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 OF THE ALLIANCE FOR RETAIL ENERGY MARKETS AND THE DIRECT ACCESS CUSTOMER COALITION TO TRACK III COMMENTS

Sue Mara
RTO ADVISORS, L.L.C.
164 Springdale Way
Redwood City, CA 94062
Telephone: (415) 902-4108
E-mail: sue.mara@rtoadvisors.com

Mark E. Fulmer
MRW & ASSOCIATES, LLC
1814 Franklin Street, Suite 720
Oakland, CA 94612
Telephone: (510) 835-1999
E-mail: mef@mrwassoc.com

Consultants to
ALLIANCE FOR RETAIL ENERGY MARKETS AND DIRECT ACCESS CUSTOMER COALITION

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In accordance with the directives provided in the March 21, 2013, *Administrative Law Judge's Ruling Seeking Comment on Track III Rules Issues* ("March 21 Ruling") and the ruling issued by Administrative Law Judge ("ALJ") David M. Gamson on March 28, 2013 by electronic mail setting this date for filing reply, the Alliance for Retail Energy Markets[1] ("AReM") and the Direct Access Customer Coalition[2] ("DACC") respectfully submit this joint reply to comments filed on April 26, 2013 on Track III issues.

I. ANY MULTI-YEAR PROCUREMENT OBLIGATION FOR LOAD-SERVING ENTITIES MUST BE ACCOMPANIED BY THE IMPLEMENTATION OF A CENTRALIZED CAPACITY MARKET.

The questions specified for comment in the March 21 Ruling focused on issues related to bundled utility procurement and the cost allocation mechanism ("CAM"). The questions posed by the ALJ on this topic had the effect of several parties taking the opportunity to advocate for the Commission to impose a multi-year forward procurement obligation on load-serving entities

[1] AReM is a California non-profit mutual benefit corporation formed by electric service providers that are active in the California's direct access ("DA") 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.

[2] 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. In the aggregate, DACC member companies represent over 1,900 MW of demand that is met by both direct access and bundled utility service and about 11,500 GWH of statewide annual usage.

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("LSEs"). AReM and DACC do not oppose that, but firmly believe that such a change to the Resource Adequacy ("RA") obligations requires the implementation of a centralized capacity market structure as well.

In both this proceeding and in the RA proceeding (Rulemaking 11-10-023), AReM has articulated the reasons that a centralized capacity market is important, especially if the capacity obligations are imposed on a multi-year forward basis.[3] Those reasons include: the adoption of a centralized forward capacity market structure will provide price transparency and liquidity that will enhance market stability and regulatory certainty, that in turn will support the development of long-term resources to meet the reliability needs of the grid through competitive markets, as well as allow LSEs the ability to manage risks associated with forward procurement. Therefore, AReM and DACC strongly oppose recommendations that suggest that capacity market implementation is not a necessary accompaniment to a multi-year forward RA obligation.

Specifically, while Calpine Corporation[4] ("Calpine") and NRG Energy, Inc.[5] ("NRG") both express support for a centralized capacity market, they nevertheless ask the Commission to impose a multi-year forward procurement obligation for all LSEs even if no centralized capacity market is implemented. Moreover, NRG claims that "many of the benefits of a centralized capacity market" can be gained simply from mandating the forward procurement obligation.[6] AReM and DACC agree that a multi-year forward obligation begins to address important reliability and grid management issues. However, AReM and DACC must respectfully and strongly disagree with NRG's contention that the benefits of centralized capacity market can be

[3] See, for example, Comments of the Alliance for Retail Energy Markets on Resource Adequacy Flexible Capacity Procurement Joint Parties' Proposal, R.11-10-023, December 26, 2012.

[4] Calpine, p. 4: "Calpine believes that all load serving entities ("LSEs"), not just the IOUs, should be subject to mandatory multi-year forward procurement requirements for system, local, and flexible capacity…"

[5] NRG, p. 1

[6] Ibid.

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largely achieved with implementation of a multi-year forward obligation alone, and that a multi-year forward capacity obligation is manageable in the absence of a centralized capacity market. To the contrary, the absence of a capacity market structure that enables suppliers to manage the risks of capacity investments and capacity obligations will serve only to entrench the potential for increasing levels of "on behalf of" procurement that must be afforded cost allocation pursuant to the CAM.

In fact, while Calpine states a clear preference for a centralized capacity market, it nevertheless offers, as an alternative, multi-year forward procurement conducted by the IOUs on behalf of all customers with such procurement afforded CAM cost recovery, validating AReM and DACC's concern that imposition of a multi-year forward obligation without a capacity market in place will lead to additional CAM treatment.[7] This is decidedly not an acceptable alternative for AReM or DACC. The anti-competitive effects of CAM have been well documented.[8] As parties' noted in their comments, CAM charges are inequitable and unfair because they result in subsidies for bundled procurement[9] and destabilize retail competition.[10] The Commission's objective should be to minimize and replace CAM – not expand it. Even Southern California Edison Company ("SCE") has noted the benefits of the centralized capacity market structure, including providing financial certainty to both new and existing generation and reducing competitive issues related to cost allocation.[11]

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[7] Calpine, p. 6.

[8] See, for example, AReM/DACC, pp. 22-23.

[9] City and County of San Francisco ("CCSF"), pp. 3-4.

[10] WPTF, p.10; CCSF, p. 6.

[11] 2012 Long-Term Procurement Plan Testimony of Southern California Edison Company on Local Capacity Requirements, R.12-03-014, June 25, 2012, pp. 20-21.

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The Western Power Trading Forum ("WPTF") also provides strong support for a centralized capacity market structure, particularly if the Commission adopts flexible capacity procurement requirements for Resource Adequacy ("RA"). However, AReM and DACC note that WPTF suggests that the capacity market implementation may follow the implementation of a multi-year forward RA obligation, rather than having both implemented in the same time frame.[12] That sequence causes significant concern to AReM and DACC, because of the likelihood of increased CAM that such a delay may cause, and because of the risk that implementation of the capacity market could languish. Therefore, AReM and DACC submit that both the forward RA procurement requirement AND formation of a capacity market structure are equally important, and therefore strongly support the commitment to and implementation of both by this Commission.

Finally, AReM and DACC agree with Pacific Gas and Electric Company ("PG&E") that consideration of any multi-year forward procurement obligation belongs in the RA proceeding[13] and previously supported PG&E's Motion to that effect.[14] The Commission has not yet acted on the Motion.

II. PARTIES AGREE THAT THE COMMISSION MUST SET CRITERIA FOR AUTHORIZING CAM.

Several parties agree that the Commission is obligated to set criteria for authorizing CAM treatment for IOU procurement pursuant to Public Utilities Code Section 365.1(c)(2)(A).[15] In

[12] WPTF, pp. 2-3.

[13] PG&E, p. 3.

[14] Response of the Alliance for Retail Energy Markets, Direct Access Customer Coalition and Marin Energy Authority to the Motion of Pacific Gas and Electric Company, R.12-03-04, October 5, 2012, pp. 4-5.

[15] See, for example, CCSF, p. 3.

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particular, the Marin Energy Authority ("MEA"),[16] CCSF,[17] and WPTF[18] all submitted proposed criteria for the Commission's consideration. The IOUs, on the other hand, continue to claim that no further criteria are needed to authorize CAM[19] and that the current *ad hoc* approach to imposition of CAM is sufficient.

In addition, the IOUs make it clear that it is their expectation that very little of their capacity procurement is not eligible for CAM and boldly set forth their plans to expand CAM beyond what the Commission has previously authorized. For example, SCE states that it plans to extend CAM to "non-conventional resources" such as energy storage[20] and to the renewable resources, ordered in Track I of this proceeding, a category of procurement that has not been subject to CAM under existing regulations.[21] PG&E proposes that CAM should be expanded to apply to all repowering or upgrades,[22] while SDG&E goes so far as to argue that <u>any</u> IOU procurement beyond 1 year is CAM.[23] Indeed, in the eyes of the IOUs and some other parties, there seems to be no limit to what can receive CAM treatment. Even Calpine, a non-IOU, asks to expand CAM to existing generation.[24] In particular, SCE asserts that CAM "benefits" all customers because they receive a proportional share of the RA capacity that has been procured

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[16] MEA, pp. 16-17.

[17] CCSF, p. 4. CCSF supported the criteria submitted by AReM, DACC and MEA in Track I of this proceeding.

[18] WPTF, pp. 11-12 and 14.

[19] See, for example, San Diego Gas & Electric Company ("SDG&E"), p. 16 and SCE, p. 18.

[20] SCE, p. 9: "The current CAM rules are working well and there are no cost allocation issues that need to be addressed at this time. SCE plans to make more detailed proposals regarding how CAM should be applied to non-conventional resources such as energy storage when it submits such projects for the Commission's approval."

[21] SCE, p. 18. In addition, Combined Heat and Power ("CHP") resources procured under the CHP settlement are all subject to CAM.

[22] PG&E, p. 13: The cost allocation mechanism ("CAM") construct currently in place can accommodate contracts for repowering or upgrading of facilities."

[23] SDG&E, p. 2: "At a foundational level, SDG&E believes that *any* new forward procurement targets (or more appropriately, requirements) that look beyond the current one year-ahead RA compliance cycle must be borne by all jurisdictional load serving entities ("LSEs"), and not limited to the IOUs." (Emphasis included)

[24] Calpine, pp. 6-7.

by the IOUs.[25] However, conferring capacity on customers who, through their competitive suppliers, are fully meeting all RA obligations and therefore neither want it nor need any share of the IOUs' procurement is hardly a benefit, which is why it is so important that the Commission address and develop a mechanism by which customers who have chosen to leave utility service through DA and/or CCA can avoid paying for utility procurement that they neither need nor want.

Moreover, each of the IOUs tries to ignore the fact that it has an obligation to meet the long-term needs of their bundled customers pursuant to AB 57. The comments of CCSF, MEA and WPTF all reinforce the point raised by AReM and DACC[26] that bundled procurement is not eligible for CAM treatment.[27] Further, as several of these parties have noted, IOU procurement that replaces resources or contracts used to meet bundled load is and should remain ineligible for CAM treatment.[28] As CCSF explains, the Commission's current approach of examining system needs before the IOUs submit their bundled procurement plans has maximized the IOUs' claims for CAM treatment:

> Moreover, in R.12-03-014 the Commission examined system needs before requiring the lOUs to file bundled procurement plans. Thus, the Commission has done the reverse of exploring IOU needs for its bundled customers, and then identifying whether additional resources are needed to ensure system and local reliability for all customers. This sequence maximizes the resources lOUs will likely claim are eligible for CAM.[29]

In fact, CCSF's concern seems to be validated by PG&E, which notes that its extensive procurement of system RA would make any minimum procurement obligation for bundled

[25] SCE, p. 17: "As demonstrated below, the benefits of the costs recovered through CAM inure to the entire system by providing RA and system reliability."
[26] AReM/DACC, pp. 3-6.

[27] See, CCSF, p. 4; MEA, pp. 9-10; WPTF, pp. 10-11.

[28] AReM/DACC, pp. 9-10; WPTF, p. 10; MEA, pp. 9-10.

[29] CCSF, pp. 3-4.

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customers a "superfluous constraint."[30]

The IOUs' expansive interpretation of what is eligible for CAM treatment directly conflicts with applicable statutes[31] and with the Commission's previous determination in D.11-05-005 that the enabling legislation, Senate Bill ("SB") 695 required adoption of criteria[32] or a "benefits test" to ensure compliance with the statute.[33] As AReM and DACC established in the April 26th comments, CAM procurement authorized by the Commission already represents **21 percent of the 2012 system peak**.[34] SB 695, and the modifications made by SB 790, do not specify that all IOU procurement is CAM procurement, but rather require defined criteria for the Commission to follow in authorizing CAM. This Track III proceeding should now undertake and complete this long overdue task. AReM and DACC recommend that the Commission convene a workshop to discuss the proposed criteria, identify points of agreement, and submit final conclusions to the Commission.

III. LSEs SHOULD HAVE THE ABILITY TO SELF-PROCURE OR OFFSET CAM.

MEA proposes that CCAs should be allowed to "offset" CAM procurement by the IOUs.[35] AReM and DACC agree and submit that the opportunity must be afforded not just to CCAs, but to all LSEs. The prospect for procurement by the IOUs "on behalf of" DA and CCA customers originates in Public Utilities Code Sections 365.1(c)(2)(A) and (B), which applies equally to customers of the electric service providers ("ESPs") and the CCAs pursuant to the

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[30] PG&E, p. 4: "As currently specified in PG&E's BPP, forward procurement of system RA by PG&E already occurs in quantities that makes any minimum limit either a superfluous constraint that would not change procurement ..."

[31] See, Public Utilities Code Sections 454.5(a) and 454.5(b)(9)(B).

[32] D.11-05-005, p. 7.

[33] D.11-05-005, p. 16.

[34] AReM/DACC, pp. 19-20.

[35] MEA, p. 3.

statute. Therefore, the opportunity to "offset" or, as AReM and DACC proposed,[36] "self-fulfill" the CAM obligation, if approved by the Commission, should be equally available to ESPs and CCAs. MEA proposes that the Commission could implement the option through an advice letter mechanism, which should be further explored.[37] AReM and DACC recommend that the Commission convene workshops to discuss the demonstration required by LSEs to elect the self-fulfillment option and a reasonable mechanism to implement it.

IV. REASONABLE FORECASTS OF DEPARTING LOAD SHOULD ELIMINATE THE FLOW THROUGH OF NON-BYPASSABLE CHARGES TO ALL DEPARTED LOAD.

A number of parties have agreed with AReM/DACC's position that the IOUs should be obligated to forecast departing load, including the Sierra Club and the South San Joaquin Irrigation District ("SSJID").[38] AReM and DACC also recommended that the Commission adopt the same approach it has applied to municipal departing load ("MDL") for DA and CCA customers, namely requiring the IOUs to include reasonable forecasts of departing load in their procurement plans and exempting all such forecast departing load from non-bypassable charges.[39] Interestingly, the IOUs state that they already forecast departing load when developing their bundled supply requirements.[40] Therefore, the IOUs should also be comfortable with AReM and DACC's recommended exemption for such forecast departing load from any new non-bypassable charges. In fact, the imposition of new non-bypassable charges on load that has been excluded from the forecast should be viewed by this Commission as an impermissible cost shifting from bundled customers to retail choice customers. We also note the comments of

[36] AReM/DACC, p. 23.

[37] MEA, p. 15.

[38] MEA, pp. 6-8; Sierra Club, p. 5; SSJID, p. 3; WPTF, p. 3.

[39] AReM/DACC, pp. 8-9.

[40] See, PG&E, pp. 4-5; SCE, p. 3.

the SSJID, which demonstrate that, at least for PG&E, the procurement uncertainty from SSJID's 600 MW of forecast departing load is far less than the normal procurement uncertainty faced by the IOU every day.[41] We expect that the same conclusion would be true for forecasts of departing DA/CCA load for PG&E as well as the other IOUs, lending more credence to the need for the Commission to re-examine whether non-bypassable charges should continue to apply to such load.

V. CAM REQUIRES A MORE PUBLIC PROCESS.

In its opening comments, AReM and DACC argued for a more public process when the Commission authorizes CAM charges for DA and CCA customers.[42] This chorus was joined by Sierra Club, which explained that the Commission should provide for "a maximum amount of transparency" and that the Procurement Review Groups ("PRGs") are "black boxes."[43] Sierra Club recommends that PRG meetings be opened to the public.[44] CAM Groups have the same flaws and the same improvements should apply.

VI. WORKSHOPS ARE NEEDED TO DISCUSS REVISIONS TO ENERGY AUCTIONS AND ESTIMATING NET CAPACITY COSTS.

CAM charges are set equal to the net capacity costs of IOU resources or contracts afforded CAM treatment, which are most cleanly and transparently established through an energy auction. Yet, the three utilities do not appear to agree on the efficacy of the energy auctions, even though SCE, the only utility to date that has conducted an auction, states: "In SCE's experience, energy auctions have served their intended purpose and the energy auction

[41] SSJID, pp. 5-6.

[42] AReM/DACC, pp. 11-13.

[43] Sierra Club, p. 7.

[44] Sierra Club, p. 11.

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process has worked well."[45] PG&E and SDG&E, neither of which have held an energy auction, bemoan the auction's reputed cumbersome nature and ineffectiveness. PG&E characterizes SCE's energy auction process as "time-consuming, costly, and results in few, if any, benefits for bundled, CCA and DA customers"[46] and advocates their elimination.[47] SDG&E states that "[e]nergy auctions create administrative burden and cause delay, and may not always be an effective means of minimizing net capacity costs"[48] and recommends "the administrative methodology to be a permanently available alternative to the energy auction approach to determining net capacity costs.[49]

This disagreement among the three IOUs concerning the efficiency and efficacy of the energy auction underscores the value of the workshop recommended by AReM and DACC.[50] By gathering the major stakeholders, a better understanding of what works, and more importantly, what does not, in the energy auctions can be achieved. Furthermore, the workshop process can offer consensus-driven solutions to the perceived problems with energy auctions and modify the process and/or requirements such that they function better and generate the maximum value for all utility customers. Without such exploration, simply throwing out the energy auction (as advocated by PG&E[51]) or allowing the IOU to unilaterally opt-out in favor of an administratively-calculated net capacity value (as advocated by SDG&E[52]) is clearly premature.

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[45] SCE, p. 17.

[46] PG&E, p. 18.

[47] PG&E, p 19.

[48] SDG&E, p. 13.

[49] SDG&E, p 15.

[50] AReM/DACC, p. 15.

[51] PG&E, p. 19.

[52] SDG&E, p. 14.

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SCE also notes that "[p]eriodic energy auctions may not be appropriate, however, for some resources such as energy storage or when new capacity is acquired via an 'RA-capacity only' contract rather than a tolling arrangement."[53] It further "…envisions that when it submits the procurement contracts for such resources for approval, it will seek the Commission's permission to not conduct energy auctions and instead use proxy methods to calculate the net capacity costs that should be allocated to all benefitting customers."[54] AReM agrees that it is nonsensical to hold an energy auction for a contract that does not provide energy, when and if such a contract has been demonstrated to meet a well-designed test demonstrating its benefit to any customers other than the IOU's bundled customers. However, the current proxy method for calculating net capacity costs, the "Joint Parties Proposal" from D.07-09-044, would be equally nonsensical, as it presupposes a resource that provides energy. While AReM and DACC continue to believe that the Commission must develop criteria for when a contract or resource is eligible for CAM treatment, including and especially for capacity-only products, the issue raised by SCE in its opening comments amplifies the need to reconsider and modify the current Joint Parties Proposal for estimating net capacity costs when an energy auction fails or is not applicable. Workshops are the best venues for exploring such modifications.

VII. <u>CONCLUSION.</u>

Parties agree that now is the time to make needed changes to the rules for the IOUs' bundled procurement plans and the process by which CAM is considered, authorized and implemented. Track III is the appropriate venue for Commission action and AReM and DACC recommend that the Commission convene workshops as discussed herein to address these issues.

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[53] SCE, p. 9.

[54] SCE, p 17.

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At the same time, parties recommending establishment of a multi-year forward procurement obligation for LSEs, in the absence of a centralized capacity market, are off the mark. Any multi-year forward procurement obligation must be accompanied by adoption of a centralized market mechanism that facilitates compliance with such obligations. Consideration of these market changes belongs in the Resource Adequacy proceeding, which addresses requirements applicable to all LSEs. AReM and DACC look forward to working with other parties and Commission staff in moving these market improvements forward.

Respectfully submitted,

Sue Mara
RTO ADVISORS, L.L.C.
164 Springdale Way
Redwood City, CA 94062
Telephone: (415) 902-4108
E-mail: sue.mara@rtoadvisors.com

/s/
Mark E. Fulmer
MRW & ASSOCIATES, LLC
1814 Franklin Street, Suite 720
Oakland, CA 94612
Telephone: (510) 835-1999
E-mail: mef@mrwassoc.com

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