

**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)

**COMMENTS OF
NRG ENERGY, INC. ON ADMINISTRATIVE LAW JUDGE'S
RULING SEEKING COMMENT ON TRACK III RULES ISSUES**

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I. INTRODUCTION.

Pursuant to the Administrative Law Judge's Ruling issued on March 21, 2013 ("Ruling"), NRG Energy, Inc. ("NRG") provides the following comments. NRG does not provide responses to each of the issues raised in the Ruling, but reserves the right to respond to any topic addressed in opening comments. NRG's opening comments focus solely on its recommendation to create a multi-year forward Resource Adequacy procurement obligation for public utilities (Issue 1.a.).

II. THE COMMISSION SHOULD ADOPT A MULTI-YEAR FORWARD RESOURCE ADEQUACY REQUIREMENT.

Issue 1.a. asks the following questions: Should the Commission modify the Assembly Bill (AB) 57 bundled procurement guidelines to indicate minimum and maximum limits for which the three IOUs must procure for future years? If so, should these minimum and maximum limits address energy, system resource adequacy ("RA"), local RA, and/or flexibility?

1. In response to these questions, NRG takes the opportunity to outline its vision for expanding the RA obligation from a one-year forward program to a multi-year forward program. While NRG continues to support the creation of a centralized capacity market to address forward procurement of capacity, the Commission can secure many of the benefits of a centralized market simply by expanding its existing RA market into the future. A five-year forward capacity procurement requirement would go a long way toward addressing the reliability issues identified by the CAISO, while significantly decreasing the uncertainty generators face under the current one-year forward framework. Reducing the risk of new investment in California generation will

directly benefit ratepayers by both decreasing the cost of RA and improving the quality of the RA product.

In California, as well as in other energy markets around the country, policymakers have imposed price caps on energy prices that prevent generators from recovering their fixed costs. A system of capacity payments, efficiently administered, can partially address the recovery of fixed costs. However, a system of capacity payments whose horizon is too short does not permit a generator to recover the costs associated with capital expenditures or large periodic expenses, even when that investment may make the most economic sense. The inability to recover such costs may result in reliability issues for existing capacity. For example, after a period of time, every generation source requires major maintenance to ensure that it will continue to operate reliably.

The single year procurement in fact *discourages* generators from investing in the long-term reliability of their units. If a generator makes a significant long-term maintenance investment, it risks pricing itself out of a contract in favor of another generator which either does not have to pay for major maintenance in that year, or even elects to forgo that major maintenance expense. Thus, the existing program may result in a least-cost procurement for a single year, but may actually increase costs on a longer term basis. Over a period of years, the current system discourages viable generators from conducting major maintenance, thereby resulting in a fleet that is less reliable.

The Commission can solve the issue of how to accommodate capital expenditures or large periodic expenses that support reliable operations for existing generators by increasing the forward term of the capacity procurement obligation. With a multi-year forward procurement obligation, generators can secure contracts that give them more certainty about future revenues. By achieving revenue certainty over a period of years, generators can incur larger costs and spread them over a period of years in a way that may make them competitive with higher cost alternatives. The ability to amortize costs over a period of years thereby enhances reliability. Not only that, multi-year forward procurement may reveal investments that make existing generation a more competitive option than other alternatives, in turn reducing costs to ratepayers.

Accordingly, the Commission should increase the forward capacity procurement obligation from one year to five years. To implement this change, the Commission should update the bundled procurement rules as follows:

- The RA procurement requirement should extend five years forward. The bundled procurement rules should specify that system needs must be procured five years forward at 70% of Year 5 needs. In the case of local capacity needs (and potentially flexible capacity needs if flexibility is adopted as a required characteristic), those requirements should be procured five years forward at 90% of Year 5 needs.
- The five-year forward procurement requirement could initially be applicable only to investor-owned utilities (IOUs). The existing one-year forward obligation would continue to apply to non-IOU load-serving entities, provided existing caps on direct access continue in place. If direct access caps are removed, then the five-year forward procurement requirement applied to IOUs would also apply to non-IOU LSEs.
- A five-year forward procurement requirement will also minimize the need for the CAISO to exercise its backstop procurement. Fluctuations in demand forecasts can be accommodated by authorizing the IOUs to reconfigure their procurement as the delivery term approaches. For example, a projection of required capacity five years out may change as the delivery year draws closer. Similar to reconfiguration frameworks used in capacity markets in other jurisdictions, allowing reconfiguration reduces the risk of either over- or under-procurement. Matching the procurement to more reliable projections closer to the year of delivery will make it less likely that the CAISO would have to rely on a backstop procurement mechanism. As a further measure to reduce the potential for backstop procurement, the CAISO should perform the five-year needs analysis with consultation from the Commission and the California Energy Commission.
- Assuming an ongoing desire to authorize the CAISO to engage in backstop procurement to protect against reliability issues associated with inadequate

procurement, the CAISO's backstop capacity procurement mechanism should be updated to conform to the new five-year forward procurement requirement. Nevertheless, the multi-year forward procurement structure should be designed to minimize, if not eliminate, the need for the CAISO to engage in backstop procurement.

- The Commission should not make any changes to the LTPP, which should remain focused on the procurement of new generation.

As discussed above, it would be ideal to combine a more forward procurement requirement with the creation of a centralized capacity market. In the absence of a centralized capacity market, LSEs can satisfy a five-year forward procurement obligation through bilateral negotiations, just as they do today for satisfying their year-ahead RA obligations.

In conjunction with a five-year forward obligation, the Commission should also make the slight modification to its bundled procurement plan rules to specify that any agreement of five years or less is not subject to additional Commission review. Current bundled procurement rules state that only agreements less than five years in term are subject to the exemption from additional Commission scrutiny.

III. CONCLUSION.

Based on the foregoing, the Commission should update its RA rules to require IOUs to procure, on a five-year forward basis, system, local, and, possibly, flexible capacity.

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Respectfully submitted,

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