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.	Filed Public Utilities Commission May 6, 2010 San Francisco, California Rulemaking 10-05-006

COMMENTS OF THE WESTERN POWER TRADING FORUM ON THE PROPOSED DECISION OF ADMINISTRATIVE LAW JUDGE ALLEN

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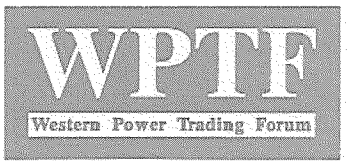

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SUMMARY OF WPTF's RECOMMENDATIONS AND HOW THE PROPOSED DECISION DEALS WITH THESE ISSUES

1. The fundamental differences between Utility Owned Generation ("UOG") and Power Purchase Agreement ("PPA") projects make bid comparisons in a 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.
    - The Proposed Decision ("PD") concurs. WPTF supports the PD with respect to prohibiting UOG from direct participation in RFOs.
2. 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").
    - The PD concurs. With specific minor modifications, WPTF supports the PD with respect to use of the CPCN process.
3. IOU development costs should be at risk and not ratepayer guaranteed
    - The PD adopts the CPCN requirement discussed in item 2 above and therefore concludes that placing IOU shareholders at risk is not required. WPTF supports the PD in this regard so long as UOG projects are not included in RFOs. Furthermore, WPTF recommends that the PD be modified to provide that if a UOG project does not ultimately move forward, the development cost risk should reside with utility shareholders.
4. IEs should be selected and paid by the Commission and not by the IOUs.
    - The PD expresses sympathy for this concept but indefinitely defers it to a later and unspecified proceeding. WPTF urges the Commission to set forth in its final decision a specific timeframe and venue in which this issue will be addressed.
5. 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.
    - The PD concurs, but nonetheless applies unnecessary, alternative conditions for contracting with OTC units. WPTF recommends modifying the PD with respect to the conditions that would be applied to contracts with OTC units.
6. WPTF recommends that IOU be allowed to buy and sell greenhouse gas ("GHG") compliance instruments and derivatives; and supports quantitative limits on IOU procurement of allowances only; IOU long-term contracts that do not provide for pass through of carbon allowance costs must be renegotiated expeditiously.
    - The PD applies restrictions on the IOUs' ability to participate in GHG compliance instruments and derivative markets that would impede the development of these markets, and unnecessarily imposes minimum procurement requirements. The PD supports renegotiation of contracts without carbon cost pass through, but falls short of addressing this in the final Order.

7. 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.

    - The PD ignores this issue. WPTF urges the Commission to set forth in its final decision a specific timeframe and venue in which this issue will be addressed.

8. 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.

    - The PD ignores this issue. WPTF urges the Commission to set forth in its final decision a specific timeframe and venue in which this issue will be addressed.

9. The Settlement clearly outlines, and the record reflects, that the ISO should complete its studies and that a determination of need must be completed by the end of 2012, especially for OTC generation and locational capacity.

    - The PD is contrary to the Settlement and the record. WPTF urges the Commission to modify the decision consistent with the settlement and move forward with a need determination to guide procurement by 12/31/12.

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I. Introduction and Summary

These opening comments are submitted on behalf of the Western Power Trading Forum ("WPTF") in accordance with the directive provided in the February 21, 2012 cover letter attached to the Proposed Decision of Administrative Law Judge ("ALJ") Peter V. Allen ("PD") and Rule 14.3 of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission").

A. Procedural background

On June 13, 2011, the ALJ's Ruling Addressing Motion for Reconsideration, Motion Regarding Track I Schedule and Rules Track III Issues ("June 13 Ruling") was issued. The June 13 Ruling cites an earlier March 10, 2011 Ruling as follows:

> Based on input from the parties and Energy Division staff, it is preliminarily determined that aspects of certain Rules Track III issues will be addressed concurrently with the System Track I schedule set forth above, including: 1) procurement rules relating to once-through cooling issues; 2) refinements to the bid evaluation process, particular weighing competing bids between utility-owned generation and power purchase agreements; 3) refinements to the existing timelines associated with the utilities' RFOs for resource adequacy products; and 4) utility procurement of greenhouse gas related products.[1]

The June 13 Ruling confirmed that parties could address those four issues, plus the additional issue of procurement oversight rules, "including the oversight responsibilities and authority of various entities (including Independent Evaluators and the Procurement Review Group) and

[1] June 13 Ruling, at pp. 4-5.

standards of conduct applicable to the utilities and their employees."[2] WPTF's testimony in this proceeding and its opening and reply briefs focused on Track III issues (1) and (2) above, as well as issues related to procurement oversight rules. The PD responds favorably to a number of the positions espoused by WPTF with regard to these issues, for which WPTF is particularly appreciative. With some modifications, as discussed below, WPTF supports the PD and urges its adoption by the Commission.

II. The PD Adopts Appropriate Refinements to the Bid Evaluation Process.

A. The PD accurately concludes that comparisons between UOG and PPA offers in an RFO are impractical and create a perception of bias.

In its briefs, WPTF has argued that the fundamental differences between utility-owned generation ("UOG") and Power Purchase Agreement ("PPA") projects make bid comparisons in a 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. The PD agrees with this position. First and foremost, the PD recognizes that the current hybrid market structure that exists in California is a likely contributor to certain elements of market failure:

> The current hybrid market structure is an artifact of the ill-fated restructuring of the California electricity markets under Assembly Bill (AB) 1890 and the subsequent California energy crisis, and it is neither elegant nor efficient.[3]

This is not the first time that the Commission has acknowledged the flaws of the hybrid market structure and indeed progress in moving beyond this flawed market design has been as inelegant and inefficient as the design itself. Nevertheless, WPTF is appreciative and fully supports the PD statement that "These different sources of electricity tend to be difficult to compare, particularly in the context of evaluating competing bids."[4] It further observes that:

> First, we agree with WPTF and SCE that it is inappropriate to have UOG projects participate in utility generation RFOs. Even if theoretically it might [be] possible to have a utility-owned project compete fairly in a utility-run RFO, in practice it will never look fair. In particular, any time that a utility-owned project is selected

[2] Id, at p. 6.

[3] PD, at p. 16.

[4] PD, at p. 27.

> in such an RFO, it will give an appearance of favoritism. Regardless of how fair an RFO was, if it looks like the one competitor had an inside track or that the judging was biased, some of the benefits of using an RFO are largely eviscerated. Potential participants may try to avoid that market, which is not a desirable outcome in the context of electricity procurement.[5]

The PD concludes that, "Accordingly, the utilities should continue to use RFOs for non-UOG procurement, consistent with prior Commission decisions, but UOG procurement will be done through the certificate of public convenience and necessity (CPCN) process."[6]

This is a highly appropriate and long overdue recognition of the very real problems associated with evaluating UOG proposals in competition with PPA bids. These include (a) the uneven life cycles of PPA contract periods (traditionally ten years) as compared to the life of a UOG asset, which inevitably tilts any discounted cash flow analysis in favor of the longer lived UOG assets; (b) the fact that PPAs and UOG have very different risk profiles, with UOG having assurance of ratepayer cost recovery while PPA project sponsors must factor a return into their bids; and (c) since UOG projects enhance utility profits through additions to rate base, whereas PPAs do not, having the IOUs in a position to evaluate their own UOG projects in comparison to PPA bids creates a very real perception of, and potential for, bias that in turn compromises the competitiveness of the RFO.

By providing that non-UOG procurement shall be done through RFOs while UOG will require a CPCN, the Commission will take an appropriate step to make some progress toward more stable and well-designed competitive markets in California. So long as there are specific controls on the UOG CPCN process to ensure that it does not undermine the competitiveness of the RFO procurement (as described in the sections that follows), developers will not be discouraged from competing in RFOs that are perceived to be "stacked" in favor of UOG options. Greater participation should lead in turn to more competition on price that will benefit all IOU ratepayers.

WPTF does recommend one minor modification to the discussion on this topic. The PD states that, "UOG facilities may either be constructed by the utility itself, or purchased by the utility."[7] WPTF recommends that the use of the term "UOG" should be clarified in the decision

[5] PD, at p. 29.

[6] PD, at p. 30.

[7] PD, at p. 27.

to make it clear that it applies as well to turnkey - also known as build/own/transfer - projects. This could be done conveniently by modifying the cited sentence as follows:

> "UOG facilities may either be constructed by the utility itself, or purchased by the utility, such as in the case of turnkey and/or build/own/transfer or other similar projects."

WPTF strongly believes that consumers benefit the most and that the procurement process proceeds most efficiently, when electricity and related products are provided by competitive suppliers. Furthermore, the Commission's explicit support for competitive market structures in D.06-07-029 showed that it intends for consumers to be able to capture the benefits that competitive markets foster. In taking the steps outlined in the PD, the Commission will move into alignment with organized markets throughout the country where there is an explicit recognition of the incompatibility of utility rate based generation investment and healthy competitive wholesale markets.

B. The PD takes the right route in determining how to fairly compare the costs of UOG and PPAs.

The PD examines the issue of how to fairly compare the costs of UOG and PPA projects, even though the UOG projects will not be allowed to directly participate in competitive RFOs. It adopts an IEP proposal, that for bid evaluation purposes the cost of UOG project and bid development should be included:

> In evaluating UOG proposals, the Commission should consider all of the project costs, and the utilities should include project development costs in their requests for acquiring UOG facilities, as well as for utility-constructed ones. If an independent developer wants utility ratepayers to pay for costs, such as planning, design, and project development, it must include those costs in its bid. If a utility did not include those cost in its bid, but recovered their costs in general rate case operating costs, the utility would be getting a ratepayer-funded cross-subsidy of its project that is unavailable to the independent developer, that would result in an unfair comparison of what appear to be project costs.[8]

This is an equitable and appropriate conclusion that will lead to greater fairness in the evaluation of UOG and PPAs. In the same context, however, WPTF notes that the PD rejects the proposal made both by WPTF and the Division of Ratepayer Advocates ("DRA") that utility shareholder

[8] PD, at p. 32.

dollars be at risk for the costs of preparing unsuccessful UOG proposals.[9] The PD notes that this recommendation appears to apply only in the case of UOG participation in RFOs and declines to adopt the proposal on the grounds that, as noted above, the PD does not permit UOG participation in utility RFOs. Assuming that the ban on UOG in RFOs is maintained, WPTF is agreeable to this conclusion. If, however, that ban is modified or eliminated, then the DRA/WPTF proposal must be adopted. However, WPTF recommends that the PD be modified to provide that if the UOG project does not ultimately move forward, the development cost risk should reside with shareholders.

C. The PD correctly adopts the requirement that a failed RFO is a fundamental precondition to UOG CPCN applications.

In addition to the requirement that CPCN applications are necessary for UOG to be considered, the PD also adopts the WPTF proposal that there must be a failed competitive solicitation before an IOU can propose UOG. WPTF contended that a failed RFO requirement is essential as a safeguard against utility actions that would provide preferences to UOG over competitive market offers, and that a utility should be able to unilaterally choose to seek authorization for a UOG project only after there has been a failed competitive solicitation, as confirmed by the RFO's independent evaluator.[10] The PD agrees and says, "We understand that requiring an RFO prior to submitting a CPCN application for a UOG project potentially adds an additional step, but it should significantly increase the transparency of the procurement process, and provide useful information to the Commission regarding the viability of competitive options to a UOG project. We adopt the WPTF recommendation on this issue."[11]

The PD then provides that if a utility believes that an RFO has failed, before it may file an application for a UOG project, the utility must submit a Tier 3 advice letter, setting forth the reasons why the RFO should be considered "failed." This process will give all interested parties the opportunity to contest any such utility advice letter, so long as the reasons for the purported failure are made public. WPTF recognizes the need for utility confidentiality as to specific bid information. However, at the same time it is critical that the public be given meaningful

[9] *See* DRA Opening Brief at p. 34, WPTF Opening Brief at p. 11.

[10] *See* WPTF Opening Brief at 9-10.

[11] PD, at pp. 36-37.

information as to why an RFO has failed. An advice letter that simply states the utility's conclusion and then attaches all the meaningful explanation supporting that conclusion in a confidential attachment would not meet that standard. To ensure full transparency to any such advice letter filing, WPTF recommends that the following language be added to the first paragraph on p. 37:

> We adopt the WPTF recommendation on this issue. One aspect that is not adequately fleshed out, however, is the criteria to be applied in determining whether or not an RFO has "failed." Because of the lack of record on this issue, we will provide general guidance in how such a determination should be made. If a utility believes that an RFO has failed, before it may file an application for a UOG project, a utility must submit a Tier 3 advice letter, setting forth the reasons why the RFO should be considered "failed." Without divulging bid information that should be deemed confidential, the advice letter should err on the side of full disclosure as to the reasons for the utility's conclusions rather than including all such information in a confidential attachment.

The Commission may also want to consider requiring that the independent evaluator must certify that an RFO has failed as a further prerequisite to the utility advice letter process.

D. The independent evaluator selection issue needs to be set for resolution in a specific phase of this proceeding.

In this context, we note that WPTF and other parties have recommended that independent evaluators should be selected and paid by the Commission. The PD punts on this issue, stating that:

> This issue was raised in our previous LTPP proceeding, and was addressed in D.07-12-052. In that decision, we stated: "At this time, it is not practical to transfer the IE contracting authority to the Commission; however, we will continue to explore ways in which to do so in the future." (*Id.* at 136.) Unfortunately, that appears to remain the case, as there do in fact seem to be practical and administrative hurdles to overcome. We agree that it would be preferable for IEs to be hired by and report to the Commission, rather than the utilities, and to the extent the barriers to doing so can be overcome in the future, we will consider this proposal again."[12]

This is regrettable. The PD's deferral of a decision on this matter will engender further uncertainty about the actual independence of independent evaluators. Furthermore, it weakens the meaningfulness of the "failed RFO" requirement. Rather than punting the issue to the

[12] PD, at p. 64.

indefinite future, the PD should at the very least provide that a specific future phase of this proceeding will entertain proposals as to how the independence of RFO evaluators can be made actual rather than merely hypothetical.

III. Once-Through Cooling Issues

A. The PD appropriately rejects Staff's OTC proposal

Appendix A to the June 13 Ruling provided that parties' testimony should address 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"). The Staff OTC Proposal recommended, among other things, that IOUs should not be permitted to enter into a contract for longer than one year with any facility identified in the SWRCB's *Statewide Water Control Policy on the Use of Coastal and Estuarine Waters Used for Power Plant Cooling (Once-Through Cooling or OTC facilities)*. Further, the Staff OTC Proposal would prohibit IOUs from entering into a contract with any OTC facility that requires operation of that facility beyond the compliance date identified in the SWRCB policy unless certain conditions applied.[13] The PD recognizes that the Staff OTC Proposal is flawed and should not be adopted. WPTF supports this outcome.

[13] a) A facility is found by the Water Resources Control Board to be fully in compliance with Section 316(b) of the Clean Water Act; or

b) If the Commission authorizes the procurement of new capacity in the LTPP proceeding, contracts longer than one year and/or that extend beyond the Water Resources Control Board OTC compliance date as detailed in the October 1, 2010 Statewide Water Control Policy on the Use of Coastal and Estuarine Waters Used for Power Plant Cooling or successor documents for the express purpose of enabling the repowering of those OTC facilities are permitted if those contracts do not result in operation of the once-through-cooling system beyond the compliance date; or

c) If an OTC facility elects to comply with the State Water Resources Control Board OTC policy by means of SWRCB Track 2 (under which water intake is reduced by 93% or screens or similar technologies that are expected to be approved by the State Water Resources Control Board are utilized), contracting with such a facility beyond the State Water Resources Control Board's compliance date is permitted. If the Track 2 compliance mechanism is not accepted for that OTC facility by the State Water Resources Control Board, any such contract must require that the contract terminate within one year from the date of the State Water Resources Control Board decision on the proposed Track 2 technology or before the State Water Resource Control Board's compliance date, whichever is sooner.

B. The Commission should eliminate the Tier 3 advice letter requirement for OTC-related contracts.

If adopted, the PD would impose a requirement that utilities submit an OTC-related contract with duration less than five years to the Commission for approval via a Tier 3 advice letter.[14] Under today's bundled procurement authority, utilities are not required to submit procurement contracts for approval if they are less than five years in duration. WPTF opposes the new requirement proposed in the PD that would apply only to OTC facilities.

Applying an advice letter process to short-term contracts will severely undermine utilities' ability to execute such contracts. A Tier 3 advice letter routinely takes six months to process, and, as some renewable developers are aware, can take years to process. Injecting the unnecessary uncertainty associated with a Tier 3 advice letter filing increases risk to the contracting parties and thereby promises to increase costs associated with those contracts. In fact, there is no compelling reason to treat shorter-term contracts with OTC facilities different from contracts of the same term with other non-OTC facilities. Applying Tier 3 advice letter requirements to competitively-priced OTC facilities will harm ratepayers. Accordingly, the Commission should delete the Tier 3 advice letter filing requirement from the PD.

C. The Commission should eliminate the Proposed Decision's extensive conditions to be applied to OTC-related contracts extending beyond the OTC compliance date.

The PD will allow contracts to extend beyond the SWRCB OTC compliance date, but only if such contracts meet the following five specified conditions: (1) allow for utility purchase or receipt of power generated by a unit using OTC only up to the SWRCB OTC policy compliance date in effect on the date the contract is signed and does not allow the utility to continue to purchase or receive power generated using OTC beyond that date even if SWRCB extends the compliance date; (2) protect utility ratepayers against stranded costs; (3) protect ratepayers against the risk of future unspecified cost increases resulting from increases in the cost of the generation unit compliance with the SWRCB OTC policy (for a utility to recover such cost increases from ratepayers, it must obtain the necessary approval from the Commission); (4) are consistent with a need authorization from the System Track of the LTPP proceeding; and (5) are consistent with other procurement rules, including the PD's requirement to file either a Tier 3

[14] *See* PD, Ordering Paragraph 3.a.

Advice Letter (for contracts with duration of less than five years) or an application (for contracts with duration of more than five years). Any such advice letter or application must show compliance with all relevant SWRCB policies and regulations, and show how the contract provides or facilitates cost-effective and reliable service.

WPTF opposes the imposition of onerous conditions that excessively limit the flexibility of utilities to contract with OTC facilities. Such contracts could be very helpful in ensuring that California meets its demand for electricity as the OTC compliance dates force facilities to comply or retire. Given the importance of grid reliability and the challenges presented by the SWRCB's OTC policy, the Commission should be looking for as much flexibility as possible to ensure the OTC policy does not adversely impact reliability. The PD's conditions, however, achieve the opposite.

For example, Condition No. 1 prohibits utilities from receiving power from an OTC after an initial compliance deadline even if the SWRCB extends that deadline. However, the PD provides no compelling reason to make the OTC compliance deadline more stringent than that imposed by the SWRCB, which is the subject-matter expert on OTC. Instead of making the OTC policy more stringent than the SWRCB would require, the Commission should embrace the idea that it may be necessary to extend an OTC deadline and allow contracts to reflect that possibility.

Utility contracts with OTC facilities obviously should not subvert the SWRCB's OTC policy. Commission staff sits on a multi-agency working group with the Water Board that reviews and provides input to the Water Board as to the compliance dates and compliance paths for the OTC policy. Commission staff is working hand in hand with the Water Board to ensure that the goals of the OTC policy are achieved in a timely manner while preserving the reliability of the grid. To that end, it is appropriate for the Commission to confirm that utilities should not be permitted to receive services from OTC facilities that fail to comply with the SWRCB's OTC policy but further obligations to the procurement process are unnecessary. With grid reliability as its paramount concern, the Commission should preserve as much flexibility as possible with respect to contracts with OTC facilities by eliminating the PD's detailed conditions that apply to such contracts and rely on the Water Board process, where the Commission staff has a seat at the table, already in place.

D. The Commission should consider the California Independent System Operator's ("CAISO") evaluation studies before drawing final need conclusions.

WPTF notes that the PD states that, "This is necessarily an interim approach, and as recommended by a number of parties, OTC issues will be examined further, either in a later phase of this proceeding or in a successor proceeding."[15] This delay in determining need as contemplated in the PD is contrary to the terms of the Settlement. As noted in WPTF's opening brief, the CAISO is engaged in studies to assess the impact of OTC retirements consistent with the SWRCB's policy. WPTF reiterates its recommendation that the Commission should incorporate the final results from the studies before making any determinations as to the need for replacement capacity associated with OTC retirements. The Commission should also take into account the additional documentation filed in the RA docket regarding the need for flexible capacity as soon as 2017. If the CPUC chooses to ignore this in the LTPP docket they should be aware they are setting two standards for procurement which could (and has) resulted in backstop procurement. The CPUC has a chance to "get it right" by setting the standards in advance. As contemplated by the Settlement Agreement, and rejected in the Proposed Decision, the Commission should expedite the consideration of the CAISO studies to ensure that any determination as to the need for replacement capacity is made by the end of 2012. Adopting final need determinations by year-end 2012 should still allow sufficient time for the IOUs to engage in competitive procurement, while complying with the deadlines in the SWRCB's OTC policy. Any delay in this determination to future proceedings will result in OTC generation not being able to repower in a timely way under the OTC policy.

At the same time, once the CAISO studies have been received and evaluated, it should be recognized that protracted uncertainty with regard to OTC operations is not productive. It will lead to hesitancy by the IOUs in entering into contracts with OTC facilities and will add additional uncertainty into the decisionmaking process of plant owners who want to update and modernize their facilities to comply with the state's OTC policy. The Commission needs to finalize its position on OTC issues soon and not leave the topic open for continual debate and discussion.

[15] PD, at p. 26.

IV. Greenhouse Gas Product Procurement

WPTF recognizes the need for the Commission to provide specific directives to the IOUs with respect to their procurement of Greenhouse Gas ("GHG") products. However, because of the potential of the rules for IOU procurement of GHG products to affect the overall carbon market, WPTF recommends modifications to the PD, as follows:

- Restrictions on IOU procurement of derivatives of GHG allowances and offsets and on re-selling should be eliminated
- Limits on IOU procurement of allowances are appropriate to level the playing field for other capped entities in the GHG trading program
- The minimum procurement limits should be eliminated

Additionally, WPTF strongly supports expeditious renegotiation of IOU contracts with non-QF facilities that do not provide for pass through of carbon allowance costs. Each of these issues is discussed in more detail below.

A. Restrictions on IOU procurement of derivatives of GHG allowances and offsets and on re-selling should be eliminated.

The PD would allow IOUs to purchase allowance futures and forwards, but would prohibit the purchase of allowance options and swaps and any type of offset derivatives. It would further prohibit the IOUs from re-selling allowances in real time, requiring them to seek Commission approval prior to any sale.

WPTF believes that these restrictions will be detrimental to the overall carbon market and will unnecessarily raise GHG costs for rate-payers. California GHG allowances prices are expected to be volatile in the early years of the cap and trade program. The ability of all entities covered by the program to mitigate the risk of this price volatility, and manage compliance costs, will be enhanced by the availability of a range of carbon hedging products, including options and swaps, and to engage on both sides of a transaction. Unfortunately, the proposed restrictions on IOUs' procurement of derivatives could actually impair the development of these products due to the fact that the collective carbon liability of the IOUs will comprise such a large share of the

California carbon budget.[16] The result will be impeded market development and reduced opportunities to minimize price exposure and increased compliance costs for all capped entities and electricity consumers.

WPTF notes that the IOUs are permitted to invest in a full range of financial hedging products for natural gas, and act as both buyers and sellers. While the IOUs expenditures for carbon will be small relative to those for natural gas, the rationale for hedging is the same for both. The Commission has determined that it is in the interest of retail ratepayers to allow the IOUs to procure natural gas hedging products and to act on both sides of the transaction; we believe that it is also in their interest that IOUs be allowed to procure a full range of carbon hedging products. For these reasons, WPTF recommends that the Commission modify the decision to allow for IOU procurement of allowance and offset forwards, futures, options and swaps and to allow for IOUs to both buy and sell compliance instruments so that they may most cost-effectively hedge their carbon liabilities.

B. Limits on IOU procurement of allowances are appropriate.

Under the PD, the IOUs would be subject to annually increasing total procurement limits on aggregate purchases of allowances, allowance forwards and futures, and offsets. In general, WPTF opposes purchase and holding limits for allowances. However, the current cap and trade regulation establishes limits on auction purchases and on holding of allowances that are more favorable to electric utilities than they are to other capped entities. In light of the discriminatory nature of CARB's rules, we believe that the Commission's proposed holding limits are appropriate to level the playing field between IOUs and other electricity and carbon market participants. We therefore support the PD's proposed limits on the procurement of allowances. However, WPTF's support for limits on the IOUs' procurement of allowance does not extend to the imposition of any limits on the procurement of allowance and offset derivatives, for the reasons discussed above.

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[16] Based on data presented by CARB, IOU procurement of GHG compliance instruments for both their own compliance needs and those required to be provided under the terms of their power purchase agreements could represent a substantial fraction of the total allowance budget in the first compliance period. (*See*, "Staff Proposal for Allocating Allowances to Electrical Distribution Utilities" at:
http://www.arb.ca.gov/regact/2010/capandtrade10/capandtrade10.htm

C. The minimum procurement requirements should be eliminated.

The PD proposes minimum procurement requirements for both 1st and 2nd compliance period allowances. While the minimum procurement requirements for the 1st compliance period align with the cap and trade regulation requirement that capped entities annually surrender compliance instruments equivalent to thirty percent of the previous year emissions, they are unnecessary because of that requirement. Further, the minimum procurement requirement for the 2nd compliance period allowances during the first compliance period may artificially increase demand for and prices of these vintages beyond what would occur under natural market conditions, raising compliance costs for all participants. For these reasons, WPTF recommends that the Commission eliminate minimum procurement requirements for the IOUs.

D. IOU long-term contracts with non-QF facilities that do not provide for pass through of carbon allowance costs must be renegotiated expeditiously.

In response to a motion filed by the Independent Energy Producers, the PD directs the IOUs to renegotiate with independent generators any non-QF contracts that do not address GHG compliance costs in order to appropriately address these costs. The PD further indicates that if renegotiated contracts are not resolved and submitted to the CPUC for approval within 60 days of the effective date of the decision, then the issue will be taken up in proceeding R. 11-03-012 (GHG Cost and Revenue). WPTF strongly supports expeditious renegotiation of contracts with independent generators that do not provide generator recovery of carbon costs. However, we note that while this issue is discussed in the proposed decision, it is not actually reflected in the decision order. We therefore respectfully request the Commission to include language in the final decision order that directs the IOUs to enter into renegotiation of affected contracts, including those not resolved by the QF settlement, and, in the event that contracts are not successfully renegotiated within 60 days, formally initiate consideration of these contracts under proceeding R. 11-03-012.

V. The PD Ignores Two Issues of Substance

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. As noted in WPTF's opening brief, 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. The lack of clear Commission directives on these topics is problematical, because utilities have already made claims that specific projects meet the criteria of SB 695 and are eligible for CAM cost allocation. Rather than leaving it to utility discretion to determine whether the CAM cost recovery mechanism applies, stakeholders should be provided a meaningful opportunity to review and provide input regarding the criteria that should apply. The LTPP Rules Track III is the venue in which to do that.

Furthermore, 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. This, too, should be address in Rules Track III.

VI. Conclusion

WPTF urges the Commission to adopt the PD of ALJ Allen with the modifications proposed herein. It carefully and thoughtfully considers the extant issues and draws conclusions that will meaningfully benefit California ratepayers.

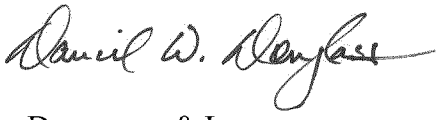
With regard to procurement issues, the PD is entirely correct to conclude that there are fundamental differences between UOG and PPA projects that make bid comparisons in a RFO impossible and create a real perception of bias when the utilities evaluate their own UOG projects in competition with PPA proposals. By requiring that UOG offers should not be considered in RFOs and should instead be proposed to the Commission via traditional applications for a CPCN only when and if a competitive solicitation has failed, the Commission takes a huge step towards creating equitable and fair conditions for evaluating UOG and PPAs. WPTF continues to recommend that the Commission needs to clarify in the forthcoming Rules Track III proceeding how IEs could be selected by and solely answerable to the Commission.

The recognition that Staff's OTC proposal is flawed and should not be adopted is entirely appropriate and the proposed approach to OTC contracting, with the additional modifications WPTF proposes, is reasonable. WPTF urges the Commission to consider the CAISO evaluation studies before drawing conclusions as to the timing of the retirement or repowering of OTC power plants and then move quickly to conclude the protracted discussion of OTC contracting issues.

WPTF also recommends that the Commission modify the decision to allow for IOU procurement of allowance and offset forwards, futures, options and swaps; allow for IOUs to both buy and sell compliance instruments; and that minimum procurement requirements should be eliminated. Further, the final decision should explicitly address expeditious renegotiation of IOU long-term contracts with facilities that do not provide for pass through of carbon allowance costs.

WPTF thanks the Commission for its attention to these issues.

Daniel W. Douglass



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