

Cost methodology comprising separate fixed cost and fuel cost components within eight to 12 months of MSG implementation.

As explained below, SCE and SDG&E have not demonstrated that their two-part proposal is just and reasonable, and therefore, the Commission should not at this time mandate that the ISO move to a two-part methodology in the future. The ISO's instant proposal is just and reasonable and there is no evidence to confirm that the two-part proposal is appropriate for the market as a whole. The Commission should accept the Transition Cost methodology embodied in the July 29 filing without further amendment. Regarding SCE's suggested terminology clarifications, the ISO agrees with the suggestions with one slight modification, which if so ordered by the Commission, the ISO will file in a subsequent compliance filing.

Finally, the ISO informs the Commission of a delay in the implementation of the MSG functionality to November 15, 2010, from the previously anticipated October 1, 2010 start date. Therefore, the ISO proposes that if so ordered by the Commission, the ISO will change the effective date of the tariff sheets implementing the Transitions Costs methodology in a subsequent compliance filing in this docket. In addition, the ISO is amending its previous request that the Commission issue an order by September 27, 2010 to October 25, 2010.

I. BACKGROUND

On May 28, 2010, the ISO filed tariff amendments necessary to implement the MSG functionality.³ The MSG functionality will enable the ISO's market

³ *California Independent System Operator Corporation*, Docket No. ER10-1360, Amendments to California ISO FERC Electric Tariff to Include Multi-Stage Generating Resource Modeling. The

software to accurately model the unique operational and economic parameters of resources, such as combined cycle generating units, which have multiple operating or regulating ranges.⁴ Such operating or regulating ranges are referred to as configurations. The May 28 filing proposed that MSG have the ability to recover the costs of transitioning from one configuration to another (*i.e.*, Transition Costs), as part of the ISO's existing bid cost recovery mechanism. On July 29, 2010 the ISO filed a proposed methodology for calculating, verifying, and mitigating such Transition Costs.

Under the ISO's proposal, Scheduling Coordinators would be permitted to submit a dollar value to reflect the costs of each upward transition (*i.e.*, a transition from a lower configuration to a higher configuration).⁵ Each value will be registered in the ISO's Master File for a minimum of thirty days and will be further indexed to the daily Gas Price Index during actual market runs. The ISO's filing explained that Transition Costs are intended to include those costs that relate directly to, or are associated with, the physical equipment switching that must occur to transition the resource to a new configuration.⁶ Such costs may include fuel, but also may include other costs such as the increased maintenance costs associated with such

Commission recently approved the ISO's proposal. See *Cal. Indep. Sys. Operator Corp.*, 132 FERC ¶ 61,087 (2010).

⁴ As described in the May 28 filing, due to their design, some generating resources have ranges between the overall minimum and maximum operating levels of the resource in which the resource cannot operate and through which it must be transitioned. Each distinct operating range is referred to as a configuration. Units with such constraints are known as Multi-Stage Generating Resources. Examples of such resources are combined-cycle units which are comprised of multiple generation resources, large thermal generators that require the operation of auxiliary equipment (*e.g.*, feed water pumps or additional boilers), and certain types of hydro-electric generation plants.

⁵ Under the ISO's proposal, downward Transition Costs will be accounted for through the submission of a heat input value to reflect the quantity of fuel used for each downward transition. Downward Transition Costs are not at issue in the instant filing.

⁶ July 29 filing Transmittal Letter at p. at 4.

transitions. However, because such costs will be driven primarily by fuel costs, the ISO proposed to index Transition Costs to the daily Gas Price Index to minimize MSG' exposure to fuel price risk.

The ISO fully acknowledged that such indexing would not capture underlying changes in Transition Costs perfectly but that it nevertheless struck a reasonable balance between finding a precise way of capturing fluctuations in Transition Costs and finding a feasible and administrable methodology for capturing such fluctuations. The ISO stated: "While the indexing of Transition Costs in this way is not a perfectly precise index insofar as some Transition Costs are not related to the cost of fuel, the Gas Price Index provides a known and measurable value for an approximation of such fluctuations."⁷

II. ANSWER

A. The ISO's Proposal, Including the Indexing of Transition Costs to the Gas Price Index is Just and Reasonable as it Provides a Quantifiable Measure of the Bulk of the Costs Related to Transitions Through Configurations

For multiple reasons, the Commission should approve the ISO's Transition Cost methodology as proposed without modification and without conditioning such approval on the implementation of a two-part Transition Cost approach at a later time. The ISO proposal is just and reasonable and represents the endpoint of an extensive and involved stakeholder process. SCE and SDG&E have failed to demonstrate that the two-part Transition Costs methodology is just and reasonable. The ISO does not oppose evaluating the performance of the instant proposal at a later time after the market has sufficient time to determine any deficiencies that may

⁷ *Id.* at 6.

exist with the currently proposed methodology. However, it is neither just nor reasonable for the Commission to dictate an alternative methodology at any point in the future that has not been vetted through the preceding stakeholder process, nor has been shown to be just and reasonable.

SCE and SDG&E offer substantially similar comments on the ISO's proposed method of indexing transition costs. SCE argues that the ISO's proposal could generate Transition Costs that do not reflect actual costs. According to SCE, this is because some portion of a Multi-Stage Generating Resource's Transition Costs would represent fixed costs that would not fluctuate with the cost of gas. For this reason, SCE argues that Transition Costs would be overstated when the daily Gas Price Index has risen after the Transition Costs are first submitted and would be understated when the daily Gas Price Index declines.

SDG&E similarly argues that if gas prices rise, then a Multi-Stage Generating Resource's Transition Cost value would increase proportionately with the increase in the cost of gas even though the actual costs associated with a transition would not have risen to that same degree. In SDG&E's view, such overstated Transition Costs would distort the economic commitment and dispatch of Multi-Stage Generating Resources. SDG&E additionally notes that it cannot identify anything in the ISO's proposal that would prevent the use of an alternative approach that avoids these problems. Based on these factors, SDG&E argues that the ISO's proposed methodology has not been proven just and reasonable, but SDG&E does not oppose the adoption of the ISO's approach at the outset of implementing the MSG functionality.

To resolve their respective concerns, both parties argue that Commission approval of the ISO's Transition Cost proposal should be conditioned on a requirement that the ISO subsequently specifically implement a two-part Transition Cost design. Under such a two-part design, MSGs would submit a Transition Cost comprising two values. One value would represent fuel costs related to a transition, while the other value would represent the fixed costs related to a transition. The fuel cost would be indexed to the daily Gas Price Index, while the fixed cost would not be indexed. SDG&E argues that the ISO should be required to make a tariff filing to implement a two-part design within six months of implementing the overall MSG functionality. SCE argues that the Commission should require the ISO to implement such a design within one year of the MSG functionality go-live date.

The ISO's July 29 filing is the product of a robust stakeholder process and is a just and reasonable approach to the accounting of Transition Costs, which during the stakeholder process were determined to be based largely on fuel costs. The ISO's proposal provides not only a just approach to providing compensation for transitions, but it also provides a reasonable method which is easily tractable, without the imposition of additional administrative complexity. SCE and SDG&E create the erroneous impression that the validity of the ISO's proposal should be evaluated solely based on the indexing aspects. Rather, the ISO's proposal is carefully constructed to provide adequate compensation for transitions while also avoiding over-compensation and opportunities for adverse market behavior such as economic withholding.⁸ In the first instance, like start-up and minimum load costs, the ISO's proposal ensures that Transition Costs be submitted to and verified by the

⁸ July 29 filing Transmittal Letter at p. 7-11.

ISO as part of the same monthly cycle currently in place for start-up and minimum load costs. Scheduling Coordinators would be permitted to submit a dollar value to reflect the costs of each upward transition (*i.e.*, a transition from a lower configuration to a higher configuration) as well as a heat input value to reflect the quantity of fuel used for each downward transition.⁹ Each value will be validated and registered in the ISO's Master File for a minimum of thirty days for use in the ISO markets and will be further indexed to the daily Gas Price Index during actual market runs.¹⁰ This will allow a Multi-Stage Generating Resource a just and reasonable opportunity to recover all appropriate costs associated with the transition of a unit from one operating configuration to another.

To guard against any adverse economic bidding behavior, the ISO will apply two rules establishing boundaries for Transition Costs submitted to the ISO without the need to inventory and verify all costs associated with a transition. When submitted to the ISO for registration in the Master File, the Transition Cost values for upward transitions will be mitigated according to the following two rules. This "top down" approach has been designed to ensure resources are also appropriately compensated for costs of transitioning from one configuration to another.¹¹

⁹ July 29 filing Transmittal Letter at p. 8.

¹⁰ *Id.*, at p. 5.

¹¹ As discussed further in the July 29 Transmittal Letter (p.7-8) the following two binding rules would apply: (1) For registered transitions in which the ISO would be dispatching or committing a resource from an off-line to an on-line configuration, the ISO will verify that the sum of the Transition Costs along the unidirectional registered upward transition path cannot exceed 125 percent of the proxy start-up cost of starting up directly into the target configuration plus 10 percent. If the Scheduling Coordinator has identified the registered configuration into which the resource would be transitioned as one into which the unit would be able to start-up directly, the lower bound for the Transition Costs will be set to \$0. On the other hand, if the Scheduling Coordinator has identified the registered configuration as one into which the resource is not able to start-up directly, the lower bound for the sum of the Transition Costs will be 100 percent of the proxy start-up costs plus 10 percent. (2) For registered transitions in which the ISO would dispatch or commit a unit that is already on-line to transition to an upward configuration, the sum of the Transition Costs on the

An important principle articulated throughout the effort to determine an appropriate model for Transition Costs was the need to compensate for costs that are actually incurred as a result of the transition. However, given the difficulties experienced in both quantifying and validating individually stated costs, the ISO proposed to pursue a “top down” approach, as opposed to a “bottom up” approach in which Scheduling Coordinators would be required to submit specific costs and the ISO would be required to validate each such cost individually. The top down approach does not, however, eliminate the need to ensure that the costs submitted actually represent a valid representation of the resource’s costs to transition to another configuration. Indeed, given the lack of quantifiable evidence of the true nature of the costs, the ISO proposed reasonable boundaries to ensure that the costs are not grossly over or understated.

While SCE and SDG&E attempt to create the impression that the ISO’s proposal fails to provide accurate and just compensations solely on the basis of indexing, it is obvious that indexing is only one component of the overall proposal, which as a whole also reasonably addresses the issues raised by SCE and SDG&E. Indexing of Transition Costs is only intended to ensure that Transition Costs track the cost of fuel which, while not the entirety of the costs to transition from one configuration to another, is the main driver of such transitions. Because Transition Costs as registered in the Master File will be applied in the actual market runs, indexing of Transition Costs is intended to ensure that such costs do not

transition path must be between 100 percent and 125 percent of the costs of transitioning directly from the lower to the higher configuration.

diverge significantly from their main driver. While the ISO and stakeholders recognized the difficulty in accounting specifically for transition costs, it is not unreasonable to conclude that the bulk of transition costs are made up of fuel costs. The difficulties in determining specifically what the non-fuel costs such as maintenance consist of is what drove the ISO and stakeholders to develop a methodology that attempts to strike a reasonable balance between the need for adequate compensation and just payment for actual costs incurred. Neither SCE nor SDG&E have demonstrated in their comments that the bulk of transition costs are not taken up by fuel. In fact, neither SCE nor SDG&E have demonstrated how their two-part Transition Costs proposal will guarantee a result that also does not over or under compensate resources for their actual costs incurred.

SCE and SDG&E purport that the two-part Transition Costs will do a better job at representing actual Transition Costs because it only requires the indexing of one part of the costs, *i.e.*, the fuel portion. Many questions remain unanswered regarding whether a two-part approach will accomplish this or how it is superior and worth the additional modifications to the ISO systems that would be necessary to implement it. In large part, the driver behind whether the two-part does a better job at valuing transition costs over time is in the division between the fixed and variable portions of the transition costs. Is the appropriate split between the two parts a 50-50 split between the fuel costs and other costs? Or is a more equitable split an 80-20 split between the fuel cost and other costs, respectively? SCE uses a 60-40 split (60 fixed and 40 variable) in its example, but provides no support for this allocation. Mathematically, if a larger portion of the Transition Costs is variable, the gas price indexing will have a more representative impact over time than is

demonstrated in SCE's example. Subsequently, it is important to consider whether single proportion would be adopted for all MSGs, or it would vary by resource or type of resource? If a single proportion would apply, then what would be the criteria to set that single proportion, and what evidence will the ISO use to set it? If the proportions were to vary by resource, then how would the ISO ensure that the proportions accurately reflect the split in the costs for each resource? After considering all these various questions, would the two-part methodology still be favorable?

Once the proportions were decided, how would scheduling coordinators and the ISO validate the fixed portions? Would the participants be required to validate the line items that make-up the the fixed costs? How would this be accomplishable? Would this be accomplishable? And if not, would the ISO's instant proposal after all be the best approach given that this very issue was already discussed in the preceding stakeholder process?

The ISO does not purport to have answers to all these questions at this time. Moreover, the ISO understands the desire to re-evaluate the proposed methodology after some experience with the market. However, there is simply a lack of sufficient analysis before the Commission to conclude that (1) the two-part proposal is a better methodology than the ISO's single part approach and (2) that the Commission must therefore compel the ISO *now* to adopt a two-part transition costs methodology. Moreover, this evaluation should not be done too hastily after implementation of the MSG functionality. The ISO and stakeholders should be afforded an opportunity to determine that sufficient time has elapsed and sufficient data are available to truly evaluate the performance of the ISO's proposed

methodology, and then the ISO and stakeholders will be better placed to propose a new methodology. It is entirely possible, that after the ISO and stakeholders have had this opportunity that they may find that the two-part approach is favorable after all. However, it is also possible that after the stakeholder process the ISO and stakeholders may find that the two part approach does not provide a better assessment of these costs and requires the resolution of issues the ISO's proposal addresses in a more just and reasonable manner.

It is important to note that SCE's and SDG&E's concerns regarding the possible under or over valuation of Transition Costs can be cured the ISO's proposal without any further changes. If the Scheduling Coordinator finds that their costs are undervalued, because the indexing affects them negatively, the Scheduling Coordinator may adjust their Transitions Costs for the next month. Because the ISO does not require a specific accounting of their Transition Costs, the ISO proposal provides sufficient flexibility to change the costs from month to month so that market participants may account for fluctuations in the gas price index.

If the Commission were to dictate the result that SCE and SDG&E have requested without the benefit of actual market experience, the ISO's market participants would lose the potential benefits of considering alternatives to the two-part Transition Costs approach. Therefore, the Commission should accept the ISO's proposal, reject SDG&E and SCE's requests for the imposition of a two-part approach at a specified later time, and allow market participants and the ISO as a group to decide an alternative approach after the ISO has had sufficient experience

with the current proposed methodology and there is sufficient data to evaluate its performance.

B. Proposed Changes to Tariff Terminology

In its comments, SCE observes that the ISO's proposed tariff language in sections 11.8.2.1.7.1 and 11.8.3.1.4.1 uses the phrase "Minimum Load amount." SCE notes that modifying the term "Minimum Load," which is a defined term in Appendix A of the tariff, with the word "amount" could create unnecessary confusion. SCE points out that it made this observation during the tariff stakeholder process and that the ISO agreed to delete the word "amount" to address this issue.

On this point, SCE is correct. The ISO's failure to delete the word "amount" in these two sections was an inadvertent drafting error. The ISO will submit the amended tariff sheets in a subsequent compliance filing if so ordered by the Commission.

SCE also requests that the ISO consider modifying the term "Transition Cost Index" as it believes this term to be confusing. SCE argues that because the term really reflects a multiplier and not an index the ISO should replace the term with a more descriptive term such as "Daily Transition Cost Multiplier." The ISO does not oppose changing the term, but does not believe the term "Daily" is necessary. The ISO will modify the term to Transition Cost Multiplier in amended tariff sheets to be filed in a subsequent compliance filing if so ordered by the Commission.

C. Extension of Implementation of MSG Functionality

On September 2, 2010, at the regularly held Market Performance and Planning Forum, the ISO announced the need to delay the implementation from October 1, 2010 to November 15, 2010. The delay was supported by participants at

the meeting, and the ISO will be taking steps to provide a schedule of the impact of this change to market participants. This schedule will be discussed at the next MSG market simulation stakeholder meeting to be held on September 9, 2010.

As a result of this delay, the ISO will be required to amend the effective date of its tariff sheets. The ISO currently anticipates an order from the Commission in this docket on September 27, 2010, in order to ensure sufficient time for the ISO to assess the impact of the Commission's order prior to the previously expected effective date. However, with the now known delay in implementation, the September 27, 2010 date is no longer a critical path. Therefore, the ISO submits an extension of this date to October 25, 2010, is sufficiently prudent, and therefore now respectfully requests that the Commission issue an order as soon as practicable, but no later than October 25, 2010. In addition, if the Commission so orders, the ISO will submit its revised tariff sheets with the new effective date in a subsequent compliance filing in this docket.

III. CONCLUSION

For the reasons provided herein, the Commission should accept the ISO's July 29 filing with the clarifications noted above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service lists for the above-referenced 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 at Folsom, CA this 3rd day of September, 2010.

/s/ Jane Ostapovich
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