

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Integrate Procurement
Policies and Consider Long-Term Procurement Plans.

Rulemaking 06-02-013
(Filed February 16, 2006)

**WORKSHOP ON ENERGY AUCTION PROPOSALS
WESTERN POWER TRADING FORUM SUMMARY OF
ENERGY AUCTION TASKFORCE MEETING
HELD ON AUGUST 25, 2006**

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**WPTF¹ Summary
of Energy Auction Taskforce Meeting
Held on August 25, 2006**

BACKGROUND:

The recently issued CPUC order on Long-term procurement directs SCE and PGE to conduct RFOs to secure 1500 and 2200 MW respectively of new generation. The order also permits the utilities to pass through the costs of the approved new generation to all retail customers – bundled and unbundled – within their territories as long as they conduct an energy auction that allows market participants to bid for the energy output of the new generation. The purpose of the energy auction is to ensure the value of the energy output of the new generation facilities for which consumers are paying is fully optimized so that the socialized residual capacity payment can be minimized. Alternatively, the IOUs may elect to charge only bundled and future departing-load customers (as of the time the new generation commitments are approved), consistent with D.04-12-048, in which case they need not conduct an energy auction.

As the energy auction represents a significant modification to energy management practices of the utilities, and because there is little to no precedent for such auctions in California, on Friday, August 25, 2006, members of WPTF, California's investor owned utilities, and several guests (e.g., Energy Service Provider company) met in Los Angeles to discuss the elements of an energy auction and how it could be implemented.

Through open discussion at the August 25th meeting, the twenty or so participants focused on defining the energy product to be auctioned rather than definitions of the auction process itself. It was the consensus of the group, especially representatives of the financial institutions, that the energy product definition was an essential element in creating an auction process from which they could derive value and, in turn, could reduce RA costs to consumers.

Therefore, this WPTF report summarizes the definitions of the energy products to be auctioned that emerged from the discussion at the above referenced meeting. This document is a work in progress, intended to allow meeting participants review the

¹ WPTF stands for the Western Power Trading Forum. WPTF is a trade association comprised largely of parties who are competitors and we are permitted to join together in cooperative regulatory ventures pursuant to a chain of legal cases that offer certain protections under what is known as the Noerr-Pennington doctrine. It basically holds that efforts to get government (legislative, executive, judicial or administrative regulatory bodies) to act in ways favorable to the membership are generally exempt from the proscriptions of the antitrust laws.

As a rule, trade associations by their nature (generally composed of competitors) are subject to close scrutiny under the antitrust laws. Accordingly, associations should operate under careful guidelines that steer them clear of conduct that would run afoul of the antitrust laws. Therefore, before the meeting held in Los Angeles on August 25, 2006, Gary Ackerman, Executive Director of WPTF made a point of reminding attendees that they were here to discuss cooperative regulatory matters and that any discussion of price or other market-sensitive information would not be allowed.

material, ask questions, and through exchange of ideas expand the understanding of the details associated with conducting an energy auction as directed in the Order.

LIST OF PRODUCT ATTRIBUTES:

As noted above, the group discussed a wide variety of energy products that could be included in the energy auctions. For the purposes of the discussion, the “utility” is the entity selling the energy product, the “buying entity” can be either a marketer or an LSE, and the “generator” is the generator selling under a long-term contract to the utility. The group developed the following framework to define each particular energy product, and to identify some implementation issues associated with each:

1. Name of energy product to be auctioned
2. General description
 - a. Unit contingent, or Firm
 - b. Day-ahead dispatch/call rights, real-time dispatch/call rights, or both
 - c. Fixed or flexible quantity nomination for (b)
3. How are the energy product rights transferred to the buying entity when the underlying contract is between the utility and the generator?
4. Which party in (3) is the scheduling coordinator responsible for balancing schedules?
5. Which party is the fuel manager?
6. What is the likely term(s) of the offering?
7. Main delivery point, and optional delivery points
8. Which party provides to the generating plant dispatch instructions and has dispatch control?
9. What are the credit implications on the buyer, the seller, and the generator?
10. What are the residual risks, besides credit related risks, to the seller from auctioning off the energy?
11. What are the expected costs and level of complexity to close the energy auction transaction?
12. What are the utility accounting requirements imposed by the product being auctioned?

Since this document is a work in progress, not all twelve descriptors are known presently for each product. However, it is the hope of the parties working together on this effort to provide as much information as possible on all descriptors for every product. Eventually, the group believes that a matrix of products and descriptors can be developed for quick reference. At this time, however, it is necessary to use a text description because much of the needed information is incomplete, and a matrix may be too sparse to be useful.

ENERGY AUCTION PRODUCTS

A) Standard Products - Unit Contingent

The selling utility will sell a standard, Unit Contingent energy product with a daily call right based on a pre-determined contract heat rate and index gas price. Because it is Unit Contingent, the obligation of the selling utility to deliver to the buyer is based on the underlying generation unit being either wholly or partially available. This is a fixed quantity offer for standard products that are known in the industry as (number of days per week and number of hours per day) 7 x 24, 6 x 16, super-peak, etc. The offering utility will tender bids for limited term, for example two-year, three-year, or five-year in duration. The utility is the scheduling coordinator, fuel manager, and provides the dispatch instructions to the plant operations manager. Delivery could either be at the busbar, or at a Hub, such as EZGen.

B) Standard Products – Firm

Same as (A), above, except the utility guarantees either energy delivery or payment of liquidated damages in the event the underlying generation unit is unable to produce the scheduled quantity. Because performance under the contract will continue even though the underlying generation facility is out of service, this firm product requires that the utility commit its own portfolio or financial backing to provide liquidated-damage coverage².

A') Standard Products - Unit Contingent with Shaping

Same as (A), above, except the buyer is able to adjust the hourly delivery quantities (i.e., shape) either on a day-ahead, or hour-ahead basis.

B') Standard Products - Firm with Shaping

Same as (B), above, except the buyer is able to adjust the hourly delivery quantities (i.e., shape) either on a day-ahead, or hour-ahead basis.

C) Back-to-Back Toll

The buying entity enters into a “tolling” contract with the utility that has the same dispatch rights (and penalty provisions) as the underlying tolling arrangement between the utility and the generator. The utility and the generator are still the counterparties for the original, underlying contract. Under this arrangement, the utility appoints the buying entity as its agent so that the buying entity can directly interface with the generator for items such as generation dispatch. The buying entity may also provide gas to the utility, which will then simultaneously provide it to the generator. The “toll” between the utility and the buying entity may be either for the full term of the Utility/PPA, or some sub-period. Delivery is likely at the busbar³.

² SCE notes that this essentially results in bundled customers subsidizing all wires customers. If a bank were to offer this “firming service”, then they would charge a fee for assuming the risk. What benefit do bundled customers get for auctioning this product? The product auctioned should be a subset of the product purchased by the utility from the new generation facility.

³ Citibank notes that banking regulations for it and other Bank Holding Companies (BHC) (e.g., Barclays Capital, JPMorgan Chase) cannot take nor give the appearance of taking direct control of an operating asset. Therefore, the Back-to-Back Toll utilizing the buyer as the utility’s agent would make it impossible

D) Synthetic Toll

Same as (C) above, except the agreement between the utility and the buying entity mimics the underlying toll between the utility and generator through a set of call options at different strike prices that results in the same dispatch outcome as if the buying entity had dispatch rights instead of call options. In this product, the utility retains all ancillary service capability of the generating units, which will be accounted for through the Joint-Parties proposal. This product may work well with peakers that have a quick start time and lower heat-rate variability due to operating level.

E) Full Assignment of PPA

Winning bidder assumes entire PPA contract from utility with approvals from project lender(s), and generation-asset owner, likely for the full duration of the PPA. Delivery is likely at the busbar.

F) Portfolio

The winning bidders contract with the utility to take product (A) from two or more generating units that are under PPAs with the utility. Here the utility “bundles” multiple units together to reduce the risk associated with the unit contingency of the standard products.

OTHER ISSUES

Other issues were raised at the meeting including: (i) the impact of the Commission’s order on the pending PG&E contracts; (ii) auction design; and (iii) auction competitiveness. As the meeting participants focused on product identification, we expect to provide input on the remaining issues as the process moves forward. The participants believe that all such issues can be satisfactorily resolved and looked forward to addressing them in the near future.

1. PG&E RFO:

PG&E recently executed five PPAs to which the energy auction would apply were PG&E to elect to recover costs from all benefiting customers, bundled and unbundled. Thus, PG&E is seeking as much clarity as possible about how an energy auction would work, and raised particular concerns about the following issues

- a. Will PG&E be taking on additional credit risk as a result of having an additional third party contract?
- b. Will PG&E be taking on additional liability risks to compensate the third party energy auction winners if the unit owner defaults?

for the BHCs to participate in the auction for this product. The BHCs would prefer a two-pass system for dispatch instructions whereby the buyer informs the utility of its dispatch decisions, and the utility passes the dispatch instructions along to the generator. Others in the group were concerned that a two-pass system could be complicated, and lead to mistakes and other liabilities that would involve costly litigation. Hence, the Synthetic Toll, Product D, was developed so that BHCs can participate along with the other financial institutions.

- c. How will it be determined if the energy auction process was competitive.
- d. What are the implications for PG&E energy purchases if the energy output of the RFO facilities is sold elsewhere?
- e. Are the incremental transactions costs associated with the energy auction recoverable and justifiable?

2. Energy Auction Competitiveness

In the absence of an energy auction deemed competitive subject to concurrence by the CPUC, or to the extent the energy auction results in residual output from the generating units that has not been auctioned, the value of the energy output of the facility committed through the RFO would be flowed through to customers based on spot energy clearing prices. The energy auction is intended transfer energy price risk to individual market participants thereby providing higher value for the energy output so as to minimize the non-bypassable charges to be assessed to all bundled and unbundled customers. A concern, however, has been raised as to how to determine whether the auction process itself was competitive, and whether the auction results actually represent a higher value for the energy output than spot pricing would achieve. The participants in the meeting acknowledged that for an auction process to create the maximum amount of interest by bidders, and therefore the maximum amount of competition, the bid evaluation process must be transparent and the circumstances under which the bid process and results could be rejected due to concerns about its competitiveness must be well understood by potential bidders in advance of the auction.