SDG&E COMMENTS ON METHODOLOGY FOR ALLOCATING TO LOAD SERVING ENTITIES IMPORT CAPACITY INTO THE CAISO CONTROL AREA FOR PURPOSES OF FULFILLING RESOURCE ADEQUACY OBLIGATIONS

On February 1, 2007, the FERC staff held a technical conference in Sacramento for purposes of furthering the conversation among stakeholders about the methodology for allocating import capacity into the CAISO control area for purposes of fulfilling resource adequacy obligations. The import allocation methodology and the methodology for allocating congestion revenue rights are the two most important matters that remain to be finalized and incorporated into the Release 1 MRTU tariff prior to commencement of the new California markets in early 2008. While there are important differences in the nature of these two types of rights, there are also substantial similarities.

The anecdotal evidence currently available is leading SDG&E to conclude that the CAISO’s proposed allocation methodologies for both rights suffer from a common defect that is likely to yield unjust and unreasonable results for SDG&E. In an effort to promote a smooth transition for purchased power contracts existing in 2006, the CAISO’s allocation schemes for both import capacity rights and congestion revenue rights on the interties allows load-serving entities to claim long-lived priorities that threaten to overwhelm the general rule that access to such rights should be based on the magnitude of the load being served. SDG&E will focus its comments below on the allocation of import capacity rights, but it wants to make stakeholders and the CAISO aware now that SDG&E believes that the priority validation mechanism for both types of rights needs to be refined further.
SDG&E recognizes and accepts the notion that the CAISO must impose limits on the use of imports to meet the California resource adequacy requirements in order to ensure that delivery of imported resources is representative of the historical import capability of the CAISO-operated grid. Given that California has chosen to socialize the fixed costs of the grid to all load-serving entities, the basic ratemaking proposition that benefits bestowed should be kept in alignment with costs incurred strongly supports the CAISO’s proposal to allocate resource adequacy import rights to each load-serving entity in accordance with its share of the total load.¹ If the CAISO had proposed to stop there, allowing the load-serving entities to trade in the secondary market for the precise amount and branch group that each needs to complement its portfolio of imported resources, then the problem that SDG&E foresees developing would be manageable. SDG&E would support such an allocation scheme for the Release 1 MRTU tariff even though it has long argued in favor of auctioning both import capacity rights and congestion revenue rights, with the resulting revenues being used to off-set the transmission access charge used to cover the fixed costs of the CAISO-operated grid.

Instead, the CAISO has proposed that load-serving entities with existing import contracts as of March 2006 be given a priority for the duration of the contract, thereby permitting these entities to use more than their load-share of the underlying import capacity for purposes of demonstrating compliance with the California resource adequacy standards. The net result is that other load-serving entities may be foreclosed in future years from including a proportionate share of imported resources in its resource adequacy demonstrations. Since energy from generators that hug the California coast, along with

¹ SDG&E supports the CAISO’s tentative decision to use coincident peak load forecast information prepared by the California Energy Commission to determine the load share elements of the allocation methodology.
most of the load, tends to be significantly more expensive than imported resources, any
load-serving entity that is not allocated its proportional share of the import capacity rights
connected to the large trading hubs on the CAISO border is likely to be disadvantaged
economically.

SDG&E believes that the CAISO is proposing to place too much weight on the
commercial arrangements existing on March 10, 2006 and too little weight on the general
rule designed to keep grid benefits bestowed in alignment with grid costs incurred. Gross
inequities can result by assigning priorities to import capacity rights on the basis of one
sample of data that is not representative of the broader data set. SDG&E cannot yet
quantify precisely the magnitude of the distortion in the future availability of import
capacity rights, but SDG&E can hardly wait for a *fait accompli* to confirm its assessment
of this potential threat. The CAISO methodology for allocating import capacity should be
modified to constrain the ability of existing imported power contracts to disadvantage the
ability of other load-serving entities to use imported resources for purposes of
demonstrating compliance with resource adequacy requirements.

SDG&E’s situation is illustrative of how a snapshot of history can produce a
distorted picture of how load-serving entities have historically been using the grid to
incorporate imported power into their procurement portfolios. In the early 1980’s,
SDG&E was virtually cut-off from the western wholesale power markets by geography
and a neighboring northern utility. Unwilling to accept its fate, SDG&E constructed the
Southwest Power Link (SWPL) and pioneered the concept that an investor-owned utility
can be successful by procuring a substantial part of its resource portfolio through
purchased-power contracts. SDG&E relied substantially on SWPL, executing long-term
contracts with Tucson Electric Power, Public Service of New Mexico, and Portland General Electric among others. Later, to enhance its ability to access the wholesale markets, SDG&E became a first mover in supporting the push toward organizing “spot” energy markets based on operational consolidation of the grid and locational marginal pricing – the very same market design that California has decided to implement some 14 years after it became SDG&E’s official corporate position. In short, because of its location in a cul-de-sac bereft of natural advantages for producing electricity, SDG&E gave top priority to strengthening its interconnections with areas that possess the advantages that SDG&E so plainly lacks.

When the California Power Exchange was formed in 1998, SDG&E was directed by the CPUC to refrain from continuing to sign long-term power contracts, so SDG&E’s reliance upon long-term contracts began to wane. The CPUC reversed course during the 2000-2001 California energy crises, but by then SDG&E was temporarily unable to sign forward power contracts because the San Diego retail prices had been capped at a level that was far below wholesale. The California Department of Water Resources stepped in to sign forward contracts, but none of the contracts allocated to SDG&E relied upon import capacity. Moreover, by then the CPUC was stressing the need for the investor-owned utilities to facilitate construction of new power plants located close to the coastal load centers, so SDG&E bought a new combustion turbine peaker and new combined-cycle base load plant, both but a few miles from downtown San Diego, and signed a long-term contract with Calpine to facilitate construction of a new combined-cycle plant also near San Diego. The cumulative effect of these unusual circumstances has conspired to leave SDG&E in 2006 with only two relatively small import contracts that can serve to
validate priority to the CRRs and import capacity rights that SDG&E so clearly needs going forward.

Ironically, now that a workable and efficient wholesale market design is about to be implemented in California, SDG&E finds itself in danger of being effectively cut-off from the broader western markets, much like it was when it started its long journey 25 years ago. A 2006 snapshot of SDG&E’s use of the grid’s capacity to import power and hedge locational price differences totally fails to reflect its pioneering past, what is reasonably already known about its future procurement portfolio, and the magnitude of the fixed transmission costs being allocated to its bundled customers. For instance, SDG&E’s ten-year long-term procurement plan submitted to the CPUC in December 2006 contains significant amounts of resources that will need to be married to import capacity rights in order to be included in SDG&E’s future demonstrations of resource adequacy. SDG&E urges the CAISO to re-assess its tentative proposal to affix unrestrained priorities to 2006 commercial arrangements that could then result in denying San Diego load-serving entities the future opportunity to gain access to the western trading hubs.

There may be several measures that the CAISO could take to ensure that its initial allocation of import capacity rights and congestion revenue rights reflect a better balance between existing and future use of the grid. With no effort to be exhaustive, SDG&E offers the following ideas for consideration by stakeholders and the CAISO:

(1) The transmission limits that govern import capacity and congestion revenue rights for the interties serving the southern half of California has always been allocated between the transmission service territories of SDG&E and SCE on
approximately a 20/80 basis. The CAISO should consider using this allocator to restrict the use of 2006 contracts to validate priorities, thereby limiting entities serving load in SCE’s historic service territory to establishing priorities over at most 80 percent of the import capacity and branch groups.

(2) The CAISO should recognize that the 2006 historical snapshot is badly distorted and allow load-serving entities to substitute known future contracts for 2006 contracts that are set to expire or otherwise be removed from the portfolio by the end of 2007. The investor-owned utilities filed long-term procurement plans at the CPUC in December 2006, and should be allowed to substitute signed contracts in those plans for resource verification purposes. Other load-serving entities should be allowed to make similar substitutions for resource verification purposes.

(3) The priority mechanism for awarding import capacity rights beyond applicable load share could be restricted to situation where the extra measure of import capacity rights is not being sought for use by load-serving entities that are below their load-share ratio. In other words, the over-validation of rights based on 2006 usage would have to give way once it comes into conflict with a future validated request by a load-serving entity that is below its load-share ratio.

SDG&E looks forward to discussing these ideas further with stakeholders and the CAISO so that a fair and equitable allocation methodology for import capacity can be submitted to FERC for incorporation into the Release 1 MRTU tariff.