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ELECTRONIC DELIVERY

California Energy Commission
Docket Office
Attn: Docket No. 06-IEP-1
1516 Ninth Street, MS-4
Sacramento, CA 95814-5512

Re: Comments on CEC's Draft 2006 IEPR Update Report

Pacific Gas and Electric Company (PG&E) respectfully submits the following comments regarding the CEC's Draft 2006 IEPR Update Report.

Thank you for considering our comments. Please feel free to call me at the number above if you have any questions.

Sincerely,

Les Guliasi

Attachment /mld

Comments of Pacific Gas and Electric Company
On the CEC's Draft 2006 IEPR Update Report

INTRODUCTION

Pacific Gas and Electric Company (PG&E) appreciates the chance to provide written comments on the CEC's Integrated Energy Policy Report (IEPR) update report, which focused on two topics: (1) the progress being made toward California's renewable energy goals, and (2) the interaction of land use planning and energy use.

With respect to increasing the percentage of renewable generation, PG&E and its regulators have made many positive steps. We believe that the CEC has an important role to play in continuing to help expand the supply of renewable resources. We believe the Commissioners have recognized how hard PG&E has worked to ramp up our procurement, and that now is not the time to redesign the developing program. We have several comments regarding continued suggestions for future program changes.

With respect to land use and energy, PG&E appreciates the CEC's thoughtful launch of this important topic. Although we have no comments at this time, we look forward to working with the CEC on developing this issue more in the 2007 IEPR.

RENEWABLE PROGRESS

PG&E is making steady progress toward achieving its 20% renewable goal. Currently PG&E has signed and obtained CPUC approval for RPS eligible contracts for approximately 16-18% of retail load to be delivered in 2010. PG&E issued its 2006 solicitation on September 11 and will be publishing its short list within a week of the CPUC's issuance of the 2003 MPR on December 14. The 2006 solicitation will contribute substantially to PG&E's portfolio of contracts for renewable deliveries.

PG&E is not alone in moving forward. Policymakers and stakeholders have gone from debating the need for new transmission to approving major lines to renewable supplies, establishing a 3rd category of transmission need specifically for renewables, and authorizing a cost-recovery mechanism to get the lines built. State utilities have signed over 50 long-term renewable contracts.

In the last two years PG&E alone has signed contracts for approximately 5% of its load. We recently announced initiatives in new biogas, tidal, and solar technologies, as well as an investigation of the feasibility of bringing renewable energy down from British Columbia. Our Long-Term Plan filing this week includes a proposal to support emerging renewable resources.

EXPANDING SUPPLY – CEC ROLE

The CEC has been an important part of the state's success in moving forward, and the most important contribution the CEC can continue to make in this area is to stay involved in activities that could lead to expanded renewable supply options. This could include:

- Continuing to search for a solution to the financing challenges of those renewable resource developments that require SEP payments;
- Remaining involved in the FERC's examination of transmission issues for renewables;
- Continuing valuable PIER research leading to more renewable resources and/or better understanding of how to integrate them;
- Implementing guidelines that will allow shaped or banked renewable power to be counted; and
- Consider leading or supporting a state agency "green team" that could facilitate the solutions for siting challenges faced by some renewable developers.

Another area where the CEC could add value is in helping new promising technologies obtain eligibility certainty. For example, PG&E recently signed a contract to buy biodigester gas to run in its power plants. Hybrid technologies, such as solar augmentation to conventional power plants, hold a lot of promise. Investor and utility appetite for new technologies wil depend in part on the recognition of generation by the technology as RPS-eligible. Finally, the CEC can play the role of a knowledgeable and honest broker to various local permitting agencies as they examine wind repowering, allowing developers to better understand possible future operating constraints.

OTHER POSSIBLE FIXES UNDER DISCUSSION

PG&E believes we are well on our way to attaining our 20% renewable goal. Indeed, our recommended resource plan in our recently filed long-term procurement plan proposes that over time we go well beyond that goal. Moreover, we believe that as the CEC and CPUC have reviewed our progress to date, we have come to a mutual understanding to "stay the course" for now. Although progress based on actual deliveries of power has been slower than had been hoped, it is not because something is fundamentally "broken" or because effort has been too limited, but because building new renewable power plants – the true goal of the RPS program – takes time. Nonetheless, the draft IEPR update contains a long list of possible fixes to the RPS program. PG&E addresses some of these issues below.

Penalties

On page 42, the draft suggests that enhanced discussion of penalties will increase the likelihood of success in achieving RPS goals. PG&E respectfully disagrees. Our recent leadership in support of AB 32 clearly demonstrates that utilities can achieve the best results for all concerned when they are doing the right things for the right reasons, not out of fear of penalties. Our support of state and national climate change legislation is another demonstration that PG&E is doing all it can to meet the RPS and climate change goals. The fact is that imposing penalties will not make these 50+ new power contracts come on line any sooner. PG&E is procuring renewable power at a faster rate than the annual RPS targets require, and will continue to do so.

Transparency

On page 44, the draft continues to encourage increased transparency. PG&E strives to use a consistent methodology across all procurement decisions including but not limited to RPS. In addition, the methodology adopted has been explained at various public forums. To further the transparency and objectivity, PG&E has obtained the services of an Independent Evaluator (IE) who will review both the individual offers as well as the methods used to value and rank the offers. PG&E's experience has been that the IE generally concurs with PG&E's valuation and ranking with only minor suggested changes.

In valuing offers, PG&E uses a market-based approach. For example, the value of energy in any given hour is the wholesale market price for energy in that hour. The value of a contract is the benefit (to PG&E's customers) of the power obtained under that contract during the hours the power is delivered, minus the cost of obtaining power under that contract. These general principles are consistently used in our procurement valuations.

For an offer type considered a "forward," energy benefit, for each hour of delivery, is the quantity of energy delivery for each hour times the forward energy price for that hour. For Peaking and Baseload products, the quantity of energy delivery for each hour is determined by the performance requirements of the offer. For As-Available products, the quantity of energy delivered in each hour is determined by the hourly generation profile of the offer. The costs are the amounts PG&E would pay for that energy under that offer.

For an offer type considered "dispatchable," the energy benefit is calculated as a daily exercise European option using the Black option pricing model. Additional details of the option depend on the nature of the particular characteristics of a specific offer. The cost for an offer classified as dispatchable is calculated the same way as described above for forwards, except that PG&E's payments for each offer are determined by the offer's pricing multiplied by the appropriate Time of Availability (TOA) factors.

Risk of Contract Failures and Delays

On page 47, the draft raises the issue that there is a risk of contract failures and delays. The commercial reality is that projects can take several years to come online after contract execution. While lack of familiarity with the permitting process and incomplete communication could result in projects not coming on-line by 2010, there are other more critical factors that could delay project construction after regulatory approval. As previously noted, financing is contingent upon approved payment streams; the availability of production tax credits may influence the funding process; and the manufacture of equipment may take more time than anticipated.

PG&E is taking steps to minimize the impact of contract failure and delay. PG&E is engaging in voluntary over procurement to accommodate potential contract failure. In 2004, PG&E's renewable procurement, as measured by contracts for future deliveries, exceeded 2% of its retail sales volume, resulting in a GWh figure that was nearly 230% of the mandatory target. PG&E currently anticipates signing contracts resulting from its 2005 RPS solicitation for the delivery of renewable generation totaling 2-4% of its annual sales. For 2006, PG&E has already signed contracts, on a bilateral basis, for more than 2% of its annual retail sales and is targeting an additional 1 to 2% of its retails sales as a result of its 2006 RPS solicitation.

The best way to reduce contract failure is to execute contracts with projects that are advanced enough to fully understand their economics, permit conditions, and deliverability. The developers themselves determine that the risk of contract failure and delay has been minimized when they are confident enough to post security deposits to assure performance. We have encountered situations where developers whose projects have been short listed during an RPS solicitation have turned down PG&E contract offers because their projects were not sufficiently advanced to meet the delivery requirements and other contract terms. While everyone wants to see more contracts, it is ultimately more productive – and reduces wasted developer money and time – for a developer to wait to sign a contract until they know a project is viable enough to meet the performance obligations.

Finally, PG&E now prepares semi-annual compliance reports to the Energy Division of the CPUC to monitor project development progress more closely. Specific notice must be provided to the Energy Division when a major project milestone is missed.

Bilateral Contracts set at the MPR

At page 49, the draft reiterates the suggestion of considering fixed price contracts. PG&E does not believe the contracting process is a major impediment to meeting RPS goals. PG&E does not believe that a standard contract, or a requirement that utilities buy power at the MPR, would be in the best interest of ratepayers. Such a requirement would mean that renewable bidders would no longer have to compete with each other, which would provide no incentive for each bidder to reduce its price or provide innovative proposals to address operating and other concerns. Conversely, bidders would have no choice, and might have to charge higher prices to compensate for that lack of flexibility. As a result, PG&E customers would have to pay higher prices for power.

Repowering

PG&E agrees with the draft's suggestion (pg. 52) that aging wind facilities pursue repowering. PG&E supports repowering of existing renewable facilities as a means of helping California reach its RPS goals. PG&E seeks to clarify that repowering is limited by the interplay of permitting and project economics rather than existing contract structure or the actions of any specific party. For example, repowering in the Altamont Pass has been limited by uncertainties associated with ongoing environmental litigation, the timing of the associated Environmental Impact Report (EIR) issuance and undefined permit requirements. Without a clear understanding of permit conditions, mitigation requirements or potential repowering timeframes, developers have not been able to develop the project economics to determine the contract price necessary to justify ordering turbines in anticipation of repowering. Absent clear economic expectations, it is difficult for developers to commit to a repowering agreement.

However, it appears that positive progress is being made between the environmental groups and Alameda County that should resolve the litigation and allow the EIR to proceed. Once the conditions and time frame for permit issuance can be reasonably predicted, developers will be in a position to negotiate PPA terms that incorporate the value of the Production Tax Credit and ensure a repowered project has the best chance of going forward. Although the decision to repower rests with the developer based on the economics of each project, PG&E has been in ongoing discussions with CALWEA to determine a framework of pre-agreed upon PPA terms in an attempt to expedite repowering discussions when they finally can occur.

Market Mechanisms

The draft proposes that market-based mechanisms to value renewable energy benefits be established (p.57). PG&E supports unbundled Renewable Energy Credits (RECs) that were authorized in SB107. PG&E also supports a coordinated effort between future carbon markets and REC markets, particularly before any expanded RPS goals are considered. However, since we do not yet know how AB 32's compliance flexibility mechanisms will be implemented, or if, how, or when a federal program will be enacted, it is difficult to know how these markets will interact with RECs. Thus, we support the draft's suggestion that there be further analysis.

Supplemental Energy Payment (SEP) Financeability

PG&E agrees that the inability of developers to finance their projects using revenue streams funded by Supplemental Energy Payments is a significant barrier to development. Developers object that reliance upon payments that must be appropriated from the state treasury as part of the annual State Budget does not provide lenders sufficient certainty. Legislation is needed to amend the SEP award structure so that funds designated as SEPs are not deposited in the Renewables Trust Fund. The draft proposes two methods to solve this problem. The proposal to transfer SEP awards into a third party escrow account could work if governance and oversight issues are properly addressed. The draft alternatively proposes that the utility bear the risk of SEPs being unavailable. While this approach may solve the SEP financeability problem, it puts utility customers at risk in a manner that was not intended by the original RPS legislation. The basic premise of the RPS program limits the IOUs annual procurement obligation to the quantity of eligible renewable resources that can be procured with available supplemental energy payments. A variant of this second proposal would provide that SEP funds are maintained in a utility's balancing account cover reasonable above-MPR costs at the time of contract approval. Given the need for legislation to resolve this issue, PG&E recommends the CEC work with interested stakeholders to reach a solution as soon as possible so that the legislative work can begin.

CONCLUSION

PG&E appreciates this chance to offer comments on the CEC's Draft 2006 IEPR Update Report. We look forward to the final report, and to continuing to work with the CEC as it looks again at these issues and other important energy policy issues for California in the 2007 IEPR.