Reliability Services Working Group Comments

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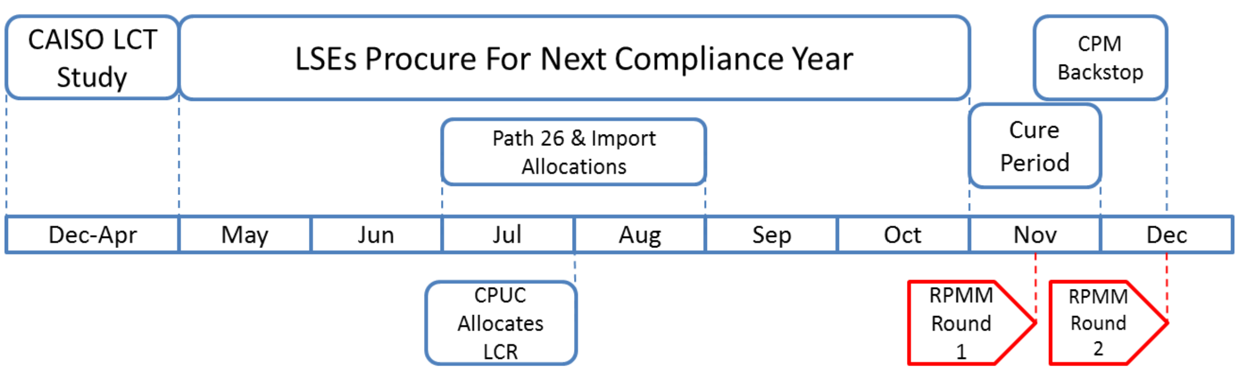
SDG&E appreciates the ISO holding a working group meeting. SDG&E felt the discussion was productive and allowed stakeholders to understand the depth of the issues and thoughts of how solutions may be formed. With that in mind, SDG&E proposes some potential topics for inclusion in the straw proposal. They include:

1. Liquidity Issues in the Annual and Monthly Residual Auctions
2. Standardized Product for the Annual Auction
3. Replacement Rule for Scheduled Generation
4. Availability Incentive and Charges

Annual Residual Auction and market liquidity

The ISO is considering two rounds of Residual Procurement Market Mechanism (RPMM) in the annual process. The first round will be voluntary while the second round will be mandatory. The RPMM offers another avenue for deficient LSEs to cure the year-ahead requirements during the cure period while not conflicting with the bilateral market options. SDG&E believes the voluntary RPMM is necessary to provide price transparency and discovery for the following compliance year's RA market. SDG&E provides a picture of the Annual RA Process below.



The proposed annual auction framework raises the following questions/issues:

1. Liquidity concerns: SCE, Calpine, and WPTF each articulated concerns about demand and market liquidity. SDG&E shares these concerns. The current penalty structure for non-compliance in place at the Commission virtually ensures that LSEs will not be voluntarily deficient in their annual or monthly showings absent a corresponding change to that penalty structure. Thus, the demand in the annual auction may be quite limited and therefore the auction is less likely to yield true capacity prices. SDG&E believes this is a foundational issue. Without some appreciable amount of demand consistently participating in the auction, the voluntary auction itself is at best a mere mechanical exercise, and at worst, a step in the wrong direction. While a change in the RA penalty structure is unlikely in the near-term, a solution may be to work with the CPUC allow *non-deficient* jurisdictional LSEs to participate in the annual auction. LSEs have incremental requirements above the 90% of system and flexibility requirements due in the annual compliance filings. While not technically deficient, LSEs could be permitted to submit demand bids in the voluntary auction to satisfy the incremental monthly requirements. This would create the possibility for the auction to have meaningful participation on both sides of the supply and demand curves.
2. Contract duration: What will be the minimum length of a contract be for a product cleared in the auction? SDG&E believes the minimum term of the annual voluntary auction could be monthly, the minimum term of the mandatory annual auction could be monthly for System and Flexibility while annual for Local if there is a Local deficiency. A Local resource may not receive an annual backstop if there is no Local deficiency. The minimum term of the monthly voluntary auction could be daily, while the backstop for the monthly process could be monthly.
3. Coordination with Existing Compliance Processes: The timing of the first round of the RPMM may conflict with the monthly processes. January T-45 compliance reporting is due around November 14th. The annual voluntary RPMM would not begin until November 21st. The ISO should consider the interaction of both processes to ensure products cleared in the annual auction will be available for the monthly processes.
4. Intertie Resources: The auction should include all resources including intertie resources. This means the buyers would have to include available import allocations to be used.
5. Coordination with Existing Compliance Requirements: The ISO should consider how not to violate the MCC bucket limitations for the buyer of generic capacity. What are the possibilities of bucket 1 through 3 and DR type of resources participating in the residual auction? Does the ISO only backstop MCC bucket 4 and Flexibility Category 1 resources in the annual time frame in case the ISO's forecasts are inaccurate and the ISO needs to CPM again for a significant event?

Standardized Product

The ISO developed the Standard Capacity Product with three guiding principles:

1. Meet the RA Requirement by streamlining and improve the RA process for market participants by providing a device that facilitates capacity trading and establishes performance rules in the tariff
2. Standard Capacity Product is fungible and can be easily traded
3. Standard Capacity Product MWs are bound by the availability standards and incentives.

The ISO ultimately established must-offer obligations for generic capacity as well as availability standards and incentives. The capacity product in its current form is more difficult to trade than before as the needs of the system are changing. The bulletin board is not utilized as it does not facilitate any capacity trading and market participants must negotiate complex terms and conditions to divide the financial risks embedded in the ISO's Tariff. In the bilateral market, a standard capacity product does not exist.

However, with the ISO's auction clearing the residual needs in the annual process, a Standardized Product must be developed. This product must include more than just the must-offer obligations and availability incentives. The ISO should consider the following when designing the products that will be cleared as part of the auction.

1. Must-offer obligations may be simplified. Generic resources should have a 24 hour MOO while flexible resources have 17 hour MOO. Any flexibility dispatch will be managed by the ISO based on ramp duration curve and least cost dispatch.
2. SDG&E believes the ISO should act as the clearing house. The market participants should not be obligated to negotiate contract terms and conditions. That would delay the actual delivery of the product. Buyer and seller need not communicate with each other for the transaction to be final.
3. ISO should consider whether the products cleared result in a "credit" or an actual resource to the buyer.
4. The ISO should set the standard for replacement requirement for outages to be seller's responsibility for any awards cleared in the annual process.

Replacement Requirement

ISO's current replacement requirement splits the responsibility between the LSE and Supplier at T-45. While this policy gave the ISO some certainty of meeting the planning reserve margin every day of the month, the implementation of the policy was filled with technical challenges that still occur today.

The products awarded in the annual process may have to participate in the monthly process. CAM and CHP credits create issues with replacement requirement. A resource that has multiple buyers also creates challenges to the replacement requirement determination. The ISO assigns the requirement pro-rata to all buyers. The single largest issue with the policy is the expectation for the Seller to share planned outage information with the Buyer. All of the above will make the Auction unworkable for an actual product. SDG&E proposes the following for the ISO to consider.

1. Ensure the annual product is a firm product.
2. Require replacement of planned outages from LSEs for their bilateral contracts at T-45 only. If Supplier wishes to provide replacement, it can do so through its own portal or through the LSE's RA plan. Any outages not replaced at T-45 even for outages requested prior to T-45 that still need replacement will be placed on the Supplier alone.
3. Suppliers will only need to provide replacement when the total system capacity is below the PRM and based on last in first out method that's currently in place.
4. Suppliers can bilaterally contract or participate in the ISO's monthly voluntary auction for replacement.

These steps will simplify the replacement requirement process and provide liquidity in the monthly auction.

Availability Incentives and Charges

ISO should reconsider the availability incentives and charges. Currently the incentives are non-existent when every resource performs above the threshold. The ISO should consider only penalizing a resource if there is a need to RUC or CPM another resource. ISO commented that it's seeing total committed capacity at barely above the planning reserve margin. SDG&E believes this is due to the risk of financial penalties for Forced Outages as well as planned outages that require replacement after the RA showing.

SDG&E believes the above four concepts help foster some ideas for the reliability services initiative.