UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation, et al.	)	**Docket Nos. EL02-15-___**
v.	)	
Cabrillo Power I LLC, et al.	)	
	)	
California Independent System Operator Corporation, et al.	)	**Docket Nos. EL03-22-___**
v.	)	
Cabrillo Power I LLC	)	

MOTION PROPOSING PROCEDURES
FOR COMMISSION PROCEEDINGS ON REMAND

Pursuant to Rule 212 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or the "Commission"), 18 C.F.R. § 385.212 (2005), the Complainants[1] hereby submit this motion proposing procedures for Commission proceedings on remand.

I. Introduction and Summary Of Relief Requested

On June 19, 2006, the United States Court of Appeals for the District of Columbia Circuit issued an Order granting the motion for voluntary remand of this proceeding.[2] The Commission

[1] The Complainants are the California Independent System Operator Corporation ("CAISO"), Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE"), San Diego Gas & Electric Company, ("SDG&E"), the California Electricity Oversight Board ("CEOB"), and the California Public Utilities Commission ("CPUC").

[2] The court further held the appeal in abeyance and ordered the Commission to file status reports with the court every 90 days.

requested that this proceeding be remanded in apparent recognition that the issues presented require further Commission action to properly address Complainants' Section 206 filings.

Complainants initiated this proceeding on November 2, 2001. The Complaint asked the Commission to investigate the justness and reasonableness of a component of the RMR rates – the Fixed Option Payment Factor ("FOPF") – payable by the CAISO under the Respondents' respective RMR agreements with the CAISO. The Complaint alleged that the FOPFs in the subject RMR agreements were unjust and unreasonable and requested that the Commission order that the FOPFs be based on a "net incremental cost" rate methodology.

By Order dated June 3, 2005[3] (which the Commission affirmed on rehearing on August 2, 2005)[4], the Commission dismissed the Complaint. The Commission based its dismissal on its erroneous finding that the issues in the complaint were resolved by a settlement agreement entered into between certain Complainants and certain affiliates of Mirant Corporation.

In this Motion, Complainants show that (1) except as to one unit owner (Williams) already dismissed from the Complaint proceeding, *no settlement between Complainants and the Respondents has mooted or otherwise resolved the issues raised in the Complaint*,[5] (2) the net incremental cost method for setting FOPF is appropriate within the RMR contract structure of the CAISO, and (3) adoption of the net incremental cost method within the CAISO is consistent with recent Commission precedent. Therefore, the Complainants respectfully request that the Commission promptly institute hearing procedures to investigate the justness and reasonableness

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[3] *California Independent System Operator Corporation v. Cabrillo Power I, LLC*, 111 FERC ¶ 61,358 (2005).

[4] *California Independent System Operator Corporation v. Cabrillo Power I, LLC*, 112 FERC ¶ 61,157 (2005).

[5] As to Williams, the FOPF for Williams units has been set by settlements filed with the Commission for fixed periods of time, the most recent of which ends on December 31, 2006.

of the FOPFs in the subject RMR agreements and determine whether the net incremental cost methodology should be adopted within the CAISO.

II. Prior RMR Settlement Agreements Reserved the FOPF Issue for Resolution through the Complaint Proceeding

Subsequent to filing the Complaint on November 2, 2001, Complainants and Respondents have set rates for Respondents' RMR agreements through numerous settlement agreements. No settlement agreement between Complainants and the remaining Respondents that was entered into after this proceeding was initiated has mooted or otherwise resolved the issues raised in the Complaint. Rather, as described in detail below, each settlement explicitly reserved the FOPF issue for resolution through this proceeding. Accordingly, except as to one unit owner already dismissed from this proceeding, the issues raised in the Complaint remain alive.[6]

The relevant refund effective date in this case is between January 1, 2002 and May 31, 2002.[7] The Complainants requested a January 1, 2002 refund effective date to coincide with the start of the 2002 RMR contract year.[8] Prior to January 1, 2002, each of the Respondents, Cabrillo, Geysers and Duke Energy South Bay, submitted a section 205 filing to revise their respective RMR rate schedules for RMR Contract Year 2002 (collectively, the "2002 RMR

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[6] *Williams Energy Marketing & Trading Co.*, 105 FERC ¶ 61,165 (2003)(order approving uncontested settlement and dismissing Williams from complaint proceeding in Docket No. EL02-15-000).

[7] Pursuant to the Federal Power Act, upon the initiation of a complaint proceeding, the Commission must set a refund effective date that is no earlier than sixty days after the date the complaint was filed, and no later than five months after the expiration of that sixty-day period. 16 U.S.C.A. § 824e(b).

[8] That was the earliest date any party could seek to adjust the RMR rate components, including the FOPF, pursuant to the terms of the 1999 RMR Settlement. *See California Indep. Sys. Operator Corp.*, 87 FERC ¶ 61,250 (1999)(approving Stipulation and Agreement dated April 2, 1999). Section I.C of that Stipulation contains the relevant terms.

proceedings").[9] Each case was settled, and each settlement agreement expressly reserved the FOPF issue for resolution through this Complaint proceeding. The relevant provisions of the settlements of the 2002 RMR proceedings are summarized below.

Cabrillo, Docket No. ER02-1264 (RMR proceeding for Contract Year 2002). The parties filed a settlement agreement on December 31, 2002, as supplemented on January 15, 2003, resolving various RMR issues including the AFRR for Contract Years 2002 and 2003. Article II, Section E, ¶ 5 of the settlement agreement, "Reservations," provides that the settlement was not intended to affect in any way the outcome of the Complaint proceedings in Docket Nos. EL02-15 and EL03-22. *See* 103 FERC ¶ 61,054 (2003) (Order Approving Settlement).

Geysers Power Company, Docket Nos. ER02-188; ER02-236 and ER02-407 (RMR proceedings for Contract Year 2002). The settlement set rates, including the AFRR, for Geysers' units for Contract Years 2002 – 2005. Section IV, Part A, ¶ 2 of the settlement agreement, "Reservations," provides that the terms of the settlement were not intended to affect in any way the outcome of the proceeding in Docket No. EL02-15, and specifically reserves the parties' rights and positions therein. *See* 102 FERC ¶ 61,221 (2003) (Order Approving Settlement).

Duke Energy South Bay, Docket Nos. ER02-10 and ER02-239 (RMR proceedings for Contract Year 2002). By settlement agreement dated June 24, 2002, the parties settled certain issues related to Duke South Bay's RMR contract. Section B, ¶ 6 of the settlement agreement, "Reservations," provides that the settlement was not intended to affect in any way the outcome of the Complaint proceeding pending in Docket No. EL02-15 and specifically reserves the parties' positions therein. *See* 101 FERC ¶ 61,190 (2002) (Order Approving Settlement).

By settlement agreement dated September 26, 2002, the parties settled additional issues related to Duke South Bay's RMR agreement for Contract Year 2002, including the AFRR. Article II, Section B, ¶ 5 of the settlement agreement, "Reservations," provides that the settlement was not intended to affect in any way the outcome of the Complaint proceeding pending in Docket No. EL02-15 and specifically reserves the parties' positions therein. *See* 101 FERC ¶ 61,190 (2002) (Order Approving Settlement).

Docket No. ER03-117 (RMR proceeding for Contract Year 2003). By settlement agreement dated October 2, 2003, the parties settled various rate issues including the AFRR for Contract Years 2003 and 2004 for Duke South Bay. Section VI of the settlement agreement, "Reservations," provides that the settlement was not

[9] RMR Contracts are one year contracts that are renewed annually based on the CAISO's determination of the local reliability needs for the upcoming calendar year. Pursuant to the terms of the 1999 Settlement, the rates for RMR Agreements, including the FOPF, are to be adjusted annually beginning January 1, 2002. *See* Complaint at p. 11.

intended to affect in any way the outcome of the Complaint proceeding in Docket No. EL02-15 and specifically reserves the parties' positions therein. *See* 105 FERC ¶ 61,246 (2003) (Order Approving Settlement).

Finally, by letter agreement dated June 29, 2005, the parties settled "all claims . . . arising under or with respect to the RMR Agreement for the period July 1, 1998 through December 31, 2002 (Settlement Period), including all claims and disputes . . . that arose out of FERC Docket No. EL02-15-000."[10] This agreement encompasses only a portion of the time frame for which refunds are sought under the Complaint;[11] accordingly, while Complainants' claim for refunds must now be limited to the portion of the refund period that falls in 2003, Complainants' entitlement to challenge Duke South Bay's RMR rate components is not moot.

In short, Complainants properly reserved the FOPF issue in their settlements with Cabrillo, Geysers and Duke South Bay. Thus, the claims raised in the Complaint concerning the FOPF remain viable. The Commission should therefore set them for hearing without further delay.

III. Commission Precedent Supports Setting the Complaint for Hearing

Since this proceeding was initiated, the Commission has issued several orders addressing the issue of what is proper compensation for generating units that are needed for local reliability. In those orders, the Commission has recognized that, on such matters, "one size might not fit all" and that regional circumstances matter.[12] This recognition supports setting the RMR compensation issue raised by the Complaint for a hearing at which the relevant circumstances in the CAISO control area can be fully considered.

Specifically, in articulating its policy on compensation for local reliability, the Commission has ruled "that there is not necessarily a standard regulatory response to this set of

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[10] The June 29, 2005 letter agreement is attached to this filing as Exhibit A.

[11] By statute, the maximum refund period is 15 months. 16 U.S.C.A. § 824e(b). Depending on the refund effective date for this proceeding, the refund period would extend to somewhere between March 31, 2003 and August 30, 2003.

[12] *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112, at P 15 (2004).

issues."[13] Rather, the Commission has concluded that, in order to support a compensation structure for units designated as necessary for reliability, an RTO or ISO must show "that the revenue produced by the proposed solution is adequate to actually solve the problem at hand and that the proposed solution includes safeguards to prevent the unwarranted exercise of market power beyond the recovery of such necessary revenue."[14]

In evaluating whether a particular RTO's or ISO's approach is appropriate, the Commission has said that it will take into account the present circumstances and expected future needs of each market.[15] Indeed, the Commission has expressly recognized that different approaches are warranted in ISO-NE, PJM and MISO, and it has rejected arguments that, because a compensation scheme made sense in one region, it should be applied in another.[16]

In short, the direction from the Commission is that ISOs and RTOs are to develop reliability compensation solutions that work within the characteristics of their particular market situation, to both adequately compensate an RMR unit for its reliability service and prevent the exercise of market power. In calling for a regionally tailored approach to RMR compensation, these rulings strongly support Complainants' request for a hearing. At such a hearing, Complainants are prepared to support their claims that, under the circumstances prevailing in the

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[13] *Id.*

[14] *Id.* at P 18.

[15] *Id.*

[16] *See PJM Interconnection, LLC*, 112 FERC ¶ 61,031, at P 32 (stating that although PJM's provisions may be different from those of ISO-NE, "it is not necessary that all RTOs use the same procedures as long as generators retain options for filing rates with the Commission, as the generators do here"); *id.* at PP 20-21 (refusing to require PJM to adopt the same procedures as MISO, stating that each RTO/ISO "is developing different systems for handling deactivation, and the Commission is not insisting that exactly the same system be applied in each RTO"); *PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,441, at P 22 (2005) (refusing to reassess or compare ISO-NE's full cost of service approach to PJM's going-forward approach, noting that the ISO-NE's "circumstances are far different from those in PJM and require different approaches and remedies. As a result, a comparison of the two approaches is not useful.").

CAISO control area, including the compensation options available to RMR unit owners under the CAISO *pro forma* RMR agreement, a just and reasonable FOPF for units operating under Condition 1 is one based on "net incremental" costs which, for uneconomic units, means going forward costs.

IV. Reliability Compensation Solutions Approved by the Commission for Other ISOs and RTOs Are Consistent with the Net Incremental Cost-Based FOPF Sought in the Complaint

A. The Issue Presented by the Complaint

As discussed above, at issue in this proceeding is what is a just and reasonable FOPF for the Respondents' RMR Units when the units elect to operate under "Condition 1." Under the CAISO's *pro forma* RMR agreement, RMR Unit owners may elect to operate under either Condition 1 or Condition 2, subject to certain limitations on the timing and frequency of the unit owner's election. Because RMR Units are dispatched by the CAISO to avoid the exercise of local market power at times of local transmission constraint, from the inception of the CAISO contract, rates for RMR Units have been cost based rather than market based. The current *pro forma* RMR contract approved as part of the 1999 Settlement uses two types of cost recovery rates: fixed cost and variable cost. Fixed cost recovery is based on the annual fixed cost of service, expressed as the Annual Fixed Revenue Requirement ("AFRR").[17]

The CAISO RMR agreement provides that an RMR Unit owner is paid a certain fraction of the unit's AFRR. That fraction is referred to as the Fixed Option Payment Factor ("FOPF"). The FOPF differs depending on whether the unit operates under Condition 1 or Condition 2, which is at the owner's discretion.

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[17] *See* the *pro forma* RMR contract, Schedule B, Equation B-5 and Section 7, filed as part of the 1999 Settlement.

Units operating under Condition 1 only recover a portion of their AFRR, represented by the FOPF, because these units may participate in the market and retain the revenues they realize from market transactions. The FOPF is intended to ensure that RMR Unit owners are compensated by the CAISO for the incremental fixed costs associated with providing RMR service but not for costs already recovered in market transactions.

Condition 2 units operate under an alternative cost recovery methodology based on full cost-of-service. A Condition 2 unit may not participate in market transactions unless the CAISO issues a dispatch notice. When the CAISO does issue a dispatch notice for a Condition 2 unit, the owner must bid to participate in the next available energy and ancillary services markets but may not retain the revenues from such market transactions. Because Condition 2 units cannot retain market revenue and operate only to provide RMR service, these units are paid 100 percent of the units' fixed costs, an FOPF of 1.0. Thus, the payment for a Condition 2 unit assures that the owner recovers all of its AFRR – both "sunk" and "going-forward" fixed costs. In short, Condition 2 results in a full cost-of-service rate.

The Complaint asserts that, when an RMR Unit owner elects to operate under Condition 1, which means it retains market revenues, the RMR Unit should recover only its net incremental costs associated with providing reliability service. This approach is consistent with Commission rulings dealing with comparable market situations.

B. Net Incremental Cost Is the Appropriate Rate Design For Condition 1 RMR Units Within the RMR Structure of the CAISO

Under Condition 1, which is premised on the RMR Unit operating as a merchant plant, a fundamental principle is that the owner should be no better off and no worse off as a result of having an RMR contract than its competitors. This market neutrality principle helps assure that

RMR contracts distort the market as little as possible by avoiding a subsidy or a fee that changes the owner's competitive economics and therefore its market behavior.

It is important to remember that all RMR owners in the CAISO have the right to elect payment under either Condition 1 (merchant plant) or Condition 2 (full cost of service). Therefore, any RMR owner that chooses to operate under Condition 1 did so because it believes that it will earn more as a merchant plant with a more limited fixed-cost RMR contract payments than it would earn with full cost of service rates. In effect, the CAISO's RMR contracts provide RMR owners with the right to elect what it expects to be the higher of full cost-of-service, on the one hand, or market with additional contract payments, on the other.

The "net incremental cost" method for Condition 1 RMR Units is designed to implement the market neutrality principle. It also provides dispatch service in support of local reliability at the least cost. To assure the RMR owner is neither better nor worse off than its competitors, an RMR Unit is first determined to be either economic or uneconomic, based on estimated market revenue for the owner (net of the variable cost to generate this revenue) and its projected cost of service. If estimated net market revenue exceeds projected cost of service, the Unit is economic, and the only costs it can recover are those costs that directly result from having an RMR contract (like contract administration), net of any benefits that result from having the contract – the "net contract cost." For an economic Unit, therefore, the FOPF is the net contract cost divided by the AFRR.[18]

If, on the other hand, estimated net market revenue is less than projected cost of service, the Unit is uneconomic. In that case, because the CAISO needs the Unit to remain available for out-of-merit dispatch when there are transmission constraints, fixed cost compensation must

[18] The fixed cost payment, as noted above, is the portion of the Unit's AFRR represented by the FOPF.

allow the owner to recover the estimated shortfall in order to remain in operation. Like the costs of administering its RMR contract net of benefits, for an uneconomic Unit, the projected fixed cost shortfall is part of the net incremental cost of having the contract because the owner presumably would not incur fixed costs to keep the Unit available for service if it had no reasonable expectation of recovering those costs.

Going forward costs are the proper measure of fixed costs used to determine the revenue shortfall for an uneconomic RMR Unit operating under Condition 1. Such costs are the fixed costs that will be incurred only when the Unit is available for dispatch; this does not include sunk costs such as return of and return on capital. If the unit were to shut down, its owner would no longer incur the fixed costs of keeping it available but also would no longer receive any payment for generation. In that case, the owner therefore would lose the opportunity to receive a return of and on its investment in the unit.

To compensate the owner of an uneconomic unit for keeping it available for local reliability dispatch, the fixed cost payment under an RMR contract is set at the owner's indifference point between continued operation and shutdown. Because the owner cannot recover any sunk costs if it shuts down the unit, even if it cannot recover any sunk costs while continuing to operate the unit, it is indifferent to the recovery of these costs. In fact, only by keeping the unit operating can an owner expect to recover *any* sunk costs. Thus, if its RMR fixed cost payment covers all expected shortfall in recovery of going forward costs, the rational owner will prefer keeping the unit available for operation because there is the opportunity to recover at least some sunk costs compared to recovering none of those costs. Therefore, for an uneconomic RMR Unit, the indifference point for setting the net incremental cost based RMR payment is the amount at which the Unit is reasonably estimated to recover all of its going

forward costs, plus other costs of having the RMR contract. For an uneconomic Unit, an FOPF calculated to reflect the net incremental cost is the net contract cost, plus going forward costs, minus estimated net market revenue, all divided by the AFRR.

C. Commission Rulings Support an FOPF Based on Net Incremental Costs for Condition 1 Units

Since the Complaint was filed, the Commission has issued a number of decisions concerning the appropriate reliability compensation schemes for PJM Interconnection, LLC ("PJM") and the New England Independent System Operator ("ISO-NE"). In these cases, the Commission's rulings ultimately depended on the particular market situation. However, the Commission's underlying rationale for approving a going forward cost approach for PJM and approving a full cost recovery requirement for ISO-NE supports the Complainants' proposed net incremental cost approach for units operating in the CAISO markets as a Condition 1 RMR unit.

1. The PJM Reliability Compensation Model Based on Going-Forward Costs that the Commission Has Approved Supports Complainants Proposed Approach to the FOPF.

In addressing reliability compensation within PJM, the Commission found that units that provide reliability service "need to be compensated at a level that adequately covers their fixed and variable costs." *PJM Interconnection, LLC*, 107 FERC ¶ 61,112, at P 40. Thus, the Commission instructed PJM to develop a policy that would provide a reasonable opportunity for recovery of going-forward costs. *Id.* PJM adopted, and the Commission ultimately approved, a two-pronged approach to compensation for units that are required for reliability but would otherwise deactivate. *PJM Interconnection, LLC*, 110 FERC ¶ 61,053, at PP 123-27, *reh'g*, 112 FERC ¶ 61,031 (2005). That two-pronged approach is functionally comparable to the Condition 1/Condition 2 choice available to owners under the CAISO's RMR *pro forma* agreement.

PJM's dual approach allows a unit owner either to file a cost-of-service rate to recover the entire cost of operating the unit or to elect to receive a deactivation avoidable cost credit ("DACC"). The DACC formula rate permits recovery of otherwise avoidable costs, plus an adder, and up to $ 2 million for project investments.[19] The DACC is intended to recover a unit's costs that would otherwise be avoidable if it were permitted to deactivate instead of providing reliability service, to the extent those costs are not recovered by net revenues. Put another way, the DACC formula rate covers the unit's going forward costs.[20]

The Commission rejected arguments that the DACC formula should provide not just for going forward costs but rather full cost recovery of, and a return on, the unit's fixed costs:

> It would not be appropriate to base compensation on generator entry costs because these do not necessarily reflect the least cost solution to reliability concerns. The goal here is to support reliability needs by fully compensating any unit for all going forward costs for the period it must delay its exit.[21]

Protestors further argued that the DACC was inconsistent with the Commission rulings involving ISO-NE RMR units. Those rulings allowed full recovery of an RMR unit's fixed costs.[22] The Commission rejected this argument and distinguished the cited ISO-NE cases. The Commission noted that the DACC is a formula rate that a generator may elect to utilize as a more

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[19] 110 FERC ¶ 61,053, at PP 98, 113. The adder increases with the amount of notice the unit gives prior to deactivation and the length of time the unit must remain in service for reliability. The CAISO's *pro forma* RMR agreement also covers the costs of capital additions and major repairs through surcharges beyond its regular fixed-cost payments. For Condition 1 Units, the annual revenue requirement to recover incremental capital cost is multiplied by a Surcharge Payment Factor similar, but not necessarily identical, to the FOPF.

[20] 112 FERC ¶ 61,031, at P 13 (2005).

[21] 110 FERC ¶ 61,053, at P 147, *reh'g*, 112 FERC ¶ 61,031, at P 14.

[22] 112 FERC ¶ 61,031, at P 16 (protestors cited the following ISO-NE RMR cases in support of their proposition: *PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,020, at P 30 (2005); *Mirant Kendall, LLC and Mirant Americas Energy Marketing, L.P.*, 109 FERC ¶ 61,227, at P 36 (2004), *reh'g denied*, 110 FERC ¶ 61,272 (2005)).

efficient alternative to either a negotiated RMR agreement or a rate case that could result in full cost-of-service recovery. The Commission concluded that there is no requirement that the DACC have the same features or provide the same compensation as would apply under an RMR agreement or result from a full rate case.[23]

PJM's Commission-approved two-pronged approach to reliability compensation for reliability units is similar to the two alternatives available under the CAISO's Condition 1/Condition 2 RMR structure. Both provide a full cost-of-service option and a second option tailored to provide for recovery of only those costs related to the provision of reliability service. The net incremental cost methodology Complainants have argued is appropriate under Condition 1 mirrors PJM's DACC formula rate. Both are designed to compensate the owner for the costs related to the provision of reliability service, offset by any revenues the unit can otherwise earn from market transactions.

2. The ISO-NE Reliability Cases Allowing Full Cost-of-Service Recovery Do Not Undermine the Complaints' Request for Relief.

The ISO-NE's market situation led the Commission to approve an RMR compensation procedure for ISO-NE that provides for full recovery of all of an RMR unit's fixed costs. The Commission has rejected arguments that the ISO-NE's compensation for an RMR agreement should be limited to a going-forward cost alternative (under which RMR units would only recover their actual and reasonable out-of-pocket costs incurred during the term of the RMR agreement) in lieu of a full cost-of-service approach in a line of ISO-NE RMR contract cases from 2004 to date.[24] In these cases, the Commission's determination that RMR contract

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[23] 112 FERC ¶ 61,031, at P 24; *see also Milford Power Co., LLC,* 112 FERC ¶ 61,154, at P 29 (2005).

[24] *See, e.g., Pittsfield Generating Co., L.P.*, 115 FERC ¶ 61,059, at PP 54, 66 (2006); *Mystic Development, LLC,* 114 FERC ¶ 61,200, at PP 36, 49 (2006); *Consolidated Edison Energy Mass., Inc.*, 112 FERC ¶ 61,263, at P 40 (2005); *PSEG Power Conn., LLC,* 110 FERC ¶ 61,020, at P 30 (2005);

compensation should not be limited to going forward costs was a fact-specific determination based on the market situation in ISO-NE, as described below. It was not a broader policy determination that an incremental or going forward cost approach is never appropriate for RMR units.[25]

In 2003, the Commission rejected several pending RMR agreements in ISO-NE because of its concern about the effect widespread use of such contracts would have on the competitive market for capacity.[26] The following year, the Commission concluded that some generators, generally older peaking units, were unable to adequately recover their fixed costs through the markets. The Commission therefore permitted the ISO-NE to use limited-term RMR agreements to keep such units in service if the units were needed for reliability.[27]

Under the ISO-NE RMR agreements, RMR units receive full cost recovery of both fixed and variable costs. They must credit any market revenue against the reliability payment

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Milford Power Co., LLC, 110 FERC ¶ 61,299, at P 70, *reh'g*, 112 FERC ¶ 61,154, at P 28 (2005); *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077, at P 46 (2005).

[25] *See, generally, PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,441, at P 23 (2005).

[26] *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077, at P 2 (2005) (citing *Devon Power LLC, et al.*, 102 FERC ¶ 61,314 (2003); *Devon Power LLC, et al.*, 103 FERC ¶ 61,082, *reh'g*, 104 FERC ¶ 61,123 (2003); *PPL Wallingford Energy LLC, et al.*, 103 FERC ¶ 61,085, *reh'g*, 105 FERC ¶ 61,324 (2003)).

[27] *PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,020, at P 18 (2005). *See also, Pittsfield Generating Co., L.P.*, 115 FERC ¶ 61,059, at P 28 (2006); *Mystic Development, LLC*, 114 FERC ¶ 61,200 (2006); *Consolidated Edison Energy Massachusetts, Inc.*, 112 FERC ¶ 61,263, at P 2 (2005). Since 2004, the Commission has accepted several RMR agreements for units that the Commission found to be aging, low capacity factor units that were performing poorly and that absent an RMR contract, were unable to recover an adequate amount of fixed costs through energy reserves or capacity markets. *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077, at PP 4, 22 (2005). The Commission found that absent a cost-of-service agreement, these older, inefficient peaking/intermediate units which were needed for reliability would not continue to operate. *Id.* at P 31. In 2005, the Commission also approved an RMR agreement for a newer base load facility, Milford, because the Milford unit was found to be similar to the other RMR units in that: (1) the unit was needed for reliability in New England and (2) there was a demonstrated inability to earn sufficient revenues to keep generation operational due to market flaws. *Consolidated Edison Energy Massachusetts, Inc.*, 112 FERC ¶ 61,263, at P 2 (2005)(citing *Milford Power Company, LLC*, 110 FERC ¶ 61,299, *reh'g*, 112 FERC ¶ 61,154 (2005)).

provided for in the RMR agreement.[28] RMR contracts serve only as "a tool of last resort . . . [b]ecause these contracts remove generators from the competitive marketplace."[29]

The Commission has upheld ISO-NE's full cost-of-service reliability compensation against several challenges because it has concluded:

> [P]roviding only minimum, marginal, and variable cost recovery to the units may not allow the unit owner to maintain the units so that they can continue to operate reliably. It would defeat the purpose of the RMR agreement, which is to ensure that the Units are available for reliability purposes.[30]

In so ruling, however, the Commission has expressly pointed to the provisions of the ISO-NE's RMR agreement that require a unit's market revenues to be credited against their monthly fixed-cost charge under the RMR agreement.[31]

The ISO-NE full cost-of-service approach is thus comparable to the Condition 2 option under the CAISO *pro forma* RMR agreement. Condition 2, like ISO-NE's approach, compensates an RMR unit for 100 percent of its fixed costs and applies to units that cannot function in the market. However, as the PJM cases discussed above illustrate, the ISO-NE RMR cases are not a bar to another RTO or ISO providing for both a full cost-of-service recovery option and an alternative, more limited cost recovery option, such as the net incremental or going forward costs approach utilized by PJM and proposed by the Complainants for units operating under Condition 1 of the CAISO *pro forma* RMR contract.

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[28] *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077, at P 65 (2005).

[29] *Id.* at P 31.

[30] *Mystic Development, LLC*, 114 FERC ¶ 61,200, at P 49 (2006).

[31] *Id.*; *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077, at P 46 (2005); *Consolidated Edison Energy Massachusetts, Inc.*, 112 FERC ¶ 61,263, at P 40 (2005).

In summary, there is a well-developed body of Commission case law that supports the approach to RMR unit compensation under Condition 1 that the Complainants seek.

V. Conclusion

For the reasons described above, Complainants respectfully request that the Commission promptly institute hearing procedures to investigate the justness and reasonableness of the FOPFs in the subject RMR agreements and determine whether the net incremental cost methodology should be applied to set rates for RMR units that have elected to be compensated as Condition 1 units.

Respectfully submitted,

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Dated: July 10, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this 10th day of July, 2006 caused to be served a copy of the forgoing Motion Proposing Procedures for Commission Proceedings on Remand upon all parties listed on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings.

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Exhibit A

SETTLEMENT AND RELEASE OF CLAIMS AGREEMENT

This Settlement and Release of Claims Agreement (the "Agreement") is entered into by and among Duke Energy North America, LLC, Duke Energy Trading and Marketing, L.L.C., and Duke Energy South Bay, LLC (collectively, "Duke Energy"), San Diego Gas & Electric Company ("SDG&E"), and the California Independent System Operator Corporation ("CAISO") referred to herein individually as a "Party" and collectively as the "Parties."

RECITALS

Whereas, the Parties have disputes between them arising under the Reliability Must-Run Service Agreement ("RMR Agreement") between Duke Energy South Bay, LLC and the CAISO, including claims and disputes that arose out of Docket No. EL02-15-000, and as a result of the settlement of matters with respect to Duke Energy in the California Refund Proceeding being conducted by the Federal Energy Regulatory Commission ("FERC") in Docket No. EL00-95 *et al. ("California Refund Proceeding");*

Whereas, the Parties have determined that it is preferable to settle the disputes addressed herein rather than continue to litigate.

Now therefore, in consideration of the mutual releases and waivers granted herein the Parties agree as follows:

ARTICLE I.
EFFECTIVENESS AND CONSIDERATION

1.1 Binding Obligation. This Agreement shall be a binding obligation of each Party immediately upon its execution by all Parties.

1.2 Consideration. The Parties acknowledge and agree that the consideration called for in this Agreement consists of the covenants and obligations set forth in this Agreement, including the mutual releases set forth in Article II.

ARTICLE II.
RELEASES AND WAIVERS

2.1 Settlement of All Claims. Under this Agreement, all claims by or against each Party arising under or with respect to the RMR Agreement for the period July 1, 1998 through December 31, 2002 ("Settlement Period"), including all claims and disputes relating to Duke Energy South Bay, LLC that arose out of FERC Docket No. EL02-15-000, are hereby deemed settled and fully resolved. Without limiting the generality of the foregoing, claims arising from the Settlement Period with respect to the following disputes and proceedings are hereby deemed settled and released:

2.1.1 All claims involving the calculation of Scheduling Coordinator Credits for purposes of the RMR Agreement to reflect mitigation in the California Refund Proceeding, as settled with respect to Duke Energy in the Settlement and Release of Claims Agreement dated September 27, 2004 ("Duke Settlement"), approved by the FERC in its Order on Settlement Agreement in *San Diego Gas & Elec. Co. v. Sellers, et al.*, 109 FERC ¶ 61,257 (Dec. 7, 2004);

2.1.2 All claims relating to Duke Energy's recovery of fuel costs for the Duke Energy South Bay, LLC facility under the RMR Agreement in light of its entitlement to recovery of a fuel cost allowance in the California Refund Proceeding, as settled in the Duke Settlement;

2.1.3 All claims relating to rejections or late payment of invoices under the RMR Agreement for RMR services rendered in 2001; and

2.1.4 All claims relating to the treatment of interest on any claims or amounts due between the Parties referred to in Section 2.1, including, without limitation, interest with respect to any of the claims described in Sections 2.1.1 through 2.1.3.

2.1.5 All claims arising under the RMR Agreement relating to the adjustment or modification of the Fixed Option Payment Factor, Annual Fixed Revenue Requirements and Variable Operation and Maintenance Rates.

2.2 Mutual Releases. Each Party hereby mutually releases and discharges each other Party, its members, owners, affiliates, officers, management committee, managing member, employees, agents, past and present, or anyone acting on its behalf from any and all past, existing, and future claims, obligations, losses, causes of action, allegations, demands and liabilities arising under or with respect to the RMR Agreement for the Settlement Period, whether known or unknown, whether asserted or unasserted, whether arising under any provisions of the Federal Power Act at FERC or as a civil claim, for refunds, interest relating thereto, disgorgement of profits, payments, penalties or other monetary or non-monetary remedies, including without limitation the claims identified in Sections 2.1.1 through 2.1.5.

2.3 Rehearing and Petitions for Review. Each of the Parties shall forego any rights to seek alternative dispute resolution, FERC review, rehearing of, or petition for appellate review with respect to any and all claims released in this Article II.

2.4 Invoices. This settlement and the release of claims hereunder shall be deemed to satisfy and close all RMR invoices issued by Duke Energy through the CAISO to SDG&E with respect to the Settlement Period. To the extent necessary to implement this settlement, Duke Energy and SDG&E agree to provide any necessary assurances or waivers to the CAISO that Duke Energy's RMR invoices to SDG&E for services supplied by the Duke Energy South Bay LLC facility during the Settlement Period pursuant to the RMR Agreement have been satisfied.

2.5 ISO Market Reruns. Nothing in this Settlement Agreement shall affect any market rerun undertaken by the ISO for all or any part of the Settlement Period.

2.6 Effectiveness of Waiver of Unknown Claims Directly Related to Performance under RMR Agreement. The Parties acknowledge and agree that their mutual releases in this Article II shall apply to known or unknown, suspected or unsuspected claims that are directly related to performance under the RMR Agreement during the Settlement Period. In furtherance of this intention, Duke Energy, SDG&E and the CAISO, with respect to the specific matters released herein, each knowingly, voluntarily, intentionally and expressly waive, as against each other, any and all rights and benefits conferred by California Civil Code Section 1542 and any law of any state or territory of the United States or principle of common law that is similar to Section 1542. Section 1542 provides:

> "A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

In connection with such waiver and relinquishment, the Parties each acknowledge that they are aware that they may hereafter discover facts in addition to or different from those which they know or believe to be true and with respect to the subject matter of this Agreement, but that it is their intention hereby to fully, finally and forever settle and release all claims, matters, disputes, differences, known or unknown, suspected or unsuspected, that are set forth in this Article II as are directly related to performance under the RMR Agreement. The releases of claims and matters related to performance under the RMR Agreement, as set forth in this Article II, shall be, and remain in effect as, full and complete releases, notwithstanding the discovery or existence of any such additional or different facts relating to the subject matter of the releases. Notwithstanding the waiver of California Civil Code Section 1542, the Parties acknowledge and agree that the releases of claims and matters related to performance under the RMR Agreement provided for in this Agreement are specific to the matters set forth in this Article II and are not intended to create general releases as to all claims, or potential claims, among the Parties.

ARTICLE III.
MISCELLANEOUS

3.1 Representation of Authority. Each Party represents and warrants that, upon execution of this Agreement, it is a corporation or limited liability company duly organized, validly existing and in good standing under the laws of the jurisdiction of its formation, and that it possesses all necessary power and authority to execute, deliver, and perform its obligations under this Agreement.

3.2 Governing Law. To the extent not governed by federal law, this agreement and the rights and duties of the Parties hereunder will be governed by and construed, enforced and performed in accordance with the law of the State of California, without giving effect to principles of conflicts of laws that would require the application of laws of another jurisdiction.

3.3 Entire Agreement. This Agreement contains the entire agreement among the Parties with respect to the subject matter hereof and there are no agreements, understandings, representations or warranties between the Parties other than those set forth herein.

3.4 Notice to Parties. Notices required under this Agreement shall be delivered to:

If to Duke Energy:

Keith L. Head

Duke Energy North America, LLC
5400 Westheimer Court
Houston, TX 77056-5310
Telephone: (713) 627-6520
Fax: (713) 627-5681
E-Mail: klhead@duke-energy.com

With a Copy to:

Mark L. Perlis

Dickstein Shapiro Morin & Oshinsky LLP
2101 L Street, NW
Washington, DC 20037-1526
Telephone: (202) 785-9700
Fax: (202) 887-0689
E-Mail: perlism@dsmo.com

If to SDG&E:

Don P. Garber
Sempra Energy
101 Ash Street
San Diego CA92101-3017
Telephone: (619) 696-4539

Fax: (619) 699-5027
E-Mail: dgarber@sempra.com

With a Copy to:

Nicholas W. Fels
Covington & Burling
1201 Pennsylvania Avenue, NW
Washington DC 20004
Telephone: (202) 662-5648
Fax: (202) 778-5648
E-Mail nfels@cov.com

If to CAISO:

Robert Kott
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, California 95630
Telephone: (916) 608-5804
Fax: (916) 351-2487
E-Mail: rkott@caiso.com

Mary Anne Sullivan
Hogan & Hartson
555 Thirteenth Street, NW
Washington, DC 20004
Telephone: (202) 637-3695
Fax: (202) 637-5910
E-Mail: masullivan@hhlaw.com

3.5 Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the Parties hereto, their affiliates, and their permitted successors and assigns.

3.6 Costs. Each Party shall bear its own costs and expenses in connection with any filings required under this Agreement, or in connection with entering into this Agreement.

3.7 Execution. This Agreement may be executed in counterparts, each of which will be deemed to be an original and all of which taken together shall constitute a single instrument. This Agreement may be executed by signature via facsimile transmission, which shall be deemed the same as an original signature.

3.8 **Modifications**. This Agreement may be modified only if in writing and signed by each of the Parties. No waiver of any provision of this Agreement or departure from any term of this Agreement shall be effective unless in writing and signed by SDG&E and the CAISO with respect to any waiver requested by Duke Energy, and by Duke Energy and the CAISO with respect to any waiver requested by SDG&E. No modification will be effective if it were to require FERC approval, absent such approval.

3.9 **Assignment**. No Party shall assign this Agreement or its rights hereunder without the prior written consent of the other Parties; provided, however, that any Party may, without the consent of the other Parties (and without relieving itself from liability hereunder), transfer or assign this Agreement to any person or entity succeeding to all or substantially all of the assets of such Party, in which case the assignee shall agree in writing to be bound by the terms and conditions hereof.

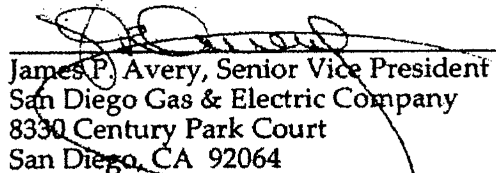
3.10 **Headings.** The headings or section titles contained in this agreement are inserted solely for convenience and do not constitute a part of this Agreement nor should they be used to aid in any manner in the construction of this Agreement.

3.11 **Multiple Counterparts**. This Agreement shall be executed in multiple counterparts.

IN WITNESS HEREOF, the Parties have executed this Agreement on June _, 2005.

For San Diego Gas & Electric Company:

Dated: 6/28/05



James P. Avery, Senior Vice President
San Diego Gas & Electric Company
8330 Century Park Court
San Diego, CA 92064

Dated: ___________

For Duke Energy North America, LLC, and Duke Energy South Bay LLC:

____
[signatory to be inserted]

3.8 **Modifications.** This Agreement may be modified only if in writing and signed by each of the Parties. No waiver of any provision of this Agreement or departure from any term of this Agreement shall be effective unless in writing and signed by SDG&E and the CAISO with respect to any waiver requested by Duke Energy, and by Duke Energy and the CAISO with respect to any waiver requested by SDG&E. No modification will be effective if it were to require FERC approval, absent such approval.

3.9 **Assignment.** No Party shall assign this Agreement or its rights hereunder without the prior written consent of the other Parties; provided, however, that any Party may, without the consent of the other Parties (and without relieving itself from liability hereunder), transfer or assign this Agreement to any person or entity succeeding to all or substantially all of the assets of such Party, in which case the assignee shall agree in writing to be bound by the terms and conditions hereof.

3.10 **Headings.** The headings or section titles contained in this agreement are inserted solely for convenience and do not constitute a part of this Agreement nor should they be used to aid in any manner in the construction of this Agreement.

3.11 **Multiple Counterparts.** This Agreement shall be executed in multiple counterparts.

IN WITNESS HEREOF, the Parties have executed this Agreement on June _ 2005.

For San Diego Gas & Electric Company:

Dated: ____________

____
[Insert signatory]
San Diego Gas & Electric Company
[Address]

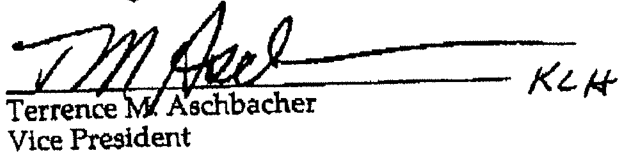
Dated: June 28, 2005

For Duke Energy North America, LLC, and Duke Energy South Bay LLC:

Randall J. Hickok (signature)
Randall J. Hickok
Vice President

Dated: June 29, 2005

For Duke Energy Trading and Marketing, L.L.C.:



Terrence M. Aschbacher
Vice President

Dated: ____________

California Independent System Operator Corporation:

____
[signatory to be inserted]

Dated: ___________

For Duke Energy Trading and Marketing, L.L.C.:

____
[signatory to be inserted]

Dated: June 29, 2005

California Independent System Operator Corporation:

By: Mary Anne Sullivan
Mary Anne Sullivan
Hogan & Hartson
555 Thirteenth Street NW
Washington, DC 20004