

Cmmr. Michael Peevey
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

October 20, 2003

Integrated Energy Policy Report Ad Hoc Committee
California Energy Commission

Dear Members of the Integrated Energy Policy Report Ad Hoc Committee:

Senate Bill (SB) 1389 recognized the need for an integrated energy policy for the state and charged the California Energy Commission (CEC) with developing an Integrated Energy Policy Report (IEPR) in 2003, and every two years thereafter, that would assess and analyse the status and the trends in the consumption and supply of gas, electricity and other forms of energy and would make policy recommendations based on in depth analysis of the energy issues facing the state.

The responsibility of the California Public Utilities Commission (CPUC) lies in Sections 25302 (e) and (f) of the Public Resources Code, added by SB 1389. Section 25302 (e) requires the CEC to consult with several entities, including the CPUC, and to consider their proposed recommendations in preparation of the IEPR. Section 25302 (f) states that:

“For the purpose of ensuring consistency in the underlying information that forms the foundation of energy policies and decisions affecting the state, those entities shall carry out their energy-related duties and responsibilities based upon the information and analysis contained in the report. If an entity listed in this subdivision objects to the information contained in the report, and has a reasonable basis for that objection, the entity shall not be required to consider that information in carrying out its energy-related duties.”

Pursuant to the above Sections, our obligation is to rely on the information and analysis in the IEPR in carrying out our energy-related duties. We are concerned that although CEC staff produced

numerous reports containing valuable analysis, it is difficult to find a linkage between that analysis and the recommendations contained in the Draft IEPR. In order to determine our ability to rely on this report to meet our statutory obligations, we need to have more information on the relationship between the underlying analysis and the IEPR's ultimate policy conclusions and recommendations.

In addition, my colleagues and I offer the following specific comments to be considered and attached to the first Draft IEPR prepared by the Ad Hoc IEPR Committee (Committee). The IEPR is required to have a statewide and regional scope. Based on that, we assume the report recommendations are applicable to investor-owned as well as municipal utilities, irrigation districts, and other load serving entities in the state. Our comments are limited to the gas and electric issues related to the investor-owned utilities (IOUs) for which this agency is responsible. These comments reflect our support for many aspects of the Draft IEPR, specifically in the area of energy efficiency and renewables, where we believe the Draft IEPR is on the right track, and also express our concerns over the discussion of transmission planning, where we believe the Draft IEPR is inconsistent with the law, or lacks adequate analysis.

What follows are our comments on specific subject areas:

Energy Efficiency: Consistent with the Energy Action Plan (EAP), the Draft IEPR recommends that the state harvest energy efficiency opportunities. The CPUC has been a strong supporter of energy efficiency and has required the IOUs to include energy efficiency measures in their procurement plans. The CPUC plans to fund approximately \$512 million electric and gas efficiency programs in 2004-2005, reassess appropriate program administration, and factor energy efficiency programs into IOU long-term procurement plans.

Renewables: The Draft IEPR recommends that the EAP-accelerated goal be legislated. For the IOUs, the CPUC has already started the process to fulfill the requirement of the Renewable Portfolio Standard (RPS) law¹, which is to establish:

- a process for determining the market price of electricity from renewable generators;
- a process for rank ordering and selection of renewable projects;

- standard terms and conditions to be used by IOUs in contracting with renewable generators.

The CPUC has authorized² the IOUs' acquisition of more than 620 MW of contracted capacity that will provide more than 4,200 GWH per year of renewable energy through 5-10 year contracts. The CPUC continues to implement the RPS legislation in conjunction with the CEC and as required by the law. While the CPUC agrees that meeting the RPS obligations as quickly as possible should be the state's goal, it is not clear that enacting legislation at this point is necessary.

Critical to the implementation of an accelerated RPS is adequate funding to support that goal. Thus far we do not have enough information to determine whether or to what extent additional funding will be necessary to accomplish an RPS goal of 20% by 2010 instead of 2017. The Draft IEPR offers no discussion on the potential impacts of enacting legislation to accelerate the RPS on the funding requirement. This can only be determined after the first round of renewables solicitation has been completed and the market price to compensate the renewable generation has been determined. At this point, it may be premature to solicit legislation.

Liquefied Natural Gas (LNG): The Draft IEPR recommends coordinating permit reviews with all entities to develop an LNG terminal on the West Coast. The Draft IEPR, however, contains no analysis for recommending this specific LNG project. The CPUC has been participating in the LNG Interagency Permitting-Working group (LNG Working Group) discussions regarding appropriate permitting of LNG facilities in California with other state and local agency staff. While the Draft IEPR appropriately advances the discussion about the use of LNG facilities as an option for increasing the state's natural gas supply, the focus should be on establishing clear, coordinated procedures for the review of LNG proposals. The Draft IEPR presents no analysis on the costs and benefits of LNG in general; whether LNG is needed or is cost effective or how it would benefit the state. Our Commissions should continue working together to identify the benefits and costs of pursuing LNG supplies for the state.

1. California Senate Bill (SB) 1078 established the California Renewables Portfolio Standard (RPS) Program.
2. In Decision (D.) 02-08-071

Reserve Requirements: The Draft IEPR recommends that all electricity providers maintain appropriate operating reserves. The CPUC is resolving reserve requirement responsibilities for entities that are under its jurisdiction in the CPUC's procurement rulemaking to ensure that reliable, secure, and reasonably-priced electricity is provided to California electric customers at all times. The Commission is scheduled to resolve these policy issues by December, and will also be addressing through workshops certain technical issues related to load forecasting and resource accounting.

Plant Retirement: The Draft IEPR recommends retiring older, inefficient natural gas-fired power plants and replacing them with new ones. The CPUC wholeheartedly agrees that old, dirty and inefficient power plants that are close to California's coastlines and are a threat to our environment should be removed from the state's energy portfolio. However, in some cases, modernizing old gas plants and taking advantage of the existing infrastructure might be a better option for the IOUs to meet the electric demand of their customers than plant retirement. Furthermore, and in support of RPS law, preference should be given to replacing some of these inefficient facilities with non-fossil fueled generation instead of new gas-fired power plants.

Core/Non-core Model: The Draft IEPR recommends examining a core/non-core model. This recommendation calls for collaboration among all agencies to explore a core/non-core market structure for 2004. Looking back on California's experience with customer choice, many critical issues remain to be resolved. California must analyze the legal and technical aspects of how to address these issues, and why a core/non-core model may work for the state. The CPUC staff is conducting a study to explore market structure changes and their implications for ratepayers, reliability, the environment, investor confidence, and market volatility, including the core/non-core model the CPUC adopted for California's natural gas market with a publication target of March 2004. The CPUC and the CEC should explore jointly the complex issues involved in potentially moving to a core/non-core electricity market structure.

Transmission Planning: The CPUC agrees with the draft IEPR conclusion that transmission planning is fragmented at present. We also agree that increased collaboration among the energy agencies on transmission planning and siting is warranted. The CPUC strongly disagrees, however, with the Draft IEPR recommendation that transmission planning should rest primarily with the CEC. Specifically, the Committee recommends that the planning process start with the IEPR. It states that:

“Permitting process for all new bulk transmission lines should be consolidated within the Energy Commission, using the Energy Commission’s power plant siting process as the model.”

We believe the recommendation is inconsistent with the EAP and our statutory obligations, and provides no benefit to the existing process.

Consistent with the EAP, we strongly support the idea that agencies that are responsible for transmission planning and permitting should work together to ensure an efficient and seamless transmission planning process. However, we disagree that CEC’s determination of need in the IEPR process will be the appropriate vehicle to satisfy this goal and our statutory obligation. By proposing that the IEPR replace the determination of need in our proceedings, CEC would conduct the economic, reliability, and environmental assessment for IOU projects. This would effectively require us to defer our responsibility to assess need for transmission projects to the IEPR process. We cannot relinquish such a responsibility, not only because it is inconsistent with the law, but also because it does not improve the current process.

The recommendation itself also complicates the transmission planning process and works counter to the stated goal of the EAP to streamline the transmission process. Currently, the CEC has no transmission responsibility. As seen in attachment 1, which illustrates the existing process, the Independent System Operator (ISO) is responsible for determining the need for new transmission projects in the state in order to meet the reliability of the grid within the state. This is accomplished after the ISO reviews the IOUs annual transmission filings. The CPUC is also responsible for assessing the need for transmission infrastructure of the IOUs and incorporates transmission costs into customers’ electric bills. This determination of need is based on both the reliability and

economic perspective. The CPUC is also responsible for reviewing applications for Certificate of Public Convenience and Necessity (CPCN). In other words, once the ISO determines a project is necessary, the IOUs bring that to the CPUC for a CPCN. This example shows that redundancy exists between the ISO and the CPUC's process in determining the needs for reliability. To mitigate this duplication of effort, every attempt should be made to coordinate the evaluation of need for a project between the two agencies. In fact, the CPUC has already begun this process. In Decision (D.) 01-10-070, the CPUC directed the two agencies to work together to establish a common methodology for evaluating economic benefits of a project. Once this methodology is in place, the ISO can apply it to evaluate IOU projects and the CPUC can utilize the ISO's determination.

Attachment 2 illustrates how this coordination can be achieved in the CPUC's process. As stated in the EAP, the CPUC is planning to open a new rulemaking to propose modifying its approach to transmission siting. Transmission assessment for the IOUs must be done in an integrated fashion as part of the IOUs resource planning to ensure the best mix of resources is employed in meeting IOU customer needs. The CPUC's procurement process is the most appropriate place to conduct evaluation of resource options for the IOUs. Once the CPUC determines the appropriate mix of the IOU resources, the IOU will incorporate the transmission components of their resource mix in their annual filings to the ISO. The ISO performs reliability and economic analysis using the adopted and agreed-upon study methodology, and determines whether transmission projects are needed to satisfy the reliability and economic needs of the grid within the state. The final step for utility-sponsored transmission projects will be for the utility to come to the CPUC for certification and California Environmental Quality Act (CEQA) review. Under modified General Orders, the CPUC would utilize the ISO need determination once it has validated that the approved study methodology was applied. This would significantly improve and streamline the current process.

Unfortunately, the CEC's proposed approach ignores important steps that integrate utility resource planning, including transmission, is silent on existing statutory responsibilities of the CPUC, and fails to improve the existing process. In addition, it would introduce uncertainty into transmission siting, and does not demonstrate a streamlined process. The Draft IEPR also ignores the stated goal

of the EAP that the CPUC will initiate an investigation to explore and improve the CPUC's CPCN process. We encourage incorporating CEC's input into this process as much as possible and as expected in the EAP.

Consistent with these comments, the CPUC looks forward to the continued collaboration and coordination among the state agencies to implement a state policy that is workable, consistent with the law, and in the best interests of customers in California.

Sincerely,

/s/ MICHAEL R. PEEVEY

MICHAEL R. PEEVEY
President

Attachments 1 and 2

Cc:

California Energy Commission:

Chairman William J. Keese
Commissioner James D. Boyd
Commissioner John L. Geeseman
Commissioner Robert Pernell
Commissioner Arthur H. Rosenfeld
Mr. Bob Therkelson, Executive Director

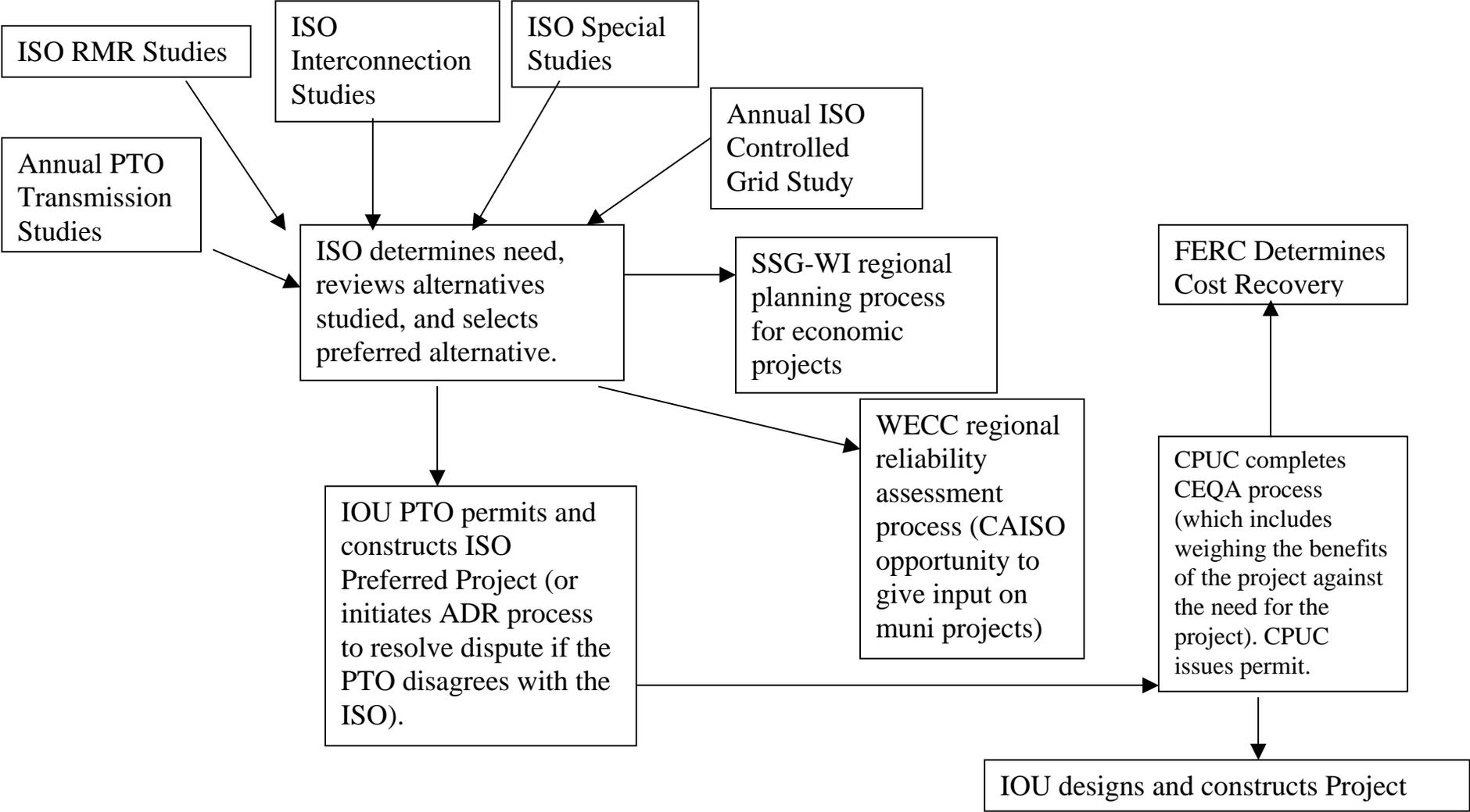
California Public Utilities Commission:

Commissioner Geoffrey F. Brown
Commissioner Susan P. Kennedy
Commissioner Loretta M. Lynch
Commissioner Carl W. Wood
Mr. William Ahern, Executive Director

California Power Authority:

Chairman S. David Freeman
Board Member Philip Angelides
Board Member Sunne Wright McPeak
Board Member Donald Vial
Ms. Laura Doll, Chief Executive Officer

Attachment 1
Current IOU Transmission Assessment
Process



Attachment 2
Proposed Transmission Assessment Process

ISO RMR Studies

CPUC's Long-term procurement proceeding determines optimal generation/ transmission/ demand response solution allowing forum for ISO, IOU and CEC (as established in the IERP) input and expertise

Annual PTO Transmission Studies

ISO Annual Grid Study

ISO Special Studies

ISO Studies Alternatives and Determines Need.

ISO Interconnection Studies

ISO Preferred Project (IOU Sponsors Project)

CPUC's CPCN Process Evaluates:
1) Reviews application of the Economic Methodology in determining need
2) Conducts CEQA)
3) Established a Cost Cap for the Project

FERC Determines Cost Recovery

CPUC conducts Cost allocation and rate design for FERC approved Revenue Requirement

Transmission Proceeding Determines Economic Methodology to be applied in Interconnection Studies and ISO economic need assessment