

**COMMENTS OF SAN DIEGO GAS & ELECTRIC COMPANY REGARDING
THE CAISO'S CAPACITY PROCUREMENT MECHANISM, AND
COMPENSATION AND BID MITIGATION FOR EXCEPTIONAL DISPATCH**

SDG&E, having reviewed the CAISO's proposed Capacity Procurement Mechanism (CPM) dated July 15, 2010 and participated in the July 22 CPM stakeholder call, urges the CAISO to develop a less expansive backstop capacity procurement mechanism. The CAISO's primary role is to use short-run energy and ancillary services markets to facilitate open-access transmission service that is efficient and reliable. The July 15 CPM proposal would expand the CAISO's short-run operational focus to include direct involvement in long-run resource adequacy matters. Under the right conditions and circumstances, using the CAISO to implement a comprehensive, market-based resource adequacy program is an attractive, if not compelling, proposition. But the recent CPUC decision on resource adequacy has firmly decided that CPUC-jurisdictional load-serving entities must meet their resource adequacy obligations without the aid of a CAISO-operated, multi-year, capacity market, or similar mechanism.¹ Expansion of the CAISO's backstop procurement role to include annual or longer-term commitments based on administratively-determined, cost-of-new-entry pricing under vaguely-defined circumstances is simply inconsistent with the resource adequacy policy preferences enunciated by the CPUC.

The CAISO, of course, has a legitimate interest in ensuring that it has adequate resources to operate the system reliably and efficiently. During the day-ahead/real-time

¹ D. 10-06-018 (June 7, 2010). For over five years, SDG&E, in concert with other market participants, argued for a long-term resource adequacy regime featuring a multi-year capacity market operated by the CAISO. After a thorough hearing, the CPUC rejected this concept in its entirety, preferring to keep the current CPUC resource adequacy program, which is based solely on bilateral procurement, intact.

operating environment, the CAISO's role is paramount. But the CAISO's role becomes more attenuated with respect to decisions made earlier than the day-ahead/real-time operating environment. SDG&E does not want to be caught in a cross-fire wherein the CPUC's resource adequacy procurement targets are trumped by later CAISO procurement of capacity to meet vague or previously unstated reliability concerns. An explicit premise of the CPUC's resource adequacy program is that the magnitude and location of the capacity needed by the CAISO to operate the system can be determined one year in advance based on forecast load and expected configuration of the grid.

SDG&E does not object to the CAISO having the role of procuring additional capacity to cover load-serving entities that failed to meet their annual resource adequacy requirements. SDG&E also agrees that significant, unexpected events could warrant the CAISO having the authority to purchase additional capacity to protect the reliability of the grid. But SDG&E sees little need for the CAISO to continue having authority to procure capacity for exceptional dispatch, and it sees no need for the CAISO to seek new authority to procure capacity for purposes of: (1) facilitating planned outages of transmission facilities or generating plants; (2) supplementing the capacity of intermittent generation that may be less available than expected; or (3) retaining generating resources that are in danger of shutting down due to lack of sufficient resources.

The apparent disconnect between the CAISO's proposal and SDG&E's perspective may, in part, be due to SDG&E's view that the CAISO's day-ahead/real-time energy and ancillary services markets should play the dominant role in preserving real-time reliability. Resources that have received a capacity payment are required to be available and ready to run because they have been paid to undertake this obligation. But

other existing resources that remain uncommitted will want to run if they are paid their incremental costs or greater. A properly crafted scarcity pricing program is an important tool for the CAISO to utilize in clearing its day-ahead/real-time markets without insisting that all responding resources be available pursuant to a capacity contract. The CPUC's existing resource adequacy program already ensures that resources amounting to 115 percent of expected load will be available during peak load hours. This broad insurance policy, when combined with real-time pricing that accurately reflects the current operational realities, should be sufficient in nearly all situations to maintain reliable operations. After all, under the circumstances being discussed, additional resources do exist. The only question is what will it take to get the existing, uncommitted resources to make an offer in the day-ahead/real-time markets. Upfront capacity payments work, but so do real-time energy prices that reflect scarcity. The CAISO seems to be giving little or no weight to the latter.

There is, of course, the well-grounded concern that there will be insufficient entry of new resources or premature exit of existing resources such that the system becomes resource deficient without adequate warning or time to implement an acceptable remedy. An organized, multi-year capacity market is designed to minimize this risk, but the CPUC has determined that this potential problem should be addressed by tools other than a capacity market run by the CAISO. The CPUC is implementing a multi-year resource planning protocol to accompany its long-term procurement proceeding for the purpose of giving jurisdictional load-serving entities rather detailed guidance about the type and amount of resources that should be procured to serve the California load. This approach may not be SDG&E's preferred solution, but it needs time to play out, and the CAISO

should not adopt an expanded capacity backstop mechanism that is likely to undermine the CPUC's role as it pertains to resource adequacy.²

Turning to the specifics of the CAISO July 15 CPM proposal, SDG&E offers the following comments:

1. A limited capacity backstop mechanism should be incorporated into the CAISO tariff without a definite sunset date.
2. CPM resources that go on planned outage during the procurement month should have their 30-day compensation prorated downward for the days on planned outage, unless a comparable substitute is offered for replacement.
3. CPM authority should be used to procure capacity to cover net system deficiencies caused by incomplete capacity procurement by load serving entities, or to address significant events not contemplated by state and local regulators.
4. Given that the CAISO now has experience with operating the new energy and ancillary services markets, the CPM tariff should eliminate CAISO authority to procure capacity for exceptional dispatch. Capacity-related operational requirements that can be anticipated a year in advance should be made public so that market participants can act on that information. The CAISO's authority to procure short-term capacity for significant, unexpected events can be used for any remaining circumstances that cannot be handled effectively by the energy and ancillary services markets.
5. The CAISO should seek authority to favor procurement of eligible capacity from a resource that is not use-limited over the eligible capacity from a resource that is use-

² It is said that good fences make for good neighbors; similarly, a clear division of regulatory labor between the CPUC and CAISO/FERC ensures that entities like SDG&E, which is regulated by both, has but one master to serve on any single issue.

limited whenever the competing resources are substantially of equal value to system reliability.

6. The CAISO should not seek CPM authority to procure capacity to cover planned outages of transmission and generation facilities. The 15 percent planning reserve margin set by the CPUC already takes into account the need for planned outages. Combined with the seasonal variation in system load, the existing planning reserve margin should provide sufficient flexibility to allow for proper maintenance without additional procurement of capacity. The proper solution from SDG&E's perspective is not more short-run capacity procurement. SDG&E believes that existing, uncommitted resources will make themselves available if the prices in the energy and ancillary services markets accurately reflect temporary scarcity conditions. Nevertheless, if the CAISO believes that the current system for handling planned outages needs further attention, it should propose any necessary modifications to the CPUC. The CAISO correctly notes that commandeering capacity for such purposes through issuance of exceptional dispatches should be avoided.

7. The CAISO should not seek CPM authority to procure capacity to cover observed less-than-planned output from intermittent resources. Any such observation should be addressed initially by procuring additional amounts of ancillary service capacity in the day-ahead/real-time markets, and secondarily by introducing this observation into the CPUC's annual resource adequacy proceeding so that a proper assessment and, if necessary, correction can be implemented for the following year.

8. The CAISO should not seek CPM authority to procure capacity from generating units that may be on the verge of exiting the market for lack of profitability. If no load-

serving entity has placed such units under a capacity contract in order to meet their resource adequacy requirements, and the units cannot garner sufficient revenues through the energy and ancillary services markets, then efficient exit from the market is the correct outcome. If the CAISO believes the units are, in fact, needed, then the CAISO must believe the annual resource adequacy requirements to be deficient. The CPUC's annual resource adequacy implementation proceeding is designed to address such matters, so there is no need to endow the CAISO with procurement authority that would enable it to execute an end-run around the CPUC's resource adequacy program.

9. SDG&E believes that the pricing for backstop capacity should be predicated on covering the going forward costs of existing generation. The CAISO should exercise its capacity backstop authority rarely in procuring supplemental capacity that, by definition, is uncommitted and has no better options available. Consequently, the CAISO need not be overly concerned with sending a price signal to market participants to induce new entry. Under the CPUC resource adequacy program, the forward price curve for new capacity is a product of numerous and continuous bilateral negotiations between buyers and sellers, each seeking to get the best price possible given the competing alternatives, including development of new supply and demand-side resources. Moreover, by introducing scarcity pricing and rationalizing market power mitigation protocols that are unduly suppressing prices in the energy and ancillary services markets, the CAISO is already taking steps to reduce the "missing money" phenomenon that has given rise to the need for capacity payments to make generators whole.

The CAISO should drop any further thought of developing a backstop capacity compensation scheme based on the cost of new entry. This ground was plowed

extensively by SDG&E and others that supported an organized capacity market for California, but such concepts have no applicability to the limited amounts of supplemental, short-term capacity that is likely to be procured by the CAISO. CAISO capacity procurement is the tail and must not be allowed to wag the CPUC resource adequacy dog.

10. SDG&E sees no need for the CAISO to spend further effort to develop one or more proposals for the procurement of non-generic capacity to meet operational needs. Instead, the CAISO should continue to focus on interjecting relevant operational requirements into the CPUC's annual resource adequacy implementation proceeding so that load-serving entities can be tasked with procuring the right amount of capacity in the right locations. Moreover, accurate pricing in the CAISO's short-run energy and ancillary services markets offers the best prospect for getting the right mix of generators running to produce a reliable and economically-efficient dispatch to serve system load. Ultimately, system load is served by energy – not capacity. The CAISO must rely more upon the energy market to *attract* available capacity and less upon the “must-offer” requirements associated with capacity contracts to *force* capacity to run.