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	R.12-03-014 (Filed March 22, 2012)

REPLY BRIEF OF THE ALLIANCE FOR RETAIL ENERGY MARKETS, DIRECT ACCESS CUSTOMER COALITION AND MARIN ENERGY AUTHORITY

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SUBJECT INDEX

1. Process changes for utility procurement to meet bundled customer load and load growth.
2. Legal and policy requirements of Commission approval of the use of the cost allocation mechanism ("CAM").
3. Criteria for the Commission to apply in approving CAM procurement.
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5. Opt out from the CAM by load-serving entities ("LSEs").

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Application of Cost Allocation Mechanism ("CAM")

- The Commission has already approved more than 7,000 megawatts of CAM procurement by the investor-owned utilities ("IOUs"), all in the absence of defined criteria for doing so. It is time for the Commission to consider and adopt a comprehensive process and reasonable criteria to ensure compliance with applicable statutes and Commission policies for CAM procurement going forward.

- The Commission should adopt and apply the proposed criteria of the Alliance for Retail Energy Markets ("AReM"), Direct Access Customer Coalition ("DACC") and Marin Energy Authority ("MEA") for determining whether to authorize an IOU's proposed CAM procurement; the proposed criteria achieve the twin goals of meeting statutory requirements and enabling retail choice.

- The Commission should implement and follow a two-stage process for evaluating and imposing CAM treatment in which it would: (1) identify the megawatts of system or local reliability need that may be subject to future CAM procurement; and (2) apply the defined criteria to an IOU's application for approval of a CAM project.

- The Commission should determine that each criterion has been met before authorizing a particular CAM procurement and should require the IOU to provide evidence to demonstrate that the project identified in its application meets the Commission-defined reliability need and cannot be reasonably met by any other resources, including economic demand response and energy efficiency.

- To determine the reliability need potentially subject to CAM procurement, the Commission should first enforce Public Utilities Code Section 454.5 and apply cost causation principles to ensure that the IOUs procure to meet the load, load growth and peak load characteristics of their bundled utility customers over the long term, including procurement of new generation resources and resources to replace terminating power purchase agreements ("PPAs") and retiring power plants. Such IOUs' long-term bundled customer needs would be taken off the top of the need potentially subject to CAM procurement.

- The Commission should specify clearly that procurement to meet the long-term needs of the IOUs' bundled customers is not subject to CAM.

- Commission consideration and implementation of a multi-year forward Resource Adequacy ("RA") procurement obligation for load-serving entities ("LSEs") should adhere to principles that minimize CAM procurement, facilitate wholesale and retail markets, and promote retail choice.

Modifications to the Calculation of CAM

- The net capacity costs calculation from the Joint Parties Proposal[1] should be modified to better reflect the increased ancillary service value and value of other products and services that the new PPAs or utility-owned generation ("UOG") plants will be able to provide.
- The net capacity costs calculation for UOG plants should start with the levelized fixed costs rather than the fixed portion of the annual revenue requirement. To do otherwise would overvalue the plants' capacity in early years and undervalue it in later ones.
- The CAM cost associated with any PPA or UOG asset should be capped, as discussed herein.

LSE Opt-Out from CAM

- The Commission should adopt the LSE Opt-Out proposal of AReM, DACC and MEA to address the anti-competitive aspects of the CAM, provide market incentives for ESPs and LSEs to procure multi-year forward RA resources, promote efficient RA procurement, and allow ESPs and CCAs to better manage their own energy portfolios based on their respective customers' needs and preferences.

- The Commission should find that the proposed LSE Opt-Out is consistent with, and achieves the objectives of, Senate Bill ("SB") 695 and is required to comply with SB 790.

[1] The Joint Parties' Proposal is an alternative to the energy auction that calculates net capacity costs on a proxy basis by imputing energy costs and revenues retroactively based on day-ahead market prices. (D.07-09-044, Appendix A)

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The Alliance for Retail Energy Markets[2] ("AReM"), the Direct Access Customer Coalition[3] ("DACC") and the Marin Energy Authority[4] ("MEA") respectfully submit this reply brief in Track 1 of the Long-Term Procurement Plans ("LTPP") proceeding pursuant to Rule 13.11 of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission" or "CPUC") and the schedule set forth by Administrative Law Judge David Gamson on August 17, 2012 at the conclusion of hearings. This reply brief conforms to the common briefing outline submitted by Southern California Edison Company ("SCE") on August 24, 2012. We include only the sections in the briefing outline on which we have reply comments.

[2] AReM is a California non-profit mutual benefit corporation formed by electric service providers that are active in the California's direct access market. This filing represents the position of AReM, but not necessarily that of a particular member or any affiliates of its members with respect to the issues addressed herein.

[3] DACC is a regulatory alliance of educational, commercial, industrial and governmental customers who have opted for direct access to meet some or all of their electricity needs.

[4] MEA is the not-for-profit public agency that administers the Marin Clean Energy community choice aggregation ("CCA") program. MEA launched electricity service to customers in May 2010. It is the first operating CCA program in the state of California.

I. EXECUTIVE SUMMARY

AReM, a coalition of Electric Service Providers ("ESPs"), DACC, a coalition of direct access ("DA") customers, and MEA, the only operating community choice aggregation ("CCA") program in California, are the only parties representing the interests of the competitive markets in this proceeding. We are also the only parties who have submitted comprehensive proposals recommending criteria and a process to apply when considering authorization of the cost allocation mechanism ("CAM") for procurement by the investor-owned utilities (IOUs"), modifications to the calculation of CAM charges, and a mechanism by which load-serving entities ("LSEs") may opt-out of CAM. Opposing parties have failed to make any substantive case to support their recommendations for rejection, often either misunderstanding or misrepresenting our proposals. Accordingly, AReM, DACC and MEA urge the Commission to adopt and implement their recommendations and proposals in Track 1 of this proceeding, thereby complying with applicable statutes and Commission policies, maintaining reliability, minimizing CAM, and supporting retail choice.

VI. COST ALLOCATION MECHANISM

A. Proposed Allocation of Costs of Needed LCR Resources

A.1 Opposing parties misunderstand or misrepresent the proposal of AReM, DACC and MEA.

The California Large Energy Consumers Association ("CLECA") appears to believe that AReM, DACC and MEA have opposed the use of CAM for allocating costs.[5] AReM, DACC and MEA have taken no such position and have not objected to the CAM as a means of allocating costs or to the definition of customers considered to be "benefiting" under the statute.

[5] CLECA Opening Brief, pp. 30-32.

Instead, AReM, DACC and MEA have focused on ways for the Commission to ensure that it properly applies and enforces the relevant Public Utilities Code sections and cost causation principles for utility procurement when considering a particular CAM project.

CLECA also argues that AReM, DACC and MEA have chosen to "emphasize" one part of the statute over another.[6] We in fact emphasize, Pubic Utilities ("P.U.") Code Section 365.1(c)(2)(A), which states that:

> (c) Once the commission has authorized additional direct transactions pursuant to subdivision (b) [regarding CAM], it shall…
>
> (2)(A)Ensure that, in the event that the commission authorizes, in the situation of a contract with a third party, or orders, in the situation of utility-owned generation, an electrical corporation to obtain generation resources that the commission determines are needed to meet system or local area reliability needs for the benefit of all customers in the electrical corporation's distribution service territory, the net capacity costs of those generation resources are allocated on a fully nonbypassable basis consistent with departing load provisions as determined by the commission, to all of the following:
>
> (i) Bundled service customers of the electrical corporation.
>
> (ii) Customers that purchase electricity through a direct transaction with other providers.
>
> (iii) Customers of community choice aggregators.

In reality, this part of the statute is in fact the *operative* section of the code and *governs* the conditions by which the Commission may authorize CAM procurement. The Commission itself has reached this same conclusion.[7] In short, CLECA misrepresents and misunderstands the proposals of AReM, DACC and MEA and its criticisms should therefore be disregarded.

On the other hand, Pacific Gas and Electric Company ("PG&E") claims that the proposals of AReM, DACC and MEA should be rejected because they are "biased and unfair" to

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[6] CLECA cites the "fair and equitable" language in P.U. Code Section 365.1(c)(2)(B). See, CLECA Opening Brief, pp. 30-31.

[7] D.11-05-005, p. 16; see also AReM-DACC-MEA Opening Brief, p. 12.

bundled customers.[8] PG&E provides no support for its conclusion, while clearly misrepresenting the AReM, DACC and MEA proposal.[9] Accordingly, PG&E's views should be disregarded.

A.2 All IOU procurement is not CAM procurement.

As opposed to CLECA, The Utility Reform Network ("TURN") acknowledges that Section 365.1(c)(2)(A) is the operative section of the code. However, it asserts that that the required statutory test is met simply because the new resources that may be authorized in this proceeding are "explicitly intended to meet local area reliability needs on behalf of all customers."[10] TURN then reiterates its earlier argument that all benefit equally from grid reliability and therefore all should pay.[11] The Division of Ratepayer Advocates ("DRA") takes a similar position, asserting that all resource additions provide benefits and therefore all must pay.[12] CLECA adopts TURN's concept that "all share equally in the 'good' of grid reliability."[13] These conclusions are nowhere to be found in the applicable statute authorizing the CAM and, as amply demonstrated in our testimony and opening brief, all IOU procurement is not automatically CAM procurement.[14] Moreover, all of these parties ignore completely the fact that DA and CCA procurement also creates reliability benefits that bundled service customers receive free of charge. Notably, TURN and SDG&E have previously agreed with us on this point in this proceeding.[15] Effectively, these parties argue for inappropriate and excessive subsidies to be

[8] PG&E Opening Brief, p. 9.

[9] On p. 9, PG&E claims that direct access and CCA customers would have "first rights" to existing generation, a concept that appears no where in the AReM, DACC MEA proposals.

[10] TURN Opening Brief, p. 20.

[11] TURN Opening Brief, pp. 20-21.

[12] DRA Opening Brief, p. 34.

[13] CLECA Opening Brief, p. 31.

[14] AReM-DACC-MEA Opening Brief, pp. 13-16; Exhibit AReM-2, pp. 4-5

[15] AReM-DACC-MEA Opening Brief, pp. 15-16

provided to bundled service customers by DA and CCA customers.[16] Simply put, the plain words of the statute do not support these interpretations and the Commission itself has previously determined that criteria or a benefits test must be developed to ensure compliance with the statute.[17]

More significantly, new resources needed to meet bundled utility load do not qualify for CAM procurement.[18] However, the Commission has not yet determined the extent to which the local reliability needs being evaluated in Track 1 are actually bundled customer needs (*i.e.*, not subject to CAM) that require IOU procurement of new resources. AReM, DACC and MEA agree with San Diego Gas & Electric Company ("SDG&E") that the Commission is obligated to distinguish bundled needs from procurement subject to CAM *before* CAM can be authorized.[19]

Ignoring bundled customer needs leads inevitably to inappropriate subsidies by direct access and CCA customers. In establishing the CAM, the Commission expressed concern that CAM might be used "inappropriately" when the new resources designated for CAM were actually needed to meet bundled load.[20] The Commission determined that cross-subsidies related to bundled customer load should be considered when authorizing CAM procurement.[21] The Commission should now fulfill its promise to ensure that IOU procurement to meet bundled load and load growth is not eligible for CAM treatment.

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[16] See, AReM-DACC-MEA Opening Brief, pp. 15-17.

[17] AReM-DACC-MEA Opening Brief, pp. 12-13.

[18] AReM-DACC-MEA Opening Brief, pp. 14-15..

[19] Exhibit SDG&E-2, p. 3, lines 23-24, p. 4, lines 1-3.

[20] D.07-12-052, p. 118.

[21] D.07-12-052, pp. 117-119.

TURN also makes the argument that new resources must be allocated to all because they are more costly.[22] TURN does acknowledge that the current high costs of new resources apply to procurement by *all* LSEs, but argues that the IOUs are the only ones that should have their procurement costs allocated to all. First, there is no support for TURN's approach in the applicable statutes. Second, TURN fails to acknowledge that relative costs of new versus existing generation change over time. Therefore, its "principle" only makes sense when the costs of new generation exceed the costs of existing generation. In fact, these tables were turned in the early 1990s when the costs of existing generation outweighed the costs of new construction,[23] making "stranded cost recovery" a key issue for the IOUs in the Commission's restructuring efforts. Finally, long-term procurement by ESPs and CCAs are affected by the same high costs, but at the same time may be done more efficiently than IOU procurement. TURN's one-sided argument should be rejected.

Finally, TURN seeks to defer any CAM decision applicable to CCAs, noting that the existing CCAs will not be affected by procurement in Southern California.[24] AReM, DACC and MEA oppose any such deferral. CAM, when properly authorized, applies equally to direct access and CCA customers. The concept that CAM provisions would differ for direct access and CCA customers is unsupported by the law or Commission policy. TURN's deferral proposal should thus be rejected.

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[22] TURN Opening Brief, p. 21.

[23] See, for example, *California's Electric Services Industry: Perspectives on the Past, Strategies for the Future*, report by CPUC Strategic Planning Department, February 3, 1993, p. 98 and pp. 107-108.

[24] TURN Opening Brief, p. 22.

A.3 The Commission should reject SDG&E's proposal for a rebuttable presumption.

Unlike the other IOUs, SDG&E at least admits that the Commission is required to adopt new policies to comply with the statute authorizing CAM procurement.[25] However, SDG&E's recommended approach is misguided and conflicts with the statutory requirements. SDG&E argues that the Commission should adopt an explicit "rebuttable presumption" that "the net capacity costs of resources it authorizes the utilities to procure (or orders them to build) in order to meet system or local reliability requirements will be allocated to all consumers within the procuring (or building) utility's service territory and recovered via the CAM."[26] It is important to understand the concept of a rebuttable presumption in order to see why SDG&E's proposal must be rejected. A rebuttable presumption is an assumption made by a court (or in this case, by the Commission) that is taken to be true unless a party successfully contests it and proves otherwise. In practice, most presumptions are "rebuttable," which means that the person against whom the presumption applies may present evidence to the contrary, which then has the effect of nullifying the presumption. As SDG&E notes, the applicable statute "§ 365.1(c), requires that to the extent IOU procurement of new generation resources benefits all customers in an IOU's distribution service territory, the net capacity costs of such procurement must be allocated to all such 'benefitting parties' located in that IOU's service territory."[27] Effectively then, the SDG&E proposal is that there be a rebuttable presumption that *all* utility procurement benefits *all* parties within a utility's service territory, which is clearly false.

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[25] SDG&E Opening Brief, pp. 14-15.

[26] SDG&E Opening Brief, p. 15.

[27] *Ibid*.

Moreover, it is telling that SDG&E's witness was initially unable to identify in hearings a manner by which a LSE could actually rebut this presumption. Rather than a *presumption*, the SDG&E proposal is that the Commission adopt what in fact is a *conclusion* that simply means that all utility procurement would be eligible for the CAM. When the presumption is so vague – that all customers benefit – rebuttal becomes essentially impossible.

SDG&E also now admits that, at a minimum, procurement that benefits bundled customers would rebut the presumption,[28] and thus presumably would not be subject to the CAM. Regardless, SDG&E's proposal for a rebuttable presumption is not supported by statute. As explained by the testimony and opening brief of AReM, DACC and MEA, the Commission is prohibited from making the upfront determination that SDG&E desires. Instead, the relevant statutes requires the Commission to determine that the need is *incremental* to an IOU's bundled customer need and to consider authorizing CAM treatment only *after* a power purchase agreement ("PPA") or utility-owned generation ("UOG") resource is presented for its approval.[29] SDG&E's proposal for a rebuttable presumption fails to meet these requirements.

A.4 Backstop procurement is not a valid comparison to CAM.

SDG&E attempts to use the backstop policies of the California Independent System Operator ("CAISO") to justify CAM treatment for IOU procurement.[30] The CAISO allocates costs for backstop procurement to all LSEs in the applicable Transmission Area Charges ("TAC") Area, unless the CAISO determines that a particular LSE is responsible. However, this comparison fails. First, the CAISO's backstop procurement is short-term – a few days, months or up to a year, while CAM procurement applies for the term of a PPA, often 20 years or more.

[28] SDG&E Opening Brief, p. 17.

[29] AReM-DACC-MEA Opening Brief, pp. 14-15.

[30] SDG&E Opening Brief, pp. 16-17.

Second, the CAISO is *not* a direct competitor of any of its market participants, whereas each IOU directly competes against ESPs and CCAs to capture load. CAM allows one competitor (the IOU) to procure on behalf of its direct competitors (the ESP and CCA), thereby controlling a portion of its competitors' energy portfolio and imposing unquantifiable and unknowable costs on the ESPs' and CCAs' customers. There is no comparable arrangement at the CAISO or, indeed, elsewhere in the world where competitive electricity markets exist. The Commission has acknowledged the anticompetitive effects of CAM[31] and should make every effort to reduce it by adopting the proposals of AReM, DACC and MEA for establishing and implementing CAM criteria, adopting a two-stage process for determining when CAM may be authorized, and adopting and implementing the LSE Opt-Out.

A.5 The Commission should adopt and implement the criteria and process proposed by AReM, DACC and MEA.

Track 1 of this LTPP proceeding is the time and place to implement a mechanism that complies with the statutory requirements. CAM procurement now exceeds 7,000 MW and is growing.[32] While the relevant statutes clearly limit when CAM procurement applies, the Commission has not yet acted to implement these limitations by establishing the criteria it must use when determining whether to approve a particular CAM project.

A fundamental principle that the Commission should adopt is that CAM procurement should be the exception, rather than the rule. The Legislature has imposed requirements the Commission must follow in imposing CAM charges on all customers. Further, the Commission previously determined in Decision ("D.") 11-05-005 that Senate Bill ("SB") 695 required

[31] D.06-07-029, pp. 24-25.

[32] Exhibit AReM-2, p. 5, lines 10-21 and Attachment.

adoption of criteria[33] or a "benefits test" to ensure compliance with the statute.[34] Subsequently, SB 790 added new Commission obligations that must also be incorporated.[35] AReM, DACC and MEA have proposed such criteria and are the only parties to do so.[36] The record is in fact devoid of proposals by other parties as to how the Commission is to comply with its statutory obligations in this regard. Importantly, the proposed criteria fully comply with applicable statutes and Commission policy on cost causation and cost shifting, thereby achieving the twin goals of meeting statutory requirements and enabling retail choice.

Along with setting reasonable criteria for determining when to authorize CAM procurement, the Commission should also set forth a process by which it makes its CAM determination in compliance with the applicable statutes. Once again, AReM, DACC and MEA are the only parties to propose such a process.[37] A critical component of the proposed process is the Commission's enforcement of P.U. Code 454.5, which establishes the requirements the IOUs must meet to serve their own bundled customer load, thereby reducing the potential for CAM to be used for that purpose.[38] Finally, the Commission must consider and apply its long-standing policy regarding cost causation to ensure that the CAM procurement and associated allocation of benefits are properly designed and implemented and fulfill its commitment to "competition and customer choice."[39] This requires that the Commission make every effort to minimize CAM procurement, while continuing to ensure that reliability requirements are met.

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[33] D.11-05-005, p. 7; see discussion in Exhibit AReM-1, p. 11.

[34] D.11-05-005, p. 16; see discussion in Exhibit AReM-1, p. 12.

[35] Exhibit AReM-1, p. 15-16.

[36] Exhibit AReM-1, pp. 30-32.

[37] Exhibit AReM-1, pp. 32-34.

[38] See discussion in Exhibit AReM-1, pp. 24-29.

[39] Exhibit AReM-1, pp. 21-24.

AReM, DACC and MEA submit that establishing the proposed criteria and process will improve transparency, ensure compliance with applicable statutes and Commission policy, and, with approval of LSE Opt-Out, ultimately lead to a reduced level of CAM procurement. We urge its adoption.

B. Should CAM Be Modified at this Time?

B.1 Objections to AReM, DACC and MEA's proposal to update the Joint Parties' CAM calculation are misplaced.

SDG&E asserts that AReM, DACC and MEA's proposal to consider additional ancillary service products beyond the non-spinning reserves when administratively calculating the CAM charge is based on "flawed assumptions" such as "a CAM unit will provide every ancillary service available."[40] These objections are based on mischaracterization of AReM, DACC and MEA's proposal, which is to *consider* all possible income streams from power and ancillary services sales; not that all would necessarily be applicable to every CAM unit under every circumstance. It is an obvious truth that a unit providing energy is precluded from providing additional reserves or that due to technical constraints some units may not provide certain ancillary service products. To this end, AReM, DACC and MEA agree with SDG&E and DRA that workshops should be held to develop the needed refinements to the Joint Parties' Proposal.[41]

Both PG&E and SCE object to AReM, DACC and MEA's proposal to change the administrative calculation methodology specified in the Joint Parties' Proposal as a violation of the settlement approved in D.07-09-044 and as such cannot be considered.[42] However, D.07-09-044 contemplated future changes. Conclusion of Law 2 to that decision in fact provides,

[40] SDG&E Opening Brief, p. 23.

[41] SDG&E Opening Brief, p 20, DRA Opening Brief, p. 36

[42] PG&E Opening Brief, p. 11, SCE Opening Brief, p. 26.

"Adoption of this Settlement Agreement does not extend to substantive issues which may come before the Commission in other or future proceedings." The Assigned Commissioner and Administrative Law Judge's Scoping Memo explicitly include "[w]hether the CAM should be modified at this time"[43] as an issue in this phase of this proceeding. Furthermore, since that time, SB 790 has revised the criteria for CAM. This act of the legislature supersedes the Settlement provisions and further provides additional "substantive issues" for the Commission's analysis and review. As such, PG&E and SCE's objection that "you can't change the Settlement" is incorrect and must be disregarded.

B.2 PG&E's Ad Hominem attack on AReM, DACC and MEA's witness should be ignored.

PG&E attempts to attack the credibility of AReM, DACC and MEA witness Fulmer by pointing out the Mr. Fulmer took a different position here concerning the use of levelized costs than while being cross-examined in R.07-05-025: He opposed levelization in that proceeding but supports it here. This attack is amusingly hypocritical, as PG&E's position concerning levelization in R.07-05-025 too **is exactly opposite the one it takes here**. In R.07-05-025, PG&E opposed Mr. Fulmer's proposal not to levelize costs.[44] Now PG&E opposes Mr. Fulmer's proposal to levelize costs here. The humor is amplified by the fact that this contradiction was pointed out to PG&E during the cross examination of its witness Mr. Martyn, but nonetheless, PG&E chose to renew the attack yet again in its brief.[45]

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[43] *Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge*, R.12-03-014, May 17, 2012, p. 6.

[44] Tr. p. 548, line 28 to p. 549, line 4 and R.07-05-025; Opening Brief of Pacific Gas And Electric Company, May 6, 2011, p. 9.

[45] Tr. p. 548, line 28 to p. 549, line 4.

The simple fact is that it is perfectly reasonable for parties and individuals to recommend an action such as cost levelization in one context and oppose it in a different context. As PG&E witness Martyn admitted under cross examination, it is reasonable to propose levelization in one context but oppose it in another:

> Q: [Mr. Douglass] Might it be reasonable to propose levelization in one context but oppose it in another based upon the different and divergent issues being addressed in a proceeding?
>
> A: [Mr. Martyn] Yes.[46]

AReM, DACC and MEA do not (necessarily) find PG&E to be inconsistent or self-serving by recommending cost levelization in one proceeding and not in another. As in each proceeding, the Commission must evaluate the reasonableness of each proposal in these differing contexts.

B.3 AReM, DACC and MEA's proposal for levelized utility-owned generation CAM costs is reasonable.

PG&E and SDG&E[47] argue that AReM, DACC and MEA's levelization proposal violates Section 365.1(c)(2)(C), which requires that the "annual revenue requirement" for UOG be used for purposes of calculating the net capacity costs to be allocated under the CAM."[48] While PG&E offers no argument beyond citing this provision of the statute and thus its position can be disregarded, SDG&E goes further by making the argument that when "there is no ambiguity in the language of the statute, then the Legislature is presumed to have meant what it said, and the plain meaning of the language governs."[49] In fact, however, there *is* ambiguity. The statute actually proposes two methods for calculating net capacity costs, depending upon whether the resource is utility-owned or procured from a third party. The Commission has broad discretion

[46] Tr. p. 549, lines 5-10.

[47] PG&E Opening Brief, p. 12; SDG&E Opening Brief, p. 24.

[48] PG&E Opening Brief, p. 12.

[49] SDG&E Opening Brief, p. 24.

to interpret statute and in doing so it must try to comply with the legislature's intent. In this case, however, the statute does not speak to the issue of levelization at all. It is neither prohibited nor prescribed. The Commission must therefore determine whether the interests of ratepayers are best served by having a more predictable and levelized cost. AReM, DACC and MEA believe that they are so served and that neither PG&E nor SDG&E make a meaningful argument in rejection of this position.

Beyond the legal issues addressed above, a number of parties objected to AReM, DACC and MEA's proposal to levelize the capital cost of utility-owned generation when calculating the CAM charge as unfair to bundled customers.[50] This is not true. As noted in our opening brief, "while the levelized cost used in the CAM calculation generally will not precisely meet the revenue requirement in a given year, over the life of the asset (for which CAM will be charged) no customer will end up paying more than their fair share."[51] It is worth noting that CAM is an approximation of capacity costs and that levelizing capital costs creates a more reasonable approximation.

SDG&E also objected to the proposal because it, "did not account for a project not available for its anticipated life."[52] The possibility that a UOG asset might not be productive for its full anticipated life is a familiar risk to regulators. Most of the depreciation and financial return to IOUs occur early in the life of an asset, leaving ratepayers at risk if the plant becomes inoperable short of its "anticipated life." The Commission will have bigger ratepayer protection issues than a perceived imbalance in the CAM if this arises: the compensation of <u>all</u> ratepayers from a largely depreciated but underperforming asset.

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[50] PG&E Opening Brief, p. 13 TURN Opening Brief, p. 23; SDG&E Opening Brief, p. 25.

[51] AReM/DACC/MEA Opening Brief, p. 25.

[52] SDG&E Opening Brief, p. 25.

B.4 AReM, DACC and MEA's CAM cap is reasonable.

SDG&E objects to AReM, DACC and MEA's proposed cap on the CAM costs associated with a particular PPA or utility-owned asset, stating that it violates P.U. Code § 365.1(c), which specifies the calculation of the CAM cost.[53] As AReM, DACC and MEA pointed out in their opening brief, the cap does not replace or supersede the legislatively-directed calculation of the CAM. Rather, it merely provides a backstop in the hopefully rare instance where the standard calculation of CAM might result in an excessive charge that clearly did not represent the value of capacity.

SDG&E also asserts that the CAM cap "entirely ignores the role of the Commission in ensuring equitable allocation of costs."[54] To the contrary, having the Commission implement the CAM cap allows the Commission to fulfill its role in ensuring equitable allocation of costs. Without the cap, customers who pay the CAM could be subject to unreasonable capacity costs, which would be counter to the Commission's often expressed commitment to competitive retail markets.

PG&E says that AReM, DACC and MEA's capping proposal confuses the "cost and value" of capacity, that it "confuses what the CAM charge represents, the residual cost of the CAM resource, with short-term RA value. The CAM charge is the residual cost of the resource after the energy and ancillary services revenues are netted from the total costs."[55] What PG&E appears to miss is that the "residual cost of the CAM resource" ***is*** the RA capacity value. This was established in D.06-07-029, the first decision addressing what has become known as CAM:

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[53] SDG&E Opening Brief, pp. 25-26.

[54] SDG&E Opening Brief, pp. 25-26.

[55] PG&E Opening Brief, p. 13.

> We find that the energy and capacity from any new resources should be unbundled, with the costs and benefits **of the RA capacity component** socialized to all customers connected to the utility's distribution system, and the costs and benefits of the energy component assigned to those that value the energy the most, as demonstrated through an auction or similar mechanism.[56] (emphasis added)

The point of the residual calculation is to value the RA capacity of the CAM contract. It appears that PG&E is the confused party with respect what the residual cost calculation represents, not AReM, DACC and MEA.

TURN suggests that it is not fair to cap the CAM while still allowing it to fall below zero.[57] While having a price ceiling without a floor may be reasonable in some instances, AReM, DACC and MEA agree with TURN here. However, TURN's solution to this proposal is the wrong one. It suggests the Commission should allow the CAM to float to any price calculated by the requisite formula, be it burdensomely great or negative.[58] The opposite is actually the preferred solution here: the Commission should institute a "collar" on CAM rates. That is, retain the CAM cap as proposed by AReM, DACC and MEA, but institute a floor price of zero.

C. Should Load-Serving Entities be Able to Opt Out of CAM?

C.1 Parties find cost shifting where there is none.

Several parties urge the Commission to reject the LSE Opt-Out, claiming that it shifts costs to bundled customers. All fundamentally misunderstand or misrepresent the proposal, which avoids cost shifting and requires Commission approval of any opt-out request.

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[56] D.06-07-029, p. 31

[57] TURN Opening Brief, p. 22.

[58] TURN Opening Brief, p. 22.

For example, SCE describes the proposal as an "opt out from CAM responsibility," which would force bundled customers to subsidize the customers of the LSE opting out.[59] SCE threatens it would no longer be willing to procure CAM projects if the LSE Opt-Out were approved.[60] SDG&E argues, without substantiation, that the customers of the LSE opting out receive a "free ride."[61] Similarly, TURN argues that the LSE Opt-Out would allow direct access and CCA customers to "avoid responsibility" for new CAM charges.[62] For its part, CLECA states that it supports the concept of an LSE Opt-Out, but asks the Commission to reject the LSE Opt-Out proposal of AReM, DACC and MEA.[63] In making this request, CLECA merely references the reply testimony of PG&E, TURN, and SCE without acknowledging that these opposing parties misunderstood many elements of the proposal as became clear during cross examination.[64]

PG&E's cost-shifting argument centers on its claim that the three opt-out options proposed allow ESPs and CCAs to "maximize" their ability to opt out "further shifting costs to bundled customers."[65] This unsubstantiated claim contains no basis in reality. The LSE Opt-Out is designed to *reduce* the CAM by transferring a portion of the procurement obligation to an ESP or CCA. When the CAM is reduced, the IOUs' bundled customers -- and all other customers – benefit from lower CAM charges. There is no "cost shifting" and the number of opt-out options makes no difference.

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[59] SCE Opening Brief, p. 27.

[60] *Ibid.*

[61] SDG&E Opening Brief, p. 26.

[62] TURN Opening Brief, p. 24.

[63] CLECA Opening Brief, p. 33.

[64] AReM-DACC-MEA Opening Brief, pp. 27-29.

[65] PG&E Opening Brief, p. 16.

As described at length in testimony and in the opening brief,[66] the LSE Opt-Out proposal of AReM, DACC and MEA transfers a portion of the responsibility for procuring to meet reliability needs to the ESP or CCA opting out, thereby *reducing* the need for CAM procurement by the IOUs. Any remaining CAM would be recovered from *all customers*. Thus, there is no ability for the ESP, CCA or their customers to "avoid responsibility" or "free ride" as some have claimed, especially considering that an ESP or CCA using the opt-out mechanism would be required to procure new capacity if required by the Commission.[67] The Commission should want to encourage ESPs and CCAs to be responsible for their own procurement, which is precisely the result that would be obtained if the AReM DACC MEA proposal were adopted. In addition and as discussed below, SB 790 requires the Commission to ensure CCAs can "maximize" the ability to determine the generation resources used to serve their own customers.[68] The LSE Opt-Out proposal is necessary to comply with the statute.

SCE also reiterates its arguments that the LSE Opt-Out is prohibited by statute and citing P.U. Code Sections 380(g), 365.1(c)(2)(A), and 365.1(c)(2)(B).[69] AReM, DACC and MEA disagree as explained in testimony and in our opening brief.[70] In summary, the LSE Opt-Out maintains the "fully nonbypassable charges" to all benefiting customers for any CAM project approved by the Commission. However, the opt out *reduces* the total megawatts of reliability resources *needed* and Section 365.1(c)(2)(A) obviously contains no prohibition on *reducing* reliability needs. In addition, Section 380(g) cited by SCE relates solely to the obligations of

[66] .Exhibit AReM-1, pp. 50-53; AReM-DACC-MEA Opening Brief, pp. 26-27.

[67] AREM-DACC-MEA Witness Mara, Tr., p. 1165, lines 8-22.

[68] P.U. Code Sections 380(b)(4) and 380(h)(5).

[69] SCE Opening Brief, pp. 27-28.

[70] Exhibit AReM-1, p. 55, lines 5-18; AReM-DACC-MEA Opening Brief, pp. 28-29.

LSEs to meet the Commission's requirements for Resource Adequacy. It has nothing at all to do with CAM. The Commission should thus disregard SCE's arguments.

C.2 The 5-year minimum contract term is reasonable and should be adopted.

TURN[71] and DRA[72] criticize the proposed 5-year minimum contract term to qualify for the LSE Opt-Out, stating that the term is too short to encourage new generation and that no developer would agree to a 5-year contract. SCE[73] and SDG&E[74] also argue that the 5-year contract minimum is too short. As our testimony makes clear, 5 years is the *minimum* term to qualify for the LSE Opt-Out.[75] The potential dearth of 5-year deals is not a valid reason to reject the proposal. If no such deals can be found, then the ESP or CCA wishing to opt out will have to sign a longer-term deal or forego the opt-out. There is no rational reason to reject a viable option simply because its use may be limited – particularly when each successful opt-out would reduce CAM procurement, thereby benefiting all customers through reduced CAM charges.

SDG&E also asserts that the 5-year minimum contract term would somehow "shift the burden of developing new generation to utility ratepayers."[76] SDG&E concludes that, because 5-year deals do not exist, ESPs and CCAs opting out would procure *existing* resources to opt-out.[77] SDG&E's astounding conclusion bears no relationship to the actual LSE Opt-Out proposal presented by AReM, DACC and MEA, which dictates that new resources *must* be procured when

[71] TURN Opening Brief, p. 25.

[72] DRA Opening Brief, p. 36.

[73] SCE Opening Brief, p. 29.

[74] SDG&E Opening Brief, p. 28.

[75] Exhibit AReM-1, pp. 55-56.

[76] SDG&E Opening Brief, p. 27.

[77] SDG&E Opening Brief, p. 28.

required by the Commission and that each opt-out request be approved by the Commission.[78] Moreover, unlike the IOUs, the ESP or CCA opting out would assume full risk of cost recovery for the transaction. As AReM, DACC and MEA have explained,[79] the LSE Opt-Out is a better deal for bundled ratepayers than the IOUs can provide – as any cost overruns or contract issues are borne solely by the ESP or CCA and have no economic consequences for the bundled customers.

C.3 Enforcement rules and other details can easily be developed at a later time.

Several parties argue that the LSE Opt-Out should be rejected simply because no enforcement rules or other details have been proposed. However, these parties have fallen far short in justifying their approach of "throwing the baby out with the bathwater."

TURN criticizes the lack of a proposed enforcement mechanism or "heavy non-compliance penalties" for the LSE Opt-Out.[80] SDG&E also complains about a lack of details regarding enforcement and on the required showing by the LSE opting out.[81] As the witness for AReM, DACC and MEA explained, the Commission could certainly propose an enforcement mechanism of its choosing.[82] The necessary details would logically be developed at the time the Commission is presented with an actual proposal for a specific opt-out. However, ESPs and CCAs opting-out should be treated no differently than the IOUs with respect to enforcement. For example, AReM, DACC and MEA are unaware of any enforcement mechanism or "heavy non-compliance penalties" applied to the IOUs for their CAM procurement obligations. As to

[78] Exhibit AReM-1, pp. 57-63; AReM-DACC MEA Opening Brief, p. 27.

[79] AReM-DACC-MEA Opening Brief, p. 28..

[80] TURN Opening Brief, pp. 25-26.

[81] SDG&E Opening Brief, p. 29.

[82] AReM-DACC-MEA Witness Mara, Tr., p. 1170, lines 2-8.

the required showing, the proposal for AReM, DACC and MEA was specific about the timing, term, quantity, resource type and resource characteristics that must be included in any showing by the LSE seeking approval for an opt-out proposal.[83] This offers considerably more detail than has been offered in other proposals subsequently approved by the Commission

C.4 The LSE Opt-Out proposal does not impair reliability.

Several parties argue that aspects of the LSE Opt-Out proposal can potentially impair reliability. These assertions are inaccurate or unproven and should be disregarded.

For example, SDG&E argues that the LSE Opt-Out proposal could affect reliability because it lacks enforcement details.[84] As noted in the prior section, the Commission could certainly propose an enforcement mechanism of its choosing.in order to ensure that there would be no impairment of reliability.

PG&E also argues that the LSE Opt-Out proposal could impair reliability.[85] PG&E claims that reliability would be impaired because new resources require 10-year contract minimums. Obviously, there is no connection between the contract term and reliability. As discussed above, if new resources are required and developers require a 10-year contract term, the ESP or CCA requesting to opt out must therefore enter into a 10-year contract to get the deal done. Whether the contract term is 5 or 10 years has no effect on reliability. PG&E's claim should be given no weight.

Moreover, SDG&E and PG&E both fail to acknowledge that AReM, DACC and MEA have adequately addressed any such concerns. Specifically, AReM, DACC and MEA have: (1) proposed that the Commission has the ultimate authority to approve each opt-out and set any

[83] Exhibit AReM-1, pp. 56-63.

[84] SDG&E Opening Brief, p. 29.

[85] PG&E Opening Brief, p. 14.

necessary compliance requirements;[86] (2) explained that reliability issues are unlikely;[87] and (3) described options available for meeting reliability issues on short notice.[88] In fact, the witness for AReM, DACC and MEA noted that SCE was able to build and bring on-line several peakers within one year of a Commission order.[89] In conclusion, the potential for reliability issues deriving from the LSE Opt-Out simply does not exist.

C.5 Any purported administrative burdens are outweighed by the benefits of the LSE Opt-Out proposal.

PG&E states various concerns about the "administrative burden" associated with LSE Opt-Out that would be imposed on the Commission and the IOUs.[90] AReM, DACC and MEA first note that the implementation of the CAM already carries significant administrative burden for the IOUs (*e.g.*, CAM review groups, calculation of CAM charges for each customer class), the Commission staff (*e.g.,* review and approval of advice letters, monthly allocation of RA credits from CAM projects to ESPs and CCAs), and the stakeholders involved in this process (*e.g.*, review and protests of advice letters). To the knowledge of AReM, DACC and MEA, the IOUs did not protest this "burden" when demanding that the Commission adopt CAM treatment for IOU procurement of new generation resources.

PG&E also expresses concern on how an LSE opt-out might impact the procurement of combined heat and power ("CHP") Resources under the CHP program, and goes on to list a few of its concerns.[91] While solutions to the questions raised by PG&E were not explicitly addressed

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[86] Exhibit AReM-1, p. 54; AReM-DACC-MEA Witness Mara, Tr., p. 1169, line 26 through p. 1170, line 8.

[87] AReM-DACC-MEA Witness Mara, Tr., p. 1170, line 9 through p. 1171, line 13.

[88] *Ibid.*

[89] D.09-03-031; AReM-DACC-MEA Witness Mara, Tr., p. 1166, lines 6-26.

[90] PG&E Opening Brief, p. 14.

[91] PG&E Opening Brief, p. 15.

in the testimony of AReM, DACC and MEA, they are not insurmountable. They can be easily addressed in a cooperative workshop or a round of comments and reply comments.

PG&E also overstates the administrative requirements of AReM, DACC and MEA's opt-out proposal.[92] The primary burden would be upon the ESP or CCA to provide the necessary data and reports in a clear and concise fashion. The protocols to verify the requesting LSE's opt-out were laid out clearly in testimony[93] and should not represent an undue burden on either Commission or utility staffs.

While PG&E is correct in observing that allowing for ESPs or CCAs to opt-out of the CAM charges associated with specific assets would create LSE-specific CAM charges, it overstates the challenge that would create.[94] For example, PG&E already has five different Power Charge Indifference Adjustment ("PCIA") charges *for each* rate schedule. This number will grow each year *ad infinitum*. In this light, calculating and implementing different CAM charges for the ESPs or CCAs who happen to opt-out is clearly a manageable task.

SDG&E takes PG&E's approach in arguing that the opt-out would be difficult to implement and complex to administer.[95] However, SDG&E's twist on this argument is to assert that LSEs would find it challenging to meet the Commission's specified reliability requirements in their opt-out proposals.[96] Rather than allow LSEs the opportunity to meet that challenge, SDG&E prefers to remove the opportunity altogether. Further, SDG&E (and PG&E)[97] keep returning to the settlement approved by the Commission for IOU procurement from CHP

[92] PG&E Opening Brief, p. 15.

[93] Exhibit AReM-1, pp. 54-59

[94] PG&E Opening Brief, pp. 16-17.

[95] SDG&E Opening Brief, p. 27.

[96] SDG&E Opening Brief, p. 27.

[97] PG&E Opening Brief, pp. 14-15.

facilities as "evidence" that the Commission has concerns about the opt-out concept. Specifically, SDG&E states that, "In deciding against inclusion of an opt out provision in the CHP settlement, for example, the Commission noted its concerns regarding the ability of non-IOU LSEs to procure the specific CHP resources needed (as well as the administrative burden inherent in placing that procurement obligation on non-IOU LSEs)."[98] In fact, at precisely the same page cited by SDG&E the Commission stated, "We remain open to consideration, in a future proceeding, of proposals whereby ESPs and CCAs may opt out of IOU procurement and procure CHP resources on their own behalf."[99] SDG&E's failure to note this statement in its citation is startling.

In conclusion, any comparison between the CHP opt-out discussed in D.10-12-035 and the CAM opt-out proposed by AReM DACC MEA is not apropos. The CHP-related opt-out concerned the feasibility of imposing an obligation to procure on ESPs and CCAs. In contrast, the proposed LSE Opt-Out in this proceeding is an option that may be exercised by an ESP and CCA only with full Commission approval and control.

C.5 SCE's proposal for an IOU opt out should be rejected.

SCE complains that if the Commission does intend to approve LSE Opt-Out for ESPs and CCAs, then the IOUs must be permitted to opt out as well.[100] The SCE concept suggests that the IOUs would have the right to ignore a CAM authorization, which would seem to be in violation of the P.U. Code.[101] Further, if the IOU opts out, their bundled customers would pay the cost of the opt-out resource (assuming the Commission would authorize cost recovery) plus share the

[98] SDG&E Opening Brief, p. 27 (citing p. 576 of D.10-12-035).

[99] D.10-12-035, at p. 56.

[100] SCE Opening Brief, p. 29.

[101] P.U. Code Section 365.1(c)(2)(A).

costs of the remaining CAM procurement with direct access and CCA customers. SCE apparently believes that its bundled customers could *escape* CAM charges if SCE is able to opt out. That is neither the proposal nor the case. When authorized and applied, CAM is paid by all customers. The goal of the LSE Opt-Out is to reduce the CAM, but AReM, DACC and MEA are cognizant that CAM will likely remain to some extent until sufficient market improvements render it unnecessary or obsolete or until the Commission "approves a centralized resource adequacy mechanism" as provided in Section 365.1(d)(1), at which time "the requirements of paragraph (2) of subdivision (c) shall be suspended."[102]

C.6 The Commission should adopt the LSE Opt-Out proposal of AReM, DACC and MEA.

The Commission should adopt the LSE Opt-Out proposal of AReM, DACC and MEA to address the anti-competitive aspects of the CAM, provide market incentives for ESPs and LSEs to procure multi-year forward RA resources, promote efficient RA procurement, and allow ESPs and CCAs to better manage their own energy portfolios based on their respective customers' needs and preferences. As explained by AReM, DACC and MEA, a LSE Opt-Out mechanism is needed to mitigate the anti-competitive effects of the CAM and specifically to comply with SB 790, which requires the Commission to ensure CCAs can "maximize" the ability to determine their own generation resources.[103]

AReM, DACC and MEA are the only parties to submit a proposal for LSE Opt-Out and urge the Commission to adopt it. The proposal includes three opt-out mechanisms: (1) Load-Ratio Share; (2) Load-Based; and (3) Customer-Based.[104] The ESP or CCA would be able to

[102] P.U. Code Section 365.1(d)(1).

[103] AReM-DACC-MEA Opening Brief, pp. 26-27, Exhibit AReM-1, pp. 52-53.

[104] Please refer to full proposal provided in Exhibit AReM-1, pp. 50-66.

select which approach works best for its own circumstances and would apply to the Commission for approval of the proposed opt-out. The ESP or CCA would be obligated to submit its proposed opt-out any time after the Commission identifies potential megawatts that may be subject to CAM procurement, but *before* the IOU completes its Request For Offer process for a PPA.[105] In addition, the LSE Opt-Out proposal establishes clear guidelines for the LSE – an essential requirement to ensure the proposal is both workable and effective. As described above and in our opening brief, no party has provided credible objections to the LSE Opt-Out proposal.[106]

Moreover, rejecting the LSE Opt-Out proposal would harm California's competitive retail market. As noted testimony and the opening brief, the Commission has already approved over 7,000 MW of CAM procurement by the IOUs.[107] Each MW of CAM procurement is a MW that the non-utility LSEs do not and cannot manage from a cost, quantity or quality perspective. In short, the ESPs and CCAs are in the unenviable position of having their competitors dictate a portion of their resource portfolio for them, undermining their ability to offer products and services that meet their customers' preferences. In addition, SB 790 provides a clear requirement that the Commission ensure CCAs can manage their resource portfolios. The concept of a LSE Opt-Out was first introduced in R.01-10-024 as a way to mitigate the anti-competitive effects of the CAM.[108] Now is the time for the Commission to mitigate this harm and take positive action to reduce future CAM procurement. Accordingly, AReM, DACC and MEA urge the Commission to adopt the LSE Opt-Out proposal.

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[105] The timing for a LSE to submit an Opt-Out proposal is discussed on p. 56 of Exhibit AReM-1 and differs depending on whether the IOU plans enter into a PPA or propose UOG for the CAM procurement.

[106] AReM-DACC-MEA Opening Brief, pp. 27-29.

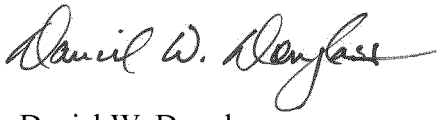
[107] Exhibit AReM-2, p.2 and p.5; AReM-DACC-MEA Opening Brief, p. 30.

[108] Exhibit AReM-1, pp. 50-51.

VIII. CONCLUSION

As detailed above and in the record of this proceeding, AReM, DACC and MEA conclude that the opposing parties have failed to provide substantive justification for their objections to the proposals of AReM, DACC and MEA. Accordingly, AReM, DACC and MEA urge the Commission to adopt and implement the recommendations and proposals provided by them in this Track 1 proceeding, thereby complying with applicable statutes and Commission policies, maintaining reliability, minimizing CAM, and supporting retail choice.

Respectfully submitted,



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