**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)

REPLY COMMENTS OF SEMPRA GLOBAL ON CAPACITY MARKETS WHITE PAPER

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I. INTRODUCTION

In accordance with the *Chief Administrative Law Judge's Ruling Providing Notice of Availability of Staff Capacity Markets White Paper and Providing for Comments* dated August 25, 2005 ("Ruling"), Sempra Global ("Global") submits its reply comments on the Staff Capacity Markets White Paper ("White Paper"). Although the range of comments was quite broad, Global's reply comments are limited in scope to (1) consistency between a capacity market design and the recently issued Draft Decision on Resource Adequacy Phase 2 (the "DD") and (2) the areas of apparent consensus among the commenting parties regarding desirable or necessary features of a capacity market in California. Global recognizes that the policies expressed in the DD have not yet been adopted by the Commission. Nevertheless, they offer insight into the probable direction in which the Commission is headed in addressing resource adequacy ("RA"), which is one of the primary drivers of the capacity market discussion. Therefore, Global assumes for reply comment purposes that the DD represents the Commission's policy preferences.

II. REPLY

The filed comments highlight the dual purposes driving the capacity market discussion in California – reliable service for electricity customers and adequate revenue to independent power producers to encourage investments in new generation to serve California. As stated in its opening comments, Global has been an advocate of an organized forward capacity market throughout this proceeding as an efficient means of allowing Electric Service Providers ("ESPs") to comply with the Resource Adequacy requirements ("RAR") that are expected to be adopted. If the RAR is to be based on physical resources under contract to load serving entities ("LSEs"), then ESPs and other small LSEs need to have a mechanism whereby they can contract for quantities sufficient to meet their RAR, as well as have the ability to buy and sell incremental capacity to keep pace with load migration. Since the opening comments were filed, the Commission has released the DD, which reiterates the Commission's policy preference that the RAR be based on a physical requirement, and that whatever instruments LSEs use to fulfill their RAR be traceable to physical plant.

The comments filed by various parties on September 23, 2005 contain a number of common themes regarding issues that staff should take into consideration when making its recommendations to the Commission. These include: (1) an expansion of the market to include a multi-year forward commitment; (2) the use of local area curves to set prices in local reliability areas; (3) the use of *ex ante* peak energy price forecasts when deducting peak energy "rents" from capacity prices, **if** deductions are made at all; and (4) give priority to local reliability needs; and (5) encourage bilateral contracting. Global reiterates its support for these five areas of widespread agreement, and notes that many of these are aspects of the Capacity Market proposal that San Diego Gas & Electric ("SDG&E") circulated two years or so ago.

The SDG&E proposal, alluded to in SDG&E's opening comments,[1] provides for an annual auction for four-year forward commitments, with new generation eligible to offer contracts of up to 10 years duration. If the initial auction falls short, the California Independent System Operator ("CAISO") would conduct an RFP to cover any shortfall, including local area shortfalls. The respective auctions would include specific requirements for local capacity needs, and any uplift charges resulting from CAISO backstop procurement would be in the form of a non-bypassable charge on all users of the CAISO grid. In addition, the proposal allows for bilateral contracting and self-provision of RAR by those LSEs who own generation.

The SDG&E proposal did not incorporate a demand curve, but the demand curve may be compatible with the proposal. Because many of the main features of SDG&E's proposal seem to have gained support from a great number of commenting parties, Global suggests that the proposal be given a fresh look as a potential model on which a California capacity market could be based.

As to the comments of specific parties, TURN advocates that, instead of a capacity market the Commission expand the scope of the RAR to include a multi-year forward commitment.[2] Under TURN's proposal, all LSEs would be required to contract three years forward for 80% of their forecast load (plus reserves), 90% two years forward, and 100% one year forward.[3] TURN's proposal is consistent with the current status of RAR, which requires a one year forward commitment of 90% of forecast load (plus reserves) supplemented by a one month forward procurement of the remaining 10%.[4] The critical distinction between the current RAR and what TURN has proposed is that under TURN's proposal, ESPs would have to forecast

[1] Opening Comments of SDG&E, at pg. 5.
[2] Opening Comment of TURN, at pp. 3-4.
[3] Id.
[4] D.04-10-035, *mimeo* at pp. 9-11, Conclusions of Law 2, 3, 23.

their load three years in advance and procure up to 80% of that load in the same timeframe. One can readily see that such a proposal is incompatible with direct access ("DA") service as it currently exists in California, and is based on an implied assumption that the only LSEs procuring under such a framework would be the three investor owned utilities ("IOUs").

There has been much discussion in this proceeding in filings by parties and in the Commission's orders about the character of DA and the potential for load migration. Even though the amount of DA load in California is capped, for the time being, DA load still has the ability to migrate from the ESP currently serving it to a different ESP or back to bundled IOU service. Attempting to force ESPs to speculate on capacity three years into the future and take long forward positions produces unacceptable business risk and credit risk that is simply not compatible with the continuation of DA. By contrast, a forward commitment complemented by a liquid, tradable capacity product and market facilitates continued DA.

On the other side of the coin, Southern California Edison ("SCE") proposes implementation of a capacity market only if the RAR is eliminated.[5] SCE's proposal would create a forward market for capacity with no obligation on LSEs to purchase that capacity. To that extent, it is also incompatible with the California markets and with the Commission's policy direction regarding RAR. It also undermines one of the two primary drivers of the capacity market discussion – developing a product to achieve compliance with the RAR. For that reason, staff should reject this idea in its recommendations to the Commission.

III. CONCLUSION

The many opening comments on the White Paper reveal broad support for a number of potential elements for the design of a capacity market in California, including a forward

[5] SCE comments at pp. 2, 6.

commitment, bilateral contracting, priority to local reliability issues, and an exploration of the use of a demand curve or curves to establish prices. Consideration of these and other elements is essential in order to fulfill the ostensible dual purposes driving the capacity market discussion – satisfaction of resource adequacy and encouraging investment in new generation. TURN and SCE have proposed alternatives or conditions that are incompatible with the policy direction expressed in prior Commission decisions and in the DD, and which should therefore not be considered further. The proposal originally circulated by SDG&E features many of the elements that garnered wide support in the comments, suggesting that that proposal should be given a fresh look.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the **REPLY COMMENTS OF SEMPRA GLOBAL ON CAPACITY MARKETS WHITE PAPER** has been served electronically on each party of record on the service list in R.04-04-003. Any party on the service list who has not provided an electronic mail address was served by placing copies in properly addressed and sealed envelopes and depositing such envelopes in the United States Mail with first-class postage prepaid.

Copies were also sent via Federal Express to Administrative Law Judge Carol A. Brown, Meg Gottstein, Mark S. Wetzell and assigned Commissioner Michael R. Peevey.

Executed this 11th day of October, 2005 at San Diego, California.

Deanna M Porter

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