UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

California Independent System Operator Corporation,
California Electricity Oversight Board,
Public Utilities Commission of the State of California,
Pacific Gas and Electric Company,
San Diego Gas & Electric Company, and
Southern California Edison Company

v. Docket No. EL02-15-002

Cabrillo Power I LLC,
Cabrillo Power II LLC,
Duke Energy South Bay, LLC,
Geysers Power Company, LLC, and
Williams Energy Marketing and Trading Company

California Independent System Operator Corporation,
California Electricity Oversight Board,
Public Utilities Commission of the State of California, and
San Diego Gas & Electric Company

v. Docket No. EL03-22-001

Cabrillo Power I LLC

ORDER DENYING REHEARING

(Issued August 2, 2005)

1. On July 5, 2005, the California Independent System Operator Corporation (CAISO), Pacific Gas and Electric Co. (PG&E), Southern California Edison Company (SoCal Edison), San Diego Gas and Electric Company (SDG&E), the California Electricity Oversight Board (Oversight Board), and the California Public Utilities Commission (California Commission) (collectively, Complainants) filed a request for rehearing of the Commission's June 3, 2005 Order in this proceeding. *California Independent System Operator Corporation v. Cabrillo Power I, LLC,* 111 FERC ¶ 61,358 (2005)(June 3 Order). In the June 3 Order, the Commission dismissed two complaints

filed by the Complainants[1] seeking to have the conclusions reached in an Initial Decision[2] regarding one component of rates for "reliability must-run" (RMR) service at three power plants,[3] applied to other RMR units in California. The component that the Complainants urged the Commission to investigate is the Fixed Option Payments for RMR units operating under what is called Condition 1.[4] Complainants had reached settlements with the owners of all other RMR units in California concerning all aspects of the rates for their RMR units. Eighteen months later, however, after the issuance of the RMR Initial Decision, Complainants sought to have the Commission find that those settlements were unjust and unreasonable based on the RMR Initial Decision.

2. Following the Commission's acceptance of a settlement agreement that resolved all issues concerning the rates for the Mirant RMR units and the termination of the dockets involved in the RMR Initial Decision without addressing the Initial Decision,[5] the Commission dismissed the complaints. The June 3 Order, dismissing the complaints, was based on the Commission's finding that the RMR Initial Decision provided no basis on which to initiate an investigation into the justness and reasonableness of the Fixed Option Payments for RMR units in California operating under Condition 1.

3. On rehearing, the Complainants argue that in the June 3 Order the Commission inaccurately described the basis of the complaints, and based on that erroneous description dismissed the complaints. As discussed below, we will deny rehearing.

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[1] In Docket No. EL02-15-000, the other complainants were: California Electricity Oversight Board, Public Utilities Commission of the State of California, Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E) and Southern California Edison Company (SoCal Edison). In Docket No. EL03-22-000, the other complainants were the California Oversight Board, the Public Utilities Commission of the State of California, and SDG&E.

[2] *Pacific Gas and Electric Company*, 91 FERC ¶ 63,008 (2000) (RMR Initial Decision).

[3] Those three power plants are those owned by what are now Mirant Energy Delta, LLC and Mirant Energy Portero, LLC and are referred to in this order as the Mirant RMR facilities or the Mirant RMR units.

[4] Under Condition 1, an RMR unit owner is paid a certain percentage of the unit's annual fixed costs, which was the main issue in the proceeding that resulted in the RMR Initial Decision.

[5] San *Diego Gas & Electric Company v. Sellers of Energy and Ancillary Service*, 111 FERC ¶ 61,017, *reh'g denied*, 111 FERC ¶ 61,354 (2005) (*Mirant Settlement*).

Background

Origins of the RMR Contracts

4. These cases originated from the restructuring process in California. When the integrated electric systems were designed, they were designed to minimize system cost (and thus price to customers). In some cases this meant using generating units to perform tasks which are essentially transmission functions. Because of this design feature, some generating units "must run" at certain times in order to ensure system reliability. Since the beginning of the restructuring process, it has been recognized that certain generating units because of their location and the configuration of the transmission system, are still needed to provide energy and ancillary services during certain hours to assure the reliable operation of the CAISO grid. These certain units are called RMR units. The underlying purpose of the RMR contracts was to assure that the CAISO would be able to call upon the RMR units when it needs them for reliability purposes to manage intra-zonal congestion and that their owners would not be able to exercise market power by withholding the RMR units' output.

5. After years of negotiation, the parties representing a broad cross section of affected interests, including all of the complainants and respondents in these complaints, as well as the parties involved in the RMR Initial Decision, reached a partial settlement (1999 settlement).[6] That 1999 settlement established a *pro forma* tariff governing the terms and conditions under which RMR services are provided. The *pro forma* tariff is structured to include a payment structure consisting of monthly availability payments to recover a percentage of the fixed costs of operation of the RMR facilities.

6. The 1999 settlement provides that RMR units may select to operate under one of two conditions -- Condition 1 or Condition 2. Under Condition 1, the RMR unit owner is paid a combination of several different rates. First, they are paid for their variable costs and for prepaid start-ups. Second, they are paid a Monthly Option Payment which, as detailed in Schedule B of the RMR Agreement, is the sum of the Monthly Availability Payment and Monthly Surcharge, less any Monthly Nonperformance Penalty.

7. Under Condition 1, an RMR unit owner is paid a certain percentage of the unit's annual fixed costs, which was the main issue in the proceeding that resulted in the RMR Initial Decision. The Fixed Option Payment is the maximum allowable Monthly Availability Payment summed over the twelve months of the year. This term does not appear in the RMR Contract itself, only in a stipulation that was part of the 1999 settlement. Participants propose Fixed Option Payments in the form of Fixed Option Payment Factors (FOPFs). The FOPF can be calculated by dividing the Annual Fixed Revenue Requirement (that was determined for each RMR facility in the 1999

[6] *Southern California Edison Company*, 87 FERC ¶ 61,250 (1999).

Settlement) by the Fixed Option Payment. If an RMR unit is available for ISO dispatch up to its Maximum Net Dependable Capacity for all of its Target Available Hours for the year, its Fixed Option Payment will equal the sum of its Monthly Availability Payments. Under the currently-effective RMR Agreements, the owner of a Condition 1 unit retains all revenues earned in the competitive markets for energy and ancillary services. None of these revenues is credited back to the ISO.

8. Alternatively, RMR generators can elect to operate under Condition 2. Under this alternative, the ISO pays 100 percent of the unit's fixed costs (assuming target availability), and the owner is not allowed to use the unit's capacity in the competitive markets for the owner's benefit. However, when the ISO dispatches the unit for reliability purposes, the owner *must* bid all capacity above that dispatched by the ISO into subsequent energy and ancillary services markets at prices determined by formulas in the contract, and the resulting market revenues are credited to the ISO.

9. In a series of settlements entered into in late 1999 and early 2000, further agreements were reached concerning the Fixed Option Payment at various RMR units.[7] The only units concerning which parties did not reach settlement were the Mirant facilities. The Mirant facilities litigated the Fixed Option Payment. All other California RMR units had negotiated settlements with FOPFs ranging from 20 to 50 percent.[8] The Mirant facilities sought FOPFs between 67 and 97 percent. That litigation resulted in the RMR Initial Decision. In the Initial Decision the judge concluded that the Fixed Option Payment for the Mirant facilities should be determined using a net incremental cost methodology.[9] Under a net incremental cost methodology, the FOPF for the Mirant RMR units would have been approximately 2.7 percent. Following issuance of the RMR Initial Decision, most RMR units exercised the option, if contractually available, to operate under Condition 2 (assuring that the unit would receive 100 percent of its fixed costs).

[7] *See, e.g., Geysers Power Company, LLC*, 90 FERC ¶ 61,096 (2000); *Southern California Edison Company*, 90 FERC ¶ 61,091 (2000), *Pacific Gas and Electric Company,* 90 FERC ¶ 61,023 (2000), *Duke Energy Moss Landing, LLC*, 90 FERC ¶61,073 (2000), *Cabrillo Power I LLC and Cabrillo Power II LLC*, 92 FERC ¶ 61,116 (2000), and *Duke Energy South Bay LLC*, 92 FERC ¶ 61, 155 (2000).

[8] These settlements were reached during the litigation process.

[9] Net incremental costs are the actual costs incurred by RMR unit owners as a result of RMR dispatches. *RMR Initial Decision*, 91 FERC at 65,113 n.25. Net incremental costs are calculated by subtracting any benefits that an RMR unit owner would not have realized in the absence of RMR dispatches from the total (gross) cost of the dispatches. *Id.*

Discussion

10. On rehearing Complaints argue that "the Commission erred in concluding that the Complainants sought to have the Commission find the rates from the April 1999 Settlement unjust and unreasonable '*based on the [Mirant] Initial decision*.' The determination incorrectly characterizes the basis for the Complainants' requested relief."[10] Complainants argue that their complaint, rather than being based on the RMR Initial Decision, was based on its rights under sections 205 and 206 of the Federal Power Act (FPA).[11] Complainants also argue that they have an independent right under section 206 of the FPA, without regard to the RMR Initial Decision, to have the Commission determine "the proper Fixed Option Payment."[12] On rehearing, Complainants suggest that the "proper" Fixed Option Payment would be based on the net incremental cost methodology (that was adopted by the judge in the RMR Initial Decision). Complainants claim that the complaints made sufficient allegations that the Fixed Option Payment must be based on net incremental costs to require a Commission investigation concerning whether the rates Complainants previously agreed to are unjust and unreasonable. Complainants ask the Commission to set the issues raised in the complaints for hearing; Complainants suggest that to the extent that the Commission has found that the differences among the RMR contracts preclude a generic approach, the proper course of action would be to sever the proceedings for individualized consideration, not to dismiss the complaints.

11. We will deny rehearing. Complainants argue that the Commission wrongly characterized the complaints as being based on the RMR Initial Decision. Our review of those complaints indicates to us that we did not wrongly characterize the complaints. Indeed, in the opening paragraph of the first complaint (filed in Docket No. EL02-15-000) the Complaints ask the Commission to investigate, under section 206 of the FPA,[13] the Fixed Option Payment solely on the basis of the RMR Initial Decision, saying,

> Because the issue of how properly to calculate the Fixed Option Payment under the RMR contracts is currently pending before the Commission on

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[10] Rehearing at 3.

[11] 16 U.S.C. §§ 824d, 824e (2000).

[12] *Id.* at 3-4.

[13] 16 U.S.C. § 824e (2000).

exceptions in Docket Nos. ER98-495-000, *et al*., the Commission should set a refund effective date of January 1, 2002 and defer further action herein until it has ruled on the exceptions in those dockets.[[14]]

12. In the complaint in Docket No. EL02-15-000[15] the first mention of the "net incremental cost" method to calculate the Fixed Option Payment was made by direct reference to the RMR Initial Decision.[16] Complainants stated that the judge had adopted the "net incremental cost method" to calculate the Fixed Option Payment in the RMR Initial Decision. The allegation of the complaint was that the Fixed Option Payments currently in effect under the owner-specific settlement exceed the levels allowable under the net incremental cost method, and to that extent, were unjust and unreasonable. The Complainants concluded that the Commission should establish a refund effective date, and then should hold the proceeding in abeyance until it acted on the exceptions to the RMR Initial Decision, "so that [the Commission's] decision there can provide guidance for the parties and the designated administrative law judges in adjusting the Fixed Option Payment."[17]

13. In the complaint in Docket No. EL02-15-000, all recitations of how to calculate the Fixed Option Payment reference the RMR Initial Decision. Indeed, the complaint repeatedly refers to testimony before the law judge in the proceeding that resulted in the RMR Initial Decision[18] and incorporates by reference the testimony submitted in that proceeding.[19] It is true that attached to the complaint was additional testimony by analysts from PG&E, SDG&E and SoCal Edison. Each of those analysts recited that the purpose of his/her testimony was to consider whether the effective Fixed Option

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[14] Complaint in Docket No. EL02-15-000 at 2.

[15] The complaint in Docket No. EL03-22-000 states that its purpose is to assure that the relief granted in Docket No. EL02-15-000 will apply to an additional generation unit at the time of its designation as an RMR unit; the complaint incorporates by reference the complaint in Docket No. EL02-15-000 and adds no additional support for the relief requested.

[16] *Id.* at 3-4.

[17] *Id.* at 4.

[18] *Id.* at 16-20.

[19] Appendix D to the complaint in Docket No. EL02-15-000. We note that some of that testimony was submitted with respect to RMR units other than the Mirant units; those other units subsequently settled the Fixed Option Payment and it is the rates agreed to in those settlements that Complainants now challenge.

Payments for RMR units in the relevant utility's service territory "exceed the amount that would be payable under the "net incremental cost" method advocated by PG&E, and adopted by the Presiding Administrative Law Judge in [the RMR Initial Decision.]"[20]

14. The timing of the rates complaints also confirms that they are based on the RMR Initial Decision. As we discussed above, the determination of the Fixed Option Payment and the FOPF was the culmination of a long process. The basic structure for RMR contracts was first determined through negotiations that were approved by the Commission in the 1999 Settlement. Following the 1999 Settlement the parties to the contracts addressed the Fixed Option Payment for each unit. As noted above, the Fixed Option Payments for all units except the Mirant units were determined by settlement during 1999 and 2000.[21] The agreements provided for FOPF of 20 to 50 percent.

15. Nevertheless, after the RMR Initial Decision issued, Complainants filed in these proceedings seeking application of the methodology embraced by the administrative law judge in order to overturn the settlements to which they had agreed. The methodology embraced by the judge permitted RMR units to receive a Fixed Option Payment that consisted only of the net incremental costs associated with the RMR units, and was based on the premise that RMR units operating under Condition 1 were not providing a service that was entitled to a more traditional recovery of costs and a return on investment.[22] Under the methodology advocated by the administrative law judge, the FOPF would have been approximately 2.7 percent. The only thing that had changed since the parties had advocated approval of the settlements that resulted in the FOPFs of 20 to 50 percent, and the filing of the complaint seeking a much lower FOPF, was the issuance of the RMR Initial Decision.

16. We conclude that we correctly characterized the complaints filed in these dockets as asking to have the conclusions reached in the RMR Initial Decision applied to other RMR units in California. Furthermore, the Complainants are incorrect that the proper course of action would have been to sever the proceedings for individualized consideration. We find that the proper course of action was to dismiss these complaints upon the termination of the Mirant RMR proceedings. In the *Mirant Settlement*, [23] the Commission terminated the Mirant RMR proceedings upon a finding the settlement

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[20] Appendix E to the complaint in Docket No. EL02-15-000. Appendices F and G contain similar recitations.

[21] Some of the settlements were reached during the course of litigation of the Fixed Option Payments.

[22] *RMR Initial Decision*, 91 FERC at 65,111-65,115.

[23] 111 FERC ¶ 61,354 at P 19-25,

resolved all claims with respect to the Mirant Parties that are addressed in the RMR Initial Decision and that all issues addressed in the RMR Initial Decision were thus moot. The proceedings were moot because the parties agreed that Mirant would be paid Condition 2 rates, not Condition 1 rates. The Commission further stated its intent not to issue an advisory opinion based on the RMR Initial Decision. The Commission stated that it never intended that generic Commission policy concerning RMR issues was to be set in the Mirant RMR proceedings and that the RMR Initial Decision was simply immaterial to any other RMR contract. Simply stated, the proceedings that resulted in the RMR Initial Decision were not intended to set generic Commission policy and the RMR Initial Decision cannot provide the basis for an investigation into the Fixed Option Payment for all other RMR units in California. The Fixed Option Payment for all other RMR units in California have been set by settlements, and the complaints have not supported their allegations that the settlements that they previously supported are now "unjust and unreasonable, unduly discriminatory or preferential" as required by section 206 of the FPA. Complainants have not carried their burden of proof under section 206.

The Commission orders:

Rehearing is hereby denied as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.