

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Integrate
Procurement Policies and Consider Long-Term
Procurement Plans.

Rulemaking 06-02-013
(Filed February 16, 2006)

**AGLET CONSUMER ALLIANCE PROPOSAL ON THE NEED FOR ADDITIONAL
POLICIES THAT SUPPORT NEW GENERATION AND LONG-TERM
CONTRACTS IN CALIFORNIA**

Pursuant to the February 23, 2006 ruling (Ruling) of Administrative Law Judge (ALJ) Carol Brown, Aglet Consumer Alliance (Aglet) submits its proposal on the need for additional policies that support new generation and long-term contracts in California. The Order Instituting Rulemaking (OIR) was signed on February 16 and mailed to interested parties concurrently with the Ruling on February 23. The ALJ's ruling expanded on the discussion in the OIR and requested that parties address specific questions. Aglet responds to the questions in Sections 2 through 7 below.

1. Recommendations

Aglet has relied on past Commission decisions and information previously obtained from the investor-owned utilities (IOUs) in developing recommendations concerning the need for additional new generation and long-term contracting policies. Aglet believes that the Commission should adopt additional policies that serve the best interests of the ratepayers of bundled utilities, and not merely create subsidies for energy suppliers. Aglet makes the following recommendations:

1. The Commission should not adopt new policies without first conducting a needs assessment.

2. The needs assessment should be based on the planning reserve method that has been used in previous long term planning proceedings at the Commission.
3. New generation proposals should compete against existing plants for contract awards in future all-source solicitations.
4. The Commission must ensure that all new generation projects are cost effective for ratepayers.

2. Are New Policies Needed?

This Commission and the California Energy Commission (CEC) have made great strides over the past few years in speeding up the plant licensing process, and in encouraging IOUs to sign long-term power contracts. The CEC has found that there is no regulatory barrier to long-term contracting (see OIR, p. 10), and current Commission rules provide adequate authority for the IOUs to sign long-term contracts either through bilateral negotiations or long-term, all source solicitations.

Aglet notes that Pacific Gas and Electric Company (PG&E) is currently conducting a long-term solicitation for new generation. PG&E expects to sign contracts for a total of 2,100 megawatts (MW) of capacity and associated energy when the solicitation is completed.

2.1 Needs Assessment

Before adopting specific policy changes to encourage the construction of new generation, the Commission should first determine whether or not there is a long-term need for additional new generation. The OIR left this determination as an open question by stating, "We defer to the Assigned Commissioner and the ALJ on the degree to which a review of need determinations should be examined in this portion of the proceeding." (OIR, p. 12.) Aglet believes that the needs assessment should be based on the planning reserve method traditionally used by the Commission, not on an operating reserve method.

Once the overall need and geographic locations for new generating plants have been determined, the Commission should order the IOUs to conduct all-source solicitations in which their needs will be filled from a combination of power purchase agreements and fixed offers, existing plants and new generation.

2.2 Cost Allocation

Cost allocation proponents may argue that cost allocation is necessary if the IOUs are procuring energy and capacity on behalf of all customers in a certain geographic region instead of only for their bundled service customers. In theory, the statewide costs of new generation should be shared among all load serving entities, energy service providers, municipalities and power aggregators. This is true because load serving entities, energy service providers and power aggregators might benefit from the addition of new generation to the grid.

While cost allocation is a worthy goal, it is burdened with administrative and legal problems, and it will be difficult, if not impossible, to implement. Additional costs will arise, to be borne by the very group that cost allocation is supposed to help — bundled service ratepayers. Any cost allocation scheme will involve audits, additional staff, litigation and other costs to be recovered from ratepayers.

Aglet believes that the “cost allocation problem” can best be solved during the contract selection process. The Commission must ensure that all approved new generation projects, whether purchase power agreements (PPAs) or turnkey offers, are cost effective. If a project is cost effective, the plant is likely to be operate, and bundled ratepayers will receive tangible benefits. Plant output will be dispatched to meet IOU load requirements or sold in the market. If the plant output is sold in the market, associated revenues will reduce overall IOU revenue requirements.

Under the Commission’s current practice, IOUs acquire resources on behalf of their customers, and the costs of the resources are recovered from customers. The IOU owns the contract and has control over dispatch of that contract, subject

to Commission guidelines. Thus, ratepayers who pay the contract costs receive all of the contract benefits. This would no longer be true if the IOUs sign contracts on behalf of other entities. Ratepayers would receive the majority of contract benefits because the IOUs would likely serve their own loads first. Customers of other load serving entities (LSEs) would absorb some contract costs but would receive few if any benefits. Pricing issues could prove vexing. If an LSE needed power in order to meet its own load, at what price would the IOUs sell that power to the LSE?

3. Is Urgent Action Required?

There is no urgent need for the Commission to act on this or any other proposal. The Commission can ensure that new generation is built in California by ordering the IOUs to conduct all source solicitations in which new generation PPAs and turnkey offers compete with existing plants for contracts. Contracting is currently going forward at a measured pace, and the IOUs are signing long term contracts. PG&E expects to complete a long term request for offers (RFO) by March 31, 2006. SCE concluded a 5-year RFO in October, 2005, and all three large utilities are currently conducting long-term RFOs for renewable resources.

4. Is Regulatory Authority Sufficient?

Current regulatory authority may not be sufficient to ensure that additional new generation is built in California. If the Commission conducts a needs assessment and finds that total energy and capacity needs exceed current IOU procurement limits established in Decision (D.) 04-12-048, the procurement limits might have to be modified. It might also be necessary to increase the authorized IOU collateral limits if current collateral limits are inadequate.

5. Effect on Ratepayers

If Aglet's proposal is accepted and all new generation is cost effective, ratepayers will suffer no harm and may benefit to the extent they will be served by a more stable and dependable electric generation and distribution system. If the Commission adopts a cost allocation proposal and does not ensure that all new

generation projects are cost effective, ratepayers will be harmed by paying higher administrative costs, regulatory staff costs and procurement costs.

6. Consistency with D.04-12-048

The Ruling asks parties to explain how their proposals apply to the “need determinations made by the Commission for Pacific Gas and Electric Company and Southern California Edison Company [SCE] in Ordering Paragraphs (OP) 4 and 5 in D.04-12-048?” (Ruling, p. 4)

In D.04-12-048, the Commission established mid-term procurement limits for PG&E and SCE. The Commission allowed PG&E to add 1,200 MW of capacity and new peaking generation in 2008 and 1,000 MW of dispatchable and new peaking generation in 2010. (See D.04-12-048, Ordering Paragraph 4.) The Commission also found that “SCE’s strategy of relying primarily on short- and mid-term contracts during this planning period is reasonable, but it may be prudent to add some long-term resources.” (D.04-12-048, Ordering Paragraph 5.)

The needs assessment discussed in Section 2.1 herein should address long-term needs that extend far beyond 2010. The needs assessment should use the CEC’s Transmittal Report as a starting point.¹ The CEC models should be carefully reviewed and adjusted if necessary for the difference between planning reserve and operating reserve, the impacts of demand response, energy efficiency, and other factors. Preliminary needs should be determined by geographic area. Projected resource adequacy requirements should then be subtracted from preliminary needs and final needs should be calculated by geographic area. Once the needs assessment is completed, the Commission can establish a long-term procurement goal for each IOU, and each IOU can conduct an all-source RFO in order to meet its goal.

¹ See “Committee Final Transmittal of 2005 Energy Report Range of Need and Policy Recommendations to the California Public Utilities Commission”, California Energy Commission, November, 2005.

7. Capacity Markets

Aglet's proposal does not interfere with the Commission's ability to consider capacity markets in Rulemaking 05-12-013. If ratepayer interests are appropriately protected, capacity markets can serve as a useful complement to long-term contracting by the IOUs. Long term procurement and capacity markets are not mutually exclusive.

On August 25, 2005 the Energy Division released a White Paper on Capacity Markets, and parties were invited to comment on the paper's merits. Many of the commenting parties felt that the existence of a capacity market would not necessarily lead to long term investment. Some of the comments included:

- The Coalition of California Utility Employees (CUE) argued that "the proposed capacity markets undercut long term procurement." (CUE reply comments, p. 7.)
- "A capacity market should provide a greater incentive for new generation investment within transmission-constrained areas." (California Electricity Oversight Board comments, p. 8.)
- "A centralized capacity market should not be conceived of as taking on more than a supportive role." (Independent Energy Producers Association comments, p. 5.)
- "A centralized capacity market will support bilateral procurement and is one part of the equation for encouraging investment in generation." (Mirant reply comments, p. 4.)
- In Eastern markets, little if any investment has been made in generation in reliance upon installed capacity market payments. (Comments of Morgan Stanley Capital Group, p. 2.)
- "For the foreseeable future, new resources will be built only on the basis of long-term contracts with credit-worthy counterparties." (PG&E reply comments, p. 3.)

- “[A] replacement, capacity market would provide a stable mechanism upon which investment can be based by providing revenue stability that leads to improved investment decisions.” (SCE reply comments, p. 4.)

8. Conclusion

The Commission should adopt Aglet’s proposals set forth herein.

* * *

Dated March 7, 2006, at Cool, California.

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CERTIFICATE OF SERVICE

I certify that I have by electronic mail this day served a true copy of the original attached "Aglet Consumer Alliance Proposal on the Need for Additional Policies that Support New Generation and Long-Term Contracts in California" on all parties of record in this proceeding or their attorneys of record. I have served paper copies of the pleading on Assigned Commissioner Michael Peevey and Administrative Law Judge Carol Brown.

In accordance with e-mail instructions from Molly Sterkel on March 3, 2006, I have by electronic mail this day served a true copy of the same document on all parties of record in Rulemaking 04-04-003 or their attorneys of record. I have not served paper copies on parties without e-mail addresses on the current service list.

Dated March 7, 2006, at Cool, California.

James Weil