



California Independent
System Operator Corporation

January 9, 2007

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

**Re: 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 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

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

**California Independent System
Operator Corporation**

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Docket No. EL08-20-000

**COMMENTS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

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Pursuant to the schedule established in the Federal Energy Regulatory Commission's ("Commission") December 20, 2007, "Order Instituting a Section 206 Investigation and Denying Motion For Reconsideration and Clarification"¹ the California Independent System Operator Corporation ("CAISO")² respectfully submits these Comments on the Commission's investigation ("Investigation") regarding an extension of the Reliability Capacity Services Tariff ("RCST") until the earlier of the implementation of the CAISO's Market Redesign and Technology Upgrade ("MRTU") or an alternative backstop procurement mechanism.

I. SUMMARY OF COMMENTS

The CAISO agrees that an extension of the existing RCST until the implementation of MRTU or an alternative backstop procurement mechanism would be just and reasonable, but is only practicable if that a few necessary tariff changes are made, as discussed in greater detail below. Extension and effective implementation of the entire RCST mechanism is impracticable without certain modifications of the CAISO

¹ *California Independent System Operator Corporation*,, 121 FERC ¶ 61,281 (2007) ("Investigation Order").

² Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the CAISO Tariff.

Tariff. For example, designation provisions of the RCST include processes and criteria are designed specifically for 2006 and 2007, and are not applicable for 2008. Further, it is unclear how multi-month designations that would extend beyond the implementation date of MRTU would be accommodated, particularly in light of the fact that the currently applicable peak energy rent calculation is based on the existing zonal pricing scheme, and a different pricing regime, *i.e.*, LMP, will be in place under MRTU. The CAISO has asked the Commission to address these issues in a Motion for Clarification filed on December 28, 2007 in this proceeding (and in Docket No. EL05-146). Absent such clarification, the Commission should only extend the daily must-offer capacity payment that the Commission approved as part of the RCST Settlement.

In addition, the Commission should not consider changing the current target capacity payment of \$73/kW-year, unless it can be demonstrated that such price no longer remains within the range of reasonableness specified by the Commission in the Order approving the RCST Settlement, *i.e.*, between the fixed costs of existing generating units and the cost of new entry. Even then, the Commission needs to exercise care in determining whether to modify an individual element of a settlement that contained numerous provisions that reflected a delicate balance of the Settling Parties' interests and which was the product of significant give and take. For example, the RCST Settlement provides for a daily MOO capacity payment that is based on 1/17th of the monthly capacity payment, rather than a proportional 1/30th of the monthly capacity payment. Under these circumstances, absent a showing of materially changed circumstances, there is no basis to change the existing level of the target capacity payment, especially for an extension of RCST for only a few months.

II. BACKGROUND

On June 19, 2001, in response to the California electricity crisis, the Commission adopted a series of mitigation measures, including the must-offer obligation (“MOO”).³ Under the must-offer obligation, all Generators in California (with certain limited exceptions) must bid their uncommitted capacity into the CAISO’s real-time energy market unless they obtain a waiver from the CAISO. Initially, if the CAISO issued a must-offer waiver denial (“MOWD”), the CAISO compensated Generators only for their Minimum Load Costs, Startup Costs, and Emissions costs.

On August 26, 2005, the Independent Energy Producers Association (“IEP”) filed a complaint in Docket No. EL05-146 to replace the existing must-offer obligation with a tariff-based procurement mechanism which it entitled the “Reliability Capacity Services Tariff” or RCST. That name was eventually adopted for Section 43 of the CAISO Tariff. Following extensive settlement discussions, on March 31, 2006, IEP, the CAISO, the California Public Utilities Commission (“CPUC”), Pacific Gas and Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company submitted an offer of settlement (“RCST Settlement”) in order to resolve all issues in that proceeding. Of significance for the issues raised by the Investigation, the RCST Settlement included a new RCST and an additional daily capacity payment for units that are denied must-offer waivers by the CAISO and that are not Reliability Must Run units, Resource Adequacy Units, or designated under the RCST. The RCST Settlement specified that all provisions of the CAISO Tariff added by the settlement terminate on December 31, 2007.

³ San Diego Gas & Elec. v. Sellers, 95 FERC ¶ 61,418 (2001).

In a June 2006 Order, the Commission found that “under the current market design, the must-offer obligation does not adequately compensate generators for the reliability services they provide.”⁴ It concluded that compensation under the must-offer obligation was not just and reasonable.⁵ Because it could not resolve all of the issues raised by the proposed RCST Settlement, the Commission directed a paper hearing.⁶

After a paper hearing, in an Order issued on February 13, 2007, the Commission approved the Settlement with minor modifications.⁷ Consistent with the Offer of Settlement, the CAISO Tariff provides that the RCST and the daily capacity payment expire on December 31, 2007.⁸

Simultaneously with the proceeding concerning RCST, the CAISO has been finalizing its MRTU tariff provisions. MRTU is currently scheduled for implementation on March 31, 2008. As the Commission has observed, the must-offer obligation will terminate with the implementation of MRTU.⁹ The CAISO is therefore in the process of developing an interim capacity procurement mechanism (“ICPM”), which will be needed under MRTU until the CAISO develops a more permanent capacity procurement mechanism in conjunction with implementation of a long-term resource adequacy framework, which is currently being addressed in a proceeding at the CPUC. The CAISO intends to file the ICPM proposal following the CAISO’s January Board of Governors meeting, to be effective simultaneous with the implementation of MRTU.

⁴ *Indep. Energy Producers Assoc. v. Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,069 at P 35 (2006).

⁵ *Id.* at P 38.

⁶ *Id.*

⁷ *Indep. Energy Producers Assoc. v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 (2007) (“RCST Settlement Order”).

⁸ *Id.*

⁹ Investigation Order at P 40.

On October 12, 2007, IEP filed a Motion in which it requested that the Commission reconsider its September 25, 2007, Notice of Extension of Time granting the CAISO an extension of time, until January 18, 2008, to file the ICPM.¹⁰ IEP asked the Commission instead to require the CAISO to file the ICPM to be effective January 1, 2008, *i.e.*, prior to implementation of MRTU. To the extent the Commission declined to reconsider its order granting the CAISO an extension, IEP asked the Commission to confirm that the CAISO's Reliability Capacity Service Tariff terminates on December 31, 2008, and that generators cannot be required to provide reliability backstop service pursuant to the CAISO's must-offer obligation "without just and reasonable and non-discriminatory compensation."

In its Answer to IEP's Motion filed on October 29, 2007, the CAISO urged the Commission to reject IEP's request that the Commission require the CAISO to file the ICPM to be effective January 1, 2008. The CAISO stated that, nonetheless, if the Commission believed that it necessary to provide additional compensation to must-offer generators effective January 1, 2008, the Commission should exercise its rights under Section 206 of the Federal Power Act and extend the daily must offer capacity payment that is currently in effect until the implementation of MRTU.

On November 9, 2007, IEP filed an Answer to the Answers to its Motion. IEP stated that the Commission should direct continuation of RCST with modifications. Of particular significance, IEP wished to eliminate the daily payment component of the RCST settlement; require RCST designations for a minimum of three months following a single MOWD; and increase the capacity payment to \$162.48/kW-yr (based on the cost

¹⁰ In actuality, as the CAISO noted in its Answer to IEP's Motion filed on October 29, 2007, the Commission did not grant such an extension, but rather granted an extension to a related compliance obligation in the MRTU proceeding.

of new entry). On November 26, 2007, the CAISO filed an Answer to IEP's Answer in which it argued, *inter alia*, that automatic multi-month designations were inappropriate for a single MOWD, and using cost of new entry to price backstop capacity provided under an interim capacity procurement mechanism was unjustifiable.

In the Investigation Order, the Commission denied IEP's Motion. It ruled that the must-offer obligation would continue until the implementation of MRTU.¹¹ It observed, however, that starting January 1, 2008, there would be no mechanism in place for compensating Generators that are denied a must-offer waiver for their capacity, because RCST would have expired.¹² Noting that RCST had been found just and reasonable; and the previous compensation under the must-offer obligation had been found to be unjust and unreasonable. the Commission preliminarily concluded that the most efficient solution is simply to extend the RCST for a relatively brief period of time until implementation of the earlier of either MRTU or an alternative backstop capacity mechanism, so that all generators are compensated for the reliability and capacity that they provide through compliance with the must-offer obligation.¹³

The Commission therefore directed the CAISO to file tariff sheets extending RCST until the earlier of the implementation of MRTU or of an alternative backstop procurement mechanism and commenced an investigation into whether extending the RCST for this period was just and reasonable. The Commission established a refund effective date of January 1, 2008.¹⁴

¹¹ Investigation Order at P 40.

¹² *Id.* at P 43.

¹³ *Id.* at PP 47-48, 53.

¹⁴ *Id.* at Ordering Paragraphs (A), (B), and (E).

The CAISO made its tariff filing to comply with the Investigation Order on December 28, 2007. Simultaneously therewith, the CAISO filed a Motion for Clarification in which it indicated that simply extending the effective date of the RCST would not accomplish the Commission's intention to extend all of the RCST provisions because certain provisions in the RCST are specific to 2006 and 2007 and make no provision (*e.g.*, provide no process or criteria) for application in 2008. Accordingly, the CAISO requested that the Commission provide guidance as to how certain of the designation provisions would be applied in 2008 if the RCST were to be extended.

II. COMMENTS

A. The Commission Should Direct Tariff Revisions Necessary To Implement An Extension Of The Entire RCST

The CAISO agrees that an extension of RCST until the implementation of MRTU or an alternative backstop procurement mechanism is just and reasonable. The Commission has issued two orders in 2007 finding RCST to be just and reasonable, including a rehearing order issued recently on December 20, 2007.¹⁵ The CAISO does not believe there are any reasons that would render the extension of the RCST for a period of months prior to implementation of MRTU unjust and unreasonable. However, the CAISO notes that extension of the entire RCST mechanism would be impracticable without certain tariff modifications consistent with the discussion herein.

For example, with the impending implementation of MRTU, it is not clear how any multi-month designations under RCST that might otherwise carry over into MRTU would work. The PER calculation methodology that is in place now is based on a zonal pricing scheme; however, there will be a LMP pricing scheme under MRTU, so the

¹⁵ *Independent Energy Producers Association, Inc. v. California Independent System Operator Corporation*, 121 FERC ¶ 61,276 (2007).

existing methodology is not workable. This requires that any RCST designations made prior to MRTU implementation terminate no later than the effective date of MRTU (or earlier if the CAISO files, and the Commission approves, an alternative capacity backstop mechanism). In any order extending the RCST, the Commission should adopt such a requirement. This is consistent with the intent of the existing Significant Event and Local RCST designation provisions of the RCST (Sections 43.4 and 42.1.2.3) which provide that designation terms expire the earlier of December 31, 2007 or MRTU implementation. Similarly, Section 43.3.2 (entitled “Monthly System Reliability Capacity Services Designations”), provides that designations shall be for the lesser of three months, the remainder of the calendar year or the period of time until MRTU becomes effective.¹⁶

Moreover, as indicated above, simply extending the RCST effective date will not accomplish an effective extension of the RCST. In that regard, certain provisions of the RCST, especially the designation provisions, are specific to 2006 and 2007 (*e.g.*, they rely on 2006 or 2007 studies, criteria and specified timelines), and make no provision for application in 2008. For example, Section 43.2.1 sets forth the process, timeline and criteria that apply to Local RCST Designations. Section 43.2.1.2 specifies that Local RCST designations are to be made based on deficiencies in meeting 2007 Local Area Reliability Requirements. These tariff provisions are not applicable to, or workable for, 2008 designations unless they are modified to incorporate new processes, timelines and criteria that would apply for 2008. In its Investigation Order, the Commission did not

¹⁶ Under Section 43.3.1, Annual System RCST designations for 2007 have a minimum term of three months and may be extended for a maximum term of the five summer months of May through September. If the Commission extends RCST, it should provide that any Annual System designations must expire upon the earlier of implementation of MRTU or a replacement backstop capacity procurement mechanism.

indicate what specific timelines and criteria should apply for 2008 or what terms would apply to any 2008 Local Deficiency RCST designations.¹⁷

In addition, Section 43.4 (entitled “RCST Designations for Significant Events”), provides that the CAISO “may designate Eligible Capacity or System Resources to provide service under this Section 43.4 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 reached 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.” Section 43.4 does not state which specific criteria (local capacity area study) apply for purposes of determining whether there is a Significant Event in 2008. Is it the 2006 study, the 2007 study or the new 2008 study (which is not mentioned in the RCST but which reflects the current reliability needs of the CAISO system)? Simply extending the effective date of the RCST does not resolve this question, and further tariff changes would be required to indicate the criteria that would be applied (and studies that would be utilized) for purposes of making 2008 Significant Event designation decisions.

Significantly, the local capacity requirements in 2008 are not the same as the local capacity requirements in 2006 and 2007. In addition, the 2006 LARN Report, 2007

¹⁷ For example, the CPUC-established local area requirements for 2007 are not the same as the 2008 local area requirements. Under Section 43.2.1.2, the CAISO examines whether there are any deficiencies in any 2007 Local Reliability Areas. However, the 2008 Local Capacity Areas are not the same as the 2007 Local Reliability Areas ; *i.e.*, the 2007 local requirements are stale, but those are the requirements specified in the current RCST. This raises the question of which local requirements -- the 2007 local area requirements as specified in the currently effective RCST or 2008 local area requirements -- would apply for the extended RCST period for purposes of determining whether there will be any Local RCST Designations in 2008 prior to MRTU. The CAISO notes that for 2008, Scheduling Coordinators would make local capacity demonstrations based on the 2008 requirements not the 2007 requirements. The Commission did not address this issue in the December 20 Order or the other changes that would be necessary to make the tariff language in Sections 43.2.1, 43.2.1.1, 43.2.1.2 and 43.2.1.3 work in 2008.

Local Reliability Areas and 2007 Local Resource Adequacy Requirements – which have served as the basis for Local and/or Significant Event RCST designations under the existing RCST – are stale and not reflective of the CAISO’s current local capacity needs in 2008. As such, it is questionable whether the existing tariff criteria can or should be used for purposes of determining whether any Local or Significant Event designations are appropriate in 2008 under any extension of the RCST.

Because the December 20 Order did not contain any specific directives or guidance in this regard, the CAISO sought expedited clarification on this issue in its December 28, 2007 Motion for Clarification. The CAISO reiterates that request here. To the extent the Commission determines that the entire RCST should be extended -- as opposed to simply extending the daily Must Offer Obligation capacity payment -- the Commission should direct the CAISO to base Local and Significant Event RCST designations on the CAISO’s 2008 Local Capacity Technical Study. The Commission has already approved (in a December 14, 2007 Order) use of the 2008 Local Capacity Technical Study for 2008 for purposes of Section 40 of the CAISO Tariff.¹⁸ The CAISO also notes that the Commission’s December 14, 2007 Order approved a process for demonstrating compliance with the Local Capacity Area Requirements (Section 40.7 of the CAISO Tariff) that could be applied before the CAISO makes any Local RCST designations in 2008. Accordingly, to the extent the Commission extends the RCST, it should authorize the CAISO to use the 2008 Local Capacity Technical Study and the Compliance Provisions of Section 40.7 for purposes determining whether Local and Significant Event RCST designations are appropriate in 2008.

¹⁸ Cal. Indep. Sys. Operator Cor., 121 FERC ¶61,258 (2007).

If the Commission decides to extend the process for making RCST designations, it is important that the Commission direct the tariff changes necessary for such designations as discussed herein and in the CAISO's Motion for Clarification filed on December 28, 2007. Further, in order to prevent interference with the orderly implementation of MRTU, it is critical that the Commission direct that any such designations terminate upon the implementation of MRTU. If the Commission does not direct such tariff revisions, then the Commission should only extend the MOO daily capacity payment.

B. Absent A Showing of Materially Changed Circumstances, The Commission Should Maintain the Existing Target Capacity Price

In the RCST Settlement Order, the Commission found that there were two reference levels for determining the price of procuring backstop capacity. At the lower end, the price should cover the fixed costs of existing generation that is needed for reliability. At the higher end, the Commission concluded that the price should not exceed the cost of new entry. Accordingly, the Commission found that a just and reasonable target capacity price lies within the range of \$64/kW-year (a reasonable proxy price for fixed operating costs of existing generation that was based on average cost of non-hydroelectric RMR units)¹⁹ and \$89/kW-year (a cost reflective of the price of new entry).²⁰ The fleet of generators that has been receiving the just and reasonable MOO capacity payment based on a target capacity price of \$73/kW-year is the same fleet of generators that will be receiving any interim compensation for the period January 1, 2008 until the earlier of MRTU implementation or implementation of a replacement

¹⁹ That proxy number was derived from Exhibit B to the CAISO's May 1, 2006 Reply Comments in Docket No. EL05-146 which set forth information regarding the costs of RMR units.

²⁰ RCST Settlement Order at P 70.

backstop capacity procurement mechanism. At a minimum, in order to justify any change in the \$73/kW-year target capacity price, there must be a showing that such target capacity price no longer remains within the two bookend reference points adopted by the Commission in the RCST Settlement Order and the recent rehearing order, *i.e.*, the fixed costs of existing generation and the cost of new entry.

However, the Commission should exercise care in deciding whether to modify, for only a several-month period, individual elements of a settlement that reflected a delicate balance of the Settling Parties' interests and which was the product of significant give and take. For example, the MOO daily capacity payment under the RCST is based on 1/17th of the monthly capacity payment, which is almost twice the proportional payment, *i.e.*, 1/30th of the monthly capacity payment. In addition, MOO generators receive payment both for Minimum Load Cost Compensation ("MLCC"), as well as an Imbalance Energy payment for their minimum load Energy. The CASIO believes that this constitutes sufficient compensation for daily MOWD's during the period prior to implementation of MRTU. Under these circumstances, absent a showing of materially changed circumstances, there is no basis to change the existing level of the daily must-offer capacity payment or the target capacity price, especially for a few-month extension of RCST.

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,

/s/ Anthony J. Ivancovich
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Dated: January 9, 2008

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 9th day of January, 2008.

/s/ *Melissa Hicks*
Melissa Hicks