Decision 06-04-040 April 13, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning. | Rulemaking 04-04-003 (Filed April 1, 2004) |

# ORDER MODIFYING D.05-10-042 AND DENYING REHEARING OF DECISION, AS MODIFIED

## I. INTRODUCTION

In this Order we modify Decision (D.) 05-10-042 ("Decision") to clarify two points about the resource adequacy requirement ("RAR") it imposes. First, we emphasize that the resource adequacy ("RA") program in place for 2006-2008 is transitional, and a fully implemented RAR program will be in place in 2009. Second, we modify the Decision to clarify that the must-offer obligation ("MOO") to be included in RA contracts is an independent, RA-based requirement that does not attempt to change or alter the current FERC-imposed MOO. Rehearing of the Decision, as modified, is denied, as being without merit.

RAR will succeed the procurement regime that came into place following the 2000-2001 energy crisis. The RAR program applies to those who provide electricity to retail customers in California, referred to as "Load Serving Entities" or LSEs.[1] Under RAR, LSEs must prove that they have obtained an amount of resources that matches their forecasted demand, plus reserves. RAR is designed to ensure that those resources are reliable and obtained at the least cost. (D.05-10-042, at p. 7.)

[1] LSEs include investor owned utilities ("IOUs"), electric service providers ("ESPs") and community choice aggregators ("CCAs"). (See Pub. Util. Code, § 380, subd. (j).).)

The Decision is the third in a series of Commission orders on RAR. Prior to issuing this decision, the Commission adopted *Policies and Cost Recovery Mechanisms for Generation Procurement (Interim Opinion)* [D.04-01-050] (2004) ___ Cal.P.U.C.3d ___, and *Policy and Program Coordination in Electric Utility Resource Planning (Resource Adequacy Opinion)* [D.04-10-035] (2004) ___ Cal.P.U.C.3d ___. Those two decisions outlined and clarified the overall policy goals of RAR, (see, D.05-10-042, at pp. 7-8), and established certain broad requirements, such as the requirement that so-called "LD contracts" not be disallowed when the RA program began and that DWR contracts count towards RAR. (*Resource Adequacy* [D.04-10-035], *supra,* at pp. 23, 64 (slip. op.).)

To implement this previously-adopted policy framework, the Decision establishes specific requirements for all LSEs in the service territories of California's three largest IOUs. To comply with RAR, LSEs must acquire "the resources needed for their individual forecasted load and a reserve margin." (D.05-10-042, at p. 11.) LSEs will demonstrate that they have met this requirement by making a series of compliance filings demonstrating "that they have acquired the capacity needed to serve their forecast retail customer load and a 15-17% reserve margin beginning in June 2006." (D.05-10-042, at p. 1.) In order to "count" towards meeting RA obligations, the LSEs' resources must have certain characteristics, which the Decision describes. (D.05-10-042, at pp. 42-82.) Suppliers are not subject to RA obligations, but because LSEs are expected to obtain resources that satisfy RAR, we anticipate that suppliers will undertake obligations to comply with RAR "indirectly through their contracts with LSEs." (D.05-10-042, at p. 14.)

The Decision explains that the development of the current RAR framework is simply one step towards an "end state for California's electric industry design." (D.05-10-042, at p. 12.) The Commission stated it would address several issues in subsequent proceedings, and noted that the CAISO's system redesign ("MRTU") is not yet complete. (D.05-10-042, at pp. 12-13, 23.) The Decision further acknowledged that the RAR

framework was, at this point, a work in progress that could well have "implementation issues." (D.05-10-042, at p. 24.) As a result, certain elements of the RA framework should be considered "transitional." (D.05-10-042, at p. 23.)

On November 30, 2004 three parties—Independent Energy Producers Association (IEP), Calpine Corporation (Calpine), and FPL Energy, LLC (FPL)—applied for rehearing of the Decision. The three rehearing applications challenge two aspects of the Decision. First, IEP and Calpine claim that the decision to phase out so-called "LD contracts"[2] is error. According to Calpine and IEP, LSEs must be prohibited from using such contracts in conjunction with RAR immediately. Second, Calpine and FPL claim that the RAR program is improper because it requires LSEs to procure resources that are subject to MOO requirements designed to ensure that those resources are available when and where needed. According to these parties, because a different MOO is currently imposed through FERC-approved tariffs, the Commission may not impose its own obligation as part of the RA framework.

Below, we carefully consider all the claims in the rehearing applications and conclude that the claims do not demonstrate error. However, for purposes of clarification of our determinations, we will modify the Decision, and deny rehearing of the Decision, as modified.[3]

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[2] LD contracts are named after their liquidated damages ("LD") provisions, which cover non-performance. Their name is used in several past decisions and is used here for the sake of clarity. However, LD contracts are relevant here because they are "non-unit-specific," i.e., they guarantee a supply of electricity but do not state its source. The RAR program requires identified sources of power (i.e., unit-specific contracts) to create reliability.

[3] Four parties filed responses to the applications for rehearing: Sempra Global ("Sempra"), Southern California Edison Company ("Edison"), Constellation Energy Commodities Group, Inc. ("Constellation") and The Western Power Trading Forum "(WPTF). In addition, the California Energy Resources Scheduling division of the Department of Water Resources ("DWR") transmitted a memorandum, dated December 14, 2005, to the Commission President.

## II. DISCUSSION

### A. The Law Does Not Prevent The Commission From Phasing Out LD Contracts.

LD contracts are "bilateral agreements that provide energy, capacity, or ancillary service products without reference to a specific unit or resource backing the obligation." (D.05-10-042, at p. 60.) The Decision notes that while these contracts have always been reliable, in-area LD contracts are not compatible with the RAR framework because they are not unit-specific. (Import LD contracts have different characteristics and are compatible with RAR, while DWR contracts are governed by separate requirements.) As a result, the Decision concludes that, "ultimately," in-area LD contracts should not be part of the RAR program. The Decision holds: "the eligibility of in-area LD contracts to qualify for the LSE's RAR showings should be phased out in a manner that fairly balances the needs of the RAR program and the interests of the LSEs that rely on LD contracts." (D.05-10-042, at p. 61.)

The phase-out balances the needs of RAR with the fact that "California's IOUs and ESPs have relied and continue to this day to rely extensively on the use of these contracts…." (D.05-10-042, at p. 61.) According to the Decision, "[t]erminating [LD contracts'] … eligibility to count for RAR … too rapidly would be unnecessarily disruptive and costly to LSEs." (Ibid.)

The applications for rehearing challenge the Decision's determination to allow LD contracts to count towards LSEs' RA obligations during the phase-out period. As explained below, the Decision's implementation of D.04-10-035's requirement to retain at least some LD contracts is legally proper and consistent with Public Utilities Code section 380.[4]

[4] Section references indicate the Public Utilities Code unless otherwise specified.

### 1. Compliance With Section 380

Calpine and IEP claim the Decision does not comply with section 380, subdivision (c). Section 380 was added in 2005 by Assembly Bill No. 380 ("AB 380") (Stat. 2005, ch. 367, §2). The bill, which was enacted as the proceeding to adopt the Decision was under way, confirms the Commission's authority to establish an RAR program, and contains requirements for the Commission and LSEs to follow. The statute became effective on January 1, 2006, after the decision was issued.

Subdivision (c) requires each LSE to "maintain physical generating capacity adequate to meet its load requirements," including reserves. In addition, this capacity must be deliverable. (Pub. Util. Code, § 380, subd. (c).) IEP argues that LD contracts cannot be used for RAR because they do not provide the required physical resources, and are not deliverable. Calpine also asserts that LD contracts contravene the statute's requirements because they are not deliverable. According to Calpine, "a deliverability determination can only be made with respect to physical resources—in other words, contracts that specify where the contract is being sourced." (Calpine's Rehearing Application, at p. 4.) As a result, these two parties claim section 380(c) requires us to entirely disallow the use of LD contracts in conjunction with an RAR program.

These claims do not demonstrate error. Both Calpine's and IEP's claims are based on a misreading of the Decision. The Decision establishes an RAR framework that does not include in-area LD contracts. The Decision states its "ultimate" goal is to disallow the use of in-area LD contracts to fulfill LSEs' capacity obligations, and the Decision's real result is to reduce the use of in-area LD contracts to 0% over a three-year period. (D.05-10-042, at p. 61.)[5] For 2006-2008, the Decision establishes a transition period during which in-area LD contracts will be phased out. Yet the two rehearing

[5] The Decision requires this result because of LD contracts' lack of unit-specific requirements and deliverability issues. Since the decision disallows the use of LD contracts for the same reasons set forth in section 380, subdivision (c), the Decision's holdings are in fact consistent with the statute's mandate.

applications describe the Decision as an affirmative determination to include LD contracts in the RAR framework. IEP argues that the Decision "permits" LD contracts to be used to satisfy RAR obligations. (IEP's Rehearing Application, at p. 3.) Calpine argues: "Allowing RAR obligations to be met through the use of LD contracts" is inconsistent with past decisions and section 380.

These allegations do not recognize the fact that the Decision repeatedly describes the requirements in place for 2006-2008 as transitional. In several places the Decision makes clear that because the RAR program creates entirely different requirements from the currently imposed procurement regime, the first few years of the RAR program will be transitional. Acknowledging that a transition period is needed to allow LSEs to change their procurement practices, the Decision states at page 11:

> LSEs and their suppliers will need to change their procurement strategies. We will seek to avoid imposing unnecessary disruptions and costs on market participants, and we recognize that transitional mechanisms will be required to avoid unduly impairing existing business arrangements.

In its discussion of the federally-imposed MOO, the Decision further acknowledges that the Commission is "permitting the use of certain non-unit-specific [i.e., LD] contracts *on a transitional basis*." (D.05-10-042, at p. 23.) Elsewhere, on page 2, the Commission states: "While we believe this decision is a significant step forward, it does not represent the final word for resource adequacy in California. More work needs to be done. We have deferred action on certain RAR program elements…."

D.04-10-035 also acknowledges that the RA framework was adopted on an accelerated basis. The Decision is designed to achieve a 15-17% reserve margin in 2006, rather than in 2008, as previously anticipated. (*Resource Adequacy Decision* [D.04-10-035], *supra*, at pp. 12-13 (slip op.).) The Decision's approach to the MOO points out the tension between the Commission's desire to have some form of framework in place for 2006 and the fact that not all of the desired program elements would be in place, or fully tested, at that time. The Decision notes that parties believed that the FERC-imposed MOO should be in place until the CAISO's MRTU was completed as "an interim

mechanism to assure dispatch of needed resources." (D.05-10-042, at p. 22.) The Decision then notes that the early stages of its RAR program should be considered experimental, noting that, "any major new program such as RAR may have unanticipated initial implementation issues, [so] it is prudent to proceed with caution." (D.05-10-042, at p. 24.)[6]

The Decision will be modified to make this aspect of the RAR program explicit. Once it is understood that the fully implemented RAR program excludes in-area LSE-negotiated LD contracts, the claim that we are improperly including them in RAR is revealed to be without merit. Further, we believe it is more than clear that we have authority to establish a transition period before fully implementing the RAR program. The rehearing parties do not even acknowledge the effect of the phase-out or provide any arguments or analysis that claim a phase-out is improper. (Compare, Commission Rules of Practice and Procedure, Rule 86.1, Code Regs, tit. 20, § 86.1.) Even section 380 allows for such a result. The statute contains no deadlines or timelines for Commission action to implement RAR. Subdivision (a), for example, does not require that the RAR framework to be established at any particular time. It also makes little sense to read a prohibition on a phase-out into section 380 when it is acknowledged that some of the LSE's procurement practices prior to RAR were the subject of Commission orders and comply with other provisions of the Public Utilities Code, such as section 454.5

Moreover, we believe that section 380, subdivision (h) explicitly gives us discretion to determine *how* to implement an RA program. Section 380(h) states that the

[6] The characterization of the first years of RAR as transitional is also supported by the record. The Workshop Report specifically describes the "Top Down" approach adopted for RAR as transitional. (Workshop Report at p. 52.) The Workshop Report further describes the task of accommodating LD contracts into the RAR framework as a matter of transitioning those contracts. (See, Workshop Report at pp. 77, 78.)

Commission is entitled to "determine and authorize the most efficient and equitable means for achieving" four enumerated goals, including achieving the overall "objectives of this section [380]." As Edison, Sempra, Constellation, and DWR point out, that authority is sufficient to allow us to establish a transition period as a "means for achieving" our RAR program. As the Decision states, adopting a transition period that allows LSEs to phase out their reliance on LD contracts without unnecessary cost or disruption is the fairest and most effective means for achieving the goals of RAR that are set forth in section 380.[7]

We do not believe the legislative purpose of section 380 is to limit or detract from our authority. The requirements contained in the statute show that the Legislature, in fact, intended section 380 to augment and clarify our authority. Subdivision (j) makes it clear that the statute was designed to assist the Commission in setting up an RAR program applicable to all LSEs by defining the term "load-serving entity" broadly. The statute's legislative history shows that a main purpose of section 380 is to eliminate any dispute over our ability to establish requirements applicable to all LSEs, including ESPs and CCAs.[8] Similarly, while the statute sets out requirements for an RA program,

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[7] IEP argues that the set of "objectives" that the Commission may use its discretion to implement is smaller than the objectives of the entire section. According to IEP, the Commission may only exercise its discretion in achieving the objectives in subdivision (b): (1) facilitating the development of new capacity, (2) equitably allocating costs, and (3) minimizing enforcement requirements and costs. The actual language of the statute is not as narrow as IEP claims. Section 380(h)(1) gives the Commission authority to authorize the most equitable means of achieving "the objectives of *this section*." (Emphasis added.) This language plainly refers to the goals expressed throughout "section" 380, not just those goals set forth in one subdivision. Moreover, the Legislature identified the "objectives" set out in subdivision (b) as the *Commission's* objectives, not those of section 380.

IEP's reading also makes little sense because subdivision (h) repeats several of the objectives from subdivision (b) in its list of goals that the Commission may use discretion to achieve. If subdivision (h)(1) intended to cross reference subdivision (b), as IEP suggests, then subdivisions (h)(2), (h)(3) and (h)(4) would not need to repeat the requirements contained in subdivision (b) because they would have been incorporated via the cross-reference in subdivision (h)(1). (Compare Pub. Util. Code, §380, subd. (h) with subd. (b).)

[8] The need for clarification is the only topic discussed in the Comment section of several bill analyses. Previously, "ESPs have contested the [Commission's] authority to require ESPs to meet the

*Footnote continued on next page*

subdivision (h) gives us discretion to determine the best way to implement those requirements. Such a statute cannot properly be read to prevent us from establishing a transition period as a way to replace the current procurement regime without causing unnecessary cost and disruption.

Finally, the rehearing applications are incorrect to claim that this Decision, D.05-10-042, makes the determination to allow LD contracts to be used in conjunction with the RAR framework. The Decision merely implements a conclusion reached in *Resource Adequacy Opinion* [D. 04-10-035], *supra*. That decision found that LD contracts, "provide economic value…" and to the extent that LD contracts are backed by portfolios of generating units, they may be more reliable than unit-specific contracts. (*Id.* at p. 23 (slip op.).) *Resource Adequacy Opinion* [D. 04-10-035], *supra,* then explicitly rejected the outcome where "we … entirely disallow their use…." (Ibid.) As a result, *Resource Adequacy Opinion* [D. 04-10-035], *supra,* establishes a counting convention that will include, in some way, LD contracts.[9] The Decision simply implemented this

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*(footnote continued from previous page)*

[Commission's] requirements, but haven't changed the [Commission's] mind or succeeded in getting a court to overturn the [Commission's] jurisdiction." The Commission supported the bill, taking the position that it "minimizes, if not eliminates, any legal uncertainty over [the Commission's] authority to set resource adequacy standards." (Sen. Rules Committee, Off. of Sen. Floor Analysis, 3d reading Analysis of Assembly Bill No. 380 (2005-2006 Reg. Sess.), as amended September 6, 2005, p. 4.) Similar language appears in the other bill analyses for AB 380. (Sen. Rules Com., Off. Of Sen. Floor Analyses, 3d reading analysis of Assembly Bill No. 380 (2005-2006 Reg. Sess.), as amended September 2, 2005, p. 4, Sen. Rules Com., Off. Of Sen. Floor Analyses, 3d reading analysis of Assembly Bill No. 380 (2005-2006 Reg. Sess.), as amended August 24, 2005, p. 4, Sen. Com on Util. and Commerce, Rep. on Assembly Bill No. 380 (2005-2006 Reg. Sess.), June 30, 2005, p. 2, Assembly Com. on Approp., Rep. on Assembly Bill No. 380 (2005-2006 Reg. Sess.), May 11, 2005, p.3, Assembly Com. on Util., and Commerce, Rep. on Assembly Bill No. 380 (2005-2006 Reg. Sess.), April 18, 2005, p. 2.)

[9] Ordering Paragraph 1of D. 04-10-035 makes all respondent LSEs "subject to the load forecasting protocols and resource counting conventions adopted in this interim order as the basis for resource adequacy requirements until directed otherwise by subsequent orders or decisions." (*Resource Adequacy Opinion* [D.04-10-035], *supra*, at p. 54[Ordering Paragraph ("OP") No. 1] (slip op.).)

requirement and must be understood as holding that if LD contracts are not to be "entirely disallowed," then they should be phased out over a three year transition period.

It is not error for us to follow the requirements established in *Resource Adequacy Opinion* [D.04-10-035], *supra*, as applied to LSEs in Ordering Paragraph 1.[10] If parties wished to challenge the legality of that order, they should have done so when it was issued. Section 1731(b) provides, in relevant part:

> After any order or decision has been made by the commission, any party to the action or proceeding . . . may apply for a rehearing in respect to any matters determined in the action or proceeding. . . . No cause of action arising out of any order or decision of the commission shall accrue in any court to any corporation or person unless the corporation or person has filed an application to the commission for a rehearing within 30 days after the … date when the commission mails the order or decision to the parties. . . .

No party filed an application for rehearing of D. 04-10-035.[11] As a result, the time for challenging the conclusion that LD contracts can be used in conjunction with the RA program has passed.

For all these reasons, the rehearing applications' claims about the effect of section 380 do not demonstrate error. Because the rehearing applications did not appear to understand the actual effect of the Decision, we will make modifications to clearly articulate the transitional nature of the 2006-2008 RAR program. We will also modify

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[10] We are also puzzled by the rehearing applications because they assert that the determination not to disallow LD contracts errs because it does not comply with a statute that became effective after *both* the initial determination to retain LD contracts was made *and* the decision implementing that determination was issued. Although aware of this timing issue, the applications cite no authority and provide no explanation about how a statute could have such a retroactive effect. (Compare, Rehearing Application of IEP, at p. 4, Rule 86.1, Code Regs, tit. 20, § 86.1.) We do not address this point in detail because we believe that our decisions are, in fact, consistent with the Legislature's directives.

[11] In fact, Calpine, one of the parties now applying for rehearing, appeared to have accepted this outcome during the workshops. Calpine's position, described in the workshop report, "was that only LD contracts signed on or before October 28, 2004 (the effective date of the Phase 1 decision) should count for resource adequacy." (D.05-10-042, at pp. 62 & 79.) This position is directly at odds with Calpine's current claim that *no* LD contracts should be allowed to count towards fulfilling RA obligations.

the Decision to make it clear that its action on the question of LD contracts only followed D.04-10-035. Rehearing of the Decision, as modified, is denied.

### 2. DWR Contracts and Imports

Calpine claims that the Decision also errs by allowing DWR contracts to be counted for RA purposes, without a phase-out period. Again, the rehearing application makes a claim of error about a determination that has already been made. The decision on how to include DWR contracts in the RA framework was definitively made in *Resource Adequacy Decision* [D.04-10-035], *supra*. That decision found, at Conclusion of Law 21:

> The long-term contracts executed by DWR should be eligible as resources even if certain features would otherwise exclude a non-DWR contract with the same terms and conditions, but the deliverability screens that will be developed in this proceeding should be applied to them.

The Decision does not make any further determinations on this matter. Rather, it simply points out that the issue was previously decided, and notes that the phase-out of LD contracts does not apply to DWR contracts, "to give effect to that decision [D.04-10-035]." (D.05-10-042, at p. 64.)[12] As discussed above, section 1731 bars any challenge of a Commission decision "in any court" if an application for rehearing is not filed. No party challenged D.04-10-035 and it became final. It is not

[12] In addition, DWR contracts are the subject of their own regulatory framework, controlled by provisions of the Water Code and various decisions. (See, e.g., Water Code, §§ 80100, 80104, 80106.) As set forth in, e.g., D.02-09-053 and D.03-06-074, DWR contracts were entered into pursuant to statutory authority during the energy crisis and subsequently allocated to IOUs as part of the IOU's resumption of procurement. As D.04-10-035 acknowledges with its separate consideration of DWR contracts, the treatment of DWR contracts was definitively resolved in decisions such as D.02-09-053 and D.02-12-069. (*Resource Adequacy Decision* [D.04-10-035], *supra*, at p. 29 (slip. op.).) It is not error for us to accommodate this separate set of procurement requirements in the Decision.

error for us to defer to previously-instituted requirements, and section 380 cannot be read to govern determinations made before the statute was enacted.

Calpine similarly claims that import LD contracts will improperly continue as part of the RAR framework. (Calpine's Rehearing Application at p. 5.) The Decision, however, clearly notes that import LD contracts have their own, unique, characteristics, distinguishing between import contracts and "in-area LD contracts" when necessary. (E.g., D.05-10-042, at p. 62.) Import contract imports qualify for RAR because they are backed by spinning reserve, are delivered on transmission capacity that cannot be curtailed, and specify a firm delivery point. (D.05-10-042, at p. 67.) The Decision explains, at p. 68:

> Firm import LD contracts do not raise issues of double counting and deliverability that led us to conclude that other LD contracts should be phased out for purposes of RAR. We note that firm import contracts are backed by spinning reserves.

The Decision also notes that, historically, imports met the CAISO's deliverability criteria. (D.05-10-042, at p. 54.) This is a key difference between in-area and import LD contracts. Import capacity can be counted towards RA obligations in a way that is consistent with section 380, subdivision (c) because import capacity: (i) meets the deliverability requirement, and (ii) has sufficient physical resources associated with it (spinning reserve and firm delivery to a specific point). We will deny the applications for rehearing on these two points.

**3. Record Issues**

Calpine claims that the phase-out of LD contracts is a "deviation from established RAR policies" that is not supported by the record. As explained above, the phase-out of LD contracts is consistent with previous Commission decisions, and in fact implements the mandate of *Resource Adequacy Decision* [D.04-10-035], *supra*. All three of our RA decisions balance numerous competing policy interests, and the interests cited by Calpine (providing financial incentives to generators) are just one of the

considerations reviewed in reaching our decisions. There is no inconsistency in recognizing competing policy objectives and then balancing those objectives when making determinations.

In addition, the record provides support for the Commission's decision to phase out LD contracts over a three year period. The Workshop Report, at p. 80, summarizes the consensus on this issue:

> Parties generally agree the existing LD contracts should have a sunset period, after which they would no longer count towards RAR. Most parties advocated that because there is no urgent need for physical capacity until the 2008/2009 timeframe, existing LD contracts should continue to count for capacity only until 2008.

Parties' comments on the Workshop report also add to the record supporting a three-year phase-out ending in 2009. For example, in their comments on the Workshop report, numerous parties—including PG&E, TURN, Constellation, ORA, and SCE—supported a three year phase-out. The Decision shows that it was cognizant of the record, noting that terminating LD contracts' eligibility for RAR immediately would be "disruptive and costly." (See, e.g., Comments of AReM on Phase 2 Workshop Report at p. 23, Comments of Constellation on June 10, 2005 Workshop Report, at p. 15 (capacity needed).) In addition, the result Calpine appears to suggest—that LSEs with sufficient resources should buy more power from in-state generators, such as Calpine, simply to meet a regulatory RA mandate—is contrary to the public interest. Calpine's result would have LSEs enter into duplicative contracts simply to meet the requirements of the RAR program—with no increase in reliability.[13] The record makes clear that such a result is

[13] The Comments of Powerex explain that LD contracts can, in fact, be far more reliable than unit specific contracts. Powerex points out that the financial wherewithal of a generator has a far greater impact on its ability to deliver on the contract than the legal structure of the contract itself. For example a generator that offers unit specific contracts but cannot, at times, afford fuel for its facilities, is less reliable than a financially secure generator that offers non-unit specific contracts enforced by an LD provision. (Comments of Powerex on Workshop Report, at p. 10.)

not in the public interest, and the RAR policy framework explicitly rejects "reliability at any cost." (D.05-10-042, at p. 8.)

### B. The RAR Framework Properly Requires LSEs to Procure Resources That Will Be Available to the CAISO When And Where Needed.

The Decision implements "a key purpose of … RAR" that is "set forth throughout our decisions on Resource Adequacy, including this one …." Resources must be "available to the CAISO when and where needed." (D.05-10-042, at p. 15.) To do this, the Decision incorporates a must-offer obligation into California's RAR program, as required by the broad policy outline established in D.04-10-035. (D.05-10-042, at pp. 14-22 (section 4.1), 26-27 (contract language).) In addition, the Decision discusses the CAISO's FERC-approved tariff, which currently imposes a different MOO (the "FERC-MOO") by requiring certain generation units not otherwise scheduled to operate and bid into the CAISO's real time market, with a provision allowing for waivers. (D.05-10-042, at pp. 21-25 (section 4.3).)

Specifically, the Decision requires LSEs to procure resources that are "available to the CAISO on a real-time basis to the extent they are able to perform." In practical terms, this means LSEs must obtain resources that participate in the "RUC" process,[14] and make unscheduled RA capacity "available to the CAISO on a real-time basis to the extent they are available to perform." (D.05-10-042, at p. 15.) In summary, LSEs are required to procure resources that have obligated themselves to comply with the terms of a Resource Adequacy-based MOO. (D.05-10-042 at pp. 14-19 (section 4.1).)

In its rehearing application, FPL asserts that because a MOO is currently contained in the CAISO's FERC-approved tariffs, the Decision may not implement any

[14] The acronym "RUC" stands for Residual Unit Commitment and is a process by which capacity is made available to the CAISO after the day-ahead market has closed if the CAISO anticipates that it will need more resources than those scheduled in the day-ahead market.

similar obligation as part of the RA framework. FPL also criticizes the Decision because the RA-based must-offer obligation is different from the FERC-MOO. (FPL's Rehearing Application, at pp. 4-5.)[15] Calpine asserts that D.05-10-042 and section 380 require the Commission to avoid using a MOO as part of the RA framework. Calpine further asserts that the Decision is internally inconsistent because it implements a MOO despite making statements supporting adequate compensation for generators. (Calpine's Rehearing Application, at pp. 7-8.) As discussed below, none of these claims demonstrates error.

**1. Claims of Federal Preemption**

The parties' preemption claims misunderstand the nature of the RA-based must-offer obligation imposed in the Decision. The Commission has clear authority to impose "regulatory requirements" on "LSEs that fall under the Commission's jurisdiction." (D.05-10-042, at p. 14.) And the must-offer obligation imposed in the Decision is just such an obligation: a state-imposed requirement that state-regulated LSEs must follow to the extent they wish to use their contracts to satisfy RA obligations. The imposition of such a requirement in the context of an RA program has no effect on the parallel FERC-approved mechanism. The RA-based MOO is a separate requirement, with different characteristics and imposed under different authority. In order to differentiate more clearly between the RA-based offer obligation and the FERC-imposed MOO, we will modify the Decision to clearly refer to either an "RA-MOO" or a "FERC-

[15] Two responses to the Applications for Rehearing agree and expand upon this point. Constellation asserts that the Commission lacks jurisdiction to extend the FERC-imposed MOO and that the Decision is not record-based. WPTF asserts that the Decision is federally preempted because it impinges on the FERC's responsibility for wholesale rates. (WPTF's Response, at p. 3.) Constellation asks the Commission to clarify that it lacks jurisdiction over the FERC-MOO and that the Decision does not prohibit "reforms" with respect to MOO compensation. Constellation also claims that the record does not support the "Commission's assertion that the [FERC-]MOO should continue." (Constellation's Response, at p. 5.) While we explain below that these points do not demonstrate error, we note that these arguments were not timely made in an application for rehearing and therefore cannot be made in "any court." (Pub. Util. Code, § 1731, subd. (b).)

MOO." We will also ensure the Decision clearly articulates the LSE-based nature of the RA-MOO.

When the RA-MOO is properly understood as an LSE-based requirement, FPL's preemption claims fail. The Court of Appeal for the Second Appellate District has summarized the limited circumstances where federal preemption can occur as follows:

> Federal statute or regulation may preempt state law in three situations, commonly referred to as (1) express preemption, (2) field preemption, and (3) conflict preemption. First, Congress can define explicitly the extent to which its enactments pre-empt state law. Second, in the absence of explicit statutory language, state law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively. Finally, state law is pre-empted to the extent that it actually conflicts with federal law. Federal regulations have no less pre-emptive effect than federal statutes. (*Southern Cal. Edison v. Public Utilities Com.* (2004) 121 Cal.App.4th 1303, 1309-1310 (internal quotation marks and citations omitted).)

FPL's application concludes, without analysis or explanation, that the RA-MOO is an "impermissible intrusion on FERC jurisdiction[,]" and that we are "without jurisdiction" to impose an RA-MOO.[16] (FPL's Rehearing Application, at pp. 4, 5.) An analysis of the three types of preemption (express preemption, field preemption, and conflict preemption) shows, in fact, that none of the requirements under which state laws or regulations may be preempted has been met.

First, because the RA-MOO is a reliability requirement imposed on California-regulated LSEs, and the express provisions of the Federal Power Act allow for state regulation of those who sell electricity to retail customers, there is no express

[16] The only support for this claim is a reference to FERC decisions discussing the CAISO's Market Redesign and Technology Update (MRTU) and sections 205 and 206 of the Federal Power Act, which do not address that statute's allocation of authority between the federal government and the states. See Commission Rules of Practice and Procedure, Rule 86.1, Cal. Code Regs., tit. 20, § 86.1.

preemption. FERC only has jurisdiction over, "the sale of electric energy at wholesale in interstate commerce…." Except in specific situations involving interconnections and wheeling, FERC's jurisdiction, "shall not apply to any other sale of electric energy…." (16 U.S.C., § 824, subd. (b) (section 201 of Federal Power Act).) Long established precedent holds that, "Congress meant to draw a bright line, easily ascertained, between state and federal regulation…." (*Federal Power Com. v. Southern Cal. Edison* (1964) 376 U.S. 205, 215-216 [11 L.Ed.2d 638, 646].)

The RA-MOO specifically does not intrude on any of the areas set aside for federal regulation under the Federal Power Act. The Decision makes clear that, "the adopted RAR framework establishes an LSE-centered obligation under which the regulatory requirements apply to LSEs that fall under the Commission's jurisdiction." (D.05-10-042, at p. 14.)[17] We specifically deferred to the CAISO's FERC tariff process any elements of the RA-MOO that involve wholesale transactions. The Decision states, "…we hereby adopt those portions of the Staff/CAISO proposal that we have control over—the LSE RAR obligations and penalties for non-compliance." (D.05-10-042, at p. 17.) The Decision makes it clear that other issues, "will be addressed in the CAISO tariff and/or protocols implementing its new market redesign." (Ibid.) Because we are only requiring that capacity contracts which count towards meeting RA obligations to serve retail load contain certain requirements, including the RA-MOO, the Decision falls

[17] In this context it is important to understand that, because it stems from state authority, the RA-MOO is different from the federally-imposed MOO in two respects. First, the RA-MOO does not create a regulatory obligation that applies to generators. Instead, the RA-MOO requires LSEs to procure resources that are contractually obligated to do certain things. Generators can choose to enter into such contacts or not. Second, while the FERC-MOO requires generators to sell to the CAISO and fixes the compensation, the RA-MOO is silent as to compensation issues. This is because the RA-MOO is a requirement LSEs must follow, and the Decision relies on voluntary, negotiated agreements to create an obligation for generators. Since the compensation that will be associated with these provisions will be voluntarily agreed to by the generators and LSEs, there is no issue as to whether or not this compensation is fair. These points explain why Constellation's concerns, summarized at footnote 15, do not show the Decision to be in error.

squarely within the jurisdiction allocated to us by Congress. As discussed below, FERC has, in fact, recognized that the current FERC-MOO "is different from" an RA-based MOO and appears to accept the legitimacy of an RA-based MOO. (*Order Accepting and Modifying Tariff Filing* (2006) 114 FERC ¶ 61, 026, 2006 FERC LEXIS 65 at p. *25, fn. 30.)

Second, claims of field preemption are clearly without merit. Field pre-emption occurs when Congress does not expressly preempt state laws or regulations but nevertheless intends the federal government to "occupy exclusively" the field of regulation so that there is "no room for supplementary state regulation." (*Southern Cal. Edison v. Public Utilities Com.* (2004) 121 Cal.App.4th 1303, 1309-1310.) Because the Federal Power Act creates a "bright line" division between state authority over retail sales and federal authority over wholesale sales, field preemption arguments against the RA-MOO must fail. (See *Federal Power Com. v. Southern Cal. Edison*, *supra*, 376 U.S. at pp. 215-216 [11 L.Ed.2d at p. 646].) The federal scheme is not so comprehensive that our regulation of retail sales service is impermissible. In fact the opposite is true: both state and federal regulators have a role to play in controlling electricity markets, with the states controlling retail sales.

Third, there is no conflict created by the CPUC's adoption of the RA-MOO and the existence of the FERC-MOO, or any other federal law, and the parties fail to demonstrate any such conflict. FPL's rehearing application asserts that the RA-MOO conflicts with federal law because FERC has concluded that, in the future, when the CAISO's MRTU becomes effective,[18] neither a day-ahead nor a real-time MOO should be implemented; instead, FERC has suggested that the MRTU include either no offer obligation or a "flexible" obligation. (FPL's Rehearing Application, at pp. 3-4.) In

[18] With the MRTU the CAISO proposes to change the way the energy markets in California work, and to implement new technology to support new markets.

support, FPL's Rehearing Application and WPTF's response cite two FERC decisions, the "September 2004 Order" (*Rehearing of The Cal. ISO's Market Redesign* (2004) 108 F.E.R.C. ¶61, 254, 2004 FERC LEXIS 1296) and the "June 2004 Order" (*Order On Further Development Of The California ISO's Market Redesign And Establishing Hearing Procedures* (2004) 107 FERC ¶61,274, 2004 FERC LEXIS 1228.)[19]

As an initial matter, FPL's argument proposes a *future* conflict between the RA-MOO and federal law, not a current conflict. Since MRTU has not been implemented and RAR is transitional for 2006-2008, only a hypothetical future conflict might exist between state and federal regulation. Such a hypothetical conflict does not result in federal preemption. (*Pacific Legal Foundation v. Resources Conservation and Development Com.* (9th Cir. 1981) 659 F.2d 903, 925, fn. 35, affd. sub nom. *Pacific Gas and Electric Co. v. Energy Resources Conservation and Development Com.* (1983) 461 U.S. 190, 203-204 [75 L.Ed. 752, 765], quoting *Goldstein v. California* (1973) 412 U.S. 546, 554 [37 L.Ed.2d 163, 173].)

Second, even once MRTU is implemented, and the RA-MOO continues, there will be no conflict with federal law, regardless of whether there is no FERC-MOO, or an alternative FERC-ordered MOO in place. FPL and WPTF misconstrue FERC's orders on these issues. In the June 2004 Order, FERC expressed concerns with the compensation terms of the FERC-MOO (which is FERC's primary concern with the FERC-MOO), and instructed the CAISO to consider a flexible-offer obligation as an alternative to continuing the FERC-MOO in the MRTU, but only if the CPUC's RAR was insufficient to meet the CAISO's operational needs. Significantly, the June 2004 Order expressly acknowledged the possibility of a voluntary, contractual obligation, i.e.,

[19] WPTF cites cases where FERC has asserted its supremacy in the face of conflicting state regulation. However, those cases are inapposite because the pleadings fail to demonstrate that the RA-MOO conflicts with federal law.

an RA-based MOO. That Order implied that such a contractual obligation would resolve its compensation concerns regarding the existing FERC-MOO:

> The Commission believes that participation in the CAISO day-ahead market should be voluntary absent a contractual obligation requiring participation in the day-ahead market, i.e., sellers should have the choice of making sales bilaterally or selling into the CAISO market. A day-ahead must offer [the CAISO's proposal to extend the FERC-MOO into MRTU] would preclude the possibility of bilateral sales by sellers after the close of the day-ahead market. A resource adequacy product, with a capacity payment, would compensate for taking away this choice and would obligate sellers to participate in the market, satisfying the CAISO's [operational] and Commission's [compensation] objectives.

(*Order On Further Development Of The California ISO's Market Redesign And Establishing Hearing Procedures*, 107 FERC ¶ 61,274, 2004 FERC LEXIS 1228 at p. *22.) FERC then affirmed this decision in the September 2004 Order cited by FPL and WPTF. Nowhere in these orders does FERC suggest that an RA-based MOO would be inappropriate, or conflict with its own determinations regarding must-offer obligations. In fact, these orders implicitly approve of such an RA-based product, on the basis that an RA capacity payment would compensate generators for the must-offer obligation.

Approximately fifteen months later, in another proceeding, FERC again recognized that a voluntarily accepted must-offer obligation, through RAR, would resolve its compensation concerns with the current FERC-MOO, and that the FERC-MOO and an RA-based MOO were different products: "We note that the current must-offer obligation in California (and the WECC), which lacks a separate capacity payment [FERC-MOO], is different from a must-offer obligation where sellers, as part of a resource adequacy program, voluntarily accept a must-offer obligation in exchange for a capacity payment [RA-MOO]." (*Order Accepting and Modifying Tariff Filing, supra*, 2006 FERC LEXIS 65 at p. *26, fn 30.)

Contrary to FPL's and WPTF's representations, FERC has expressed no objection to the continuation of either a day-ahead or real-time MOO "beyond implementation of a Resource Adequacy Requirement ("RAR") Program in California[,]". (Compare, FPL's Rehearing Application, at p. 4, WPTF's Response, at p. 2.) Rather, FERC's orders demonstrate that it is opposed to the continuation of the existing FERC-MOO in the tariff implementing the MRTU because of its concerns that the FERC-MOO does not adequately compensate generators. Further, the cited FERC Orders reveal that FERC would likely *welcome* an RA-based MOO as a replacement for any FERC-ordered MOO. Thus, there is no evident conflict with federal law; in fact, the situation is quite the contrary. Additionally, once the FERC orders are properly understood, parties' claims that the RA-MOO conflicts with the FERC-MOO simply because the RA-MOO is different from the FERC-MOO are shown to be without merit. (FPL's Rehearing Application, at p. 4.) The RA-MOO is necessarily different from the FERC-MOO, most significantly because generators will be compensated for their capacity under the RA-MOO, but also because it stems from different authority, with the obligation being placed on LSE.

Ultimately, the parties' preemption claims may simply result from the fact that the Decision's discussion of the FERC-MOO in section 4.3 is unclear, and in one place mistakes a position taken by the parties as a position taken by FERC. Section 4.3 is designed to explain our view of the current FERC-MOO in response to a suggestion from parties that we should declare RAR to be "fully implemented" in order to give FERC an indication that it could terminate the FERC-MOO now. Section 4.3 gives our views on this suggestion and does not extend or establish any regulatory requirements. Because the current RA framework contains a transition period and the MRTU is not effective we want to make this point clear by modifying this section.

**2. State Law Claims**

Calpine asserts that the must offer requirements adopted in the Decision conflict with section 380 and previous Commission decisions. This claim is based, in turn, on Calpine's view that because the RA-MOO provides "inadequate compensation," its continued use runs contrary to the goal of encouraging the construction of new facilities by compensating generators sufficiently to encourage new construction. (Calpine's Rehearing Application, p. 8.)

This appears to be a policy argument. The application refers to portions of the Decision that attempt to balance the goal of fostering new generation with the other goals of RAR. Since the purpose of the Decision is to balance a number of competing policy considerations, referring to only one of these competing considerations does not show error. The Decision states in its introduction, "we will, all other things being equal, give preference to those [policies] that promote appropriate investment…." (D.05-10-042, p. 9.) The requirements of section 380 must be considered in light of the Commission's discretion, discussed above. Moreover section 380 only requires the Commission to encourage new generation, it does not contain any requirements relating to generator compensation. As a result, there is no contradiction in the decision to adopt a MOO as part of the RA framework. That decision simply represents an appropriate balancing of competing policy interests. The Decision considers *both* how generator compensation effects investment in new capacity, *and* how to make resources available to the CAISO when needed. At page 15, the Decision points out that, "a key purpose of our RAR is to ensure that resources are made available to the CAISO when and where they are needed . . .RA resources must be made available to the CAISO on a real-time basis to the extent they are able to perform." It is not error to balance this concern with concerns about generator compensation.

In addition, Calpine fails to establish that the RA-MOO will have the negative compensation effects the application claims. The Decision does not specify what compensation should be provided for generators that agree to RA contracts

including RA-MOO provisions. Because compensation issues will be dealt with as part of the contracting process, they can be assumed to be fair to generators.

### 3. Record Issues

In a response to the Applications for Rehearing, Constellation asserts that the record was not sufficiently developed to support our adopting the requirement that LSEs must procure resources that are available to the CAISO when and where needed. This claim will be denied for two reasons. First, such a claim cannot be made in a response to an application for rehearing. Parties seeking rehearing should make their claims in an application for rehearing within 30 days of the mailing of a decision, not 45 days later in a response. (Pub. Util. Code, § 1731, subd. (b).) If Constellation truly wished to assert that the Commission could not adopt such a requirement without further proceedings, it should have both (1) filed a timely application for rehearing on the matter and (2) explained what actual issues the rehearing would need to address. Second, the record supports Commission action on must-offer issues, both in terms of the elements we look for in RA resources and the discussion of the FERC-MOO. In their comments on the Workshop Report a number of parties pointed out that unless the RAR framework could immediately guarantee the CAISO sufficient resources, the current mechanism to ensure reliability, the FERC-MOO, should remain in place until the MRTU is complete. In addition, the workshop report showed that parties actively considered how to provide the CAISO with the resources it needed to ensure reliability, including the methods we adopted.

## II. CONCLUSION

After careful consideration, we have concluded that the rehearing applications' main claims do not take account of the two important facts we have made clear through the modifications we adopt today: (1) the 2006-2008 RAR framework is transitional, and the use of a phase-out period to eliminate LD contracts is an appropriate exercise of discretion and consistent with section 380; and (2) the RA-MOO is a state-

imposed requirement that applies to LSEs and does not interfere with federal jurisdiction. We will modify the Decision and deny rehearing on these points. Upon additional consideration, we have determined that the rehearing application's remaining claims are also without merit, and will be denied. Therefore, rehearing of D.05-10-042, as modified, is denied.

**THEREFORE, IT IS ORDERED** that:

1. D.05-10-042 is modified as follows:

   a. After the first sentence of the first full paragraph on page 3, following the bullet points, insert: "For example, the RA framework will remain in transition for 2006-2008 as we phase out certain non-unit-specific contracts."

   b. A new fifth sentence is added to the first paragraph on page 14, immediately prior to the sentence beginning, "The alternative of delaying …." The new sentence shall read: "In addition, we adopt a phase-out of certain contracts that are not compatible with RAR but cannot be eliminated immediately without unnecessary cost or disruption."

   c. The Heading for Section 4.1 is restated to read:

      "Contractual Obligations Necessary For A Resource To Count Towards RAR." The Table of Contents is modified to reflect this change.

   d. The third, partial, paragraph on page 15 that carries over to page 16 and begins "As set forth throughout our decisions …" is restated to read:

      "As set forth throughout our decisions on Resource Adequacy, including this one, a key purpose of our RAR is to ensure that resources are made available to the CAISO when and where they are needed. Thus, we clarify here that in order for a resource to count towards an LSE's RAR, an RA resource's contractual requirements cannot end with the RUC process. We hereby adopt the CAISO's request regarding RA resource availability as a form of RA must-offer obligation ("RA-MOO") and require that LSEs contract with RA resources to comply with the RA-MOO. Among other things, the RA-MOO will require RA resources to be made available

to the CAISO on a real-time basis to the extent they are physically able to perform. As a practical matter, this means that units that are already running and that have unscheduled RA capacity shall make that unscheduled RA capacity available to the CAISO, if requested. Additionally, short start RA units must self-schedule or offer into the CAISO's hour-ahead market and real time market for each hour of the operating day, subject to use limitation and contingency designations, even if not scheduled in the day-ahead market or committed by RUC, unless otherwise released from this obligation by the CAISO consistent with the CAISO's existing must-offer waiver denial process under the FERC-approved MOO. (We note that the FERC-approved MOO process is mirrored by the RA-MOO in the language drawn from SVLG's proposal and adopted in section 4.4.) LSE contracts with RA resources should reflect these obligations, as well as a general obligation to comply with CAISO tariff requirements so that the CAISO can further refine the operational characteristics of the RA-MOO to meet its reliability needs."

e. The second sentence of the first full paragraph on page 16, which sentence begins, "We hereby reiterate…" is restated to read: "We hereby reiterate that in order to meet their RA obligations LSEs must procure resources that are obligated to submit a zero dollar ($0) bid for RA capacity into RUC and that are not eligible for any RUC availability payment or revenue."

f. The Heading for Section 4.3, on page 21, is restated to read: "The FERC-Based Must Offer Obligation (FERC-MOO)." The Table of Contents is modified to reflect this change.

g. Section 4.3, beginning on page 21 with the words "The MOO is a FERC-approved…" and ending on page 25 with the words "…MRTU process is implemented[]" is restated to read:

"The existing MOO is a FERC-approved, CAISO-administered mechanism under which certain generation units not otherwise scheduled are obligated to operate and bid into the CAISO's real time market ("FERC-MOO"). The FERC-MOO mechanism includes a process under

which the CAISO grants or denies MOO waiver requests, also known as the "must-offer waiver denial" or "MOWD" process. The CAISO provides some compensation to units that are denied waivers and are thus required to be prepared to operate in real time. Parties have asked that this Decision signal to FERC that the FERC-MOO can be eliminated. FERC has indicated its intent that the FERC-MOO should be terminated when the CAISO's market design is implemented. (Rehearing of The Cal. ISO's Market Redesign (2004) 108 F.E.R.C. 61, 254, 2004 FERC LEXIS 1296and Further Development of the Cal. ISO's Market Redesign (2004) 107 F.E.R.C. 61, 274, 2004 FERC LEXIS 1228.) Generators, in particular, are eager to see the FERC-MOO eliminated as soon as possible, and they recommend that the Commission support termination of the FERC-MOO before FERC when the RAR program is implemented. Other parties believe that the mechanism should be retained until both the RAR and the CAISO's Market Redesign and Technology Upgrade (MRTU) programs are operating. At the time we issue this decision, MRTU is slated to commence operation in February 2007.

In connection with the SVLG's proposal for standard contract language (see Section 4.4 below), the Phase 2 workshop report invited comments on whether the Commission should take the position that the FERC MOO and associated must-offer waiver denial process should remain in place until the MRTU process is implemented (Topic 4). Also, in connection with interagency coordination issues (see Section 5 below), the workshop report invited comments on (1) the proposition that the Commission, the CAISO, and the FERC must coordinate to determine both replacement requirements and the schedule for eliminating the CAISO's FERC-MOO authority (Topic 13); and (2) the proposition that RAR will replace the FERC MOO (Topic 14). We take up these three related topics here to address the Commission's policy position on these issues.

The CAISO, LSEs, and their customers generally supported having the FERC-MOO, including the must-offer waiver denial process, in place until the CAISO's

MRTU program is implemented. As described in the workshop report, there is concern that if the FERC-MOO and the associated waiver process are eliminated prior to MRTU implementation, the CAISO will not have a mechanism to commit RA resources for the next day. However, such a mechanism will be available with implementation of the day-ahead market as part of the MRTU. They argue that retaining the FERC-MOO until MRTU implementation would provide an interim mechanism to assure dispatch of needed resources. Additionally, SCE believes that retention of the FERC-MOO will provide needed market power mitigation until MRTU is implemented. Joint Parties believe that the FERC-MOO will remain necessary until the Commission's RAR program has been proven to meet California's energy needs, the CAISO has implemented the MRTU and its day-ahead market, and the CAISO has authority to enter into backstop local capacity contracts.[8] They also propose that the CAISO track must-offer waiver denials for non-RA resources and report them to the Commission. They believe that this would indicate whether: (1) the CAISO is relying on excess reserve levels, (2) needed local resources have been properly identified, and (3) the RAR program design is missing any needed element.

Suppliers of generation and others opposing continuation of the FERC-MOO beyond June 2006 contend that it would undermine the incentive to contract for long term capacity, and discourage investment by continuing short-term procurement and inadequate compensation. They also believe that the FERC-MOO will not be necessary when the RAR program is operative, and in particular they dispute the workshop report's conclusion that the FERC-MOO mechanism is necessary as an interim measure for the CAISO to commit resources in the day ahead time

[8] CMTA states that it no longer joins the other parties with which it submitted joint comments (CLECA and Joint Parties) with respect to their positions on the MOO. CMTA now characterizes the MOO as a "vestige of the energy crisis which should be eliminated as soon as possible." (CMTA supplemental comments, p. 2.)

frame. For example, IEP contends that there is no need to retain the FERC-MOO since RAR contracts will provide the CAISO with the commitments and resource availability is needs.

It appears that the availability of the FERC-MOO as a backstop procurement mechanism available to the CAISO may discourage long term contracting for capacity and provide inadequate compensation to generators, thereby discouraging the creation of a stable investment environment. For these reasons, the FERC-MOO is not aligned with some of our RAR goals, and thus it is appropriate that FERC is considering its eventual replacement.[9] However, we understand and appreciate the need for the FERC-MOO as a backstop procurement mechanism during the transition to a comprehensive RAR program.

The RAR program outlined in this decision is not complete. As discussed later in this decision, we are permitting the use of certain non-unit specific contracts for RAR showings on a transitional basis. These contracts may not provide the CAISO with the level of commitment that unit-specific contracts should provide. Additionally, we decline to impose a localized RAR at this point. Finally, any major new program such as RAR may have unanticipated initial implementation issues. Consequently, it is prudent to proceed with caution. For the early stages of the RAR program, we do not have the same level of confidence as the generator parties that RAR contracts will provide the CAISO with the commitments and resource availability that it needs. Thus, we support FERC's determination that FERC-MOO remain in place until the CAISO's market design is implemented and our RAR program becomes fully implemented.

[9] We note that on August 25, 2005, IEP filed a complaint with FERC, seeking to replace the MOO with an alternative tariffed payment structure. The Commission will be participating in that proceeding, *Independent Energy Producers Assoc. v. California Independent System Operator Corp.*, FERC Docket No. 05-146 (IEP Complaint).

While we recognize that the continued existence of the FERC-MOO may act as a disincentive for LSEs to enter into forward contracts, one of our purposes in moving towards a complete RAR is to provide the incentives that should lead to that very result – forward contracting. Eventually, adding a multi-year forward commitment dimension to the RAR program may enhance this effect. In any event, we note that nothing prohibits multi-year forward capacity commitments from qualifying for year-ahead RAR showings, and we encourage such commitments. At this time, we decline to adopt as part of our policy position on the FERC-MOO the other preconditions for termination of the FERC-MOO that were suggested by Joint Parties. In particular, we will not adopt the position that that the RAR program be proven (at least in the context of a formal proceeding) to have met California's energy needs, as that strikes us as an unnecessarily high standard for elimination of a mechanism that appears to be at odds with our RAR goals.[10] The proposal that the CAISO track waiver denials for non-RA resources and report them to the Commission appears reasonable as an early means of monitoring the effectiveness of the RAR program. We request that the CAISO periodically provide such reports to our Energy Division during the transitional period between the commencement of the RAR program and the termination of the FERC-MOO.

The workshop report states that continuation of the FERC-MOO mechanism on an interim basis may require that supplier cost information be provided to the CAISO so that it can efficiently select necessary resources. It also notes that existing FERC-MOO compensation may duplicate payments under RA contractual arrangements, and suggests that appropriate adjustments to FERC-MOO compensation for RA resources should be considered. After reviewing all of the comments and replies, we are

[10] Of course, mid-course corrections to the RAR program may prove necessary. Also, as noted elsewhere in this decision, we are planning to conduct further proceedings to upgrade the RAR program and to consider developing a centralized capacity market.

persuaded that these measures are not necessary and we will not advance them at FERC. In particular, the possibility of duplicate payments seems somewhat unlikely.

Finally, with regard to the concerns raised in the FERC-MOO discussions that the CAISO needs a mechanism to commit RA Resources in the day ahead time frame, we note that we are ordering that RA contracts require resources to comply with an RA-MOO mechanism, and the CAISO tariff generally (see the discussion in Section 4.1, above). We have also outlined contract language that mirrors the FERC-MOO in section 4.3, below. We anticipate that the RA-MOO will mirror the FERC-MOO's must-offer waiver denial process. This will ensure that the CAISO has a mechanism to commit RA resources in the day ahead time frame, regardless of the existence of the FERC-MOO, and will ensure that RA resources are available to the CAISO when needed, which is one of the primary goals of our RAR."

h. Section 5.a.iv of the contract language on page 27 should be clarified to read: "iv. Capacity must be made available subject to the existing FERC Must Offer Obligation ("FERC-MOO") or if the FERC-MOO is no longer operative, Capacity shall be made available subject to the same obligations and timelines that exist under the current FERC-MOO process.

i. At the end of the first full paragraph on page 60, which begins "D.04-10-035 noted that LD contracts…," new language is inserted reading: "Because of their reliability, among other factors, D.04-10-035 concluded that LD contracts must be used in conjunction with RAR, and that decision concluded that these contracts would not be 'entirely disallow[ed].' (D.04-10-035, at p. 23 (slip. op.).) We must accommodate that holding here."

j. The paragraph that spans pages 60-61, beginning, "However, despite their proven performance…" and ending with "forward capacity payments" is eliminated. In its place the following language is inserted at the beginning of the first full paragraph on page 61: "However, LD contracts do present us with some concerns. LD contracts may not always be subject to

deliverability screens, and they present a risk of double counting. There is a risk these resources may not be available to the CAISO, despite historical precedents, and these contracts may not induce forward capacity payments. We expressed some concern on these matters in D.04-10-035."

k. The last sentence of the first, partial, paragraph on page 62, which sentence begins, "Accordingly it is our policy," and ends, "the interests of LSEs that rely on LD contracts[,]" is eliminated. In its place the following language is added:

"D.04-10-035 has already determined that in-area LD contracts should not be entirely eliminated once the RAR program begins. Accordingly, to comply with that requirement, and to take into account the interests of LSEs that rely on LD contracts, we will establish a transition period during which in-area LD contracts may be used in conjunction with the RAR program. Once the phase-out is over, the RAR program will operate without in-area LD contracts. Adopting a transition period allows us to implement an RAR program now while also taking into account the reality that completely disallowing these contracts, even if permitted, would be costly and disruptive."

l. The fifth sentence of the paragraph headed "**Sunset Date**" on page 64 that begins "Therefore, we determine that…" is restated to read: "Therefore, we determine that in-area LD contracts will not count for purposes of RAR showings after the transition period ends on December 31, 2008."

m. Finding of Fact 9, on page 98 is restated to read:

"To count towards RAR, LSE contracts with RA resources should include an RA MOO requirement as described in section 4.1 of this Decision, and similar to the FERC-ordered MOO (including the associated must-offer waiver denial process) and should require the resource to comply with the CAISO tariff generally. We are instituting this requirement as part of the RA framework to ensure that RA resources are made available to the CAISO when needed."

n. A new Finding of Fact 27a is inserted after Finding of Fact 27 reading:

"DWR LD contracts are the subject of a different procurement regime, governed by previous decisions and portions of the Water Code enacted in response to the energy crisis. Their status as RA resources has been previously established and is not affected by this decision."

o. Finding of Fact 31, on page 101, is restated to read:

"Terminating the eligibility of LD contracts to count for RAR showings too rapidly would contravene D.04-10-035 and would be unnecessarily disruptive and costly to LSEs. Using a transition period to move towards our goal of a fully capacity-based program is an appropriate way to balance the needs of RAR with the fact that LSEs have made commitments while operating under a different procurement regime."

p. Conclusion of Law 14, on page 104, is restated to read:

"Pursuant to D.04-10-035, LD contracts cannot be entirely disallowed from use in conjunction with the RAR program. A transition period should be established in which the eligibility of in-area LD contracts to count towards an LSE's RAR showings is phased out. This transition period accommodates the directives of D.04-10-035 and effectively balances the needs of the RAR program and the interests of LSEs that rely on LD contracts."

2. Rehearing of D.05-10-042, as modified herein, is denied.

This order is effective today.

Dated April 13, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners