Item #94
(5508)

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: April 5, 2006

To: The Commission
(Meeting of April 13, 2006)

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

Subject: **AB 2960 (Ridley-Thomas) - Energy: electrical corporation procurement plans.**
As Introduced February 24, 2006

LEGISLATIVE SUBCOMMITTEE RECOMMENDATION: Oppose

SUMMARY OF BILL:

This bill requires electric utility procurement plans approved by the Commission to provide for appropriate incentives to reduce the possibility that natural gas price volatility will increase prices for electricity generated from natural gas.

SUMMARY OF SUPPORTING ARGUMENTS FOR RECOMMENDATION:

AB 2960 is not necessary because current law requires utility procurement plans approved by the Commission to provide for price stability and the moderation of price risk in order to achieve just and reasonable rates. Consistent with these statutory requirements, the Commission has adopted regulatory polices governing the utilities' electric procurement price risk management practices. The goals of these policies are to protect utility ratepayers against the possibility of future electric rate increases caused by either electric or natural gas price volatility.

Furthermore, the proposed legislation would require that the Commission authorize the use of an incentive based price risk management approach toward achieving price stability and electric procurement cost minimization for natural gas fired generation. Without further deliberation, such an approach might not be in the best interest of utility ratepayers. Rather than issue a statutory mandate, it is more appropriate to maintain the Commission's discretion to consider the merits of various utility price risk management strategies (including the use of appropriate incentives) through its electric procurement rulemaking proceedings.

DIVISION ANALYSIS (Energy Division):

The objective of AB 2960 is already manifested through existing state law and the Commission's current regulatory polices.

The proposed legislation seeks to ensure that a utility's electric procurement plan mitigates against the effect of natural gas price volatility on electricity rates. This is a worthwhile public policy objective as it serves to reduce the possibility of electricity rate increases driven by higher natural gas prices. However, existing state law currently requires the Commission to adopt electric procurement polices addressing the appropriate level of price risk associated with a utility's electricity supply portfolio in order to achieve just and reasonable rates (see Public Utilities Code sections 454.5 (b) (1), (d) (4) and (5)).

Consistent with these statutes, the Commission has adopted a comprehensive price risk management policy governing the utilities' electric procurement practices. The basic elements of this policy require the electric utilities to: 1) measure the value of their electric supply portfolio exposed to price risk (referred to as the "To Expiration Value at Risk" or TeVaR); 2) report TeVaR to the Commission regularly, and; 3) confer with Commission staff and other stakeholders (such as the Division of Ratepayer Advocates and TURN) when TeVaR is estimated to exceed a specified level to determine if procurement hedging strategy modifications are needed. This threshold level was developed in order to protect utility ratepayers against the possibility of future rate increases resulting from electric and natural gas price volatility. Pursuant to the Commission's adopted price risk management policies, electric utilities do engage in strategies, including financial hedging, designed to mitigate against volatility in natural gas supply costs.

In addition to being unnecessary, AB 2960 may result in forcing the Commission to adopt price risk management policies that are not optimal or do not serve utility ratepayers. Although not explicitly stated in the proposed legislation, incentive based regulatory programs generally involve a sharing of an activities benefits and risks between the utility and its ratepayers. Such an approach might not be suited for all situations or be unnecessary in order to achieve the desired public policy objective. Additionally, the use of incentives may introduce additional regulatory concerns such as the potential for manipulation or "gaming" to the unjust benefit of certain parties.

Given the aforementioned considerations, an incentive based regulatory program should be undertaken only after thoughtful deliberation. Therefore, it is more appropriate that the Commission maintain the latitude to consider the use of incentives or other methodologies for natural gas price risk management through its rulemaking processes. The Commission has the authority to undertake such an investigation on its own initiative. (As information, the Commission is currently reviewing the requirements for the upcoming filing of new utility Long Term Procurement Plans in Rulemaking (R.) 06-02-013.)

PROGRAM BACKGROUND:

The Commission developed its current electric procurement risk management policies in its electric procurement rulemaking R. 01-10-024. In Decisions 02-10-062, 02-12-074 and 03-12-062, issued in R.01-10-024, the Commission considered and adopted various elements of its current price risk management policies.

LEGISLATIVE HISTORY:

None

FISCAL IMPACT:

The fiscal impact of this bill would be minor and absorbable. AB 2960 should not increase the staff's current workload by any appreciable amount. The bill requires utilities to include incentives in their Long Term Procurement Plans (LTPP) related to natural gas price risk management. Staff currently reviews electric utility price risk management strategies within the context of the Commission's electric procurement proceeding. Accordingly, analysis of any additional strategies resulting from AB 2960 would be incorporated into this existing review.

STATUS:

This bill was heard in the Assembly Utilities and Commerce Committee on April 3, 2006 and passed. The bill will be heard next in the Assembly Appropriations Committee.

SUPPORT/OPPOSITION:

Support

Clean Power Campaign (sponsor)

Opposition

Sempra Energy

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BILL LANGUAGE:

BILL NUMBER: AB 2960 INTRODUCED
BILL TEXT

INTRODUCED BY Assembly Member Ridley-Thomas

FEBRUARY 24, 2006

An act to amend Section 454.5 of the Public Utilities Code, relating to energy.

LEGISLATIVE COUNSEL'S DIGEST

(1) The existing 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. Among the objectives that a procurement plan is required to accomplish are to moderate the price risk associated with serving its retail customers and to provide for just and reasonable rates, with an appropriate balancing of price stability and price level in the plan.

This bill would require that an additional objective of an electrical corporation's procurement plan is to provide for appropriate incentives to mitigate against price volatility in natural gas supply costs when an electricity supply contract provides for the price of electricity to increase when the price of natural gas used to generate the electricity increases.

(2) Under existing law, a violation of the Public Utilities Act or an order or direction of the commission is a crime.

Because the provisions of this bill would be a part of the act and because a violation of an order or decision of the commission implementing its requirements would be a crime, the bill would impose a state-mandated local program by expanding an existing crime.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

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

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

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

(a) Natural gas plays a critical role in California's energy market, with generation of electricity accounting for half of the natural gas consumed in the state.

(b) Natural gas supplies are dwindling nationally and the gap between demand for, and supplies of, natural gas is widening, causing an increase in price volatility.

(c) Because of price escalation clauses in electricity supply contracts, natural gas price volatility affects residential, commercial, and industrial electricity bills and threatens California's economy.

(d) While California's programs for promoting energy efficiency and expansion of renewable energy resources for the generation of electricity are important policies for decreasing the state's use of natural gas, additional steps need to be taken to mitigate against natural gas price volatility.

(e) Wholesale generators, electrical corporations, and gas corporations are the only entities that are in a position to undertake steps to mitigate against natural gas price volatility.

(f) The Public Utilities Commission should establish appropriate incentives for wholesale generators, electrical corporations, and gas corporations to mitigate against the risks of price volatility for natural gas used to generate electricity.

SEC. 2. Section 454.5 of the Public Utilities Code is amended to read:

454.5. (a) The commission shall specify the allocation of electricity, including quantity, characteristics, and duration of electricity delivery, that the Department of Water Resources shall provide under its power purchase agreements to the customers of each electrical corporation, which shall be reflected in the electrical corporation's proposed procurement plan. Each electrical corporation shall file a proposed procurement plan with the commission not later than 60 days after the commission specifies the allocation of electricity. The proposed procurement plan shall specify the date that the electrical corporation intends to resume procurement of electricity for its retail customers, consistent with its obligation to serve. After the commission's adoption of a procurement plan, the commission shall allow not less than 60 days before the electrical corporation resumes procurement pursuant to this section.

(b) An electrical corporation's proposed procurement plan shall include, but not be limited to, all of the following:

(1) An assessment of the price risk associated with the electrical corporation's portfolio, including any utility-retained generation, existing power purchase and exchange contracts, and proposed contracts or purchases under which an electrical corporation will procure electricity, electricity demand reductions, and electricity-related products and the remaining open position to be served by spot market transactions.

(2) A definition of each electricity product, electricity-related product, and procurement related financial product, including support and justification for the product type and amount to be procured under the plan.

(3) The duration of the plan.

(4) The duration, timing, and range of quantities of each product to be procured.

(5) A competitive procurement process under which the electrical corporation may request bids for procurement-related services, including the format and criteria of that procurement process.

(6) An incentive mechanism, if any incentive mechanism is proposed, including the type of transactions to be covered by that mechanism, their respective procurement benchmarks, and other

parameters needed to determine the sharing of risks and benefits.

(7) The upfront standards and criteria by which the acceptability and eligibility for rate recovery of a proposed procurement transaction will be known by the electrical corporation prior to execution of the transaction. This shall include an expedited approval process for the commission's review of proposed contracts and subsequent approval or rejection thereof. The electrical corporation shall propose alternative procurement choices in the event a contract is rejected.

(8) Procedures for updating the procurement plan.

(9) A showing that the procurement plan will achieve the following:

(A) The electrical corporation will, in order to fulfill its unmet resource needs and in furtherance of Section 701.3, until a 20 percent renewable resources portfolio is achieved, procure renewable energy resources with the goal of ensuring that at least an additional 1 percent per year of the electricity sold by the electrical corporation is generated from renewable energy resources, provided sufficient funds are made available pursuant to Section 399.6, to cover the above-market costs for new renewable energy resources.

(B) The electrical corporation will create or maintain a diversified procurement portfolio consisting of both short-term and long-term electricity and electricity-related and demand reductions products.

(C) The electrical corporation will first meet its unmet resource needs through all available energy efficiency and demand reduction resources that are cost effective, reliable, and feasible.

(10) The electrical corporation's risk management policy, strategy, and practices, including specific measures of price stability.

(11) A plan to achieve appropriate increases in diversity of ownership and diversity of fuel supply of nonutility electrical generation.

(12) A mechanism for recovery of reasonable administrative costs related to procurement in the generation component of rates.

(c) The commission shall review and accept, modify, or reject each electrical corporation's procurement plan. The commission's review shall consider each electrical corporation's individual procurement situation, and shall give strong consideration to that situation in determining which one or more of the features set forth in this subdivision shall apply to that electrical corporation. A procurement plan approved by the commission shall contain one or more of the following features, provided that the commission may not approve a feature or mechanism for an electrical corporation if it finds that the feature or mechanism would impair the restoration of an electrical corporation's creditworthiness or would lead to a deterioration of an electrical corporation's creditworthiness:

(1) A competitive procurement process under which the electrical corporation may request bids for procurement-related services. The commission shall specify the format of that procurement process, as well as criteria to ensure that the auction process is open and adequately subscribed. Any purchases made in compliance with the commission-authorized process shall be recovered in the generation component of rates.

(2) An incentive mechanism that establishes a procurement benchmark or benchmarks and authorizes the electrical corporation to

procure from the market, subject to comparing the electrical corporation's performance to the commission-authorized benchmark or benchmarks. The incentive mechanism shall be clear, achievable, and contain quantifiable objectives and standards. The incentive mechanism shall contain balanced risk and reward incentives that limit the risk and reward of an electrical corporation.

(3) Upfront achievable standards and criteria by which the acceptability and eligibility for rate recovery of a proposed procurement transaction will be known by the electrical corporation prior to the execution of the bilateral contract for the transaction. The commission shall provide for expedited review and either approve or reject the individual contracts submitted by the electrical corporation to ensure compliance with its procurement plan. To the extent the commission rejects a proposed contract pursuant to this criteria, the commission shall designate alternative procurement choices obtained in the procurement plan that will be recoverable for ratemaking purposes.

(d) A procurement plan approved by the commission shall accomplish each of the following objectives:

(1) Enable the electrical corporation to fulfill its obligation to serve its customers at just and reasonable rates.

(2) Eliminate the need for after-the-fact reasonableness reviews of an electrical corporation's actions in compliance with an approved procurement plan, including resulting electricity procurement contracts, practices, and related expenses. However, the commission may establish a regulatory process to verify and assure that each contract was administered in accordance with the terms of the contract, and contract disputes which may arise are reasonably resolved.

(3) Ensure timely recovery of prospective procurement costs incurred pursuant to an approved procurement plan. The commission shall establish rates based on forecasts of procurement costs adopted by the commission, actual procurement costs incurred, or combination thereof, as determined by the commission. The commission shall establish power procurement balancing accounts to track the differences between recorded revenues and costs incurred pursuant to an approved procurement plan. The commission shall review the power procurement balancing accounts, not less than semiannually, and shall adjust rates or order refunds, as necessary, to promptly amortize a balancing account, according to a schedule determined by the commission. Until January 1, 2006, the commission shall ensure that any overcollection or undercollection in the power procurement balancing account does not exceed 5 percent of the electrical corporation's actual recorded generation revenues for the prior calendar year excluding revenues collected for the Department of Water Resources. The commission shall determine the schedule for amortizing the overcollection or undercollection in the balancing account to ensure that the 5 percent threshold is not exceeded. After January 1, 2006, this adjustment shall occur when deemed appropriate by the commission consistent with the objectives of this section.

(4) Moderate the price risk associated with serving its retail customers, including the price risk embedded in its long-term supply contracts, by authorizing an electrical corporation to enter into financial and other electricity-related product contracts.

(5) Provide for just and reasonable rates, with an appropriate balancing of price stability and price level in the electrical corporation's procurement plan.

(6) Provide for appropriate incentives to mitigate against price volatility in natural gas supply costs where the electricity is being generated from the burning of natural gas and the electricity supply contract provides for the price of electricity to increase when natural gas prices increase.

(e) The commission shall provide for the periodic review and prospective modification of an electrical corporation's procurement plan.

(f) The commission may engage an independent consultant or advisory service to evaluate risk management and strategy. The reasonable costs of any consultant or advisory service is a reimbursable expense and eligible for funding pursuant to Section 631.

(g) The commission shall adopt appropriate procedures to ensure the confidentiality of any market sensitive information submitted in an electrical corporation's proposed procurement plan or resulting from or related to its approved procurement plan, including, but not limited to, proposed or executed power purchase agreements, data request responses, or consultant reports, or any combination, provided that the Office of Ratepayer Advocates and other consumer groups that are nonmarket participants shall be provided access to this information under confidentiality procedures authorized by the commission.

(h) Nothing in this section alters, modifies, or amends the commission's oversight of affiliate transactions under its rules and decisions or the commission's existing authority to investigate and penalize an electrical corporation's alleged fraudulent activities, or to disallow costs incurred as a result of gross incompetence, fraud, abuse, or similar grounds. Nothing in this section expands, modifies, or limits the State Energy Resources Conservation and Development Commission's existing authority and responsibilities as set forth in Sections 25216, 25216.5, and 25323 of the Public Resources Code.

(i) An electrical corporation that serves less than 500,000 electric retail customers within the state may file with the commission a request for exemption from this section, which the commission shall grant upon a showing of good cause.

(j) (1) Prior to its approval pursuant to Section 851 of any divestiture of generation assets owned by an electrical corporation on or after the date of enactment of the act adding this section, the commission shall determine the impact of the proposed divestiture on the electrical corporation's procurement rates and shall approve a divestiture only to the extent it finds, taking into account the effect of the divestiture on procurement rates, that the divestiture is in the public interest and will result in net ratepayer benefits.

(2) Any electrical corporation's procurement necessitated as a result of the divestiture of generation assets on or after the effective date of the act adding this subdivision shall be subject to the mechanisms and procedures set forth in this section only if its actual cost is less than the recent historical cost of the divested generation assets.

(3) Notwithstanding paragraph (2), the commission may deem proposed procurement eligible to use the procedures in this section upon its approval of asset divestiture pursuant to Section 851.

SEC. 3. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.