



California Independent
System Operator Corporation

January 24, 2007

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

**Re: Reply Comments of the California Independent System Operator
Corporation
Docket Nos. EL08-20-000 and 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 Reply Comments of the California Independent System Operator Corporation.

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

The Independent Energy Producers Association (“IEP”) and Energy Companies³ contend that the RCST designation and compensation provisions are unjust and unreasonable and unduly discriminatory. Neither has demonstrated any changed circumstances that would justify reversal of the Commission’s previous conclusion (most recently affirmed on December 20, 2007) that the existing RCST designation procedures and compensation are just and reasonable and not unduly discriminatory.

IEP’s and Energy Companies’ only criticism of the RCST designation process is that the CAISO has not made as many RCST designations as they think it should have. However, IEP and Energy Companies cite nothing but the total number of Must-Offer Waiver Denials (“MOWDs”) to support their claim that maybe there should have been more RCST designations, but that number by itself proves nothing. IEP and Energy Companies ignore the fact that there are no hard triggers for RCST designations. The CAISO tariff sets forth specific preconditions for RCST Significant Event designations following MOWDs, and the CAISO has explained in each of its Significant Event reports the reasons why the preconditions that must occur to warrant Significant Event RCST designations of capacity were not met except in two instances (one which did not ultimately result in a designation of capacity due to the failure to satisfy another provision of the RCST). IEP and Energy Companies do not present one iota of evidence that the CAISO has improperly implemented the RCST Settlement or improperly applied the RCST tariff language with respect to the designation of RCST Units for Significant

³ Energy Companies are comprised of Dynegy Moss landing LLC, Dynegy Morro Bay LLC, El Segundo Power LLC, and Reliant Energy LLC.

Events. In particular, they cannot identify a single instance where the CAISO would have been required to make a Significant Event designation under the RCST but did not.

IEP asserts that the CAISO, by issuing real-time MOWDs using its Real-Time Commitment (“RTC”) software (which commits effective and available units in economic order) has violated the tariff requirement that the CAISO exhaust RA, RMR, and RCST units before issuing MOWDs to other units. However, IEP fails to mention that the tariff requirement is not absolute, but applies only when conditions allow. In this instance, the CAISO tariff requires the CAISO to use economic dispatch in making certain real-time commitments. Thus, when operating under this Real Time Dispatch procedure, the CAISO cannot deny a real-time MOWD to a less expensive effective non-RA unit prior to a more expensive effective RA unit without running afoul of the economic dispatch requirements and the RTC previously approved by the Commission. These economic dispatch tariff provisions and RTC software, which were implemented as part of the so-called MRTU (formerly MD02) Phase 1B amendments, predate RCST and were not changed by the RCST Settlement. Even if the Commission were to determine that economic dispatch was inappropriate, the fact is that Must-Offer Generators will have been fully compensated for the real-time MOWDs via receipt of the daily 1/17th capacity payment.⁴

⁴ IEP is being internally inconsistent: it seeks to “count” the number of RTC waiver denials to support its claim that the CAISO has made a large number of waiver denials without resulting RCST designations, but then it turns around and argues that it “appears to be a violation of the terms of the Settlement” for the CAISO to have issued those RTC MOWDs in the first place (which, if correct, would result in such MOWDs

IEP also incorrectly claims that the CAISO does not consider real-time MOWDs made through the RTC application when performing Significant Event evaluations. As demonstrated by the various Significant Event Reports, the CAISO performs a Significant Event evaluation *whenever* a unit is denied a must-offer waiver four times. This includes waiver denials issued through the RTC application. The Commission should not countenance IEP's incorrect claims.

Moreover, IEP's proposed automatic three-month designation following a single MOWD would impose an unjust and unreasonable burden on ratepayers by requiring the CAISO to essentially contract for three months of capacity even if there is no need for the capacity beyond the day on which the MOWD is issued. RCST was designed to avoid such situations by limiting multi-month designations to situations where the CAISO determined that there was a Significant Event and that an RCST designation was "necessary" for the reasons specified in the tariff to address the reliability needs raised by the Significant Event. The RCST also requires the CAISO to take into consideration the duration of the Significant Event in determining whether to make a designation which would have a minimum term of three months (along with three months of capacity payments). IEP's proposal offers no such protections. It would also allow gaming: certain units could obtain RCST designation by self-scheduling for a period of time and then stopping the schedule – forcing the CAISO to issue a MOWD because no comparable units could start up in time to meet reliability needs, and thereby enabling the unit to receive an automatic three-month capacity contract.

not counting for Significant Event evaluation/designation purposes and a large number of 1/17th daily capacity payments not being made to generators).

IEP also contends that RCST compensation is unjust and unreasonable, while Energy Companies assert that extending RCST beyond March 31, 2008, would be unjust and unreasonable. Neither identifies any changed circumstances that would render the RCST compensation previously approved by the Commission (*i.e.*, a target capacity price of \$73/kW-year and a daily capacity payment for each MOWD equal to 1/17th of the monthly capacity payment) unjust and unreasonable for the few-month period prior to the implementation of MRTU or an alternative backstop mechanism.

The *only* changed circumstance that either offers is an increase in the cost of new entry, which IEP discusses at length. The cost of new entry, however, was not the basis for the Commission's determination that the compensation was just and reasonable. Energy Companies, IEP and Mr. Cavicchi ignore the Commission's unambiguous statement in the Rehearing Order that the cost of new entry only establishes the upper limit of the range of reasonableness, while the lower limit is established by the fixed costs of existing units. IEP and Energy Companies (which represent existing generation) offer no evidence whatsoever regarding the lower bookend of the range of reasonableness, *i.e.*, the fixed costs of existing generation. The current target capacity payment is within the range of reasonableness to the extent it remains above the lower limit of that range. IEP and Energy Companies have not pointed to any changed circumstances that have materially altered the fixed costs of existing units such that the current target capacity payment no longer remains just and reasonable. The CAISO also notes that under the daily Must Offer capacity payment, for each day of a MOWD -- one 30th of a month -- generators receive 1/17th of the monthly target capacity payment, *i.e.*, almost twice the proportional payment.

Using the cost of new entry for the target capacity payment would also impose an unnecessary burden on California ratepayers. The RCST extension will only be in place for a short period of time – not long enough to encourage new generation. Thus, cost of new entry will be paid to existing generating units. Based on evidence presented during the RCST proceeding, the fixed costs of existing generation is significantly below the cost of new entry price that IEP proposes. In addition, very few load pockets on the CAISO grid are currently in need of additional generation, which further calls into question the need for uniform cost of new entry pricing. In the remaining load pockets where there is surplus capacity but potentially some concentration of ownership, additional investment does not seem to be needed in the near-term. Thus, cost of new entry pricing is neither needed nor appropriate. Indeed, paying RCST units the cost of new entry would provide units in those areas with an unfair competitive advantage.

Energy Companies ask the Commission not to extend RCST beyond March 31, 2008, and to appoint a settlement judge to supervise the stakeholder process for the development of an alternative backstop capacity mechanism if MRTU is delayed beyond March 31, 2008. To the extent that the CAISO determines that MRTU can be implemented before June 1, 2008, there is no reason to terminate RCST prior to that time. If it is just and reasonable to extend RCST for three months, then it is just and reasonable to extend RCST for four or five months, pending implementation of MRTU or an alternative backstop mechanism. To the extent, the MRTU date is postponed until after the high demand summer season, then consideration of an alternative backstop capacity procurement mechanism would be appropriate. The CAISO is committed to work with stakeholders on an expedited basis to develop such a mechanism to be implemented by

June 1, 2008. The CAISO does not believe, however, that the appointment of a settlement judge is necessary or appropriate.

SWP contends that its off-peak pump Loads are unjustly being allocated the same RCST costs as on-peak loads and that the methodology unduly discriminates against Controllable Loads that are able to shift to the off-peak hours. The Commission has already rejected these arguments in finding this allocation to be just and reasonable in the proceeding on Amendment No. 60 to the CAISO Tariff. SWP's contentions are a collateral attack on previous Commission orders.

II. BACKGROUND

The background of this proceeding was set forth in the CAISO's initial Comments, and the CAISO will not repeat it here.

Twenty-four parties have submitted motions to intervene (or notices of intervention) in the Investigation. Eleven of these parties (plus the CAISO) provided comments or statements of position. Only two parties – the Independent Energy Producers Association (“IEP”) and the California Department of Water Resources-State Water Project (“SWP”) – opposed the extension of the RCST as unjust or unreasonable without significant modifications.⁵ One set of parties commenting jointly – Dynegy Moss Landing, LLC, Dynegy Morro Bay, LLC, El Segundo Power, Inc., and Reliant Energy, Inc. (“Energy Companies”) – asked that the Commission not extend RCST beyond March 31, 2008.

⁵ Some parties also expressed support for the CAISO's Motion for Clarification filed in this docket on December 21, 2007, or requested certain assurances.

On January 14, 2008, the CAISO filed a status report with the Commission concerning MRTU implementation. The CAISO informed the Commission that implementation on March 31, 2008, was no longer possible. The CAISO was unable at that time to provide a new implementation date.

II. REPLY COMMENTS

A. Extension of the RCST Is Just and Reasonable and Not Unduly Discriminatory.

IEP contends that the RCST designation provisions and compensation are unjust and unreasonable and that price discrimination exists between new and existing Generating Units. Energy Companies make similar assertions in arguing that RCST should not be extended beyond March 31, 2008. The Commission, however, has previously found RCST designation procedures and compensation to be just and reasonable.⁶ As the CAISO noted in its initial comments, such provisions should not be changed unless it is demonstrated that such provisions are no longer just and reasonable. Specifically, parties should be required to show changed circumstances that have vitiated the basis of the Commission's prior rulings, including a ruling from December 20, 2007. Neither IEP nor Energy Companies have identified any such changed circumstances.

1. The RCST Designation Process Is Just and Reasonable.

IEP's only argument regarding the RCST designation process is its claim that the CAISO has abused its discretion by failing to make more RCST designations. Energy Companies repeat a similar contention that they made in their complaint filed in Docket

⁶ *Indep. Energy Producers Assoc. v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 ("Order on Paper Hearing"), reh'g denied, 121 FERC ¶ 61,276 ("Rehearing Order") (2007).

No. EL08-13. If this assertion were true, however – which it is not – it is beyond the scope of this proceeding. As the Commission has recognized in its December 20, 2007 Investigation Order (P 35), the “the Commission is simply investigating the justness and reasonableness of extending the termination date of RCST until the earlier of the implementation of either MRTU or an alternative backstop capacity procurement mechanism” and “parties are requested to limit their comments to the issue of the justness and reasonableness of extending the termination date of the RCST.” The more appropriate forum for consideration of this contention is a proceeding concerning the CAISO’s administration and implementation of the RCST, not a proceeding limited to the justness and reasonableness of extending the applicability of the RCST tariff provisions themselves.⁷

In any event, as the CAISO thoroughly explained in its December 20, 2007 Answer to Energy Companies’ complaint in Docket No. EL08-13 and in its November 15, 2007 Answer to Williams’ *Motion to Supplement Motion for Clarification* filed in Docket No. EL05-146, the CAISO has *not* abused its discretion: the CAISO’s implementation of RCST is entirely consistent with the terms of the tariff and the RCST settlement. IEP does not prove otherwise. IEP simply *assumes* that the CAISO must have abused its discretion because only one RCST designation resulted from the 525 MOWDs issued between June 1, 2006 and December 31, 2007.⁸ The lack of RCST designations, however, is due to the CAISO’s conscientious application of the

⁷ See, e.g., Investigation Order at P 52.

⁸ IEP at 6.

prerequisites for such designations that were included in the RCST Settlement and its adherence to the designation criteria and standards set forth in the tariff.

IEP ignores the fact that, as the CAISO has explained in previous filings, the RCST Settlement and the Commission-approved tariff provisions implementing the RCST establish specific requirements before the CAISO can even exercise its discretion to designate a unit; there are no hard triggers for multi-month RCST designations, nor are such hard triggers appropriate. First, there must be a Significant Event – which, for 2006, is defined as an event “that results in a material difference in ISO-Controlled Grid operations relative to what was assumed in developing the LARN Report for 2006 that causes or threatens to cause a failure to meet Applicable Reliability Criteria.” For 2007, it is “an event that results in a material difference in ISO Controlled Grid operations relative to what was assumed by the CPUC and Local Regulatory Authorities in developing Local Resource Adequacy Requirements for 2007 that causes, or threatens to cause, a failure to meet Applicable Reliability Criteria. Thus, the issuance of an MOWD or any number of MOWD’s does not – and cannot – establish that a Significant Event occurred.⁹ Second, under Section 43.4, the CAISO may designate capacity to provide

⁹ Further, IEP’s raw numbers do not tell the whole story. For example, of the 328 MOWDs reported for 2007, 175 were commitments by the RTC software (computer-driven by economic considerations, as discussed *infra*); 56 other commitments occurred when RA units were available because of an emergency, a unit test, or when a large, self-scheduled unit ceased self-scheduling and RA units could not be started in time; 36 were committed incorrectly by the operator; and the remaining 61 commitments were

service under the RCST following a Significant Event *if* such an RCST designation is *necessary to remedy any resulting material difference* in ISO Controlled Grid operations relative to the assumptions in the LARN Report. Again, the number of MOWDs is irrelevant to this determination. The restrictions on the CAISO's ability to make Significant Event designations were just as important to some parties to the Settlement as the CAISO's authority to make designations was to the Energy Companies.

Further, because Significant Event designations have a minimum term of three months (and will be paid monthly capacity payments for every month that they are designated), Section 43.4 also requires the CAISO to take into account the expected duration of the Significant Event in determining whether or not to make an RCST designation. Under the Significant Event/Repeat MOWD evaluation process, the CAISO is also required to indicate whether any RA resources or RMR units were available and called by the CAISO before it denied a FERC must-offer Generator's waiver request. Finally, the CAISO must explain why Non-Generation Solutions were insufficient to prevent the use of denials of must offer waivers for local reasons.

The CAISO applied these criteria to each of the MOWDs that were issued. By doing so, it determined that only two events would have warranted Significant Event RCST designations.¹⁰ IEP has not identified even a single instance in which the CAISO

approximately 2/3 for local purposes and 1/3 for the Santa Ana firestorm, when RA units were unavailable or ineffective.

¹⁰ See *CAISO Answer to Williams Power Company LLC* at 6-9. As the CAISO has previously noted, the CAISO was unable to make a Significant Event RCST designation for one of the events -- the CEC's upward revision to its Summer 2006 Demand outlook

failed to apply the specified criteria or applied them incorrectly. The fact that those criteria were applied to a large number of MOWDs – which is the entire basis of IEP’s contention – means nothing without a showing that there were MOWDs that satisfied these criteria, but upon which the CAISO nevertheless refused to base an RCST designation.

Although IEP argues that the settling parties anticipated that the CAISO would no longer have a need to regularly issue MOWDs¹¹ after the implementation of RCST,¹² IEP’s only authority for this proposition is the self-serving affidavit it submitted in this proceeding. In fact, nothing in the tariff or the settlement supports such a statement. IEP’s claim, moreover, is contrary to the comments and evidence presented by the CAISO in support of the RCST Settlement. In its comments, the ISO explained its implementation of an interim Resource Adequacy program reduced the number of

-- because designation criteria specified in another section of the RCST (*i.e.*, in the general RCST designation provisions not the Significant Event provisions) were not satisfied. *See* Answer to Williams at 7-8; Answer to Energy Companies at fn.

24. Specifically, the RCST Settlement only permitted the CAISO to designate units that have a capacity that is slightly more or slightly less than the identified deficiency.

Because the capacity of the only unit that was available to satisfy the deficiency was more than four times the amount of the deficiency, the CAISO was unable to make a RCST designation.

¹¹ Presumably, IEP is referring to MOWDs issued to non-RA Units; MOWDs also are the mechanism for commitment of RA Units as well as Must-Offer Generators.

¹² IEP at 5.

MOWDs issued to generating units that might be eligible for capacity payments under the RCST, but that the number was still substantial.¹³ The potential payments under the RCST were thus far lower than they would have been in the absence of the Resource Adequacy program, but there is no basis for IEP's claim that MOWDs would no longer be issued. Further, as the Commission has recognized,¹⁴ neither the settlement nor the tariff permits designations for zonal reliability concerns, and more than half of the MOWDs issued by the CAISO between June 1, 2006 and February 28, 2007, were zonal issues (exclusive of 22 MOWDs issued in January 2007 because the operator mistakenly believed the unit to be an RA unit).¹⁵ In any event, the degree to which daily MOWDs can be reduced is highly dependent on system circumstances on a given day.

¹³ See Reply Comments and Answer to Motion to Dismiss of the CAISO, Docket No. EL05-146 at 9-10 (Sep. 26 2006); Comments of the CAISO, Docket No. EL05-146 at 5 (May 1, 2006). With its September 26, 2006 Comments, the CAISO presented a corrected calculation showing that of the 1287 unit-days of MOWDs during 2005, 353 involved units that were FERC Must Offer resources (*i.e.*, not RA or RMR resources) on June 1, 2006. See Second Declaration of Mark Rothleder at 4. The actual number of MOWDs for the 19 month period June 1, 2006 through December 31, 2007 is consistent with this number (and would be even lower if one deducts the MOWDs that were incorrectly made).

¹⁴ *California Independent System Operator Corporation*, 121FERC 61,276 at P 46 (2007).

¹⁵ Retroactive RCST Significant Event Summary at 3-4

<http://www.caiso.com/1c20/1c20e8373c330.pdf>.

IEP has not presented *any* evidence showing that the CAISO should have made additional RCST designations under the tariff.¹⁶ IEP does not identify any deficiency in the CAISO's analysis of whether the events included in the reports constituted Significant Events that would have necessitated a designation of capacity, consistent with the criteria identified above. IEP does not explain why it would have been *necessary* to designate any of the units that were denied MOWDs under the RCST in response to a Significant Event. In particular, IEP does not even attempt to explain why any particular units should have received RCST designations. Also, IEP does not show that the CAISO has improperly implemented the RCST Settlement or improperly applied the RCST tariff language with respect to the designation of RCST Units for Significant Events. In short, IEP does not provide one iota of evidence that the CAISO has failed to fulfill its obligations under the RCST Settlement and the Tariff with respect to the designation of units. Accordingly, the Commission should not countenance these baseless allegations.

IEP also asserts that in allowing its RTC software, which commits effective units in economic order, to make certain real time MOWDs, the CAISO has violated the tariff requirement that the CAISO exhaust RA, RMR, and RCST units before issuing MOWDs to other units.¹⁷ However, Section 40.7 of the CAISO, provides, "*To the extent*

¹⁶ Energy Companies state that there were some hot weather periods in 2007 as well as fire emergencies. However, they do not attempt to show how those events met the Significant Event designation criteria set forth in the tariff or that their duration was such that a three-month designation of capacity was "*necessary*". Energy Companies forget that the CAISO is not permitted to exercise its discretion outside the confines of the tariff.

¹⁷ IEP at 7.

conditions permit, the ISO will revoke the waivers of Resource Adequacy Resources and RCST resources prior to revoking the waivers of other FERC Must-Offer Generators.” (Emphasis added.) Although conditions rarely interfere with the CAISO’s ability to follow this sequence day-ahead, the CAISO’s real-time commitment procedures and software are a condition that does not always allow the CAISO to do so in real-time. Section 34.3 of the CAISO Tariff, which the Commission approved as part of Phase 1B of MRTU, provides, “The ISO shall employ a multi-interval constrained optimization methodology (RTD Software) to calculate an optimal dispatch for each Dispatch Interval within a time horizon that shall extend to the end of the next hour. . . . The ISO also shall instruct resources to start up or shut down over the time horizon based on their submitted and validated Start-Up Fuel Costs, Minimum Load Costs and Energy Bids... The ISO shall only start resources that can start within the time horizon”¹⁸ The RTC software provides the functionality required by the CAISO Tariff by committing resources for a capacity deficiency expected in a two hour horizon, based on short term load forecasts and committed capacity, using economic considerations. When operating under this Real Time Dispatch procedure, the CAISO cannot deny a real-time MOWD to a less expensive effective non-RA unit prior to a more expensive effective RA unit without violating the requirement for economic dispatch. The CAISO’s RTC software, tariff

¹⁸ Section 34.3.0.2 provides that the CAISO “shall not discriminate between Generating Units, System Units, Loads, Curtailable Demands, Dispatchable Interconnection schedules and System Resources other than based on price, and the effectiveness (*e.g.*, location and ramp rate) of the resource concerned to respond to the fluctuation in Demand or Generation or to resolve Inter-zonal Congestion.”

provisions and practices predate RCST and were not changed – nor were they intended to be changed -- by the RCST Settlement or the tariff provisions implementing the Settlement. The only change brought about by the RCST Settlement was to add the words “*and RCST*” to Section 40.7.

In any event, even if the Commission were to conclude that the use of the RTC software in such circumstances was inappropriate, Must-Offer Generators have suffered no harm. They have received the daily capacity payment for MOWDs resulting from the RTC, Minimum Load Cost Compensation, payments for minimum load energy, startup costs, and, if applicable, emissions costs. The only significant effect of this procedure is that the CAISO has had to conduct additional Significant Event evaluations due to MOWDs resulting from Real-Time commitments.

IEP also errs when it states that the MOWD process is discriminatory because the CAISO does not consider real-time MOWDs made through the RTC application when performing Significant Event evaluations.¹⁹ Contrary to IEP’s statement, the CAISO performs a Significant Event evaluation *whenever* a unit is denied a must-offer waiver four times, including denials issued through the RTC application.²⁰ IEP’s own

¹⁹ IEP at 7-9, Cavicchi Aff. at P 10-11.

²⁰ Real Time commitments are divided into two categories – Manual commitments and RTC (computer driven) commitments. Manual commitments are reviewed just like day-ahead commitments. *See, e.g.*, Report for week ending 8/4/07: <http://www.caiso.com/1c44/1c44b81030fd0.pdf>. When a unit is committed by RTC, the CAISO first determines whether RA Units were available. If RA units were available, the CAISO has concluded that there was no Significant Event requiring a designation of

“evidence” demonstrates that point. For example, in the October 27, 2007, MOWD evaluation cited by IEP and Mr. Cavicchi, the CAISO stated “The CAISO determined that there was no Significant Event related to the real-time system MOWD commitments on *all* of these days because in all cases other RA or RMR units were available in real-time for commitment.” (Emphasis added.) Commitments on all but one of those days were made by the RTC application. Thus, IEP’s claim is belied by the very evidence it cites.²¹

The CAISO’s Significant Event Reports show that it does consider RTC MOWDs in its Significant Event evaluation process. IEP’s real complaint seems to be that the CAISO’s consideration of RTC MOWDs did not result in a greater number of RCST designations. As explained above, however, this proves nothing. Moreover, in the circumstance of RTC MOWDs, it is not surprising because, as also explained above, one of the factors the CAISO is required by Section 43.4 of the tariff to consider is the expected duration of the Significant Event. Because RTC MOWDs are issued when capacity, because there was no real shortage of capacity. *See, e.g.*, Report for week ending 12/22/07: <http://www.caiso.com/1cc5/1cc59404446c0.pdf>.

If RA units were not available, the review is conducted as with day-ahead commitments. *See, e.g.* Report for week ending 9/9/06: <http://www.caiso.com/1c6c/1c6cddf9dbe0.pdf>.

²¹ IEP counts the number of RTC MOWDs for purposes of supporting its claim that there have been a large number of MOWDs but a limited number of RCST designations, but then inconsistently claims that the CAISO should not be making these RTC MOWDs. IEP cannot have it both ways.

other units are available for commitment (*i.e.*, there is no resource shortage of RA or RMR generation and, as such, there is not likely to be any material change in assumptions from what was assumed in establishing local capacity requirements), based on economic criteria, and to address events that typically are of a very short-term, point-in-time nature, they will unlikely constitute a Significant Event that necessitates the multi-month procurement of capacity.

Moreover, IEP's proposed solution for the alleged problem – an automatic three-month designation following a single MOWD – would impose an unjust and unreasonable burden on ratepayers. It would require the CAISO to contract for three months of capacity even if there is no need for the capacity beyond the day on which the MOWD is issued. The automatic three-month designation of capacity is wholly unrelated to the nature of the event that led to the MOWD in the first place or the expected duration of such event. In other words, the CAISO would be paying for capacity for every day during a three-month period whether it needs the capacity or not. This proposal essentially amounts to forced contracting for units that do not have RA or RMR contracts.

IEP's proposal would also create gaming opportunities. There are examples of large, slow starting, non-RA units, frequently being self-scheduled. Such units are similar in design to many of the RA units in the region. CAISO operators will count these self-schedules in their calculations on-line generation. When such Generator ends its self-schedule, operators are left with a big gap to fill and short amount of time to fill it. (The operators would only learn of the schedule at approximately noon the day before the operating day.) Where the available RA units are large, slow starting units, *i.e.*,

units that could not be started by the time they are needed the next day, the operators have no choice but to deny waivers for the Generator's units (which were already running). Under IEP's proposal, any similarly situated Generator could force the CAISO to give it a multi-month RCST designation by simply self-scheduling a unit with a long lead time for start up for a few days, and then stopping. The existing RCST avoids this situation.

Multi-month RCST designations were specifically limited to situations where the CAISO determined that "an RCST designation is necessary to remedy any resulting material difference in ISO Controlled Grid operations relative to the assumptions reflected in the LARN Report for 2006 or relative to the CPUC's and, if applicable, a Local Regulatory Authority's development of Local Resource Adequacy Requirements for 2007" "taking into account the expected duration of the Significant Event." *See* Section 43.4 of the CAISO Tariff. Limitations on the extent of multi-month forward procurement are not unreasonable. Capacity should be procured on a forward basis to meet a specific future need or requirement; multi-month procurement should not be a "reward" for having been available on a given day in the past. In contrast to Significant Event RCST designations, MOWDs, are for a single day and are based on whether or not the CAISO needs a unit to be available *on that day*. The must-offer obligation has operated in this manner for more than half a decade, and, although the Commission may have found the must-offer pricing to be unjust and unreasonable, the Commission has never found the daily MOWD process to be unjust and unreasonable.

In sum, neither IEP nor the Energy Companies have provided any evidence that the CAISO's implementation of the RCST designation process is in any manner

inconsistent with the RCST tariff procedures that the Commission has approved as just and reasonable. Moreover, even if the CAISO had done so, it would not be relevant to whether the procedures themselves remain just and reasonable.

2. RCST Provides Just and Reasonable Compensation

IEP also contends that RCST compensation is unjust and unreasonable. Energy Companies assert that compensation would be unjust and unreasonable if RCST were extended beyond March 31, 2008. Neither IEP nor Energy Companies identify any changed circumstances that would render unjust and unreasonable continued applicability of the existing RCST compensation scheme for the few month period prior to the earlier of implementation of MRTU or an alternative backstop procurement mechanism.

The *only* changed circumstance that IEP offers is an increase in the cost of new entry, which IEP discusses at length.²² Whether or not “[t]he original RCST compensation system was determined using the cost of new entry,” as is asserted by Mr. Cavicchi,²³ the cost of new entry was not the basis for the Commission’s determination that the compensation was just and reasonable. IEP and Mr. Cavicchi ignore the Commission’s unambiguous statement in the Rehearing Order that the cost of new entry

²² Energy Companies also rely on changes in the cost of new entry to support their argument for a higher capacity payment in the event MRTU is delayed past March 31, 2008. Energy Companies at 17-19. Their argument is flawed for the same reasons as is IEP’s argument. In the event that MRTU is delayed past the summer, and a new interim capacity mechanism is required, the CAISO takes no position at this time as to the appropriate target capacity payment for such a program.

²³ Cavicchi Aff. at ¶ 16.

only establishes the upper limit of the range of reasonableness.²⁴ The lower limit is established by the fixed costs of existing units.²⁵ Because the current target capacity payment is above the lower limit of the range of reasonableness, the Commission found it to be just and reasonable. Unless IEP can point to some changed circumstance that has materially altered the fixed costs of existing units, the current target capacity payment remains just and reasonable and within the zone of reasonableness. However, neither IEP nor Energy Companies provide any evidence regarding the fixed costs of existing units or demonstrating that the \$73/kW-year target capacity price is no longer within the two bookend pricing reference points established by the Commission in its orders on the RCST Settlement.

The fleet of generators that has been receiving the just and reasonable MOO daily capacity payment based on a target capacity price of \$73/kW-year is the same fleet of generators that will be receiving a RCST payment for the few-month interim period prior to implementation of MRTU or an alternative backstop mechanism. The average cost of existing generation is not likely to change materially during this few month period, and certainly will not be at the cost of new entry as proposed by IEP.

Using the cost of new entry for the target capacity payment would also impose an unnecessary burden on California ratepayers. The use of the cost of new entry is generally justified as an incentive for new generation in areas where it is needed. While the CAISO agrees that it may be appropriate to adjust capacity payments in the future in conjunction with implementation of a long-term RA framework designed to elicit

²⁴ Rehearing Order at P 23.

²⁵ *Id.*

investment in generation (or other means to achieve RA) – an issue that is currently being addressed in a proceeding at the California Public Utilities Commission – this does not constitute such a situation. There would be only a short, few month period between the termination of RCST and the implementation of ICPM under MRTU (or implementation of an alternative backstop mechanism prior to MRTU). A backstop mechanism that will be in place only for a few months is not intended to, and cannot be expected to, provide incentives for new generation. Rather, its purpose is to provide the CAISO with the ability to call on *existing* units not under RA or RMR contracts if the CAISO need them on a particular day. Thus, it will only produce revenues for existing resources, and the cost of new entry is significantly higher than the fixed costs of existing generation.²⁶

Furthermore, even assuming *arguendo* that cost of new entry pricing was appropriate under an interim program expected to be in place only for a few months, it would not be appropriate to apply such pricing in a uniform manner. In particular, cost of new entry pricing should be considered as a possible backstop price only when there is a capacity deficiency in a local area or system zone and the intent of the mechanism is to incent new generation (which is not the case with a backstop mechanism that will only be in place for a few months). RA requirements are currently set on both a local area and

²⁶ IEP states that the new generation that has been built is being compensated through cost-based rates or long-term contracts. IEP at 13. If that is the case, these units will not benefit from cost of new entry pricing, only existing units will.

²⁷ The Commission can compare the \$148/KW-year and other cost of new entry prices specified by IEP with the fixed costs of RMR units as shown in Exhibit B to the CAISO's Reply Comments filed on May 1, 2006 in Docket no. EL05-146.

system basis. Many of the local areas are small relative to total CAISO capacity MW (as shown in the Table below) and have a concentration of ownership. Were the backstop mechanism to be designed to send investment price signals, the cost of new entry should be considered as a possible backstop price only when there is a capacity deficiency in a local area or system zone. The Table below shows the most recent evaluation of the deficiency or surplus in the 10 local capacity areas that the CAISO has defined for the CAISO grid. Only three of these local areas are deficient relative to the RA requirement and one is just above the RA requirement, based on the reliability needs defined in the CAISO's local capacity studies. This assessment suggests that only few locations on the CAISO Controlled Grid would even warrant high backstop prices if a cost of new entry approach were to be applied. However, most of the capacity in those tight areas is either owned by investor owned utilities or is under multi-year RA contract, thereby indicating that even if a cost of new entry approach were to be applied, it would provide no near-term benefits to Energy Companies. In the remaining load pockets, where there is a surplus of capacity, additional investment does not seem to be needed in the near term; so using cost of new entry pricing to spur additional investment is neither needed nor justifiable for the period under consideration (or any other subsequent development of backstop pricing rules). Using cost of new entry as the backstop price in these circumstances could only serve to increase the forward RA prices in these areas to the extent any generation owners have market power.²⁷

For example, consider a hypothetical scenario in which there is a load pocket with 50% additional capacity (MW) than is needed to fulfill the local RA requirement. There is also substantial concentration of ownership of that capacity because only one or two

**Table -- Comparison of 2008 Locational Capacity Requirement Need and
Qualifying Capacity**

Local Area Name ^{1/}	Total '2008 LCR Need based on Category C with Operating Procedure ^{1/} (MW)	Total Qualifying Capacity ^{1/} (MW)	Surplus or (Deficit) (MW)	Surplus or (Deficit) (%)
Humbolt	175	180	5	3%
North Coast/North Bay	676	883	207	
Sierra	2092	1780	(312.00) ^{2/}	(15%) ^{2/}
Stockton	786	536	(250.00) ^{2/}	(32%) ^{2/}
Greater Bay	4688	6214	1526	33%
Greater Fresno	2382	2991	609	26%
Kern	486	646	160	33%
LA Basin	10130	12093	1963	19%
Big Creek/Ventura	3658	5396	1738	48%
San Diego	3033	2919	(114.00) ^{2/}	(4%) ^{2/}
Total	28106	33638		

sellers exist. In that situation, the cost of new entry backstop price would be used not to incent new generation but to provide sellers with a bargaining tool in bilateral RA negotiations with buyers. This occurs because sellers would know that if buyers did not accept the offered forward RA prices, they could rely on the CAISO to procure that capacity through the backstop and at a price at cost of new entry. To mitigate this market power, there would need to be additional rules for backstop capacity pricing, such as an administrative demand curve for capacity that lowers the backstop price in relation to the surplus market supply condition. Such rules have not been proposed by the Energy Companies.

^{1/}

Source: CAISO "2008 Local Capacity Technical Analysis Report and Study Results," Updated April 3, 2007, table on page 4 of 85 pages. Data for San Diego local area is from "Report and Study Results Update for San Diego, Updated June 19, 2007, which was filed with the CPUC.

^{2/}

Generation deficient Local Capacity Area (or with sub-area that are deficient) – deficiency included in LCR. Generator deficient area implies that in order to comply with the criteria, at summer peak, load must be shed immediately after the first contingency.

Also, the CAISO does not believe that cost of new entry is the appropriate price benchmark for MOWD commitments in response to daily or real-time needs. Under the must-offer obligation, the CAISO will issue MOWDs in the day-ahead and intra-day timeframes to non-RA units in response to contingencies. It is not appropriate to base payments for unplanned, unanticipated, short-term procurement on the cost of new entry because the purpose of this type of procurement is to employ existing units that are available to address short-term contingencies or reliability needs, not to provide incentives for new generation. There is no legitimate basis to pay a price based on cost of new entry to existing units under these types of circumstances. Even ignoring the fact that new entry could not enter the market in the necessary timeframe to provide the service, there is no indication that new units should even enter the market at that particular location in the long-term.

3. The RCST Is Not Unduly Discriminatory.

IEP asserts that existing Generating Units suffer price discrimination vis-à-vis new Generating Units. The supposed basis for the claim is that existing units only receive market compensation, while new units receive compensation beyond market prices because they are built by Load Serving Entities or have longer-term contracts. The problem with IEP's argument is that these circumstances, even if true, do not constitute discrimination under either the Federal Power Act or Commission precedent.

Mr. Cavicchi attempts to avoid this problem by redefining discrimination. He states, “Price discrimination as used herein refers to the ability of buyers of system reliability services to be able to obtain those services from existing generators at prices lower than the otherwise indicated value of these services to buyers.”²⁸ This, however, is not the undue discrimination prohibited by the Federal Power Act. As defined by the Commission, undue discrimination is the unjustified dissimilar treatment of similarly situated entities.²⁹ Neither IEP nor Mr. Cavicchi demonstrate that RCST compensation meets this definition.

IEP’s comparison with new generation is inapt. The existence of unduly discriminatory RCST compensation is not determined by comparing the compensation that new Generating Units receive from bilateral contracts or cost-of-service based rates with the compensation that existing Generating Units receive from bilateral contracts or the market-based rates that they have chosen.³⁰ The only relevant compensation for such a determination is RCST compensation which is the same for all units. The CAISO has no obligation to ensure through its rates the financial success of any unit; its only obligation is to provide just and reasonable and non-discriminatory compensation for the

²⁸ Cavicchi Aff. at ¶ 3, n.1.

²⁹ See *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 115 (2003).

³⁰ It is the CAISO’s understanding that the generation being built by load serving entities is being priced on a cost-of-service basis. On the other hand, the generators represented by IEP have opted for market based rates, not cost-based rates for their generation. Thus, the two are not similarly situated.

services provided under its tariff, and the Commission has previously found that the existing RCST does that.

Moreover, although Mr. Cavicchi asserts that inadequate revenues (for total fixed cost recovery) can be expected from CAISO markets if investment in new capacity is undertaken,³¹ and that the circumstances are worse for existing Generating Units,³² it is not the Commission's responsibility under a market-based rate pricing system to ensure that Generators recover their "total fixed costs." The only cost recovery that is required is cost recovery proportional to the service provided. RCST achieves that objective. Under the existing daily Must Offer capacity payment, for each day of a MOWD -- 1/30th of a month -- generators receive 1/17th of the monthly capacity payment that the commission has determined is just and reasonable, *i.e.*, almost twice the proportional payment. This is certainly more reasonable than the proposal to be paid 25% of the annual fixed costs of a new unit upon issuance of a single MOWD.

For the same reasons, Energy Companies' assertion that the compensation for MOWDs is unduly discriminatory vis-à-vis RA and RMR Units is mistaken. The comparison of daily MOWDs to RMR and RA is not apt. RMR contracts are annual contracts for the purpose of addressing specific long-term local reliability needs not addressed through Resource Adequacy contracts. In other words, the CAISO needs a particular unit, in a particular location on a long-term basis to maintain reliability. RA contracts enable load serving entities to meet specific capacity obligations imposed on them by their applicable regulatory authority. RA contracts also provide capacity

³¹ Cavicchi Aff. at ¶ 23.

³² *Id.* at ¶¶ 25-26.

needed to meet known system and local reliability criteria needs as defined by the CAISO's local capacity studies and the requirements of the RA programs of the CPUC and Local Regulatory Authorities. MOWDs, in contrast, address events that are varied, unanticipated and short-term. In other words, MOWDs pertain to occurrences that are not planned-for by the CPUC, Local Regulatory Authorities or the CAISO and which generally last only short periods of a day or days. Multi-month commitments generally are not required by such events, but the RCST provides for the possibility of multi-month commitments in the case of a Significant Event (provided that specified requirements are met). Although Energy Companies object to the fact that the CAISO has not made more Significant Event designations, they do not provide any evidence showing that the CAISO has failed to follow the tariff requirements or that there were other Significant Events where a RCST designation would have been "necessary" under the tariff. Particularly telling is the fact that Energy Companies do not attempt to explain why their specific units should have received Significant Event designations but did not.

Also, unlike RA Units and Condition 2 RMR Units, Must-Offer Generators do not commit their capacity exclusively for CAISO (or LSE) use. (Condition 1 RMR Units may participate in Market Transactions but, as a result, their Fixed Option Payment is less than their Annual Fix Revenue Requirement.) On the other hand, Must-Offer Generators are free to enter into bilateral contracts for any or all of their capacity; only capacity that is uncommitted on a given day must be available to the CAISO (if the CAISO need it and denies the unit's request for a waiver). The CAISO pays for the capacity consistently with the extent it is available to the CAISO. If the CAISO calls upon that capacity to be available, it pays for it. As indicated above, for each day of a

MOWD, generators receive one 17th of the monthly target capacity payment, in addition to Minimum Load Cost Compensation, an Imbalance energy payment for minimum load energy, Startup Costs, and Emissions costs. If the CAISO anticipates a longer-term need for the capacity of a particular unit – as where LSEs do not fulfill their RA requirement or a Significant Event occurs – the CAISO has the ability to make a longer-term payment pursuant to an RCST designation. Energy Companies are essentially trying to force the CAISO give longer-term capacity payments to units that did not receive RA contracts, irrespective of whether the CAISO needs the capacity for the term of the commitment period they are seeking.

B. The Commission Should Continue RCST Until the Earlier of the Implementation of MRTU or of an Alternative Backstop Capacity Mechanism Developed Through a Stakeholder Process.

In their comments, Energy Companies ask the Commission not to extend RCST beyond March 31, 2008. They also request, that the Commission appoint a settlement judge to supervise the stakeholder process for the development of an alternative backstop capacity mechanism if MRTU is delayed beyond March 31, 2008.

On January 14, 2008, the CAISO filed a status report with the Commission indicating that MRTU would in fact be delayed beyond March 31, 2008. The CAISO is not as yet able to determined the extent of the delay, but the CAISO is making every effort to implement MRTU before the peak summer months.

To the extent that the CAISO determines that MRTU can be implemented before June 1, 2008, the CAISO believes that there is no reason to terminate RCST prior to that time. If the Commission, as it proposes, determines that it is just and reasonable to extend RCST for three months, then it is difficult to think of any reason why it would not

be just and reasonable to extend RCST for four or five months pending implementation of MRTU or an alternative backstop mechanism.

If the MRTU date is postponed until after the high demand summer season, then it would be appropriate to implement an alternative backstop capacity procurement mechanism. The CAISO has already made a commitment that, under such circumstances, it would work with stakeholders on an expedited basis to develop a new mechanism that could be implemented by June 1, 2008. The CAISO believes such a schedule is workable. If MRTU is delayed until after the summer season, the current demands on CAISO resources will be somewhat alleviated. Moreover, unlike the circumstances a month ago, the CAISO has virtually completed the development of its Interim Capacity Procurement Mechanism (“ICPM”), to be implemented with MRTU, and will be filing an ICPM tariff amendment shortly.

The CAISO does not believe that the appointment of a settlement judge is necessary or appropriate under the circumstances. Generators propose such action in order to expedite the development of an alternative program by March 31, 2008. As discussed above, the CAISO does not believe an arbitrary termination date is appropriate. If the Commission extends RCST until the implementation of MRTU, unless MRTU is postponed beyond summer 2008, then the alternative program would not need to be in place until June 1, 2008, (if it becomes necessary). Also, as is illustrated by the history of the RCST proceeding and the ongoing stakeholder process to develop an ICPM, stakeholders have a diversity of interests, as well as a wide spectrum of positions, and are polarized on many key issues. Under these circumstances, a settlement process will not likely lead to consensus on the issues. It would also conflict with the CAISO’s

stakeholder process to develop a backstop proposal to be effective June 1, 2008, in the event MRTU is delayed past the Summer of 2008. The CAISO will need to run an expedited stakeholder process given the timeline within which an interim backstop proposal will need to be filed. The CAISO will have every incentive to do so, because the Commission has determined the compensation under the must-offer obligation is unjust and unreasonable without a capacity payment and has recognized the CAISO's commitment to have some form of alternative backstop capacity mechanism in-place for the summer months

Moreover, the appointment of a settlement judge would be administratively cumbersome, because stakeholder conferences should occur in California in order to facilitate participation. The CAISO also believes that the appointment of a settlement judge would interfere with the CAISO's right to develop and propose amendments to its tariff under Section 205 of the Federal Power Act. While the Commission does have ongoing complaint proceedings, which would allow it to direct a new rate, the CAISO does not believe that Section 206 ordinarily contemplates the imposition of an entire new procurement program on a public utility. The CAISO therefore urges the Commission to allow the stakeholder process to proceed in an expedited manner.

C. The CAISO Has No Objection to Holding Docket No. EL08-13 in Abeyance.

Energy Companies ask that the Commission hold their complaint in Docket No. EL08-13 in abeyance unless MRTU is deferred beyond March 31, 2008, in which case they ask the Commission to hold that extending RCST through Summer 2008 would be unjust and unreasonable. The CAISO believes that it has demonstrated the flaws in Energy Companies' complaint in its Answer to that complaint in Docket No. EL08-13.

This Commission will rule on the validity of Energy Companies' arguments in that docket, not in this. Nonetheless, the CAISO has no objection to holding Docket No. EL08-13 in abeyance. Because of the status of MRTU implementation discussed above, however, the CAISO believes it would be more appropriate to hold the proceeding in abeyance until the implementation of MRTU, unless implementation is delayed beyond June 1, 2008. As the CAISO has previously stated, in the event MRTU is delayed beyond Summer 2008, the CAISO will work with stakeholders to develop an alternative mechanism to be effective prior to the high demand summer months.

D. The RCST Allocation Provisions Remain Just and Reasonable.

In the Order on Paper Hearing, the Commission approved allocation of capacity payments associated with units that receive a must-offer waiver denial in a manner consistent with the Commission's decision in the Amendment No. 60 proceeding.³³ SWP contends that it would be unjust and unreasonable to extend that allocation methodology.

SWP contends that, under the Amendment No. 60 methodology, it is forced to subsidize its competitors.³⁴ It also asserts that its off-peak pump Loads are unjustly being allocated the same RCST costs as on-peak loads and that the methodology discriminates against Controllable Loads that are able to shift to the off-peak hours.³⁵

³³ Order on Paper Hearing, P 125.

³⁴ SWP at 2.

³⁵ *Id.* at 3.

These are precisely the arguments SWP made, and the Commission rejected, on rehearing of the Order on Paper Hearing.³⁶ Absent a showing of changed circumstances, SWP's arguments are a collateral attack on the Commission's prior orders.

The only thing close to a changed circumstance that SWP's asserts is the CAISO's alleged "insistence" in Docket No. ER04-835 that the Amendment No. 60 cost allocation would last only into 2006 and would not be extended, and the Initial Decision's "reliance" on that consideration. The examination of the actual CAISO language quoted by SWP, however, refutes any contention that the CAISO offered any guarantees that the Amendment No. 60 cost allocation would cease in 2006:

[U]nder Commission orders, the Must-Offer Obligation will cease *no later than the implementation of MRTU* in early 2007 and likely as early as the beginning of the Resource Adequacy Requirement. *California Ind. System Oper. Corp.*, 108 FERC ¶ 61,254 at P 10 (2004). *As of the date of this Brief*, therefore, the time horizon of future MLCC allocation is six months to a year— and it will be much shorter by the time of a Commission decision.³⁷

The CAISO was clear that the only definitive factor would be the implementation of MRTU, which is the date on which, as the Commission has clarified,³⁸ the must-offer obligation terminates.

More significantly, in rejecting SWP's arguments on rehearing *in late 2007* and finding the Amendment No. 60 allocation just and reasonable, the Commission again noted that the must-offer obligation would continue until the implementation of MRTU,

³⁶ Rehearing Order at PP 65-66, 73.

³⁷ SWP at 2, n.2 (emphasis added and SWP emphasis omitted).

³⁸ *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,281 P 34.

then scheduled for January 31, 2008.³⁹ A three month extension of that date is certainly not a changed circumstance that would justify revisiting the Commission's rulings.

III. CONCLUSION

For the reasons discussed above, the CAISO requests that the Commission extend the RCST in a manner consistent with the discussion herein.

Respectfully submitted,

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³⁹ *Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,193 at P 101 (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 as well as all parties in Docket No. EL05-146, 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 24th day of January, 2008.

/s/ Melissa Hicks
Melissa Hicks

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