

BEFORE THE
PUBLIC UTILITIES COMMISSION
OF THE
STATE OF CALIFORNIA

Order Instituting Rulemaking to Oversee the
Resource Adequacy Program, Consider Program
Refinements, and Establish Annual Local
Procurement Obligations.

R.11-10-023

**RESPONSE OF
SHELL ENERGY NORTH
AMERICA (US), L.P. TO PG&E'S MOTION
TO TRANSFER ISSUES BETWEEN PROCEEDINGS**

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In accordance with Commission Rule 11.1(e), Shell Energy North America (US), L.P. (“Shell Energy”) files its response to the “Motion of Pacific Gas And Electric Company to Move the Track 3 Multi-Year Procurement Requirement Issue to the Resource Adequacy Proceeding, and to Defer Remaining Track 3 Issues,” which was filed on September 20, 2012.¹ Shell Energy objects to PG&E’s proposal to shift consideration of a multi-year forward procurement requirement from the long-term procurement planning (“LTPP”) proceeding (R.12-03-014) to the resource adequacy (“RA”) proceeding (R.11-10-023). Shell Energy also objects to PG&E’s proposal to extend the current, one-year forward RA procurement requirement to a multi-year procurement requirement, as well as PG&E’s proposal to require LSEs to purchase “flexible” capacity as a part of the RA procurement obligation. Contrary to PG&E’s assertion (Motion at p. 2), there is not an “emerging consensus among the parties” that these additional requirements should be imposed on all LSEs.

¹ Shell Energy also files today a substantially similar response to PG&E’s corresponding motion in R.12-03-014.

I.

INTRODUCTION

In its September 20 motion, PG&E proposes to transfer consideration of two issues: a multi-year procurement requirement; and a flexible resource procurement requirement, to the Commission's RA proceeding (R.11-10-023). PG&E states that "[t]he two topics are too closely related to be artificially separated." Motion at p. 3.

In support of its motion, PG&E states that "[t]here appears to be an emerging consensus among the parties . . . that the current, one-year forward [RA] program should be improved in at least two respects." Motion at p. 2. First, PG&E asserts that the RA procurement obligation should include a "flexible capacity" procurement requirement. Second, PG&E proposes a "multi-year forward procurement" requirement for all LSEs. Id.

Shell Energy is not a part of what PG&E characterizes as an "emerging consensus" on these matters. First, if the CAISO concludes that it needs "additional assurances" with respect to the availability of flexible resources, the CAISO can develop flexible capacity products and a market structure for the purchase of these products. This Commission can consider, in the LTPP proceeding, whether the IOUs should be allowed - - or required - - to purchase flexible products on a forward basis in order to hedge against the costs of acquiring flexible capacity on a short-term basis. The Commission should not impose a flexible capacity procurement obligation on all LSEs, however.

Second, the LTPP proceeding is the proper forum for consideration of a multi-year RA capacity procurement requirement for the IOUs. The Commission can decide whether the IOUs' long-term procurement plans should include multi-year forward capacity procurement. A multi-year forward procurement requirement should not be imposed on ESPs, however. The ESP business model is very different from the business model of the IOUs, which enjoy guaranteed

cost recovery. ESPs cannot predict the level of their customer load over a multi-year period. Imposing a multi-year procurement obligation on ESPs would force ESPs - - or their customers - - to bear the financial burden of forward procurement costs, making direct access service a less competitive and less attractive procurement option.

On these bases, Shell Energy urges the Commission to reject PG&E's motion. The RA proceeding should address a definition of "flexible capacity" and a quantification of the flexible capacity needed for system reliability. The issues of whether the IOUs should purchase flexible capacity, and whether the IOUs should be subject to a multi-year capacity procurement obligation, should be addressed in the LTPP proceeding.

II.

FLEXIBLE CAPACITY PROCUREMENT BY THE IOUS SHOULD BE ADDRESSED IN THE LTPP PROCEEDING

PG&E incorrectly assumes that the appropriate means to ensure the availability of sufficient "flexible" capacity is for the Commission to impose a flexible capacity procurement mandate on all LSEs. See Motion at p. 2. Apparently, PG&E seeks to have the Commission impose this mandate on all LSEs through the RA proceeding.

Imposing an additional RA procurement obligation on LSEs at this time, however, would impede the operation of the bilateral capacity market. LSEs have relied on the bilateral market structure - - and the capacity requirements established through the adopted Standard Capacity Product ("SCP") - - to purchase capacity to meet their RA procurement obligations. The Commission should take the steps necessary to fully embrace the SCP and the bilateral capacity market, including implementation of the voluntary electronic bulletin board that was approved in D.10-06-018 (June 3, 2010). Imposing a new flexible capacity procurement obligation would add another layer of complexity - - and cost - - to LSEs' RA procurement obligations.

Mandating LSE procurement of “flexible” RA capacity would increase costs for LSEs’ customers, without any demonstration that a refinement of RA capacity characteristics is required. Bilateral procurement of reliability products to hedge a future load obligation is a more economically efficient means by which to acquire flexible resources. The Commission should consider this approach for the IOUs in the LTPP proceeding.

Imposing an additional RA capacity obligation on all LSEs, however, would disadvantage ESPs and CCAs that would have to purchase incremental flexible capacity from IOUs that may possess market power and whose ratepayers have paid for the IOU-owned capacity. Furthermore, it is not clear whether flexible capacity procurement is even needed, as the existing generation fleet appears to have sufficient flexible capacity to meet system reliability needs.

The FERC-approved CAISO tariff provides the CAISO with authority to develop a market for flexible capacity products. The tariff provides that the CAISO is “responsible for ensuring that there are sufficient [a]ncillary [s]ervices available to maintain the reliability of the CAISO [c]ontrolled [g]rid” Tariff Section 8.1. Through the price paid for balancing reserves² or ancillary services, the CAISO provides incentives for generators to offer “regulation,” “spinning reserves,” and “non-spinning reserves.” The costs of these operational services are paid by all customer load through charges imposed upon Scheduling Coordinators. Ancillary services are provided by generators through a competitive bidding mechanism. See CAISO Tariff, Sections 8.3.6; 8.3.7. Imposing an additional flexible capacity procurement obligation could result in duplicative costs to ratepayers.

² The CAISO once had a “replacement reserve” product that provided energy within one hour. This product was discontinued, however. Based on recent representations by the CAISO regarding the need for flexible capacity, it now appears that such a “replacement reserve” may be one of the new flexible capacity products needed.

If the CAISO believes that flexible capacity is needed, the CAISO can identify the products to be purchased based on its obligation to ensure that ancillary services remain available to provide contingency reserves for grid reliability. The CAISO's establishment of new flexible capacity or balancing reserve products would help to "firm" the increased deliveries from renewable supplies that are anticipated under the 33 percent RPS requirement.

Once the CAISO identifies the flexible capacity products that are needed and specifies the corresponding load obligation, LSEs should be free to choose whether to purchase these products in bilateral transactions on a forward basis, or pay the cost of CAISO purchases in the spot market on behalf of their load. Rather than have the Commission impose a flexible capacity mandate as a part of an LSE's RA capacity procurement obligation, the CAISO should develop a market for flexible capacity products. The Commission should allow the IOUs to procure these products in the most cost efficient manner, including the purchase of these products on a forward basis.

The Commission should authorize the IOUs to procure flexible capacity products as a hedge against the CAISO's daily clearing of those products, similar to the current CAISO ancillary services markets. Today, the IOUs can procure ancillary services capacity (to which they have access through tolling agreements and utility-owned generation) and then bid that capacity into the CAISO ancillary services markets. The IOUs can then bid in ancillary services equal to their load obligation and net out (get charged and paid for) their supply and their obligation.

A flexible capacity requirement should not be added to an LSE's current RA capacity procurement obligation. Rather, flexible capacity should be an option for an LSE to purchase if the LSE determines that this is the most cost effective means of serving its load. For this reason, the issue of flexible capacity procurement should be addressed in the LTPP proceeding. The

IOUs should be allowed to propose, in their long-term procurement plans, purchases of flexible capacity in bilateral markets in order to hedge against the cost of flexible capacity purchased for load by the CAISO. There is no reason to impose a flexible capacity obligation on ESPs, however.

III.

CONSIDERATION OF A MULTI-YEAR FORWARD PROCUREMENT OBLIGATION SHOULD BE IN THE LTPP PROCEEDING IN CONNECTION WITH THE IOUS' LONG TERM PROCUREMENT PLANS

The LTPP proceeding is the appropriate forum for consideration of whether the IOUs should be required to purchase capacity on a multi-year forward basis. A multi-year forward procurement obligation should not be imposed on ESPs, however. Because most contracts with direct access (“DA”) customers are limited to one year, it is difficult (if not impossible) for ESPs to make capacity commitments for terms longer than one year. If the Commission is truly interested in ensuring that some level of retail competition remains in California through the DA program, the Commission should maintain a forward bilateral procurement option that aligns with the term of an LSE’s load obligation: one-year ahead.

The IOUs’ bundled customers do not carry the debt liability for the IOUs’ forward procurement of RA. This burden is borne by the IOUs, which have guaranteed cost recovery through Commission-approved rates. ESPs do not have guaranteed cost recovery. ESPs’ customers likely would have to carry the financial burden for the forward RA procurement, if the mandate is extended to ESPs. The effect of a multi-year forward (three or more years) RA

procurement obligation could force most DA customers back to the IOU, thus inhibiting the Commission's objective of promoting a hybrid market.³

A multi-year forward procurement requirement for RA capacity would impose a severe financial burden on DA customers. The liability associated with a multi-year RA procurement obligation would be difficult for DA customers to carry on their balance sheets. Such a financial burden would in turn inhibit DA customers' ability to fund other capital expenditures intended for their core businesses, thus driving DA customers back to the IOUs, or even worse, to another state.

IV.

CONCLUSION

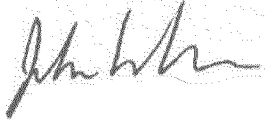
PG&E's September 20 motion should be rejected. PG&E failed to establish that a flexible capacity procurement obligation should be imposed on all LSEs, or that the Commission should consider a flexible capacity procurement mandate in the RA proceeding. Although the Commission might consider how to define "flexible capacity" in the RA proceeding, any consideration of a flexible procurement obligation (limited to the IOUs) should remain in the LTPP proceeding.

Similarly, the Commission's consideration of a multi-year forward procurement obligation should be limited to the IOUs, and should be undertaken in connection with the IOUs' long-term procurement plans. A multi-year capacity procurement obligation should not be

³ In D.10-06-018, the Commission recognized that "requiring a multi-year forward commitment would be more difficult for ESPs than IOUs to comply with because ESPs lack ratepayer-guaranteed funding and may be less creditworthy than IOUs, and because load forecast and load migration issues associated with the current program could be accentuated with a forward commitment greater than one year." Decision at p. 67.

considered for ESPs. The LTPP proceeding is the appropriate forum for discussion of a multi-year procurement obligation for the IOUs.

Respectfully submitted,



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