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THE DIVISION OF RATEPAYER ADVOCATES' OPENING COMMENTS ON THE PROPOSED DECISION ON TRACK I AND TRACK III ISSUES

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I. INTRODUCTION

Pursuant to California Public Utilities Commission ("Commission") Rules of Practice and Procedure 14.3, the Division of Ratepayer Advocates ("DRA") respectfully submits the following opening comments on the Proposed Decision on System Track I and Rules Track III of the Long-Term Procurement Plan Proceeding and Approving Settlement (hereafter, the "PD") of Administrative Law Judge ("ALJ") Peter Allen. DRA is generally supportive of the PD, and offers these opening comments to recommends additional clarification and limited changes to the PD, focusing on the following "Rules Track III" issues: Section 3.3, Utility Owned Generation (UOG) v. Power Purchase Agreement (PPA); Section 3.5, Greenhouse Gas Product Procurement; and Section 3.7, Rulebook (Procurement Oversight Rules).

In summary, DRA makes the following recommendations:

1. The refinements to the UOG procurement policy framework should apply to both fossil and preferred resources, including renewable generation;
2. The Greenhouse Gas (GHG) product procurement authority should allow the purchase of offset forwards;
3. The Commission should impose ARB's 8% quantitative limit on offsets for a compliance period, not annually;
4. The Commission should allow the IOUs, in limited situations, to procure GHG compliance instruments through bilateral transactions (including brokers) without utilizing a competitive solicitation process;
5. The Commission should clarify the requirements regarding purchasing GHG compliance instruments on exchanges; and
6. The Commission's Energy Division should make the final decision on the assignment of Independent Evaluators to specific projects.

II. DISCUSSION

A. The PD's Refinements to the UOG Procurement Policy Should Not Exclude Proposed Renewable Energy Generation.

DRA largely supports the refinements to the Commission's existing policy for evaluating UOG proposals, which will make it easier to compare them to PPA proposals. While the PD recognizes the current disparity in the way that these two types of projects are compared and takes many steps to improve the current rules and increase the transparency of this process, it stopped short of applying the refined UOG procurement framework to renewable generation in this proceeding.[1] The PD makes this exception without reference to any discussion in the record.

The record in this proceeding is not silent on this issue. DRA specifically recommended that "the Commission simply require that all UOG opportunities (fossil or preferred resources) be tested by a competitive solicitation.[2] No party proposed to exclude new renewable projects from review in this proceeding. In fact, proposed renewable UOG projects were of a particular concern to DRA.[3]

DRA discussed and cited examples of UOG proposals that have been difficult to compare in the past, including both fossil and renewable resources: PG&E Manzana, PG&E Oakley, PG&E Fuel Cell Program, PG&E PV Program, SDG&E El Dorado, SDG&E Calpeak, SDG&E Solar Energy Program, SCE Solar PV Program, and SCE Fuel Cell Program.[4] Furthermore, among the other parties that addressed the policy framework for UOG procurement in their opening and reply briefs (PG&E, SCE, SDG&E, Independent Energy Producers Association, Western Power Trading Forum, Pacific Environment, and Californians for Renewable Energy), none made a distinction between fossil and renewable resources.

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[1] PD, p. 28, fn. 13.
[2] DRA Testimony, August 4, 2011, p. 12.
[3] DRA Testimony, August 4, 2011, p. 11.
[4] DRA Testimony, August 4, 2011, pp. 54 - 61.

Despite the fact that a record on this issue was developed in this proceeding, the PD concludes without discussion that the UOG procurement policy framework for renewable resources is "more appropriately addressed in the RPS Rulemaking, R.11-05-005."[5] DRA respectfully suggests that this issue was properly within the scope of the instant Long Term Procurement Planning proceeding, and should not be deferred to the RPS Rulemaking, where it may or may not be addressed. With a significant number of applications for renewable UOG expected as a result of SB 2(1x), proper evaluation of these types of UOG projects should be addressed now. The Manzana project proposed by PG&E illustrates the difficulty faced by parties and the Commission in trying to determine if a proposed renewable UOG has been fairly compared to PPAs without a clear framework for UOG procurement.[6] In conclusion, nothing in the record supports the exclusion of renewable UOG resources; to the contrary, the record shows that the refined UOG procurement policy framework can and should be applied to both fossil and preferred resources, including renewable generation. To the extent the Commission, in its RPS proceeding, determines it is necessary to further refine this policy framework specifically for renewable resources, it may do so then.

B. Greenhouse Gas Product Procurement

The PD provides the Investor Owned Utilities (IOUs) with authority to procure certain GHG compliance instruments needed to comply with the GHG cap-and-trade program promulgated by the California Air Resources Board (ARB) pursuant to AB 32.[7] DRA submits the following comments regarding the GHG product procurement authorized in the PD.

1. DRA supports the PD's requirement that sellers assume the risk of invalidated offsets.

The PD authorizes the IOUs to procure no more than 8% of their annual compliance requirement in the form of offsets that are CARB-certified at the time of

[5] PD, footnote 13, p. 28.
[6] PG&E Manazana Application, A.09-12-002.

purchase.[8] DRA supports the IOUs' use of CARB-certified offsets up to the 8% quantitative limit imposed by ARB, as this provides an important cost containment mechanism. The 8% limit is applicable to all compliance entities under ARB's cap-and-trade regulation,[9] and the IOUs should be in the same position as other compliance entities in this regard.

The PD correctly recognizes that the purchase of offsets is inherently more risky than the purchase of allowances, specifically because of the provision in the cap-and-trade regulation that makes offset buyers liable for offsets that do not meet measurement or verification requirements and are therefore invalidated by ARB. The PD addresses the invalidation risk of offsets by requiring that IOUs only purchase offsets if the seller of those offsets assumes the risk of invalidation.[10] Although this requirement could lead to higher offset prices, as offset sellers will incur additional risk and factor it into prices, DRA supports this policy because it protects ratepayers from the risk of invalidation.

2. The Final Decision should allow IOUs to purchase offset forwards.

The PD would restrict the IOUs from purchasing offset forwards or entering into contracts for the purchase of offset forwards. The PD offers the following reasoning:

> "Given the risk inherent in offsets, the additional risk of purchasing other derivative products, and the limited amount of offsets that can be used for compliance, we do not see enough potential benefit to justify the utilities' purchase of offset futures or forwards."[11]

DRA questions this rationale for restricting the purchase of offset forwards, for the following reasons. First, although it is uncertain whether such forward products or contracts will even be available for offsets, it appears that this restriction is unnecessary

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(continued from previous page)
[7] Cal. Health and Safety Code § 38500.
[8] PD, pp. 41-42.
[9] Article 5: California Cap on Greenhouse Gas Emissions and Market Based Compliance Mechanism (referred to as "Cap and Trade Regulation") (October 2011), Section 95854.
[10] PD, p. 42.
[11] PD, p. 50.

given the PD's requirements that all offsets authorized for purchase by the IOUs must be CARB-certified and that offset sellers assume the risk of invalidated offsets. Those requirements effectively neutralize the inherent risk in offsets to the IOUs. As long as there is sufficient protection from the risks of purchasing offsets, there is no reason to prohibit the IOUs from entering into a forward contract for offsets (provided that purchases stay within the overall GHG compliance product procurement limits established by the Commission). Second, DRA recognizes the risk of purchasing certain derivative products, however DRA believes that the risk associated with offset forwards can be addressed by imposing the same requirements as used for allowance futures and forward contracts to mitigate the default risk. This includes applying the standard procurement credit and collateral requirements to those transactions, and may also include additional credit and collateral requirements as appropriate. Finally, it is not clear why the 8% quantitative limit on offsets would be a reason to restrict the use of offset forwards, as long as the total procurement of offsets does not exceed the 8% compliance period limit imposed by ARB or the overall procurement limits imposed by the PD.

DRA therefore recommends that the PD eliminate the restriction that the IOUs may not purchase offset forwards or enter into contracts for the purchase of offset forwards. Longer-term contracts for offsets can provide offset project developers with financial certainty and less risk, which could result in lower offset prices for the IOUs and lower compliance costs. It is likely not the least cost approach to require the IOUs to wait and buy offsets each year. To mitigate the default risk of offset forwards, DRA recommends that the same credit and collateral requirements that govern the IOUs' purchase of allowance futures and forward contracts be applied to the IOUs purchase of offset forward contracts. Additionally, the IOUs can include provisions in their contracts with offset sellers that specify that offsets must be CARB-certified at the time of delivery.

3. The Commission should impose ARB's 8% quantitative limit on offsets for a compliance period, not annually.

The PD imposes a restriction that each utility may purchase no more than 8% of their annual compliance requirement in the form of offsets, in order to make sure the procurement of offsets is consistent with ARB's approach.[12] However, this restriction is not entirely consistent with ARB's approach and is not supported by the record in this proceeding. ARB imposes the 8% quantitative limit on offsets for each compliance period, not annually.[13] Imposing the requirement annually could have implications for the IOUs' ability to procure enough offsets to reach the 8% ARB limit, and thus could potentially raise costs for ratepayers. For instance, if there are no offsets yet available in 2013, or if the IOUs are not able to procure 8% of their compliance obligation in offsets in 2013 (or any given year), then under the current PD's language, the IOUs would not be able to make up for this deficiency in the following year(s) of the same compliance period. Instead, they would have to procure 100% of their 2013 compliance obligation in allowances, at a presumably higher cost than if they had been able to use offsets.

It is unclear whether the PD intentionally imposed this additional requirement, particularly since the PD mentioned being consistent with ARB's approach. Neither the PD, nor the record in this proceeding provides justification for imposing an annual limit on offset procurement, instead of imposing the limit over the compliance period as in ARB's regulation. DRA recommends that the Final Decision authorize the IOUs to purchase no more than 8% of their <u>compliance period</u> compliance requirement in the form of offsets.[14]

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[12] PD, pp. 41-42.
[13] Article 5: California Cap on Greenhouse Gas Emissions and Market Based Compliance Mechanism (October 2011), Section 95854, p. A-91.
[14] DRA's provides its recommended modified text in Appendix A.

4. The Commission should allow the IOUs, in limited situations, to procure GHG compliance instruments through bilateral transactions (including brokers) without utilizing a competitive RFO process.

The PD requires that to the extent the IOUs wish to procure authorized GHG compliance instruments via bilateral transactions (including brokers), the IOUs must utilize a competitive RFO process.[15] The stated goal is to ensure that the counterparties the IOUs are buying from are sound and legitimate sellers who will deliver the purchased compliance products, and that the prices paid by the IOUs for those products are reasonable.[16] DRA supports these goals, however, questions whether a competitive RFO process is necessary before each bilateral transaction.

It is not clear whether the requirement to utilize a competitive RFO process before each bilateral transaction for authorized GHG compliance instruments will be beneficial in all situations and there does not appear to be record support for such a requirement. It is possible that in some circumstances, an IOU may need to procure a limited amount of GHG compliance instruments in order to meet an annual or compliance period compliance obligation in a short amount of time. If the IOUs are not able to timely procure GHG compliance instruments in this situation because they must first issue a competitive RFO, this could present a timing issue that could ultimately raise costs for ratepayers. In addition, in some instances, such as when an IOU is procuring GHG compliance instruments to meet a residual compliance obligation or to fill out its portfolio of GHG compliance instruments according to its internal emissions projections and management framework, transactions for GHG compliance instruments could be small. The use of a broker may be the most efficient and cost-effective way to make this sort of transaction.

There are other mechanisms, outside of a competitive RFO process, to ensure that the prices paid by the IOUs for GHG compliance instruments are reasonable. This

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[15] PD, p. 51.
[16] PD, p. 50.

includes benchmarking the GHG compliance instrument prices offered by brokers to the ARB auction clearing prices for allowances, to clearing prices on exchanges offering California GHG compliance instruments, and to prices offered by other brokers. Likewise, if counterparties of brokered transactions are subject to credit and collateral agreements, then the Commission can be assured that the counterparties the IOUs are buying from are legitimate sellers.

DRA recommends that as with the procurement of electricity and gas resources, the Commission consider the potential need for smaller, short-term transactions for GHG compliance instruments, and allow the use of bilateral transactions outside of a competitive RFO process, including brokered bilateral transactions. One way to accomplish this would be to set a threshold or minimum quantity of GHG compliance instruments required to hold a competitive RFO in order to justify the administrative costs and time involved in the process. For GHG compliance instrument needs below that threshold (e.g. 50,000 metric tons CO_2 equivalent) the IOUs could be authorized to procure via bilateral transactions (including brokers) without holding a competitive RFO first.

5. The Commission should clarify the requirements regarding purchasing GHG compliance instruments on exchanges.

The PD requires that prior to purchasing GHG compliance instruments on an exchange, a utility must submit a Tier 2 Advice Letter detailing: 1) what exchange they are seeking to use; 2) the liquidity and transparency of the exchange, specifically for California GHG compliance instruments, including an explanation of how the Commission can be assured that the price of products procured on the exchange are reasonable; and 3) the regulatory authority or authorities the exchange is subject to.[17] DRA supports the requirement that the IOUs must file an Advice Letter in order to be

[17] PD, pp. 51-52.

authorized to procure GHG compliance instruments on an exchange. However, DRA recommends that this requirement be clarified to address the following two uncertainties.

First, the PD should clarify whether once a specific exchange is approved by the Commission the IOUs are authorized to procure GHG compliance instruments on that exchange in the future without filing an Advice Letter, or if the IOUs must submit an Advice Letter prior to each transaction on an exchange. DRA recommends that the requirement to submit an Advice Letter applies to the use of a particular exchange for the first time, and not to each transaction on an already Commission-approved exchange.

Second, it is unclear how the Commission will assess whether the liquidity of an exchange can provide the required assurance of reasonable prices for GHG compliance instruments. During the first compliance period, the IOUs will be some of the largest compliance entities under the cap-and-trade regulation, with their total GHG emissions exposure projected to be approximately 25% of the entire market in 2013 and 2014. Since IOUs would be a major source of market liquidity for GHG compliance instruments, it is possible that the liquidity of exchanges may not develop as quickly as hoped for by the Commission. While DRA agrees in principle with the requirement that the IOUs detail the liquidity of an exchange before gaining approval to transact on that exchange, the Commission should recognize the IOUs share of the total market and their impact on the potential liquidity, and include this in its assessment of approving a given exchange. DRA recommends that an assessment to ensure that the price of GHG allowances on exchanges are reasonable would also include benchmarking those prices to the ARB auction clearing prices for current and future year vintage allowances, and to the prices offered by brokers and through the IOUs' competitive RFO process.

C. The Energy Division Should Determine the Assignment of Independent Evaluators to Specific Projects or Tasks.

The PD states, and DRA agrees, that "it would be preferable for IEs to be hired by and report to the Commission, rather than the utilities."[18] However, due to barriers (such

[18] PD, p. 64.

as the length of the state contracting process), the PD determined that this proposal could not be implemented at this time, but should be considered again in the future.

The PD, however, did not address DRA's second recommendation to help reduce the potential for conflict of interests, which is that after the IE pool is selected the Energy Division should make the final determination of the IE assignments for individual projects. The barriers underlying the concerns expressed in the PD would not prevent the Commission from taking this positive step toward greater IE independence.

III. CONCLUSION

DRA supports the PD, and recommends that the Commission adopt the PD with the limited changes and clarifications suggested above. Appendix A includes DRA's recommended modifications to the Findings of Fact, Conclusions of Law and Ordering Paragraphs of the PD.

Respectfully submitted,

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APPENDIX A

DRA's Proposed Changes to the Proposed Decision

(Proposed additions are included with underlines and proposed deletions with strikethroughs.)

Findings of Fact:

Add the following Finding of Fact: No party argued that fossil and preferred resources, including renewable generation, should be treated differently in a UOG procurement policy framework.

Add the following Finding of Fact: It would be preferable for IEs to be hired by and report to the Commission, rather than the utilities, and to the extent the barriers to doing so can be overcome in the future, we will consider this again.

Add the following Finding of Fact: These barriers largely have to do with the state contracting process which may unduly restrict selection of qualified IEs and present additional administrative burden.

Add the following Finding of Fact: There are no unduly burdensome barriers created if the final decision on IE assignments is made by the Commission Staff.

Conclusions of Law:

Add the following Conclusion of Law: The UOG procurement policy, as refined in this decision, should apply to fossil and preferred resources, including renewable generation.

Add the following Conclusion of Law: The final decision on IE assignments to individual projects should be made by the Commission Staff to better ensure IE independence.

Add the following to Conclusions of Law 8: The utilities should be allowed to procure certain greenhouse gas compliance instruments at this time, specifically allowances, allowance forwards and futures, and offsets and offset forwards.

Ordering Paragraphs:

Add the following Ordering Paragraph: The UOG procurement policy, as refined in this decision, shall apply to fossil and preferred resources, including renewable generation.

Add the following Ordering Paragraph: The final decision on IE assignments to individual projects will be made by Commission Staff.

Add the following Ordering Paragraph between 8(d) and 8(e): PG&E, SCE, and SDG&E may procure offsets via forward contracts, and should apply their standard procurement credit and collateral requirements to these transactions, and may also impose additional credit and collateral requirements as appropriate.

Change the following Ordering Paragraph 8(d) to: PG&E, SCE, and SDG&E may purchase no more than 8% of their ~~annual~~ compliance period compliance requirement in the form of offsets.

Other (typographical error):

DRA identifies what is most likely an inadvertent typographical error in the PD related to offsets. DRA believes that the second line of the third paragraph on page 40 should read:

> "As SCE observes, ~~allowances~~ offsets must be certified, and there is no guarantee that they will be certified, or even that they will retain their certification. This issue of validity does not exist for allowances."