

118 FERC ¶ 61,096  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

Independent Energy Producers  
Association

Docket No. EL05-146-000

v.

California Independent System Operator  
Corporation

ORDER ON PAPER HEARING

(Issued February 13, 2007)

1. On July 20, 2006,<sup>1</sup> as clarified on September 27, 2006,<sup>2</sup> the Commission issued an order in this proceeding that instituted an investigation, pursuant to section 206 of the Federal Power Act (FPA),<sup>3</sup> upon the complaint (Complaint) filed August 26, 2005 by the Independent Energy Producers Association (IEP). The Complaint raised issues concerning the justness and reasonableness of the must-offer obligation under the California Independent System Operator Corporation (CAISO) Tariff.
2. As discussed in more detail below, the July 20 Order established paper hearing procedures to review evidence on whether the rates and cost allocation under the contested Offer of Settlement filed in this proceeding or some other rates

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<sup>1</sup> *Independent Energy Producers Association*, 116 FERC ¶ 61,069 (2006) (July 20 Order).

<sup>2</sup> *Independent Energy Producers Association*, 116 FERC ¶ 61,297 (2006) (September 27 Order).

<sup>3</sup> 16 U.S.C. § 824e (2000), *amended by* Energy Policy Act of 2005, Pub L. No. 109-58, § 1285, 119 Stat. 594, 980-81 (2005).

and cost allocation are just and reasonable with respect to the must-offer obligation. In this order, we approve the Offer of Settlement as modified herein, finding that, as a result of the additional evidence provided in the paper hearing, it presents a just and reasonable outcome for this proceeding.

## **I. Background**

3. In an order issued on April 26, 2001,<sup>4</sup> the Commission established a prospective mitigation and monitoring plan for the California wholesale electric market. 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 during all hours if it is available and not already scheduled to run through bilateral agreements. The CAISO implemented the must-offer obligation beginning July 20, 2001.

4. In an order issued on June 17, 2004,<sup>5</sup> the Commission recognized the California Public Utilities Commission's (CPUC) plan to phase in resource adequacy requirements and suggested that if the CAISO determines that the resource adequacy requirements are sufficient to meet its operational needs, the resource adequacy requirements and obligations could serve to replace the existing must-offer obligation.<sup>6</sup> Additionally, on July 8, 2004,<sup>7</sup> the Commission advised that if IEP believed the current must-offer obligation to be unjust and unreasonable, it may seek to initiate a section 206 proceeding to challenge the justness and reasonableness of the current method and seek an alternative proposal.<sup>8</sup>

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<sup>4</sup> *San Diego Gas & Electric Co., et al.*, 95 FERC ¶ 61,115 at 61,355-57 (2001), *order on reh'g, San Diego Gas & Electric Co., et al.*, 95 FERC ¶ 61,418 (2001), *order on reh'g, San Diego Gas & Electric Co., et al.*, 97 FERC ¶ 61,275 (2001), *order on reh'g, San Diego Gas & Electric Co., et al.*, 99 FERC ¶ 61,160 (2002), *petition pending sub nom. Public Utilities Commission of the State of California, et al. v. FERC*, 9<sup>th</sup> Cir. Nos. 01-71051, et al. (placed in abeyance Aug. 21, 2002).

<sup>5</sup> *California Independent System Operator Corp.*, 107 FERC ¶ 61,274 (June 17, 2004 Order), *order on reh'g*, 108 FERC ¶ 61,254 (2004).

<sup>6</sup> See June 17, 2004 Order at P 26-28.

<sup>7</sup> *California Independent System Operator Corp.*, 108 FERC ¶ 61,022 (July 8, 2004 Order), *order on reh'g*, 109 FERC ¶ 61,097 (2004).

<sup>8</sup> July 8, 2004 Order at P 116.

5. On August 26, 2005, IEP filed the Complaint under section 206 of the FPA.<sup>9</sup> The Complaint alleged that the existing must-offer obligation under the CAISO Tariff is flawed and no longer just and reasonable. The Complaint also requested that the Commission direct the CAISO to replace the existing must-offer obligation and related minimum load cost compensation tariff provisions with an interim set of tariff provisions.

6. On November 14, 2005, IEP requested that the Commission defer action on the Complaint pending settlement discussions with the parties.<sup>10</sup> On November 18, 2005, Commission Staff convened a technical conference to discuss the issues raised in the Complaint.

7. On March 31, 2006, the Settling Parties<sup>11</sup> filed the Offer of Settlement that proposes the institution of a Reliability Capacity Services Tariff (RCST). The RCST, which was initially proposed by IEP in the Complaint, modifies the existing Commission-imposed must-offer obligation under the CAISO Tariff, as well as other market design elements. The Settling Parties state that the Offer of Settlement resolves the Complaint.

8. In the July 20 Order, the Commission found that the compensation to generators under the must-offer obligation is no longer just and reasonable. The Commission also found that the rates and cost allocation mechanism under the Offer of Settlement have not been shown to be just and reasonable. Therefore, the July 20 Order set forth three data requests and established paper hearing procedures to review evidence on whether the rates and cost allocation under the Offer of Settlement or some other rates and cost allocation are just and reasonable with respect to the must-offer obligation. The July 20 Order also established a refund effective date.

9. In addition, the July 20 Order permitted each seller of eligible capacity as defined under the terms of the Offer of Settlement, at its election, to collect the Offer of Settlement rates from the date of the order, so long as such seller agrees that all of these revenues will be subject to refund, even if they are collected after the statutory refund period ends. The Commission directed each seller making

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<sup>9</sup> 16 U.S.C. § 824e (2000).

<sup>10</sup> IEP and the CAISO filed joint motions to continue deferral of action on the Complaint on December 9, 2005, and on December 19, 2005.

<sup>11</sup> 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).

this election to inform the Commission in writing of its intention to do so within 15 days of the date of the July 20 Order.<sup>12</sup>

10. In response to clarification requests of the CAISO, Powerex, Northern California Power Authority (NCPA), and the Joint Parties,<sup>13</sup> the Commission issued the September 27 Order clarifying that it was permitting implementation of the rates proposed in the Offer of Settlement on an interim basis and subject to refund. The Commission stated that, upon approval of appropriate interim tariff sheets, the CAISO would be authorized to implement all of the terms of the Offer of Settlement relating to the sale of capacity and each potential seller of capacity would be authorized to collect the Offer of Settlement rates if the seller made an election pursuant to the July 20 Order and the clarifications provided in the September 27 Order. The Commission also stated that the interim tariff sheets should include the cost allocation methodologies and all reporting and procedural requirements set forth in the Offer of Settlement. However, the Commission stated that it was not authorizing the CAISO to implement the provisions in the Offer of Settlement relating to automatic mitigation procedures (AMP) and ancillary services on an interim basis. The Commission directed the CAISO to make a compliance filing to implement the Offer of Settlement rates as directed in the July 20 Order and as clarified in the September 27 Order.<sup>14</sup>

11. Six Cities filed a request for rehearing of the July 20 Order and Six Cities and SVP filed requests for rehearing of the September 27 Order. Each will be addressed in a future order.

## **II. The Offer of Settlement**

12. The Offer of Settlement proposes to institute the RCST that, in part, modifies the compensation for units dispatched under the must-offer obligation. The Settling Parties state that the RCST complements the CPUC resource

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<sup>12</sup> Notices of election were filed by Calpine Corporation, on behalf of its designated subsidiaries; GWF Energy, LLC; La Paloma Generating Company, LLC; LS Power Generation, LLC; Mirant Corporation, on behalf of its designated subsidiaries; NRG; Powerex Corp.; Reliant Reliant Energy Services, Inc., on behalf of its designated subsidiaries; and Williams Power Company, Inc.

<sup>13</sup> The Joint Parties are the CPUC, PG&E and SoCal Edison.

<sup>14</sup> The CAISO filed its compliance filing on October 20, 2006. The Commission will address the compliance filing in a subsequent order.

adequacy requirements program by providing a transition mechanism to the CPUC's implementation of resource adequacy.<sup>15</sup>

13. The Settling Parties state that the tariff provisions implementing the terms of the Offer of Settlement will automatically expire on the earlier of December 31, 2007, or the implementation of the CAISO's Market Redesign and Technology Upgrade (MRTU), except to the extent necessary to provide compensation to those units that provided service under those provisions prior to their termination.

14. Under the Offer of Settlement, the RCST will provide a backstop procurement mechanism to the CAISO and establish both the price for procuring backstop generation capacity as well as the method for allocating the costs incurred. The RCST provides the CAISO with the authority to designate RCST units if either of the following situations arise. First, the CAISO will make RCST designations on behalf of LSEs that are short of meeting either local or system requirements established by either the CPUC or other Local Regulatory Authority under the CAISO's Interim Reliability Requirements Program (IRRP). Second, the CAISO will make RCST designations if system conditions change significantly and the resources procured in meeting resource adequacy requirements are no longer sufficient to maintain reliability standards.

15. As proposed under the Offer of Settlement, the RCST also provides compensation to resources that are needed to meet short-term reliability requirements but are not designated as RCST units as described above. These non-RCST designated units fall into two categories. First, units that are denied must-offer waivers and are not currently operating under capacity contracts (*i.e.*, resource adequacy, RMR, and RCST) are eligible for daily must-offer capacity payments. Second, units that are frequently mitigated and are not designated as RCST units and are not eligible for the must-offer capacity payment will be eligible for compensation through implementation of a bid adder. The RCST refers to this as a frequently mitigated bid adder.

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<sup>15</sup> The CPUC is requiring Load Serving Entities (LSEs) subject to its jurisdiction to acquire capacity needed to serve 115-117 percent of their forecast retail customers' load beginning in June 2006. In addition, Local Regulatory Authorities will establish capacity requirements for LSEs subject to their jurisdiction.

**A. RCST Designation for Resource Adequacy**

16. The Settling Parties state that the CAISO will make system RCST designations by assessing the costs and benefits of such designations to total grid reliability based on a unit's effectiveness at resolving local and zonal constraints. System RCST designations are made on both a year-ahead showing and a month-ahead showing.<sup>16</sup> Pursuant to the Offer of Settlement, the year-ahead RCST designations have a minimum term of three months and a maximum term of four months for 2006 (June through September) and five months for 2007 (May through September). Month-ahead RCST designations are limited to the lesser of three months or the balance of the calendar year.

17. Local RCST designations occur only if there is an aggregate deficiency by CPUC-jurisdictional LSEs and non-CPUC-jurisdictional LSEs in meeting the local resource adequacy established by the CPUC and other Local Regulatory Authorities. The local RCST designations for 2007 will be for the full year and will be made only after the CAISO nominates reliability must-run (RMR) units for 2007.

**B. Must-offer Capacity Payment and RCST Designation for a Significant Event**

18. Under the Offer of Settlement, the CAISO retains the current must-offer requirement. However, before issuing a must-offer waiver denial, the CAISO must first exhaust the other reliability resources under contract for capacity (*i.e.*, resource adequacy, RMR and units with system or local RCST designations) available to it. Any unit denied a must-offer waiver that is not under contract for capacity will receive a daily capacity payment equal to 1/17th of the monthly RCST capacity charge for each day that the unit receives a must-offer waiver denial.

19. Additionally, if the CAISO issues a must-offer waiver denial on four separate days in any one-year period, the CAISO will evaluate whether a significant event has occurred that warrants an RCST designation for that resource.

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<sup>16</sup> The CAISO may issue RCST designations to internal resources or system resources. However, system resources are subject to the import limits for resource adequacy purposes.

**C. Frequently Mitigated Bid Adder**

20. Additionally, the Offer of Settlement includes a \$40 bid adder for frequently mitigated units (FMU bid adder) that have had their incremental bids mitigated for local area constraints more than four times in a day and are not receiving other capacity payments under RCST, must-offer, RMR or resource adequacy. The Settling Parties assert that it is appropriate for a unit whose bid is taken out of merit order to receive a payment in lieu of the capacity payments. Under the Offer of Settlement, the total amount of FMU bid adders for any unit shall not exceed the daily capacity payment equal to 1/17<sup>th</sup> of the monthly RCST capacity payment. Further, frequently mitigated units will stop accruing adders in a calendar month once the combined total compensation reaches the maximum monthly RCST payment.

**D. RCST Capacity Payment**

21. Under the Offer of Settlement, generation capacity that is designated under the RCST will be paid a monthly RCST payment based on the following formula:

$$\text{RCST Payment} = [(\text{Monthly RCST Charge}) - (\text{Monthly PER} \times .95)] \times (\text{Availability Factor}) \times (\text{Net Qualifying Capacity})$$

22. The monthly RCST charge is calculated by multiplying the target capacity price of \$73/kW-yr by monthly shaping factors, which are intended to weight the value of capacity according to demand.<sup>17</sup> The target capacity price is the annualized fixed cost of a hypothetical new combustion turbine generator, identified as the reference resource.

23. Monthly PER, or peak energy rent, is the revenue that the hypothetical reference resource would earn in excess of its variable costs from sales of energy and non-spinning reserves. The reference resource is assumed to be dispatched for energy whenever the energy price during the month is greater than the reference resource variable cost. When not dispatched for energy, the reference resource is assumed to provide non-spinning reserves. The reference resource variable cost is based on the following operating characteristics: 10,500 Btu/kWh heat rate, \$3.15/MWh variable operations and maintenance cost, \$0.71/MWh emissions rate, and a daily gas price based on the RMR contract formula used in the relevant investor-owned utility service area.

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<sup>17</sup> The illustrative tariff sheets accompanying the filed Offer of Settlement contain tables indicating the value of the monthly shaping factors.

24. The availability factor provides for bonus payments above and penalties below 95 percent availability. The availability factor provides the incentive for generators to actually provide the RCST capacity when it is needed. The net qualifying capacity is based on the value of a unit's capacity as used for resource adequacy planning purposes.

25. A generation unit that is not designated under the RCST and is issued a must-offer waiver denial will receive a daily capacity payment equal to 1/17th of the monthly RCST charge. The unit also will receive start-up and minimum load costs and imbalance energy payments until the sum of all of these amounts reaches a cap. Similar to the monthly payment for units designated as RCST units, the cap for units not designated as RCST units is equal to the monthly RCST charge minus the monthly PER. After this cap is reached, the unit will continue to receive start-up and minimum load costs and imbalance energy payments when issued any additional must-offer waiver denials.

#### **E. RCST Cost Allocation**

26. The Offer of Settlement includes provisions for allocating the costs associated with RCST and the new payments associated with the must-offer obligation. The Offer of Settlement allocates the cost of system RCST designations to those LSEs with deficient resource adequacy demonstrations based on the ratio of such deficiency relative to deficiencies in the CAISO Control Area. The Settling Parties add that the cost allocation for local RCST designations for 2007 is reserved pending action by the CPUC and Local Regulatory Authorities in establishing local resource adequacy requirements. The Offer of Settlement proposes to allocate costs incurred for local RCST designations triggered by a significant event to all Scheduling Coordinators for LSEs in the transmission access charge area in which the significant event occurred.

27. The Offer of Settlement proposes to allocate capacity payments associated with units that receive a must-offer waiver denial in a manner consistent with the Commission's decision in the Amendment No. 60 proceeding.<sup>18</sup> Finally, the Offer of Settlement proposes to allocate costs associated with FMU bid adders using the grid operations charge methodology set forth in the CAISO Tariff section 27.1.3.

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<sup>18</sup> See Docket No. ER04-835-000.

**F. Ancillary Services**

28. The Settling Parties state that the CAISO will procure ancillary services from RMR resources that switch from condition 1 to condition 2<sup>19</sup> after March 31, 2006 to satisfy ancillary services requirements in the same manner that the CAISO has historically used condition 2 units for ancillary services. Specifically, the Settling Parties state that the cost-based bids of such condition 2 units will be placed in the ancillary services bid stack, and the CAISO will accept bids in the stack in merit order. However, under the term of the Offer of Settlement, the Settling Parties state that bids of condition 2 RMR resources that are condition 2 prior to March 31, 2006, will not be considered by the CAISO in the ancillary services bid evaluation process. The Offer of Settlement proposes to clear the ancillary services' markets using market-based offers before using condition 2 RMR ancillary services bids.

**G. System Automatic Mitigation Procedures**

29. Under the Offer of Settlement, the system AMP threshold will be set at \$200/MWh effective June 1, 2006 and mitigation measures will not be applied to energy bids projected to be dispatched as imbalance energy in hours which the zonal energy price is projected to be below the \$200/MWh threshold. The current AMP threshold is set at \$91.87. The Settling Parties state that all resources shall be subject to system AMP and that the conduct and impact tests currently in place will remain unchanged.

**III. Procedural Matters**

30. On August 21, 2006, the Settling Parties filed a response (Settling Parties' Response) to the data requests set forth in the July 20 Order.

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<sup>19</sup> Condition 1 RMR units may participate in bilateral contracts or energy and ancillary service market transactions and retain revenues from such transactions. Condition 2 RMR units cannot enter into these transactions unless they are dispatched by the CAISO and do not retain any revenues.

31. On September 11, 2006, initial comments were filed by Six Cities<sup>20</sup>; the California Department of Water Resources – State Water Project (State Water Project); the California Electric Oversight Board (CEOB); the California Municipal Utilities Association (CMUA); the City of Santa Clara, California, d/b/a Silicon Valley Power (SVP); the Modesto Irrigation District (Modesto); NRG<sup>21</sup>; the Northern California Power Agency (NCPA); and Williams Power Company, Inc. (Williams). A number of these comments assert that the Settling Parties failed to present additional evidence in response to the issues identified by the Commission. Six Cities makes this same assertion in a motion to reject the Offer of Settlement (Motion to Reject).

32. On September 26, 2006, the CAISO filed reply comments and an answer to the Motion to Reject. IEP and SoCal Edison filed answers to the Motion to Reject. SVP filed an answer and joinder to the Motion to Reject. Six Cities and State Water Project filed reply comments. The Settling Parties filed a statement of continued support for the Offer of Settlement. On October 4, 2006, Williams filed a motion for leave to answer and answer to IEP's reply comments and the CAISO's answer to the Motion to Reject and reply comments.

33. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure generally prohibits answers to answers unless otherwise ordered by the decisional authority.<sup>22</sup> We will accept Williams' answer because it will assist the Commission in its decision-making process.

#### IV. Discussion

##### A. Legal Standard for Approving the Offer of Settlement

34. Noting the four approaches in *Trailblazer Pipeline Company*<sup>23</sup> that the Commission may utilize to address a contested settlement, the Settling Parties urge the Commission to approve the Offer of Settlement as a package under the second *Trailblazer* approach, which (as discussed below) allows the Commission to approve a settlement as a package if it determines that the overall result of the

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<sup>20</sup> The Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California.

<sup>21</sup> NRG Power Marketing, Inc. and West Coast Power LLC.

<sup>22</sup> 18 C.F.R. § 385.213(a)(2).

<sup>23</sup> *Trailblazer Pipeline Company*, 85 FERC ¶ 61,345 (1998), *order on reh'g*, 87 FERC ¶ 61,110 (1999) (*Trailblazer*).

settlement is just and reasonable. The Settling Parties maintain that each aspect of the Offer of Settlement is a negotiated compromise that forms an overall package to which all of the Settling Parties could agree. The Settling Parties further state that disturbing any aspect of the overall settlement may upset the balance of interests achieved, alter the entire agreement, and threaten the agreed-to package. Accordingly, the Settling Parties urge the Commission to consider the Offer of Settlement as a package to avoid disturbing that carefully wrought balance, and to find the overall result to be just and reasonable.

35. Parties submitting comments on the Offer of Settlement continue to assert that the Settling Parties have not met their burden to establish that the rates and cost allocation mechanisms proposed by the Offer of Settlement are just and reasonable.<sup>24</sup> They assert that the Settling Parties' Response provides little or no new evidence and that the Settling Parties made no effort to respond to any of the concerns previously raised in initial comments of the non-settling parties.

36. State Water Project asserts that the Settling Parties' Response fails to address whether the Offer of Settlement satisfies the public interest test set forth in *Trailblazer*. State Water Project contends that because the Commission may approve a contested settlement only if it provides a reasoned basis, supported by substantial record evidence, or if it determines that there is no genuine issue of material fact, the proposed cost allocation methodology cannot be approved on this record. State Water Project further argues that even assuming that a public interest finding could be made, the Offer of Settlement meets none of the four *Trailblazer* approaches for approval.

37. In its Motion to Reject, Six Cities argues that because the Settling Parties' Response did not comply with the July 20 Order, the Commission should summarily reject the Offer of Settlement as unjust and unreasonable, consistent with the findings in the July 20 Order.<sup>25</sup> Six Cities claims that summary disposition of a proceeding, or part of a proceeding, is appropriate when parties fail to comply completely with Commission directives concerning the submission of evidence.

38. To further support its Motion to Reject, Six Cities asserts that summary rejection of the Offer of Settlement is particularly appropriate, because it is intended to be implemented on an interim basis only. Six Cities states that IEP

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<sup>24</sup> Six Cities, State Water Project, CEOB, CMUA, SVP, Modesto, NRG, Williams.

<sup>25</sup> Six Cities' Motion to Reject is supported by CMUA and NCPA.

and the CAISO agree that the concerns raised in IEP's Complaint will be addressed through the CAISO's MRTU submitted in Docket No. ER06-615-000.

39. CMUA argues the Settling Parties' repeated emphasis on the totality of the Offer of Settlement raises questions about the nature and effect of the very proceedings the Commission has ordered. However, CMUA asserts that even if the Commission does not accept each and every element of the Offer of Settlement, other market participants such as CMUA members will be left hanging with respect to how the Settling Parties will decide to proceed, and how that affects their cost exposure and subsequent procurement efforts. Compounding this uncertainty are the valid questions raised by the CAISO itself on how the Commission intends it to implement either the Offer of Settlement or the terms of any subsequent Commission Order.

40. Six Cities also asserts that the Settling Parties have failed to establish that granting the CAISO additional resource procurement authority is a necessary or appropriate means of addressing concerns relating to the adequacy of compensation for generators subject to the must-offer obligation. Six Cities contends that the RCST is an unnecessary fifth reliability program, in addition to what the Six Cities argues are the CAISO's four existing programs: Market Procedure M-438, the IRRP, RMR and the must-offer obligation.

41. In its answer to Six Cities' Motion to Reject, SoCal Edison points out that Six Cities' initial comments in opposition to the Offer of Settlement stated that "the RCST settlement offer raises a number of issues of material fact that cannot be resolved on the basis of the record now before the Commission."<sup>26</sup> Therefore, SoCal Edison contends that by Six Cities' own admission, the Commission may not grant the Cities' Motion to Reject because there are material issues of fact in dispute, and it should be summarily denied. SoCal Edison further asserts that the Settling Parties' Response fully responded to each of the Commission's requests for information and that Six Cities' mere claim that the information provided is unsatisfactory does not constitute failure on the part of the Settling Parties to comply with the July 20 Order.

42. The CAISO also argues that Six Cities' assertion that the Settling Parties have failed to show that the Offer of Settlement is a necessary or appropriate means of addressing the inadequate compensation to generation subject to the must-offer obligation is beyond the scope of the paper hearing. The CAISO

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<sup>26</sup> Answer of SoCal Edison at 3 (citing comments of Six Cities filed April 20, 2006, at 7).

disputes Six Cities' contention that RCST is an unnecessary fifth reliability program, stating that Market Procedure M- 438 was developed simply to implement the CPUC's interim local reliability requirements, which will be replaced by the CPUC's local resource adequacy requirements, and that the IRRP integrates the CAISO's operations with California's resource adequacy requirements. According to the CAISO, neither of these procedures establishes independent CAISO reliability requirements (other than informational requirements) and these procedures do not overlap with the RMR provisions. The CAISO further explains that the must-offer obligation acts as a backstop to these programs, ensuring that the CAISO has capacity to draw upon in the event capacity available through the other programs is inadequate to resolve reliability requirements. According to the CAISO, must-offer waiver denials are decided taking into account the other resources available, thus there is no overlap between these mechanisms.

43. IEP asserts that Six Cities cites to no case in which the Commission has granted a motion for summary rejection in this posture. IEP submits that the absence of precedent on this point is not an aberration; rather, motions for summary disposition are not the appropriate procedural vehicle to decide whether to approve an offer of settlement. According to IEP, motions for summary disposition before the Commission are akin to motions for summary judgment in federal district court, and are used to decide whether any material fact remains in dispute as to a claim (or counterclaim) and if the moving party is entitled to judgment as a matter of law.

### **Commission Determination**

44. Rule 602(h)(1)(i) of the Commission's rules of practice and procedures provides that the Commission may decide the merits of a contested offer of settlement if the record contains substantial evidence upon which to base a reasoned decision.<sup>27</sup> Where a settlement is contested, the Commission must make "an independent finding supported by "substantial evidence on the record as a whole" that the proposal will establish "just and reasonable" rates.<sup>28</sup> The Commission has established a number of approaches for reviewing contested settlements based on the individual factual circumstances of each case.<sup>29</sup> Under

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<sup>27</sup> 18 C.F.R. § 385.602(h)(1)(i) (2006).

<sup>28</sup> See *New Orleans Public Service, Inc. v. FERC*, 659 F.2d 509, 511-12 (5<sup>th</sup> Cir. 1981), citing *Placid Oil Co. v. FPC*, 483 F.2d 880, 893 (5<sup>th</sup> Cir. 1973), *aff'd sub nom. Mobil Oil Corp. v. FERC*, 417 U.S. 283, 314 (1974).

<sup>29</sup> See *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 (1998), *reh'g denied*,  
(continued...)

the first approach explained in *Trailblazer*, the Commission can address the settlement provisions on the merits. This approach is appropriate where the issues are primarily policy issues or the parties have agreed that the record is sufficient to

decide the issues on the merits.<sup>30</sup> Under the second approach in *Trailblazer*, the Commission may approve a contested settlement as a package if the overall result of the settlement is just and reasonable and contesting parties' rates are "no higher than any just and reasonable rate the Commission could establish after full litigation of the case on the merits."<sup>31</sup>

45. We will review the Offer of Settlement under the just and reasonable standard of review, and will approve the Offer of Settlement as modified herein, as discussed below. Because of the need to modify the Offer of Settlement, we cannot approve the Offer of Settlement under the second *Trailblazer* approach, as advocated by the Settling Parties.<sup>32</sup>

46. As noted above, the Commission instituted this section 206 proceeding in the July 20 Order because we found that given the current compensation structure, generators under the must-offer obligation may not have sufficient opportunity to recover their fixed costs in the energy market. Under the RMR construct and the CPUC resource adequacy program, generators receive capacity payments. Under the must-offer obligation, generators do not receive a capacity payment. The Offer of Settlement helps to resolve this inconsistency, ensuring that generators acting as reliability backstops receive fair compensation in the form of a capacity payment.

47. State Water Project argues that the Offer of Settlement is not in the public interest. Regardless of whether the Commission is required to make such a finding for a contested settlement, we conclude that the RCST, as proposed under the Offer of Settlement and as modified herein, is consistent with the public

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87 FERC ¶ 61,110 (1999) (*Trailblazer*).

<sup>30</sup> The Commission also has taken this approach in the case where it was necessary for the Commission to send data requests to the proponent of a settlement in order to develop sufficient facts to uphold the settlement on the merits. See *Trailblazer*, 85 FERC at 62,342 n. 23, citing *Koch Gateway Pipeline Company*, 74 FERC ¶ 61,088 (1996), *reh'g*, 75 FERC ¶ 61,132 (1996) (Koch). In *Koch*, the court affirmed the Commission as to all issues, but one. *Exxon Corp. v. FERC*, 114 F.3d 1252 (D.C. Cir. 1997).

<sup>31</sup> *Id.* at ¶ 62,342-43.

<sup>32</sup> See *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006).

interest because it is an important addition to the CAISO market that will complement the CPUC resource adequacy program and provide certain generators a compensatory capacity payment for the reliability services they provide. The fact that the Offer of Settlement, as modified, resolves a difficult, contentious matter also weighs in favor of our conclusion that the Offer of Settlement, as modified, is consistent with the public interest. Additionally, the Commission strongly favors settlements, particularly in difficult cases like the instant proceeding.<sup>33</sup>

48. In the absence of a compensation structure for the must-offer obligation such as that proposed by the Offer of Settlement, non-resource adequacy (and non-reliability must-run) generators would continue to be subjected to a must-offer obligation that may not provide them sufficient opportunity to recover their fixed costs in the energy market. This has been the situation since the Commission imposed the must-offer obligation in 2001, and has been a continuing source of contention. As the Offer of Settlement represents an agreement among the CPUC, the CAISO, generators and the three largest IOUs in California -- parties with divergent interests on the issue of compensation to generators under the must-offer obligation -- the Commission finds that the Offer of Settlement provides a just and reasonable solution to this problem.

49. We disagree with Six Cities that the RCST adds an unnecessary mechanism for the CAISO to procure resources for reliability purposes. Under the RCST, the CAISO will compensate units that are needed for reliability reasons and that are not receiving adequate compensation from the CAISO's energy market. Consistent with the implementation of resource adequacy programs and market design elements incorporated in MRTU, the RCST will provide a capacity payment to units that are needed by the CAISO for reliability reasons and that are not already receiving a capacity payment. Additionally, the RCST payment structure better reflects the costs to these units for providing reliability services and reduces the likelihood that units needed for reliability purposes will be mothballed or shut down and unavailable when needed. Therefore, we find that the RCST is neither unnecessary nor duplicative; instead, we find that it augments both market design and reliability initiatives.

50. The Settling Parties urge the Commission to approve the Offer of Settlement as a package under the second Trailblazer approach because, the

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<sup>33</sup> See, e.g., *Idaho Power Co.*, 109 FERC ¶ 61,308 at P 5 (2004) (stating that the Commission is "strongly in favor of settlements, particularly in cases [that are] hotly contested and complex").

Settling Parties assert, the overall result of the Offer of Settlement is just and reasonable. However, as discussed above, we find that approval under the second approach is not appropriate here because certain proposals included in the Offer of Settlement, namely, the Ancillary Services and AMP proposals, as discussed in more detail below, prevent us from concluding that the overall result of the Offer of Settlement, as filed, is just and reasonable. Further, we cannot find that under the Offer of Settlement, as filed, the parties objecting to the Offer of Settlement, would “be in no worse position under the terms of the settlement than if the case were litigated,” and that the filed Offer of Settlement, as a package, achieves an overall just and reasonable result within a zone of reasonableness.<sup>34</sup>

51. In the paper hearing, the parties had further opportunity to present facts in support of their positions in this proceeding. As a result of the paper hearing, the record now includes additional empirical data to support the costs and cost allocations under the Offer of Settlement. Therefore, we find that the contested issues in this proceeding can be resolved on the merits or have been resolved by application of Commission policy and its rulings in other orders involving the CAISO market. Accordingly, we will apply the first *Trailblazer* approach to analyze the specific issues raised by the parties opposing the Offer of Settlement, and modify the Offer the Settlement as necessary to ensure that it is just and reasonable.

52. The Commission emphasizes that it has reviewed in detail the issues raised by the contesting parties. Each of these issues is discussed in detail below. As a result of its review, the Commission is satisfied that it has given thorough consideration to the interests of the contesting parties. Thus, we find that the Offer of Settlement, as modified herein, presents a just and reasonable outcome to this proceeding and is supported by substantial evidence that provides the basis for our approval. Given our conclusions here, we therefore deny Six Cities’ Motion to Reject.

## **B. Specific Issues Raised With Respect to the Offer of Settlement**

### **1. RCST Capacity Payment**

53. The July 20 Order required the Settling Parties to fully support the cost basis, relevance and appropriateness of each assumed component used to determine the RCST capacity payment (*e.g.*, the target capacity price of \$73/kW-yr, the assumed heat rate of 10,500 Btu/kWh, and the target availability factor of 95 percent).

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<sup>34</sup> *Trailblazer*, 87 FERC ¶ 61,110 at 61,339.

a. **Target Capacity Price**

**Settling Parties' Response**

54. The Settling Parties state that they have provided additional support for the Offer of Settlement's target capacity price of \$73/kW-yr. Specifically, the Settling Parties' affidavit by Joseph Cavicchi (Cavicchi Affidavit) shows that the range of estimated costs for the installation of a two-unit, approximately 350 MW frame-type peaking plant is between \$62 and \$89/kW-yr, and that \$73/kW-yr is near the middle of that range. The Cavicchi Affidavit notes that one study by the California Energy Commission estimates the cost of new entry in California for a combustion turbine is \$88/kW-yr.<sup>35</sup>

55. Further, the Settling Parties assert that a \$73/kW-yr fixed cost is well below the annual fixed cost levels of the new gas turbine units approved by the Commission for purposes of calculating the annual reference values in connection with the New York ISO's installed capacity demand curves for 2005 through 2008. The Settling Parties also note that the Commission previously approved an installed capacity deficiency charge of \$6.66/kW-month, equivalent to \$79.72/kW-yr, for ISO New England. They submit that \$73/kW-yr is thus demonstrably within the zone of reasonableness.<sup>36</sup>

**Comments**

56. Six Cities argues that the compensation set forth in the RCST will not serve as an incentive to construct new generation, because the lead time applicable to such projects is substantial due to inadequacies in the existing transmission grid, environmental restrictions and siting requirements. Six Cities alleges that the RCST settlement framework will allow incumbent generators to exercise market power to demand compensation in excess of their costs. CMUA adds that the Settling Parties do not explain why existing suppliers should be paid the cost of new entry, or how the RCST mechanism works in conjunction with similar mechanisms, such as RMR contracts.

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<sup>35</sup> Settling Parties used a 2003 study by the California Energy Commission and adjusted the study's \$82/kW-yr figure to \$88/kW-yr to account for inflation at 2.5 percent per annum. See "Comparative Cost of California Central Station Electricity Generating Technologies," California Energy Commission, August 2003.

<sup>36</sup> Settling Parties cite *New England Power Pool and ISO New England*, 100 FERC ¶ 61,287 (2002).

57. Six Cities argues that the RCST methodology has the potential to over-compensate generators and thereby create a disincentive to participate in the bilateral energy markets and in the day-ahead CAISO ancillary services markets. Six Cities explains that generators that wait to receive must-offer waiver denials from the CAISO are likely to receive a greater level of compensation under the RCST methodology than if they self-schedule in the day-ahead energy markets. Furthermore, generators that receive must-offer waiver denials will also receive payments for start-up costs and minimum load energy at the imbalance energy price. State Water Project concurs with Six Cities.

58. Six Cities maintains that the RCST mechanism will result in substantial payments to generators and potentially considerable costs for CAISO market participants. For example, Six Cities maintains that for the period from June 1, 2006 through July 24, 2006, the CAISO would have incurred nearly \$20 million in RCST capacity payments.

59. Six Cities argues that if the Commission approves an RCST approach, it should be modified so that generators receive a fixed capacity charge of \$25/kW-yr. According to Six Cities, this figure is based upon a target \$52/kW-yr capacity price minus an average PER of \$29/kW-yr, plus a 10 percent adjustment.<sup>37</sup> Six Cities asserts that this capacity payment recognizes that the RCST methodology is intended to be in place for only a short period of time, does not create incentives for generators to withhold capacity, and is fixed and straightforward to calculate.

60. Finally, Six Cities argues that permitting generators to recover RCST capacity payments under the must-offer obligation in addition to the start-up and minimum load payments will result in a duplicative capacity payment. Six Cities submits that the Commission has characterized the combination of start-up and minimum load payments as including a proxy for a capacity payment, which a generator will already be receiving through the RCST capacity payment. Six Cities adds that even after a must-offer unit receives capacity payments and start-up and minimum load payments that reach the monthly RCST capacity payment cap, the unit will continue to receive start-up and minimum load payments.

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<sup>37</sup> In Six Cities' affidavit, Mr. Hsi Bang Tang explains that: (1) \$52/kW-yr is based upon the average annual fixed revenue requirements for generators subject to RMR contracts, which constitutes a reasonable proxy for generators that would be called upon pursuant to the RCST Tariff; (2) \$29/kW-yr is based upon the CAISO's own estimate of the annual value of the PER; and (3) a 10 percent adjustment reflects uncertainty in the calculations.

61. Williams submits that the capacity price is not sufficient to compensate must-offer generators for the reliability services they provide. Williams asserts that if the reasonable peaking technology choice is a frame-type unit,<sup>38</sup> the reasonable cost should be in the \$84 to \$99/kW-yr range,<sup>39</sup> whereas if aero-derivative technology with its faster-starting capability is the right choice, the cost would reasonably fall within the range of \$134 to \$176/kW-yr.<sup>40</sup>

62. NRG likewise argues that the negotiated target capacity price in the Offer of Settlement is artificially low. It asserts that the cost of new entry in California is very high due to high permitting and site costs and high construction costs, which are not fully included in the Offer of Settlement capacity price. NRG asserts that while the Offer of Settlement provides adequate compensation at least for its contemplated duration, NRG intends to challenge any undue continuation of the Offer of Settlement as being unjust and unreasonable.

### **Reply Comments**

63. In response, Six Cities argues that in addition to lacking proper evidentiary support, Williams and NRG's assertions concerning the costs for various types of new generators are irrelevant. Six Cities reiterates that any RCST capacity charge should be based on the fixed costs for existing generators in the CAISO control area, because the RCST is only an interim program and only existing generators may be called upon to provide RCST service.

64. IEP disagrees with Six Cities' assertion that the Offer of Settlement should not employ a capacity price based on the cost of new entry. IEP argues that one goal at the outset of this proceeding was to begin to send appropriate price signals

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<sup>38</sup> Williams explains that aero-derivative units are capable of providing non-spinning reserve, while slower-starting frame-type turbines cannot.

<sup>39</sup> Williams cites the California Energy Commission as noting that \$84/kW-yr is low when compared to actual completed projects in California. *See* "Public Utilities Commission of the State of California," I.D. #5452, Resolution E-3980 (April 13, 2006). Williams submits that, in terms of installation and fixed operation costs in urban areas in California, the ISO New England's proposed annualized cost of \$99/kW-yr for Southwest Connecticut compares more favorably. *See* Prepared Direct testimony of John J. Reed on Behalf of ISO New England, Inc., Docket No. ER03-563-030 (August 31, 2004).

<sup>40</sup> Williams cites "Independent Study to Establish Parameters of the ICAP Demand Curves for the New York Independent System Operator," Docket No. ER05-428-000 (January 7, 2005).

to suppliers to invest capital in the California generation market. IEP submits that if the Commission were to approve a RCST compensation level other than the cost of new entry even during this interim period, then it would not send the correct signals to the market. IEP also notes that the \$73/kW-yr is not the price at which suppliers will be compensated because the peak energy and ancillary services rent deduction will serve to provide suppliers with compensation that is comparable to that under a cost-based RMR agreement. Finally, IEP disagrees with Williams' assertion that a more appropriate reference unit is an aero-derivative unit, noting that a frame-type combustion turbine exists that can produce 150 MW within ten minutes. Such a turbine can provide non-spinning reserves that the reference resource is assumed to be capable of providing.

65. The CAISO submits that while the \$73/kW-yr target price may be below the cost of new construction, it is a compromise amount that is agreed to by the vast majority of suppliers, the vast majority of load that will be paying the RCST rates proposed in the settlement, and the CPUC, which has jurisdiction over such load. The CAISO argues that the target price is supportable whether the Commission determines that the payment should be based on the cost of building a new unit or be within the range of the fixed costs of existing units. The CAISO argues that the \$73/kW-yr capacity price is within the range of the annual fixed costs of existing RMR units and is only slightly above the \$64/kW-yr weighted average annual cost for non-hydroelectric units, which are the types of units that will be eligible to receive a capacity payment. The CAISO concludes that averaging \$82/kW-yr (the mean of the five annualized cost of new entry estimates presented in the Cavicchi Affidavit) with \$64/kW-yr (the average cost of non-hydroelectric RMR units) yields an "eminently reasonable" price of \$73/kW-yr.<sup>41</sup>

66. The CAISO notes that in *Devon Power* the Commission found the transitional payments in the ISO New England Forward Capacity Market to be "well within the range of reasonableness."<sup>42</sup> There, existing installed capacity will initially be paid \$3.05/kWh-month (\$36.6/kW-yr) and later 4.10/kW-month (\$49.2/kW-yr). The CAISO adds that these payments include no PER reduction and that a PER of \$29/kW-yr, as used by Six Cities in its calculations, would put the Offer of Settlement's \$73/kW-yr in the same range. The CAISO adds that the New England transitional payment, which will be made on an annual basis, will almost certainly be more than any RCST capacity payments, which may not be annual, plus any must-offer capacity payments, which are only daily.

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<sup>41</sup> See CAISO Reply Comments at fn. 10 (September 26, 2006).

<sup>42</sup> *Devon Power LLC*, 115 FERC ¶ 61,340 at PP 101-103 (2006) (*Devon Power*).

67. The CAISO and IEP disagree with Six Cities' contention that the capacity charge will create a disincentive to participate in bilateral energy and CAISO ancillary services markets. They submit that generators cannot afford to await a must-offer waiver denial because there is no guarantee that such a denial will be forthcoming. Further, they argue that a must-offer capacity charge that is too low could prove a disincentive for LSEs to enter into bilateral arrangements, because LSEs will simply rely on the CAISO to procure the necessary reliability resources more cheaply through the must-offer process. IEP adds that if the Offer of Settlement is implemented, day-ahead purchasing decisions may be affected because of the potential for higher must-offer costs in real-time. IEP offers that higher must-offer costs may result in greater demand and bilateral contracting in the day-ahead market.

68. The CAISO also disagrees with Six Cities that the capacity payment is duplicative. It asserts that until the cap is reached, the continued payment for start-up and minimum load costs is simply a part of the total daily payment, and if a generator did not continue to receive start-up and minimum load payments, a daily capacity payment greater than 1/17th of the monthly RCST charge might be necessary. The CAISO acknowledges that while a must-offer generator will continue to receive start up and minimum load costs/Imbalance Energy payments after the cap is reached, the unit does not have an RMR or resource adequacy contract, is not designated as an RCST unit and thus must recover all of its fixed costs from the market and through the must-offer compensation. The CAISO argues that retention of the start-up and minimum load payment will help such units recover their fixed costs in an environment in which they will not be receiving a capacity payment every day. The CAISO anticipates that outside of critical periods like the summer 2006 heat wave, must-offer generators will rarely reach the cap.

### **Commission Determination**

69. The Settling Parties justify the \$73/kW-yr target capacity price on the basis that it is appropriate to use the cost of new entry to set the price for backstop capacity procurement. As discussed below, we find that the RCST's target price establishes a just and reasonable rate for capacity that the CAISO would purchase as a provider of last resort.

70. The paper hearing in the instant proceeding has established two reference levels in determining the price of procuring backstop capacity. At the lower end, the price should at least cover the fixed costs of existing generation that is needed

for reliability.<sup>43</sup> The CAISO indicates that a reasonable proxy representing the fixed costs of existing generation is the average annual fixed costs of non-hydroelectric RMR units, or \$64/kW-yr. At the higher end, the price should not exceed the cost of new entry that would allow investment in new generation capacity. The Settling Parties submit that comparable estimates for the cost of new entry range from \$62/kW-yr to \$89/kW-yr, although suppliers such as Williams and NRG argue that these estimates generally understate the cost of new entry for a turbine in California. Of particular note is the California Energy Commission's \$88/kW-yr cost of new entry estimate for a combustion turbine in California. Accordingly, we conclude that a just and reasonable target capacity price lies within the range of between \$64/kW-yr and \$89/kW-yr.

71. In arguing that the RCST should compensate existing generators only for their fixed costs, Six Cities misstates the purpose of the RCST. The RCST is intended only as a backstop when longer-term bilateral contracting between LSEs and generators pursuant to California's resource adequacy program is inadequate.<sup>44</sup> A just and reasonable price for backstop capacity should encourage LSEs and generators to engage in longer-term contracting and not rely on the RCST mechanism. Accordingly, the price for backstop capacity should be high enough so that LSEs do not simply rely on the backstop mechanism to meet their resource adequacy requirements.

72. We find that the RCST target capacity price of \$73/kW-yr is within the range of reasonable capacity prices. We disagree with Six Cities' argument that the RCST inappropriately uses the cost of new entry to price backstop capacity; instead, the proposed target capacity price appears to understate the actual cost of new entry in California. We note that this is especially true in load pocket areas<sup>45</sup> where the RCST mechanism may be most needed. At the same time the \$73/kW-yr capacity price is not so low as to encourage LSEs to rely on the RCST backstop mechanism to meet their capacity needs, as is the case for RMR units. Accordingly, we approve the RCST target capacity price of \$73/kW-yr as just and reasonable.

73. In addition, we note that the term and capacity payment under the RCST is consistent with the term and payment under RMR contracts. As noted earlier, the

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<sup>43</sup> See, e.g., *Devon Power* at P 102.

<sup>44</sup> See also *PJM Interconnection*, 107 FERC ¶ 61,112 at P 20, 21 (2004) (discussion on long-term bilateral contracting and backstop solutions).

<sup>45</sup> Load pockets tend to be located in urban areas that have, among other things, higher construction and permitting costs.

average annual cost for non-hydroelectric RMR units is \$64/kW-yr, and the term of an RMR contract is one year. Under the RCST, the payment structure consists of generally shorter terms, and therefore, we do not find it unreasonable that the capacity price is relatively higher than the RMR contract price paid to incumbent generators.

74. As California evolves from an energy-only market, the RCST establishes a transitional price for capacity that provides a compensatory payment to units that are needed for reliability services until MRTU is implemented. The RCST provides the CAISO with the ability to procure capacity as a provider of last resort. This authority is then retained under MRTU. The RCST also establishes a transitional price for backstop capacity that better reflects a unit's costs for providing reliability services. Once MRTU is implemented, a more complete market structure will provide appropriate price signals on the value of energy and capacity to market participants.

75. We are not persuaded by arguments that the RCST mechanism will create a disincentive to participate in the bilateral energy markets and in the day-ahead ancillary services markets. The CAISO correctly notes that generators are not guaranteed a must-offer waiver denial and corresponding payment if they choose not to participate in other markets. Furthermore, as we discuss above, the target capacity price approved in this settlement should encourage generators to instead negotiate contracts.

76. We reject Six Cities' argument that the RCST mechanism is not just and reasonable in that it will result in substantial payments from market participants to generators. While mindful of the financial impact to customers, our primary concern in approving the RCST mechanism is to offer a reasonably compensatory capacity payment to generators that provide needed reliability services and that are not currently being fully compensated. Additionally, Six Cities appears to agree in principle that \$64/kW-yr, the average annual fixed costs of non-hydroelectric RMR units, is a reasonable target capacity price.<sup>46</sup> This is only slightly less than the RCST capacity price of \$73/kW-yr.

77. We also reject Six Cities' argument that generators will receive duplicative capacity payments consisting of both an RCST payment and a start-up and

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<sup>46</sup> Six Cities notes that it did not have access to actual cost data for generators eligible for the RCST capacity payment and instead calculated the average annual fixed cost of all RMR units (\$52/kW-yr) and then added a 10 percent uncertainty factor. See Hsi Bang Tang Testimony at 19.

minimum load payment. While Six Cities is correct that units dispatched under the must-offer obligation would receive these payments, the addition of startup and minimum load costs to the daily RCST must-offer payment merely reduces the number of must-offer waiver denials necessary to reach the maximum allowable monthly compensation. Although a generator would continue to receive a start-up and minimum load payment after its daily RCST payments reached the monthly RCST capacity charge cap, we find that this payment structure provides appropriate compensation to generators for being available for reliability purposes. Further, we note that a unit that continues to receive daily RCST payments could potentially become eligible for RCST designation as a significant event, and the unit would no longer be eligible for start-up and minimum load payments.

**b. Peak Energy Rent Deduction**

**Settling Parties' Response**

78. The Settling Parties maintain that the target heat rate for the reference resource of 10,500 Btu/kWh is reasonable.<sup>47</sup> Exhibit No. 3 from the Settling Parties response identifies seven turbines by manufacturer with heat rates ranging from 10,099 Btu/kWh to 11,267 Btu/kWh.

79. The Settling Parties note that the Commission's orders on ISO New England's Forward Capacity Market proposal and the New York ISO's installed capacity demand curve proposals approved the use of a hypothetical proxy peaking unit as the basis for determining the PER amount. Likewise, the RCST utilizes a hypothetical peaking unit for purposes of determining the PER.

**Comments**

80. In their original comments, Six Cities argues that the presumed heat rate for the proxy unit is unreasonably high and will result in overcompensation of RCST units, because it is unlikely that the market will clear above the 10,500 Btu/kWh heat rate for many hours of the year, thus limiting the PER offsets. Six Cities adds that the RCST settlement framework resembles the current RMR condition 1 contracts with one major, unjustified difference. Six Cities states that units under RMR condition 1 contracts are paid only a portion of their demonstrated, going forward fixed costs. In contrast, Six Cities submits that under the settlement offer, RCST units would receive substantially higher capacity payments, and they could keep their market revenues as long as they are more efficient than the proxy unit.

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<sup>47</sup> Cavicchi Affidavit at P 8.

81. Six Cities instead argues for a fixed PER of \$29/kW-yr and submits that a fixed PER is straightforward, transparent and easy to administer. Six Cities opposes any adjustments based upon actual PER and in particular opposes the adjustment proposal in the Offer of Settlement as excessively complicated. Six Cities submits that the Settling Parties have failed to provide any documentation to explain how the proposed adjustment would operate or justify the parameters for calculating it despite the fact that PER appears to have a substantial impact on RCST costs. State Water Project concurs with Six Cities.

82. The CAISO asserts that IEP proposed a heat rate of 10,817 Btu/kWh and the settlement resulted in a heat rate of 10,500 Btu/kWh. It argues that is a reasonable compromise. The CAISO adds that in any case the actual effect of the proxy unit's heat rate on the peak energy rent will be minimal, because the PER has two components that would vary in opposite directions with changes in the heat rate. On one hand, there is an energy component made up of the difference between the operating cost of the proxy resource and the hourly energy price when the hourly energy price is greater than the operating costs of the proxy unit. On the other hand, there is the non-spinning reserve capacity payment for any hour that the hourly energy price is less than the proxy unit's operating costs.

83. The CAISO argues that the calculation of the PER is essentially the same as that for ISO New England's local installed capacity mechanism, as approved in *Devon Power*. The CAISO also argues that the calculation of the RCST payment using a flat PER based on historical data would not provide just and reasonable compensation. For example, the CAISO submits that the \$29/kW-year used by the Six Cities is based on 2005 market conditions, but that this does not reflect the changes in January 2006 to the bid cap or the effects of the summer 2006 heat wave.

84. Williams argues that a frame-type resource cannot provide non-spinning reserve, because it cannot synchronize to the grid and ramp to full load in ten minutes; thus, Williams argues that the Offer of Settlement inappropriately subtracts non-spinning reserve revenues from the monthly capacity price. Williams proposes that the Commission either strike the proposed non-spinning reserve revenue deduction from the calculation of the capacity price, or require the target capacity price to reflect an aero-derivative combustion turbine that can actually provide ten-minute non-spinning reserve.

85. The CAISO responds that although the Settling Parties have provided data on the cost of a new frame unit, that data is evidence of the reasonableness of the target capacity price. In addition, the CAISO notes that the PER used in

connection with ISO New England's capacity market is similarly calculated based on the costs and revenues of a hypothetical proxy unit.<sup>48</sup>

### **Commission Determination**

86. We find that the heat rate used in the RCST PER calculation is appropriate. The proposed heat rate is well within the range of turbine heat rates that the Settling Parties identify in their response. Furthermore, we agree with the CAISO that the effect of picking a different heat rate would likely be minimal because the RCST payment is adjusted downward by energy rents if the reference resource is estimated to be infra-marginal, or by ancillary rents if the reference resource would not be economically dispatched for energy. Therefore, we find the proposed heat rate to be a reasonable component of the RCST payment calculation.

87. We also find that the benefits of the PER deduction would be reduced under Six Cities' proposal to use a fixed PER. As explained by ISO New England:

[T]he PER deduction primarily acts as a hedge for load against price spikes in the energy market. Because suppliers will be giving back to load energy rents earned by a hypothetical unit in the actual energy market, it also acts as a disincentive for suppliers to exercise market power in the energy market.<sup>49</sup>

88. We find that the RCST PER deduction appropriately uses a variable formula to determine the amount of energy rent offset to a generator's capacity payment. We also agree with the CAISO that a flat PER would not provide a just and reasonable rate during extreme conditions when generators are receiving either significant energy rents or no energy rents at all. Accordingly, we approve the RCST PER deduction.

89. As noted elsewhere in this order, the RCST target capacity price is not based on the cost of new entry for a specific turbine in California, and the target availability is merely a negotiated figure that is higher than the average availability

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<sup>48</sup> The CAISO cites: "Explanatory Statement of the Settling Parties in Support of Settlement Agreement", Docket No. ER03-563-000 *et al.*, at p. 31 (March 6, 2006).

<sup>49</sup> See Explanatory Statement in Support of Settlement Agreement at p. 31, ISO New England, Inc., Docket No. ER03-563-000 *et al.*, (March 6, 2006).

for all turbines. Furthermore, IEP correctly notes that there does exist a frame-type unit that provides non-spinning reserve. We do not find it necessary to precisely model the formula that calculates RCST payments on an actual turbine. Thus, while Williams correctly points out that the hypothetical unit cannot provide non-spinning reserve, we find this point to be immaterial, because the PER is not meant to precisely model a particular unit.

c. **Target Availability Factor and Monthly Shaping Factors**

**Settling Parties' Response**

90. The Settling Parties maintain that the 95 percent target for availability is another example of a negotiated compromise among the parties that is a reasonable value.<sup>50</sup> In support they state that the availability factor of 95 percent is based on combustion turbine manufacturers' specifications as to what may be expected from a new frame-type combustion turbine in California. When a resource falls below the target availability of 95 percent, its monthly capacity payments will be reduced. Similarly, resources that exceed that target, and thereby exceed what would reasonably be expected of a new frame-type combustion turbine, will receive an increased payment for the superior availability.

91. The Settling Parties note that the Commission has approved other contested settlements that include performance availability metrics and cite to the ISO New England's Forward Capacity Market proceeding as an example.<sup>51</sup> The Settling Parties add that the Commission stated that measuring availability "provides an appropriate incentive for generators to provide reliable service during the periods of system stress, which preserves reliable service."<sup>52</sup>

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<sup>50</sup> Settling Parties state that Mr. Cavicchi gathered availability data from the North American Electric Reliability Council's Generation Availability Data System (GADS). The GADS measurement of availability includes the availability factor and equivalent availability factor. The data show that availability for gas turbines over 50 MW in capacity is 92% and the equivalent availability factor is 90%.

<sup>51</sup> See generally *Devon Power*.

<sup>52</sup> Settling Parties Response at 7, citing *Devon Power* at P 159.

### Comments

92. In their original comments, Six Cities submits that there is no justification for the target availability of 95 percent and the monthly shaping factors. The CAISO and IEP respond that Six Cities does not suggest any alternative level of availability. IEP argues that the economic penalties for RCST capacity being unavailable below the 95 percent target, and economic incentives for being available more than 95 percent of the time, provide the proper incentive for performance. The CAISO adds that the 95 percent availability target reflects a negotiated number that is higher than the 92 percent availability target proposed by IEP in the Complaint.

93. With respect to the monthly shaping factors, the CAISO notes that although the capacity may not differ month-to-month, the likelihood that the capacity will be called upon is greatest during the peak months. The CAISO submits that monthly shaping factors increase the incentive for generators to ensure that their units are available during the peak months when they are most needed.

94. In the paper hearing, the CEOB contends that the Commission should reject the bonus payment component of the Offer of Settlement for capacity availability above 95 percent. First, there is no economic justification established by the proponents nor is there any evidence that the bonus payments will benefit California ratepayers. Second, the capacity payment is a fair payment for the reliability services a generator provides and there is no need for a greater incentive because a generator will have a contractual obligation to perform when called upon by the CAISO. Third, the bonus payment is a backdoor method to increase the level of the RCST payment by 13.9 percent without giving the ratepayers additional reliability, or other value added service, in exchange for the enormous cost of this component. Lastly, the Settling Parties incorrectly cite to *Devon Power*, which does not provide any type of bonus payment. The CEOB submits that instead the Commission merely approved a method of measuring the time frame in which a generator had the obligation to make its capacity available to the ISO.<sup>53</sup>

95. IEP argues in response that the availability payment structure illustrates the common commercial practice of providing bonuses when performance exceeds the baseline and assessing penalties when performance is below the baseline. IEP submits that if under-performance was penalized without rewarding enhanced performance, the payment structure would be unbalanced and inequitable. IEP

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<sup>53</sup> The CEOB cites *Devon Power* at PP 152-159.

adds that the market will benefit from greater reliability if this added incentive results in more units operating at increased availability.

96. The CAISO asserts that while the average availability for gas turbines over 50 MW is 92 percent, the Offer of Settlement adopts an even higher availability factor of 95 percent. The CAISO argues that given the fact that no party disputes the 95 percent baseline availability factor, a unit that is available 100 percent of the time provides more benefit and service than a unit that is available only 95 percent of the time, and it is thus appropriate to pay more to the unit available 100 percent of the time. Finally, the CAISO argues that an equivalent RCST capacity price of \$83/kW-year for 100 percent availability is not unjust and unreasonable and is within the range of annualized cost estimates provided by the Settling Parties and within the range of the annual fixed revenue requirements of RMR units.

### **Commission Determination**

97. We approve the RCST target availability provision as it reflects the fact that the RCST is designed to enhance reliability, and availability is a key component. The Settling Parties correctly note that the target availability factor is higher than the average turbine availability of 92 percent. We find that the 95 percent target is thus a reasonable component of the RCST payment calculation.

98. Further, the availability provision provides economic incentives for generators to be available. Payments are increased for enhanced availability levels and reduced if availability falls below the target availability. While the CEOB is correct in noting that the New England ISO's capacity mechanism approved in *Devon Power* does not provide payments for enhanced generator availability, we note that none of our findings in *Devon Power* prevent additional payments for higher availability. Higher availability can provide enhanced reliability – assuming units are properly maintained – and thus provide additional benefits that merit compensation. Finally, we note that at 100 percent availability a generator would receive the maximum RCST payment (minus any peak energy revenues) of just over \$83/kW-yr, which is still within the range of capacity prices discussed above.

99. Regarding monthly shaping factors, we find that this provision provides a reasonable incentive for generators to respond to dispatch instructions when their energy is most needed. According to this provision, if a generator is not available during times when demand is relatively high, its RCST capacity payments will be reduced by a proportionately large amount. Like the target availability factor, we find that the monthly shaping factors are consistent with the overall purpose of the

RCST: to ensure sufficient generation capacity is actually available when it is needed to maintain reliability by adequately compensating generators.

## **2. Cost Allocation Mechanism**

100. The July 20 Order required the Settling Parties to fully explain and document the reasonableness of the proposed cost allocation mechanisms.

### **Settling Parties' Response**

101. The Settling Parties state that, until the implementation of MRTU, the cost allocation methodologies proposed under RCST are appropriate and consistent with current cost allocation structures. Under the RCST, procurement costs incurred for meeting resource adequacy requirements are allocated to deficient LSEs. Costs incurred under the must-offer obligation are allocated in accordance with the final Commission decision in the Amendment No. 60 proceeding. All other costs are allocated either by existing methodologies or by each LSE's load ratio share as defined in its respective resource adequacy program.

### **RCST Designations Due To Deficient Resource Adequacy LSEs**

102. The Settling Parties submit that the proposed allocation of system RCST costs is just and reasonable for several reasons. First, the causal relationship is clear and unambiguous. Second, the allocation will provide an incentive for LSEs to comply with resource adequacy requirements.<sup>54</sup> Finally, the allocation is consistent with the duties and responsibilities imposed by the CAISO's IRRP, which coordinates California's resource adequacy requirements with CAISO operations.

103. The Settling Parties state that because the CAISO has determined that there would be no local RCST designations for 2006, issues concerning the allocation of 2006 local RCST costs are moot. Additionally, the Offer of Settlement does not propose an allocation of costs incurred for local RCST designations in 2007. Rather, it reserves the issue for a subsequent filing by the CAISO.

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<sup>54</sup> LSEs can avoid these costs by ensuring that they are not deficient.

### **Must-Offer Obligation**

104. The RCST proposes that must-offer capacity payments be allocated in accordance with the Commission's decision regarding Amendment No. 60<sup>55</sup> to the CAISO Tariff. The RCST does not change the nature of the services provided by units under the must-offer obligation, nor does it change the criteria regarding the denial of must offer waivers, other than to require that the CAISO first use RMR, resource adequacy and RCST units, before denying the waiver request. The Settling Parties argue that the allocation of must-offer capacity costs should be consistent with the Commission's determination concerning cost allocation in Amendment No. 60, because the same reliability dispatch decisions that give rise to the incurrence of the costs addressed in the Amendment No. 60 proceeding also give rise to the incurrence of must offer capacity costs.

### **Significant Event Designations**

105. The Settling Parties state that unlike system and local RCST costs, significant event designations cannot be attributed to the failure of a particular LSE's resource adequacy requirements. The Settling Parties state that significant events result in a material difference in CAISO grid operations from the assumptions used in developing reliability requirements – for example, a transmission outage. According to the Settling Parties, because the nature of such events can vary significantly, it is difficult to fashion an allocation that ensures that the costs are allocated to the proximate cause of the event. Instead, the RCST allocates the costs to loads that will derive a significant benefit from the RCST designations.

106. The Settling Parties have proposed that, for 2006, the costs of any significant event designation be allocated to LSEs in the transmission zone where the significant event occurred and be based on each LSE's load ratio share percentage. The Settling Parties state that this allocation is similar in many ways to the allocation of the costs of RMR units. The difference between RMR costs and significant event costs is that existing transmission contract customers do not pay RMR costs.

107. According to the Settling Parties, the question, therefore, is whether the services provided through significant event designations are the same services that are provided under existing transmission contracts. The Settling Parties submit

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<sup>55</sup> The CAISO filed Amendment No. 60 to modify the allocation of must-offer costs relating to minimum load cost compensation.

that they are not. The Settling Parties state that significant event designations address only new, unplanned needs that are outside the normal and expected course of events and that such designations are made only after RMR contracts have been negotiated.

108. Lastly, the Settling Parties note that the methodology for allocating the costs of significant events in 2007 will be included in a subsequent filing.

### **FMU Bid Adder**

109. The RCST provides that the FMU bid adder costs are allocated in accordance with Section 27.1.3 of the CAISO Tariff. Under Section 27.1.3, costs of intra-zonal congestion management are allocated to Scheduling Coordinators within the zone with intra-zonal congestion, and scheduled exports from the zone with intra-zonal congestion.

110. The RCST does not change how the CAISO manages intra-zonal congestion. Rather, it potentially modifies the compensation for a unit that is dispatched out of sequence to relieve intra-zonal congestion and that has its energy offer mitigated. Therefore, the Settling Parties submit that the bid adder should be allocated in the same manner as the associated, underlying bid costs that are incurred by the CAISO in the management of intra-zonal congestion.

#### **a. General Cost Allocation Issues**

### **Comments**

111. CMUA and Six Cities argue that the cost allocation proposed in the RCST will result in similarly situated LSEs being exposed to different costs. For example, Six Cities asserts that if an LSE is short of system resources<sup>56</sup> for one month, the LSE may be required to pay the costs associated with the designation of a RCST unit for a three-month period.

112. CMUA adds that the cost allocation proposed is not sufficiently linked to the underlying unit commitment decisions of the CAISO. Six Cities states that without a cost/benefit analysis, the Commission cannot conclude that the RCST settlement is just and reasonable. Six Cities contends that the RMR process is the most appropriate response to the issues raised by the Complaint.

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<sup>56</sup> System resources are resources located outside the CAISO control area.

113. Six Cities asserts that the method for allocating costs at issue in the Amendment No. 60 case is tied to daily commitment costs, and that the monthly capacity payment cap under the RCST is ill-suited to the Amendment No. 60 allocation methodology. Six Cities argues that a just and reasonable approach would be to allocate the costs associated with the must-offer obligation over the entire month.

114. Six Cities asserts that the Commission should require the CAISO to provide additional data documenting the reasons for dispatching units under the must-offer obligation before approving any allocation methodology for RCST costs. Given the CAISO's representation that LSEs have procured resources sufficient to meet their resource adequacy requirements, Six Cities submits that the reason why so many are being dispatched under the must offer obligation is unclear.

115. State Water Project asserts that the Settling Parties' Response provides no information as to how the over \$21 million in estimated capacity costs apparently incurred in June through August would be allocated under the RCST. Additionally, State Water Project argues that the responses offer no specifics as to the actual causes underlying incurrence of these costs. State Water Project argues that to the extent that costs are developed and paid recognizing this fact, so too should they be allocated to the loads in those urban areas and not to loads outside of those areas.

116. SVP points out that the RCST lacks an allocation methodology for local and significant event RCST costs in 2007, and asserts that the Commission must, at a minimum, reject the aspects of the proposal that create costs without an allocation method.

### **Reply Comments**

117. In response to the Six Cities' contention that the 2006 allocation of system RCST costs improperly requires an LSE that is deficient for one month to bear the costs of deficiencies for the three-month period of an RCST designation, the CAISO states that this argument fails to take into account the fact that the LSE will receive a three-month credit for the RCST designation in determining its monthly deficiency.

118. In response to Six Cities' assertion that must-offer capacity costs be allocated over the entire month, the CAISO submits that the proposed allocation is just and reasonable and that the proposal under the Offer of Settlement is more administratively straightforward and less burdensome than the methodology proposed by Six Cities.

119. In response to Six Cities' contention that the Commission should require the CAISO to provide data documenting the reasons for must-offer waiver denials prior to approving any allocation methodology, the CAISO states that one of the benefits of the Offer of Settlement is the increased reporting requirements imposed on the CAISO and the increased transparency that will result.

120. The CAISO, in response to State Water Project's assertion regarding the \$21 million in must-offer capacity costs, states that the allocation methodology is clearly set forth. The CAISO states that if the Commission makes the Offer of Settlement effective June 1, 2006, must-offer capacity costs will be allocated in accordance with the decision regarding minimum load cost in the proceedings on Amendment No. 60.

121. Regarding the allocation of 2007 costs, the CAISO asserts that the Commission often approves costs as being just and reasonable without simultaneously approving the allocation. The CAISO argues that the justness or reasonableness of the costs to be paid suppliers for the reliability services they provide is not dictated by the allocation methodology that is ultimately approved, and vice-versa.

### **Commission Determination**

122. We find that the RCST proposal meets the reliability needs of the CAISO while ensuring that all generators providing reliability services will be appropriately compensated and will remain available for dispatch by the CAISO. As discussed further below, we find that the cost allocation proposed by the Settling Parties reasonably reflects cost causation by assigning costs to the entities that benefit from reliability commitment decisions made by the CAISO.

123. We disagree with commenters that argue that additional RMR contracts should be negotiated instead of implementing RCST. As previously discussed by the Commission, RMR contracts may not provide the correct price signals for new investment.<sup>57</sup> The RCST coupled with the implementation of resource adequacy programs will ensure adequate compensation to the generators that are providing reliability services and is consistent with current market design initiatives.

124. We disagree with Six Cities that more data is necessary to determine whether the cost allocation methodologies associated with must-offer capacity

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<sup>57</sup> See *California Independent System Operator Corporation*, 112 FERC ¶ 61,013 (2005).

payments are just and reasonable. In this proceeding, we do not need additional information to determine that the reasons for the incurrence of these costs are just and reasonable. However, in general, we agree with Six Cities that the CAISO's reasons for dispatching units for reliability purposes should be made as transparent as practically possible. We note that the RCST includes reporting requirements that should improve transparency, and we accept the CAISO assertion that the reason for any significant event designation will be fully explained.

125. As explained by the Settling Parties, the must-offer capacity costs provided for under RCST are not intended to compensate units for a new service, but instead, are intended to provide a compensatory payment to units providing reliability services that are operating without a capacity contract. The nature of this reliability service is unchanged by the RCST. We find the proposal to allocate must-offer capacity costs consistent with the allocation of minimum load costs, and, in accordance with the Amendment No. 60 proceeding, is just and reasonable, because the must-offer capacity costs are incurred for the same reasons as minimum load costs. Therefore, we find that the RCST capacity costs incurred for the dispatch of units under the must-offer obligation should be allocated in accordance with the Commission's determination in the Amendment No. 60 proceeding.

126. We disagree with State Water Project that the RCST is ambiguous regarding the allocation of must-offer capacity costs. We also accept the Settling Parties' proposal to re-file a cost allocation methodology for 2007 local RCST and significant event costs upon completion of the appropriate stakeholder processes but not later than 60 days prior to the effective date.

**b. Coincident Peak/Resource Adequacy Entity**

**Comments**

127. State Water Project alleges that the proposal to socialize must-offer capacity costs across all hours is not just and reasonable because fact, precedent, and policy support a coincident peak cost allocation. State Water Project argues that the Commission should support demand response by ordering a coincident peak allocation method for all RCST costs, including but not limited to must-offer capacity costs. State Water Project adds that if the record is sufficient to support a new charge to compensate peaking capacity, so too is the record sufficient to support a determination that the cost allocation to demand response that provides the same on peak capacity is insufficient.

128. State Water Project states that the Settling Parties' Response failed to address State Water Project's arguments and evidence concerning the

impossibility of State Water Project being an LSE. State Water Project does not serve retail load, and State Water Project asserts that an LSE, by definition, must serve retail load. Accordingly, State Water Project submits that it should be removed from the list of LSEs receiving an allocation of resource adequacy costs.

### **Reply Comments**

129. In response to State Water Project's argument that the RCST does not use a coincident peak methodology for cost allocation, the CAISO states that this is not correct. The CAISO points out that the LSE's load share percentage is based on coincident peak loads.

130. Despite the inclusion of State Water Project among LSEs, the CAISO states that State Water Project will not have any allocation of RCST costs. Additionally, the CAISO asserts that State Water Project's inclusion as an LSE will be determined by the outcome of its rehearing request in Docket No. ER06-723-000.

131. Additionally, the Settling Parties state that State Water Project shall be required to develop, in conjunction with the CAISO, a program that ensures that it will not unduly rely on the local resource procurement practices of CPUC-jurisdictional LSEs and non-CPUC-jurisdictional LSEs.

### **Commission Determination**

132. Under the RCST, the costs associated with local resource designations due to a significant event will be allocated based on each LSE's load share percentage. The load share percentage is based on the ratio between the LSE's coincident peak load and the total coincident peak load of all LSEs. We find that the RCST's use of a coincident peak cost allocation methodology is just and reasonable. Lastly, as to whether State Water Project is an LSE, the Commission has found that State Water Project is an LSE for resource adequacy purposes.<sup>58</sup>

#### **c. Designation issues**

##### **Comments**

133. Six Cities states that there is no justification for a term of a RCST designation beyond one month. Six Cities argues that an LSE that is short of its

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<sup>58</sup> See *California Independent System Operator Corporation*, 118 FERC ¶ 61,045 at P 24 (2007); see also *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 at P 1138 (2006).

local resource adequacy requirement for the peak month may be compelled to pay RCST costs for an entire year, and an LSE that is short of its system resource adequacy requirements for one month may be compelled to pay RCST costs for three months or more.

134. Powerex argues that the RCST is vague and potentially discriminatory with respect to system RCST designations. Powerex asserts that the timing and term of local RCST designations will interfere with the LSEs' system resource adequacy procurement process. Additionally, Powerex submits that system RCST designations should be performed before local RCST designations in order to ensure that eligible system suppliers are not prematurely ruled out.

135. Because of its generating portfolio, almost all of which is long term in nature, NCPA argues that it would have to make long-term adjustments to its power supply program to comply for the period between the proposed effective date and the end of 2007, or pay large amounts of money for a result that would do no one, including the CAISO, any good.

### **Reply Comments**

136. The CAISO asserts that Six Cities is confusing RCST designation issues with allocation issues in arguing for shorter-term designations. The CAISO submits that the RCST designation period takes into account both the duration of the CAISO's reliability needs, the generators' need for revenue stability, and administrative efficiency (*i.e.*, not having to make designation decisions each and every month). The CAISO asserts that a reasonable RCST designation period reduces the likelihood that marginal but needed generating units will be mothballed or shut down and unavailable when needed.

137. The CAISO disagrees that the RCST is not clear regarding the determination of system RCST requirements. The CAISO states that it can only designate system RCST to meet month-ahead and year-ahead system resource adequacy deficiencies.

138. Additionally, the CAISO argues that Powerex's claim that the RCST discriminates against system resources is without merit. The CAISO asserts that the RCST's requirement that the CAISO make system designations by assessing the costs and benefits of such designations to total grid reliability based on the unit's effectiveness at resolving local and zonal constraints and the overall cost of the designation is intended to provide for the maintenance of reliability at the lowest cost.

139. The CAISO states that the RCST simply directs the CAISO to consider factors that can prevent unnecessary costs or duplicative designations. The CAISO points out that if it can designate a RCST unit to meet a system deficiency that also can satisfy any zonal or potential local needs, the CAISO will reduce the aggregate cost of the program by reducing the potential for must-offer waiver costs and significant event designations. The CAISO points out that system resources can compete fairly with other resources and that there can be no discrimination when the decision is made according to overall costs and benefits.

### **Commission Determination**

140. We find that the term of RCST designations as proposed in the RCST strikes a reasonable balance between providing generators with stable capacity payments and meeting the reliability needs of the CAISO grid. For system designations and local designations in 2007, the term of the capacity payment will be determined in part by the resource adequacy requirements established by the CPUC and other Local Regulatory Authorities. Regarding capacity payments under the must-offer obligation and FMU bid adder provisions, we find that the term of the capacity payment is consistent with the duration of the reliability need of the CAISO.

141. Additionally, we disagree that the proposal to procure RCST capacity to meet system resource adequacy requirements is vague. The RCST requires the CAISO to procure RCST for system needs only to extent that an LSE has not met its resource adequacy requirements.

142. Further, we find that the RCST does not unduly discriminate against system resources. The CAISO has a responsibility to consider the overall reliability benefit of making a RCST designation. The benefit of making a system-wide RCST designation may include reducing the potential of having to later procure local resources to meet an unexpected system event.

#### **d. Allocation to Existing Contract Customers/Exports and Wheel-Throughs**

### **Comments**

143. Modesto asserts that the Commission should deny any requests to pass-through the cost of significant event designations to existing transmission contract customers. Modesto notes that the Commission's decisions on whether to permit the pass-through of CAISO market costs to existing transmission contract customers have often been based on fact-intensive inquiries. Modesto argues that this analysis cannot be conducted based on the record here.

144. State Water Project states that no RCST costs, including must-offer capacity costs and significant event designation costs, should be allocated to existing transmission contract customers. State Water Project asserts that reliability services must be presumed to be included in the firm transmission service provided in the contracts and additional reliability costs cannot be imposed absent contract modification.

145. SMUD argues that the RCST is unjust, unreasonable, and unduly discriminatory to the extent that it seeks to allocate costs of the resource adequacy-related capacity needs of CAISO control area to California LSEs located outside of the CAISO control area. Additionally, SMUD argues that the resource adequacy-related capacity payments allocated to in-state exports are particularly unreasonable and objectionable when applied to wheel-throughs. SMUD points out that its wheel-through over the CAISO controlled grid is simultaneous, matching import and export transactions.

146. Modesto protests the allocation of minimum load costs associated with the must-offer obligation to exports and wheel-through transactions. Modesto submits that the responsibility for ensuring the reliability of load outside of the CAISO control area lies with those control area operators and those entities serving load outside the CAISO control area. Modesto argues that entities outside the CAISO control area do not create the need for such costs, and the pass-through is not commensurate with the principles of cost causation.

147. SVP disagrees with the Settling Parties' claim that significant event RCST is a new service because it addresses sudden unplanned needs for capacity. SVP submits that unplanned needs for capacity have occurred as long as there have been transmission and generation systems.

### **Reply Comments**

148. The CAISO asserts that the determinative question regarding the ability to charge existing transmission contract customers for reliability costs is whether the services provided are the same services that are provided under the existing transmission contract.

149. The CAISO explains that there are two types of charges that apply to load served by existing transmission contracts under the RCST. The CAISO states that the first type is charges for significant event designations, which provide a back-up service that was not available under existing transmission contracts. Prior to the formation of the CAISO, the CAISO argues that utilities would plan their capacity needs, and that utilities had no obligation to provide for transmission capacity that might be needed to address a change in grid operations that was not

anticipated in those criteria. However, if such an event occurred, and the necessary capacity was not available, the CAISO explains that the firm existing transmission contract schedules would be subject to curtailment.

150. In contrast, the CAISO explains that the authority to make significant event designations allows the CAISO to draw upon all uncommitted capacity. Thus, the CAISO states that it can immediately ensure the commitment of the necessary capacity to address the problem until the underlying cause is resolved. The CAISO concludes that this ability to create such back-up capacity is solely the product of the integration of market and reliability functions under the CAISO, and is thus a new service appropriately charged to load served by existing transmission contracts.

151. The CAISO states that the second type of charge, must-offer capacity payments for must-offer waiver denials, performs the same sort of back-up function as significant event designations. Under the RCST, the CAISO states that the outcome of the Amendment No. 60 proceeding will control allocation of the must-offer capacity payments. The CAISO asserts that the exact same decision that gives rise to the incurrence of minimum load costs will give rise to the incurrence of a daily must offer capacity payment.

152. In response to Modesto's concerns, the CAISO states that the issue of allocating costs to exports and wheel-throughs is before the Commission in the Amendment No. 60 proceeding in Docket No. ER04-835-000, and argues that it need not be addressed in this proceeding.

### **Commission Determination**

153. We agree with the Settling Parties that the significant event RCST designation costs are incurred as part of providing a new reliability service. As explained by the CAISO, in the unlikely event of an unanticipated change in system conditions that warrants the designation of additional capacity, the CAISO's ability to dispatch units under the significant event provision may permit uninterrupted service to existing transmission contract customers that historically may have been curtailed. Also, we note that significant event designations will occur because of an unpredictable event, and therefore, it is unrealistic to expect resource adequacy requirements, which are based on expectations of system conditions, to be sufficient to address unforeseen reliability needs. Therefore, because the costs of significant event designations represent payment for a new service that will benefit existing transmission contract customers as well as other load alike, we find the Settling Parties' proposal to allocate these costs to existing transmission contract customers to be just and reasonable.

154. Regarding the allocation of RCST costs to exports and wheel-throughs, we again find that the issue of whether must-offer capacity costs are allocated to exports and wheel-throughs is a matter that was determined in the Amendment No. 60 proceeding where a full evidentiary record has been developed.<sup>59</sup> As previously stated, we find that it is just and reasonable to allocate the capacity costs associated with units being dispatched under the must-offer obligation in the same manner as the commitment costs incurred under the must-offer obligation. Therefore, we approve of the Setting Parties' proposal to allocate such costs in accordance with the Amendment No. 60 proceeding.

e. **Metered Sub-System Cost Allocation**

**Comments**

155. SVP asserts that the Commission should require any allocation mechanism included in a compliance filing in this proceeding to exclude Metered Sub-Systems (MSSs) from allocation of RCST costs. Because of their unique obligations to meet load or face severe financial penalties, summarized below, SVP argues that MSSs are operating under a higher standard of reliability requirements than non-MSS LSEs. Because they have greater incentives to maintain reliability, or pay a heavy price for reliability services if they are purchased, SVP argues that MSSs do not receive the same benefits of RCST services as other LSEs may receive. SVP argues that the imposition of RCST costs on top of the MSS agreement's penalty and payment provisions would constitute a double charge for any reliability costs.

**Reply Comments**

156. To the extent that SVP is concerned with the costs of local RCST designations, the CAISO explains that SVP's concern has been rendered moot because, as discussed previously, there will be no local RCST for 2006. With regard to system RCST designations, the CAISO states that as long as SVP contributes to reliability by complying with any resource adequacy requirements established by its own Local Regulatory Authority, it will not be subject to any costs for RCST.

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<sup>59</sup> The Commission issued an order in this proceeding on December 27, 2006. See *California Independent System Operator Corporation*, 117 FERC ¶ 61, 348 (2006).

157. The CAISO adds that neither the Offer of Settlement nor the IRRP Tariff proposes to modify the responsibility of MSSs for minimum load costs, emissions costs, and start-up costs.

### **Commission Determination**

158. The RCST alters neither the contractual terms of MSS agreements nor the financial penalties under MSS agreements associated with scheduling deviations during real-time operations. These financial penalties stem from the costs that the system may incur because of scheduling deviations. In contrast, the RCST governs the rules by which the CAISO can designate backstop capacity, the price paid for backstop capacity, and the methodologies used to allocate the costs incurred for purchasing backstop capacity. These costs are incurred to help ensure reliability and to improve the CAISO's ability to respond to unforeseen changes in system conditions. All customers, including MSSs, benefit from the reliable operation of the grid, and therefore it is reasonable and appropriate that every customer receive an allocation of backstop procurement costs incurred to maintain that reliability. As a general matter,<sup>60</sup> we reject the assertion that the costs associated with the procurement of backstop capacity should not be allocated to MSSs, and we disagree with SVP that RCST capacity costs are a duplicative reliability cost.

#### **f. Capacity Credit**

##### **Comments**

159. The CMUA claims that considerable confusion remains on how RMR capacity owned by CMUA members will be counted toward capacity requirements, in particular when the RMR contracts do not fully recover the fixed costs of the units. NCPA is concerned that its RMR units, which are used to meet NCPA's load, will be allocated to PG&E. NCPA adds that the CPUC, the CAISO and others have not even discussed this issue with NCPA, nor sought to amend the RMR contracts.

160. Alliance argues that the RCST does not provide CPUC-jurisdictional LSEs with the ability to count the RCST capacity against their CPUC resource adequacy requirements. Alliance asserts that this failure puts energy service providers in the position of having to pay for RCST capacity to meet a CAISO reliability need and

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<sup>60</sup> See *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 at P 1197 (2006).

having to buy additional, perhaps duplicative, capacity to meet their CPUC resource adequacy requirements. NCPA argues that an LSE should be permitted to meet its adequacy requirement with out of state generating resources coupled with firm transmission rights.

### **Reply Comments**

161. Regarding duplicative procurement, the CAISO responds that it will only designate system RCST after a review of the year-ahead and month-ahead demonstrations, so LSEs can avoid duplicative procurement simply by fulfilling their resource adequacy requirements. Additionally, the decision whether to allow deficient LSEs to “lean on” the CAISO rather than fulfill their requirement in subsequent month-ahead demonstrations should be with the CPUC.

162. In response to NCPA, the CAISO states that because there will not be any 2006 local RCST designations, NCPA’s arguments and concerns regarding the criteria used in the 2006 LARN Study and the crediting of NCPA’s RMR capacity against the local area requirements of the entities who were actually paying the RMR rates for such capacity were mooted.

163. The CAISO explains that, under the Offer of Settlement, it can make local RCST designations for 2007 only if an entity is deficient in meeting local 2007 resource adequacy requirements established by either the CPUC or a Local Regulatory Authority. The CAISO also explains that the RCST does not include RMR crediting provisions or LARN Study provisions. The CAISO further responds that resource adequacy requirements established by the CPUC and other Local Regulatory Authorities will determine the degree to which out-of-state generation can serve resource adequacy requirements.

### **Commission Determination**

164. The decision to allow RCST capacity procured by the CAISO to count towards a CPUC-jurisdictional LSE or non-CPUC-jurisdictional LSE resource adequacy requirement should be determined by the CPUC or Local Regulatory Authority. Additionally, we note that if resource adequacy requirements are met by the CPUC-jurisdictional or non-CPUC-jurisdictional LSE, there will be no potential for duplicative RCST charges.

165. Regarding external resources, we agree with the CAISO that the CPUC or Local Regulatory Authority should establish the degree to which external resources with firm transmission satisfy resource adequacy requirements.

166. As previously discussed, there will not be any local RCST procurement in 2006. Further, as the CAISO explains, the RCST does not include RMR credit provisions or LARN Study provisions. Therefore, NCPA's arguments regarding RMR units being inappropriately credited to PG&E are moot.

**3. Frequently Mitigated Bid Adder, Automatic Mitigation Procedures, and Ancillary Service Bids**

167. The July 20 Order also required the Settling Parties' to fully explain and document how the following provisions of the Offer of Settlement are necessary to ensure just and reasonable compensation to generators under the must-offer obligation: (1) frequently mitigated bid adders (2) automatic mitigation procedures, or AMP, and (3) evaluation of ancillary service bids.

**a. FMU Bid Adder**

**Settling Parties' Response**

168. The Offer of Settlement includes a \$40 adder for units that are not receiving capacity payments through RCST, the must-offer obligation, RMR or resource adequacy contracts, and that have had their incremental bids mitigated for local constraints more than four times in one day (FMU Bid Adder). The Settling Parties explain that the bid adder is a surrogate for a must-offer capacity payment, RMR contract, or RCST capacity payment for that portion of capacity which is needed for reliability on a given day but is not under contract.

169. The Settling Parties claim that the FMU bid adder assists in making it economically viable for units to remain in operation until they are no longer needed for reliability or obtain a resource adequacy contract for their full capacity. The Settling Parties state the bid adder recognizes that when such units are taken out of merit order and mitigated under the CAISO's local market power mitigation measures, it is appropriate for such units to receive a payment in lieu of the capacity payments made for RCST and must offer waiver denials.

170. The Settling Parties allege that the FMU bid adder is reasonable because: (1) the adder cannot exceed the daily must-offer capacity payment for any day; (2) the adder will stop accruing once payments exceed the level of the maximum monthly RCST payment; and (3) the adder plus the mitigated price cannot exceed a resource's supplemental energy bid. In further support, the Settling Parties add that this type of bid adder is found in other ISO/RTOs.

### **Comments**

171. The CEOB argues that there is no economic justification for the FMU bid adder and that it undercuts the goal of achieving a competitive market outcome. With the FMU bid adder, the CEOB points out that a generator can be routinely mitigated while receiving payments up to the unit's bid price. The CEOB argues that the provision effectively circumvents the purpose of the entire mitigation process. Additionally, the CEOB asserts that the FMU bid adder distorts the market by adjusting upward the real-time market clearing price by the amount of the bid adder. Lastly, the CEOB also argues that the proposed Offer of Settlement's treatment of the FMU bid adder is very different from the MRTU version and more costly.

172. Six Cities asserts that the definition of "frequently mitigated" in the Offer of Settlement is inconsistent with any normal understanding of the term "frequent." Six Cities calculates that a generator would be eligible for the FMU Bid adder if its bids were mitigated during four out of two hundred eighty-eight intervals in a trading day, or 1.4 percent of the time. Additionally, the Six Cities argues that there is no supporting explanation for the magnitude of the adder. The likely effect of this element of the Offer of Settlement is to encourage inflated bidding by any resources that are eligible for the adder. Six Cities asserts that the FMU bid adder is unsupported and is likely to result in unduly high compensation to generators.

### **Reply Comments**

173. The CAISO states that the FMU bid adder addresses revenue adequacy issues for units that are subject to the must-offer obligation and which are taken out of merit order because the CAISO needs them for reliability purposes. The CAISO states that the frequently mitigated bid adder is essentially a substitute for an RMR contract. IEP and the CAISO explain that the frequently mitigated bid adder pays a generator for the portion of capacity that is needed for reliability purposes that receives no compensation under an RMR contract, as an RCST capacity payment, or as a must-offer capacity payment. IEP and the CAISO note that these units are not fully contracted under the resource adequacy program and are not eligible to receive a must-offer capacity payment. Because such units are needed for reliability purposes, IEP argues that an additional payment is justified to ensure that they remain available.

174. The CAISO replies that the FMU bid adder will only be paid to the specific unit that is dispatched out of sequence for reliability reasons. The CAISO explains that because units that are called out-of-sequence to alleviate a local problem are

not eligible to set the market clearing price, the payment of a FMU bid adder will not raise the market clearing price by the amount of the bid adder.

175. Based on actual experience since June 1, 2006, the CAISO predicts that the impact of the FMU bid adder will be negligible, and notes that the Commission has previously approved a FMU bid adder mechanism for PJM and, more recently, for the CAISO as part of its conditional acceptance of the MRTU Tariff. Moreover, the CAISO states the price paid to a frequently mitigated unit can never exceed its bid price.

### **Commission Determination**

176. We agree with the Settling Parties that it is reasonable to compensate units that have had their supplemental incremental bids mitigated for local constraints and that are not receiving other capacity payments (through RCST, must offer, RMR or resource adequacy). As explained by the Settling Parties, the units that would receive compensation under the FMU bid adder provision are providing similar reliability services as other units that are operating under a capacity contract. Therefore, it is reasonable to compensate these units in a similar manner.

177. The compensation provided for under the FMU provision is consistent with other capacity payments established under the RCST. As explained by the Settling Parties, the FMU bid adders will stop accruing in any calendar month once the combined value reaches the level of the monthly RCST capacity payment. Also, we find that the application of the FMU bid adder will be limited because units that are contracted for capacity will not receive the bid adder payment. Additionally, we note that the bid adder is unit specific compensation and, unlike the bid adder that will be implemented under MRTU, will not impact energy market clearing prices.

178. Therefore, we find the FMU bid adder to be a just and reasonable mechanism to provide a capacity payment to resources providing reliability services and not operating under a capacity contract and not eligible to be designated under RCST, commensurate with the reliability services they provide.

### **b. RMR Condition 2 Bid Process**

#### **Settling Parties' Response**

179. The Offer of Settlement proposes to clear the ancillary services markets using market-based offers before using condition 2 RMR ancillary services bids. The Settling Parties state that this provision results in just and reasonable market-based prices for ancillary services without any impact on current condition 2 RMR

agreements. The Settling Parties assert that condition 2 RMR contracts make cost-based ancillary services bids available to the CAISO that may affect the overall supply curve as well as the market clearing prices for ancillary services.

### **Comments**

180. The CEOB asserts that providing general opportunities to generators to make money is completely outside the scope of the Complaint. The CEOB asserts that forcing the CAISO to wait until there is bid insufficiency before turning to lower cost bids distorts the ancillary services market and imposes potentially large costs on the ratepayers, without an attendant increase in reliability. The CEOB argues that when the current mechanism was put into place, it was clearly understood that cost-based condition 2 bids would tend to be higher than competitively priced market bids, but that having all bids in merit order was an important mitigation against the submission of market bids at prices above competitive levels.

181. The CEOB submits that the proposed change is only of any value to generators if they intend to raise their bids above the previously prevailing levels and that taking lower priced bids before taking higher priced bids defines a competitive market. The CEOB also asserts that the proposed Offer of Settlement discriminates against current RMR condition 2 units and will encourage market manipulation in the quest for maximum profits. Lastly, the CEOB contends that the process proposed by the Settling Parties once was in effect, with minor differences, and that a jump in ancillary services bids occurred as a result of the distorted market rule.

182. NCPA cautions that the Offer of Settlement provision may significantly increase the market clearing price for ancillary services, since the cost-based ancillary services bids from the condition 2 RMR units will not be used in the bid stack, even though the CAISO pays full capacity cost for these units.

### **Reply Comments**

183. The CAISO submits that ancillary services are reliability services; therefore it is appropriate to consider changes to the ancillary services markets as part of the Offer of Settlement that addresses the adequacy of compensation for reliability services being provided in the marketplace. Given that RCST units will have a must-offer obligation to provide ancillary services to the extent capable, the CAISO argues that it is appropriate to address ancillary services compensation issues as part of the Offer of Settlement. The CAISO submits that the proposed treatment of RMR condition 2 bids is an acceptable short-term market design change under the circumstances. The CAISO adds that the proposal is especially

appropriate as an element of a broader, negotiated settlement that had to resolve difficult and contentious compensation issues.

184. The CAISO notes that the proposed treatment of RMR condition 2 cost-based bids will only be in effect until MRTU is implemented. Moreover, the CAISO explains that the only units eligible for this treatment are those RMR units that were condition 2 prior to the filing of the Offer of Settlement. Thus, the CAISO submits that the impact of the proposal will be limited.

185. The CAISO explains that the proposal will allow market-based bids, including market-based bids from units subject to the must-offer obligation and RCST units, to determine ancillary services prices before any cost-based bids are taken. The CAISO asserts that the ancillary services provision is not unreasonable for the interim period until MRTU implementation.

186. In response to the CEOB's concerns about suppliers exercising market power in the ancillary services market, the CAISO submits that the appropriate response should be to propose appropriate mitigation measures to address the situation and take any other appropriate actions.

### **Commission Determination**

187. For the same reasons proffered by commenters, we find the proposal to remove condition 2 RMR units from the ancillary bid stack to be beyond the scope of the Offer of Settlement. Additionally, we do not share the Settling Parties' concern about the potential market problems resulting from the use of condition 2 RMR units to provide ancillary services. The Settling Parties have not provided any supporting evidence or justification for making the CAISO wait until there is bid insufficiency before turning to cost-based condition 2 RMR unit bids. The provision could interfere with the CAISO's ability to procure ancillary services at least cost to the detriment of California electricity customers. Additionally, we find persuasive NCPA's argument that this provision may increase the market clearing price for ancillary services because the cost-based ancillary service bids from condition 2 RMR units will not be used in the bid stack, even though the CAISO pays full capacity cost for these units. Therefore, we find the Settling Parties' proposal to clear the ancillary services markets using market-based offers prior to using condition 2 RMR ancillary service bids to be unwarranted and not justified. Accordingly, the Commission will require the Offer of Settlement to be modified to remove this proposal.

c. **Automatic Mitigation Procedures**

**Settling Parties' Response**

188. The Settling Parties provide additional support for the Offer of Settlement's provision that raises the threshold for the AMP in the CAISO's Tariff to \$200 per MWh. The Settling Parties stress that the existing \$91.87 AMP price screen has been unchanged since the energy crisis era, when it was set to match the bid cap on energy. The Settling Parties state that with the current gas prices expected to be in place when the revised AMP price screen would go into effect in November 2006, a market clearing price of \$91.87 is not by itself necessarily indicative of the exercise of market power and may not itself warrant further AMP testing under circumstances where the resulting clearing price may be consistent with competitive market conditions.<sup>61</sup>

189. The Settling Parties state that although the Commission has previously found that it is inappropriate to lower or eliminate the \$91.87 price screen, the increase in gas prices and the volatility of such prices supports increasing the AMP price screen. Finally, the Settling Parties note that system AMP will be eliminated with the implementation of MRTU. In light of the fact that system AMP has rarely been triggered since its implementation, the increase in the price screen to \$200 represents a reasonable transition during the period preceding the MRTU implementation. The Settling Parties therefore assert that the increase in system AMP compliments this transition and is a reasonable component of the overall settlement package.

**Comments**

190. The CEOB contends that there is no showing that the current trigger for system AMP is unjust and unreasonable, and that raising the threshold for system AMP to \$200/MWh will vitiate this mitigation tool. The CEOB points out that although AMP has rarely been triggered, it still provides a legal and operational basis to correct uncompetitive market outcomes. The CEOB argues that the rise in natural gas prices is not a justification for raising the trigger of system AMP. The CEOB points out that the reference prices used in the AMP are adjusted to reflect

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<sup>61</sup> Settling Parties state that in 2002 when the \$250 bid cap and \$91.87 AMP price screen were imposed, natural gas prices were between \$3 and \$4 per MMBtu. Currently, gas prices reported for September 2006 are \$6.70 per MMBtu and over \$11.00 for January and February 2007. Figures are taken from [www.nymex.com](http://www.nymex.com) on August 16, 2006.

changes in natural gas prices. Therefore, the CEOB concludes that although higher gas prices may lead to higher market price forecasts by the CAISO, which may in turn more frequently trigger the running of the AMP screens, bids will not fail the AMP test more frequently because the price of natural gas today is higher than it was in 2002.

191. The CEOB claims that there has never been excessive mitigation in California, even at today's natural gas prices. Additionally, the CEOB asserts that raising the price screen trigger to \$200 is not a reasonable transition during the period preceding the MRTU implementation, and that raising the system AMP trigger will only guarantee that AMP will never be triggered between this date and the implementation of MRTU. The CEOB adds that leaving California ratepayers without any mechanism to check the exercise of market power cannot be deemed to be a reasonable transition to MRTU.

192. Finally, the CEOB argues that the Commission must be cognizant that system AMP affects all generators, not just those who supply a capacity reservation service, and that to the extent that raising the trigger of system AMP imposes costs on consumers, the benefits will flow to all generators, not just those who provide a capacity reservation service.

193. In contrast, NRG supports measures to address the overly broad mitigation regime that currently exists in the CAISO markets and provide fixed cost recovery to generators. NRG asserts that the Settling Parties cannot claim that the RCST capacity rate is a fully compensatory rate for generators dispatched to support system reliability. Instead, NRG asserts that there is a clear expectation that the energy market will also provide meaningful revenues to generators. In recognition of higher gas costs, NRG argues that the increase in the AMP threshold is appropriate.

194. NRG argues that the CAISO's mitigation regime is overly-broad and operates to suppress prices below competitive levels, resulting in the market sending the wrong price signals to investors and the curtailment of price increases attributable to genuine scarcity. Further, NRG argues that an increase in the AMP trigger is consistent with the Commission's recent ruling in New York rejecting the extension of AMP on a system wide basis in the Real Time Market outside the New York City load pocket, determining that market mitigation suppresses prices in workably competitive markets.

### **Reply Comments**

195. The CAISO argues that retention of the existing \$91.87 price screen could increase the likelihood of unnecessary testing for potential mitigation, something

that the Commission sought to avoid in setting the level of the AMP price screen. IEP submits that the \$91.87 threshold is no longer just and reasonable because it requires the CAISO to conduct unnecessary testing and may lead to unjust and unreasonable over-mitigation.

196. IEP argues that raising the AMP threshold will help to alleviate unnecessary testing by the CAISO and the possibility of unfair excessive mitigation. More importantly, IEP asserts that the Commission has already accepted the CAISO's proposal to eliminate the \$91.87 AMP threshold as part of the MRTU. IEP asserts that increasing the AMP threshold to \$200 in the interim period is a logical step toward eliminating the concept altogether.

### **Commission Determination**

197. We find that the modification of the AMP trigger proposed in the Offer of Settlement is beyond the scope of this proceeding. The primary issue underlying the Complaint was that the Commission-imposed must-offer obligation provided unjust and unreasonable compensation for needed capacity and reliability services. In our July 20 Order, we agreed and found it discriminatory that units under the must-offer obligation would be required to operate for reliability purposes in a manner similar to units contracted for capacity under the resource adequacy program and not receive a similar capacity payment.<sup>62</sup> However, the AMP modification proposed in the Offer of Settlement will affect the revenues of all units alike, whether or not the unit is operating under the must-offer obligation or under a resource adequacy program.

198. Further, the Settling Parties have not provided evidence that unnecessary testing or mitigation has occurred, and they have not sufficiently explained why the proposed AMP modification would serve as a transition to MRTU. By the Settling Parties' own admission, system AMP has rarely been triggered since its implementation. Therefore, we cannot conclude that the AMP modification is necessary to ensure just and reasonable compensation to generators dispatched under the must-offer obligation. Lastly, we note that the implementation of MRTU will include different mitigation measures, and we find that simply modifying the AMP trigger does not necessarily provide an effective transition to MRTU.

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<sup>62</sup> See July 20 Order at P 36.

#### 4. Effective Date

199. NRG asserts that prospective implementation of the Offer of Settlement as of June 1, 2006 would constitute an insufficient remedy, because generators have been systematically denied just and reasonable compensation for the reliability services that they have provided in the past. NRG argues that because the Commission correctly found that compensation to generators under the must-offer obligation is not just and reasonable and established a refund effective date of August 26, 2005, the date IEP filed its initial Complaint, the Commission should accept the Offer of Settlement effective August 15, 2005. According to NRG, this would ensure that generators that were previously denied an opportunity to recover their fixed costs under the must-offer obligation are eligible for some manner of payment for the reliability service they provided, but for which they were not adequately compensated. Six Cities responds that there is no legal foundation for NRG's suggestion that any RCST rate approved by the Commission as a result of this proceeding be implemented retroactively as of August 15, 2005.

#### Commission Determination

200. As an initial matter, the basis for the NRG's selection of the August 15, 2005 date is unclear, since the refund effective date established by the July 20 Order is August 26, 2005, the date IEP filed its Complaint. Assuming that the NRG intended to propose an effective date of August 26, 2005, we decline to accept such a proposal. Rather, we exercise our discretion to fashion an appropriate remedy in this case and will order prospective implementation of the Offer of Settlement, as of June 1, 2006, sixty days after the date the Offer of Settlement was filed. We find the Settling Parties' request to have the Offer of Settlement be made effective June 1, 2006 to be reasonable. This case involves a change in rate design and market rules that, while appropriate on a prospective basis, is inappropriate for retroactive application, given the disruptive effect this remedy would have on the CAISO market.<sup>63</sup>

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<sup>63</sup> See, e.g., *Connecticut Valley Electric Co. v. FERC*, 208 F.3d 1037, 1044 (D.C. Cir. 2000) (noting that the breadth of the Commission's discretion is at its "zenith" when fashioning remedies); *Niagara Mohawk Service Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967) (same).

The Commission orders:

(A) The Commission approves the Offer of Settlement, as modified herein.

(B) The CAISO is directed to file tariff sheets to implement the Offer of Settlement, as modified herein.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.