125 FERC ¶ 61,053
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

California Independent System Operator Corporation Docket Nos. ER08-556-000
ER06-615-020

ORDER ACCEPTING TARIFF FILING SUBJECT TO MODIFICATION

(Issued October 16, 2008)

1. On February 8, 2008, the California Independent System Operator Corporation (CAISO) filed the Interim Capacity Procurement Mechanism (ICPM) pursuant to section 205 of the Federal Power Act (FPA)[1] and part 35 of the Commission's regulations.[2] The purpose of the ICPM is to enable the CAISO to acquire generation capacity to maintain grid reliability if load serving entities (LSEs) fail to meet resource adequacy requirements; procured resource adequacy resources[3] are insufficient; or unexpected conditions create the need for additional capacity. The ICPM is intended to replace the current Transitional Capacity Procurement Mechanism (TCPM) and to be implemented simultaneously with the CAISO's Market Redesign Technology Upgrade (MRTU). For the reasons discussed below, the Commission conditionally accepts the ICPM filing, subject to modification.

[1] 16 U.S.C. § 824(d) (2006).

[2] 18 C.F.R. Part 35 (2008).

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

I. Background

A. RCST

2. On April 26, 2001, the Commission established a prospective mitigation and monitoring plan for the California wholesale electric markets.[4] One of the fundamental elements of the plan was the implementation of a must-offer obligation pursuant to which most resources 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. The must-offer obligation is "designed to prevent withholding and thereby to ensure that the CAISO will be able to call upon available resources in the real-time market to the extent that energy is needed."[5] A generating unit may request a waiver of its must-offer obligation. If the CAISO denies a waiver request (must-offer waiver denial), the resource is required to remain available, i.e., is "committed."

3. On August 26, 2005, Independent Energy Producers Association (IEP) filed a complaint against the CAISO under section 206 of the FPA.[6] The complaint alleged that the Commission-imposed must-offer obligation under the existing CAISO Tariff was flawed and no longer just and reasonable. The complaint also requested that the Commission direct the CAISO to modify the compensation received by resources operating under the must-offer obligation by including an interim set of tariff provisions that would remain in effect until the CAISO's market redesign goes into effect.

4. On March 31, 2006, the Settling Parties[7] filed an Offer of Settlement of the IEP complaint proposing the institution of the Reliability Capacity Service Tariff (RCST). In conjunction with the must-offer obligation, the RCST provided a backstop capacity

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

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

[6] 16 U.S.C. § 824e (2006).

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

procurement mechanism to the CAISO that included provisions establishing the following: (1) a daily must-offer capacity payment rate; (2) an RCST capacity payment that would result from a Significant Event designation; (3) a monthly RCST capacity payment due to a designation resulting from deficiency in resource adequacy demonstrations; and (4) monthly capacity payments to frequently mitigated units. In addition, the RCST established cost allocation methodologies and established the rules by which the CAISO can procure RCST capacity.

5. In the Order on Complaint and Offer of Settlement, the Commission found that, under the then-current market design, the compensation to resources under the must-offer obligation was no longer just and reasonable.[8] However, the Commission was unable to find that the rates and cost allocation mechanism under the contested Offer of Settlement were just and reasonable. Accordingly, the July 20 Order established paper hearing procedures to review evidence on the rates and cost allocation issues presented by the Offer of Settlement.

6. In the Order on Paper Hearing, the Commission approved the Offer of Settlement, with modifications, as just and reasonable.[9] Under the terms of the Offer of Settlement, the RCST would expire on the earlier of December 31, 2007 or MRTU implementation.[10]

7. On December 20, 2007, the Commission instituted a proceeding, in Docket No. EL08-20-000, pursuant to section 206 of the FPA[11] to investigate the justness and reasonableness of extending the RCST until the earlier of the implementation of either MRTU or an alternative interim backstop capacity procurement mechanism.[12] In that order, the Commission recognized the CAISO's commitment to develop an updated backstop capacity procurement mechanism, if MRTU were delayed, and stated that it

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

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

[10] Order on Paper Hearing, 118 FERC ¶ 61,096 at P 13. On June 11, 2007, the Commission denied requests for rehearing of the July 20 Order. *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,266 (2007), *pet. for review pending sub nom., Cities of Anaheim v. FERC*, Case No. 07-1222, *et al.* (D.C. Cir., filed June 20, 2007).

[11] 16 U.S.C. § 824e.

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

"expect[ed] the CAISO to follow through with its commitment to initiate a new stakeholder process and modify the RCST accordingly."[13]

8. Also on December 20, 2007, in the RCST Rehearing Order, the Commission denied requests for rehearing and granted in part and denied in part the requests for clarification arising out of IEP's complaint in Docket No. EL05-146 concerning the must-offer obligation under the CAISO's Tariff.

9. On December 28, 2007, the CAISO filed a motion for clarification of the RCST Extension Order. On February 4, 2008, the Commission granted the CAISO's request and clarified that, among other things: (1) the CAISO properly implemented the RCST Extension Order in its amendment of section 43.3 of the CAISO Tariff; (2) the CAISO should use the 2008 Local Capacity Technical Study to determine if capacity designations are appropriate; and (3) all features of the RCST, including RCST designations, will expire upon the implementation of either MRTU or an alternate backstop procurement program.[14]

10. On March 28, 2008, the CAISO filed an alternate backstop capacity procurement mechanism, the TCPM, to replace the RCST. The TCPM serves as a bridge between the RCST and the ICPM and retains many of the components of the RCST, while adopting some of the changes developed during the ICPM stakeholder process. On May 30, 2008, the Commission issued an order conditionally accepting the TCPM effective June 1, 2008.[15]

B. Exceptional Dispatch

11. On June 27, 2008, the CAISO filed proposed tariff revisions, which provide mitigation measures for the Exceptional Dispatch provisions of the MRTU Tariff.[16] The term "Exceptional Dispatch" refers to an instruction by the CAISO to a specific resource to increase or decrease its energy supply or demand from its day-ahead schedule. Specifically, exceptional dispatches are entered manually by the CAISO, not cleared by the MRTU software, and include instructions for forced start-ups, forced shut-downs,

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[13] *Id.* P 38.

[14] *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 122 FERC ¶ 61,091, at P 9, 10 (2008).

[15] *Cal. Indep. Sys. Operator Corp.*, 123 FERC ¶ 61,229, at P 1 (2008) (TCPM Order).

[16] *See* CAISO June 28, 2008 Transmittal Letter re Proposed Modifications to Exceptional Dispatch Provisions of MRTU Tariff, Docket No. ER08-1178-000.

operation at minimum operating level, and the provision of incremental or decremental energy. As discussed further below, the Exceptional Dispatch provisions and the ICPM are both reliability procurement mechanisms proposed by the CAISO that together will help the CAISO to maintain system reliability.

C. Relevant MRTU Orders

12. The CAISO filed the MRTU Tariff on February 9, 2006, in Docket No. ER06-615-000. On September 21, 2006, the Commission conditionally accepted the filing, subject to modification.[17] On June 25, 2007, the Commission conditionally accepted certain MRTU-related compliance filings made by the CAISO, subject to additional modifications.[18] At the same time, the Commission directed the CAISO to explore with stakeholders opportunities for LSEs to avoid potential CAISO remedial procurement by curing a collective shortfall in local capacity area resource requirements.[19] In a January 9, 2008 order, the Commission conditionally accepted, subject to modification, the proposed MRTU Tariff revisions related to resource adequacy, and deferred resolution of other MRTU compliance issues.[20]

13. On June 19, 2008, the Commission issued an order extending the RCST from January 1, 2008 through May 31, 2008.[21] In this order, the Commission found that the RCST continued to be just and reasonable until June 1, 2008, the date the TCPM became effective. The Order Extending RCST also terminated the Commission's section 206 investigation into the justness and reasonableness of extending the RCST.

II. The ICPM Proposal

14. The ICPM proposal is an interim, tariff-based capacity procurement mechanism designed to supplement or backstop resource adequacy procurement when necessary to maintain reliable grid operations. The ICPM is designed to work under the new MRTU

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

[18] *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,313 (2007), *order on reh'g*, 121 FERC ¶ 61,030 (2007).

[19] *Id.* P 380.

[20] *Cal. Indep. Sys. Operator Corp.*, 122 FERC ¶ 61,017, at P 1 (2008).

[21] *Cal. Indep. Sys. Operator Corp.*, 123 FERC ¶ 61,280 (2008) (Order Extending RCST).

market paradigm, and is similar to pre-MRTU capacity backstop mechanisms (i.e., the RCST and the TCPM). The ICPM creates the framework under which the CAISO is permitted to make capacity designations and establishes the price for procuring backstop capacity services, as well as the method for allocating the costs incurred. However, unlike the pre-MRTU capacity backstop mechanisms, the ICPM is voluntary.

15. Under the ICPM proposal, the CAISO would be permitted to designate capacity resources in order to maintain reliable grid operation if either: (1) an LSE has not procured the full amount of its local or system-wide resource adequacy requirements, when the portfolio of resources procured by all LSEs in an area is insufficient to meet the reliability criteria for the area (Tier 1 ICPM designation); or (2) if an ICPM Significant Event[22] occurs that creates a need to supplement resource adequacy resources (Tier 2 ICPM designation). ICPM designations are made for a minimum term of one-month and require the designated resource to offer its designated capacity into the MRTU markets for the period of designation. In exchange for these services, resources procured under the ICPM receive a capacity payment of $41/kW-year, unless they are able to cost justify a higher price.

III. Notice, Intervention, and Responsive Pleadings

16. Notice of the proposed amendments was published in the *Federal Register*, 73 Fed. Reg. 10,019 (2008), with motions to intervene, comments, and protests due on or before February 29, 2008. Timely motions to intervene, comments, and/or protests were filed by the following entities: (1) Western Area Power Administration (Western); (2) PG&E; (3) Department of Water Resources State Water Project (SWP); (4) California Municipal Utilities Association (CMUA); (5) IEP; (6) Northern California Power Agency (NCPA); (7) City of Santa Clara, California and the M-S-R Public Power Agency (Santa Clara); (8) The Utility Reform Network (TURN); (9) Alliance for Retail Energy Markets (AReM); (10) SoCal Edison; (11) Calpine Corporation (Calpine); (12) CPUC; (13) Dynegy Moss Landing, LLC and Dynegy Morro Bay LLC, El Segundo Power, LLC, and Reliant Energy, Inc. (California Generators); (14) Metropolitan Water District of Southern California (Metropolitan); (15) Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (Six Cities); (16) Modesto Irrigation District; (17) NRG Power Marketing, Inc., Cabrillo Power I LLC, Cabrillo Power II LLC and Long

[22] ICPM Significant Events are defined as "a substantial event, or combination of events, that is determined by the CAISO to either result in a material difference from what was assumed in the resource adequacy program for purposes of determining the [resource adequacy requirements], or produce a material change in system conditions or in CAISO [controlled grid operations], that causes, or threatens to cause, a failure to meet [reliability criteria] absent the recurring use of [non-resource adequacy resource(s)] on a prospective basis." CAISO February 8, 2008 Transmittal Letter in Docket Nos. ER08-556-000 and ER06-615-020 at 3 (ICPM Transmittal).

Beach Generation LLC; (18) Constellation Energy Resources, LLC, Constellation Energy Commodities Group, Inc., and Constellation New Energy, Inc. (Constellation), and Mirant Energy Trading, Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC (Mirant).[23]

17. The Electric Power Supply Association and the City of Burbank, California and Turlock Irrigation District filed motions for leave to intervene out-of-time. Reply comments and/or answers were filed by the following: (1) NCPA; (2) SoCal Edison; (3) CAISO; and (4) PG&E.

18. Calpine filed a motion to lodge the CAISO's comments and reply comments that were filed before the CPUC on the topic of a centralized capacity market structure. In response, the CPUC filed a motion in opposition and both PG&E and the CAISO filed answers. Calpine then filed an answer in response to the CPUC, PG&E, and the CAISO.

IV. Discussion

A. Procedural Matters

19. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedures, 18 C.F.R § 385.214(d) (2008), the Commission will grant the late filed motions to intervene of the Electric Power Supply Association, the City of Burbank, California, and Turlock Irrigation District, given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

20. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept the answers to protests/comments filed by NCPA, SoCal Edison, CAISO, and PG&E, and will, therefore, reject them.

21. We deny Calpine's motion to lodge pleadings filed in the CPUC's pending proceeding to establish the parameters for the appropriate future resource adequacy structure for utilities under its jurisdiction. We find that the additional information would not assist us in our assessment of the justness and reasonableness of the ICPM. As opponents to the motion point out, the information Calpine seeks to lodge pertains to the mechanism for the "next generation" of resource adequacy, not the ICPM, and is, therefore, beyond the scope of the instant proceeding. We further note that insofar as the

[23] Constellation and Mirant will hereafter be referred to as Constellation/Mirant to reflect their Joint Motion to Intervene, Protest and Comments filed on February 29, 2008.

information that Calpine seeks to lodge is the subject of an on-going CPUC proceeding, the Commission will not rely on or draw any conclusions from this pending state proceeding.

B. Conditional Acceptance

22. The Commission conditionally accepts the CAISO's ICPM proposal. While further refinement of the ICPM is necessary, as discussed below, we find that, in general, the CAISO's proposal establishes a reasonable backstop capacity procurement mechanism for the period starting with MRTU implementation. We discuss below findings and conclusions that primarily address contested aspects of the CAISO's ICPM proposal. Our review of the ICPM proposal and implementing tariff provisions that are not contested and not specifically discussed below indicates that they are just and reasonable, and we hereby accept them.

C. Price

Proposal

23. Under the ICPM, the proposed capacity payment to an ICPM resource is $41/kW-year. The CAISO provides that this number is based on the recovery of the going-forward costs of a new simple cycle 50 MW unit built by a merchant resource, as supported by a California Energy Commission (CEC) study in 2007, plus a 10 percent adder.[24] Unlike pre-MRTU backstop capacity procurement mechanisms, peak energy revenues and ancillary service revenues are not deducted from the $41/kW-year capacity payment.[25] Additionally, resource owners who believe their going-forward costs[26] plus 10 percent exceed $41/kW-year may file at the Commission to cost justify a higher capacity payment, provided that they justify the higher price based on the same going-forward fixed costs elements that underlie the $41/kW-year capacity price.

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[24] The CAISO provides that "A 10 [percent] adder is in-line with adders previously approved by the Commission…." ICPM Transmittal at 4 n.5.

[25] The proposed capacity price is subject to an ICPM availability factor and a level monthly shaping factor.

[26] Going-forward costs are defined for purposes of the CAISO proposal as the sum of fixed operation and maintenance, ad valorem, and administrative and general costs. ICPM Transmittal at 4 n.5. Going-forward costs are generally understood to be the minimum fixed costs that a resource needs to recover in order to remain available for operation and does not include capital and financing costs.

Comments and Protests

1. Support for $41/kW-year Capacity Price

24. SoCal Edison, CMUA, PG&E and Six Cities all support the proposed $41/kW-year capacity price. Specifically, CMUA believes that the Market Surveillance Committee "got it right" when it concluded that the short-term nature of the ICPM is not intended to provide long-term investment price signals for new investment.[27] CMUA elaborates that the ICPM is merely a fail-safe for the existing resource adequacy program and that it is designed to meet short-term and/or unanticipated reliability needs, and not to provide incentives for new investment. Accordingly, CMUA argues that the CAISO has shown the ICPM pricing to be just and reasonable and urges the Commission to accept it.

25. PG&E asserts that the proposed ICPM price represents a compromise that is well within the Commission's zone of reasonableness standard for backstop procurement mechanisms that was applied to the RCST Settlement.[28] Further, PG&E states that the CAISO's ICPM compensation is carefully constructed to have a threshold sufficiently high to encompass nearly all resources, thus not creating an incentive for resources to avoid contracts, while assuring the limited number of resources that may have costs above the threshold that they will receive the compensation they deserve.

2. Opposition to $41/kW-year Capacity Price

26. California Generators, IEP, Constellation/Mirant, and Calpine are all opposed to the proposed capacity price of $41/kW-year. Specifically, California Generators state that the proposed $41/kW-year price is unjust and unreasonable because it abandons the Commission approved approach for determining capacity price targets based on the cost of new entry, and it does not reflect the recent run-up in the costs to maintain or build new capacity. California Generators expound that the Commission found the cost of new entry to be part of a just and reasonable approach in the RCST Settlement and that there is no reason to believe this methodology is unjust and unreasonable.

27. California Generators argue that the cost of new entry has increased from the $88/kW-year price assumed in the RCST Settlement to $205/kW-year. As such, California Generators argue that if the CAISO had proposed an ICPM capacity price in a

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[27] CMUA urges the Commission to adopt the ICPM as a package. CMUA believes that unraveling certain terms, such as pricing, would erode the fairly broad support for the ICPM filing.

[28] PG&E states that the CAISO's ICPM proposal is, with the exception of the voluntary nature of its designations, a reasonable and well-balanced extension of the RCST designed for the MRTU environment.

manner similar to the RCST Settlement, i.e., the same point between the cost of new entry and the fixed costs of existing generation, the proposed capacity price would be $117/kW-year. Accordingly, California Generators recommend that the Commission direct the CAISO to apply the updated data for an applicable proxy unit, with internally consistent operating characteristics, to arrive at an updated capacity price of no less than $117/kW-year.

28. California Generators state that the CAISO supports the $41/kW-year price by referring to the CPUC's finding that the bilateral market for system resource adequacy is generally $15-$25/kW-year, while local resource adequacy contracts are $20-$45/kW-year. California Generators assert that, although the CAISO maintains the $41/kW-year price is in the upper end of the price ranges for resource adequacy capacity, the CAISO neglects to note that LSEs may be excused from having to meet local area requirements if the price offered by prospective resource adequacy resources is higher than $40/kW-year. Thus, California Generators contend that $40/kW-year serves as a de facto cap on the price of resource adequacy capacity.

29. According to California Generators, neither the CPUC nor the CAISO explain that the bilateral market value of resource adequacy capacity is adversely affected by resources that are deemed to provide resource adequacy reliability service. California Generators contend that demand response, imported resource adequacy, and firm liquidated damage contracts drive down the value of identifiable, physical, dispatchable, and available capacity.

30. California Generators state that the reliability service that the CAISO receives from non-resource adequacy units under its ICPM proposal is exactly the same service that is provided by resource adequacy units, and that the Commission has clearly stated that generating resources that provide similar reliability services must be provided a similar payment.[29] However, according to California Generators, the payments provided under the ICPM proposal are in no way similar to the payments provided to resource adequacy units because the resource adequacy capacity is contracted forward and the capacity payments are provided on the basis of projected need. As such, California Generators contend that suppliers of resource adequacy capacity are paid for available capacity whether or not such units are actually dispatched during the resource adequacy delivery period.

31. California Generators assert that if resource adequacy requirements are sufficient, there would be little need for the ICPM. California Generators further argue that if the

[29] California Generators February 29, 2008 Protest, Docket Nos. ER08-556-000 and ER06-615-020, at 13 (quoting July 20 Order, 116 FERC ¶ 61,069 at P 36) (California Generators Comments).

CAISO always has access to inexpensive,[30] short-term reliability insurance through its backstop capacity procurement mechanism, there is no incentive to develop and enforce resource adequacy requirements that provide the CAISO with the capacity it requires to maintain reliability, and no incentive for investors to risk capital in a market whose prices and requirements are undermined by such practices.

32. IEP takes exception to basing the ICPM price on the short-run going-forward costs of a new merchant peaking unit, which IEP asserts does not bear a relationship to the existing resources in California. IEP argues that capacity prices should instead be based on market-based going-forward costs, rather than the going-forward costs of a new merchant peaking unit.[31]

33. IEP alleges that the ICPM will not overcome existing market distortions. Further, IEP explains that current market prices indicate that California's wholesale prices will continue to signal that no new capacity is needed, and that depressed market prices will put retirement pressure on existing units and on producing new capacity.

34. Calpine states that the ICPM and the resource adequacy program fail to compensate capacity on call to the CAISO at levels that reflect the value of reliability services, i.e., the cost of new entry or the full fixed costs of investment. Further, Calpine alleges that the CAISO's proposed formula rate, which is limited to going-forward costs, did not result from a stakeholder consensus, or a methodology based upon evidentiary presentations by stakeholders. Thus, Calpine argues that going-forward fixed costs do not reflect a market price for capacity and, therefore, the compensation formula is unjust and unreasonable. Moreover, Calpine states that the ICPM discriminates among resources that are providing the same capacity-only product, and subjects them to the same availability requirements.

35. According to Calpine, the CAISO has erred in prescribing a formula rate based on going-forward costs, which denies compensation for fixed capital costs or for returns on investment. For this reason, Calpine argues that the Commission should not accept the

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[30] California Generators claim that the CAISO's proposal to acquire Net Qualifying Capacity from non-resource adequacy contracted resources is inexpensive insurance, i.e., inexpensive relative to the cost of new entrant capacity or the value of lost load.

[31] IEP February 29, 2008 Protest, Docket Nos. ER08-556-000 and ER06-615-020, at 12 (IEP Protest). IEP contends that although the realized CAISO wholesale spot market electricity prices have not been at sufficient levels to support investment in new capacity, over 5000 MW have been added between 2004-2007, primarily by the investor owned utilities (IOUs), which must be anticipating or receiving compensation outside of the CAISO's wholesale markets. *Id.* at 4.

ICPM without conducting an evidentiary proceeding that examines the use of installed generation capacity to provide valuable reliability services in California, including in the resource adequacy program.

36. Calpine explains that it proposes the use of a traditional cost-of-service model, as under reliability must-run, for calculating capacity compensation, and that the CAISO should not have rejected its proposal, which does not require a new form of reliability must-run contract. Calpine states that capacity compensation available to existing generation under either resource adequacy or the ICPM will not be adequate to fill the gap of missing money resulting from heavy mitigation in energy markets, and resource adequacy.[32] Calpine does not object to a safe-harbor type compensation rate, if based on full investment costs that would accompany the CAISO's procurement of backstop capacity. However, Calpine contends that the backstop capacity must be accompanied by a cost-of-service election, with owners of installed generation on call to the CAISO for its reliability needs. Calpine explains that the resources that would utilize the cost-of-service election are those that are not recovering their full fixed costs from mitigated energy markets and non-market capacity payments. Accordingly, Calpine asserts that the Commission should direct the CAISO to develop a straw proposal for a uniform set of availability obligations, with performance measures, targets, penalties, and bonuses, which would apply to both CAISO-procured capacity or resource adequacy, or other bilaterally procured capacity.

37. Calpine states that reliability must-run arrangements were instituted as a market mitigation measure for units needed for local reliability; however, the assumption was that non-mitigated units would have a reasonable opportunity to recover their investment costs in the energy markets. Calpine asserts that has proven not to be the case, because all units are effectively limited in their energy revenues as a result of mitigation in those markets. Further, Calpine notes that installed generation may not have a reasonable opportunity to recover the money that results from mitigation. Additionally, Calpine refutes the notion that there is surplus capacity, and therefore, the CAISO can justify paying less than the value of the capacity because there is not a competitive market for capacity.

38. Constellation/Mirant assert that the Commission should recognize the impact that the ICPM price will have on California's resource adequacy capacity markets. Constellation/Mirant disagree with the CAISO's assertion that the interim nature of the ICPM is a reason to support a non-market based pricing mechanism that does not accurately reflect replacement costs. Accordingly, Constellation/Mirant argue that allowing the CAISO to procure capacity resources, even for an interim period, without sufficient regard to market-based approaches, will be detrimental to the success of those

[32] Calpine February 29, 2008 Protest, Docket Nos. ER08-556-000 and ER06-615-020, at 11.

markets. Further, Constellation/Mirant explain that suppliers view the ICPM price as establishing a cap on market transactions, and load representatives view the ICPM price as establishing a price floor.

39. With regard to the CAISO's statement that it intends to procure a capacity-only product that has the same obligation to offer into the energy markets as resource adequacy resources, Constellation/Mirant assert that the pricing of a uniform capacity product will clear at the price of the marginal resource, whether it is procured bilaterally or through a centralized clearing capacity market structure. In areas where the supply is at or close to equilibrium, the price will be at or close to the cost of new entry because the marginal resource is a new unit. Accordingly, Constellation/Mirant submit that these same pricing realities should apply to the CAISO's capacity procurement.

40. Constellation/Mirant argue that the ICPM price represents the price that will be paid if the resource is not procured bilaterally, setting a target for bilateral transactions, and thus impacting forward prices. Constellation/Mirant request that the Commission direct the CAISO to implement pricing for its Tier 1 procurement that reflects a realistic assessment of replacement costs. With respect to Tier 2, Significant Event procurement, if the Commission does not eliminate Significant Event procurement authority, Constellation/Mirant assert that it should direct the CAISO to finalize the demand curve approach proposal it raised during the stakeholder process so that Significant Event procurement in regions with multiple alternative sources has a lower price than Significant Event procurement in areas with few alternatives.

Determination

41. For the reasons explained below, we find that the proposed ICPM price of $41/kW-year will result in appropriate compensation to resources that provide backstop capacity services. First, like the pre-MRTU backstop capacity mechanisms (i.e., RCST and TCPM), the ICPM is a mechanism for procuring capacity for short periods to meet system reliability needs and, therefore, is not designed to encourage new investment. Rather, the pricing structure is designed to ensure just and reasonable treatment of non-resource adequacy resources that are needed for reliability services and to provide an incentive to these resources to voluntarily accept ICPM designations. We find this position to be consistent with our previous findings that when similar reliability services are provided by non-resource adequacy resources and resource adequacy resources, similar compensation is warranted.[33] Also, we note that because acceptance of ICPM designations is voluntary, resources are free to decline an ICPM designation and pursue other avenues of recovering their fixed costs. Thus, we disagree with commenters that

[33] *See* TCPM Order, 123 FERC ¶ 61,229; RCST Rehearing Order, 121 FERC ¶ 61, 276; RCST Extension Order, 121 FERC ¶ 61,281; and Order Extending RCST, 123 FERC ¶ 61,280.

argue the ICPM fails to provide appropriate compensation. Further, we point out that, as the CAISO provides, the bilateral price for resource adequacy services ranges between $15/kW-year and $45/kW-year.[34] Consequently, we find that the CAISO's proposal to price backstop capacity at the upper end of this range is not unreasonable and provides non-resource adequacy resources with a payment for capacity services that is comparable to the payment received by resource adequacy resources. Additionally, as discussed in detail below, the ICPM designation term is consistent with the monthly demonstration requirement under the CPUC's resource adequacy program.[35] Therefore, we find that the ICPM compensation, which is based on the capacity price and the term of the designation, is comparable with the compensation afforded to resource adequacy resources through bilateral contracts.

42. Second, we note that the CPUC is currently engaged in an effort to implement a long-term capacity procurement mechanism. In recognition of the CPUC's ongoing proceeding, we are not inclined to modify the proposed backstop capacity price by adopting a pricing methodology, based on the cost of new entry, to support long-term capacity investments. As discussed above, we find that such a methodology for pricing ICPM backstop capacity would not encourage new investment. Further, we note that the ICPM is scheduled to sunset by December 31, 2010. In its evaluation of the CAISO's predecessor backstop capacity procurement mechanisms, the RCST and the TCPM, the Commission expressly rejected cost of new entry pricing because we found the short-term capacity procurement under these mechanisms did not provide sufficient long-term price signals to indicate the need to build new generation.[36] Like the RCST and TCPM mechanisms, the ICPM is not designed to evaluate whether new investment is actually needed, but rather it provides the CAISO with a temporary tool to procure additional existing capacity when the capacity procured by LSEs under the resource adequacy program is insufficient to meet reliability needs.[37] Although we agree with commenters

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[34] *See* ICPM Transmittal at 36.

[35] *See Interim Opinion Regarding Res. Adequacy*, Decision 04-10-035, Cal. P.U.C. (Oct. 28, 2004).

[36] TCPM Order, 123 FERC ¶ 61,229 at P 76 (quoting RCST Rehearing Order, 121 FERC ¶ 61,276 at P 23).

[37] We take administrative notice of evidence filed on record in a CPUC proceeding that indicates that the RCST payment, which is the RCST target capacity price of $73/kW-year minus peak energy rents, was roughly equivalent to a capacity payment of $40/kW-year without deducting peak energy rents. CAISO's June 19, 2006 Comments on May 30, 2006 Draft Decision, *Order Instituting Rulemaking to Consider Refinements to and Further Development of the Commission's Resource Adequacy Requirements Program*, Docket No. R.05-12-013.

that if resource adequacy procurements were sufficient there would be little need for the ICPM, we find that many of the concerns raised in the instant proceeding regarding long-term incentives are best addressed in the CPUC's ongoing resource adequacy proceeding and, therefore, decline to modify the ICPM in anticipation of the outcome of that proceeding.

43. Third, as a temporary mechanism that is designed to fill gaps between resource adequacy procurement and actual reliability needs, it is important that the proposed ICPM backstop capacity price does not significantly influence current bilateral prices. In particular, the backstop capacity price must not be too high, such that it puts upward pressure on bilateral prices, nor should it be too low, such that it serves as a disincentive for LSEs to meet their resource adequacy requirements. By pricing ICPM capacity at the higher end of existing bilateral contracts, we find that the CAISO's proposed price of $41/kW-year strikes a reasonable balance between these competing objectives. Also, because the backstop price is relatively high compared with existing bilateral arrangements, it will provide an appropriate incentive for LSEs to actively pursue bilateral contracts, and, since the price resides within the range of existing contracts, it will not inappropriately increase the existing rate for capacity services.

44. Finally, we note that the CAISO's proposal provides resources the opportunity to cost justify going-forward costs in excess of the proposed backstop capacity price. This feature will ensure that existing resources needed for reliability services are given the opportunity to demonstrate incurred costs in excess of $41/kW-year and to recover these costs. In summary, we find that the proposed backstop price, coupled with the opportunity to justify additional compensation if the costs of providing backstop capacity service exceed $41/kW-year, ensures that resources providing backstop capacity services will be adequately compensated, and that non-resource adequacy resources, needed for reliability services, are treated in a similar manner to resources operating under a capacity contract. For these reasons, we accept the CAISO's proposed $41/kW-year capacity price, which includes the opportunity for resources to cost justify higher going-forward costs as just and reasonable compensation for backstop capacity services under California's existing capacity construct.

D. Designations

Proposal

45. As stated above, the ICPM proposal specifies two circumstances that would trigger ICPM procurement. First, ICPM procurement is triggered when an LSE, or group of LSEs, has not purchased the full amount of required local or system-wide resource adequacy requirements by the time of the resource adequacy showing for the year, or when it has met the procurement targets, but sufficient capacity was not procured to meet

specific CAISO locational needs.[38] Second, the ICPM proposal provides for procurement by the CAISO when it determines that a Significant Event[39] has occurred that creates a need to supplement LSE-procured capacity within the compliance year. Additionally, regardless of the triggering circumstance, the ICPM proposal provides for voluntary participation, such that a resource owner is not required to accept an ICPM designation.

46. The ICPM also proposes a 30-day initial designation term for Significant Events, which the CAISO may extend. Further, the ICPM proposes that the term of payments to ICPM resources vary from a minimum of 30-days to a maximum of 12 months, depending on the resource adequacy requirement deficiency being remedied and the period of the deficiency. Last, the ICPM proposal affords the CAISO the opportunity to purchase a portion of a resource rather than all of its capacity.[40]

1. Significant Events

a. Voluntary Nature of Participation

Comments and Protests

47. All of the comments discussing the voluntary nature of participation under the ICPM were either opposed to this feature, or at a minimum, expressed some reservations about its adoption. Although stating that it would have preferred that ICPM designations be mandatory, TURN supports the CAISO's proposal and asserts that it represents "a just and reasonable compromise under which all of the affected interests are fairly treated."[41]

48. Six Cities and CMUA express concern over the voluntary nature of Significant

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[38] This type of procurement would occur in advance of the applicable compliance period. Under the ICPM proposal, LSEs are provided an opportunity to cure any deficiency before the CAISO procures backstop capacity.

[39] *See* discussion in text, *supra*, at P 15 n.22.

[40] In the event that multiple resources are eligible to accept an ICPM designation, but not all are needed, the CAISO provides that it will select a resource based on physical effectiveness in addressing the reliability need, price, and PMin level, which is defined as the minimum normal capability of the resource. Additionally, resources accepting the ICPM minimum price, or specifying a higher price prior to designation, will have priority in the designation process. In the event of a tie, the CAISO will use a random selection mechanism to break the tie.

[41] TURN February 29, 2008 Motion for Leave to Intervene and Comments, Docket Nos. ER08-556-000 and ER06-615-020, at 3.

Event designations. According to Six Cities and CMUA, when ICPM designations are made to address deficiencies in LSE procurement, it seems unlikely that a resource declining a designation under the ICPM would result in an intractable threat to reliability. However, Six Cities and CMUA explain that when a designation is necessary to address a reliability problem arising from a Significant Event, there is a greater potential that designation of a particular resource may be imperative. Consequently, Six Cities urges the Commission to remain open to further review of the Significant Event designation process as experience with ICPM is gained.

49. IEP submits that the CAISO improperly asserts that its proposal is just and reasonable because it is temporary and resources are not required to accept designations. IEP takes exception to these positions because the CAISO's backstop procurement program has been "interim" since 2001 and because "the CAISO clearly expects that these existing generating units will be available under its proposal."[42] IEP further notes that the CAISO's assertion that "…from a reliability perspective, the CAISO will be able to meet its reliability needs whether a unit accepts an ICPM designation or is available on a daily basis through [residual unit commitment]."[43] According to IEP, neither the ICPM capacity payment nor residual unit commitment payment correspond to the value of the capacity being provided to the CAISO. IEP contends that the price should be based on competitive price levels.

50. Because ICPM designations are limited to reliability, PG&E asserts that declining a designation can threaten reliability. PG&E explains that in local transmission-constrained areas, particular units often provide the most effective and, in many circumstances, the only solution to transmission contingencies.[44] Therefore, PG&E asserts that in order to avoid involuntary load curtailments, the CAISO would likely commit a needed resource through Exceptional Dispatch, after the close of the day-ahead market, which would result in the CAISO's integrated forward market software not reflecting the commitment or operation of the Exceptional Dispatch resource. Thus, congestion management and other reliability functions that would normally occur in the day-ahead time frame of the integrated forward market, would be deferred to real-time, resulting in possible detrimental impacts to system reliability that could compound as the need for the resource is extended over the time. Additionally, PG&E states that Significant Events would likely be time-critical and urgent circumstances in which prevention of service disruption is critical. For this reason, PG&E provides that resources should not be allowed to turn down the requirement to support reliability.

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[42] IEP Protest at 13.

[43] *Id.* (quoting ICPM Transmittal at 28).

[44] PG&E elaborates that substitute units may be less effective, resulting in unnecessary exposure to reliability risks.

Further, PG&E submits that it is concerned that voluntary ICPM designations, particularly with regard to local transmission-constrained areas and Significant Event designations, will undermine the ICPM's purpose of preventing threats to reliability, and will encourage attempts at gaming. Finally, PG&E asserts that the ICPM's voluntary designation approach has not been satisfactorily justified.

51. According to PG&E, the ability to decline an ICPM designation creates an incentive for owners of multiple units to game the process. PG&E explains that by allowing resources to decline designations, the CAISO may be forced to increase alternate designations, thereby, involving more units and/or megawatts. As a result, PG&E contends that units that are less effective or less economic may have to be designated, resulting in improper enrichment of the affected owners, increased customer costs and reduced reliability. Furthermore, PG&E points out that the CAISO's Market Surveillance Committee noted that declining an ICPM designation may allow a resource to exercise substantial local market power, which would result in distortions of the MRTU residual unit commitment process.

52. Although the CAISO states that it will alert its Department of Market Monitoring about ICPM designations that are declined, PG&E asserts that past history has demonstrated that ex post analyses are often controversial, difficult, and resource-intensive. Accordingly, PG&E recommends that the Commission direct the CAISO to make ICPM designations mandatory.

53. Similarly, the CPUC states that without a must-offer obligation, resources may physically or financially withhold their capacity from the CAISO and, resources that are aware of a need for their services, may withhold capacity or energy to elevate prices. According to the CPUC, this is most likely when the CAISO is attempting to procure capacity to meet local reliability needs for a Significant Event, in which only a limited number of units may resolve the reliability concern. The CPUC notes that the Market Surveillance Committee advised that some ICPM designations should be made mandatory, but the CAISO did not heed this advice.

54. The CPUC states that implementation of a voluntary ICPM will cause greater need for market power mitigation tools within the Exceptional Dispatch process because the voluntary nature of the ICPM makes Exceptional Dispatch a backstop to the ICPM. The CPUC contends that a mandatory ICPM for resources in local areas, or in the case of Significant Events, would prevent this opportunity to exercise market power and relieve pressure from Exceptional Dispatch. Further, the CPUC states that the fact that resources may file with the Commission to seek a higher capacity payment prevents any concern that resources would be subject to an unreasonable taking of a property right or would fail to profit.

Determination

55. While we recognize commenters' concerns, we nevertheless find the voluntary nature of the ICPM proposal to be just and reasonable for several reasons. First, an ICPM designation results in a minimum 30-day obligation to actively participate in the CAISO's markets. Given the obligation that ensues from an ICPM designation, we consider it appropriate to give market participants the choice of whether to volunteer to provide backstop capacity service. Furthermore, we find it reasonable not to impose a blanket, potential 30-day service obligation on all resources, when some resources would rather decline it (potentially availing the designation to other resources that would prefer it), and their ongoing participation in the markets may not be necessary. Second, we note that the CAISO retains the authority to commit any resource that is necessary for reliability reasons through Exceptional Dispatch.[45] Therefore, even if a resource chooses to decline a 30-day ICPM designation, the CAISO can still commit this resource for reliability purposes when its capacity services are needed. We find that this Exceptional Dispatch obligation will discipline resources' behavior in the markets. Finally, we note that, as discussed above, the ICPM proposal provides resources with just and reasonable compensation for the backstop capacity services they provide. We find that this compensation will provide an appropriate incentive for uncontracted resources to accept an ICPM designation.

56. With respect to pricing, we are mindful of the interrelation between the voluntary backstop capacity mechanism, the ICPM, and the mandatory backstop capacity measure, Exceptional Dispatch. We agree that the relative pricing of backstop capacity services must be carefully considered in order to maintain appropriate incentives. Consequently, in part to ensure appropriate incentives, in a contemporaneous order in Docket Nos. ER08-1178-000 and EL08-88-000, we are instituting a section 206 investigation into the CAISO's Exceptional Dispatch mechanism, and accepting and suspending the CAISO's proposed mitigation for Exceptional Dispatch. This action in the Exceptional Dispatch

[45] *See* the order on Exceptional Dispatch in Docket No. ER08-1178-000, which is being issued concurrently with the instant order, *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,055 (2008); *see generally* CAISO June 28, 2008 Transmittal Letter re Proposed Modifications to Exceptional Dispatch Provisions of MRTU Tariff, Docket No. ER08-1178-000, at 2-5.

We note that, while we are initiating an FPA section 206 investigation to ensure the continued justness and reasonableness of the Exceptional Dispatch provisions of the MRTU Tariff, we do not anticipate eliminating Exceptional Dispatch entirely from the CAISO's market redesign. *See Cal. Indep. Sys. Operator Corp.* 125 FERC ¶ 61,055 at P 97.

proceeding will ensure that the ICPM and Exceptional Dispatch processes interact efficiently, and also that they retain appropriate economic incentives. However, we are not persuaded by assertions that a voluntary ICPM is not just and reasonable, nor do we consider it wise to delay resolution of this issue, given the impending MRTU implementation date.

b. Significant Event Definition

Comments and Protests

57. All of the comments addressing the ICPM Significant Event definition either oppose the definition or express concerns about its adoption. Six Cities states that it is concerned that the definition of a Significant Event is open ended and could impose costs on LSEs. According to Six Cities, this concern is mitigated by the reporting process included in the ICPM and the opportunity for LSEs to assist the CAISO in identifying alternative solutions to reliability problems arising from Significant Events.

58. CMUA provides that, during the stakeholder process, it expressed concerns about the CAISO's broad discretion to make Significant Event designations. CMUA states that it does not seek to modify the definition at this time, but rather to highlight potential issues that may arise when these provisions are implemented. According to CMUA, the CAISO enumerates several reasons for Significant Event designations, such as line or facility outages or other unexpected physical events, which are fairly easy to understand, while other reasons, such as modeling or study errors, are not so easy to accept as reasons for incurring costly ICPM designations. CMUA states that it is not clear that all of these types of data or modeling errors will be CAISO errors, and asserts that the CAISO should clarify where certain errors originate. Also, CMUA contends that it is not clear why, if large participating transmission owners make errors in transmitting data or models to the CAISO, the entire market should pay for those errors. CMUA argues that this result would not be consistent with cost causation principles and, therefore, CMUA requests clarification from the CAISO regarding the nature of some of these data or modeling errors, including why it would be just and reasonable to make all customers responsible for data transmission errors from the large participating transmission owners, if that is the CAISO's intention.

59. Although SoCal Edison generally supports the ICPM proposal, it does not support the proposed Significant Event definition. Specifically, SoCal Edison asserts that the definition is overly broad and not consistent with the deference given to the local regulatory authority under the CAISO Tariff. According to SoCal Edison, under the proposed definition, the CAISO would be permitted to designate an ICPM resource based on its determination of the appropriateness of resource adequacy program assumptions relative to the information the CAISO has at the time of making the designation. SoCal Edison explains that this is troubling since the Commission-approved CAISO Tariff gives deference to the local regulatory authority regarding key elements of the resource

adequacy program, including the planning reserve margin, load forecast, and resource adequacy counting rules. SoCal Edison elaborates that the CAISO's proposed definition does not contain the clear sense of materiality necessary to justify the potential costs LSEs could be required to bear if the CAISO makes a Type 2 ICPM designation. Although SoCal Edison agrees with the CAISO that the definition should not be overly prescriptive, it asserts that the definition should be specific enough so that it would not permit the CAISO to make an ICPM designation that would override resource adequacy policy decisions made by a local regulatory authority, consistent with the CAISO Tariff.

60. SoCal Edison asserts that a Significant Event should be the result of a physical change to the electrical grid, which includes resource and transmission facility outages, e.g. loss of a major intertie line and a large resource adequacy resource for several weeks during peak summer load conditions. SoCal Edison proposes the following alternative definition:

> **ICPM Significant Event** – An event that either i) poses a credible threat that could result in a significant physical change to the CAISO grid or ii) has resulted in a significant physical change to the CAISO grid that causes, or threatens to cause, a failure to meet [Applicable Reliability Criteria] absent the recurring use of a [non-resource adequacy] resource(s) on a prospective basis.[46]

61. In the event its proposed definition of a Significant Event is not adopted, SoCal Edison asks the Commission to direct the CAISO to supplement its proposal by requiring the following: (1) that prior to extending the initial ICPM designation, a CAISO officer should be required to advise the CAISO Board if an initial Type 2 designation will be extended beyond the original 30-day period, and preferably, request/receive approval to make such an extension; and (2) that a CAISO officer should be required to report to the CAISO Board for any instance in which a specific unit is designated more than once within a calendar year due to an ICPM Significant Event.[47]

62. Calpine states that capacity procured under the ICPM would assume the same availability obligations and provide the same capacity-only reliability services to the CAISO as resource adequacy resources. Further, Calpine explains that the ICPM would give the CAISO independent authority to find LSE procurement under the resource adequacy program to be deficient. Specifically, Calpine provides that the ICPM would give the CAISO new authority to procure capacity outside of the resource adequacy program if the CAISO finds that there are unforeseen or changed circumstances that

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[46] SoCal Edison February 29, 2008 Comments, Docket Nos. ER08-556-000 and ER06-615-020, at 5 (SoCal Edison Comments).

[47] *Id.* at 5.

affect system reliability or grid operations, or if resource adequacy procurement is ineffective or insufficient to meet the CAISO's reliability needs. Thus, Calpine argues that the CAISO would have the authority to procure capacity that it deems necessary for reliability purposes through a unilateral designation process, employing vague and non-reviewable designation standards, rather than through either a market mechanism or a bilateral, negotiated mechanism.

63. Calpine notes that neither reliability must-run nor the prevailing resource adequacy program provides for procurement of capacity on such a discretionary and divisible basis. Moreover, Calpine explains that the capacity-only product consists of an entire unit's commitment being available to the CAISO, and elaborates that such a commitment is typically obtained on an annual basis. According to Calpine, the capacity costs – both the full fixed costs and the going-forward fixed costs – are indivisibly associated with the entire unit and are not incurred on an incremental basis. Further, because the ICPM does not treat backstop capacity like reliability must-run or resource adequacy capacity, Calpine submits that it is plainly discriminatory.

64. Santa Clara contends that the Commission should reject the CAISO's broad discretion in designating a Significant Event, which provides only post-procurement notification to market participants. Santa Clara explains that the ICPM Significant Event definition gives far more discretion to the CAISO than the RCST Significant Event definition, which required an event that results in a material difference in CAISO-controlled grid operations relative to what was assumed in developing resource adequacy requirements that cause, or threaten to cause, a failure to meet applicable reliability criteria. Further, Santa Clara submits that the ICPM definition removes the subjective determination of what constitutes a material difference by allowing the CAISO to make this determination. Accordingly, Santa Clara is concerned with the breadth of discretion the proposed ICPM provisions would give to the CAISO, and requests that the Significant Event definition be returned to that provided under the RCST.[48]

65. Constellation/Mirant argue that the CAISO's ability to designate resources under the ICPM due to Significant Events should be eliminated,[49] or, if not eliminated, the Significant Event definition should be modified to limit designations to when the aggregate available capacity, on a system, zonal, or local basis as appropriate, is reduced below the authorized minimum operating reserve criteria levels as a result of a

[48] Santa Clara February 29, 2008 Motion to Intervene and Comments, Docket Nos. ER08-556-000 and ER06-615-020, at 7 (Santa Clara Comments).

[49] Constellation/Mirant states that the ICPM proposal is fundamentally flawed, will undermine the existing capacity procurement programs in effect in California, and will ultimately work at odds with the MRTU design that the CAISO is endeavoring to deploy. Thus, Constellation/Mirant assert that the ICPM is unjust and unreasonable.

Significant Event. Specifically, Constellation/Mirant argue that if Significant Event designations are not eliminated in their entirety, the definition of a Significant Event should be modified to the following:

> A Significant Event has occurred when an event, or combination of events, has occurred that causes the availability of resources that have been committed for [resource adequacy] purposes for system, zonal, or local requirements to have been reduced to a level that is equal to or less than the peak load for the system, zone, or local area plus 8 [percent], and the Significant Event is expected to continue for the lesser of (i) the remainder of the annual compliance period or (ii) two months.[50]

66. Constellation/Mirant argue that the CAISO's list of events that may cause it to procure for a Significant Event, does not warrant backstop procurement authority. First, concerning changes to the system such as loss of a generating or transmission facility inside or outside the CAISO control area, Constellation/Mirant assert that these are the types of specific, transitory events for which a planning reserve margin exists. Second, concerning changes to forecasts and/or changes to established reliability criteria or laws, Constellation/Mirant contend that these are events that should impact the implementation of the capacity requirements during the next planning and implementation cycle, rather than serve to impose new obligations during the existing period. According to Constellation/Mirant, the process of changing and updating forecasts and implementing new reliability criteria or legal requirements should be done in an orderly manner so as to minimize disruption to markets. Third, regarding the discovery of specific errors in the modeling tools, Constellation/Mirant assert that this is a situation that can be avoided by testing and review of the model design and input assumptions and should not serve as a reason for backstop procurement authority. Finally, concerning the insufficiency of resource adequacy resources to clear the day-ahead or real-time requirements, Constellation/Mirant argue that these are related to the events discussed above, are specifically contemplated in the development of an appropriate planning reserve margin and, thus, should not form a basis for ad hoc changes to the planning reserve margin.

67. Constellation/Mirant assert that the ICPM should not undermine the robustness of market-based capacity procurement by giving the CAISO authority to procure additional resources beyond what existing policies require, as articulated in the planning reserve margin and resource adequacy provisions. Additionally, Constellation/Mirant state that such broad procurement authority would impose unnecessary costs on California customers.

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[50] Constellation/Mirant February 29, 2008 Protest, Docket Nos. ER08-556-000 and ER06-615-020, at 11-12 (Constellation/Mirant Protest).

68. Constellation/Mirant explain that if an event not contemplated in the planning criteria occurs, the market should send price signals to attract additional energy from surrounding regions, induce demand response, and attract any resources that may not be committed to the CAISO under resource adequacy. Further, Constellation/Mirant note that unplanned-for operational issues that arise in the short-term are not solved by procurement of more capacity, but rather by procuring more energy. Thus, Constellation/Mirant contend that Significant Event procurement of capacity is unlikely to significantly increase grid reliability any more than purchasing short-term energy.

69. According to Constellation/Mirant, Significant Event procurement will undermine market signals that influence investment decisions and the effectiveness of the demand response resources that LSEs have procured to meet their resource adequacy requirements. Constellation/Mirant explain that this occurs for Significant Events because the CAISO is essentially procuring capacity in place of energy and ancillary services. Further, Constellation/Mirant note that while capacity programs are intended to support investment in sufficient capacity in the system, prices from the energy and ancillary services market provide critical information to the market about what kind of investment is needed in the markets (i.e., baseload, peaking, intermediate, ramping, etc.).

70. California Generators state that the CAISO has unrestrained discretion with regard to Significant Events. Specifically, California Generators assert that the CAISO has unbounded discretion to interpret the following: (1) what events produce material changes in system conditions or the CAISO controlled grid operations; (2) what events produce material changes to the assumptions in the resource adequacy requirements; and (3) what constitutes recurring use. According to California Generators, the Significant Event definition is inherently arbitrary, subjective, non-transparent, and prone to bias.

Determination

71. We accept the CAISO's proposed definition of "Significant Event" for the ICPM, which is the same as the definition we recently approved for the backstop capacity mechanism currently in place in California, the TCPM. In the order conditionally accepting the TCPM, we disagreed with some commenters' claim that the TCPM Significant Event definition would result in the CAISO procuring TCPM capacity in excess of applicable reliability criteria.[51] As we explained in the TCPM Order, the Significant Event definition "is sufficiently restrictive in that it uses an objective, transparent baseline" and "it does not modify existing reliability criteria."[52] Further, we found that the authority to designate backstop capacity resources should not be tied to either operating reserve levels or a physical change in the electrical grid, because doing

[51] *See* TCPM Order, 123 FERC ¶ 61,229 at P 49.

[52] *Id*.

so could limit the CAISO's ability to procure sufficient capacity resources to meet existing reliability criteria.[53] The same rationale applies to use of this Significant Event definition in the ICPM context.

72. We disagree that the ICPM is inconsistent with the deference given to local regulatory authorities under the CAISO Tariff. The CAISO is in a unique position to, in any given situation, assess whether resource adequacy resources are sufficient to meet existing reliability criteria, and to determine when insufficient capacity has been procured to maintain reliable grid operations. Additionally, we find that the ICPM Significant Event definition appropriately limits the CAISO's procurement of capacity to existing reliability criteria. Thus, the ICPM Significant Event definition should not permit the CAISO to change its current practices, nor should it interfere with the role of local regulatory authorities in the resource adequacy program. Rather, we find that the Significant Event definition is narrowly tailored to limit the CAISO's ICPM Significant Event procurement authority to situations when reliability is threatened and, therefore, provides the CAISO with an appropriate tool for maintaining grid reliability.

73. While we agree with Constellation/Mirant that the markets should send an appropriate price signal to attract energy from uncontracted resources during tight system conditions, we disagree that the ICPM affects this outcome. Instead, we find that the ICPM – a voluntary program – simply helps ensure that non-resource adequacy resources are available to meet reliability needs when resource adequacy resources are insufficient and that these resources are appropriately compensated.

74. Finally, in response to commenters' requests for additional reporting requirements, we find that additional reporting requirements are not necessary because the Significant Event reports will provide stakeholders with sufficient information to ascertain the reason for an ICPM designation. Accordingly, we will not require additional reporting.

c. Role of Exceptional Dispatch

Comments and Protests

75. California Generators state that while the must-offer obligation will cease under MRTU, the obligation for a non-resource adequacy resource to operate when the CAISO requires performance to maintain grid reliability is not becoming extinct. To meet reliability needs, even if those needs are not reflected in either the forward resource adequacy requirements or in the daily MRTU reliability requirements, California Generators contend that the CAISO will retain the ability to call on non-resource adequacy units under participating resource agreements by way of its Exceptional Dispatch authority. Further, California Generators note that the Commission struck down

[53] *Id.* P 51.

compensation provisions under the must-offer obligation that did not compensate units for their capacity services.

76. California Generators argue that the proposed Significant Event definition, in conjunction with the proposed one-month minimum term, all but guarantee that the CAISO will not designate a unit unless it requires that unit for a month or longer. California Generators elaborate that although the CAISO states that the new, more flexible, Significant Event definition and the one-month minimum term may lead to more designations under the ICPM, actual experience with RCST, in which the CAISO made only one designation despite denying must-offer waivers for at least 31 units on 525 separate occurrences, seems a more reliable indication of things to come.

77. California Generators propose that the first Exceptional Dispatch of a non-resource adequacy resource for reliability purposes should trigger a balance-of-year ICPM designation if the resource is located within one of the ten local reliability areas, which have CAISO-defined local area requirements, or should trigger a three-month ICPM designation if the resource is not located within one of those local reliability areas.

78. California Generators explain that a non-resource adequacy unit that is exceptionally dispatched by the CAISO provides exactly the same reliability service as a forward-contracted resource adequacy unit and is therefore entitled to payment similar to resource adequacy resources. Therefore, according to California Generators, since resources that satisfy local area requirements are contracted for a one-year term, a unit in a local area that is exceptionally dispatched by the CAISO should be designated as an ICPM resource for the balance of the year.

79. To support its proposed three-month term for ICPM designations, California Generators explain that the minimum term for ICPM could either be five months, consistent with the requirement to procure 90 percent of capacity a year in advance, or one-month, consistent with the requirement to procure capacity up to 115 percent of monthly peak demand capacity at least one-month ahead, or three months (the average of those two figures). Further, California Generators propose that any Exceptional Dispatch of a non-resource adequacy unit after the initial ICPM designation period(s) should trigger an ICPM designation effective for that month. Finally, California Generators request that the Commission make sure that the CAISO does not circumvent these triggers through Exceptional Dispatch. Accordingly, California Generators contend that Exceptional Dispatch should not become the CAISO's new must-offer waiver denial process in which eligible capacity is used to resolve reliability issues without just and reasonable compensation.

80. California Generators argue that the basis for reliability must-run compensation, the unit's annual fixed revenue requirement, includes a return on capital; whereas, the CAISO's proposed ICPM payment of $41/kW-year is based only on going-forward costs. California Generators contend that absent an ICPM designation, there is no identifiable

fixed cost recovery provided to non-resource adequacy units. Further, California Generators note that while the daily payment option under the RCST replaced long-term forward capacity compensation with a daily payment, there is no corresponding daily payment under the ICPM.

81. Constellation/Mirant state that Exceptional Dispatch eliminates the need for Significant Event procurement authority. Constellation/Mirant explain that when Significant Events occur and system reliability is threatened, the ability to procure resources to maintain grid reliability is not enhanced by the CAISO's authority to designate resources that can be dispatched through Exceptional Dispatch as capacity resources. If specific units that are not otherwise committed to providing reliability services through a resource adequacy contract are still participating in the market at the time of the Significant Event, Constellation/Mirant assert that they are available, through Exceptional Dispatch, to offer their energy to the CAISO and the marketplace for the duration of the Significant Event. Constellation/Mirant argue that Significant Event procurement authority is not likely to further incent these units to provide energy. Finally, Constellation/Mirant assert that the Commission should direct the CAISO, on an annual basis, to conduct a review process with the CPUC to analyze Significant Events that occurred to determine whether modifications to the planning reserve margin are warranted.

Determination

82. As discussed *supra,* the Commission recognizes the relationship between the ICPM and Exceptional Dispatch, and reiterates that the interrelated nature of the two mechanisms is addressed in the Exceptional Dispatch proceeding.[54] Regarding Constellation/Mirant's argument that Exceptional Dispatch eliminates the need for the ICPM, we disagree. The ICPM, like other pre-MRTU backstop mechanisms, provides the CAISO with the ability to procure additional capacity when the capacity provided by resource adequacy resources is insufficient. By compensating non-resource adequacy resources when they are needed for reliability capacity services, this process encourages these resources to remain available to the CAISO. Once procured, the CAISO then schedules the ICPM resources through its day-ahead and real-time markets. In contrast to ICPM, Exceptional Dispatch provides the CAISO with the authority to manually commit resources that were not committed during the clearing of the day-ahead and real-time markets. These commitments are performed outside of the CAISO's markets and do not ensure the forward availability of resources. Further, commitments made through Exceptional Dispatch involve resource adequacy resources and non-resource adequacy resources alike. Thus, we find that Exceptional Dispatch does not eliminate the need for

[54] *See* discussion in text, *supra*, P 56.

the ICPM, which allows the CAISO to procure non-resource adequacy resources, ensure their forward availability, and compensate them accordingly.[55]

83. In response to California Generators' concerns regarding the CAISO's discretion to refrain from offering ICPM designations in favor of Exceptional Dispatch, the Commission finds that the California Generators' concerns are best addressed in the section 206 investigation of Exceptional Dispatch in Docket Number EL08-88. Accordingly, we decline to take action in the instant proceeding.

d. Minimum One-Month Designation Term

Comments and Protests

84. IEP asserts that the ICPM designation component is arbitrary and fails to correct capacity deficiencies. Specifically, IEP raises concerns about the amount of discretion given to the CAISO in determining the term of the designation/payment, and asserts that allowing term lengths of only one-month contradicts the need of the owner to establish fixed operations and maintenance budgets ahead of time and to plan to complete capital investments. IEP elaborates that it would be just and reasonable for designations to be for one-year terms, or in a case where a Significant Event results in an offer of designation, until the end of the demonstration period. As a result, IEP states that when the resource adequacy process does not satisfy reliability needs, the CAISO should designate capacity on a forward basis to compensate for the known and identifiable shortfall. IEP asserts the following in its opposition to the ICPM designation process: (1) the CAISO should designate accurate expected need and disregard demand response that is not capable of serving its reliability needs; (2) a unit that receives one must-offer waiver denial should be designated on that basis; and (3) the CAISO should not be allowed to designate for only a monthly term. IEP contends that designation terms should be offered on an "annual or (balance of [resource adequacy] compliance period) multi-month" basis, which is consistent with planning, operation, and investment timeframes.[56]

85. The CPUC argues that the CAISO should begin dialogue with market participants during the initial 30-day designation period to determine whether a Significant Event is expected to exceed the initial 30-days and whether operational solutions other than the ICPM capacity resource should address the CAISO's operational and reliability needs. According to the CPUC, such discussion would allow it to address any dispute regarding

[55] The CAISO's need for a backstop capacity procurement mechanism will be reduced when resource adequacy requirements are refined to provide the CAISO with the capacity resources it needs.

[56] IEP Protest at 22.

the CAISO's assessment of whether a Significant Event had occurred beyond those system conditions presumed as the basis for the CPUC's and/or local regulatory authorities' resource adequacy programs.

86. California Generators note that reliability must-run service is contracted for a full year while a unit that provides local capacity service under the ICPM could be designated for as little as one-month, or not at all, even though it is satisfying the same reliability need.

87. According to California Generators, while resource adequacy service is contracted for a year, five months, or, at worst, for one-month, Type 2 ICPM reliability service is designated after-the-fact for likely no more than one-month. Thus, California Generators state that ICPM payments are not intended to provide recovery for capital costs. For these reasons, California Generators assert the Commission cannot find that the proposed ICPM payment is comparable to the payment provided to resource adequacy resources for the same reliability services and, thus, the California Generators submit that the ICPM compensation mechanism and the payments cannot be just and reasonable.

88. In contrast, PG&E supports the flexible term length and ability to procure partial units that are proposed in the ICPM.

Determination

89. We accept the CAISO's proposed minimum 30-day ICPM designation because it is consistent with both the resource adequacy program and prior Commission action, and disagree with commenters who complain that 30-days is too short. The resource adequacy program requires LSEs to make a monthly procurement demonstration and, to meet this requirement, LSEs may choose to contract on a monthly basis. Therefore, it is likely that certain resource adequacy resources operate under monthly arrangements. For this reason, we find that the ICPM proposal to offer a minimum 30-day designation is consistent with the resource adequacy construct. Further, the 30-day minimum designation is consistent with prior Commission action. For example, in the TCPM proceeding, the Commission found that a minimum 30-day designation of non-resource adequacy resources was necessary to ensure that non-resource adequacy resources receive comparable treatment and just compensation when called upon to provide capacity services.[57] For these reasons, we find that IEP's concerns about the CAISO's discretion to designate resources for minimum 30-day terms are unfounded, as a 30-day term is consistent with the resource adequacy construct. Additionally, we reiterate that the ICPM is voluntary, such that resources interested in pursuing longer designations, may do so through other capacity procurement programs.

[57] TCPM Order, 123 FERC ¶ 61,229 at P 59.

90. Finally, we reject the CPUC's suggestion that the CAISO accelerate its consideration of alternatives to the ICPM for more long-term Significant Events, and instead find that the CAISO's proposed timeline for evaluating alternatives to ICPM designations is reasonable. Under the CAISO's proposal, if a Significant Event lasts longer than the initial 30-day designation period, it is automatically extended for 60 days, and after this initial 30-day period, the CAISO and its stakeholders may begin considering alternative means for addressing the capacity shortfall.[58] We find that this timeframe strikes a reasonable balance between efficiency, which results from implementing a pre-approved administrative price, and flexibility, which is necessary to tailor a remedy to redress a longer-term Significant Event.

e. Partial Designation

Comments and Protests

91. IEP contends that the CAISO should not be allowed to partially designate a resource. Specifically, IEP asserts that partial designation of resources is unjust, unreasonable, and unduly discriminatory. According to IEP, the plant components and systems must be operated and maintained regardless of the unit's expected operational range. As a result, IEP asserts that paying only the fixed costs, when an entire unit must be operated and maintained, is unjust and unreasonable. IEP elaborates that owners must plan investments to maintain the availability of the entire plant, not a portion. Consequently, IEP asserts that compensation for partial unit capacity is not equal to the unit's going-forward costs.

92. California Generators state that partial unit designation ignores the indivisibility of a call option on the entire capacity of a resource. Also, California Generators provide that this call option effectively requires that the entire resource be available, even if the CAISO identifies a reliability need that is less than the capacity of an available unit. Therefore, California Generators argue that compensation should be based on the entire qualifying eligible capacity of a resource procured by the CAISO and not on designated slices of partial unit capacity. California Generators elaborate that the fixed costs of a unit are incurred indivisibly and not incrementally and that this is true for both fixed capital costs and going-forward costs. Further, California Generators contend that if partial unit designation becomes the norm it will mean that some portion of a unit's fixed costs will not be recoverable through capacity compensation. California Generators argue that partial unit procurement is, in effect, a means of substantially reducing compensation to units that incur costs as, and can only be committed as, an indivisible whole part. Accordingly, California Generators assert that capacity does not have any associated marginal fixed costs and that the ICPM proposal is the CAISO's attempt to

[58] *See* MRTU Tariff § 43.2.5.

apply a marginal cost pricing mechanism to the invariant fixed costs associated with a capacity only product.

93. California Generators state that if partial unit designation is approved, certain deficiencies must be addressed. Specifically, California Generators point out that section 43.3 of the proposed MRTU Tariff provides that the CAISO may not designate less than a unit's PMin level. California Generators assert that it is unclear from this definition whether the PMin level is the unit's stable operating point under manual control, a point at which the unit typically cannot be dispatched to provide energy and respond in the same dispatch interval, or the unit's minimum stable operating point, a point from which the unit could be dispatched and respond in the same dispatch interval. California Generators request that the CAISO be required to designate at least the unit's dispatchable minimum load amount.

Determination

94. We disagree with commenters regarding the partial designation of ICPM resources and find that this component of the ICPM is consistent with the procurement rules under the CPUC's resource adequacy program.[59] The ICPM, like the pre-MRTU backstop capacity mechanisms, is, in part, intended to ensure comparable treatment of resources providing reliability capacity services. By proposing to allow resources to be partially designated as ICPM capacity resources, the ICPM accomplishes this objective by implementing designation rules comparable to the resource adequacy program. There is no evidence on record that would indicate that this treatment is unduly discriminatory, in part because participation in the ICPM is voluntary, thereby leaving resources able to pursue fixed costs recovery through other mechanisms. Thus, we are not persuaded that different designation rules for both the ICPM and the resource adequacy program are warranted. Further, we find that California Generators have not demonstrated that modifying the PMin definition to require the CAISO to designate the unit's dispatchable minimum load amount is necessary in order to ensure comparable treatment between resource adequacy and non-resource adequacy resources. Accordingly, we accept the ICPM's proposal to permit the partial designation of capacity resources.

2. Net System Deficiencies

Comments and Protests

95. The CPUC states that section 43.1.3 of the MRTU Tariff does not contain a provision preventing the CAISO from making ICPM designations on behalf of a deficient LSE when there is no collective system deficiency. The CPUC suggests that the CAISO

[59] *See* Cal. P.U.C. Decision 04-10-035; *Opinion on Local Res. Adequacy Requirements*, Decision 06-06-064, Cal. P.U.C. (June 29, 2006).

determine whether there is a net system deficiency by taking into account all LSE resource adequacy showings prior to designating generation to address individual LSE system resource deficiencies. Otherwise, the CPUC contends that CAISO procurement would exceed that level deemed appropriate by California for the year-ahead reliability requirement, which would exceed both the CAISO's and the Commission's jurisdiction over short-term system reliability.

Determination

96. We agree with the CPUC that the CAISO should not procure system capacity under the ICPM unless a net system deficiency exists. To do otherwise may result in more capacity being procured than is necessary to operate the CAISO system reliably. Accordingly, we direct the CAISO to submit clarifying tariff language to section 43.1.3 of the MRTU Tariff within 30 days of the date of this order.

E. Cost Allocation and Resource Adequacy Credits

Proposal

97. The ICPM proposal includes the following cost allocation provisions: (1) if an individual scheduling coordinator for an LSE is responsible for a shortfall in procurement of local capacity area resources or resource adequacy resources, and that scheduling coordinator fails to cure the deficiency, the costs of the ICPM procurement are assigned to the non-compliant scheduling coordinator; (2) costs associated with collective procurement shortfalls or Significant Events are allocated proportionately to scheduling coordinators in the effected areas; however, LSEs will first have an opportunity to cure their allocable portion of the collective deficiency; and (3) costs incurred for a Significant Event are allocated to scheduling coordinators in the effected areas based on actual load during which the designation occurred. When designations are made for reasons other than Significant Events, the CAISO will provide credit to the affected scheduling coordinators for LSEs, which corresponds to the quantity of their resource adequacy obligations. The CAISO argues that also providing such credits to LSEs for ICPM Significant Event procurements is not appropriate, as this would result in a decrease of available resource adequacy capacity, which was already determined to be insufficient and was the reason for the CAISO having to make a Significant Event designation.

Comments and Protests

98. Constellation/Mirant and AReM state that the CAISO's proposal should provide capacity credits to affected LSEs for ICPM procurements exceeding 30 days in order to allow LSEs to adjust their resource adequacy compliance positions to minimize costs to their customers. Constellation/Mirant argue that providing capacity credits for the duration of the ICPM procurement will provide LSEs the opportunity to adjust their means of maintaining resource adequacy compliance and reduce costs.

99. Further, Constellation/Mirant state that any argument by the CAISO that the provision of such credits is not appropriate for Significant Event procurements must rest on an assertion that either the planning reserve margin target, or the local capacity requirement study process is incorrect. Accordingly, Constellation/Mirant assert that if the Commission grants Significant Event procurement authority, it should make sure that the affected LSEs receive appropriate resource adequacy credits.

100. AReM states that not providing resource adequacy credits for Significant Events exceeding 30 days will result in over-procurement of capacity by LSEs and higher costs for California consumers.[60] Specifically, AReM recommends changing the cost allocation approach so that it is based on the CEC's forecast data, adjusted for load migration, which is already used as the basis for the LSEs' monthly resource adequacy showings. AReM notes that the language in section 43.7.3 addressing cost allocation for a collective deficiency could be used as a model.

Determination

101. We disagree with Constellation/Mirant and AReM that resource adequacy capacity credits should be awarded to LSEs affected by ICPM procurements. If the CAISO were to allow LSEs to count ICPM capacity resources towards their resource adequacy requirements, it would result in no additional capacity being procured. Thus, the CAISO would be left with insufficient capacity to meet its reliability needs. For this reason, consistent with our determination in the TCPM proceeding, we accept the CAISO's proposal to not credit ICPM capacity that is procured to address a Significant Event against an LSE's resource adequacy requirements.[61]

F. Miscellaneous

1. Price Discrimination

Comments and Protests

102. IEP contends that existing resources are subject to price discrimination. Specifically, IEP asserts that existing resources and new generation provide identical capacity and reliability benefits; however, new resources are paid a higher price for the same service.

[60] AReM provides that if the Commission grants its request for the ICPM to be modified to include resource adequacy credits for Significant Events exceeding 30 days, then the corresponding cost allocation provisions must also be modified.

[61] TCPM Order, 123 FERC ¶ 61,229 at P 102.

103. Similarly, Calpine states that the ICPM would discriminate among resources that provide the same capacity only product, which subjects them to the exact same availability requirements. Further, Calpine contends that the capacity only product must be uniformly defined and compensated in a comparable manner.

Determination

104. The Commission has previously dismissed IEP's concerns that existing resources are subject to illegal price discrimination.[62] Specifically, the Commission has explained that the compensation provided under backstop capacity procurement mechanisms uniformly applies to all resources that are operating without a capacity contract and are needed for reliability capacity services.[63] As discussed herein, the Commission finds that the proposed compensation for backstop capacity services under the ICPM is just and reasonable.[64] We remain unconvinced that existing resources are subject to illegal, discriminatory treatment under the ICPM, and, accordingly, find that no Commission action is warranted.

2. Modification of the RCST or Development of an Alternative Mechanism

Comments and Protests

105. IEP advocates modifying the RCST instead of implementing a new tariff. In support of this position, IEP asserts that the RCST has a sound economic basis and that it provides an appropriate ground for establishing a backstop capacity compensation mechanism. Additionally, IEP asserts that the RCST can be modified by updating the capacity price and designation process. Also, IEP encourages the Commission to investigate the compensation for capacity services in the CAISO markets and to establish a just and reasonable price that fairly comports with the value of the services provided.

106. According to IEP, modifying the RCST will not interfere with the functioning of bilateral markets because there is no evidence that any supplier of capacity chose to not execute a forward resource adequacy contract in order to capitalize through the RCST. IEP further explains that if market power problems do arise, the CAISO can designate the relevant resource with a reliability must-run contract.

107. Calpine argues that the Commission should reject the ICPM proposal and initiate a proceeding to develop a meaningful, market-based structure for capacity procurement in

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[62] *Id.* P 98-99.

[63] *Id.* P 98.

[64] *See* discussion in text, *supra*, P 41.

California that comprehensively addresses the limitations of the resource adequacy program and the CAISO's administrative procurement of capacity. Calpine reiterates its proposal, rejected by the CAISO during its stakeholder process, that, until California develops and implements a robust, centralized, forward capacity market, resources should be permitted to elect out of the ICPM and be able to seek and receive capacity compensation under a cost-of-service based mechanism. Calpine also states that the CAISO should be directed to initiate a stakeholder process for the development of standardized availability obligations that would apply to all CAISO capacity procurements.

Determination

108. We find that IEP has failed to demonstrate that the ICPM is unjust and unreasonable and, therefore we need not address the merits of IEP's proposal to modify the RCST rather than accept the ICPM.[65] Additionally, we note that the CPUC has initiated a proceeding to develop a long-term capacity procurement program, and the ICPM is voluntary, so there is no need to permit resources to elect to "opt out" of the ICPM, since they are free to choose whether or not to participate in the ICPM. We therefore disagree with Calpine that an additional proceeding to develop a market-based procurement program should be initiated at this time.

3. Demand Response

Comments and Protests

109. IEP asserts that the CAISO's continued reliance on resources that are not under a forward resource adequacy contract is indicative of a structural problem with the resource adequacy process. IEP explains that because the resource adequacy process allows LSEs to deduct expected demand response from its capacity requirements, a need remains for the CAISO to procure backstop capacity. Further, IEP submits that much of the demand response resources that are counted as resource adequacy cannot be called upon until a Stage 2[66] emergency exists. According to IEP, the CAISO stated that demand response

[65] 16 U.S.C. § 824e; *see also* Order Extending RCST, 123 FERC ¶ 61,280 and *Cal. Indep. Sys. Operator Corp.*, 124 FERC ¶ 61,271 (2008).

[66] A Stage 1 emergency occurs when operating reserves fall below the Western Electricity Coordinating Council (WECC)/North American Electric Reliability Corporation (NERC) requirements of 6-7%, and a Stage 2 emergency occurs when operating reserves fall below 5%. *See* Affidavit for IEP on February 29, 2008, Docket Nos. ER08-556-000 and ER06-615-020, at P 18 (citing 2007 CAISO Summer Loads at P 2 and Appendix G).

programs, under the existing resource adequacy program, cannot be relied upon as a capacity resource.

110. IEP states that the ICPM fails to address over-reliance on phantom demand response in the resource adequacy process. Specifically, IEP provides that demand response needs to be real and available to the CAISO to thwart system emergencies. IEP elaborates that although demand response resources that are available after a system emergency is declared may help control events, they are not resource adequacy products. IEP provides that "the misuse of demand response that is not available until after a system emergency has been called not only undermines reliability, but skews the forward [resource adequacy] market."[67] Further, IEP explains that this discourages LSEs from procuring future generation in a forward resource adequacy market because, due to demand response, it is deemed unneeded. However, IEP explains that when this generation is needed at the last minute, backstop procurement is necessary to avoid a system emergency.

Determination

111. We disagree with IEP that the ICPM fails to address over-reliance on demand response in establishing resource adequacy requirements. On the contrary, we find that the ICPM is designed for exactly that type of situation: to address capacity shortfalls, including those that may result from over-reliance on demand response. As discussed above, the ICPM, like the pre-MRTU backstop capacity programs, is designed to fill any gap that exists between the capacity procured under the resource adequacy program and the capacity that the CAISO needs to operate its system reliably. In the instant proceeding, we are not addressing whether resource adequacy requirements should be modified; rather, we are assessing only whether the ICPM is a reasonable mechanism to backstop the resource adequacy program. Accordingly, we reject IEP's argument that the ICPM is incomplete because it fails to address how demand response is factored into the determination of resource adequacy requirements.

4. Reporting Timelines

Comments and Protests

112. Santa Clara asserts that the Commission should reject the CAISO's procurement report filing timelines. Santa Clara explains that preliminary reports of Significant Event designations under section 43.5.1 are to be posted within two business days of the designation; however, that section is limited to Significant Event designations and does not provide any notice of designations for reasons such as procurement shortfalls or local resource effectiveness deficiencies. Santa Clara asserts that regardless of the cause for

[67] IEP Protest at 17.

the designation, the same preliminary notice of a designation, within two business days, should occur.

113. According to Santa Clara, under proposed section 43.5.2, detailed reports of designations, for any reason, are not due for up to 30 days after the designation. Santa Clara points out that this timeframe is not consistent with the timeframe for similar reports required under the RCST. Specifically, Santa Clara notes that the Commission directed the CAISO to revise its RCST Tariff to require it to file procurement reports within 10 days of the end of each month.[68] Santa Clara explains that the CAISO's proposed reporting under section 43.5.2 could result in notice occurring beyond the time period currently approved for RCST, i.e., if the CAISO makes a designation on the 30th day of a month, the report will not be posted until 20 days after the deadline contained in the existing RCST Tariff. As a solution, Santa Clara suggests that the CAISO modify section 43.5.2 to require the report to be posted on or before the earlier of 10 days after the end of the month, or 30 days after the designation occurs.[69]

Determination

114. We agree with Santa Clara that the reporting timelines should be consistent with the reporting timelines established in the RCST. Additionally, we find that preliminary reports explaining ICPM designations should include designations associated with LSE deficiencies. Accordingly, we direct the CAISO to make a filing with the Commission within 30 days of this order that modifies sections 43.5.1 and 43.5.2 of the MRTU Tariff consistent with Santa Clara's request.

5. ICPM Sunset

Proposal

115. The ICPM proposal provides that it will sunset on December 31, 2010.

Comments and Protests

116. California Generators state that a tariff-imposed deadline to require a stakeholder process to replace the ICPM is necessary given a tariff-imposed expiration date. California Generators propose that the CAISO be required to commit to commence the stakeholder process to replace the ICPM no later than December 1, 2009, which would provide a full year to consider alternatives and prevent what happened with RCST from happening with ICPM, namely, the extension of the ICPM by default. Alternatively,

[68] Santa Clara Comments at 7 (citing *Cal. Indep. Sys. Operator Corp.*, 122 FERC ¶ 61,107, at P 76-79 (2008)).

[69] *Id.* at 8.

California Generators propose that there be no fixed sunset date for the ICPM. According to California Generators, if MRTU runs as designed and a centrally cleared forward capacity market is approved and operating, the ICPM should fade away as an unneeded relic.

Determination

117. While we will not direct the CAISO to initiate a stakeholder process by December 1, 2009, given prior Commission action, it should be clear to both the CAISO and its stakeholders that resources utilized for backstop capacity services must be appropriately compensated for their services and that the Commission will not accept a temporary lapse in such compensation.[70] Therefore, if the CAISO needs to rely on backstop capacity services beyond the ICPM's proposed sunset date, in order to reliably operate its system, we expect the CAISO to make a timely filing with the Commission that will ensure the continuation of just and reasonable compensation for the services rendered.

6. The Role of Residual Unit Commitments and Reliability-Must-Run

Comments and Protests

118. California Generators explain that one of the features of the approved MRTU market design is the residual unit commitment mechanism, which allows the CAISO to commit units to meet forecasted reliability needs that were not committed through the integrated forward market. According to California Generators, to be eligible to participate in the residual unit commitment process, a unit must first bid into the integrated forward market.

119. California Generators note that resource adequacy units are required to bid into the integrated forward market, and therefore into the residual unit commitment process. However, the resource adequacy units must bid $0/MW in the residual unit commitment process and are not eligible for residual unit commitment payments even if the residual unit commitment availability price clears at a non-zero value. California Generators elaborate that because the residual unit commitment process procures capacity based upon optimizing the combined cost of the residual unit commitment availability payment and the unit's start-up and projected minimum load costs, the residual unit commitment availability price could be greater than $0/MW. Thus, California Generators propose that where any non-resource adequacy capacity was selected in the residual unit commitment market because it provided reliability service that could not be provided by a resource adequacy unit, rather than being selected because of lower costs and therefore only

[70] *See* RCST Extension Order, 121 FERC ¶ 61,281.

displacing a resource adequacy unit, the non-resource adequacy unit be designated as an ICPM resource for a three-month term. California Generators argue that while this path to designation requires the CAISO to discern why a unit was committed in the residual unit commitment process, it provides certainty of designation if the non-resource adequacy unit was required to provide reliability service equivalent to a resource adequacy unit.

120. Constellation/Mirant state that if ICPM procurement is approved, the CAISO should be directed to eliminate any new reliability must-run designations so that its backstop capacity procurement authority is consolidated into a single mechanism. Further, Constellation/Mirant assert that the CAISO fails to provide any meaningful distinction between ICPM procurement authority and reliability must-run procurement authority. Specifically, Constellation/Mirant contend that the resource adequacy requirement should be the primary vehicle for capacity procurement and, to the extent the resource adequacy requirement is correctly defined and sufficiently enforced, any capacity procurement outside of the resource adequacy requirement mechanism should be minimal. Therefore, if the ICPM is authorized, Constellation/Mirant assert that authorization should eliminate the need for continued reliance on new reliability must-run contracts.

Determination

121. For the following reasons, we reject the arguments raised in regard to the residual unit commitment process and reliability must-run contracts. First, we disagree with California Generators that a commitment under the residual unit commitment process warrants an ICPM designation. Specifically, the residual unit commitment process is a voluntary process that allows non-resource adequacy resources to specify the price at which they are willing provide their capacity services. Because a resource can specify its own price,[71] the Commission does not need to take action under the ICPM proposal to ensure that such a resource receives just and reasonable compensation. Second, an ICPM designation imposes certain requirements, which include a 30-day obligation to offer into the CAISO's markets. It would be inappropriate for the Commission to assume that all resources would prefer such an obligation over the ability to offer their capacity services on a daily basis through the residual unit commitment process. Finally, while other regional transmission operators have processes similar to the residual unit commitment process, there is no precedent for providing resources committed through these processes with forward capacity compensation. Accordingly, we will not require the CAISO to offer ICPM designations to non-resource adequacy resources that are committed through the residual unit commitment process.

[71] *See* MRTU Tariff § 31.5.1.

122. We also disagree with Constellation/Mirant regarding the elimination of reliability must-run contracts.[72] While local resource adequacy requirements might eventually eliminate the need for some existing reliability must-run contracts and, therefore, are expected to reduce the overall number of future contracts, there is no evidence before us to indicate that all the reliability must-run contracts, currently addressing local reliability needs, should be terminated, or that we should preclude the CAISO from entering into new reliability must-run contracts.

7. Miscellaneous

123. California Generators state that section 43.4.1 of the MRTU Tariff requires that resources designated under the ICPM must comply with the offering requirements set forth in section 40.6.1, which provide that a resource may satisfy its offering obligations by submitting self-schedules or economic bids for its resource adequacy capacity. California Generators suggest that the last section of section 43.4.1 be changed to read: "In addition to [e]nergy [b]ids, resources designated under the ICPM shall submit [a]ncillary [s]ervices [b]ids for their ICPM capacity to the extent that the resource is certified to provide the [a]ncillary [s]ervice and to the extent the unit is not already self-scheduled."[73] California Generators explain that since a resource could satisfy its offering obligation by fully self-scheduling its ICPM capacity, submitting a bid for the resource's certified ancillary services capacity for ICPM capacity already self-scheduled in the integrated forward market could either cause the unit to be over-bid in the integrated forward market or require that the unit bid capacity that is not designated under ICPM into the ancillary services markets.[74]

124. CMUA states that the last sentence of section 43.4.1 provides that "in addition to [e]nergy [b]ids, resources designated under the ICPM shall submit [a]ncillary [s]ervices bids for their ICPM capacity to the extent that resource is certified to provide the [a]ncillary [s]ervice."[75] CMUA seeks clarification of this issue, and provides that it does not recall stakeholder discussion on this issue. CMUA notes that it is aware that the issue

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[72] Reliability must-run contracts address localized, long-term reliability needs and may indicate the need for upgrading local transmission facilities.

[73] California Generators Comments at 34-35.

[74] California Generators state that this could occur in a scenario where a 200 MW unit is designated to provide 100 MW of ICPM service and is certified to bid 25 MW of an ancillary service but has already self-scheduled 100 MW in the integrated forward market. *Id.* at 34 n.53.

[75] CMUA February 29, 2008 Comments, Docket Nos. ER08-556-000 and ER06-615-020, at 8.

of ancillary service bidding requirements is being discussed in conjunction with the ongoing stakeholder process on scarcity pricing. Further, CMUA contends that it would be inappropriate to prejudge the outcome of that discussion by seeking to add treatment to the CAISO Tariff in this docket, if the potential ancillary services bidding requirement is not central to the ICPM proposal. Accordingly, CMUA requests that the Commission require that the CAISO clarify its position on this matter.

Determination

125. In response to CMUA, we clarify that capacity resources designated under the ICPM should have the same obligation to offer both ancillary services and energy as resources designated under the resource adequacy program. We disagree with California Generators that self-scheduling ICPM capacity in the integrated forward market will result in the CAISO over-committing an ICPM capacity resource. Instead, consistent with the treatment of resource adequacy resources, we find that this bidding practice will permit the CAISO to co-optimize between energy and ancillary services. Accordingly, we decline to adopt California Generator's proposed tariff modification to section 43.4.1.

The Commission orders:

The CAISO's ICPM filing is hereby conditionally accepted, subject to the CAISO submitting a compliance filing within thirty (30) days of the date of this order, as discussed in the body of the order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.