

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

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| Independent Energy Producers Association |) | |
| Complainant |) | |
| v. |) | Docket No. EL05-146-___ |
| California Independent System Operator Corporation |) | |
| Respondent |) | |

**REQUEST FOR CLARIFICATION, OR IN THE ALTERNATIVE REHEARING,
AND FOR EXPEDITED ACTION
OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to Rules 212 and 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 713, the California Independent System Operator Corporation (“CAISO”) submits this request for clarification or, in the alternative, rehearing of the Order on Complaint and Offer of Settlement, *Independent Energy Producers Assoc. v. California Indep. System Oper. Corp.*, 116 FERC ¶ 61,069 (2005) (“Order on Complaint”). The CAISO needs guidance from the Commission on a number of important issues in order to properly implement the Order on Complaint. Although the Order on Complaint states that sellers of Eligible Capacity may elect to collect the Offer of Settlement rates as of July 20, 2006, further detail and instruction is necessary before the CAISO may properly comply with this aspect of the Order on Complaint. The CAISO therefore is filing the instant request for clarification, or in the alternative rehearing, and requests that the Commission act on the instant filing expeditiously. The CAISO requests the Commission to either provide the requested guidance and then consider the remaining issues during the paper hearing process or shorten the response

time for this motion to August 7, 2006, and promptly issue an order providing the needed guidance thereafter.

I. Background

On August 26, 2005, the Independent Energy Producers Association (“IEP”) filed a complaint under section 206 of the Federal Power Act alleging that the compensation paid to Generators¹ under the CAISO’s must-offer obligation was no longer just and reasonable. IEP asked that the must-offer obligation be replaced by a Reliability Capacity Services Tariff (“RCST”), under which Generators would commit capacity to the CAISO for reliability purposes and receive payments for the capacity as well as any Energy delivered.

The parties to the complaint and other intervenors in the proceeding initiated settlement discussions, and IEP asked the Commission to defer ruling on the Complaint pending the conclusion of those discussions. Following protracted negotiations, on March 31, 2006, various parties filed an Offer of Settlement with the Commission. The Offer of Settlement proposed the establishment of an RCST to backstop, to the extent required by system and local reliability criteria, the Resource Adequacy requirements imposed on load-serving entities by California law. The Offer of Settlement also proposed to maintain the must-offer obligation for certain circumstances not addressed by the RCST and to modify payment under the must-offer obligation to include a capacity payment. In addition, the Offer of Settlement provided for payments to frequently mitigated units and modified the CAISO’s Automated Mitigation Procedure and Ancillary Services Dispatch procedures.

¹ Capitalized terms not otherwise defined have the meaning given them in the ISO Tariff or the Offer of Settlement.

The Offer of Settlement included illustrative tariff sheets that the CAISO indicated it would implement and file with the Commission as actual tariff sheets if the settlement were approved. The CAISO did not file any tariff amendments under Section 205 of the Federal Power Act in conjunction with the Offer of Settlement. A number of parties contested the settlement.

On July 20, 2006, the Commission issued the Order on Complaint. The Commission declined to terminate the must-offer obligation, but found that the compensation provided under the must-offer obligation was no longer just and reasonable. Order on Complaint at PP 35, 38. The Commission concluded that it could not find that the rates and cost allocation under the Offer of Settlement were just and reasonable, and set those issues for a paper hearing. *Id.* at P 38. In the interim, the Commission ordered:

We will permit each seller of Eligible Capacity as defined under the terms of the Offer of Settlement, at its election, to collect the Offer of Settlement rates from the date of this order, so long as such seller agrees that all of these revenues will be subject to refund, even if they are collected after the statutory refund period ends. Each seller making this election must inform the Commission in writing of its intention to do so within 15 days of the date of this order.

Id. at P 40. The Commission established a Refund Effective Date of August 26, 2005.

II. Statement of Issues

1. The Commission should clarify whether it has authorized the CAISO to implement the Offer of Settlement as a whole pending a final ruling on the complaint and Offer of Settlement or, if not, should specify which Offer of Settlement rates or other terms of the Offer of Settlement that it has authorized subject to refund: Must Offer Capacity Payment rates, RCST rates in the event the CAISO were to designate a unit under the Significant Event provisions of the settlement, RCST rates in the event the CAISO were to designate a unit as a result of a deficiency in monthly Resource Adequacy showings, the payment to frequently mitigated units, a

combination of these rates, or any other terms of the Offer of Settlement, including, for example, reporting and evaluation, a revised Automatic Mitigation Procedure price screen, and non-consideration of cost-based bids from Reliability Must Run Condition 2 units in the Ancillary Services bid evaluation process.

2. The Commission should clarify (a) its authority under Section 206 of the Federal Power Act or otherwise to implement the settlement or impose Offer of Settlement rates on an interim basis subject to refund; and (b) how such settlement terms or rates should be implemented (*e.g.*, a compliance filing or filing under Section 205 of the Federal Power Act).
3. The Commission should clarify that the CAISO has authority to recover amounts paid under the Offer of Settlement rates and address the allocation of those costs, including both billable quantities and appropriate Market Participants.
4. The Commission should clarify that the Refund Effective Date does not prejudice, but merely establishes the outside limit of, the effective date of any rates or programs that the Commission subsequently approves in this proceeding.
5. The Commission should clarify whether it intends to establish the allocation of 2007 RCST costs in this proceeding.
6. The Commission should order sellers that elect to collect the Offer of Settlement rates to provide notice to the CAISO at the same time the seller notifies the Commission of its election.

III. Statement of Errors

The Order on Complaint erred in the following manners:

1. The Commission did not specify whether it has authorized the CAISO, on an interim basis, subject to refund, to implement the Offer of Settlement or, if not, which individual rates and terms of the Offer of Settlement that it has authorized on that basis.
2. The Commission has not indicated its authority to implement interim rates that it has not found to be just and reasonable, subject to refund, in a proceeding under Section 206 of the Federal Power Act or indicated how such rates will be implemented absent tariff sheets on file specifying such rates.
3. The Commission did not specify the CAISO's authority to recover payment of the Offer of Settlement Rates and the allocation of those costs.

4. The Order on Complaint is unclear whether the Refund Effective Date prejudices, or merely establishes the outside limit of, the effective date of any rates and terms of the Offer of Settlement or other action on the Complaint that the Commission subsequently approves in this proceeding.
5. The Commission did not state whether it intends to establish the allocation of 2007 RCST costs in the paper hearing proceeding.
6. The Commission did not order sellers that elect to collect the Offer of Settlement rates to provide notice of their election to the CAISO at the same time they provide notice to the Commission.

IV. Request for Clarification

The CAISO appreciates the Commission’s action in the Order on Complaint as a significant step toward ensuring that the CAISO has available the necessary capacity to comply with system-wide and local reliability criteria. However, the Order on Complaint raises a number of issues that need to be clarified or resolved if the CAISO is to be able to implement the Order on Complaint consistent with the Commission’s intention and in an efficient and effective manner. The CAISO also seeks clarification, or in the alternative rehearing, regarding a number of important issues pertaining to the paper hearing and the Commission’s treatment of the Offer of Settlement. The CAISO therefore asks the Commission expeditiously to clarify or grant rehearing on the issues discussed below.

A. The Authorized “Offer of Settlement Rates”

The Order on Complaint sets only the “rates and cost allocation mechanism under the Offer of Settlement or some other rates and cost allocation . . . with respect to the must-offer obligation” for hearing.² The Order on Complaint also permits sellers of Eligible Capacity as defined in the Offer of Settlement to collect the “Offer of Settlement

² Order on Complaint, Ordering Paragraph (B).

rates” from July 20, 2006 at their election.³ However, the Order on Complaint does not specify whether the Offer of Settlement rates that the Commission permitted to go into effect (subject to refund) include all of the terms and conditions of the Offer of Settlement or, if not, which “Offer of Settlement rates” sellers may collect.

The CAISO requests that the Commission clarify which terms and conditions of the Offer of Settlement rates it intended to authorize, subject to refund, by the Order on Complaint. Specifically, under the Offer of Settlement, sellers of Eligible Capacity, as defined by the Offer of Settlement, are eligible to receive the following rates for 2006: (1) a must-offer daily capacity payment to the extent they submit a must-offer waiver request that is denied (Section 7.2); (2) a RCST payment if the Eligible Capacity is designated as RCST capacity as a result of a net shortfall in Month-Ahead System Resource Adequacy Requirements Demonstrations or due to a significant event (Section 6.2); and (3) a Frequently Mitigated Unit Adder (Section 5.3). In addition, there are a number of reporting and procedural requirements of the Offer of Settlement. For example, the CAISO must evaluate, following four must-offer waiver denials for a Generating Unit, whether a Significant Event has occurred that would justify designating the unit as an RCST unit. The CAISO must also report information on, *inter alia*, its evaluation of Significant Events. Because the Order on Complaint does not specify which of these rates and terms it authorized, the CAISO is unable to implement the Commission’s order with any confidence that it is doing so correctly.

From the fact that the Commission set only the rates (and rate-related issues such as the revised Automatic Mitigation Procedure price screen and treatment of RMR 2

³ *Id.* at P 40.

Ancillary Services bids) and cost allocation for hearing, the CAISO could infer that the Commission, in authorizing Offer of Settlement rates subject to refund, intended the CAISO to implement all terms and conditions of the Offer of Settlement. The lack of a specific statement, however, prevents the CAISO from acting on such an inference. The Commission's authorization of payments to "sellers of Eligible Capacity," as defined by the Offer of Settlement, does not provide sufficient clarity. Sellers of Eligible Capacity are subject to the FERC must-offer obligation, which is an existing ISO tariff provision, and may thus receive the must-offer daily capacity payment. Sellers of Eligible Capacity may also receive payments if the Eligible Capacity is designated as RCST capacity (indeed, only Eligible Capacity is qualified for designation); however, once designated as RCST capacity, the capacity no longer meets the definition of Eligible Capacity for the duration of the designation.⁴ In addition, because the payment of an "adder" to Frequently Mitigated Units affects a universe wider than just sellers of Eligible Capacity, it is not clear whether the Commission intended that compensation also to go into effect to electing sellers, subject to refund, effective July 20, 2006. The Order on Complaint also makes no mention of reporting and procedural terms.

Because the CAISO is not certain which of the foregoing provisions it should implement in order to effectuate the Commission's intent, the CAISO requests clarification of the order in this regard.

B. The CAISO's Authority to Collect the Offer of Settlement Rates.

Section 205 of the Federal Power Act authorizes the Commission to permit the collection of filed rates, subject to refund, that it has not found to be just and reasonable.

⁴ As defined in the Offer of Settlement, Eligibility Capacity does not include capacity that has already been designated under the RCST Tariff.

The Offer of Settlement included detailed illustrative tariff sheets, but the CAISO did not file those tariff sheets under Section 205, and the current ISO Tariff rate does not include the Offer of Settlement Rates. Thus, the Offer of Settlement rates that the Commission has authorized the CAISO to pay to electing sellers of Eligible Capacity are not currently part of the CAISO's filed rate.

Section 206 of the Federal Power Act allows the Commission, after finding that a filed rate is unjust, unreasonable, or discriminatory, to direct a just and reasonable rate. It also allows the Commission, when it determines the just and reasonable rate, to order refunds, from the Refund Effective Date, of the difference between the charged rate and the just and reasonable rate. Courts have concluded that the Commission may, consistent with Section 206, implement an interim rate, subject to refund, (1) where it has determined a just and reasonable rate, but has deferred the determination of price squeeze issues (which can render a just and reasonable rate discriminatory), *Kansas Cities v. FERC*, 723 F.2d 82, 91-97 (D.C. Cir. 1983); and (2) where the Commission is employing a two step process under which it has determined a just and reasonable revenue requirement, but has directed the utility to file for Commission review rate sheets implementing that revenue requirement, *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 584.

The current proceeding, however, is in a different procedural posture. This is a Section 206 proceeding in which the Commission has authorized the collection, subject to refund, of rates that differ from the filed rate and which the Commission has not found to be just and reasonable. In any event, regardless of the Commission's authority to authorize such interim rates, the Commission has not in this proceeding directed the

CAISO to make a compliance filing implementing the Offer of Settlement rates such that they would constitute a filed rate.

This issue is further complicated if the Commission is, indeed, authorizing implementation of only certain payments under the Offer of Settlement. The Offer of Settlement was submitted as an integrated whole, balancing payments, allocations, restrictions on the CAISO's employment of the must-offer obligation, and reporting requirements. By its terms, it is only effective if approved without modification, unless Settling Parties agree to the modification. Whether such an Offer of Settlement can be implemented piecemeal on an interim basis, absent approval by all parties, is a significant question.

The CAISO is concerned that paying and charging rates other than the filed rate could arguably exceed the CAISO's authority under the Federal Power Act and could expose the CAISO to subsequent, complicated, litigation and potential liability. The CAISO therefore requests that the Commission clarify both its authority for allowing the collection and payment and the method by which the CAISO should seek to implement such rates.⁵

In the interim, the CAISO intends to track costs such that it can make whatever adjustments are necessary, retroactive to July 20, 2006, when the Commission provides the necessary clarification.⁶ The CAISO also intends to comply, to the extent consistent

⁵ The CAISO is evaluating whether filing tariff sheets to implement the Commission's order would facilitate the resolution of this issue. If it concludes that such a filing is appropriate, it will take such action expeditiously.

⁶ Indeed, the CAISO is tracking the costs from June 1, 2006, in order to make adjustments if the Commission approves the Offer of Settlement with the effective date included therein.

with current tariff provisions and competitive concerns, with all of the reporting and procedural requirements of the Offer of Settlement.

C. Allocation of Offer of Settlement Rates

Although the Order on Complaint authorizes the sellers of Eligible Capacity to collect the Offer of Settlement Rates, it does not specifically authorize the CAISO's recovery of those payments or determine the manner in which the CAISO is to allocate to Market Participants the amounts paid out. As the Commission is aware, under section 11.16.1 of the ISO Tariff, the CAISO can only pay out amounts that it has collected, except to the limited degree that it can employ the Reserve account. Thus, the CAISO cannot pay the Offer of Settlement rates to sellers of Eligible Capacity unless it has in place a mechanism to recover those costs from Market Participants.

The CAISO would expect that the Commission intended that the CAISO allocate the costs of the Offer of Settlement rates according to the methodology(ies) set forth in the Offer of Settlement, but cannot so presume. The CAISO would also expect the Commission to grant the CAISO surcharge authority in the event the allocation methodology(ies) ultimately adopted by the Commission is different than the Offer of Settlement methodology(ies). In any event, the CAISO notes that it does not have any filed tariff sheets with the Commission reflecting the Offer of Settlement Allocation methodology(ies) and the Commission has not found such methodology(ies) to be just and reasonable. Thus, the same questions raised in Section A are raised here – how does the Commission expect the CAISO to implement such allocation methodology(ies).

Accordingly, the CAISO requests that the Commission clarify the authority and manner of the CAISO's recovery of payments under the Offer of Settlement Rates.

D. Refund Effective Date

The Commission established a Refund Effective Date of August 26, 2005, the earliest possible date under Section 206. The Offer of Settlement, however, provided an effective date of June 1, 2006. That effective date was part of the overall negotiated balance in the Offer of Settlement and coincides with the implementation of the CPUC's Resource Adequacy Program, which is fundamentally intertwined with the terms of the proposed settlement. A decision by the Commission to change the date that the rates in the Settlement would go into effect would undermine the entire balance that was fundamental to the Offer of Settlement.

Implementing the terms of the Offer of Settlement retroactively is particularly problematic with regard to the modification of the trigger for the Automatic Mitigation Procedure and the limits on the dispatch of Condition 2 Reliability Must Run units for Ancillary Services. Retroactive implementation of these provisions would require extensive re-runs of the CAISO markets. Indeed, even implementing these provisions from the date of the Commission's clarification back to July 20, 2006, subject to refund, would be burdensome, especially if the Commission did not adopt such provisions following the paper hearing.

The CAISO is not aware of any statute or precedent that would require that the effective date of the rates under the Offer of Settlement or otherwise directed by the Commission coincide with the Refund Effective Date. The CAISO therefore requests that the Commission clarify that the establishment of the August 26, 2005 Refund Effective Date for the proceeding does not prejudice whether the Commission will approve the June 1, 2006, effective date contained in the Offer of Settlement, if it

approves the Offer of Settlement, or the effective date of any other rates or terms that the Commission might impose as a result of the complaint.

E. 2007 Allocation

The Offer of Settlement did not propose an allocation of RCST costs incurred in 2007. Rather, it reserved the issue in expectation of a Section 205 filing by the CAISO proposing an allocation. The CAISO anticipated that such a filing would be the result of a stakeholder process that would be held following the CPUC's and any Local Regulatory Authority's imposition of local capacity requirements. In that way, the CAISO could tailor the allocation to the specific requirements imposed by the CPUC and any Local Regulatory Authority. In the Order on Complaint, the Commission set for paper hearing the justness and reasonableness of the rates and allocation under the Offer of Settlement. It indicated that an order was likely by November 2006. The Commission did not specify whether its investigation, and subsequent resolution, would include the allocation of RCST costs for 2007.

If the CAISO is to propose an RSCT cost allocation for 2007 under Section 205, it must begin stakeholder processes and other efforts to develop its proposal well before November 2006. The CAISO therefore requests that the Commission clarify whether it intends to address the 2007 allocation of RCST costs in the paper hearing process in this docket or whether the CAISO should address such issue via a Section 205 filing.

F. Notice of Election

The Order on Complaint requires sellers of Eligible Capacity that intend to collect the Offer of Settlement rates to notify the Commission within 15 days of the Order on

Complaint,⁷ but does not require sellers to provide notice to the CAISO. All payments under the Offer of Settlement, however, are processed through the CAISO's markets and cannot be collected unless the CAISO is aware of the applicability of such rates.

In addition, the Commission did not specify whether the election is a one-time election or, if not, the circumstances and frequency under which it can be revoked. The CAISO therefore requests that the Commission clarify that the election of the Offer of Settlement rates is a one-time event and that sellers must provide notice of the election to the CAISO as well as the Commission.

V. Conclusion

The CAISO requests that the Commission expeditiously clarify the Order on Complaint regarding the issues described above or, if clarification is not appropriate, grant rehearing to resolve those issues.

Respectfully submitted,

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Attorneys for the California Independent System
Operation Corporation

⁷ Order on Complaint at P 40.

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 1st day of August, 2006 at Washington, D.C.

/s/ Daniel Klein
Daniel Klein
(202-756-3300)