BEFORE THE PUBLIC UTILITIES COMMISSION OF THE

STATE OF CALIFORNIA

Order Instituting Rulemaking into Implementation of Public Utilities Code Section 390	)))	Rulemaking 99-11-022

REPLY COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) ON PROPOSED DECISION OF COMMISSIONER NEEPER CONCERNING PHASE I ISSUES

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Many QF Parties take issue with the PD's essential finding that there is capacity value in the PX market-clearing price, contending that the PD has "misused the term 'capacity.'"[1] The comments offered in support of this position simply reiterate arguments previously made and properly rejected by the PD. They also defy common sense and logic. As almost every party has conceded, and as the PD correctly finds, the market-clearing price referenced in § 390 was always intended to be an "all-in" price that reflects the value of both energy and capacity.[2] For this reason, § 390(d) prohibits paying the capacity value in the clearing price to QFs that receive fixed capacity payments. The PD also correctly finds that QFs that do not receive such capacity payments should be paid the *full* clearing price, but should not receive an additional capacity payment. It would be incongruous to find that, although the market-clearing price often contains capacity value for some QFs, the very same market prices do not include capacity value for others.

As the PD accurately observes, "no credible expert" could contend that today's inflated PX prices do not reflect non-energy values, including capacity value, and it is therefore not surprising that the QF Parties have failed to locate an expert witness willing to make such an assertion. Instead, CAC, IEP and others must revert to a rigid interpretation of § 390(d) to claim the absence of capacity value. Rather than establishing the absence of capacity value, however, this line of argument illustrates that the definition of capacity value in § 390 fails to work in practice. Accepting that the value of capacity is zero because § 390(d) says it is elevates form over substance and ignores the uncontroverted record evidence. The better view, as advocated by SCE and adopted by the PD, is that the zero value consistently yielded by Section 390(d) establishes that § 390(d) doesn't perform its intended function of eliminating capacity value from the PX clearing price.

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[1] *See, e.g.* CAC at 3-5; IEP at 1-2.

[2] Non-QF generators selling into the PX must, of course, recover both variable and fixed operating costs from the market-clearing price, plus a profit element.

Under these circumstances, the PD's preference for using an equal weighting of the ISO's day-ahead market-clearing price for spinning reserve and non-spinning reserve ("Spin/Non-Spin") as a proxy to determine capacity value is reasonable. PD at 21. The ISO uses these ancillary services markets to maintain its required operating reserve margins at a total prescribed level of 7% of load. Generators bidding into these markets essentially make two different bids – a capacity bid and an energy bid. PD at 19; TR (Stern) at 427-8. The first bid is the generator's price for providing Spin/Non-Spin reserve. Since the purpose of the Spin/Non-Spin is to hold in "reserve" a prescribed amount of generating capability (such reserves being required in the event of unanticipated generator outages or increases in electrical load), the capacity payment represents the sole compensation to the generator in most hours.[3] A prudent bidder doesn't normally expect to produce energy, and a rational bidder can be expected to bid just less than its fixed costs. Therefore, the ancillary services market price is a reasonable, albeit systemically low, proxy for capacity.[4]

Ironically, the only QF Party to question the merits of the PD's preferred subtracter methodology is CCC, which initially proposed the ancillary services market prices as a reasonable proxy for capacity value.[5] CCC argues that a Spin/Non-Spin subtracter cannot be used to derive an energy value from the PX day-ahead price because the PX price and the ISO real-time price are roughly equivalent and bidders in the ancillary services market receive both the real-time energy price and the value of the 50/50 subtracter. CCC at 5. This argument is based on flawed facts, assumptions and logic, and it should be rejected. First, there is no record support whatever for CCC's contention that the PX day-ahead price and the ISO real time price are equivalent in those instances in which the ISO has dispatched Spin/Non-Spin providers to

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[3] The second bid is a "strike" price for energy. In the event that the ISO dispatches the generator to produce energy, the generator receives a payment both for providing spinning or non-spinning reserves and for energy, based on the ISO's real-time price.

[4] *See, Annual Report on Market Issues and Performance*, at 4-15, http://caiso.com/docs/2000/07/27/2000072710233117407.html

[5] PD at 21. A number of the QF Parties object to the PD's discussion of the 50/50 Spin/Non-spin subtracter as being "dictum" contending that the Commission lacks discretion to define capacity other than as provided in the second sentence of Section 390(d), regardless of whether that definition yields an absurd result. The Commission's discretion is not so limited. SCE Opening Brief *passim*. Furthermore, the PD's discussion of capacity value, as well as its preferred alternative for extracting that value, are appropriate. *See Delta Dental v. Mendoza* 139 F.3d 1289, 1296 (9th Cir. 1998).

produce energy.[6] Second, a bidder in the ancillary services market receives an energy payment in addition to the capacity payment *only on the rare occasions that it is dispatched,* and even in those rare instances, only a limited amount of the reserve generation is actually dispatched.[7]

CCC also contends that adopting the Spin/Non-Spin subtracter may result in some QFs receiving $0 or even negative amounts in hours when "generation is needed most," but the data provided by CCC do not support its argument.[8] At best CCC has shown that in a limited number of hours in August, 2000, the 50/50 subtracter value exceeded the PX clearing price. Application of the subtracter in August, however, would have resulted in only an average 23% reduction in the PX day-ahead clearing price. In stating its preferred approach to valuing capacity, the PD recognized that, based on CCC's data, the subtracter could reduce the PX price by between 12% and 59%, a significant range. PD at 21. CCC's argument merely shows that the hourly range might be even greater in a limited number of hours given recent market conditions, but it does not invalidate the proposed methodology in principle. CCC's focus on a few hours ignores that the *net* effect of the methodology is a modest discount to the PX price even in the volatile month of August, 2000.

CCC's claim that application of the methodology will send an inverted price signal to QFs in some on-peak hours also fails to take into account the substantial fixed capacity payments that are simultaneously received by the QFs that would be subject to the subtracter. Those payments create a significant inducement to generate regardless of the price for energy. When

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[6] CCC relies on Dr. Shelhorse's rebuttal testimony that the *average* PX-day-ahead and ISO real-time prices have tended to equilibrate; Both Dr. Shelhorse and CCC witness Beach agree that there are "significant deviations" in any given hour. Ex. 54, p. 8.

[7] This occurs either when (1) the volume Spin/Non-Spin needed to meet the ISO's percentage margin requirements is lower than forecast, or (2) in system emergencies. SCE is prepared to present evidence that the number of hours in which bidders in the ancillary services market have been dispatched has been statistically insignificant, and that only a small percentage of generation was actually dispatched in such hours, thus showing that no meaningful obstacle exists to the PD's preferred capacity subtracter methodology.

[8] Cite to CCC. CCC purports to show ISO ancillary service market prices for August, 2000. CCC's reliance on this data is troublesome given its recent contention that there is no "value in updating the comparison exhibits." Joint Response of CCC, et al. to PG&E's Petition to Set Aside Submission, etc. ("Joint Response") at 4. If the Commission intends to consider CCC's late submission, Edison is prepared to offer at least the evidence attached to this brief as Exhibit "A," comparing (i) the average SP-15 day-ahead price PX clearing price by hour in August, 2000 (ii) the average SP-15 day-ahead clearing price minus the average Spin/Non-Spin price for the same period and (iii) the result in (iii) plus the average contractual capacity payments made in the same hours; Exhibit B showing that out of 744 hours in August, application of the Spin/Non-Spin subtracter yielded negative *energy* prices in only 12 hours, and prices in the range of $0-50.00 in only 190 hours; and Exhibit "C,"

Continued on the next page

such payments are added to PX clearing prices – even adjusted by the Spin/Non-Spin subtracter – QFs remain, on average the highest paid generators in the state.[9]

Turning to the line loss issues, with the notable exception of CCC (which recognizes the merit of applying GMMs to QF payments in at least some form), all of the QF Parties criticize the PD's adoption of GMMs. The principal arguments leveled against GMMs are that there is insufficient record support for adopting them and that they would violate PURPA. Both of these arguments lack merit. In its testimony and briefs, SCE showed that the unit cost of purchasing energy in the PX is different (and in almost all cases considerably lower) than the unit cost of purchasing a like amount of energy from a QF at PX prices if GMMs are not applied to the payment to the QF.[10] Despite two days of hearings and hundreds of pages of testimony, briefs and comments on line loss issues, no QF Party has persuasively refuted the lesson taught by SCE's hypothetical. Caithness argues that GMMs are not absolutely perfect. No methodology applied to a complex system, however, could ever achieve this standard, and certainly the asserted lack of pinpoint precision does not justify retaining a far less precise methodology that systematically overpays QFs. The QF Parties also fail to establish that GMMs are contrary to PURPA. Caithness, for example, argues that GMMs violate PURPA because they reflect *ISO* system losses, not *utility* system losses, but the federal implementing regulations do not make this distinction, instead comparing the cost of buying QF power with the cost of buying it elsewhere.[11] Because the alternative source, in this case the PX, uses GMMs to adjust payments, QF payments must likewise be adjusted to achieve ratepayer indifference.[12]

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showing the application of the subtracter to combined energy and capacity payments on a typical day in July, 2000 (used as a demonstrative exhibit at oral argument).

[9] Firm capacity QFs realize about $280 MWh for capacity in summer on-peak hours, but even averaged over all hours, the capacity payment is about $58/MWh. As Exhibit A shows, taking this capacity payment into account results in an all-in payment (after subtracting the Spin/Non-Spin value of capacity) of $161/MWh to QFs receiving such payments compared to the average price of $153/MWh paid to non-QF generators for the same period.

[10] The section of SCE's brief quoting and discussing this hypothetical is attached for the Commission's convenience as Exhibit "D."

[11] FERC's regulations require that in setting avoided cost, the Commission must, "to the extent practicable," take into account "the *costs* or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing utility had . . . purchased an equivalent amount of electric energy. . . ." 18 CFR 292.304(e)(4) (emphasis supplied).

[12] Lack of space compels SCE also to rely on and join ORA's Reply Comments concerning line loss issues.

Finally, the Commission should reject requests to delay its Phase I decision. Contrary to earlier assertions that "this proceeding should proceed rapidly to a Proposed Decision and Commission Resolution,"[13] some parties now contend that the *entire* Rulemaking must be delayed because the market is "out of whack."[14] While SCE agrees that there are serious concerns about the market's functionality, these concerns should be addressed in Phase II.[15]

Respectfully submitted,

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[13] Joint Response, at 4.

[14] Enron, at 4; SeaWest, at 4; FPL, at 2-5.

[15] Section 390 does not require that the Commission find that the market is "functioning properly" in all respects, but only for the purpose of setting SRAC. PD, at 34. The PD's proposed "functioning properly" criteria fail to meet this standard only insofar as they do not directly address the issue of market power. SCE also agrees with PG&E that eliminating the true-up at this time is unreasonable given the PD's recognition that Section 390(d) does not properly account for the value of capacity in the clearing price. PG&E, at 4-6. Indeed, if, as Caithness asserts, the market is not "functioning properly" for *any* purpose, how can the Section 390(d) formula be applied literally *without* retaining the true-up? Caithness, at 1.

CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true copy of **REPLY COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) ON PROPOSED DECISION OF COMMISSIONER NEEPER CONCERNING PHASE I ISSUES** on all parties identified on the attached service list. Service was effected by means indicated below:

X Placing the copies in properly addressed sealed envelopes and depositing such envelopes in the United States mail with first-class postage prepaid (Via First Class Mail);

☐ Placing the copies in sealed envelopes and causing such envelopes to be delivered by hand to the offices of each addressee (Via Courier);

X Transmitting the copies via facsimile, modem, or other electronic means (Via Electronic Means).

Executed this **13th day of October, 2000**, at Rosemead, California.

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October 13, 2000

Docket Clerk
California Public Utilities Commission
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RE: RULEMAKING 99-11-022

Dear Docket Clerk:

Enclosed for filing with the Commission are the original and five copies of the **REPLY COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) ON PROPOSED DECISION OF COMMISSIONER NEEPER CONCERNING PHASE I ISSUES** in the above-referenced proceeding.

We request that a copy of this document be file-stamped and returned for our records. A self-addressed, stamped envelope is enclosed for your convenience.

Your courtesy in this matter is appreciated.

Very truly yours,

James B. Woodruff

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Enclosures

cc: All Parties of Record
(U 338-E)