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

REPLY COMMENTS OF SHELL ENERGY NORTH AMERICA (US), L.P. ON TRACK III RULES ISSUES

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In accordance with the procedural schedule established by the Presiding Administrative Law Judge, Shell Energy North America (US), L.P. ("Shell Energy") files its reply comments on Track III issues as set forth in the Presiding Judge's March 21, 2013 Ruling. Shell Energy's reply comments address three matters: first, establishing criteria for invoking the cost allocation mechanism ("CAM") for new IOU generation resources; second, whether the Commission should impose, upon all load-serving entities ("LSE"), a multi-year forward capacity procurement requirement; and third, whether a centralized capacity market should be addressed in this LTPP proceeding.

I.

INTRODUCTION

A. Examination of the CAM is Needed

A number of parties assert that the CAM is functioning properly and should not be modified. Shell Energy strongly disagrees. Under the current CAM structure, the IOUs have little if any guidance as to the criteria for invoking the CAM for new capacity procurement. The Commission must clarify the circumstances when an IOU's proposed new capacity procurement will and will not be eligible for CAM treatment.

Unfortunately, it appears that the current presumption is that any new capacity that an IOU may acquire for its bundled sales customers will also "benefit" all system customers, and thus should receive CAM treatment. This approach is not consistent with prior Commission decisions, and it is not consistent with applicable statutes. The Commission must address specific parameters for application of the CAM.

B. Multi-Year Forward Procurement Obligation

Certain opening comments propose that the Commission approve a multi-year forward capacity procurement obligation that applies to all LSEs. This proposal is outside the scope of issues to be addressed in this LTPP proceeding. The LTPP proceeding may be a proper forum for the Commission to consider a multi-year forward capacity procurement requirement for the IOUs. A capacity procurement obligation for non-IOU LSEs, however, was not addressed in the Presiding Judge's March 21 Ruling, and is not a proper subject for this proceeding.

Moreover, as a substantive matter, a multi-year forward procurement requirement should not be imposed on non-IOU LSEs, including electric service providers ("ESP"). 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 capacity procurement obligation on ESPs would force ESPs -- or their customers -- to bear the financial burden of forward procurement costs, making direct access ("DA") service a less competitive and less attractive procurement option. A multi-year forward procurement obligation should not be adopted for non-IOU LSEs.

C. Centralized Capacity Market

A number of parties assert that the Commission should approve a centralized capacity market. The matter of a centralized capacity market was not raised in the Presiding Judge's

March 21 Ruling, and such a dramatic change in the capacity market structure raises policy issues and factual issues that are far outside the scope of this proceeding.

If the Commission wishes to revisit the matter of a centralized capacity market, the Commission should devote a new rulemaking proceeding to this issue. Adoption of a centralized capacity market would fundamentally alter the bilateral capacity structure that has operated effectively since the inception of the State's resource adequacy ("RA") program. Moreover, a centralized capacity market raises jurisdictional issues, including whether this Commission should cede control of the terms and conditions for procuring RA capacity. Calls for consideration of a centralized capacity market in this proceeding must be rejected.

II.

THE COMMISSION SHOULD ADDRESS, IN THIS PROCEEDING, THE SPECIFIC CRITERIA FOR APPLICATION OF THE CAM

In its opening comments, SDG&E states that applicable statutes and Commission decisions "clearly define the circumstances in which the CAM must be applied to IOU procurement." SDG&E Comments at p. 12. To the contrary, the Commission has failed to articulate the circumstances in which the CAM may be applied to new IOU generation resources. The CAM has been implemented in a manner that presumes that the capacity needs of DA and CCA load cannot or will not otherwise be served by departing load customers' suppliers. The CAM has been implemented in a manner that allows IOUs to purchase new capacity for their bundled customer requirements, but charge the cost of this capacity to all system customers as "benefitting customers." The Commission must establish clear parameters for applicability of the CAM.

P.U. Code Section 365.1(c)(2)(A) provides that the "net capacity costs" of an IOU's new generation resources are to be allocated to all system customers, but only when the Commission

determines that these resources "are needed to meet system or local area reliability needs for the benefit of all customers" in the IOU's service territory. In other words, in order for the Commission to approve CAM treatment, the IOU must demonstrate that its purchase of a new generation resource is necessary to meet system or local capacity requirements for all customers in its service territory, not merely for the purpose of meeting its bundled sales customers' procurement requirements.

An IOU invariably argues that procurement of new local generation resources will provide local grid reliability benefits for all customers in its service territory, including direct access and CCA customers. Yet ESPs and CCAs have a corresponding obligation to procure local generation resources to meet their customers' local (and system) reliability requirements. ESPs and CCAs that meet their own local and system RA obligation (as demonstrated in filings with the Commission) should not also bear the cost of the IOU's local capacity procurement.

In its comments, SCE states that the CAM "allows the costs and benefits of new generation to be shared by all benefitting customers in an IOU's service territory." SCE Comments at p. 9. SCE's comments highlight the current problem with the CAM. Neither the IOUs nor the Commission make a distinction between generation resources that are purchased by the IOUs to meet their own bundled sales customer requirements, and generation resources that are purchased by the IOUs to meet system or local capacity requirements for the benefit of all system customers.

ESPs and community choice aggregators ("CCAs") are responsible for purchasing system capacity and local capacity for their own customers in accordance with the Commission's decisions implementing the RA program. See D.06-06-064 (June 29, 2006). If there are no limits placed on application of the CAM -- if an IOU can trigger CAM treatment simply by asserting that its proposed capacity procurement will "benefit all customers" -- ESPs and CCAs

will have a diminished role in purchasing system and local capacity under the RA program. In fact, as AReM and DACC noted in their opening comments, authorized CAM procurement accounts for 21 percent of CAISO system peak in 2012. See AReM/DACC Comments at pp. 19-20.

A further problem with the CAM is that notification to an ESP or CCA of additional capacity that is allocated to its customers through the CAM generally occurs after the non-IOU LSE has procured capacity for its own customer load. The CAM allocation causes excess capacity procurement by the ESP or CCA, which results in excess costs borne by ratepayers.

The IOUs have been able to justify CAM treatment by asserting that virtually any new generation resource will "benefit" all customers in the IOU's service territory. PG&E even acknowledges that "with regard to a [least cost best fit] evaluation, CAM-eligible resources are subject to the same evaluation process as resources that are procured solely for PG&E's bundled customers." PG&E states further: "All of the resources in an RFO are evaluated based on the same LCBF criteria. There is no differentiation between CAM-eligible resources and resources intended only for bundled customers." PG&E Comments at p. 18 (emphasis added).

The Commission should establish, in Track III of this proceeding, specific criteria for application of the CAM to the IOUs' new generation resource procurement. As set forth in the opening comments of AReM and DACC (pp. 20-22), the presumption should be that when an IOU purchases new generation resources, this procurement is to serve the IOU's bundled sales customers. The IOU should bear the burden to demonstrate that any new generation resource procurement is needed to meet identified system or local reliability requirements, and that this identified need cannot and will not be met through resources procured by non-IOU LSEs. Only if this burden is met by the IOU should the Commission grant CAM treatment for the IOU's new generation resource.

III.

ANY CONSIDERATION OF A MULTI-YEAR FORWARD PROCUREMENT OBLIGATION SHOULD BE LIMITED TO THE IOUS

Calpine proposes, and DRA suggests, that all LSEs should be subject to "mandatory multi-year forward procurement requirements for system, local and flexible capacity . . . ." Calpine Comments at p. 4, DRA Comments at p. 3. This proposal as it relates to non-IOU LSEs is outside the scope of the issues listed in the Presiding Judge's March 21 Ruling. In that Ruling, the Judge solicited comments on "maximum and minimum limits on IOU forward purchasing of energy, capacity, fuel, and hedges." Ruling at p. 2 (emphasis added). Neither the Judge's March 21 Ruling nor the May 17, 2012 Scoping Memo addressed the capacity procurement obligations of non-IOU LSEs.

Whether or not 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 non-IOU LSEs. Because most contracts with 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 obligation for ESPs that aligns with the typical term of an ESP's load obligation: one-year ahead.

ESPs do not have guaranteed cost recovery for their forward capacity procurement costs. If a multi-year capacity procurement mandate were to be imposed upon ESPs, ESPs' customers likely would have to carry the financial burden for the forward capacity procurement. The liability associated with a multi-year RA procurement obligation would be difficult for DA customers to carry on their balance sheets, and could in turn inhibit DA customers' ability to

fund other capital expenditures intended for their core businesses. A multi-year forward capacity procurement obligation for ESPs could force most DA customers back to the IOU, thus inhibiting the Commission's objective of promoting a hybrid market.[1]

Moreover, it has not been demonstrated that a three-to-five year forward capacity procurement obligation would be sufficient to finance retrofits to existing generation facilities, much less the construction of new generation resources. The issues surrounding multi-year forward capacity procurement are complex, and if considered for non-IOU LSEs, should be addressed in a separate proceeding. Consideration of a multi-year forward capacity procurement obligation must be in the context of other proposals, such as allowing the IOUs to include existing generation resources in their procurement solicitations.

The LTPP proceeding is traditionally devoted to issues related to IOU procurement. Consideration of a multi-year forward capacity obligation for non-IOU LSEs should not be addressed in this proceeding.

IV.

CONSIDERATION OF A CENTRALIZED CAPACITY MARKET IS NOT WITHIN THE SCOPE OF ISSUES IN THIS PROCEEDING

Several parties (Calpine; WPTF; NRG Energy) make reference, in their opening comments, to a "centralized capacity market." The issue of a centralized capacity market was not raised -- or even mentioned -- in the Presiding Judge's March 21 Ruling. Consideration of a centralized capacity market is not within the scope of issues in this proceeding. If the

[1] In D.10-06-018 (June 3, 2010), 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.

Commission decides to address the concept of a centralized capacity market, the Commission should do so in a separate proceeding that is devoted to this issue.

In D.10-06-018 (June 3, 2010), the Commission decided not to adopt a centralized capacity market for California. The Commission determined that "establishing a centralized auction [would] involve more fundamental changes in the [RA capacity] program and redefinition of the roles of the Commission, the CEC, the CAISO, and perhaps the FERC." Decision at p. 59. The Commission continued: "[D]esigning and implementing a new auction process would be costly, complex and resource intensive." Id.

In addition, the Commission stated, in D.10-06-018, that a centralized capacity market "is not necessarily the most effective way to develop and trade specialized capacity" to meet both the State's environmental goals and satisfy the CAISO's operational needs. Id. at p. 60. In this connection, the Commission already has adopted, and in some cases is considering, a variety of means by which LSEs may meet their RA capacity requirements (CHP; distributed generation; demand response; storage; as well as system and local RA capacity). In R.11-10-023, the Commission is also considering whether to impose an additional - - flexible capacity - - procurement requirement. With so many different products, it is unclear how a centralized capacity market would accommodate these resources. A centralized capacity market is better suited to a market with a single standard capacity product.

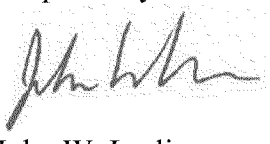
A centralized capacity market could also result in excess capacity resources, the cost of which must be borne by ratepayers. Issues and consequences of a transition to a centralized capacity market should not be addressed in this LTPP proceeding. The opening comments promoting adoption of a centralized capacity market should be disregarded.

V.

CONCLUSION

The Commission should establish, in Track III of this proceeding, specific criteria for application of the CAM. Consideration of a centralized capacity market is outside the scope of this proceeding and should not be included in this proceeding. Finally, although consideration of a multi-year forward capacity procurement requirement for the IOUs may be appropriate in this proceeding, this is not a proper forum for consideration of procurement requirements for non-IOU LSEs.

Respectfully submitted,



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