Joint Energy Auction Implementation Proposal of PG&E, SCE and SDG&E

California Public Utilities Commission
Workshop – December 18, 2006

Key Modifications to Joint Energy Auction Proposal

- Additional language explaining risks associated with the proposed products.
- Clarified that a secondary auction with call options would occur within 6 months of failed auctions.
- Clarified the day-ahead call option was for the full size of the Utility PPA, not a portion of it.
- Added statement that utilities will work with potential bidders to standardize the auction contracts.
- Added language addressing utility participation in their own auctions.
- Responded to question regarding the applicability of New Jersey and Illinois auctions.

Background

- On July 20, 2006, the Commission issued D.06-07-029, which adopted a plan to allocate the benefits and costs of new generation resources to all benefiting customers in each IOU's service territory.
- To be eligible for the cost allocation mechanism, the “energy rights” to non-utility built or owned new generation resources must be unbundled and offered for sale through an energy rights auction.
- The decision ordered the Energy Division to conduct workshops and ordered the utilities to submit implementation proposals in the LTPP proceeding.

Schedule

- On September 25, 2006, the Commission issued an Assigned Commissioner's Ruling and Scoping Memo on the Long-Term Procurement Phase of R.06-02-013.
- The scoping memo directs:
  - the utilities to meet and confer with one another and the Energy Division regarding implementation of the energy auctions;
  - the utilities to file energy auction implementation proposals by October 20, 2006; and
  - the Energy Division to conduct a workshop on November 1, 2006 to discuss the utilities energy auction implementation proposals.
- PG&E, SCE and SDG&E filed their Joint Proposal on October 20, 2006.

Policy Principles

- The auction should seek to “maximize the energy value and minimize the residual cost” of new generation resources.
  - The auction process and products should be designed to attract a sufficient number of bidders to make the auction competitive.
- The auction should seek to minimize residual credit and other risks.
  - The contractual terms of the energy products that will be sold at auction should closely match the dispatch rights, operational constraints, gas supply requirements, and avoidable cost payments of the underlying contract between the utility and the new generation resource.
- The Joint Parties’ proposal to value the energy from new generation resources at spot market prices should apply to all time periods in which a new generation resource’s energy rights have not been sold.
- The costs of implementing the auction should not be disproportionate to the costs and benefits to be allocated.
  - The utilities should not be required to conduct more than one auction per year.

Initial Auction Products

- Two products for initial SCE and PG&E energy auctions:
  - Back-to-back toll:
    - Transfers the same dispatch rights, operational constraints, gas supply requirements, and avoidable cost payments in the underlying tolling contract between the utility and the new generation resource to the successful bidder.
    - The energy rights from an entire unit will be auctioned. A single unit will not be disaggregated into multiple, or smaller sized back-to-back tolls.
    - Product term: 2 to 5 years.
    - The successful bidder will act as an agent for the awarding utility: the successful bidder will be the scheduling coordinator and fuel manager for the new generation resource PPA.
    - The successful bidder will also be required to perform the necessary settlement activities associated with both the back-to-back toll and the new generation resource PPA.
  - Novation:
    - Essentially assigns a new generation resource PPA to the winning bidder.
    - The winning bidder will be able to fully utilize the new generation resource as it deems appropriate to maximize its energy dispatch value and ancillary services.
    - Minimizes risk for the customers being allocated the benefits and costs of non-utility built or owned new generation resources and the utilities entering into and managing the underlying PPAs.

Subsequent Auction Products

- If there is insufficient interest in the initial auction products, the utilities may offer additional products in subsequent auctions:
  - Unit contingent day-ahead call option
    - Energy-only product in which the successful bidder receives the right, but not the obligation, to take energy and pay a price based on a pre-determined contract heat rate and index gas price.
    - The option is for a fixed quantity for a relatively standard and predetermined time block (*e.g.*, 7x24, 6x16, super-peak, *etc.*).
    - The product is unit contingent – not firm.
    - Product term: 2 to 5 years.
    - The utility is the scheduling coordinator, fuel manager, and provides the dispatch instructions for the underlying new generation resource.
  - Utilities may propose additional products for future auctions at a later date, subject to Commission approval.

Auction Procedures

- Utility identifies portfolio of non-utility built or owned new generation PPAs for which it elects to use the D.06-07-029 cost allocation methodology and corresponding delivery dates.
  - To minimize construction risk in the auction products, products will not be auctioned until the associated new generation facility is on-line.
- Utility selects an independent evaluator (IE) to oversee the auction.
- Utility identifies products for each non-utility built or owned new generation PPA and auction schedule and rules, in consultation with the IE and Energy Division.
- Utility selects independent third-party consultant to provide an independent market value assessment of the products:
  - Minimum Bid Price: To be awarded, a bid must be equal to or greater than a set percentage of the market value assessment.
  - The percentage will be determined by the utility, in consultation with the IE and Energy Division.
- The utility will administer the auction, review all bids, determine winning bidders and negotiate final contracts, with IE and PRG oversight.

Regulatory Approvals

- The Commission decision adopting the energy auction process should pre-approve the use of the back-to-back toll, novation and unit contingent day-ahead call option products and the auction process as reasonable and deem them to be incorporated into the utilities’ respective procurement plans.

RA Capacity and Cost Allocation

- The RA Capacity will be allocated to LSE’s based on the share of 12-month coincident peak demand.
- Monthly adjustments due to load migration will be allocated by the Energy Division and/or CEC.
- More detailed ratemaking proposals on implementing the auction-based cost allocation methodology will be included in Phase II of the LTPP proceeding.