Pacific Gas and Electric Company™

Les Guliasi
Director
State Agency Relations

Pacific Gas and Electric Company
P.O. Box 77000, MC B29L
San Francisco, CA 94177-0001

415.973.6463
Fax: 973.9572

DOCKET
06-IEP-1 / 03-RPS-1078
DATE Jul 11 2006
RECD. Jul 12 2006

July 11, 2006

ELECTRONIC DELIVERY

California Energy Commission
Dockets Office
1516 Ninth Street, MS-4
Sacramento, CA 95814-5512

Attn: Docket Nos. 03-RPS-1078 and 06-IEP-1

Re: PG&E's Comments on the June 27, 2006, Electricity Committee Workshop: Lowering the Effective Cost of Capital for Generation Projects (California Credit Policies)

Pacific Gas and Electric Company (PG&E) respectfully submits the following comments on issues associated with the credit policies that were discussed at the workshop.

We appreciate a chance to comment on this important matter. Please feel free to call me at (415) 973-6463 if you have any questions.

Sincerely,

Les Guliasi

Attachment

cc: Chuck Najarian

Comments
Electricity Committee Workshop:
Lowering the Effective Cost of Capital for Generation Projects
California Credit Policies
June 27, 2006

Pacific Gas and Electric Company (PG&E) appreciates the opportunity to participate in the workshop and to provide comments on the following key issues:

- Changes in market structure and business model of Sellers
- Goal of protecting utility customers
- Collateral requirements for various technologies
- Inconsistency of analysis of cost of collateral
- Importance of both big and small entities in the value chain

Key Issues

The structure of the energy market and the composition of Sellers in California have evolved since the energy crisis. Part of that evolution includes a change in the business model of Sellers. Prior to the energy crisis, many Sellers were well capitalized, investment grade entities. Following the energy crisis, the Sellers consist of either non-investment grade entities or Special Purpose Entities (an entity that is formed for the sole purpose of generating power), each required to provide a certain level of performance assurance to Buyers. PG&E notes that a majority of bidders into its all-source and renewable solicitations are Special Purpose Entities. Given the volume of bankruptcy filings and subsequent contract rejections that the industry has seen over the past few years, PG&E does not take collateral requirements lightly. If there were some alternative way to mitigate the risk of loss due to Seller non-performance caused by bankruptcy or other factors, then the current level of collateral requirements could be adjusted accordingly. The course of evolution in the California energy markets has led to the collateral requirements we see today.

With respect to collateral requirements, PG&E notes that its key objective is to ensure that Sellers perform on their contracts. With each level of required security, PG&E is attempting to protect its customers from unreliable offers, from potential project delays, and from contract defaults. PG&E points out that Sellers' contract performance is the main goal; in other words, PG&E prefers that Sellers perform on their contracts rather that breach a contract and potentially forego their collateral. PG&E further notes, consistent with the presentation by Black & Veatch, that not all operating collateral must be posted. The amount of required posting is a function of the Sellers' collateral threshold, as determined in large part based on the Seller's credit rating. Regardless of whom the Sellers are, or how big or small they are, the same collateral requirements apply to all Sellers in order to protect PG&E's customers.

PG&E acknowledges that the presentation by Black & Veatch highlights the cost impact differences of collateral requirements for different technologies, as presented for a proxy wind and geothermal project. Based on that analysis, as it relates to bid deposits and development

security, projects with lower capacity factors tend to have a higher collateral cost per kW hour. For future renewable energy solicitations, PG&E is willing to consider a collateral structure that results in more comparable requirements from project to project, regardless of the technology employed.

The main area of inconsistency from the workshop is related to opinions on the actual cost impact to projects as a result of the cost of meeting collateral requirements. Both Black & Veatch and Starwood Capital Group presented workshop participants with results based on analysis with a large number of assumptions. Depending on the assumptions, such as the cost of a Letter of Credit, one could determine a wide range of outcomes. Interestingly enough, the presenters seem to have focused on lesser capitalized entities, assuming that such entities would incur high costs to meet the requirements. Each of these assumptions, including the cost of lost debt capacity (as footnoted in Starwood's presentation), should be more fully vetted to determine the true cost impact. The analysis should be further expanded to evaluate the cost impact to well capitalized Sellers. The results may show that investment grade Sellers would not face the same costs as non-investment grade Sellers; in fact, the cost to investment grade Sellers of meeting collateral requirements may be negligible.

PG&E agrees with points made by Southern California Edison (SCE) and further discussed by workshop participants: that capital markets are efficient and that capital will find good projects. Capital does have its competitive advantage. With respect to renewable energy projects and the history of small entities bringing such projects to market, PG&E appreciates the past contributions of these developers/owners and understands the value they can continue to add to help the IOUs reach the 20 percent RPS target by 2010. Both big and small entities are important in bringing new sources of renewable energy to California. PG&E is convinced that good projects of all sizes will, in fact, come to fruition even in light of the collateral requirements necessary to protect PG&E customers. Consequently, PG&E believes its credit policy is appropriate for the current energy market.

PG&E looks forward to building on the discussions in the workshop and to continue to adapt its credit policies to the changing energy market.