123 FERC ¶ 61,229
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

California Independent System Operator Corporation — Docket No. ER08-760-000

ORDER ACCEPTING TARIFF FILING SUBJECT TO MODIFICATION

(Issued May 30, 2008)

1. On March 28, 2008, the California Independent System Operator Corporation (CAISO) filed the Transitional Capacity Procurement Mechanism (TCPM) pursuant to section 205 of the Federal Power Act (FPA)[1] and part 35 of the Commission's regulations.[2] The TCPM's purpose is to enable the CAISO to acquire generation capacity to maintain grid reliability if load serving entities (LSEs) fail to meet resource adequacy requirements; procured Resource Adequacy resources[3] are insufficient; or unexpected conditions, *i.e.*, "Significant Events," create the need for additional capacity.

[1] 16 U.S.C. § 824(d) (2000 & Supp. V 2005).

[2] 18 C.F.R. Part 35 (2007).

[3] A resource adequacy resource is a generator that has been procured by an LSE in response to resource adequacy requirements implemented by either the California Public Utilities Commission (CPUC) or other local regulatory authority. Significantly, resource adequacy resources operate under a capacity contract, which provides these generators with an additional opportunity to recover fixed costs vis-à-vis resources that lack these contracts. For the purpose of this proceeding, non-resource adequacy resources refer to generators that are not operating under a capacity contract (i.e., resource adequacy or Reliability Must-Run (RMR) contract).

The TCPM is intended to serve as a bridge between the current Reliability Capacity Services Tariff (RCST) and the proposed Interim Capacity Procurement Mechanism (ICPM),[4] which the CAISO intends to implement simultaneously with its Market Redesign Technology Upgrade (MRTU). The TCPM has a proposed effective date of June 1, 2008, and will terminate upon the effective date of MRTU and ICPM implementation. For the reasons discussed below, the Commission accepts the TCPM filing, subject to modification, effective on June 1, 2008, as requested.

I. Background

A. RCST

2. On April 26, 2001, the Commission established a prospective mitigation and monitoring plan for the California wholesale electric markets.[5] One of the fundamental elements of the plan was the implementation of a must-offer obligation, pursuant to which most generators serving California markets are required to offer all of their capacity in real time and during all hours if the capacity is available and not already scheduled to run through bilateral agreements. The CAISO implemented the must-offer obligation beginning July 20, 2001. The must-offer obligation is "designed to prevent withholding and thereby . . . ensure that the CAISO will be able to call upon available resources in the real-time market to the extent that energy is needed."[6] A generating unit may request a waiver of its must-offer obligation. If the CAISO denies a waiver request (must-offer waiver denial), the generator is required to remain in operation, i.e., is "committed."

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[4] The CAISO filed the ICPM on February 8, 2008, in Docket No. ER08-556-000.

[5] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 95 FERC ¶ 61,115 (2001), *order on reh'g*, 95 FERC ¶ 61,418 (2001), *order on reh'g*, 97 FERC ¶ 61,275 (2001), *order on reh'g*, 99 FERC ¶ 61,160 (2002), *pet. granted in part and denied in part sub nom. Public Utils. Comm'n of the State of Cal. v. FERC*, 462 F.3d 1027 (9th Cir. 2006).

[6] *Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,193, at P 2 (2007) (*citing San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 95 FERC ¶ 61,418, at 62,551 (2001)).

3. In an order issued on June 17, 2004,[7] the Commission recognized the CPUC's plan to phase-in resource adequacy requirements and suggested that, if the CAISO determines that resource adequacy requirements are sufficient to meet its operational needs, the resource adequacy requirements could serve to replace the existing must-offer obligation.[8] Additionally, on July 8, 2004,[9] the Commission advised that if the Independent Energy Producers Association (IEP) believed the current must-offer obligation to be unjust and unreasonable, it may seek to initiate a section 206 proceeding to challenge the current method and implement an alternative proposal.[10] The Commission concluded that the must-offer obligation should remain temporary, and reiterated its suggestion that if resource adequacy requirements are sufficient to meet operational needs, the resource adequacy requirements can replace the existing must-offer obligation.[11]

4. On August 26, 2005, IEP filed a complaint against the CAISO under section 206 of the FPA.[12] The complaint alleged that the Commission-imposed must-offer obligation under the CAISO Tariff was flawed and no longer just and reasonable. The complaint also requested that the Commission direct the CAISO to replace the must-offer obligation and related minimum load cost compensation tariff provisions with an interim set of tariff provisions that would remain in effect until the CAISO's market redesign goes into effect.

[7] *Cal. Indep. Sys. Operator Corp.*, 107 FERC ¶ 61,274 (2004) (June 2004 Order), *order on reh'g*, 108 FERC ¶ 61,254 (2004).

[8] *See* June 2004 Order, 107 FERC ¶ 61,274 at P 26-28.

[9] *Cal. Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,022 (2004) (July 2004 Order), *order on reh 'g*,108 FERC ¶ 61,097 (2004).

[10] July 2004 Order, 108 FERC ¶ 61,022 at P 116.

[11] *Id*. P 114-115. The Commission subsequently reiterated its intent that the must-offer obligation should be temporary. *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,069 (2006) (July 20, 2006 Order).

[12] 16 U.S.C. § 824e (2000).

5. On March 31, 2006, the Settling Parties[13] filed an Offer of Settlement of the IEP complaint that proposed the institution of the RCST. In conjunction with the must-offer obligation, the RCST provides a backstop capacity procurement mechanism to the CAISO that includes provisions establishing: (1) a Daily Must-Offer Capacity Payment rate; (2) an RCST capacity payment due to a designation resulting from a Significant Event;[14] (3) a monthly RCST capacity payment due to designations resulting from deficiency in resource adequacy showings; and (4) monthly capacity payments to frequently mitigated units.[15] The RCST was to be effective until the earlier of December 31, 2007 or the implementation of either MRTU or an alternate backstop capacity procurement mechanism. In addition, the RCST established cost allocation methodologies and governed the rules by which the CAISO can procure RCST capacity.

6. In the July 20, 2006 Order on Complaint and Offer of Settlement, the Commission found that, under the then-current market design, the compensation to generators under the must-offer obligation was no longer just and reasonable. However, the Commission was unable to find that the rates and cost allocation mechanism under the contested Offer of Settlement were just and reasonable. Accordingly, the July 20, 2006 Order established paper hearing procedures to review evidence on the rates and cost allocation issues presented by the Offer of Settlement.[16] On February 13, 2007, in the Order on Paper Hearing, the Commission approved, with modifications, the Offer of Settlement as just and reasonable.[17]

[13] The Settling Parties are: IEP; the CAISO; the CPUC; Pacific Gas and Electric Company (PG&E); San Diego Gas & Electric Company (SDG&E); and Southern California Edison Company (SoCal Edison).

[14] An RCST Significant Event is an event that results in a material difference in ISO Controlled Grid operations relative to what was assumed by the CPUC and Local Regulatory Authorities in developing Local Resource Adequacy Requirements for 2007 that causes, or threatens to cause, a failure to meet Applicable Reliability Criteria.

[15] The RCST established a Target Capacity Price of $73/kW-year and a Daily Must-Offer Capacity Payment rate equal to 1/17 of the monthly capacity payment.

[16] *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,069, at P 38 (2006) (July 20, 2006 Order).

[17] *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096 (2007) (Order on Paper Hearing), *order on reh'g*, 121 FERC ¶ 61,276 (2007) (RCST Rehearing Order).

7. On December 20, 2007, the Commission instituted a proceeding in Docket No. EL08-20-000 pursuant to section 206 of the FPA[18] to investigate the justness and reasonableness of extending the RCST until the earlier of the implementation of either the MRTU or an alternative interim backstop capacity procurement mechanism.[19] Pursuant to section 206, the RCST Extension Order established a refund effective date of January 1, 2008, and sought comments on the proposal to extend the RCST beyond its original termination date. In addition, the Commission denied IEP's request for reconsideration and clarification of the Commission's notice granting the CAISO an extension of time to file resource adequacy provisions related to its ICPM. In the RCST Extension Order, the Commission recognized the CAISO's commitment to develop an updated must-offer obligation compensation mechanism, if MRTU were delayed, and stated that it "expect[ed] the CAISO to follow through with its commitment to initiate a new stakeholder process and modify the RCST accordingly."[20]

B. Relevant MRTU Orders

8. The CAISO filed the MRTU Tariff with the Commission on February 9, 2006. Subsequently, on September 21, 2006, the Commission issued an order that conditionally accepted the filing, subject to modifications.[21] On June 25, 2007, the Commission conditionally accepted certain compliance filings made by the CAISO, subject to additional modifications.[22] The Commission also directed the CAISO to explore with stakeholders opportunities for LSEs to avoid potential CAISO remedial procurement by curing a collective shortfall in Local Capacity Area Resource Requirements.[23] In a January 9, 2008 Order, the Commission conditionally accepted, subject to modification,

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[18] 16 U.S.C. § 824e (2000).

[19] *Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,281 (2007) (RCST Extension Order).

[20] *Id*. P 38.

[21] *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 (2006) (MRTU Order), *order on reh'g*, 119 FERC ¶ 61,076 (April 2007 MRTU Rehearing Order), *order on reh'g and denying motion to reopen record*, 120 FERC ¶ 61,271 (2007) (September 2007 MRTU Rehearing Order).

[22] *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,313 (2007) (June 25 Order).

[23] *Id.* P 380.

the proposed MRTU Tariff revisions related to resource adequacy, and deferred resolution of other MRTU compliance issues.[24]

C. ICPM

9. On February 8, 2008, the CAISO filed the ICPM, which the CAISO proposes to become effective simultaneously with the implementation of MRTU.[25] Similar to RCST and TCPM, the ICPM is an interim, tariff-based capacity procurement mechanism designed to supplement or "backstop" resource adequacy procurement when necessary to maintain reliable grid operations. The ICPM differs from the RCST and TCPM, however, in that it is designed to work under the new MRTU market paradigm, which includes locational marginal pricing and scarcity pricing components, but, significantly, no must-offer obligation.[26]

II. The TCPM Proposal

10. On March 28, 2008, the CAISO filed its proposed TCPM to bridge the period between the currently effective RCST and the proposed ICPM. As described in more detail below, the TCPM retains many of the components of the RCST and adopts some of the changes proposed in the ICPM Filing. Although the TCPM incorporates certain changes developed during the ICPM stakeholder process, the CAISO explains that the TCPM proposal is designed to work with the existing (pre-MRTU) market structure. Therefore, the CAISO states that the TCPM proposal is based on modifications to the RCST, not a new framework.

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[24] *Cal. Indep. Sys. Operator Corp.*, 122 FERC ¶ 61,017, at P 1 (2008) (MRTU Resource Adequacy Order).

[25] CAISO February 8, 2008 Transmittal Letter, Docket Nos. ER08-556-000 and ER06-615-020, at 2.

[26] The ICPM proposes a minimum annual capacity price of $41/kW-year, which is lower than the minimum annual capacity price under either RCST or the proposed TCPM, but, unlike those prices, does not require deduction for peak energy revenues or Ancillary Service revenues. *See id.* at 4. The ICPM filing is pending before the Commission. *See* Docket Nos. ER08-556-000 and ER06-615-020. We note that the Commission is evaluating the ICPM proposal in its entirety in Docket Nos. ER08-556-000 and ER06-615-020, and that acceptance in this order of aspects of the TCPM that reflect changes proposed in the ICPM filing does not constitute prejudgment of those issues in the context of the ICPM proposal.

11. The CAISO states that the TCPM proposal builds upon the existing RCST in five primary ways. First, the CAISO points out that the TCPM increases the current RCST Target Capacity Price from $73/kW-year to $86/kW-year. The CAISO states that the updated rate is based upon an escalation of the RCST capacity price for two years using the Consumer Price Index-Urban (CPI-U) and then adding 10 percent to that amount in recognition of the fact that the CPI-U is only a general inflation factor that may not capture all of the appropriate costs. The CAISO states that the TCPM also increases the current Daily Must-Offer Capacity Payment from the RCST rate of 1/17 of the monthly target capacity payment, to 1/8 of the monthly target capacity payment. The CAISO explains that this increase was intended to strike a balance between stakeholder positions.

12. Second, the TCPM incorporates increased flexibility to use the backstop mechanism to address unexpected, short-term reliability needs, i.e. Significant Events. The CAISO maintains that the revised TCPM Significant Event designation process has been tailored to match the scope and expected duration of the TCPM Significant Event as well as ensure that designations are made in a transparent manner. These changes in definition and flexibility are also reflected in the CAISO’s ICPM proposal.

13. Third, the CAISO states that the TCPM proposes tariff language to address how the CAISO would procure backstop capacity for resource adequacy deficiencies under local requirements, and how the CAISO would address a collective deficiency relative to the local resource adequacy requirement. The CAISO notes that these provisions and the associated cost allocation were derived from similar provisions in the proposed ICPM proposal.

14. Fourth, the CAISO explains that the TCPM adds tariff language to address allowing LSEs to credit certain TCPM procurement in resource adequacy showings. However, the CAISO notes that TCPM Significant Event designations will not be credited. The CAISO also included this feature in its ICPM proposal.

15. Finally, the CAISO states that the TCPM incorporates a cost allocation methodology for TCPM Significant Events, which is also reflected in its ICPM proposal, and is based on Market Participants' actual usage of the CAISO system during the period of the TCPM Significant Event. The CAISO explains that this is a change from the RCST mechanism, which allocated Significant Event procurement costs on the basis of coincident peak load during the year preceding the Significant Event. The CAISO maintains that the revised proposal better aligns cost incurrence with the parties that benefit from the designation of capacity.

III. Notice, Intervention, and Responsive Pleadings

16. Notice of the proposed amendments was published in the *Federal Register*, 73 Fed. Reg. 19,201 (2008), with motions to intervene, comments, and protests due on or before April 18, 2008. Timely motions to intervene were filed by the following: (1)

NRG Power Marketing, Inc., Cabrillo Power I LLC, Cabrillo Power II LLC and Long Beach Generation LLC (NRG Companies); (2) Alliance for Retail Energy Markets (AReM); (3) California Department of Water Resources State Water Project; (4) SoCal Edison; and (5) Modesto Irrigation District. Timely motions to intervene with comments and/or protests were filed by the following: (1) Northern California Power Agency (NCPA); (2) California Municipal Utilities Association (CMUA); (3) Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (Six Cities); (4) City of Santa Clara, California and the M-S-R Public Power Agency (Santa Clara); (5) Constellation Energy Commodities Group, Inc. and Constellation New Energy, Inc. (Constellation); (6) AReM; (7) Department of Energy Western Area Power Administration (Western); (8) Dynegy Moss Landing, LLC and Dynegy Morro Bay LLC, El Segundo Power, LLC, and Reliant Energy, Inc. (collectively California Generators); and (9) IEP. SoCal Edison filed timely comments.

17. On April 21, 2008, PG&E filed a motion for leave to intervene and comment out-of time and the CPUC filed a motion to intervene out-of-time. Subsequently, the CAISO filed an answer and SoCal Edison filed reply comments.

IV. Discussion

A. Procedural Matters

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission’s Rules of Practice and Procedures, 18 C.F.R § 385.214(d) (2007), the Commission will grant PG&E’s and CPUC’s late-filed motions to intervene given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

19. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept either the CAISO’s answer or SoCal Edison’s reply comments and will, therefore, reject them.

B. Conditional Acceptance

20. The Commission conditionally accepts the CAISO's TCPM proposal. While further refinement of the TCPM is necessary, as discussed below, we find that, in general, the CAISO’s proposal establishes a reasonable backstop capacity procurement mechanism for the period starting June 1, 2008, until the implementation of MRTU.

C. Significant Events

21. The CAISO explains that the primary focus of its TCPM proposal is to provide the CAISO with greater authority and flexibility to respond to unexpected events that create short-term reliability problems. Accordingly, the CAISO proposes a broader definition of Significant Event, and decreases the initial Significant Event designation period from three months to one-month (30 days). The CAISO asserts that it has balanced this additional authority with heightened reporting obligations to provide increased transparency of its designations and give market participants the opportunity to avoid lengthy designations by proposing alternative solutions.[27]

1. The CAISO's Ability to Designate Capacity for Significant Events

22. The CAISO proposes two main changes from the designation process under the RCST. First, the CAISO proposes to include the authority to make a "collective deficiency" designation if the portfolio of resources procured by all Scheduling Coordinators for LSEs in a local area is not sufficient to meet the reliability criteria for the local area. Second, the CAISO proposes a number of changes to the process and criteria for designating units for Significant Events.

23. For designating capacity when Significant Events arise, the CAISO proposes to use the same three-step process it crafted for the ICPM. Step One: The CAISO would identify event(s) that may violate an assumption of the resource adequacy program or result in a material change in system conditions or in CAISO-controlled grid operations. In either case, if the event indicates the need to procure capacity on a prospective basis, the CAISO would procure the needed capacity for a 30-day period. The CAISO would then post an explanation of the event and its expected duration. Step Two: If the CAISO determines that the TCPM Significant Event is likely to persist longer than 30-days, the CAISO would extend that designation for another 60 days (for a total 90-day designation). During this extended time, market participants will have the opportunity to review the CAISO's explanation for the TCPM Significant Event and provide alternative solutions that meet the CAISO's operational needs. Step Three: Prior to the end of the 90-day period, the CAISO would assess the proposed solutions to decide whether they mitigate completely or partially the ongoing need for the TCPM capacity. The CAISO asserts that this process provides the CAISO with the designation flexibility it needs,

[27] *See* CAISO March 28, 2008 Transmittal Letter (CAISO TCPM Transmittal) at 28.

while providing increased transparency and certain protections to alleviate concerns about unnecessary procurement.[28]

Comments and Protests

24. Many of the commentors oppose the discretion afforded the CAISO to make a TCPM designation due to a Significant Event. Santa Clara contends that the Commission should reject the CAISO's broad discretion over whether or not to designate a Significant Event, which provides only post-procurement notification to market participants and consideration of alternative stakeholder solutions.

25. Constellation argues that the CAISO's ability to designate resources as a result of Significant Events should be eliminated. Constellation contends that if not eliminated, the Significant Event definition should be modified so that designations will occur only when the aggregate capacity availability is to be reduced below operating reserve levels.

26. California Generators contend that the TCPM designation should be "automatically triggered" by a single must-offer waiver denial.[29] They argue that the CAISO's capacity procurement and compensation mechanism "must not discriminate among suppliers of capacity based on whether, or under what circumstances, the generating capacity operates or not."[30] According to California Generators, the CAISO appears to use a different standard of need for RMR and resource adequacy capacity resources, as opposed to non-resource adequacy resources, providing exactly the same reliability service provided under the TCPM. RMR and resource adequacy resources receive capacity payments over the course of the entire year, regardless of whether these resources are called on to operate. Unlike the proposed TCPM, designations for resource adequacy resources (and RMR units) are not based on a measure of recurring use, but rather on future projections of need, which may or may not be realized. California Generators assert that capacity service is not only provided when a unit is called upon to operate, but also when a unit has made itself available to operate if called. California Generators assert that compensation for TCPM service should not be based on an as-used daily or hourly basis, but rather as a service that warrants a longer term designation when need is demonstrated, as is the case when must-offer waivers are denied.

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[28] CAISO TCPM Transmittal Letter at 30-31.

[29] For explanation of the must-offer waiver denial, *see supra*, P 2.

[30] California Generators' April 18, 2008 Protest (California Generators' Protest) at 5.

27. IEP claims that the TCPM, regardless of the CAISO's characterization of it as transitional, is unjust, unreasonable, and unduly discriminatory in its designation and compensation of existing generation for the necessary reliability services that they provide. In its January 9, 2008 comments on the extension of the RCST, which IEP refers to in the instant proceeding, IEP asserted that it made clear that RCST's designation provisions were unjust, unreasonable, and unduly discriminatory. Specifically, IEP notes that, since implementing the RCST, the CAISO has only designated one generating unit under the RCST.[31] Yet, IEP asserts that, as demonstrated by the CAISO's own reports, the CAISO regularly and continually has committed units under the must-offer obligation. IEP states that, from June 1, 2006 to December 22, 2007, the CAISO issued 525 commitments to 31 generating units.

28. Although not expressly argued herein, in the IEP RCST Comments incorporated by reference in its TCPM Protest, IEP claimed that the CAISO's own classification and treatment of must-offer waiver denials has served to undermine the designation process.[32] In the instant proceeding, IEP argues that nothing in the TCPM changes the manner in which the CAISO classifies must-offer waiver denials. Thus, IEP concludes that the non-Significant Event designation process in the TCPM suffers from the same flaws affecting the RCST designation process.

29. Further, IEP maintains that the CAISO has not "improved" upon the RCST Significant Event designation process. IEP claims that the TCPM simply adopts the purported improvements that the CAISO has made in its ICPM filing. To date, IEP notes that the Commission has not accepted these "improvements."

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[31] IEP January 9, 2008 Comments, Docket Nos. ER06-615-003, *et al.*, at 6 (IEP RCST Comments). IEP states that its protest to the TCPM mirrors and echoes the protests that it has lodged in response to the proposed extension of the RCST and the ICPM proposal. IEP April 18, 2008 Protest at 3 (IEP TCPM Protest). Taken individually and collectively, IEP asserts that these "band-aids" for existing generation supply compensation fail to do anything but put off for another three years the transition to a final capacity procurement model, let alone an end-state capacity procurement model. *Id*. at 3-4. IEP reiterates the arguments that it has made in the open dockets concerning the RCST Extension and ICPM proposals, as well as the Indicated Generators complaint in *Dynegy Moss Landing, LLC, et al. v. Cal. Indep. Sys. Operator Corp.*, Docket No. EL08-13-000 (November 30, 2007). IEP TCPM Protest at 4. IEP urges the Commission to focus on these issues and establish paper hearings to assess the justness and reasonableness of the TCPM. *Id.* at 3-4.

[32] *Id.* at 4-5.

30. In its RCST Comments, which IEP refers to in its instant protest, IEP argued that the Commission should order the CAISO to designate a unit after a single must-offer waiver denial and eliminate tariff language concerning the designation upon a declaration of a "Significant Event." In the instant proceeding, IEP claims that a designation of a generating unit after a single Day-Ahead or Real-Time must-offer waiver denial is fair, just, and reasonable. IEP states that the TCPM (as with the RCST before it and ICPM after it) is the CAISO's fourth line of defense (fifth in the case of the ICPM) to ensure that it meets its reliability needs. IEP explains that before reaching the TCPM stage, the CAISO has the following tools at its disposal: (1) resource adequacy resources provided by the CPUC program and by programs implemented by self-regulating LSEs; (2) RMR contracting; and (3) other bilateral contracting as allowed for by the CAISO Tariff.[33] IEP claims that, consistent with fundamental economic principles, the ultimate reliability backstop mechanism should provide the clearest economic signal to the market of the need to invest in new supply. By giving the CAISO numerous daily reliability call options, IEP argues that the TCPM ensures that such an economic signal is muted.

Determination

31. We accept the CAISO's proposed designation of capacity under the TCPM, subject to modification. We find that, with regard to Significant Event designations, the CAISO has excessive discretion. Specifically, we are concerned that the proposal lacks an objective benchmark that would require the CAISO to designate capacity resources. The data supplied by IEP supports this determination.[34] We find that this discretion would lead to the creation of two classes of resources that the CAISO would rely on to meet the same reliability needs: (1) resources that have secured contracts for forward capacity under resource adequacy or RMR contracts; and (2) resources under the must-offer obligation that receive only daily payments when called upon. Failure to designate TCPM capacity resources appropriately could result in unduly discriminatory treatment among classes of generators, where resources that lack resource adequacy contracts or RMR agreements receive insufficient compensation for the reliability services they provide. Consequently, we find that, in the context of the TCPM's proposal as a whole, the CAISO has failed to show that the broad discretion proposed for making Significant Event designations is just and reasonable.

32. Accordingly, we direct the CAISO to modify its proposal by incorporating an objective criterion and providing units with a minimum 30-day capacity designation upon

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[33] IEP TCPM Protest at 6. *See also* IEP February 9, 2008 ICPM Protest, Docket Nos. ER08-556-000 and ER06-615-020, at 1-2 (IEP ICPM Protest).

[34] *See infra* P 35 and footnote 43.

the first commitment under the must-offer obligation.[35] As explained below, we find that this modification will ensure non-discriminatory treatment between both resource adequacy resources and units under RMR contracts, on the one hand, and non-resource adequacy resources on the other hand. We also find that, notwithstanding this modification, the CAISO will retain adequate, but not potentially discriminatory, discretion for designating capacity under the TCPM.

33. The origins of the must-offer obligation stretch back more than seven years, to when it was introduced as a temporary measure to prevent withholding during the California energy crisis of 2000-2001.[36] It is currently used to address system, zonal, and local reliability needs.[37] The Commission has called for the CAISO to replace the must-offer obligation under MRTU with a resource adequacy program that compensates resources on a forward basis for their capacity services.[38] The CAISO first incorporated a set of resource adequacy requirements into its tariff in June of 2006,[39] and continues to work with the CPUC and other local regulatory authorities to refine and expand these requirements so that the CAISO can reliably operate the grid.[40]

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[35] In exchange for its commitment to make its capacity available for the first 30 days, the resource should receive payment equal to 1/12 of the appropriately adjusted annual Target Capacity Price per proposed CAISO Tariff section 43.7. Also, while the Commission requires a minimum 30-day designation, the CAISO may designate for a longer term, if warranted, depending on its assessment of the expected duration of the Significant Event. For further discussion of the designation term, *see infra* P 59.

[36] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 95 FERC ¶ 61,418, at 62,551 (2001).

[37] July 2004 Order, 108 FERC ¶ 61,022 at P 62.

[38] June 2004 Order, 107 FERC ¶ 61,274 at P 26-27 (directing the CAISO to rely upon resource adequacy requirements under MRTU to meets its operational needs, or alternatively, to modify the must-offer obligation).

[39] *Cal. Indep. Sys. Operator Corp.*, 115 FERC ¶ 61,172 (2006).

[40] For example, in 2007 the CPUC introduced local resource adequacy requirements. In 2008 the CPUC incorporated restrictions on procurement by LSEs that recognize Path 26 transfer limitations, thereby ensuring sufficient resources on either side of the zonal constraint.

34. In the transition from a reliability framework dependent upon the must-offer obligation to one based upon a comprehensive set of resource adequacy requirements under MRTU, the Commission has worked to ensure non-discriminatory treatment of generators and other resources. At a minimum, resource adequacy units receive monthly payments for capacity to cover their fixed costs. Similarly, RMR units have annual contracts that provide payment related to their fixed costs. In the July 20, 2006 Order, the Commission concluded that it is unduly discriminatory to require non-resource adequacy units to comply with the must-offer obligation and provide similar reliability needs as resource adequacy units, without receiving a similar capacity payment.[41] Moreover, the Commission approved the RCST settlement because it resolved this inconsistency among classes of generators, "ensuring that generators acting as reliability backstops receive fair compensation in the form of a capacity payment."[42]

35. In the first 18 months that the RCST has been effective, IEP reports that the CAISO issued 525 must-offer commitments to 31 generators, but only designated one generating unit for payment under the RCST.[43] This data indicates that the CAISO frequently relies on the must-offer obligation to maintain reliability, but usually only provides the daily Must-Offer Capacity Payment, rather than a monthly capacity payment.[44] Since resource adequacy generators providing essentially the same service would receive a monthly capacity payment, this data indicates that the CAISO generally fails to compensate non-resource adequacy resources in a manner commensurate with the compensation provided resource adequacy resources (and RMR units). While measurable strides have been made toward enhancing reliability, commentors and the CAISO's own analysis suggest a number of shortcomings in the current resource

[41] July 20, 2006 Order, 116 FERC ¶ 61,069 at P 36

[42] Order on Paper Hearing, 118 FERC ¶ 61,096 at P 46.

[43] IEP's TCPM Protest at 4-5.

[44] Even though the daily target capacity payment is increased under the proposed TCPM, relative to the RCST, and the Significant Event definition has been modified to increase the likelihood of designation, we nevertheless find that the stark disparity between the number of must-offer commitments as compared with the single designation over an 18-month period warrants limiting the CAISO's discretion to ensure resources are properly compensated.

adequacy program,[45] which inadvertently place the CAISO in the position of relying on must-offer units to meet reliability needs.

36. Accordingly, we find from this evidence that the CAISO has relied on the must-offer obligation when the resource adequacy program is not able to provide it with sufficient resources to operate the grid reliably.[46] Further, as proposed, the broad Significant Event discretion under the TCPM would allow the CAISO to use non-resource adequacy generators to ensure reliability just as it uses resource adequacy resources (and RMR units). However, the CAISO would be able to use these non-resource adequacy resources without making a capacity designation that would give them a monthly capacity payment comparable to the payment resource adequacy resources and RMR units receive for providing essentially the same service. This disparate treatment may result in unduly discriminatory treatment of certain non-resource adequacy generators. While our required modification to the Significant Event designation may result in some additional costs to electricity customers, once a unit is designated under the TCPM, it is "on call" for the entire 30 days of designation (or longer, if the CAISO chooses to designate for a longer period), and it is actually providing a monthly service to customers. Moreover, the TCPM is a backstop mechanism that should be used infrequently, and even less often going forward. Thus its costs should be minimal.

37. Finally, we note that our decision to limit the CAISO's discretion is consistent with recent orders that have replaced discretionary standards with more transparent, objective standards for CAISO action.[47] Accordingly, we direct the CAISO to make a compliance filing within 30 days of the date of this order with revised tariff sheets that require the designation of a TCPM capacity resource for a (minimum) 30-day period upon the first commitment, i.e. must-offer waiver denial, of a resource under the must-offer obligation.

[45] Two examples of perceived shortcomings of the present resource adequacy program are the following: (1) the fact that liquidated damages contracts qualify as resource adequacy resources but the CAISO cannot commit them because they are not tied to a specific unit; and (2) a lack of performance criteria to provide incentives for resources to maintain their availability and offer their capacity when needed. *See, e.g.,* CAISO Retroactive RCST Significant Event Summary for Period 6/1/06 – 2/28/07, at 5-6 (July 19, 2007) (*available* at http://www.caiso.com/1c20/1c20e8373c330.pdf); MRTU Order, 116 FERC ¶ 61,274 at P 1202-1218.

[46] *See* footnote 45; *See also* California Generators' Protest at 7 (citing IEP RCST Comments).

[47] *See,* e.g., *Cal. Indep. Sys. Operator Corp.*, 123 FERC ¶ 61,097 (2008).

2. Significant Event Definition

38. The CAISO proposes to broaden the definition of Significant Event to improve its ability to address unforeseen or changed circumstances, or deficiencies in resource adequacy programs, where lack of action by the CAISO to address a known problem could jeopardize reliability.[48] The broader definition would permit the CAISO to make TCPM Significant Event designations for capacity for *any* event that produces a material change in system conditions or in CAISO-controlled grid operations, as well as events that result in a material difference from what was assumed in the resource adequacy program for purposes of determining the resource adequacy capacity requirements.

Comments and Protests

39. Many of the commentors oppose the proposed Significant Event definition,[49] arguing that it is overly broad, vague, and provides the CAISO with too much discretion. SoCal Edison explains that the CAISO's proposed definition of a TCPM Significant Event does not contain a clear sense of "materiality," which is necessary to justify the potentially significant costs that LSEs could be required to shoulder if the CAISO makes a TCPM Significant Event designation. Although SoCal Edison agrees that the definition should not be overly prescriptive, it contends that the definition should be specific enough to prevent the CAISO from making TCPM designations that would override resource adequacy policy decisions made by a local regulatory authority, consistent with the CAISO's Tariff. SoCal Edison asserts that a Significant Event should be the result of a physical change to the electrical grid, which includes loss of a major intertie line and a large resource adequacy generator for several weeks during peak summer load conditions.[50]

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[48] To compare the RCST definition with the proposed TCPM definition, *see* CAISO TCPM Transmittal Letter at 28-29.

[49] Under the TCPM, a Significant Event is "a substantial event, or combination of events, that is determined by the ISO to either result in a material difference from what was assumed in the [resource adequacy] program for purposes of determining the [resource adequacy] capacity requirements, or produce a material change in system conditions or in ISO-controlled Grid Operations, that causes, or threatens to cause, a failure to meet Reliability Criteria absent the recurring use of a non-[resource adequacy] resource(s) on a prospective basis." ISO Tariff Appendix A.

[50] SoCal Edison proposes the following alternative definition: An event that either (i) poses a credible threat that could result in a significant physical change to the CAISO grid or (ii) has resulted in a significant physical change to the CAISO grid that causes, or

(continued…)

40. SoCal Edison requests that, in the event its proposed definition of a Significant Event is not adopted, the Commission should direct the CAISO to supplement its proposal with the following: (1) prior to extending the initial TCPM designation, a CAISO Officer should be required to advise the CAISO Board if an initial Significant Event designation will be extended beyond the original 30-day period, and preferably, request and receive approval to make such an extension; and (2) a CAISO Officer should be required to report to the CAISO Board for any instance in which a specific unit is designated more than once within a calendar year due to a TCPM Significant Event.

41. Santa Clara claims that the TCPM Significant Event definition, which adopts the definition proposed in the ICPM, gives far more discretion to the CAISO than the RCST Significant Event designation does. Santa Clara is concerned about the breadth of discretion the proposed provisions would give to the CAISO, and requests that the TCPM use the RCST definition of a Significant Event instead.

42. Constellation argues that the CAISO's ability to designate resources as a result of Significant Events should be eliminated. Constellation contends that the planning reserve margin already takes into account many of the events for which the CAISO seeks Significant Event procurement authority. Constellation asserts that such broad Significant Event procurement authority, in combination with the capacity obligations applicable to LSEs, will impose unnecessary costs on consumers. According to Constellation, none of the stated events listed by the CAISO should trigger backstop procurement authority.

43. For example, Constellation argues that the loss of a local resource adequacy resource after the annual LSE resource adequacy showing is a specific transitory event for which the planning reserve margin exists. Constellation contends that events such as an official change in the adopted load forecast by the California Energy Commission (CEC) after it has been used in resource adequacy showings by LSEs, should impact the implementation of capacity requirements during the next planning and implementation cycle, rather than imposing new obligations during the existing period. Finally, Constellation maintains that other events, such as an error in load distribution factors, can be avoided by careful testing and review of the model design and input assumptions.

44. Constellation explains that resource adequacy requirements establish the rules for how much "insurance" LSEs must purchase to ensure that the system has sufficient resources to cover reliability contingencies. Constellation elaborates that if operational

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threatens to cause, a failure to meet Reliability Criteria absent the recurring use of a non-resource adequacy resource(s) on a prospective basis. SoCal Edison April 18, 2008 Comments at 6.

issues arise that go beyond what the system planned for, the product to be procured to meet the emergency need is energy, not capacity. According to Constellation, the Significant Event proposal will undermine market signals that influence investment decisions and the effectiveness of the demand response resource that LSEs have procured to meet their resource adequacy requirement. Constellation contends that if not eliminated, the Significant Event definition should be modified so that designations will occur only when the aggregate capacity availability is to be reduced below operating reserve levels.[51] Finally, Constellation recommends that the Commission require the CAISO to conduct an annual review process with the CPUC to determine whether the occurrence of Significant Events warrant a modification of the planning reserve margin.

45. California Generators contend that the proposed definition of Significant Event is subjective, ambiguous, and provides the CAISO with unchecked and excessive discretion to make TCPM designations. Specifically, they argue that the CAISO has not offered an objective way to assess "recurring basis," "material difference," or "material change." As a result, California Generators argue that there is no way to determine whether these overly broad terms will be applied on a consistent basis.

46. According to California Generators, it is not clear how the new Significant Event definition solves the problem the CAISO identified in the RCST definition, namely, that it requires the CAISO to take into account the expected duration of the event. California Generators submit that under TCPM, the CAISO must still unilaterally and subjectively determine what constitutes "recurring use."

47. California Generators argue that the definition focuses on subjective periods of use, which perpetuates the CAISO's misconception that capacity is a daily product. California Generators reiterate that the amount of actual use is irrelevant in determining whether the unit provides capacity service to the CAISO.

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[51] Constellation recommends the following definition of Significant Event: A Significant Event has occurred when an event, or combination of events, has occurred that causes the availability of resources that have been committed for resource adequacy purposes for system, zonal, or local requirements to have been reduced to a level that is equal to or less than the peak load for the system, zone, or local area plus eight percent, and the Significant Event is expected to continue for the lesser of (i) the remainder of the annual compliance period or (ii) two months. Constellation April 18, 2008 Comments at 10.

Determination

48. We find that the proposed Significant Event definition, in conjunction with the objective threshold detailed above, will enable the CAISO to further reduce its reliance on daily commitments under the must-offer obligation. Consequently, we accept it. We note at the outset that our directive requiring the CAISO, under the TCPM, to designate any unit committed under the must-offer obligation for a minimum term of 30-days may tend to limit the application of the Significant Event definition. However, the tariff definition of "Significant Event" is broader than the circumstances under which the CAISO can commit a unit under the must-offer obligation process, and can also be used to designate capacity for events lasting longer than 30 days.

49. We disagree with commentors' claim that the TCPM Significant Event definition will result in the CAISO procuring TCPM capacity in excess of applicable reliability criteria. Indeed, the CAISO may only declare a Significant Event in two situations: (1) if there is a "material" difference from what was assumed in the resource adequacy program for purposes of determining the resource adequacy requirements; or (2) if it determines that the event "causes or threatens to cause, a failure to meet Reliability Criteria."[52] We find that first prong of the definition is sufficiently restrictive in that it uses an objective, transparent baseline – the resource adequacy program assumptions upon which procurement was based – and sets a high bar by requiring a "material" change from those initial objective assumptions. As for the second prong, the TCPM filing does not modify existing reliability criteria; consequently, this definition limits considerably the CAISO's discretion to declare a Significant Event in this situation. In addition, the TCPM proposal includes enhanced reporting requirements, which will allow market participants to monitor any TCPM capacity designation, as well as the CAISO's exercise of its authority to designate.[53]

50. We find that the limitations contained in the definition, coupled with the increased transparency in the CAISO's enhanced reporting requirements, including posting of

[52] CAISO Tariff, Appendix A.

[53] The CAISO has proposed to adopt the ICPM reporting obligations in addition to the RCST reporting requirements. In this regard, the CAISO has retained the obligation under section 40.15.1 to issue a Must-Offer Waiver Denial Report and under section 40.15.2 to publish a monthly minimum load cost report. The CAISO also retained the responsibility under section 40.15.4 to produce a TCPM Significant Event /Waiver Denial Report. In addition, the TCPM proposal includes the following two additional types of reports: (1) Market Notice within Two Business Days of Each Designation under section 43.6.1; and (2) Designation of a Resource under section 43.6.2.

designations, renders the Significant Event definition just and reasonable. Further, we have no evidence before us to indicate that the CAISO would procure reliability capacity services in excess of its needs. On the contrary, we note that the CAISO has complained that the more narrowly defined RCST Significant Event definition has unduly limited its ability to designate capacity resources to address reliability concerns.[54] We agree with the CAISO that it is important to remove any similar restrictions from the TCPM, to ensure reliability.

51. We disagree with the recommendations offered by Constellation and SoCal Edison, and find that the authority to designate TCPM capacity resources should not be tied to either operating reserve levels or a physical change in the electrical grid. We find that these recommendations could limit the CAISO's ability to procure sufficient capacity resources in order to meet existing reliability criteria. Further, we note that the TCPM proposal includes enhanced reporting requirements, which will allow market participants to be aware of any TCPM capacity designation and monitor the CAISO's use of its authority to designate.

52. We acknowledge that resource adequacy requirements are intended to provide the CAISO with a sufficient set of capacity resources to operate the grid reliably, and that the CPUC is continuing to work to refine its resource adequacy program. However, as discussed above, evidence suggests that in the near term the CAISO may continue to rely on non-resource adequacy resources subject to the must-offer obligation in order to reliably operate its system. If capacity services from these non-resource adequacy generators are needed to meet reliability criteria, these resources must be treated in a similar manner as resource adequacy generators that are afforded forward capacity compensation. The proposed definition of a Significant Event supports such an outcome.

53. Finally, we note that accepting the broader definition of Significant Event is consistent with our directive above requiring the CAISO to designate non-resource adequacy resources for a minimum 30-day period upon their first commitment under the must-offer obligation.[55] The definition of Significant Event involves the CAISO's ability

[54] CAISO TCPM Transmittal at 30.

[55] Viewed another way another way, we are not actually limiting the CAISO's discretion to designate – it can still designate consistent with its forward need. All the Commission is really doing in this order is removing the CAISO's option to pay the resources it relies upon to provide backstop capacity services a daily capacity payment in lieu of a more equitable monthly (30-day) payment. The broader definition similarly increases the likelihood that non-resource adequacy resources will be designated when the CAISO needs to rely on them to provide backstop capacity, and ensures that these resources will receive a 30-day payment for the capacity services they provide.

to *procure* non-resource adequacy resources that it identifies as necessary to maintain reliability going forward. It is reasonable to give the CAISO sufficient latitude to designate the resources it needs on a forward-basis in order to ensure that these resources are fairly compensated for the reliability services they provide, and that they remain economically viable for the duration of the reliability need. Discretion regarding capacity designation, however, involves *payment* for capacity services rendered, and it is reasonable to limit the CAISO's discretion with respect to payment, to ensure non-discriminatory treatment of resources providing essentially the same service.

54. Accordingly, for these reasons, we accept the Significant Event definition as filed, and find that it provides the CAISO with appropriate authority to designate non-resource adequacy capacity when necessary.[56]

3. Designation Term

55. The CAISO proposes to limit initial TCPM Significant Event designations to 30 days, instead of the three-month minimum term for Significant Event designations under RCST.[57] The CAISO states that this will improve the CAISO's ability to make designations to meet shorter-term reliability needs without having to take into account the burdensome cost impacts of a minimum three-month designation. However, if a TCPM Significant Event is expected to last more than 30 days, the CAISO will then be able to extend the designation another 60 days.[58]

Comments and Protests

56. California Generators urge the Commission to reject the proposal to pay a daily payment for capacity service under the TCPM and, instead, direct the CAISO to automatically grant a three-month TCPM designation for any non-resource adequacy, non-RMR capacity committed through a must-offer waiver denial. First, California Generators state that a generating unit that has incurred fixed and going-forward costs by remaining available to the CAISO and being denied a must-offer waiver would not expect to recover its fixed costs through the CAISO's energy markets in the non-peak

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[56] Any capacity resource that is called upon under the must-offer obligation will be entitled to a minimum designation of 30 days. As a result, the Significant Event definition and processes will apply to the designated capacity resource and will also govern any continuation of the designation beyond 30 days.

[57] *See* proposed CAISO Tariff section 43.4.

[58] CAISO TCPM Transmittal Letter at 31-32.

seasons. California Generators add that the amount of operating use has no bearing on the costs a generating unit owner incurs by keeping the unit's capacity available or "on call" for the CAISO's use. California Generators argue that a three-month designation would recover these fixed costs incurred during months when the unit is not operating in the CAISO's markets. They further contend that a three-month designation is a reasonable compromise between a one-month resource adequacy requirement and the five-month resource adequacy season. Last, California Generators assert that a three-month designation is consistent with the approved terms of RCST, upon which TCPM is based.

57. IEP argues that the TCPM's reduction of the term of designation from three-months to one-month runs directly counter to the economic arguments that IEP and its members have been making concerning their need for certainty with respect to compensation for providing reliability services. IEP asserts that a generator cannot appropriately plan infrastructure investment based upon the possibility that the CAISO may designate it, thereby entitling the generator to a one-month capacity payment.

58. IEP refers to its ICPM Protest, in which IEP argued that the ICPM designation component is arbitrary and fails to correct capacity deficiencies.[59] IEP raised concerns in that pleading about the amount of discretion given the CAISO in determining the term of the designation/payment, and insisted that allowing term lengths of only one-month contradicts the owner's need to establish fixed operations and maintenance budgets ahead of time and plan to complete capital investments. IEP further contended that it would be just and reasonable for designations to be for one-year terms, or, in a case where a Significant Event results in an offer of designation, for the balance of the resource adequacy compliance period. As a result, IEP stated that when the resource adequacy process does not satisfy reliability needs, the CAISO should designate capacity on a forward basis to compensate for the known and identifiable shortfall.

<u>Determination</u>

59. We accept the CAISO's proposed minimum 30-day term, and, as discussed above, direct the CAISO to modify its TCPM proposal to require designation of a capacity resource under the TCPM for a minimum 30-day term when the resource is first committed under the must-offer obligation.[60] Several of the generators have suggested that the initial TCPM designation term should be for a minimum of three months.

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[59] IEP ICPM Protest at 14.

[60] Consistent with the CAISO's proposal, units that are committed in the middle of the month will receive a minimum 30-day payment.

However, we find that this 30-day minimum term, as opposed to a longer term, will better enhance the CAISO's ability to respond to shorter-term events in a cost-effective manner. In addition, resource adequacy showings are made in part on a monthly basis.[61] Consequently, a minimum 30-day TCPM designation is more consistent with the resource adequacy program, and will better ensure non-discriminatory treatment between resource adequacy units and non-resource adequacy units going forward. IEP and California Generators have not shown that a 30-day designation provides insufficient compensation, and the CAISO retains the discretion to designate units for a longer period, if the expected duration of the Significant Event so warrants.

D. Price

1. Target Capacity Price and the Cost of New Entry

60. The TCPM proposes to increase the compensation for backstop capacity services by increasing the monthly RCST Target Capacity Price from $73/kW-year to $86/kW-year. The CAISO explains that the updated Target Capacity Price is based upon an escalation of the existing RCST capacity price for two years using the CPI-U, with an adjustment of 10 percent based on the fact that the CPI-U is only a general inflation factor that may not capture all of the appropriate costs that should be taken into account in determining the appropriate TCPM capacity payment.[62] The CAISO notes that the $86/kW-year price lies between the fixed costs of existing generation and the cost of new entry,[63] which is the range that the Commission found to be just and reasonable in the RCST proceeding for pricing backstop capacity.[64]

Comments and Protests

61. SoCal Edison, Six Cities, AReM, PG&E, and CMUA argue that the CAISO has failed to justify the 10 percent adder included in the proposed TCPM Target Capacity Price. Specifically, AReM notes that the RCST price on which the TCPM price is based was established in a settlement, and CMUA points out that the CAISO has not presented cost data to show that current RCST payments fail to recover costs plus a reasonable rate of return. AReM states that it is willing to accept an inflation adjustment on top of this

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[61] Sections 40.2.1.1 and 40.2.2.4 of the CAISO Tariff require Scheduling Coordinators representing LSEs to submit annual and monthly resource adequacy plans.

[62] CAISO TCPM Transmittal at 2.

[63] *Id*.

[64] Order on Paper Hearing, 118 FERC ¶ 61,096 at P 70.

settlement price, but contends that the 10 percent adder goes too far. PG&E believes that inclusion of a proxy for the 2008 CPI (extrapolated from the 2007 CPI) would be justified and would be far more appropriate than the seemingly arbitrary 10 percent figure. IEP argues that compensation should exceed mere going-forward costs. AReM and CMUA request that the Commission reject the proposed adder and direct the CAISO to constrain its price increase to the documented inflation adjustment.

62. SoCal Edison states that the Commission found the RCST pricing terms ($73/kW-year, 1/17 capacity factor) to be just and reasonable.[65] SoCal Edison asserts that the CAISO's primary justification for the 10 percent adder and revised capacity factor are to balance stakeholder interests and account for "cost components not captured by the [CPI-U], and consideration of the values of other inflation indices."[66] Also, SoCal Edison notes that according to the CAISO, it can provide a margin for error in recognition of the fact that it does not have comprehensive cost information regarding the fixed costs of all existing units. As such, SoCal Edison asserts that the CAISO cannot quantify the fixed costs of existing units with any degree of certainty. SoCal Edison maintains that the Commission must determine the just and reasonableness of the payment based upon the evidence presented by the parties. According to SoCal Edison, the CAISO has not specifically provided evidence that TCPM designated generators receiving a capacity payment based upon $77.89/kW-year will not be able to recover their costs. As a result, SoCal Edison contends that the Commission should not approve the 10 percent adder.

63. Six Cities state that the CAISO properly rejected the $117/kW-year Target Capacity Price proposed by California Generators. According to Six Cities, California Generators' proposed 60 percent increase in the Target Capacity Price is based entirely on claims of dramatic increases in cost of new entry over the past several years. However, Six Cities add that increases in cost of new entry have no impact whatsoever on the fixed costs of existing units, which are the only resources that the CAISO could call upon under the TCPM. Six Cities submit that the CAISO's assertion that "[t]he sole result of [California Generators'] proposal would be a revenue windfall for existing units, without incenting new generation" is correct and compelling.[67]

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[65] SoCal Edison Comments at 3 (citing Order on Paper Hearing, 118 FERC ¶ 61,096 at P 72).

[66] SoCal Edison Comments at 3.

[67] Six Cities April 18, 2008 Protest at 5 (citing CAISO TCPM Transmittal at 23).

64. With regard to the proposed increase in the Target Capacity Price to $86/kW-year, Six Cities point out that the sum of the inflation rates for the two indicated years is 6.6 percent, which would increase the RCST price to $77.89/kW-year.[68] Six Cities elaborate that the remainder of the proposed increase reflects the 10 percent adder, which the CAISO characterizes as appropriate to recognize "uncertainties" or to capture costs that are "difficult to quantify." Based on these facts, Six Cities assert that the CAISO's purported justification for the 10 percent adder is inadequate.

65. Six Cities provide that an inflation adjustment to the $73/kW-year Target Capacity Price approved by the Commission as just and reasonable in the RCST docket seems appropriate, but contends that the CAISO fails to provide any reasoned explanation for the proposed 10 percent adder included in the TCPM proposal. If the Target Capacity Price level approved for the RCST is just and reasonable without such an adder, Six Cities assert that vague references to "uncertainties" and "difficult to quantify costs" do not justify application of a percentage adder to that level above and beyond reported inflation.[69]

66. Six Cities explain that the July 20, 2006 Order expressed concern that generators recover fixed cost contributions from market transactions sufficient to remain in operation. However, although a number of generators repeatedly have characterized the payment levels under the RCST as non-compensatory,[70] Six Cities state that not one of them has made any attempt to demonstrate that the RCST payment levels are inadequate to provide a reasonable contribution to their actual going forward costs or that they have been unable to earn reasonable returns on their investments through sales of energy,

[68] *Id*. at 6. According to Six Cities, the CAISO has not presented any evidence to suggest that a $77.89/kW-year Target Capacity Price, adjusted for monthly shaping factors and peak energy rent, would not be expected to yield net capacity payments comparable to the fixed Target Capacity Price proposed in the ICPM filing. *Id*. at 7.

[69] Six Cities provides that in attempting to support the 10 percent adder, the CAISO observes at page 15 of the Transmittal Letter that it does not have "comprehensive cost information regarding the fixed costs of all existing units." *Id*. Six Cities also notes that it is the generators that have control of information concerning their fixed costs. According to Six Cities, generators have failed to make available any information concerning the adequacy of revenues in CAISO market transactions to cover not only their fixed costs but also a reasonable return on their investment, despite their repeated characterizations of the RCST payment mechanism as non-compensatory. *Id*.

[70] Six Cities Protest at 9.

Ancillary Services, and RCST payments. Rather, Six Cities contend that their assertions have been based exclusively on claimed entitlement to compensation based upon the cost of new entry, which would provide payments far in excess of their actual costs, including a reasonable return on investment.

67. Similarly, NCPA contends that the CAISO has not provided any legitimate justification for increasing the Target Capacity Price. NCPA states that in explaining the development of the price increase, the CAISO "acknowledges that it does not have comprehensive information regarding the annual fixed costs of existing generators (for purposes of establishing the appropriate capacity price floor) . . . ."[71] According to NCPA, this statement reveals that the CAISO has little objective support for the proposed price increase. Instead, NCPA contends that the escalation is a relatively arbitrary increase of the current capacity price. Moreover, NCPA points out that the current capacity price itself is not based on objective cost information and asserts that it is the product of a settlement agreement and thus has no basis in current existing generator costs.

68. California Generators argue that the CAISO has retained much of the non-pricing provisions of RCST but deviated without justification from the principle upon which the RCST settlement price was derived, i.e., the cost of new entry. They accuse the CAISO of inflating the outdated RCST price using inapplicable price increases. Instead, California Generators call for updated estimates of the fundamental determinants of the RCST price and for determining a TCPM capacity price that lies proportionally between the updated estimates of the unrecovered fixed costs of existing generation and the current, rapidly escalating real cost of new generation.

69. California Generators contend that the CAISO's backstop price must be sufficiently high to ensure that resource adequacy requirements themselves are set at appropriate levels. According to California Generators, the CAISO's extensive use of non-resource adequacy, non-RMR capacity under RCST is evidence that California's resource adequacy requirements do not provide the CAISO with the capacity it needs for reliable operations. They further assert that meaningful and current cost of new entry estimates will ensure that the TCPM price meets the Commission's requirements and provides a meaningful incentive for the CAISO to adopt robust resource adequacy requirements.

70. California Generators cite SoCal Edison's two recent capacity additions that reveal cost of new entry values far in excess of the outdated 2003 values relied upon in the

[71] NCPA April 18, 2008 Comments at 4 (citing CAISO TCPM Transmittal at 16).

RCST settlement.[72] They argue that any non-resource adequacy and non-RMR unit that is denied a must-offer waiver provides exactly the same reliability service as the new peakers and should be compensated accordingly. California Generators also cite to the CAISO's Department of Market Monitoring's recently released 2007 Annual Report that points to dramatic increases in the average annualized fixed costs of new entry turbines due to increases in construction material costs, siting, and permitting costs and the cost of investment capital.[73]

71. California Generators disagree that using cost of new entry to set the TCPM price too high will encourage the exercise of market power and discourage suppliers from negotiating resource adequacy contracts with buyers. They point out that LSEs may be excused from having to meet local area requirements if the price offered by prospective resource adequacy generators is higher than $40/kW-yr. California Generators emphasize that LSEs will be excused at this $40/kW-year price point, despite the fact that there is surplus capacity in seven of the 10 local areas, which would ordinarily lead to the conclusion that prices are sufficiently competitive.

72. Six Cities, NCPA, AReM, CMUA, and PG&E point out that cost of new entry pricing for TCPM is not appropriate. Six Cities and PG&E contend that the CAISO's TCPM proposal is consistent with the Commission's determination in the RCST case that the cost of new entry is not a proper basis for pricing capacity purchased from existing resources as a backstop to LSE procurement under resource adequacy requirements. Six Cities provide that the Commission's RCST Rehearing Order stated that the just and reasonable Target Capacity Price is lower than the cost of new entry.[74] Six Cities elaborate that the Commission's conclusion that the cost of new entry is not a proper basis for pricing under the RCST mechanism is equally applicable to the TCPM proposal.

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[72] The proposed capacity additions are: (1) a December 31, 2007 request for four simple cycle turbine peakers totaling 180 MW for an annualized cost of $205/kW-yr; and (2) an April 4, 2008 application that included a proposal for a five-unit LMS-100 project totaling 479 MW for an annualized cost of between $208/kW-yr and $219/kW-yr.

[73] The Annual Report indicates that the average annualized fixed cost of new entry for combined cycle and combustion turbines is $133/kW-yr and $162/kW-yr, respectively.

[74] Six Cities Protest at 4-5. *See also* RCST Rehearing Order, 121 FERC ¶ 61,276 at P 23 (Target Capacity Price should be greater than the fixed costs of existing generation in order to encourage longer-term bilateral contracting but less than the cost of new entry); Order on Paper Hearing, 118 FERC ¶ 61,096 at P 70-71.

73. NCPA argues that new entry cannot compete with existing capacity to provide the service; rather, it is going forward costs that are appropriate to compensate generators already in the market. NCPA explains that it is California's resource adequacy program that is designed to accomplish this goal through long-term bilateral contracting, rather than through incentive pricing of interim, short-term procurements to address contingencies. CMUA states that the TCPM is a short-term fail-safe mechanism to backstop the existing resource adequacy program, and that it is designed to meet unanticipated reliability needs, not to provide a revenue stream to support new generation. Therefore, CMUA urges the Commission not to be distracted by arguments made by generators regarding infrastructure investment and incentives for new entry. CMUA asserts that those issues are for long-term resource adequacy policy.

74. AReM states that it strongly agrees with the CAISO's explanation for why it would not be appropriate to base the TCPM price on the cost of new entry. AReM concurs with the CAISO that cost of new entry is only appropriate when the product or service sought is far enough in the future that the market must provide a signal for new investment and new entry can actually compete with the existing supply to provide the requested service. AReM states that this is not the case with TCPM capacity, which must come from existing generation capacity, and which has a term of no more than a few months.

<u>Determination</u>

75. As noted by commentors, the Commission found the RCST Target Capacity Price of $73/kW-year to be just and reasonable and within the range of reasonable capacity prices, i.e., the fixed costs of existing generation and the cost of new entry.[75] We continue to find that, under the CAISO's capacity construct, the fixed costs of existing generation and the cost of new entry establish a just and reasonable range for the TCPM Target Capacity Price. Thus, in the instant proceeding, we agree with commentors that it is reasonable to adjust the capacity price under TCPM in order to account for price increases that have occurred since the RCST Target Capacity Price was approved by the

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[75] Order on Paper Hearing, 118 FERC ¶ 61,096 at P 72. Under the RCST, the "reasonable range" was estimated between $64/kW-year and $89/kW-year. *Id*. P 70. Currently, the CAISO provides estimates of the fixed costs of existing units at approximately $32.44/kW-year and the cost of new entry, based on a CEC cost study that finds the average cost of new entry of a Conventional Simple Cycle CT (100 MW) unit -- averaging the costs of merchant generator, investor owned utility and publicly owned utility construction, at approximately $145.54/kW-year. *See* CAISO TCPM Transmittal at 23-24 (citing CEC Cost Study at Appendix E).

Commission, approximately two years ago. Further, we find that the CAISO's proposed use of the CPI-U inflation factor is a reasonable means to account for such increases in prices.[76] With respect to the proposed 10 percent adder, however, we find that the CAISO has failed to support its reasonableness.

76. As pointed out by AReM, the $73/kW-year RCST capacity price is a negotiated term that originated in the RCST settlement. In the RCST Rehearing Order, the Commission explained that the backstop capacity price should not be based on the cost of new entry; rather, a just and reasonable backstop capacity price should "be no less than the fixed costs of existing generation but no more than the cost of new entry."[77] While the RCST Target Capacity Price does not necessarily represent the actual costs that a generator will incur, the price was found to be just and reasonable because it fell within a reasonable range for pricing backstop capacity under the CAISO's capacity construct. As noted above, we find that the CAISO's proposal to adjust the RCST capacity price on the basis of a recognized index is appropriate, and that the CPI-U reasonably accounts for price increase trends. In addition, we find that the TCPM capacity price, as adjusted by the CPI-U, of $77.89/kW-year remains within the reasonable range.

77. However, we disagree with the CAISO that a "margin for error" should be accounted for by simply adding 10 percent to the TCPM's adjusted Target Capacity Price. On the contrary, we find that it is not reasonable to increase the proposed adjustment to the capacity price by 10 percent simply because the CPI-U "may not capture all of the appropriate costs and considerations."[78] As the CAISO states, it cannot quantify the fixed costs of existing units with any degree of certainty; thus, we find that the CAISO has failed to justify the proposed 10 percent adder.

78. Finally, regarding comments on the cost of new entry, we reaffirm our prior findings that, under the CAISO's capacity construct, it is not reasonable to base backstop

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[76] A variety of matters before the Commission have used the CPI-U index as a standard rate of inflation. *See Moon Lake Elec. Ass'n, Inc*. 116 FERC ¶ 62,069 (order finding that the annual charge shall be calculated for the year by escalating the base annual charge, utilizing the CPI-U); *see also United Illuminating Co.*, 108 FERC ¶ 63,005 (2004) (order approving a settlement that requires one party to an interconnection agreement to pay, among other things, an annual facilities charge that will be based on the first year's AFC and adjusted annually to the CPI-U). *See also* http://www.bls.gov/cpi/home.htm.

[77] RCST Rehearing Order, 121 FERC ¶ 61,276 at P 23.

[78] CAISO TCPM Transmittal at 2.

capacity pricing on the cost of new entry.[79] Instead, we reiterate that backstop capacity procurement is not intended to promote the construction of new generation and that the anticipated short-term nature of the TCPM does not provide the long-term incentive required to attract new investment. IEP's own comments recognize this fact.[80] At the same time, we find that the price should be high enough to provide incentives to LSEs to contract responsibly for needed capacity. Further, as mentioned above, the TCPM backstop capacity price of $77.89/kW-year lies within the limits that the Commission has found to be just and reasonable for pricing backstop capacity services under the CAISO's capacity construct. Accordingly, we accept the CAISO's proposal to adjust the RCST capacity price by the CPI-U, subject to the CAISO making a compliance filing with the Commission that removes provisions relating to the 10 percent adder within 30 days of the date of this order.[81]

2. <u>Daily Must-Offer Capacity Payment</u>

79. The CAISO proposes to increase the Daily Must-Offer Capacity Payment from 1/17 of the monthly Target Capacity Price under the RCST to 1/8 of the monthly target capacity price under the TCPM. The CAISO believes that a 1/8 payment better reflects the fact that non-resource adequacy, non-RMR resources are providing reliability services pursuant to a must-offer obligation.[82] The CAISO asserts that the 1/8 payment also strikes a balance between the divergent positions of the stakeholders.[83]

<u>Comments and Protests</u>

80. SoCal Edison, Six Cities, NCPA, CMUA, and PG&E all oppose the CAISO's proposed shift from basing a Daily Must-Offer Capacity Payment on a factor of 1/17 to 1/8 of the monthly capacity payment. According to these entities, the CAISO's

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[79] RCST Rehearing Order, 121 FERC ¶ 61,276 at P 23-26.

[80] *See supra*, P 57 of this order.

[81] Although we find that the CAISO has failed to support its proposed 10 percent adjustment factor in this proceeding, our determination is without prejudice to considering additional evidence in support of the adjustment in other proceedings. In this regard, we would like to note that the proposed $86/kW-year price also falls within the reasonable range for pricing backstop procurement.

[82] CAISO TCPM Transmittal at 25.

[83] *Id.*

justification for more than doubling the factor that was found to be just and reasonable under RCST is not sufficient.

81. Specifically, SoCal Edison, Six Cities, and NCPA object to the CAISO's rationale that a 1/8 payment strikes a reasonable balance between the disparate positions of the various stakeholders. According to NCPA, missing from this explanation is any mention of evidence supporting the increase; the CAISO has not provided data showing that generators are being under-compensated. In addition, NCPA states that it is not aware of any specific quantitative information that generators have provided to the CAISO to demonstrate that the RCST payment levels have not sufficiently contributed to their actual going forward costs or that they have not been able to earn a reasonable return on their investment through the sales of energy, Ancillary Services, and RCST payments.[84] Similarly, Six Cities argue that the TCPM filing makes no effort to justify the increase by reference to cost considerations, but simply characterizes it as a compromise between generators that have not entered into resource adequacy or RMR contracts and want higher payments for denials of must-offer waivers and LSEs that have resisted the generators' demands. Likewise, NCPA asserts that the TCPM proposal does not provide cost support for increasing the Daily Must-Offer Capacity Payment.

82. SoCal Edison notes that Must Offer Generators receive the imbalance energy market price for their minimum load energy, which is combined with the Daily Must-Offer Capacity Payment to count towards the total monthly capacity payments. Therefore, SoCal Edison contends that under the 1/8 Daily Must-Offer Capacity Payment, Must Offer Generators could receive their monthly capacity payment even if they only received a few must-offer waiver denials. SoCal Edison provides that this would be inconsistent with the premise behind the current RCST mechanism upon which TCPM was based: Monthly capacity payments are intended to compensate for sustained must-offer waiver denials that represent Significant Event conditions.

83. Six Cities argue that the CAISO's proposal to more than double the Daily Must-Offer Capacity Payment, from 1/17 of the monthly capacity payment under the RCST to the proposed 1/8 of the monthly capacity payment under the TCPM, is unjustified. Six

[84] NCPA asserts that the unsupported increase is of particular concern in light of the CAISO's very broad definition of a "Significant Event" during which it could use TCPM to designate capacity to respond to "unexpected events that create short-term reliability problems." NCPA Comments at 5 (citing CAISO TCPM Transmittal at 28). NCPA further asserts that because must-offer obligation resources are more likely to be used during Significant Events, which the CAISO has wide discretion to declare, it is especially important that the proposed rate increase be demonstrated to be just and reasonable with a fully developed quantitative analysis.

Cities maintain that if the Daily Must-Offer Capacity Payment of 1/17 of the monthly capacity charge approved in the RCST docket is just and reasonable, then a proposal to more than double that price must be based upon something more than a desire to appease generators that want more money.

84. NCPA further contends that the increase is based on the CAISO's "belie[f] that a 1/8 payment better reflects the fact that non-resource adequacy, non-RMR resources are providing reliability services pursuant to a mandatory [must-offer obligation]."[85] NCPA explains that the CAISO has not given market participants sufficient information to enable them to accurately forecast the impact of these price increases. Specifically, NCPA contends that the task of balancing disparate interests should not relieve the CAISO of its obligation to provide stakeholders with the data necessary to estimate the impacts of TCPM.[86]

85. CMUA explains that the Commission found the RCST Daily Must-Offer Capacity Payment of 1/17 of the monthly capacity payment to be just and reasonable and that the CAISO has not presented substantial evidence to show that the proposed increase is necessary to ensure that suppliers receive fair compensation. Similarly, PG&E contends that there is no reasonable basis for the CAISO to depart from a broadly-based settlement agreement that has been repeatedly challenged, extensively reviewed by the Commission, and consistently upheld by the Commission as just and reasonable. Accordingly, PG&E and CMUA request that the Commission reject the proposed Daily Must-Offer Capacity Payment.

Determination

86. As discussed above, the Commission has directed the CAISO to modify the TCPM proposal to designate all generators that are committed under the must-offer obligation as TCPM capacity resources for a minimum term of 30 days. Upon receiving a designation, a TCPM capacity resource will receive the monthly capacity payment for

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[85] NCPA Comments at 5 (citing CAISO TCPM Transmittal at 25).

[86] Given the delays in the implementation of MRTU, NCPA argues that market participants must assume that TCPM will be in place for the duration of 2008, which NCPA asserts raises the stakes on the pricing issue. NCPA elaborates that other uncertainties compound market participants' concerns, for example, it argues the definition of a Significant Event gives the CAISO broad discretion to call on TCPM when contingencies occur. According to NCPA, market participants are thus forced to conservatively estimate the impacts of TCPM, which makes it all the more important that the CAISO provide hard data supporting its proposed price increases.

its services. Because this modification negates the need for a Daily Must-Offer Capacity Payment, the CAISO's proposed increase of the monthly capacity payment from a factor of 1/17 to 1/8 is moot.

E. Miscellaneous

1. Cost Allocation

87. The CAISO proposes to allocate the costs of capacity designations to remedy collective deficiencies in local resource adequacy requirements to all LSE Scheduling Coordinators in the Transmission Access Charge areas in which the deficiency exists. The CAISO notes that the original local resource adequacy requirements, which were developed and approved by the Commission under Section 40 of Appendix CC of the CAISO Tariff, also provided for allocation to all LSE Scheduling Coordinators within the Transmission Access Charge areas.

Comments and Protests

88. Western recognizes that other entities have raised related concerns with the Commission regarding the allocation of the local requirement on the proportionate share of the Transmission Access Charge Area load verses the share of load in the locally constrained area.[87] According to Western, the CAISO states that the reason for this methodology is "the data is not available to allocate the cost of local capacity with greater granularity, so the CAISO believes an allocation methodology based on the location of a LSE's load is not currently practical."[88] Western also provides that it understands the Commission, for now, has accepted this explanation.[89] However, Western notes that the CAISO is still developing the methodology for its technical study. In addition, Western claims that the CAISO recognized it may need to reconsider the allocation methodology.[90]

89. Under the CAISO's proposed cost allocation methodology, which is based on the proportionate share of the Transmission Access Charge Area load rather than load within a locally constrained area, Western argues that it will incur significantly higher costs for

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[87] Western Protest at 5 (citing MRTU Resource Adequacy Order, 122 FERC ¶ 61,017 at P 52-55).

[88] *Id.* (citing MRTU Resource Adequacy Order, 122 FERC ¶ 61,017 at P 54).

[89] *Id*. (citing MRTU Resource Adequacy Order, 122 FERC ¶ 61,017 at P 55).

[90] *Id.* (citing MRTU Resource Adequacy Order, 122 FERC ¶ 61,017 at P 54).

its resource adequacy procurement. Western states that its load is not responsible for the percentage of local costs it will pay and, therefore, it is not consistent with cost causation principles for Western's LSE customers to be responsible for these charges and thus is unjust and unreasonable. Western maintains that the CAISO should be asked to reconsider whether a more granular allocation methodology would address this unjust and unreasonable outcome. Therefore, Western requests that the Commission order the CAISO to reconsider whether it could allocate the costs on a local level to the customers that actually incur, and are responsible for, the costs.

90. Western claims that the tariff should defer to it, as a local regulatory authority, regarding the appropriate allocation for local capacity. Western maintains that the Commission recognized that the CAISO would defer to local regulatory authorities regarding allocation of local capacity.[91] Further, Western asserts that the Commission has held, in part, that if any entity disagrees with the CAISO's application of local capacity area resource requirements, it can file a complaint if it is unjust and unreasonable.[92] Western elaborates that "now that it is clear the backstop procurement costs will be allocated on a proportionate share of the [Transmission Access Charge] load rather than a proportionate share of the locally constrained area load, it is also clear that these costs are unjust and unreasonable."[93] As such, Western argues that the appropriate remedy would be for a local regulatory authority to have the discretion to set its own local requirement. Western explains that this would still allow the CAISO to engage in backstop procurement of local capacity, up to the requirement set by the local regulatory authority rather than the local requirement set by the CAISO.

<u>Determination</u>

91. The Commission disagrees with Western's claims that the TCPM cost allocation proposal is unjust and unreasonable and that the CAISO should have limited authority to procure the reliability capacity services that it identifies as necessary in order to reliably operate its electrical grid. With respect to the CAISO's proposal to allocate TCPM capacity costs based on each LSE's share of load within the Transmission Access Charge Area, the Commission has previously explained that "allocating procurement obligations according to an LSE's contribution to [Transmission Access Charge] area peak load is a

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[91] *Id.* at 6 (citing MRTU Order, 116 FERC ¶ 61,274 at P 1162).

[92] *Id*. at 7 (*citing Cal. Indep. Sys. Operator Corp*., 119 FERC ¶ 61,076, at P 555 (2007)).

[93] *Id.* at 7.

just and reasonable method of allocation."[94] In the instant proceeding, Western fails to provide any evidence that would justify the Commission reconsidering its prior determination.

92. Regarding the CAISO's authority to procure reliability capacity services, the Commission previously concluded that the CAISO is responsible for determining "the minimum amount of capacity that must be available to the CAISO within each local capacity area."[95] As discussed above, the Commission finds that the TCPM provides the CAISO with the appropriate authority to make TCPM capacity designations upon identifying a reliability capacity service need. Western has failed to persuade the Commission otherwise. Accordingly, we accept the CAISO's proposed TCPM cost allocation methodology as filed.

2. Price Discrimination

93. The pricing provisions of the CAISO's TCPM proposal, i.e. the Target Capacity Price and Daily Must-Offer Capacity Payment, apply uniformly to all generating units operating without a capacity contract. Moreover, the CAISO provides that the Commission has recognized that the CAISO needs the authority to engage in backstop procurement to maintain reliable systems operations. Additionally, the CAISO notes that the Commission has already determined that it is appropriate for the CAISO to have authority to procure non-resource adequacy resources to address reliability needs.[96]

Comments and Protests

94. In its comments in the RCST proceeding, which it refers to in the current proceeding, IEP argued that the backstop capacity procurement mechanism in place retains, rather than corrects, the price discrimination that exists between how existing, non-resource adequacy generation and other forms of generation are compensated. In these comments, IEP contended that price discrimination exists between new and existing generation because new units are being constructed by the LSEs and guaranteed a specific level of compensation or subject to compensation under longer-term contracts as opposed to being compensated based on the expectations of future market prices.[97] In contrast, IEP asserted that existing generators are dependent on wholesale market levels

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[94] MRTU Resource Adequacy Order, 122 FERC ¶ 61,017 at P 55.

[95] MRTU Order, 116 FERC ¶ 61,274 at P 1119.

[96] CAISO TCPM Transmittal at 11.

[97] IEP RCST Comments at 13 (discussing IEP Aff. P 22).

and therefore subject to price discrimination for providing the same reliability services as the new generators.

95. IEP's RCST Comments expressed concern that "[a]s new capacity resources are added, the market prices available to existing resources will be under pressure to decline."[98] IEP claimed that the current compensation mechanism results in existing resources being compensated at lower levels than new resources. For these reasons, IEP asserted in the RCST proceeding that the Commission may rectify this situation by increasing the RCST target capacity price to reflect the more recent data and be more consistent with the compensation for new units.

96. In the instant proceeding, IEP notes that the CAISO has underscored and validated the evidence of price discrimination in its most recent Market Monitoring Report. IEP contends that the report, issued for the March 26-27, 2008 Board of Governors meeting, concludes that "spot market revenues continue to be below the cost of new generation investment."[99] According to IEP, despite clear signals not to invest in new generation, the CAISO has seen the interconnection of 14,949 MW of new generation. Thus, IEP asserts that new generation is receiving extra-market compensation that far exceeds the signals that market prices send, and the price paid to existing resources for the same services.

97. Moreover, IEP claims that California is doing nothing at the state level to address this undue discrimination in reliability compensation. In its April 1, 2008 All Source Request For Offers, IEP states that PG&E specifically excludes any existing generation from being able to offer its services – it only will accept offers from new resources. While the Commission does not have jurisdiction to direct PG&E or any other utility as to what supply resources it must purchase, IEP states that the Commission certainly has jurisdiction to require that the market compensate all generation for providing equivalent services. IEP urges the Commission to do that here.

<u>Determination</u>

98. We disagree with IEP that existing generators are subject to undue price discrimination. The TCPM uniformly applies to all generators that are operating without a capacity contract and are needed for reliability capacity services. In fact, both new and existing generators receive identical compensation under the TCPM for the services they provide. Further, the Commission finds that the compensation provided to these non-

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[98] *Id.* at 15 (discussing IEP Aff. P 26).

[99] IEP TCPM Protest at 7.

resource adequacy generators under the TCPM, as modified herein, is just and reasonable. Moreover, we note that a market-based rate should not guarantee cost recovery, but rather fairly compensate generators for the services they provide, without discriminating among classes of generators providing the same service.[100] We find that the TCPM accomplishes this goal.

99. Finally, we note that IEP does not provide any empirical evidence in support of its claim of impermissible price discrimination. Based on the evidence on record in the instant proceeding, we find that IEP has failed to demonstrate unduly discriminatory treatment of existing generation.

3. Resource Adequacy Credits

100. The CAISO proposes to allow LSE Scheduling Coordinators to receive credit toward their resource adequacy obligations as a result of certain TCPM procurement.[101] However, the CAISO does not propose to allow TCPM Significant Event designations to count toward resource adequacy showings.[102]

Comments and Protests

101. AReM and Constellation argue that LSEs should receive capacity credits for any TCPM procurement that exceeds 30 days. In support of this contention, AReM explains that the CAISO allows resource adequacy credits for TCPM procurement of longer than 30 days to meet resource adequacy deficiencies. In response to the CAISO's assertion that resource adequacy credits should not be provided for procurement for Significant Events because it would "exacerbate" the reliability issue and potentially lead to additional TCPM procurement, AReM asserts that although there may be some unique and rare cases where this could occur, in the vast majority of the cases, TCPM procurement without associated resource adequacy credits would result in consumers overpaying for reliability. Similarly, Constellation argues that while this crediting is already performed where the TCPM procurement is made due to an LSE's resource adequacy deficiency, it should also be performed for any other reason, especially if the

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[100] Similarly, in the context of default bids, the Commission has found that sellers owning existing resources are not provided any guarantee for cost recovery or assurance that their offer will be accepted and included in the calculation of market clearing prices. *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318, at P 139 (2007).

[101] CAISO TCPM Transmittal at 38-39. *See also* CAISO Tariff section 43.9.

[102] *Id*.

CAISO retains Significant Event procurement authority. Constellation argues that providing capacity credits that run for the duration of the TCPM procurement will provide LSEs with the opportunity to adjust their means for resource adequacy compliance and reduce costs for their customers.

Determination

102. We disagree with AReM and Constellation that the CAISO should provide resource adequacy credits for TCPM capacity resources that are procured under the TCPM as a result of a Significant Event, regardless of the duration of the event. In these instances, the CAISO will designate additional non-resource adequacy capacity when, absent the use of these non-resource adequacy resources, the CAISO will not be able to meet applicable reliability criteria. If the CAISO were to allow LSEs to count capacity resources corresponding to a Significant Event towards their resource adequacy requirements, it would result in no additional procurement of capacity. Instead, it would result in TCPM capacity displacing the capacity resources that should be procured under the resource adequacy program.[103] Accordingly, with regard to the Resource Adequacy Credits, we accept the CAISO's proposal as filed.

The Commission orders:

(A) The Commission accepts the TCPM filing, subject to the modifications discussed in the body of this order, effective June 1, 2008.

(B) The Commission directs the CAISO to submit a compliance filing within 30 days of the date of this order, consistent with the modifications discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

[103] Since Significant Events are triggered when resource adequacy resources are insufficient, crediting these TCPM capacity resources may ultimately prevent the CAISO from meeting the reliability criteria that Significant Event was intended to address.