

WSPP Inc.



To: WSPP Membership
February 19, 2008

From: WSPP Contingency Reserves Task Force of the Executive Committee

INTERIM REPORT ON CONTINGENCY RESERVES IN WECC

Executive Summary

What is the issue?

Recent WECC actions have caused a disruption in the marketplace.

For years there has been disagreement among WSPP members over reserves issues and what constitutes firm power. The market has functioned despite the disagreement, largely because events had not forced the issues. Recent developments are now forcing contingency reserves issues to a head.

WSPP Schedule C says *"Seller shall be responsible for ensuring that Service Schedule C transactions are scheduled as firm power consistent with [WECC]."* Many in the past believed that this meant the seller would provide the reserves. However, the WECC just recently stated that *"... It is up to Purchasing Selling Entities to determine their level of acceptable deliverability risk and determine who has contingency reserve responsibility."*

This action has set up a conflict among WSPP parties trading schedule C products, since there is now disagreement over who carries the responsibility for reserves. Forcing the issue is the requirement that the Balancing Authority ("BA") carrying the reserve responsibility now be identified on each and every tag, and that that responsibility then be reflected in the respective BAs' calculations of contingency reserve requirement.

Some in WSPP have sent letters soliciting agreement, or making statements, pursuant to their individual company interpretation. The net effect of all of this has been an immediate impact on liquidity. Particularly on electronic trading platforms, and especially for term products, markets for physical power are extremely thin. Given that a large number of WSPP members traditionally trade physical power, this does not bode well for the industry. In addition, various parties are not trading with others who do not agree with their position on this issue.

What is our response?

Our plan is to first provide as much education to the membership as possible. WSPP has formed a task force to facilitate this. The task force has invested significant time in preparing this report. It is designed to describe the issue in detail, present all perspectives in an unbiased fashion, and in an unbiased fashion present several solutions along with an assessment of their particular strengths, weaknesses, and hurdles. The Executive Committee (which includes **all** members) will then be asked to use the report to develop consensus around a plan of action. The plan of action may include working with WECC or FERC to resolve these issues.

Ultimately, the goal is to develop language that is clear, agreed to, and understood by at least 90% of the membership.

What is my responsibility?

Each member is being asked to spend the requisite amount of time learning about and debating the issue, and participating in the development of a consensus direction. Our current plan is to have a webinar, followed by a conference call, followed by a discussion at the April Operating Committee meeting, and possibly a workshop after that. Each of the task force members has also obligated themselves to be available for one on one discussions with anyone desiring an education on the issues.

With the reality that a 90% vote is required to adopt new language, the Task Force respectfully requests that each of us make best efforts to consider each solution with the most open mind possible, and be willing to work toward consensus.

What do we do about existing deals?

The task force has concluded that any new language that comes out of this effort be part of a new product to be used going forward, and not be used to replace the existing Schedule C language. Leaving the existing service schedule untouched preserves any arguments the members believe they may have for deals that have not run their full term yet.

What are the potential solutions?

Solution 1	WECC passes Bal-002
Solution 2	Agree on one product (Product 1)
Solution 3	Develop and adopt 2 products (Products 1&2)
Solution 4	Develop and adopt 2 products (Products 1&3)
Solution 5	Agree on one product (Product 3)
Solution 6	Agree on one product (Product 2)

Product 1 is defined as “Seller ensures that the source Balancing Authority supplies reserves.”

(With this product, the sink BA can decrement their load responsibility (reserve requirement), and the source BA is obligated to increase their load responsibility.)

Product 2 is defined as “Firm Energy sold separately from contingency reserves.” This product would be consistent with the WECC product code, which states *“This product may be curtailed only in the event of a reliability condition or to meet Seller’s public utility or statutory obligations for reliability of service to native load. [This] product cannot be interrupted for economic reasons.”* This product would also include liquidated damages unless agreed otherwise.

Product 3 is defined as ““Purchaser ensures that the sink Balancing Authority supplies reserves.”

What are the strengths and weaknesses of each potential solution?

Please see pages 14 through 21 of this report.

I. BACKGROUND

A. The WECC Letter

In its November 7 letter, WECC explained as follows,

The WECC Operating Reserve mandatory reliability standard allows for the transferring of reserve responsibility between Balancing Authorities (BA) through interchange transactions; many or most of which are transactions under the WSPP agreement. This transfer of reserve responsibility must be properly accounted for when determining the BA Load Responsibility as it is a major component from which the amount of required reserves is calculated. This results in the use of commercial terms such as Firm, Interruptible, and Recallable in determining the minimum required reserves in a sanctionable reliability standard.

* * *

The Market Interface Committee discussed these documents and voiced concerns that market participants that have addressed reserve issues with their transactions may be surprised when e-Tags specifying the reserve obligation are denied by BAs that were not parties to the transaction, or have a different understanding of the reserve obligation. There is concern there may be disruption or reduced liquidity in the marketplace as merchant entities and BAs attempt to resolve reserve designation issues in existing contracts and with future transactions traded through brokers or electronic trading platforms such as the Intercontinental Exchange (ICE).

B. WSPP Background

For years there has been disagreement among WSPP members over reserves issues. Some believe that Sellers are required to provide contingency reserves, but others disagree. The issue appears to be limited to the WECC outside of the CAISO. The market has functioned despite the disagreement, largely because events had not forced the issues. Recent developments are now forcing contingency reserves issues to a head.

WSPP Service Schedule C, specifically Section C-3.10, provides, “*Seller shall be responsible for ensuring that Service Schedule C transactions are scheduled as firm power consistent with the most recent rules adopted by the applicable NERC regional reliability council.*”

Those who believe Sellers are responsible for providing contingency reserves argue that, in the past, the WECC required the generator or “Source” BA to be responsible for carrying reserves. This interpretation may not have evolved with changes in market structure and participants over the years. Today, there are many Sellers who are not BAs or generators, and there are generators that can not obligate their BAs to carry reserves for export transactions.

Some interpret the words “scheduled as firm power” in Service Schedule C to mean that the product, when scheduled, comes with reserves. Others argue that this interpretation is not applicable outside of the WECC, or within the CAISO, and is not supported by any current language in the WSPP Agreement or WECC standards.

Part of Schedule C, section C-3.3 reads “*Firm capacity transactions shall include buying, selling, or exchanging capacity between Parties with or without associated energy. Firm capacity is deemed a capacity sale from the Seller’s resources and backed by the Seller’s capacity reserves.*” Some argue that every energy transaction must come with capacity, since capacity is required to generate energy on a firm basis. By extension, they contend, capacity must come with the Seller’s reserves.

WSPP history tends to explain why many believe that Sellers are to carry reserves. The purchase price for a transaction under Schedule C, under the WSPP Agreement as approved in 1991, likely reflected the cost of reserves as well as the energy, since reserves were accounted for in the calculation of cost-based ceiling prices for such transactions. *See Western Systems Power Pool*, 55 FERC ¶ 61,099, 61,339 (1991) (Trabandt, dissenting) (“staff allowed additional charges for fixed costs (taking a typical overhead percentage) and reserves (because utilities must maintain a cushion for emergencies.)”). On rehearing, the Commission affirmed the inclusion of the cost of reserves in the rates, stating that the Commission “adopted as a benchmark the fixed costs faced by the native load ratepayers” and concluded that, since the “costs for the native load ratepayer include reserves[,] . . . it is entirely appropriate to factor these costs into the margin.” *Western Systems Power Pool*, 55 FERC ¶ 61,495, 62,717 (1991). In addition, the Commission stated that “it is because utilities maintain reserves that many coordination transactions, including those under the WSPP, are possible.” *Id.* The inclusion of the cost of reserves in the cost-based ceiling price for transactions under the WSPP Agreement may explain the inclusion of the language specifying that firm capacity is “backed by Seller’s reserve capacity.” *See Gainesville Utilities Dept. v. Florida Power Corp.*, 402 U.S. 515, 518 and n.2 (1971) (regarding general practice in the early 1970s regarding spinning reserves).¹

Those who argue against a Seller obligation to provide contingency reserves contend that the phrase “*with or without energy*” in Schedule C establishes that capacity can be sold independent of energy (e.g., Resource Adequacy Capacity) and there are clearly transactions for firm energy only without any reference to capacity. In any event, this language of Schedule C applies to capacity sales, not energy sales. Nowhere in Schedule C are “seller’s capacity reserves” defined. Operating reserves are not discussed within the context of Schedule C. Sellers that are neither state-regulated utilities nor operators of BAs may not have any “reserves” requirement at all, other than to have the financial ability to pay damages if they fail to deliver the contract quantity of capacity or energy.

¹ For background only, former WSPP Operating Procedure No. 3 stated that sales of non-interruptible power under Schedule C “are transactions that cannot be interrupted by Supplier, or Receiver” and that “[s]ince the Supplier cannot interrupt [these] transactions, they must be backed with ‘Seller’s system capacity reserves.’” WSPP Operating Procedure No. 3 at 2.

Some (including Bobby Campo) maintain that it was never envisioned that Schedule C would place an obligation on the Seller to **provide** reserves, but rather that they would make sure that when the power was scheduled it was done according to scheduling guidelines for firm power.

Others argue that many Purchasing and Selling Entities do not have a system, so they can not provide, and in some cases, can not even procure, contingency reserves, and that a requirement that they provide reserves will bar them from the market. Some independent power producers believe that the “system” behind transactions from their generation is that of the BA from which they purchase control area services. Some market participants contend that a formal WSPP action that interprets or clarifies that Sellers must provide contingency reserves could result in antitrust/restraint of trade issues.

The FERC pro-forma Open Access Transmission Tariff (“OATT”) does not require transmission providers to offer reserves for transactions serving load outside the transmission provider’s control area. FERC does require transmission providers to offer reserves (if requested) to transmission customers for transactions serving load within their control areas. (see Attachments 3 & 4 shaded text.)

Some opine that the definition of firm, when the WSPP was created, generally meant that a party had physical resources to deliver power, and that the only excuse for not delivering was to protect system reliability. However, the issue of whether a Seller is always expected to provide contingency reserves or not appears separate and distinct from the question of the characteristics of firm power, and whether the Seller must have capacity to back its firm sales.

With the unbundling of functions, and the identification of “Balancing Authorities,” FERC has recently had to discuss the identification of those responsible to provide ancillary services, including capacity reserves. As noted, a transmission provider is to provide capacity reserves in its control area, but is not required to provide the service outside its control area. By contrast, merchants are permitted to sell ancillary services under a market based tariff that expressly allows such sales, including a specific description of the services.

C. Forcing the Issue

On September 7, 2007, WECC approved its “Interpretation of Load Responsibility” coincidentally with the implementation of eTag 1.8. Many thought that WECC was making a new policy statement. However, WECC claims that they were simply stating what they believed to be true all along. In pertinent part, it said *“Energy product definitions are determined by the entities that are parties to the transaction. It is up to Purchasing Selling Entities to determine their level of acceptable deliverability risk and determine who has contingency reserve responsibility.”* (see Attachment 5)

This action has set up a conflict among WSPP parties trading schedule C products. Whereas there was tacit agreement (some believe; others do not believe) that WECC implied that sellers carry reserves, now WECC makes it plain that the parties to a transaction choose who carries that responsibility. Forcing the issue is the requirement that the BA carrying the reserve

responsibility now be identified on each and every tag, and that it be reflected in the respective BA's calculations of contingency reserve requirement.

Some in the WSPP have sent letters soliciting agreement, or making statements, pursuant to their individual company interpretation.

The net effect of all of this has been an immediate impact on liquidity. Particularly on electronic trading platforms, and especially for term products, markets for physical power are extremely thin. Given that a large number of WSPP members traditionally trade physical power, this does not bode well for the industry. In addition, various parties are not trading with others who do not agree with their position on this issue.

D. Northwest Power Pool Action

In response to WECC's actions, the Northwest Power Pool issued a statement staking out default positions, though they allowed agreement otherwise. (see Attachment 1)

E. Other pertinent considerations:

WECC allows for the transfer of load responsibility via interchange schedules. In essence, this has been happening for years via **some** WSPP Schedule C transactions. Recent events (WECC interpretation of load responsibility, eTag 1.8) will begin to reveal three things; (1) that in certain transactions, parties that assumed that load responsibility was being provided by a counterparty were mistaken, (2) that the price of some transactions has included this reserves component (whether overtly recognized or not), and (3) the uncertainty over whether or not a product came with reserves has resulted in a price adjustment. As buyers and sellers begin to discuss whether a product is coming with reserves or not, the value of those reserves will begin to become apparent as prices are negotiated. WECC does not prohibit the buying or selling of reserves and in fact has recently adopted product codes specifically developed for identifying reserve products on tags.

To complicate matters, there is general disagreement over what constitutes **contingency reserves** as defined by the WECC. Reserves are defined by NERC (see Attachment 2) and consist of Operating Reserves, which is made up of Regulating Reserve and Contingency Reserve (contingency reserves are the subject of our issue). In the WECC, contingency reserves are made up of one-half spinning and one-half non-spinning. The amount of reserves required is calculated as the greater of: (a) the most severe single contingency, or (b) 5% of the load responsibility served by hydro, and 7% of the load responsibility served by thermal.

A transmission provider is required to offer to provide (or offer to arrange with the local control area operator) certain ancillary services to the transmission customer serving load *within* the transmission provider's control area. In addition, the transmission customer serving load within the transmission provider's control area is required to acquire these ancillary services, whether from the transmission provider, from a third party, or by self-supply. However, the *pro forma* OATT does not require the transmission provider to offer these ancillary services to customers serving load outside of its control area.

Under this framework, some sellers maintain that they cannot obligate their BA, which may be a third party, to provide reserves for sales made by their merchant function for exports leaving their BA (control area). By contrast, they maintain that they **can** provide reserves if the merchant is the purchaser, and the purchase will be sunk in their BA, since FERC has mandated that the sink BA is the provider of last resort. These conclusions appear correct. Likewise, a third party can provide the reserves to a BA on an unbundled basis if it has the requisite market-based authority. For example, a BA with an independent power producer (“IPP”) within its boundaries is not obligated to provide reserves to the IPP if the IPP is exporting power outside the BA. Furthermore, unless it is purchasing reserves on behalf of its BA, it may make little sense for an IPP to procure reserves from third parties, as these can only back up the IPP’s schedule if activated by, and deliverable to, the source BA.

A large segment of financial institutions, marketers, and merchants generally have no view or preference as to what product WSPP should be, as long as the product is common, uniform, and widely traded.

Some question whether an ancillary service product sold bundled as part of a market-based capacity and/or energy transaction by an entity without market-based rate authority is legitimate. In general, jurisdictional utilities can sell ancillary services under an OATT, or under a specific, market-based rate authority. See Legal Appendix attached hereto.

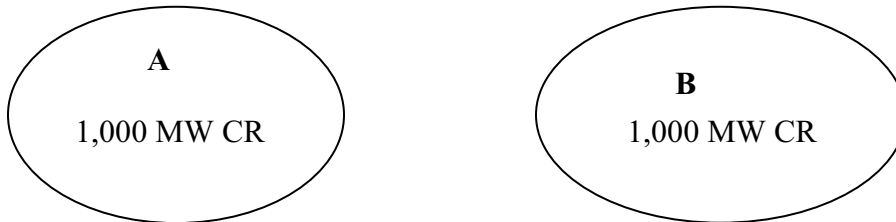
For some flavor behind the arguments, see Sempra Global’s request for clarification on FERC Order 890 (attachment 6), in Schedules 5 and 6 of the FERC *pro forma* OATT (attachment 3), and in the FERC Order responding to Puget’s request for deviation from the FERC *pro forma* OATT (attachment 4).

F. Technical Background

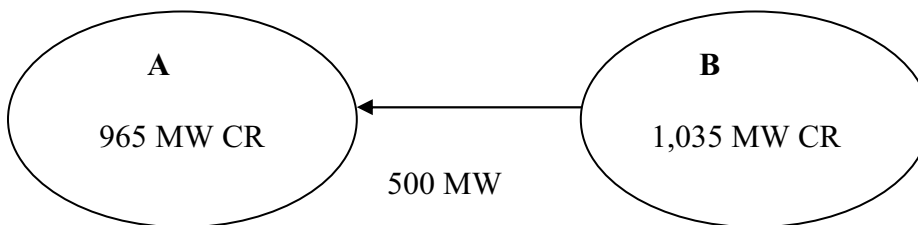
Reserve requirement versus reserve deployment. There is a difference between using interchange transactions to affect the calculation of reserve requirement, or “load responsibility,” and using interchange transactions to deploy reserves. Interchange transactions that transfer load responsibility do not provide for the deployment of the transferred reserves by the transferring party. Interchange transactions to convey a reserve transaction (buy/sale of reserves) allow the buyer to initiate deployment of the reserves. These concepts are explained further in the examples below:

Consider two Balancing Authorities, each with a 1,000 MW reserve requirement (based on load responsibility). A and B are not members of the same reserve sharing group.

LOAD RESPONSIBILITY TRANSFER



A and B Balancing Authorities each have a contingency reserve requirement of 1,000 MW based on their load responsibility calculation. There are no sales between them so each must carry 1,000 MW of contingency reserves.

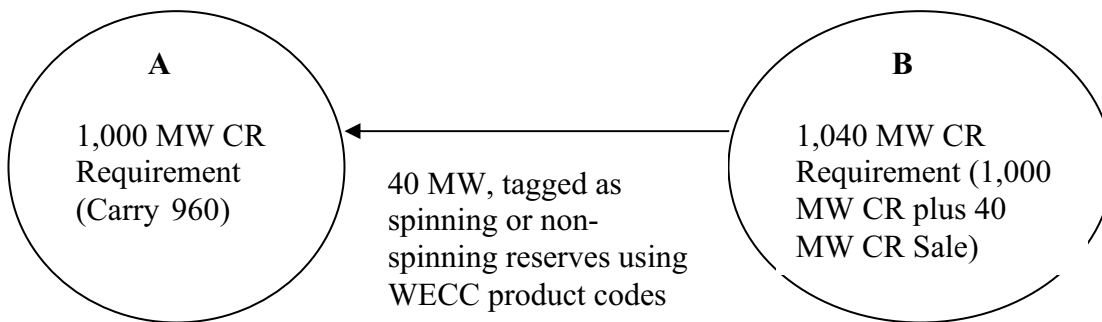


A and B Balancing Authorities each have a contingency reserve requirement of 1000 MW based on their load responsibility calculation and there is a 500 MW Schedule C (with reserves) sale by B to A. According to current practice, a 500 MW sale of Schedule C (with reserves) from B to A will result in the “Load Responsibility” requirement of A being reduced by 500 MW, which in turn reduces A’s reserve requirement to 965 MWs (1000 MW less 7% of 500 MW) and the load responsibility in B being increased by 500 MW resulting in a contingency reserve requirement of 1,035 MWs (1000 MW plus 7% of 500 MW). However, if a disturbance event occurs in A, A has no right to call on the additional reserves B holds due to the sale it made to A. Furthermore, B is under no obligation to deploy the additional reserves it holds, as a result of the 500 MW sale it made to A, to assist A in recovering from its disturbance. Rather, the Reserve Sharing Group to which A belongs to will cover the event using whatever deployment scheme they have.

Reserves are an amount over and above the 500 MW transaction, they are not “part of” the 500 MW. In this sense, no firm transaction comes with reserves, only an obligation on the source Balancing Authority to increase the amount of reserves it holds. It should be noted that this is generally what is meant in the WECC when someone asks if the transaction is “with reserves.”

RESERVE TRANSACTIONS (buying and selling reserves)

Reserves can be deployed via interchange transactions by buying and selling reserve products per the product codes adopted by WECC, as shown below: The rules for this type of transaction would require that the energy be delivered over firm transmission and that it is delivered within 10 minutes of notice. A and B Balancing Authorities (see bubbles below) each have a contingency reserve requirement of 1000 MW based on their load responsibility calculation. B has sold A 40 MW of spinning or non-spinning reserves. According to current practice, the 40 MW reserve sale from B to A will result in no increase in the reserve requirement of A (remains at 1000 MW) and a 40 MW increase in the reserve requirement of B (1000 MW plus 40 MW). If a disturbance event occurs in A, A has the right to call on the reserves B holds due to the reserve sale B made to A. Furthermore, B is obligated to deliver the 40 MW reserve sale to A within 10 minutes of notice to assist A in recovering from its disturbance.



II. Possible WSPP Solutions

A. Product Definition Solutions

In response to the liquidity issue, the task force is currently examining the following possible solutions.

Solution 1	WECC passes Bal-002
Solution 2	Agree on one product (Product 1)
Solution 3	Develop 2 products (Products 1&2)
Solution 4	Develop 2 products (Products 1&3)
Solution 5	Agree on one product (Product 3)
Solution 6	Agree on one product (Product 2)

Throughout the report:

Product 1 is defined as “Seller ensures that the source Balancing Authority supplies reserves.”

(With this product, the sink BA can decrement their load responsibility (and therefore the contingency reserve requirement), and the source BA is obligated to increase their load responsibility by the same amount.)

Product 2 is defined as “Firm Energy sold separately from contingency reserves.” This product would be consistent with the WECC product code, which states “*This product may be curtailed only in the event of a reliability condition or to meet Seller’s public utility or statutory obligations for reliability of service to native load. [This] product cannot be interrupted for economic reasons.*” This product would also include liquidated damages unless otherwise agreed.

Product 3 is defined as ““Purchaser ensures that the sink Balancing Authority supplies reserves.”

Existing Contracts

The task force believes that the existing language of Schedule C should be left intact regardless of which solution WSPP may pursue. This preserves whatever arguments the parties believe they have regarding who carries the reserve responsibility under existing contracts whose terms precede, and may extend beyond, the adoption of any of the solutions above. Any language describing Products 1, 2, or 3 would be in addition to Schedule C and would be in effect after their adoption by the WSPP.

Some members have pointed out that the current WSPP Agreement does not contain clear damages provisions for failure to supply reserves, and that during the development of new products the members should address this issue.

Evaluation of Solutions

Each of these possible solutions are evaluated, in as non-biased a fashion as possible, according to the following criteria:

Strengths

Weaknesses

Value Shifts – this is an attempt to identify if there are any members who may be affected financially.

Functional fix required – are there any contract, scheduling, or technical actions that may be required in order to implement the solution.

Regulatory fix required – are there any actions required of any authoritative bodies.

Probability of 90% approval – these are subjective data garnered by observation.

Solution 1: WECC passes Bal-002-WECC-1

The current draft of Bal-002-WECC-1 removes the ability of BAs to transfer load responsibility via energy transactions. It effectively prevents contingency reserve responsibility from being transferred via transactions such as under WSPP Schedule C energy. However, contingency reserves transactions (buys/sales) may still be transferred through interchange schedules using new product codes (specific to contingency reserves) developed by WECC.

Strengths

- May substantially resolve the issue without WSPP action.
- The solution, like the problem, will be limited to the WECC Region.
- PSEs with or without systems can buy reserves and, subject to FERC requirements (have cost-based or market-based rate authority), schedule reserves under new WECC product codes.
- Separates reliability world from commercial world, which is consistent with direction of FERC and the rest of the U.S.

Weaknesses

- May not receive sufficient support at March WECC Operating Committee meeting to advance
- Market dysfunction may continue until Bal-002-WECC-1 is implemented, which most likely won't be until early 2009.
- Deficit BAs need a way to meet their new reserve requirement.
- Because of the requirement to transfer reserves over firm transmission, the potential pool of reserve providers may be reduced.
- Slight chance of continued disagreement over what Schedule C means since some people believe you must have access to reserves in order to sell Schedule C firm energy.

Value shifts

- Whereas under the existing standard BAs can rely on WSPP transactions utilizing non-firm transmission to reduce their reserve requirement, if Bal 002 passes they would have to purchase firm transmission for delivery of reserves.

Functional fix required

- WECC will most likely remove requirement to specify party responsible for reserves on the tag.

Regulatory/agency fix required

Approval required by:

- WECC Operating Committee,
- WECC Board,
- NERC Board, and
- FERC.

Probability of 90% vote at WSPP Etc.
NA. Probability of passage at WECC - 50%
No action required at WSPP

Solution 2: Agree on one product (Product 1)

Product 1 - Seller ensures that the source BA supplies reserves.

Strengths

- Changes to the WSPP agreement can be done within WSPP.
- May allow some BAs to count on WSPP imports to reduce operating reserve requirement.
- A single standard product improves the chances of consistent application and increased liquidity in the marketplace.

Weaknesses

- Parties who cannot obtain reserves from their BA cannot provide this product.*
- Some believe there would be antitrust concerns with this product.
- This is a bundled product that links firm energy and contingency reserves, which is an ancillary service. If the product is exported, the seller appears to need to assure it has requisite market-based authority to sell the AS together with the firm energy, or may be required to demonstrate that it is selling the bundled product at cost-based rates.
- This product is not the same product that is trading in the rest of the continent.

Value shifts

- Parties who cannot obtain reserves from their BA cannot provide this product.

Functional fix required

- Requires new or modified WSPP language (e.g., creation of a new service schedule, clarification of remedies for not performing on reserves provisions).
- WECC could remove requirement to specify party responsible for reserves on the tag.

Regulatory fix required

- Requires FERC approval of new WSPP filing.

*A FERC action requiring BAs to provide reserves (not imbalance energy) to sellers delivering out of the BA would significantly alleviate this weakness. However, we understand that filings have been or will be made by parties asking FERC to do just this. We are told that FERC declines to require this, and has reiterated that it is the responsibility of the sink BA to be the provider of last resort for reserves.

Probability of 90% approval

This has been proposed to the Executive Committee as an interim measure, and only applicable to ICE trades. It failed, and in fact only achieved a 50% approval.

Solution 3: Develop two products (Products 1&2)

Rather than attempting to agree on a default product, develop two products as follows:

Product 1 - Seller ensures that the source BA supplies reserves.

Product 2 – Firm energy sold separately from reserves.

Strengths

- Changes to the WSPP Agreement can be done within WSPP.
- May allow some BAs to count on WSPP imports via Product 1 to reduce their operating reserve obligations.
- Allows market participants to determine their preferred products.
- If both products end up with sufficient liquidity, this provides an alternative to those who can't supply Product 1.
- WECC has already developed a means to separate the two products using the e-tag form.

Weaknesses

- Scheduling/tagging issues.
- The ICE has claimed that bifurcating products usually results in a reduction in liquidity.
- Potential for market confusion. Requires education on product distinctions.
- Parties who cannot obtain reserves from their BA cannot provide Product 1, which would limit them to Product 2.
- If some market participants are limited to selling Product 2, some believe there would be antitrust concerns with this solution.
- Broker markets and electronic trading platforms would have to identify which product is being transacted.
- Product 1 is a bundled product that links firm energy and contingency reserves, which is an ancillary service. If Product 1 is exported, the Seller appears to need to assure it has requisite market-based authority to sell the ancillary service together with the firm energy, or may be required to demonstrate that it is selling the bundled product at cost-based rates.
- Product 1 is not the same product that is trading in the rest of the continent

Value shifts

- Parties who cannot obtain reserves from their BA cannot provide Product 1, which would limit them to Product 2.

Functional fix required

- Product differentiation would be required in the broker markets and on electronic trading platforms.
- Requires creation of two new WSPP service schedules

Regulatory fix required

- Requires FERC approval of WSPP filing.

Probability of 90% vote

- Not clear - Some entities will not support bifurcating the market in this manner.

Solution 4: Develop two products (Products 1&3)

Rather than attempting to agree on a default product, develop two products as follows:

Product 1 - Seller ensures that the source BA supplies reserves

Product 3 – Purchaser ensures that the sink BA supplies reserves.

Strengths

- Changes to the WSPP agreement can be done within WSPP.
- May allow some BAs to count on WSPP imports via Product 1 to reduce their operating reserve obligations.
- Allows market participants to determine their preferred products.
- If both products end up with sufficient liquidity, this provides an alternative to those who can't supply Product 1.
- Product 3 is consistent with FERC having designated the sink transmission provider to load as having to offer reserves.
- WECC has already developed a means to separate the two products using the e-tag form.

Weaknesses

- Scheduling/tagging issues.
- The ICE has claimed that bifurcating products usually results in a reduction in liquidity.
- Potential for market confusion. Requires education on product distinctions.
- Parties who cannot obtain reserves from BA cannot provide Product 1, which would limit them to Product 3.
- If some market participants are limited to selling Product 3, some believe there would be antitrust concerns with this solution.
- Broker markets and electronic trading platforms would have to identify which product is being transacted.
- Product 1 is a bundled product that links firm energy and contingency reserves, which is an ancillary service. If Product 1 is exported, the Seller appears to need to assure it has requisite market-based authority to sell the ancillary service together with the firm energy, or may be required to demonstrate that it is selling the bundled product at cost-based rates.
- Product 1 is not the same product that is trading in the rest of the continent. It is debatable whether Product 3 is.

Value shifts

- If the market moves toward Product 3 as a default, some BAs claim their costs to satisfy reserve requirements will go up (may be at least partially offset by potential reduction in price for firm energy).
- Parties who cannot obtain reserves from their BA cannot provide Product 1, which would limit them to Product 3.

Functional fix required

- Product differentiation would be required in the broker markets and on electronic trading platforms.
- Requires creation of two new WSPP service schedules

Regulatory fix required

- Requires FERC approval of WSPP filing.

Probability of 90% vote

- Unclear. Some entities have indicated they would not vote for this.

Solution 5: Agree on one product (Product 3)

Product 3 – Purchaser ensures that the sink BA supplies reserves. This essentially removes reserves from being transferred via WSPP Schedule C transactions.

Strengths

- Changes to the WSPP agreement can be done within WSPP.
- A single product improves the chances of consistent application and increased liquidity in the marketplace.
- Allows all market participants equal opportunity to transact in a non-discriminatory manner (reduces anti-trust risk)
- Product 3 is consistent with FERC having designated the sink transmission provider to load as having to offer reserves.

Weaknesses

- Relies on FERC Orders regarding reserves supplied by sink BA.
- BAs that have relied on WSPP Schedule C imports to satisfy reserve obligations will need to rely on their own generation or get reserves elsewhere.
- Applicability may be limited to the WECC (may not make sense elsewhere).

Value shifts

- Some BAs claim their costs to satisfy reserve requirements will increase (may be at least partially offset by potential reduction in price for firm energy).

Functional fix required

- Requires a reserves market (which may exist already via WECC new product codes being traded under existing WSPP).

Regulatory fix required

- Requires creation of a new service schedule, and FERC approval of WSPP filing.

Probability of 90% vote

- Unclear. Some entities have indicated they would not vote for this.

Solution 6: Agree on one product (Product 2)

Product 2 - Energy without reserves.

Strengths

- Changes to the WSPP agreement can be done within WSPP.
- A single product improves the chances of consistent application and increased liquidity in the marketplace.
- Product 2 is consistent with products traded in the CAISO and other markets throughout North America, which might facilitate broader use of the WSPP Agreement.
- Allows all market participants equal opportunity to transact in a non-discriminatory manner (reduces anti-trust risk).
- WECC has already developed a definition of firm power (without reserves) that we can use for Product 2.
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Weaknesses

- BAs that have relied on WSPP Schedule C imports to reduce reserve requirements will need to rely on their own generation or get reserves elsewhere.
- Firm transmission must be used to deliver operating reserves when purchased from outside of the BA

Value shifts

- Some LSEs claim their costs to satisfy reserve requirements will go up (may be at least partially offset by potential reduction in price for firm energy).

Functional fix required

- Requires a reserves market (which may exist already via WECC new product codes being traded under existing WSPP).

Regulatory fix required

- Requires creation of a new service schedule, and FERC approval of WSPP filing.
-

Probability of 90% vote

- Unclear. Some entities have indicated they would not vote for this.

B. Reserves Market Alternatives

Some of the previous solutions remove the ability of Load Serving Entities (“LSEs”) to use WSPP Schedule C purchases to reduce their operating reserve requirements. Some have said they will not vote for any of these solutions unless they have the ability to satisfy their obligations via interchange schedules.

WECC has developed new product codes specifically identified for contingency reserve transactions. Some believe these products are currently being traded under the WSPP umbrella. The task force will follow up on this to determine if this new “market” can serve to satisfy the needs of these LSEs. Note: although it is permitted to trade products under the WSPP Agreement other than the service schedule products, WSPP does not substitute for any needed market based rate authority.

If not, the task force is considering the following products that may also be used.

Reserves Market 1 – WSPP Capacity Product

BAs and other market participants, would trade contingency reserves as capacity with “on call” energy under current Schedule C product definition.

Strengths

- Market is created quickly.
- Allows broad market participation.

Weaknesses

- Some suggest this would require some entities (like BAs or Transmission Providers) to join WSPP, but this would not be true for transactions conducted under a different contractual arrangement.

Value shifts

- None identified.

Functional fix required

- May require telemetry between BAs, or between Reserve Sharing Groups for the Spinning Reserve product.
- May require a modified remedy for non-performance (could be specified in confirmation rather than contract amendment).
- May want to create a standard confirmation for this product to facilitate its use.
- BAs that do not already have them may possibly need to augment trading systems and personnel.

Regulatory fix required

- Each entity need to assure has requisite market based rate authority to sell contingency reserves, or will need to sell them at cost-based rates.

Reserves Market 2 – New WSPP Market based Tariff

BAs and market participants could trade contingency reserves under new WSPP filed OATT or, more likely, a service schedule.

Strengths

- Uses existing WSPP structure.
- Market is created relatively quickly.
- Allows for broad market participation.

Weaknesses

- Requires BAs to join WSPP, unless they transact under different contractual arrangements.

Value shifts

- None identified.

Functional fix required

- May require telemetry between BAs for Spinning Reserve product.
- BAs that do not already have them may possibly need to augment trading systems and personnel.

Regulatory fix required

- FERC approval of WSPP ancillary services tariff (without the requirement of individual provider filings).
- Each entity need to assure has requisite market based rate authority.

Reserves Market 3 – New WSPP Cost based Tariff for reserves used within a BA and Market based Tariff for reserves used for export

BAs, merchants, generators and others trade contingency reserves under new WSPP service schedule.

Strengths

- Uses existing WSPP structure.
- Market is created relatively quickly.
- Allows for broad market participation.
- A cost-based product could be made, potentially, part of the WSPP Agreement, without the need for separate market based authorizations.

Weaknesses

- Requires BAs to join WSPP, unless they transact under an alternate contractual arrangement.

Value shifts

- None identified.

Functional fix required

- BAs that do not already have them may possibly need to augment trading systems and personnel.
- May require telemetry between BAs for Spinning Reserve product.

Regulatory fix required

- FERC approval, with cost justifications.

Attachment 1

NWPP Response to the new WECC Interpretation of Load Responsibility October 11, 2007

On September 7, 2007 the WECC Board of Directors approved an interpretation of Load Responsibility associated with the WECC Balancing Authority L-STD-002-0; refer to attachment. Although this interpretation will not become effective until after the implementation of e-Tag version 1.8, which is currently expected sometime in December of 2007, the Northwest Power Pool Reserve Sharing Group (NWPP RSG) will operate within its program in accordance with the following.

The NWPP RSG's longstanding interpretation has been that the "source" Balancing Authority is required to include its exports in the calculation of its Load Responsibility (the only exception being interruptible exports). This new interpretation of Load Responsibility is meant to allow either the "source" or "sink" Balancing Authorities to include a transaction in its Load Responsibility. In doing so, it raises questions about the way that the NWPP RSG will ensure that the Contingency Reserves being carried actually meet the minimums prescribed in the WECC Standards.

The NWPP RSG will retain its current Reserve Sharing program; including the "Firm For The Hour" definition as it pertains to the Participating Balancing Authority Areas within the NWPP RSG, accommodating unit contingent (firm contingent energy code) transactions. However, the NWPP RSG will make the following changes in compliance with the new interpretation.

- NWPP RSG members (for which they are the source) will not retain Contingency Reserve responsibility associated with exports out of the NWPP area, unless the etag indicates otherwise.
- NWPP RSG members will agree with the WECC assumption that transactions between Balancing Authorities that are unit contingent (firm contingent energy code) will be treated the same as transactions with generating units residing inside the sink Balancing Authority for Contingency Reserve purposes.
- NWPP RSG members (for which they are the sink) will retain Contingency Reserve responsibility for all imports into the NWPP area, unless the etag indicates otherwise.
- Within operating hour schedule cuts of non-interruptible energy imports or exports, in or out of the NWPP RSG area, will not be initiated nor accepted by NWPP RSG members, except: 1) For reliability purposes or 2) if mutually agreed to by the source and sink balancing authorities or 3) if it is a unit contingent (firm contingent energy code) transaction. A single generator contingency is not an acceptable reason for cutting a firm transaction, unless it is a unit contingent (firm contingent energy code).

Balancing Authority participants in the NWPP RSG are: AESO, AVA, BCTC, BPAT, CHPD, DOPD, GCPD, IPC, NWMT, PACE, PACW, PGE, PSE, SMUD, SCL, SPPC, TPWR, TID, and WAUW.

Attachment 2

NERC Reserve requirements/definitions

Standard Balancing AuthorityL-002-0 — Disturbance Control Performance
Adopted by NERC Board of Trustees: February 8, 2005 2 of 6
Effective Date: April 1, 2005

R3. Each Balancing Authority or Reserve Sharing Group shall activate sufficient Contingency Reserve to comply with the DCS.

R3.1. As a minimum, the Balancing Authority or Reserve Sharing Group shall carry at least enough Contingency Reserve to cover the most severe single contingency. All Balancing Authorities and Reserve Sharing Groups shall review, no less frequently than annually, their probable contingencies to determine their prospective most severe single contingencies.

WECC Standard Balancing AuthorityL-STD-002-0 – Operating Reserves

The reliable operation of the interconnected power system requires that adequate generating capacity be available at all times to maintain scheduled frequency and avoid loss of firm load following transmission or generation contingencies. This generating capacity is necessary to:

- supply requirements for load variations.
- replace generating capacity and energy lost due to forced outages of generation or transmission equipment.
- meet on-demand obligations.

a. Minimum Operating Reserve. Each Balancing Authority shall maintain minimum Operating Reserve which is the sum of the following:

(i) Regulating reserve. Sufficient Spinning Reserve, immediately responsive to Automatic Generation Control (AGC) to provide sufficient regulating margin to allow the Balancing Authority to meet NERC's Control Performance Criteria (see Balancing AuthorityL-001-0).

(ii) Contingency reserve. An amount of Spinning Reserve and Nonspinning Reserve (at least half of which must be Spinning Reserve), sufficient to meet the NERC Disturbance Control Standard Balancing AuthorityL-002-0, equal to the greater of:

(a) The loss of generating capacity due to forced outages of generation or transmission equipment that would result from the most severe single contingency; or

(b) The sum of five percent of the load responsibility served by hydro generation and seven percent of the load responsibility served by thermal generation.

The combined unit ramp rate of each Balancing Authority's on-line, unloaded generating capacity must be capable of responding to the Spinning Reserve requirement of that Balancing Authority within ten minutes

(iii) Additional reserve for interruptible imports. An amount of reserve, which can be made effective within ten minutes, equal to interruptible imports.

(iv) Additional reserve for on-demand obligations. An amount of reserve, which can be made effective within ten minutes, equal to on-demand obligations to other entities or Balancing Authorities.

b. Acceptable types of Nonspinning Reserve. The Nonspinning Reserve obligations identified in subsections a(ii), a(iii), and a(iv), if any, can be met by use of the following:

(i) interruptible load;

(ii) interruptible exports;

(iii) on-demand rights from other entities or Balancing Authorities;

(iv) Spinning Reserve in excess of requirements in subsections a(i) and a(ii); or

(v) off-line generation which qualifies as Nonspinning Reserve.

c. Knowledge of Operating Reserve. Operating Reserves shall be calculated such that the amount available which can be fully activated in the next ten minutes will be known at all times.

FROM THE NERC GLOSSARY FOR SPINNING RESERVE

http://www.nerc.com/~filez/standards/Reliability_Standards_Regulatory_Approved.html

Spinning Reserve: Unloaded generation that is synchronized and ready to serve additional demand.

Attachment 3

FERC Pro-Forma OATT Schedules (Brenda, is that the source?)

SCHEDULE 5

Operating Reserve - Spinning Reserve Service

Spinning Reserve Service is needed to serve load immediately in the event of a system contingency. Spinning Reserve Service may be provided by generating units that are on-line and loaded at less than maximum output and by non-generation resources capable of providing this service. **The Transmission Provider must offer this service when the transmission service is used to serve load within its Control Area.** The Transmission Customer must either purchase this service from the Transmission Provider or make alternative comparable arrangements to satisfy its Spinning Reserve Service obligation. The amount of and charges for Spinning Reserve Service are set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

SCHEDULE 6

Operating Reserve - Supplemental Reserve Service

Supplemental Reserve Service is needed to serve load in the event of a system contingency; however, it is not available immediately to serve load but rather within a short period of time. Supplemental Reserve Service may be provided by generating units that are online but unloaded, by quick--start generation or by interruptible load or other non-generation resources capable of providing this service. **The Transmission Provider must offer this service when the transmission service is used to serve load within its Control Area.** The Transmission Customer must either purchase this service from the Transmission Provider or make alternative comparable arrangements to satisfy its Supplemental Reserve Service obligation. The amount of and charges for Supplemental Reserve Service are set forth below. To the extent the Control Area operator performs this service for the Transmission Provider, charges to the Transmission Customer are to reflect only a pass-through of the costs charged to the Transmission Provider by that Control Area operator.

Attachment 4

(This is FERC's response to a filing by a Northwest IOU for deviations from certain provisions of the 890 *pro forma* Open Access Transmission Tariff).

ORDER ON PROPOSED TARIFF REVISIONS

(Issued December 4, 2007)

Under section 3 of the *pro forma* OATT, the transmission provider is required to offer to provide (or offer to arrange with the local control area operator) certain ancillary services to the transmission customer serving load *within* the transmission provider's control area. In addition, the transmission customer serving load within the transmission provider's control area is required to acquire these ancillary services, whether from the transmission provider, from a third party, or by self-supply. However, the *pro forma* OATT does not require the transmission provider to offer these ancillary services to customers serving load outside of its control area. Nor does the *pro forma* OATT require the transmission customer serving load outside of the transmission provider's control area to demonstrate that it has acquired ancillary services from another source before it may decline a transmission provider's offer of ancillary services.

Attachment 5

Proposed WECC Interpretation of “Load Responsibility”

Approved by the WECC Board of Directors September 7, 2007

This document contains an interpretation of the WECC defined term “Load Responsibility.”

Current Load Responsibility definition: A control area’s firm load demand plus those firm sales minus those firm purchases for which reserve capacity is provided by the supplier.

Interpretation of Load Responsibility:

A Balancing Authority’s (BA) Load Responsibility is the algebraic sum of the BA Area’s:

- Net Generation
- Minus (-) Net Actual Interchange (NAI) (- or +)
 - NAI Exports are positive (+), NAI Imports are negative (-)
- Minus (-) loads that can be interrupted in 10 minutes or less by contractual agreement.
- Plus (+) Interchange Schedule exports where the BA is identified as retaining Contingency Reserve responsibility through the e-Tag process.
 - Contingency Reserve responsibility is identified as required by INT-BPS-014-0 Identification of Contingency Reserve Responsibilities in the e-Tag
- Minus (-) Interchange Schedule imports where another BA is identified as having Contingency Reserve responsibility through the e-Tag process.
 - Contingency Reserve responsibility is identified as required by INT-BPS-014-0 Identification of Contingency Reserve Responsibilities in the e-Tag

The following assumptions apply only to the interpretation of Load Responsibility:

1. WECC should focus on the interpretation of reliability criteria. It should not define energy market products.
2. Energy product definitions are determined by the entities that are parties to the transaction.
 - It is up to Purchasing Selling Entities to determine their level of acceptable deliverability risk and determine who has contingency reserve responsibility.
3. The minimum Contingency Reserve requirement under NERC’s standard is equivalent to the individual BA’s or Reserve Sharing Group’s Most Severe Single Contingency (MSSC). (NERC BAL-002-0 R3.1)
 - The corresponding WECC Contingency Reserve requirement is the “loss of generating capacity due to forced outages of generation or transmission equipment

that would result from the most severe single contingency;” (BAL-STD-002-0 section B.a.ii.(a))

4. The WECC’s additional 7% Thermal/5% Hydro of Load Responsibility Contingency Reserve requirement is more stringent than NERC’s MSSC requirement because the greater of the 7/5% or MSSC shall be used. The term Load Responsibility is only relevant in calculating the additional requirement imposed by the WECC Standard.
5. The current WECC Contingency Reserve requirement represents a holistic approach to carrying Contingency Reserves for the entire Western Interconnection. The Load Responsibility calculation is used to “transfer” Contingency Reserve responsibility between BAs.
 - Energy with associated Contingency Reserve can be exported and imported between Balancing Authority Areas. However, if Contingency Reserve is associated by agreement with the energy transaction, the responsibility for the Contingency Reserve obligation will remain with the Source BA. In other words, the BA exporting energy that has associated Contingency Reserve would increase its “Load Responsibility” by the amount of the energy being exported. The BA importing the energy has the ability to reduce its “Load Responsibility” by the same amount. This has the effect of maintaining the appropriate amount of Contingency Reserve on a Western Interconnection wide basis.
6. No WECC Minimum Operating Reliability Criteria or NERC Standard requires that energy imports be delivered over FERC defined "Firm" transmission.
 - The only exception is the delivery of operating reserve energy between Balancing Authorities. (MORC Section I.A.6.)
7. Contingency Reserve attributes associated with the traded energy must be identified and tracked to ensure compliance to Reliability Standards. This will be accomplished by the implementation of WECC Business Practice INT-BPS-014-01.
 - An Imported Interchange Schedule must have associated Contingency Reserve based on the information in the e-Tag in order for it to decrement the Sink BA’s Load Responsibility.
8. All energy imports into a BA are in effect “contingent” based on the availability of the transmission path or paths used to deliver the energy. The importing BA must be prepared to compensate for the loss of the imported energy resource just as they must be prepared to compensate for the loss of energy from a generating unit internal to the Balancing Authority.
 - This concept eliminates the need for a “Unit Contingent” product definition for reliability purposes.
9. WECC MORC requires that BAs must carry 100% Reserves for interchange schedules that can be interrupted at the sole discretion of the source PSE within 10 minutes or less and “on demand” obligations that must be provided in 10 minutes or less. Transactions of greater time duration are not mentioned.

10. Transactions between BAs that are contingent upon specific generating units output may be treated the same as transactions of generating units output residing inside the sink BA for contingency reserve purposes.
11. Nothing precludes individual BAs nor a Reserve Sharing Group from carrying more Contingency Reserve than the WECC Board Interpretation of the WECC Standard BAL-STD-002-0 - Operating Reserve.

Attachment 6

Sempra Global's Request for Clarification of FERC Order No. 890

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Preventing Undue Discrimination and Preference in Transmission Service)))))	Docket No. RM05-25-000 and RM05-17-000
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**REQUEST FOR REHEARING OR CLARIFICATION OF
SEMPRA GLOBAL**

This Request for Rehearing or Clarification is filed by Sempra Global pursuant to Rule 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2007), and addresses the Commission’s Order No. 890-A, issued on December 28, 2007.¹

**I.
STATEMENT OF ISSUE**

The Commission’s Order No. 890-A incorrectly presumes that a generator serving load outside the control area can as a practical matter make alternative comparable arrangements to provide operating reserves on behalf of its load by contracting with third parties or that the generator could, as part of its negotiation with a customer, request that its customer acquire reserves from its transmission provider as necessary to support the transaction. In order to at least partially address this issue, Sempra Global requests that the Commission clarify that Schedule 9 – Generator Imbalance Service may be utilized to provide sufficient imbalance energy to keep a customer’s schedule whole for at least 2 hours following a generator derating or forced outage if necessary to allow the generator sufficient time to find and schedule replacement energy.

**II.
DISCUSSION**

Among many issues, Order No. 890-A addresses the March 19, 2007 request for rehearing or clarification filed by Sempra Global, which had urged the Commission to

¹ Order No. 890-A, *Preventing Undue Discrimination and Preference in Transmission Service*, 121 FERC ¶ 61,297 (2007).

make additional clarifications with regard to operating reserves by confirming an obligation on the part of transmission providers to offer and make these services available to transmission customers regardless of whether the customer is serving load within the transmission provider's control area. Sempra Global explained that, within the Western Electricity Coordinating Council ("WECC"), various transmission providers interpret the pro forma OATT language differently. The lack of a clear requirement for transmission providers to offer operating reserves to customers that do not serve load in the control area is an especially critical issue in the WECC, where some have argued that power cannot be sold as "firm" under the Western Systems Power Pool ("WSPP") Agreement unless it includes operating reserves.

Order No. 890-A denied Sempra Global's request, noting that "[i]t would be inappropriate to require the transmission provider to use its resources to provide additional operating reserves to loads in other control areas because the transmission providers in those control areas are under their own obligation to make operating reserves available." *Id.* at P 505. The Commission further noted that "[o]perating reserves are needed to serve load within the control area in the event of system contingencies. Unless alternative arrangements are made, the transmission provider provides these reserves from its own resources." *Id.* While Sempra Global understands the basis for the conclusions above, as explained herein, it appears that the Commission's conclusions are based at least in part on certain faulty assumptions with regard to how some transactions in the West are effectuated by generators, the implications of which may not have been fully considered when the Commission issued Order No. 890-A.

The Commission concluded in Order No. 890-A that the existing requirements of the pro forma OATT are sufficient to ensure that operating reserves are available to serve the type of transactions discussed by Sempra Global's request, noting that a generator serving load outside the control area "can make alternative comparable arrangements to provide reserves on behalf of its load by contracting with third parties" and that it "could also request, as part of its negotiation with a customer, that the customer acquire reserves from its transmission provider as necessary to support the transaction." *Id.* at P 506.

Part of the difficulty with the Commission's assumptions stems from the differing definitions for "reserves" in the West. In the WECC, "Operating Reserves" consist of two main components: Regulating Reserve and Contingency Reserve.² Regulating Reserve in the WECC includes an amount of "Spinning Reserve"³ immediately responsive to Automatic Generation Control to provide sufficient regulating margin to allow the Balancing Authority ("BA") to meet NERC's Control Performance Criteria (BAL-001-0).⁴ NERC's Glossary of Terms Used in Reliability Standards (May 2, 2007) defines Contingency Reserve as "capacity deployed by the Balancing Authority to meet the Disturbance Control Standard (DCS) and other NERC and Regional Reliability Organization contingency requirements." WECC then further defines Contingency Reserve to include "[a]n amount of Spinning Reserve and Non Spinning Reserve (at least half of which must be Spinning Reserve), sufficient to meet the NERC Disturbance Control Standard BAL-002-0" and specifies that "[t]he combined unit ramp rate of each

² WECC Standard BAL-STD-002-0 – Operating Reserves.

³ WECC defines Spinning Reserve as unloaded generation that is synchronized and ready to serve additional demand. *Id.*

⁴ *Id.*

Balancing Authority’s on-line, unloaded generating capacity must be capable of responding to the Spinning Reserve requirement of that Balancing Authority within ten minutes.”⁵ WECC requires that, once activated, Operating Reserves must be restored within 60 minutes.⁶

Thus, some of the confusion relates to the fact that, while the WECC definitions are not identical, WECC’s “Regulating Reserve” could include, but would not necessarily be limited to, services offered under the pro forma OATT as Schedule 3 – Regulation and Frequency Response Service, while WECC’s “Contingency Reserve” could include, but would not necessarily be limited to Schedule 5 – Operating Reserve – Spinning Reserve Service and Schedule 6 – Operating Reserve – Supplemental Reserve Service.

Although independent power generators do have access to OATT Schedule 3 – Regulation and Frequency Response Service and OATT Schedule 9 – Generator Imbalance Service from their source (or “host”) BA, they may not have access to any Contingency Reserves for exports from their host BA. As a practical matter, it can be difficult – if not impossible – for generators to contract for Contingency Reserves from a third party without switching to that party’s BA or having a dynamic schedule or other telemetry to enable the provider of Contingency Reserves to know when the generator trips, and to have the reserves provider’s generation respond within ten minutes. Intra-hour schedule changes are not normally allowed by most BAs in the West, and Operating and/or Contingency Reserve service can most logically be provided to a BA or Reserve Sharing Group (“RSG”), not an individual generator. This complex type of arrangement

⁵ *Id.*

⁶ *Id.* The NERC requirement is 90 minutes. NERC Standard BAL-002-0 — Disturbance Control Performance.

could not be practicably implemented for short-term transactions, or when the output of a generator is split between multiple buyers and ultimately delivered into multiple BAs. Even if a generator were able to contract with a third party to provide operating reserves, Sempra Global is not aware of any workable mechanism to assure a load (or “sink”) BA that it will have access to such reserves (which might be quite remote from the load) when needed.

In addition, a generator, as a seller, does not necessarily have a “load.” Transactions frequently involve numerous parties between the generator and the load. As such, a generator may not know who the load is until the NERC eTags are generated during the WECC pre-scheduling process, which typically takes place the day before power flows.

Moreover, even if the sink BA is known at the time a long-term transaction is entered into, a generator may still be unable to procure operating reserves to support the transaction. A case in point involves a firm energy transaction entered into in 2002 between Sempra Generation (“Sempra Gen”) – a subsidiary of Sempra Global – and a western load-serving entity (“Western LSE”), with the point of delivery at the interface between the transmission system owned by Sempra Gen’s source (or “host”) control area and the transmission system of the Western LSE.⁷ Neither the “host” transmission provider nor its merchant group would provide operating reserves to Sempra Gen, an independent power producer exporting power from its control area.⁸ Schedules were

⁷ The transaction called for firm energy during the peak hours of the summer months for three successive years.

⁸ It is noteworthy that, although the transmission provider indicated that it would not offer operating reserves to Sempra Gen, this transmission provider exported its own generation as “firm” bundled with operating reserves.

tagged by Sempra Gen's transmission provider as "Generator Firm," yet when Sempra Gen's plant tripped, the transmission provider cut the schedule to Sempra Gen's customer in the middle of an operating hour.

Because the point of delivery was at the interface between Sempra Gen's transmission provider and the Western LSE's transmission provider, Sempra Gen was not a "transmission customer" of the Western LSE's transmission provider, and as such was not entitled to purchase operating reserves from that source. Nor was the Western LSE willing to provide operating reserves, because it had entered into the firm energy transaction with Sempra Gen in order to reduce its operating reserves obligation.⁹

The above example illustrates how, contrary to the suggestion in Order No. 890-A, it can be very difficult or impossible for a generator serving load outside its host BA to make alternative comparable arrangements to provide operating reserves on behalf of its customer's load by contracting with third parties. Moreover, since many LSEs in the West enter into firm energy import transactions specifically to reduce their operating reserves obligations, it would rarely be fruitful for the generator to request, as part of its negotiation with a customer, that the customer acquire reserves from its transmission provider as necessary to support the transaction.

In lieu of modifying the pro forma OATT, and for reasons given above, Sempra Global respectfully requests that the Commission, at a minimum, provide clarification that Schedule 9 – Generator Imbalance Service may be utilized to provide sufficient

⁹ Participation in the Southwest RSG, this group would only have entitled Sempra Gen to share any operating reserves it already had, and membership would have imposed a significant and unreasonable operating reserves obligation that (because Sempra Gen was not a control area operator) Sempra Gen would not otherwise have had. Moreover, the RSG did not provide any market for acquiring operating reserves.

imbalance energy to keep a customer's schedule whole for at least 2 hours following a generator derating or forced outage if necessary to allow the generator sufficient time to find and schedule replacement energy. This clarification is needed because, if a generator trips within 20 minutes prior to the beginning of the hour, it is too late to schedule replacement energy for the hour that is about to begin. The 25% penalty rate applicable to such volumes of imbalance energy will provide sufficient incentive for generators to minimize their use of this service. Clarifying that "Generator Firm" schedules are "firm for the hour" in this manner, while short of addressing the full scope of the problems faced by generators in obtaining in operating reserves in the West,¹⁰ will at least serve to provide some level of certainty for transactions such as those described herein.

III.

WHEREFORE, for the reasons set forth above, Sempra Global respectfully requests that the Commission clarify and/or modify Order No. 890-A as forth herein.

Respectfully submitted,

/s/ Daniel A. King
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On behalf of Sempra Global

Dated: January 28, 2008

¹⁰ In order to more completely address these issues, Sempra Generation may in the future join other market participants in separately seeking clarifications regarding the implementation and interpretation of the WSPP Agreement and/or WECC Reliability Standards pertaining to operating reserves.

LEGAL APPENDIX re SALE OF ANCILLARY SERVICES

Following is general background on sales of ancillary services.

There are requirements and restrictions placed on the third-party provider of ancillary services, however. In *Avista Corp.*, 87 FERC ¶ 61,223, at n.1, (“*Avista I*”), *order on reh’g*, 89 FERC ¶ 61,136 (1999) (“*Avista II*”), the Commission stated that it may authorize the sale of such services “only in conjunction with a requirement that such third parties establish an Internet-based OASIS-like site for providing information about and transacting ancillary services.” *Id.* The information posted on the OASIS-like site should include “postings of offers of services available and their offering prices and would provide customers the ability to request services and make bids for these services” as well as “information about accepted and denied requests and the reasons for denial. *Id.* at 61,884. All third-party providers were required to file with the Commission one year after the site becomes operational, and every three years thereafter, a report detailed their activities in the ancillary services market. *Id.*

However, the Commission found in Order No. 697 that the establishment and maintenance of an OASIS-like site and the triennial filing requirement were superseded by the Commission’s Electronic Quarterly Report (“EQR”) filing requirement for market-based rate sellers. Order No. 697 at P 1058 (“We conclude that our EQR filing requirement provides an adequate means to monitor ancillary services sales by third parties such that the posting and reporting requirements established in *Avista I* are no longer necessary.”). However, the Commission retained the ability to require such a report by a third-party supplier of ancillary services at any time. *Id.* at P 1059; *Dynegy Power Marketing, Inc.*, 120 FERC ¶ 61,278, at P 23 (2007). In the EQRs, third-party suppliers provide “information regarding their ancillary services transactions for the quarter, including the ancillary service provided, the price, and the purchaser.” Order No. 697 at P 1058.

The Commission requires “jurisdictional utilities offering off-system ancillary services for sale must do so pursuant to a specific tariff,” *Avista II* at 61,391, and “include language in their market-based tariffs identifying the ancillary services that they offer.” Order No. 697 at P 1060. The tariff requirement can be met by amending the utility’s market-based rate tariff to permit the utility to sell certain ancillary services at market-based rates “provided that these services are not sold in conjunction with transmission service pursuant to [the utility’s] open access transmission tariff,” *Wisconsin Public Service Corp.*, 91 FERC ¶ 61,254, at 61,889 (2000), because the ancillary services sold pursuant to an open access transmission tariff are required by Order No. 888 to be sold at cost-based rates to transmission customers. Tariffs of third-party providers must include provisions for the three restrictions below. *See, e.g., Id.* at 61,891; *Ameren Energy Marketing Co.*, 95 FERC ¶ 61,448, 62,626 (2001).

Restrictions on Sales of Ancillary Services at Market-Based Rates.

The Commission listed three situations in which it would prohibit this approach to sales of ancillary services by a third-party provider. First, a third-party provider cannot sell ancillary

services at market-based rates to an independent system operator or a regional transmission organization, where the entity has no ability to self-supply ancillary services but instead depends on third parties. *Avista I* at n.12. The Commission clarified that this prohibition does not apply only to Commission approved RTOs, as defined in Order No. 2000,² because Order No. 2000 was issued six months after the Commission issued the policy in *Avista I*. *Wisconsin Public Service Corp.*, 91 FERC ¶ 61,254, at n.9.

Second, to address affiliate abuse concerns, the Commission forbade sales of ancillary services at market-based rates to a traditional, franchised public utility affiliated with the third-party supplier, or “to sales where the underlying transmission service is on the system of the public utility affiliated with the third-party supplier.” *Avista I* at n.12.

Third, a third-party provider is prohibited from selling ancillary services at market-based rates “to a public utility who is purchasing ancillary services to satisfy its own open access transmission tariff requirements to offer ancillary services to its customers.” *Id.* However, the Commission stated that it is open to considering requests for such services at market-based rates on a case-by-case basis. *Id.* The reasoning behind this prohibition is that the Commission believes that the “backstop of cost-based ancillary services from the transmission provider will, in effect, limit the price at which customers are willing to buy ancillary services” and that such backstop pricing and the Internet site requirements “will provide an appropriate and effective safeguard against potential anticompetitive behavior.” *Id.* at 61,883. In addition, the Commission determined that it is able “to grant blanket authority for flexible pricing only because the price charged by the third-party supplier is disciplined by the obligation of the transmission provider to offer these services under cost-based rates. This discipline would be thwarted if the transmission provider could substitute purchases under non-cost-based rates for its mandatory service obligation.” *Avista II* at 61,391-92 (citations omitted).

The Commission, in fact, recently granted waiver of the third prohibition above in *Dynegy Power Marketing, Inc.*, where the Commission permitted such sales without the safeguard of a price cap. 118 FERC ¶ 61,094, *order on reh'g*, 120 FERC ¶ 61,278 (2007), *reh'g pending*. In *Dynegy*, Ameren Illinois Utilities³ divested their generation to affiliates or others under the Illinois Electric Service Customer Choice and Rate Relief Law of 1997 and, therefore, are not able to self-supply the ancillary services required by their OATTs. In order to acquire the requisite ancillary services, Ameren Services Company, an affiliate of Ameren Illinois Utilities, issued a request for proposals (“RFP”) for bids to supply ancillary services. Dynegy won a portion of the RFP to provide certain ancillary services to Ameren Illinois Utilities at market-

² *Regional Transmission Organizations*, Order No. 2000, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000), *petitions for review dismissed sub nom. Pub. Util. Dist. No. 1 v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

³ Ameren Illinois Utilities include Central Illinois Light Company d/b/a AmerenCILCO, Central Illinois Public Service Company d/b/a AmerenCIPS, and Illinois Power Company d/b/a AmerenIP.

based rates. 118 FERC ¶ 61,094, at PP 3-4. Initially, the Commission granted the waiver, but conditioned the waiver on there being a cost-based backstop. *Id.* at P 23. The Commission capped Dynegy's market-based rates at the cost-based rates before the Commission in the proceeding concerning the winning bids of Ameren affiliates winning bids for the RFP in Docket Nos. ER07-169, ER07-170. *Id.* at P 21. However, on rehearing the Commission found that the RFP was a "reasonable and appropriate method to solicit potential suppliers" in the interim before the Midwest Independent System Transmission Operator, Inc.'s ancillary service market becomes operational and removed "the contingency that the Dynegy rates be no higher than the rates approved" in Ameren affiliates proceeding. 120 FERC ¶ 61,278, at P 19. The Commission limited this finding stating "[o]ur decision in this regard is based on the fact that these rates are intended to be for an interim period only," *id.*, because the term of the agreement to provide ancillary services was from January 1, 2007 through December 31, 2007. In light of the Commission's instruction that "the grant of waiver in this proceeding does not infer that Dynegy would automatically be granted the same waiver related to a new RFP," Dynegy filed a request for waiver of certain sections of its market-based rate tariff to provide Ameren Illinois Utilities with ancillary services at market-based rates pursuant to an RFP for the year 2008 in Docket No. ER08-356. The Commission has yet to issue an order in this proceeding.

Organized Markets.

The Commission authorized the sale of ancillary services at market-based rates for the following organized markets: California Independent System Operator ("CAISO"),⁴ ISO New England, Inc. ("ISO-NE"),⁵ New York Independent System Operator ("NYISO"),⁶ and PJM Independent System Operator ("PJM").⁷ The Commission required that each organized market present a market power analyses containing the following elements: 1) the product market - ancillary services to be sold at market-based rates; 2) quantities required - estimates of both total demand and supply available in the market for each ancillary service; 3) calculation of market shares for each seller within each product market; 4) HHIs – calculation of Hirschman-Herfindahl Indices for each product market; and 5) analysis of barriers to entry and potential competitors. *Midwest Independent Transmission System Operator, Inc.*, 119 FERC ¶ 61,311, at P 41. Further, in denying the Midwest ISO's request for permission to operate an ancillary

⁴ *AES Redondo Beach, L.L.C.*, 83 FERC ¶ 61,358, *order on reh'g*, 85 FERC ¶ 61,123 (1998), *order on reh'g*, 87 FERC ¶ 61,208, *order on reh'g*, 88 FERC ¶ 61,096 (1999), *order on reh'g and clarification*, 90 FERC ¶ 61,036.

⁵ *New England Power Pool*, 85 FERC ¶ 61,379 (1998), *reh'g denied*, 95 FERC ¶ 61,074 (2001).

⁶ *Central Hudson Gas & Electric Corp.*, 86 FERC ¶ 61,062, *order on reh'g*, 88 FERC ¶ 61,138 (1999).

⁷ *PJM Interconnection, L.L.C.*, 86 FERC ¶ 61,247 (1999); *Atlantic City Electric Company*, 86 FERC ¶ 61,248, *clarified*, 86 FERC ¶ 61,310 (1999), *PJM Interconnection, L.L.C.*, 91 FERC ¶ 61,021 (2000).

services market, the Commission found that the Midwest ISO must lay out a readiness plan and safeguards. *Id.* at P 46. Specifically, the plan must detail the how the start-up of an ancillary services market will not adversely affect reliability and evaluate the success of the implementation of the ancillary services market, given that the Midwest ISO will be taking over the existing functions managed by the balancing authorities and will become the sole entity managing system reliability and ensuring that the market framework provides adequate reserves reliably and efficiently. *Id.* at PP 46-47.

While the market operator is not exempt from conducting a market power analysis under *Avista I*, utilities participating in those organized ancillary services markets may be granted market-based rate authority pursuant to *Avista I*. See, e.g., *TransAlta Energy Marketing (U.S.) Inc.*, 112 FERC ¶ 61,335 (2005) (granting authority to sell ancillary services at market-based rates into the CAISO, ISO-NE, PJM, and NYISO markets); *Oasis Power Partners, LLC*, 109 FERC ¶ 61,180 (2004) (same); *AES Placerita, Inc.*, 89 FERC ¶ 61,202 (1999) ((granting authority to sell ancillary services at market-based rates into the CAISO market).