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County of Santa Cruz

BOARD OF SUPERVISORS

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JEFF ALMQUIST
FIFTH DISTRICT

AGENDA: 4/16/02

April 8, 2002

BOARD OF SUPERVISORS
County of Santa Cruz
701 Ocean Street
Santa Cruz, CA 95060

RE: SUPPORT FOR FEBRUARY, 2002, CALIFORNIA PUBLIC UTILITIES
COMMISSION FILING WITH THE FEDERAL ENERGY REGULATORY
COMMISSION ON POWER PURCHASE CONTRACTS

Dear Members of the Board:

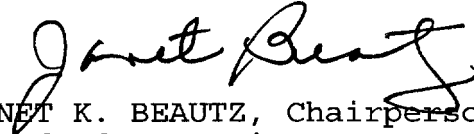
As we are all aware, beginning in June, 2000, and continuing for a year, wholesale electricity prices ran to unprecedented levels, leaving California ratepayers saddled with extraordinarily high energy costs. Then in January, 2001, the cash flow position of affected utility companies prevented them from purchasing power to fulfill their obligation to serve the public. **As a** result, the State of California, through the California Department of Water Resources, entered into long-term contracts to purchase power on behalf of the utilities. The California Public Utilities has since determined that the State was overcharged for these contracts and on February 25, 2002, filed a Section 206 complaint with the Federal Energy Regulatory Commission (FERC) against specified sellers of long-term power contracts to the Department of Water Resources.

As you will see from the attached letter, the Santa Cruz County Energy Commission recently reviewed this matter and has recommended that the Board communicate with our federal representatives to urge their support for the petition filed by the Public Utilities Commission. **As** you will recall, on February 26, 2002, the Board took action to co-sign a complaint demanding rate reductions and refunds of overcollected rates from PG&E. I believe that positive action on the recommendation from the Commission is another step our Board can take to protect ratepayers.

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April 8, 2002
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Accordingly, I recommend that the Board direct the Chairperson to write to our federal representatives urging their support for the petition filed by the California Public Utilities Commission against sellers of long-term power contracts.

Sincerely,



JANET K. BEAUTZ, Chairperson
Board of Supervisors

JKB:ted
Attachment

cc: Energy Commission

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February 24, 2002 PUC: 18

Media Contact: PUC Press Office, 415.703.1366, ne.ws@cpuc.ca.gov

PUC TO MAKE COMPLAINT TO FERC AGAINST SELLERS OF LONG-TERM POWER CONTRACTS

The California Public Utilities Commission (PUC) on Monday will file a Section 206 complaint with the Federal Energy Regulatory Commission (FERC) against specified sellers of long-term power contracts to the California Department of Water Resources (DWR).

Section 206 of the Federal Power Act (FPA) requires that the FERC ensure that all wholesale power contracts are "just and reasonable," with respect to both price and non-price terms and conditions, and affected entities may file a complaint at the FERC over any contract.

The Complaint

The PUC's complaint addresses 44 transactions embodied in 32 contracts with 22 sellers. The PUC's preliminary calculations indicate that collectively, the challenged contracts are priced at levels exceeding just and reasonable prices by approximately \$21 billion.

In addition to unreasonable pricing, the terms and conditions of each contract are unjust and unreasonable, including provisions providing for:

- Payment priority over bond repayment;
- . Attempted evasion of FERC review of the contracts;
- . Asymmetrical credit treatment that calls for DWR to remain creditworthy, but not the seller of the contract;
- . "Most-favored nation" treatment with respect to credit and security provisions, requiring DWR to offer the most favorable credit terms offered to any other seller to sellers with these provisions in their contracts;
- . Asymmetrical mitigation and termination treatment, which, for example, call for termination payments in the event of a DWR breach, but not in the event of a seller's breach.

In bringing this complaint, the PUC seeks abrogation of the contracts, which will enable California to obtain replacement contracts as necessary at reasonable prices and on reasonable terms. In the alternative, the PUC asks the FERC to reform the challenged contracts to provide for just and reasonable pricing, reduce the duration of the contracts, and strike from the contracts the specific contract terms and conditions found to be unjust and unreasonable.

"It is our hope that the FERC moves expeditiously on this matter to give much-needed justice to ratepayers," said Loretta Lynch, President of the PUC. "When these contracts were negotiated, the sellers had California over a barrel. Now it's time for the FERC to recognize last year's out of control market prices and lower California's power costs."

History 13

In the midst of an unprecedented electric crisis, DWR was forced to procure enormous amounts of power in order to keep the lights on in California - under conditions of extreme market power.

At that time, the FERC had already found that unjust and unreasonable rates had been charged in the California markets, and had held that "there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA."

In the months in which DWR negotiated the bulk of the contracts (February-April 2001), spot market prices averaged over \$300/MWh every hour of every day - ten times higher than prior year prices. Suppliers took advantage of their market power and charged unreasonable prices, for unreasonably lengthy periods, and under unreasonable non-price terms and conditions. DWR was forced to accept these terms or let the state go black.

On Monday, the Electricity Oversight Board (EOB) will also make a Section 206 complaint to the FERC. "Last year, FERC's indifference unnecessarily cost Californians billions of dollars for energy. Now, federal regulators say they cannot give relief to California unless it files a complaint. Tomorrow's filing by the PUC and EOB will put FERC to the test," said Governor Gray Davis.

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February 24, 2002

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PUC SECTION 206 COMPLAINT FACT SHEET

Section 206 Complaints

- The Federal Energy Regulatory Commission (FERC) has on several occasions invited the PUC to file a Section 206 complaint with respect to the DWR contracts.
- . The Federal Power Act ("FPA") requires that the FERC ensure that all wholesale power contracts are "just and reasonable," both in price and in non-price terms and conditions.
- . A public utility's rates are just and reasonable under the FPA, and therefore lawful, when they fall within a "zone of reasonableness" within which the rates are high enough to be compensatory to the utility but not excessive for the consumer.
- . Section 206 of the FPA provides that a party may file a complaint at the FERC over any contract. If the FERC finds that any price or non-price term in the contract is "unjust, unreasonable, unduly discriminatory or preferential," the FERC "shall determine the just and reasonable" price and/or term. The FERC also has the authority to reject the contract altogether.
- Although parties to contracts may waive their rights to file Section 206 complaints seeking to modify the contracts, third parties affected by the contracts may always file a complaint.

Possible FERC Remedies

- The FERC is not required to act on a complaint on any particular timeline. When the FERC receives a complaint it may: (1) Summarily grant the complaint and order the relief requested; (2) Order a trial-type hearing to resolve the issues raised by the complaint; (3) Reform the contracts as they see fit; or (4) Summarily reject the complaint.

PUC Claims

- . The PUC submits that each of the challenged contracts must be abrogated because they are unjust and unreasonable.
- . The PUC's preliminary calculations indicate that collectively, the challenged contracts are priced at levels exceeding just and reasonable prices by approximately \$21 billion.
- In addition to unreasonable pricing, the non-price terms and conditions of each contract are unjust and unreasonable. Specific unjust and unreasonable non-price terms and conditions in the challenged contracts include provisions providing for:
 - o Payment priority over bond repayment;
 - o Attempted evasion of FERC review of the contracts;
 - o Asymmetrical credit treatment that calls for DWR to remain creditworthy, but not the seller of the contract;
 - o "Most-favored nation" treatment with respect to credit and security provisions, requiring DWR to offer the most favorable credit terms offered to any other seller to sellers with these provisions in their contracts;
 - o Asymmetrical mitigation and termination treatment, which, for example, call for termination payments in the event of a DWR breach, but not in the event of a seller's breach.

. The PUC does not need to provide specific factual evidence of any particular seller's efforts to exert market power (although such evidence will certainly be pursued in discovery). Rather, it is enough that "systemic conditions" at the time provided the opportunity for sellers to engage in anticompetitive behavior. In December of 2000, FERC held that this condition was met.

. Sempra charges the California Department of Water Resources (DWR) \$160/MWh for peak energy from April 2002 to September 2002, a price that is almost 250% above the \$45.80/MWh benchmark based on information provided to Wall Street by Calpine.

. PacifiCorp Power Marketing charged DWR over \$400 million in capacity payments alone over a ten year period, for approximately 60% of the capacity of a plant that cost \$309 million to construct and will operate for 20-30 years.

. The Fresno Agreement calls for a variable Operation & Maintenance (O&M) payment of \$12/MWh. The FERC has previously found \$2.00/MWh to be a reasonable amount for O&M costs.

. The "Calpine 2b" capacity payments cost \$80-\$90 million/year for 20 years or, approximately \$1 billion, on a net present value basis. Calpine 2b provides power 16 hours a day Monday through Saturday for 2,000 hours a year. Using extremely conservative estimates of capital cost, capacity payments are more than double the total construction costs of approximately \$370 million (495 MW x \$750,000/MW). Yet DWR is charged for twice the cost of capacity for which it has access to for less than 25% of the time. Calpine 2b's exorbitant capacity charge is in addition to the \$73/MWh cost of energy.

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