

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: June 27, 2005

To: The Commission
(Meeting of June 30, 2005)

From: Delaney L. Hunter, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: AB 1576 (Nunez) Electrical corporations: rates: repowering projects
As Amended (May 23, 2005)

Recommendation: Support if amended.

Summary: This bill authorizes the state's electric utilities to enter into long-term contracts for the output of repowered generation facilities and declares that the costs of such contracts shall be recoverable in rates from all customers who benefit from the repowered facilities. The contracts would be on a cost-of-service basis. The recoverable costs include any collateral requirements and debt equivalence associated with the contract.

The purpose of the bill is to facilitate the repowering of existing electric generating facilities that are strategically located and interconnected to gas transmission pipelines and the electric transmission system in a manner that optimizes their reliability, deliverability, cost-effectiveness, and their ability to deliver power to load centers. Many such plants are old and are less than optimal in their current condition, and they are at high risk of being retired even though they (a) are helpful to the state's reserve margin, and (b) provide necessary services, such as local reliability and voltage support, etc. Repowering old units with new generating technology would make such units more cost-effective by increasing the net generating capacity, reducing the heat rate, and reducing emissions. The bill specifies that the costs "shall be recoverable in rates from all customers who benefit, taking into account any collateral requirements and debt equivalence associated with the contract."

Analysis: There are three major elements of AB 1576:

1. The bill would create a new class of power plants: repowered units necessary for local reliability, whose costs would be recovered on a cost-of-service basis,

even though they are not owned by a regulated electric utility. Only certain plants would qualify:

- Repowering of an existing project, located within the existing boundaries of the existing plant, not requiring significant additional rights-of-way or fuel-related transmission facilities, and would result in significant and substantial increases in efficiency;
 - California Energy Commission certifies that the project is eligible for certification pursuant to Section 25550.5 of the Public Resources Code;
 - The California Independent System Operator (or local system operator) certifies that the project is necessary for local area reliability and the Commission or local governing body concurs; and
 - The output is provided at cost of service.
2. The costs of these contracts would be "recoverable in rates from all customers who benefit."
 3. The recoverable costs should include collateral requirements and debt equivalence.

Long-term power contracting. AB 1576 attempts to end the stand-off between the owners of some existing plants that are extremely helpful for local reliability and the utilities by authorizing utilities to enter into long-term contracts.¹ The plant owners complain that they cannot get contracts that are fully compensatory of their costs. Utilities have voiced concern about the locational market power certain plants could exert. The Commission has indicated these plants should be saved and upgraded. We have said so in more than one decision (see particularly D.04-01-050²). In addition, the Energy Action Plan favors this type of investment,³ but so far we have not seen investors willing to undertake such investments without a long-term contract. It is important to note that under existing authority, utilities can seek to enter into long-term power purchase agreements (PPAs) for repowered projects by conducting a competitive resource solicitation and submitting contracts for pre-approval by the Commission via an application filing. While this bill authorizes long-term contracting, it does not address at all the procurement process(es) the utilities should use to solicit

1 Currently, the utilities are authorized to enter into contracts up five years in term under approved procurement plans. If a utility wishes to enter into a contract for a term exceeding five years, the utility must file an application for Commission review.

2 D.04-01-050, p. 54: "To the extent that new generation resources are required, the utilities should first consider the overall advantages of repowering at existing plants or of development of brown field sites located close to load rather than development of new green field sites remote from load and requiring substantial transmission and other upgrades to the system."

3 Energy Action Plan, adopted by the Commission, May 8, 2003. P. 6. "The state needs to ... modernize old, inefficient and dirty plants."

PPAs (resource specific RFO⁴ vs. all-source RFO vs. bilateral negotiated contract) and how such contracts would be reviewed by the Commission.

Cost recovery. This bill would provide protection to a utility's customers in that costs would be "recoverable from all customers who benefit." We should expect that the customers of other LSEs would have a different view. This matter is currently before the Commission in its resource adequacy proceeding and is also a pending matter in SCE's June 2, 2005 Application for Approval of Contracts to Secure Additional Capacity for System Reliability in SP-15. AB 1576's attempt to resolve this matter for one type of resource (i.e., repowered units) jumps ahead of the Commission's own efforts to decide this matter on a broader basis for all utility procurement.

Debt equivalence. This bill clears up the question about collateral and debt equivalence. The Commission has determined in the most recent procurement decision (D.04-12-048) that debt equivalence is a real phenomenon.⁵ But that decision did not award recovery, it pushed the subject over to the cost-of-capital proceedings, where no such award has been granted. This bill ends any tentativeness about such recovery for PPAs with repowered units by explicitly granting recovery of debt equivalence. Again, the bill proposes to resolve this matter apart from the Commission's attempt to decide this issue on a broader procurement context.

Creation of a new class of generators. AB 1576 creates a whole new category of generator entities whose costs the Commission would have to monitor and evaluate for reasonableness. Contracts entered into under this bill are to be cost-based, whereas all other procurement transactions executed by utilities are market based. This results in a new and fragmented market structure in California. Additionally, the bill does not provide any guidance as to how the Commission shall integrate a cost-of-service contract review process into the AB 57 procurement and cost recovery framework that emphasizes the use of upfront standards of review.

CPUC jurisdiction. It is not clear whether the transactions between the cost-of-service plants and the cost-of-service utilities would be CPUC jurisdictional. In fact, since the power would be delivered to a utility as wholesale power, most likely, the transaction would be subject to FERC jurisdiction. This is a legal point, and a legal analysis would be appropriate.

RECOMMENDED AMENDMENTS

Given concerns about the current language in the bill and because the bill presupposes outcomes of current Commission proceedings, staff recommends working with the author's office to strike the current language in the bill and work to enact potential incentives and policies encouraging the repowering of strategically located generation facilities in California.

4 Request For Offer

5 D.04-12-048. See extended discussion in section VIII.E, p. 142 and following.

LEGISLATIVE HISTORY

On June 1, 2005, the bill passed out of the Assembly on a 76-0 vote. The bill is scheduled to be heard on Thursday, June 30th in the Senate Committee on Energy, Utilities and Communications.

SUPPORT/OPPOSITION

Support:

None on file.

Opposition:

None on file.

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BILL LANGUAGE:

BILL NUMBER: AB 1576 AMENDED
BILL TEXT

AMENDED IN ASSEMBLY MAY 23, 2005
AMENDED IN ASSEMBLY APRIL 12, 2005

INTRODUCED BY Assembly Member Nunez

FEBRUARY 22, 2005

An act to add Section 454.6 to the Public Utilities Code, relating to public utilities.

LEGISLATIVE COUNSEL'S DIGEST

AB 1576, as amended, Nunez. Electrical corporations: rates: repowering projects.

Under existing law, the Public Utilities Commission has regulatory authority over public utilities, including electrical corporations. Existing law authorizes the commission to fix the rates and charges for every public utility, and requires that those rates and charges be just and reasonable. Under existing law, a public utility has a duty to serve, including furnishing and maintaining adequate, efficient, just and reasonable service, instrumentalities, equipment, and facilities as are necessary to promote the safety, health, comfort, and convenience of its patrons and the public. The Public Utilities Act requires the commission to review and adopt a procurement plan for each electrical corporation in accordance with specified elements, incentive mechanisms, and objectives, including the requirement that the procurement plan enable the electrical corporation to fulfill its obligation to serve its customers at just and reasonable rates.

Existing law, until January 1, 2007, requires the State Energy Resources Conservation and Development Commission (Energy Commission) to establish a process for the expedited review of applications to construct and operate thermal powerplants and related facilities and for the expedited review of repowering projects.

This bill would require ~~the commission to deem a contract entered into pursuant to a~~ that the costs of a contract entered into pursuant to a procurement plan by an electrical corporation for the output of a repowering project that meets specified criteria to be ~~reasonable per se, and would require that the costs of that contract be~~ recoverable in rates from all customers who benefit, taking into account any collateral requirements and debt equivalence associated with the contract.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. The Legislature finds and declares all of the following:

(a) It is in the public interest for the this state's electricity

generating facilities to provide clean, reliable, efficient, and affordable power to the state's electricity consumers.

(b) Certain existing electric generating facilities are strategically located and interconnected to gas transmission pipelines and the electric transmission system in a manner that optimizes their reliability, deliverability, their cost-effectiveness, and their ability to deliver power to load centers.

(c) Many of these existing electric generating facilities, while located on optimal sites, exhibit less than optimal environmental performance, reliability, and efficiency compared to facilities that have been more recently permitted to operate.

(d) According to the State Energy Resources Conservation and Development Commission, a number of these older, less efficient electric generating facilities are at a high risk of being retired in the next several years. As a result, their generating capacity, which establishes a valuable reserve margin for the state, helps to provide local reliability and voltage support, and alleviates transmission congestion, will no longer be available.

(e) Because of their strategic location and existing infrastructure, it is in the best interest of the state to optimize the use of these sites by repowering these facilities.

(f) Investment in repowered electric generating facilities replaces our aging facilities with more efficient and cost-effective facilities that enhance environmental quality and provide economic benefits to the communities in which they are located.

(g) Therefore, it is in the public interest for the state to facilitate investment in the repowering of older, less-efficient electric generating facilities in order to improve local area reliability and enhance the environmental performance, reliability, efficiency, and cost-effectiveness of these facilities.

(h) An effective means for facilitating that investment, while ensuring adequate ratepayer protection, is to authorize electrical corporations to enter into long term contracts for the output from these facilities on a cost-of-service basis.

SEC. 2. Section 454.6 is added to the Public Utilities Code, to read:

454.6.

(a) ~~The commission shall deem a~~ A contract entered into pursuant to Section 454.5 by an electrical corporation for the output of a repowering project that meets the criteria specified in subdivision (b) ~~to be reasonable per se, and the costs of that contract~~ shall be recoverable in rates from all customers who benefit, taking into account any collateral requirements and debt equivalence associated with the contract.

(b) To be eligible for rate treatment in accordance with subdivision (a), a project shall meet all of the following criteria:

(1) The project is a modification of an existing generation unit of a thermal powerplant that meets all of the following criteria:

(A) The project complies with all applicable requirements of federal, state, and local laws.

(B) The project is located on the site of, and within the existing boundaries of, an existing thermal facility.

(C) The project will not require significant additional rights-of-way for electrical or fuel-related transmission facilities.

(D) The project will result in significant and substantial increases in the efficiency of the production of electricity,

including, but not limited to, reducing the heat rate, reducing the use of natural gas, reducing the use and discharge of water, and reducing air pollutants emitted by the project, as measured on a per-kilowatthour basis.

(2) The State Energy Resources Conservation and Development Commission certifies that the project is eligible for certification pursuant to Section 25550.5 of the Public Resources Code.

(3) The Independent System Operator or local system operator certifies that the project is necessary for local area reliability, and the commission or local governing body, as applicable, concurs.

(4) The project provides its output to consumers of this state at the cost of generating that electricity, including a reasonable return on the investment and the costs of financing the project.