

Decision 07-09-044 September 20, 2007

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Integrate
Procurement Policies and Consider Long-Term
Procurement Plans.

Rulemaking 06-02-013
(Filed February 16, 2006)

**OPINION ADOPTING JOINT SETTLEMENT AGREEMENT,
AS CLARIFIED, REGARDING PRINCIPLES FOR THE
ENERGY AUCTION PROCESS AND PRODUCTS**

Summary

This decision adopts all provisions of the Joint Settlement Agreement (Settlement Agreement/Settlement) presented by Settling Parties¹ outlining Principles for the process and products to be included in the energy auction established by the Commission in Decision (D.) 06-07-029, except for two specific clarifications of the Settlement's proposed allocation of resource adequacy (RA) capacity (Section VIII.A.2)² and several other general clarifications.

¹ The Settling Parties include Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric (SDG&E), Constellation Energy Commodities Group, Inc., Constellation NewEnergy, Inc. (Constellation), Western Power Trading Forum (WPTF), the Division of Ratepayer Advocates (DRA), Aglet Consumer Alliance (Aglet), J. Aron & Company, The Utility Reform Network (TURN), Mirant Corporation; Mirant California, LLC, Mirant Delta, LLC (collectively Mirant), Alliance for Retail Energy Markets (AREM), and Barclays Bank, PLC. A copy of the Settlement Agreement is attached to this decision as Attachment A.

² The Settling Parties propose allocation of RA capacity by the California Energy Commission (CEC) adjusted on a monthly basis to facilitate load migration. This

Footnote continued on next page

Background

In D.06-07-029, the Commission adopted a cost-allocation methodology (CAM) that allows the advantages and costs of new generation to be shared by all benefiting customers in an investor owned utility's (IOU) service territory. The decision designated that the IOUs should procure the new generation through long-term power purchase agreements (PPA). The capacity and energy from the PPA are unbundled and the rights to the capacity are to be allocated among all the load serving entities (LSE) in the IOU's service territory. Each LSE would share in the capacity according to the LSE's share of the 12-month service area coincident peak, and the LSE can apply the capacity towards its RA requirement. The LSEs' customers receiving the benefit of this additional capacity pay only for the net cost of this capacity, determined as a net of the total cost of the contract minus the energy revenues associated with dispatch of the contract.³

The energy revenues are to be determined by the results of periodic energy auctions for the PPA energy rights.⁴ The Commission ordered in D.06-07-029 that the utilities develop implementation proposals for the energy auctions and

decision instead clarifies that the Energy Division (ED) of the California Public Utilities Commission has the responsibility of RA counting, and that revisions to facilitate load migration will be made on a quarterly rather than monthly basis. Also, the date of the notification described in Section VIII A 2. b. is changed from June to July.

³ Each IOU will perform annual forecasts and true ups for the net costs and charge them to all benefiting customers via a wires charge.

⁴ D.06-07-029 at 31, Item #16.

that the ED hold workshops “prior to the IOUs’ filing their Implementation Proposals, and subsequent workshops as needed.”⁵

On September 25, 2006, an Assigned Commissioner’s Ruling/Scoping Memo was issued that directed the utilities to file their implementation proposals for the energy auction by October 20, 2006. The IOUs made their filing on October 20th, and a workshop for all parties was subsequently conducted on November 1, 2006.

On November 17, 2006, the assigned Administrative Law Judge (ALJ) issued a ruling establishing a schedule for the submission of new or revised energy auction proposals on December 12, 2006, to be followed by a workshop on December 18, 2006. At the December 18th workshop, it became evident that there were many complex, interrelated issues related to the energy auction. As a result, the parties agreed that it would be appropriate to refer issues regarding the energy auction process and products to mediation in an effort to resolve many of the underlying issues.

On January 3, 2007, ALJ Kenneth Koss was appointed to oversee mediation efforts to develop the energy auction process and products. ALJ Koss subsequently provided notice to all parties on the service list in this proceeding as to the time and location of the first mediation session.⁶ After the first noticed mediation session, the parties agreed to continue meeting to work towards the

⁵ *Id.*

⁶ This notice satisfied the conditions of Commission Rule 12.1(b), requiring settling parties to “convene at least one conference with notice and opportunity to participate provided to all parties for the purpose of discussing settlements in the proceeding.” Thus, the Commission does not need to convene any additional conferences before approving this settlement.

development of a settlement agreement. Since January, a number of parties have been actively involved in negotiating numerous aspects of the energy auction process and products. The parties have engaged in almost twenty negotiating sessions, either face-to-face or telephonic, and have exchanged detailed draft proposals. As a result of these intensive mediation efforts, SCE; SDG&E; PG&E; Constellation; WPTF; DRA; Aglet; J. Aron & Company; TURN; Mirant; AReM; and Barclay's Bank, PLC (Settling Parties) reached a settlement regarding principles for the process and products for the energy auction.⁷ The auction described in the settlement agreement is essentially a sealed bid auction with an undisclosed minimum bid price. The settlement agreement is attached as Appendix A to this decision.

The motion to approve the Settlement regarding Energy Auction Principles was filed on May 11, 2007. During the 30-day comment period, no comments were filed on the proposal. We further note that the Settlement has been uncontested since its presentation.

Clarifications

Before addressing the settlement as a whole, we address several aspects that require clarification.

D.06-07-029 states that the auctions are to be administered by a third party (FOF 20), but the Settlement indicates that the IOU will hire an independent evaluator to oversee the utility's preparation for and administration of the energy auction. Since the joint parties appear agreeable to IOU administration

⁷ SDG&E supports the settlement as long as it is interim in nature and is not precedent setting.

of the auctions with independent oversight, this decision approves this change in implementation details.

Item I.A. of the Settlement Agreement states that the IOU identifies the new generation for which it “elects to use the D.06-07-029 cost allocation methodology....” As noted in D.06-07-029, implementation details associated with the CAM are being addressed in Phase II of the proceeding. The energy auction is one component of the implementation details, but additional components, including how the IOU is to determine whether a resource qualifies as a system resource eligible for CAM treatment will be addressed in Track 2 of the proceeding. At that time, if necessary, the Settlement and this decision will be modified to accurately reflect how system resources eligible for CAM treatment are identified by the IOU.

We also clarify aspects of Section VIII, A.2. a-d, and language reflecting this clarification is attached as Appendix B. The Commission’s ED staff, instead of the CEC, will have the responsibility for allocating RA capacity. This clarification is consistent with the current process of RA capacity allocation. Currently, the CEC does not allocate RA impacts except for load forecasts and demand response.

In addition, the Settlement Agreement specifies that all LSEs will be notified in June of the amount of RA capacity they will be receiving. We changed the notification month to July.

The Joint Parties also requested in their comments that we restore the second sentence of Section VII.A.2.e in the Settlement Agreement providing for revised allocations of RA credits to account for not only load migration, but also for any changes in the capacity associated with an energy auction contract. We

confirm in this decision that we will allocate the capacity based on the net qualifying capacity (NQC) or changes in NQC to a unit.

We also clarify, at the request of the Joint Parties, that all RA credit allocations will be provided to LSEs by the ED consistent with current practice that ensures that the LSEs receive the allocation information in time for their compliance filing deadlines.

And finally, the PD clarified that ED would be performing quarterly reallocation of capacity subject to the CAM, instead of monthly as set forth in the Settlement Agreement. The PD stated that RA allocations for each LSE would be performed each year, even in multiyear contracts, so as to accurately reflect potential shifts in proportionate load share, and the revisions would be done by Ed on a quarterly basis. ED staff does not anticipate a large quantity of capacity allocated via this mechanism in compliance year 2008. In comments, AReM and the Joint Parties suggested adoption of a sunset date for the quarterly reallocations, so that the decision reflects the concerns of the Settling Parties that the reallocations accurately reflect any changes in the capacity. The Commission is mindful of Settling Parties concerns and will see that a means for ensuring fair and equitable implementation of the CAM for RA purposes is discussed in a workshop in the RA proceeding, R.05-12-013 or its successor proceeding.

Finally, some of the terms used in the Settlement Agreement are not entirely common to Commission electricity regulation parlance. Consequently, to ensure that all Settling Parties and other stakeholders are clear about the meaning of the language used in the agreement, Appendix C provides a list of definitions for terms used in the Settlement Agreement that are somewhat unique to the proposed Energy Auction.

These clarifications are consistent with the “fair and reasonable compromise” that the Settling Parties have aimed to accomplish. In particular, the clarifications ensure that Commission involvement is maintained throughout the RA allocation process without placing an undue burden on Commission or CEC staff.

Settlement Agreement

The Settlement Agreement is the product of extensive and intensive mediation sessions, and the balancing of the Settling Parties’ numerous interests. The resulting Principles regarding the Energy Auction Process and Products are intended to balance the various interests at stake, and to develop a fair and transparent process that was not unnecessarily lengthy or administratively burdensome.

In summary, the Settlement Agreement contains the following key Principles:

- A description of the selection and qualifications for an Independent Evaluator (IE) who will be used to oversee the energy auction (Section II).
- A description in detail of the pre-bid auction process, including the development of *pro forma* documents, soliciting stakeholder input, identifying auction timing and products, submission of counterparty information, and indicating whether the utility will participate in the auction process (Section III).
- An outline of provisions regarding the retention of a market valuation consultant to determine the value of the energy rights being auctioned. This valuation will be used to provide an independent assessment of the market value of the products offered in the energy auction (Section III.D).
- A description of two products that shall be included in the energy auction – a Back-to-Back Toll and a Residual Back-to-

Back Toll with associated Day-Ahead Unit Contingent Call Options – and a third product, Novation, that may be offered if the utility elects to do so. The Principles also provide that Parties may propose additional products (Section IV).

- A description of the bid evaluation process including establishing a minimum bid price, the bid valuation process, and awarding the winning bids (Section V).
- An outline of the provisions regarding subsequent auctions if an auction fails and a review of the auction process (Sections VI and VII).
- A description of the allocation of RA benefits and net costs (Section VIII).
- A detailed description of the Settling Parties' Proposal that will be used to value the energy rights if an auction is unsuccessful or has not yet occurred (Section IV).

The parties began with rules concerning when a utility must elect the new CAM procedures for a new generation resource, which is at the time the utility files an application. Then the rules continue on to set forth how an IE is selected, that the IE should have qualifications similar to those identified in D.04-12-048, and that the costs associated with the IE are included as part of the Energy Auction PPA cost.

Section III addresses the Pre-Bid process and includes the timing of pre-bids and what is to be included in the initial Pre-Bid documents. Rules for soliciting stakeholder input are detailed. If a utility elects not to bid on the Back-to-Back Toll product, the utility is to select an independent third-party consultant to provide a market value assessment (MVA) of the products for each identified term. Section II also provides guidance on review of the bid evaluation process, submission of acceptable counter-party information, and specifics on the pre-bid documents for the Long Beach Generation PPA [D.07-01-041].

Section IV describes the energy auction products: (1) a Back-to-Back Toll and (2) a Residual Back-to-Back Toll with associated Day-Ahead Unit Contingent Call Options. Also, a utility may offer Novation of any other Commission-approved product. The major work of the Settling Parties appears to be on reaching an agreement on the description of these products and establishing all the parameters for the contingencies associated with each product, such as terms, size, scheduling coordinator and fuel manager, settlement activities, delivery points, payments, default, termination, and credit and collateral.

Section V addresses the bid valuation and award process, including establishing a minimum bid price (if required), establishing the MVA, establishing the minimum bid percentage, calculation and release of the minimum bid price, and bid valuation methodology for the successful bids.

Section VI sets forth rules if no bids are accepted and Section VII provides for an energy auction review process. Section VIII addresses the allocation of the RA benefits, including the recommendation that the CEC allocate the RA capacity. This is the section that we clarify by having the Commission's ED allocate the RA capacity pursuant to the peak load share of each LSE representing benefiting customers as we defined in D.06-07-029. This section also allocated the net costs to benefiting customers following the Energy Auction.

Section IX discusses the Settling Parties Proposal that is to be used to determine the net cost of a PPA when an Energy Auction PPA is operational, but the energy auction was unsuccessful for a number of reasons.

Discussion

Pursuant to Section 12.1(d) of the Commission Rules of Practice and Procedure, Commission approval of a settlement, even if uncontested, may only be granted if the settlement is reasonable in the light of the whole record,

consistent with law, and in the public interest. After reviewing the Settlement Agreement in its entirety, we find that the Settlement Agreement, with clarifications set forth above, is reasonable in light of the whole record, consistent with law, and in the public interest.

As suggested by the motion for approval and chronicled in this order, the Settlement is the result of almost 20 mediation sessions, and represents a compromise formed by more than ten different settling parties. To begin, we note that the Settlement Principles establish a clear process for the energy auction. In particular, the process requires a timeline sufficient to allow notice to stakeholders and broad participation in the auction process. It also requires an IE whose selection is dependent upon ED approval, for the purpose of overseeing the preparation and administration of the auction. In addition, the auction process utilizes an independent consultant to provide a MVA of the products being offered.

Next, the Settlement Principles identify two products that will be offered in the energy auction, and allows for additional products. The crafting of these Principles was the result of negotiations on the part of market participants who wanted to develop products that would be attractive to potential bidders and offer bidders an opportunity to bid on products most suited to their needs, yet would also maximize the value of the energy to benefiting customers. This is consistent with the directives from D.06-07-029 that the cost of the energy from the new generation resources should be born by the market participants, including the IOUs, who value it the most. Specifically, the Principles provide a variety of products for which participants may bid, the opportunity for the creation of new energy products for which participants may bid, and a procedurally fair chance for them to bid.

In addition, the Settlement Principles set forth the mechanics for allocating the RA benefits and net costs, consistent with the maxims established in D.06-07-029.

We find that the Settlement is reasonable in light of the whole record because its principles and the products effectively balance the interests of the various parties and also establish a process that is transparent and that instills faith in market participants.

Finally, the Settlement is in the public interest because it facilitates the procurement of new generation in California and creates a transparent market process that should indirectly reduce the cost of energy to utility ratepayers. As the Commission noted in D.06-07-029, “we are faced with the urgent need to bring new capacity on line as soon as 2009”⁸ We found that developers require long-term contracts to undertake new projects, and all LSEs, including the IOUs, were unwilling to sign long-term contracts because of perceived risks associated with market, regulatory and customer uncertainty. We concluded in D.06-07-029 that Commission action was necessary to incentivize “new steel in the ground.”

We therefore established the CAM set forth in D.06-07-029 whereby the IOUs were designated as the procurers of the long-term contracts for new generation, but the costs and benefits of the capacity and energy would be shared by all benefiting parties in the IOUs’ respective service territories. Through the CAM methodology, utility ratepayers would not bear the cost of this new generation alone, but the costs would be shared. The Energy Auction

⁸ D.06-07-029, p. 3.

Principles set forth in the Settlement are the corner-stone for implementing the benefit and cost sharing from D.06-07-029. The Settling Parties are already eager to activate the auction process in the case of the re-powered Long Beach generating facility, approved in D.07-01-041.

For the reasons discussed above, we find that, with the clarifications set forth above, the Settlement is reasonable in light of the whole record, consistent with law, and in the public interest. We therefore grant Settling Parties' motion to approve the Settlement with clarification, as set forth in the order below.

Conclusion

We find that the Settlement Agreement with the recommended clarifications meets the requirements of Rule 12.1(d) and we adopt the Settlement with the clarifications described in the clarifications section of the decision, including the specific clarifications provided in Appendices B and C. The clarifications in no way materially alter the process established by Settling Parties and do not address issues integral to the Settlement, but instead streamline the process to make it consistent with current RA allocation and accounting practices (Appendix B) or provide definitional clarity to the Settlement Agreement (Appendix C).

Comments on Proposed Decision

The proposed decision of ALJ Brown was mailed to the parties in accordance with Pub. Util. Code § 311 and Rule 14.3 of the Commission's Rules of Practice and Procedure.

Comments were received on September 5, 2007 from AReM and Settling Parties. No reply comments were received. In general, the comments support the PD, but request some modifications to the clarifications the Commission made to the Settlement Agreement. The Commission has carefully weighed the

balance of interests achieved in the Settlement Agreement with the clarifications made in the PD to accommodate Commission staff's role in the allocation of the benefits of energy auction contracts, and makes some adjustments that should reach an acceptable equilibrium. The changes have been incorporated into the final decision but address the following: a procedure for switching from quarterly reallocation of capacity to monthly; the timing for RA credit allocations; and adding language to Section VIII.A.2.e.concerning changes in load migration associated with an energy auction contract.

In addition, the Commission added a further refinement to the final decision specifying that since this decision establishes the details of the energy auction process, PG&E should make an election within 45 days of the date of mailing of this final decision, by way of an Advice Letter, as to which of the five PPA resources from its 2004 RFO results, as approved by the Commission in D.06-11-048, would be subject to the cost sharing mechanism as developed in D.06-07-029.

Assignment of Proceedings

Michael R. Peevey is the assigned Commissioner and Carol A. Brown is the assigned ALJ in this proceeding.

Findings of Fact

1. Settling Parties presented the Commission with a Joint Settlement Agreement entered into by PG&E, SCE, SDG&E, Constellation, WPTF, DRA, Aglet, J. Aron & Company, TURN, Mirant, AReM, and Barclays Bank, PLC.
2. The Settlement Agreement addresses Item 16 of D.06-07-029, which requires a periodic auction process for the distribution of energy rights in new generation contracts. This process is necessary in order for LSEs to implement the cost and benefit sharing mechanism established in D.06-07-029.

3. The Settlement Agreement is the result of nearly twenty mediation sessions for the purpose of establishing principles for the auction process required in D.06-07-029.

4. The Settlement Agreement establishes principles that ensure an independent, transparent, and fair auction procedure in which multiple stakeholders and the Commission retain active involvement.

5. The Settlement Agreement establishes products that facilitate an active market, and allows for the development and auction of new products.

6. We find that the Settlement Agreement reaches a compromise that is reasonable in light of the whole record.

7. We find that the Settlement Agreement is consistent with law, especially as required by D.06-07-029.

8. We find that the Settlement Agreement, with clarifications, benefits the public by creating a fair and efficient market for energy products that facilitates the building of new generation facilities in the State.

Conclusions of Law

1. The Settlement Agreement, with clarifications, meets the requirements of Rule 12.1 of the Commission's Rules of Practice and Procedure and is adopted by the Commission.

2. In accordance with Rule 12.5, the settlement is binding on all parties in this proceeding and resolution in this settlement is limited to the issues in this proceeding. Adoption of this Settlement Agreement does not extend to substantive issues which may come before the Commission in other or future proceedings.

ORDER

IT IS ORDERED that:

1. The Settlement Agreement entered into between the Settling Parties (attached as the May 11, 2007 Joint Motion and Appendix A thereto), with the clarifications set forth in Appendices B and C, is adopted.

2. Each IOU shall set up a balancing account to record the costs and benefits (including any associated nonbypassable charges collected) and perform annual true ups for all of its cost-allocation methodology (CAM) identified resources. In general, the CAM resource account should be divided into sub-accounts that track these costs and benefits for each CAM-identified resource.

3. Pacific Gas and Electric Company should make an election within 45 days of the date of mailing of this final decision, by way of an Advice Letter, as to which of the five power purchase agreements' resources from its 2004 RFO results, as approved by the Commission in D.06-11-048, would be subject to the cost sharing mechanism as developed in D.06-07-029.

This order is effective today.

Dated September 20, 2007, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

[D0709044 Appendices A-C](#)