125 FERC ¶ 61,055
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. ER08-1178-000
EL08-88-000

ORDER ACCEPTING AND SUSPENDING TARIFF FILING, INSTITUTING A SECTION 206 INVESTIGATION, AND ESTABLISHING A TECHNICAL CONFERENCE

(Issued October 16, 2008)

1. On June 27, 2008, the California Independent System Operator (CAISO) filed to revise the Exceptional Dispatch provisions of the Market Redesign Technology Upgrade (MRTU) Tariff.[1] The Commission accepted the original Exceptional Dispatch provisions in its September 2006 order conditionally accepting the MRTU Tariff.[2] In this order, the Commission finds pursuant to section 205 of the Federal Power Act (FPA)[3] that the CAISO's proposed tariff revisions may not be just and reasonable because certain resources may not receive adequate compensation for the capacity services they provide, as explained below. Accordingly, the Commission accepts and suspends for a nominal period the CAISO's proposed tariff revisions to become effective upon implementation of the MRTU Tariff, subject to refund and to the outcome of an FPA section 206[4] investigation in Docket No. EL08-88-000 into the continued justness and reasonableness

[1] CAISO's June 27, 2008 Amendment to Revise Exceptional Dispatch Provisions of the MRTU Tariff, Docket No. ER08-1178-000 (tariff revisions).

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

[3] 16 U.S.C. § 824d (2006).

[4] 16 U.S.C. § 824e (2006).

of the Exceptional Dispatch mechanism as a whole. The Commission institutes this section 206 investigation because we find that, due to changes in circumstances discussed below, the Exceptional Dispatch tariff provisions of the MRTU Tariff may no longer be just and reasonable.[5] To facilitate expeditious resolution of this investigation, the Commission establishes a technical conference.[6] At that time we will discuss issues raised by the CAISO's filing, as well as our proposed solution, discussed below. Parties will have an opportunity to comment after the technical conference.

I. Background

A. The Must-Offer Obligation

2. On April 26, 2001, the Commission established a prospective mitigation and monitoring plan for the California wholesale electric markets.[7] 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 . . . ensure that the CAISO will be able to call upon available resources in the real-time market to the extent that energy is needed."[8] 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."

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[5] We note that, consistent with the FPA, the refund effective date is the earlier of the MRTU start-up date or five months after publication of the notice of investigation in the *Federal Register.* 16 U.S.C. § 824e.

[6] We note that the Commission intends to conclude this investigation in a reasonable timeframe so as to not adversely impact the currently planned February 1, 2009 implementation date for MRTU.

[7] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 95 FERC ¶ 61,115, *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).

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

3. On August 26, 2005, Independent Energy Producers Association (Independent Energy Producers) filed a complaint against the CAISO under section 206 of the FPA.[9] The complaint alleged that the Commission-imposed must-offer obligation under the CAISO Tariff was flawed and no longer just and reasonable. The complaint also requested that the Commission direct the CAISO to modify the compensation received by resources operating under the must-offer obligation with 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[10] filed an Offer of Settlement of the Independent Energy Producers' complaint that proposed the institution of the Reliability Capacity Service Tariff (RCST). In conjunction with the must-offer obligation, the RCST provided a backstop capacity 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 a July 20, 2006 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.[11] However, the Commission was unable to find that the rates and cost allocation mechanism under the contested Offer of Settlement were just and reasonable. Accordingly, the July 20, 2006 Order established paper hearing procedures to review evidence on the rates and cost allocation issues presented by the Offer of Settlement.

[9] 16 U.S.C. § 824e.

[10] The Settling Parties are: Independent Energy Producers; CAISO; Public Utilities Commission of the State of California (CPUC); Pacific Gas and Electric Company (PG&E); San Diego Gas & Electric Company; and Southern California Edison Company (SoCal Edison).

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

6. In the Order on Paper Hearing, the Commission approved, with modifications, the Offer of Settlement as just and reasonable.[12] Under the terms of the Offer of Settlement, the RCST would expire on the earlier of December 31, 2007 or MRTU implementation.[13]

7. On December 20, 2007, the Commission instituted a proceeding pursuant to section 206 of the FPA,[14] in Docket No. EL08-20-000, 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.[15] 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 "expect[ed] the CAISO to follow through with its commitment to initiate a new stakeholder process and modify the RCST accordingly."[16]

8. In a second order issued on December 20, 2007, the Commission denied requests for rehearing and granted in part and denied in part the requests for clarification arising out of Independent Energy Producers' complaint in Docket No. EL05-146 concerning the must-offer obligation under the CAISO's Tariff.[17]

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 "Significant Event"

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[12] *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).

[13] Order on Paper Hearing, 118 FERC ¶ 61,096 at P 13. On June 11, 2007, the Commission denied requests for rehearing of the Settlement Order and the Clarification 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).

[14] 16 U.S.C. § 824e.

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

[16] *Id.* P 38.

[17] *Cal. Indep. Sys. Operator Corp.*, 121 FERC ¶ 61,276, at P 1 (2007) (RCST Rehearing Order).

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 capacity procurement program.[18]

10. On March 28, 2008, the CAISO filed an alternate backstop capacity procurement mechanism, the Transitional Capacity Procurement Mechanism (TCPM), to replace the RCST. The TCPM serves as a bridge between the RCST and the Interim Capacity Procurement Mechanism (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.[19]

B. <u>Relevant MRTU Orders</u>

11. 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 MRTU Tariff, which included tariff provisions to implement Exceptional Dispatch, subject to modification.[20] The Exceptional Dispatch provisions of the MRTU Tariff authorize the CAISO to manually commit and/or dispatch resources (generating units and participant loads) that are not cleared through market software in order to maintain reliable grid operations. In addition to maintaining reliability, Exceptional Dispatch enables the CAISO to address a variety of other specific situations that require dispatch of a resource outside of a market schedule, including the following: (1) addressing transmission-related modeling limitations; (2) performing Ancillary Services testing; (3) performing pre-commercial operations testing for generating units; (4) mitigating for over-generation; (5) providing for voltage support; (6) accommodating Transmission Ownership Rights and Existing Transmission Contact self-schedule changes after the market close of the hour-ahead scheduling process; and (7) reversing a commitment instruction issued through the integrated forward market that is no longer optimal as determined through Residual Unit Commitment.[21] Under the MRTU Tariff, the CAISO can issue Exceptional Dispatch instructions for forced start-up, forced shut-down, operation at minimum operating level (Pmin), incremental energy, or decremental

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

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

[20] *See* September 2006 MRTU Order, 116 FERC ¶ 61,274.

[21] *See* MRTU Tariff § 34.9.

energy.[22] Exceptional Dispatch is intended to take effect simultaneously with MRTU implementation.

12. On February 8, 2008, the CAISO filed its proposed ICPM,[23] which is meant to operate in conjunction with Exceptional Dispatch.[24] The ICPM is a voluntary backstop capacity mechanism designed to provide a means for the CAISO to procure capacity when needed to meet reliability criteria or otherwise maintain reliable grid operations. Under the ICPM, the CAISO may designate resources to maintain reliable grid operation if: (1) a load serving entity has not procured the full amount of its local or system-wide resource adequacy requirements; (2) the portfolio of resources procured by all load serving entities in an area is insufficient to meet the reliability criteria for the area (Tier 1 ICPM designation); or (3) an ICPM Significant Event[25] occurs that creates a need to supplement resource adequacy resources (Tier 2 ICPM designation). The ICPM designation is for a minimum term of one-month and requires the designated resource to offer into the MRTU markets for the designation period. Specifically, a resource accepting an ICPM designation will receive a capacity payment and incur a daily obligation to submit economic bids or self-schedules into the day-ahead market for the term of the designation. ICPM will be implemented simultaneously with MRTU start-up.

C. <u>Summary of the Proposed Tariff Revisions</u>

13. On June 27, 2008, the CAISO filed the proposed tariff revisions, which provide mitigation measures for the Exceptional Dispatch provisions of the MRTU Tariff that the Commission has already accepted. The CAISO submitted the proposed mitigation

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[22] The CAISO may exceptionally dispatch all types of resources. Exceptional dispatches of energy are settled pursuant to section 11.5.6 of the MRTU Tariff.

[23] *See* CAISO February 8, 2008 Amendments to Implement an Interim Capacity Procurement Mechanism in Docket Nos. ER08-556-000 and ER06-615-020.

[24] We note that an order conditionally accepting the ICPM in Docket Nos. ER08-556-000 and ER06-615-020, is being issued concurrently with the instant order.

[25] 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 No. ER08-556-000 at 3 (ICPM Transmittal).

measures because it had become apparent to the CAISO that some resources could potentially exercise local market power when issued Exceptional Dispatch instructions, and also that exceptional dispatches will be far more frequent than originally expected when Exceptional Dispatch was proposed and accepted in the MRTU proceeding.[26] The CAISO asserts that mitigation is appropriate because, although the MRTU market has local market power mitigation mechanisms in place, exceptional dispatches are settled out-of-market and, consequently, are not covered by the mitigation provisions of the existing MRTU Tariff.

14. The CAISO proposes to mitigate resources that are issued exceptional dispatches for the following three reasons: (1) to address reliability requirements related to non-competitive transmission constraints; (2) to ramp units up from minimum operating levels to minimum dispatchable levels to protect against contingencies that are not directly incorporated or sufficiently met by the MRTU software; or (3) to address other special unit-specific operating or environmental constraints not incorporated into the MRTU model. The CAISO expects that the majority of exceptional dispatches will be related to either forced generation or transmission outages, or local constraints that are not modeled. The latter includes voltage stability constraints (which would require a resource to operate at a minimum level) and contingencies related to Path 26,[27] a constraint that requires units to be committed to ensure that sufficient 30-minute dispatchable capacity is online south of Path 26.

15. The CAISO proposes to mitigate all resources so that they receive the higher of: (1) their default energy bid; or (2) the locational marginal price. Under the proposed mitigation, resources with capacity contracts, i.e., resource adequacy resources, reliability must-run resources, and ICPM resources, will earn no additional capacity-related revenues through Exceptional Dispatch. However, for non-resource adequacy resources, the CAISO proposes to allow for additional "supplemental revenues."[28] This is because non-resource adequacy resources have no guaranteed fixed cost recovery for providing

[26] When the Commission approved Exceptional Dispatch in the MRTU filing, we emphasized that Exceptional Dispatch instructions should "not become a frequent occurrence and should be reserved for genuine emergencies." September 2006 MRTU Order, 116 FERC ¶ 61,274 at P 267.

[27] Path 26 is a set of three 500 kV transmission lines that connects SoCal Edison to PG&E; in the summer, Path 26 often becomes overloaded.

[28] Supplemental revenues equal the higher of: (1) the locational marginal price or (2) the resource's actual bid, minus the resource's default energy bid. Supplemental revenues are the total amount of revenue received by a resource above its default energy bid after following an Exceptional Dispatch instruction.

capacity and because locational marginal prices will likely be suppressed when Exceptional Dispatch instructions are issued.[29]

16. Thus, non-resource adequacy resources that receive Exceptional Dispatch instructions will be paid the higher of: (1) their default energy bid; (2) the locational marginal price; or (3) their actual bid.[30] While the CAISO proposes to allow non-resource adequacy resources to accrue supplemental revenues as a contribution toward their fixed costs, the CAISO proposes to mitigate non-resource adequacy resources by capping the amount of supplemental revenues that may accrue. The CAISO will cap the amount of supplemental revenues that a non-resource adequacy resource can accrue in a 30-day period at $41/kW-year, or the same as a capacity payment associated with an ICPM designation.

II. <u>Notice, Intervention, and Responsive Pleadings</u>

17. Notice of the proposed tariff revisions was published in the *Federal Register*, 73 Fed. Reg. 40,569 (2008) with motions to intervene, comments, and protests due on or before July 18, 2008. Timely motions to intervene, comments, and/or protests were filed by the following: (1) Alliance for Retail Energy Markets (AReM); (2) Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (Six Cities); (3) CPUC; (4) City of Santa Clara, California and the M-S-R Public Power Agency (Santa Clara); (5) Modesto Irrigation District; (6) NRG Power Marketing, Inc., Cabrillo Power I LLC, Cabrillo Power II LLC, Long Beach Generation LLC, and El Segundo Power LLC; (6) PG&E; (7) Powerex Corporation (Powerex); (8) Reliant Energy, Inc. (Reliant); (9) Western Power Trading Forum (WPTF); (10) SoCal Edison; (11) Dynegy Moss Landing, LLC and Dynegy Morro Bay LLC (Dynegy); and (12) Calpine Corporation (Calpine).

18. Answers and/or reply comments were filed by SoCal Edison, PG&E, CAISO, and the CPUC.[31]

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[29] Locational marginal prices may be suppressed because exceptional dispatches are settled out-of-market and considered effectively in the real-time market as energy with a bid of zero. This effectively shifts the supply stack to the right and lowering locational marginal prices.

[30] The CAISO proposes to mitigate Exceptional Dispatch instructions more stringently during the first four months of MRTU and then to relax the mitigation. Under the more stringent mitigation, non-resource adequacy resources will be paid the higher of: (1) the LMP or (2) their default energy bid plus $24/MWh.

[31] We note that the CAISO's and CPUC's Answers were filed out-of-time.

III. 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. 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 will accept the answers filed by SoCal Edison, PG&E, CPUC, and the CAISO because they assisted us in our decision making process.

B. Comments on the Proposed Tariff Revisions

1. Mitigation

Proposal

20. Under the proposed tariff modifications, mitigation rules would apply to exceptional dispatches that are issued to resources for the following reasons: (1) to address reliability requirements related to non-competitive transmission constraints; (2) to ramp units from minimum operating levels to minimum dispatchable levels in order to protect against reliability contingencies that are not directly incorporated or sufficiently met by the MRTU software; or (3) to address other special unit-specific operating or environmental constraints that are not incorporated in the MRTU model.[32] Additionally, the bidding limitations that apply to bids generally also apply to exceptional dispatches because, in both cases, the CAISO considers the same set of market bids.

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[32] CAISO June 27, 2008 Exceptional Dispatch Mitigation Transmittal Letter in Docket No. ER08-1178-000 at 6 (Exceptional Dispatch Mitigation Transmittal). Because exceptional dispatches are issued outside of the MRTU software, resources that receive Exceptional Dispatch instructions are not subject to the Market Power Mitigation and Reliability Requirement Determination process, which the CAISO uses to mitigate the potential exercise of market power in its integrated forward market and real-time market. The CAISO anticipates that exceptional dispatches will typically be required to address a transmission constraint or generation unit operating constraint that was not captured in the models used in the integrated forward market, the Reliability Unit Commitment process, or the real-time market. This will include instances when the CAISO's market software is unable to dispatch a particular needed resource and the CAISO dispatchers need to manually send a dispatch instruction, which will then be incorporated in the MRTU software for the dispatch interval. *Id.* at 4.

a. The Need for Mitigation

Comments and Protests

21. WPTF argues that Exceptional Dispatch is already mitigated by both its inability to set the market clearing price and the energy bid offer cap.[33] WPTF contends that the three additional forms of mitigation[34] for Exceptional Dispatch, introduced in the tariff revisions, are unnecessary. WPTF asserts that if Exceptional Dispatch is truly infrequent and unpredictable, a supplier will not be able to anticipate the onset of an Exceptional Dispatch event. WPTF also points out that if a supplier changed its bidding behavior after receiving an Exceptional Dispatch instruction, the CAISO's market monitor should be able to detect such behavior and take appropriate action. Moreover, WPTF argues that excessive ex ante mitigation should not be a substitute for effective market monitoring. Finally, WPTF contends that the proposed mitigation of Exceptional Dispatch is unnecessary since the CAISO has pledged to take quick action if an issue arises under MRTU.[35]

22. WPTF asserts that providing the CAISO with additional Exceptional Dispatch mitigation measures reduces the incentives for the CAISO to work with market participants to resolve the problems that make Exceptional Dispatch necessary. Further, WPTF notes that the ability of the CAISO to mitigate Exceptional Dispatch reduces the incentives for the CAISO to update and reform the integrated forward market modeling of the transmission constraints that can lead to the need for Exceptional Dispatch.

23. According to WPTF, the CAISO's assertion that Exceptional Dispatch mitigation is necessary in order to prevent a supplier from rejecting a Tier 2 ICPM designation is flawed. WPTF explains that by using this argument, the CAISO reveals its belief that there is apparently an overlap, as well as discretion, in the events that would trigger

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[33] WPTF July 18, 2008 Comments in Docket No. ER08-1178-000 at 6 (WPTF Comments).

[34] WPTF points out the following three additional ways that the CAISO proposes to mitigate exceptional dispatches: (1) by preventing a unit from being paid its energy bid price in the first four months of MRTU; (2) by preventing non-resource adequacy resources, non-reliability must-run resources, and ICPM capacity from being paid their energy bid price when exceptionally dispatched; and (3) by capping the level of revenues exceptionally dispatched resources could earn above their default energy bid. *Id.* at 6-7.

[35] *See id.* at 7 (citing Joint Comments of Keith Casey and Frank Wolak to the July 1, 2008 Technical Conference reviewing wholesale markets, Docket No. AD08-9, at 2-3).

Exceptional Dispatch mitigation and the events that may trigger an ICPM designation. WPTF states that if there was no overlap between the triggering events, the CAISO would not be concerned with supplier incentives to accept or decline an ICPM designation, as an ICPM designation would never be offered for Exceptional Dispatch conditions. WPTF states that if mitigation is not eliminated altogether, then the overlap between Exceptional Dispatch events and Tier 2 ICPM designations must be specifically addressed.

Answers

24. The CPUC argues that WPTF's concern that the CAISO's proposal will result in the imposition of multiple mitigation measures is unfounded and unwarranted. Noting that the proposal will not impact suppliers in the long-term, the CPUC states that the CAISO's proposal to not pay units their full bid price during the first four months following MRTU is necessary to ensure the smooth implementation of MRTU. In addition, the CPUC asserts that, after the first four months of MRTU implementation, these resources will receive their bid price until they reach the supplemental revenue cap.

25. In response to WPTF's arguments, the CAISO explains that it plans to use the information obtained from Exceptional Dispatch to modify and improve both the Full Network Model and the MRTU software. The CAISO elaborates that experience and corresponding improvements in the Full Network Model and the MRTU software may reduce the frequency of Exceptional Dispatch to a level where specific mitigation of Exceptional Dispatch will become very rare and infrequent.

26. According to the CAISO, the idea that the infrequency of Exceptional Dispatch will prevent the exercise of market power incorrectly assumes that one can predict how often Exceptional Dispatch will be needed to address local reliability issues with any accuracy. The CAISO explains that although its goal is for Exceptional Dispatch to be used rarely and infrequently, it is concerned that it may have to issue Exceptional Dispatch instructions more frequently to address local reliability issues that are not modeled in the Full Network Model, particularly during the first two years of MRTU. Moreover, the CAISO explains that the mitigation provisions were designed to address exceptional dispatches that would be predictable, due to operator actions and known system conditions, regardless of frequency.

27. The CAISO disagrees with WPTF's argument that market power should only be addressed after the fact and believes that WPTF's approach conflicts with the Commission's preference for a priori mitigation based on clear thresholds and market

rules.[36] The CAISO also notes that even though appropriate mitigation rules can be implemented relatively quickly, procedural and software requirements may result in a significant lag before such rules can be implemented. According to the CAISO, the Exceptional Dispatch provisions have the advantage of allowing the CAISO to mitigate market power at the time the CAISO commits or dispatches resources.

28. According to the CAISO, there is no merit to the argument that mitigation will reduce the incentives for it to improve MRTU and thereby reduce the need to use Exceptional Dispatch. The CAISO states that it will be required to publish the reasons for any Exceptional Dispatch, as well as all instances of Exceptional Dispatch, which will not only provide a high level of transparency to market participants but will create an incentive for the CAISO to do all it can to address the underlying reasons for Exceptional Dispatch.

b. Circumstances Where Mitigation Applies

i. Section 39.10(1): Mitigation for Addressing Transmission Constraints Not Modeled in the Competitive Constraints Run

Comments and Protests

29. WPTF objects to the mitigation proposal under section 39.10(1), which addresses the mitigation of transmission constraints not modeled in the competitive constraints run.[37] Specifically, WPTF contends that the tariff revisions indicate that the CAISO may use and mitigate Exceptional Dispatch for any transmission constraint that is not modeled in the competitive constraints run. WPTF asserts that from a practical standpoint, there is no difference between not modeling a constraint and not enforcing that constraint. As such, WPTF argues that the section's condition would authorize the CAISO to use and mitigate Exceptional Dispatch for any non-competitive constraint because "[no] non-competitive [c]onstraints are enforced (or, effectively) modeled in the [c]ompetitive [c]onstraints [r]un."[38] WPTF argues that this cannot be the CAISO's intent, and thus

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[36] CAISO's August 5, 2008 Answer in Docket No. ER08-1178-000 at 6 (*citing PJM Interconnection, L.L.C.*, 112 FERC ¶ 61,031, at P 63 (2005); *ISO New England Inc.*, 104 FERC ¶ 61,039, at P 38 (2003)) (CAISO Answer).

[37] WPTF notes that section 39.10 of the MRTU Tariff defines the competitive constraints run as the first optimization run of the Market Power Mitigation and Reliability Requirement Determination process through which all pre-designated competitive constraints are enforced.

[38] WPTF Comments at 10.

requests that if the Commission approves the CAISO's proposal to mitigate Exceptional Dispatch, the Commission direct the CAISO to revise proposed section 39.10 to read: "(1) addressing reliability requirements related to transmission [c]onstraints not enforced in the [c]ompetitive [c]onstraints [r]un of the [Market Power Mitigation and Reliability Requirement Determination]."[39]

Answer

30. In response, the CAISO explains that it intends to have the authority to mitigate exceptional dispatches for any non-competitive constraint. According to the CAISO, it needs to be able to employ the Exceptional Dispatch mitigation provisions to address all constraints that are not modeled in the competitive constraints run of the Market Power Mitigation-Reliability Requirement Determination.

ii. Section 39.10(2): Mitigation for the Purpose of Ramping Units Up

Comments and Protests

31. WPTF objects to section 39.10(2), which allows for mitigation for the purpose of ramping up units. WPTF states that the CAISO attempts to justify the use of Exceptional Dispatch for this purpose by citing the need for unloaded capacity to be available to address contingencies that overload Path 26, which the CAISO claims is a well known constraint that is not modeled in the MRTU Full Network Model.[40] WPTF claims that the CAISO neither supports the use of Exceptional Dispatch for this problem nor justifies why any such Exceptional Dispatch should be mitigated.

32. WPTF provides that a common term for the product the CAISO describes as the need for unloaded capacity is operating reserve. WPTF notes that the CAISO currently

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[39] *Id.*

[40] The CAISO provides that "The Path 26 constraint is not modeled in the [Full Network Model] due to the constraint's complexity. Nevertheless, the CAISO anticipates that this reliability requirement will likely be indirectly met as a result of other constraints incorporated into the [Full Network Model] and by market schedules resulting from the [integrated forward market] and, therefore, the frequency of today's must-offer commitments for Path 26 is not likely to be any indication of the frequency of exceptional dispatches under MRTU. In addition, although voltage support and stability constraints are also not modeled explicitly in the [Full Network Model], they may in some cases be converted into and modeled as flow-based constraints." CAISO Exceptional Dispatch Mitigation Transmittal at 20.

operates markets for the following three types of operating reserves: (1) spinning; (2) non-spinning; and (3) regulation. According to WPTF, the MRTU Tariff authorizes the CAISO to procure these reserves on a sub-regional basis as necessary. Further, WPTF contends that the CAISO seeks to use Exceptional Dispatch, which is an extra-market mechanism, to procure operating capacity in spite of the fact that the CAISO operates markets for procuring operating capacity, and that nothing would prevent the CAISO from procuring 10-minute reserves to meet a 30-minute contingency.

33. According to WPTF, the fact that the CAISO has not modeled a particular constraint, such as Path 26, which gives rise to the need for operating reserves, does not justify the use of Exceptional Dispatch to procure operating reserves. WPTF notes that the CAISO has already developed a system to determine the amount of unloaded capacity that is needed to protect against Path 26 overloads. WPTF states that since this system currently exists, the CAISO can use it to set the operating reserve requirements in its markets. If the Commission permits the CAISO to use Exceptional Dispatch to procure operating reserves, WPTF urges the Commission to reject the CAISO's proposal to mitigate Exceptional Dispatch for procuring reserves for competitive Path 26.

34. In addition, WPTF states that the CAISO's proposal to mitigate exceptional dispatches that are used to procure operating reserves to address Path 26, which is a competitive path under MRTU,[41] is inconsistent with the CAISO's proposal to only mitigate Exceptional Dispatch for reliability requirements related to non-competitive paths. WPTF also claims that the CAISO's proposal to mitigate exceptional dispatches that are used to procure operating reserves is inconsistent with the fact that, apart from a $250/MW offer cap, the CAISO does not have authority under its MRTU Tariff to mitigate ancillary service bids.

Answers

35. With respect to WPTF's argument that the CAISO does not justify the use or mitigation of Exceptional Dispatch to address contingencies, such as an overload of Path 26, the CAISO states that it has explained that it needs to employ the Exceptional Dispatch mitigation provisions to prevent the exercise of local market power in situations where a reliability constraint is not modeled in the Full Network Model, which is the case with Path 26. In addition, the CAISO states that it does not intend to use Exceptional Dispatch to procure operating reserves and explains that, under MRTU, the CAISO will continue to procure enough 10-minute operating reserves to meet all of the North

[41] Path 26 is the transmission interface between the current SP26 and ZP26 congestion zones. WPTF Comments at 11(citing MRTU Order, 116 FERC ¶ 61,274 at P 1030).

American Electric Reliability Corporation's and the Western Electricity Coordinating Council's reliability standards to address 10-minute contingencies.

36. The CAISO explains, however, that it may also use Exceptional Dispatch as one of a variety of means to address 30-minute contingencies. The CAISO recognizes that it may be appropriate to develop a new market product that can help to protect against 30-minute contingencies and states that it has started discussion with stakeholders to review the need for such a product. The CAISO provides that the potential need for and the appropriate design of such a product can only be accurately assessed after MRTU is implemented and the CAISO has gained experience with the new market design.

37. Further, the CAISO states that the Commission should reject WPTF's argument that the proposal to mitigate Exceptional Dispatch to address contingencies on Path 26 is inconsistent with the proposal to use Exceptional Dispatch to address reliability requirements related to non-competitive transmission constraints. According to the CAISO, there is no inconsistency, as the provisions were included to specifically address two different circumstances where the CAISO will mitigate Exceptional Dispatch. In addition, the CAISO states that WPTF's argument that section 39.10(2) is inconsistent with the fact that the MRTU Tariff contains no provisions regarding the mitigation of ancillary services bids is meritless. The CAISO explains that it would not use section 39.10(2) for the purpose of committing units to provide ancillary services or imposing an ancillary services offer obligation under the current MRTU market rules.

iii. Section 39.10(3): Mitigation for Addressing Unincorporated Operating or Environmental Constraints

Comments and Protests

38. WPTF provides that the September 2006 MRTU Order authorized the CAISO to use Exceptional Dispatch for the purpose of addressing "other special unit-specific operating or environmental [c]onstraints not incorporated into the [Full Network Model] or the CAISO's market software."[42] WPTF asserts that while the CAISO indicated it would provide additional details on the nature of the constraints that would result in Exceptional Dispatch, the only constraints that the CAISO lists are the Path 26 constraint and Delta Dispatch. WPTF asserts that the CAISO should explain why it must use Exceptional Dispatch in the identified circumstances when the purpose of the zonal and local resource adequacy requirements is (1) to provide sufficient capacity within a defined geographic area and (2) to maintain reliability. Further, WPTF asserts that if the Commission approves any form of mitigation for Exceptional Dispatch, the Commission

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[42] *Id.* at 12.

should only authorize the CAISO to use and mitigate Exceptional Dispatch for addressing certain constraints and situations where the CAISO has demonstrated that the zonal and local capacity already provided to it for reliability is ineffective and that the constraints and situations warrant mitigation.

39. Regarding the CAISO's proposal to mitigate and use Exceptional Dispatch for other special unit-specific operating or environmental constraints, WPTF argues that it is impossible for market participants to discern from this vague language which constraints would fall under this proposed authority. For instance, WPTF notes that the CAISO's MRTU Tariff definition of constraints is "[p]hysical and operational limitations on the transfer of electrical power through transmission facilities."[43] WPTF states that it is unclear how this definition, which narrowly applies to transmission facilities, applies to generating unit-specific operating characteristics. WPTF states that it is similarly unclear how this transmission-focused definition applies to environmental constraints, which would appear to require shifting the generation from one resource to another because of things like restrictions on emissions or outlet water temperature, not because of limitations on power flows through transmission facilities. WPTF elaborates that this ambiguity effectively delegates inappropriate decisional discretion to the CAISO to decide whether a particular set of events should precipitate an hourly Exceptional Dispatch or ICPM designation. As such, WPTF asserts that it also, by extension, puts the Commission in the position of determining, ex ante, the reasonableness of the CAISO's exercise of this discretion.

40. According to WPTF, if the Commission permits the CAISO to mitigate Exceptional Dispatch, the Commission should require the CAISO to submit a clear, precise, more narrow description of this use of extra-market authority, and provide analysis justifying the existence of market power that warrants mitigation.

Answers

41. In response to WPTF's assertion that the CAISO should explain why Exceptional Dispatch is needed to address Delta Dispatch and Path 26, in light of the purpose of zonal and local resource adequacy requirements, the CAISO reiterates that Path 26 and Delta Dispatch need to be addressed through Exceptional Dispatch because they can present opportunities for the exercise of market power since they are extremely difficult to model. The CAISO explains that although it expects to have all the resource adequacy resources it needs to address local requirements, the CAISO may still need to utilize exceptional dispatches because the MRTU market software may not dispatch the required resource adequacy resources due to constraints that are not sufficiently modeled.

[43] *Id.* at 13 n.22.

42. The CAISO states that it requests approval of section 39.10 so that it can apply mitigation measures to Exceptional Dispatch in all conditions where there is significant potential for the exercise of market power due to localized or unit specific constraints and other reliability requirements that are not subject to the mitigation measures incorporated in the MRTU software. Further, the CAISO provides that section 39.10(3) addresses the problems that idiosyncratic operating parameters and constraints exist that cannot reasonably be modeled, and also that environmental constraints are not engineering constraints and, therefore, cannot be modeled.[44] The CAISO explains that it needs the experience that will come with the operation of the MRTU markets in order to determine whether changes need to be made to the Full Network Model.

c. <u>Compensation</u>

<u>Proposal</u>

43. Under the tariff revisions, in circumstances where mitigation applies, exceptionally dispatched resources will be paid the higher of the resource's default energy bid or the locational marginal price at the resource's location. According to the CAISO, mitigating payments for an Exceptional Dispatch to the higher of the resource's default energy bid or the locational marginal price closely mirrors the market result that would occur if the reliability requirement creating the need for the Exceptional Dispatch were incorporated in the MRTU software.[45]

44. The tariff revisions provide additional mitigation rules that are designed to facilitate the recovery of fixed costs by providing supplemental revenues to resources that meet the following criteria. First, the resource must not be under a reliability must-run contract, must not be designated under ICPM, and must not be a resource adequacy

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[44] CAISO's Answer at 16.

[45] The CAISO provides that the combination of mitigation and Exceptional Dispatch could, at times, suppress locational marginal prices because additional incremental energy delivered by exceptionally dispatched resources will be considered in the real-time market as energy with a price of zero. In general, resources with capacity contracts, such as ICPM capacity, reliability must-run resources, and resource adequacy resources, are guaranteed contributions toward fixed cost recovery under their capacity contracts. Therefore, such resources should be less susceptible to the impact on market revenues caused by infrequent exceptional dispatches than resources without capacity contracts. On the other hand, suppressed locational marginal prices could affect the recovery of fixed costs by resources without capacity contracts, when such resources are infrequently dispatched or are often subject to mitigation while also being the unit setting the marginal price.

resource or, if it is a partial adequacy resource, its non-resource adequacy capacity must be needed. Second, the resource must have a bid in the integrated forward market and hour-ahead scheduling process/real-time market for the applicable operating day or hour in which it is issued an Exceptional Dispatch instruction.[46] Third, the resource must not have accrued an amount of Exceptional Dispatch supplemental revenues in the past 30 days that is equal to or greater than the monthly ICPM capacity payment that the resource would have been eligible for if it was designated under the ICPM.[47]

45. During the first four months of MRTU, eligible mitigated resources will receive supplemental revenues equal to the higher of the resource-specific settlement interval locational marginal price minus the default energy bid price for the resource or the default energy bid plus a $24/MWh adder, minus the default energy bid price for the resource, multiplied by the amount of energy provided by the resource under Exceptional Dispatch. Starting at the beginning of the fifth month of MRTU, eligible resources would receive supplemental revenues equal to the higher of the energy bid price for the resource minus the default energy bid price for the resource, or the resource-specific settlement interval locational marginal price, minus the default energy bid price for the resource, multiplied by the amount of energy provided by the resource.

46. In any case where the energy bid price for a mitigated resource is lower than the resource's default energy bid price, and the resource-specific settlement interval locational marginal price is lower than both the energy bid price for the resource and the default energy bid price for the resource, the CAISO proposes to settle the Exceptional Dispatch at the resource's energy bid price. According to the CAISO, this is consistent with the settlement rule for market power mitigation in the current MRTU Tariff.[48]

i. <u>Mitigated Revenues</u>

<u>Comments and Protests</u>

47. Reliant argues that compensation on the basis of a unit's default energy bid fails to account for the actual costs that a unit will incur when responding to an Exceptional

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[46] According to the CAISO, providing supplemental revenues to resources that do not have bids in the market would create an incentive for resources to exit the market either in anticipation of an Exceptional Dispatch or force the CAISO to issue an Exceptional Dispatch that will provide the resource with a supplemental payment.

[47] CAISO Exceptional Dispatch Mitigation Transmittal Letter at 9.

[48] *Id*.

Dispatch instruction.[49] Reliant argues that if the full cost of dispatch is ignored, the CAISO may use Exceptional Dispatch instead of addressing the constraints that drive the need for dispatch.[50]

48. Noting that a variable cost default energy bid is calculated on the basis of day-ahead natural gas prices, Reliant states that compensation on the basis of a variable cost default energy bid fails to account for the higher natural gas costs that a unit may incur when the Exceptional Dispatch occurs on an intra-day basis. Reliant asserts that if the natural gas that is burned pursuant to an Exceptional Dispatch instruction from the CAISO was not scheduled due to the Exceptional Dispatch occurring later in the day, beyond what is feasible for gas nominations to occur, the resource responding to an Exceptional Dispatch could well face the prospect of paying 150 percent of the highest published gas index price during the recent five-day period.[51] In addition, Reliant asserts that the CAISO's proposal does not account for the natural gas local distribution company balancing charges and penalties that a unit will incur when responding to an unanticipated Exceptional Dispatch instruction.

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[49] Reliant's July 18, 2008 Protest in Docket No. ER08-1178-000 at 4 (Reliant Protest).

[50] *Id.* at 8. Reliant argues that the CAISO's Exceptional Dispatch proposal reduces the urgency of incorporating the changes required to resolve the limitations of the MRTU software and network model representation.

[51] Additionally, Reliant explains that in order for the CAISO's Exceptional Dispatch compensation proposal to be compensatory, a resource would always have to be exceptionally dispatched on a day-ahead basis so as to allow the resource to procure fuel supplies at the price at which the CAISO is basing its Exceptional Dispatch compensation. Alternatively, Reliant contends that if a resource were committed and dispatched on an intra-day basis, fuel costs on an intra-day basis would have to be equivalent to the day-ahead fuel costs on which the CAISO is basing its compensation. Reliant asserts that neither assumption is likely to be true. Moreover, Reliant explains that Exceptional Dispatch is more likely to occur on an intra-day basis when intra-day natural gas is more expensive than the day-ahead gas costs reflected in the CAISO's default energy bid, or may only occur during energy event days, i.e., the loss of the Pacific DC Intertie, a result which the CAISO states would require that unloaded capacity be available to address 30-minute contingencies on Path 26. *Id.* at 6.

49. Acknowledging that a unit may seek a negotiated default energy bid,[52] Reliant contends that a negotiated default energy bid may still result in under compensation and may harm the ability of a unit to be awarded a bid in normal MRTU markets. Reliant explains that, as currently modeled in the MRTU software, default energy bid parameters impact the ability of a generating resource to lower its start-up and minimum generation costs when bidding into the CAISO's integrated forward and real-time markets. Further, Reliant avers that if a resource were to negotiate a default energy bid with the CAISO it would be raising these parameters. Therefore, according to Reliant, raising the default energy bid can harm the ability of a resource to be awarded a bid in MRTU integrated forward and real-time markets.

50. Reliant requests that the Commission order the CAISO to develop monitoring tools to determine whether the bids of a resource subject to Exceptional Dispatch are the result of market power instead of simply assuming, as the tariff revisions do, that market power exists. Further, Reliant states that while the additional uncompensated costs to a resource of responding to an Exceptional Dispatch can be millions of dollars per dispatch, the cost to the CAISO of developing a surgical response to what it describes as the rare and infrequent use of Exceptional Dispatch is surely less than the costs to resources responding to the CAISO's Exceptional Dispatch instructions.[53]

51. Reliant also asks that, in order to facilitate the development of negotiated default energy bids, the Commission order the CAISO to modify its MRTU software to allow offers for start-up and minimum generation that are less than or equal to default energy

[52] Reliant states that when it requested that the CAISO consider accepting invoices for fuel costs incurred but not compensated when responding to an Exceptional Dispatch, the CAISO indicated that the submission of invoices was not a feature of organized power markets. Reliant agrees with the CAISO but submits that when an independent system operator categorically mitigates all bids responding to an Exceptional Dispatch and takes away the ability of a market participant to express its costs in bids, there are few options. According to Reliant, the CAISO also suggested that Reliant raise the operating cost compensation issues with the Commission and consider a negotiated default energy bid with the CAISO. *Id.* at 6-7.

[53] *See id.* at 9 (citing CAISO Exceptional Dispatch Mitigation Transmittal Letter at 19). According to Reliant, the CAISO could compare bids submitted after the issuance of an initial Exceptional Dispatch call to bids that a resource or type of resource has submitted in the past under similar energy and fuel market circumstances. In the alternative, the CAISO's department of market monitoring could mitigate a settlement amount after reviewing a bid submitted by a resource that is exceptionally dispatched.

bid parameters.[54] Finally, Reliant states that the Commission should order the CAISO to accept invoices for verifiable costs and provide compensation for verifiable costs that exceed a unit's variable cost default energy bid, if the unit and the CAISO have not agreed on a negotiated default energy bid and the MRTU software has not been modified as requested.

Answers

52. The CAISO asserts that Reliant's arguments regarding the possibility of under compensation are speculative and run contrary to the Commission's repeated acknowledgement that the negotiated rate option is flexible enough to allow resources to be fully compensated.[55] Further, the CAISO states that each negotiated default energy bid must be filed with the Commission for informational purposes after it is negotiated and, to the extent the Commission then determines that the negotiated default energy bid is not just and reasonable it may require retroactive adjustments.

53. The CAISO argues that the Commission should reject Reliant's proposed modification of the MRTU software, which would allow offers for start-up and minimum load generation that are less than or equal to a resource's default energy bid parameters, as resources are able to obtain full compensation pursuant to a negotiated default energy bid without Reliant's suggested modification. Further, according to the CAISO, under the MRTU Tariff a resource located within a local capacity area that chooses the registered cost option can receive up to 200 percent of projected proxy costs with regard to its start-up and minimum load costs, and a resource located outside of a local capacity area, that chooses the registered cost option, may receive up to 400 percent of such projected proxy costs. The CAISO explains that although the values the resource specifies for its start-up and minimum load costs will be in place for six months after the resource chooses the registered cost option, the 200 percent and 400 percent caps should be high enough to ensure that the resource recovers all of its start-up and minimum load costs. Moreover, the CAISO asserts that even if gas costs rise sharply during the six-

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[54] *See id.* (stating that the requested modification would allow a negotiated default energy bid to be developed with the CAISO as an alternative to reliance on the variable cost default energy bid, which is not remunerative when a generating unit is dispatched on an intra-day basis).

[55] CAISO's Answer at 26 (citing *Cal. Indep. Sys. Operator Corp.*, 120 FERC ¶ 61,271, at P 17; MRTU Rehearing Order, 119 FERC ¶ 61,076, at P 510 (2007); MRTU Order, 116 FERC ¶ 61,274, at P 1046 and 1048 (2006)).

month period, the resource can always choose to recover its costs by switching to the proxy cost option.[56]

54. According to the CAISO, the Commission should also reject the proposal to submit invoices for verifiable costs, as the submission of invoices is not a feature of organized power markets and the negotiated default energy bid option.

55. The CAISO asserts that there is no need to develop market monitoring tools in place of the proposed mitigation measures because the proposal reflects the circumstances in which the CAISO has determined that mitigation is appropriate because the existence of market power is likely.[57] According to the CAISO, since exceptional dispatches result from real-time system or operating constraints that are not captured in the MRTU market software, it is not feasible to develop the type of automated tests for local market power that Reliant seems to suggest should be utilized to trigger mitigation.

ii. Supplemental Revenues: Opposition to the Proposed Rules Governing Payments of Supplemental Revenues

Comments and Protests

56. To ensure that supplemental revenues are factored into the CAISO's selection process, AReM and Six Cities urge the Commission to order that section 34.9 be modified to expressly adopt such a requirement.

57. WPTF argues that the Commission should reject the requirement that a supplier must have submitted an energy bid as a condition for receiving supplemental revenues when exceptionally dispatched. WPTF states that by requiring that non-resource adequacy capacity submit a bid into the CAISO’s markets in order to be eligible for supplemental revenues, the CAISO is effectively extending the must-offer obligation to non-resource adequacy capacity. WPTF expands that non-resource adequacy capacity is not the capacity that the CAISO should rely on for grid reliability, and as such, is no different than capacity that has been de-listed in ISO-New England’s Forward Capacity

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[56] *Id.* at 28 (citing MRTU Tariff at section 30.4).

[57] *Id.* at 17.

Market. WPTF notes that the Commission has already found that such de-listed capacity is not required to submit a bid.[58]

58. As such, WPTF asserts that if the CAISO wants particular resources to offer into its markets, it should work to secure resource adequacy or reliability must-run contracts or ICPM designations for non-resource adequacy resources and not impose punitive cost recovery conditions on its extra-market procurement.

59. WPTF argues that the CAISO's proposal to exclude resource adequacy, reliability must-run, and ICPM resources from earning supplemental revenues fails to account for the possibility that a resource may be under a resource adequacy contract or ICPM designation for only part of its capacity, or for only a short period of time. WPTF states that of the three types of resources that are excluded from receiving so-called supplemental revenues, only reliability must-run units are contracted for a full year. WPTF submits that it is unreasonable to think that a resource would recover all of its annual fixed costs from a one-month resource adequacy contract or a one-month ICPM designation. Accordingly, WPTF argues that the Commission should limit the CAISO's proposal to deny Exceptional Dispatch supplemental revenues to only reliability must-run units.[59]

Answers

60. The CPUC asserts that WPTF's argument that the requirement that non-resource adequacy resources must have a bid in the markets before they can receive supplemental revenues is illogical because the proposed requirement merely requires entities to have a bid in the market in order to receive supplemental payments and does not place any undue burden or must-offer obligation on non-resource adequacy resources. The CPUC also disagrees with WPTF's argument that resource adequacy, reliability must-run, and ICPM resources should receive supplemental revenues, as these resources already receive compensation for their fixed costs and, therefore, should not be compensated twice for their fixed costs.

61. The CAISO argues that the Commission should reject Six Cities' suggested tariff modification, that section 34.9 be modified to expressly require that the impact of

[58] WPTF Comments at 17 (citing *ISO New England, Inc.*, 119 FERC ¶ 61,239 (2007) approving section 13.6 of Market Rule 1). Section 13.6.2.1.1 of Market Rule 1 states "[a] Generating Capacity [r]esource that is fully de-listed is not required to offer into the Day-Ahead Energy Market or Real-Time Energy Market." *Id.*

[59] This would entitle resource adequacy resources and ICPM designated units to supplemental revenues.

supplemental revenue payments be considered when selecting resources for Exceptional Dispatch. The CAISO elaborates that the revisions to section 34.9 already state that the CAISO will seek to issue Exceptional Dispatch instructions on a least-cost basis, and therefore the revisions permit, but do not require, the CAISO to conduct least-cost Exceptional Dispatch, while taking the impact of supplemental revenue payments into account.

62. According to the CAISO, the tariff revisions already permit recovery of supplemental revenues by partial resource adequacy resources and partial ICPM resources that satisfy certain criteria, to the extent that their capacity is not committed as resource adequacy capacity or ICPM capacity.[60] In addition, the CAISO states that WPTF's argument concerning the continued existence of the must-offer obligation is an attack on provisions that the Commission has already approved. The CAISO notes that under the current MRTU Tariff, the CAISO has the authority to issue Exceptional Dispatch instructions to all types of resources. The CAISO argues that WPTF's assertion is merely an untimely collateral attack on the Commission's previous authorization to the CAISO to use Exceptional Dispatch. The CAISO elaborates that if a non-resource adequacy resource believes that it needs supplemental revenues, it should be required to submit an energy bid. Finally, the CAISO notes that nothing prevents a unit that does not have a bid in the market from submitting an energy bid into the next eligible market interval during an Exceptional Dispatch.

d. <u>Designation</u>

<u>Proposal</u>

63. Under the proposed tariff revisions, Exceptional Dispatch would not result in the immediate designation of a resource under the ICPM;[61] rather, the CAISO proposes to relax mitigation, subject to a revenue cap set at the monthly ICPM rate.[62]

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[60] CAISO's Answer at 18 (citing sections 39.10.1.3(ii) and 39.10.2.3(ii)).

[61] The CAISO states that Exceptional Dispatch may be needed for a very short-term and transitory reliability requirement. In that case, the CAISO provides that a monthly or multi-month ICPM designation would be inappropriate. On the other hand, the CAISO proposes that a major reliability event should lead to the offer of an ICPM designation.

[62] The CAISO states that this approach would lead to a similar financial outcome, in some circumstances to an ICPM designation for the month. However, the CAISO's proposal provides that when resources face competition for Exceptional Dispatch,

(continued…)

i. Support for Automatic ICPM Designation Under Exceptional Dispatch

Comments and Protests

64. Dynegy, Calpine, and Reliant support the WPTF Protest and reiterate the position that non-resource adequacy units that are exceptionally dispatched for ICPM-type events should receive an ICPM designation. In particular, Dynegy emphasizes that any Exceptional Dispatch of non-resource adequacy, non-reliability must-run, or non-ICPM capacity, through which the CAISO procures services akin to the reliability services provided by resource adequacy units, should trigger a minimum one-month ICPM designation. Similarly, Calpine elaborates that because both exceptionally dispatched resources and ICPM designated resources address reliability requirements in a similar manner, Exceptional Dispatch should be compensated in the same manner as an ICPM designation. Likewise, Reliant notes that the Commission has held that "generating resources that provide similar reliability services must be provided a similar payment."[63]

65. WPTF argues that the Commission should direct that any Exceptional Dispatch of non-resource adequacy, non-reliability must-run, and non-ICPM capacity that occurs for the same reasons that the CAISO procures capacity pursuant to ICPM should result in an ICPM designation of the needed capacity. WPTF claims this modification to the proposed tariff revisions is necessary because both the tariff revisions and ICPM give the CAISO broad discretion about when Exceptional Dispatch and ICPM designations are permitted.[64]

66. WPTF argues that while the CAISO asserts that the ICPM is significantly different from Exceptional Dispatch, the CAISO unsuccessfully distinguishes these two mechanisms. WPTF notes that the CAISO systematically avoids hard triggers and that the CAISO exposes its interest in retaining discretion over the use of ICPM and

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supplemental revenues will accrue more slowly. Therefore, the CAISO asserts that relaxed mitigation is a more flexible market-based mechanism.

[63] Reliant's Protest at 11 (citing *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,069, at P 36 (2006)).

[64] WPTF states that its proposed modifications are necessary to minimize market uncertainty about when and how the CAISO is permitted to intervene in market outcomes. WPTF Comments at 21.

Exceptional Dispatch in both the ICPM filing and the tariff revisions.[65] WPTF argues that such discretion serves to fragment and undermine the market for reliability services and creates unreasonable and unnecessary uncertainty in the recovery of capacity related costs for uncontracted resources; thus, WPTF contends it should be rejected.

67. WPTF notes that Exceptional Dispatch for the purpose of facilitating testing at the request of a resource's scheduling coordinator or decremental Exceptional Dispatch should not trigger an ICPM designation. As such, WPTF requests that the Commission order that any Exceptional Dispatch of a non-resource adequacy resource, non-reliability must-run resource, and non-ICPM capacity, for a purpose that would permit the CAISO to make an ICPM designation, should trigger an ICPM designation for the capacity subject to Exceptional Dispatch.

68. In support of its suggested modifications, WPTF submits that the Commission ordered a similar remedy when it considered the circumstances in which a Significant Event warranted a TCPM designation.[66] In that case, WPTF notes that the Commission directed the CAISO to provide a 30-day TCPM designation upon the first commitment under the must-offer obligation. WPTF provides that the Commission reasoned that designation upon the first commitment was just and reasonable when the CAISO was using non-resource adequacy and non-reliability must-run resources without monthly capacity payments comparable to those provided to resource adequacy and reliability must-run resources.

69. WPTF agrees that the Exceptional Dispatch of energy is not the same operational process as committing units by denying or revoking a waiver of the must-offer obligation, but that the service provided may be the same. WPTF states that both Exceptional Dispatch and the denial of a must-offer waiver can provide the CAISO with reliability services from resources that have not received monthly capacity payments comparable to those provided to resource adequacy and reliability must-run units. WPTF states that where the CAISO uses Exceptional Dispatch to obtain reliability service from non-resource adequacy resources or non-reliability must-run capacity, it is no different than the reliability service the CAISO obtains from non-resource adequacy, non-reliability must-run capacity through a must-offer waiver denial. As such, WPTF argues that whenever the CAISO uses Exceptional Dispatch to procure reliability service from non-

[65] "As the CAISO has explained in the ICPM Tariff Amendment, it does not want to have a prescriptive 'hard trigger' for an ICPM Significant Event that does not allow it to exercise prudent judgment based on Good Utility Practice to avoid designations that are not required." *Id.* at 22 (citing CAISO Exceptional Dispatch Mitigation Transmittal Letter at 21 (quoting ICPM Tariff Amendment)).

[66] *Id.* at 23 (citing TCPM Order, 123 FERC ¶ 61,229 at P 31).

resource adequacy resources and non-reliability must-run resources, the CAISO should be required to provide an ICPM designation.

ii. Opposition to Automatic ICPM Designations Under Exceptional Dispatch

Comments and Protests

70. In light of the CAISO's acknowledgement that many Exceptional Dispatch instructions are likely to result from market software limitations, Six Cities concur with the CAISO's determination that transitory needs for limited resources do not justify a monthly or multi-month designation. According to Six Cities, the creation of an automatic designation rule could create an incentive for resources to inappropriately force exceptional dispatches in order to obtain designations, and accompanying capacity payments, as ICPM resources. Six Cities assert that such "conduct should be discouraged through appropriately-designed market structures rather than incentivized, particularly in the area of reliability."[67]

Answers

71. The CPUC argues that the circumstances where Exceptional Dispatch can be used should be clearly defined in advance and the events leading to an Exceptional Dispatch should be reported. The CPUC provides that it agrees with the CAISO that if Exceptional Dispatch is used to address a transitory need, an ICPM designation is not warranted. The CPUC claims that WPTF's arguments that Exceptional Dispatch should result in automatic ICPM designations are a "blatant attempt to obtain additional revenues for [resources] under the ICPM payments, and a deliberate blurring of the rationales behind Exceptional Dispatch and the ICPM."[68] The CPUC argues that WPTF's proposal would impose excessive costs on ratepayers and further implies that every minor software and operational shortcoming justifies the maximum cost to load serving entities and ratepayers, even when the problem can be addressed in short order.

72. In addition, the CPUC argues that WPTF's proposal has implications for the CPUC's resource adequacy market. According to the CPUC, WPTF's proposal to automatically designate Exceptional Dispatch resources under the ICPM would deter units from signing long-term bilateral resource adequacy contracts, which would undermine the market stability and reliability gains established by the resource adequacy program.

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[67] Six Cities July 18, 2008 Comments in Docket No. ER08-1178 at 3.

[68] CPUC August 7, 2008 Answer in Docket No. ER08-1178-000 at 6.

73. The CAISO states that it believes that the Exceptional Dispatch of a non-resource adequacy resource for local needs would be a rare occurrence and should not automatically trigger an ICPM designation. According to the CAISO, if a resource that is not a resource adequacy, reliability must-run, or ICPM resource is issued Exceptional Dispatch instructions on rare and infrequent occasions, which is the CAISO's goal, the resource cannot be considered to be providing the same reliability service as one of the types of forward-contracted resources with must-offer requirements that Reliant describes. Further, the CAISO explains that if the same resource is frequently issued Exceptional Dispatch instructions, it will receive supplemental revenues up to the level of the monthly ICPM payment, even without an ICPM designation, which will thereby ensure that such a resource receives sufficient compensation.

74. The CAISO argues that Reliant's reliance on the TCPM Order is misplaced and that it ignores the critical differences that the Commission has recognized between the market and tariff environment under the MRTU and the current environment in which the TCPM applies. The CAISO notes that, in the TCPM Order, the Commission recognized that "the ICPM differs from the RCST and TCPM . . . in that it is designated to work under the new MRTU market paradigm, which includes locational marginal pricing and scarcity pricing components, but, significantly, no must-offer obligation."[69] The CAISO explains that an Exceptional Dispatch instruction is quite different from a must-offer waiver denial.[70]

75. In its answer, SoCal Edison argues that automatically designating exceptionally dispatched resources under the ICPM conflicts with the voluntary nature of the ICPM. SoCal Edison argues that it would be discriminatory to allow a resource to decline an ICPM designation, leaving the CAISO uncertain how to address grid reliability needs, while requiring the CAISO to make a 30-day ICPM designation when it may not be necessary to meet grid reliability needs.

76. SoCal Edison disagrees with WPTF's statement that ordering the CAISO to provide non-resource adequacy resources and non-reliability must-run resources a 30-day ICPM designation upon the first Exceptional Dispatch is akin to the Commission's requirement that the CAISO provide a non-resource adequacy or a non-reliability must-run resource a 30-day TCPM designation upon the first denial of a must-offer waiver request. SoCal Edison asserts that a must-offer waiver denial is not the same as an Exceptional Dispatch. According to SoCal Edison, if a resource is denied a must-offer waiver request, the resource will be required to go from planned non-operation to

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[69] CAISO's Answer at 23 (quoting TCPM Order, 123 FERC ¶ 61,229 at P 9).

[70] *Id.* at 24 (citing CAISO Exceptional Dispatch Mitigation Transmittal Letter at 23).

commitment at minimum load. SoCal Edison states that, on the other hand, if a unit is exceptionally dispatched, the unit may already be committed and have just been dispatched up a few megawatts to preserve grid reliability.

77. Similarly, PG&E argues that WPTF's proposal fails to account for the fact that Exceptional Dispatch and ICPM each address different reliability concerns, and also fails to recognize that an automatic designation would distort market behavior by creating undue incentives for resources to create circumstances requiring Exceptional Dispatch.

e. Mitigation in Months One through Four and Month Five Forward

Proposal

78. The proposed tariff revisions set forth two different methodologies for determining Exceptional Dispatch compensation.[71] For the first four months of MRTU operations, the CAISO proposes that mitigated resources eligible to receive supplemental revenues will be settled at the higher of the default energy bid price plus a $24/MWh adder or the resource-specific settlement interval locational marginal price, up to a prescribed revenue cap.[72] At the beginning of the fifth month of MRTU operations, the CAISO proposes that mitigated resources eligible to receive supplemental revenues will be settled at the higher of the resource's energy bid price or the resource-specific settlement interval locational marginal price, up to the level of the ICPM monthly payment.

79. The CAISO recognizes that one possible disadvantage of this methodology is that it is possible an eligible mitigated resource could quickly reach the level of the revenue cap. Additionally, the CAISO recognizes that a resource may decline an ICPM

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[71] The CAISO anticipates that Exceptional Dispatch will be used more frequently during the early years of MRTU, especially during the first months of implementation, than during subsequent periods. *See* CAISO Exceptional Dispatch Mitigation Transmittal Letter at 6, 11, 19, 20-21.

[72] The cap is applied in the following way. The CAISO will track the amount of Exceptional Dispatch supplemental revenues that a mitigated resource receives in any 30-day period that starts with the first Exceptional Dispatch of the resource and re-sets with the first Exceptional Dispatch after any 30-day period. Within each such 30-day period, a mitigated resource will be eligible to receive Exceptional Dispatch supplemental revenues so long as the resource has not accrued an amount of Exceptional Dispatch supplemental revenues that is equal to or greater than the monthly ICPM capacity payment for which the mitigated resource would be eligible if the mitigated resource had been designated as ICPM capacity.

designation because accepting the designation would render it ineligible for supplemental revenues. The CAISO further acknowledges that, in some cases, a resource could reject the ICPM offer in order to accrue supplemental revenues until the revenue cap is reached and then accept the ICPM designation later, if the offer is still available. However, the CAISO states that the benefits of the methodology outweigh the potential disadvantages, because supplemental revenues are capped in most cases at the ICPM level and the double payment scenario is unlikely to occur. Moreover, according to the CAISO, most exceptional dispatches will be of resource adequacy resources.[73]

Comments and Protests

80. SoCal Edison asserts that the proposed mitigation should be modified out of concern that the proposal, beginning in the fifth month, will not result in just and reasonable outcomes to consumers and may also distort a resource's incentives to sell resource adequacy capacity. According to SoCal Edison, beginning in month five of the market, the CAISO proposes to implement a monthly revenue cap that reflects capacity payments that would be paid to the unit if it was under a monthly ICPM designation. However, SoCal Edison states that the CAISO will not apply any bid mitigation to the unit during Exceptional Dispatch.

81. While SoCal Edison supports the revenue cap, it has concerns that non-resource adequacy units will immediately change their bids after they receive an Exceptional Dispatch, resulting in units having the ability to quickly extract non-competitive rents from the market. According to SoCal Edison, while the CAISO will cap the total monthly additional non-competitive market rents at the equivalent of a monthly ICPM capacity payment, this cap may be reached very quickly, in some case it could be reached within only a few hours of Exceptional Dispatch. SoCal Edison asserts that if there is any systemic problem, the CAISO may still require the unit after the monthly payment cap is reached, which SoCal Edison anticipates would result in the CAISO offering the unit an ICPM designation. According to SoCal Edison, this would result in that unit receiving twice the monthly ICPM capacity payment.

82. SoCal Edison states that the most obvious solution is simply to maintain the CAISO's proposal intended for the first four months of operation, unit is paid the higher of the resource-specific settlement interval locational marginal price or the default energy bid + $24 MW/hour, as a permanent structure. SoCal Edison asserts that the second, but less preferable, alternative would be to limit daily Exceptional Dispatch rents to a maximum of 1/30th of the monthly ICPM payment.

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[73] *Id.* at 14.

83. WPTF states that because the CAISO proposes to cap the amount of mitigated Exceptional Dispatch supplemental revenues these resources can earn in a 30-day period beginning on day one of MRTU implementation, it is unnecessary to settle mitigated Exceptional Dispatch differently in the first four months following MRTU implementation than in the proceeding period. WPTF argues that the proposed cap provides a sufficient safeguard against excessive supplemental revenues. Further, WPTF argues that the Commission should direct the CAISO to settle mitigated Exceptional Dispatch as the higher of the resource's locational marginal price, or the resource's energy bid price, beginning upon MRTU implementation.

84. According to WPTF, the CAISO's proposal to cap the amount of supplemental revenues that can be earned in a 30-day period at the proposed monthly ICPM payment is unreasonable when a resource is paid its locational marginal price. WPTF claims that if a resource merely earned the locational marginal price at its location because it was dispatched in the market, there would be no cap on those margins. Further, WPTF argues that imposing a cap on the margins earned when a resource merely earns the locational marginal price at its location – including when it is exceptionally dispatched – is inappropriate. Accordingly, WPTF asserts that the Commission should direct the CAISO to amend its tariff language so that only the supplemental revenues that are earned when the exceptionally dispatched resource is paid its energy bid price count towards the proposed 30-day revenue cap.

<u>Answers</u>

85. The CAISO argues that WPTF has not provided any reason as to why the revenue cap should make it unnecessary to utilize the different methodology the CAISO proposes for the initial period after MRTU implementation. The CAISO explains that the proposed methodology is necessary to ensure that supplemental revenues do not accrue at an excessive rate, as the CAISO anticipates that Exceptional Dispatch instructions will need to be issued more frequently during the first few months after MRTU implementation.[74]

86. Further, the CAISO reiterates that the proposed tariff revisions have some disadvantages, such as the possibility of double compensation. However, the CAISO asserts that the benefits of the proposal outweigh the potential disadvantages, especially because most exceptional dispatches will be to resource adequacy resources, supplemental revenues will be capped at the ICPM level, and the double-payment scenario is unlikely. Further, the CAISO explains that its proposal strikes an appropriate balance of stakeholder interests by providing backstop capacity payments, when

[74] CAISO's Answer at 21.

appropriate for reliability support, and by not triggering ICPM designations with every Exceptional Dispatch of a resource without a capacity contract.[75]

87. Moreover, the CAISO explains that because the revenue cap applies only to supplemental revenues, a resource subject to Exceptional Dispatch can retain its entire locational marginal price revenue just as a resource dispatched through the market can. According to the CAISO, even after the supplemental revenue cap becomes applicable, a resource subject to mitigation would face no cap on locational marginal price revenues. In contrast, the CAISO explains that under WPTF's proposal, a resource subject to Exceptional Dispatch could accrue large amounts of revenues due to high locational marginal prices and then obtain supplemental revenues if locational marginal prices drop. Further, the CAISO asserts that the proposed monthly cap avoids the potential of over-payment of resources because it counts any revenues accrued pursuant to initially high locational marginal prices as contributing toward revenues above the default energy bid, which could be considered contributions toward fixed costs. The CAISO also asserts that the monthly cap does not hinder the accrual of locational marginal price revenues, but rather, only seeks to reasonably limit the opportunity to accrue additional supplemental revenues when locational marginal prices are low and a resource submits high bids.

2. Miscellaneous Issues

a. Sunset

Proposal

88. The proposed tariff revisions state that the Exceptional Dispatch mitigation measures will terminate 24 months after MRTU implementation.[76]

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[75] *Id.* at 25.

[76] The CAISO provides that this termination date is proposed because of the uncertainties surrounding the frequency and predictability of Exceptional Dispatch and the nature of ICPM designations, along with the ongoing evolution of the resource adequacy program. The CAISO would retain all rights pursuant to section 205 of the FPA with regard to the mitigation measures. If, at the end of this 24-month period, actual experience indicated that market power issues associated with Exceptional Dispatch are still frequent enough to warrant maintaining the mitigation, then the CAISO will file either an extension of the mitigation provisions or revised mitigation provisions that reflect the CAISO's initial experience with Exceptional Dispatch under MRTU.

Comments and Protests

89. SoCal Edison asserts that the Exceptional Dispatch mitigation provisions should not sunset in 24 months, as proposed by the CAISO, but should be a permanent MRTU feature.

90. In contrast, WPTF asserts that the Commission should terminate the mitigation provisions 12 months after MRTU implementation. According to WPTF, the Commission has already ordered the CAISO to implement many functions that will improve the depth, liquidity and credibility of the markets, such as scarcity pricing and convergence bidding, no later than twelve months after MRTU implementation. WPTF notes that there are other market products, such as a 30-minute reserve product, that would further reduce the purported need for Exceptional Dispatch, which may also be in place within 12 months of MRTU deployment. WPTF also states that terminating the Exceptional Dispatch mitigation provisions 12, rather than 24 months, after MRTU implementation creates the appropriate urgency for the CAISO to take the steps needed to procure the reliability products it needs through, not outside, its MRTU markets.

Answer

91. The CAISO states that the reason it proposes that the tariff revisions sunset after 24 months is that experience with MRTU and corresponding changes in the Full Network Model and the MRTU software may make Exceptional Dispatch so infrequent that mitigation becomes rare.[77] The CAISO believes that it is premature to decide whether the Exceptional Dispatch provisions should remain in effect indefinitely, and states that if actual experience indicates that market power remains an issue with Exceptional Dispatch, the CAISO will either file an extension of the provisions or revised provisions that reflect the CAISO's initial experience with Exceptional Dispatch under MRTU.[78] In addition, the CAISO argues that the Commission should reject WPTF's proposal because the market improvements that WPTF mentions are not guaranteed to fully eliminate the need for the Exceptional Dispatch mitigation provisions. The CAISO states that if experience indicates that market power issues associated with Exceptional Dispatch are still frequent enough to warrant continued mitigation, the CAISO will file an extension of the mitigation provisions or revised mitigation provisions that reflect the CAISO's experiences under MRTU.

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[77] *Id.* at 4.

[78] *Id.* at 30-31.

b. Dispatched Reliability Must-Run, Resource Adequacy, and ICPM Resources Will Recover Locational Marginal Price

Comments and Protests

92. WPTF points out that in its proposal, the CAISO notes that resources will "…always keep any market revenues earned from [locational marginal prices] at their locations."[79] WPTF states that it does not appear that this would be the case if a resource adequacy, reliability must-run, or ICPM resource, that receives a mitigated Exceptional Dispatch, earns a locational marginal price that is set by another unit's market bid. WPTF states that in that instance, the resource adequacy unit would be excluded from keeping the amount between its locational marginal price and its default energy bid because that margin would be deemed supplemental revenues. WPTF claims that it is unreasonable to preclude a resource adequacy, reliability must-run, or ICPM resource from earning the difference between its locational marginal price and its default energy bid simply because it is exceptionally dispatched.

Answer

93. The CAISO states that the requested clarification is unnecessary, as under the proposed tariff revisions, resource adequacy, reliability must-run, and ICPM resources will receive Exceptional Dispatch mitigation payments equal to the higher of the default energy bid price or the resource-specific settlement interval locational marginal price.[80] The CAISO states that, therefore, the tariff revisions always permit resource adequacy, reliability must-run, and ICPM resources to earn the locational marginal prices at their location.

c. Updating the Full Network Model

Proposal

94. The CAISO provides that, ideally, it would be able to incorporate an outage or de-rate into the Full Network Model within one to 24 hours, which would allow a return to

[79] WPTF Comments at 19 (citing CAISO Exceptional Dispatch Mitigation Transmittal Letter at 15).

[80] CAISO Answer at 33-34 (citing CAISO Exceptional Dispatch Mitigation Transmittal Letter at 10-11; Amendment at Attachment B (proposed section 11.5.6.7.2).

reliance on market mechanisms to establish schedules, with little if any opportunity for market participants to adjust their bidding practices.[81]

Comments and Protests

95. WPTF notes that in justifying the need for Exceptional Dispatch, the CAISO states that it will take ideally between one and 24 hours to update the Full Network Model to include resource de-rates and transmission contingencies, but that it may take longer during the first two years of operations under MRTU. WPTF does not understand why it will take the CAISO that long to reflect transmission contingencies and resource de-rates in its Full Network Model. WPTF states that given the CAISO's assertion that this limitation may allow for the exercise of market power, and given the CAISO's further assertion that it requires the authority to mitigate Exceptional Dispatch to address that market power, WPTF requests that the Commission condition any approval of the CAISO's proposal on receiving a full and satisfactory explanation as to what the CAISO must do to update the Full Network Model in order to account for these limitations, and why it takes so long.

96. The CAISO states that, although it will make every effort to quickly address any issues with MRTU, including updating the Full Network Model, the amount of time required to address and resolve any particular issue depends on the nature of the issue. Accordingly, the CAISO is unable to make generalized statements about what may be required to update the Full Network Model, especially in light of the fact that MRTU is not yet in effect.

Commission Determination

97. We find that, due to the changes in circumstances discussed below, the Exceptional Dispatch mechanism accepted by the Commission in the September 2006 MRTU Order may no longer be just and reasonable. While we continue to recognize the need for some limited backstop capacity mechanism to ensure grid reliability, we are concerned that the CAISO's intended expanded reliance on Exceptional Dispatch, coupled with its payment structure, may yield unjust and unreasonable outcomes that unduly discriminate against non-resource adequacy resources. We therefore initiate a section 206 investigation[82] to examine the Exceptional Dispatch provisions of the MRTU Tariff, including the CAISO's proposed tariff revisions mitigating Exceptional Dispatch.

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[81] CAISO Exceptional Dispatch Mitigation Transmittal Letter at 19. The CAISO states, however, that it will not always be possible to update the Full Network Model so quickly, especially during the first two years of operation.

[82] 16 U.S.C. § 824e.

Consequently, because we are investigating all Exceptional Dispatch tariff provisions, and because we find the CAISO's proposed tariff revisions may not be just and reasonable, we accept and suspend these proposed modifications, to become effective upon implementation of the MRTU Tariff, as requested, subject to refund and the outcome of the section 206 proceeding.

98. As explained below, the Commission is particularly concerned that the proposed revisions fail to provide non-resource adequacy resources with sufficient compensation for the reliability services they provide under Exceptional Dispatch. Given the intertwined nature of Exceptional Dispatch and the ICPM, as well as our goal of encouraging participation in the resource adequacy program and the voluntary ICPM, we think that the reasonable and efficient solution would be to provide non-resource adequacy resources with an offer of an ICPM designation upon receipt of their first Exceptional Dispatch instruction. Finally, in order to explore expeditiously issues relating to the pricing, mitigation, and frequency of use of the Exceptional Dispatch mechanism and the Commission's proposed remedy, we direct staff to convene a technical conference in the near future, the details of which will follow in a subsequent notice. An opportunity to comment will be provided following the technical conference.

99. With respect to the changes in circumstance that have occurred since the Commission accepted the Exceptional Dispatch provisions of the MRTU Tariff, we find there are at least two main categories of changed circumstances: (1) the CAISO's significantly increased anticipated usage of the Exceptional Dispatch; and (2) the evolution of the Commission's policy that non-resource adequacy resources should receive compensatory payment for the resource adequacy services they provide.

100. As to the first significant change, in its proposed tariff revisions, the CAISO repeatedly reiterates that Exceptional Dispatch instructions will be far more frequent than originally contemplated in the MRTU proceeding.[83] This is a stark departure from the Commission's understanding of the original MRTU proposal in which Exceptional Dispatch was proposed to be, by definition, "exceptional." Specifically, in the September

[83] *See* Exceptional Dispatch Mitigation Transmittal Letter at 6, 11, 19, 20-21. The CAISO states that as "software has been developed and the CAISO has gained experience with MRTU market simulations, the CAISO has become aware that Exceptional Dispatch may be required more frequently than previously expected, especially during the first few months of operations under MRTU." *Id.* at 6. Additionally, the CAISO provides that "the CAISO is concerned that it may have to issue [e]xceptional [d]ispatches more frequently to address local reliability issues that are not modeled in the [Full Network Model] incorporated into the CAISO's [integrated forward market] and [hour ahead scheduling process/real-time] software, particularly during the first two years of operations under MRTU." *Id.* at 19.

2006 MRTU Order, we found that "Exceptional Dispatch should not become a frequent occurrence and should be reserved for genuine emergencies where the CAISO needs to take actions outside the market software for maintaining system reliability."[84]

101. Regarding the second significant change, when the Commission accepted Exceptional Dispatch in the September 2006 MRTU Order, we had not yet held that resources providing reliability backstop capacity services must be paid commensurately with resource adequacy resources. When Exceptional Dispatch was filed and accepted, the ICPM had not yet been proposed, thus the Commission had no basis on which to judge how the two mechanisms would interact. Moreover, at that time, not only had the ICPM not been proposed, but neither of its predecessor backstop capacity mechanisms, the RCST and TCPM, had been accepted. Thus, neither the Commission nor parties to the MRTU proceeding were in a position to comment on or evaluate how the ICPM would interact with Exceptional Dispatch. Further, the voluntary nature of the ICPM, and its pricing structure, could have a substantial impact on the need for Exceptional Dispatch, as Exceptional Dispatch essentially backstops the voluntary ICPM.

102. Subsequent to accepting Exceptional Dispatch, the Commission issued decisions in the RCST and TCPM proceedings. In those orders, the Commission consistently found that resources that provide the CAISO with reliability service through the must-offer obligation must be compensated in a manner similar to resources that are designated under the resource adequacy program.[85] In evaluating the RCST, the Commission found that under the must-offer obligation, resources that are not compensated for their capacity services "may not have sufficient opportunity to recover their fixed costs in the energy market."[86] In the Commission's order involving the TCPM, the Commission rejected a daily capacity payment as compensation for services provided under the must-offer obligation as potentially unduly discriminatory.[87] Instead, the Commission found that a

[84] MRTU Order, 116 FERC ¶ 61,274 at P 267.

[85] *See* TCPM Order, 123 FERC ¶ 61,229 at P 36; Order on Paper Hearing, 118 FERC ¶ 61,096 at P 46; RCST Extension Order, 121 FERC ¶ 61,281 at P 34.

[86] July 20, 2006 Order, 116 FERC ¶ 61,069 at P 37.

[87] TCPM Order, 123 FERC ¶ 61,229 at P 36.

single must-offer waiver denial must result in an automatic, minimum 30-day TCPM designation.[88]

103. In contrast to the RCST and TCPM, the Exceptional Dispatch mechanism does not include an explicit capacity payment comparable to the capacity compensation afforded to a resource adequacy resource, and, in certain cases, it provides no guaranteed fixed cost recovery. While we recognize that the CAISO did not have the benefit of our directives in the predecessor backstop capacity proceedings – RCST and TCPM – when Exceptional Dispatch was initially filed and accepted in the September 2006 MRTU Order, we nevertheless find that the Exceptional Dispatch mechanism may not provide just and reasonable compensation for non-resource adequacy resources. Specifically, non-resource adequacy resources that provide reliability service to the grid should be paid in a similar manner – and subject to similar obligations – as resource adequacy resources, which includes fixed cost recovery. As stated above, in the TCPM Order, the Commission rejected the CAISO's proposal to compensate on a daily basis non-resource adequacy resources whose must-offer waiver requests were denied.[89] The Commission found that compensating non-resource adequacy resources with a daily capacity payment, in contrast to the monthly capacity payment resource adequacy resources receive, could result in unduly discriminatory treatment among generator classes.[90] Proposed sections 11.5.6.1 and 11.5.6.2 of the MRTU Tariff provide that non-resource adequacy resources will be paid on an even more granular basis, hourly, instead of daily, even though the Commission rejected the daily payment as insufficient (i.e., too granular) in the TCPM Order.[91]

104. We are concerned that, under Exceptional Dispatch, some non-resource adequacy resources will be unable to recover any fixed costs in certain circumstances. A non-resource adequacy resource that has no bid in the market will be paid the higher of its default energy bid or the locational marginal price. If the locational marginal price is

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[88] *Id.* P 31-32. Additionally, the Commission found that "once a unit is designated under the TCPM, it is 'on call' for the entire 30 days of designation (or longer, if the CAISO chooses to designate for a longer period), and it is actually providing a monthly service to customers." *Id.* P 36.

[89] *Id.* P 31-37, 59.

[90] *Id.* P 31.

[91] *See id.* P 31-37, 59. We note that, while the CAISO claims that it will exceptionally dispatch resources for reasons other than it will designate resources under the ICPM, there is ostensibly no efficient, objective way to discern in all cases the reasons for reliance on capacity resources.

lower than the default energy bid – a distinct possibility, given the price-depressing effect of Exceptional Dispatch supply instructions[92] – the non-resource adequacy resource will receive only its default energy bid, which is not designed to provide fixed cost recovery.[93] This may not be just and reasonable compensation for a resource that is providing backstop capacity to the CAISO and the grid. Additionally, if, for example, a transitory constraint that could be resolved in the first hour led to the Exceptional Dispatch of a non-resource adequacy resource, the resource would be prevented from recovering fixed costs via higher energy bids in subsequent hours. As a result, the non-resource adequacy resource would have provided needed reliability service, but would be paid only one hour's worth of its default energy bid (assuming the locational marginal price is lower than the default energy bid), and would receive little, if any, contribution to recovery of fixed costs. In an order issued concurrently with the instant order, the Commission finds that the ICPM payment is a just and reasonable rate for resources that are needed to maintain grid reliability.[94] In light of this determination, the Commission expects that a just and reasonable Exceptional Dispatch mechanism would include a similar capacity payment to all non-resource adequacy resources that provide service under Exceptional Dispatch.[95]

105. For the above reasons, we establish a section 206 proceeding in Docket No. EL08-88 to investigate the continued justness and reasonableness of the Exceptional Dispatch mechanism. In cases where, as here, the Commission institutes a section 206

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[92] *See supra* P 15 n.29.

[93] Section 39.7 of the MRTU Tariff provides that the scheduling coordinator for a generator can rank the three different options for calculating the resource's default energy bid for purposes of mitigation. The three options include: (1) a variable cost option, which provides for variable cost recovery plus 10 percent; (2) a locational marginal price option, which is the weighted average of the bottom quartile of historical locational marginal prices at the resource's node; or (3) a negotiated rate option, which includes a submission by the resource and is subject to review.

[94] *See* the order in Docket Nos. ER08-556-000 and ER06-615-020, which is being issued concurrently with the instant order.

[95] The Commission would expect the only Exceptional Dispatch instructions that would not trigger an offer of a capacity payment would be: (1) Exceptional Dispatch instructions to perform testing of a resource at the request of the resource's Scheduling Coordinator; or (2) Exceptional Dispatch instructions to provide decremental energy. Commenters that request that ICPM designations be offered to all resources that are exceptionally dispatched acknowledge that ICPM designations would be improper under these two circumstances. *See, e.g.*, WPTF Comments at 22.

investigation on its own motion, section 206(b), as amended by section 1285 of the Energy Policy Act of 2005,[96] requires that the Commission establish a refund effective date that is no earlier than the date of the publication of the notice of the initiation of the Commission's investigation in the *Federal Register*, and no later than five months after the publication date. In order to give maximum protection to customers, consistent with precedent,[97] we will establish a refund effective date of the earlier of day one of MRTU implementation or five months from the date of publication of notice of this action in the *Federal Register*. In addition, section 206 of the FPA requires that, if no final decision has been rendered by the earlier of the refund effective date or the 180-day period commencing upon initiation of a proceeding pursuant to this section, the Commission shall state the reasons why it failed to do so and shall state its best estimate as to when it reasonably expects to make such a decision. Given the nature and complexity of the matters to be resolved, we expect that we should be able to render a decision by January 30, 2009, assuming the case does not settle.

106. As for the CAISO's section 205 filing, we recognize the potential need for mitigation of Exceptional Dispatch, as discussed further below; however, we find that the proposed tariff revisions intending to mitigate Exceptional Dispatch may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Significantly, we find that, particularly with respect to the proposed hourly compensation provisions, the proposed tariff revisions may not compensate non-resource adequacy resources sufficiently for the backstop capacity services they provide under Exceptional Dispatch. Furthermore, given that we are launching a section 206 investigation into the continuing justness and reasonableness of the Exceptional Dispatch provisions of the MRTU Tariff, any modifications to those tariff revisions should be contingent on the outcome of that investigation. Accordingly, pursuant to section 205 of the FPA,[98] we conditionally accept and suspend for a nominal period the CAISO's proposed tariff revisions to be effective upon MRTU start-up, as requested, subject to refund and the outcome of the investigation under section 206 of the FPA into the Exceptional Dispatch provisions of the MRTU Tariff.

107. The Commission continues to be committed to facilitating timely MRTU implementation. Accordingly, we have crafted a possible remedy to address our

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[96] Energy Policy Act of 2005, Pub. L. No. 109-58, § 1285, 119 Stat. 594, 982-83 (2005).

[97] *See, e.g.*, *Indiana Municipal Power Agency v. PSI Energy, Inc.*, 85 FERC ¶ 61,073 (1998); *Canal Electric Co.*, 46 FERC ¶ 61,153, *reh'g denied*, 47 FERC ¶ 61,275 (1989).

[98] 16 U.S.C. § 824d.

concerns, that would: (1) provide non-resource adequacy resources with the offer of an ICPM designation upon receiving their first Exceptional Dispatch; and (2) cap the amount a non-resource adequacy resource may receive in a 30-day period under the ICPM, Exceptional Dispatch or both mechanisms together at the ICPM price of $41/kW-year. This should ensure that non-resource adequacy resources are appropriately compensated for their backstop capacity services, regardless of which tariff mechanism authorized their service. We also propose this price so as not to undercut the voluntary ICPM program. Furthermore, the ICPM price cap should negate the possibility of double payment under the CAISO's proposed tariff revisions and market design. Under the proposal as filed, a non-resource adequacy resource that is likely to be exceptionally dispatched for an extended period of time could decline an ICPM designation, earn supplemental revenues equal to the cap in as little as eight hours,[99] and then accept the still-outstanding ICPM designation offer, effectively being paid twice. The CAISO itself acknowledges the potential for this "double payment" to occur.[100] The Commission believes that the potential double recovery could be averted by requiring the CAISO to incorporate in the MRTU Tariff a provision that limits the amount of revenue a non-resource adequacy resource receives under Exceptional Dispatch or ICPM or both together to $41/kW-year.

108. Under the Commission's proposed remedy, the need for Exceptional Dispatch would not disappear, as it is inextricably linked to the voluntary nature of the ICPM. Thus, we establish this investigation into Exceptional Dispatch with an eye towards assessing what, if any, modifications must be made to ensure its continued justness and reasonableness under MRTU. To this end, and consistent with the CAISO's proposed tariff revisions, the Commission will also investigate the reasonableness of mitigating Exceptional Dispatch, due to the potential to exercise market power.[101] Specifically, we are concerned that, absent proper mitigation, resources could forgo the ICPM designation

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[99] By offering at the MRTU offer cap of $500/MWh, a resource with a default energy bid of $50/MWh could reach the monthly ICPM payment cap by the 8th hour of the first day of being exceptionally dispatched.

[100] CAISO Exceptional Dispatch Mitigation Transmittal Letter at 14.

[101] As the CAISO points out in its filing, the CAISO's Department of Market Monitoring determined that suppliers could, at times, reasonably anticipate Exceptional Dispatch instructions and exercise local market power. Because Exceptional Dispatch instructions are exempt from mitigation by the automatic mitigation mechanism found in MRTU's integrated forward market and residual unit commitment – Market Power Mitigation and Reliability Requirement Determination – it appears a need remains for a mitigation mechanism for Exceptional Dispatch.

and earn in excess of the ICPM payment by submitting high offers into the market and being continually exceptionally dispatched.

109. Finally, the Commission plans to vet several issues raised in the proposed tariff revisions, as well as the Commission's proposed remedies in a technical conference. As discussed above, we will allow parties to discuss both the proposed tariff revisions and the Commission's proposal relating to Exceptional Dispatch compensation for non-resource adequacy resources. In addition to the issues discussed above, the Commission is concerned about the expected frequency of exceptional dispatches related to the inadequacies of the MRTU software. The Commission also understands that Exceptional Dispatch instructions issued due to contingencies that are not fully modeled – e.g., Path 26[102] – may be frequent as opposed to "exceptional." The Commission recognizes that, in addition to improved modeling, there may be other mechanisms for addressing these contingencies besides Exceptional Dispatch, such as a new ancillary service (e.g., a 30-minute spinning reserve product), or a more fully developed Full Network Model.

The Commission orders:

(A) The CAISO's proposed tariff revisions to mitigate Exceptional Dispatch under MRTU are hereby accepted for filing and suspended for a nominal period, to become effective upon implementation of MRTU, as requested, subject to refund and the outcome of the 206 investigation into the continued justness and reasonableness of the Exceptional Dispatch provisions of the MRTU Tariff, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by sections 205 and 206 of the FPA, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the FPA (18 C.F.R., Chapter I), an investigation shall be held concerning the continued justness and reasonableness of the CAISO's Exceptional Dispatch.

(C) The Secretary shall promptly publish in the *Federal Register* a notice of the Commission's initiation of this proceeding under section 206 of the FPA in Docket No. EL08-88-000.

(D) The refund effective date in Docket No. EL08-88-000, established pursuant to section 206(b) of the FPA, shall be the earlier of MRTU implementation or five months from the date this action is published in the *Federal Register*.

[102] *See supra* P 14 n.27 and P 34 n.41.

(E) Commission staff is hereby directed to convene a technical conference to further explore the CAISO's Exceptional Dispatch mechanism and proposed mitigation of exceptional dispatches, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.