STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
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January 16, 2009

Agenda ID #8246
Ratesetting

TO PARTIES OF RECORD IN APPLICATION 07-12-029

This is the proposed decision of Administrative Law Judge (ALJ) Brown. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 14 of the Commission's Rules of Practice and Procedure (Rules), accessible on the Commission's website at www.cpuc.ca.gov. Pursuant to Rule 14.3, opening comments shall not exceed 15 pages.

Comments must be filed either electronically pursuant to Resolution ALJ-188 or with the Commission's Docket Office. Comments should be served on parties to this proceeding in accordance with Rules 1.9 and 1.10. Electronic and hard copies of comments should be sent to ALJ Brown at cab@cpuc.ca.gov and the assigned Commissioner. The current service list for this proceeding is available on the Commission's website at www.cpuc.ca.gov.

/s/ MICHELLE COOKE for
Karen V. Clopton, Chief
Administrative Law Judge

KVC:avs

Attachment

Decision **PROPOSED DECISION OF ALJ BROWN (Mailed 1/16/2009)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U338-E) for Recovery of Peaker Costs.	Application 07-12-029 (Filed December 31, 2007)

DECISION ALLOCATING RECOVERY OF PEAKER COSTS BY SOUTHERN CALIFORNIA EDISON COMPANY TO ITS BUNDLED SERVICE CUSTOMERS

1. Summary

This decision allocates the costs and resource adequacy benefits of Southern California Edison Company's (SCE) four peaker units, which are owned and operated by SCE, to SCE's bundled service customers, as opposed to all benefiting customers. The issue of whether the requested costs are just and reasonable will be determined in a subsequent decision. This proceeding remains open.

2. Background

A threshold issue in this application is to determine what customer base should pay for the costs of SCE's four peaker units. An understanding of the events in the summer of 2006 that led to the Commission directing SCE to build up to 250 megawatts (MW) of peaking power is useful in resolving this issue. In July 2006, a prolonged and severe summer heat storm hit California and stretched to capacity the state's electric resources, especially in southern California. In response to a widely held concern for the adequacy of the state's electric resources for summer 2007, President Peevey issued an Assigned

Commissioner's Ruling (ACR)[1] on August 15, 2006 ordering SCE to build in its service territory five peaker units, 49MW each, that could provide additional capacity and collateral grid-reliability benefits in time for summer 2007. The ACR also authorized SCE to "seek different ratemaking treatment for the costs of these peakers than would otherwise be applicable to utility-owned generation under Decision (D.) D.06-07-029."[2] While the ACR did not address the ratemaking treatment of the peakers, it directed SCE to track its cost by an advice letter, and file an application for the cost recovery and ratemaking issues.

SCE immediately responded to the ACR and undertook the process for developing five peaker units, but as of this date, only four are built and operational. The fifth peaker unit is still in the permit and development stages and is not addressed in either the application filed by SCE or this decision. SCE filed Advice Letter 2031-E for interim treatment of the costs of the peakers, and Resolution E-4031, issued November 9, 2006, set forth the procedures for the interim tracking of the peaker installation and acquisition costs.
Resolution E-4031 directed SCE to file an application to demonstrate the reasonableness of these costs and to address SCE's recovery of the associated revenue requirement for 2007-2008. On December 31, 2007, SCE filed the instant application for the recovery of the peaker costs.

The Commission issued D.06-07-029 on July 20, 2006 in order to address who pays for certain costs in order to stimulate the development of new generation. The three investor-owned utilities (IOUs) were reticent to impose the

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1 The ACR was issued in Rulemaking (R.) 06-02-013, the Commission's long-term procurement plan proceeding for the state's three major investor-owned utilities.

2 ACR, p. 7.

costs of new generation on their bundled customers and the independent power producers (IPP) were adverse to investing in new generation without the assurance of long-term contracts. This resulted in a stalemate with no new generation being built in California. D.06-07-029 addressed this conundrum by establishing a cost-sharing mechanism (CAM) to support the IOUs investment in long term power purchase agreements (PPAs) for new generation from the IPPs. In summary, D.06-07-029 designates the IOUs as procurers of new generation for their respective service territories through the PPAs. The capacity and energy from the PPAs is unbundled and the IOUs allocate the rights to the capacity to all load-serving entities (LSE) in their service areas so that the LSEs can apply the capacity to their resource adequacy requirements. The energy from the PPAs is auctioned pursuant to protocols established in D.07-09-044. 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 received from the auction.

D.06-07-029 specifically excluded utility-owned generation (UOG) from this cost-sharing mechanism because UOG "generation is essentially dedicated to bundled customers."[3] D.06-07-029 has not been modified to change the exclusion of UOG from the CAM.

3. This Application

On December 31, 2007, SCE filed this application seeking allocation of the resource adequacy capacity and the costs of the energy from the peaker units to all benefitting customers, and not just to its bundled customers, even though the

[3] D.06-07-029, p. 4.

peakers are owned by SCE. SCE requested the CAM treatment because it contends that it developed the peaker units to provide capacity and grid-reliability benefits to all electricity customers on its distribution system and therefore it is appropriate that all benefitting customers, not just its bundled service customers, pay the costs. SCE proposes that in lieu of the time, effort and cost of an energy auction that the energy value of the peakers be allocated pursuant to a formula set forth in the "Joint Proposal" that is summarized at D.06-07-029, pp. 14-18. SCE also supports its request for the CAM cost allocation because the utility was authorized in the ACR to seek different rate treatment for the peakers.

SCE's application states that the total acquisition and installation cost for the four peakers through November 2007 is $238 million and that the operation and maintenance costs from August 2007 through November 2007 is $1.279 million. SCE's testimony states that all of these costs are reasonable and justified and should be recoverable.

Alliance for Retail Energy Markets (AReM) filed a protest to the application, the Division of Ratepayer Advocates (DRA)[4] filed a response and the California Cogeneration Council and California Wind Energy Association (CCC/CWEA) filed comments. The Utility Reform Network (TURN) filed a Motion of Consolidation of Capital Recovery Issues and Deferral of those Issues to Phase 2.

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[4] DRA's response did not focus specifically on SCE's application, but more on whether the use of an ACR, that is issued by just one Commissioner and not the full Commission, is the appropriate vehicle to direct a utility to undertake the type of investment that SCE undertook pursuant to the August 15, 2006 ACR.

A Prehearing Conference (PHC) was held on April 8, 2008. At the PHC, SCE was directed to supplement its application and a schedule was established for parties to brief the cost allocation issue. Briefs were received from TURN, Western Power Trading Forum (WPTF), AReM, and Energy Producers and Users Coalition (EPUC). Reply briefs were received from WPTF/AReM, TURN and SCE.

4. The Controversy

SCE argues that based on the direction it was given in the August 15, 2006 ACR to develop the peaker units to provide urgently needed capacity and grid-reliability benefits for its entire transmission and distribution system as well as the California Independent System Operator (CAISO) grid, and the fact that the ACR invited SCE to seek different rate treatment, its ratepayers are entitled to have the costs borne by all benefitting customers pursuant to the CAM established in D.06-07-029. SCE further contends that the peakers were clearly intended to benefit system-wide customers because the added capacity and grid-reliability from the peakers reduces the risk of shortages and blackouts during peak demand periods and other system emergencies and helps to minimize and contain any such events that do arise. While SCE acknowledges that D.06-07-029 directed that the costs of new UOG would be allocated only to bundled service customers, SCE argues that allowing the costs to be spread to all benefitting customers is consistent with the overall intent and purpose of the Decision.

TURN posits that "Edison's proposal represents the only fair and equitable outcome to the unusual circumstances that gave rise to the construction of the four (and potentially five) SCE-owned peaker plants developed as a result of the ACR."[5] TURN supports its position by citing to the fact that in D.06-07-029 SCE was directed to procure 1500 MW of new *non-utility* generating capacity for its service territory, and less than one month later the Commission directed SCE to "pursue the development and installation of up to 250 MW of black-start, dispatchable generation capacity within its service territory . . . ."[6] From TURN's perspective, when the chronology of events is combined with the language from the ACR that states that the new units "should bring collateral benefits to SCE's transmission and distribution system as well as the CAISO grid,"[7] it is clear that the peakers are to benefit all customers in SCE's service territory and it is appropriate for all benefiting customers to pay. TURN finds further support for this argument in the ACR language that invited SCE to seek different ratemaking treatment for the peakers.

TURN also contends that it is particularly inappropriate for SCE's bundled customers to pay for the peakers because the cost is quite high considering the expedited construction schedule that SCE was ordered to undertake. As TURN argues "there is no reason why bundled service customers alone should be forced to pick up all of the costs simply because Edison was the party that was available to install the new capacity on the expedited schedule that circumstances required. Bundled service customers did not ask for these peaker plants any more than unbundled customers did."[8]

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[5] TURN Opening Brief, May 28, 2008, p. 1.

[6] *Id.*, p. 1, citing the ACR, p. 2.

[7] *Id.*, p. 2.

[8] *Id.*, p. 3.

EPUC, AReM and WPTF,[9] however, all argue against allowing SCE to allocate the costs of the peakers to all benefiting customers. EPUC asks the Commission to clarify that even if the CAM is applicable to the peakers, that Customer Generation Departing Load is not obligated to pay such a charge.

AReM states that SCE's request to apply the CAM to the peaker costs should be denied for the following reasons: first, it conflicts with the principles that established the CAM in D.06-07-029; second, all new demand side and supply side resources in SCE's territory tangently provide benefits to the system as a whole; third, the ACR did not direct SCE to develop the peakers on behalf of all customers in its service territory -- rather SCE was directed to have new IOU generation on-line by 2007; fourth, the load growth that gave rise to the ACR is from SCE's bundled customers, not from direct access customers; and fifth, principles of cost causation dictate that the SCE peaker costs should be bourne by those parties who caused the need for their construction – SCE's bundled customers.[10]

From AReM's perspective, D.06-07-029 was carefully crafted to insure that application of the CAM did "not impinge on the energy procurement activities of ESPs [energy service providers]."[11] Therefore, according to AReM, the CAM would not be applicable to UOG and when it was applicable to PPAs, the CAM would recover only the net capacity costs of the new generation, following an auction for the energy value of the contract. Furthermore, AReM argues, D.06-07-029 specifically excluded UOG because that generation is essentially

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9 WPTF joins in the response filed by AReM, but does not file a separate pleading.

10 AREM's Response, May 28, 2008, p. 3.

11 *Id.*, p. 4.

dedicated to bundled customers. The capacity and energy from the new generation contracts was unbundled, as AReM contends, "to limit the procurement role of the IOUs."[12] AReM, therefore states that to allow SCE to allocate the costs of the peakers to all benefiting customers would undermine the careful balancing that the Commission did in D.06-07-029 to avoid undermining the competitive market. AReM's clients, other Energy Service Providers (ESPs), have to serve their own customers' needs, and from AReM's analysis of the ACR, the peakers were developed to meet SCE's bundled customers' loads.

In addition, AReM argues that the fact that there might be collateral benefits to SCE's whole system from the peakers is not sufficient reason to have all customers pay for the peakers. As AReM states, any new generation, even if intended solely for bundled customers, will provide reliability benefits for the system, but that does not justify allocating the costs to all bundled and direct access customers. Furthermore, AReM contends, if an ESP adds a new resource or implements an energy efficiency or demand response program, the benefits will inure to the whole grid, yet the utility's bundled customers are not asked to share in the cost.

Finally, AReM reads the ACR differently than SCE or TURN. AReM does not see that the ACR expanded SCE's authorization from D.06-07-029 to procure new generation for all customers. AReM views the need that prompted the ACR arising from IOU load increases from bundled customer growth, and not caused by any growth in the direct access customer base. As AReM reminds the Commission, direct access is closed to new customers, and has been since 2001;

[12] *Id.*, p. 4.

direct access commercial and industrial customers have the flattest load profiles in SCE's service territory; and direct access load has declined precipitously in recent years.[13] Therefore, AReM, argues, cost allocation should follow cost causation and in this case, SCE's bundled customers prompted the need, they should pay.

In the alternative, AReM asks that if the Commission considers applying the CAM to the peaker costs, it should require SCE to follow the auction protocols set forth in D.07-09-044 and not allow the utility to circumvent that process.

5. Discussion

In D.06-07-029, which established the CAM, the Commission specifically excluded UOG from the CAM cost sharing mechanism. While it is obvious that when D.06-07-029 was under consideration the Commission did not foresee or address the exigent circumstances that arose with the heat storm just a few weeks later, the language in the decision is quite unambiguous: UOG is excluded from the CAM treatment. D.06-07-029 has not been modified and the Commission is bound to follow that directive. Therefore, the language excluding UOG from application of the CAM is controlling, and the costs of the SCE peaker is allocated to SCE's bundled ratepayers.

However, the August 15, 2006 ACR directed SCE to develop utility-owned generation so that the new resources could be on line by summer 2007. The ACR also discussed the collateral grid reliability benefits that the new peakers would bring. And finally, the ACR invited SCE to seek different rate treatment for the

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[13] *Id.*, pp. 7-8.

peaker costs. SCE followed the Commission's direction, built the peakers on an expedited schedule, and is now seeking "different" rate treatment for the peakers so its bundled ratepayers do not have to bear the full cost. As SCE argues in its brief, it did not build these peakers for its bundled customers, these peakers were in addition to its existing power procurement requirements for its bundled customers. TURN also argues that the system needed the peakers, regardless of which loads were growing and therefore all load is equally responsible for the marginal costs of new capacity, in proportion to their contribution to peak load.

When the ACR is read in concert with the arguments presented by SCE and TURN, a strong case can be made that it would have been equitable to have the costs of the peakers shared by all benefiting customers. It is therefore appropriate to consider developing an exception to the UOG CAM exclusion under circumstances such as the one we face in this proceeding in our long term procurement rulemaking (R.08-02-007) because the CAM was developed in the procurement rulemaking.[14] Therefore, we will take this question up on a prospective basis in the upcoming Phase II of the 2008 Long-Term Procurement Plans rulemaking (R.08-02-007), within the CAM refinement issue identified in the proceeding's Preliminary Scoping Memo:

> "Consider whether and to what extent refinements to policies distinguishing system versus bundled resource needs, including a methodology that allocates the cost of new generation to system and bundled customers." (R.08-02-007 Preliminary Scoping Memo, Page 11.)

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[14] The CAM was developed in the predecessor to R.08-02-007, which was R.06-02-013.

6. Phase 2 of Proceeding

On November 12, 2008 parties conducted a telephonic hearing to discuss the proceedings necessary for resolution of this application. Parties agreed that the issue of the reasonableness of the costs requested by SCE for the peaker units could not properly be addressed by the stakeholders until the Commission made a determination as to what customer base would pay the costs. Once this decision is issued by the Commission, parties will determine procedures and a schedule for final resolution of the issues presented in the application.

7. Motions

On March 21, 2008 TURN filed a Motion for Consolidation of Capital Recovery Issues. TURN was concerned that all acquisition and installation costs for the four peakers would be diffused in multiple different rate proceedings and TURN wanted them all consolidated for a single review. At the time TURN filed its motion, SCE was submitting capital forecasts in its 2009 General Rate Case (General Rate Case), would be including some peaker costs in its 2009 Energy Resource Recovery Account and potentially would be filing a subsequent application for the costs of the fifth peaker when it is built. TURN felt that this piecemeal analysis of the peaker costs was not the best way to proceed and proposed that the Commission consolidate the review of all costs for the peakers into one proceeding. Due to the passage of time since the motion was filed and the fact that some issues are moot (the SCE 2009 GRC is before the Commission now), the motion is denied, without prejudice.

8. Comments on Proposed Decision

The proposed decision of the Administrative Law Judge in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of

Practice and Procedure. Comments were filed on ___________, and reply comments were filed on ________________ by ________________.

9. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Carol Brown is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. On July 20, 2006, the Commission issued D.06-07-029 establishing a CAM to support the IOUs investment in long-term PPA for new generation from IPPs.
2. Pursuant to the CAM, all benefitting customers in an IOU's service territory would share in the capacity benefits from the PPA and, the IOU would auction the energy from the PPA, and benefitting customers would pay the net cost of the PPAs minus revenues from the energy auction.
3. D.06-07-029 specifically excluded UOG from the CAM because UOG is essentially dedicated to bundled service customers.
4. D.06-07-029 has never been modified or amended to remove the exclusion of UOG from eligibility for the CAM.
5. On August 15, 2006 an ACR issued ordering SCE to build up to 250 MW of peaking units [five units of 49MW each] in its service territory that could be on-line by summer 2007.
6. The ACR authorized SCE to seek different ratemaking treatment for the costs of the peakers than would otherwise be applicable to UOG projects.
7. SCE undertook the development of the five peaker units and by summer 2007 four peaker units were on-line and fully operational. The fifth unit is still in the permit and development stage and is not addressed in the application or this decision.

8. This application seeks allocation of the resource adequacy capacity and costs of the energy from the four peaker units to all benefitting customers pursuant to the CAM established in D.06-07-029.

9. SCE seeks the CAM allocation because the peakers provide capacity and grid reliability benefits to all electricity customers on its distribution system and all benefitting customers should pay for the costs.

Conclusions of Law

1. D.06-07-29 established a CAM for the allocation of the benefits and costs of resources that the IOUs procure for their respective systems, but UOG resources were explicitly excluded from this CAM treatment.

2. D.06-07-029 has not been modified or amended to remove the exclusion of UOG from eligibility for the CAM.

3. The four peakers developed by SCE pursuant to the August 15, 2006 ACR are UOG and therefore the costs and resource adequacy benefits are excluded from CAM treatment.

O R D E R

1. The costs and resource adequacy benefits of the four peaker units developed, owned and operated by Southern California Edison Company (SCE) are to be allocated to SCE's bundled service customers pursuant to Decision 06-07-029.

2. The Commission will consider an exception to the utility-owned generation exclusion to apply on a prospective basis for circumstances similar to those of this application in Phase II of the 2008 Long-Term Procurement Plans rulemaking (Rulemaking 08-02-007).

3. The Utility Reform Network's March 21, 2008 Motion for Consideration of Capital Recovery Issues is denied without prejudice.

4. Application 07-12-029 remains open.

This order is effective today.

Dated ____________________________, at San Francisco, California.

INFORMATION REGARDING SERVICE

I have provided notification of filing to the electronic mail addresses on the attached service list.

Upon confirmation of this document's acceptance for filing, I will cause a Notice of Availability of the filed document to be served upon the service list to this proceeding by U.S. mail. The service list I will use to serve the Notice of Availability of the filed document is current as of today's date.

Dated January 16, 2009, at San Francisco, California.

/s/ ANTONINA V. SWANSEN
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