



California Independent
System Operator Corporation

November 26, 2007

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

**Re: Answer of the California Independent System Operator Corporation
to the Answer of the Independent Energy Producers Association
Docket No. EL05-146-**

Dear Ms. Bose:

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the California Independent System Operator Corporation ("CAISO") respectfully submits this Answer to the Answer of the Independent Energy Producers Association.

If there are any questions concerning this filing, please contact the undersigned.

Respectfully Submitted,

/s/ Anthony J. Ivancovich

Anthony J. Ivancovich
Counsel for the California Independent
System Operator Corporation

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

California Independent System Operator Corporation)	Docket No. ER06-615-
)	
Independent Energy Producers Association)	
)	
v.)	Docket No. EL05-146-
)	
California Independent System Operator Corporation)	
)	

**ANSWER OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO THE ANSWER OF THE INDEPENDENT ENERGY PRODUCERS
ASSOCIATION**

Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213, the California Independent System Operator Corporation (“CAISO”) respectfully submits this Answer to the Answer of the Independent Energy Producers Association (“IEP”) to the Answers to IEP’s *Motion for Reconsideration or Clarification* (“Motion”).

The CAISO recognizes that Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213, generally prohibits the filing of an answer to an answer. The Commission has waived this prohibition, though, to accept an answer that aids the Commission in understanding the issues, provides additional information to assist the Commission in the decision-making process, and helps to ensure a complete and accurate record in a case. *See, e.g., Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251 at 61,886 (2002); and *Delmarva Power & Light Company*, 93 FERC ¶ 61,098 at 61,259 (2000). In this instance, IEP has requested

that the Commission accept its Answer to the CAISO's Answer. In its Answer, IEP makes a new, specific, substantive proposal that was not included in its Motion and to which the CAISO has not had an opportunity to reply. IEP's proposal would significantly modify the nature of the Must Offer Obligation ("MOO"), as well as the existing Reliability Capacity Services Tariff ("RCST"), and the price paid to generating units that are committed under the MOO. IEP also makes other new arguments that require a CAISO response. If the Commission accepts IEP's Answer, the Commission should accept this responsive Answer of the CAISO so that the CAISO will have an opportunity to respond to IEP's new arguments and proposals and Commission will have a complete record necessary to reach a decision.

I. BACKGROUND

In its Motion, IEP asked the Commission to reconsider its September 25, 2007, Notice of Extension of Time granting the CAISO an extension of time, until January 18, 2008, to comply with a requirement in the Commission's June 25, 2007 MRTU Order that the CAISO work with stakeholders to explore potential opportunities for load serving entities to cure a collective shortfall in local capacity area deficiencies. Instead, IEP requested that the Commission require the CAISO to file its Interim Capacity Procurement Mechanism ("ICPM"), which is intended to be effective on the effective date of MRTU implementation, to be effective January 1, 2008, *i.e.*, prior to implementation of MRTU. To the extent the Commission declines to reconsider its order granting the CAISO an extension, IEP asked the Commission to confirm that the RCST terminates on December 31, 2008, and that generators cannot be required to provide

reliability backstop service pursuant to the MOO without just and reasonable and non-discriminatory compensation.”

In its Answer to the Motion, the CAISO argued that IEP’s Motion should be rejected, *inter alia*, for the following reasons:

- The Commission has never directed the termination of the current CAISO Tariff’s MOO on the earlier of the full implementation of a resource adequacy program or December 31, 2007, as asserted by IEP. The orders to which the IEP refers addressed proposals for a flexible MOO to be implemented *after* the implementation of MRTU.
- Nothing in the RCST Settlement or the Commission’s orders in the RCST docket terminates the MOO on December 31, 2007, or any other date. After the RCST tariff provisions terminate, the existing MOO and compensation provisions that were in existence prior to the RCST Settlement will remain and will constitute the controlling filed rate unless or until the Commission approves a new compensation scheme.
- In its September 25, 2007, Notice, the Commission did not grant the CAISO an extension of its obligation to file the ICPM; the CAISO has no such obligation. Rather the Commission granted the CAISO an extension regarding the filing of a related compliance filing pertaining to MRTU. IEP’s Motion amounts to an impermissible effort to force the CAISO to exercise its rights under Section 205 of the Federal Power Act.
- The empirical evidence of the last year demonstrates that, contrary to IEP’s assertions, the existing Resource Adequacy program is not sufficient to ensure the reliability of the CAISO Controlled Grid absent a backstop reliability procurement program.

The CAISO stated further that the ICPM, which is being developed as a backstop mechanism for MRTU; is not designed to function in a pre-MRTU environment. The CAISO suggested that, if the Commission believes that it necessary to provide additional compensation to Must-Offer generators effective January 1, 2008, the Commission should exercise its rights under Section 206 of the Federal Power Act and extend the daily Must Offer capacity payment that is currently in effect until the implementation of MRTU.

On November 9, 2007, IEP filed an Answer to the Answers to its Motion. IEP asserts that the CAISO's Chief Executive Officer had made statements inconsistent with the CAISO's positions in its Answer, that the Commission is legally required under Section 205 of the Federal Power Act to revise the compensation for Must-Offer Generators, and that if the Commission were to direct continuation of the RCST beyond the agreed-to termination date specified in the RCST Settlement and in the CAISO Tariff, it should make modifications to the RCST. As discussed below, the modifications that IEP proposes represent significant changes not only to the RCST, but also to the MOO.¹ IEP's Answer contains a brand new proposal -- not set forth in its original Motion -- that has the following elements:

- the Daily payment component of the RCST settlement should be eliminated;
- the RCST designation trigger for a non-RA generator should be a single Must Offer Waiver Denial ("MOWD") and such designation should be for a minimum term (as described below);
- the Significant Event references and its use in RCST designation evaluation should be deleted from the RCST altogether;
- the minimum term for a RCST designation should be the greater of three months or the duration of the event or circumstances that triggered the CAISO's backstop procurement, not extend into the next RA compliance year, unless the RCST designated unit is not under RA contract for its capacity in the next RA compliance year;
- the capacity payment price that will be paid to any unit that the CAISO designates under these modified RCST tariff provisions should be based on a reference resource with an annual capacity payment of \$162.48/kW-yr. based on the California Energy Commission's ("CEC") calculation of the value of capacity of an LM6000 simple cycle unit;

¹ IEP's proposal with an automatic three month designation in the event a unit is denied a Must Offer waiver, is not a continuation of the RCST Settlement. It is an entire rewrite of the daily MOO under the CAISO Tariff. The CAISO notes, however, that the Commission has not found MOO to be unjust and unreasonable; it only found the compensation scheme that existed prior to the RCST Settlement to be so. Thus, IEP's Answer goes beyond the scope of previous filings in an attempt to modify portions of the CAISO Tariff that have not been found unjust and unreasonable.

- the circumstances that triggered the CAISO's backstop procurement should be posted on the CAISO website within seven days of the designation; and
- allocation of the costs from such procurement should be based upon the current RCST allocation methodology.

II. ARGUMENT

A. The CAISO's Answer Is Fully Consistent With The Statements Of Its Chief Executive Officer

IEP cites a statement by the CAISO's Chief Executive Officer as "undermine[ing] the CAISO's argument that before the implementation of MRTU: (1) the continuation of daily MOO, pre-MRTU, is an acceptable payment scheme; and that (2) no feasible alternatives to daily MOO exist. IEP states that, in an October report to the CAISO Board of Governors, the Chief Executive Officer stated that the ICPM will be implemented by May 31, 2008, even if MRTU is delayed.

As an initial matter, it should be noted that the report stated that *an* ICPM – not necessarily *the* ICPM that the CAISO is currently developing for implementation with MRTU – would be implemented by May 31, 2008.² Consistent with this statement, the CAISO stated in its Answer that in the event the CAISO determines that MRTU will be delayed beyond March 31, 2008, the CAISO will notify the Commission of such decision by January 31, 2007, *i.e.*, following a CAISO Board meeting which is scheduled for the end of January, and will commence a stakeholder process to consider development of a backstop capacity program/Must Offer pricing scheme to be effective before the high-demand summer season (assuming that MRTU will not be in effect by May 31, 2008).

² As the CAISO indicated in its Answer, the ICPM mechanism that the CAISO is currently designing for use under MRTU is not consistent with and will not function under the pre-MRTU market structure.

Moreover, there is no inconsistency between the Chief Executive Officer's statement and the CAISO's Answer. If IEP's reference to the "continuation of daily MOO, pre-MRTU . . . payment scheme" is a reference to the pre-RCST payment scheme, IEP misrepresents the CAISO's position. The CAISO has acknowledged that the Commission has found the pre-RCST payment scheme unjust and unreasonable. The CAISO simply stated, as discussed below, that the Commission has no obligation to direct a new payment scheme to be in effect for only three months.

If IEP was instead referring to the daily MOO capacity payment of 1/17 of the RCST monthly compensation, there is nothing inconsistent between the CAISO's intention to "commence a stakeholder process to consider development of a backstop capacity program/Must Offer pricing scheme to be effective before the high demand summer season"³ and the CAISO's position that the RCST daily payment of 1/17 of the RCST monthly compensation would be just and reasonable compensation effective January 1, 2008. Neither the CAISO's Answer nor the CEO report indicate what the specific elements of any scheme that might go into effect on May 31, 2008 would be. As indicated in the CAISO's answer, that is an issue that would have to be explored with stakeholders.

In any event, the Commission has repeatedly stated that there can be more than one just and reasonable rate.⁴ The fact that the CAISO is willing to consider exercising its Section 205 authority to recommend a new MOO/RCST pricing scheme does not imply in any manner that the existing scheme under the RCST Settlement is unjust or

³ See CAISO Answer at 5.

⁴ See, e.g., *New England Power Co.*, 52 FERC ¶ 61,090 at 61,336 (1990), *reh'g denied*, 54 FERC ¶ 61,055, *aff'd Town of Norwood v. FERC*, 962 F.2d 20 (D.C.Cir. 1992); citing *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C.Cir. 1984), *cert. denied*, 469 U.S. 917 (1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to alternatives).

unreasonable. Indeed, the currently effective \$73/kW-year target capacity payment that the Commission found to be just and reasonable in its February 13, 2007 Order approving the RCST Settlement remains within the range of the two reference points specified by the Commission in that order, *i.e.*, the fixed costs of existing generating units and the cost of new entry.⁵ IEP relies on a draft California Energy Commission report which indicates that the cost of new entry price for a simple cycle unit is \$162.48/kW-year. That same report shows the going forward fixed costs (fixed O&M, insurance and *ad valorem* taxes) of that same type of unit to be approximately \$37/kW-year. Thus, the currently effective target RCST capacity price of \$73/kW-year is well within the range of those two bookend pricing points. As such, consistent with the rationale stated in the February 13 Order, the \$73/kW-year capacity price remains within the range of reasonableness.

Similarly, the CAISO has never stated that no feasible alternatives to daily MOO exist. The fact that the CAISO in its Answer stated its willingness to work with stakeholders to consider developing such a program if MRTU is delayed beyond the summer of 2008 demonstrates the CAISO's belief that such alternatives do exist. Rather, the CAISO's position is that, given the importance of developing a capacity backstop under MRTU, and given that the CAISO's resources and efforts are focused on implementing MRTU by March 31, 2008, it would be unwise for the CAISO to divert its resources toward developing a distinct new product or pricing scheme that will only be in

⁵ In the February 13, 2007 Order, the Commission found that there were two reference levels for determining the price of procuring backstop capacity. At the lower end, the price should cover the fixed costs of existing generation that is needed for reliability. At the higher end, the Commission concluded that the price should not exceed the cost of new entry. Accordingly, the Commission found that a just and reasonable target capacity price lies within the range of \$64/kW-year (a reasonable proxy price for fixed operating costs of existing generation that was based on average gas-fired RMR units) and \$89/kW-year (a cost reflective of the price of new entry). *Independent Energy Producers Association v. California Independent System Operator Corporation*, 118 FERC ¶61,096 at P 70 (2007) ("February 13 Order").

effect for a few months prior to MRTU implementation. IEP has presented no evidence to the contrary.

B. The Commission Is Not Obligated to Impose an Interim Pricing Scheme.

IEP contends that “Section 205 of the FPA unequivocally provides that the Commission has no option, but to effect a change in the CAISO Tariff to ensure that the compensation provisions are just and reasonable.” IEP misstates the Commission’s authority. The Commission has no authority to impose a new rate under Section 205.⁶ Under Section 205 of the Federal Power Act, only the CAISO has the authority to propose such amendments to the Commission. The Commission can, however, impose a just and reasonable rate under Section 206 of the FPA after a finding that the existing rate is unjust or unreasonable, and that a new rate is just and reasonable. In this instance, the Commission has found the pre-RCST Must-Offer compensation to be unjust and unreasonable. However, the Commission has found the currently effective daily MOO capacity payment, which is based on a target capacity price of \$73/kW-year, to be just and reasonable. IEP has not shown that the \$73/kW-year price is unjust and unreasonable.

Nonetheless, as the CAISO explained in its Answer, the Commission’s actions under Section 206 of the Federal Power Act are a two-step process. First, the Commission may conclude that a rate is unjust and unreasonable. 16 U.S.C. § 824e. “Thereafter” the Commission may prescribe a just and reasonable rate. There is no requirement that the Commission act contemporaneously, or even immediately, to

⁶ . See *Sierra Pacific Power Co. v. FPC*, 350 U.S. 348 (1956).

prescribe a new rate.⁷ Thus, the “unjust and unreasonable” rate remains in effect except as modified by the Commission.

Under these circumstances, , the Commission has full legal authority to leave the pre-RCST Must-Offer compensation in place until the implementation of MRTU. Contrary to IEP’s arguments, the Commission has already determined that the MOO itself will continue until MRTU.⁸ If, however, the Commission chooses to act under Section 2006 before that date, the CAISO has recommended that it extend the RCST daily payment of 1/17 of the RCST monthly compensation for the reasons discussed herein and in the CAISO’s Answer.

C. IEP’s New Proposal Is Not Just and Reasonable

IEP proposes two significant and fundamental changes to the RCST and to the MOO. First, the daily capacity payment and the Significant Event designations are replaced with a three-month designation every time the CAISO denies a Must Offer Waiver. Second, the compensation is to be based on a \$162.48/kW-yr. estimated cost of new entry. Neither can be justified under the circumstances.

IEP’s proposed automatic three-month designation is, in effect, a complete replacement for the current daily MOO with a mandatory multi-month capacity procurement program. IEP offers no evidence why a daily MOO is unjust and unreasonable or why the required multi-month term it proposes is just and reasonable. Thus, IEP fails to satisfy both prongs of Section 206 in this respect. Also, IEP’s recommendation is inconsistent with the Commission’s recent order stating that the MOO will continue until implementation of MRTU. IEP’s proposal could also impose

⁷ *Sebring Util. Comm. v. FERC*, 591 F.2d 1003, 1013 n. 40 (5th Cir. 1979).

⁸ *California Independent System Operator Corp, et al.*, 121 FERC ¶ 61,193 at PP 2 and 101 (2007).

an inappropriate burden on ratepayers, *i.e.*, requiring the CAISO to pay for three months of capacity even if there is no specified future need for the capacity at the time of the designation. In that regard, under IEP's proposal, the CAISO could be required to designate a unit for a minimum three-month period even if the CAISO only needed the unit for the one day it denied the unit's waiver request, and the event that supported the waiver denial has ended prior to the designation. That is inconsistent with the intent of the Significant Event designation provisions of the current RCST which contemplate that a Significant Event, *i.e.*, the event which gives rise to the designation of capacity, will continue beyond the date of the designation. It could also leave the CAISO with unexpired three month designations at the time MRTU is implemented. MRTU has no mechanisms in place to use those designations.

In addition, IEP has failed to show that its proposed capacity payment is just and reasonable under the circumstances.. IEP claims that the existing RCST target capacity price may be unjust and unreasonable. IEP states that the RCST compensation was a negotiated amount for settlement purposes only and that the "reference resource" upon which the compensation amount in the RCST is based fails to adequately compensate generators because it does not represent capacity prices for new entry in the California market. However, IEP fails to show why cost of new entry is the appropriate price for MOO commitments for the three month period prior to implementation of MRTU.

There is only a three month gap between the termination of RCST and the implementation of MRTU. Obviously, the purpose of a "few-month" backstop capacity program is not to incent new generation; its purpose is to provide the CAISO with the ability to call on existing units not under RA contracts if the CAISO needs them to

maintain system reliability. In that regard, the only generating units that might receive a capacity payment during this three-month period would be existing units that do not have RA contracts. The CAISO also notes that CPUC-regulated load serving entities have already made their RA showings (both system and local) for 2008. IEP fails to show why MOO capacity must be priced based on new entry under these circumstances.

In addition, although the annual capacity payment under RCST was negotiated, in its order on the paper hearing, the Commission recognized that a payment below the cost of new entry may be just and reasonable. In fact, the Commission specifically found the RCST rate to be just and reasonable.⁹ As discussed above, applying the same rationale employed by the Commission in the February 13 Order, the \$73/kW-year target capacity price remains just and reasonable. The CAISO also notes that the existing MOO daily capacity payment under the RCST Settlement is based on 1/17th of the monthly capacity payment, rather than 1/30th of the monthly capacity payment. The CAISO submits that this is more than sufficient compensation during the few-month period prior to MRTU. Absent a showing of changed circumstances, IEP's contention that the existing level of the daily MOO capacity payment is unjust or unreasonable constitutes a collateral attack on the Commission's determination in the February 13 Order.

I. CONCLUSION

For the reasons discussed above and in its Answer, the CAISO requests that IEP's Motion for Reconsideration of Clarification be denied.

⁹ February 13 Order at P 72.

Respectfully submitted,

/s/ Anthony J. Ivancovich
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Dated: November 26, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service list for the captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 26th day of November, 2007.

/s/ *Melissa Hicks*
Melissa Hicks