

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Develop
Additional Methods to Implement the
California Renewables Portfolio Standard
Program.

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Rulemaking 06-02-012

**JOINT OPENING BRIEF OF THE UTILITY REFORM NETWORK AND
THE CALIFORNIA WIND ENERGY ASSOCIATION ON
THE ROLE OF SHORT-TERM CONTRACTING WITHIN THE
RENEWABLES PORTFOLIO STANDARD PROGRAM**

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Pursuant to the briefing schedule adopted by Administrative Law Judge Simon at the May 17, 2006, evidentiary hearings, The Utility Reform Network (TURN) and the California Wind Energy Association (CalWEA) hereby submit this joint opening brief on the role of short-term contracting within the Renewables Portfolio Standard (RPS) program. TURN and CalWEA offer this joint brief to assist the Commission in the continuing evolution of the RPS program structure.¹

I. SUMMARY OF FINDINGS AND RECOMMENDATIONS

The issue of short-term contracting under the RPS program has prompted parties to offer varied perspectives on current market realities, possible future market structures, and the extent to which the Commission should establish particular requirements regarding the duration of renewable power contracts offered by retail sellers. This brief offers the following findings for consideration by the Commission:

- A review of recent renewable development activity in California and other states demonstrates that long-term contracts are critical to the development of new renewable generation. There appears to be a very limited capacity for developing new renewable generation under short-term contracts or on a merchant basis. (Section II)

- Substantial amounts of new renewable capacity are needed to meet California's 20% RPS target. In order to ensure sufficient supplies to meet

¹ CalWEA does not join in, and takes no position on, the issues or recommendations contained in Sections III and Subsections IV.A and IV.B of this opening brief.

the RPS requirements of Electric Service Providers (ESPs) alone, the state needs the equivalent of more than 1,000 MW of new wind generation by 2010. (Section III.A)

- Electric Service Providers (ESPs) should not be expected to enter into longer-term renewable supply contracts for new generation unless ordered to do so by this Commission. There is no evidence that sufficient short-term contracting opportunities will be available to allow ESPs meet RPS program goals. (Section III.B, III.C)
- A reliance on short-term contracting in a market where supplies are insufficient to meet the RPS compliance obligations of all LSEs will fail to stimulate adequate new generation and could be extremely detrimental to the interests of consumers. (Section III.D)

Based on these findings, the Commission should make the following determinations:

- The achievement of the 20% RPS target will require that new generation is developed to serve all LSEs including Investor-Owned Utilities (IOUs), Electric Service Providers (ESPs) and Community Choice Aggregators (CCAs). (Section IV)
- Unless the Commission wishes to direct the IOUs to procure sufficient incremental generation to meet the RPS requirements of their bundled and direct access customers, all LSEs should be required to demonstrate that their procurement transactions result in the development of new generation infrastructure. (Section IV.A)

- ESPs and CCAs should be subject to specific minimum requirements for the portion of their annual procurement targets to be satisfied by electricity acquired from new renewable generation. (Section IV.A)
- ESPs and CCAs should be provided with sufficient compliance flexibility to allow for the lead time associated with the development of new resources under long-term contracts. (Section IV.B)
- ESPs should be eligible to seek Commission-approved rate recovery for long-term renewable resource contracts. (Section IV.C)
- The Commission should develop an RPS Procurement Entity to enable long-term contracting on behalf of direct access customers. (Section IV.C)
- IOUs should be required to continue their current practice of conducting annual solicitations and offering exclusively long-term contracts. Short-term contracts should only be permitted in response to offers made by sellers. Additional requirements for new generation should be considered if IOUs procure nontrivial quantities of existing renewable power under short-term contracts. (Section IV.D)
- There should be no access to Supplemental Energy payments for contracts of less than 10 years. (Section V)

II. LITTLE NEW GENERATION IS LIKELY TO BE DEVELOPED OUTSIDE OF LONG-TERM CONTRACTS

Some parties assert that the development of new generation can occur under a range of conditions and urge the Commission to avoid establishing any specific procurement requirements for LSEs participating in the RPS program. The

evidence demonstrates that long-term contracts play a critical role, both within and outside of California, and that it would be unreasonable to expect that a significant amount of new renewable capacity will be developed outside of long-term contracts. While the notion of providing “flexibility” can be appealing, the Commission must recognize that the actions of a single buyer in the wholesale electric market can have widespread impacts on all market participants. Since there is no way to effectively compartmentalize the consequences associated with scarcity in electric markets, the Commission needs to determine what renewable procurement practices will maximize the likelihood that sufficient renewable generation will be developed in the coming years to allow all Load Serving Entities (LSEs) to meet the established RPS targets.

A. Experiences to date in California demonstrate the importance of long-term contracting in stimulating new generation

As explained in TURN’s testimony, the historical development of renewable generation in California was based on the availability of long-term contracts with utilities. The bulk of the current base of renewable generation was constructed under long-term contracts executed during the 1980s and the lack of such contracts during the 1990s resulted in a *de facto* freeze on the development of new projects.²

Although much has changed about the structure of the electric industry since those days, actual experience demonstrates that long-term contracts still play an essential role in developing nearly all new renewable generation both in California and around the country. Since 2001, the California Department of Water Resources and the three major California Investor Owned Utilities (IOUs) have executed 35 contracts for a minimum of 2,030 MW of new renewable generation. With the exception of two contracts for 6 MW of capacity, all the

² Ex. 5, page 3.

remaining agreements (covering 99.7% of the new MWs) have a term of at least 10 years.³

The supply of new generation developed outside of long-term contracts appears to be marginal. Although the Commission has allowed developers to respond to IOU solicitations with bids for shorter term contracts, few offers have been submitted.⁴ As explained by PG&E witness Pappas, any observed offers were simply not cost-effective in comparison to other long-term contract options.⁵ SCE's own witnesses support the finding that "it is unlikely that we will see new development on the back of short-term contracts."⁶

The testimony presented by developers of renewable generation supports this conclusion. Green Power Institute witness Reese, a developer of biomass plants, explains that

in our experience, a contract term of 15 is the minimum feasible for a power plant project. A term of 20 or more years is even better...can you imagine us going to our bank and saying "lend me 150 million dollars, I've got a 2-year power sales contract?" In my opinion, short-term contracts of less than ten-years are virtually unworkable for new renewable energy facility development.⁷

Similarly, CalWEA witness Morrison (a developer of new projects) explains that long-term stable revenue streams are needed to assure project finance lenders and investors that capital cost recovery will not be jeopardized by electricity market price volatility.⁸ Given this reality, "the only developers likely to be able to develop and finance a renewable power plant without a long-term contract are

³ Ex. 5, page 5.

⁴ D.02-08-071, page 33; D.03-06-071, page 58. See Ex. 5, pages 5-6.

⁵ Reporter's Transcript (RT) Vol. 3, pages 389-390.

⁶ RT Vol. 3, page 464.

⁷ Ex. 10, page 3.

⁸ Ex. 2, pages 4-6.

very large developers with substantial resources – primarily the unregulated affiliates of large electric utilities.”⁹ Warning against the development of policies which assume the entrance of merchant generation, Morrison recounts how the development of conventional generation in the late 1990s without long-term contracts led to “financial disasters when spot power prices collapsed” and

in the space of six to nine months during 2001 and 2002, a robust and liquid market for financing merchant gas plants completely evaporated and disappeared. Large and supposedly stable development companies went bankrupt quickly; tens of billions of dollars of investments in merchant power projects were written off (with more to come). Ultimately, the retail consumers of electricity in North America will pay the price for these inappropriate risks.¹⁰

The prime example of the merchant generation bust in California is the now-bankrupt Calpine Corporation. TURN’s testimony highlights the fact that Calpine, one of the leaders in the development of merchant conventional generation in California and across the country, acknowledged the reality (prior to filing for bankruptcy) that the markets have fundamentally changed in recent years. When asked in the fall of 2005 about the prospects for completing its partially constructed Otay Mesa generating station, Calpine’s expert witness explained that

I doubt very seriously that Calpine would develop this plant or any plant at this point in time without a long-term PPA. I think it's been well documented that because of the California market structure -- well, not only the California market structure but just nationally, you know, changes in the market structure, that entities need long-term -- the only way to get new resources built is for entities to receive long-term PPAs.¹¹

The evidence in this proceeding identifies only two possible developers which could finance and construct new renewable projects outside of long-term

⁹ Ex. 2, page 5.

¹⁰ Ex. 2, pages 4, 5.

¹¹ Ex. 5, pages 9-10.

contracting arrangements – FPL Energy (FPLE) and PPM Energy – both of which have parent companies and affiliates with the resources to allow for balance sheet financing. Yet the reality is that of these two, only PPM Energy has indicated both the ability and interest in developing any new renewable generation which is not fully contracted under long-term agreements.

FPL Energy witness Seymour clarified that his company, despite being amongst the largest developers of wind projects in the United States, has not built a single project in the Western United States (WECC) without first securing long-term contracts covering all of the facility output.¹² Perhaps more importantly, Mr. Seymour stated that FPLE would not be willing to build a new renewable project in California without a long-term contract covering 100% of the facility output. Rejecting the notion that FPLE would build a large project with a single so-called ‘anchor tenant’ taking a share of the output under a long-term deal and leaving the remaining capacity available for shorter-term arrangements, Seymour explained that “we don't think the California market would support our particular risk tolerance at this time for short-term deals” and elaborated that “under the market rules that we have today in California, we would have a hard time entering into anything other than a long-term contract in California.”¹³

The other identified developer, PPM Energy, has indicated its interest in pursuing new projects without fully contracting the output under long-term commitments. PPM demonstrates some track record in this respect, having partnered with FPLE in California under a long-term contract to construct the HighWinds project in Solano County. Half of the facility output was under long-term contracts by the date of commercial operations with remaining half being

¹² RT Vol. 1, pages 57-58.

¹³ RT Vol. 1, pages 77-78, 80.

sold under various term contracts shortly thereafter.¹⁴ PPM also claims that it began initial development work on other projects in California without specific offtake agreements, although all such facilities appear to have been fully subscribed under long-term contracts well in advance of final construction or commercial operations.¹⁵ Perhaps most important, for purposes of this proceeding, is the fact that PPM has publicly stated that its business model is premised on 90% of its generation being sold under long-term contracts.¹⁶ This statement suggests that there is a limit to the appetite for risk by even the most sophisticated and deep-pocketed developers.

Despite the ability and willingness of PPM to take limited merchant development risks, PPM witness Glader acknowledged that

the most common means of investing in a project or getting the capital for the project would be to get that long-term contract, bringing it out to the market and have investors bring the money from there. That is the norm. That will continue to be a very, very popular approach and probably the norm as far as the approach to developing projects.¹⁷

Other parties advocating contracting flexibility also agree about the central role played by long-term contracting. PG&E witness Pappas admitted that

In order to get to 20 percent, we're going to have to have quite a few new resources. We can't just be trading short-term resources back and forth. We're not going to get to 20 percent. And I think everybody agrees that in order to get new resources, that will primarily come from long-term contracts....for most developers a long-term contract would be a requirement in order to build a new project.¹⁸

Despite the intense interest in this topic, it is important to note that only a single

¹⁴ Ex. 5, page 6; RT Vol. 1, page 39.

¹⁵ RT Vol. 1, pages 33-35.

¹⁶ Ex. 5, page 14.

¹⁷ RT Vol. 1, page 39.

¹⁸ RT Vol. 3, pages 413-414, 423.

developer of renewable projects has indicated both the willingness and ability to proceed with a limited quantity of merchant project development. The Commission should therefore recognize that this “niche market” is unlikely to produce anything close to the amount of new resources needed to meet the ambitious goals of the RPS program.¹⁹

B. Experiences in other states demonstrate that California is not unique

A review of other states reveals that, when compared California, there are relatively few differences with respect to the role played by long-term contracts in enabling new renewable resource development. In an effort to move beyond anecdotes, TURN provided specific evidence regarding the extent to which merchant development is occurring outside of California. Reviewing the development of new wind projects greater than 10 MW in size since 2001 in seven states (totaling 4,308 MW), TURN found that 90% of new capacity was constructed under long-term contracts (typically between 10-20 years).²⁰ The surveyed states included Texas, Pennsylvania, Oregon, Washington, Iowa, Colorado and New Mexico. In particular, TURN noted that 83% of new wind capacity in Texas – a state some parties suggest demonstrates the viability of merchant development -- was constructed under long-term contracts.

Only 4 out of 45 projects included in the survey were constructed without long-term contracts. Of the four, all were developed by FPL Energy and one involves a long-term purchase contract with PPM Energy which, as with the HighWinds project, resells the electricity and environmental attributes to various buyers primarily under long-term contracts. Despite the inclusion of 24 distinct developers in the survey, only FPLE and PPM were found to have financed and

¹⁹ RT Vol. 1, pages 137-138.

²⁰ Ex. 5, pages 6-9.

constructed any new renewable projects in these states without long-term contracts. As previously noted, FPLE indicated during hearings that it would not develop any new projects in California without long-term contracts.

Other evidence on renewable project development realities in other states was provided by the Alliance for Retail Energy Markets (AREM). AREM witness Hitt offered certain details about eight new renewable energy projects in five states for which Constellation New Energy has contracted to buy various combinations of energy, capacity and Renewable Energy Certificates (RECs).²¹ These projects include biomass, photovoltaics, wind, and landfill gas resources. Except for one facility, a biomass plant in New York under a contract duration of 8 years and 8 months, all the projects are being developed under contracts of at least 10 years in length.²²

Recent reports by industry experts consistently recognize that long-term contracts are necessary to the development of new renewable generation. For example, a National Renewable Energy Laboratory (NREL) study notes that

Although voluntary demand for renewable energy or RECs can provide important revenue for renewable energy projects, generally it is inadequate to serve as the primary basis for project finance. **Even demand backed by a long-term RPS by itself is insufficient by itself for project financing**, because financial institutions generally require a more direct and legally enforceable commitment. Part of the problem is that projects are financed over 10 to 20 years, while most purchase commitments for voluntary and compliance demand are for only one or two years.²³

²¹ Ex. 14, page 8.

²² See Ex. 15; RT Vol. 2, pages 347, 350-352, 363. Two of the projects have 20-year contracts (Equinox contract with Burlington Electric Department, Brightfields Solar project) and one has obtained a guaranteed "put" for the price of RECs for years 11-14 (Commonwealth Energy Bedford).

²³ Ex. 5, pages 10-11. [emphasis added]

Another report prepared for the Lawrence Berkeley National Laboratory reached similar conclusions in assessing the interaction between long-term contracts and other incentive support mechanisms:

Financial incentives of various forms, whether based on electrical production or capital investment and whether paid as a direct cash incentive or as a favorable loan program, can also be used to encourage renewable energy development. Without a long-term power purchase agreement, however, this policy mechanism has been found to generally play a supplemental role to other policies in encouraging stable and sizable growth in renewable energy markets.²⁴

This reality has also been accepted by other state Commissions. The New York Public Service Commission recently adopted a centralized procurement model under which the state energy agency is charged with conducting solicitations to purchase renewable power under long-term commitments. In justifying this approach, the Commission noted that “the record in this proceeding demonstrates that, at this time, potential developers of such resources likely will need long-term contracts if they are to obtain financing.”²⁵

In Nevada, an official task force found that the 3-5 year contracts typically executed by direct access customers served by competitive providers are “much shorter than an expected contract between a non-utility supplier and a renewable energy developer which could be ten years or more to obtain the necessary financing for a renewable energy project.”²⁶ In response to the fact that the loss of investment-grade credit ratings by the two major Nevada utilities jeopardized the viability of projects being developed under long-term contracts, the Nevada Public Utilities Commission created a “Temporary Renewable Energy Development” (TRED) program to provide additional assurances of payment

²⁴ Ex. 5, page 11.

²⁵ Ex. 5, page 11.

²⁶ Ex. 5, page 12.

under long-term contracts.²⁷ These actions again demonstrate that developers need both long-term contracts and credit assurances to be able to move forward with their projects.

Although there are certainly a few examples of developers building projects on a merchant (or quasi-merchant) basis, the Commission should recognize that any empirical review of actual projects demonstrates that long-term contracts are fundamental to putting new steel in the ground. During evidentiary hearings, TURN witness Freedman summarized his findings as follows:

My testimony identifies a few examples of where new generation has been developed in the absence of long-term contracts, but the point of my testimony is that this is really a niche market, and it represents a very small fraction of the new development that has occurred in California and in a number of other states. I don't think anywhere in my testimony I suggest that it is impossible to build new plants without a long-term contract or that zero megawatts will come on line. In fact, the charts that I've provided show just the opposite. But a very, very small fraction of the generation that is being developed is done without long-term contracts...and further, when you look to see the entities that have been developing that generation, it suggests a very small pool of developers with a limited capacity to build new generation absent long-term contracts.²⁸

The Commission should therefore carefully analyze any claims regarding the likelihood of future project development and avoid assuming the widespread existence of market, financing and developer attributes which are not currently found in California or anywhere else in the United States.

²⁷ Ex. 5, pages 12-13.

²⁸ RT Vol. 1, pages 137-138, 148-149.

III. UNLESS THE COMMISSION ACTS TO ENSURE LONG-TERM PLANNING TO MEET RPS TARGETS BY LOAD SERVING ENTITIES, THE ECONOMIC CONSEQUENCES COULD BE SIGNIFICANT FOR ALL CALIFORNIA CUSTOMERS

Consistent with its activities on a broad range of procurement policies, the Commission should adopt prospective requirements on the assumption that consumers would be ill-served by a 'wait and see' approach. Rather than waiting for a cycle of boom and bust and fighting with LSEs over noncompliance penalties, the Commission should seek to be ahead of the curve and enforce requirements which force all LSEs to pursue opportunities to procure from new generation. The alternative approach of offering complete 'flexibility' could prove to be a costly and inefficient experiment in collective inaction.

A. Significant quantities of renewable energy are needed to satisfy 20% of direct access loads in 2010

A key consideration in this proceeding relates to the amount of renewable generation needed to satisfy the RPS compliance requirements of direct access (DA) customer loads. In order to ensure sufficient supplies, the procurement activities of the ESPs will need to stimulate the development of substantial new renewable capacity in the coming years. Based on the recent data on direct access customer loads, TURN calculated a range of possible renewable capacity requirements which correlate to achievement of the 20% target in 2010.

TURN's range includes a base case (assuming zero growth in DA loads), a high case (25% growth in DA loads), and a low case (25% decline in DA loads). The results are presented in the following table:²⁹

²⁹ Ex. 5, page 20.

| | <u>2006</u> | <u>2010</u> <u>(base)</u> | <u>2010</u> <u>(high)</u> | <u>2010</u> <u>(low)</u> |
|-------------------|-------------|------------------------------|------------------------------|-----------------------------|
| DA GWh sales | 21,320 | 21,320 | 26,650 | 15,990 |
| RPS target | 1% | 20% | 20% | 20% |
| RPS GWh | 213 | 4,264 | 5,330 | 3,198 |
| MW(a) | 24 | 487 | 608 | 365 |
| MW(wind @ 35% CF) | 70 | 1,391 | 1,738 | 1,043 |

Although DA loads have recently been declining, it is reasonable for the Commission to consider base, high and low scenarios. As explained by TURN witness Freedman, DA customer loads reached a peak in 2004, so the use of current loads represents a cautious projection.³⁰ Customers who signed up for DA service prior to September 20, 2001, remain eligible to switch back and forth between bundled and DA providers. Those who have returned to bundled service since the 2004 peak must remain with the incumbent IOU for a three-year minimum period but can return to DA service with six month advance notice.³¹ As a result, some customers currently on bundled service could return to DA prior to 2010.

Given the rules adopted by the Commission, and the fluctuations in DA loads over time, the Commission should consider a range of DA load scenarios in assessing the potential renewable generation requirements associated with ESP RPS compliance. The ranges provided in TURN's testimony are well within the realm of possible outcomes.

³⁰ RT Vol. 1, page 151.

³¹ D.03-05-034, Ordering Paragraphs #4, #11.

B. Electric Service Providers do not intend to enter into long-term supply agreements unless required to do so by regulatory order

The testimony of AREM witnesses provides a clear indication of how ESPs in California can be expected to procure renewable power to meet RPS obligations. It is important to distinguish between the transactions that an ESP will voluntarily pursue under their self-described business model, and the commitments that an ESP is capable of executing if subject to specific regulatory requirements. This section summarizes the types of procurement ESPs can be expected to conduct if given complete flexibility within the RPS program. Section IV(C) provides evidence that some ESPs are capable of making longer-term commitments and offers specific mechanisms for enabling such procurement by all ESPs.

AREM witnesses offer three criteria which typically guide ESP procurement decisions -- a desire to match retail and wholesale commitments, confidence in the future of retail markets, and the specific demands of any applicable regulatory requirements. A review of these three criteria leads to the conclusion that ESPs do not intend to procure renewable energy under long-term contracts unless the Commission establishes specific requirements for such transactions.

Although ESPs do not formally disclose information about specific customer contracts, Constellation New Energy (CNE) witness Hitt explained that her company has customer commitments in California ranging from one month to as long as three years.³² AREM witness Hoeckstra stated that, in his experience,

end-use customers making decisions about procuring electricity generally limit their commitments to the next two years, three years or less. And it's very infrequent for a customer to contract and commit beyond that.³³

³² RT Vol. 2, page 335.

³³ RT Vol. 2, pages 278-279.

Hoeckstra stated that he had “never seen anything” approaching a ten-year customer commitment in California and in his entire career could only point to a single contract of such length in Texas, under which the customer was tied to a specific generating asset.³⁴ When asked whether the length of customer commitments was likely to change in California, Hoeckstra responded

Probably not, given the uncertainty in the marketplace, given the level of wholesale energy prices, given the reluctance, frankly, of customers to make commitments of that length, because of their uncertainty around global competition, whether they will be this business at any particular location or not. The fact is in my experience, customers generally don't make those kind of commitments because they can't.³⁵

According to AREM witness Hoeckstra, ESPs typically procure electricity in the wholesale market consistent with the duration of retail customer commitments.³⁶ In his testimony, he insisted that it would be financially imprudent for an ESP to enter into long-term wholesale power contracts on behalf of short-term customers.³⁷ Specifically, Hoeckstra claims that

a financially prudent ESP would attempt to match its supply commitments with its customers' purchase obligations and...limit the mismatches both in terms of the volume of power, the term of a commitment, the dollar value, the potential risk exposure. And it is the attempt to limit the risk of financial loss because of mismatches that is driving the decision making.³⁸

When asked about the likelihood that an ESP would enter into any long-term renewable energy contracts, given the reality of retail customer commitments, Hoeckstra offered the following replies:

³⁴ RT Vol. 2, pages 280, 285.

³⁵ RT Vol. 2, page 285.

³⁶ RT Vol. 2, page 273.

³⁷ Ex. 13, page 4.

³⁸ RT Vol. 2, p.282.

the question would be: without customer commitments of ten years or more, would ESPs enter into supply purchases of ten years or more? And in that context, my answer would be no, I wouldn't expect ESPs to do that, because of the large potential mismatches between their supply and their demand.³⁹

.....

Q: If an ESP received an offer from a new project for 15 years to build a new wind project, yet that ESP didn't have any direct access customer contracts longer than, say, four years, in the current market structure would the ESP enter into that?

A: My expectation is -- the answer to that is no because the circumstances in that example would represent a substantial mismatch between supply commitments and their customer purchase commitments that would tend to violate some of the principles that I talked about, business model where commitments are driven by customer requirements, risk policy limits and so on. So I wouldn't expect that would be an outcome that would come to pass.⁴⁰

The testimony of AREM is replete with such statements. If these claims are to be taken at face value, then the Commission should conclude that ESPs are unwilling to voluntarily make long-term contractual commitments for renewable power due to incompatibilities, under their business model, between taking long-term wholesale market positions to serve short-term retail customer commitments.

Despite these claims, AREM does offer another possible criteria for ESPs voluntarily executing longer-term power contracts. According to AREM witness Hitt, Constellation New Energy has been willing to engage in long-term commitments in the New England and Mid Atlantic states based "on the confidence we have in the future of the retail market in these regions."⁴¹ Hitt explained that one key factor is whether "based on the stability of the retail

³⁹ RT Vol. 2, p.287.

⁴⁰ RT Vol. 2, page 273.

⁴¹ Ex. 14, page 9.

market, we believe that our load will either remain stable or grow over a period of time.”⁴²

Other testimony offered by AREM demonstrates that ESPs do not perceive the California retail market as being stable. AREM witnesses Hoeckstra and Counihan both point to declining DA loads in recent years, and Counihan urges the Commission to assume a one-third decline in DA sales by 2010 based on a forecast released by the California Energy Commission.⁴³ Positing that this forecast is reasonable, Counihan claims that “long-term forward contracting in a declining market is particularly difficult to justify and still comply with customary risk management policies.”⁴⁴ AREM witness Hitt similarly expresses concerns with the lack of “predictability” in California retail markets and suggests that this uncertainty means “it is very difficult to make a commitment right now on a long-term basis.”⁴⁵ Indeed, Hitt asserted Constellation New Energy would not voluntarily execute long-term contracts in California in the absence of certainty with respect to the future of the direct access market.⁴⁶

It is therefore reasonable to conclude that ESPs will not choose to enter into long-term contracts based on the belief that the California retail market is stable. If anything, the bleak assessment of the retail market in California will almost certainly dissuade ESPs from taking any longer-term risks unless one of two events occurs – major structural changes in the retail market or specific renewable procurement requirements promulgated by order of this Commission. Since the direct access suspension is a matter of state law and is outside the scope of this proceeding, the Commission must determine RPS policy based on the current environment for retail competition in California. But the Commission

⁴² RT Vol. 2, page 326.

⁴³ Ex. 13, Table 1, Page 11; Ex. 32, pages 1-2.

⁴⁴ Ex. 32, page 2.

⁴⁵ RT Vol. 2, page 328.

⁴⁶ RT Vol. 2, page 329.

does have the authority to require certain procurement activities by ESPs to fulfill their RPS obligations. Based on the evidence, it should be obvious that ESPs will only make longer-term commitments as the result of specific regulatory requirements.

AREM claims that ESPs will procure as necessary to satisfy Commission-adopted requirements. AREM witness Hitt states unequivocally that, with respect to RPS requirements, Constellation New Energy will “meet the obligation we’re required to meet.”⁴⁷ The Commission should take AREM and CNE at their word and adopt the requirements needed to ensure that new renewable generation is developed to serve ESP loads.

C. Opportunities to enter into short-term contracts for renewable power will be limited in the California market

Accepting that little new generation will be constructed in the absence of long-term contracts, and granting the ESP argument that they wish to procure consistent with the duration of their own customer commitments, the obvious conclusion is that ESPs will seek to procure from existing renewable generation under short-term contracts. The remaining question is whether it is reasonable to expect sufficient supplies of existing uncontracted generation will be available to satisfy ESP procurement needs under the RPS.

As explained by TURN, it is highly unlikely that the IOUs will manage to exceed their RPS targets prior to 2010 and they do not appear to have excess supplies to sell under short-term arrangements to other LSEs.⁴⁸ This is very different from the situation in Texas where the IOUs and publicly-owned utilities appear to

⁴⁷ RT Vol. 2, page 336.

⁴⁸ Ex. 5, page 13.

have overcontracted for renewable power and are able to sell excess RECs to other LSEs under short-term arrangements.⁴⁹

The only sources available to ESPs appear to be existing units without contracts or Qualifying Facilities (QF) with expiring contracts. When asked about the ability to procure existing renewable resources in California, AREM witness Hitt stated “it is a limited market...to any type of contracts, short, long-term, short-term purchases, et cetera. It is a limited market right now, generally speaking.”⁵⁰ In fact, no AREM witness was able to point to any available supplies of existing renewable power able to sell to ESPs today.

With respect to expiring QF contracts, SCE and PG&E offered similar assessments for the coming years. PG&E witness Pappas explained that PG&E currently projects 90% of these contracts will be renewed.⁵¹ SCE notes that, even if it failed to renew any expiring contracts, there is little eligible capacity which could even theoretically become available between now and 2010.⁵²

Given these realities, the Commission must wonder where the ESPs will get the renewable power needed to meet RPS targets. Unless there are specific assumptions made with respect to new generation to serve these LSEs, there is no indication that supplies of existing renewables will be sufficient. Absent a far more comprehensive showing in this respect, the Commission should be very concerned about embracing a *laissez faire* approach based purely on the faith that needed supplies will simply materialize at the appropriate moment.

⁴⁹ Ex. 5, page 13, footnote 25.

⁵⁰ RT Vol. 2, pages 323-324.

⁵¹ RT Vol. 3, page 374.

⁵² Ex. 18, page 7.

D. A scarcity of renewable resources combined with escalating RPS requirements and no long-term contracting by ESPs could lead to extreme price volatility and substantial detrimental economic impacts for customers

As explained in TURN's testimony, there are several possible outcomes associated with allowing ESPs to procure under short-term contracts in a constrained supply situation.⁵³ It is reasonable to expect that there will be fierce competition amongst buyers for any existing uncontracted renewable generation. This competition will raise the prices paid for power from existing facilities and the impact will be detrimental to all LSEs (including the IOUs).

The Commission should be very concerned about the linkages between short-term and long-term markets, whether it be for gas-fired generation or renewable power. Volatile and escalating short-term prices could cascade into long-term contract markets and lead to higher costs for such agreements.⁵⁴ Experiences in other parts of the US and Europe validate these concerns.

As explained in a recent report by the Lawrence Berkeley National Laboratory, states with RPS programs but insufficient long-term contracting can experience price escalation without realizing a corresponding increase in new generation. In discussing the cost of Tradable Renewable Energy Credits (TREC) in the New England markets, the report explains that

the high price of TREC is caused by RPS-driven demand that temporarily exceeds available renewables supply (Massachusetts, and Connecticut Class I). Though such a price rise might be considered an efficient reaction to a supply-demand imbalance, the more fundamental problem is that even at these high prices, renewable generation supply is not rapidly

⁵³ The complete discussion of this issue can be found in Ex. 5, pages 13-19.

⁵⁴ This crossover impact was observed when the California Department of Water Resources attempted to negotiate long-term power contracts during a period of extremely high short-term prices.

expanding. The reason: a lack of long-term contracting.⁵⁵

The absence of development in response to high TREC prices in other states suggests that California may experience similar price increases, and that such prices will not be sufficient to produce new supply if some LSEs avoid long-term contracting. In reviewing international experience with RPS policies, the same report finds that markets characterized by short-term purchasing behavior are inefficient, subject to price volatility, and significantly less effective at stimulating the construction of new renewable capacity. The authors offer the following observations:

In other states, however, short term TREC trade dominates, and that trade is sometimes at high prices that are more driven by penalty levels than by supply and demand. To some extent, this is a remarkable observation, contrary to what intuitively is perceived by many as efficient... Evidence to date suggests that RPS policies based on such short-term trade will be costly compared to other, more stable forms of policy support... Where RPS-driven RE demand exceeds available supply, and short-term trade in TRECs dominates over long term contracting, RPS policies appear to be a costly and unstable way of achieving renewable energy objectives.⁵⁶

Taken together, the evidence demonstrates that there are serious risks to reliance on short-term contracting in connection with RPS policies. These risks appear to be directly related to the balance between existing supplies of renewable generation and the demand associated with compliance requirements. Since the supply/demand balance in California shows the need for major capacity additions, the risks of reliance on short-term contracting are significant and could have far-reaching consequences for the ultimate success of the RPS program.

⁵⁵ Ex. 5, page 15, citing Review of International Experience with Renewable Energy Obligation Support Mechanisms, Lawrence Berkeley National Laboratory, LBNL-57666, June 2005, page 47.

⁵⁶ Ex. 5, pages 16-18, citing Review of International Experience with Renewable Energy Obligation Support Mechanisms at 7, 48, 51, 55.

IV. THE COMMISSION SHOULD REQUIRE ALL LOAD SERVING ENTITIES TO BE RESPONSIBLE FOR THE CREATION OF NEW RENEWABLE GENERATION INFRASTRUCTURE.

The most important determination to be reached by the Commission in this proceeding is whether all LSEs will be responsible for the creation of new renewable generation. There should be little debate as to the urgent need for significant increases in the amount of capacity to meet the RPS program goals of achieving a 20% renewable portfolio. The major question yet to be resolved is which entities will be responsible for bringing this new capacity into existence.

In testimony, TURN has identified two possible solutions – (1) directing the IOUs to engage in long-term renewables contracting on behalf of all ESP/CCA customers, or (2) establishing new generation or long-term contracting requirements for all LSEs as part of RPS compliance rules.⁵⁷ While either model could satisfy the primary objective of stimulating new infrastructure development, TURN recommends that the Commission adopt LSE-specific requirements for new generation. If the Commission rejects this approach, it should consider directing the IOUs to procure excess renewable power under long-term contract and allocating the net incremental costs amongst all LSEs.

A. All ESPs and CCAs should be required to demonstrate procurement of new renewable generation as an escalating percentage of annual procurement targets

There are two possible ways to craft an LSE-specific requirement. The Commission could require all LSEs to satisfy a certain portion of RPS compliance through the use of long-term contracts with new resources. Under an alternative approach, the Commission could simply permit LSEs to demonstrate the

⁵⁷ Ex. 5, pages 20-23.

procurement of new generation resources regardless of the duration of the underlying contractual obligation.

TURN recommends that the Commission adopt this second approach and require each ESP and CCA to demonstrate that a minimum percentage of its RPS compliance was acquired from new facilities built no earlier than 2006. This policy properly recognizes that the goal of long-term contracting is to create new generation and thereby mandates a specific result without prescribing the form of the underlying procurement transactions. In recognition of the lead time associated with new development, the requirement should escalate over time at the following rate:⁵⁸

| | |
|------|---|
| 2006 | 0% of Annual Procurement Target from new resources |
| 2007 | 20% of Annual Procurement Target from new resources |
| 2008 | 40% of Annual Procurement Target from new resources |
| 2009 | 60% of Annual Procurement Target from new resources |
| 2010 | 80% of Annual Procurement Target from new resources |

This requirement would allow some portion of ESP/CCA compliance to be met through contracts with any available existing facilities while guaranteeing that renewable procurement activities will create new infrastructure. To the extent that new generation can be built under short-term contracts (or on a purely merchant basis), ESPs and CCAs would be able to satisfy their obligations without long-term contracting.

This approach is consistent with the Commission's determination that ESPs and CCAs are not subject to identical compliance rules as the IOUs. In D.05-11-025, the Commission reached the following relevant conclusions:

⁵⁸ Ex. 5, page 23.

The Commission has policy discretion to determine the manner of ESP and CCA participation in the RPS program.⁵⁹

ESPs, CCAs, and small and multi-jurisdictional utilities should not be treated identically to the investor-owned utilities for purposes of the manner in which they meet RPS program requirements listed in Conclusion of Law 1.⁶⁰

The manner in which ESPs, CCAs, and small and multi-jurisdictional utilities should comply with RPS requirements should be further explored.⁶¹

The new generation requirement should be understood to be within the scope of the discretion outlined in this decision. To the extent that the Commission decides that its discretion does not extend to the use of a new generation requirement, then TURN recommends the adoption of long-term contracting requirements for new generation using the escalation schedule listed above.

B. ESPs/CCAs should be allowed to defer a demonstration of compliance with the new generation obligations by providing evidence of long-term supply agreements for new generation which meet multi-year RPS obligations

Consistent with the flexible compliance rules applicable to the IOUs, the Commission should allow ESPs and CCAs to defer their demonstrations of annual compliance with the new generation requirements by making a showing of executed contracts for resources scheduled to come online within the 3-year deficit banking window.⁶² For CCAs, the Commission could permit a showing that the municipality has made a firm commitment to acquire sufficient new resources within the applicable flexible compliance window. In either case, the

⁵⁹ D.05-11-025, Conclusion of Law #2.

⁶⁰ D.05-11-025, Conclusion of Law #3.

⁶¹ D.05-11-025, Conclusion of Law #4.

⁶² This is consistent with Conclusion of Law #1 in D.05-11-025.

ESP or CCA would be required to present specific contracts or other commitments to the Commission for review and approval.

C. ESPs financially incapable of executing long-term contracts should be able to avail themselves of alternative procurement and cost recovery mechanisms

The procurement of new renewable generation is likely to entail significant long-term contracting by ESPs. If the Commission adopts a new generation requirement, it is appropriate to consider how ESPs will manage to meet the standard through a combination of short and long-term contracts. The testimony of AREM and SCE suggests that some ESPs are capable of entering into long-term contracts for new resources without any special assistance from the Commission. The fact that ESPs are capable of such contracts does not mean that they will voluntarily enter into long-term agreements absent specific new generation requirements being adopted by the Commission. Indeed, the testimony from AREM is stocked with claims that, left to their own devices and without any new generation obligations, ESPs will not enter into long-term contracts to serve California retail customers.

SCE points out that most of the major ESPs in California have parent companies with credit ratings and revenues comparable to Edison International.⁶³ Given this reality, SCE correctly urges the Commission to “be skeptical of the ESPs’ position regarding their inability to incur the risk of long-term contracting obligations and whether long-term contracting is not possible under their business model.”⁶⁴ This contention is borne out by the fact that Constellation New Energy provided some specific examples of long-term contracting in other states and explains that the company executes “short-term and long-term

⁶³ Ex. 20, page 3.

⁶⁴ Ex. 20, page 3.

contracts...to meet our obligations from both a regulatory perspective as well as from our customer demand.”⁶⁵

Despite assertions that ESPs simply cannot take the risk of longer-term wholesale commitments, AREM witness Hoeckstra acknowledged that affiliates of California ESPs routinely take “open positions” associated with trading and the development of new generation.⁶⁶ Protestations notwithstanding, the requirements of the federal Sarbanes-Oxley law do not appear to create hurdles for these entities to operate without precisely matching purchase obligations with sales commitments. As acknowledged by Hoeckstra, the risk profile of each affiliate is determined by the desires of the corporate parent.⁶⁷ There does not appear to be any compelling reason preventing these same parent companies from permitting their ESPs to assume some amount of “open positions” needed for RPS compliance.

To the extent that the Commission believes some ESPs may have problems complying with a new generation standard, there are two mechanisms outlined in the TURN testimony that could assist with the financial risks associated with long-term contracting. Both mechanisms could be made available to ESPs on a voluntary basis.

Under the first approach, the Commission could authorize individual ESPs to receive guarantees of rate recovery of long-term contract costs from retail customers.⁶⁸ AREM witness Hoeckstra agreed that the availability of this type of a rate recovery mechanism would “improve the likelihood that [ESPs] could prudently or reasonably make a long-term commitment” and “mitigate risk to a

⁶⁵ RT Vol. 2, page 324.

⁶⁶ RT Vol. 2, pages 294-296.

⁶⁷ RT Vol. 2, pages 295-296.

⁶⁸ Ex. 15, page 21; See also RT Vol. 2, pages 220-222.

sufficient extent.”⁶⁹ An ESP would submit long-term contracts to the Commission for approval and receive an order allowing the recovery of contract costs from current customers. The costs and compliance benefits of resources acquired under such contracts would follow the customers (regardless of which LSE serves them) through the duration of the contract. The Commission could authorize such an approach pursuant to the cost recovery guarantees in §399.14(f) of the Public Utilities Code and applied to ESPs under the requirements in §399.12(c)(3)(C) which specify that ESPs shall comply with the RPS program under the “same terms and conditions” as an electrical corporation.⁷⁰

The second approach involves the creation of a third-party Procurement Entity (PE) to solicit and execute long-term contracts on behalf of any participating LSE. Under this approach, the PE would procure eligible renewable energy resources to serve participating retail customers and be subject to Commission oversight. The creation of a PE is specifically authorized under §399.14(e) of the Public Utilities Code and was endorsed by the Commission as worthy of further exploration in D.05-11-025.⁷¹ After consulting with a variety of stakeholders, TURN developed and submitted, as part of prepared testimony, a detailed proposal for the creation of a PE structure.⁷² The creation of such an option obviously requires additional work by many parties to design the specific mechanics of the structure.

⁶⁹ RT Vol. 2, pages 291-293.

⁷⁰ See Cal. Pub. Util. Code §399.14(f) (“Procurement and administrative costs associated with long-term contracts entered into by an electrical corporation for eligible renewable energy resources pursuant to this article, at or below the market price determined by the commission pursuant to subdivision (c) of Section 399.15, shall be deemed reasonable per se, and shall be recoverable in rates.”)

⁷¹ D.05-11-025, Ordering Paragraph #5 (“We will further explore the potential use of procurement entities or other third party intermediaries to facilitate the procurement of renewable generation by ESPs, CCAs, and small and multi-jurisdictional utilities.”)

⁷² Ex. 5, Appendix E.

D. IOUs should be required to continue conducting regular solicitations offering contracts of 10, 15 and 20 years

TURN and CalWEA urge the Commission to retain the current IOU requirements for the conduct of annual solicitations offering long-term (10, 15, 20 year) contracts. These solicitations provide regular opportunities for a wide variety of interested developers to offer their products under long-term arrangements subject to a standardized evaluation methodology and reviewed by both Commission staff and the members of each utility's Procurement Review Group. The IOUs should not be allowed to seek short-term offers as part of these annual solicitations.

As discussed in Section II, there are only a very few large developers likely to be able to rely on short-term contracts to develop new renewable projects in California. TURN and CalWEA are concerned that, in light of utility concerns with "debt equivalence" and their stated preference for short term contracts, if the utilities are authorized to solicit short-term contracts, there will be an opportunity for these large developers to either take advantage of the utility preference and drive up short term prices for renewable power or, in the alternative, offer discounted prices to gain market share. As CalWEA witness Morrison testified:

Therefore, were the Commission to authorize the utilities to rely on short-term contracts, CalWEA is concerned that small developers will be squeezed out of the market by large developers. This is, obviously, not good for small developers, many of whom are CalWEA members, but it is also not good for California consumers. Short-term contracts also are not in consumers' interest because they lose the long-term price hedge value of renewables, and pay higher prices during the short-term because costs must be recovered in a compressed time frame. The Commission should encourage competition in the development of renewable resources by promoting long-term contracts in order to ensure that California consumers obtain the best price and most diverse set of products as possible. By concentrating renewable generation in the hands of a few

large developers, price competition and product and technology innovation will suffer.⁷³

TURN and CalWEA do not oppose continuing to allow IOUs to execute shorter-term contracts if the nonconforming duration is proposed by a seller, as there may be circumstances in which a short-term contract is reasonable for all parties. However, in light of the concerns expressed herein, the Commission should carefully review IOU procurement activities to prevent excess reliance on short-term contracts. To the extent that an IOU seeks to procure a nontrivial amount of renewable power under short-term contracts, the Commission may consider additional requirements to ensure that a minimum portion of such energy is associated with new generation (rather than relying on existing facilities) and to ensure that competition among renewable suppliers is maximized.

V. NO SUPPLEMENTAL ENERGY PAYMENTS SHOULD BE AVAILABLE FOR CONTRACTS OF LESS THAN 10 YEARS

As explained in previous sections, prices in short-term markets may be elevated when compared with long-term contracts. If any LSE (including IOUs, Community Choice Aggregators, and ESPs) desires the flexibility associated with shorter-term commitments, they should not be given the opportunity to draw on Supplemental Energy Payments (SEPs) financed by surcharges collected from all ratepayers. Otherwise entities electing to enter into short-term contracts would be held harmless while all ratepayers are forced to subsidize economically inefficient behavior. Consistent with the intent of the RPS legislation, those funds should be limited to the least-cost long-term contracts with new facilities.

If SEPs are not carefully administered and used to support least-cost procurement activities, there is a real risk that the funds will be prematurely

⁷³ Ex. 2, pages 5-6.

depleted. The consequence of such depletion is that IOUs, ESPs and CCAs would have their RPS obligations limited to the purchase of renewable energy at prices no greater than the applicable market price referent.⁷⁴ This self-limiting feature of the RPS program based on overall compliance costs must be taken into account when determining which purchases should be eligible for SEP awards.

The Commission should therefore require that any LSE seeking SEP funds make a showing of least-cost procurement practices including the conduct of solicitations for long-term renewable resources and the selection of lowest-cost alternatives. Although it is unlikely that the Commission will make any determinations regarding SEP awards in this phase of the proceeding, the potential application of SEPs to the procurement activities of ESPs should be kept in mind while designing the applicable procurement requirements.

VI. CONCLUSION

TURN and CalWEA urge the Commission to adopt the facts, conclusions and recommendations contained in this brief.⁷⁵

⁷⁴ Cal. Pub. Util. Code §399.15(b)(4).

⁷⁵ As noted in the introduction, CalWEA does not join in, and takes no position on, the issues or recommendations contained in Sections III and Subsections IV.A and IV.B of this opening brief.

Respectfully submitted,

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