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

| Rulemaking Regarding Whether, or Subject to What Conditions, the Suspension of Direct Access May Be Lifted Consistent with Assembly Bill 1X and Decision 01-09-060 | Rulemaking 07-05-025<br>(Filed May 24, 2007) |
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# REPLY COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39-E) ON PROPOSED DECISION


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## I. THE PD CORRECTLY IMPLEMENTS SECTION 394.24(E).

Parties representing Electric Service Providers ("ESPs") and large, commercial Direct Access ("DA") customers filed voluminous comments opposing the financial security requirements adopted in the *Proposed Decision Adopting Direct Access Reforms* ("PD"). However, as the PD correctly explains, Public Utilities Code section 394.25(e) requires ESPs to provide security for any re-entry fee imposed on involuntarily returned DA customers.[1] There is no dispute that "re-entry fees" for involuntarily returned DA customers would include the difference in costs between the bundled portfolio service rate and market rates at the time the DA customers returned (*i.e.*, the "incremental procurement costs" to serve returning customers). Because the incremental procurement costs are a re-entry fee imposed on returning DA customers, Section 394.25(e) is clear these costs are the "obligation" of the ESPs and that ESPs are required to provide security to demonstrate they can cover these costs.

Despite this clear statutory language, the DA Parties argue that they should only be required to provide security that covers the administrative fees associated with the involuntary returned DA customers, and that the involuntarily returned customers should be responsible for all of the incremental costs, even if these customers are completely unaware of their potential liability.[2] Limiting the security to administrative fees, as the ESPs suggest, is clearly

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[1] PD at pp. 56-58.

[2] DA Parties Comments at pp. 5-6; Commercial Energy Comments at pp. 7-8.



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inconsistent with the statutory requirement that the ESP security cover "any" re-entry fees. The ESPs also claim that Section 394.25(e) is only intended to protect bundled customers. This assertion is simply wrong; Section 394.25(e) is in a section of the code providing for DA "consumer protection", and thus this section is not simply for the benefit of bundled customers.

## II. PARTIES RELY ON AN ERROR IN THE PD TO MISREPRESENT THE IMPACT OF THE FINANCIAL SECURITY REQUIREMENT.

The PD includes an example intended to demonstrate that the cost to ESPs associated with the financial security requirements is not excessive, noting that the cost of $112 million in security is only $1.1 million. However, the PD erroneously summarizes the DA Parties' testimony, explaining that an ESP "with $2 million in annual sales" would be required to provide $112 million in financial security.[3] In fact, the DA Parties' testimony does not refer to $2 million in sales, but rather 2 million MWh in sales, which, at a price of $55/MWh, would result in $110 million in sales.[4] Thus, for an ESP with $110 million revenues (not $2 million), the cost of $112 million in financial security would be $1.1 million, or 1% of total revenues. Although the example in the PD is based on the DA Parties' own testimony, the DA Parties and other affiliated parties exploit the error in the PD (*i.e.,* mistakenly referring to $2 million in sales instead of 2 million MWh in sales) and misleadingly argue that the financial security requirement adopted in the PD would result in ESPs paying 50% of their revenues in bond costs.[5] These arguments, which the DA Parties are well aware are based on a simple error in the PD, should be disregarded.

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[3] PD at p. 57.

[4] Exhibit ("Ex.") 201 at pp. 13-14 (DA Parties, Fulmer).

[5] DA Parties Comments at p. 8; *see also* Pilot Power Comments at p. 2; Commercial Energy Comments at p. 2; Retail Energy Supply Association ("RESA") Comments at p. 5.



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## III. EXAGGERATED CLAIMS CONCERNING THE ALLEGED DETRIMENTAL IMPACT OF THE PD ARE BASELESS.

In addition to their reliance on an error in the PD, ESP parties' comments are replete with "the sky is falling" rhetoric predicting the end of DA in California.[6] These claims are a distraction. First, as explained above, even using the DA Parties' own testimony, the financial security costs even in the most extreme market conditions are 1% or less of an ESP's overall revenues; and the PD allows ESPs to provide corporate guarantees in certain circumstances, which would have no cost.[7] Second, what the ESPs are now complaining of, the requirement that they post financial security, is standard practice in the energy industry.[8] The ESPs simply want to avoid providing security for risks that they create, which is contrary to industry practice and recent federal efforts to restructure the credit risks of markets.[9] Third, the ESPs do not dispute the evidence offered by SCE and PG&E that financial security is readily available for qualified entities.[10] Finally, the ESPs offer no evidence that "the sky will fall", only rhetoric. The reality is that market participants, including both IOUs and non-IOUs, routinely post security for transactions, as PG&E demonstrated in its testimony.[11] For example, PG&E recently posted over $700 million of financial security for transactions that it has entered into and has Commission authority for up to $4 billion in short-term borrowing capacity to meet collateral requirements and provide sufficient working capital.[12] The ESPs' claims that they will no longer be able to operate in California are simply baseless.

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[6] *See e.g.* Commercial Energy Comments at p. 6; Pilot Power Comments at pp. 2-3.

[7] Some parties complain that the AA rating for a corporate guarantee adopted in the PD is too stringent, arguing that the IOUs' credit ratings are below AA. *See e.g.* DA Parties at p. 9. However, the issue is not the credit rating of the IOUs, but rather the financial stability of a party guaranteeing an ESP's obligation.

[8] *See* PG&E Opening Post-Hearing Brief at pp. 29-32.

[9] *Id.*

[10] Ex. 400 at pp. 4-10 to 4-14 (PG&E, Hessami); Ex. 300 at pp. 59-62 (SCE, Singh).

[11] Ex. 400 at pp. 4-1 – 4-10 (PG&E, Hessami).

[12] D.09-05-002.



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## IV. THE FINANCIAL SECURITY METHODOLOGY IS REASONABLE.

Parties criticize the financial security methodology adopted in the PD claiming that the historic volatility information data is unreliable.[13] However, as PG&E witness Hessami testified at the hearings, historic volatilities are generally used in the industry and are "highly credible."[14] Parties also claim that a 95% confidence interval, similar to what the Commission adopted in D.07-12-052, is excessive, but then fail to offer any alternative confidence interval.[15] They also fail to recognize that exchanges and clearing entities use a far more conservative confidence interval than 95%. Some parties also criticize recalculating the financial security requirements every six months.[16] However, this approach benefits ESPs as it captures changes in the market more readily, so that if market prices fall, an ESP does not need to wait an entire year before lowering the amount of financial security that it needs to provide. Further, depending on market prices, there are many instances when there is no security requirement for six months, even if market prices were to rise to levels that would justify a security amount under a shorter security calculation period. Compared to normal industry practice and exchange and clearing requirements where parties must almost daily post the security requirement or risk default, the proposed bond methodology provides the ESP almost 60 days to prepare for any collateral needs. ESPs have access to the same model, prices and volatilities to calculate their own estimate from the time the prices are available to dispute any discrepancy, manage financial planning, or shop for acceptable alternatives for the security amount namely letters of credit, performance bond or acceptable third party or parental guarantee. Finally, some parties suggest that the Commission establish a new phase of this proceeding to re-litigate PG&E's and SCE's proposed financial

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[13] *See e.g.*, City and County of San Francisco ("CCSF") Comments at pp. 4-5.

[14] Transcript at p. 628, line 13 to p. 629, line 2 (PG&E, Hessami).

[15] CCSF Comments at p. 7.

[16] Commercial Energy Comments at p. 3.



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security model that was adopted by the PD.[17] The financial security methodology was the subject of extensive written testimony, cross-examination and briefs. There is no need to re-do this entire process or give parties a second bite at the apple.

## V. THE RPS ADDER PROPOSED BY THE JOINT PARTIES IS ERRONEOUS.

In opening comments, the Joint Parties erroneously assert that their Green Benchmark should be the only data used to calculate the Renewable Portfolio Standard ("RPS") adder for the Market Price Benchmark ("MPB") calculation because the Green Benchmark reflects the utilities' costs for renewable energy.[18] The Joint Parties' argument demonstrates a complete misunderstanding of the purpose of the MPB and is legally erroneous because it is inconsistent with Commission precedent. The Commission has repeatedly explained that the purpose of the MPB is to establish the market value of each utility's portfolio.[19] The PD correctly determines that the RPS adder should reflect the market value of renewables, although PG&E believes that the PD errs in adopting a formula which includes the Green Benchmark for 68% of the RPS adder.[20] The costs paid by an IOU are not the same as market value of RPS-eligible energy. The market value is the value of RPS-eligible energy to all of the participants in the "market", including ESPs, Community Choice Aggregators and Publicly Owned Utilities. If the Joint Parties' reasoning was adopted by the Commission, the IOUs would never have above-market costs because the "market" would be defined solely as the IOU costs.

Respectfully submitted,
CHARLES R. MIDDLEKAUFF

By: *_/s/ Charles R. Middlekauff_*

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[17] DA Parties Comments at pp. 12-13; RESA Comments at p. 9.

[18] Joint Parties Comments at pp. 4-5; *see also* California Large Energy Consumers Association and California Manufacturers and Technology Association ("CLECA/CMTA") Comments at pp. 4-6.

[19] *See* Ex. 400 at pp. 1-5 to 1-8 (PG&E, Barry) (describing MPB and Commission precedent).

[20] PD at p. 9.



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