Decision **DRAFT DECISION OF ALJ HALLIGAN** (Mailed 12/6/2004)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for Order Approving Power Purchase Agreement Between Southern California Edison Company and Reliant Energy Etiwanda, Inc.	Application 04-10-004 (Filed October 2004)

OPINION GRANTING APPROVAL FOR SOUTHERN CALIFORNIA EDISON COMPANY TO ENTER INTO A CAPACITY TOLLING AGREEMENT WITH ENERGY ETIWANDA, INC.

Summary

In this decision, we grant the application of Southern California Edison Company (SCE) to enter into a two-year Capacity Tolling Agreement (Agreement) with Reliant Energy Etiwanda, Inc. (REE). The Agreement provides for dispatchable energy from REE's Generation Units 3 and 4 (Units) and will assist SCE in meeting its electrical capacity and regulatory requirements and facilitate SCE's ability to meet customer load in the day ahead, hour ahead, and ancillary services markets, while providing credit safeguards and favorable termination rights.

Applicable Law

SCE's application was filed pursuant to Public Utilities Code Section 454.5[1], Commission Decision (D.) 02-10-062, and D.03-12-062. As SCE notes in its application, pursuant to its Assembly Bill (AB) 57 Procurement Plan, adopted by the Commission in D.03-12-062, SCE regularly procures and sells electrical capacity, energy and natural gas to fulfill its customer Residual Net Short needs and most economically dispose of Residual Net Long positions. Transactions entered into in compliance with the approved Procurement Plan are not subject to transactions-specific Commission approval. However, to the extent a transaction fall outside of the approved Procurement Plan, SCE is authorized, pursuant to Section 454.5 and D.02-10-062, to file an application requesting expedited approval of a specific contract. The procedures for the applications are set forth in Appendix C of D.02-10-062.

SCE also states that its application is consistent with the Commission's direction in D.04-07-028, addressing the utilities' responsibility for local reliability.

SCE filed the full terms of the Agreement under seal, requesting that the terms be kept confidential pursuant to the Protective Order issued on May 1, 2002, in Commission Rulemaking (R.) 01-10-024 and the modified Protective Order approved on May 20, 2003, in the same docket.[2] SCE filed and served a

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[1] All statutory references are to the California Public Utilities Code, unless otherwise noted.

[2] Although SCE's application refers to a Protective Order issued on May 20, 2003 in R.04-04-003, the May 20, 2003, Modified Protective Order was issued in the predecessor rulemaking R. 01-10-024.

redacted version of Exhibit 1, along with Exhibit 2 to the service list. An unredacted version of Exhibit 1, along with Exhibit 2 and confidential Exhibits 3 and 4 were provided under seal to the Commission and the members of SCE's PRG consistent with the Protective Order discussed above. SCE requested that the unredacted versions and confidential Exhibits remain under seal.

The Proposed Agreement

SCE states that it identified a need for capacity as early as the summer months of 2004 and initiated a Request for Offers (RFO) on April 26, 2004, consistent with D.03-12-062, to procure unit-contingent Tolling Products and dispatchable Call Options. Following the release of the RFO, but prior to the development of a short-list in the RFO, the California Independent System Operator (CAISO) informed SCE that the REE Units were needed back on line as soon as possible to resolve a transmission reliability problem in SCE's service area. SCE responded by requesting that REE provide an Etiwanda-specific offer consistent with the other terms and conditions of the April 26, 2004 RFO.

SCE explains that REE submitted an Etiwanda-specific offer on June 14, 2004, but that the offer, which was based, in part, on a Federal Energy Regulatory Commission (FERC) approved Tolling Agreement, contained unacceptable legal, credit and operational risks for SCE's customers. Consistent with the Procurement Plan provision allowing bilateral negotiations within 30 days of an RFO, using the RFO as a strong showing for comparative pricing, SCE continued to negotiate with REE. Since the negotiations continued for more than 30 days prior to reaching agreement, the Agreement does not fall within the authorized Procurement Plan.

The Agreement does not fall within the approved Procurement Plan for several reasons. First, a tolling agreement is not one of the authorized bilateral

products provided for in D.03-12-062 and D.04-07-028. SCE points out that D.03-12-062 limited authorization of negotiated bilateral contracts to the following three circumstances:

> "First, for short-term transactions of less than 90 days duration and less than 90 days forward, the IOUs are authorized to continue to use negotiated bilaterals subject to the strong showing standard we adopted in D.02-10-062, as modified by D.03-06-067. Any such negotiated bilateral transactions shall be separately reported in the utilities quarterly compliance filings.
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> "Second, utilities may use negotiated bilateral contracts to purchase longer term non-standard products provided they include a statement in quarterly compliance filings to justify the need for a non-standard product in each case. The justification must state why a standard product that could have been purchased through a more open and transparent process was not in the best interest of ratepayers.
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> "Last, we expand the authorization for use of negotiated bilaterals for standard products in instances where there are five or fewer counterparties who can supply the product, as suggested by SCE. We limit this authority, however, only to the two categories of gas products cited by SCE: gas storage and pipeline capacity. In such instances, the utility needs to affirm that five or fewer counterparties in the relevant market offered the needed product. Any resulting contract shall be separately reported in the utilities' quarterly compliance filings." (D.03-12-062, *mimeo.* pp. 39-40.)

D.03-12-062 concluded that "Negotiated bilateral transactions should be separately reported in the utilities' quarterly compliance filings." (D.03-12-062, *mimeo.* p. 84, Conclusion of Law 11.)

SCE also notes that D.04-07-028 relaxed the restrictions on negotiated bilateral contracts to allow utilities to engage in bilateral negotiated contracts for capacity and energy from power plants for the purpose of enhancing local area

reliability, but continued to require that such transactions be included in the IOUs quarterly compliance filings. (D.04-07-028, *mimeo.* p. 17-18)

Second, the Agreement term is inconsistent with the pre-approved contract duration for contracts that become effective after December 31, 2004. Third, the Agreement has not been addressed in any of SCE's quarterly compliance filings, as it arose since the most recent filing.[3] Finally, as noted above, since the Agreement was executed more than 30 days after SCE concluded its RFO for Offers for electrical capacity for unit-contingent Tolling Products and/or dispatchable Call-Option products, it does not qualify as an exempt bilateral contract under D.03-12-062.

The Agreement provides that SCE will provide REE natural gas, which REE will burn to produce electricity. SCE is able to dispatch the energy in any hour of the day, seven days a week. SCE also serves as the fuel manager and scheduling coordinator under the Agreement, allowing it to achieve greater ratepayer benefit by having the generating units follow the variability of the real-time electricity requirements.

SCE states that the capacity that will be procured under the Agreement is within the capacity and ratable rate limits of SCE's Procurement Plan and the pricing terms of the Agreement are reasonable, especially compared to the bid prices obtained in the RFO process. The pricing provisions of the Agreement include a Capacity Charge, shaped by month throughout the year, based on the

[3] SCE states that the Agreement will be addressed in SCE's October 30, 2004, quarterly compliance filing, but notes that there is no clear process to achieve Commission approval of a specific item in the filing, nor is action on the compliance filing required to conform to a specific schedule.

ratio of forward power prices to natural gas prices and a Tolling Fee, which is made up of a Capacity Charge plus a Variable Operation and Maintenance (O&M) Charge, based on unit availability and designed to compensate REE's variable O&M costs and is only paid on the amount of electricity REE actually delivers to SCE.

The Agreement also includes contract provisions designed to ensure REE's compliance with the Agreement, or allow SCE to replace REE's product using collaterals and other guarantees. In particular, under the terms of the Agreement: (1) SCE is not required to remit payments under the Agreement until the month following delivery; (2) REE is precluded from scheduling any outages during the peak months of June 1 through October 31; (3) SCE is authorized to inspect the units at anytime there is an outage; and (4) the Agreement provides a guaranteed heat rate, with financial adjustments depending on performance.

Although the Agreement did not result from the RFO process and does not fully conform to the pre-approved procurement products and processes set forth in its Procurement Plan and D.03-12-062 and D.04-01-050, SCE believes the Agreement provides economic benefits to its customers and should be approved.

TURN's Response

The Utility Reform Network (TURN) filed a limited protest to SCE's application on November 5, 2004. TURN agrees that the Agreement offers reasonable value to SCE's bundled customers, based on its ongoing participation in SCE's Procurement Review Group (PRG) and its review of the application, but expresses concern that SCE's likely use of the REE units to meet local area reliability needs raises cost allocation concerns that must be addressed by the Commission.

First, for the year 2005, TURN seeks assurance that the costs of maintaining and operating the Units to provide grid reliability services will be allocated to all of SCE's transmission customers and that REE is not being paid twice to maintain and operate the Units.

Second, since the local reliability policies expressed in D.04-07-028 expire at the end of 2005, TURN suggests that in order to ensure that the allocation of the costs of the Units for local reliability services for the second year of the Agreement (2006), the Commission should commit to addressing local reliability issues to ensure that the net costs of any use of the Units in 2006, for local reliability purposes continue to be allocated to all SCE customers consistent with D.04-07-028.

TURN requests that the Commission approve the Agreement, but also requests that the Commission: (1) confirm that certain contract provisions and or policies allocate local area reliability costs reasonably among all SCE transmission customers; and (2) specify that future "local area reliability policies will cause such costs to be allocated to all customers. TURN states that if the Commission does not make such findings, TURN cannot support approval of the Agreement.

TURN notes that, although the Commission recognized these principles in D.04-07-028, D.04-07-028 only remains in effect through the end of 2005, unless superseded by another order or orders addressing the same issues.

Discussion

After reviewing the public and non-public versions of SCE's application, as well as TURN's limited protest, we conclude that the Agreement is reasonable and we approve it. SCE presented testimony that the Agreement provides economic benefit to SCE's customers by providing reasonable hedging against

current projections of future prices, along with dispatching flexibility and performance guarantees. The Agreement will also assist in satisfying certain concerns regarding transmission reliability issues in SCE's service area, by ensuring that the REE Generation Units 3 & 4 are online and available for local area reliability for the term of the Agreement. TURN agrees. No other party filed a protest to the application.

The only remaining issues are TURN's concerns regarding cost responsibility for the REE Units when they are used to provide local area reliability. TURN agrees that the Units provide economic benefits to SCE's bundled customers when they are used to meet the energy needs of its bundled customers. However, TURN urges the Commission to condition its approval of the Agreement on assurances that the costs of maintaining the REE Units to provide grid reliability services will be allocated to all SCE's transmission customers and that REE will not be paid twice to maintain the Units.

As TURN notes, the Commission acknowledged the first principle in D.04-07-028, stating: "We expect IOU's to attempt to recover appropriately allocated reliability-related costs through their FERC Reliability Services tariff provisions. If utilities are denied recovery through this channel utilities may seek cost recovery in the appropriate ERRA proceeding." (D.04-07-028, *mimeo*, p. 24) SCE agrees that D.04-07-028 represents the Commission's current policy for local area reliability and argues that affirmation of this policy is not necessary to approve the Agreement. TURN is correct, however, that since the policy articulated in D.04-07-028 expires at the end of 2005, unless otherwise ordered, the Commission will not have a stated Commission policy on cost responsibility for local area reliability post 2005.

This does not bar our approval of the Agreement because, as SCE notes, the Commission has indicated in D.04-10-035 that it will develop policies for local area reliability for future years in connection with the Resource Adequacy workshops to be held in Phase 2 of the Resource Adequacy part of R.04-04-003. SCE further states that it is SCE's understanding that each load serving entity's responsibility for local grid reliability and allocation of local grid reliability costs will be addressed in Phase 2 workshops and the anticipated Commission decision on Resource Adequacy (SCE Response, p. 4). Therefore, while we are sensitive to TURN's concerns that the appropriate regulatory framework is not in place to ensure that local area reliability costs are fairly borne by all of SCE's transmission customers, we agree with SCE that TURN's concern is premature. The Commission's current policies for local area reliability are articulated in D.04-07-028. Future cost responsibility policies for local area reliability will be addressed as part of the Phase 2 of the Resource Adequacy review. Morever, we agree with SCE that the Agreement offers economic benefits to SCE's bundled customers independent of its local area reliability benefits.

Need for Expedited Consideration

Rule 77.7(f) (9) of the Commission's Rules of Practice and Procedure provides in relevant part that:

> "… the Commission may reduce or waive the period for public review and comment under this rule…for a decision where the Commission determines on the motion of a party or on its own motion, that public necessity requires reduction or waiver of the 30-day period for public review and comment. For purposes of this subsection, "public necessity" refers to circumstances in which the public interest in the Commission adopting a decision before the expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for public review and comment. "Public

> necessity includes, without limitation, circumstances where failure to adopt a decision before expiration of the 30 day review and comment period…would cause significant harm to public health or welfare. When acting pursuant to this subsection, the Commission will provide such reduced period for public review and comment as is consistent with the public necessity requiring reduction or waiver."

We balance the public interest in ensuring that the Agreement is in place to both provide economic benefit to SCE's customers and prevent a continuation or reoccurrence of the system reliability concerns which led to the issuance of D.04-07-028 against the public interest in having a full 30-day comment period. Although the immediate need for the Agreement is mitigated somewhat by the fact that REE Units are subject to an RMR contract for 2005, and will therefore be back on line regardless of whether we approve the Agreement, there is currently no assurance that these units will continue to be subject to an RMR contract in 2006 or beyond or otherwise available to SCE to meet its customers energy needs. Therefore, we find that a delay in approval of the Agreement has the potential to unnecessarily compromise future local area reliability in SCE's service territory. We find that a reduced review and comment period balances the need for public with the need for timely action on SCE's application.

Pursuant to Public Utilities Code Section 311(g)(3) and Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure, we reduce the public review and comment period to seven days for opening comments and nine days for reply comments. Comments were received on December 13, 2004 from SCE. We make no changes to the draft decision.

Categorization and Need for Hearings

SCE filed this application on October 6, 2004. Resolution ALJ 176-3140 issued October 7, 2004 specified that this is a ratesetting proceeding and that no hearings are necessary. We confirm these preliminary determinations.

Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Julie Halligan is the assigned ALJ in this proceeding.

Findings of Fact

1. The Capacity Tolling Agreement will provide SCE with a reasonable economic source of energy to meet its energy, local reliability and resource adequacy needs.

2. SCE's execution of the Capacity Tolling Agreement is consistent with D.03-12-062, D.04-07-028, and other relevant Commission decisions.

3. The Commission's current policies for local area reliability are articulated in D.04-07-028.

4. Future cost responsibility policies for local area reliability will be addressed as part of the Phase 2 of the Resource Adequacy review.

5. A delay in approval of the Agreement will cause significant harm to public health and welfare by unnecessarily compromising system reliability in SCE's service area.

I. Conclusions of Law

1. It is reasonable and in the public interest to approve the Capacity Tolling Agreement with Reliant Energy Etiwanda, Inc.

2. This order should be effective today to prevent significant harm to public health and welfare, and secure continued local area reliability in SCE's service territory.

O R D E R

IT IS ORDERED that:

1. The Application of Southern California Edison Company for authority to enter into a Capacity Tolling Agreement with Reliant Energy Etiwanda, Inc. is granted.

2. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.