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

THE DIVISION OF RATEPAYER ADVOCATES' REPLY COMMENTS ON PROPOSED PROCUREMENT RULES IN TRACK III OF THE LONG-TERM PROCUREMENT PLAN PROCEEDING

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I. INTRODUCTION

Pursuant to the May 17, 2012 Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge (Scoping Memo) and Administrative Law Judge (ALJ) David Gamson's November 1, 2012 email message specifying the date for reply comments on Track III of the long-term procurement planning (LTPP) proceeding, Rulemaking (R.)12-03-014, the Division of Ratepayer Advocates (DRA) submits the following reply comments on Track III Procurement Rules.

DRA submits these recommendations in response to parties' opening comments on:

- Issues 3 & 4 related to Greenhouse Gas (GHG) emissions reductions and GHG compliance instruments and procurement authority;
- Issue 10 on refinements to the Procurement Review Group (PRG) process;
- Issue 11 on refinements to the independent evaluator (IE) process; and
- Issue 12 related to multi-year forward procurement.

II. SUMMARY OF RECOMMENDATIONS

DRA offers these recommendations in response to the parties' opening comments on the issues set forth in the Scoping Memo.

A. Issue 3: Greenhouse Gas (GHG) Emissions Reduction Issues

- The Commission should adopt DRA's proposal that the investor-owned utilities (IOUs) develop Marginal Abatement Cost (MAC) curves for GHG emissions reductions. DRA's proposal would not impose further command-and-control GHG emissions reductions programs as discussed by Southern California Edison Company (SCE) in its opening comments.
- The opening comments of Sierra Club California (Sierra Club) and California Environmental Justice Alliance (CEJA), which recommend that the Commission require the IOUs to demonstrate that they are actively analyzing and seeking all available GHG emissions reductions as a component of their strategy to comply with the market-based cap-and-trade program, are consistent with the intent of DRA's recommended MAC curve.

B. Issue 4: GHG Procurement Rules

- DRA opposes Pacific Gas and Electric Company's (PG&E) request to modify current GHG procurement rules to allow utility procurement of offset credits that are developed by the utility, without need for a separate application.

C. Issue 10: Procurement Review Group (PRG)

- DRA disagrees with the Sierra Club that PRG meetings should comply with the Bagley-Keene Act. The PRG groups advise the IOUs, not the Commission. PRG meetings are not the type of meeting that Bagley-Keene was designed to make public. Moreover, requiring the disclosure of market-sensitive information through open public meetings may result in higher electricity rates, thus harming ratepayers.

D. Issue 11: Refinements to the Independent Evaluator (IE)

- The Commission should adopt DRA's proposal on the IE as presented in DRA's opening comments, with one exception. DRA now recommends that the Energy Division (ED), rather than members of the PRG, resolve any potential conflict of interest of the IE.

E. Issue 12: Multi-year forward procurement requirements

- The centralized capacity market issues raised by Calpine Corporation (Calpine) are outside the scope of Track III, which is only to address multi-year forward procurement requirements and should not be considered here.
- If the Commission intends to consider the suggestions in the Brattle Group Report in this proceeding, at minimum, it should ensure that the scope of issues to be addressed includes those DRA raises in these comments.

III. DISCUSSION

DRA appreciates the opportunity to respond to opening comments filed by parties in Track III of the LTPP proceeding. Parties' comments address a variety of issues related to procurement rules for GHG, the PRG process, the integrity of the IE process, and the purported need for a central capacity market.

A. GHG Emissions Reductions

SCE recommends that the Commission not entertain any proposal that would impose command-and-control GHG emissions reduction programs on the IOUs in the LTPP. SCE argues that: 1) the Commission already reviews the programmatic measures that reduce GHG emissions such as Energy Efficiency and Demand Response programs in proceedings outside of the LTPP; 2) the LTPP takes into account the *effect* of preferred resource programs and procurement in its analysis, which forms the basis for Commission authorization of procurement of needed resources; and 3) a market-based mechanism should be more efficient than command-and-control regulation.[1] Accordingly, SCE urges the Commission not to require the IOUs to pursue additional programmatic measures simply to achieve additional emissions reductions.[2]

DRA's opening comments recommend that as part of the long-term procurement planning process, the IOUs develop Marginal Abatement Cost (MAC) curves for all available GHG emissions reductions in their portfolios. The MAC curves would represent the IOUs' best estimates of the GHG emissions reductions available across their portfolios and the average cost of achieving those GHG reductions from a given measure. DRA is not proposing at this time that the MAC curves result in binding requirements that the IOUs must achieve. Rather, the MAC curves would provide policy guidance on cost-effective GHG emissions reductions options and serve as another evaluation metric to gauge the success of current IOU programmatic measures to reduce GHG emissions.

SCE notes that a market-based mechanism to achieve GHG emissions reductions (i.e. cap-and-trade) should be more efficient than command-and-control regulation. The IOUs, as regulated utilities, must demonstrate that as a component of their strategy to comply with the market-based cap-and-trade program, they are looking at **all** available internal emissions reductions, even those above and beyond the targets set for energy efficiency and demand response. To ensure that the cap-and-trade program is achieving GHG emissions reductions efficiently, the IOUs should develop MAC curves to show that they are actively analyzing and seeking all available GHG emissions reductions across their portfolios and are complying with cap-and-trade in a reasonable and prudent manner.

Both Sierra Club and CEJA offer opening comments that support the premise of DRA's recommendation and fall within the May 17, 2012 Scoping Memo Topic No. 3: "[e]nsuring utilities reduce their need to procure GHG compliance instruments by pursuing cost-effective GHG emissions reductions on a portfolio-wide basis." In discussing previous LTPP decisions, Sierra Club highlights the importance that the Commission has placed on strengthening the IOUs' procurement plans by actively considering the GHG impacts of their procurement choices beyond the mandated programmatic measures: "[w]hile hitting a target for energy efficiency or demand response may satisfy other obligations of the utility, that does not constitute a ceiling on

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[1] Southern California Edison Company's Comments on Proposed Track 3 Procurement Rules, November 2, 2012, (SCE Opening Comments), pp. 18-20.

[2] SCE Opening Comments, p. 20.

those resources for purposes of procurement."[3] Examining the marginal costs of measures to reduce GHG emissions, including both those measures already in place through existing programs and additional measures available to the IOUs, can help facilitate a more comprehensive and transparent understanding of the economic impact of procurement decisions in a GHG-constrained system.

Additionally, CEJA agrees that "the initial step for ensuring that utilities reduce their need to procure GHG compliance instruments is requiring a thoughtful evaluation of potential emission reduction measures that the utility could undertake."[4] The development of MAC curves for GHG reductions could be a useful step in such an evaluation, but DRA remains open to other proposals or rules that will encourage the vigorous analysis of the GHG reduction and cost implications of long-term procurement decisions that the Commission envisioned in Decision (D.)07-12-052.[5]

B. GHG Procurement Rules

The Commission determined in D.12-04-046 that utilities are not authorized to develop their own offset projects without seeking authorization from the Commission via application.[6] PG&E urges the Commission to modify the current GHG procurement rules to allow the IOUs to procure offset credits that are developed by the utility, without the need for a separate application.[7] DRA interprets PG&E's request to mean that PG&E wishes to develop offset projects without filing an application. PG&E provides no support for this recommendation other than mentioning the cost savings that offset credits may provide in lieu of allowances. DRA acknowledges that offsets may be available at a discount to allowances, and supports the IOUs' use of offsets, to the extent allowed by the California Air Resources Board (CARB), to meet their cap-and-trade compliance requirements.[8]

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[3] Comments of Sierra Club California on Track 3 Rules, November 2, 2012, (Sierra Club Opening Comments), p. 3, quoting D.12-01-033 at p. 21-22.

[4] California Environmental Justice Alliance's Comments Related to Certain Track III Issues, November 2, 2012, (CEJA Opening Comments), p. 5.

[5] D.07-12-052, p. 239.

[6] D.12-04-046, p. 44

[7] Comments of Pacific Gas and Electric Company Regarding Track 3 Issues in the 2012 Long-Term Procurement Plan OIR, November 2, 2012, (PG&E Opening Comments), p. 3.

[8] The CARB Cap-and-Trade Regulation allows the use of offsets for 8% of an entities compliance

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However, DRA opposes PG&E's request to allow the IOUs to develop offset projects without filing an application. The application process would allow parties more than 30 days to review the application before filing a response and would include the possibility of hearings to develop a record on contested issues of fact. In contrast, even a Tier 3 Advice Letter would only allow parties 20 days to review the AL before responding, and hearings to develop a record on contested issues of fact would not be an option.

DRA does not oppose utility development of offset projects that would generate cost-competitive offset credits under CARB's cap-and-trade program. However, PG&E does not explain why such utility-developed offset projects should not be subject to Commission review through an application. Developing offset projects entails significant risk,[9] yet the IOUs are not in the primary business of generating compliance offset credits, and to date, have little to no experience doing so. While procuring offset credits through an RFO and similar approved methods is appropriate for assessing offers from counterparties offering compliance offsets, DRA agrees with the current Commission rules that require separate review of utility proposals to develop offset projects

The application process provides the Commission and interested stakeholders the opportunity to review the reasonableness of the costs, revenues, and risks associated with utility development of compliance offsets under the recently launched cap-and-trade program. For these reasons, the Commission should deny PG&E's request to allow utility procurement of offset credits that are developed by the utility, without need for a separate application.

C. Procurement Review Group

Sierra Club recommends that the Commission adopt rules that apply the Bagley-Keene Act to meetings of the Procurement Review Groups (PRGs), contending that "the current form and operation of the PRGs appear "inconsistent with California law which requires public agencies and their advisory bodies to conduct public meetings."[10] DRA respectfully disagrees

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obligation.

[9] This includes the risk of invalidation, which D.12-04-046 places on the seller of offsets. In the case of utility developed offset projects the utilities would be the seller of offsets and would assume the risk of invalidation.

[10] Sierra Club Opening Comments, p. 3.

with Sierra Club's recommendation that the Commission adopt standards for the PRGs to comply with the Bagley-Keene Act. While it is true that the Bagley-Keene Act (Government Code Sections 11120-11132) requires state bodies to hold open meetings, including publication of meeting agendas at least ten days in advance of the meetings, the PRGs are not "state bodies" that must comply with the Bagley Keene Act.[11] Instead, the PRGs are composed of a group of non-market participants that advise the utilities[12] rather than the Commission, and as such, need not comply with Bagley-Keene requirements.

Sierra Club argues that "[e]ach PRG is an exclusive group of non-market participants" that in effect replaces the "open and transparent procurement review process" required by law.[13] DRA respectfully disagrees that the PRG process is a substitute for Commission review. Instead, the PRG process allows non-market participants to gain access to information about utility procurement plans in advance of formal filings at the Commission.

The PRGs began in 2002 to help the IOUs meeting their service obligations to customers immediately after the electricity crisis. In D.02-08-071, the Commission approved the joint request of SCE, PG&E, the Utility Reform Network (TURN) and the Consumers Union to create utility-specific PRGs comprised of eligible non-market participants. While the IOUs are not required to heed the advice of PRG members, in fact it appears that the PRG process reduces litigation regarding IOU procurement[14]

Participation in each IOU's PRG is limited to non-market participants, and members are required to maintain the confidentiality of market-sensitive information. Requiring that market sensitive information remain confidential protects the interest of ratepayers, by not disclosing information that would harm the IOUs' ability to engage in competitive procurement.

D. Refinements to the Independent Evaluator Process

DRA's opening comment recommend that the Commission adopt the proposed changes to the IE process to resolve the inherent conflict of interest in the current IE process, a concern

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[11] *See* Government Code Section 11121, which defines state body for purposes of the Bagley-Keene Act. None of the definitions apply to the PRGs, each of which advises a utility, but not the Commission.

[12] The advice the PRG members offer to the utilities is not binding.

[13] Sierra Club Opening Comments, p. 4.

[14] D.03-12-063, p. at 46.

echoed by CEJA.[15] Upon further consideration, DRA revises its recommendation and the Commission's Energy Division (ED), rather than members of the PRG, resolve a potential conflict of interest of an IE. To reflect this change, DRA revises the last paragraph of Section B (2) of DRA's opening comments to as follows:

> DRA supports full adoption, with the following exception, of the previously proposed IE oversight rules. In Section 1(b) of Appendix B, the third bullet states "An IE may be disqualified from participating in an RFO process if there are particular egregious (emphasis added) conflicts of interest that arise during the contract." The term "particular egregious" is unnecessary and allows for a wide range of interpretation. DRA recommends the words "particular egregious" be removed. ~~To allow consideration of potential conflicts of interest that may arise during the contract, DRA proposes that a potential disqualification for conflict of interest should be considered at a PRG meeting where a quorum is present. If a majority of PRG members vote to allow the IE to continue under the specific circumstances that arise, then the IE would be allowed to continue.~~ If a potential conflicts of interest arises, it should be referred to Energy Division for appropriate resolution.

E. Multi-Year Forward Procurement

Calpine's opening comments state that:

> "procurement policies and practices have created market conditions that do not ensure existing resources not under long-term contracts have access to sufficient and stable revenue streams over the near term (1-3 years) to recover going-forward costs (including major maintenance costs). As a result, such resources are at risk of economic retirement, notwithstanding a demonstrable need for these resources over intermediate-term (3-5 years) and long-term (greater than 5 years) planning horizons. To address these "market shortcomings," the California Public Utilities Commission ("Commission") must change existing procurement rules."[16]

Calpine therefore recommends that the Commission consider a fundamentally different framework for long-term planning and generation procurement, including the transfer of resource adequacy (RA) procurement responsibility from the IOUs to the California Independent System Operator (CAISO).[17] Although the Scoping Memo identifies "multi-year forward procurement"

[15] CEJA Opening Comments, p. 4.

[16] Comments of Calpine Corporation on Track 3 Procurement Rules, November 2, 2012 (Calpine Comments), p. 1. Attached to Calpine's Comments is "Resource Adequacy in California: Options for Improving Efficiency and Effectiveness," an October 2012 paper written by the Brattle Group (Brattle Group Report), which further elaborates on Calpine's criticism of the California's current RA structure and recommendations for improving it.

[17] Calpine Opening Comments, p. 5.

as an area in which the Commission will consider proposals to change procurement rules, Calpine's suggestion to consider transferring procurement authority to the CAISO goes beyond the scope of the Track III procurement rules.

The Brattle Group Report suggests changing the LTPP and RA to a centralized capacity market in which all capacity receives the same price, or alternatively, changing the LTPP to include only facilities that have contracts with a term of at least 10 years on the supply side of the supply and demand equation before determining the need for further resources.[18] Implementation of either of these options would require numerous significant policy changes. If the Commission wishes to consider these options as a viable alternative to the current procurement structure, issues related to a centralized capacity market (or other significant changes to the procurement market structure) should be considered through the establishment of an entirely different proceeding, as the changes would impact both the RA and the LTPP processes. This inquiry should be a comprehensive process that involves LTPP and RA stakeholders.

The first step in that process would be determining the procurement problems the Commission seeks to resolve. Next, the Commission should decide if re-designing the capacity market, as the Calpine opening comments and the Brattle Group Report recommend, would effectively address those procurement problems or whether less complicated or less risky solutions exist. Thus, the recommendations of the Brattle Group Report should be viewed holistically within the context of the problems it seeks to resolve, whether it appropriately addresses California's issues, and whether it will result in potentially negative consequences to California's ratepayers and whether the costs to implement and risks outweigh any potential benefits.

In the absence of guidance from the Commission on how it will consider the suggestions in the Brattle Group Report, DRA summarizes its initial views on some of the issues highlighted in the report, as well as concerns with the policy solutions presented in that report.

[18] Brattle Group Report, pp. 3-4.

1. Has local capacity pricing incented new generation in regions of the country that have centralized capacity markets?

The LTPP process is designed to develop new generation, both when and where it is needed, and to enable the utilities' compliance with local capacity requirements. Centralized capacity markets, such as PJM's Reliability Pricing Model (RPM),[19] attempt to meet reliability requirements using locational reliability pricing, similar to the local RA payments in California.[20] Yet it is unclear whether centralized capacity markets have produced new generation in transmission constrained regions without significant government intervention.[21] Large portions of California are transmission-constrained. DRA is concerned that under a centralized capacity market, California would experience a similar situation in which a centralized capacity market fails to result in the development of new generation in transmission constrained areas.

2. How would market power be mitigated in a centralized capacity markets, given the widespread belief that market power is inherent in a capacity market?

The CAISO has acknowledged the potential for market power abuse in capacity markets.[22] Unlimited use of market power can lead to higher prices to the detriment of ratepayers. Attempts to divide a capacity market based on location or operational characteristics would exacerbate the potential impacts of market power. DRA is concerned about the potential for the abuse of market power in transmission constrained local capacity regions[23] This concern

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[19] PJM is a regional transmission organization (RTO) that covers Pennsylvania, New Jersey, Maryland, and has a presence in ten other states and the District of Columbia.

[20] PJM Manual 18: PJM Capacity Market, p. 11 <http://www.pjm.com/~/media/documents/manuals/m18.ashx>

[21] *See e.g.,* New Jersey Board Of Public Utilities Board Staff Report on New Jersey Capacity, Transmission Planning and Interconnection Issues, Docket Nos. EO11050309 and EO09110920, December 2011, pp. 3-4. (available at http://nj.gov/bpu/pdf/announcements/2011/capacityissues.pdf) ("New Jersey's reliance on the Reliability Pricing Model ("RPM") capacity market, however, has been a disappointing experience .... Since its implementation in 2007, RPM's annual capacity auctions have brought to New Jersey consumers high capacity prices - reflecting local generation shortages - but have produced little new generation capacity in response to those high market price signals.")

[22] CAISO DMM: http://www.caiso.com/1c59/1c59f04237820.pdf.

[23] A similar risk of market power would exist if a capacity market is established to acquire flexible capacity needed to integrate intermittent renewable energy. The Brattle Group seeks to address operational flexibility by dividing the market into operational characteristics like ramping ability. Brattle Group Report, p. 43.

is not new, but moving to a centralized capacity market risks undermining the current working solution for mitigating market power.[24] If proper mitigation strategies are not implemented, generators with a large concentration of resources in a particular Local Capacity Area could make more revenue, thereby raising costs to ratepayers, by withholding resources from the central capacity market.

A fundamental question is whether market power mitigation measures have the potential to minimize the benefits of any change in capacity market design, and as a result, such market power mitigation measures must be studied to determine their effect on ratepayer costs. Before moving to a centralized capacity market that requires an entirely new strategy for mitigating market power in capacity markets, the Commission should carefully consider whether it is better than the existing structure. D. 10-06-018 suggests this same approach:

> "Unless we can find either a package of modifications or an entirely new formulation that is superior to the current program, we would maintain the status quo notwithstanding its shortcomings."[25]

3. How would restructuring the current bilateral capacity market impact compliance with California's loading order, and would it limit the ability of the utilities to achieve Greenhouse Gas targets cost effectively?

The Brattle Group Report does not discuss the impact of its proposed reforms on compliance with the loading order, nor whether a centralized capacity market would mute prices intended by the cap-and- trade regulations to signal a switch to lower carbon fuel sources. Capacity markets have tended to reward all capacity equally regardless of its fuel source, so before implementing a capacity market in California, the Commission should consider its impacts to preferred resources in the loading order and GHG costs.

Currently, the utilities make procurement decisions based on a range of information including the cost of RPS compliance, the cost of achieving cost-effective energy efficiency and demand response procurement, and the cost of buying pollution allowances. It is unclear how

[24] The Commission established the Resource Adequacy bilateral capacity market, which limited market power abuse through maintain the confidentiality of the utilities' compliance with RA requirements and the capacity prices secured in IOU auctions and bilateral contracts. Therefore, market participants are not aware of how much residual capacity the utility needs when negotiating with generators.

[25] D.10-06-018, p. 40.

preferred resources would be acquired in a capacity market if resources were selected solely based on Net Qualifying Capacity (NQC) and price. As a result, it appears that a centralized capacity market could blunt the impact of a price on carbon. If the Commission establishes a centralized capacity market in California, the Commission needs to ensure that the integrity of the loading order and policies that support demand side and supply side resources are not only maintained, but the principles that designates these resources as "preferred" are not stripped away as a result of such reforms.

4. What would it cost to implement the changes suggested in the Brattle Group Report?

A central topic of debate that is missing from the Brattle Group Report is any estimate of the costs to implement its recommended reforms. When discussing market reforms to the degree that this report suggests, implementation costs must be estimated. Without this important information, it is impossible to conduct a cost-benefit analysis to determine the value of changing procurement structures. If centralized capacity markets reduce costs, but implementation of the market raises costs above the potential savings, then it is not worth pursuing.

IV. CONCLUSION

DRA respectfully requests that the Commission adopt the recommendations in these reply comments.

Respectfully submitted,

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