UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket Nos. ER08-1178-000 and EL08-88-000**

REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION REGARDING TECHNICAL CONFERENCE

Pursuant to the procedures established at the November 6, 2008 Technical Conference convened in the above-referenced proceeding by the Staff of the Federal Energy Regulatory Commission ("Commission"), and the notice of extension of time issued by the Commission on November 26, 2008, the California Independent System Operator Corporation ("CAISO")[1] hereby submits its Reply Comments regarding matters discussed in the Comments submitted by other parties in the proceeding.[2]

I. BACKGROUND AND SUMMARY

In its Comments, the CAISO set forth its positions on the issues discussed at the Technical Conference,[3] discussed its authority to issue Exceptional

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1 Capitalized terms not otherwise defined herein are defined in Appendix A to the CAISO's Market Redesign and Technology Upgrade ("MRTU") Tariff.

2 The following parties filed Comments: the CAISO; California Department of Resources State Water Project ("SWP"); California Public Utilities Commission ("CPUC"); Calpine Corporation ("Calpine"); Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside California ("Six Cities"); J.P. Morgan Ventures Energy Corporation and BE CA LLC (together, "J.P. Morgan"); Mirant Energy Trading, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC (collectively, "Mirant"); Northern California Power Agency ("NCPA"); Pacific Gas and Electric Company ("PG&E"); Reliant Energy, Inc. ("Reliant"); Southern California Edison Company ("SCE"); and Western Power Trading Forum ("WPTF"). Except where otherwise indicated, citations in these Reply Comments are to parties' Comments.

3 The Technical Conference addressed issues raised by the CAISO's Exceptional Dispatch proposal that was filed in this proceeding on June 27, 2008 ("June 27 Filing"). Specifically, the Technical Conference addressed the following issues: (1) the CAISO's Exceptional Dispatch pricing proposal and the alternative proposal contained in the Commission's October 16, 2008, Order on the June 27 Filing, *California Independent System Operator Corp.*, 125 FERC ¶ 61,055

Dispatches in the event of a Market Disruption, explained how the CAISO's proposal to utilize a $24/MWh bid adder approach for the first four months after MRTU go-live can be utilized with the revised Exceptional Dispatch pricing proposal the CAISO included in its Comments, and described the features of that revised pricing proposal, which provides compensation to eligible resources (resources that do not have a Resource Adequacy ("RA") contract, a Reliability Must-Run contract, or an Interim Capacity Procurement Mechanism ("ICPM") designation) triggered by certain Exceptional Dispatches.

As explained in the Comments, the revised Exceptional Dispatch pricing proposal takes into account statements contained in the October 16 Order and Commission Staff comments and parties' comments at the Technical Conference. The revised pricing proposal builds on features of the Exceptional Dispatch proposal contained in the June 27 Filing by including the following elements (some of which are discussed in more detail in Section II of these Reply Comments):

(1) Eligible resources would have two options to receive compensation when they are exceptionally dispatched by the CAISO: (a) an ICPM designation for 30 days, either for a partial or full unit depending on the amount of capacity subject to an eligible Exceptional Dispatch within the 30-day period; or (b) a bid-based supplemental revenue payment (referred to hereafter as "supplemental revenues") calculated according to the pricing rules

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(2008) ("October 16 Order"); the frequency of Exceptional Dispatch; (3) modeling and software limitations; and (4) the scope of the CAISO's Exceptional Dispatch Bid mitigation proposal.

contained in the June 27 Filing (including the supplemental revenue cap).

(2) Eligible resources (non-RA and partial RA units) would be required to indicate seven days in advance of the first day of each calendar month which method they prefer for Exceptional Dispatch compensation.[4] Once that election has been made, the following rules would apply: (a) if a resource elects an ICPM designation for a particular month, once an Exceptional Dispatch is triggered, the resource would not be eligible to choose the supplemental revenues option for any subsequent Exceptional Dispatches during the 30-day period; and (b) if a resource elects supplemental revenues for a particular month, once an Exceptional Dispatch is triggered, the resource will not be eligible to choose the ICPM designation option for any additional Exceptional Dispatches during the subsequent 30 days.[5] If no election is made, the resource will be treated as having selected the ICPM designation option.

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[4] For ease of reference, in both the CAISO's Comments and these Reply Comments the phrase "non-RA resource" or "non-RA unit" is used to mean a resource or unit that is non-RA, non-RMR, and non-ICPM.

[5] With regard to this element of its Exceptional Dispatch pricing proposal, the CAISO provides the following clarification that would apply if the resource accepts a Significant Event ICPM designation during any 30-day period triggered by an Exceptional Dispatch. If a resource had elected an ICPM designation for a 30-day period, and if the resource subsequently accepts an ICPM Significant Event designation during the 30-day period, the Significant Event designation would trigger a new 30-day period for the designated capacity. If the level of capacity of the prior ICPM designation exceeded the Significant Event designation, the resource would be eligible for the ICPM compensation for the balance of the original 30-day period. If the resource had elected supplemental revenues and if the resource subsequently accepts an ICPM Significant Event designation during the 30-day period, the Significant Event designation would trigger a new 30-day period for the designated capacity and terminate the payment of supplemental revenues. Moreover, as per the double payment rule described in the CAISO's Comments and below in these Reply Comments, the ICPM payment may have to be adjusted also to ensure that the sum

(3) The following types of Exceptional Dispatches would trigger a unit's eligibility for an ICPM designation or, if elected, supplemental revenue payments: (a) any Exceptional Dispatch commitment of a non-RA unit that would result in the unit being eligible for an ICPM designation; (b) any eligible Exceptional Dispatch for incremental energy (*i.e.*, a dispatch of energy above PMin) that moves a non-RA resource (with no partial capacity contracts or designations) beyond its Self-Schedule amount or market-based commitment/dispatch level; (c) any eligible Exceptional Dispatch for incremental energy that moves a partial RA or partial ICPM resource to a point that is beyond its Self-Schedule amount or market-based commitment or dispatch level, and beyond its RA or ICPM capacity amount; and (d) an eligible Exceptional Dispatch of a resource that has been subject to an Exceptional Dispatch ICPM designation in a 30-day period in which its RA contract or otherwise obtained ICPM designation decreases in quantity.

(4) The following types of Exceptional Dispatches would not make a unit eligible for an ICPM designation or supplemental revenue payments: (a) an Exceptional Dispatch for decommitment or decremental energy; and (b) an Exceptional Dispatch issued in circumstances where the resource has to be moved for reasons unrelated to the CAISO's needs (*e.g.*, when CAISO operators have

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of supplemental revenues and ICPM revenues for the 30-day period do not exceed an ICPM payment.

to move and possibly hold a resource either above or below a Forbidden Operating Region while the Real-Time Market software is trying to move the resource to a point within the resource's Forbidden Operating Region), though such a resource would still be subject to mitigation.

(5) If a resource with an existing ICPM designation at PMin (or a partial RA contract at PMin) is subsequently exceptionally dispatched by the CAISO above PMin during the 30-day period, the CAISO will calculate the MW corresponding to that Exceptional Dispatch, assuming it is an eligible Exceptional Dispatch, and provide an incremental ICPM designation for that amount. If the unit is exceptionally dispatched multiple times during the 30-day period, the "incremental" ICPM designation will be for the largest quantity for which the resource was subject to an eligible Exceptional Dispatch.

(6) If an eligible Exceptional Dispatch for incremental energy moves a non-RA resource beyond its market-based or self-scheduled commitment or dispatch level, and the incremental energy Exceptional Dispatch amount is below the resource's PMin, the resource would be eligible for a designation to its PMin.

(7) ICPM designations will be adjusted to be consistent with any partial RA designations, and bidding or scheduling obligations therein, that a resource has entered into, both before the ICPM designation and

in the 30-day period following an Exceptional Dispatch. First, as stated in the CAISO's Comments, if an RA resource has entered into a contract to provide RA capacity less than its PMin, that resource has an obligation to make that RA capacity available to the CAISO and, therefore, must offer its PMin to the CAISO. Such a unit is not eligible for ICPM designation for the difference between PMin and its contracted RA capacity less than PMin. Second, in order to prevent ICPM designations below PMin, the CAISO may need to adjust the ICPM designation quantity assigned to a resource with an existing partial RA or partial ICPM that is offered an (additional) ICPM designation for part of the unit's capacity in response to an Exceptional Dispatch, and whose prior ICPM or RA capacity terminated within the 30-day period.[6] The CAISO further clarifies that if a resource obtains a partial ICPM designation due to an Exceptional Dispatch and then during the 30-day period obtains a partial RA designation, the ICPM designation will be adjusted to ensure that the CAISO is not over-procuring capacity.[7]

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[6] For example, consider a unit that is partial RA for 130 MW and has a PMin of 50 MW; assume further that the unit then receives a further ICPM designation of 30 MW. If the resource's RA contract expired during the 30-day period, the CAISO would have to adjust its ICPM designation from 30 MW to 50 MW in order to prevent an ICPM designation below PMin.

[7] For example, consider a unit that obtains a partial ICPM designation of 100 MW on June 15 and then submits to the CAISO a partial RA Contract designation of 200 MW for the month of July. In this instance, the CAISO will "terminate" the partial ICPM designation for the period July 1 – July 15, because the partial RA exceeds the ICPM designation and making payments for both would result in the double procurement of capacity. If that same resource instead obtained a partial RA contract designation of 75 MW for the month of July, then the CAISO would reduce its ICPM designation by 75 MW, for a total capacity coverage of 75 MW under RA and 25 MW under ICPM.

(8) In order to prevent any double payment to resources during a 30-day period, and consistent with the principle set forth in the October 16 Order, in any 30-day period, a resource committed through Exceptional Dispatch would not be permitted to earn, through the sum of ICPM capacity payments and supplemental revenues, payments greater than the applicable monthly ICPM payment (which will be based on the higher of $41/kW-year or a resource's Commission-approved ICPM rate above $41/kW-year, whichever is applicable).[8]

For the reasons explained below and in the CAISO's Comments, the Commission should find that this revised Exceptional Dispatch pricing proposal, and the elements of the Exceptional Dispatch proposal included in the June 27 Filing that the Comments stated should be retained, are just and reasonable and consistent with the principles set forth in the October 16 Order. As such, the Commission should approve them expeditiously so that they can be implemented simultaneously with the implementation of MRTU. Conversely, the Commission should not accept the alternative pricing proposals and the arguments submitted by parties in their Comments, to the extent those pricing proposals and arguments are inconsistent with the CAISO's Comments and Reply Comments.

[8] CAISO at 5-16. The discussion above is a summary of the revised Exceptional Dispatch pricing proposal; the CAISO's Comments provide the revised pricing proposal in its entirety.

II. REPLY COMMENTS

A. Not All Types of Exceptional Dispatches Should Necessitate an Offer of ICPM Designation or Supplemental Revenues.

As discussed above, the CAISO in its Comments proposed that certain types of Exceptional Dispatches be ineligible for ICPM designations or supplemental revenues. There appears to be largely universal support for such limitations.[9]

The one exception is Calpine, which argues that every Exceptional Dispatch should result in an ICPM designation. Calpine contends that there is no meaningful distinction between the circumstances under which the CAISO may invoke Exceptional Dispatch and those under which ICPM designations are permitted.[10] Contrary to Calpine's assertion, it is not possible to equate Exceptional Dispatch with the process for ICPM designations in Section 43 of the MRTU Tariff. Under Section 43.1, ICPM designations are possible only when Resource Adequacy capacity is insufficient to meet reliability criteria or when there is a Significant Event. Activities such as accommodating ramping and Forbidden Operating Region limitations, responding to requests for Ancillary Services or pre-commercial operation testing, or reducing the output of a unit would not constitute a permissible basis for an ICPM designation. None of these actions reflect a need of the CAISO for a generating unit's capacity. Requiring a capacity payment under such circumstances would unjustly saddle ratepayers with costs even though the resource did not provide a capacity service.

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9 *See, e.g.*, NCPA at 5-7; Reliant at 13; Six Cities at 8-9; WPTF at 6.

10 Calpine at 2.

While there is large agreement that certain Exceptional Dispatches should not entail ICPM designations, there are differing opinions as to the means of accomplishing that end. Some commenters, for example, would specify the types of Exceptional Dispatch that are not eligible for ICPM designation.[11] The Six Cities, in contrast, point out that the CAISO has acknowledged that it cannot anticipate all circumstances in which it may need to use Exceptional Dispatch. Because some of these circumstances may not require capacity, the Six Cities urge the Commission to limit the CAISO's obligation to offer ICPM designations to circumstances in which capacity is needed.[12] The CAISO agrees with the concept that it should be obligated to offer ICPM designations (or supplemental revenues) when a resource is providing a capacity service to the CAISO, but that the CAISO should not be obligated to do so when the resource is not providing a capacity service to the CAISO.

Mirant suggests that the offer be triggered whenever the CAISO uses Exceptional Dispatch to force a unit on or to prevent a unit from turning off.[13] The CAISO agrees that designations should be made under such circumstances. It does not agree with Mirant's suggestion, however, that the designation must be for the entire capacity of the unit. As proposed by the CAISO, the CAISO would be obligated to offer an ICPM designation to PMin in the event of an Exceptional Dispatch commitment and, as discussed in its Comments and these Reply Comments *infra*, the CAISO would increase that designation in the event the CAISO issued a further Exceptional Dispatch based on the CAISO's operational

[11] Reliant at 13-14; WPTF at 13.
[12] Six Cities at 10.
[13] Mirant at 3.

needs. Similarly, if the CAISO issues an Exceptional Dispatch to keep a resource from turning off, the minimum designation would be to PMin. Again, the CAISO would increase the designation quantity in the event the CAISO issued a further Exceptional Dispatch based on the CAISO's operational needs.

WPTF states that ICPM offers should not be offered in connection with Exceptional Dispatches that (1) reduce the output of a resource, (2) are issued to accommodate resource constraints, including ramping and Forbidden Operating Region limitations; and (3) are issued for PMax, Ancillary Services, and pre-commercial operations testing.[14] The CAISO also agrees with this statement. In this regard, the CAISO wants to make clear that in these circumstances the resource would not be subject to either an ICPM designation or supplemental revenues, but any bids for such dispatches would still be subject to mitigation if otherwise applicable. Specifically, Exceptional Dispatches to accommodate resource constraints would be subject to mitigation.

The CAISO believes that these principles provide a workable framework that should apply directly or indirectly to the situations the CAISO anticipates facing. The only situation not addressed above is Exceptional Dispatch to increment a resource that was not committed through Exceptional Dispatch and is in the market but is operating at a level below the level determined by CAISO operators to be required. In this case, the CAISO agrees that it should make an offer of an ICPM designation or supplemental revenues at the dispatch increment (*i.e.*, the difference between the market level output and the Exceptional Dispatch level) or PMin, whichever is greater consistent with the rules discussed above.

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[14] WPTF at 6.

B. SWP Raises Issues Regarding Participating Loads, but These Issues Are Beyond the Scope of This Proceeding.

SWP's comments raise a number of issues regarding the treatment of Participating Load under the MRTU Tariff.[15] These issues concern the circumstances under which the CAISO can or cannot issue Exceptional Dispatches of Participating Loads based on unique characteristics and/or requirements of SWP's Participating Load.

The primary thrust of this proceeding, however, is to explore issues relating to the pricing, mitigation, and frequency of use of Exceptional Dispatch, not previously accepted tariff language.[16] The CAISO believes that SWP's issues are best addressed outside this proceeding.

The CAISO has already engaged SWP is discussions regarding the treatment of Participating Load. The CAISO commits to pursuing these discussions diligently in an effort to address these issues as expeditiously as possible. In the interim, the CAISO notes that SWP is the only current Participating Load. Section 22.13 of the MRTU Tariff ensures that SWP will not need to violate any of its legal obligations as a result of CAISO dispatches. Section 22.13 provides: "Nothing in this CAISO Tariff is intended to permit or require the violation of federal or California law concerning hydro-generation and Dispatch, including but not limited to fish release requirements, minimum and maximum dam reservoir levels for flood control purposes, and in-stream flow levels." The CAISO recognizes that more specific assurances and procedures may be appropriate in recognition that SWP's primary responsibility is managing

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[15] SWP at 3-21.

[16] *See* October 16 Order at P 98.

the California State Water Project but believes that these can be developed through continued discussions.

C. The Commission Should Approve the CAISO's Proposal for Partial Unit Designations.

Some suppliers advocate ICPM designations for the entire capacity of a unit that is committed under Exceptionally Dispatch (or the entire capacity that is not already subject to a Resource Adequacy or ICPM commitment).[17] Others advocate a full capacity designation for any Exceptional Dispatch.[18] Neither is appropriate.

These parties contend that when the CAISO commits a unit pursuant to the Exceptional Dispatch procedures it is essentially using the entire unit to ensure reliability and, as such, should pay for the entire capacity of the unit.[19] Reliant points to the Commission's concern that exceptionally dispatched units would not have any opportunity to recover their fixed costs and deduces from that the exceptionally dispatched units must recover their entire fixed costs.[20] This does not follow.

The only fixed cost recovery with which the Commission was concerned was in connection with the capacity committed through Exceptional Dispatch. Just and reasonable compensation requires that the CAISO only compensate units for the capacity that the CAISO *uses*. That is exactly what the CAISO proposes. The claim that the CAISO is using the entire capacity of a unit every time it commits a non-RA unit via Exceptional Dispatch is simply incorrect. The

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17 WPTF at 5; J.P. Morgan at 3-4; Mirant at 4.

18 Reliant at 2, 7.

19 *See, e.g., id.* at 7.

20 *Id.* at 10.

CAISO is only using the amount of capacity that it exceptionally dispatches. The most common example is where the CAISO commits a unit via Exceptional Dispatch at PMin. At the time of the unit commitment, the CAISO does not need – and may never need – any additional capacity from the unit unless a contingency occurs. The CAISO would offer an ICPM designation for the unit's capacity at PMin. Under those circumstances, the unit is free to submit bids or not for the remainder or its capacity into the market (and to the extent it does submit bids for such capacity, it can submit bids for Energy and/or Ancillary Services as it desires). There is no offer obligation with respect to the capacity of the unit above PMin. Stated differently, the CAISO has no more "access" to capacity that has not been exceptionally dispatched than it does to capacity of a unit that has submitted bids into the market but has not been dispatched by the market. Yet no one suggests that the CAISO should pay the entire fixed costs of the latter.

In the above example, if a contingency were to occur and the CAISO were to need Energy (above PMin) from the unit (and the unit has not submitted market bids for such capacity), the CAISO would have the ability to dispatch – via the Exceptional Dispatch provisions – additional Energy from the unit to meet the contingency. If this occurs, under the CAISO's revised proposal, the CAISO will also be required to offer an ICPM designation for the highest MW of capacity (above PMin) that the CAISO has exceptionally dispatched. Thus, under the CAISO's proposal, the CAISO is offering ICPM designations for all capacity that it uses via the Exceptional Dispatch mechanism.

The suppliers' proposal to require whole unit commitments is also inconsistent with the RA program and the ICPM program, both of which permit partial unit designations and provide for capacity payments only for the amount of capacity that is needed. As such, it is contrary to the principle espoused by the Commission in the October 16 Order (and the Commission's order approving the ICPM proposal[21]) that non-RA resources that provide reliability service to the grid should be treated in a similar manner as RA resources. On the other hand, suppliers seek more favorable treatment for non-RA resources that are exceptionally dispatched than for RA units or units designated through the ICPM process previously approved by the Commission. That should not be countenanced.

The suppliers have not explained why, if it is just and reasonable to compensate Resource Adequacy and ICPM units for only part of their capacity – as the Commission has found – it is somehow unjust and unreasonable similarly to compensate a unit that has been exceptionally dispatched. Indeed, as the CAISO explained in its Comments, requiring a designation for a unit's full capacity could undermine the ICPM process. In that regard, a unit that was needed in response to a Significant Event would have an incentive to decline a partial ICPM designation knowing that the CAISO would likely need to issue it an Exceptional Dispatch, after which it would obtain a full-unit ICPM designation.[22] Suppliers have provided no logical reason – nor is there one – why an

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21 *California Independent System Operator Corp.*, 125 FERC ¶ 61,053 (2008).
22 CAISO at 17-18.

exceptionally dispatched unit must have a full capacity designation, while Resource Adequacy and ICPM units need not.

Similarly, if the CAISO had procured a particular reliability service through a market mechanism, a unit's full capacity would likely not have been procured. For example, if the CAISO were procuring a 30-minute operating reserve product through the market, then a particular thermal unit with 400 MW capacity with a PMin of 80 MW and with the ability to ramp 2-5 MW/minute at different ranges of output would be able to sell approximately 60 – 150 MW of 30-minute reserves (as long as its initial set point was below the upper limit of its reserve capability). It would not receive any reserve payments up to PMin (but would cover its start-up costs through its Bid). Moreover, this would be the maximum range of sellable capacity, significantly less that the full 400 MW capacity of the resource. Moreover, if there were a competitive market for such a product, it would have to compete to sell this capacity, which will put downward pressure on prices. In contrast, under the CAISO's proposal, if such a unit were committed *once* through Exceptional Dispatch to cover a 30-minute contingency, it would automatically receive the 80 MW ICPM designation to PMin and then could receive additional designations if operators further exceptionally dispatch it to a higher output level. In other words, the partial designation approach in this and many realistic examples of Exceptional Dispatch commitments for capacity would be comparable to the likely capacity in MW that the resource could sell in reserves. The same can be said for existing defined operating reserve products:

the CAISO does not pay for the full capacity of resources providing such services and only procures the amount needed to meet reliability requirements.

For all of these reasons, the Commission should reject the suppliers' arguments and should approve the CAISO's proposal for partial unit designations.

D. The Commission Should Not Direct the Development of New Products at this Stage of MRTU Development.

WPTF and J.P. Morgan contend that services such as 30-minute reserves and voltage support should be procured as new products through market mechanisms rather than through Exceptional Dispatch. In the interim, they recommend that the Commission direct a specific compensation mechanism for the CAISO's use of such services (which is the equivalent of establishing new products).[23] The CAISO disagrees that any such products should be developed at this time.

WPTF is correct that CAISO is considering new reserve products, such as a 30-minute operating reserve and voltage support. Some of these efforts are already underway.[24] Any such new market product, however, should be carefully

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[23] WPTF at 3, 10-12, J.P. Morgan at 3, 7-10.

[24] The CAISO has begun discussions in its stakeholder initiatives forum to review whether there is a need for a new product to address 30-minute contingencies. On November 7, 2008, the CAISO posted on its website an issue paper regarding the subject entitled "30-Minute Ancillary Services" (as WPTF and J.P. Morgan both note), and on November 14, 2008, the CAISO held a stakeholder conference call to discuss it. As for Voltage Support services, a CAISO final report issued July 7, 2008 concerning the "Market Initiatives Roadmap" stakeholder process identified (at pp. 10-11) the development of such services as a low-priority item due in part to limited interest from stakeholders – six of the seven stakeholders who commented on the Voltage Support services issue ranked it as a low-priority item. *See* http://www.caiso.com/1ff9/1ff9aee434530.pdf. The CAISO will assign the issue a higher priority if sufficient stakeholder interest in it develops, but for the present the CAISO needs to focus on addressing the MRTU-related issues that have already been identified as high-priority items. It would be inappropriate for the CAISO to divert its finite resources away from resolving those items.

analyzed in the context of an operating MRTU in order to determine its appropriate definition (including locational aspects) and the appropriate mechanism to procure it. This proceeding, which is primarily concerned with Exceptional Dispatch compensation, is not the appropriate forum in which to create viable new market products.

Moreover, in the absence of a defined requirement and a market for the product, neither the Commission nor the CAISO can determine the value of the reliability service. For example, as discussed at the Technical Conference by CAISO staff, typically many units can provide capacity for coverage of contingencies South of Path 26; the market value of such reserves in a competitive market may thus be very low. For example, the average market prices (in $/MW) for 10-minute spinning reserve was $10.11 in 2006 and $5.42 in 2007, while 10-minute non-spinning reserve was $5.96 in 2006 and $3.98 in 2007.[25] A 30-minute reserve product would be expected to have lower prices than the 10-minute reserve products. And even at the currently prevailing prices of 10-minute spinning reserves, on a per-MW basis it would take many hours of accepted reserve bids to equal the monthly ICPM payment, which has a monthly value of $3416.70 per MW.[26] Hence, the resulting ICPM payment to a designated unit may at times be higher than if its capacity were procured through a market for a future 30-minute operating reserve product.

The proposed method for determining partial ICPM designations, on the basis of Exceptional Dispatch MW, is an appropriate mechanism to have in place

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[25] CAISO, 2007 Annual Report on Market Performance and Issues, p. 4.3 (available at http://www.caiso.com/1f9c/1f9c8a8cddd0.html).

[26] $41/kW-year × 1,000 kW/MW ÷ 12 months/year = $3,416.70/MW-month.

while the need for and value of potential additional products are evaluated based on the actual functioning of MRTU. This mechanism provides just and reasonable compensation in a variety of different situations without imposing the burden of defining which of many possible reliability needs are being served. Post-MRTU implementation will give rise to empirical data concerning whether new products are needs, and if so, how they should be defined.

E. A Cap on Supplemental Revenues Is Appropriate.

WPTF and J.P. Morgan object to the CAISO's proposal to cap the amount a non-Resource Adequacy resource may receive in a 30-day period under the ICPM or Exceptional Dispatch, or both mechanisms together, at the ICPM price of \$41/kW-year.[27] WPTF points out that ICPM resources are entitled to receive market revenues in excess of the \$41/kW-year capacity payment.[28]

The CAISO is not entirely clear which revenues WPTF and J.P. Morgan believe would be subject to the cap. The argument about ICPM resources suggest that they believe that the cap applies to all revenues received by ICPM and Exceptional Dispatch units. WPTF also argues, "[A] unit Exceptionally Dispatched will . . . be subject to the full local market power mitigation screen, just like all other [Resource Adequacy] resources. Once designated, existing mitigation measures address the potential for the abuse of market power." From this argument, it appears that WPTF is referring to revenues received by an exceptionally dispatched unit that accepts an ICPM designation.

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[27] WPTP at 7-8; J.P. Morgan at 3-4.

[28] WPTF at 8.

This confusion suggests that WPTF and J.P. Morgan may have misunderstood the proposed cap. The CAISO only proposes to cap the sum of supplemental revenues that an exceptionally dispatched unit may receive if it declines an ICPM designation and any *capacity* payments from an ICPM designation unrelated to an Exceptional Dispatch. The CAISO does not intend to cap *market* payments, which would, as WPTF recognizes, be subject to mitigation under the CAISO's proposal.

To the extent that WPTF's and J.P. Morgan's concerns are based on a misunderstanding of the cap, they are thus misplaced. It is possible, however, that WPTF and J.P. Morgan are complaining about the cap on supplemental revenue payments. An exceptionally dispatched unit that accepts an ICPM designation would not be eligible for supplemental revenue payments for any ICPM capacity, so the cap would not come into play. It would come into play for a unit with a partial ICPM designation that is exceptionally dispatched and declines a further ICPM designation. The reason for the cap on supplemental revenues for such a unit is to ensure that a resource electing supplemental revenues will not receive more compensation that it would have received had it accepted an ICPM designation.[29]

In response to the CPUC, the CAISO would not in this regard agree with the CPUC's argument that Residual Unit Commitment ("RUC") revenues should be included in calculating the cap.[30] The cap is intended to address market power issues when the CAISO needs to procure non-market capacity from a unit.

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[29] *See* Transmittal Letter for June 27 Filing at 15-17; CAISO Answer to Comments and Protests, Docket No. ER08-1178-000 (Aug. 5, 2008), at 20 ("CAISO Answer").

[30] CPUC at 7.

RUC revenues, which are received through the market, do not present these issues. A resource electing the supplemental revenues alternative should be eligible to retain all market revenues earned during the 30-day period.

F. The Commission Should Accept the Exceptional Dispatch Market Power Mitigation Measures the CAISO Proposes.

Mirant argues that an exceptionally dispatched unit's revenues should not be capped for any reason.[31] This argument is without merit. In the October 16 Order, the Commission stated that one of the two components of its suggested remedy was to cap the amount that a non-RA resource may receive during a 30-day period under ICPM, Exceptional Dispatch, or both mechanisms together at the ICPM price of $41/kW-year. The Commission explained that the cap would negate the possibility of a double payment to generators.[32] Therefore, contrary to Mirant's belief that no cap should apply for any reason, the Commission correctly recognizes the need for a cap in order to prevent double payment. The CAISO's revised Exceptional Dispatch payment proposal also includes a cap for the purpose of preventing double payment. The Commission should accept that proposal for the reasons the CAISO has explained.[33] Moreover, a cap is needed in order to ensure that RA and non-RA units are treated consistently with one another and to avoid upsetting the balance established between the RA program and ICPM. In the absence of a cap on the prices paid by mitigated non-RA units, the RA program would be undermined because resources would have an incentive not to sign RA contracts in expectation of instead having the

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[31] Mirant at 8.
[32] October 16 Order at P 107.
[33] *See* CAISO at 7-8, 10-11, 15-16, 18.

opportunity to obtain double payments as exceptionally dispatched non-RA resources.

Mirant also asserts that once energy offer prices of a unit subject to Exceptional Dispatch are mitigated and the unit receives a 30-day ICPM equivalent payment, any energy provided from the unit during Exceptional Dispatch should receive the higher of its Default Energy Bid or the prevailing Locational Marginal Price ("LMP").[34] Mirant fails to recognize that, under the CAISO's payment proposal, the cap would apply only to supplemental revenues, and even after the supplemental revenue cap started to apply under the mitigation provisions, the resource then subject to mitigation would face no cap on LMP revenues. Thus, Mirant would always receive the higher of its Default Energy Bid or the LMP. The CAISO's proposed monthly cap counts any revenues accrued pursuant to initially high LMPs as contributing toward revenues above the Default Energy Bid that could be considered contributions towards fixed costs, *i.e.*, supplemental revenues. The monthly cap does not hinder accrual of LMP revenues but only seeks to reasonably limit the opportunity to accrue additional high supplemental revenues when LMPs are low and a resource submits high Bids.[35]

WPTF correctly notes that, in the June 27 Filing, the CAISO proposed to mitigate three categories of Exceptional Dispatches of eligible non-RA resources: (1) Exceptional Dispatches to address reliability requirements related to non-competitive transmission constraints; (2) Exceptional Dispatches to ramp units up

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[34] Mirant at 8.
[35] *See* CAISO Answer at 29-30.

from Minimum Load to minimum dispatchable levels to protect against reliability contingencies that are not directly incorporated or sufficiently met by the MRTU market software; and (3) Exceptional Dispatches to address other special unit-specific operating or environmental constraints not incorporated in the MRTU model. However, WPTF goes on to state erroneously that, at the Technical Conference, the CAISO proposed additional categories of Exceptional Dispatches to be mitigated, beyond the three it had originally proposed.[36] WPTF appears to be referring to Exceptional Dispatches to address the various types of constraints (voltage-related constraints, on-line capacity-based constraints, environmental constraints, and resource constraints) that the CAISO discussed at the Technical Conference.[37] Contrary to WPTF's assertion, these constraints are not addressed under new categories of Exceptional Dispatches that the CAISO only now proposes to mitigate. Rather, these are constraints that are to be mitigated pursuant to the three categories of Exceptional Dispatches listed in the June 27 Filing.[38]

WPTF and J.P. Morgan argue that Exceptional Dispatch energy payments should only be mitigated if the CAISO can demonstrate a high likelihood of market power, or its actual exercise.[39] The three categories of Exceptional Dispatch listed in the June 27 Filing cover the situations that the CAISO and the CAISO's Department of Market Monitoring have identified as presenting a

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[36] WPTF at 9.

[37] See "Uses of Exceptional Dispatch in MRTU Market," a PowerPoint presentation that the CAISO presented at the Technical Conference and that was posted in this proceeding on November 12, 2008, at slides 3-5.

[38] *See* CAISO at 27-28, 30-37.

[39] WTPF at 3, 10; J.P. Morgan at 4.

significant potential for the exercise of market power due to highly localized or unit-specific constraints and other reliability requirements that are not subject to the automated Local Market Power Mitigation ("LMPM") provisions incorporated in the MRTU software. For the reasons the CAISO has explained, it is appropriate to mitigate Exceptional Dispatches in these three situations.[40] In the October 16 Order, the Commission itself stated that, "[b]ecause Exceptional Dispatch instructions are exempt from mitigation by the automatic mitigation mechanism found in MRTU's integrated forward market and residual unit commitment – Market Power Mitigation and Reliability Requirement Determination – it appears a need remains for a mitigation mechanism for Exceptional Dispatch."[41] The Commission should disregard the attempts of WPTF and J.P. Morgan to unduly narrow the scope of mitigated Exceptional Dispatch.

G. The Commission Should Approve the Termination Date Regarding Exceptional Dispatch that the CAISO Proposes In These Reply Comments.

The CPUC suggests that Exceptional Dispatch should terminate on December 31, 2010, in order to coincide with the termination date of the ICPM provisions.[42] The CAISO agrees that a termination date is appropriate, but believes that two years of experience with MRTU is necessary in order to evaluate the continuing need for these programs or for a replacement. The

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[40] *See* CAISO at 28-29; Transmittal Letter for June 27 Filing at 6-8. As explained above, the CAISO does not propose to mitigate Exceptional Dispatches in situations other than these three. *Cf.* SCE at 3, 9-10 (proposing that all RA, ICPM, and non-RA resources that have reached their monthly supplemental revenue cap should be subject to market power mitigation of their energy bid if they are committed or incrementally dispatched under Exceptional Dispatch).

[41] October 16 Order at P 108 n.101.

[42] CPUC at 7-8.

CAISO therefore suggests that Exception Dispatch terminate 24 months after the implementation of MRTU and that the termination date for ICPM be revised accordingly.

WPTF and J.P. Morgan request that any provisions the Commission approves to mitigate energy payments for Exceptional Dispatch should terminate no later than one year after MRTU go-live.[43] The Commission should reject this request. There is no reason to believe that the 12 months after MRTU go-live provide a sufficient amount of time to resolve the issues that require the use of mitigated Exceptional Dispatch. To the contrary, as the CAISO has explained throughout this proceeding, the complexity of the MRTU market and the changes that will be made to that market suggest that it is prudent to maintain the Exceptional Dispatch mitigation provisions for the first 24 (not 12) months after MRTU go-live and then to evaluate whether the mitigation provisions should be maintained or should be terminated.[44]

Reliant argues that Exceptional Dispatch capacity compensation should not terminate when Exceptional Dispatch mitigation terminates.[45] The CAISO disagrees. Under the CAISO's revised Exceptional Dispatch pricing proposal, in order to prevent any double payment to a resource during a 30-day period, a resource committed through Exceptional Dispatch would not be permitted to earn, through the sum of ICPM capacity payments and supplemental revenues, payments greater than the applicable monthly ICPM payment during the 30-day period. If Exceptional Dispatch mitigation were permitted to terminate while

[43] WPTF at 3, 12; J.P. Morgan at 3.

[44] Transmittal Letter for June 27 Filing at 17; CAISO Answer at 3-4, 30-31.

[45] Reliant at 14-15.

Exceptional Dispatch capacity compensation continued on, that would create the risk of double payments in certain situations. Therefore, Exceptional Dispatch mitigation should not terminate prior to the termination of Exceptional Dispatch capacity compensation.

H. Other Issues

The CPUC asserts that Exceptional Dispatch instructions should follow certain inflexible rules: for Exceptional Dispatches that procure capacity services, RA units should always be called on before non-RA units; and when energy services are provided under an Exceptional Dispatch instruction, units with bids in the market should be considered first, and should be selected on a least-cost basis.[46] The CPUC does not explain why it believes these rules should always apply or why the CAISO's proposed priorities contained in Section 34.9 of the MRTU Tariff are not sufficient. Those proposed priorities are that (i) the CAISO will consider the effectiveness of a resource along with Start-Up Costs and Minimum Load Costs when issuing Exceptional Dispatches to commit a resource to operate at Minimum Load, (ii) the CAISO will also consider Energy Bids, if available and as appropriate, when it issues Exceptional Dispatch instructions for Energy, and (iii) the goal of the CAISO will be to issue Exceptional Dispatch instructions on a least-cost basis.[47] Thus, the CAISO proposes to employ priorities that allow for more flexibility than those than the CPUC suggests. Ensuring that the priorities stated in Section 34.9 are flexible is appropriate because Exceptional Dispatches will take place under different

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[46] CPUC at 4.

[47] June 27 Filing at Attachment B (proposed Section 34.9 of the MRTU Tariff).

operating conditions and each Exceptional Dispatch determination (*e.g.*, each least-cost determination) will thus be made on the basis of various factors, such as the ability to access information about Bids from relevant prior market periods (IFM/HASP/RTM) in a timely fashion, the expected duration of the Exceptional Dispatch, the effectiveness of resources, and whether a prospective mitigated resource has reached its supplemental revenue cap or when it is due to reach the cap. For these reasons, the Commission should accept the provisions in Section 34.9 as proposed by the CAISO.

The Six Cities state that, while they do not support a diversion of resources away from preparations for MRTU go-live, the CAISO should modify or update its Full Network Model and MRTU software, if possible, to minimize the need to rely on out-of-market dispatch instructions.[48] The CAISO will make every effort to address any issues with MRTU (*e.g.*, by updating the Full Network Model or addressing MRTU market software problems) as promptly as it can, but it is unrealistic to assume that such issues can always be addressed quickly. The CAISO will be monitoring the need for Exceptional Dispatch, especially during the first two years after MRTU go-live, in order to determine where improvements can be made and whether mitigated Exceptional Dispatch should be retained after that time. The Six Cities also assert that the CAISO should submit further information in this proceeding concerning the software and modeling constraints it discussed during the Technical Conference.[49] Although the Six Cities could not have been sure at the time that the CAISO would do so, the CAISO provided

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[48] Six Cities at 10-11.
[49] *Id.*

such information in its Comments.[50] The CAISO also notes that the ongoing MRTU implementation process at the CAISO is available to all Market Participants and the Six Cities can raise any questions or requests for information that they may have in implementation meetings or directly through their CAISO representative. The Six Cities do not explain why the record requires any additional information and the CAISO does not believe further information would be of any benefit to the Commission in resolving the issues presented in this proceeding.

NCPA asserts that a pair of amendments to the MRTU Tariff that the CAISO has submitted in other proceedings (Docket Nos. ER09-240 and ER09-241) "raise concerns" that the CAISO is tinkering with tariff fundamentals at the last minute, and that the Commission should take these tariff changes into account when determining the appropriate level of compensation for units that receive Exceptional Dispatches.[51] The Commission should disregard NCPA's assertions. There is no relationship between other MRTU Tariff amendment proceedings and the proceedings here, other than in the superficial sense that all of these proceedings concern various provisions of the MRTU Tariff. Thus, there is no relationship between a Commission finding that the MRTU Tariff amendments submitted in those other proceedings should be approved as just and reasonable (or, alternatively, should be rejected as unjust and unreasonable) and a Commission finding in the instant proceeding as to what the Exceptional Dispatch compensation level should be.

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50 CAISO at 23-27, 30-37.
51 NCPA at 3.

NCPA also argues that increased use of Exceptional Dispatch will cause such risk of increased prices for ratepayers that the Commission should initiate its own investigation into the continued justness and reasonableness of the entire MRTU Tariff itself and should make MRTU Tariff implementation in its entirety subject to refund.[52] This NCPA argument grossly overstates the expected volume and financial effects of Exceptional Dispatch. Although the CAISO anticipates that it will likely have to issue more Exceptional Dispatches than previously expected, it nevertheless expects that the total number of such Exceptional Dispatches will still constitute only one percent or less of the several thousand automated dispatches that will occur daily under MRTU. The CAISO anticipates that most of these Exceptional Dispatches will be for reasons akin to the reasons that the CAISO issues out-of-sequence dispatches under its current market design, and for the three categories of Exceptional Dispatches specified in the June 27 Filing, Bid mitigation will serve to reduce the amounts that exceptionally dispatched units receive and that ratepayers will be required to pay. Further, the CAISO has committed to exploring a number of potential improvements to MRTU functionality after go-live, some of which should reduce the need for Exceptional Dispatches.[53] Thus, there is no reason to balloon the scope of the instant proceeding by requiring the entire MRTU Tariff to be made subject to investigation and refund.

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[52] *Id.* at 3-4.
[53] CAISO at 20-22.

Reliant argues that the Commission should require the CAISO to create a transparent list detailing why each Exceptional Dispatch has occurred.[54] The Commission has already done so: in the September 2006 MRTU order, it directed the CAISO to publish all instances of Exceptional Dispatch, including total hourly volumes and hourly weighted average prices by transmission operator service territory, on the CAISO's Open Access Same-Time Information System ("OASIS").[55] As it explained in the transmittal letter for the June 27 Filing,[56] the CAISO will create an automated posting process with regard to the information required by the September 2006 Order, and will publish summary reports on the CAISO website concerning the reasons why it has conducted Exceptional Dispatches. In the transmittal letter to the June 27 Filing, the CAISO proposed to publish the summary report for each month approximately 30 days after the month is over. The CAISO wished to apprise the Commission and the parties that it will not be able to publish these reports as quickly as initially proposed due to the need to rely on manual processes to validate Exceptional Dispatches, including the reasons for the Exceptional Dispatches. Accordingly, the CAISO now proposes to include information on the reasons for validated Exceptional Dispatches in its post-MRTU implementation quarterly reports. The CAISO may still be in the process of validating Exceptional Dispatches for the particular quarter being reported, in which case the information will be reported in the next quarterly report. Although such information will likely need to be aggregated at some level (*e.g.*, by the various categories established for logging

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54 Reliant at 14.

55 *California Independent System Operator Corp.*, 116 FERC ¶ 61,274, at P 267 (2006).

56 Transmittal Letter for June 27 Filing at 7.

Exceptional Dispatches), the CAISO believes this information will provide a high level of transparency to Market Participants concerning the frequency, volume, costs, causes, and degree of mitigation of Exceptional Dispatches.[57]

Finally, the CAISO wishes to remind the Commission and parties that the Exceptional Dispatch mitigation and compensation described above will not be implemented in an automated fashion. Therefore, the CAISO will have to implement the tariff revisions regarding Exceptional Dispatch mitigation and compensation, including any revisions directed by the Commission, through a manual process.[58] Specifically, the CAISO anticipates that it will not be able to calculate supplemental revenues until after settlements statements for any affected months have been published. Since the 30-day periods for determining supplemental revenues will likely often straddle two calendar months,[59] supplemental revenues will not be calculated until after the final settlement statements for the second month are issued. The provision of ICPM payments to resources accepting ICPM designations should be less complicated. The CAISO, however, anticipates calculating the ICPM payment amounts after the final settlement statements for each month are issued.

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57 The provision of this information should also satisfy the Six Cities, which request that the CAISO issue market notices detailing the MW amounts of and reasons for Exceptional Dispatches. Six Cities at 11.

58 *See* Transmittal Letter for June 27 Filing at 29.

59 *See* CAISO at 7-8.

III. CONCLUSION

Wherefore for the foregoing reasons, the CAISO requests that the Commission act on the CAISO's Exceptional Dispatch proposal in a manner consistent with the discussion herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each party listed on the official service list for these 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 Washington, D.C. on this 9th day of December, 2008.

/s/ Bradley R. Miliauskas
Bradley R. Miliauskas