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Decision 02-02-028 February 7, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into Implementation of Public Utilities Code Section 390.	Rulemaking 99-11-022 (Filed November 18, 1999)

ORDER GRANTING LIMITED REHEARING OF DECISION (D.) 01-03-067 FILED BY QF PARTIES

In this decision, we address the rehearing applications of Decision (D.) 01-03-067 filed by numerous QF parties. D.01-03-067 modified Decision (D.) 96-12-028, which adopted a transitional SRAC Formula ("Transition Formula") for each utility to calculate its short run avoided cost ("SRAC") payments to qualifying facilities (QFs). (*Re Implementation of Biennial Resource Plan Update* [D.96-12-028] (1996) 69 Cal.P.U.C.2d (1996) 546, 556-58.) The Transition Formula included a utility-specific "factor" which was designed to relate SRAC prices to gas border prices for each utility. The Transition Formula was adopted pursuant to Public Utilities Code section 390(b),[1] which was enacted as part of California's electric restructuring in 1996. D.01-03-067, among other things, modified the transitional SRAC formula by: 1) replacing Edison's fixed factor with dynamic formula and 2) establishing a procedure to replace the Topock index with the Malin index.

The following parties filed timely applications for rehearing: 1) Independent Energy Producers Association ("IEP"); 2) Mega Renewables, Mega Hydro I and Central Hydroelectric Corporation (collectively, "Hydro Parties"); 3) Calpine Corporation ("Calpine"); 4) Cogeneration Association of California ("CAC"); 5)

[1] Unless otherwise specified, all statutory references are to the Public Utilities Code.

Caithness Energy, L.L.C. ("Caithness"); 6) CE Generation, L.L.C. ("CE Generation"); 7) Tracteble Power, Inc. and Tractebel Energy Marketing (collectively, "Tractebel"); 8) California Cogeneration Council ("CCC"); 9) County of Los Angeles ("LA"); 10) Pacific Gas and Electric Company ("PG&E"); and 10) Southern California Edison Company ("Edison").[2]

In its rehearing application, IEP asserts that the Commission denied the parties due process by not holding evidentiary hearings prior to adopting the modified Transition Formula ("Modified Formula"). Additionally, while it does not believe it is legal error, IEP contends that the Commission should have authorized QFs to enter into optional fixed payment arrangements in lieu of the SRAC formula.[3]

In their rehearing application, Hydro Parties maintain that the decision violates the Public Utilities Regulatory Policies Act ("PURPA") and the FERC regulations implementing PURPA by setting QF payments at less than the utilities' avoided costs and interferes with their contracts with the utilities in violation of the state and federal constitution. They make general assertions regarding lack of due process in adopting the Malin index and violation of Public Utilities Code section 390(b).[4] Finally, the Hydro Parties incorporate by reference a Petition for Enforcement Action filed by CCC at the FERC.[5]

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[2] PG&E and Edison's rehearing applications were addressed in D.01-12-025. Thus, this decision addresses the rehearing applications of the QF Applicants.

[3] This has been addressed in D.01-06-015. That decision outlined three non-standard contract modifications that, if made prior to July 15, 2001, would be deemed reasonable; this safe harbor date was extended to July 31, 2001 in D.01-09-021 and reiterated in D.02-01-033. One of the modifications was to replace the standard SRAC energy price terms with a fixed price of 5.37 cents/kWh for five years. (D.01-06-015 at p. 4.)

[4] Hydro Parties assert that the Commission acted without due process because there was no evidence to support the adoption of the Malin indices. (Hydro Parties App. at p. 2.) We are unclear whether Hydro Parties are challenging the sufficiency of evidence or the adequacy of notice and opportunity to comment on the adoption of the Malin index. However, we address both issues in this memo. Additionally, since Hydro Parties failed to specify how the decision violated section 390(b), we are unable to respond to its allegation.

[5] As a general matter, incorporation of an entire document "by reference" does not meet the specificity requirements of section 1732 or Rule 86.1 of the Commission's Rules of Practice and Procedure. This is especially true for a document which has not even been filed in a proceeding before this Commission. However, in this instance, we will address issues in that document to the extent that they have also been specifically raised by other QF parties in their rehearing applications.

Similar to IEP, Calpine also argues that the decision violated parties' due process rights by not holding evidentiary hearings and providing a meaningful opportunity to comment on the Malin indices. Furthermore, it raises arguments that: 1) the decision to replace the Topock gas price indices was not based on evidence in the record or supported by the findings; 2) the Commission violated PURPA by establishing QF energy payments below utility avoided costs; 3) the Commission violated PURPA by engaging in utility-type "reasonableness" regulation; 4) the decision was not in the public interest since it served to discourage existing and new QF generation; and 5) the decision constituted an unlawful taking.

In its rehearing application, CAC alleges the following: 1) the decision is overly broad in that it applies to nonstandard contracts which have fixed pricing terms; 2) once the Commission established the Transition Formula for calculating SRAC prices, its jurisdiction to further regulated those prices was terminated; 3) the decision violated section 390(b) by changing the Transition Formula and permitting a Consumer Transition Price ("CTP") to replace the formula in certain instances; and 4) the decision violates PURPA by setting QF payments below utility avoided costs and discriminating against QFs. CAC also raises similar arguments as Calpine claiming that the decision is not supported by record evidence, violates due process and is poor public policy. Finally, it requests clarification of the role of the CTP.

As a member of IEP, Caithness indicates its support of IEP's rehearing application. Further, it maintains that the decision violates PURPA and the FERC regulations implementing PURPA in its discussion of the CTP.

In its rehearing application, CE Generation raises arguments similar to CCC and Calpine regarding the changes to the SRAC formula and the fact that no evidentiary hearings were provided.

Tractebel, CCC and County of LA raise substantially similar allegations as Calpine regarding the decision's impact on PURPA and the FERC regulations

implementing PURPA. Tractebel and CCC also contend that dynamic factor adopted for Edison violates section 390(b) because the factor in effect replaces the statutory SRAC formula with an index methodology. Tractebel further asserts that the decision violates section 390(b) because the Malin index plus transportation costs does not reflect the "California natural gas border price indices" as required by the statute. Finally, CCC requests that oral argument be granted.

We have carefully considered all the arguments presented by the QF Applicants and are of the opinion that they have failed to demonstrate good cause for granting rehearing. While we conclude that rehearing is not warranted, we do recognize certain errors or ambiguities in the decision that require clarifying modification. Therefore, our order today modifies D.01-03-067 consistent with our discussion below.

DISCUSSION:

I. CONSTITUTIONAL ISSUES

A. Due Process

Applicants assert that the Commission erred in not holding evidentiary hearings prior to modifying the Transition Formula. IEP contends that because the Commission was changing a prior decision, it was required to hold evidentiary hearings. (IEP App. at p. 2, referencing Pub. Util. Code §1708.) Calpine and CAC also believe that hearings needed to be held pursuant to section 1708. (Calpine App. at p. 18; CAC App. at p. 12.) Applicants assert that by not holding hearings, the Commission denied them due process. (IEP App. at pp. 3-4; Calpine App. at p. 18; CAC App. at p. 12.) IEP and Calpine specifically assert that written comments were not adequate to meet due process requirements.

Applicants' arguments with respect to a right to an evidentiary hearing in these matters are without merit. The U.S. Supreme Court has held that there is no right to an evidentiary hearing where a rule of conduct applies generally. (See *Bi-Metallic*

Investment Company v. State Board of Equalization of Colorado (1915) 239 U.S. 441 (no right to a hearing before state entities could increase property taxes in that state).) Our decision to modify the Transition Formula affected the QFs as a whole.[6] Consequently, we properly decided to not hold evidentiary hearings.

Applicants' assertions that evidentiary hearings were required under section 1708 are also misplaced. Simply because there is a modification does not mean that an evidentiary hearing is required under all circumstances. Section 1708.5(f) provides:

> "Notwithstanding Section 1708, the [C]ommission may conduct any proceeding to adopt, amend, or repeal a regulation using notice and comment rulemaking procedures, without an evidentiary hearing, except with respect to a regulation being amended or repealed that was adopted after an evidentiary hearing, in which case the parties to the original proceeding shall retain any right to an evidentiary hearing accorded by Section 1708." (Pub. Util. Code, §1708.5, subd. (f).)

Section 1708.5(f) is applicable in this instance. In adopting the Transition Formula, the Commission was establishing a regulation because it had "general applicability and future effect." (See Stats. 1999, ch. 568, §1, subsection (b), which defines a regulation.) Since no evidentiary hearings were held when we adopted the Transition Formula, we were not required to conduct an evidentiary hearing before modifying the Transition Formula.

CE Generation also believes that it was denied due process because it was provided an inadequate opportunity to comment on the Modified Formula.[7] (CE

[6] The California Supreme Court has stated: "In adopting rules governing service and in fixing rates, a regulatory commission exercises legislative functions delegated to it and does not, in so doing, adjudicate vested interests or render quasi-judicial decisions which require a public hearing for affected ratepayers." (*Wood v. Public Utilities Commission* (1971) 4 Cal.3d 288, 292.)

[7] Calpine also believes it was denied due process by the shortened comment period. Specifically, it asserts that additional time was needed due to an "eleventh hour decision" to substitute Malin for Topock for all three utilities. (Calpine App. at p. 19.) However, the Draft Decision of Commissioner Wood issued January 10, 2001 ("Draft Decision") specifically replaced the Topock index with the Malin index for all three utilities. (Draft Decision, January 10, 2001, OP 7.) This determination was restated in the Revised Draft Decision of Commissioner Wood issued March 21, 2001 ("Revised Draft Decision"). (Revised Draft Decision, March 21, 2001, OP 7.) Therefore, Calpine was well aware that we intended to change the border index and had sufficient opportunity to comment on this determination.

Generation App. at p. 17.) It notes that parties were given two days to comment on the revised draft decision, rather than the 30 days provided under Rule 77.7 of the Commission's Rules of Practice and Procedure. (CE Generation App. at p. 18.) CE Generation fails to demonstrate that the 48 hour period provided to comment on the proposed decision violates its due process rights, and does not provide any authority to support its position. Furthermore, it has failed to show that the 48 hour period, by itself, violates due process. Although 48 hours is a short period for comments, CE Generation is well aware that at the time the decision was issued, the State of California and the energy utilities were in a time of crisis, and that it had been necessary to expedite many of our decisions, including D.01-03-067. Indeed, CE Generation itself notes the dire circumstances facing QFs and the need to assure that QFs would be paid for the energy they sold to the utilities. (CE Generation Comments, filed March 23, 2001, p. 6.)

B. Takings

Applicants contend that the decision interferes with the power purchase agreements between them and the utilities because the utilities' payments will no longer reflect their full avoided costs. Consequently, they assert that the decision is in effect a taking in violation of the federal and state constitution. (Hydro Parties App. at pp. 2-3; Calpine App. at p. 20.) These arguments are without merit. Applicants' takings claims are premised on their assertions that the Modified Formula results in SRAC prices below <u>their</u> operating costs. However, SRAC payments were never intended to reflect QF operating costs. Rather, PURPA "caps" SRAC payments at the utility's avoided costs. (18 C.F.R. §292.304(a)(2).) In this instance, utility avoided costs are calculated based on the Transition Formula established in section 390(b). As discussed in D.01-12-025, the decision denying PG&E and Edison's rehearing applications of D.01-03-067, we have legal authority to adjust SRAC prices to ensure compliance with section 390. (D.01-12-025 at p. 4.) Consequently, the fact that QFs are receiving payments less than their operating costs does not constitute a taking.

II. EVIDENTIARY SUPPORT

Applicants believe that the Malin index cannot be substituted for the Topock index because there is no evidence that the Topock prices were not robust and no longer reflected Edison's avoided costs and that the Malin index is a reasonable proxy for Southern California. (Calpine App. at pp. 4-6, 8; CAC App. at pp. 9-11; CE Generation App. at p. 11; Tractebel App. at p. 8; LA County App. at p. 2.) These allegations are without merit.

Section 390(b) requires that the Transition Formula be based on "an average of current California gas border price indices." In D.96-12-028, we determined that the Topock index used to calculate the SRAC prices were robust and met the market-based pricing requirements of section 390. (D.96-12-028, 69 Cal.P.U.C.2d at p. 552.) However, evidence in the record convinced us that that the Topock index was no longer sufficiently robust to be utilized on a prospective basis.

A review of the record shows that there was sufficient evidence to support a finding that the Topock index was not sufficiently robust. ORA first raised this issue in its response to Edison's Petition to Modify D.96-12-028. It noted that the Commission had filed a Section 5 complaint at FERC against El Paso Natural Gas Company, El Paso Merchant Energy Gas L.P., and El Paso Merchant Energy Company (collectively, "El Paso") asserting that there was evidence suggesting price manipulation of the California border gas prices. (Response of the Office of Ratepayer Advocates to Southern California Edison Petition to Modify D.96-12-028 ("ORA Response"), filed August 28, 2000, p. 8.) Edison also discussed the Commission's Section 5 complaint against El Paso as evidence that the prices reflected in the Topock index was no longer robust and representative of a competitive market. (Reply of Southern California Edison to Responses to Petition to Modify D.96-12-028 ("Edison Reply"), filed Sept. 27, 2000, at pp. 18-23.) In addition, Edison submitted a report prepared by the Brattle Group relating to the effect of price manipulation on prices at Topock. (Edison Reply, Exh. C.)

Although the QFs disputed this evidence in both their Sept. 27, 2000 and Oct. 30, 2000 comments, their arguments were unpersuasive. For example, QF Parties[8] argued that the Topock index was robust because there was little variance in the prices reported by the three publications used to calculate the utilities' avoided cost postings and various QF projects had tied their prices to gas prices at Topock. (Comments of QF Parties, filed September 27, 2000, at pp. 3, 8.) However, neither the accuracy in reporting Topock prices nor the fact that QFs have tied their prices to Topock address whether the index itself represented a competitive market. CCC also disputed the Brattle Group's report and submitted its own report, entitled "Market Power and the California Natural Gas Price Index." (CAC Opposition to Petition to Modify D.96-12-068, filed Oct. 30, 2000, Exh. A.) Based on evidence in the record, we concluded that the Topock index was no longer robust and therefore could not accurately serve as a proxy for utility avoided costs.

Applicants also argue that the Commission's Section 5 complaint is either irrelevant or cannot be used as a basis for concluding that Topock is no longer robust. (CAC App. at p. 11; CE Generation App. at p. 11; Calpine App. at p. 5; CCC App. at pp. 8-9.) However, we did not rely on this complaint to conclude that Topock was not robust. Rather, D.01-03-067 stated that "it is clear that almost none of the QFs that submitted declarations actually purchase gas at Topock, and thus their purchases are not reflected in the Topock price reported in various publications. . . . This reduces the liquidity of the Topock market, making it more susceptible to price manipulation." (D.01-03-067 at p. 19.) It was this reduced liquidity, along with the possibility of market

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[8] CCC, Caithness, FPL Energy, IEP, and Watson Cogeneration Company collectively filed a response and are referred to in this section as QF Parties.

abuse alleged in our Section 5 complaint, that convinced us that Topock was not robust.[9]

There was also sufficient evidence in the record to support a decision to replace the Topock index with the Malin index. In response to the ALJ's Sept. 1, 2000 ruling, Edison recommended that the Topock indices be replaced by either the Malin index or the San Juan Basin plus $.18/MMBtu. (Reply of Southern California Edison to Responses to Petition to Modify D.96-12-028 ("Edison Reply"), filed Sept. 27, 2000, at p. 9.) In support of its recommendation, Edison submitted a chart indicating correlation in prices between these three indices. (Edison Reply at p. 27.) No parties dispute that Malin is not a valid proxy for utility avoided costs. However, several QFs noted that if Malin were to be used, that an intrastate transportation rate to southern California should be added to that amount. (Joint Reply of Coral Energy Resources, L.P. and Engage Energy US, L.P. to the Response of ORA to Edison's July 28, 2000 Petition for Modification ("Coral Energy Joint Reply"), filed Sept. 27, 2000, at p. 4; Comments of QF Parties, filed Sept. 27, 2000, at p. 11.)

Comments by various QF parties argued that the Malin index could not be used because gas from Malin does not directly serve southern California. Applicants also raised these arguments in their rehearing applications. However, this does not prevent use of Malin plus transportation as a proxy for Edison's avoided cost. Section 390(b) does not require that the gas border prices represent <u>where</u> the utility would procure its gas, but rather whether the gas border price is a <u>reasonable proxy</u> for utility avoided cost. Therefore, it is within our discretion to determine which indices would most appropriately represent utility avoided costs. Contrary to Applicants' assertions, the agreement entered into between the QFs and Edison to use the Topock index in the

[9] In fact, the FERC has determined that the Topock market may have been subject to market abuse. On December 27, 2001, the FERC ordered supplemental hearings on the issue of whether El Paso had made all its pipeline capacity available between Nov. 1, 2000 and Mar. 31, 2001. (Order Denying Motion to Strike and Remanding Proceeding for Limited Supplemental Hearing [RP00-241-000], issued December 27, 2001.) In that order, the FERC noted that its Market Oversight and Enforcement Section had found that there was evidence to suggest that El Paso had exercised market power by withholding unused pipeline capacity between November 2000 and March 2001. These hearings were held the week of January 7, 2002, and a decision would be issued as soon as practicable.

Transition Formula does not prevent us from changing the index. In D.96-12-028, we noted that Edison and several QF parties had filed an agreement to use the Topock index in the Transition Formula. (D.96-12-028, 69 Cal.P.U.C. at p. 552-53.) Our determination to use the Topock index, however, was not due to this agreement, but rather because we determined that the index was robust and reflected market conditions. (*Id*. at p. 552.) Additionally, we contemplated that the index could be changed. (*Id*. at p. 553-54.) As discussed above, we determined that evidence in the record suggested that the Topock index was no longer robust and could not be used reliably in calculating SRAC prices. Consequently, the gas index in the Transition Formula needed to be changed.

In an emergency motion filed on November 28, 2000, Edison asserted that the Malin index was no longer robust and that the proper index to be used should be "a '10/90' average of (1) the simple average of the three Topock border indices currently in use in the SCE Transition Formula and (2) SoCalGas' monthly published Schedule G-CS Cost of Gas (WACOG)." (Emergency Motion of Southern California Edison, filed Nov. 28, 2000, at p. 14 and fn. 12.) However, Edison provided no convincing evidence that there was in fact market manipulation at Malin. Indeed, Edison's Emergency Motion only demonstrated that if this alternative "index" were used, the reduction in its QF payments would have been greater than if the Malin index were used. Consequently, we declined to adopt this proposal. Several QFs also argued that even if Topock were not robust, the Commission should have used another southern California border index, not Malin. Although other southern California border indices do exist, Coral Energy et al. note that these indices reflect prices close to prices at Topock. (Coral Energy Joint Reply at p. 4.) Based on our determination that Topock was not sufficiently robust, it would not make sense to replace Topock with an index which closely reflects Topock. Moreover, there was no evidence in the record to demonstrate that any of these proposed alternative indices were accurate or robust, as required in D.96-12-028.

Section 390(b) requires that the formula use "California gas border price indices." Additionally, D.96-12-028 required the new index demonstrate that it was robust. (D.96-12-028, 69 Cal.P.U.C. at p. 552.) As discussed above, only the Malin index met these requirements. However, based on comments provided by some QFs, a transportation cost was added to this index to more accurately represent Edison's avoided costs. While it can always be argued that additional evidence is needed to support a decision, this decision was issued under emergency circumstances. However, the decision noted that the substitution of the Malin index for the Topock index was temporary and ordered a workshop to consider gas cost options to replace Topock. (D.01-03-067 at pp. 21, 35 [OP 7 & 9].) Consequently, the Commission properly concluded that the Malin index plus transportation costs was a reasonable proxy for southern California.

We find that D.01-03-067 does not clearly explain why we chose to substitute the Malin index for the Topock index. Nor have we provided findings of fact and conclusions of law in the decision as required by Public Utilities Code Section 1705 support this decision. However, this error was inadvertent, and thus, we will modify D.01-03-067 to provide such a clarifying explanation and to make separate findings of fact and conclusions of law that encompass all the rationale and policy determinations that we discussed in the text of this decision. We modify D.01-03-067 in the manner set forth in the ordering paragraphs.

III. PURPA REQUIREMENTS

Section 210 of PURPA directs FERC to implement the legislation requiring public utilities under state regulation to purchase electricity from QFs at prices set by avoided cost. (16 U.S.C. §824(a)-3.) However, state regulatory commissions were given broad authority to establish avoided costs. (18 C.F.R. §§292.301-292.304.) Applicants contend that not only is the Commission precluded from modifying the Transition Formula, but also that the modification violates PURPA by setting QF prices below utility avoided costs and is discriminatory and contrary to the public interest.

CAC contends that under *Freehold Cogeneration Associates v. Board of Regulatory Commissioners* (3d Cir. 1995) 44 F.3d 1178, once a QF contract price is set, a state no longer has jurisdiction to change that price. (CAC App. at p. 2.) It appears to believe that since the SRAC formula adopted in D.96-12-028 contained specific values, the Commission may not amend this formula. (CAC App. at p. 3.) CAC's reliance on *Freehold* is misplaced. That case concerned long-term contracts and a fixed avoided cost, while D.01-03-067 applies to short-run avoided costs the QFs and utilities agreed would be set by the Commission in their standard offer contracts. Additionally, even if *Freehold* were applicable in this instance, there is no violation since D.01-03-067 did not modify the Transition Formula itself, but only updated components within the formula. These components are subject to Commission interpretation and we are not prohibited from updating them as necessary to ensure continued compliance with section 390.[10]

Applicants' arguments regarding avoided costs are premised on their belief that the Transition Formula accurately represents utility avoided costs.[11] The Transition Formula established in accordance with section 390(b) was intended to be an interim method for calculating SRAC payments. The Legislature contemplated that this methodology would be replaced by the "clearing price paid by the independent Power Exchange." (See Pub. Util. Code §§390(b) and (c).) However, the Transition Formula has been in place for over 4 years. It would be unreasonable to believe that this interim formula would still accurately reflect current utility avoided costs. Furthermore, Applicants merely assert that the Transition Formula yields SRAC payments that cover their operating costs. Applicants have not submitted persuasive evidence that the

[10] Pursuant to the C*hevron* doctrine, an agency's interpretation of the statutes it is empowered to enforce, and of its own regulations, should be given deference by a reviewing court, unless the interpretation is arbitrary, capricious, or manifestly contrary to the statute or regulation. (*Chevron, U.S.A. v. Natural Resources Defense Council* (1984) 467 U.S. 837, 844, 864-866; *see also*, *Clark v. Alexander* (4th Cir. 1996) 85 F.3d 146, 152 ("…the fact that an interpretation [of the state agency] is not in the form of a promulgated rule will not prevent that interpretation from being afforded deference by courts if it is consistent with federal provisions and is reasonable.").)

[11] Applicants' arguments that the decision to use historical IER and O&M components results in QF prices below utility avoided costs are also without merit. D.01-03-067 noted that there was no evidence in the record to update the IER and O&M components. (D.01-03-067 at p. 13.) Therefore, it ordered further proceedings to determine these amounts. Until these amounts are determined, Applicants' assertions are premature.

Transition Formula in fact represents current utility avoided costs. Evidence in the record led us to conclude that the Transition Formula was yielding SRAC payments above utility avoided costs. Therefore, in order to comply with the FERC's mandate that SRAC payments not exceed avoided costs, we acted within our discretion to modify the Transition Formula.

Applicants' assertions that D.01-03-067 discriminates against QFs in favor of larger generators and is not in the public interest are also without merit. Applicants fail to consider that in addition to being nondiscriminatory and in the public interest, PURPA requires prices to "be just and reasonable to the electric consumer of the electric utility." (18 C.F.R. §292.304(a)(1)(i).) In D.01-03-067, we attempted to balance these requirements. Indeed, subsequent decisions further demonstrate we have has neither discriminated against QFs nor acted contrary to the public interest. For example, in D.01-06-015, issued on June 13, 2001, we pre-approved several possible non-standard amendments that were designed for those QFs facing significant financial hardship if their energy prices were determined by the new SRAC formula using Malin gas indices. That decision also authorized QFs to request partial payment of past due amounts to ensure that they would continue operations.

IV. SECTION 390(b)

Section 390(b) requires that the Transition Formula

> reflect a starting energy price, adjusted monthly to reflect changes in a starting gas index price in relation to an average of current California gas border price indices. The starting energy price shall be based on 12-month averages of recent, pre-January 1, 1996, short-run avoided energy prices paid by each public utility electrical corporation to nonutility power generators. The starting gas index price shall be established as an average of index gas prices for the same annual periods.

Applicants contend that the decision violates section 390(b) in two main ways. First, they do not believe that the Malin index can be substituted for the Topock index in the Transition Formula. Second, they assert that by replacing Edison's fixed

factor with a formula, the decision violates section 390(b) by reinstating the index methodology. Both of these assertions are without merit.

Applicants' allegations regarding the Commission's authority to substitute the Malin index with the Topock index have already been addressed in Section II of this decision and are not discussed again here. With respect to the dynamic factor, California Cogeneration Council (CCC) states

> Application of the factor sub-formula effectively replaces the SRAC methodology mandated by Section 390(b) with the index methodology used for SRAC pricing prior to electric industry restructuring. Under the index methodology, SRAC prices were set based on the applicable IER, utility-electric-generation gas rate, and various cost adders, most notably the adder for O&M costs. See D.96-12-028, supra, at 3. D.01-03-067 effectively resurrects the index methodology. (CCC App. at p. 18.)

Energy Division staff have confirmed that when the fixed factor is replaced by the dynamic factor, the essential components required by section 390(b), the starting energy price and the starting gas border price in the Transition Formula, are algebraically cancelled out. This would therefore result in a formula which is essentially the index formula replaced by section 390.

Section 390(b) did not specify a specific transitional formula. Rather, it broadly proscribed the main components to be included in the formula. Thus, it is within our authority to develop the Transition Formula, so long as it is in compliance with section 390(b). The fixed factor "reflect[s] an escalation of that portion of the [energy] price that is dependent on variable or escalating gas costs." (D.96-12-028, 69 Cal.P.U.C.2d at p. 550.) While a utility-specific factor is not specified in section 390(b), we determined that it was "necessary to yield a fair representation of the historical values required by AB 1890." (D.96-12-028, 69 Cal.P.U.C.2d at p. 553.) As discussed previously, while the Transition Formula was intended to be used on an interim basis, it has actually been in place for over four years. Edison's Petition for Modification noted

"the Factor established by the Commission in 1996 no longer properly adjusts for the actual impact of changes in border gas prices on [Edison's] assumed avoided cost." (Edison Petition for Modification, filed July 28, 2000, at p. 3.) This would mean the Transition Formula was resulting in higher QF payments than utility avoided costs. Consequently, we determined that the factor should be changed to ensure compliance with PURPA.

The dynamic factor formula adopted in D.01-03-067 is the same formula used to calculate the fixed factor adopted in D.96-12-028. (D.01-03-067 at p. 6.) Therefore, our adoption was consistent with the prior decision. Section 390(b) requires the Transition Formula to include a starting energy price and a starting gas border price. The Modified Formula still includes these two components. Although the dynamic factor results in a Modified Formula that is similar to the index formula, there is no error, since the Transition Formula itself mimics the index formula. (See D.01-03-067 at p. 12 ("[Section] 390(b) currently requires [the Commission] to calculate SRAC using gas prices as the primary input, effectively trying to mimic the index methodology.").) Consequently, we have complied with section 390(b).

V. CONSUMER TRANSITION PRICE

Parties have asserted that the Consumer Transition Price ("CTP") violates both PURPA and section 390. Calpine believes that by establishing a CTP, the Commission is imposing utility-type ratemaking on QFs, which is in direct violation of PURPA. (Calpine App. at p. 11.) CAC asserts that the CTP violates PURPA and is discriminatory against QFs because it places a cap on QF prices. (CAC App. at pp. 4-7.) Caithness and CE Generation also assert that the CTP conflicts with the PURPA and the FERC regulations implementing PURPA. (Caithness App. at p. 8; CE Generation App. at p. 5.) CE Generation further asserts that the CTP violates section 390 because short-run avoided costs are specifically to be determined by the transition formula specified in section 390(b). (CE Generation App. at p. 16.)

Applicants' arguments are based on their mistaken belief that D.01-03-067 intended the CTP to impose a cap or ceiling on QF payments. This is not the case. The CTP is a reasonableness benchmark which serves as a general pricing goal for the average cost of QF production. (D.01-03-067 at p. 22.) D.01-03-067 clearly notes that the CTP is neither a cap nor ceiling on payments. (D.01-03-067 at pp. 2, 22-23, 29.) The CTP does not replace the Transition Formula. Thus, there is no violation of section 390(b). Additionally, since QF payments are not in any way limited by this amount, PURPA is not implicated. Consequently Applicants' arguments are without merit.

VI. NON-STANDARD CONTRACTS

CAC contends that the decision is overbroad in that it also applied to non-standard contracts, which have fixed pricing terms. (CAC App. at p. 2.) It notes that the terms of these contracts were expressly approved by the Commission in D.99-12-071 and may not be modified without the QF's consent. (CAC App. at p. 2, citing *Freehold Cogeneration Associates v. Board of Regulatory Commissioners*, *supra*, 44 F.3d 1178.) CAC is correct. The Modified Formula does not apply to non-standard contracts, or to non-standard amendments to contracts in which QFs and Edison, PG&E or SDG&E reached private agreements on the calculation of short-run avoided costs and QF energy payments.[12] Therefore, we modify D.01-03-067 to add this clarifying language.

VII. ORAL ARGUMENTS

CCC requests that the Commission grant oral argument on the issues raised in its rehearing application. (CCC App. at p. 19.) It asserts that granting oral argument is warranted because the decision "dramatically departs from established avoided cost doctrine without [sic] disastrous consequences for QFs and the California economy and without adequate justification or explanation." (CCC App. at p. 19.)

[12] FERC regulations permit QFs and an electric utility to agree to a price for the purchase of electricity that differs from the price established by a State commission. (18 C.F.R. §292.301(b).)

Rule 86.3 of the Commission's Rules of Practice and Procedure specifies that oral argument will be considered if the application "demonstrates that oral argument will materially assist the Commission in resolving the application, and . . . raises issues of major significance for the Commission." (Cal. Code of Regs., Tit. 20, §86.3.) As discussed above, there is no finding that we have departed from existing Commission precedent without adequate explanation. Accordingly, CCC's request for oral argument is denied.

THEREFORE, IT IS ORDERED that:

1. D.01-03-067 is modified to insert the following clarifying language after the sentence "We find that adopting a Malin border price plus intrastate transportation as a temporary replacement for Topock meets the requirements of § 390(b)." on page 21:

> "In D.96-12-028 we determined that the Malin index was sufficiently robust to meet the requirements of section 390(b). We have not been presented with any evidence which would lead us to question its reliability and robustness. Parties have proposed that the Topock index be replaced with either another southern California index or a 10/90 average of the Topock index and SoCalGas' monthly published Schedule G-CS Cost of Gas, rather than the Malin index. However, we decline to adopt one of these alternatives as there is no evidence in the record to demonstrate that they are sufficiently accurate or robust as required by D.96-12-028."

2. D.01-03-067 is modified to insert the following Findings of Fact on page 31 after Finding of Fact 14:

> "15. Price manipulation by El Paso Natural Gas Company and its affiliates would affect the robustness of gas prices at Topock.
>
> 16. Published indices also exist for southern California border delivery points at North Needles, Wheeler Ridge and Kern River Station.

17. In D.96-12-028, the Commission determined that the Malin index was sufficiently robust to serve as a proxy for utility avoided costs."

3. D.01-03-067 is modified to insert the following Conclusion of Law on page 33 after Conclusion of Law 14:

"14. The Malin index is sufficiently robust to be utilized in the Modified Formula."

4. D.01-03-067 is modified to insert the following Ordering paragraph on page 36:

"14. The SRAC formula changes adopted in this decision, with respect to both the gas border price indices used and the modified Edison factor, are applicable only to Commission-approved standard offer contracts and the terms and conditions therein."

5. CCC's request for oral argument is denied.

6. Rehearing of D.01-03-067, as modified, is denied.

Dated February 7, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners