Comments of Southern California Edison (SCE)
CAISO Backstop Capacity Product
May 25, 2007

Summary

SCE appreciates the opportunity to provide comments on the CAISO's backstop capacity product. SCE supports the development of a backstop capacity procurement mechanism that can be in effect before the end of this year so that the CAISO can, if necessary, procure needed capacity based on clear and transparent criteria. We cannot rely on the current RMR contract for backstop procurement because the RMR cost allocation is inconsistent with today's Resources Adequacy structure. RMR costs are allocated to PTOs in whose service area the generator is located and this is fundamentally inconsistent with LSE-based RA requirements. The urgency of this backstop product effort is even greater if the CAISO's proposal to make the RMR criteria equal to the LCR Criteria is adopted by the CAISO Board.

As detailed below, we believe that we should utilize as much of the current RCST structure as possible, revising as necessary to be consistent with MRTU. SCE supports many of the preliminary positions provide by the CAISO in its May 18, 2007 stakeholder meeting presentation. A lot of debate has taken place to develop the current RCST mechanism, including a lot of give and take regarding obligations and compensation, and we should utilize as much of that mechanism as possible.

Trigger Mechanism

Under the current CAISO Tariff, RCST designation is triggered off of must-offer waiver denials (MOWDs). If a non-RA/non-RMR generator is denied a must-offer request for a sufficient number of times, a review process is triggered to determine if conditions warrant the generator being designated as an RCST resource. This approach fits well with the pre-MRTU market structure where even non-RA/non-RMR resources are subject to FERC's must-offer obligation. If a non-RA/non-RMR generator under a FERC must-offer obligation is consistently needed to reliability operate the grid, that generator should be eligible to receive just and reasonable compensation.

However, under MRTU, there will not be a must-offer obligation on non-RA/non-RMR resources. With a very limited exception, a must-offer waiver denial process is not provided for under the MRTU Tariff. In addition, non-RA/non-RMR generators are eligible for RUC availability payments based on voluntarily submitted bids into the CAISO's integrated forward market. Since non-RA/non-RMR generators aren't obligated to offer into the CAISO markets, and there is additional compensation available under MRTU for those non-RA/non-RMR generators that choose to offer, the current trigger mechanism based upon the must-offer waiver denial process is not appropriate for MRTU.

Under MRTU, SCE believes that there needs to be a forward looking trigger mechanism based upon LSE RA compliance filings and technical analysis of a "significant and enduring" event. SCE offers these suggested trigger mechanisms for consideration (we recognize that the implementation details would need to be developed).

Backstop capacity procurement shall be considered (not automatically occur) under the following conditions:

1) If an LSE is found to be deficient in meeting its System RA and/or Local RA obligation, the CAISO shall be permitted to determine whether or not it needs to backstop procure additional resources. Such a determination shall be based on the applicable criteria for System RA and Local RA. An LSE filing deficiency does not automatically trigger backstop procurement.
2) In the case where no LSE is deficient in meeting its System RA or Local RA obligation, but the CAISO identifies a local area reliability need because the aggregate LSE RA showings are not "effective" to meet the local requirement identified in the Local Capacity Study, the CAISO shall be permitted to backstop procure the most cost-effective resource(s) to meet the identified need.
3) If the CAISO determines that a "significant and enduring" event has occurred within its control area, the CAISO shall perform a technical analysis to determine if the CAISO can still meet System and Local RA criteria.
    - What is a "significant and enduring" event? A possible definition for consideration: A significant and enduring event is an unplanned outage of both transmission facilities and RA/RMR resources that 1) was not considered in the Local RA studies and 2) is expected to result in the CAISO not being able to meet Local RA criteria for a sustained period of time (e.g. weeks).

If a significant and enduring event occurred, the CAISO would be permitted (not automatic) to backstop procure generation to meet Local RA criteria. Market participants should be notified of the CAISO's intent to backstop procure generation and the CAISO should also obtain CAISO Board approval before entering into a backstop procurement commitment.

Cost Allocation

In general, backstop procurement costs should be allocated to the entity that was deficient in meeting its System RA or Local RA obligation. Given the LSE-based RA requirements, it is inappropriate to allocate backstop procurement costs to PTOs, as is done for RMR cost allocation. PTOs do not file RA compliance filings and do not drive backstop procurement by the CAISO. Allocation of costs

to PTOs would result in the PTO recovering those costs from transmission customers, many of whom would not have been served by the LSE who was deficient in meeting its RA obligation.

There may be some cases where all LSEs have met their RA obligations but the CAISO still needs to backstop procure a limited amount of capacity to meet a reliability need (e.g. to meet a Local RA requirement due to "effectiveness factors"). In such cases, the backstop procurement costs should be allocated to the Scheduling Coordinator (SC) for LSEs that had a Local RA obligation in the TAC area where the backstop procurement was required based on their load ratio share in the TAC area. For example, if an LSE has 10% of its load in PG&E's TAC area, and the CAISO was required to procure 100 MW of backstop capacity in PG&E's TAC area a Local RA requirement due to "effectiveness factors", the SC for that LSE would be responsible for 10% of the backstop costs.

Finally, for significant and enduring events, costs should be allocated the same way they are under Section 43.8 of the current CAISO Tariff:

- "If the ISO makes any Significant Event RCST designations under Section 43.4 during 2007, the ISO will allocate the costs of such designations to all SC-RA Entities in the TAC Area(s) in which the Significant Event caused or threatened to cause a failure to meet Applicable Reliability Criteria based on Scheduling Coordinators' 2007 RA Entity Load Share Percentage(s) in such TAC Area(s)."

Generator Compensation

Before discussing compensation, it is important to recognize how the generator would have ended up being eligible for backstop procurement by the CAISO. First, the generator would not have been identified as necessary to meet an RMR requirement (at least given the current RMR criteria and process). Second, the generator would not have been contracted by an LSE via a competitive procurement process to meet a System RA or Local RA requirement. Finally, the generator would not have elected to terminate its operations, presumably because it believed it would still be in its best interest to continue operations even without an RA or RMR agreement (e.g. make sufficient energy and RUC market revenues, sell to an LSE outside the CAISO control area, etc.). The situation under MRTU will be dramatically different than today where the generator is under a FERC must-offer obligation regardless of its business environment.

SCE agrees with the principle included in the CAISO's May 18, 2007 presentation (slide #12): Once designated through the backstop mechanism, a resource would be treated like a Resource Adequacy resource. This means that once a resource is actually procured under the backstop mechanism, it would then have a daily offer obligation, an obligation to submit a $0 availability bid in

RUC (and not be eligible to receive a RUC availably payment), and would no longer eligible for a Frequently Mitigated Bid Adder.

Some parties indicated at the May 18 meeting that they believe the generator capacity payment is too high (e.g. should be cost-based), and others believe it is too low (e.g. should be based on cost of a new peaker). SCE supports the compensation for generators that was accepted by FERC for the current RCST mechanism. The compensation mechanism, a capacity payment less peak energy rents, was appropriate given the burdens and benefits that were incorporated into the overall RCST settlement. Given the need to have a backstop capacity mechanism developed and filed with FERC by September, it would likely be challenging to begin to unravel the various trade-offs made that resulted in the current RCST compensation package.

SCE agrees with comments expressed at the stakeholder meeting that the expected duration of this backstop mechanism can have an impact on what parties may believe is an appropriate compensation level. However, suggestions that the backstop capacity payment should be based upon the cost of emergency peaker resources are completely unacceptable.

Role of RMR

It is SCE's position that the CAISO cannot rely on the current RMR contract for backstop procurement because the cost allocation is inconsistent with today's Resources Adequacy structure. RMR costs are allocated to PTOs in whose service area the generator is located and this is fundamentally inconsistent with LSE-based RA requirements. The need to develop an alternative backstop capacity product is even greater if the CAISO's proposal to make the RMR criteria equal to the LCR Criteria is adopted by the CAISO Board.

SCE recognizes that some services, such as blackstart and duel-fuel capability, may need to continue to be procured via "RMR-like" contracts for an interim period. However, changing the RMR criteria to equal the LCR criteria is very problematic without a corresponding change to ensure that costs associated with such RMR backstop procurement are allocated to deficient LSEs or, in the case where there are no deficient LSE(s), to the SC(s) for the LSE(s) that had a Local RA obligation in the TAC area where the backstop procurement was required based on their load ratio share in the TAC area.

Duration of Product

Assuming the compensation and cost allocation under the current RCST mechanism remain in place for the backstop capacity product under MRTU, SCE generally supports the duration of the backstop procurement agreement presented in the CAISO's May 18, 2007 stakeholder meeting presentation. The

duration depends upon the reason for the backstop procurement, as described below:

- If the CAISO determines that it is necessary to backstop procure in order to address a deficiency in an LSE(s) year-ahead System RA showing, the backstop capacity commitment shall be for a minimum of 5 months (May-Sept). The maximum duration should be one year.
- If the CAISO determines that it is necessary to backstop procure in order to address a deficiency in an LSE(s) Local RA showing, the backstop procurement commitment shall be a calendar year (January through December).
- If the CAISO determines that it is necessary to backstop procure in order to address a deficiency in an LSE(s) month-ahead System RA showing, the backstop capacity commitment shall be for the balance of calendar year
- If the CAISO determines that it is necessary to backstop procure in order to address a significant and enduring event, the backstop capacity commitment shall be a minimum of 3 months and a maximum of up to the time that the CAISO determines that the event will remain in effect. Prior to entering the agreement, the CAISO should determine the maximum duration of the agreement (i.e. specify the expected duration of the event and limit the backstop commitment to that expected duration).

Do Non-RA/Non-RMR Generators Have An Obligation to Be Ready to Perform?

Unlike today's CAISO tariff where generators under a PGA are under the FERC must-offer obligation, it is unclear if PGA generators are under any kind of offer obligation to be "ready to perform" if they are designated as a backstop capacity resources. It is our belief that backstop procurement designations under MRTU must be forward looking based on technical analysis – not backward looking based on historical performance like today. Based on that premise, suppose that a PGA generator does not have an RA or RMR contract. Further suppose that the generator does not plan to operate for the non-summer months. If a significant and enduring event occurs, and the CAISO identifies the resources as needed for backstop capacity from February through May, is the generator obligated to be ready to perform during that time period? SCE requests the CAISO clarify its understanding of the obligation of non-RA/non-RMR generators under a PGA to be ready to perform under MRTU.