

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

Order Instituting Rulemaking to Consider	)	
Refinements to and Further Development of the	)	R.05-12-013
<u>Commission's Resource Adequacy Program.</u>	)	

**SUBMISSION OF TRADABLE CAPACITY PRODUCT WORKSHOP REPORT OF  
SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E)**

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Pursuant to the direction of Energy Division staffers, Southern California Edison Company ("SCE") submits this Workshop Report on the Tradable Capacity Product workshop held March 27, 2006 by the California Public Utilities Commission ("CPUC"). Parties may comment on the Workshop Report, attached hereto as Appendix A pursuant to the schedule set forth in the e-mail entitled "R.05-12-013—Remaining Schedule in Local Resource Adequacy Requirements Phase 1."

Respectfully submitted,

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# Appendix A

**Workshop Report on  
Tradable Capacity Product Issues  
Relevant to Phase 1 of R.05-012-013**

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## **I. Workshop Objective**

The California Public Utilities Commission (CPUC) hosted a workshop on March 27, 2006 to discuss certain regulatory issues parties believed needed resolution in the near term in order to facilitate the development of tradable capacity products. Issues listed below were identified by parties as (1) potential barriers to contracting for resource adequacy products; (2) needing resolution at the CPUC in the near term; and (3) having one or more potential solutions. These issues were discussed at the workshop on March 27, 2006 and the following sections reflect consensus solutions reached, or the solutions/options available for consideration. Parties may comment on this Workshop Report and any other relevant issues by April 18, 2006. Reply comments will be due April 25, 2006. Note that as volunteers prepared this Workshop Report, it may not reflect all opinions or solutions raised at the March 27 workshop. Accordingly, parties should feel free to use their comments to elaborate on issues or solutions they believe are not reflected herein and which could be of assistance in the CPUC's deliberation on these issues.

Many of the issues outlined below are inherent in a bundled product typically transacted in the California market. However, clarification around these issues is important for an unbundled capacity product because the only value of this product is derived from the Resource Adequacy (RA) eligibility (i.e., countability) of the transaction versus the other benefits associated with a product that may also include energy or ancillary services components as well. A tradable bilateral capacity product should provide a more efficient means to achieve RA compliance, especially for smaller load serving entities (LSEs). Parties believe that timely resolution of these issues will facilitate the evolution of a standardized product(s) and facilitate transactions of such product(s).

## **II. Background**

SCE and others market participants recommended that a workshop be initiated through the R.05-12-013 docket as a result of three separate specific events.

First, SCE has been conducting a series of conference calls among market participants to discuss issues related to resource adequacy transaction confirmation language.<sup>1</sup>

The emphasis of this effort has been on developing a commercially acceptable sharing of risks between the buyer and seller of such product(s) given the current state of CPUC and California Independent System Operator (CAISO) requirements. Through this effort, key policy issues or lack of certainty regarding potential CPUC or CAISO actions have been identified as potentially limiting transactions from occurring or adding a significant "risk" premium to one or both counterparties relative to the other available products in the market.

Second, market participants have now had direct experience contracting for capacity in order to achieve compliance with the system Resource Adequacy Requirements (System RAR) showings that were required on February 16, 2006. Negotiating and executing capacity

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<sup>1</sup> The end product is envisioned to be a transaction confirmation which describes the commercial arrangements of a particular transaction and is governed by a master enabling agreement, typically either an Edison Electric Institute (EEI) or Western System Power Pool (WSPP).

transactions was made more difficult, and potentially more costly than necessary, because of the lack of market rules specifying the circumstances—forced, maintenance, or planned outages—under which an LSE or the capacity supplier might be required to replace capacity that had been identified in the compliance showings.

Third, the proceeding has already had the benefit of formal comments submitted in this docket by various parties, which identify outstanding issues or regulatory rules that need to be addressed to better define the RA product and respective obligations of buyer and seller. Additionally, some issues arise because of the spectrum of common commercial relationships that can exist in the wholesale power market between generating asset owners, power marketers, investors, and LSEs that may not have been contemplated during the development of the CPUC's RAR policies.

Several parties believe that resolution of, or additional clarity regarding, these issues can bring significant value to ratepayers by increasing product options to meet RA needs and/or lowering costs through reduced risk premiums, which suppliers may require to accommodate the current uncertainty.

### **III. Definitions**

During the course of earlier discussions, it became apparent that further discussions would benefit from a common set of definitions to some additional concepts. For example, discussions about development of a “standard product” do not require development of rigid, pre-approved or mandated contract language because such rigidity could in fact hamper creative commercial arrangements. Instead, the standard product definition would outline the regulatory requirements, expectations and obligations between an LSE acquiring RA Capacity and a supplier.

In some instances, the commercial arrangement may be a stand-alone contract. In other instances, the RA Capacity may be secured through a “confirmation agreement” made pursuant to an umbrella “master enabling agreement,” such as the EEI or WSPP agreements. Development of a standard product would reduce transaction costs and also allow for the trading of capacity in secondary markets.

- A *master enabling agreement* typically contains the general commercial terms under which counterparties agree to conduct business. No transaction specific information is contained as part of this agreement. EEI and WSPP are two typical “standard” agreements that many parties use in the California markets. Although these agreements are relatively standard, the parties typically negotiate specific modifications to the standard terms to match the specific situation.
- A *transaction confirmation* contains the transaction specific information in which the parties agree. Typically, product, price, delivery point and delivery period are common minimum requirements. Depending on the transaction, the confirmation may be a relatively straightforward and simple one-page document to a very extensive description of terms and conditions required for the particular situation. The confirmation may also

contain terms such as collateral calculations, price mechanisms or other provisions that are either not defined in the master enabling agreement or need to be modified to fit the specific transaction under consideration.

## **IV. Workshop Issues**

### **Issue 1: Forced Outage Impact On Qualifying Capacity**

#### ***1.a. Description of the Issue***

Certain parties are concerned that current counting rules and proposed CAISO tariffs do not provide clarity on the effect of forced outage rates on Qualifying Capacity (QC). In addition, it is unclear if and how testing requirements and protocols will be developed and applied either related to repairs after forced outages or on a routine basis. The impact of such actions on QC is also unclear. Uncertainty in these areas may lead to suppliers not offering all available QC to market participants in anticipation of some form of “derate” once such rules are established. Uncertainty regarding treatment of QC will also affect LSEs since requiring the replacement of derated capacity would effectively require the LSE to account for forced outages twice. Additionally, with regard to scheduled outages, parties believe that so long as any scheduled outage change is approved by the CAISO pursuant to its Open Access Transmission Tariff (Tariff), the movement of the Scheduled Outage date change should not automatically trigger any replacement obligation upon the LSEs. This is notable, because often times LSEs are not aware of when generators have scheduled such outages.

#### ***1.b. Potential Solutions***

##### **1.b.i. Workshop Consensus**

***Forced Outages.*** At the March 27 workshop, there was general consensus that the CPUC must clarify the following regarding the impact of forced outages on QC. The policy for RA will be that “forced is forced” and that LSEs may rely on QC from such units in their RA compliance filings until the QC for that unit is changed (a process that is envisioned to occur once a year). In order for LSEs and others to make informed decisions regarding the products they will use in their upcoming year-ahead filings, the QC for any generator shall be established approximately 90 days before the year-ahead compliance filing is due (about July 1, 2006 for this cycle). This approach recognizes that QC is not a function of availability and that D.05-10-042 tasked the CAISO with developing performance standards for generators. Under this approach, an LSE who has claimed QC from a unit which experiences a forced outage will be able to count the QC from that unit in its RA compliance filings and will not incur any penalty or replacement obligation for that QC. This approach will essentially give LSEs the right to rely on the QC they have purchased from generators for one year, without fear of penalty or other obligation arising from forced outages within the year. For contracts greater than one year, buyers and sellers of such products would need to incorporate contractual terms which assign the risk for future changes to QC. Such an approach to forced outages will remain in force until parties and the CPUC gain further experience with forced outages and their impact on the RA program.



**Scheduled Outages.** For RA counting purposes, LSEs should use the following scheduled outage criteria. If the CAISO changes the approved schedule for a RA resource, the LSE will not be held responsible for procuring replacement capacity. However, the CAISO’s denial of an original scheduled outage request on a RA resource does not constitute a “change” in a scheduled outage, and, therefore does not warrant an exemption from replacement procurement.

<b>Scheduled Outages</b>	
<b>Time Period</b>	<b>Description of How Resource Would Count at Time of the Showing</b>
<b>Summer</b> May through September	Any month where days of scheduled outages exceed 25% of days in the month, the resource does not count for RA. If scheduled outages are less than or equal to 25% the resource does count for RA.
<b>Non-Summer Months</b>  October through April	For scheduled outages less than 1 week, the resource counts for RA.  For scheduled outages 1 week to 2 weeks, the amount counted for RA is prorated using the formula: [ 1 - (days of scheduled outage/days in month) - 0.25] * MW = RA The formula will allow resources to count between 50% and 25%.  For scheduled outages over 2 weeks, the resource does not count for RA.

## **Issue 2: Derates and Qualifying Capacity**

### **2.a. Description of Issue**

The CPUC has acknowledged that an RA resource’s QC can change over time. A major risk that must be accommodated in commercial transactions, particularly those of any meaningful duration, is the risk of capacity derates. Currently, there are no clear rules concerning when derates can occur, what notice might be provided to LSEs, the process by which the CAISO will derate a resource, and how QC can be affected by future deliverability assessments.

Imposition of QC adjustments on a regular cycle, and the potential for suppliers to lose a quantity of product they would otherwise be able to sell, provides an additional market incentive—above and beyond the existing regulatory requirements imposed by the CPUC through General Order (GO) 167—to maintain the availability of capacity.

During the workshop there was extensive discussion regarding CAISO’s need to potentially adjust a supplier’s QC levels based upon an established or ongoing loss of capacity (or recovery of capacity based on maintenance or capital additions). Similarly, buyers and sellers have a commercial need to know, in advance, what QC adjustments will be made so that the supplier or buyer can determine if replacement capacity is or will be required over the term

of the transaction. Accordingly, such adjustments need to occur on a known and standardized cycle to sufficiently accommodate the transaction time needed for LSEs to the annual year-ahead RAR showings.

## ***2.b. Potential Solutions***

### **2.b.i. Workshop Consensus**

Parties appeared to have reached a consensus opinion that in order for LSEs and others to make informed decisions regarding the products they will use in their upcoming year-ahead filings, the QC for any generator shall be established approximately 90 days before the year-ahead compliance filing is due (about July 1, 2006 for this cycle). This approach recognizes that QC is not a function of availability and that D.05-10-042 tasked the CAISO with developing performance standards for generators.

### **2.b.ii. Open CAISO Solution Issue**

CAISO's responsibility for developing and implementing the QC adjustment mechanism is an integral part of the RA program. Irrespective of the timing of any capacity market development, sellers and buyers need to have the generator availability performance standards and QC rating mechanism in place to assure system reliability. CAISO's efforts can be guided by the experiences and processes already developed in other jurisdictions which are based on industry standard measures found in the NERC GADS program.<sup>1</sup>

## **Issue 3: Penalties For Non-Performance**

### ***3.a. Description of the Issue***

Penalties for non-performance have not been defined. It is unclear when the LSE has demonstrated compliance with the RA requirements and when its obligation ends with respect to the seller's performance. Such uncertainty affects the determination of performance exposure between the parties and how to collateralize that exposure. Any potential penalties for non-performance should be clearly defined in order to facilitate the most economic transactions. Additionally, it is unclear what penalties are applied for non-compliance with must-offer obligations and how these may be assessed.

Additionally, as confusion continues to exist over the implementation of the new RA rules, parties hope that the CPUC will wisely exercise its discretion before assessing penalties or sanctions. Many parties feel that the penalty level will have significant commercial implications as it will be a key driver in the risk allocation embedded in individual commercial transactions and risk management in portfolio development. Thus, while the penalty must act as a deterrent to LSE non-compliance, the penalty provisions should not be so punitive as to cause

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<sup>1</sup> See, e.g., NYISO Installed Capacity Manual, Sections 4.4 (Operating Data Reporting Requirements), and 4.5 (Calculation of the Amount of Unforec Capacity Each Resource May Supply). Material is posted at [http://www.nyiso.com/public/webdocs/products/icap/icap\\_manual/icap\\_mnl.pdf](http://www.nyiso.com/public/webdocs/products/icap/icap_manual/icap_mnl.pdf).

irreparable financial harm to LSEs or to unnecessarily raise transaction-related costs. Other parties believe that the CPUC should not consider license registration revocation as a penalty measure that could be imposed on ESPs, as there is no similarly severe deterrent that could be imposed on the IOUs for non-compliance. Finally, parties raised concerns that penalties for RA non-compliance cannot be used to pay for the replacement cost of missing capacity as CPUC-imposed penalties, by statute, accrue to the State's General Fund.

### ***3.b. Potential Solutions***

Parties seemed to agree that the RA non-compliance penalty should be a fixed number and not the subject of a methodology. However, there was no agreement on what that fixed number should be. Options for this number are: a) a randomly chosen number (e.g., \$100 kW/yr); b) a number previously used by the CPUC as the value of capacity (e.g., \$80 kW/yr); c) a number tied to the price of capacity in another venue; or d) a number chosen as a proxy for the value of capacity until there is a functioning monthly capacity market in California.

Parties also agreed that the issue of which entity should receive the funds was significant and should be resolved. Options for payment are that funds accrue to the State's General Fund, per statute, or that penalties are paid to the CAISO to offset the costs of required backstop procurement.

Other options presented included removing the penalty concept from D.05-10-042 as it does not recognize new facts such as the state of discussions on the Reliability Capacity Services Tariff filed by IEP at the FERC.

Parties further agreed that the CPUC should clarify that an LSE's obligation ends at the year-ahead and month-ahead showings, and that failure to meet the requirements of such showings will result in the assessment of penalties by the CPUC, while Scheduling Coordinators will be assessed penalties by the CAISO for failure to adhere to the must-offer obligations placed upon RA resources.

Lastly, parties agreed that current CPUC processes do not give LSEs any level of certainty regarding their compliance with the RA requirement. The Energy Division has identified a possible solution to this uncertainty. Under this solution, the CPUC would define a process by which LSE penalties will be defined, i.e., through a general order. In the meantime, RA violations will be handled through: (1) a notification letter with 20 days to remedy; and (2) if failure to remedy, the CPUC will initiate an enforcement proceeding.

## **Issue 4: Maintenance And Repair Obligations**

### ***4.a. Description of the Issue***

Maintenance and repair obligations, if any, have not been defined for all units. The CPUC should consider if minimum standards should be applied in order to ensure that reliable capacity is available under the must-offer obligation for all units. Many parties have very different standards and it would be helpful to have a common requirement for this product.

Under current draft tariff language, the standard is “good utility practices,” but some parties are concerned that the CAISO tariff language is not as robust as it could be. While parties generally felt that GO 167’s obligations are enough, for those units to which it applies, there was no agreement on how to enforce such obligations on units outside of the jurisdiction of the CPUC and thus outside the reach of GO 167.

#### ***4.b. Potential Solutions***

For certain units, enforcement of generator operation and maintenance standards is under the auspices of the CPUC. As authorized in GO 167, the CPUC was ordered “to implement and enforce standards for the maintenance and operation of electric generating facilities and power plants... to ensure that electric generating facilities are effectively and appropriately maintained and efficiently operated, and to ensure electrical service reliability and adequacy.” (see General Order No. 167, p. 3.) The Consumer Protection and Safety Division (CPSD) of the CPUC is the administrative unit for GO 167, and as such, is authorized and required to conduct formal audits of generation assets and receive timely reporting on operation and maintenance practices by the generation asset owners. As such, it appears maintenance and repair concerns are sufficiently addressed by the CPSD.

For units to which GO 167 does not apply, parties suggested adding “good utility practice” to the existing four minimum standards for generators.

Additional solutions include imposing specific seller’s maintenance and repair obligations allowing parties to determine the obligation via contract.

### **Issue 5: Bulletin Board and Centralized Title Clearing**

#### ***5.a. Description of the Issue***

There is no process or mechanism to verify that the QC an LSE is buying is, in fact, available. The CAISO does have a process in place to post and update the QC for the net dependable capacity. This process does not take into account planned outage information or provide insight into the availability of the QC for purchase by an LSE. This is particularly an issue for transactions of partial units where several parties may be transacting for different “pieces” of a generating unit. It is unclear what role the CPUC or CAISO will provide and what process will be used to resolve conflicts over QC counting rights between LSEs and asset owners.

Additionally, mechanisms such as electronic bulletin boards are especially important for LSEs to manage their capacity positions between the time they must make their annual showings and the time they must make their month-ahead showings. While the aggregate amount of system and Local RAR obligation will remain constant from the annual showing to the month ahead showing, the entity responsible for serving the load and thus complying with the RAR showing may well change. Thus, LSEs will need to either buy or sell capacity to match their obligations, and a mechanism, such as a bulletin board, would be a useful interim tool to facilitate these transfers. Parties assert that a bulletin board-type mechanism will aid in helping

market liquidity and transparency since it would include a posting of bids and offers (an ICE type of trading platform) and a posting of executed transactions (Platt's type of price discovery)

### ***5.b. Potential Solutions***

General consensus was achieved around the idea that the CPUC should opine on bulletin boards as a useful tool that will assist in the implementation of an RA program because it will promote transparency and liquidity in the market. Consensus was also achieved around the idea that the CPUC needs to give general guidance about what types of attributes this bulletin board should consider (e.g., whether the attribute is local or system, whether the attribute is to an energy equivalent or a "green tag" equivalent). Parties seemed to agree that with such guidance the separate effort to explore the structure of bulletin boards could continue and that the group could return to the CPUC for additional guidance if further stumbling blocks were encountered.

## **Issue 6: Clarity On Import Requirements**

### ***6.a. Description of the Issue***

Several issues contribute to the uncertainty created by current import requirements. First, there is a lack of clarity regarding the state of multi-year import contracts within the RA structure. Currently the CAISO allocates RA Countable import rights once a year to CPUC-jurisdictional LSEs. This may create RA-counting risk for multi-year contracts because there is uncertainty regarding whether there will be import rights to support such a contract beyond the current year. This uncertainty creates risk that neither the buyer nor the seller wants to bear, and may drive the RA premium exorbitantly high if this risk is priced into the contract. Absent revisions or clarifications, the uncertainty associated with future allocations could result in imports being limited to annual terms, thereby limiting the hedge value of such contracts and the attractiveness of the CAISO markets to importers.

Second, further clarity is required with respect to how intertie space is allocated. Pursuant to the D.05-10-042, the CPUC has allocated import capacity on the basis that existing contracts get a preference for import capacity and then all remaining capacity is allocated on a load-share basis. However, D.05-10-042 is not clear as to whether that preferential allocation will be applicable if those contracts are extended pursuant to evergreen provision that may exist in those contracts. If existing import capacity holders are able to exercise their evergreen provisions in their supply contracts, thereby foreclosing a re-allocation of that import capacity to all load-serving entities, it limits the ability of other LSEs to get an equitable share of the import capacity on a load-share basis, it creates a preference for existing contracts over new long-term contracts. The CPUC adopted this policy so as not to disadvantage existing contract agreements and to encourage long-term contracting.

Lastly, other questions relative to the use of imports as capacity resources that should be addressed during the workshop process include: a) Will external units have to be certified by CAISO before qualifying as counting toward RA?; b) Will firm transmission be required to deliver power to the point of delivery?; c) Will import capacity that comes from a specific unit be subject to the same *resource adequacy obligation* rules as a unit in CAISO territory? That is,

how will the Must-Offer, derates, and outages be handled?; and d) Are reserves required for a unit or for a control area, if at all? How will control area emergencies be handled? That is, can firm import RA be subject to energy curtailments?

### ***6.b. Potential Solutions***

Parties agreed that the issue of whether must-offer obligations are applicable to import resources is the subject of SCE's pending Petition for Modification of D.05-10-042. ALJ Mark Wetzell authorized the submission of reply comments on issues related to this subject by all parties.

No consensus was achieved on the issues of uncertainty relating to the annual intertie allocation and the possible derating of imports. One solution on the issue of derating of imports is that, until and unless the CAISO annual import deliverability test is significantly modified, there should be no reductions in import capacity due to derates, outages or other performance-related events. Indeed, the CAISO annual assessment as currently performed, recognizes these kind of derates explicitly and will reduce future deliverability accordingly.

Energy Division suggests that although the CPUC may need to adopt rules to establish if (or how) the CPUC's RAR program will support multi-year import allocations, it is possible that this issue may need to be deferred to Phase 2.

Constellation suggests that when contracts that have been granted a preferential intertie allocation expire, or at least the pricing terms of the contract expire, the intertie capacity should be re-allocated on a load-share basis, as the contractual basis for the intertie allocation no longer exists. Specifically, the intertie allocation preference that the CPUC afforded to existing import contracts should not be applicable to those contracts beyond their primary terms; i.e., extension of those contracts pursuant to evergreen provisions, (if such evergreen provisions exist in the contracts) should not serve to extend the preferential allocation of intertie space. Constellation does not have specific proposals at this time to address the other issues in this Section.

## **Issue 7: Creditworthiness**

### ***7.a. Description of Issue***

Some LSEs have discovered that QC is only available from non-credit worthy counterparties. What is the responsibility of LSEs to enter into RA contracts with generators or other suppliers that are not creditworthy?

In particular, non-IOUs do not have AB57 rate recovery, but they do have internal credit requirements for their counterparties. If a transaction must occur under the regulatory requirement, the cost of the transaction will increase in light of the additional security provisions that must be put into place. Other questions include whether credit worthiness going to be part of a standardized product definition, and whether there should be processes and standards for LSEs to seek an RAR compliance waiver due to issues associated with credit.

As discussed at the workshop, some IOUs will not enter into a master agreement with a counterparty that cannot meet the buyer's creditworthiness threshold. Additionally, some RA capacity contracts may be executed on a stand-alone basis without a master/umbrella agreement. The central issue is whether the CPUC's RA policies should (setting aside the legal question of whether that can be done) force the non-IOU LSEs into high-risk (and higher cost) transactions where there is no assurance of Commission-guaranteed cost recovery.

By resolving issues related to the previous issues, other market makers may enter the market and transact directly with non-creditworthy generators and sell RA services in the secondary market. To the extent a secondary market occurs, parties will have the opportunity to transact with creditworthy counterparties and this issue should be mitigated.

### ***7.b. Potential Solutions***

#### **7.b.i. Consensus Solution**

The CPUC should not decide or impose any specific credit requirements for the standard capacity product, as those requirements will be determined by the individual companies based upon internal risk controls. For transactions undertaken pursuant to a master agreement, the master agreement is likely to address credit issues. For "one-off" transactions not undertaken under a master agreement, negotiated provisions outside of the standard RA capacity product definition, would address creditworthiness concerns.

The CPUC should, however, anticipate the need for LSEs to seek waivers from full RA compliance should circumstances exist where they cannot secure RA capacity from providers under terms that satisfy their creditworthiness thresholds. Such waiver requests should be on a case-by-case basis, and cannot, by definition, be addressed through *ex ante* standards.

## **Issue 8: Intermediaries**

### ***8.a. Description of Issue***

An intermediary is a party in the middle of a RA capacity transaction chain. For example, an intermediary may be a power marketer that secured long-term rights to market the energy and capacity from an asset owner's projects, or it may be another LSE that is seeking to "lay off" some RA capacity that is surplus for some period of time without completely relinquishing their rights for the capacity in later periods. In other contexts the intermediary may exist because the RA capacity seller was better able to transact with an entity due to creditworthiness concerns.

Some parties are concerned that the RAR policies presume that transactions occur solely between LSEs and generating asset owners, and therefore assume that a contract for RA Capacity can directly impose outage scheduling requirements or other performance obligations on the generating capacity. This will not be the case where the generator did not concede those rights in an initial transaction (i.e., the asset owner did not give the marketer the ability to dictate

outage timing or duration because such activities are inherent in maintaining the value of the property).

There is a need for clarity in way the RA program interacts between the CPUC's policies over LSEs and CAISO's policies with respect to QC certification and availability obligations.

### ***8.b. Potential Solutions***

The regulatory structure should not assume that the LSE will only secure QC directly from an asset owner, but instead should assume the existence of a secondary market. If the RA structure is clear that LSEs simply carry an obligation to procure QC, and that generating assets providing QC carry availability obligations directly to the CAISO, then the regulatory structure should not require QC purchasers impose specific requirements such scheduling obligations as in bilateral contracts with their supplier. This will result greater ability of RA capacity to move in a secondary market for the standardized product, which is at the heart of the effort to create a standard product.

## **Issue 9: Pooling Of Assets And Substitution**

### ***9.a. Description of the Issue***

Pooling a portfolio of units with specific unit identification can help reduce the seller's counting risks identified above, as well as allow the optimization of the generation fleet over different times of the year. Lack of pooling assets or excessive restrictions on capacity substitution may result in less generation being made available to the market. It is not clear if, how and what timing is required to identify that a specific generating unit is required to ensure proper instruction on the must offer obligation. This should be explored for potential flexibility.

As it currently stands, replacement capacity has to be at the same busbar. Pooling of assets will probably be even more problematic with respect to local RAR compliance showings.

### ***9.b. Potential Solutions***

This issue was not addressed at the workshop. However, various solutions were proposed by parties before the workshop.

Constellation suggested that the specific procedures for qualification of pooled assets as capacity resources from the NYISO be adopted. SCE suggests that the CPUC allow LSEs to substitute qualifying capacity from resources up to the month-ahead showing. After the month-ahead planning process is complete, any unit substitution for purposes of must-offer obligation is an issue for the CAISO.

Energy Division suggests that the current busbar rule be expanded to plant level.

The CAISO suggests that it must know which units will be available to commit and control in day ahead and real-time. As such, the CAISO has consistently stated that RA



resources must be identified in the month-ahead reports so that the CAISO can configure the specific resources into its systems, as necessary, and effectively run the grid. The CAISO cannot support proposals that would move identification of the specific resources to anything closer than the month-ahead showing. As appropriate, the CAISO could consider the concept of pooling/portfolio RA resources in the context of its MRTU phase II design.

With regard to substitution, the CAISO feels it must have full authority to determine whether or not a substitution can be made since the information and knowledge to do so is the purview of the CAISO. Clearly, a substituted unit does not necessarily have to be at the exact same "busbar" but it must be electrically equivalent to the substituted-for unit and provide comparable benefits to the transmission system. If allowed, any substitution would be evaluated by the CAISO on a case-by-case basis and subject to the particular transmission configuration and resources already operating. Substitution allowed without professional and prudent evaluation could lead to CAISO re-dispatch, resulting in undesirable cost shifts and/or market manipulation opportunities.

## **Issue 10: Regulatory Uncertainty and Sellers Obligation to Perform if Failure to Receive Adequate Compensation for Ancillary Services or Energy from CAISO**

### ***10.a. Description of Issue***

**Market Compensation.** Given market design uncertainties at the CAISO, some generators may believe that they do not have an obligation to perform if they do not receive adequate compensation for Ancillary Services or Energy from CAISO.

Even though generators have a new price cap regime, there is future regulatory uncertainty (MRTU, etc.) that makes generators wary of how their obligation will be compensated in the future.

**Regulatory Uncertainty.** It is difficult to reflect in contracts what happens in the event of major regulatory changes, such as things that might affect counting rules, testing requirements, etc.

Regulatory uncertainty pertains to both single year and multi-year contracts. Some believe the California track record is particularly poor on this point. All parties would like to see sufficient regulatory stability to sign multi-year deals.

### ***10.b. Potential Solutions***

Time did not allow this issue to be discussed at the workshop.

Ultimately, this issue turns on whether the marketplace can develop for RA capacity based upon the interaction of multiple markets that would provide revenues to generator owners: the market for unbundled RA capacity, plus the markets for energy and ancillary services. If

suppliers do not have confidence that the marketplace will provide sufficient revenues, then the CPUC and CAISO should expect that new infrastructure will not develop (absent extra-market guarantees of revenue) and the continued availability of existing capacity would be questionable.

Based upon comments presented in the discussion paper, it appears there is a consensus that the CPUC and the CAISO should each adopt a policy whereby any regulatory changes to their respective RA programs would only become effective through a phase-in basis (where the change would be significantly disruptive), or prospectively after the completion of the current RA year-ahead compliance cycle. Market participants should be given ample opportunity to participate in formal proceedings that seek to change market rules (whether at the CPUC or CAISO). In that setting, market participants should be given the opportunity to specifically address the impact that the proposed regulatory change would have on existing contracts and thus the opportunity to secure appropriate transition mechanisms or other accommodations. This would mean that generators could point out that their continued availability could be put at risk by the market change, or that the market structure would not support new asset development.

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Executed this **3rd day of April, 2006**, at Rosemead, California.

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