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March 7, 2006

Docket Clerk
California Public Utilities Commission
505 Van Ness Avenue, Room 2001
San Francisco, CA 94102

Re: *Order Instituting Rulemaking to Integrate Procurement Policies and Consider
Long-Term Procurement Plans (R. 06-02-013)*

Dear Docket Clerk:

Enclosed for filing is the original and five (5) copies of *Pacific Gas and Electric Company's Proposal on Policies Needed To Support New Generation and Long-Term Contracting* in the above-referenced matter.

Please file the original document, date-stamp a copy, and return the enclosed copy in the postage-paid, self-addressed envelope provided for this purpose.

Sincerely,

Charles R. Middlekauff

cc: President Michael R. Peevey
Commissioner Geoffrey F. Brown
Commissioner Dian M. Grueneich
Commissioner Rachelle Chong
Commissioner John Bohn
ALJ Carol A. Brown
Mr. Sean Gallagher, Director, Energy Division
Official Service List for R.04-04-003

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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

U 39 E

R. 06-02-013

**PACIFIC GAS AND ELECTRIC COMPANY'S PROPOSAL ON POLICIES
NEEDED TO SUPPORT NEW GENERATION AND LONG-TERM
CONTRACTING**

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I. INTRODUCTION

PG&E fully supports the Commission's conclusion that the first order of business in this proceeding should be the consideration and adoption of policies to support new generation and long-term contracts in California. California clearly needs new generation and long-term contracts for continued reliable and cost-effective electric service. In order to promote new generation, it is essential that the Commission approve and implement interim and permanent mechanisms to allocate the benefits and costs of new generation and long-term contracts to all customers who benefit from and on whose behalf these new resources are developed.

PG&E, Southern California Edison (“SCE”), The Utility Reform Network (“TURN”), and NRG Energy, Inc. (collectively “Joint Parties”) are submitting a concurrent filing outlining a proposal for a transitional benefit and cost allocation mechanism that will encourage the development of new generation and long-term contracts for new resources, while ensuring that the associated costs are equitably allocated among all customers (“Joint Proposal”). In this filing, PG&E describes the need for new generation and long-term contracts in Northern California. This need will only be satisfied if an equitable cost allocation mechanism, such as the Joint Proposal, is expeditiously adopted by the Commission. Without appropriate and equitable cost allocation, new generation will likely not be built and long-term contracts will not be entered into, and the looming need in Northern California will go unmet. Given the time required to contract for and build new generation, it is essential that the Commission act quickly to adopt and implement the Joint Parties’ proposed cost allocation mechanism. PG&E will also discuss in this filing several limited modifications to the Joint Proposal. Finally, PG&E addresses the questions raised in Administrative Law Judge (“ALJ”) Carol Brown’s February 23rd Ruling.

II. CALIFORNIA NEEDS NEW GENERATION AND LONG-TERM CONTRACTS.

A. The Need For New Generation And Long-Term Contracts In California Is Well Recognized.

California’s need for new generation and long-term contracts is well-recognized. In the 2004 Long Term Procurement Plan (“LTPP”) proceeding, the Commission determined that there would be a need for new generation and capacity in both Northern

and Southern California and specifically authorized PG&E to contract for new capacity that could come on-line starting in 2008.¹ More recently, both the Commission and the California Energy Commission (“CEC”) have recognized the need for new generation in California to replace aging existing generation that will be retired and to satisfy increasing demand.² In its *Committee Final Transmittal of 2005 Energy Report*, the CEC also noted the need for long-term contracts to encourage the development of new generation in California.³ In short, there is general agreement that California needs to develop new generation and long-term contracts, especially given the lead-time necessary to plan, finance, permit and build new generating facilities.

B. There Is A Need For New Generation And Long-Term Contracts In Northern California.

As a result of the Commission’s need determination in the 2004 LTPP proceeding, PG&E issued a Long-Term Request for Offers (“LTRFO”) seeking proposals for new generation and long-term contracts.⁴ PG&E intends to present the results of the LTRFO process to the Commission in a separate application which will be filed in late March. However, even with the new generating resources expected to come on-line as a result of the LTRFO process, PG&E anticipates the need for additional new generation in Northern California.

¹ D.04-12-048 (2004), Findings of Fact 14, 19-20.

² See e.g. *Energy Action Plan II*, October 2005 at 10 (“Even with the emphasis on energy efficiency, demand response, renewable resources, and distributed generation, investments in conventional power plants will be needed.”); *2005 Integrated Energy Policy Report*, November 2005 at 44-48, 59-62.

³ *Committee Final Transmittal of 2005 Energy Report*, November 2005 at 13-16.

⁴ In the 2004 LTPP, the Commission determined the need for 2,200 MW in new generation in Northern California by 2010. See D.04-12-048, Finding of Fact 19. That determination is now firmly established and should not be re-litigated in this proceeding.

PG&E has prepared a preliminary analysis to determine its service area need for new generating capacity based on a reasonable outlook of supply and demand assumptions. PG&E's analysis is primarily based on information from the most recent CEC load and resource outlook ("Outlook Report"),⁵ with adjustments made to reflect updates to certain input assumptions and information from recent Commission decisions and PG&E filings. PG&E's analysis focuses on the need for new resources within the California Independent System Operator Corporation's ("ISO") Northern Region (NP26). Since PG&E's service territory represents approximately 92% of the NP 26 region load,⁶ the total need for new resources in PG&E's service area is assumed to be 92% of the resource needs in NP 26.

Based on the analysis below, and in order to be able to achieve the Commission's required 15-17% planning reserve requirement, PG&E proposes a procurement target of approximately 1,500 MWs of new resources in its service area in 2011. This is in addition to the 2,200 MWs the Commission approved in D.04-12-048. The addition of new resources will maintain electric system reliability and preserve market liquidity to the benefit all existing and future customers in PG&E's service area, including PG&E bundled customers, Direct Access ("DA") customers, future Community Choice Aggregation ("CCA") customers, customers who are located or locate within PG&E's service territory but take service from a local publicly owned utility⁷ after the date a

⁵ CEC's *Electricity Outlook for Summer 2006 and Beyond*, presented at the Energy Action Plan II Meeting on December 12, 2006 ("Outlook Report").

⁶ PG&E's service area peak load is 92% of the NP26 peak load.

⁷ "Local publicly owned utilities" are defined in Public Utilities Code section 9604(d).

commitment to new generation is made and customer generation and local publicly owned utility departing load (jointly “Benefiting Customers”).

1. Assumptions for Demand/Supply Balance Estimate Used In PG&E’s Analysis.

PG&E’s procurement need analysis uses assumptions available in CEC and Commission documents, supplemented with data from recent Commission decisions and PG&E filings. PG&E’s analysis is included as Table 1. For the amount of existing generation resources in NP 26 (Table 1, Line 1), PG&E relied on the CEC’s Outlook Report. PG&E placed retirements into two categories. The first category (Table 1, Line 2) includes units that have announced retirement dates. This category includes 369 MW by 2009 reflecting the retirements of the Hunters Point and Humboldt Bay power plants. The second category (Table 1, Line 3) identifies potential retirement units. For this category, PG&E included the 4,309 MW identified in the *2004 CEC Staff Draft Report 100-04-005D Resource, Reliability and Environmental Concerns of Aging Power Plant Operations and Retirements* and the *July 2005 CEC Staff Report 700-2005-019-ED2 Revised California and Western Electricity Supply Outlook*. These units are shown to be retiring between the years of 2008-2014.

The forecast of renewable capacity (Table 1, Line 4) is derived from the renewable forecast PG&E included in its December 2005 supplemental RPS filing. PG&E also included a forecast of distributed generation solar (“DG-Solar”) (Table 1, Line 11) consistent with the California Solar Initiative (“CSI”) contained in D.06-01-024. The Resource Adequacy (“RA”) value of the CSI capacity allocated to PG&E in the decision

was estimated at 37% of the CSI installed capacity forecast, consistent with the generation profiles between the hours of 4:00 P.M. and 7:00 P.M. PG&E has also included an incremental amount of small DG combined heat and power (“DG-CHP”) (Table 1, Line 12) based on the historical 3-year average of actual DG-CHP hook-ups to PG&E’s electric system.

PG&E’s analysis includes an additional 2,200 MWs of new generation by 2010 (Table 1, Line 5), reflecting the long-term procurement authorization in D.04-12-048. In addition, PG&E has included 190 MWs of new generation as high probability new generation additions in Northern California (Table 1, Line 6). This includes the 40 MWs for the San Francisco Peaker plant shown in the Outlook Report and 150 MWs of new generation to replace the fossil-fuel generation facilities at PG&E’s Humboldt Bay Power Plant.

In developing its assumption on the net interchange into the NP 26 Region (Table 1, Line 7), PG&E used the 2,348 MWs of available Northwest imports capacity estimated by the ISO for RA planning purposes.⁸ An adjustment was made to account for the expectation that some renewables, included as part of PG&E’s RPS additions, will be from the Northwest. For the assumption on exports to ISO Southern Region, PG&E used the CEC’s Outlook Report assumption of 3,000 MW.

⁸ Supplemental Deliverability Study: Import Levels for Resource Adequacy (RA) Planning Purposes <http://www.caiso.com/docs/2005/09/23/20050923165719616.pdf>.

PG&E used the 1-in-2 Summer Temperature Demand forecast from the CEC's 2005 Energy Demand Forecast⁹ High Case for the NP 26 Region with an average growth rate of 1.7% per year (Table 1, Line 9). PG&E believes this is the most plausible demand forecast based on analysis of recorded data and previous forecasts.

PG&E included the Commission's energy efficiency goals¹⁰ and used load profiles for uncommitted energy efficiency programs to derive a load reduction at the time of the coincident peak (Table 1, Line 10). PG&E also updated the CEC Outlook Report's demand response estimates to reflect: (1) the increase in price sensitive response from small customers enabled by the AMI project;¹¹ (2) changes in price sensitive demand response associated with its existing large customer programs, with peak demand in excess of 200kW, plus the demand response from the Department of Water Resources ("DWR") wholesale pumps (Table 1, Line 14); and, (3) some reduction in its interruptible/curtailable demand response programs after 2007 (Table 1, Line 15).

For resource adequacy purposes, a planning reserve margin of 15-17% has been adopted by the Commission. In its analysis of procurement need, PG&E used 17% to partially address uncertainty in forecasting loads, demand-side programs, and retirements of existing resources and the building of new resources on time (Table 1, Line 18).

PG&E has also shown the effect of load reduction from demand response and DG

⁹ California Energy Demand 2006-2016, Staff Energy Demand Forecast, Revised September 2005, <http://www.energy.ca.gov/2005publications/CEC-400-2005-034/CEC-400-2005-034-SF-ED2.PDF>

¹⁰ D.04-09-060.

¹¹ PG&E used the Base Case demand response forecast from its June 16, 2005 AMI filing.

programs on reserve margin requirements as separate line items (Table 1, Lines 19 to Line 20).

2. Resulting Supply/Demand Balance

The result of PG&E's supply/demand balance analysis is shown in Table 1. Line 22 shows the amount of surplus or deficit of the NP 26 Region to a 17% planning reserve requirement. This is then converted to PG&E's service area need on Line 23 by accounting for the portion of the area corresponding to PG&E's service territory (*i.e.*, 92% of the load). In 2010, PG&E shows a service area surplus of approximately 200 MWs above the planning reserve requirement. This assumes the full amount of LTRFO new generation (*i.e.*, 2,200 MWs) comes on line by 2010. By 2013, PG&E shows a service area planning reserve deficit of approximately 1,500 MWs, primarily as a result of existing generating facility retirements (Table 1, Line 23).

3. Procurement Strategy

In the 2004 LTPP proceeding, the Commission addressed the importance of considering uncertainty on planning for new resources:

Because there is no way to predict the energy demand/supply situation with any certainty, especially in the face of changing load situations, the IOUs should include a mix of resources, fuel types, contract terms and types, with some baseload, peaking, shaping and intermediate capacity, with a healthy margin of built-in flexibility and sufficient resource adequacy in their procurement portfolios.¹²

As noted above, it is generally recognized that forecasts of energy demand/supply balance contain considerable uncertainty, including uncertainty regarding demand

¹² D.04-12-048, Finding of Fact 17.

forecasts as well as achieving (by predetermined dates) policy objectives for Customer Energy Efficiency (“CEE”), demand response, renewable resources, CSI and retiring aging power plants.

In addition to these uncertainties, building new resources introduces another set of unique uncertainties or “commercial execution risks.” For any new generation capacity, and particularly for large new fossil-fired facilities, a number of development and construction steps need to be accomplished in a timely fashion to bring generation on-line when planned. When a project is in its developmental and construction stages, many permits need to be obtained, long-term access to a reliable fuel supply must be arranged, regulatory approvals of the negotiated contracts need to be obtained, financing and access to credit needs to be arranged, major equipment such as turbines and generators needs to be purchased, electric transmission and system upgrades should be completed. While projects with signed contracts from PG&E have a high likelihood of success, for planning purposes the possibility that some projects may not come on-line exactly when expected needs to be recognized.

In order to ensure reliability for Californians, it is preferable for an IOU not to be in a “catch up” mode in acquiring new resources. Contract negotiation and execution should be done sufficiently ahead of resource need in order to allow the IOU the flexibility to accept more attractive offers and decline less attractive offers. In order for the IOU to maintain a “healthy margin of built-in flexibility and sufficient resource adequacy in their procurement portfolios,” PG&E proposes to base procurement decisions on the supply/demand balance based on a 17% planning reserve margin

accelerated two years for execution risk management lead time, as shown on Line 24 of Table 1. This concept is also illustrated in Figure 1. From Figure 1, the PG&E service area need for additional new resources (beyond the approved 2,200 MW LTRFO) in 2013 is approximately 1,500 MWs. Under PG&E's proposal, the procurement process would target procuring 1,500 MWs for delivery in the 2011 time frame. In light of contract execution risk and uncertainties associated with new resources described above, this procurement strategy would allow sufficient flexibility to procure necessary new resources and maintain system reliability and market liquidity.

Table 1 – CAISO Northern Region (NP26) Supply/Demand Balance (MWs)

| Resource Adequacy Planning Conventions | | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|---|--------|--------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1 | Existing Generation | 24,573 | 24,573 | 24,573 | 24,573 | 24,573 | 24,573 | 24,573 | 24,573 | 24,573 | 24,573 |
| 2 | Retirements (Known) | (219) | (219) | (369) | (369) | (369) | (369) | (369) | (369) | (369) | (369) |
| 3 | Retirements (Potential) | - | (680) | (1,020) | (2,327) | (2,327) | (2,534) | (3,973) | (4,309) | (4,309) | (4,309) |
| 4 | PG&E RPS Additions (Including Imports) | 67 | 178 | 278 | 600 | 672 | 880 | 981 | 1,108 | 1,181 | 1,253 |
| 5 | PG&E Long-term RFO | 0 | 1,200 | 1,200 | 2,200 | 2,200 | 2,200 | 2,200 | 2,200 | 2,200 | 2,200 |
| 6 | High Probability CA Additions | 40 | 40 | 190 | 190 | 190 | 190 | 190 | 190 | 190 | 190 |
| | NW Imports | 2,348 | 2,348 | 2,348 | 2,348 | 2,348 | 2,348 | 2,348 | 2,348 | 2,348 | 2,348 |
| | Adjustment RPS NW Imports | - | (30) | (49) | (156) | (156) | (156) | (171) | (171) | (187) | (202) |
| | Exports to SP26 | -3,000 | -3,000 | -3,000 | -3,000 | -3,000 | -3,000 | -3,000 | -3,000 | -3,000 | -3,000 |
| 7 | Net Interchange (less RPS NW Imports Adjustment) | -652 | -682 | -701 | -808 | -808 | -808 | -823 | -823 | -839 | -854 |
| 8 | Total Net Generation | 23,809 | 24,410 | 24,152 | 24,059 | 24,131 | 24,133 | 22,779 | 22,569 | 22,627 | 22,684 |
| 9 | 1-in-2 Summer Temperature Demand (Normal) | 20,747 | 21,074 | 21,423 | 21,799 | 22,220 | 22,588 | 23,004 | 23,359 | 23,738 | 24,108 |
| 10 | Uncommitted Energy Efficiency | - | - | (181) | (363) | (535) | (721) | (922) | (1,162) | (1,381) | (1,597) |
| 11 | DG-Solar | (13) | (29) | (51) | (78) | (112) | (153) | (205) | (276) | (364) | (478) |
| 12 | DG-CHP | (11) | (23) | (34) | (45) | (57) | (68) | (79) | (91) | (102) | (113) |
| 13 | Adjusted 1-in-2 Summer Temperature Demand | 20,723 | 21,022 | 21,157 | 21,312 | 21,516 | 21,647 | 21,797 | 21,831 | 21,891 | 21,920 |
| 14 | Price Sensitive Demand Response (DR) ² | 302 | 433 | 601 | 735 | 774 | 798 | 812 | 823 | 833 | 844 |
| 15 | Interruptible/Curtailable Programs ² | 300 | 200 | 200 | 200 | 200 | 200 | 200 | 200 | 200 | 200 |
| 16 | Planning Reserve ¹ (%) | 17.8% | 19.1% | 17.9% | 17.3% | 16.7% | 16.1% | 9.1% | 8.1% | 8.1% | 8.2% |
| 17 | Planning Reserve | 3,688 | 4,020 | 3,796 | 3,682 | 3,589 | 3,484 | 1,994 | 1,762 | 1,769 | 1,808 |
| 18 | Planning Reserve Requirement (17%) | 3,523 | 3,574 | 3,597 | 3,623 | 3,658 | 3,680 | 3,706 | 3,711 | 3,721 | 3,726 |
| 19 | Price Sensitive DR reserve credit | (51) | (74) | (102) | (125) | (132) | (136) | (138) | (140) | (142) | (143) |
| 20 | Interruptible/Curtailable Programs reserve credit | (51) | (34) | (34) | (34) | (34) | (34) | (34) | (34) | (34) | (34) |
| 21 | Net Planning Reserve Requirement | 3,421 | 3,466 | 3,460 | 3,464 | 3,492 | 3,510 | 3,533 | 3,537 | 3,546 | 3,549 |
| 22 | Surplus/Deficit CA ISO NP 26 Northern Region | 268 | 554 | 336 | 217 | 97 | (27) | (1,539) | (1,776) | (1,777) | (1,741) |
| 23 | PG&E Service Area Need at 92% ³ | 246 | 510 | 309 | 200 | 89 | (25) | (1,416) | (1,634) | (1,635) | (1,602) |
| 24 | PG&E Procurement Target (2 year advance) | - | - | - | (25) | (1,416) | (1,634) | (1,635) | (1,602) | | |

¹ Planning Reserve calculation ((Total Generation+Demand Response+Interruptibles)/Normal Demand)-1.
² Demand Response and Interruptibles added to Operating Generation in Reserve Margin formula from Footnote 2.
³ PG&E Service Area Need from CEC High Case 1 in 2 Scenario: (PG&E Bundled Customer + PG&E Direct Access + PG&E San Francisco)/CA ISO NP26 Demand

PG&E Service Area Procurement Need Determination

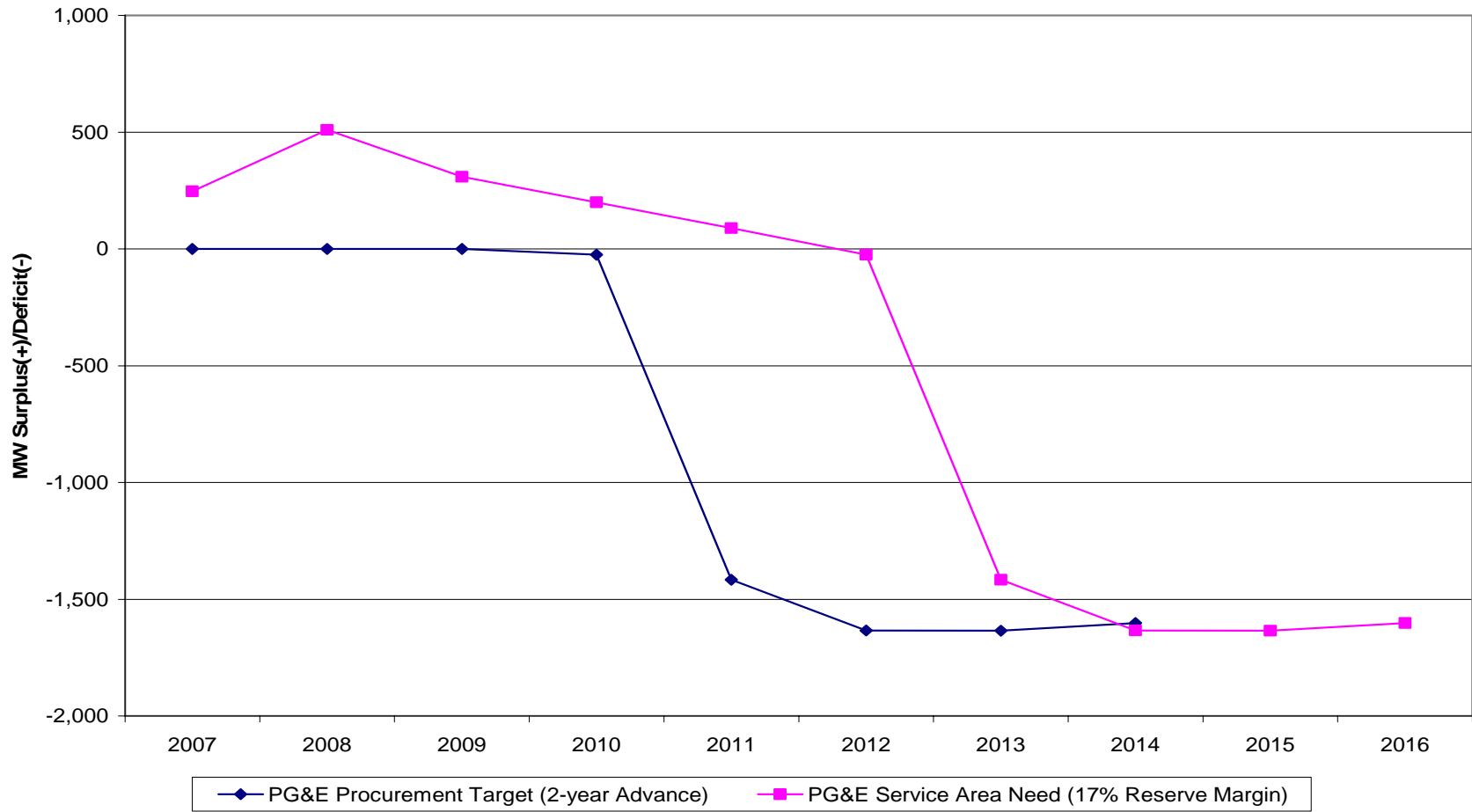


Figure 1

III. SEVERAL MODIFICATIONS TO THE JOINT PROPOSAL ARE REQUIRED.

After the *Order Instituting Rulemaking* was issued in this proceeding, the Joint Parties worked intensively to develop the proposal they are submitting concurrent with this filing. However, given the shortened procedural schedule, there were several issues the Joint Parties were unable to fully address. Thus, in this filing, PG&E suggests several limited modifications to the Joint Proposal that the parties were unable to fully explore and resolve before the March 7th filing deadline. These modifications are described below.

A. The IOUs Should Be Designated With Responsibility For Obtaining New Generation.

The Joint Proposal refers to “one or more entities” being designated by the Commission to procure new generation. PG&E believes that the IOUs should be responsible procuring new generation and long-term contracts for its service territory. It is unclear what “other entity” could or would assume this responsibility. Moreover, since the majority of the customers paying for new generation and long-term contracts will be the IOU’s customers, the IOUs have the strongest incentive to obtain the least cost, best fit new generation and long-term contracts to satisfy area needs.

B. The Joint Parties’ Proposal Should Apply To Both Contract And Utility Owned New Generation.

The Joint Proposal does not specifically identify the sources of new generation to which it applies. PG&E believes that the costs associated with new, non-RPS eligible generation, whether contracted for or built by an IOU, should be allocated under the Joint

Proposal. California needs new generation, it is that simple. Whether the new generation is contracted for or built by an IOU, the need and benefits are the same. To support new generation, the Commission should make clear that the Joint Proposal applies to all new, non-RPS generation, including both utility owned and contracted.

C. If The Commission Considers An Opt Out, It Should Set The Matter For Hearing

In the past, several parties have raised the issue of an “opt out” structure for cost allocation. If the Commission believes an opt out is appropriate, then it should immediately hold workshops to develop the specific elements of an opt out to be included in the Joint Proposal, including incorporating the multi-year resource adequacy requirements that are currently at issue in Phase 2 of the Resource Adequacy proceeding and requiring the LSE to demonstrate that it has contracted for or built new generation. All LSEs should be required to satisfy multi-year resource adequacy requirements before being eligible for an opt out of the proposed allocation mechanism. To the extent an LSE satisfies the multi-year opt-out requirements, its customers would not be responsible for new generation and long-term contract costs incurred after the date compliance was demonstrated. However, the LSE customers would continue to be responsible for new generation and long-term contract costs incurred before the demonstrated compliance date, as such costs were incurred on the LSE’s customers’ behalf.

D. Certain Other Ratemaking Issues Need To Be Clarified.

As discussed above, PG&E believes that the costs associated with new generation, whether contracted for or built by an IOU, should be allocated under the Joint Proposal.

To ensure that all customers share in the benefits associated with new generation whether owned or through contract and that bundled customers are not charged twice for the costs associated with new generation, certain offsetting entries to PG&E's existing Energy Resource Recovery Account ("ERRA") and Utility Generation Balancing Account ("UGBA") mechanisms will be necessary. With respect to the new generation Net Cost Balancing Account, PG&E proposes to establish separate subaccounts to address the difference between the ratemaking associated with new generation under contract and utility ownership. The first subaccount would record the net costs associated with utility-owned new generation resources. The second subaccount would record net costs of PPA new generation. PG&E proposes establishing the Net Cost Balancing Account cost elements in future ERRA proceedings. The new generation net cost balancing account and its subaccounts will be established in accordance with the principles described in the Joint Proposal.

IV. PG&E'S RESPONSES TO RULING'S QUESTIONS FOR CONSIDERATION.

In her February 23rd ruling, ALJ Brown requested that the parties address seven questions in their March 7th proposals.¹³ PG&E addresses each of these questions below.

A. Question #1 – Policy Proposals To Support New Generation And Long-Term Contracts.

As discussed above in Section II.A, there is a significant need in California to develop policies that support new generation and long-term contracts. However, IOUs

¹³ *Administrative Law Judge's Ruling Setting Prehearing Conference and Setting Workshop on Review of Policy Proposals to Support New Generation*, issued February 23, 2006 at 3-4.

may be unwilling to build new generation or enter into long-term contracts if all of the associated costs are born by bundled customers, while the benefits of the new generation and long-term contracts are enjoyed by all Benefiting Customers. No other LSE has stepped forward and indicated that it is willing to build new generation or enter into long term contracts. Indeed, at the February 28th Pre-Hearing Conference, some Energy Service Provider (“ESP”) representatives indicated that ESPs and other non-IOUs do not have the resources or the ability to enter into long-term contracts. To resolve the lack of new generation investment, PG&E strongly supports the Joint Proposal, with the limited modifications described above in Section III.

B. Question #2 – The Need For Expedient Commission Action.

Given the significant lead time needed before new generation can be proposed, contracted for, financed, permitted and constructed, it is imperative that the Commission act as soon as possible to approve a mechanism for allocating benefits and costs. Without an allocation mechanism, it is likely that new generation development and long-term contracting will continue to be stalled. For example, PG&E plans to file its LTRFO results at the end of March, 2006. However, in the LTRFO application, PG&E will request an allocation of benefits and costs based on the Joint Proposal. An equitable benefit and cost allocation mechanism is an essential part of PG&E’s LTRFO application, without which the LTRFO contracts may not be finalized. It is critical that the Commission act promptly on this issue in order to insure that current and future RFOs are successful. The Commission has clearly recognized the need to address this issue

promptly by setting it as the “first order of business” in this proceeding.¹⁴ The Commission must now act expeditiously to address the need.

C. Question #3 – The Need For New Regulatory Authority.

While PG&E has authority under D.04-12-048 to contract for new generation, the Commission did not specifically address cost allocation mechanisms for this new generation. It is important at this stage, before long-term contracts are finalized by PG&E and the other IOUs, that the Commission clearly identify the groups of customers that will be responsible for the costs associated with this new generation.

D. Question #4 – Impact On Ratepayers.

The Joint Proposal equitably allocates new generation and long-term contract benefits and costs among all Benefiting Customers. If this or a similar proposal is not adopted, the IOU bundled customers will bear all of the costs for new generation and long-term contracts, even those these new resources will have been undertaken on behalf and to the benefit of a broader group of customers. Failing to adopt a benefit and cost allocation mechanism will result in cost shifting from departing load customers to IOU bundled customers, contrary to the principles in AB 380 and recent Commission decisions.¹⁵

¹⁴ *Order Instituting Rulemaking*, R. 06-02-013 (“OIR”) at 11.

¹⁵ *See e.g.*, D.02-11-022, Finding of Fact 35 (failure to approve non-bypassable charge would result in significant cost shifting to IOU bundled customers); D. 03-07-028 (same for municipal departing load).

E. Question #5 – Duration Of Allocation Mechanism.

The Joint Proposal would apply to all new generation built by and long-term contracts entered into by the IOUs, unless an IOU applies for different treatment.¹⁶ The Joint Proposal would be put in place immediately and would continue until permanent mechanisms (*e.g.*, a capacity market in California) are adopted by the Commission. Moreover, under the Joint Proposal, cost allocation would continue through the life of a new generation project or for the entire term of a contract. Thus, costs incurred while the Joint Parties' proposed allocation mechanism is in place would continue to be allocated even after permanent mechanisms to support new generation are adopted.

F. Question #6 – Application To 2004 LTPP Need Determination.

The Joint Proposal would apply to the new generation determination made in D.04-12-048, as well as new generation needs identified in this proceeding. PG&E expects that in the second part of this proceeding, specific needs for PG&E's service area and for PG&E's bundled customers will be identified and determined. Costs and benefits associated with new generation built or long-term contracts executed to satisfy this need would also be allocated using the proposed transitional mechanism.

G. Question #7 – Impact On Proposals Regarding Capacity Markets.

The Joint Proposal should be adopted as an interim measure pending the Commission's consideration of capacity markets in R.05-12-013. Once capacity markets are approved and implemented in California, the transitional allocation methodology will

¹⁶ If an IOU requested different treatment, it could do so in the application it filed for approval of a long-term contract or authority to build new generation. Any such request would be judged on its own merits.

CERTIFICATE OF SERVICE BY ELECTRONIC MAIL OR U.S. MAIL

I, the undersigned, state that I am a citizen of the United States and am employed in the City and County of San Francisco; that I am over the age of eighteen (18) years and not a party to the within cause; and that my business address is Pacific Gas and Electric Company, Law Department B30A, 77 Beale Street, San Francisco, CA 94105.

I am readily familiar with the business practice of Pacific Gas and Electric Company for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, correspondence is deposited with the United States Postal Service the same day it is submitted for mailing.

On the 7th day of March 2006, I served a true copy of:

Pacific Gas and Electric Company's Proposal On Policies Needed To Support New Generation and Long-Term Contracting

By Electronic Mail – serving the enclosed via e-mail transmission to each of the parties listed on the official service list for R.04-04-003 and R.06-02-013 with an e-mail address.

By U.S. Mail – by placing the enclosed for collection and mailing, in the course of ordinary business practice, with other correspondence of Pacific Gas and Electric Company, enclosed in a sealed envelope, with postage fully prepaid, addressed to those parties listed on the official service list for R.04-04-003 and R.06-02-013 without an e-mail address.

I certify and declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on this 7th day of March, 2006 at San Francisco, California.

/S/

Jennifer S. Newman