

**DRAFT**

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**  
**ENERGY DIVISION**

**Item # 32 I.D.# 6085**  
**RESOLUTION E-4031**  
**November 9, 2006**

**R E S O L U T I O N**

Resolution E-4031. Southern California Edison Company (SCE) requests the Commission's approval to establish the Peakers Generation Memorandum Account (PGMA) and to revise the Generation Sub-account of the Base Revenue Requirement Balancing Account (BRRBA).

The PGMA will record the revenue requirement (i.e., incremental O&M expenses, book depreciation, applicable taxes, and an authorized rate of return on rate base) as each peaking facility is completed and closed to plant-in-service. The revenue requirement recorded in the PGMA will be transferred to the Generation Sub-account of the BRRBA on a monthly basis.

By Advice Letter 2031-E Filed on August 24, 2006.

---

**SUMMARY**

This Resolution approves SCE's request to establish a Peakers Generation Memorandum Account (PGMA) and to revise the Generation Sub-account of the Base Revenue Requirement Balancing Account (BRRBA). This Resolution also authorizes SCE to record the revenue requirement as each peaking generation plant is completed and becomes used and useful. The revenue requirement will be recorded in the PGMA and will be transferred to the Generation Sub-account of the BRRBA on a monthly basis.

**BACKGROUND**

On August 15, 2006, in Rulemakings 05-12-013 and 06-02-013, an Assigned Commissioner's Ruling (ACR) "Addressing Electric Reliability Needs in Southern California For Summer 2007" directed Southern California Edison Company (SCE) to, among other thing, pursue the development and installation of up to 250 MW of black-start, dispatchable generation capacity within its

service territory for summer 2007 operation. The ACR invited SCE to file an advice letter to establish a memorandum account in which it would record the acquisition and installation costs.

**Assigned Commissioner's Ruling directed SCE to procure 250 MW of utility owned generation that can be online in time for summer 2007.**

The ACR directed SCE to procure black-start, dispatchable generation capacity within its service territory for summer 2007 operation.

The ACR stated that it was taking these actions in response to the critical near-term needs in southern California that was identified by the California Independent System Operator (CAISO).

The CAISO's assessment for the summer of 2006 indicated that it could handle a demand in excess of 48,000 MW, close to what demand was forecasted to be under extreme temperatures that materialize once every 10 years, with limited to no impact on firm load customers.<sup>1</sup> However, the CAISO reports, the peak demand during that heat wave was 51,000 MW, well above any of the scenarios it had assumed in its assessment. As the CAISO notes, that was over 12% higher than last year's record, 6% higher than the worst case scenario the CAISO analyzed in its assessment, and 38% higher than the peak demand of the crisis year 2001; it represents the demand forecasted not to appear until five years from now. Across the CAISO's service area, weighted average temperatures ranged between 106 and 110 degrees Fahrenheit on various days, something California and the West have not experienced in recent history; these temperatures were higher than anything recorded in the 30-year history of the temperature models used by the CAISO.[8/15/06 ACR]

**ACR invited SCE to file an advice letter to establish a memorandum account.**

The ACR noted that it did not appear possible for SCE to develop and for the Commission to consider proposals for ratemaking treatment of the costs of developing and installing the utility-owned generation prior to the time such generation would be installed. As such, the ACR invited SCE to file an advice

---

<sup>1</sup> Prepared Statement of Yakout Mansour, President and Chief Executive Officer of CAISO, before the California State Senate Committee Governmental Organizations, dated August 9, 2006. The statement is available at the CAISO's website.

letter to establish a memorandum account in which it would record the acquisition and installation costs of the generation facilities.

**SCE filed Advice Letter 2031-E to establish the Peakers Generation Memorandum Account.**

SCE filed Advice Letter 2031-E on August 24, 2006. The advice letter sought Commission permission to establish the Peakers Generation Memorandum Account (PGMA) and to revise the Generation Sub-account of the Base Revenue Requirement Balancing Account (BRRBA).

**NOTICE**

Notice of AL 2031-E was made by publication in the Commission's Daily Calendar. SCE states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

**PROTESTS**

Advice Letter 2031-E was not protested.

**DISCUSSION**

Energy Division has reviewed SCE's Advice Letter 2031-E and recommends approval as clarified. The clarifications are needed to ensure that the Commission's direction and SCE implementation are consistent with the intent of the ACR.

**The advice letter filed by SCE exceeds the ACR's directive.**

The ACR invited SCE to file an advice letter to establish a memorandum account to "record the acquisition and installation costs." SCE's advice letter, in addition to establishing a memorandum account, sought authority to record the revenue requirement (i.e., incremental O&M expenses, book depreciation, applicable taxes, and an authorized rate of return on rate base) arising from with the acquisition costs, installation costs, and other related costs associated with peaking generation units and non-ISO transmission facilities upgrades associated with interconnecting the peaker units. SCE proposes to calculate the revenue requirement as each peaking facility is completed and closed to plant-in-service.

SCE further proposes that the revenue requirement recorded in the memorandum account be transferred to the Generation Sub-account of the BRRBA on a monthly basis.

SCE's filing highlights the different purpose of its proposed memorandum account. SCE proposes to use the memorandum account to record the revenue requirement associated with the peaker plants. The ACR directive indicated that the memorandum account was to record the acquisition and installation costs. The ACR did not address revenue requirement for the peakers.

**SCE does not require a memorandum account to record acquisition and installation costs.**

SCE states that prior to the peaker plants going into service, SCE spends the cash to construct the project and those expenditures are accumulated and tracked in a "work order" and those expenditures are recorded as an asset (Construction-work-in-progress) on the general ledger. SCE also accrues allowance for funds used during construction (AFUDC) associated with the expenditures in the work order. As the peaker costs are tracked in a "work order", a mechanism already exists at SCE to record the acquisition and installation costs.

**SCE proposes to record \$57 to \$71 million of revenue requirement to the PGMA**

SCE estimates that, for up to 250 MW of resources (5 combustion turbines of approximately 45 MW each), the total costs associated with the development, installation and start-up will probably exceed \$250 million. As noted above, these costs will be accrued and tracked in a "work order", not the PGMA.

Based on the estimated \$250 million of capital expenditures to install 5 peaking units, SCE estimates that the annual revenue requirement will be approximately \$40 to \$50 million. SCE proposes to record the revenue requirement in the PGMA. Assuming that the units go in-service in August 2007, the revenue requirement recorded in the PGMA in 2007 will be approximately \$17-\$21 million (5 month) and another \$40-\$50 million in 2008, for a total of \$57-\$71 million. Beyond 2008, the annual revenue requirement for the peakers will be included in SCE's authorized 2009 GRC revenue requirement which is currently scheduled to be implemented on January 1, 2009.

**SCE's advice letter filing seeks to neutralize the income statement impact once the peakers are in service.**

Once the peaker plants are operational and transferred to plant-in-service, SCE starts recording depreciation, O&M, and tax expenses. Recording these expenses without a corresponding increase in revenues will result in SCE's recorded earnings to be negatively impacted. Allowing SCE to record the revenue requirement in a memorandum account without the monthly transfer to the BRRBA does not mitigate the earnings impact, as SCE's memorandum account balances cannot be recorded on the general ledger until the Commission has approved rate recovery through a balancing account. SCE's advice letter proposal to record the revenue requirement to the memorandum account with a monthly transfer to the Generation Sub-account of the BRRBA neutralizes the income statement impact. SCE is ensured that the addition of the power plants will not affect SCE's opportunity to earn its authorized rate of return.

SCE will track the revenue requirement for each unit separately.

**Mitigating circumstances compel deviating from standard Commission procedure.**

As described above in the ACR, unanticipated conditions occurring during the summer of 2006 have prompted the CAISO to identify critical near-term needs in southern California for summer 2007. Accordingly, the ACR directed SCE to, among other things, pursue new utility-owned peaker units with the characteristics described in the ACR that provide up to 250 MW of new generation and can be online in time for August 1, 2007. SCE would ordinarily be required to procure any such resources through a competitive solicitation, pursuant to D.04-12-048. As competitive IOU procurement processes are key elements of the Commission's procurement regime, the ACR directed SCE to promptly evaluate any offers for resources in its on-going New Generation Request for Offers (RFO) process that have the features described in the ACR and to submit any resulting contracts for Commission approval by November 15, 2006, to the extent agreements can be reached for appropriate resources. However, given the extremely limited timeframe to bring such units online, there would not be sufficient time for SCE to wait until the results of that process are known and only then initiate its development of any still-needed utility-owned generation. Nor is there sufficient time for SCE to initiate and conduct a separate RFO that would include consideration and evaluation of new utility-owned

resources along with third party resources. In light of the foregoing mitigating circumstances, it is reasonable to permit SCE to proceed with the development of this limited amount of utility-owned resources outside of a competitive procurement process.

Additionally, allowing SCE to request authority to record revenue requirements associated with the peaker plants via an advice letter is not standard Commission practice. The advice letter process is an informal procedure. A revenue requirement request, should, under normal circumstances, be filed under an application process with its more formal procedures.

However, given that the peaker units were not forecasted in the 2006 GRC, begin accruing operational expenses by summer 2007, and that an application process may take a year or longer, there are sufficient mitigating circumstances for SCE's request.

**Burden to show reasonableness of accrued costs will be on SCE.**

SCE should be prepared to demonstrate that the accrued costs were reasonable. Accrued costs include all costs related to acquisition and installation of the peaker plants tracked through the "work order" system (estimated at \$250 million), as well as the associated revenue requirement recorded to the memorandum account once the plants are in service (estimated at \$57-\$71 million). SCE should file an application no later than December 31, 2007 to demonstrate that the costs were reasonable.

**The Preliminary Statement for the Peakers Generation Memorandum Account should be clarified.**

SCE should submit a substitute tariff sheet for the preliminary statement for the PGMA to clarify the purpose of the memorandum account. The currently stated purpose "to record the costs of acquisition and installation" is not correct and is misleading. SCE should properly state that the purpose of the PGMA is to record the revenue requirement associated with the peaker plants.

**SCE's proposal to submit a monthly status report is welcomed.**

In SCE's advice letter filing, SCE proposed to submit a monthly "Planning and Construction" Report to keep the Commission informed of the progress of the

projects. That report will include information such as the status of the projects, the costs incurred from inception to date, and any issues or concerns regarding the projects so that the Commission can provide guidance as the project advances.

The Commission endorses SCE's proposal for a monthly status report. We request that the date of August 1, 2007 be identified as being the peaking generation on-line date with all corresponding progress measured to this date.

**Effective date should be November 9, 2006.**

SCE request for an effective date of August 15, 2006 is denied.

The Commission's standard practice is to authorize memorandum accounts to be effective only on or after the date on which the Commission approves them. Accordingly, we will authorize this memorandum account to be effective as of the date of today's decision. As SCE does not plan to record any amounts in this memorandum until the peaker plants are in service, there is no harm to SCE.

### **COMMENTS**

Public Utilities Code section 311(g)(1) provides that resolutions generally must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and placed on the Commission's agenda no earlier than 30 days from the date of mailing.

SCE provided comments on the draft resolution on October 26, 2006 to parties on service list for E-4031, R.04-04-003, and R. 06-02-013. No other party provided comments. No parties provided reply comments on the draft resolution.

In its comments, SCE requested clarifications confirming that SCE may develop up to 250 MW of new utility-owned generation as described in the ACR outside

of a competitive solicitation process, as a limited exception to the requirements of D. 04-12-048.

Based in part on SCE's comments, the draft resolution is being modified. Modifications to the draft resolution have been incorporated throughout as reflected herein.

## **FINDINGS**

1. Assigned Commissioner's Ruling (ACR) "Addressing Electric Reliability Needs in Southern California For Summer 2007" directed Southern California Edison Company (SCE) to pursue the development and installation of up to 250 MW of black-start, dispatchable generation capacity within its service territory for summer 2007 operation.
2. The ACR invited SCE to file an advice letter to establish a memorandum account in which SCE would record the acquisition and installation costs.
3. SCE filed Advice Letter 2031-E on August 24, 2006 to establish the Peakers Generation Memorandum Account (PGMA) and to revise the Generation Sub-account of the Base Revenue Requirement Balancing Account (BRRBA).
4. No protests were filed.
5. Advice Letter 2031-E, in addition to establishing a memorandum account, sought authority to record the revenue requirement (i.e., incremental O&M expenses, book depreciation, applicable taxes, and an authorized rate of return on rate base) arising from the acquisition cost, installation costs, and other related costs associated with peaking generation units.
6. SCE estimates total revenue requirement to be recorded in the PGMA of \$57-\$71 million, based on an estimated capital expenditures of \$250 million to install 5 peaking units.
7. SCE proposes to calculate the revenue requirement as each peaking facility is completed and closed to plant-in-service.
8. SCE further proposes that the revenue requirement recorded in the PGMA be transferred to the Generation Sub-account of the BRRBA on a monthly basis.
9. The cost to be recorded in the PGMA is different from what the ACR directed. The ACR directed SCE to record "acquisition and installation costs" of the peaker plants. SCE filed its advice letter to record the revenue requirements associated with the peaker plants.
10. As SCE utilizes a "work order" to accumulate and track the costs associated with the peaker plants, SCE does not require a memorandum account for that purpose.

11. SCE states that once the plants are in service, SCE will begin recording depreciation, O&M, and tax expenses.
12. Recording these expenses without a corresponding increase in revenue will result in SCE' recorded earnings to be negatively impacted.
13. SCE's advice letter proposal to record the revenue requirement to the memorandum account with a monthly transfer to the Generation Sub-account of the BRRBA neutralizes the negative earnings effect caused by the peaker plants.
14. SCE will track the revenue requirement for each unit separately.
15. Allowing SCE to procure utility-owned generation outside of the competitive solicitation process and to request authority to record revenue requirements associated with the peaker plants via an advice letter is not standard Commission practice.
16. A revenue requirement request, should, under normal circumstances, be filed under an application.
17. Mitigating circumstances that require a limited exception from the competitive solicitation requirement of D.04-12-048 and standard Commission practice for requesting changes in authorized revenue requirements include: the unanticipated conditions arising in summer 2006 that prompted the CAISO to identify an urgent need for quick-start peaker units in southern California by summer 2007, the length of time for SCE to initiate and conduct a separate RFO for peaker units that would include new utility-owned resources and third party resources, the length of a formal application process associated with a revenue requirement request, the peaking units not being forecasted in the 2006 GRC, and the anticipated accrual of operational expenses by summer 2007.
18. SCE should be prepared to demonstrate that the acquisition and installation costs accrued in a "work order" and the associated revenue requirement recorded to the PGMA were reasonable.
19. SCE should submit a substitute sheet for the preliminary statement for the PGMA to clarify that the purpose of the memorandum account is to record the associated revenue requirement of the peaker plants, and not the acquisition and installation costs.
20. SCE's proposal to submit a monthly status report is welcomed.
21. SCE requests an effective date of August 15, 2006 for Advice Letter 2031-E.
22. The Commission's standard practice is to authorize memorandum accounts to be effective only on or after the date on which the Commission approves them.

**THEREFORE IT IS ORDERED THAT:**

1. The request of the Southern California Edison Company (SCE) to establish the Peakers Generation Memorandum Account (PGMA) and to revise the Generation Sub-account of the Base Revenue Requirement Balancing Account (BRRBA) as requested in Advice Letter AL 2031-E is approved.
2. SCE is authorized to record the revenue requirement (i.e. incremental O&M expenses, book depreciation, applicable taxes, and an authorized rate of return on rate base) arising from the acquisition costs, installation costs, and other related costs associated with peaking generation units and non-ISO transmission facilities' upgrades associated with interconnecting the peaker units.
3. SCE is authorized to record the revenue requirement to the PGMA as each peaker plant is completed and becomes used and useful.
4. SCE shall track the revenue requirement for each unit separately.
5. SCE is authorized to develop utility-owned peaker units, consistent with the requirements of the ACR and this Resolution, without using a competitive solicitation process to procure such units as required by D.04-12-048.
6. SCE shall file an application no later than December 31, 2007 to demonstrate the reasonableness of the accrued acquisition and installation costs tracked in a "work order" and the associated revenue requirement recorded to the PGMA.
7. SCE shall file a substitute preliminary statement for the PGMA to clarify the purpose of the PGMA.
8. SCE shall file a monthly "Planning and Construction" report and identify the date of August 1, 2007 as being the on-line date with all corresponding progresses measured to this date.
9. The effective date of Advice Letter 2031-E is November 9, 2006.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on November 9, 2006; the following Commissioners voting favorably thereon:

---

STEVE LARSON  
Executive Director