

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION E-4000

June 15, 2006

R E S O L U T I O N

Resolution E-4000. San Diego Gas and Electric Company (SDG&E) requests approval to update its Assembly Bill 57 Procurement Plan as filed in compliance with Decision (D.)04-12-048. SDG&E's request is approved.

By Advice Letter AL 1745-E Filed on November 16, 2005 and Supplemental AL 1745-E-A Filed on March 22, 2006.

SUMMARY

SDG&E's updated short-term procurement plan (STPP) is approved.

This Resolution approves the updates San Diego Gas and Electric Company (SDG&E) filed to its STPP. In Decision (D.)04-12-048, we granted authority for California's three large investor-owned utilities to procure electricity over a rolling ten year period (Conclusion of Law 39). This first 5-year STPP as reflected in the updates submitted by SDG&E in ALs 1745-E/-E-A includes the following changes:

- A new longer term hedging strategy;
- An increasing need to buy significant quantities of gas for electric generation; and
- Quantification of portfolio elements reflecting the reallocation of the dispatchable CDWR-Williams contract (known as "Williams D") effective January 1, 2007 and the Enviropel project.
- Several new procurement products.

SDG&E's proposed updated STPP, as reflected in AL 1745-E and Supplemental AL 1745-E-A, is responsive to the requirements adopted in D.04-12-048 and is therefore approved.

BACKGROUND

D.04-12-048 authorizes the utilities to engage in longer term procurement.

The Commission determined that extending the utilities' procurement authority on a rolling 10-year basis is reasonable, given that the long-term procurement plans cover a ten-year period and they will be updated and reviewed every two years (D.04-12-048, Conclusion of Law #39). Previously, the Commission had granted more limited procurement authority, generally one year at a time since SDG&E resumed procurement in January 2003.

Updates or modifications to STPPs in between the biennial review are to be filed with an advice letter (Ibid. Finding of Fact 106). SDG&E last updated its STPP, effective March 25, 2005.¹

SDG&E requested that the Commission issue a resolution approving SDG&E's updated STPP.

On November 16, 2005, SDG&E filed AL 1745-E to update its current STPP, in compliance with Finding of Fact 106 of D.04-12-048. In Attachment A² to AL 1745-E, SDG&E outlines its proposed procurement plan and ratemaking treatment that contains the upfront standards, required by Assembly Bill 57, which will govern SDG&E's electric procurement activities over a rolling five year period. (See Attachment A to AL 1745-E-A at p. 2, which characterizes the original AL.) The significant changes SDG&E proposes in the updates to its approved STPP are summarized and explained in the discussion section of this resolution.

SDG&E supplemented its AL to reflect the reallocation of the Williams D contract and the loss of the Enviropel project.

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1. By Advice Letter 1676-E, approved on September 14, 2005 with an effective date of March 25, 2005.
 2. Attachment A to AL 1745-E and Attachment A to AL 1745-E-A contain confidential information and therefore are protected from disclosure under the statutory provisions of Section 583 of the California Public Utilities Code and the Commission's General Order 66-C and are subject to the provisions of the May 1, 2003 Revised Protective Order adopted in R.01-10-024. Therefore, the unredacted (non-public) version of Attachment A is being submitted to the Commission and SDG&E's Procurement Review Group (PRG) only.

On December 15, 2005, the Commission issued D.05-12-021, which addressed the reallocation of California Department of Water Resources (CDWR) contracts. The primary impact on SDG&E was the reallocation of the dispatchable CDWR-Williams contract (known as Williams D), that was reallocated to Southern California Edison Company, effective January 1, 2007.

On January 20, 2006, SDG&E sent a letter to the developer of the Enviropel project, terminating this Power Purchase Agreement. Thus, SDG&E's supplemental AL also removes the Enviropel project from its forecast of renewables.

Due to these changes, SDG&E filed Supplemental AL 1745-E-A on March 22, 2006. Attachment A to AL 1745-E-A is an addendum to the procurement plan update originally filed in Attachment A of AL 1745-E. (See footnote 2.).

SDG&E filed an application to request increased short-term borrowing authority.

To Execute the STPP updates filed in AL 1745-E, SDG&E states that it requires the Commission to approve an increase in borrowing authority. Cash requirements for collateral and liquidity needed to implement the proposed new hedge plan were not contemplated in the Cost of Service rate case approved for SDG&E prior to its rolling ten year trading authority granted in D.04-12-048.

On December 22, 2005, SDG&E filed Application (A.) 05-12-026 requesting authority to increase its current short-term borrowing authority by an aggregate principal amount of \$150 million in addition to the 5 percent issuance of short-term debt that does not require Commission approval pursuant to § 823(c).³ In D.06-05-029, issued May 25, 2006, the Commission granted SDG&E the authority requested in A.05-12-026.

SDG&E requires approval of its updated STPP so that it can begin contracting to secure resources to meet immediate needs.

SDG&E expects that it will file a comprehensive update of the 5 year AB57 Procurement Plan as part of the consolidated LTRP/STPP filing to be made at

3. All statutory references are to the Public Utilities Code unless otherwise indicated.

the PUC in the summer of 2006. However, given the supply charges noted above, and the immediate need to begin contracting to secure replacements, SDG&E requests that the Commission approve this update to the 5 year STPP as soon as possible.

NOTICE

Notice of AL 1745-E and Supplemental AL 1745-E-A were made by publication in the Commission's Daily Calendar (on November 11, 2005 and on March 27, 2006 respectively). SDG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

No party protested Advice Letter AL 1745-E or Supplemental AL 1745-E-A.

DISCUSSION

In AL 1745-E/-E-A, SDG&E responds to the Commissions granting longer term trading authority, specifically a rolling ten year procurement authorization. SDG&E's request for authority to extend the term of its hedging activities recognizes its procurement obligation for its electricity customers, as well as the limits adopted in D.04-12-048. We find that SDG&E prudently seeks to manage ratepayer exposure to market price movements and therefore adopt the STPP as updated in AL 1745-E/-E-A.

The update to SDG&E's STPP filed in AL 1745-E proposes two significant changes: (1) a modified hedging strategy, including a longer term of hedging and (2) procurement of an increased Gas Supply for Utility Retained Generation (URG). Certain elements of SDG&E's updated STPP are confidential, as well as some of the reasons supporting SDG&E's approach. Therefore, we will address those elements and supporting reasons in general to avoid inappropriate disclosure.

SDG&E requests authority to extend the term of hedging and modify its hedging strategy.

SDG&E requests authority for longer term hedging relative to its updated STPP effective March 25th, 2005. Under its currently effective STPP, SDG&E calculates Remaining Customer Risk Tolerance (CRT) and value-at-risk (VaR) as the

primary measures to assess the risk of higher costs in fulfilling its load obligation. In this update to that plan, for years 1 and 2 in the rolling five year hedge horizon, SDG&E will use a strategy for hedging based on CRT and VaR to Expiration, in a manner that is consistent with the current risk mitigation activities under SDG&E's approved STPP and Fuel Supply Plan. In addition, SDG&E proposes in this plan to change its hedge strategy to hedge some portion of electric load for ratepayers in future years. In its update, SDG&E outlines the details of its hedging plan, including hedging objectives and targets that, when approved, will become the upfront guidelines envisioned in AB57 that will guide SDG&E's future hedging activities.

The term of SDG&E's proposed longer term hedging authority is based on a number of factors, including the following: (1) recent Commission authorization, in D.04-12-048, which expanded SDG&E's procurement authority to a rolling ten years, (2) market liquidity in years beyond the current year, and (3) SDG&E's ability to identify resources available for its customers to accurately calculate the volume of SDG&E residual net short and gas positions. SDG&E's update includes a discussion of forecast SDG&E risk positions and a description of its expanded hedge plan. That is, SDG&E presents its expected electric portfolio, showing the portion of the portfolio which is already hedged, e.g., the volumes no longer exposed to market price fluctuations. These volumes are primarily made up of fixed price contracts, such as CDWR fixed price contracts that are allocated to SDG&E for operational administration, and existing hedges (for 2006). Also, SDG&E presented the unhedged portion of the portfolio, e.g., those volumes which are impacted by changes in market prices. SDG&E plans to fill these open positions with renewable resources as SDG&E works towards the goal of having 20% of its portfolio needs met through renewable resources by 2010; energy from Qualifying Facilities; generation from CDWR contracts with tolling provisions; SDG&E owned or contracted units (Miramar, Palomar and Otay); and finally SDG&E's market purchases. SDG&E discusses risk and risk mitigation alternatives associated with each.

SDG&E's proposed update recognizes that in granting extended trading authority, the Commission requires that "Contracts with duration five years or longer be submitted with an application to the Commission for preapproval." (D.04-12-048, at p. 108). SDG&E also recognizes that it may observe market conditions that cause it to meet and confer with its Procurement Review Group and Energy Division Staff specifically to review market conditions, cost forecasts, portfolio positions and possible adjustments to SDG&E's hedging strategy.

SDG&E states that it “will of course continue with its quarterly updates to the PRG, regardless of any changes in its CRT metric.” (SDG&E AL1745-E, Attachment A at p. 19).

SDG&E proposes reasonable limits on collateral and fixed priced volumes that could constrain its hedging activity.

SDG&E outlines an amount of collateral that it is prepared to make available to support this hedge plan and the conditions associated with this collateral. As explained in the Background section of this resolution, SDG&E states that it requires the Commission to approve an increase in borrowing authority to Execute the STPP updates filed in AL 1745-E. One implication of SDG&E’s proposed new hedging strategy, which involves larger transaction volumes, is the potential for greater divergence between the transaction price and market prices through time. The updated Plan proposed by SDG&E creates a much larger potential need for SDG&E to hold or post collateral. SDG&E explains the collateral requirement and proposes a collateral limit. While the actual collateral requirements will depend upon the actual volumes of liquidity demanding transactions used by SDG&E as well as actual market prices, clearly a forecast of a long-term need for some base level of collateral / liquidity is warranted to support the hedging outlined in this plan.

SDG&E requests we approve its proposed explicit limit on the amount of financial resources that the company will be required to dedicate on behalf of ratepayers in executing this long term hedging plan. SDG&E sets this limit in recognition of 1) the size of the anticipated liquidity requirements, 2) the types of products SDG&E expects to use to fulfill much of the identified hedging, and 3) the impact on the company’s financial resources of raising cash or cash equivalents to be used for collateral beyond the established limit. SDG&E forecasts that its proposed limit will be sufficient collateral to undertake the first years of this plan. SDG&E will have an opportunity to file updates to this collateral limit in the 2006 and 2008 Long Term Procurement Plans (LTPP). SDG&E states that setting such a limit is consistent with AB57 stated goal of assuring creditworthiness.

If SDG&E undertakes hedges in executing this plan that require collateral in excess of the adopted limit, then SDG&E will need to either 1) seek increased borrowing authority from the Commission to fund margin requirements which are in excess of the established limit or, 2) “unwind” sufficient hedges to move

the collateral requirements under the limit identified. Unwinding of hedges would increase ratepayer exposure to market price movements.

In addition, SDG&E has established certain volume limits on the amount of its portfolio that will have the price fixed in advance. This limit could also cause SDG&E to hedge less than otherwise anticipated under its proposed new hedging strategy. The limits SDG&E proposes are reasonable, and we adopt them.

SDG&E updates its STPP to reflect its increasing role in gas procurement for Utility Retained Generation (URG).

At the end of July 2005, SDG&E took ownership of the Miramar gas fired peaking facility, returning SDG&E to the role of electric fuel purchasing. Within the next five years, SDG&E will add a utility owned combined cycle facility and a 10 year tolling contract with another combined cycle facility. These facilities will create a need for SDG&E to buy significant quantities of gas for electric generation.⁴ SDG&E's updated STPP reiterates those plans and expands their scope (to include the gas for generation at the Otay Mesa facility) and in time (for additional years).

SDG&E plans to optimize the new gas portfolio by combining the procurement of this gas with that gas which SDG&E buys as agent for CERS (California Energy Resources Scheduling, division of California Department of Water Resources) to supply the longterm dispatchable contracts that have been allocated to SDG&E for operational purposes. This approach maximizes economic and operational efficiency when procuring and scheduling gas used for electric generation, although individual procurement transactions and hedges will be made in a manner generally consistent with forecast volumes of each book to maintain appropriate sharing of carrying costs and credit. When procuring gas, gas-related services and hedging for CERS, SDG&E traders will

4. SDG&E filed its plan to buy gas for RAMCO (Miramar) in AL 1644-E, approved on March 2, 2005 and has begun purchasing gas for use in electric generation at that facility. SDG&E submitted a similar gas procurement plan for approval in AL 1710-E for the Palomar generation facility which SDG&E plans to take ownership and assume operational control in mid 2006. AL 1710-E was approved effective August 19, 2005.

continue to act as limited agent for CERS and all gas purchased for forecast CERS needs will remain the financial obligation of CERS. This relationship is outlined in the DWR-SDG&E Operating Agreement Exhibit B and is further detailed in SDG&E's various Gas Supply Plans. The costs associated with these DWR volumes, purchased as agent for DWR, will continue to be recovered through the CERS annual revenue requirement.

SDG&E's STPP may include new products, such as resource adequacy products, renewable energy credits, and emissions reduction credits to the extent authorized.

SDG&E updates its STPP to reflect certain new products. Since SDG&E filed its last full short term procurement plan in May 2003, SDG&E has undertaken significant procurement, and we have adopted new policies that have or will change the nature of the California energy market. SDG&E describes new products for procurement, not specified in D.02-10-062 Table 1, that it feels it will need to make use of in meeting its' customers requirements during the term of this STPP. In adding resource adequacy products to its STPP, SDG&E states that the cost of these would be fully recoverable through SDG&E's ERRA. In adding renewable energy credits (REC's), SDG&E states that if the Commission authorizes SDG&E to buy REC's, then SDG&E request the Commission's authorization to buy REC's under this plan to count toward SDG&E's RPS target. We can not make that determination here. In adding emissions reduction credits, SDG&E states that their costs would be recovered through SDG&E's non-fuel generation balancing account NGBA).

We note that in D02-10-062, the Commission stated, "While we authorize the utilities to procure the products described in Table 1, this list should not be considered exhaustive." (At p. 3). Therefore, SDG&E may employ these products to the extent allowed in appropriate other forums.

SDG&E should begin contracting to secure resources to meet the needs explained in AL 1745-E-A.

As explained previously, SDG&E states that given the reallocation of the Williams contract and the loss of the Enviropel project and the immediate need to begin contracting to secure replacements, SDG&E requests that the Commission approve this update to the 5 year AB57 Procurement Plan as soon as possible. With the addendum filed in Attachment A to the updated STPP filed in AL 1745-E-A, SDG&E's STPP reflects the impact of the reallocation of Williams D and the loss of Enviropel on the SDG&E supply portfolio so that the Commission

has an accurate plan for SDG&E as required by AB57. We support SDG&E's plan to immediately procure the replacement resources that are needed and thus approve the addendum filed in AL 1745-E-A.

SDG&E shall include RFO Procedures in its upcoming Long-Term Procurement Plan (LTPP) filing.

D.02-10-062 requires each utility to update its procurement plans to specify and describe the solicitation process and evaluation tools and methodology it will use to rank and select bids," (at p. 31). We adopted these requirements to ensure that any procurement for new capacity for which the utility seeks pre-approval by the Commission complies with AB 57. Filing the details specified in the factors listed in section VI.A of D. 02-10-062 provides the utility assurance that the Commission will find a particular RFO reasonable, as long as it is Consistent with the filed details.

In its May 2003 STPP, SDG&E, for cause at the time, did not meet that requirement. SDG&E's proposed procurement plan as updated in AL 1745-E/-E-A, still lacks the detailed requirements set forth in D. 02-10-062 regarding competitive solicitations, including an RFO.

Consistent with Supplemental AL 1745-E-A explained previously, SDG&E issued an RFO on May 24, 2006. SDG&E reviewed the draft RFO in advance with its PRG and addressed the feedback it received. As discussed herein, we support SDG&E's efforts to procure the needed resources explained in Supplemental AL 1745-E-A. However, SDG&E should have a plan that addresses each of the factors required by D.02-10-062.

We recognize that time is short, given the time involved in conducting an RFO. SDG&E states in Attachment A to Supplemental AL 1745-E-A that it "expects that it will file a comprehensive update of the 5 year AB57 Procurement Plan as part of the consolidated LTRP/STPP [sic] filing to be made at the PUC in the summer of 2006." Therefore, in approving SDG&E's STPP update, we direct SDG&E to address, in the upcoming LTPP filing, each of the factors required in section VI.A of D.02-10-062.

COMMENTS

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to PU Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived."

FINDINGS

1. Consistent with the directive in D.04-12-048 that updates or modifications to STPPs in between the biennial review are to be filed with an advice letter, SDG&E filed AL 1745-E to update its STPP. Due to the subsequent substantial loss of resources contained in the STPP filed in AL 1745-E, SDG&E filed Supplemental AL 1745-E-A on March 22, 2006.
2. SDG&E last updated its STPP by Advice Letter 1676-E, approved on September 14, 2005 with an effective date of March 25, 2005.
3. SDG&E requested that the Commission issue a resolution approving SDG&E's updated STPP, which presents the upfront standards required by Assembly Bill 57 that will govern SDG&E's electric procurement activities and their ratemaking treatment over a rolling five year period.
4. All hedging done in compliance with the terms of this plan will be eligible for full, timely recovery through rates.
5. D.05-12-021, issued on December 15, 2005, addressed the reallocation of California Department of Water Resources (CDWR) contracts. The primary impact on SDG&E was the reallocation of the dispatchable CDWR-Williams contract (known as Williams D), that was reallocated to Southern California Edison Company, effective January 1, 2007.
6. With the addendum filed in AL 1745-E-A, SDG&E's STPP reflects the impact of the reallocation of Williams D and the loss of Enviropel on the SDG&E supply portfolio so that the Commission has an accurate plan for SDG&E as required by AB57.
7. To Execute the STPP updates filed in AL 1745-E, SDG&E states that it requires the Commission to approve an increase in borrowing authority, as requested in A.05-12-026.
8. SDG&E requests Commission approval for its updates to the 5 year STPP to immediately begin contracting to secure certain replacement resources.
9. The STPP updates contained in AL 1745-E and Supplemental AL 1745-E-A are responsive to the rolling ten year procurement authority granted in D.04-

- 12-048. SDG&E prudently seeks to manage ratepayer exposure to market price movements.
10. SDG&E proposes reasonable limits on collateral and fixed priced volumes that could constrain its hedging activity.
 11. If SDG&E undertakes hedges in executing this plan that require collateral in excess of the adopted limit, then SDG&E will need to either 1) seek increased borrowing authority from the Commission to fund margin requirements which are in excess of the established limit or, 2) “unwind” sufficient hedges to move the collateral requirements under the limit identified.
 12. SDG&E updates its STPP to reflect its increasing role in gas procurement for Utility Retained Generation (URG).
 13. SDG&E’s STPP may include new products, such as resource adequacy products, renewable energy credits, and emissions reduction credits to the extent authorized.
 14. No party protested Advice Letter AL 1745-E or Supplemental AL 1745-E-A.

THEREFORE IT IS ORDERED THAT:

1. The request of SDG&E to update its STPP, as filed in AL 1745-E and Supplemental AL 1745-E-A, is approved.
2. In approving SDG&E’s STPP update, we direct SDG&E to address, in the upcoming LTPP filing, each of the factors required in section VI.A of D.02-10-062.

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 June 15, 2006; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners