

SCE CRR Proposal

Introduction

SCE believes that the CRR Auction Analysis Report does not provide information to target a single cause of CRR underfunding. As such, SCE believes that it is now appropriate to begin discussion of the policy and suggest changes to the CRR design to effectuate such policy.

In order to address the significant underfunding of CRRs and to fairly allocate such underfunding, SCE proposes an alternative to a simple removal of the CRR auction process as proposed by the DMM. While SCE does not object to the discontinuance of the auction, SCE sees an alternative that will provide the same underfunding relief without a complete abandonment of the CRR auction process.

Reason for Change

Fundamentally, SCE sees the CRRs inherent within the grid as serving those that have historically paid for the transmission grid. Indeed, the original design of the CRR process has a primary methodology that allocates CRRs to load serving entities (LSE). However, the process currently sets aside some of the inherently available CRRs that are then auctioned to any entity registered with the CAISO. While these registrants include LSEs, it also may include any party that may or may not have a financial interest in an actual physical flow of energy and the resultant exposure to congestion that this physical flow may have and/or the party may have another way to mitigate such exposure (e.g. a generator with a contract to deliver energy at their bus bar rather than at the load which would not expose the generator to congestion and would allow the purchaser to procure CRRs, potentially through the allocation process, to hedge the congestion risk associated with the physical flow from the contract). As a result of this process, to the extent there is a CRR underfunding, load pays an uplift to honor the CRRs whether those CRRs were allocated to an LSE or won at auction by an entity not hedging load risk.

While load has/will ultimately pay for the Transmission grid that made the CRRs inherently available, those in the auction will only pay the auction clearing price. That auction clearing price will clear at the highest bidder. One would expect that in a perfectly competitive environment, the price of the highest bidder would approach the value of the congestion for the source sink pair of the CRR over its term. But CRRs contain risk, thus even under perfect competition speculators will demand something that exceeds a risk-free return in order to buy/sell. To the extent speculators are marginal in the CRR auction, there is a structural bias for the CRR auction to return revenue to load that is *less* than one would expect as the value of congestion the CRR will represent.

Due to rules external to the CAISO and incentives provided to various market participants both within the CAISO market as well as from external regulation, there is not a perfectly competitive market for these CRRs which may have the net effect of producing auction prices that deviate even further from actual market congestion results. As a result of these, and possibly other factors, prices of CRRs at

auction have regularly cleared well below the actual value of congestion. Since currently load is responsible for CRR underfunding, in the presence of such underfunding, effectively the auction holder obtains value from the transmission system, even though load continues to pay 100% for the system. The CAISO should correct this inappropriate transfer.

Result

As a result of the transfer noted above, stakeholders have called for change. For example, the DMM issued a proposal that the CRR auction be removed from the CAISO and all CRRs be allocated to LSEs instead. SCE does not object to this approach as it will address the issues listed in the section above. In addition, a large number of entities have raised concerns over this issue as the CAISO has produced its data to evaluate the issue.

SCE sees an alternative that would allow for an allocation and an auction process to allow LSEs and other participants to have an opportunity to obtain CRRs and at the same time would completely eliminate any underfunding from the auction. The structure would also help address negative impacts of insufficient competition and prevent the CAISO from becoming the counterparty to a transaction even if the transaction price is unreasonable.

SCE Proposal

SCE proposes that the CAISO implement a two-step approach that includes an allocation and an auction process that are treated completely separately in all respects.

Step 1: The Allocation Process

First, the CAISO would allocate all CRRs that are feasible based upon the Transmission grids capability.¹ The CAISO would no longer “reserve” CRRs for the auction process but instead would release everything (properly derated) to the allocation process. The remainder of the allocation process would be conducted as it is in the CAISO tariff today and would not require the CAISO or LSEs seeking CRRs in an allocation to do anything differently than today. The only change to the allocation process would be the quantity of CRRs made available as none would be held for the auction process. The allocation process would be available to the current participants that are eligible for the CRR allocation process today. That is LSEs as defined in the current CAISO tariff. This process can continue to have an annual as well as monthly processes as it does today. At the conclusion of the allocation process, any CRR that was not requested and therefore not allocated is simply held by the CAISO and not sold in the auction (it is possible that those CRRs not allocated in the annual process could be included in the later monthly allocation process but in no case will a CRR that is offered for allocation then be offered for auction).

¹ This process should continue to derate the Transmission grid for known and unanticipated, but historically observed outages, in order to minimize the potential for underfunding associated with the allocation process.

Once the annual and monthly allocation processes are complete, the LSEs holding them will receive all available revenues (or pay all costs associated with any counter flow) for the CRRs specifically allocated to them. In the event that the CAISO experiences underfunding from these allocated CRRs, the CAISO will allocate such underfunding to CRR holders that were allocated CRRs. Any underfunding will not impact those that participate in the auction process described below. The CAISO would continue to utilize the same settlement process as they do today. That is, any CRR that was not allocated is held by the CAISO and revenues accrue to offset any underfunding from any other CRR. The only element in the settlement that will be any different is that net auction revenues will not be pooled to offset or contribute to any net underfunding. To the extent that there is a net underfunding, the CAISO will allocate such underfunding to load in order to fund the CRR just as is done today.

Step 2: The Auction Process

In addition to the allocation of system inherent CRRs described above, the CAISO can conduct a market to allow willing counterparties to create a CRR by bidding equal and opposite flows. Simply put, if Party 1 wants to buy a CRR from point A to point B, they will only get that CRR if Party 2 sells a CRR from point B to point A². It is anticipated that the CAISO would need to continue to require appropriate collateral to ensure that expected payments will be made. In this process, there would be no under or overfunding since all transactions are backed by a willing counterparty³. The price paid to purchase the CRR would be paid to the CRR seller and the actual congestion values would be paid to the CRR holding the flow direction and paid by the CRR holding the counter flow in an equal amount. The value of the CRR would be established by willing counter parties taking opposite sides of a transaction with known obligations. The CAISO would no longer be the seller or buyer of CRRs as they are today. Those that funded the Transmission grid (i.e. load) would not be exposed to results of this auction process, unless they willingly participated in it.

Conclusion

SCE supports modifications to the existing CRR auction process. While SCE believes that a discontinuance of the auction process would address the inequitable treatment of parties that is experienced today, SCE believes that an alternative that would preserve some form of financial only market can be retained and structured such that the financial and physical entities are able to participate without any cross impacts. For these reasons, SCE encourages the CAISO to consider the separation of the allocation and auction as described above.

² When presenting this concept previously, some parties have indicated that a one-shot auction may not provide enough information to allow counterparties to evaluate what is available and adjust such that their offer or bid can clear. SCE understands this concern and could consider alternative mechanisms (e.g. bid/offer bulletin boards, descending clock auction, etc.) to address this concern.

³ The remaining risk is primarily counter-party default. The CAISO should ensure sufficient collateral practices to virtually eliminate this risk. If any collateral insufficiency exists, SCE believes the risk should be borne by the counterparty(ies).