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Decision 04-11-034 November 19, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on policies and practices for advanced metering, demand response, and dynamic pricing.	Rulemaking 02-06-001 (Filed June 6, 2002)

OPINION DIRECTING PG&E TO NEGOTIATE AN AGREEMENT WITH THE CALIFORNIA POWER AUTHORITY FOR OPERATION OF THE DEMAND RESERVES PARTNERSHIP PROGRAM

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OPINION DIRECTING PG&E TO NEGOTIATE AN AGREEMENT WITH THE CALIFORNIA POWER AUTHORITY FOR OPERATION OF THE DEMAND RESERVES PARTNERSHIP PROGRAM

I. Summary

This decision directs Pacific Gas and Electric Company (PG&E) to negotiate an agreement with the California Consumer Power and Conservation Financing Authority (CPA) for the future operation and management of the Demand Reserves Partnership (DRP) program and file and serve a term sheet containing the general principles it has agreed to with the California Power Authority by November 30, 2004, and a final agreement by February 1, 2005.

II. Background

The DRP is a demand response program developed by the CPA and the California Department of Water Resources (DWR). In 2002 CPA and DWR executed a five-year contract, the Demand Reserves Purchase Agreement,[1] that allows DWR[2] to secure power though reductions in demand, rather than generation.

A. Program Operation

There are various supporting contracts, called "Demand Reserves Provider Agreements," which underlie the Demand Reserve Purchase Agreement. These contracts, between the CPA and eight third-party aggregators, specify the terms

[1] The Demand Reserves Purchase Agreement has been amended yearly, most recently in August 2004. The name of the agreement and its terms changed with each amendment, but for purpose of this decision, we refer to the DWR-CPA agreement by its original name, and summarize the terms that are currently in effect.

[2] During the 2000-01 Energy Crisis, DWR began securing power on behalf of investor-owned utilities (IOUs) some of whom were not creditworthy.

and conditions under which the aggregators provide power to the CPA. The terms of the supporting contracts basically mirror the terms of the Demand Reserve Purchase Agreement, except for the prices paid by DWR to the CPA. The aggregators, or "Demand Reserve Providers," in turn, have individual agreements with electricity customers who provide the actual demand reduction. The CPA does not negotiate those agreements and is not privy to their contents.

The Demand Reserve Purchase Agreement enables DWR to purchase power from CPA when energy supplies are short or when it is economic to do so.[3] DWR electronically notifies CPA and (and its contractor Automated Power Exchange (APX)) how much power it needs. CPA and APX then notify the aggregators, who notify participating customers. Participating customers curtail their load and make power available for the customers of the utilities.

In exchange for their participation in the DRP, customers receive a monthly capacity payment (based on the amount of load committed for reduction) along with an energy payment (actual amount of energy reduced).

The program operates year-round, but is designed to provide power during summer months when it is most needed. In Summer 2002, the program had 15 megawatts (MW) of capacity; by Summer 2004, the program's capacity increased to 356 MWs.[4] The Demand Reserves Purchase Agreement provides for two more summers of operation (2005 and 2006).

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[3] Currently the price of power under the Demand Reserve Purchase Agreement is $80 per megawatt-hour (MWh). As discussed in Section II.B of this decision, the utilities have pending agency agreements with DWR that would enable them, as agents to DWR, to also schedule and dispatch the DRP when it fits within their least-cost dispatch requirements.

[4] Utilities' monthly demand response reports for the month of August 2004.

B. The Commission Directed the DRP to Be Incorporated Into the Utilities' Scheduling and Dispatch Functions

In Decision (D.) 03-06-032, the Commission recognized the DRP as a viable and important program, and the only demand response program that allowed participation by direct access customers. The Commission therefore directed PG&E, Southern California Edison Company (SCE), and San Diego Gas & Electric Company (SDG&E) (the utilities) to develop implementation plans with DWR and the CPA to ensure that the utilities dispatch DRP power when it is cost-effective to do so. The demand response MWs generated by the DRP are credited to the utilities' attainment of their demand response MW goals,[5] adopted also in D.03-06-032.

In July 2004, the utilities reported that they were in negotiations with DWR on prospective agency agreements, which would govern the terms of how and when DWR and the utilities could schedule and dispatch the DRP. The utilities would act as agents to DWR, enabling them to schedule and dispatch the DRP when it was cost-effective, as well as assisting DWR with other tasks such as verifying the invoices DWR receives from the CPA.

One key area of dispute in the negotiations was DWR's insistence that it retain its authority to schedule and dispatch the DRP, with that authority limited to reliability or testing purposes. Commission Resolution E-3875 addressed this issue by absolving the utilities from least-cost dispatch penalties when DWR triggers the program for reliability or testing purposes. Resolution E-3875 also

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[5] The MW goals are based on a percentage of the utilities' annual system peak demand. For 2005, the utilities are directed to attain demand response MWs that equate to 3% of their annual system peak demand.

resolved several other issues of disagreement between the utilities and DWR and directed the utilities to file final agency agreements for Commission approval.[6] Upon the Commission approval of the proposed agency agreements between each of the utilities and DWR, the utilities would be agents of DWR for the DRP.

III. The CPA's Operating Budget Will Be Depleted by November 30, 2004

Acting Chair of the CPA, Sunne McPeak, requested the Commission's assistance in ensuring the continued functioning of the DRP in a letter dated November 5, 2004, to Commission President Michael R. Peevey.[7] According to the letter, the Governor's budget for 2004-2005 effectively reduced the CPA's funding with the result that the CPA's operating fund will be exhausted by November 30, 2004. At the same time, according to the letter, the administration supports the DRP as an important contributor to meeting the state's electric reliability needs and has indicated that the DRP should continue after the CPA's operating funding is depleted.

The CPA initially attempted to place the program with the California Energy Commission (CEC), but according to the CPA that effort failed because the CEC currently lacks the statutory authority to buy and sell power as required by the DRP contracts. The CPA suggests that the IOUs are well-suited to take over the CPA's contractual responsibilities since they regularly buy and sell

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[6] The utilities filed advice letters 2563-E (PG&E), 1720-E-B (SCE) and 1512-E-B (SDG&E) on October 8, which contain their proposed agency agreements with DWR. On October 26, DWR informed the Commission that it has not reached agreement with SDG&E and thus will not sign the draft proposed by SDG&E in its advice letter.

[7] A copy of the letter was served on Rulemaking (R.) 02-06-001 on November 10, 2004.

power, and therefore requests that the Commission takes the steps necessary to transfer responsibility for the DRP to one or more of the IOUs.

Because no changes have been made to its originating statute, the CPA will remain a legal entity after November 30, 2004 despite having exhausted its operating budget. Because the CPA will continue to statutorily exist, its specific funds for the DRP remain established in statute as well. According to a memo from Laura Doll Executive Director of the CPA to the Energy Division, dated November 18, 2004, these circumstances require that an official state government individual must be designated as Fiscal Agent of the CPA with the delegated ability to administer remaining financial actions and/or contractual actions associated with the closeout of the CPA. The CPA states that because the DRP provides critically needed demand response resources to the state, its operation should be continued through 2007. Given the importance of the program, the CPA is arranging to secure a Fiscal Agent who will act on its behalf to ensure the continued functioning of the DRP while the program's operational management is transferred to PG&E in 2005. The Fiscal Agent will have oversight of funds received from DWR, make payments to DRP aggregators and contractors, approve any new agreements with aggregators, and have financial and legal responsibilities for the DRP. The Fiscal Agent will also be empowered to approve the anticipated operational agreement with PG&E. The CPA anticipates that the Fiscal Agent will be from the state Business, Transportation and Housing Agency and that the arrangement will be finalized prior to November 30.

IV. Program Obligations, Funding and Costs

A. Contracts

The operation of the DRP is governed by a set of contracts that the CPA has with several entities. There are a total of 20 contracts: (1) the Demand

Reserve Purchase Agreement between DWR and CPA; (2) demand reserve provider contracts with eight aggregators (also called demand reserve providers); (3) a demand reserves provider contract with an end-user customer (the California State Water Project (SWP)); (4) demand reserve delivery agreements with five energy service providers (ESPs); (5) an agreement with the California Independent System Operator (ISO); and (6) agreements with four contractors, including the "Demand Reserves Power System Development and Operations Agreement" between CPA and APX.

1. Demand Reserves Purchase Agreement

The Demand Reserves Purchase Agreement governs the sale of power to DWR by the CPA, which the CPA provides through participating end-users that agree to curtail their power use.[8] The Demand Reserve Purchase Agreement is a capacity plus energy contract and is in place until May 2007. The contract has been amended each year since 2002; the terms described here reflect the most recent agreement.[9]

End-users determine their participation in the program by selecting to be in one of three groups (Group A, B or C), each with different incentives and obligations.

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[8] As explained, CPA contracts directly with only one end-user, the State Water Project. Most participating end-users contract with one of the eight aggregators with whom CPA has contracts.

[9] The terms of the Demand Reserves Purchase Agreement were recently renegotiated in 2004. CPA signed the revised agreement, known as the "Second Amended and Restated Demand Reserves Provider Interagency Agreement "during the summer. DWR has verbally agreed to its terms, but has not yet signed the revised agreement.

The CPA is obligated to nominate an amount of load to DWR at the beginning of the month, organized according to the three groups. The following table indicates the commitment levels and capacity payment rates for each group:

	Hours of Interruption Per Call	**Capacity Payment CPA Charges DWR**
Group A	Minimum of 1 hr., up to 3 hrs.	$10,000/MW-month
Group B	Minimum of 1 hr., up to 5 hrs.	$11,000/MW-month
Group C	Minimum of 1 hr., up to 8 hrs.	$12,000/MW-month

The capacity payments listed above are paid in June, July, August, and September. For the remaining months of the year, the capacity payment is $500/MW-month.

In addition to their monthly nominations, customers may increase their nominated amount two days ahead of each program day. The aggregators inform the CPA of these adjustments, which in turn informs DWR. This increase is called Additional Hourly Capacity. DWR pays for this capacity at a prorated calculation of the monthly capacity payments in the table above. The monthly nomination of load, along with the Additional Hourly Capacity, is effectively what the CPA is committing to deliver to DWR should the program be called. Whenever the program is actually called and load is interrupted, DWR pays the CPA $80 per MWh for actual interruption in addition to the capacity payments listed above.

Penalties for failure to perform include loss of capacity payments, loss of energy payments and payment of ISO imposed penalties for deviations from scheduled load. DWR imposes these penalties on the CPA, which in turn imposes the penalties on the aggregators. The aggregators, in turn, impose these penalties on their specific end-users who failed perform.

The DRP is limited to 24 hours of interruption per month and 150 hours per year, irrespective of the group a participant selects. All groups must be reserved one day in advance of interruption with the actual notification for interruption at least 3 and ½ hours ahead of the actual interruption. This allows the interruption to be scheduled in the ISO hour-ahead markets.

As noted in Section II.B, the utilities have pending agency agreements with DWR that would enable them to trigger the program if it is cost-effective to do so. The pending agency agreements enable DWR to call the program for reliability reasons or for testing purposes.

2. Demand Reserve Provider Contracts

The Demand Reserve Provider or aggregator contracts basically mirror the Demand Reserve Purchase Agreement between DWR and the CPA, and they all expire in May 2007. In order for the CPA to nominate the load it can deliver to DWR, the CPA must be informed by the aggregators regarding the amount of load they can deliver if called. Thus, the contracts between the aggregators and the CPA specify that the aggregators nominate their monthly loads (organized according to the groups their end-users select to be in), and inform the CPA of any Additional Hourly Capacity that could be provided. The Demand Reserve Provider contracts follow a standard form for the most part, and the only significant difference between these contracts and the CPA-DWR contract is the capacity payment rates:

Group A: $8,500/MW-month

Group B: $9,000/MW-month

Group C: $10,000/MW-month

The capacity payments listed here are paid in June, July, August, and September. For the remaining months of the year, the capacity payment is $330/MW-month.

The energy rate paid by the CPA to the aggregators is $80 per MWh, the same rate that DWR pays to the CPA.

Penalties for failure to perform include loss of capacity payments, loss of energy payments and payment of ISO imposed penalties for deviations from scheduled load. The aggregators, presumably collect penalties from their end-user participants depending on the specific terms of the contracts they have with those entities. Consistent failure to perform by an aggregator enables the CPA to remove that aggregator from the program.

3. Demand Reserves Provider Contract With State Water Project

The CPA typically does not interact with end-users, as it relies on the aggregators to enroll end-users that are interested in participating in the DRP. The one exception to this is the SWP. The CPA contracts directly with the SWP because its contribution of 200MW exceeds the total MW provided by all the aggregators combined. The terms of the contract between SWP and CPA are virtually the same as the Demand Reserves Provider contracts.

4. Demand Reserves Delivery Agreements

These are agreements between ESPs and the CPA. The purpose of these agreements is to address the demand response reduction provided by Direct Access (DA) end-user participants in the DRP. The agreements are designed to ensure that the ESPs of DA customers are willing and able to move the power (made available by the customer's reduction in demand) to the IOU who would be triggering the program. Unlike the CPA's contracts with the aggregators, the contracts with the ESPs are unique from each other, each reflecting the varying circumstances of the customer and the ESP. Further these contracts expire at the end of 2004, and must be renewed by the CPA or its successor in order for DA customers to participate in the program in 2005.

The ESPs receive no compensation for entering these agreements, but participate so that their end-use customers have the opportunity to participate in the program. Thus the end-users and the aggregators benefit from these agreements.

5. CPA – ISO Contract

The CPA has a contract with the ISO that requires the CPA to follow the terms and conditions of the ISO tariff with respect to load that CPA brings to participate in the ISO ancillary service market.

The technical requirements and specifications are designed to allow the ISO to use the load so nominated as non-spinning reserve under Western Electricity Coordinating Council (WECC) reliability criteria. Failure to perform results in loss of payments from the ISO and penalties outlined in the ISO tariff.

The DRP currently is not operating the component known as Non-Spin Ancillary Services as the technical details of how this particular product will be provided are still in the design phases with the IOUs and other parties.

6. CPA – APX Contract

APX is a consulting firm that provides software communication and scheduling coordination services to the CPA for the DRP. Specific services provided by APX include software development and maintenance for the program, meter reading for verification of demand response load reductions, meter registration for end-use customers, scheduling coordination services for direct access customers, and notification services when the program is dispatched. APX is also responsible for maintenance and management of the DRP website which is the systems backbone of the program, collecting and summarizing performance of all the meters registered to participate, and providing settlement calculations. APX is compensated directly by the CPA for development costs and all other fees charged by APX are based on program enrollment. The contract with APX runs through until May 2007.

7. Management and Administrative Contracts

The CPA has contracts with three individuals for managerial, legal, and administrative services for the DRP. These services include management of the CPA's DRP contracts, management of APX, marketing the program to potential aggregators, verification of meter information for purposes of invoicing DWR, communication with utilities, aggregators, DWR, and ESPs, resolving disputes and contract renegotiations. These contracts are in effect until May 2007.

B. Program Costs

1. Aggregator Payments

The largest costs for the DRP are the payments due to the aggregators for demand response provided under the contracts. These costs will fluctuate depending on the amount of MWs that the aggregators can nominate. The CPA's current and forecasted estimates for these costs for the remainder of the program are as follows:

Year	Payments to Aggregators	Assumed MWs
June '04 – May '05	$8.4 million	232
June '05 – May '06	$16.1 million	500 (Aug – Sept.)
June '06 – May '07	$20.3 million	500 (June – Sept.)

2. Administrative Costs

The administrative costs for the program are largely based on the contract with APX (which has both development costs (at least through 2004) and operational costs that fluctuate based on participation levels), the management services contracts, and marketing costs. The CPA's current and forecasted estimates for these costs for the remainder of the program are as follows:[10]

Year	Payments to APX	Program Mgmt.	Program Marketing
June '04 – May '05	$1.37 million	$396,000	$40,000
June '05 – May '06	$1.71 million	$420,000	$60,000
June '06 – May '07	$2.1 million	$480,000	$20,000

C. Program Funding

The DRP currently has two sources of revenue to cover its expenses: DWR and the IOUs.

1. DWR

As described earlier, the Demand Reserves Purchase Agreement requires DWR to compensate the CPA for demand response reductions it provides. Each year DWR provides to the Commission its estimated annual revenue requirement to cover the costs of the energy supply contracts that it signed, including the costs of paying for the Demand Reserves Purchase Agreement with the CPA. Upon the Commission approval of its annual revenue requirement, DWR collects its revenues through a component in the IOUs' rates. For the 2005

[10] CPA's DRP pro-forma Financial Model submitted to Energy Division on November 2, 2004.

calendar year, DWR estimates that it will need approximately $16.9 million to pay for the Demand Reserves Purchase Agreement.[11]

[11] DWR's Determination of Revenue Requirement for the period January 1, 2005 through December 31, 2005, dated November 4, 2004.

DWR's Actual Annual Costs for the DRP

2002	$523,000
2003	$12.7 million
2004	$12 million (approx.)

2. IOUs

For 2003 and 2004, the utilities provided a total of approximately $2.7 million to the CPA to cover a portion of the CPA's initial upfront costs for the DRP.[12] When the DRP initially started in 2002, the CPA incurred significant start-up costs for front-end software development by APX and did not have the revenues to offset those costs since participation was just beginning to build. The funding authorized by the Commission in 2003 enabled the program to continue functioning.

The utilities have proposed that they continue a level of funding for the DRP for its remaining years.[13] The Commission will determine in R.02-06-001 whether any funding from the utilities is necessary, and if so, the appropriate amount.

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[12] D.03-06-032 authorized $1.6 million (for both 2003 and 2004) for the utilities to reimburse the CPA for its DRP administrative expenses. The utilities book these costs to their Advanced Metering Demand Reduction Memorandum Accounts (AMDRMA). For 2003, the utilities paid $1.2 million, and for 2004, the utilities will pay approximately $1.5 million according to invoices provided by PG&E to Energy Division on October 27 and 28, 2004.

[13] Utilities' October 15, 2004 filings for demand response programs and budgets for 2005 and beyond.

D. Anticipated Costs and Revenue Post-2004

By its second year of operation (June 2003 – May 2004) the program's participation levels had reached the point where its generated revenues offset its operating costs, and as of October 2004, the program has actually accumulated a reserve of about $2 million. That reserve is kept in the DRP Fund, which is a sub-account of the CPA Fund.[14]

The CPA anticipates that the program can continue to attract more participants to the program in 2005, thereby increasing its capacity to 500 MWs[15] and sustaining that amount into 2006. It also anticipates launching its non-spin ancillary services product in 2005. Given those assumptions, the CPA anticipates that for the June 2005 – May 2006 year, its revenues will be at least $19.2 million (assumes discontinuance of utility funding for administrative expenses), while its expenses will be approximately $18.2 million, creating a gross margin of $917,000.[16] For the June 2006 – May 2007 year, the CPA anticipates $24.2 million in revenues and $22.9 million in expenses, creating a gross margin of $1.3 million for that year.[17]

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[14] Section 3370 of the Public Utilities Code created the CPA fund in the State Treasury for purposes of implementing CPA's programs.

[15] CPA's draft Business Plan, dated October 4, 2004, submitted to Energy Division on October 21, 2004.

[16] CPA's DRP pro-forma financial model submitted to Energy Division on November 2, 2004.

[17] CPA's DRP pro-forma financial model submitted to Energy Division on November 2, 2004.

V. Ratepayer Benefits

The DRP generates demand response reductions—a resource available to the utilities in the event that the cost of other resources exceeds the cost of DRP energy, or if supply constraints threaten the reliability of the grid. In either case, ratepayers benefit from the demand response provided by participants in the program. The program is also recognized as unique from the utilities' other demand response programs in that it allows DA customer participation. In 2004, DWR triggered the program at least five times: June 30, July 22, August 11, September 7, September 23, and October 27.[18]

CPA DRP Program Usage for 2004

	MWs Called (Nominated by Participants)	MWs Provided
June 30	200	177.14
July 22	200.2	260.12
August 11	200.7	195.94
September 7	200	354.31
September 23	32.47	29.65
October 27	Not Available	Not Available

Source: CPA

VI. PG&E Is Directed to Negotiate an Agreement With the CPA

The DRP provides a substantial amount of demand response MWs that can be called on by either the IOUs or DWR to address either economic or reliability concerns until May 2007. According to CPA, with continued marketing the DRP has the capacity to expand beyond its current level of 230-270

[18] CPA's response to Energy Division data request submitted on November 12, 2004.

MWs, to as many as 500 MWs in 2005.[19] In 2003 we recognized the DRP as an important program, and that it currently holds a unique place among demand response programs because of its capacity to include DA customers.[20] Given its importance in providing demand response capability for both economic and reliability reasons, we agree that it makes sense to ensure the benefits of the DRP program are not lost after the CPA's operating budget has been exhausted. Utilities regularly purchase and sell energy, so having a utility assume the CPA's role in operating and managing the program for the next two summers is something we must consider given the importance of demand response as a key part of the Energy Action Plan's loading order.

Since the CPA requested the Commission's assistance in continuing the DRP, Energy Division staff has been discussing continuation of the DRP with the utilities and the CPA. PG&E, the utility whose service territory has the majority of DRP's MWs, has been discussing operation of the DRP program with the CPA. We direct PG&E to continue its negotiations with the CPA to settle on terms of an agreement that would effectively enable PG&E to operate, manage, and maintain the CPA's responsibilities for the program. We believe that directing one utility to negotiate an agreement (as opposed to directing all three) is the most pragmatic means of transferring the responsibility of the program in as seamless a manner as possible. We select PG&E as the most appropriate choice

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19 CPA's draft Business Plan, dated October 4, 2004, submitted to Energy Division on October 21, 2004.

20 The Commission will be considering extending utility demand response programs to DA customers in R.02-06-001 as the utilities have made this proposal as part of their efforts to achieve their demand response goals for 2005 (Utilities' October 15 filing).

from among the three affected utilities because the majority of MWs generated by the DRP are in its territory.

While the CPA has advised us that its operating budget will expire by November 30, 2004, its statutory authority[21] remains unaffected, meaning that it still remains as a legally constituted entity, albeit without funding for its administrative responsibilities. The CPA will continue to legally exist, along with the CPA Fund which is also set forth in statute.[22] The CPA fund is continuously appropriated by statute and is where the DRP Fund resides. As noted earlier, the DRP Fund currently carries a balance of approximately $2 million.

According to the CPA, it will secure a Fiscal Agent, most likely located in the state Business, Transportation and Housing Agency who will have signatory authority to approve payment from the DRP Fund to the CPA's DRP contractors and counterparties. Securing a Fiscal Agent is critical, as it will enable the program to have access to the DRP Fund and therefore continue after November 30. The CPA's Fiscal Agent will also have the signatory authority to finalize an agreement with PG&E. The CPA has indicated that it believes an agreement authorizing PG&E to run the DRP as the CPA's agent, under the ultimate direction of the CPA Fiscal Agent, is the best interim solution for continuing the program. We direct PG&E to file and serve by November 30, 2004 a term sheet, which would contain the general principles it has agreed to with the CPA for operation of the DRP post-November 30. We select November 30 as

[21] Sections 3300 et seq. of the Public Utilities Code.

[22] Section 3370 of the Public Utilities Code.

the deadline for this term sheet as we want to be informed of the CPA's key principles for the DRP's on-going management at the time that it transfers its signing authority to the Fiscal Agent.

We also direct PG&E to submit to the Commission for final approval its proposed agreement with the CPA. The proposed agreement shall contain the final terms agreed to by both PG&E and the CPA's Fiscal Agent, and shall at least reflect a commitment by PG&E to maintain and operate the DRP in a prudent manner, and in the interest of the ratepayers. We leave the specific details of this agreement to be developed between the CPA (and its Fiscal Agent) and PG&E, but we will consider an agency agreement or an agreement by PG&E to accept assignment of the CPA's contracts. The draft shall be served upon the service list for R.02-06-001 or its successor, and be subject to comment before the Commission determines if it is acceptable.

We also direct PG&E to submit a cost-effectiveness analysis of the DRP using the recently renegotiated terms of the Demand Reserves Purchase Agreement as described in this decision. D.03-06-032 recognized the DRP as a viable program as well as a cost-effective one based on the terms of the program in 2003. The contract between the CPA and DWR has since been amended and it is therefore necessary to update our understanding of the cost-effectiveness of the program using its latest terms. PG&E shall use the same cost-effectiveness methodology that was employed in D.03-06-032.

We advise the CPA, PG&E, and the parties to this proceeding that we take this action as an interim step to keep the program intact, and that all stakeholders will still have an opportunity to provide their input when the draft agreement is submitted. Ultimately we may determine that the proposed agreement is unacceptable and that other alternatives are more appropriate.

We also recognize that if PG&E were to assume the CPA's responsibilities for the DRP (either as an agent, or as an assignee of its contracts), it would in effect, be on "both sides" of the foundational contract, given its pending agency agreement with DWR to schedule and dispatch the program. There are likely conflicts of interest that need to be further explored, understood and ultimately resolved, that we are unable to address in this order. Directing PG&E to negotiate an agreement with the CPA provides the Commission the time to contemplate the appropriate role of the utilities in the DRP before a final direction is taken. We therefore direct Energy Division to suspend PG&E's advice letter filing seeking approval of its agency agreement with DWR and direct Energy Division, PG&E, and DWR to begin discussions on a revised agency agreement that addresses any potential conflicts of interest.

VII. Comments on Draft Decision

The Draft Decision in this matter was not mailed to the parties. In this case, we were alerted on November 5, 2004 that the CPA had been unsuccessful in identifying another state agency to take over operation of the DRP upon expiration of CPA's operating budget. Because of the importance of the DRP as a source of committed load reduction, we must identify a party to assume responsibility for operating the program before November 30, 2004. Given the timing of the Commission's November meeting and the need to establish a negotiation and transfer process by November 30, 2004, public necessity requires that the Commission adopt a decision regarding continuation of the DRP before expiration of the normal 30-day public review and comment period. Therefore, in accordance with Section 311(g)(3) of the Public Utilities Code and Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure, public review and comment has been waived.

VIII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Michelle Cooke is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The DRP is a demand response program created in 2002 by the CPA and the DWR.

2. The foundation of the program is the Demand Reserves Purchase Agreement, a five-year contract between the CPA and the DWR. The Demand Reserves Purchase Agreement enables DWR to purchase power from CPA when energy supplies are short or the cost is lower than other available resources.

3. The utilities have pending agency agreements with DWR, which would enable them, as agents to DWR, to also schedule and dispatch the DRP when it fits within their least-cost dispatch requirements.

4. The pending agency agreements enable DWR to call the program for reliability reasons or for testing purposes.

5. There are various supporting contracts, called "Demand Reserves Provider Agreements," which underlie the Demand Reserves Agreement. These contracts, between the CPA and several third-party aggregators, specify the terms and conditions of how aggregators provide power to the CPA.

6. The Demand Reserve Providers, in turn, have individual agreements with electricity customers who provide the actual demand reduction.

7. In exchange for the reduction in load, participants are paid a monthly capacity payment (based on the amount of load committed for reduction) along with an energy payment (actual amount of energy reduced).

8. In Summer 2002, the program had 15 MW of capacity; by Summer 2004, the program's capacity increased to 356 MWs. The contract between DWR and CPA provides for two more summers of operation (2005 and 2006).

9. The demand response MWs generated by the DRP are credited to the utilities' attainment of the demand response MW goals adopted in D.03-06-032.

10. Commission Resolution E-3875 absolved the utilities from least-cost dispatch penalties when DWR triggers the program for reliability or testing purposes.

11. Upon the Commission approval of the proposed agency agreements between each of the utilities and DWR, the utilities would be agents of DWR for the DRP.

12. A letter from CPA Acting Chair Sunne McPeak dated November 5, 2004, to Commission President Michael R. Peevey requested the Commission's assistance in ensuring the continued functioning of the DRP.

13. The CPA operating fund will be exhausted by November 30, 2004.

14. The Governor's administration supports the DRP as an important contributor to meeting the state's electric reliability needs and has indicated that the DRP should continue after the CPA's operating funding is depleted.

15. The IOUs are well-suited to take over the CPA's contractual responsibilities since they regularly buy and sell power, and therefore requests that the Commission takes the steps necessary to transfer responsibility for the DRP to one or more of the IOUs.

16. The Demand Reserves Delivery Agreements are designed to ensure that the ESPs of DA customers are willing and able to move the power (made available by the customer's reduction in demand) to the IOU who would be triggering the program.

17. The Demand Reserves Delivery Agreements each reflect the varying circumstances of the customer and the ESP. These contracts expire at the end of 2004, and must be renewed by the CPA or its successor in order for DA customers to participate in the program in 2005.

18. The CPA typically does not interact with end-users, as it relies on the aggregators to enroll end-users that are interested in participating in the DRP. The one exception to this is the SWP, which is an end-user DRP participant that has a contract directly with the CPA.

19. Purpose of the CPA-ISO contract is to bind the CPA to follow the terms and conditions of the ISO tariff with respect to load that CPA brings to participate in the ISO ancillary service market.

20. The DRP currently is not operating the component known as Non-Spin Ancillary Services as the technical details of how this particular product will be provided are still in the design phases with the utilities and other parties.

21. APX is a consulting firm that provides software communication and scheduling coordination services to the CPA for the DRP.

22. APX is compensated directly by the CPA for development costs and all other fees charged by APX are based on program enrollment.

23. The CPA has contracts with three individuals for managerial, legal, and administrative services for the DRP. These contracts are in effect until May 2007.

24. The largest costs for the DRP are the payments due to the aggregators for demand response provided under the contracts. These costs will fluctuate depending on the amount of MWs that the aggregators can nominate.

25. The administrative costs for the DRP are largely based on the contract with APX (which has both development costs (at least through 2004) and operational

costs that fluctuate based on participation levels), the management services contracts, and marketing costs.

26. Each year DWR provides to the Commission its estimated annual revenue requirement to cover the costs of the energy supply contracts that it signed, including the costs of paying for the Demand Reserves Agreement with the CPA.

27. For the 2005 calendar year, DWR estimates that it will need approximately $16.9 million to pay for the Demand Reserves Purchase Agreement.

28. As of October 2004, the program has actually accumulated a reserve of about $2 million. That reserve is kept in the DRP Fund, which is a sub-account of the CPA Fund.

29. The CPA anticipates that the DRP will increase its capacity to 500 MWs in future years and generate positive gross margins in 2005 and 2006.

30. Ratepayers benefit from the demand response provided by participants in the DRP.

31. In 2004 DWR triggered the program at least five times: June 30, July 22, August 11, September 7, September 23, and October 27.

32. After November 30, 2004, the CPA will continue to legally exist, along with the CPA Fund which is also set forth in statute. The CPA fund is continuously appropriated by statute and is where the DRP Fund resides.

33. The CPA will secure a Fiscal Agent, most likely located in the state Business, Transportation and Housing Agency, who will have signatory authority to approve payment from the DRP Fund to the CPA's DRP contractors and counterparties who will have authority to finalize an agreement with PG&E.

34. An agreement authorizing PG&E to run the DRP, under the ultimate direction of the CPA Fiscal Agent, is the best interim solution for continuing the program.

Conclusions of Law

1. Given its importance in providing demand response capability for either economic or reliability reasons, the Commission should ensure that the benefits of the DRP are not lost after the CPA's operating budget has been exhausted.

2. PG&E should continue negotiations with the CPA on the terms of an agreement, which would enable PG&E to operate, manage, and maintain the CPA's responsibilities for the program effectively.

3. Utilities regularly purchase and sell energy, so having a utility assume the CPA's role in operating and managing the program for the next two summers is something the Commission must consider given the importance of demand response as a key part of the Energy Action Plan's loading order.

4. Directing one utility to negotiate an agreement (as opposed to directing all three) is the most pragmatic means of transferring the responsibility of the program in as seamless a manner as possible.

5. PG&E is the most appropriate choice from among the three affected utilities because the majority of MWs generated by the DRP are in its territory.

6. Securing a Fiscal Agent is critical, as it will enable the DRP to have access to the DRP Fund and therefore continue after November 30.

7. The CPA's Fiscal Agent should retain the APX contract and the DRP managerial/administrative contracts for at least an interim period of time.

8. PG&E should file and serve by November 30, 2004 a term sheet, which would contain the general principles it has agreed to with the CPA for the DRP post-November 30.

9. PG&E should submit to the Commission for final approval its proposed agreement with the CPA. The proposed agreement shall reflect the final terms agreed to by both PG&E and the CPA's Fiscal Agent, and shall at least reflect a

commitment by PG&E to maintain and operate the DRP prudently and in the interest of the ratepayers.

10. PG&E should submit a cost-effectiveness analysis of the DRP using the recently renegotiated terms of the Demand Reserves Purchase Agreement as described in this decision.

11. This decision is an interim step to keep the DRP intact, and that all stakeholders will still have an opportunity to provide their input when the draft agreement is submitted.

12. Energy Division should suspend PG&E's advice letter filing seeking approval of its DRP agency agreement with DWR and begin discussions with PG&E and DWR on a revised agency agreement direct Energy Division, PG&E, and DWR to begin discussions on a revised agency agreement that addresses any potential conflicts of interest.

13. The public necessity requires that we waive the normal public review and comment period for this decision.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) shall, by November 30, 2004, file and serve on the service list of Rulemaking (R.) 02-06-001, a term sheet containing the general principles it has agreed to with the California Power Authority for the future operation and management of the Demand Reserves Partnership (DRP) program.

2. PG&E shall by February 1, 2005, file and serve on the service list of R.02-06-001, or its successor proceeding, its draft agreement with the California Consumer Power and Conservation Financing Authority (CPA), reflecting the

final terms agreed to by both PG&E and the CPA's Fiscal Agent, which shall at least reflect a commitment by PG&E to maintain and operate the DRP prudently and in the interests of ratepayers. Comments on the draft agreement are due on February 15 and replies are due on February 22.

3. PG&E shall by February 1, 2005, file and serve on the service list of R.02-06-001, or its successor proceeding, a revised cost-effectiveness analysis of the DRP using the same methodology that was employed in Decision 03-06-032. Comments on the analysis are due on February 15 and replies are due on February 22.

4. Energy Division shall suspend PG&E's advice letter filing seeking approval of its agency agreement with the California Department of Water Resources (DWR) and begin discussions with PG&E and DWR on a revised agency agreement that addresses any potential conflicts of interest.

This order is effective today.

Dated November 19, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I dissent.

/s/ CARL W. WOOD
Commissioner

I reserve the right to file a dissent.

/s/ LORETTA M. LYNCH
Commissioner