

SCE Comments on the Draft CRR Credit Requirement Tariff Language Dated June 6, 2007

CAISO Reponses ADDED

SCE appreciates the opportunity to provide comment on the proposed tariff language governing CRR credit terms. SCE generally believes that the proposed tariff language is in concert with the direction established in the stakeholder process and ultimately approved by the CAISO Board. SCE does believe however that certain areas of the tariff could benefit from modification and/or clarification. SCE submits the following for your consideration.

Credit Requirement Formula

Calculation of credit requirement

SCE understands and appreciates the intent of the formula utilized to calculate the credit requirement for both short-term and long-term CRRs. However, SCE remains concerned that if the CRR Auction Price and the CAISO calculated Expected CRR Congestion Revenue differ substantially, such a difference could cause dramatic and potentially unnecessary credit obligations. Worse yet, those obligations would apply to allocated rights for which the allocation process preceded the auction process and for which entities made requests without being able to ascertain the credit obligations prior to their request. This is particularly concerning in the first year where entities will have no experience with LMP nor with the auction of CRRs and therefore will have little basis to estimate their credit exposure prior to the allocation and auction.

At a minimum, SCE requests that the CAISO implement some process that would ensure that if the CRR Auction Price differs significantly from the CAISO calculated Expected CRR Congestion Revenue, the impact on credit obligations will be mitigated. Take for example, a scenario in which the CRR Auction Price clears at \$1 while the CAISO calculated Expected CRR Congestion Revenue is \$10 and the Fifth Percentile CRR Congestion Revenue is \$-1. Under these circumstances, for a one year right, the credit obligation would be \$10/MW $(-1 + 10 - (-1))$. On the other hand, had the auction cleared at the CAISO calculated Expected CRR Congestion Revenue, the credit obligation would have been \$1/MW $(-10 + 10 - (-1))$. This unanticipated eight fold increase in credit obligation would likely have significant consequences on the entity holding this right.

It is not clear that the auction result provides sufficient evidence that the CAISO calculated Expected CRR Congestion Revenue should be adjusted as it is in this formula. In fact, the CRR process developed by stakeholders relies primarily on an allocation of rights and may have a very small auction market. SCE understands that even with a small number of bids, the CAISO can calculate auction results for all source sink pairs. However, it is not clear that a small number of bids will produce economically efficient results.

Based upon these observations, SCE recommends that the auction price be restricted to be $\pm 20\%$ of the CAISO calculated Expected CRR Congestion Revenue. In the example above where the auction cleared at \$1, this would equate to a credit obligation of \$3 (-8 +10 -(-1)). By utilizing such a process, a CRR holder will be able to reasonably estimate and bound their credit exposure of holding a CRR prior to that close of the auction process.

CAISO Response

The CAISO's intention is to calculate Expected CRR Congestion Revenue based on the CRR Auction Prices and will clarify the definition of Expected CRR Congestion Revenue accordingly. SCE's question in this regard appears to be based on an assumption that the CAISO would be forecasting Expected CRR Congestion Revenues or using LMP study data to calculate Expected CRR Congestion Revenues. This is not the case. The CAISO believes the only reasonable basis for calculating the Expected CRR Congestion Revenues are the CRR Auction Prices. The Credit Margin, on the other hand, is based on LMP study data but is based on the *variability* between LMPs and not on the LMPs themselves. The CAISO has revised the tariff language to reflect these distinctions.

SCE is correct that LSEs will not know their credit requirements for their allocated CRR proposals until after the auction but believe this is a risk that LSEs can manage by selecting CRRs with positive expected value and electing to purchase some CRRs in the auction. The CAISO believes this is the right approach due to the lack of any other reasonable alternative. Since the CAISO will be calculating the Credit Margins based on the variability of LMPs in the LMP studies, the CAISO can and will publish the Credit Margins in advance of the CRR allocation.

Formulaic consistency

Taken in context, it appears that the tariff language intends to calculate credit requirements on a dollar per megawatt basis. However, the tariff language and additional definitions are not completely clear in this matter. Notably, the Credit Margin is defined as Expected CRR Congestion Revenue minus Fifth Percentile CRR Congestion Revenue. The use of the term revenue here implies price multiplied by quantity (or dollars per megawatt multiplied by megawatts).

SCE recommends therefore that section 12.6.3.4, and the definitions of Credit Margin, Expected CRR Congestion Revenue, Fifth Percentile CRR Congestion Revenue be clarified so that they are evaluated on a dollars per megawatt basis and are on consistent terms with the CRR Auction Price.

CAISO Response

The CAISO agrees that the tariff language requires modification to be consistent and has revised the tariff language accordingly.

Frequency of Evaluation

As drafted, section 12.6.3.1(c) states:

The ISO shall reevaluate the credit requirements for holding CRRs, and shall adjust the credit requirements accordingly, not less than annually. The ISO may adjust the credit requirements for holding CRRs with terms of one year or less more frequently than annually at the ISO's discretion to account for changes in the monthly auction prices for CRRs. The ISO may adjust the credit requirements for holding long-term CRRs annually to reflect the number of years remaining in the term of any Long Term CRR, to reflect the changes in auction prices of one-year CRRs in annual auctions, and to reflect updates to Credit Margins based on actual Locational Marginal Price data derived from market operations.

SCE notes that the CAISO allocation and auction processes operate annually and monthly. SCE believes that it is likely that a significant portion of CRR holders will participate in the monthly allocation and/or auction process. Further, the CAISO will evaluate the credit obligation of a CRR holder based upon the entire portfolio of their CRR holdings. Since it is likely that a majority of the holders will obtain additional CRRs in the monthly allocation and auction process, the CAISO will necessarily have to re-evaluate credit on a monthly basis.

Given this, SCE does not believe it would be a significant burden for the CAISO to re-evaluate the credit obligation of all CRR holders on a monthly basis. As such, SCE recommends section 12.6.3.1(c) be modified as follows:

The ISO shall reevaluate the credit requirements for holding CRRs, and shall adjust the credit requirements accordingly, not less than monthly. The ISO may adjust the credit requirements for holding CRRs with terms of one year or less more frequently than monthly at the ISO's discretion to account for changes in the monthly auction prices for CRRs. The ISO may adjust the credit requirements for holding long-term CRRs annually to reflect the number of years remaining in the term of any Long Term CRR, to reflect the changes in auction prices of one-year CRRs in annual auctions, and to reflect updates to Credit Margins based on actual Locational Marginal Price data derived from market operations.

CAISO Response

The CAISO accepts the suggestion change.

Credit Evaluation for Transfers in the Secondary Registration System (SRS)

As drafted, Section 12.6.3.1(d) states:

In cases where the ownership of a CRR is to be transferred through either the Secondary Registration System or through load migration, the ISO shall, if necessary, evaluate and adjust the credit requirements for both the current owner of the CRR and the prospective owner of the CRR as appropriate.

SCE notes that there is no timing requirement in the current draft of this section. SCE continues to advocate that such credit evaluation and any necessary posting of additional credit should take place before the CAISO approves any SRS transfer. Therefore, SCE recommends modification to 12.6.3.1(d) as follows:

In cases where the ownership of a CRR is to be transferred through either the Secondary Registration System or through load migration, the ISO shall, if necessary, evaluate and adjust the credit requirements for both the current owner of the CRR and the prospective owner of the CRR as appropriate. Such evaluation and any incremental credit requirements resulting must be met prior to the transfer becoming effective.

CAISO Response

The CAISO agrees to add tariff language to require credit requirements be satisfied as a condition precedent to the transfer of CRRs.

Publication of Data

In order to provide market participants with a means to evaluate their credit obligation with respect to planned allocation requests and/or auction bids, the CAISO should post the Expected CRR Congestion Revenue, and the Fifth Percentile CRR Congestion Revenue. Such posting should be made in a manner to allow ample time for market participants to evaluate the impacts of their requests and/or bids prior to the allocation and auction process. The commitment to publish such data should be included in the tariff.

CAISO Response

As discussed above, the Expected CRR Congestion Value will be based on the CRR Auction Prices and, therefore, cannot be known in advance. The Credit Margins can be published in advance and the CAISO agrees to publish the Credit Margins in advance of the first CRR Allocation, which is scheduled to begin on July 20.

Potential Typographical Error

SCE believes that there is a typographical error in section 12.5(d). Currently, the section reads:

The ISO may restrict, suspend, or terminate the Market Participant's CRR Entity Agreement of Service Agreement.

SCE believes that this should read:

The ISO may restrict, suspend, or terminate the Market Participant's CRR Entity Agreement and/or Service Agreement.

CAISO Response

The CAISO will make the correction changing “of” to “or”.