Regulators are Just People

"The hardest thing you can do is smile when you are ill, in pain, or depressed. But this no-cost remedy is a necessary first half-step if you are to start on the road to recovery."

Allen Klein

"I am told that there is a proverbial phrase among the Inuit: 'A long time ago, in the future.' Let the children see our history, and maybe it will help to shape the future."

Romeo LeBlanc

I'm not a big fan of year-end reviews recapping the highlights of the last twelve months, as if I actually knew which events and stories played a major role in the evolution and development of western power markets during 2015. I don't know any better than any of you which stories have been important and which ones were fluffs. However, I do spend more time than you chronicling those events, bringing to light the innovations, the ridiculous, the ironic, and the comical. Therefore, as the story-teller (rather than the oracle), here is my list of the top ten events for the last year, ranked in reverse order of relative importance:

Western States Playbook

WPTF General Meeting: Thursday and Friday, Feb. 25 and 26, at the Grand Del Mar in Del Mar, CA. Keynote speakers will include FERC Commissioner Colette Honorable (invited), SCE Sr. VP for Regulatory Affairs Ron Nichols, and Bob Hemphill, author of the book, "Stories from the Middle Seat." For more information and to register please click here.

10) Mexico Energy—the country is taking giant steps to transform its natural gas and electricity industries into ones that use world-class competitive platforms. Most of the changes happened in natural gas production and delivery in 2015 principally because the state electric utility, CFE, made multi-billion dollar awards for multiple natural gas pipeline projects originating in Texas and transshipping the commodity to CFE's power plants in Mexico. Additionally, the state-owned oil and gas production monopoly, PEMEX, ceded its monopoly control of its gas pipeline system to a new independent operator known as CENEGAS that is instituting open access tariffs and will be responsible for the future build out of the gas transportation network exclusive of the CFE pipes. Expect the pace of energy reformation in Mexico to increase exponentially in 2016.

9: FERC and Competitive Markets—the Commission initiated a NOPR on real-time wholesale power markets and passed conforming rules intended to increase coordination between natural gas and wholesale power scheduling set against a backdrop of declining enthusiasm among FERC staffers and commissioners regarding the benefits of competitive wholesale energy markets. A test of wills is shaping up between several PJM states and FERC. An example of these potential challenges was evident in separate filings in Ohio by PJM participants (AEP and First Energy) to revert to ratepayer protection for cost-coverage of those utilities' coal and nuclear assets. Will FERC intervene to preserve wholesale competition? How are these state-initiated proposals any different than the capacity proposals from New Jersey and Maryland that afforded ratepayer protection for new electric generating resources and, in effect, thumbed its nose at the PJM forward capacity market? Will FERC mount an effective response to further challenges of its jurisdiction over the nation's organized wholesale power markets?

8: Declining Oil and Natural Gas Prices— Demand reductions and supply increases in oil and natural gas combined with a stronger U.S. dollar contributed to the price drops in the U.S. Other contributing factors included significant declines in credit available to support trading and the increased trader reporting requirements under Dodd Frank. The aggregate impact of these factors resulted in lower commodity-trading volumes. Prices should flatten out next year but it's still uncertain when prices will climb back to long-term average levels.

7: EPA Clean Power Plan—the agency's final rules included new approaches for states to comply with the effort to reduce GHG emissions. It seems increasingly likely that states will opt for mass-based compliance instruments and forego rate-based ones. The next step may be combinations of state programs that will permit trading of allowances across multiple jurisdictions. For a variety of reasons, California's cap-and-trade program will remain a stand-alone program. So much for being a global leader.

6: California CPUC Ex Parte Rules—it wasn't a single event but rather a series of events that started with a data discovery of the San Bruno gas pipeline explosion which exposed emails between principals at PG&E and the CPUC. Like a cancer, it was revealed that this pattern of communication was

Out of Luckhardt

[Click here to learn about the author

Unfinished Business

PANC honored Senate President pro Tempore Kevin de León on Wednesday for his leadership on SB 350. The pro Tem had just returned from Paris where many countries asked him to talk about California's success reducing GHGs while not stifling economic growth. California's rock star status hinges upon its ability to maintain jobs and economic growth while transitioning the economy to low and zero carbon alternatives. Although just getting an agreement in Paris from all participating countries to take action and set goals to reduce GHGs is a major accomplishment, no country will face punishment if they fail to meet their goals. It will be up to the next conference to obtain binding commitments for GHG reductions. This final agreement that merely sets country goals shows how difficult it is for the world to transition away from fossil fuels.

Similarly, SB 350 advanced low carbon goals for the energy sector and even paved the way to transition the ISO to an RTO, but SB 350 was not able to address transportation. Unlike the rest of the US, California cannot ignore transportation, as the transportation sector produces the greatest amount of GHGs. Also, the economy wide goals beyond 2020 are only contained in executive orders. SB 32's economy-wide reductions for 2030 and beyond were unable to achieve the necessary votes to advance. These unfinished steps in GHG reductions will require participation from all Californians, from shifting load in response to time of use rates to finding zero or low carbon transportation options. The open question is whether the average Californian is willing to make those changes.

spread across several other long-term matters before the commission. The drive-by news media made hay from this story and it's likely that we haven't seen the last of it. A pall has been cast over the commission with regard to who may speak or communicate with commissioners and decisional staffers with an intense focus on ex parte filing requirements that go along with any such communication. No one seemed certain of what they could say or be required to report and for at least half of 2015 there was a shutdown mentality at the CPUC. President Picker and his colleagues had the unenviable task of righting the ship and to their credit they have been getting it done. However, things will never return to the way they once were. Informal communications between parties and commissioners are gone. Isn't it time that the CPUC adopted ex parte rules that are similar to FERC's? That is, no discussion by outside parties of any matter before the commission?

5: CAISO Awards for Transmission Elements in Competitive Solicitations—FERC attempted to revolutionize the planning and development of long transmission lines through its Order 1000. However, the CAISO did the heavy lifting for California in 2015 and made its first awards to non-incumbents for transmission elements included in the CAISO's transmission plan. The deciding factors in the CAISO's well-documented and timely selections included cost caps for fixed O&M. Those were the risks the incumbents wouldn't swallow and, as a result consumers in the CAISO footprint will benefit from the well-structured competition for construction of the future transmission grid.

4: CAISO Energy Imbalance Market (EIM)—the evolution of the EIM began in earnest two years ago and notably broadened the new market's footprint in 2015. NV Energy joined PacifiCorp in becoming operational participants, and other outside utilities such as Puget Energy, APS, and Portland General Electric announced their intentions to participate. Other utilities are investigating the opportunity. At the same time, the homegrown Northwest Power Pool effort to develop a competitive platform has fallen apart. Former participants have announced their departure, and the few remaining utilities willing to fund the alternative platform are having increasing difficulty justifying the cost.

What we believe…

1) Competition yields lower electricity rates.
2) Stable and transparent rules and regulations promote private investment.
3) Private investors, rather than utilities, will spend money on new power plants and transmission facilities if they can earn a return that is balanced with the risks.
4) Private sector investment results in lower average prices without risking consumers' money.

3: FERC v. Powhaten Energy Fund—something of a food fight in that Powhaten has taken extensive measures to explain to the world and not just FERC's Office of Enforcement (OE) that the rules under which the fund participated in PJM's "up to congestion" transmission rights market were FERC-approved and therefore perfectly legal. Odd then that OE comes along after the fact and attempts to assess civil penalties and disgorgements topping $30 million. Separately, the Barclays case against FERC for market manipulation allegations is also in federal court but nothing material occurred in that matter in 2015. Next year, however, if FERC loses either of these two cases then it will trigger a sea change in the way the OE conducts future investigations.

2: SB 350 Last Minute Amendments—the California Senate bill was significantly amended by the Governor's office the night before the legislative session ended. The most significant of those amendments for our businesses was the language that set forth a timeline with explicit steps for the CAISO to free itself from being a one-state grid operator. During the energy crisis the California legislature shut down that possibility with emergency legislation passed in 2002. Now, however, there is a real possibility of seeing a regional grid starting with California and branching out to neighboring states.

1: PacifiCorp/CAISO MOU—when it was announced few people expected it, and the rest of us were simply amazed. PacifiCorp did the math and could see that California's excess energy generation during daytime hours was a boon for PacifiCorp's ratepayers. As a participating transmission owner in the CAISO, PacifiCorp can significantly lower the cost of transacting for California's excess energy possibly at give-away prices. If PacifiCorp does the deal, then NV Energy is sure to follow suit since the two utilities are joined at the hip of Warren Buffet. That's the game changer for 2015, if not the decade to come.

That's the way I see it. Feel free to chime in with your viewpoints and we'll begin 2016 with a robust debate.

Last week I mentioned that the legislative agenda in California for 2016 will include a strong push for early retirement of PG&E's Diablo Canyon nuclear plant. However, another political hot potato that is more than just circulating the rumor mill is legislation to aid community choice aggregation (CCA). CCA is a form of retail access whereby a community, such as Sonoma County (through its Joint Power Authority, Sonoma Clean Power) combines the power procurement of the populace except for those residents and businesses that opt out. Those that opt out of CCA service continue to have their energy needs served by the incumbent IOU (in Sonoma County's case, PG&E). However, the IOU continues to own and maintain the distribution infrastructure in Sonoma, does the billing, and provides emergency repairs to fix outages. The IOU then charges each customer class in the CCA a Power Charge Indifference Adjustor (PCIA) to recover the costs for rate-base investments made by the utility that benefit all customers … including CCA customers. Hence, the term of art; non-bypassable charges. These charges are levied by rate class to CCA consumers on ¢/kWh basis.

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Last week, the <u>San Francisco Chronicle</u> printed a story entitled, "PG&E Looking To Raise Fee On Green Energy," that reported on the double whammy being felt by CCA customers. The first whammy is that PG&E energy procurement adjustment has gone down due to lower natural gas prices. That means PG&E's bundled customers receive a small benefit not shared by CCA customers. Further, for CCA customers either present or potential that are comparing PG&E's energy costs to a competitive CCA rate, the reduction in PG&E's costs not enjoyed by the CCA make the assessment more challenging for the latter.

The second whammy is that PG&E's PCIA has been increased given yesterday's approval by the CPUC. Per the <u>SF Chronicle</u>, "Early last month, the Pacific Gas and Electric Co. quietly filed an application to as much as double its exit fee for customers transferring to local green energy programs like CleanPowerSF, Marin Clean Energy and Sonoma Clean Power. The fee, called a Power Charge Indifference Adjustment, or PCIA, helps PG&E pay for energy it contracted for when it had more customers."

The state politicians representing the various load pockets served by CCA aggregators are not pleased with the PCIA increase and PG&E is in a vulnerable position with respect to the state legislature. We'll watch the development of legislative initiatives in 2016 that not only attempt to retire Diablo, but stomp on PG&E's ability to charge higher exit fees.

Let's gear up the holiday table with some timely advice from Burrito test kitchen diva, Laura Manz: "The last recipe of the year takes advantage of the season's bounty of fresh cranberries. It requires a few steps that yield a festive and light ending for every holiday event. Pop some extra bags of cranberries in your freezer to make this again at your summer cookout. Wishing you joy and good eats in the New Year!"

In a 9" round cake pan combine 4 Tbsp. (1/2 stick) of unsalted butter and ¾ cup of brown sugar. Bake in a 350-degree oven until caramelized, stirring occasionally to combine ingredients and distribute them evenly. Remove the pan from the oven and allow it to cool.

In a mixing bowl combine zest from a juicing orange (such as a Valencia) with 1½ cups all-purpose flour, 2 tsp. of baking powder and 1/4 tsp. of salt.

<u>… and, what we should do:</u>

1. Believe in ourselves.
2. Encourage creation of independent, multi-state regional transmission organizations that coordinate policies with respective state utility commissions.
3. Support rules for resource adequacy that apply uniformly among all load-serving entities.

In a separate bowl combine 9 oz. (2 2/3 cups) of fresh cranberries with the juice of the orange, about ¼ cup.

Use an electric mixer to beat 8 Tbsp. (1 stick) of unsalted butter and 1 cup of sugar until fluffy. Beat in 1 tsp. of vanilla and, one at a time, the yolks from 2 eggs. Blend the wet ingredients along with ½ cup of whole milk and the dry ingredients.

In a separate bowl beat the two egg whites with ¼ tsp. of cream of tartar until soft peaks form. Working gently, fold the egg whites into the batter until fully incorporated, trying to keep as much of the air in the egg whites as possible.

Spread the cranberry-orange mixture evenly over the sugar in the pan then carefully spread the batter over the top. Bake at 350 degrees until the top is browned and the cake pulls away slightly from edges of pan and a toothpick inserted comes out clean, about 30 minutes. Let the cake cool for 15 minutes before inverting onto a cake plate.

Here's your weekly slice of cake, your cranberries, and you can eat it too:

>>> Things in the People's Republic of California

@@@ Remember When Electric Generating Capacity Meant Something?

>>> Shout Outs

>>> Odds & Ends (_!_)

>>> Things in the People's Republic of California

@@@ Remember When Electric Generating Capacity Meant Something?

A Burrito reader forwarded to me a really fascinating article that ran in the December 10th edition of Utility Dive entitled, "Why 'Capacity Will No Longer Be The Coin Of The Realm' In The Power Sector." The story chronicles a keynote speech by CAISO CEO Steve Berberich delivered at the PowerGen conference held in Las Vegas a few weeks ago. In it, Steve poses a new paradigm for thermal generator capacity that challenges the old model by stating the position that, "Capacity will no longer be the coin of the realm. Capability will be the coin of the realm."

Steve's meaning is clear. As penetration of variable energy resources (renewables) increases, demand for thermal capacity becomes more about accommodating renewables than accommodating electricity peak demand. It's amazing how things have changed in less than six years. I wonder if things can change again in the next six years, although in which direction I haven't a clue. Of course, we are very familiar with how this story goes... The obvious question is: how will fast-ramping thermal capacity be compensated for providing those attributes? The question has been addressed by the CAISO through its FRAC-MOO stakeholder process and if you don't know what that means, then let me quickly summarize. It's a service that adds compensation to thermal generation asset owners that can demonstrate the ability to ramp up or down within a tolerance band, offer that same capacity to load-serving entities to comply with the flexibility requirement in the CPUC's annual RA showing, and in exchange for the additional payment (regardless how small or trivial) the asset must be bid into the CAISO market each hour the resource is available.

It all sounds peachy except that there is currently far more flexible capacity in California than is needed to comply with the RA requirement. However, that surplus may dry up in few years as more renewables hit the grid.

A fellow panelist joining Berberich at PowerGen was James Schetter, president of the energy research firm Renewable Impacts. Schetter put forward the notion that resources that cause the need for greater flexibility should also pay for the accommodating flexibility. "Schetter has a novel idea to correct for cycling costs: making renewable energy developers pay for the increased cycling they cause … In crafting their new report, Schetter and his team analyzed 100 different power plants in the CAISO footprint, producing more than 300 cycling causality reports outlining the sources of the increased ramping. The firm analyzed 12 different drivers of cycling, including renewables, system load, other thermal plants, power imports and more."

<u>…and, what we should do (cont.):</u>

4. Enforce competitive solicitations by utilities for purchasing either thermal or renewable power.
5. Support choice among retail electricity customers.
6. Lobby for core/non-core split of retail customers.
7. Advocate against policies that limit, through bid mitigation, merchant returns on investment that are utility-like returns.

The study alluded to in Schetter's remarks concluded that most of the CAISO's cycling currently is due to non-renewable causes, although as more renewable resources are added in future years the story will change accordingly. "In 2012, Schetter said, solar energy was responsible for 2.6% of the cycling of the 100 traditional generation plants examined in the CAISO footprint. Wind energy drove 7.7% of the cycling, and other renewables, such as small hydro and biomass, caused 1.7%. The balance was made up of the demands of power imports, thermal and nuclear plants (31%), and the demands of CAISO load (57%)." But in a separate study using 2013 CAISO data the findings were as follows: "While solar had been responsible for 2.6% of the cycling a year before, the firm found it was responsible for 7.6% of it in 2013. Wind's causality grew as well, although less so than solar, leaving it responsible for 7.9% of the cycling in CAISO in that year."

Them's fightin' words to the people whose incomes depend on milking the solar and wind juggernaut. According to Utility Dive there was ample pushback from members in the PowerGen audience along the lines that causality doesn't mean that renewable resource should pay. Maybe they are right. After all, the consumer ends up footing the bill no matter who pays it upstream. However, the imaginary victory of renewable resources being price competitive with thermal resource, already a deeply flawed concept because those comparisons never include the capital cost for maintaining a backup thermal fleet to assure grid reliability, now has the additional thorn of incremental variable costs in the form of cycling thermal units up and down to accommodate the swings in net load.

Case in point, one renewable industry supporter at the conference, an attorney whose clients include renewable developers, offered a counter argument reported as follows: "'The fact that something takes away part of your market or changes the way you need to upgrade doesn't mean that external force is responsible for paying you for the change — why are renewables responsible immediately for those changes?' 'Because they're intermittent,' someone from the audience cut in. To that, [Renewable Impacts] Schetter added: 'Because they're the driver.'" There's nothing like a bit of cost causation and allocation to make a good story. It will start a religious war … always fun to watch … from a formidable distance.

>>> Shout Outs

Our deepest condolences go to Mary Lynch on the loss of her father, John "Jack" Tritch who died at the age of 88 on December 7. The family has requested donations to the Alzheimer Foundation in lieu of flowers. You can send condolence messages to Mary at mary.lynch@constellation.com.

Congratulations to Velocity Merchant Energy LP based in Houston, Texas as being WPTF's newest general member. The contact person at Velocity is Kyle Charles and he can be reached at kcharles@velocityenergy.com or 713-490-7648.

An anonymous letter came to us as follows: "What did that writer *Vox Vates* say two years ago that you quoted in the Burrito? That we were creeping back into another form of 'cost of service'? Centralized capacity markets were not enough, now we have the return of guaranteed rate of return. The long, slow slide to assets backed up by ratepayers, further undermining those assets that were backed by shareholders, further undermining competitive procurement. When the market for power stabilizes – which it eventually will – what will be left? Certainly no investor support for generation assets. It reminds me of the line from *A Man for All Seasons* (about Sir Thomas More's opposition to Henry VIII) when Sir Thomas' son-in-law decries the wrongs of the Church. Sir Thomas asks 'Would you cut down all the laws in England to get at wrong, to get at the Devil as you perceive him'. His son-in-law says, 'Aye, I would cut down all the laws to get at wrong'. Sir Thomas replies; 'And what would you do when you have cornered the Devil and he turns round to face you? Where would you hide, having cut down all the laws of England'.

"Regulators are just people. They have such difficulty not giving in to the expedient and then have to live with the consequences. In 20 years, we may have regulators bemoaning the existence of out of market assets for which rate payers are on the hook and then have to find ways to pay for stranded assets. My children will pay for it but I will advise them to not get involved in any regulated enterprise for it will never achieve the desired outcome. Something will always stop the political/regulatory dynamic from allowing the market to settle itself and find equilibrium."

Regulators are just people?? Didn't Barbara Streisand record that number early in her career? I'll give it some thought.

Alan Meck came back for some more on the global warming dilemma threatening our collective existence. You know I love debating with Alan. He replied to my last snippets as follows: "I think Tom Steyer's billions of dollars are slightly cleaner (but only slightly) than the Koch's in that he's spending it altruistically as opposed to self-interestedly. But more broadly, both the Koch's & Steyer's money is a symptom of a system gone wrong. I'd rather we do away with special interest money altogether and let the 97% of climate scientists speak for themselves.

"I did need to clarify my point about what it costs to stop climate change and what we can do. Yes it would be massively expensive to try to prevent the catastrophic effects of climate change, and while I do believe the expense is necessary, that's only part of the issue. The other impacts we're having on the globe come merely as a result of our emissions and those are a) not debatable, so far as I know, and b) more easily preventable. For example, if it turns out to be true that we've killed 40% of the world's phytoplankton since 1950 (which produce 50% - 90% of the world's oxygen), that's a result of ocean acidification. If we begin to seriously cut carbon, that trend will reverse itself more quickly than the effects of climate change because, so far as I understand the science of diffusion, ocean acidification is not cumulative in the same way. Simply by reducing overall carbon in the atmosphere, we reduce carbonic acid in the ocean. And what's promising is that in 2015 we've already begun to reverse our total CO2 emissions[1]."

Alan, I need to discourage you from quoting the BBC and the UK Guardian as your primary data sources. Get some independent research that stands up to critical review. If there's been a downturn in CO2 emissions, then it's more likely due to the economic downturn in Asia, South America, and Western Europe than anything else. And if Tom Steyer is so damn altruistic then why doesn't he donate 90% of his wealth to halting climate change? He'll still be rich and the human species can survive. Win-win. Right? Or is there a rational amount of spending that resonates with one's sense of utility?

[1] http://www.bbc.com/news/science-environment-35029962

Finally, we can't have a year-end Burrito without hearing from Jack (Ellis). So, heeeeeere's Jack. "One of the essential but rarely mentioned ingredients of Vito Stagliano's 'well regulated markets' is vigilant management oversight of trading operations. Without it, one individual can wreck a firm's reputation, as Bruno Iksil (a.k.a., the London Whale) did in the case of JP Morgan, or it can bring down an entire firm, which is what happened when Nick Leeson circumvented internal controls at Barings Bank. Those who claim traders and their employers are simply acting in accordance with Adam Smith's explanation of the role of self-interest when they exploit loopholes in the rules or push on the boundaries of ethical behavior have apparently never read The Wealth of Nations, which explains the role of self-interest in the larger context of productive economic activity.

"When regulators establish onerous rules, policies and penalty assessments that diminish liquidity in wholesale electricity markets, it is often done in response to traders who take advantage of badly constructed rules for short-term gain and the managements who turn a blind eye because they're more concerned with meeting next quarter's profit targets than the long-term viability of their businesses. Electricity isn't the first market where regulators have had to rein in trader excesses and at least a few of the firms that have been dinged for their bad behavior have long histories in the trading business. Sensible managements should structure compensation so that employees can't get away with engaging in behavior that risks the firm's reputation.

"Commodity markets are supposed to facilitate commerce. They were never intended to be money machines or to provide a playground for traders at the expense of commercial parties."

An excellent year-end message with Peace on Earth written all over it. Thanks, Jack.

>>> Odds & Ends (_!_)

One of these days I will do a retrospective on the ten best stories ever printed in the Burrito since 1998. Maybe I need some research assistants to help whittle down the field since by my casual estimate there have been over 1,000 stories carried less a few duplicates (from old age forgetfulness). I mean without the stories, how would you ever get to this place?

Pilot Situation

An air traffic control tower suddenly lost communication with a small twin engine aircraft. A moment later the tower land line rang and was answered by one of the employees.

The passenger riding with the pilot who lost communications was on a cellular phone and yelled "Mayday, mayday!! The pilot had an instant and fatal heart attack. I grabbed his cell phone out of his pocket and he had told me before we took off he had the tower on his speed dial memory. I am flying upside down at 18,000 feet and traveling at 180 mph. Mayday, mayday!!"

The employee in the tower had put him on speaker phone immediately. "Calm down, we acknowledge you and we'll guide you down after a few questions. The first thing is not to panic, remain calm!!"

He began his series of questions:

Tower: "How do you know you are traveling at 18,000 feet??"

Aircraft: "I can see that it reads 18,000 feet on the Altimeter dial in front of me."

Tower: "Okay, that's good, remain calm. How do you know you're traveling at 180 mph?"

Aircraft: "I can see that it reads 180 mph on the Airspeed dial in front of me."

Tower: Okay, this is great so far, but it's heavily overcast, so how do you know you're flying upside down?"

Aircraft: "The poop in my pants is running out of my shirt collar."

I'd say that's a pretty reliable indicator. Here's your closer for today and 2015, and the next three weeks:

A guy walks into a bar with an octopus. He sits the octopus down on a stool and tells everyone in the bar that this is a very talented octopus. He can play any musical instrument in the world. He hears everyone in the crowd laughing at him, calling him an idiot, etc. So he says that he will wager $50 to anyone who has an instrument that the octopus can't play.

A guy walks up with a guitar and sets it beside the octopus. The octopus starts playing better than Jimi Hendrix, just rippin' it up. So the man pays his $50. Another guy walks up with a trumpet. The octopus plays the trumpet better than Dizzie Gillespie. So the man pays his $50. Then a Scotsman walks up with bagpipes. He sits them down and the octopus fumbles with it for a minute and sits it down with a confused look. "Ha!" the Scot says. "Can't you play it?"

The octopus looks up at him and says, "Play it? I'm going to screw it as soon as I figure out how to get its pajamas off."

I never heard that last one before. I swear it. Pretty funny too.

Please, please, please have a happy and safe holiday season. I wish you all a Merry Christmas and a Happy New Year. We'll reconvene on January 8, 2016.

gba