BEFORE THE PUBLIC UTILITIES COMMISSION OF

THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Continue Implementation and Administration of California Renewables Portfolio Standard Program	Rulemaking 11-05-005 (Filed May 5, 2011)

OPENING COMMENTS OF THE UTILITY REFORM NETWORK ON THE PROCUREMENT EXPENDITURE LIMITATIONS FOR THE RENEWABLES PORTFOLIO STANDARD PROGRAM

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OPENING COMMENTS OF THE UTILITY REFORM NETWORK ON THE PROCUREMENT EXPENDITURE LIMITATIONS FOR THE RENEWABLES PORTFOLIO STANDARD PROGRAM

Pursuant to the January 24, 2012 ruling of ALJ Simon, The Utility Reform Network (TURN) hereby submits these opening comments on the procurement expenditure limitations contained in Public Utilities Code §399.15 and enacted in SBx2 (Simitian). As an active participant in the legislative negotiations surrounding this portion of SBx2, TURN has a strong interest in ensuring that the Commission faithfully implements the cost containment provisions in a manner consistent with the intent of the Legislature.

Question 1 – Uniform application to each electrical corporation

The procurement expenditure limitation methodology should be designed to apply to each Investor Owned Utility (IOU) in a functionally similar manner. This means that while the same methodology should be applied to each IOU, the inputs necessarily differ in order to reflect the specifics of the individual utility portfolio. The statutes contemplate that these specifics will differ in referencing (in §399.15(c)(1)) the "most recent renewable energy procurement plan" for each utility and (in §399.15(c)(2)) "the potential that some planned resource additions may be delayed or canceled." While it is appropriate to use different portfolio, need and scenario inputs for each utility, it would be inappropriate to adopt divergent methodologies for calculating the limitation.

Question 2 – Procurement costs applied to the limitation

The language of SBx2 explicitly requires that "the costs of all procurement credited toward achieving the renewable portfolio standard are counted towards the

limitation."[1] This unambiguous directive effectively means that any procurement of renewable resources by an electrical corporation counts towards the limit regardless of the driving factors behind the procurement. The Legislature enacted this section to prevent the Commission from excluding any renewable procurement initiatives from the cost limitation regardless of whether they occur under the explicit rubric of the RPS program.

The ruling lists a variety of procurement transactions that fit this definition including contracts executed pursuant to PURPA, the Renewable Auction Mechanism, the SB 32 Feed-in Tariff, Bilateral negotiations, and utility-owned generation. Procurement under all these programs is credited to RPS compliance and therefore falls under the limitation. To the extent that the Commission (or the Legislature) creates new renewable procurement tools, all costs associated with these transactions would also be subject to the limitation. The costs of utility owned generation should be treated in exactly the same manner as costs incurred through power purchase contracts.

The Commission may not exclude the cost of any future renewable procurement from the limitation unless the transaction provides no credit towards RPS compliance and fails to convey any Renewable Energy Credits (RECs) to the buyer.[2] One example would be a net metered solar installation that conveys RECs to entities other than the IOU serving the net metered customer. In this case, any costs associated with the net metering arrangement cannot be counted towards the limitation since the output is not credited towards RPS compliance.

The cost limitation applies solely to the direct costs paid by the IOU to procure energy and RECs from the seller. No indirect, system, portfolio or transmission costs

[1] Cal. Pub. Util. Code §399.15(d)(2)

[2] Procurement via a PURPA contract is always credited towards RPS compliance regardless of whether a REC is created (see §399.21(a)(4) and (a)(5)) and therefore must be counted towards the limitation.

may be included in the calculation of procurement costs. SBx2 continues the previous understanding of procurement costs originally enacted in SB 1078 (Sher, 2002). Under the prior RPS program, the IOUs were prohibited from counting as above-market costs any "indirect costs associated with the purchase of eligible renewable energy resources, such as imbalance energy charges, sale of excess energy, decreased generation from existing resources, or transmission upgrades".[3] SBx2 contains virtually identical language with respect to what can be considered a "procurement expenditure" for purposes of calculating the limitation.[4] The Commission should not disturb this understanding.

The "costs of all procurement" should initially be determined at the time that a procurement contract is approved by the Commission. This approach is consistent with the authorization in §399.15(f) for an electrical corporation to "refrain from entering into new contracts" if "projected costs" will exceed the overall cost limitation. The future costs of these contracts can be easily modeled using expected annual generation, assumed delivery profiles, expected online date, and specified contractual payments. While this information may not provide absolute certainty, it will provide a sufficiently robust forecast to determine the likely costs to be paid in future years. As actual costs are incurred, each electrical corporation should adjust its forecasts to reflect the most up-to-date information.

Contractual commitments made prior to the enactment of SBx2 should be considered relevant procurement expenditures so long as they involve deliveries that occur in 2011 or later.[5] There is nothing in the statutory language exempting prior contractual obligations from the limitation.[6] The development of a standard methodology

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[3] Previous Cal. Pub. Util. Code §399.15(a)(2)(enacted in SB 1078, effective January 1, 2003).
[4] Cal. Pub. Util. Code §399.15(d)(3). This section also adds "costs associated with relicensing any utility-owned hydroelectric facilities".
[5] Contracts that terminated prior to 2011 are not relevant for this analysis.
[6] This does not mean that prior contracts are at risk of premature termination. In the event that the limitation is exceeded, a utility may refrain from executing additional contracts. Under no

should include, as inputs, the expected costs of renewable procurement from the existing portfolio, the projected costs for executed contracts that have not yet led to deliveries and the forecasted costs for procurement commitments not yet executed. This approach will allow the limitation to cap total portfolio costs rather than simply incremental costs incurred after a certain date. Such an approach will create greater transparency and assist the Commission and Legislature in understanding the full procurement costs of achieving RPS targets.

The Commission can combine expected future costs with anticipated procurement identified in each IOU procurement plan to generate a raw cost estimate. This estimate must then be adjusted to account for the potential for delays or cancellations and a margin of overprocurement. This resulting information should then be assessed to determine whether it would cause "disproportionate" rate impacts during the relevant compliance period. The rate impact test would be applied to potentially reduce the overall limitation based on the desire to mitigate excessive increases in rates.

Questions 3, 4 and 5 – Applicable time period for the limitation

The statute is not explicit with respect to the applicable time period for measuring whether the cost limitation has been exceeded. The Commission may choose to measure the limit annually (as is suggested by §399.15(g)(2)(A)), for each compliance period, or as a single period that runs through 2020. TURN recommends that the Commission apply the limitation to total procurement expenditures by compliance period. This approach would lead to separate limitations for 2011-2013, 2014-2016, 2017-2020 and an annual limit for the years beyond 2020.

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circumstances should the Commission attempt to retroactively apply cost limits to impair previously approved procurement commitments.

This approach is consistent with the metrics for determining RPS compliance, will ensure that cost containment mitigates rate impacts in the years prior to 2020, and allows methodological or input revisions to apply to the final compliance period. Since post-2020 compliance will be demonstrated annually, the procurement expenditure limit should become annual at that point.

Question 6 – Reliance on IOU procurement plans

For purposes of developing a cost limitation for a specific IOU, the most important elements of the most recent RPS procurement plan relate to expected renewable resource need by compliance period, net short positions, projected contract failure rates, resource diversity and the procurement mechanisms anticipated to be used to achieve compliance.[7] This information will allow the Commission to develop a realistic assessment of the possible costs that could be incurred to meet the targets for each compliance period.

Since the Commission is constrained in its ability to adjust the cost limit for each utility (see answer to Questions 9 and 10), any post-January 1, 2017 update should rely on information in the most recent adopted procurement plan (pursuant to §399.15(e)(1)). Apart from this update, the Commission should review any revised assumptions in future procurement plans for purposes of determining whether the IOU should adjust its procurement strategies to address the possibility of exceeding the adopted cost limitation.

Question 7 – Reliance on the expected cost of new renewable resources

[7] The Commission can base its estimates on the expected contribution of the RAM, FIT or RPS solicitations towards compliance.

SBx2 directs the Commission to review the present and future costs of renewable resources in order to protect ratepayers from a situation in which market-based pricing substantially diverges from a cost-based price. The Legislature included this provision based on concerns that RPS procurement obligations could create short-term or long-term scarcity and lead to potential price gouging by sellers. Although this phenomena is not being observed in current utility solicitations, market dynamics could shift fairly rapidly in future years. In the event that seller prices reflect speculation rather than fundamental costs, the expenditure limitation should provide a safety valve and protect ratepayers from disproportionate rate increases.

The Commission's review of expected renewable resource procurement should attempt to determine present and future cost-based pricing for anticipated renewable resources. This exercise can rely on both confidential and public data since the best information on current pricing trends comes from offers received, and contracts executed, by utilities in RPS and RAM solicitations for projects with a variety of online dates. This data can be used to validate public forecasts or cost of generation studies.

The methodology should distinguish between utility-owned and independently-owned generation. The key difference between these ownership models involves cost of capital, depreciation schedules, and the ability of third-party developers to fully monetize various tax benefits. In other proceedings, TURN has demonstrated that federal tax normalization requirements (which only apply to regulated utilities) can significantly increase ratepayer costs for utility-owned renewable generation relative to the costs paid to third-party developers under PPAs.[8] The Commission may have to assume higher costs for certain utility-owned renewables (e.g. solar) as a result.

[8] For example, see Testimony of William Marcus on behalf of TURN in A.09-12-002.

Questions 8 and 11 – Potential for delays/cancellations and overprocurement

The development of a procurement expenditure limitation must take into account the likelihood of delays and cancellations for projects currently under contract but not yet operational. The inclusion of this language in SBx2 demonstrates that the Legislature was aware that a sizable percentage of contracted projects do not achieve commercial operation on time, or at all, and wanted to ensure that the procurement expenditure limit took this reality into account.

Each IOU currently accounts for failure and delay by incorporating adjustments into internal confidential forecasts (which are shared with their Procurement Review Groups) along with public materials in filed renewable procurement plans. To mitigate the risk of noncompliance, IOUs are contracting for excess renewable generation in each compliance period. TURN recommends that the margin of excess procurement in §399.13(a)(4)(D) is the correct strategy for addressing failure risks for purposes of both procurement planning and adopting a reasonable expenditure limit.

The Commission may wish to adopt generic failure/delay rates based on historical experience and suggestions by the utilities. TURN believes that the development of individualized estimates for each project would not be worth the required effort. Rapidly changing circumstances can suddenly transform a project with a seemingly high probability of success into an almost certain-to-fail endeavor. TURN would support using a success rate of between 50-70% to discount contracted (but not constructed) renewables.[9]

A prudent IOU will plan to contract for additional generation sufficient to compensate for the discounted success rate applied to projects not yet under

[9] This range is consistent with publicly disclosed utility assumptions.

construction. This additional procurement should be included in assumptions used to develop the expenditure limitation for each utility. This means that the limitation should accommodate costs associated with procurement that exceeds the anticipated compliance requirements. To accomplish this goal, the Commission could apply a discount to the expected cost of newly contracted (but not yet constructed) projects for purposes of assigning contract costs to the limitation.[10] This approach will ensure that the limitation does not artificially constrain procurement to the amount of nameplate Megawatt-hours needed to ensure compliance in a given period.

Questions 9 and 10 – Permissible updates to the cost limitation

The Commission has two windows of opportunity to create and update the cost limitation. The first opportunity occurs at the present moment with the initial creation of a cost limitation methodology and inputs. Once this limitation is adopted, it may not be modified until 2017. In enacting §399.15(e)(1), the Legislature clarified that any modification to the cost limitation "shall take effect no earlier than January 1, 2017" and must be preceded by a report by the Commission assessing whether the adopted cost limitation will permit each utility to "achieve a 33-percent renewables portfolio standard by December 31, 2020".

These requirements were specifically included in SBx2 to prevent the Commission from creating a cost limitation that can be modified at will. If the Commission may change the cost limitation at any time (and any number of times), the mechanism loses its value in providing meaningful cost constraints. The Legislature delegated this function to the Commission (rather than enacting a prescriptive methodology in statute) with the understanding that the limitation would be initially implemented

[10] For example, if a contract is expected to cost $1,000,000 over the 2014-2016 timeframe but the underlying project is assigned a 60% chance of success, the utility could assign $600,000 to the expenditure limit.

and then only modified in 2017 after the Legislature had been notified of proposed changes.

In this proceeding, the Commission should adopt limitations for the following periods – 2011-2013, 2014-2016, 2017-2020 and 2021 and beyond. No earlier than January 1, 2017, the Commission may adopt prospective changes to the limits for 2017-2020 and 2021 and beyond. Therefore the constraints created in this proceeding are binding and non-modifiable for the first two compliance periods. Any lessons learned after the adoption of the limits should be incorporated into revisions that may not take effect until 2017.

Question 12 – Relationship between procurement limit and least-cost/best-fit

The procurement expenditure limitation may not incorporate the "total cost basis" factors enumerated in §399.13(a)(4)(A). The least-cost/best-fit analysis performed by a utility includes estimated transmission upgrade costs, portfolio integration costs and other indirect costs. These costs are explicitly prohibited from being considered "procurement expenditures" and included in the limitation pursuant to §399.15(d)(3).

The procurement expenditure limitation methodology should not be used by the utilities for purposes of ranking bids, conducting least-cost/best-fit analyses, or establishing renewable premium (or mark-to-market) values. The methodology may, however, be relevant to determining the total amount of procurement that should occur over a specific period. If contract costs are high relative to their proportional contribution to the limit, the utility may wish to scale back on procurement quantities to preserve headroom under the cap. Each utility should be mindful of the contribution of each contract to their cost limitation and track progress towards procurement and cost targets as part of any solicitation.

Question 13 – Value of diversified resource portfolio

The Commission may, and should, take into account the value of diversified resources procured by utilities in the development of the limitation. Utilities have already identified certain types of resources that merit special treatment based on their location, interconnection, and project size. TURN does not believe that the cost limitation prejudges the inclusion of such preferences. The limitation should incorporate assumptions regarding the expected resource mix based on existing Commission policies and the preferred portfolios contained in an adopted renewable procurement plan. The expenditure limitation methodology should not give "extra credit" for any particular type of resource but should model the anticipated costs of any resources that are assumed to be included in a future utility resource portfolio.

Question 14 – Application of limitation to individual contracts

The Commission should not use the cost limitation as the basis for determining the reasonableness of the pricing of any particular procurement contract submitted for approval. Individual contract prices will differ from the assumptions used to develop the overall limitation. The process of establishing cost limits should not effectively create pre-approved prices that can be sought by sellers regardless of market conditions or fundamental cost drivers. The Legislature did not intend for the cost limitation to transform the RPS into a European-style Feed-in Tariff program. The Commission should therefore be very wary about establishing pre-blessed prices that become targets for sellers. The observance of this type of bidder behavior was a driving force behind the elimination of the Market Price Referent from the cost containment paradigm in SBx2.

The Commission should require utilities to estimate the contribution of each contract towards the limitation established for each compliance period. To the extent that the contract puts a utility 'over the top' and would exceed the cost limitation, the utility has a statutory right to refrain from proceeding with execution and approval. Moreover, each utility should provide a snapshot of its total costs relative to the limit for purposes of determining whether the overall cost impact is justified given remaining needs, timing, and other relevant factors.

Question 15 – Monitoring status of the cost limitation

The procurement expenditure limitation adopted in this proceeding should include a methodology for monitoring the progress of each utility towards its overall cap. As explained in response to Question 14, each utility should be required to provide a running cost total at the time a new contract is submitted for approval. In addition, each utility should provide a year-end summary as part of its RPS progress report.

Apart from annual reviews as part of the progress reports and inclusion in any future renewable procurement plans, the Commission should not engage in a specific formal analysis of the status of the cost limitation until it prepares a report for submission to the Legislature by January 1, 2016 (pursuant to §399.15(e)(1)). Because the utilities will be submitting regular updates, the Commission will be able to take action at any point if it determines that the limitation may be prematurely exhausted.

Respectfully submitted,

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VERIFICATION

I, Matthew Freedman, am an attorney of record for THE UTILITY REFORM NETWORK in this proceeding and am authorized to make this verification on the organization's behalf. The statements in the foregoing document are true of my own knowledge, except for those matters which are stated on information and belief, and as to those matters, I believe them to be true.

I am making this verification on TURN's behalf because, as the lead attorney in the proceeding, I have unique personal knowledge of certain facts stated in the foregoing document.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on February 16, 2012, at San Francisco, California.

_____/S/_____

Matthew Freedman
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