PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION **RESOLUTION E-4026**
October 19, 2006

R E S O L U T I O N

Resolution E-4026**.** Southern California Edison Company for approval of 61 fixed energy price agreements with existing renewable qualifying facilities with a fixed energy price of 6.15 cents/kWh for a five-year period commencing on May 1, 2007 and ending on April 30, 2012, escalated one percent annually beginning in the second year.

By Advice Letter (AL) 2021-E filed on July 28, 2006.

SUMMARY

This resolution approves Southern California Edison Company's (SCE) request for approval of 61 fixed energy price agreements with existing renewable qualifying facilities (QFs).

This Resolution approves 61 fixed-price agreements with existing renewable qualifying facilities (QFs), as submitted by Southern California Edison Company (SCE). The agreements have a fixed energy price of 6.15 cents/kWh for a five-year period commencing on May 1, 2007 and ending on April 30, 2012, escalated one percent annually beginning in the second year. [1] QF capacity payments, whether for as-available power or contractually based, are unaffected by the proposed agreements.

[1] The 61 agreements include three agreements with non-gas fired cogeneration QFs who entered into fixed price amendments with SCE during the energy crisis. The term "renewable QFs," as used in this advice letter, includes these non-gas fired cogeneration QFs.

BACKGROUND

On July 28, 2006, SCE filed AL 2021-E requesting approval of 61 fixed energy price agreements with existing renewable QFs. Specifically, SCE requests approval of Agreement No. 2. The original Agreement (a.k.a., the Renewable Fixed Price Agreement) for a five-year, fixed energy price of 5.37 cents/kWh was executed on or about June 19, 2001 between SCE and 90 renewable QFs. On or about November 30, 2001, this group of 90 QFs and SCE entered into Amendment No. 1 to the Agreement. The Agreement and Amendment No. 1, constitute SCE's current 5.37 cents/kWh contracts with renewable QFs, and are collectively referred to herein as the Renewable Fixed Price Agreement.

In June 2001 in Decision (D.) 01-06-015, the Commission approved a voluntary fixed energy price contract amendment option available to all QFs, regardless of technology type.[2] The contracts were originally approved for all QFs, and for the period of roughly mid-2001 through mid-2006. However, because of negotiated contract provisions specific to the utility, SCE's five-year, fixed-price contracts for 5.37 cents/kWh had an actual contract term of May 1, 2002 through April 30, 2007.

SCE offered the new five year contracts (Agreement No. 2) to the 90 renewable QFs that are currently under the Renewable Fixed Price Agreement. SCE subsequently made Agreement No. 2 available to one additional QF that had not previously executed a Renewable Fixed Price Agreement, bringing the total number of QFs eligible for Agreement No. 2 to 91. Of the 91 renewable QFs that were offered Agreement No. 2, sixty-one QFs actually signed Agreement No. 2. Thus, as soon as the renewable QFs on the 5.37 cents/kWh contracts expire, the 61 QFs that executed Agreement No. 2 will immediately commence a new five-year, fixed energy price period.

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[2] In June 2001, during the aftermath of the 2000-2001 energy crisis, the Commission approved D.01-06-015, et. al., which allowed QFs to enter into any one of three voluntary contract amendments. The three amendment options were either (a) supplemental payments for one year for QFs demonstrating immediate need for such funds in order to continue operations, (b) fixed energy prices for five-years at 5.37 cents/kilowatt-hour (kWh), or (c) incentive payments for energy produced above normal operating levels.

SCE requests that the Commission issue a resolution approving each Agreement No. 2, as listed in the AL in Appendix F and in Appendix G (collectively, the Agreements), in its entirety and finding that:

(i) the Agreements and SCE's entry into the Agreements are reasonable and prudent for all purposes, including, but not limited to, SCE's recovery in rates of all payments made under the Agreements, subject only to Commission review of the reasonableness of SCE's administration of the Agreements; and

(ii) the terms of the Agreements shall be in lieu of and replace in their entirety such orders as the Commission may have previously issued or may hereafter issue that require SCE to make any payments to the QFs for energy deliveries during the New Fixed Rate Period that are different from or are in addition to the payment obligations established by the Agreements.

Agreement No. 2 is contained in Appendix A to AL-2021-E. In addition to the standard form of Agreement No. 2, there are four variants to Agreement No. 2 that were required in order to be consistent with variants of the original Renewable Fixed Price Agreement. The four variants are contained in Appendices B, C, D, and E to AL-2021-E.

NOTICE

Notice of AL 2021-E was made by publication in the Commission's Daily Calendar. Southern California Edison Company (SCE) states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

There were no protests to Advice Letter 2021-E.

DISCUSSION

QFs seeking new contracts due to actual or impending contract expirations currently have three options.

Prior to a final decision in Phase 2 of the Avoided Cost Rulemaking (R.) 04-04-025, as jointly combined with R.04-04-003 on QF issues, QFs seeking new contracts (presumably due to actual or impending expiration) currently have three options:

- Five-year Standard Offer 1 (SO1) contract. D.05-12-009 directed PG&E, SCE, and SDG&E to continue purchasing power pursuant to a five-year SO1 contract from any QF with a contract set to expire after January 1, 2006, and before the Commission's issuance of a final decision in the combined dockets, R.04-04-003 and R.04-04-025.
- Bilateral contract negotiation (D.04-12-048 and D.04-01-050), and
- Participation in utility power solicitations, such as Requests for Offers (RFOs) (D.04-12-048 and D.04-01-050).

Agreement No. 2 was the result of bilateral contract negotiations between SCE and the QFs.
Agreement No. 2 was negotiated bilaterally between SCE and the QFs. SCE stated that, over the last year, it had engaged in ongoing discussions with renewable QF representatives concerning the possibility of a second, five-year fixed price period that would commence at the end of the current Fixed Price Period.

> The Fixed Price Period, as referred to herein, is for the period of May 1, 2002 through April 30, 2007, during which time the vast majority of renewable and non-renewable QFs under contract to SCE are being paid a fixed energy price of 5.37 cents/kWh.
>
> The New Fixed Price Period, as referred to herein, is for the period of May 1, 2007 through April 30, 2012 when the 61 renewable QFs under Agreement No. 2 would be under contract to SCE at a fixed energy price of 6.15 cents/kWh, escalated one percent annually beginning in the second year.

On or about May 3, 2006, SCE and representatives of two of SCE's major renewable QFs reached an agreement in principle to enter into pricing agreements that would provide for a new fixed price for energy for the New Fixed Price Period. On May 10, 2006, prior to executing any agreements with QFs, SCE presented the terms and conditions of the agreements to its Procurement Review Group (PRG).

On May 10, 2006, SCE made Agreement No. 2 available to all of 90 QFs that had previously executed Renewable Fixed Price Agreements (5.37 cent/kWh contracts). SCE subsequently made Agreement No. 2 available to one additional QF that had not previously executed a Renewable Fixed Price Agreement, bringing the total number of QFs eligible for Agreement No. 2 to 91.

Specifically, SCE posted the agreement on its website and emailed copies of the agreement to all of the QFs that had previously agreed to fixed price terms. SCE requested that such parties indicate their interest in receiving such an agreement by the close of business on May 19, 2006 and further indicated that SCE would countersign executed agreements received by the close of business on May 31, 2006. As of May 31, 2006, 59 of the 91 eligible QFs had executed Agreement No. 2 or one of the variants of Agreement No. 2 described above. Subsequently, two additional QFs executed Agreement No. 2, bringing the total number of QFs that executed Agreement No. 2 or one of the variants of Agreement No. 2 to 61.

Power from the 61 QFs represent over 90% of the 2005 energy deliveries from eligible renewable QFs

According to SCE, the 61 QFs include those owned by most of SCE's "major" QF owners and represent over 90% of the 2005 energy deliveries from eligible QFs.[3] In addition, the 61 QFs represent 1,840 MW of May 2006 on-line capacity (AL 2021-E, Appendix F)

Agreement No. 2 provides revenue certainty to renewable QFs and benefits SCE and its customers by providing a physical hedge against natural gas price volatility.

Agreement No. 2 is a voluntary agreement to pay a fixed energy price for five years in lieu of short-run avoided cost (SRAC) energy payments, which vary monthly with the price of natural gas. Agreement No. 2 provides value to both SCE's customers and its QFs by decoupling the energy payments made by SCE

[3] Eligible QFs is the group of renewable QFs to which SCE offered Agreement No. 2. This group includes the 90 renewable QFs currently on the 5.37 cents/kWh Renewable Fixed Price Agreements, along with one additional renewable QF is not currently on a Renewable Fixed Price Agreement. Although the additional QF was offered Agreement No. 2, it did not opt to enter into this contract.

to these QFs from the monthly index price for natural gas. A fixed price has value to renewable QFs, whose operating costs are not tied to the cost of natural gas, because it provides for a greater level of revenue certainty. A fixed price can also provide value to SCE's customers by operating as a physical hedge against natural gas price volatility.

Agreement No. 2 expressly conveys all Environmental Attributes, Capacity Attributes and Resource Adequacy Benefits generated or produced under the contract.

> QF signatories to Agreement No. 2 have expressly agreed to convey "all Environmental Attributes, Capacity Attributes and Resource Adequacy Benefits generated or produced … during the New Fixed Rate Period to SCE … (AL 2021-E, Appendix A, Section 3.4.1).

Pricing under Agreement No. 2 should be compared to a reasonable forecast of future SRAC energy prices.

In the absence of Agreement No. 2, QFs currently on the 5.37 cents/kWh contracts will be paid posted SRAC energy prices commencing on May 1, 2007, when the current five-year Fixed Price Period expires. Therefore, the evaluation of customer benefits from the execution of Agreement No. 2 requires a comparison of pricing under Agreement No. 2 with forecasts of SRAC energy payments over the New Fixed Price Period.

Agreement No. 2 is reasonable for SCE and its ratepayers compared to a reasonable forecast of future SRAC energy prices.

The energy price under Agreement No. 2 is fixed at 6.15 cents/kWh escalated by one percent annually commencing in the second year of the New Fixed Price Period. This equates to a five-year levelized price of 6.26 cents/kWh. On May 3, 2006, the day that SCE concluded negotiations for Agreement No. 2 and reached an agreement in principle with respect to the New Fixed Price, the levelized price of a five-year strip of natural gas on NYMEX plus Southern California basis and intrastate transportation was $8.60/MMBtu at the burner-tip.[4]

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[4] Prices were levelized using a 10.5% discount rate. SCE calculated the gas price on May 3, 2006 as follows: NYMEX at Henry Hub (HH) ($8.947/MMBtu) + SoCal basis (-$0.903/MMBtu) + intrastate transportation ($0.558/MMBtu), resulting in a burnertip gas price of $8.602/MMBtu. Because NYMEX HH was not available for the period January through April 2012, SCE used January through April 2011 prices as proxy.

Footnote continued on next page

SCE calculated breakeven gas prices under the two forecast scenarios discussed below. The respective breakeven gas prices represent 12% lower (at $7.58/MMBtu) and 23% lower (at $6.63/MMBtu) gas prices, as compared with the burner tip forecast of $8.60/MMBtu.

SCE compared the price terms under Agreement No. 2 (a five-year levelized value of 6.26 cents/kWh) with SCE's current SRAC energy formula using two different heat rates:

(1) **Forecasted Scenario 1**: SCE's current Incremental Energy Rate (IER) of 9,140 Btu/kWh with a five-year levelized gas price of $8.60/MMBtu at the burner-tip. This would result in a five-year fixed energy price of 8.06 cents/kWh. The breakeven gas price for this scenario is $6.63/MMBtu. Thus, under this scenario, if gas prices over the next five years average more than $6.63/MMBtu at the burner-tip, and these QFs would have been on SCE's SRAC energy pricing at the 9,140 Btu/kWh heat rate, then Agreement No. 2 results in lower costs..

(2) **Forecasted Scenario 2**: Assume an Incremental Energy Rate of 8,000 Btu/kWh (SCE's SRAC proposal in R.04-04-025) with a five-year levelized gas price of $8.60/MMBtu at the burner-tip. This resulted in a five-year fixed energy price of 7.08 cents/kWh. The breakeven gas price for this scenario is $7.58/MMBtu. Thus, under this scenario, if gas prices over the next five years average more than $7.58/MMBtu at the burner-tip, and these QFs would have been on SCE's SRAC energy pricing at an 8,000 Btu/kWh heat rate, then Agreement No. 2 results in lower costs .

Agreement No. 2 at a levelized value of 6.26 cents/kWh is less than, and therefore more cost-effective, than either forecasted scenario at 7.08 cents/kWh or 8.06 cents/kWh. Of course, the actual benefits that result from committing to

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Because SoCal basis was not available for the period January 2011 through April 2012, SCE used December 2011 SoCal basis as a proxy. Intrastate transportation was forecast as the average of $0.558/MMBtu based on current SoCalGas rates applied to gas futures pricing.

a fixed price contract depend on future natural gas prices. Notwithstanding, there is a reasonable expectation that Agreement No. 2 will provide significant benefits to SCE and its customers, and to renewable QFs.

In addition, Energy Division staff observed that, over the last 12 months, the posted burner tip gas price in SCE's SRAC formula had a levelized value of $7.85/MMBtu, using the same methodology in this AL. Over the next five years, a levelized gas price of $7.85/MMBtu would yield a five-year fixed energy price of 7.37 cents/kWh, where (9,140 Btu/kWh * $7.85/MMBtu) + 0.2 cents/kWh for O&M. Thus, over the next five years, given SCE's current SRAC energy formula, and a burner tip gas price equivalent to prices over the last 12-months for SCE, the proposed contract Agreement No. 2 is still reasonable.

In AL 2021-E, SCE requested that the Commission find "the Agreements and SCE's entry into the Agreements are reasonable and prudent for all purposes, including, but not limited to, SCE's recovery in rates of all payments made under the Agreements, subject only to Commission review of the reasonableness of SCE's administration of the Agreements." We agree with SCE's request, subject to clarification that cost recovery shall be made via the Energy Resource Recovery Account (ERRA) process. In E-4002,[5] we noted that we have previously outlined the process for balancing the ERRA accounts and tracking administration of power procurement contracts, and reaffirm that this process is the correct one for determining rate recovery.[6]

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day

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[5] In E-4002, we approved a tolling agreement between PG&E and Duke Energy Marketing America (DEMA) for electricity and capacity from the Moss Landing generating station, Units 6 and 7.

[6] D.02-10-062 pages 62-64.

period may be reduced or waived upon the stipulation of all parties in the proceeding.

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.

However, as a courtesy, Energy Division will email a copy of this draft to the R.04-04-025 and R.06-05-027 service lists. At the time the AL was filed, SCE mailed copies of AL 2021-E to the two service lists.

FINDINGS

1. SCE filed AL 2021-E on July 28, 2006 requesting approval of 61 fixed energy price agreements with existing renewable QFs with a fixed energy price of 6.15 cents/kWh for a five-year period commencing on May 1, 2007 and ending on April 30, 2012, escalated one percent annually beginning in the second year.

2. D.04-01-050 and D.04-12-048 identified bilateral contract negotiation as an allowable option for QFs facing actual or impending contract expiration.

3. QF capacity payments, whether for as-available power or contractually based, are unaffected by the proposed agreements.

4. The 61 QF signatories to Agreement No. 2 represent over 90% of the 2005 energy deliveries from eligible QFs to SCE, and 1,840 MW of May 2006 on-line capacity (AL 2021-E, Appendix F).

5. Agreement No. 2 expressly conveys the environmental and capacity attributes to SCE, as well as the Resource Adequacy benefits of the projects under contract.

6. Agreement No. 2 provides value to both SCE's customers and its QFs by decoupling the energy payments made by SCE to these QFs from the monthly index price for natural gas. A fixed price has value to renewable QFs, whose operating costs are not tied to the cost of natural gas, because it provides for a greater level of revenue certainty. A fixed price can also

provide value to SCE's customers by operating as a physical hedge against natural gas price volatility.

7. Agreement No. 2 is reasonable for SCE and its ratepayers compared to a reasonable forecast of future SRAC energy prices.

8. The Agreements and SCE's entry into the Agreements are reasonable and prudent. SCE should use the Energy Resource Recovery Account (ERRA) proceeding process to recover in rates the procurement costs related to the Agreements.

9. AL 2021-E was not protested.

10. AL 2021-E should be approved.

THEREFORE IT IS ORDERED THAT:

1. The request of Southern California Edison Company, for approval of 61 fixed-price agreements with existing renewable qualifying facilities with a fixed energy price of 6.15 cents/kWh for a five-year period commencing on May 1, 2007 and ending on April 30, 2012, escalated one percent annually beginning in the second year, as requested in Advice Letter AL 2021-E is approved.

2. Southern California Edison Company shall track expenses incurred from these Agreements in its ERRA account which shall be subject to Commission review via the ERRA proceeding.

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 October 19, 2006; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

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

Commissioner Dian M. Grueneich, being necessarily absent, did not participate.