

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

Order Instituting Rulemaking to Integrate and Refine Procurement Policies and Consider Long-Term Procurement Plans.

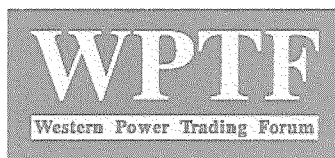
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May 6, 2010 San Francisco, California  
Rulemaking 10-05-006

**REPLY BRIEF OF THE  
WESTERN POWER TRADING FORUM**

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## SUMMARY OF WPTF's RECOMMENDATIONS

1. The once-through cooling ("OTC") proposal presented by the Energy Division Staff ("Staff") of the California Public Utilities Commission ("Commission") is flawed and should not be adopted.
2. The fundamental differences between Utility Owned Generation ("UOG") and Power Purchase Agreement ("PPA") projects make bid comparisons in an Request for Offers ("RFO") impossible and create a real perception of bias when the Investor Owned Utilities ("IOUs") evaluate their own UOG projects in competition with PPA proposals.
3. IOU development costs should be at risk and not ratepayer guaranteed.
4. UOG offers should not be considered in RFOs. Rather, utility-owned projects should be proposed to the Commission via traditional applications for a certificate of public convenience and necessity ("CPCN") only after a competitive solicitation has failed, as confirmed by an Independent Evaluator ("IE").
5. The Commission needs to clarify in the forthcoming Rules Track III proceeding how the Cost Allocation Mechanism ("CAM") is to be implemented; how to distinguish between system and bundled resource needs; and how the test of "who benefits" under Senate Bill ("SB") 695 will be implemented.
6. IEs should be selected and paid by the Commission and not by the IOUs.
7. Information controls are essential to prevent the sharing of critical information among IOU personnel. Appropriate Codes of Conduct should be developed with IE, Procurement Review Group ("PRG") and Energy Division input, and submitted for approval by the Commission.

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**I. INTRODUCTION AND SUMMARY**

This reply brief is submitted on behalf of the Western Power Trading Forum (“WPTF”) in accordance with the directive provided by Administrative Law Judge (“ALJ”) Peter Allen and Rule 13.11 of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”).

**A. Description of WPTF**

WPTF is a California non-profit, mutual benefit corporation. It is a broadly based membership organization dedicated to enhancing competition in Western electric markets in order to reduce the cost of electricity to consumers throughout the region while maintaining the current high level of system reliability. WPTF actions are focused on supporting development of competitive electricity markets throughout the region and developing uniform operating rules to facilitate transactions among market participants.

WPTF provides a voice through which its members can influence the development of market structures throughout the West. The membership of WPTF includes generators,

scheduling coordinators, investment banks, energy service providers, energy consultants and public utilities, all of which are active participants in the restructured California electricity market. WPTF has a vital interest in the development of a competitive electric market and in the reduction of barriers that may exist in the very structure of new markets.

## **B. Summary of Reply Comments**

WPTF replies herein to opening briefs of several other parties. Our comments are organized by issue, rather than by party, given the wide diversity of issues under consideration in this phase of the Long-Term Procurement Plan (“LTPP”) proceeding. Our initial focus is on the issue of UOG offers and whether they can or should be included in utility RFOs and related bid evaluation issues. Parties’ comments on Staff’s proposal regarding procurement rules related to contracts with any facility subject to the State Water Resources Control Board’s (“SWRCB”) *Statewide Water Control Policy on the Use of Coastal and Estuarine Water Used for Power Plant Cooling* (the “Staff OTC Proposal”) are addressed next. We also reply to the parties that addressed the issue of whether IEs should be hired by the Commission, followed by brief comments regarding the CAM issue.

## **II. DRA’S RECOMMENDATIONS FOR TREATMENT OF UOG AND PPA PROJECTS IN RFOS FURTHER ELUCIDATE THE REASONS WHY SUCH COMPARISONS SHOULD BE AVOIDED; IF THE COMMISSION CONTINUES TO PERMIT UOG PROJECTS TO PARTICIPATE IN RFOS, THEN SOME OF DRA’S RECOMMENDATIONS SHOULD BE ADOPTED.**

In its opening brief, WPTF noted the very real problems associated with evaluating UOG proposals in competition with PPA bids. We cited the uneven life cycles of PPA contract periods (traditionally ten years) that are shorter than the life of a UOG asset, pointing out that this inevitably tilts any discounted cash flow analysis in favor of the longer lived UOG assets.

We noted the very different risk profiles of PPAs and UOG, with PPA project sponsors needing to factor a return into their bids while UOG having the assurance of ratepayer cost recovery. There is a clear financial incentive for utilities to pursue UOG projects that enhance utility profits through additions to rate base, as opposed to PPAs, which do not. Finally, we observed that having the IOUs evaluate their own UOG projects in comparison to PPA bids creates a very real bias that in turn compromises the competitiveness of the RFO.

The Division of Ratepayer Advocates (“DRA”) disagrees, including in Section III.C.2 of its opening brief a section entitled, “Utility Owned Generation *Can* be Compared with Independently Owned Generation and *Should* Be Tested by the Competitive Solicitation Process.”<sup>1</sup> Therein, DRA continues to support the inclusion of UOG in utility RFOs, saying that, “In actuality, the current state of UOG and PPA comparison falls squarely in the middle of the extreme viewpoints of the IOUs and WPTF. That is, PG&E and SDG&E are wrong in portraying the process of comparing UOG and PPA offers as needing no refinements. Likewise, SCE and WPTF are wrong in suggesting that the process of comparing UOG and PPA offers is utterly impossible and should not even be attempted.”<sup>2</sup>

DRA concludes that the truth is in between and the Commission should neither ignore the issue, as PG&E and SDG&E suggest, nor give up trying to address them, as per the recommendations of SCE and WPTF. Instead, DRA concludes that the Commission should require that all UOG must be tested by competitive solicitations. As for actual bid comparison, DRA also proposes that UOG project costs should be amortized over the same term as the PPA

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<sup>1</sup> DRA Opening Brief, at pp. 29-36.

<sup>2</sup> Id, at pp. 29-30.

contract.<sup>3</sup> DRA further recommends that the Commission should provide specific guidance to IOUs regarding input assumptions and forward cost curves used in UOG valuations<sup>4</sup>; it should establish cost caps for capital costs and O&M for UOG projects<sup>5</sup>; establish clear pay for performance mechanisms in UOG projects similar to PPAs<sup>6</sup>; and, importantly, shareholders should finance the costs for IOUs to develop a UOG bid and should absorb costs on failed UOG bids.<sup>7</sup>

Simply put, DRA’s recommendations carefully outline what it would take for UOG to be evaluated more fairly in a head to head comparisons with PPAs – in essence, DRA’s recommendations would require the comparison process to incorporate evaluation metrics for the UOG projects that are more directly comparable to PPAs. In short, DRA’s recommendations would make the UOG project look more like PPAs in the evaluation process. In doing so, DRA’s recommendations drive home the real flaws that exist when head to head comparisons of UOG to PPA projects are allowed, and as such, should lead the Commission to reject the idea of allowing UOG and PPAs in the same solicitations.

Should the Commission nonetheless decide to continue considering UOG and PPA projects in the same solicitation, it should give serious consideration to adopting the DRA recommendations outlined above. WPTF finds particularly compelling DRA’s recommendation that UOG project costs should be amortized over the same term as the PPA contract. Further, we note in the same regard that The Utility Reform Network (“TURN”) also said that, “The

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<sup>3</sup> Id, at p. 32.

<sup>4</sup> Id, at p. 33.

<sup>5</sup> Ibid.

<sup>6</sup> Id, at pp. 33-34.

<sup>7</sup> Id, at p. 34.



Commission should require that the critical cost parameters of any UOG bid should be binding on the IOU for the first ten years of project operations.”<sup>8</sup> This should also be adopted if the Commission continues to allow UOG to compete in utility RFOs.

In summary, if the Commission should decide that UOG projects can participate in RFOs, then it should be explicit that: (a) UOG project costs must be amortized over the same term as PPA contract proposals; (b) the IOUs are to be provided specific guidance regarding input assumptions and forward cost curves used in UOG valuations; (c) there must be cost caps for capital costs and O&M for UOG projects; (d) pay for performance mechanisms must be mandated; (e) the critical cost parameters of any UOG bid should be binding on the IOU for the first ten years of project operations; (f) any development costs that are associated with that project must be included in the evaluation process; and (g) development costs should be at risk and not ratepayer guaranteed in order to minimize the perception of bias and to level the playing field among market participants.

### **III. THE STAFF’S RECOMMENDATIONS ON ONCE-THROUGH COOLING ISSUES SHOULD BE REJECTED.**

In its opening brief, WPTF contended that there were numerous flaws in the Staff’s OTC proposal that argue against its adoption. Numerous parties concurred with this position and urged rejection of the Staff’s proposal. For example, DRA states that, “the one-year limitation on utility contracting does not appear to produce any identifiable benefits to ratepayers.”<sup>9</sup> NRG Energy, Inc. (“NRG”) speaks to the topic in detail, observing that there is no reason to limit contracting opportunities for OTC plants prior to the compliance dates established by the

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<sup>8</sup> TURN Opening Brief, at p. 7.

<sup>9</sup> DRA Opening Brief at pp. 25-26.

SWRCB; limiting the ability of LSEs to contract with OTC units is likely to increase the prices such LSEs pay for generating capacity; and lack of access to longer-term contracts may lead to decreased system reliability, because longer-term contracts allow for longer-term system planning.<sup>10</sup>

We also note and agree with the comments of San Diego Gas & Electric (“SDG&E”),<sup>11</sup> Pacific Gas & Electric Company (“PG&E”),<sup>12</sup> Southern California Edison Company (“SCE”),<sup>13</sup> and the Independent Energy Producers Association (“IEP”),<sup>14</sup> all of whom note the myriad problems raised by the Staff’s OTC proposal. IEP said it best when it noted:

Energy Division’s proposal is misguided and would likely increase ratepayers’ costs. The compliance dates that the State Water Resources Control Board has established for OTC plants extend to 2017 or 2020, and it makes little sense to limit PPAs to one year for facilities that can operate lawfully and within the restrictions adopted by the Board for up to eight more years. Because the capital costs of these units have largely been recovered, they are able to offer capacity and Local RA capacity at attractive prices. Restricting these units’ ability to contract for more than one year will reduce available capacity and predictably increase ratepayers’ costs.<sup>15</sup>

In conclusion, WPTF also endorses the recommendation of GenOn California North, LLC (“GenOn”) that the Commission encourage policy recommendations in the subsequent phase of the proceeding:

Finally, in light of the further needs analysis contemplated by the Settlement Agreement, and the CAISO's focus on evaluating how OTC compliance deadlines affect the need for new capacity to meet LCR, the Commission should allow parties to make policy recommendations regarding the replacement of OTC

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<sup>10</sup> NRG Opening Brief, at pp. 2-3.

<sup>11</sup> SDG&E Opening Brief, at pp. 21-24.

<sup>12</sup> PG&E Opening Brief, at pp. 16-18

<sup>13</sup> SCE Opening Brief, at pp. 17-21.

<sup>14</sup> IEP Opening Brief, at pp. 33-34.

<sup>15</sup> Ibid.

facilities in the next phase of this proceeding. It is difficult to make cogent recommendations regarding what types of procurement policies are needed to support OTC goals until the CAISO's additional study results are known. As the understanding of the impacts of OTC retirements becomes more complete, policy choices that are not readily apparent today may become more apparent then.<sup>16</sup>

WPTF reiterates the point made in its opening brief: the Commission should await the final results from the studies before making any determinations as to the need for replacement capacity associated with OTC retirements. Waiting until the CAISO studies are complete prior to making any determination as to the need for replacement capacity may entail a modest delay. However, it should still allow sufficient time for the IOUs to engage in competitive procurement in this cycle, if necessary, or in the next cycle, while complying with the deadlines in the SWRCB's OTC policy.

#### **IV. INDEPENDENT EVALUATORS SHOULD BE SELECTED AND PAID BY THE COMMISSION IN ORDER TO ASSURE REAL INDEPENDENCE.**

WPTF was pleased to see that there was widespread support for the principle that in order for IEs to be truly independent, they should be retained by and solely answerable to the Commission. If, as the Staff Proposal suggests, the role of the IE is to, "provide an independent evaluation of the IOU's bid evaluation and selection process and help inform the Commission and the PRG about the process,"<sup>17</sup> then the IE's actual independence must be assured. Most notably, it was parties whose primary reason for existence is to protect the interests of ratepayers that endorse this recommendation.

DRA states that it, "recommends a change in the current rules that provide that the IOU contract and hire the IEs. Instead, the Commission should require Energy Division Staff to

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<sup>16</sup> GenOn Opening Brief, at pp. 2-3.

<sup>17</sup> Attachment 1, at p. 8.

contract, hire and manage IEs.”<sup>18</sup> DRA correctly points out that there is a fundamental conflict faced by an IE which must manage “its role as an impartial evaluator who must objectively critique and monitor IOU procurement activities, and its financial interest in getting paid by the IOU.”<sup>19</sup> It further states that the current “arrangement creates the appearance of impropriety and the potential for a conflict of interest.” WPTF concurs.

TURN also addresses this issue persuasively, noting the strong potential for conflicts of interest. Notably, TURN also cites its Procurement Review Group experience over the years in support of the proposition that IEs should be retained and supervised by the Commission:

This fundamental conflict of interest means that IEs are typically reluctant to challenge major procurement decisions made by the IOUs, instead preferring to focus on minor disagreements that do not pose the risk of alienating their sponsor. TURN has observed this dynamic up-close for many years. Although TURN believes that the IEs have provided a valuable service to the Commission and ratepayers to date, the switch to Commission management would liberate the IEs to provide far more useful (and less constrained) analysis without the fear of jeopardizing future contracting opportunities.<sup>20</sup>

It is clear that having an IE be retained by the utility whose procurement it is supposed to evaluate on an independent basis is inconsistent with good procurement practice. As a result, WPTF Joins with DRA, TURN and with Pacific Environment, who also supported this policy,<sup>21</sup> in recommending that any IE be retained by and solely answerable to the Commission, with the associated costs charged back to the IOU and collected in rates. As noted in WPTF’s opening brief, only with this step can a truly independent evaluator be selected and commissioned to act as the watchdog that the interests of ratepayers deserve.

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<sup>18</sup> DRA Opening Brief, at pp. 27-28.

<sup>19</sup> Id at p. 28.

<sup>20</sup> TURN Opening Brief, at p. 9.

<sup>21</sup> Pacific Environment Opening Brief, at pp. 46-48.

**V. THERE IS A CONTINUING NEED FOR THE COMMISSION TO CLARIFY IN THE FORTHCOMING RULES TRACK III PROCEEDING HOW THE CAM IS TO BE IMPLEMENTED; HOW TO DISTINGUISH BETWEEN SYSTEM AND BUNDLED RESOURCE NEEDS; AND WHETHER THERE SHOULD BE A TEST OF “WHO BENEFITS” UNDER SB 695.**

In its opening brief, WPTF noted that Attachment 1 of Appendix B of the June 10 Ruling included a Staff proposal with respect to CAM that purportedly, “explains the rules related to participation, roles, and meeting protocols for the CAM group.”<sup>22</sup> However, the Staff proposal ignores the fundamental changes in the CAM that have occurred due to the passage of SB 695. Specifically, in D.11-05-005, the Commission addressed some CAM issues, but left for future clarification the most fundamental issue of just which utility investments are eligible to be afforded CAM treatment. D.11-05-005 in fact notes that there are some issues that remain to be resolved, which include:

1. The development of policies and processes for distinguishing between system and bundled resource needs, and related cost allocation.
2. Whether there should be a test of “who benefits” under SB 695, and if so, the construction of such a test.<sup>23</sup>

The decision also notes that “we intend to further develop the record in later phases of this proceeding in order to resolve these issues.”<sup>24</sup> In its opening brief, WPTF recommended that the Commission direct that the outstanding CAM issues be specifically addressed in the forthcoming Rules Track III Issues proceeding.

Two parties responded to this issue. SCE alleged that WPTF’s comments were out of scope and procedurally improper<sup>25</sup>, but provided no alternative to when or how the important

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<sup>22</sup> See June 13 Ruling, at p. 3.

<sup>23</sup> D.11-05-005, at p. 16.

<sup>24</sup> Id, at p. 17.

<sup>25</sup> SCE Opening Brief, at p. 37.

issues should be addressed. On the other hand, in its discussion recommending rejection of the Proposed Procurement Oversight Rules,<sup>26</sup> PG&E noted that certain elements of the proposed rules were incorrect and needed to be updated, most notably that, “the Cost Allocation Mechanism (“CAM”) Group rules included in the Procurement Oversight Rules need to be updated to reflect changes resulting from SB 695 and D.11-05-005 that address cost allocation issues.” While PG&E’s opening brief does not constitute an outright endorsement of WPTF’s recommendation that the issue be specifically addressed in the next phase of the proceeding, it is nevertheless a clear acknowledgement that the ramifications from SB 695 need to be more fully and clearly addressed.

Moreover, it is critical that the Commission move on this issue promptly, because requests have already been approved by the Commission for cost recovery under the new CAM provisions of SB 695,<sup>27</sup> and additional requests for cost allocation under SB 695 are pending before the Commission, all without clear and completely defined rules for its implementation.<sup>28</sup>

This is a real issue that has immediate implications for utility decisionmaking with regard to procurement and for the procurement decisions that direct access and community choice aggregation suppliers must make. The Commission has already ruled that it will not be left to utility discretion to determine whether the CAM cost recovery mechanism applies. But the

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<sup>26</sup> PG&E Opening Brief, at pp. 30-36.

<sup>27</sup> See, D.10-07-045, at pp. 44-45 and D.10-12-035, at pp. 47-50.

<sup>28</sup> For example, in A.11-05-023,<sup>28</sup> SDG&E has requested that the cost recovery for these agreements be approved by the Commission in accordance with the Cost Allocation Mechanism provided for in California Public Utilities Code Section 365.1(c) and Commission decision D.11-05-005. WPTF has joined with the Alliance for Retail Energy Markets, Energy Users Forum and Direct Access Customer Coalition in filing a June 24, 2011, protest to this request, noting that “SDG&E seriously mischaracterizes the provisions of D.11-05-005 with respect to the application of the CAM and whether it permits SDG&E to seek CAM treatment for the PPTAs. With these mischaracterizations exposed, it is apparent that SDG&E has failed to show these agreements meet the reliability requirements for which CAM treatment is permitted.”

Commission has not yet taken the additional step of establishing further clarity on when it will – and will not – impose the CAM. Such clarity is urgently needed, and all stakeholders should be provided a meaningful opportunity to review and provide input regarding the criteria that should apply. The Commission must act speedily to resolve the outstanding CAM issues in the next phase of Track III.

## **VI. CONCLUSION**

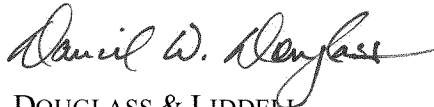
WPTF reiterates its call for the Commission to adopt the following positions in this proceeding:

1. Staff's OTC proposal is flawed and should not be adopted.
2. The fundamental differences between UOG and PPA projects make bid comparisons in an RFO impossible and create a real perception of bias when the utilities evaluate their own UOG projects in competition with PPA proposals.
3. If the Commission continues to allow UOG to compete in RFOs, IOU project development costs attributable to "utility development offers" should be at risk and not ratepayer guaranteed.
4. UOG offers should not be considered in RFOs. Rather, utility-owned projects should be proposed to the Commission via traditional applications for a CPCN only when and if a competitive solicitation has failed, as confirmed by an IE.
5. The Commission needs to clarify in the forthcoming Rules Track III proceeding how the CAM is to be implemented; how to distinguish between system and bundled resource needs; and whether there should be a test of "who benefits" under Senate Bill ("SB") 695.
6. IEs should be selected by and solely answerable to the Commission.

7. Information controls are essential to prevent the sharing of critical information among IOU personnel. Appropriate Codes of Conduct should be developed with IE, PRG and Energy Division input, and submitted for approval by the Commission.

WPTF thanks the Commission for its attention to these issues.

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