market.

Initial Decision at P 138.

The Commission's order on the Initial Decision was issued on December 27, 2006.

### **III. CAISO AUTHORITY TO TAKE INTO ACCOUNT THE NEED FOR GENERATING CAPACITY TO MEET OPERATING RESERVE REQUIREMENTS IN DETERMINING WHETHER TO ISSUE MUST-OFFER WAIVERS**

#### **A. The Commission's Findings in Opinion No. 492 Are Contradictory**

Opinion No. 492 first acknowledges that the CAISO has the authority under approved provisions of the ISO Tariff to grant must-offer waiver or exemption requests so as “to provide sufficient on-line generating capacity to meet operating reserve requirements” but then makes the

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<sup>5</sup> *California Independent System Operator Corp.*, 113 FERC ¶ 63,017 (2005).

contradictory finding that the CAISO does not have the authority to deny must-offer waiver or exemption requests “in anticipation of a shortage of ancillary services.” Opinion No. 492 at P 111. These findings are inherently contradictory because operating reserves are ancillary services.

Specifically, Opinion No. 492 states:

The tariff language approved by the Commission [in 2002] . . . states that exemptions will be granted so as to provide sufficient on-line generating capacity to meet operating reserve requirements and to account for other physical operating constraints of generating units. In the Amendment No. 60 Hearing Order, the Commission accepted the transfer of this authority from CAISO tariff section 5.11.6 to section 5.11.6.2. The Commission has found it reasonable that the CAISO provide such exemptions at its sole discretion since such discretion is reviewable by the Commission.<sup>6</sup>

Opinion No. 492 goes on to state:

However, approval of this tariff provision did not include the authority to deny exemption from must-offer obligation in anticipation of a shortage of ancillary services or otherwise commit any generating unit to provide ancillary services. Additionally, the CAISO has not cited to any pre-existing tariff language that supports this position. Accordingly, the CAISO would need to file a tariff amendment under section 205 to propose language that would provide the appropriate authority to deny must-offer obligation waivers in anticipation of a shortage of ancillary services because the current tariff does not include this authority.<sup>7</sup>

“Operating Reserves” are defined in the ISO Tariff as “The combination of Spinning and Non-Spinning Reserve required to meet WECC and NERC requirements for reliable operation of the ISO Control Area.”<sup>8</sup> Spinning Reserve and Non-Spinning Reserve are two of the six Ancillary Services defined in the ISO Tariff. These definitions highlight the contradiction in

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<sup>6</sup> Opinion No. 492 at P 111, *citing* 108 FERC ¶ 61,022 at Ordering Paragraph (A) and May 15, 2002 Order, 99 FERC ¶ 61,158 at 61,630.

<sup>7</sup> Opinion No. 492 at P 111.

<sup>8</sup> Operating Reserves under the WECC Minimum Operating Reliability Criteria are the equivalent of the ISO’s Regulation, Spinning Reserves, and Non-Spinning Reserve Ancillary Services. Tr. 737 (CAISO Witness Bodine). As noted in the CAISO’s November 30, 2005 Brief on Exceptions in this proceeding, the CAISO would not deny waivers because of an anticipated shortage of Regulation because of the specific requirements for the provision of Regulation. November 30, 2005 Brief on Exceptions at 6 n.4.

Opinion No. 492. In essence, Opinion No. 492 states that the CAISO has the authority to grant must-offer exemptions so as to provide sufficient on-line generating capacity to meet Operating Reserve requirements, but does not have the authority to deny exemption from the must-offer obligation in anticipation of a shortage of Operating Reserves (*i.e.*, a shortage of certain Ancillary Services).

Opinion No. 492's finding that the CAISO does not have the authority to deny waivers from must-offer obligation in anticipation of a shortage of ancillary services is inconsistent with the ISO Tariff language originally contained in Section 5.11.6 and then moved by Amendment No. 60, without substantive modification, to Section 5.11.6.2. Specifically, Section 5.11.6.2 states, *inter alia*, that "[t]he ISO shall grant waivers so as to: (1) provide sufficient on-line generating capacity to meet operating reserve requirements . . . ." This language expressly provides that the CAISO should not grant, *i.e.*, it should deny, a must-offer waiver request if the CAISO believes that it will have shortage of certain ancillary services that will prevent the CAISO from meeting operating reserve requirements. Moreover, the Commission has also found in the May 15, 2002 Order, and confirmed again in Opinion No. 492, that the CAISO may decide whether to grant or deny must-offer waiver requests "at its sole discretion." By rejecting the CAISO's authority to deny must-offer waiver requests in anticipation of a shortage of operating reserves, *i.e.* a shortage of certain ancillary services, however, Opinion No. 492 substantially limits the CAISO's discretion.

Opinion No. 492 is correct insofar as it finds that the CAISO has no authority to force Generating Units to bid into Ancillary Service markets through the must-offer process. Throughout the course of the Amendment No. 60 proceedings, the CAISO has never asserted that the must-offer requirement provides authority to the CAISO to compel Generating Units to



submit bids into the Ancillary Services markets, and the CAISO has never directed a resource to submit bids. Resources that are denied must-offer waiver requests should have an economic incentive to submit bids in the Ancillary Services markets. Even if they do not, however, the denial of must-offer waiver requests ensures that there is adequate capacity on-line that can be dispatched in an emergency under the ISO Tariff if the shortage of Ancillary Services materializes.

The CAISO generally commits units to meet operating reserve requirements through its Ancillary Services markets. Under the Tariff revisions accepted in Amendment No. 60, Generating Units that are denied must-offer waivers may bid into the Ancillary Service markets and, if their bids are accepted, do not forfeit payment of MLCC costs. *See California Independent System Operator Corp.*, 108 FERC ¶ 61,022 at PP 83, 87-88. Thus, where there is insufficient on-line capacity to meet operating reserve requirements, the CAISO could issue must-offer waiver denials in the reasonable expectation that most, if not all, of the Generating Units for which denials are issued will bid their uncommitted capacity into the Ancillary Services markets *even though they are not required to do so*. Such a response would relieve the CAISO's anticipated shortage of Ancillary Services. In the event that a Generating Unit has been denied a requested must-offer waiver so that the CAISO can ensure sufficient on-line generating capacity to meet operating reserve requirements and does not bid into the Ancillary Service markets, the CAISO would still have the option to call upon the Generating Unit for Energy under the must-offer obligation or otherwise as needed to address System Emergency conditions under the ISO Tariff, including those that might arise if there are insufficient operating reserves in the CAISO's market.<sup>9</sup> Ensuring that generating capacity is available to address reliability concerns in this manner is consistent with the Commission's previous finding

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<sup>9</sup> *See* Section 7.4 of the ISO Tariff.

“that the Must-Offer Obligation should provide the ISO adequate capacity to help meet operating requirements.”<sup>10</sup> This does not, however, mean that the CAISO’s authority to deny must-offer waiver requests compels such Generating Units to bid into the Ancillary Service markets.

Opinion No. 492 states that “the CAISO has not cited to any pre-existing tariff language that supports [the] position” that the CAISO has “the authority to deny exemption from must-offer obligation in anticipation of a shortage of ancillary services”). Opinion No. 492 at P 111. This is incorrect. In its November 30, 2005 Brief on Exceptions in this proceeding, the CAISO explained that its authority to deny requested must-offer waivers in anticipation of a shortage of operating reserves and, therefore certain ancillary services, is specified in the language of Section 5.11.6.2 of the ISO Tariff. The CAISO also explained that, although this language was included in Amendment No. 60, the substance of Section 5.11.6.2 predated Amendment No. 60. Indeed, the Commission specifically approved this language in 2002, two years before the filing of Amendment No. 60: “we find the ISO's proposal that exemptions will be granted so as to (1) provide sufficient on-line generating capacity to meet operating reserve requirements; and (2) to account for other physical operating constraints of generating units reasonable.” May 15, 2002 Order, 99 FERC ¶ 61,158 at 61,630.

In any event, the pre-existing ISO Tariff language moved to Section 5.11.6.2 in Amendment No. 60 (and is currently found in Section 40.9 of the current ISO Tariff (*i.e.* the simplified and reorganized ISO Tariff) was accepted by the Commission in the July 8, 2004 Order on Amendment No. 60; it was not set for hearing. *See California Independent System Operator Corp.*, 108 FERC ¶ 61,022 at Ordering Paragraph (A). There is thus nothing improper or illogical about the CAISO’s continued reliance upon this language as the basis for its authority to deny must-offer waiver requests in anticipation of a shortage of operating reserves, including

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<sup>10</sup> May 15, 2002 Order, 99 FERC ¶ 61,158 at 61,630.

those Ancillary Services – Spinning and Non-Spinning Reserves – defined as Operating Reserves under the ISO Tariff.

**B. The Commission’s Findings In Opinion No. 492 Substantially Limit the Scope of the Must-Offer Obligation**

The effect of Paragraph 111 of Opinion No. 492, if not reversed, would be to turn the must-offer obligation on its head. The must-offer obligation requires must-offer generators to be on-line unless granted a waiver; Paragraph 111 would require the CAISO to grant must-offer waivers except in certain limited circumstances. This is contrary to the broad scope of the must-offer obligation in the ISO Tariff and as directed in prior Commission orders. There is no provision in the ISO Tariff for the CAISO to deny waivers for any particular reason. The simple reason for this is that generators have no entitlement to waivers under specific circumstances. Under the approved provisions of the ISO Tariff, as explicitly endorsed by the Commission, the grant of waivers is in the CAISO’s sole discretion, subject to Commission oversight. *See San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.*, 99 FERC ¶ 61,658 at 61,630. The CAISO does not need specific authority to decline to exercise its discretion to grant must-offer waivers, it only need exercise its discretion in a reasonable and non-discriminatory manner. The must-offer obligation applies to every generator (other than hydro units) at all times *regardless of whether the CAISO's has identified a need for the resource* and even if a resource is not needed for either Energy or Ancillary Services, *unless* the CAISO elects to grant a requested waiver.

The finding that the CAISO does not have the authority to deny waivers from the must-offer obligation in anticipation of a shortage of ancillary services would only make sense if the must-offer obligation applied solely to the more limited universe of resources that the CAISO concludes would actually be required to generate Energy in real-time. Such an interpretation

would prevent the CAISO from relying on the must-offer obligation to fulfill one of the original purposes of this requirement, to “provide the ISO adequate capacity to help meet operating requirements.” May 15, 2002 Order, 99 FERC ¶ 61,158 at 61,630.

For all intents and purposes, Opinion No. 492 subjects the CAISO for the first time to a “must-waiver obligation.” This new obligation requires the CAISO to waive the must-offer requirement unless the CAISO determines that a generator is needed to provide Energy in real-time. If the CAISO wants to rely upon the must-offer obligation for any purposes other than a known need for real-time Energy, Opinion No. 492 would require that the CAISO must file new tariff language.

The limitation on the scope of the must-offer obligation and the new requirement that CAISO grant must-offer waivers except in certain circumstances substantially limits the effectiveness of the must-offer obligation. Contrary to long-standing Commission precedent, the CAISO can no longer rely on the must-offer obligation to meet operating reserve requirements established by the WECC and NERC for reliable operation of the ISO Control Area. The CAISO does not believe that the Commission intended to so limit the effectiveness of the must-offer obligation to ensure that reliability requirements can be satisfied. The Commission should therefore reverse Paragraph 111 of Opinion No. 492 and find that the CAISO has the authority to deny waivers from the must-offer obligation in anticipation of a shortage of ancillary service capacity to meet operating reserve requirements or, indeed, any other reliability need.

**C. The Commission Has Failed to Find That the Approved ISO Tariff Language Granting the CAISO Authority to Take into Account the Need for Generating Capacity to Meet Operating Reserve Requirements in Determining Whether to Grant Must-Offer Waivers Is Unjust and Unreasonable**

As discussed above, the Commission expressly approved as reasonable the language in the ISO Tariff confirming the CAISO’s authority to take into account the need for “sufficient on-line generating capacity to meet operating reserve requirements” in determining whether to grant a requested must-offer waiver.<sup>11</sup> The Commission again accepted that language in its order setting Amendment No. 60 for hearing.<sup>12</sup>

Although Opinion No. 492 purports to re-affirm this language, in practice, the Order’s finding that the CAISO does not have the authority to deny waivers from the must-offer obligation in anticipation of a shortage of ancillary services prevents the CAISO from exercising its authority under the plain meaning of this Tariff language. As such, Opinion No. 492 has the practical effect of rejecting the previously-approved language in the ISO Tariff that, “The ISO shall grant waivers so as to: (1) provide sufficient on-line generating capacity to meet operating reserve requirements . . . .”

Pursuant to Section 206 of the Federal Power Act, the Commission can only direct a public utility to modify terms and conditions previously found to be just and reasonable if it finds that such terms and conditions have become “unjust, unreasonable, unduly discriminatory or preferential.” The Commission has not initiated a 206 proceeding nor has it found that the terms and conditions originally approved in Section 5.11.6 – and subsequently moved, without substantive modification, to Section 5.11.6.2 and then Section 40.9 – are unjust, unreasonable,

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<sup>11</sup> May 15, 2002 Order, 99 FERC ¶ 61,158 at 61,630 (“we find the ISO’s proposal that exemptions will be granted so as to (1) provide sufficient on-line generating capacity to meet operating reserve requirements; and (2) to account for other physical operating constraints of generating units reasonable.”).

<sup>12</sup> Opinion No. 492 at P 111 (“In the Amendment No. 60 Hearing Order, the Commission accepted the transfer of this authority from CAISO tariff section 5.11.6 to section 5.11.6.2.”).

unduly discriminatory or preferential. Indeed, this Tariff language remains just and reasonable because it is still appropriate for the CAISO to rely upon the must-offer obligation to ensure that operating reserve requirements are met. The Commission states as much in Opinion No. 492 when it confirms that “exemptions will be granted so as to provide sufficient on-line generating capacity to meet operating reserve requirements and to account for other physical operating constraints of generating units.” Opinion No. 492 at P 111.

Absent a finding that the ISO Tariff language in question is unjust and unreasonable, the Commission cannot prevent the CAISO from exercising its authority under this Tariff language to deny waivers from the must-offer obligation in anticipation of a shortage of ancillary services when the CAISO concludes such waivers must be denied to provide sufficient on-line generating capacity to meet operating reserve requirements.

**D. In the Alternative, the Commission Should Clarify That Opinion No. 492 Does Not Prevent the CAISO From Taking Into Account the Need For Generating Capacity To Meet Operating Reserve Requirements In Determining Whether To Grant Must-Offer Waivers**

The CAISO acknowledges that there is some ambiguity in Paragraph 111 of Opinion No. 492 and that the Commission may not have intended the adverse effects discussed in this Rehearing Request. For example, Paragraph 111 could have been intended to state that the CAISO does not have the authority under the must-offer provisions of the ISO Tariff: (1) to require any Generating Unit to bid into the CAISO’s Ancillary Service markets; or (2) to deny a requested exemption from the must-offer obligation in anticipation of a shortage of ancillary services other than an anticipated shortage of operating reserves.

Such a clarification of Paragraph 111 would resolve the contradictions discussed above. Such a clarification would also confirm that the CAISO can continue to exercise its discretion to deny must-offer waiver requests when the CAISO concludes that such denials are needed to

provide sufficient on-line generating capacity to meet operating reserve requirements. The CAISO agrees that it does not require the authority to deny a requested waiver from the must-offer obligation in anticipation of a shortage of ancillary services other than an anticipated shortage of operating reserves. Therefore, as an alternative to granting the CAISO's Rehearing Request on this issue, the Commission should provide the specific clarification described above.

#### **IV. ALLOCATION OF START-UP AND EMISSIONS COSTS RELATED TO MUST OFFER WAIVER DENIALS**

##### **A. Motion for Clarification**

Opinion No. 492 requires the CAISO to allocate the Start-Up and Emissions Costs associated with Must-Offer Waiver Denials ("MOWD") "*in proportion* and in a similar manner to [Minimum Load Cost Compensation Costs or] MLCC costs." Opinion No. 492 at P 98 (emphasis added). The CAISO seeks clarification, or in the alternative, rehearing on the issue of how such allocation is to be accomplished.

In pre-filed testimony and during the hearing in this proceeding, the CAISO explained that difficulties existed in attempting to allocate Start-Up and Emissions Costs in the same manner as MLCC costs. *See, e.g.*, Ex. No. ISO-19 at 19-20; Tr. 756:9 – 757:12. In their own testimony, Pacific Gas and Electric Company and the State Water Project ("SWP"), suggested mechanisms by which the costs could be allocated in proportion to MLCC costs, rather than being individually calculated. These alternatives, cited by the Commission in Paragraph 97 of Opinion No. 492, call for an allocation of Start-Up and Emissions Costs that is proportional to the allocation of MLCC costs. In the PG&E proposal, such costs would be allocated "to the same constituency and in the same proportions as the Minimum Load Cost allocations." Ex. No. PGE-4 at 6. PG&E provided the following example:

Emissions costs	\$10	
Start-Up costs	<u>\$12</u>	
Total	\$22	
		<u>% of Total MLC</u>
Local Minimum Load Costs	\$50	62.5
Zonal Minimum Load Costs	\$20	25.0
System Minimum Load Costs	<u>\$10</u>	<u>12.5</u>
Total Minimum Load Costs	\$80	100.0%

Using this example, the total Emissions and Start-Up costs of \$22 would be allocated 62.5% (\$13.75) to “Local” Minimum Load Costs, 25% (\$5.50) to “Zonal” Minimum Load Costs, and 12.5% (\$2.75) to “System” Minimum Load Costs.

*Id.*

The SWP method is described slightly differently:

The ISO should charge for emissions and startup costs in proportion to its MLCC billings. Thus, if startup and emission costs in a given month were 5 percent of total MLCC costs for that month, each entity receiving an invoice for MLCC costs should also be charged and additional 5% for startup and emissions costs....Under [SWP’s] proposal, each market participant would pay the same percentage of startup and emissions as it pays for MLCC costs.

Ex. SWP-1 at 40.

The CAISO does not have actual data available for calculating Start-Up and Emissions Costs as it does for MLCC costs. This is because the CAISO does not have true Start-Up and Emissions Costs figures until it receives a bill from the Generating Unit owner that has incurred the costs up to a year after the cost is incurred. This is in contrast to the case of MLCC, as the CAISO calculates and pays MLCC based on heat rate on the normal CAISO payment calendar. Therefore, in order to allocate the former costs in proportion to MLCC costs, the CAISO will



have to use projected or estimated total costs. This was pointed out by CAISO witness Catherine Bodine at the hearing in discussing the allocation of Start-Up Costs:

Q The proposal referred to there by PG&E, SWP, and Staff is the proposal which says allocate startup costs, proportionally, in the same way that MLCC costs are proposed to be allocated to the three buckets; is that right?

A It's allocation of the cost *estimate* that would be allocated proportionally, yes.

Q As far as you are aware, there are no particular implementation problems that would stand in the way of the ISO's doing that in the event the FERC orders that should be done?

A That's fairly easy implementation.

Tr. 836 (emphasis added). In pre-filed testimony, the Commission Staff endorsed the PG&E/SWP mechanisms, but also recognized the need for estimates to be used for these calculations: “PG&E’s and SWP’s recommendations . . . appear to be administratively workable and not complex. . . recognizing that the amounts of monthly Emissions Costs and monthly Start Up costs are *forecasted* amounts based on the ISO’s forecast of the annual charges...” Ex. No. S-18 at 27:6-9.

Opinion No. 492 directs the CAISO to allocate the costs in a similar manner and in proportion to MLCC costs, and references the above-quoted portion of Ms. Bodine’s testimony to support its finding that such an allocation is possible. The Commission does not, however, mention the crucial element of the testimony – that such allocations would require the use of cost estimates rather than actual costs. Opinion No. 492 at PP 96-98.

For this reason, the CAISO seeks clarification that the Commission’s Order permits estimated Start-Up and Emissions Cost data to be used in the proportional allocation mechanism dictated by that order.

## **B. Alternative Request for Rehearing**

In the event that the Commission does not grant the CAISO's Motion for Clarification regarding whether the CAISO may use estimated Start-Up and Emissions Costs related to MOWDs in allocating such costs to Market Participants, then the CAISO respectfully seeks rehearing of Opinion No. 492 on this issue.

As described above, it is not possible for the CAISO to use actual Start-Up and Emissions figures to calculate the proportional share of such costs to allocate to Market Participants. Start-Ups Costs would be particularly difficult – if not impossible - because to determine the purpose of each start-up in the case of units that are on for a month or more at a time would be a completely manual, and thus labor-intensive, effort. The Emissions Costs also would be a difficult undertaking, because even though these costs could be determined in a manner proportional to the megawatt hours in question, there would still be the issue of the invoices for Emissions Costs coming to the CAISO up to a year after the fact, necessitating a “re-allocation” based on actual figures. Were that the mechanism ordered by the Commission, the effort involved would be akin to doing a re-run of the cost allocation every month. This would be the case for both Emissions and Start-Up Costs.

In light of the relatively small amount of these costs in comparison to MLCC costs,<sup>13</sup> and the fact that the must-offer mechanism itself is not a permanent feature of the CAISO's market design, the cost and effort of implementing such workarounds simply would not be justified.

For this reason, the CAISO requests rehearing on the issue of whether Emissions and Start-Up Costs related to MOWDs may be calculated using cost estimates.

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<sup>13</sup> In its October 26, 2004 testimony, the CAISO demonstrated that the Start-Up and Emissions Costs for the most recent 12 months for which it had invoices at that time were \$1.79 million and \$2.05 million, respectively, in comparison to \$125 million for MLCC costs in calendar year 2003. Ex. No. ISO-1 at 22:2-5.

**V. CONCLUSION**

Wherefore, for the reasons discussed above, the CAISO respectfully requests that the Commission clarify and grant rehearing of Opinion No. 492 as requested above.

Respectfully submitted,

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## Certificate of Service

I hereby certify that I have this day served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 26<sup>th</sup> day of January, 2007 at Folsom in the State of California.

/s/ Sidney Mannheim Davies

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