UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 492

California Independent System Operator Corporation	Docket Nos. ER04-835-000
Pacific Gas and Electric Company	
v.	EL04-103-000 (consolidated)
California Independent System Operator Corporation	

OPINION AND ORDER ON INITIAL DECISION

Issued: December 27, 2006

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(consolidated)

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APPEARANCES

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

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v. (consolidated)

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OPINION NO. 492

OPINION AND ORDER ON INITIAL DECISION

(Issued December 27, 2006)

1. This case is before the Commission on review of an Initial Decision resolving issues related to the allocation of must-offer obligation costs in the California Independent System Operator Corporation's (CAISO) Amendment No. 60 to its open access transmission tariff (CAISO tariff).[1]

2. The Initial Decision generally upholds as just and reasonable the proposed method for allocating must-offer obligation costs. We largely affirm the Initial Decision but reverse it on the following issues: (1) whether wheel-through schedules should be exempted from all or some system minimum load costs compensation (MLCC) costs, and (2) whether start-up and emissions costs of units denied must offer waivers should be allocated in the same manner as those associated with MLCC and whether a revision to the allocation of these costs should be addressed in this proceeding.

[1] *Cal. Indep. Sys. Operator Corp.*, 113 FERC ¶ 63,017 (2005) (Initial Decision).

Background

3. On July 20, 2001, the CAISO implemented a temporary must-offer requirement as an element of the mitigation and monitoring plan in response to the California energy crisis.[2] Pursuant to the must-offer obligation, most generators serving California markets are required to offer all of their capacity in real time during all hours if it is available and not already scheduled to run through bilateral agreements.[3] The must-offer obligation is "designed to prevent withholding and thereby to ensure that the CAISO will be able to call upon available resources in the real-time market to the extent that energy is needed."[4] If must-offer generators are required to operate at minimum load to ensure that they are and will be available for the CAISO to dispatch in real time, then they receive MLCC.[5] A generating unit may request a waiver of its must-offer obligation. If the CAISO denies a waiver request (must-offer waiver denial), then the generator is required to remain in operation and is compensated for the costs of running at its minimum operating level,[6] including when the CAISO actually dispatches energy from the unit or the generator provides ancillary services. The CAISO currently allocates MLCC costs to market participants on a system-wide basis. The must-offer obligation will continue for a

[2] Through a series of orders issued since April 2001, the Commission has addressed the must-offer obligation, including application and compensation issues. *See Cal. Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,022 at P 2-8 (2004) (Amendment No. 60 Hearing Order) (providing summary of Commission action).

[3] *See San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 95 FERC ¶ 61,115 at 61,355-57 (2001), *order on reh'g, San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 95 FERC ¶ 61,418 (2001) (June 2001 Order), *order on reh'g, San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 97 FERC ¶ 61,275 (2001), *order on reh'g, San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 99 FERC ¶ 61,160 (2002), *petition pending sub nom. Public Utilities Comm'n of the State of California v. FERC*, 9th Cir. Nos. 01-71051, *et al.* (placed in abeyance Aug. 21, 2002).

[4] June 2001 Order, 95 FERC ¶ 61,418 at 62,551.

[5] The MLCC costs consist of minimum operating level costs plus a $6.00/MWh adder for variable operations and maintenance. Initial Decision at n.24.

[6] These costs include start-up, emissions and MLCC costs.

locked-in period that will end with implementation of the CAISO's Market Redesign and Technology Upgrade (MRTU), now expected on January 31, 2008.[7]

4. On May 11, 2004, in Docket No. ER04-835-000, the CAISO filed Amendment No. 60 to, among other things, modify certain payment terms and the allocation of must-offer costs in a manner more consistent with cost causation principles. Based upon its determination that must-offer generation has been committed primarily to satisfy local, zonal or system reliability requirements, the CAISO proposed to allocate MLCC costs according to a three-category (or "bucket") rate design.[8]

5. On May 18, 2004, in Docket No. EL04-103-000, Pacific Gas and Electric Company (PG&E) filed a complaint against the CAISO, alleging that the methodology for allocating must-offer obligation costs to PG&E was unjust, unreasonable and unduly discriminatory. PG&E also alleged that Amendment No. 60 indefinitely prolonged the CAISO's allocation method, even though the CAISO had the ability to apportion must-offer obligation costs more equitably in a timelier manner. PG&E requested that the Commission consolidate its complaint with the Amendment No. 60 proceeding in Docket No. ER04-835-000.

6. On July 8, 2004, the Commission issued two orders. First, the Commission set PG&E's complaint for hearing, established a refund effective date of July 17, 2004 and consolidated Docket Nos. EL04-103-000 and ER04-835-000.[9] Second, the Commission accepted Amendment No. 60, subject to modification, and set for hearing the allocation of must-offer obligation costs.[10]

7. The presiding judge held a hearing from June 28, 2005 through July 19, 2005. On October 31, 2005, the presiding judge issued an Initial Decision. The active parties included the CAISO, the California Department of Water Resources State Water Project (SWP); the California Electricity Oversight Board; the California Municipal Utilities

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[7] *See* http://www.caiso.com/18d1/18d1c5ed71060.pdf.

[8] *See infra* P 16.

[9] *Pacific Gas and Elec. Co. v. Cal. Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,017 (2004) (PG&E Complaint Hearing Order).

[10] Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022. We note that the CAISO's Reliability Capacity Services Tariff in Docket No. EL05-146-000 and the Interim Reliability Requirements Program in Docket No. ER06-723-000, *et al.*, which both will terminate with MRTU implementation, will also follow this cost allocation methodology.

Association; the California Public Utilities Commission (CPUC); Calpine Corporation; the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (collectively, Southern Cities); the Cities of Redding and Santa Clara, California and the M-S-R Public Power Agency; the City of Vernon, California; Duke Energy North America, LLC and Duke Energy Trading and Marketing, L.L.C.; the Independent Energy Producers Association (IEP); the Los Angeles Department of Water and Power; the Metropolitan Water District of Southern California; Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC, Mirant Potrero, LLC; the Modesto Irrigation District; the Northern California Public Power Agency; PG&E; Powerex Corp. (Powerex); the Sacramento Municipal Utility District (SMUD); San Diego Gas & Electric Company (SDG&E); Southern California Edison Company (SoCal Edison); the Transmission Agency of Northern California; the Turlock Irrigation District; Williams Power Company and West Coast Power, LLC; and Commission trial staff (Trial Staff). In addition to its brief on exceptions, Powerex filed a motion to reopen the record. Trial Staff filed an answer, to which Powerex responded.

8. Having reviewed the record, the Initial Decision and the parties' briefs, we summarily affirm and adopt the findings by the judge with respect to the following issues: (1) the factors to consider in determining whether Amendment No. 60's cost allocation proposal is just, reasonable and not unduly discriminatory (Issue No. 1); (2) whether the concept of classifying MLCC costs into three buckets is just and reasonable (Issue No. 2); (3) Southern Cities' proposal to use the CAISO's RMR cost allocation methodology; (4) SWP's proposal to create geographic sub-zones so that costs are allocated only to loads located in areas for which costs are incurred and based on scheduling coordinator-identified load groups or other CAISO settlement designations and loads located in areas that do not cause MLCC costs to be incurred are excluded; (5) the CAISO treatment of MLCC costs related to must offer waivers denied for more than one reason (Issue No. 12); (6) whether non-local MLCC costs should be assessed only to load occurring in the peak time periods for which must offer waivers are denied (Issue No. 6); and (7) if non-local MLCC costs should be allocated only to loads occurring in the peak time periods for which must offer waivers are denied, how should the peak period be defined? (Issue No. 7). Any issues not specifically referenced in this opinion are likewise affirmed.

Discussion

A. Procedural Issues

1. Powerex's Answer

9. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to an answer unless otherwise ordered by the

decisional authority. We are not persuaded to accept Powerex's answer and will, therefore, reject it.

2. Motion to Reopen the Record

10. Powerex has filed a motion to reopen the record to admit evidence that became available after the close of the record that it claims would shed light on whether Amendment No. 60 comports with the principle of cost causation and whether Powerex's alternative proposal is just and reasonable. Powerex seeks admission of the CAISO's Market Monitoring Report for Events of June-July 2005 and Assessment of Day-Ahead Scheduling Practices issued on September 7, 2005 (Market Monitoring Report); the CAISO's Amendment No. 72 to its tariff filed with the Commission in Docket No. ER05-1502-000 on September 22, 2005 (Amendment No. 72);[11] and the Commission's November 21, 2005 order on Amendment No. 72.[12]

11. In particular, Powerex contends that the Market Monitoring Report states that the allocation of system MLCC costs to net negative uninstructed deviations is inconsistent with cost causation and creates no incentive for "load-scheduling entities" to accurately schedule load in the day-ahead timeframe.[13] Powerex adds that the Market Monitoring Report illustrates that the amount of system MLCC costs that are allocated to market participants is rapidly increasing and spikes in peak months.[14] Powerex also contends that, through Amendment No. 72, the CAISO proposed, and the Commission accepted, implementing a 95 percent day-ahead scheduling requirement for load-serving entities (LSEs) in the CAISO markets. Powerex states that the Commission recognized the need to require scheduling coordinators to schedule at least 95 percent of forecasted demand in the day-ahead timeframe because, if the day-ahead schedules are significantly less than forecasted load, the CAISO commits 4,000 to 4,500 MW of generation capacity to ensure reliability, which significantly strains CAISO operators and imposes higher MLCC costs on market participants.[15] Powerex states that the Commission also recognized that the

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[11] In Amendment No. 72, the CAISO proposed to revise the CAISO tariff to require scheduling coordinators to submit day-ahead schedules that reflect 95 percent of their forecasted daily demand.

[12] *Cal. Indep. Sys. Operator Corp.*, 113 FERC ¶ 61,187 (2005) (Amendment No. 72 Order).

[13] *Citing* Market Monitoring Report at 15.

[14] *Id*. at 7-8.

[15] *Citing* Amendment No. 72 Order, 113 FERC ¶ 61,187 at P 3-4.

CAISO had experienced increased load underscheduling behavior.[16] Powerex argues that this evidence constitutes extraordinary circumstances that supports opening of the record because it (1) addresses whether the CAISO's system MLCC cost allocation is consistent with cost causation principles and (2) directly contradicts the CAISO's arguments that Powerex's proposal is unjust and unreasonable.

12. Trial Staff answers that the need to bring this proceeding to a close outweighs Powerex's claim that the subject documents warrant the reopening of the record. If the Commission admits the subject documents into the record, Trial Staff requests that the Commission provide the opportunity for discovery and answering testimony. If the Commission denies Powerex's motion, then pursuant to Rules 212 and 510(c) of the Commission's Rules of Practice and Procedure, Trial Staff requests that the Commission strike all references and statements regarding the Market Monitoring Report and Amendment No. 72 from Powerex's brief on exceptions.

13. We deny Powerex's motion to reopen the record. In exercising our discretion over whether to reopen a record, the Commission looks to whether or not the movant has demonstrated the existence of extraordinary circumstances that outweigh the need for finality in the administrative process.[17] Here, Powerex has failed to provide such extraordinary circumstances. It merely puts forth additional documentation that it claims supports its positions in these proceedings. Accordingly, we deny the motion to reopen the record, and we strike all references to these documents from Powerex's brief on exceptions.

B. Cost Allocation Issues[18]

[16] *Citing id*. at P 3.

[17] *See East Texas Elec. Coop. v. Central and South West Serv., Inc.*, 94 FERC ¶ 61,218 at 61,801 (2001).

[18] We note that we discuss the cost allocation issues in the order addressed by the judge, except with respect to the issue of the incremental cost of local and zonal. However, unlike the Initial Decision, we have inserted in the appropriate places in the discussion the issues from the joint stipulation of issues. SWP contends that the Initial Decision is flawed because it departs from the joint stipulation of issues and thus fails to address matters raised in the joint stipulation. In particular, SWP claims that the Initial Decision fails to address "whether pump loads should be exempt from all or some of MLCC costs." SWP also alleges that no party briefed whether Attachment E to the Amendment No. 60 filing, which was not filed as a tariff, should supplant the tariff language accepted and suspended in the Amendment No. 60 Hearing Order. Thus, SWP

(continued)

1. Factors to Consider in Determining Whether Amendment No. 60's Cost Allocation Proposal is Just, Reasonable and Not Unduly Discriminatory (Issue No. 1)

Whether the Concept of Classifying MLCC Costs into Three Buckets (Local, Zonal and System) is Just and Reasonable (Issue No. 2)

14. As a threshold matter, the judge notes that, pursuant to section 205(e) of the Federal Power Act (FPA), the CAISO bears the burden to prove that the tariff changes proposed in Amendment No. 60 are just, reasonable and not unduly discriminatory and do not render previously-approved tariff provisions unjust, unreasonable or unduly discriminatory.[19] He adds that alternatives to any of the proposed tariff changes may be considered only if one or more of the proposed changes is found unjust, unreasonable or unduly discriminatory and only on a change-specific basis.[20]

15. With respect to the factors for determining whether the cost allocation proposal is just, reasonable and not unduly discriminatory, the judge finds that Commission precedent indicates that an entity may be deemed to have caused costs either if it is directly responsible for imposing the cost burden or if the entity benefits from the costs

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alleges that the judge strayed beyond the joint statement of issues when he considered the Attachment E criteria. Consequently, SWP requests that the Commission review the issues *de novo*. Trial Staff responds that the judge examined all the issues, even though his examination did not follow the order of the joint statement of issues.

We disagree with SWP. Although the judge did not address the issues in the order presented by the parties, the judge did address all the issues in the joint stipulation, including the exemption for pump loads. *See infra* P 69. Furthermore, we agree with the CAISO, that contrary to SWP's assertion, the issue of whether use of Amendment No. 60 with the Attachment E criteria as an alternative to Amendment No. 60 as filed was identified in the joint statement of issues and briefed by the parties. *See infra* P 20-21. Accordingly, we decline to review the issues *de novo*.

[19] Initial Decision at P 33.

[20] *Id*.

that were incurred.[21] With respect to the latter, he finds that Commission precedent establishes that benefits derived properly may be considered in determining whether the proposed allocation of costs to the specific regions or locations where the underlying constraints are located is just and reasonable.[22] The judge concludes that *Devon Power LLC*[23] and *PJM Interconnection, LLC*[24] neither supplant the long line of Commission authority endorsing benefits-based cost allocation under appropriate circumstances nor prohibit the type of cost allocation in Amendment No. 60.[25] He adds however that the degree of benefits received under the Amendment No. 60 cost allocation must be considered because Commission precedent does not support benefits-based cost allocation when the benefits at issue are insubstantial, limited or purely speculative.[26] The judge requests that the Commission clarify that equitable cost allocation based exclusively on derived benefits is legitimate in situations in which it cannot be determined who is directly responsible for imposing the costs at issue.[27]

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[21] *Id*. at P 39 (*citing Cal. Power Exch. Corp.*, 106 FERC ¶ 61,196 at P 17 (2004); *Cal. Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,032 at P 10 (2004); *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004) (*citing KN Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992))).

[22] *Id*. at P 39-40 (*citing Cal. Power Exch. Corp*., 106 FERC ¶ 61,196 at P 17 (2004); *Cal. Indep. Sys. Operator Corp*., 106 FERC ¶ 61,032 at P 10 (2004); *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004); *Midwest Indep. Transmission Sys. Operator, Inc*., 108 FERC ¶ 61,163 at P 587 (2004); *Cal. Indep. Sys. Operator Corp*., 103 FERC ¶ 61,114 at P 20-26 (2003); *Pacific Gas & Elec. Co*., 100 FERC ¶ 61,160 at P 15 (2002); *Cal. Indep. Sys. Operator Corp*., 99 FERC ¶ 63,020 at 65,109-11 (2002); *Midwest Indep. Transmission Sys. Operator, Inc*., 98 FERC ¶ 61,141 (2002)).

[23] 107 FERC ¶ 61,240 at P 43 (2004).

[24] 107 FERC ¶ 61,112 at P 22 (2004).

[25] Initial Decision at P 40-42.

[26] *Id*. at P 42 (*citing American Elec. Power Serv. Corp*., 111 FERC ¶ 61,180 at P 5, 25-30 (2005); *Cal. Indep. Sys. Operator Corp*., 106 FERC ¶ 61,032 at P 5, 20 (2004); *New York Indep. Sys. Operator, Inc.*, 102 FERC ¶ 61,284 at P 14-15 (2003)).

[27] *Id*. at P 45.

16. The judge then analyzes whether the concept of classifying MLCC costs according to three categories (local, zonal and system) is just and reasonable.[28] Under the three bucket MLCC cost allocation methodology proposed in Amendment No. 60, MLCC costs are separated into three categories based on the reason(s) generating units are committed and operated under the must-offer obligation.[29] MLCC costs incurred for local reliability are allocated monthly to the PTO in whose service area the generating unit is located.[30] MLCC costs incurred for zonal reliability are allocated to total monthly demand within the affected zone.[31] MLCC costs incurred for system reliability are allocated first to net negative uninstructed deviations, up to a capped $/MWh rate, with any excess allocated to monthly demand and in-state exports.[32]

17. The judge finds that the process by which the CAISO formulated the three bucket approach supports a conclusion that the methodology is generally just, reasonable and not unduly discriminatory.[33] He notes that the methodology resulted from the CAISO's comprehensive effort to identify and remediate must-offer cost allocation deficiencies in cooperation with all potentially affected stakeholders.[34] He finds that the process was based on empirical data and analyses that confirmed that it was possible for the CAISO, within certain operational, administrative and market limitations, to allocate MLCC costs with much greater geographic specificity than previously done.[35] He finds that the proposal is specifically tailored to allocate MLCC costs among market participants based on both direct cost causation and comparative benefits.[36] He notes that empirical data and analyses are used to match local and regional costs to responsible customers and

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[28] *Id*. at P 60.

[29] The judge notes that, although the CAISO incurs three types of costs under the must-offer obligation (start-up costs, emissions costs and MLCC costs), only MLCC costs are addressed in Amendment No. 60. *Id*. at n.24.

[30] *Id*. at P 56 (*citing* Exh. ISO-20 at 20-21).

[31] *Id*.

[32] *Id*.

[33] *Id*.

[34] *Id*.

[35] *Id*. (*citing* Exh. ISO-20 at13; Exh. ISO-18; Exh. ISO-19 at10-11).

[36] *Id*. at P 60-62.

system costs are allocated to all market participants because their collective need/demand for a reliable grid causes that category of costs to be incurred and they collectively benefit from the incurrence of those costs.[37] He concludes that the proposal is just and reasonable and not unduly discriminatory because it provides a level of differentiation among MLCC cost allocation categories that conceptually satisfies the Commission's policy of matching costs to the greatest extent practicable to the customers responsible for imposing the cost burden or benefiting from it.[38] He notes that the benefits-based cost allocation is not insubstantial, limited or purely speculative.[39]

18. We affirm the judge's findings on these issues. No party to this proceeding filed exceptions to the judge's findings (1) on the factors to consider in determining whether the cost allocation proposal is just, reasonable and not unduly discriminatory or (2) that the concept of the three bucket approach is just and reasonable. We agree with the judge's analysis of the standard for determining whether the proposal is just, reasonable and not unduly discriminatory and, therefore, we summarily affirm and adopt his findings. We decline, however, to address the judge's request that the Commission clarify that equitable cost allocation based exclusively on derived benefits is legitimate in situations in which it cannot be determined who is directly responsible for imposing the costs at issue. The judge had before him evidence on who caused the costs and who benefited from them. He did not need to look exclusively at derived benefits. Therefore, the issue is not before us here. Accordingly, we decline to provide this clarification because it is beyond the scope of this proceeding.

19. Our review indicates that the CAISO's three bucket approach will result in a more appropriate matching of costs incurred to the customers who are responsible for imposing the costs or received benefits from the expenditure of theses costs. Accordingly, we summarily affirm and adopt the judge's findings that the concept of allocation MLCC costs according to which category a unit belongs is just, reasonable and not unduly discriminatory.

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[37] *Id*. at P 61-62.

[38] *Id*. at P 62.

[39] *Id*. at n.33.

2. Should MLCC Costs be Allocated to Each of the Local, Zonal and System Categories Pursuant to the Criteria Used by the CAISO to Classify Units Committed Under the Must-Offer Waiver Denial Process as Set Forth in Attachment E to the CAISO's Filing or in Another Manner? (Issue No. 3)

a. Whether Attachment E, as Included in the CAISO's May 11, 2004 Filing, Should Be Deemed Part of Amendment No. 60? (Issue No. 15); Whether the Criteria Used by the CAISO to Classify Units Committed Under the Must Offer Waiver Denial Process Should be Included in the CAISO Tariff? (Issue No. 16)

20. The judge then considers the proposed criteria for allocating costs. He finds that the CAISO's proposed criteria for determining whether a generating unit falls within the local, zonal or system categories, set forth in Attachment E to the filing, have not been included in the tariff itself and thus are not part of the tariff amendment.[40] Because Amendment No. 60 does not include specific, fixed or transparent category classification criteria, he concludes that it is not just and reasonable.[41]

21. He adds that the CAISO will have to re-file Attachment E criteria with the Commission—either in accordance with a compliance filing directive or *de novo* in accordance with FPA Section 205.[42] The judge then considers the alternative cost allocation proposals before him (*i.e.*, the criteria set forth in Attachment E and those proposed by market participants).[43]

22. We agree that CAISO's filing did not provide proposed tariff sheets with specific, fixed or transparent category classification criteria and that, therefore, the judge could consider the alternative proposals before him. We note, however, that the procedural course taken by the judge is unusual because, after concluding that Amendment No. 60 without Attachment E was not just and reasonable, he then proceeds to evaluate both documents along with a number of alternatives proposed by the commenters. In order to avoid the need for such procedural action in the future, the CAISO and other filing entities must include in their FPA section 205 filing proposed tariff language that contains specific information related to their rate proposal as required by the FPA.

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[40] *Id*. at P 79-80.

[41] *Id*. at P 81-82.

[42] *Id*. at P 116.

[43] *Id*. at P 83.

b. Review of Alternative Cost Allocation Proposals

(1) CAISO's Attachment E Criteria

(a) Attachment E Criteria in General

23. The judge first considers Attachment E because it is part of the CAISO's filing.[44] In Attachment E, the CAISO sets forth the criteria it will use to determine if a unit has been committed to meet local, zonal or system requirements. Under the CAISO's Attachment E criteria, to determine if a unit is classified as a local reliability unit, the CAISO considers if it operated to maintain power flows, maintain acceptable voltage levels at a network location or to accommodate the forced or scheduled outage of a network component within a congestion zone.[45] To determine if a unit is classified as a zonal reliability unit, it considers if a unit operated for those same tasks between congestion zones and if it maintained operations of an inter-zonal[46] transmission path(s) and provided ancillary services that the CAISO procured for a zone.[47] To determine if a unit is classified as a system reliability unit, it considers if it operated to meet forecast control-area demand and provided ancillary services that the CAISO procured for the control-area.[48] All local MLCC costs will be allocated monthly to the PTO in whose service area the implicated generating unit is located.[49] All zonal MLCC costs will be allocated to total monthly demand within the affected zone.[50] All system MLCC costs

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[44] *Id*. at P 83.

[45] *See* CAISO Amendment No. 60, Attachment E. *See also* Initial Decision at P 65 and 86 (*citing* Exh. S-21 at 1; Exh. ISO-22 at 22).

[46] He notes that inter-zonal interfaces consist of (i) transmission paths between the three existing CAISO congestion zones (NP-15, ZP-26 and SP-15) and (ii) transmission paths between the CAISO control area and other control areas. Initial Decision at n.34 (*citing* Exh. ISO-22 at 22).

[47] *See* CAISO Amendment No. 60, Attachment E. *See also* Initial Decision at P 65 and 86 (*citing* Exh. S-21 at 2-3; Exh. ISO-22 at 26-27).

[48] *See* CAISO Amendment No. 60, Attachment E. *See also* Initial Decision at P 65 (*citing* Exh. ISO-22 at 27) and 86 (*citing* Exh. S-21 at 3).

[49] Initial Decision at P 86 (*citing* Exh. S-21).

[50] *Id*.

will be allocated first to net negative uninstructed deviations (up to a capped rate) and any excess will be allocated to monthly demand and in-state exports.[51]

24. The judge concludes that the Attachment E criteria are just and reasonable because they are clear, unambiguous, adequately-detailed and incorporate objective unit classification/MLCC cost allocation benchmarks.[52] He finds that, on their face, the enumerated unit classification criteria reflect adequate geographic, operational and functional specificity to satisfy the just, reasonable and not unduly discriminatory standard.[53] He states that each of the enumerated criteria in all three categories has a direct and predominant causal benefit connection to the geographic and operational category to which it is assigned and MLCC costs allocated.[54] He concludes that, although ideally MLCC cost classification might be based on more precise criteria, those specified in Attachment E have a sufficient level of geographic, functional and operational differentiation to satisfy the Commission's policy that costs be matched, to the greatest extent practicable, to the customers responsible for imposing the cost burden at issue or benefiting from it.[55]

25. We summarily affirm and adopt the judge's finding that the Attachment E MLCC cost allocation is just, reasonable and not unduly discriminatory and satisfies the Commission cost causation and benefits derived standard. Attachment E should be included in the CAISO tariff because it is an integral part of the CAISO's proposed rate design. Therefore, we direct the CAISO to submit a compliance filing, within 60 days of

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[51] *Id*. Net negative uninstructed deviations represent the amount of energy the CAISO needs to balance demand and supply and subsumes (i) real-time demand not scheduled in forward markets, (ii) interchange scheduled in forward markets that does not appear in real time, and (iii) generation scheduled in forward markets that does not appear in real time. *Id*. at n.36 (*citing* Exh. ISO-22 at 27-28). The capped rate is intended to serve as a proxy for what a reasonable per-MWH minimum load cost would be and is calculated by dividing total monthly minimum load costs by total monthly MWh produced by units operating at minimum levels in accordance with the must-offer obligation. *Id*. at n.35 (*citing* Exh. ISO-22 at 29).

[52] *Id*. at P 86.

[53] *Id*. at P 87.

[54] *Id*.

[55] *Id*.

the date of this order, incorporating the Attachment E criteria, as modified below, into the CAISO tariff.

(b) Application of Attachment E Criteria

26. The judge next considers the CAISO's actual classification of units pursuant to the Attachment E criteria.[56] He raises concerns with the CAISO's classification of two constraints: Miguel Transformer Bank (Miguel) and South of Lugo Transformer Path (South of Lugo). Specifically, the CAISO has proposed to exclude Miguel and South of Lugo from the local category.[57] The CAISO proposes to include Miguel and South of Lugo in the zonal cost allocation category because, in operation, each provides a "more regional benefit" to the entire SP-15 zone.[58] The judge states that the record establishes that Miguel and South of Lugo do not satisfy the inter-zonal interface definition and therefore would fall into the local cost allocation category under the Amendment No. 60 Attachment E methodology. The judge finds that it is not just and reasonable for the CAISO to deviate from its proposed objective MLCC cost allocation criteria, create exceptions to the criteria or designate the criteria as discretionary.[59] The judge finds that either the units must be properly categorized as zonal constraints due to their operational characteristics or the CAISO must revise the local-zonal classification criteria.[60]

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[56] *See id*. at P 88.

[57] *Id*. at n.37.

[58] *Id*. at P 88. The judge notes that the CAISO also proposes to include the Southern California Import Transmission Nomogram in the zonal cost allocation category because, in operation, it provides a "more regional benefit" to the entire SP-15 zone. *Id*. He notes that the Southern California Import Transmission Nomogram transmission constraint lies within the existing CAISO congestion zones and that Southern California Import Transmission Nomogram technically does not satisfy the inter-zonal interface definition. *Id*. at n.34 (citing Exh. ISO-22 at 7, 23-25; Exh. SCE-1 at 8-9). However, he finds that Southern California Import Transmission Nomogram applies to five transmission paths importing power into southern California from Arizona, Nevada, Utah and the Pacific Northwest. *Id*. at P 89 (*citing* Exh. S-21 at 2; Exh. ISO-22 at 24-25). He concludes, therefore, that Southern California Import Transmission Nomogram is properly categorized as zonal and no adjustment to the Attachment E zonal criteria is necessary. *Id*. at P 89.

[59] *Id*. at P 88.

[60] *Id*. at P 88, 116.

Miguel

27. The judge finds that Miguel does not satisfy the inter-zonal interface definition, as shown on Attachment E because it lies within the three existing CAISO congestion zones and, therefore, would fall into Attachment E's local cost allocation category.[61] However, he concludes that Miguel has been appropriately categorized by the CAISO as zonal because its actual operational characteristics indicate that it provides regional reliability benefits that are more consistent with a zonal categorization.[62] The judge concludes that the constraint associated with Miguel would not necessarily require the CAISO to modify the Attachment E zonal criteria but suggests that the CAISO modify either the tariff definition of inter-zonal interface or the Attachment E zonal criteria to accommodate Miguel.[63]

28. On exceptions, Southern Cities argues that the Commission should reject the judge's determination and conclude that, according to the Attachment E criteria, Miguel is a local constraint. Southern Cities argues that, if the Commission adopts the judge's finding that Miguel is a zonal constraint due to its operational characteristics and alleged provision of regional reliability benefits, the Commission would eliminate the distinction between local and zonal constraints in the Attachment E criteria and leave the classification of intra-zonal costs to the CAISO's determination of which constraint provides a regional benefit. Southern Cities also suggest that, if significant congestion exists at Miguel, the CAISO should create a new zone so that congestion can be mitigated through market mechanisms.

29. PG&E responds by having Miguel deemed a local constraint that Southern Cities seeks to avoid paying its fair share of the Miguel costs; however, because the costs associated with must-offer waiver denials in the Miguel area have a zonal benefit, it is appropriate to allocate it to the zonal bucket. SoCal Edison argues that strict adherence to a bright-line test for MLCC cost allocation is inappropriate because Miguel has significant regional impacts and, to be just and reasonable, must be assigned to the zonal bucket regardless of whether it meets the generally applicable criteria for a zonal MLCC constraint set forth in Attachment E. SoCal Edison also states that the CAISO will not have unfettered discretion to determine which constraints provide significant regional benefits because the CAISO will have to file any future modification to Attachment E with the Commission for approval.

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[61] *Id*. at P 67, n.38, 88, n.34 (*citing* Exh. ISO-22 at 7, 23-25; Exh. SCE-1 at 8-9).

[62] *Id*. at P 90.

[63] *Id*.

30. Trial Staff contends that it is appropriate to classify Miguel as a zonal interface, not an intra-zonal constraint. It states that Miguel does interconnect an area within the CAISO control area to another control area and certain operational factors (*e.g.*, ability of generators throughout SP-15 to mitigate congestion at Miguel and *pro rata* curtailment as the mitigation measure of last resort) confirm that Miguel is a zonal interface. Trial Staff adds that Miguel is subject to a nomogram[64] that supports the transfer of energy between control areas as required by the Attachment E zonal criteria. Trial Staff also argues that the establishment of another zone suggested by Southern Cities is outside the scope of this proceeding.

31. We affirm the judge's findings on the zonal categorization of Miguel. We agree with Trial Staff that Miguel satisfies the Attachment E criteria in that it interconnects an area within the CAISO control area to another control area. The record evidence also supports the finding that Miguel provides regional reliability benefits that are more consistent with a zonal categorization than with a local one.[65] For example, CAISO Operating Procedure No. T-132E clearly shows that Miguel supports the transfer of energy between the control areas of the Imperial Irrigation District, Mexico, and Arizona.[66] In addition, we agree with Trial Staff that generation units in both SDG&E and SoCal Edison and units north of Midway are effective in mitigating congestion at Miguel, which supports the conclusion that Miguel is zonal in nature since generation throughout the zone can be used to mitigate congestion.[67] Thus, we find that Miguel satisfies the zonal criteria set forth in Attachment E and, therefore, that criteria would not need to be modified to accommodate Miguel. However, as recommended in the Initial Decision, we direct the CAISO to modify the tariff definition of inter-zonal interface in order to more accurately describe the function of Miguel. Regarding Southern Cities' argument concerning adherence to Attachment E criteria, we find that, if the CAISO determines that the operating characteristics of a unit may cause a change in the bucket allocation, the CAISO can propose to amend the Attachment E criteria in an FPA section 205 filing.

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[64] A nomogram is a set of operating or scheduling rules that are used to ensure that simultaneous operating limits are respected.

[65] *See* Exh. S-6 at 22-24 (protected).

[66] *See* Exh. S-13 at 2 (protected).

[67] *See* Exh. S-6 at 23 (protected); Exh. S-13 at 6 (protected).

South of Lugo

32. The judge finds that South of Lugo does not satisfy the inter-zonal interface definition because it lies within the three existing CAISO congestion zones and, therefore, would fall into Attachment E's local cost allocation category.[68] Therefore, the judge concludes that South of Lugo should be categorized as a local constraint, rather than zonal.[69] He adds that it does not satisfy the Attachment E zonal criteria because it (1) does not implicate transmission paths between congestion zones; (2) constitutes a network location where must-offer generation is used to maintain acceptable voltage levels; and (3) does not operate within the requirements of any nomogram governing the operations of an inter-zonal transmission path.[70] He also finds that South of Lugo should be characterized as a local constraint based upon its operational characteristics and the CAISO's Operating Procedures.[71] He finds that assertions to the contrary are based only on broad statements.[72]

33. PG&E contends that there is no clear basis for allowing the Attachment E criteria to be modified to accommodate Miguel but not South of Lugo. If the Commission decides to require the CAISO to provide more support to establish the zonal designation, PG&E requests that the Commission make clear that, once any further showing is made, the zonal treatment of South of Lugo will apply to the entire period, starting on July 17, 2004.

34. SoCal Edison argues that South of Lugo should be classified as zonal because (1) constraints on the South of Lugo path provide a regional benefit to Southern Cities' loads and Southern Cities contribute to constraints on the South of Lugo path; and (2) it is associated with multiple 500kV transmission paths. SoCal Edison also contends that it is inconsistent to adhere to the Attachment E criteria when classifying South of Lugo but not when classifying Miguel or the Southern California Import Transmission Nomogram. SoCal Edison claims that the factors that justify departure from the Attachment E criteria

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[68] Initial Decision at P 67, n.38, 88, n.34 (*citing* Exh. ISO-22 at 7, 23-25; Exh. SCE-1 at 8-9).

[69] *Id*. at P 91 (*citing* Exh. ISO-22 at 22-23; Exh. S-18 at 11; Exh. S-21 at 2-3).

[70] *Id*. (*citing* Exh. S-6 at 28:12-18 (protected); Tr. 1536; Exh. S-21 at 1-3).

[71] *Id*. (citing Exh. S-6 at 28-30 (28:12-18 protected); Exh. SOC-1 at 17; Exh. SOC-28 at 11-12; Tr. 1574 (protected)).

[72] *Id*. (*citing* Exh. ISO-22 at 25-26; Exh. SCE-1 at 8-9; Exh. PGE-5 at 13; Exh. SWP-18 at 19).

(*i.e.*, it provides a regional reliability benefit) for Miguel to be classified as zonal also apply to South of Lugo.

35. SoCal Edison also asserts that the version of CAISO Operating Procedure T-144 is beside the point because, under cost causation and benefit principles, the evidence shows that South of Lugo should be treated as zonal. SoCal Edison claims that, if the Initial Decision is not overturned on this point, it will be unjustly required to pay over $165 million in MLCC costs associated with South of Lugo, while Southern Cities and SDG&E will not pay anything, even though all CAISO grid users in southern California cause South of Lugo costs and they benefit from the must-offer calls that relieve the constraint.

36. Southern Cities responds that, if the Commission accepts SoCal Edison's argument that South of Lugo should be classified as zonal because the incurrence of MLCC costs to relieve the constraint benefits, then any objective cost allocation criteria would be eliminated because relieving any constraint benefits to some degree load inside the zone to some degree (and outside the zone). Trial Staff notes that South of Lugo satisfies local category criteria, and the constraint's operational characteristics and CAISO Operating Procedures support that it is local. Trial Staff states that, rather than allocate MLCC costs on the basis of second-hand general effects, the CAISO should allocate costs based on clear, unambiguous operational characteristics. Trial Staff adds that the fact that Southern Cities contributes to and benefits from the CAISO's incurrence of South of Lugo MLCC costs does not contradict the classification of South of Lugo as local because Southern Cities' service territories and loads are embedded in the PTO service territory of SoCal Edison. Trial Staff argues that PG&E and SoCal Edison make no attempt to quantify, estimate or otherwise describe the amount or nature of South of Lugo's regional impacts.

37. Trial Staff claims that there is no sound evidence or legal basis for the Commission to recommend a zonal allocation of MLCC costs for the South of Lugo constraint. It adds that, because MLCC costs were socialized among all customers on a control area-wide basis prior to the filing of Amendment No. 60, categorizing South of Lugo as zonal, rather than local, will defeat the stated purpose of Amendment No. 60 to better reflect cost causation principles.

38. SWP and SoCal Edison contend that the South of Lugo constraint belongs in the zonal category for MLCC cost allocation because multiple PTOs cause South of Lugo flows. SoCal Edison contends that it is contrary to cost causation principles to require SoCal Edison customers to pay all the South of Lugo MLCC costs, particularly the costs that are necessary to ensure an uninterrupted service to Southern Cities' loads. SWP adds that accurate price signals and demand response cannot occur if entities causing the MLCC costs for South of Lugo are not allocated their share of the costs incurred for that constraint. SWP contends that a zonal allocation of South of Lugo MLCC costs, adjusted

to exclude SWP's pump load, ensures that those causing the costs pay for the costs they cause.

39. We affirm the judge's findings that South of Lugo should be categorized as a local constraint. The record shows that the South of Lugo constraint satisfies all of the Attachment E criteria for the local category and none of the Attachment E criteria for the zonal category. The South of Lugo transmission lines are not part of any transmission path between congestion zones, are not part of a nomogram that governs the operations of an inter-zonal transmission path, and are operated to maintain voltage stability. We also agree with Trial Staff that South of Lugo's operational characteristics, as well as the CAISO Operational Procedures, demonstrate that it should be characterized as a local constraint. Regarding the argument that there is no basis (1) upon which to distinguish between South of Lugo and Miguel for cost allocation purposes; and (2) for allowing the Attachment E criteria to be modified to accommodate Miguel but not South of Lugo, we find that (1) the judge's conclusions above clearly show that South of Lugo fully satisfies the local category under Attachment E while Miguel satisfies the zonal category, and (2) Attachment E criteria does not need to be modified to accommodate the Miguel constraint.

(c) Under Attachment E, Whether the "Incremental Cost of Local" Approach for Determining the Allocation of MLCC Costs Between "System" and "Local" Categories is Just and Reasonable? (Issue No. 4)

40. In addition to the three bucket allocation, the CAISO includes an "incremental cost of local" cost allocation methodology in its Attachment E criteria. According to this methodology, when a must-offer unit is committed for local reliability requirements and the unit commitment simultaneously satisfies a system requirement, the CAISO allocates only the incremental cost of committing the unit to the local category/PTO.[73] The incremental cost of local is calculated by subtracting the cost of committing the cheapest available unit(s) from the cost of committing the required must-offer unit(s).[74]

[73] *Id*. at P 117 (*citing* Exh. S-21 at 2). During the MLCC stakeholder process, SoCal Edison requested that the CAISO use this methodology in its proposal. *Id*. at P 117.

[74] *Id*. (*citing* Exh. S-21 at 2).

41. The judge concludes that Commission policy and the record support the net incremental cost of local approach.[75] He finds that the CAISO is capable of implementing the methodology.[76] He also finds that the methodology is capable of differentiating between local and system MLCC cost components when a must-offer unit committed for local reliability requirements simultaneously satisfies system requirements.[77] He concludes that this differentiation is consistent with Commission policy that costs be matched, to the greatest extent practicable, to the customers responsible for imposing the cost burden or benefiting from it.[78] He also finds that the net incremental approach results in appropriate cost sharing, not cost shifting.[79] He rejects any claim that the net incremental cost of local approach undermines CPUC policies on local reliability/resource adequacy.[80] He also rejects any contention that the approach is discriminatory or preferential because it inures primarily, or exclusively, to SoCal Edison's benefit.[81] He states that a non-differentiated local MLCC cost allocation imposed unwarranted system costs on SoCal Edison.[82]

42. Although he concludes that the net incremental approach is generally just, reasonable and not unduly discriminatory, he finds that certain modifications are necessary.[83] He suggests that, due to data inaccuracies in the proceeding, the CAISO should be required (1) to post on its website adequate information to provide market participants with the ability to confirm the appropriateness/accuracy of its net incremental cost of local allocations, and (2) to provide all data, protocols and calculations relied

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[75] *Id*. at P 120.

[76] *Id*. (*citing* Exh. S-21 at 2; Exh. ISO-20 at 18).

[77] *Id*. at P 120.

[78] *Id*.

[79] *Id*. at P 121.

[80] *Id*.

[81] *Id*.

[82] *Id*.

[83] *Id*. at P 122.

upon to allocate net incremental local/system costs from July 17, 2004 to September 3, 2004 per the Security Constrained Unit Commitment (SCUC) proxy methodology.[84]

43. On exceptions, PG&E argues that the judge's finding that Commission policy and the record overwhelmingly support this approach is unsupported and erroneous. PG&E asserts that it along with the CPUC, IEP and Southern Cities have demonstrated that the net incremental cost of local approach is a self-serving proposal developed by and only benefiting SoCal Edison and thus is discriminatory and preferential. PG&E disputes the judge's conclusion that the net incremental cost of local approach is cost sharing. PG&E contends that, consistent with the CAISO's stated goals under the proposed rate design, the costs incurred for local reliability in southern California should be borne by the customers who benefit from those costs (*i.e.*, customers in southern California).

44. SoCal Edison responds that the absence of a net incremental cost of local approach would force SoCal Edison ratepayers to pay the costs of system reliability on behalf of ratepayers located outside SoCal Edison territory, including those located in northern California.[85] SoCal Edison states that this result would be contrary to cost causation principles and unjust and unreasonable. Trial Staff states that, consistent with cost causation and benefit principles, the CAISO charges the cost of a local must-offer unit that resolves both a local and system problem to the local PTO and to the system bucket.[86] Trial Staff also states that the incremental cost of local methodology is just and reasonable because of its cost sharing feature that permits a local unit to resolve both a local and system constraint. SoCal Edison adds that PG&E's cost shifting argument is based on the erroneous assumption that the net incremental cost of local methodology shifts costs of local reliability to the system bucket. SoCal Edison explains that this claim is untrue because, under the net incremental cost of local approach, the cost of local reliability is allocated to the local bucket and the appropriate system-related costs are assigned to the system bucket. SoCal Edison argues that this approach recognizes that there should be cost sharing between local and system costs when a unit provides both local and system reliability.

45. Southern Cities contends that, within the context of the multi-dimensional reliability cost allocation scheme in California, the net incremental cost of local approach is inequitable because the CAISO has used its must-offer obligation authority as a

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[84] *Id*. (*citing* Exh. ISO-22 at 40-42).

[85] SoCal Edison Brief Opposing Exceptions at 14.

[86] Trial Staff Brief Opposing Exceptions at 86.

substitute for RMR contracting in southern California, which has resulted in different cost allocation schemes between northern California (that is RMR unit-rich) and southern California (that is RMR unit-poor).[87] Southern Cities argue that RMR costs (high in NP-15 and low in SP-15) are allocated only to the responsible utility or PTO in whose service area the RMR unit is located, while local MLCC costs (high in SP-15 and low in NP-15) are first allocated to the local PTO and then, per the incremental cost of local approach, a portion is reallocated to all load in the system category.[88] Southern Cities argue that this result is discriminatory.

46. SoCal Edison responds that Southern Cities' argument regarding must-offer waiver denial and RMR unit designation is misplaced. SoCal Edison and Trial Staff claim that this proceeding is the wrong forum in which to raise concerns with the CAISO's failure to designate sufficient RMR units in southern California. SoCal Edison adds that RMR units and must-offer obligation units are determined through separate processes and are not and cannot be used interchangeably. SoCal Edison states that the fact that some units that were previously RMR units have experienced must-offer waiver denials does not mean that these units, in their must-offer waiver denial capacity, are being used for the same purposes as they were when they were designated RMR units. Trial Staff adds that undue discrimination is not present here because the evidence shows that market participants that benefit from RMR units used to resolve local reliability problems are not similarly situated to market participants that benefit from must-offer units that resolve both local and system reliability problems.

47. Southern Cities states that the Commission has found that it is just and reasonable to use the SCUC computer application as a tool to minimize must-offer waiver denials once reliability needs have been met.[89] But Southern Cities claims that the Commission did not find that it is just and reasonable to reallocate costs incurred through local must-offer waiver denials to the system bucket based on the SCUC assessment of the incremental system benefit provided by local waiver denial.

48. We affirm the judge's findings on this issue. We agree with the judge and Trial Staff that this differentiation is consistent with the Commission's policy that costs be matched, to the greatest extent practicable, to the customers responsible for imposing the cost burden or benefiting from it. We also agree with Trial Staff that, if a must offer unit

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[87] Southern Cities Brief on Exceptions at 24.

[88] *Citing Cal. Indep. Sys. Operator Corp.*, 90 FERC ¶ 61,315 at 62,041 (2000); Exh. ISO-1 at 40-44.

[89] *Citing* Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022 at P 76.

is denied a waiver for local reasons and another generating unit that otherwise would have been committed for system reasons is not denied a waiver because the local unit also meets the system needs, it is appropriate to distribute the costs of the must offer unit among the system and local buckets. Accordingly, since under its SCUC application,[90] the CAISO has established that it is capable of differentiating between local and system MLCC cost components when a must-offer unit committed for local reliability requirements simultaneously satisfies system requirements, we find the CAISO's proposal to reflect that part of these costs be assigned to local and part to system buckets is just and reasonable.

49. However, we direct the CAISO to make certain modifications to its methodology as recommended by the judge. The CAISO must post on its website adequate information to provide market participants with the ability to confirm the appropriateness or accuracy of its incremental cost of local allocations in accordance with the SCUC application.

(d) Incremental Cost of Zonal

50. SoCal Edison proposes broadening the incremental cost of local methodology to include zonal costs.[91] SoCal Edison argues that in many instances MLCC costs are incurred for multiple purposes, including local, zonal and system reliability, and a just and reasonable cost allocation methodology should address all such situations. In order to ensure that the allocation of costs under Amendment No. 60 is just and reasonable, SoCal Edison requests that, consistent with the CAISO's proposal regarding the treatment

[90] The CAISO will run its SCUC application twice. First, to determine what units must be committed to meet local reliability needs, flag those units as required, and run the SCUC application based on the CAISO demand forecast and system requirements to obtain a total "extra-market" unit commitment cost. Next, the CAISO will have to turn off any units manually flagged as needed for local reliability requirements and re-run the SCUC application again using the same demand forecast and system requirements to obtain an unconstrained, total "extra-market" unit commitment cost. If the units committed in the first SCUC run for local reliability requirements are not the cheapest units to be committed for system needs, the SCUC application will commit different, less expensive units in the unconstrained run. The difference between the cost of the first run and the second run represents the costs that the CAISO will pass to the local PTOs; the commitment costs determined in the second unconstrained run will be allocated as a system requirement.

[91] SoCal Edison Brief on Exceptions at 19-20.

of local costs, the Commission also order that only the incremental cost of zonal should be allocated to the zonal bucket and all other costs associated with that must-offer waiver denial be allocated to the system bucket.

51. PG&E responds that SoCal Edison's proposal to apply the incremental cost treatment to zonal should be rejected because (1) SoCal Edison provides no citation to the record or Commission precedent to justify its proposal, and (2) it would be a return to the pre-Amendment No. 60 situation in which costs were spread system-wide.

52. Based on the record, we cannot determine whether the proposed methodology for determining the incremental cost of zonal is just and reasonable. As noted by Trial Staff, there is no record evidence supporting this proposed methodology,[92] nor is there any evidence that the CAISO could use its SCUC application or any other means to distinguish the incremental zonal costs from system costs. Therefore, we reject the incremental cost of zonal methodology based on the record before us.

(2) Other Proposals

(a) Whether LSEs Should be Permitted to Self-Provide Local Generation (or Inertia) & Thereby Avoid Southern California Import Transmission Nomogram-Related MLCC Costs (Issue No. 11)

53. Once a generator is producing power, there is a large amount of mechanical energy, or inertia, that the generator converts from mechanical energy into electric energy. When a generator that is interconnected to the transmission grid fails (a forced outage event), inertia from other generators that are synchronized and connected to the grid plays a role in supplying additional energy to the system to make-up for the lost energy of the failed generator. When energy is imported into the control area, a certain level of local generation must be on-line to provide inertia to support these imports.[93] The Southern California Import Transmission Nomogram graphically depicts the interrelation between certain transmission lines that are used to import power into southern California and the inertia available in southern California.

54. The judge separately considered Southern Cities' proposal to establish a mechanism that would allow LSEs to self-provide their load-ratio share of generation (*i.e.*, inertia) to avoid Southern California Import Transmission Nomogram-related

[92] Trial Staff Brief Opposing Exceptions at 88, n.408.

[93] *See* Exh. S-6 at 6-17; Exh. SOC-28 at 7.

MLCC cost allocation.[94] To achieve this objective, Southern Cities proposes that the CAISO amend CAISO Operating Procedure T-103 (T-103) for the Southern California Import Transmission Nomogram.[95]

55. The judge finds no compelling policy reason to reject the proposal. He concludes, however, that the CAISO should not be required to revise T-103 to accommodate the self-provision of inertia because it is currently infeasible for the following reasons: (1) LSEs do not provide the CAISO with the real-time power flow information required to determine LSE-specific load-ratio shares of inertia for the Southern California Import Transmission Nomogram and (2) the CAISO cannot determine Southern California Import Transmission Nomogram-related inertia requirements, which are zonal, until it has addressed its local reliability requirements, which is too late to accommodate the self-provision of inertia for the Southern California Import Transmission Nomogram.[96] He also finds that it would require resource and time-intensive modifications to CAISO operating and settlement procedures and software that are not proportionate to any resulting advantages, especially given that (1) they would apply to one constraint and (2) the Southern California Import Transmission Nomogram is expected to be superseded by June 2006 due to system upgrades and expansions.[97] The judge also finds that the proposal could be discriminatory because it is limited to Southern California Import Transmission Nomogram.[98] He recommends that Southern Cities pursue this proposal in the on-going MRTU proceeding.[99]

56. On exceptions, Southern Cities state that that the judge's operational and practical concerns have been discredited by the record or are based on the CAISO's unstudied assumptions. They also argue that the issues of self-provision applying to only one constraint and the replacement of the Southern California Import Transmission Nomogram in 2006 are irrelevant to the propriety of self-provision for Southern California

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[94] Initial Decision at P 97. Through this mechanism, an LSE could self-provide its inertia to resolve the Southern California Import Transmission Nomogram constraint instead of paying its demand-based share of Southern California Import Transmission Nomogram-related (zonal) MLCC costs. *Id*. at P 98.

[95] *Id*.

[96] *Id*. at P 99 (*citing* Exh. ISO-21 at 11-12; Tr. 419, 422).

[97] *Id*. (*citing* Exh. S-6 at 16-17, 18-19; Exh. 19 at 22; Tr. 499).

[98] *Id*. at n.60.

[99] *Id*. at P 99.

Import Transmission Nomogram-related MLCC costs. They state that they do not object to a self-provision mechanism for other constraints but that the Southern California Import Transmission Nomogram is the only one for which self-provision would be appropriate. They also state that the fact that the Southern California Import Transmission Nomogram may be replaced or renamed does not undercut the fact that the CASIO will continue to require inertia produced by local generating units to sustain imports into southern California. They argue that the CAISO tariff, CAISO practice and Commission precedent dictate that, if a party is forced to pay a share of reliability-type costs, it is entitled to the opportunity to avoid those costs by providing its fair share of the reliability-type service.[100] They contend that self-provision of inertia is not only a feasible element of the Amendment No. 60 methodology but also is necessary to ensure that market participants have the option of avoiding exorbitant Southern California Import Transmission Nomogram-related MLCC costs through their own resource planning and market behavior.[101] Finally, they respond that the judge's conclusion that the proposal should be addressed in the MRTU proceeding is not feasible because (1) the CAISO is not scheduled to implement MRTU until March 2007 and the Commission has indicated that the CAISO's must-offer obligation authority will not extend into this time period;[102] and (2) none of the CAISO conceptual MRTU proposals addresses the issue of self-providing inertia.

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[100] *Citing PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112 at P 72 (2004); Order No. 888 at 31,715-16; *Order Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, FERC Stats. & Regs. 1999-2003 ¶ at P 287 (2002); *Cal. Indep. Sys. Operator Corp.*, 105 FERC ¶ 61,091 at P 58 (2003); *Cal. Indep. Sys. Operator Corp*., 107 FERC ¶ 61,274 at P 53 (2004).

[101] Southern Cities claims that the CAISO has incurred more than $ 45 million in the Southern California Import Transmission Nomogram and Southern California Import Transmission Nomogram -related MLCC costs from June to October 2004. *Citing* Exh. SCE-7. Southern Cities contends that Southern California Import Transmission Nomogram MLCC costs are reduced when local generation runs anywhere in the SP-15 Zone's Los Angeles Basin. *Citing* Exh. SOC-3 at 116; Exh. SOC-2 at 107. They argue that, under the Attachment E zonal cost allocation, these costs are spread to all load in the zone regardless of an LSE's absolute or relative contribution of inertia in the zone. *Citing* Tr. 413:4-24. They assert that, if Amendment No. 60 is implemented with a self-provision mechanism for at least Southern California Import Transmission Nomogram-related MLCC costs, LSEs will be forced to pay a static share of these costs irrespective of their contribution to them and thus will be dissuaded from building new generation.

[102] *Citing Cal. Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,254 at P 10 (2004).

57. The CAISO challenges the assertion that the Initial Decision rejection of the self-provision proposal relies upon discredited testimony. The CAISO states that, in each instance, the judge properly found that the proposal would raise implementation or cost-effectiveness issues. SoCal Edison states that Southern Cities have not provided a specific cost estimate to show that the cost of implementing their proposal would not be substantial, while the CAISO has provided evidence that the proposal would be burdensome. Trial Staff agrees that the record does not support Southern Cities' claim that the proposal is fairly simple and inexpensive. SWP states that Southern Cities' proposal, which is limited to generating units, excludes the use of time sensitive pricing that produces price signals and demand response. It argues that Southern Cities' proposal should not be accepted, unless self-provision through demand response is permitted.

58. We affirm the judge's findings on this issue. We agree with the CAISO that there are serious obstacles to the implementation of an inertia self-provision mechanism. The CAISO states that the Southern California Import Transmission Nomogram determines the CAISO's generation requirement through historic flows, not through current load. The CAISO further states that historic flows are not easily disaggregated into LSE increments of load ratio share.[103] Also, as noted by the judge, there is record evidence that indicates that by the time the CAISO knows its Southern California Import Transmission Nomogram requirements, it is too late to implement a self-provision process that would necessarily require revisions to the day-ahead schedules. We also note that, in CAISO Amendment No. 72, both PG&E and the CAISO submitted specific proposals regarding the submission of day-ahead schedules that the Commission rejected in large part due to being operationally burdensome for the CAISO to implement.[104] Our finding here is consistent with the Commission's finding with respect to Amendment No. 72 inasmuch as the evidence indicates that it would be operationally burdensome to implement the self provision of inertia related to the Southern California Import Transmission Nomogram. We also agree with the CAISO that from a settlements perspective, creating an entirely new process to address the constraint would be overly burdensome and counter productive in the current environment since the benefits would inure to a few and the costs associated with these adjustments would be spread across all rate payers while this argument is not determinative of this issue. We find that the recognition of costs and benefits is a factor in a review of a proposed rate design and the record here indicates the costs associated with this proposal would be substantial.

[103] CAISO Pre-Trial Brief at 18-19. *See also* Exh. ISO-21 at 10-11.

[104] *See Cal. Indep. Sys. Operator Corp.*, 115 FERC ¶ 61,168 at P 15 (2006).

(b) Whether Non-Local MLCC Costs Should Be Allocated on a Daily or Monthly Basis (Issue No. 5)

59. SWP proposes to allocate MLCC costs according to a modified version of Attachment E. First, SWP proposes that zonal and system cost would be allocated daily, not monthly.[105] Also, it proposes that Sunday costs would be allocated to Monday because Sunday costs are primarily incurred so that must-offer generators with lengthy start-up periods are ready to meet Monday peak load conditions.[106]

60. The judge concludes that daily allocation is just, reasonable and not unduly discriminatory.[107] He adds that, although he finds that it would be just, reasonable, not unduly discriminatory and preferable to allocate zonal and system MLCC costs on a daily basis, he finds that it would also be just, reasonable and not unduly discriminatory to allocate these costs on a monthly basis as done in Attachment E, particularly given that monthly allocation squares with the CAISO's start-up and emissions cost allocation methodology.[108]

61. On exceptions, PG&E requests that, because the CAISO's monthly allocation was found just reasonable and not unduly discriminatory and consistent with the allocation methodology used for start-up and emissions costs,[109] the Commission clarify that the monthly allocation of MLCC costs is accepted for the system and zonal categories. PG&E adds that a daily allocation would introduce unfairness to the process (*e.g.*, the problem of allocating MLCC costs for weekend days).

62. Trial Staff and Powerex argue that, because Amendment No. 60 proposed only a monthly allocation of non-local MLCC costs, a finding that the monthly allocation was

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[105] Initial Decision at P 100, 101.

[106] *Id*. at P 101 (*citing* Exh. SWP-1 at 9).

[107] The judge finds that the CAISO does not oppose calculating these costs daily, it is capable of doing so, and such allocation is not inconsistent with procedural requirements or other Commission precedent. *Id*. at P 102 (*citing* Exh. ISO-20 at 36; Tr. 852; Exh. ISO-9; Exh. ISO-11; Exh. ISO-15; Exh. ISO-17; Exh. ISO-20 at 46-47; Exh. ISO-8).

[108] *Id*. at P 116.

[109] PG&E states that the Commission has directed this consistency. *Citing San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 97 FERC ¶ 61,293 at 62,363 (2001) (December 2001 Order).

just, reasonable and not unduly discriminatory should have ended the legal analysis. They assert that the judge erred by continuing to find that a daily allocation would also be just, reasonable and not unduly discriminatory. Trial Staff and Powerex request that the Commission decline to consider a daily allocation of non-local MLCC costs or modify Amendment No. 60 with respect to the proposed monthly allocation of non-local MLCC costs.

63. SWP responds that: (1) daily allocation satisfies cost causation better because the causes of must-offer generation commitments vary by hour and by day; (2) the judge correctly found that daily allocation is not necessarily inconsistent with a monthly allocation of start-up and emissions costs; and (3) allocating costs incurred in a different way each day on a monthly basis blunts price signals, erecting barriers to demand response.

64. We find that, because the CAISO proposed only a monthly allocation of non-local MLCC costs in Amendment No. 60, the determination that the monthly allocation was just and reasonable should have ended the judge's analysis, and alternative proposals should not have been considered.[110] Therefore, we reject as unnecessary the judge's conclusion that daily cost allocation would also be just, reasonable, and not unduly discriminatory.

(c) Whether ETC Schedules Should be Exempted from All or Some Zonal MLCC Costs (Issue No. 8)

65. SWP proposes that existing transmission contract (ETC) schedules be exempt from the portion of zonal MLCC costs associated with inter-zonal congestion.[111] The judge finds that SWP's argument that this proposal is consistent with historical circumstances fails because: (1) it does not account for the fact that the must-offer obligation was an emergency measure implemented by the Commission in response to the California energy crisis and (2) it is inconsistent with the Commission edict that "all users of the transmission grid will be assigned [MLCC] costs consistent with the [CAISO's] markets performing a reliability function."[112] The judge also rejects the contention that the Commission's alleged prohibition on charging congestion charges to

[110] *See Cal. Indep. Sys. Operator Corp.*, 111 FERC ¶ 61,337 at P 27 (2005).

[111] Initial Decision at P 100, 105.

[112] *Id*. at n. 70 (*quoting San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 99 FERC ¶ 61,158 at 61,633 (2002)).

ETCs, except in contract conversion or termination, extends to MLCC cost allocation.[113] The judge concludes that ETC schedules should not be exempted from the portion of zonal MLCC costs associated with inter-zonal congestion.[114] He states that it follows that Amendment No. 60 is just, reasonable and not unduly discriminatory insofar as it allocates zonal MLCC costs to total demand within the affected zone, including ETC loads.[115]

66. On exceptions, SWP argues that it is contrary to Commission precedent to allocate to ETCs must-offer costs incurred as a result of inter-zonal congestion. SWP contends that the judge fails to address Commission precedent that ETCs do not contemplate congestion charges of any type, except in conversion or termination of contract rights. SWP claims that, although there is no tariff language authorizing circumvention of the requirement to honor ETCs, the Initial Decision would impose MLCC costs because ETCs receive an "extra-contractual benefit" of reduced curtailment. SWP asserts that the judge does not explain why customers under ETCs who are providing firm, non-curtailable transmission service benefit from a reduction in the potential for curtailment. Finally, SWP argues that, because Commission precedent requires an unbundling and contract amendment in connection with the imposition of additional reliability and redispatch costs on ETC service, allocating MLCC costs to ETCs would result in an impermissible double recovery of reliability costs from ETC customers. For these reasons, SWP concludes that ETC schedules should be excluded from zonal must-offer generation costs. SWP adds that Amendment No. 60 violates the filed rate doctrine because it does not specify that zonal MLCC charges will be applied to ETCs.

67. SoCal Edison responds that, while the CAISO tariff contains an express ETC exemption from inter-zonal congestion charges in section 2.4.4.4.4.1, there is no similar exemption for MLCC costs or costs incurred "due to inter-zonal congestion." The CAISO, SoCal Edison and Trial Staff explain that MLCC costs are not usage or congestion charges because they are incurred to maintain real-time reliability of the transmission grid. The CAISO notes that congestion management procedures are addressed in one part of the CAISO tariff (sections 7.2 and 7.3), while MLCC charges are addressed in another (section 5.11.6.1.2). The CAISO, SoCal Edison and Trial Staff explain that the allocation of zonal MLCC costs to demand served by an ETC is consistent with Commission precedent because the charges reflect a new service not

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[113] *Id*. at P 106-07 (*citing* Item by Reference #1, v. 1, First Revised Sheet No. 323, Second Revised Sheet No. 307A, Original Sheet No. 56; Exh. S-18 at 20).

[114] *Id*. at P 108.

[115] *Id*.

provided under the ETCs. The CAISO and SoCal Edison argue that the filed rate doctrine has not been violated because CAISO tariff section 5.11.6.1.2 states that zonal MLCC costs will be assessed to demand within the zone the MLCC costs are incurred and ETC loads represent demand within the zone. Trial Staff adds that, contrary to SWP's assertion, Opinion No. 459,[116] does not preclude ETCs from incurring MLCC costs.

68. We affirm the judge's findings on this issue. Since the inception of the must-offer program, ETC customers have been liable for and have paid MLCC. MLCC costs are different from congestion costs and charges for RMR units, and thus the allocation of MLCC costs to ETC customers is not a double recovery. MLCC charges are incurred to compensate a generator that operates at minimum load, regardless of whether that generator is dispatched by the CAISO to relieve congestion. Therefore, we agree with the judge that there is a distinct difference between MLCC costs that are incurred to ensure grid reliability and congestion charges that are based on grid usage.

(d) Whether Pump Loads Should be Exempted from All or Some MLCC Costs (Issue No. 10)

69. SWP argues that, if must-offer generation costs are allocated based on the reliability benefits of avoiding load curtailments, pump loads that may be interrupted or curtailed as reliability resources should not be allocated the same costs as other firm loads.[117] The judge finds that the proposed exclusion of pump loads is impracticable and thus not shown to be just, reasonable and not unduly discriminatory.[118]

70. On exceptions, SWP argues that the judge's analysis of benefits as applied to pump load should be reversed. SWP states that there is no logical basis for the presumed benefits to SWP pump load because its pump loads are primarily off-peak loads not located in load pockets and thus are not among the "entities that cause costs and should pay for such costs." SWP adds that the judge does not identify the benefits to SWP or considers the degree of benefits SWP pump loads might actually receive. It asserts that the judge completely ignores the contested issue of whether its pump loads should be exempted from these costs because its pump loads are treated as interruptible. In support,

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[116] *Pacific Gas & Elec. Co.*, 100 FERC ¶ 61,160 at P 13-20, *reh'g denied*, 101 FERC ¶ 61,139 at P 8 (2002), *reh'g denied*, 102 FERC ¶ 61,009 (2003).

[117] Initial Decision at P 100.

[118] *Id*. at P 109 (*citing* Exh. ISO-19 at 21; Tr. 676; Exh. SWP-17; Exh. SCE-6 at 28-29; Tr. 686, 697; Tr. 1111-12, 1121-25); *Id*. at n.71.

SWP cites four factors as evidence of the CAISO's right to interrupt SWP's pump loads: (1) SWP's participating load curtailment activities, (2) SWP's underfrequency load shedding, (3) SWP's remedial action scheme or participation, and (4) the CAISO's confidential operating procedures, requests or orders to curtail "less important" SWP load prior to other, firm load.[119] If Amendment No. 60 costs are allocated using imputed benefits, SWP requests that the Commission (1) recognize the diminished degree of reliability dispatchable pump loads experience and (2) credit the reliability benefits provided by curtailable pump loads that can be interrupted to support other firm loads.

71. The CAISO responds that the assertion that SWP does not benefit from must-offer generation because its pump loads are interruptible is not supported by the record.[120] The CAISO states that the record indicates that (1) the CAISO does not have authority to direct SWP loads to be involuntarily interrupted or curtailed; (2) the CAISO will direct the pump loads to be interrupted or curtailed only if SWP voluntarily bids those loads into the CAISO's markets or pursuant to a remedial action scheme in an agreement with the CAISO or a PTO; (3) since the beginning of the must-offer obligation, the CAISO has not directed SWP pump loads to be interrupted or curtailed involuntarily; and (4) SWP's pump loads are set to trip automatically at a higher frequency in the event of a frequency disturbance.[121] SoCal Edison adds that the CAISO has treated SWP load as firm load since January 1, 2005 when the SWP/SoCal Edison contract expired and SWP load is treated as firm load when the CAISO derives a total control-area firm load requirement and determines the need for must-offer waiver denials. SoCal Edison also states that the CAISO does not treat SWP pump load as dispatchable and SWP has not agreed to serve as a reliability resource when requested by the CAISO. Trial Staff contends that the fact that SWP pump loads may be interrupted for an emergency is irrelevant to the propriety of allocating MLCC costs because SWP's loads benefit from the enhanced reliability the must-offer generation provides.

72. We affirm the judge's findings on this issue. SWP argues that it should be exempted from MLCC costs because its pump loads are treated as interruptible by the CAISO. Our review indicates that the CAISO has provided compelling arguments that rebut SWP's argument that its pump loads are interruptible. As such, we find that the allocation of MLCC costs to SWP's pump loads is reasonable.

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[119] SWP Brief on Exceptions at 73-74.

[120] CAISO Brief Opposing Exceptions at 26-30.

[121] *Id*.

(e) Whether the CAISO Should Allocate System MLCC Costs Based on Deviations Between Metered Load and Day-Ahead Scheduled Load (Where Day-Ahead Scheduled Load Deviates from Total Metered Load by More Than a Five Percent Threshold) (Issue No. 13)

73. Powerex objects to the Attachment E system category criteria because they allocate system MLCC costs to net negative uninstructed deviations.[122] Powerex argues that allocating system MLCC costs to net negative uninstructed deviations unfairly imposes duplicate charges on energy imports and imposes costs incurred in the day-ahead timeframe on net negative uninstructed deviations that is a function of the real-time imbalances between schedules and demand.[123] Powerex proposes to remedy these defects by allocating system MLCC costs to the specific scheduling coordinator(s) responsible for the day-ahead scheduled load/actual metered load differentials that cause the costs to be incurred.[124]

74. While the judge accepts the contention that allocating system MLCC costs to net negative uninstructed deviations compels an entity to make two payments based on the same deviation, he rejects the contention that the payments are duplicative.[125] He finds that, like a toll, system MLCC costs allocated to net negative uninstructed deviations are not a penalty but rather a use charge that recoups the proportionate cost the underlying deviation imposes on the transmission system.[126] He adds that it is appropriate to allocate deviations beyond the importer's control to net negative uninstructed deviations because fault is immaterial to cost incurrence and therefore to cost causation.[127] The judge

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[122] Initial Decision at P 110.

[123] *Id*. at P 110, 113.

[124] *Id*. at P 110.

[125] *Id*. at P 111.

[126] *Id*. He finds that the same holds true for the claim of redundancy when scheduling coordinators pay the full, real-time cost of any replacement energy the CAISO must procure to balance schedule/real-time demand deviations. *Id*. at n.73.

[127] *Id*. at P 112. He states that it is not clear why deviations beyond the importer's control are excused from uninstructed deviation penalties (a fault-based penalty) but not from system MLCC (the use-based cost of balancing system schedules and real-time demand). *Id*. (*citing* Tr. 812, 531, 534, 817).

concludes that the record does not support Powerex's proposed allocation.[128] He finds that, although it is desirable from an operations standpoint for day-ahead schedules to match scheduling coordinators' actual metered load as closely as possible, Powerex has not demonstrated any compelling reason to bind scheduling coordinators to total day-ahead scheduled load for system MLCC cost allocation purposes.[129] He adds that, although the proposed five percent tolerance band is intended to temper the proposal, Powerex has not provided a basis for this figure other than a data response indicating that it is generally accepted that forward market schedules should be within five percent of real-time load.[130] He states that it is unclear how and why system MLCC costs would be allocated when the total system day-ahead schedule/metered load differential falls between 95 percent and 100 percent.[131]

75. The judge concludes that Powerex has failed to demonstrate that allocating system MLCC costs proportionately among scheduling coordinators when total system scheduled load is less than 95 percent of metered load is just, reasonable and not unduly discriminatory.[132] He also concludes that it is just, reasonable and not unduly discriminatory to allocate system MLCC costs to net negative uninstructed deviations because such deviations are the predominant cause-in-fact of system MLCC cost incurrence.[133]

76. On exceptions, Powerex argues that the judge erred in finding that system MLCC costs can be allocated to schedule deviations between the hour-ahead and real-time markets because the CAISO does not consider historical data regarding schedule changes between the hour-ahead and real-time markets or consider deviations in import schedules between hour-ahead and real-time schedules when making must-offer waiver denial decisions in the day-ahead time frame. Powerex contends that such deviations could not have caused the incurrence of MLCC costs. Powerex also contends that the record does not show that such deviations benefit from the incurrence of MLCC costs. Powerex adds that the judge does not address the record evidence showing that allocation to deviations in import schedules is not supported.

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[128] *See id*. at P 113-14.

[129] *Id*. at P 114.

[130] *Id*. at n.76 (*citing* Exh. S-24 at 2).

[131] *Id*. at n.76.

[132] *Id*. at P 114.

[133] *Id*.

77. Powerex contends that, contrary to the judge's conclusion that it had not demonstrated a legitimate reason to bind scheduling coordinators to total day-ahead scheduled load for system MLCC cost allocation purposes, Powerex showed that its proposal would encourage scheduling coordinators to submit more accurate schedules in the day-ahead timeframe when the CAISO makes its must-offer waiver denial decisions. Powerex notes that, although the CAISO has claimed that Powerex's proposal could impose additional work and costs on the CAISO, the CAISO has never quantified the costs or specified the additional work.

78. Even if its modifications were not adopted, Powerex contends that the judge should have accepted that deviations in import schedules that are outside of the reasonable control of the scheduling coordinator should not be allocated any system MLCC costs because it is unreasonable to impose costs if the scheduling coordinator cannot control the deviation. Powerex claims that the CAISO does not necessarily rely on must-offer obligation capacity to provide the energy to meet the deviation, instead of purchasing energy in the real-time market. Therefore, Powerex argues that in many cases there is no direct or even indirect nexus between the incurrence of the MLCC costs in the day-ahead market and the energy purchased in the real-time market to meet the schedule deviations.

79. The CAISO believes that the Attachment E criteria provide a preferable alternative to Powerex's proposal, because the CAISO would need to expend resources on software development to implement Powerex's proposal, and any software work could adversely affect or delay MRTU implementation. Trial Staff argues that Powerex's proposal fails for several reasons: (1) it is not ripe for consideration because the judge has found that the CAISO's cost allocation proposal is just and reasonable, (2) Powerex has not demonstrated that the CAISO's proposal for allocating system MLCC costs violates cost causation/benefits received principles, (3) Powerex's proposal does not explain how system MLCC costs would be recovered if the five percent threshold is not reached, and (4) Powerex has not explained how its approach would result in a more just and reasonable allocation of MLCC costs. Trial Staff requests that the Commission strike Powerex's references to the extra record evidence in its Brief on Exceptions and Appendices A and B of Powerex's Brief on Exceptions.

80. We affirm the judge's findings on this issue. We find that, with respect to system requirements, the CAISO commits units when it expects that demand in the CAISO control area will exceed the supply (generating units and energy imported into the control area) that scheduling coordinators have scheduled in advance of real-time operations.[134] Net negative uninstructed deviations represent the amount of energy that the CAISO must

[134] Exh. ISO-22 at 27: 16-20.

secure in real-time to keep demand and supply in balance. Because scheduling coordinators are effectively "buying" this amount of energy to balance their portfolios in real-time, the amount of net negative uninstructed deviations a scheduling coordinator incurs is an appropriate quantity on which to allocate the costs of the CAISO procuring the additional supply needed to keep the CAISO control area in balance.

81. We find Powerex's arguments unavailing. The CAISO's day-ahead must-offer commitments are based on day-ahead estimates of the degree to which demand will exceed supply in *real time*.[135] In fact, it is clear from the record that must-offer waiver denial decisions are based on estimated data of real-time loads (which in turn are based on historical experience) for the day on which the units will be required to be online, and not based on final day-ahead schedules. It is thus misleading to characterize the must-offer waiver denial process as purely a "day-ahead" process.[136]

(f) Whether Wheel-Through Schedules Should Be Exempted from All or Some System MLCC Costs (Issue No. 9)

82. Powerex also objects to the Attachment E system category criteria because they include wheel-through schedules in the allocation.[137] The judge concludes that on balance wheel-through transactions derive sufficient benefit from reliable grid operation to justify the minimal level of potential system MLCC cost liability that might be imposed on them under Attachment E.[138]

83. In reaching this conclusion, the judge finds that, if system MLCC costs are allocated exclusively to net negative uninstructed deviations, wheel-through schedules require no exclusion because they are by definition simultaneous imports and exports, deemed delivered and, thus, cannot result in net negative uninstructed deviations.[139] He finds that, even under Attachment E, system MLCC costs could be allocated to wheel-through schedules only to the extent that the specified net negative uninstructed deviations cap is exceeded and inasmuch as they could be classified as exports.[140]

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[135] Exh. No. S-25. *See also* CAISO Operating Procedure M-432C.

[136] Exh. S-18 at 18.

[137] Initial Decision at P 110.

[138] *Id*. at P 115.

[139] *Id*.

[140] *Id*. (*citing* Exh. S-21 at 3).

He finds, therefore, that system MLCC costs could be allocated to wheel-through schedules only if: (1) the CAISO is incurring system MLCC costs; (2) the specified net negative uninstructed deviations cap is exceeded; and (3) the wheel-through transaction(s) at issue qualifies as export (*i.e.*, the schedule(s) covered energy transmitted from the CAISO control area to a different California control area).[141] The judge balances these findings against his finding that wheel-through schedules have no significant causal nexus to system MLCC cost incurrence.[142] The latter finding is based upon the fact that (1) wheel-through schedules originate and are delivered outside the CAISO control area;[143] (2) the CAISO does not have any involvement in these transactions, except as the transmission provider and control area services coordinator that is fully compensated through wheeling/grid access charges;[144] and (3) all requisite ancillary services are provided by the sending/receiving control areas.[145]

84. On exceptions, SMUD and Powerex contend that the judge erred in finding that benefits to wheel-throughs justify an MLCC cost allocation because there was no cost causation nexus between the costs incurred by the CAISO and the services provided to wheel-throughs. They state that the Commission's principle that costs that are incurred for the benefit of an integrated system and that cannot be precisely traced to a particular user(s) can reasonably be rolled into the rates paid by all users of the service does not support the allocation of costs to customers that did not cause the costs to be incurred or that benefit directly from them.

85. SMUD and Powerex argue that wheel-throughs do not receive substantial benefits from must-offer waiver denials that cause system MLCC costs and thus should not be allocated system MLCC costs. They explain that the CAISO issues must-offer waiver denials to serve its control area load and to serve as a back-stop to exports from CAISO control area resources. They state that wheel-through loads are not located in the CAISO control area and are not served by CAISO control area resources. Therefore, they contend that wheel-through loads are not taken into account in the must-offer waiver denial process and do not directly benefit from must-offer waiver denials. They add that system MLCC costs result from must-offer waiver denials used to address CAISO control

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[141] *Id*. (*citing* Exh. ISO-20 at 33).

[142] *Id*. at P 115.

[143] *Id*. (citing Exh. SMD-1 at 6-7).

[144] *Id*. (*citing* Exh. SMD-1 at 6-7, 18-19; Exh. SMD-2).

[145] *Id*. (*citing* Exh. SMD-2).

area-wide shortfalls that do not serve resource shortfalls in non-ISO control areas. They thus assert that wheel-through loads located in non-CAISO control areas do not benefit from must-offer waiver denials. They also state that, if a wheel-through schedule were to fail to deliver, the non-ISO control area (not the CAISO) must (1) make up the shortfall and (2) carry the ancillary services for the wheel-through. They add that any degree of generalized grid benefit that wheel-throughs receive from must-offer waiver denials caused by system problems is limited and insubstantial, especially given that wheel-throughs pay for use of the CAISO-controlled grid under the wheeling-access charge and for the CAISO's control area services. They contend that these payments ensure that there is no subsidization or free rider concern for wheel-throughs. They state that their insubstantial benefits are underscored by the fact that wheel-throughs serving load located outside of California will not be allocated MLCC costs.

86. In response to SMUD and Powerex's arguments regarding the benefits received by wheel-throughs, Trial Staff states that the record supports the judge's finding that wheel-throughs should be assessed MLCC costs, particularly given the nature of wheel-through transactions and the fact that wheel-throughs are only subject to Tier 2 system MLCC costs (*i.e.*, the excess MLCC costs beyond those allocated to net negative uninstructed deviations). Trial Staff adds that wheel-throughs are only allocated the Tier 2 system MLCC costs if exports remain in California. Trial Staff contends that SMUD seeks to avoid MLCC costs even though it uses the CAISO facilities to transmit wheel-through energy transactions. It argues that the essence of a wheel-through is the transmission service and, to the extent that a reliable grid enhances the CAISO's ability to provide that service, wheel-throughs benefit. It also states that Commission precedent supports the concept that wheel-throughs benefit from system-wide upgrades or services and should share such costs.[146]

87. SMUD and Powerex assert that the judge's different treatment of operationally and physically identical wheel-throughs contravenes Commission precedent that like cases should be treated alike.[147] They claim that there is no rational basis for distinguishing between wheel-through load located outside of the CAISO control area in California and load located outside of California. They assert that the judge fails to explain how California load receives more of a benefit than load located outside of California. They add that the exemption of Metered Sub-System (MSS) load from

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[146] *Citing Cal. Indep. Sys. Operator Corp.*, 99 FERC ¶ 63,020 at 65,133-34;*Cal. Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,114 at P 52-65; *Public Serv. Co.*, 22 FERC ¶ 63,083, 65,268-69, *reh'g denied in part and modified in part on other grounds*, 24 FERC ¶ 61,007 (1983).

[147] *Citing Buckeye Pipe Line Co.*, 13 FERC ¶ 61,267 at 61,595 (1980).

system remainder MLCC costs under the Attachment E allocation criteria undermines the "degree of benefit" rationale for allocating system remainder MLCC costs to in-state wheel-through loads because MSS load is not only located within California but also located within the CAISO control area.

88. Trial Staff responds that in-state exports are treated differently because the Commission-instituted must-offer program is for in-state exports only. It adds that the comments on MSS load are misleading because Attachment E shows that MSS costs are subject to MLCC system costs and, by agreement, the CAISO and MSS market participants may have negotiated a different cost allocation for system MLCC costs than proposed under Amendment No. 60.

89. SMUD and Powerex also challenge the judge's justification for denial of a wheel-through exemption based on the fact that the cost liability for wheel-throughs of the system MLCC costs would be minimal. They argue that, because there is no cost causation nexus for allocating MLCC costs to wheel-throughs, any allocation of MLCC costs to wheel-throughs is unlawful, even if the allocation is small. They also dispute the evidentiary basis for the finding that the cost would be minimal.

90. We reverse the judge's findings on this issue. We first note that we agree with the judge that wheel-through schedules have no significant causal nexus to system MLCC cost incurrence. Additionally, no party has filed exception to that fact. Because the CAISO's proposal is limited to wheeling through transactions for export to another control area within California, the record should include information to justify and support the allocation of MLCC costs to wheel-through transactions to control areas within California. Absent such a showing, it is unreasonable to assess such charges while allowing wheel-through transactions that go to control areas outside of California to enjoy the same grid reliability benefits as those within California at no cost. Thus, any assignment of MLCC costs to wheel-through transactions to control areas within California by definition requires evidence to demonstrate the reasonableness of that specific allocation and cannot be affirmed on the sole basis of secondary grid reliability. Since the record includes no such showing, we reverse the judge on this issue. We also agree with SMUD and Powerex that the magnitude of MLCC costs that would be allocated under the CAISO's proposal is not relevant in the determination of whether such allocation is just and reasonable.

3. Other Issues

a. Whether Start-Up and Emissions Costs of Units Denied Must Offer Waivers Should be Allocated in the Same Manner as Those Associated with MLCC and Whether a Revision to the Allocation of These Costs Should Be Addressed in This Proceeding? (Issue No. 14)

91. The purpose of Amendment No. 60 is to allocate must-offer costs in a manner more consistent with cost causation. However, the CAISO proposes to change only its methodology for allocating MLCC costs, not its start-up and emissions costs. The CAISO states that it did not propose to change the allocation of start-up and emissions costs because they were small relative to the amount of MLCC costs and that creating and maintaining a complex system to track and allocate these costs was not viewed as an efficient use of CAISO resources.[148] The judge finds that the Commission did not set this issue for hearing and therefore it is beyond the scope of this proceeding.[149]

92. On exceptions, PG&E argues that this conclusion is not supported by the Commission's orders in this proceeding. PG&E contends that, since it has demonstrated that the CAISO can readily apply the three category approach to start-up and emissions costs, there is no reason not to apply it to those costs as well. PG&E adds that it raised this issue in its FPA section 206 complaint. PG&E has proposed an allocation for start-up and emissions-related must offer obligation costs and also supports SWP's proposal.

93. Trial Staff argues that Commission precedent demonstrates that the Commission's policy is to have all three of the costs associated with the must-offer obligation (*i.e.*, emissions, start-up and MLCC costs) recovered in the same manner.[150] Trial Staff contends that, given the Commission's mandate and the CAISO's acknowledgement that it has the requisite data, the recovery of emissions and start-up costs should be consistent with the CAISO's proposal to recover MLCC costs. Trial Staff claims that, in violation of CAISO tariff provisions and principles of cost causation, the CAISO bases emissions payments on all CAISO dispatches (*i.e.*, all instructed energy). It asserts that this impropriety can be eliminated if emissions costs are allocated like MLCC costs are

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[148] For its most recent twelve months, the CAISO's emissions costs were $2.05 million and start-up costs were $1.79 million. *See* Exh. ISO-1 at 22:2-5. In contrast, MLCC costs for 2003 were $125 million. *Id.*

[149] Initial Decision at P 133.

[150] *Citing* June 2001 Order, 95 FERC ¶ 61,418 at 62,563; December 2001 Order, 97 FERC ¶ 61,293 at 62,363.

allocated under Amendment No. 60. Trial Staff states that, if it is no longer just and reasonable as of July 17, 2004 to allocate MLCC costs system-wide as stated in Stipulation No. 3, then it is no longer just and reasonable as of that date to allocate emissions and start-up costs in that manner. Trial Staff also states that the CAISO did not describe or support how complex or costly a system the CAISO will need to track and allocate its recovery of emissions and start-up costs.[151]

94. Powerex argues that, contrary to these assertions, in the December 2001 Order, the Commission stated only that MLCC costs "should be directly invoiced to the [CA]ISO and the [CA]ISO should recover these costs consistent with the methodology used for the recovery of emissions and start-up fuel costs."[152] Powerex contends that the Commission did not establish a requirement that any time the allocation methodology was changed for one type of cost that it automatically be applied to another type of cost. Powerex underscores this point by stating that, on rehearing, the Commission modified the allocation of start-up fuel costs based on the particular facts surrounding those costs and allowed start-up fuel costs to be allocated differently than emissions costs.[153]

95. Powerex and SoCal Edison contend that the issue was not set for hearing because the Amendment No. 60 Hearing Order did not explicitly discuss those costs. Powerex claims that the fact that PG&E raised the issue in its complaint is irrelevant; SoCal Edison contends that PG&E limited its complaint to MLCC costs. Powerex and the CAISO state that there is no basis to reverse the judge's conclusion on start-up and emissions costs because no party has made a showing that the current allocation of start-up and emissions costs is unjust and unreasonable. Powerex adds that other proposals for allocating start-up and emissions costs have not been shown to be just and reasonable. If the Commission decides to review these costs, the CAISO has no objection to the start-up costs proposal, but it finds the emissions costs proposal problematic because the CAISO cannot isolate must-offer waiver denial emissions costs from other must-offer generator emissions costs.

96. We reverse the judge's findings on this issue. In the complaint proceeding, PG&E alleged that the CAISO's current allocation of must-offer obligation costs, including MLCC costs, were unjust, unreasonable, and unduly discriminatory.[154] In the PG&E

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[151] *See* Exh. S-18 at 24: 7-10.

[152] *Quoting* December 2001 Order, 97 FERC ¶ 61,293 at 62,363.

[153] *Citing San Diego Gas & Elec. Co. v . Sellers of Energy and Ancillary Serv.*, 107 FERC ¶ 61,166 at P 63 (2004).

[154] *See* PG&E Complaint Hearing Order, 108 FERC ¶ 61,017 at P 2.

Complaint Hearing Order, the Commission stated that PG&E presents issues of material fact that cannot be resolved based on the record before it.[155] Those issues of fact included "whether the CAISO's current allocation of [must-offer obligation] costs is unjust and unreasonable," and, "if so, what replacement allocation would be just and reasonable, taking into account the feasibility of implementing such a methodology."[156] Thus, the PG&E Complaint Hearing Order set for hearing the allocation of all must-offer obligation costs (MLCC, start-up, and emissions), not just MLCC.

97. The record indicates that both PG&E and SWP proposed similar mechanisms that would result in emissions and start-up costs being categorized and allocated in the same proportion as MLCC costs.[157] On cross examination, CAISO witness Bodine admitted that allocating start-up costs as proposed by PG&E and SWP would be fairly easy to implement.[158] Bodine also admitted that the CAISO has the data available to break apart the aggregated bill from a generator to separate emissions costs associated with a must offer waiver denial from emissions costs associated with when the unit is in the market.[159]

98. Given that the PG&E Complaint Hearing Order set the allocation of all must-offer costs for hearing and that the record establishes that the CAISO has the data available to allocate these costs in a manner consistent with MLCC costs, we will require the CAISO to allocate emissions and start-up costs in proportion and in a similar manner to MLCC costs. Additionally, we agree with Trial Staff that Commission precedent demonstrates that, since the establishment of the must offer program, the Commission has required that all three costs associated with the must-offer obligation (*i.e.*, emissions, start-up and MLCC costs) be allocated consistently. Accordingly, we direct the CAISO to file tariff language, within 60 days of the date of this order, allocating these costs as discussed.

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[155] *Id*. at P 16.

[156] *Id*.

[157] Exh. PGE-4 at 6; Exh. SWP-1 at 40.

[158] Tr. 836: 1-11.

[159] Tr. 842: 1-17.

b. Whether the Proposed Definition of "Reliability Services Costs" is Just and Reasonable? (Issue No. 17)

99. In the stakeholder process, SoCal Edison requested that local MLCC costs allocated to a PTO be characterized as reliability services costs.[160] In Amendment No. 60, reliability services costs is defined as

> [t]he costs associated with services provided by the ISO: 1) that are deemed by the ISO as necessary to maintain reliable electric service in the ISO Control Area; and 2) whose costs are billed by the ISO to the Participating TO pursuant to the ISO Tariff. Reliability Services Costs include costs charged by the ISO to a Participating TO associated with service provided under an RMR contract (Section 5.2.8), local out-of-market dispatch calls (Section 11.2.4.2.1), and Minimum Load Costs associated with units committed under the must-offer obligation for local reliability requirements (Section 5.11.6.1.4).[161]

100. The judge finds that the Amendment No. 60 Hearing Order expressly provided for the inclusion of a reliability services costs definition in the CAISO tariff.[162] He also finds that the proposed definition is not so vague, overly broad or discretionary to be unjust or unreasonable. He adds that the possibility that the definition may prove inadequate or problematic in application is a matter that cannot be addressed here in a manner that would not be purely speculative, arbitrary and capricious.[163]

101. On exceptions, SMUD argues that the judge ignored substantial evidence that the definition is unjust and unreasonable for several reasons. First, it does not have operative effect because the CAISO already has authority to charge PTOs for RMR service costs under CAISO tariff section 5.2.8 and for local out-of-market dispatch calls under CAISO tariff section 11.2.4.2.1.[164] Second, it is unduly vague, broad and is open to mischief

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[160] Initial Decision at P 136.

[161] *Id*. (*citing* Item By Reference #1, v.1, Superseding Second Revised Sheet No. 344).

[162] *Id*. at P 137 (*citing* Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022 at P 69-70).

[163] *Id*. at P 137.

[164] SMUD adds that CAISO tariff section 5.11.6.1.4 also specifies that local MLCC will be allocated by the CAISO to the PTOs.

because it grants the CAISO undue discretion by allowing it the unqualified right to "deem" costs as reliability service costs as long as they are "necessary to maintain reliable electric service in the [CAISO] Control Area." SMUD acknowledges that the definition does contain specific criteria but claims that the operative criteria for determining what qualifies as such a cost is that the CAISO deem it such a cost and then file with the Commission for approval. SMUD contends that, through this definition, the Commission may be impermissibly delegating its authority to the CAISO to determine just and reasonable rates. SMUD recommends striking the definition without prejudice.

102. SoCal Edison and Trial Staff respond that SMUD's request that the Commission reject the definition as inconsistent with the Commission's determination in the Amendment No. 60 Hearing Order that the CAISO should include such a definition in the CAISO tariff. SoCal Edison and Trial Staff add that the definition is not vague and limitless because it enumerates three specific criteria that the CAISO must abide by in classifying costs as reliability services costs. SoCal Edison and Trial Staff also state that the definition does not pre-empt or pre-suppose Commission approval for any new or additional CAISO classification of costs as reliability services costs because the Commission will have to determine the CAISO's classification is just and reasonable each time a classification is made. Trial Staff adds that the definition includes only costs that are within the CAISO's operations and responsibilities.

103. We affirm the judge's findings on this issue. We find the proposed definition of reliability services costs is just, reasonable and not unduly discriminatory. The Amendment No. 60 Hearing Order determined that it was reasonable for the CAISO to include such a definition in its tariff.[165] The proposed definition only includes costs that are within the CAISO's operations. Therefore, the inclusion of costs other than those specified in the definition will need Commission approval.

c. Does the CAISO Have the Authority to Commit a Generating Unit Under the Must Offer Obligation to Provide Ancillary Services? (Issue No. 18)

104. The judge finds that the CAISO has not established that it has authority to commit must-offer generators to provide ancillary services.[166] The judge states that the CAISO merely cites Amendment No. 60 itself, thus apparently proposing that granting itself authority to commit must-offer generation to provide ancillary services confers the

[165] Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022 at P 69.

[166] Initial Decision at P 138.

authority needed.[167] He adds that the CAISO should not be permitted to circumvent and expand the ancillary services market by abusing the must-offer obligation to force generators to have no rational choice but to offer into that market.[168]

105. On exceptions, the CAISO acknowledges that it only commits units to provide ancillary services through its ancillary services market and does not have authority to force generating units to bid into those markets through the must-offer process. But the CAISO states that the CAISO tariff gives it authority to deny must-offer waivers if there will be insufficient on-line generating capacity to meet operating reserve requirements.[169] The CAISO finds this authority in CAISO tariff section 5.11.6, which states that the CAISO has sole discretion to grant waivers, subject to Commission oversight.[170] It argues that it does not need specific authority to decline to exercise its discretion; it only needs to act reasonably and state its reasons. It contends that, therefore, the lack of explicit tariff authority to deny waivers cannot provide a basis for concluding that the CAISO may not deny waivers because of an anticipated shortage of ancillary services.

106. The CAISO adds that it was proper to rely upon CAISO tariff section 5.11.6.2 in Amendment No. 60 for support because (1) the substance of that section predated Amendment No. 60; (2) Amendment No. 60 merely transferred the approved language in section 5.11.6[171] to 5.11.6.2; and (3) section 5.11.6.2 was approved by the Commission in the Amendment No. 60 Hearing Order.[172]

107. The CAISO asserts that the judge ignores the fact that (1) a fundamental purpose of the must-offer obligation is to ensure that the CAISO has adequate operating reserves and (2) the must-offer obligation is by its nature a requirement (*i.e.*, if the CAISO does

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[167] *Id.*

[168] *Id.*

[169] The CAISO notes that generating units that are denied must-offer waivers may bid into the ancillary services markets, and, if their bids are accepted, they do not forfeit payment of MLCC costs. *Citing* Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022 at P 83, 87-88 (2004).

[170] *Citing San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 99 FERC ¶ 61,158 at 61,630.

[171] *Id.*

[172] *Citing* Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022 at Ordering Paragraph (A).

not grant a waiver, then a generator must bid into the CAISO markets if it has available capacity). It contends that, if the CAISO denies a waiver because of an anticipated ancillary services shortage, the CAISO is simply fulfilling its obligation to administer the must-offer obligation.

108. SWP responds that nothing in the CAISO tariff authorizes use of must-offer generation for ancillary services, much less provides allocation of such costs. SWP claims that the use of must-offer generation to meet ancillary service needs would cause those who self-provide ancillary services to be charged twice. SWP adds that it would violate the filed rate doctrine to find that the CAISO has authority to use must-offer generation for ancillary services because customers have not been given reasonable notice that the charges will be imposed on them.

109. Trial Staff contends that the CAISO's reliance on Amendment No. 60 to justify its authority to commit a generating unit under the must-offer obligation to provide ancillary services is circular reasoning because the argument assumes away the issue. It asserts that, even if CAISO tariff section 5.11.6.2 applies, the CAISO would still lack authority because (1) operating reserves include only two of the six ancillary services and (2) proposed section 5.11.6.2 does not discuss ancillary services. It adds that, through Ordering Paragraph (A), the Commission only accepted section 5.11.6.2; it did not find that the proposed section was just, reasonable and not unduly discriminatory. It contends that, since the CAISO sought approval of section 5.11.6.2, it does not matter that that language of that section mirrors a provision previously approved by the Commission; a Commission finding that the provision is just, reasonable and not unduly discriminatory is required. Trial Staff also claims that "relieving the [CA]ISO's anticipated shortage of Ancillary Services" cannot be the basis for denying must-offer waivers. Trial Staff adds that (1) there is no connection between non-rescindable MLCC costs for generating units providing ancillary services and the authority to commit a generating unit under the must-offer obligation to provide ancillary services, (2) Amendment No. 60 does not address the allocation of MLCC costs when generating units are committed under the must-offer obligation to provide ancillary services, and (3) the CAISO has not issued must-offer waiver denials to provide ancillary services or otherwise commit any generating unit to provide ancillary services.

110. We affirm the judge's findings on this issue. We find that the must-offer obligation was implemented as a mitigation measure against physical withholding of generation to influence prices improperly. Subsequently, the CAISO offered to grant temporary exemptions from must-offer obligation when possible as an alternative during periods when not every generating unit need to be online and available to ensure reliable and competitive markets.

111. The Commission found reasonable the CAISO's proposal to grant exemption of the must-offer obligation under certain conditions and directed the CAISO to make a

compliance filing to incorporate provisions for granting must-offer obligation exemptions into its tariff. The Commission further directed the CAISO to include enough specificity to ensure that these procedures are non-discriminatory and transparent to market participants and to the Commission.[173] The Commission explained that the intent in approving the CAISO's must-offer obligation exemption procedures was to assist generators with long start-up times and high MLCC costs and to provide flexibility to the CAISO regarding the balancing of load and resources. The tariff language approved by the Commission that implemented this intent states that exemptions will be granted so as to provide sufficient on-line generating capacity to meet operating reserve requirements and to account for other physical operating constraints of generating units. In the Amendment No. 60 Hearing Order, the Commission accepted the transfer of this authority from CAISO tariff section 5.11.6 to section 5.11.6.2.[174] The Commission has found it reasonable that the CAISO provide such exemptions at its sole discretion since such discretion is reviewable by the Commission.[175] However, approval of this tariff provision did not include the authority to deny exemption from must-offer obligation in anticipation of a shortage of ancillary services or otherwise commit any generating unit to provide ancillary services. Additionally, the CAISO has not cited to any pre-existing tariff language that supports this position. Accordingly, the CAISO would need to file a tariff amendment under section 205 to propose language that would provide the appropriate authority to deny must-offer obligation waivers in anticipation of a shortage of ancillary services because the current tariff does not include this authority.

d. Should Scheduling Coordinators Who Self-Provide Ancillary Services Be Allocated MLCC Costs for Ancillary Services? (Issue No. 19)

112. The judge finds that he does not need to address this issue because he has determined that the CAISO does not have authority to commit must-offer generators to provide ancillary services.[176]

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[173] December 2001 Order, 97 FERC ¶ 61,293 at 62,363.

[174] Amendment No. 60 Hearing Order, 108 FERC ¶ 61,022 at Ordering Paragraph (A).

[175] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 99 FERC ¶ 61,158 at 61,630.

[176] *See* Initial Decision at P 139 (referencing ruling on Issue No. 18).

113. We affirm the judge's findings on this issue. Because the CAISO does not have the authority to commit must-offer generators to provide ancillary services, no entities would be allocated MLCC costs for ancillary services, including scheduling coordinators.

e. Whether the Manner in Which the CAISO Allocated Must Offer Obligation-Related Charges, Including MLCC Costs, Prior to October 1, 2004 Was Just, Reasonable and Not Unduly Discriminatory (Issue No. 20)

114. The judge finds that this issue was resolved by Stipulation No. 3, in which the CAISO conceded that the pre-Amendment No. 60 cost allocation methodology was not just and reasonable as of July 17, 2004. As a result of this stipulation, the refund effective date was established as July 17, 2004.[177]

f. Whether the Refund Effective Date of July 17, 2004 Should be Conditioned in Any Way (Issue No. 21)

115. The judge states that, although the CAISO "does not object to a July 17, 2004 refund effective date," the net incremental local costs should not be used to calculate refunds from July 17, 2004 to September 30, 2004.[178] The Initial Decision does not explain why net incremental local costs should not be used during the July 17 – September 30, 2004 time period, and this created some concern about how refunds should be calculated during this period. The Initial Decision found the Amendment No. 60 methodology just and reasonable, and the CAISO proposed an effective date of October 1, 2004. This date was proposed in part because the software needed to calculate the net incremental local costs, specifically, the SCUC was not available until September 3, 2004. The issue of how to calculate refunds from the refund effective date of July 17, 2004 through the proposed effective date for Amendment No. 60 was addressed by several parties on exceptions.

116. For example, PG&E states that, although the judge finds that net incremental local costs should not be used to calculate refunds, the judge does not state how refunds should be calculated, given the fact that the pre-Amendment No. 60 methodology is not just and reasonable but the Amendment No. 60 methodology is not in effect for that time period. PG&E argues that, for the refund period, it would be fair, equitable and easy to implement the proposed three-bucket costs allocation approach with the exception that the customers of the local PTO would pay for local costs. PG&E contends that this

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[177] *Id*. at P 140 (*citing* Stipulation #3, Jan. 29, 2005).

[178] *Id*. at P 141.

approach would avoid any alleged problem with the absence of the SCUC program from July 17, 2004 to September 3, 2004. PG&E states that, only if the Commission is convinced that such an allocation is unfair, should the Commission order the CAISO to employ a proxy methodology described in Exhibit ISO-22.[179] The CAISO agrees that it is unclear whether the proxy methodology should be applied.

117. SoCal Edison argues that the net incremental cost of local methodology should become effective on October 1, 2004. It contends that Stipulation No. 3, which established a July 17, 2004 refund effective date, was not unanimous and thus does not resolve the issue. SoCal Edison asserts that significant data problems before October 1, 2004 prevented the CAISO from implementing Amendment No. 60 before that date. Specifically, it states that neither the incremental cost of local methodology nor a reasonable proxy can be implemented before October 1, 2004. It notes that the CAISO has conceded that its proposed proxy for the incremental cost of local methodology during the pre-SCUC period (July 17, 2004 to September 30, 2004) is not as accurate as the fully-realized post-SCUC method for calculating the incremental cost of local. SoCal Edison claims that the proxy is not a reasonable substitute for a SCUC-based determination of costs. It adds that adoption of a July 17, 2004 effective date without the net incremental cost of local methodology will unfairly shift to SoCal Edison costs that would otherwise be spread across the system.

118. The CAISO counters that SoCal Edison misunderstands the effect of Stipulation No. 3. The CAISO states that, as the proponent of a new rate methodology, a stipulation by it in a complaint proceeding that its rates are unjust and unreasonable is determinative.[180] Trial Staff agrees that, because the CAISO is the filing party whose proposal is at issue, its agreement to Stipulation No. 3 should be dispositive.

119. The CAISO further argues that SoCal Edison is confusing the Commission's responsibilities when evaluating a public utility's rates with its responsibilities when selecting an alternative rate following a finding that a rate is unjust and unreasonable. Specifically, the CAISO states that whether the pre-Amendment No. 60 methodology was just and reasonable after July 17, 2004 is independent of whether the Amendment No. 60 methodology was just and reasonable between July 17, 2004 and September 30, 2004. The CASIO states that the first issue (whether the pre-Amendment No. 60 methodology is just and reasonable) was established by stipulation. As for the second issue, whether the Amendment No. 60 methodology is just and reasonable for the calculation of refunds, the CAISO contends that there is no evidence of continuing data

[179] *Citing* Exh. ISO-22 at 40-42.

[180] CAISO Brief Opposing Exceptions at 38.

problems that would interfere with the implementation of the methodology directed by the judge. The CAISO notes that the only remaining data problems (*i.e.*, instances in which waiver denials were attributed to more than one category) were specifically addressed by the judge.

120. SWP agrees with the July 17, 2004 effective date for Amendment No. 60 that excludes the incremental cost of local calculation. SWP contends that SoCal Edison was afforded special treatment through the incremental cost of local methodology that is impossible to calculate until a later date. PG&E adds that SoCal Edison does not offer legal or factual support to justify the rejection of the Commission's previously-set, July 17, 2004 refund effective date.

121. SMUD argues that, to continue to socialize MLCC costs to entities for the refund period, based solely on load levels, when the CAISO knows that the vast majority of these costs are incurred due to specific locational causes and has demonstrated the ability to allocate the costs to the entities situated in these locations would violate the cost causation principle that entities should pay for the costs they cause. SMUD claims that (1) for 2004 and the first half of 2004, the vast majority of MLCC costs were incurred due to constraints in SoCal Edison's SP-15 zone, (2) the old allocation methodology spread a considerable portion of these costs to load outside of SP-15; and (3) SoCal Edison is arguing that an unquantified and speculative over-allocation of local MLCC costs to SoCal Edison for the refund period should justify further socialization of all MLCC costs to load located outside of SP-15 when it is known that such load does not cause the vast majority of these costs. SMUD asserts that the CAISO's significant effort to correct data problems undermines SoCal Edison's argument that the data problem makes it unreasonable to apply Amendment No. 60 to the refund period. SMUD states that, although unnecessary due to the CAISO's stipulation, the CAISO and other active parties have provided substantial evidence that the old MLCC cost allocation methodology was unjust and unreasonable as of July 17, 2004.

122. Trial Staff urges the Commission not to use the net incremental local costs to calculate refunds from July 17, 2004 through September 30, 2004. Trial Staff requests that the Commission instead allocate the local MLCC costs to the applicable PTO. Trial Staff contends that this approach (1) would alleviate SoCal Edison's concern regarding the CAISO's ability to accurately and reasonably implement the incremental cost approach to determine the local MLCC costs from July 17, 2004 through September 30, 2004 and (2) would allow refunds to be effective as of July 17, 2004. Trial Staff claims that SoCal Edison's position would reduce refunds simply to ensure that SoCal Edison receives the most favorable outcome with respect to the allocation of MLCC costs.

123. We affirm the judge on both effective dates at issue. Because the CAISO is the filing party in this proceeding, as well as a signatory to Stipulation No. 3, we find the July 17, 2004 stipulated effective date for the proposed allocation of must-offer related

charges under Amendment No. 60 is just and reasonable. We find an October 1, 2004 effective date is required for the net incremental cost of local component of the CAISO's proposal because the software for such calculations was not in place until that time. In light of the judge's decision on the net incremental cost of local effective date, which we affirm, we will clarify one aspect of the Initial Decision. Although the judge discusses the proposed SCUC proxy methodology and reaches a determination that obviates the use of this proposed methodology, he nevertheless directs the CAISO to provide all data, protocols and calculations in allocating net incremental local or system costs for the period between July 17, 2004 and September 30, 2004 in accordance with the SCUC proxy methodology. Because the Initial Decision does not clearly reject the proposed SCUC proxy methodology, we clarify that the CAISO's proposed SCUC proxy methodology is rejected.

The Commission orders:

(A) The Initial Decision is hereby affirmed, in part, and reversed, in part, as discussed in the body of this order.

(B) The CAISO is hereby directed to make a compliance filing, within 60 days of the date of this order, as discussed in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.