



## SDG&E Comments on February 14, 2012 Cost Allocation Guiding Principles Straw Proposal

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The CAISO has committed itself to a holistic review of the various mechanisms through which the CAISO allocates market costs to market participants. The CAISO is proposing the following seven elements or principles to help guide the effort: (1) Causation, (2) Comparable Treatment, (3) Policy Alignment, (4) Incentivize Behavior, (5) Manageable, (6) Synchronized, and (7) Rational. The CAISO intends to apply these guiding principles to the flexible ramping product currently being developed. After that, the CAISO states it will launch a subsequent stakeholder initiative to review existing cost allocations to ensure they are consistent with the cost allocation guiding principles developed through this process.

SDG&E appreciates the CAISO effort to establish guiding principles for allocating ISO market costs among market participants.<sup>1</sup> SDG&E provides feedback on the guiding principles proposed by the CAISO as well as comments on their prioritization and enforcement.

### **Guiding Principles Must Be Prioritized to Support the Overall Objective of Market Efficiency**

SDG&E believes the overarching guiding principle should be that *cost allocation supports market efficiency*; in other words, cost allocation should provide market participants the information and monetary incentives needed to offer products and services to meet load requirements at the most competitive price. This overarching principle is consistent with several others already

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<sup>1</sup>SDG&E notes that the CAISO's straw proposal does not appear to address cost allocation principles for non-"market costs," e.g., principles governing the allocation of fixed costs associated with transmission expansion as contemplated by the requirements of FERC Order 1000. SDG&E assumes cost allocation principles for fixed transmission costs will be addressed in the CAISO's FERC Order 1000 stakeholder initiative.

proposed by the CAISO – including causation, incentivizing behavior, comparable treatment, and synchronizing costs to billing determinants. A common denominator of each is that it is based on objective rationale and expresses no preference to resource type or market participant.

### **Cost Allocation must be Indifferent to State Policy Objectives**

The CAISO argues that cost allocation mechanisms should support the “economically efficient achievement of state and federal policy goals,” and asks if those goals can be “more optimally achieved by allocating costs to load-serving entities that bilaterally procure resources that drive certain costs.” SDG&E strongly believes that Policy Alignment should not be a guiding principle for cost allocation. The CAISO must implement cost allocation based on objective and apolitical rationale that establishes a solid foundation upon which effective policy relies. Misallocating market costs to “facilitate” policy objectives will reduce overall market efficiency and increase the cost of achieving policy objectives. In fact, such misallocations have already clouded signals that would otherwise support market efficiency, and has likely already increased the costs of meeting certain policy objectives. For example, stakeholders unfamiliar with the intricacies of PIRP and Regulation cost allocations may not understand the true cost of integrating PIRP resources into the market. If these costs are not accounted for through clear, rational allocation, policymakers have flawed information upon which to judge the costs imposed by PIRP-eligible generating resources. The CAISO’s objective in this process must be to provide a transparent, subsidy free market where entities that cause costs—and that are in the best position to manage those costs—are directly allocated those costs. Once accomplished, Local Regulatory Agencies (LRAs) and market participants can implement policy objectives through LRA-jurisdictional contract terms and other commercial means, rather than through opaque subsidies and distorted market signals. SDG&E strongly recommends the CAISO strip Policy Alignment from the proposed principles guiding cost allocation.

### **Whether Market Participants can “Manage” Costs is Irrelevant**

SDG&E is also troubled with the proposed principle that cost allocation be “Manageable.” The CAISO seeks to ensure market participants “have the ability to manage exposure to the allocation” and that “allocating unmanageable costs does not provide market participants with the opportunity to minimize the cost drivers the cost allocation is intended to incent.” SDG&E believes the CAISO’s primary focus should be on allocating costs to market participants who drive the need for those costs. Market participants can then decide whether to manage those costs through

technology improvements, or to hedge those costs through bilateral contracts. Having the CAISO enable market participants' ability to subjectively weigh what may or may not be a manageable cost should not be a guiding principle. This principle opens the door for market participants to make subjective and self-serving arguments that could conflict with the goal of supporting market efficiency. SDG&E believes the CAISO should avoid an allocation framework that enables market participants to hide behind reasons why proper cost allocation would be costly or inconvenient. Rather, the allocation framework should cause us to strive toward process improvements, innovation and other solutions that advance the goal of market efficiency.

SDG&E believes the desire to support overall market efficiency should be self-evident. Unfortunately, numerous current CAISO market components are paid for through allocations that do not support of market efficiency, including PIRP, Regulation and the Flexible Ramp Constraint currently at issue at FERC. The need for prioritizing and *applying* cost allocation principles should be a requirement; otherwise, to the extent that allocation principles such as supporting policy and managing exposure remain, this initiative will accomplish nothing because subjective and self-serving arguments will roadblock the implementation of rational cost allocation.

### **Guiding Principles Must Be Applied To Existing Flawed Cost Allocation Mechanisms**

SDG&E appreciates the CAISO's pledge that it will commence a subsequent stakeholder process to apply the adopted elements of this proposal to existing cost allocation mechanism to ensure consistency with the adopted principles. Toward this end, SDG&E suggests as part of this process the CAISO specifically identify the existing cost allocation structures it intends to review, prioritize the order of review, and set specific target timelines for review.