

Decision **PROPOSED DECISION OF ALJ GAMSON** (Mailed 1/29/2008)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Southern California Edison Company's (U338E)
Application for Approval of Additional Demand
Response Resource Purchase Agreements.

Application 07-10-013
(Filed October 17, 2007)

**ORDER APPROVING FOUR SOUTHERN CALIFORNIA EDISON COMPANY
DEMAND RESPONSE CONTRACTS**

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**ORDER APPROVING FOUR SOUTHERN CALIFORNIA EDISON
COMPANY DEMAND RESPONSE CONTRACTS****1. Summary**

Southern California Edison Company (SCE) proposes eight new third-party dispatchable demand response contracts (the Contracts). We approve four of the eight proposed Contracts, which are cost effective on a portfolio basis. These are the two Ancillary Service Coalition, LLC Contracts, one North American Power Partners, LLC Contract and the EnergyConnect, Inc. day ahead Contract, allowing for up to 190 MW of demand response. We note that the two Ancillary Services Coalition, LLC Contracts have the highest individual cost-effectiveness scores and are structured in a superior way to the other Contracts such that a greater portion of incentive monies earned is through program participation performance, as opposed to enrollment of capacity. In light of the currently developing rules for demand response that are being addressed in Rulemaking (R.) 07-01-041 SCE could consider submitting additional contracts in SCE's June 1, 2008 application for 2009 through 2011 demand response programs, taking into account cost-effectiveness and other standards now being developed in that rulemaking. In addition, nothing in this ruling prevents SCE from continuing bilateral negotiations in order to improve the cost effectiveness of the contracts we do not approve at this time. This decision also denies TURN's request for oral argument.

2. Background

In Decision (D.) 06-11-049, the Commission directed SCE to "pursue Requests for Proposals (RFP) and bilateral arrangements for additional demand

response resources and file an application with the Commission requesting approval for specific contracts by February 28, 2007.”¹ D.06-11-049 adopted a number of demand response programs for SCE and Pacific Gas and Electric Company (PG&E) following a heat storm in 2006 and in anticipation of increased reliance on demand response in 2007 and beyond. In addition to augmenting existing demand response programs, D.06-11-049 directed SCE and PG&E to solicit bids for agreements under which third parties would procure demand response. On May 28, 2007, D.07-05-029 approved five demand response agreements between PG&E and third parties, and one between SCE and EnerNOC.

SCE filed its application for eight additional aggregator contracts and served testimony on October 17, 2007. The Division of Ratepayer Advocates (DRA) filed a protest on November 19, 2007. The Utility Reform Network (TURN), EnerNOC, and Alliance of Retail Energy Markets (AReM) filed responses to the application on November 19, 2007. A Prehearing Conference (PHC) was held on December 7, 2007. SCE served Errata to its testimony on December 1, 2007. SCE served supplemental testimony on December 14, 2007. DRA, TURN and Alternative Energy Resources (AER) served intervenor testimony on December 21, 2007. SCE served Reply Testimony on December 28, 2007. Briefs were filed by SCE, DRA, TURN, AER, EnerNOC and North America Power Partners (NAPP) on January 7, 2008.

R.07-01-041 is the Commission’s Rulemaking on demand response programs. Among other things, this proceeding’s scope includes establishing

¹ See Ordering Paragraph 5 of D.06-11-049.

methodologies to determine the cost-effectiveness of DR programs.² SCE is required to file an application for 2009 through 2011 demand response programs on June 1, 2008.³

3. Scoping Ruling

In the December 18, 2007 Scoping Ruling of Assigned Commissioner and Administrative Law Judge, the following were identified as issues in the proceeding:

1. Are the contracts reasonable and should they be approved?
2. Is SCE's proposed budget for administering the contracts reasonable?
3. Do these contracts adhere to current Commission regulations and guidance?
4. Is SCE's cost recovery and ratemaking proposal reasonable?
5. Should the demand reductions achieved by the contracts count towards the Commission's goals for Edison's demand response program portfolio if such goals are adopted by the Commission?
6. Does SCE have a need for the proposed resources in 2008 and beyond?
7. Are the contracts and administration of the contracts consistent with the likely future wholesale market design? Should the contracts be approved or modified based on expected outcomes or anticipated policy changes to the wholesale market design?

² R.07-01-041, April 18, 2007 Assigned Commissioner and Administrative Law Judge's Scoping Memo and Ruling, p. 3.

³ See D.06-03-024 at p. 20.

8. Should these contracts be approved or modified based on expected outcomes or anticipated policy changes in R.07-01-041?
9. How should the resource adequacy credits associated with the contracts be allocated to the load-serving entities, given previous Commission guidance?
10. Will customers that sign up with aggregators through these programs also be able to participate in dynamic pricing rates such as critical peak pricing or real time pricing, if approved by the Commission in the future?
11. Should the Commission authorize SCE to negotiate changes to the baseline methodology in the event the Commission approves a different baseline methodology?

We will address each of the above issues in this order, to the extent relevant or controversial.

4. SCE's Proposal

SCE seeks approval of eight demand response resource purchase agreements with third party aggregators. The Contracts are estimated to cost \$216 million⁴ and SCE expects them to provide firm, reliable price responsive demand response resources for up to five years beginning in 2008. A summary

⁴ Not including energy payments, estimated at \$47 million, based on expected scenario that all available hours of energy for each resource are dispatched every year at 100% of rated resource capacity during peak months. (SCE Exhibit 1, footnote 6.)

of the public portions of the Contracts is provided as Table 1, taken from SCE's Testimony Table III-1.

PUBLIC REDACTED VERSION

Table 1
Summary of the Contracts

Seller	Ancillary Services Coalition, LLC	Ancillary Services Coalition, LLC	Alternative Energy Resources, Inc.	EnergyConnect, Inc.
DR Type	Dispatchable Demand Response (aggregated bundled, Direct Access (DA) and Community Choice Aggregation (CCA) customer load)	Dispatchable Demand Response (aggregated bundled, Direct Access and CCA customer load)	Dispatchable Demand Response (aggregated bundled, Direct Access and CCA customer load)	Dispatchable Demand Response (aggregated bundled, Direct Access and CCA customer load)
Size	Up to 50 MW by 2011	Up to 45 MW by 2011	Up to 50 MW by 2010	Up to 20 MW by 2010
Dispatch Notice	[REDACTED] day ahead	[REDACTED] day of	[REDACTED] day of	[REDACTED] day of
Trigger	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Delivery Period	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Duration per Event	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Maximum Event	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Capacity Credit Rate	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Baseline	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program
Energy Credit Rate	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Delivered Energy Payment Calculation	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program
Delivered Capacity Payment Calculation	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program
Penalties	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program	Same as SCE's Capacity Bidding Program
Payment	No later than 60 days after Operating Month	No later than 60 days after Operating Month	No later than 60 days after Operating Month	No later than 60 days after Operating Month
On-Line Date	Upon Commission approval	Upon Commission approval	Upon Commission approval	Upon Commission approval
Term of Contract	5 Years	5 Years	5 Years	4 Years
Termination	If not approved by Commission by February 29, 2008; otherwise for cause	If not approved by Commission by February 29, 2008; otherwise for cause	If not approved by Commission by February 29, 2008; otherwise for cause	If not approved by Commission by February 29, 2008; otherwise for cause

The Contracts would become effective upon the Commission's final approval. However, to the extent final Commission approval has not been received by April 30, 2008, the Contracts would terminate under their own terms.⁵

SCE states that the Contracts in this Application are the final negotiated results of an open market Request For Offers (RFO) that initially procured seventeen indicative offers for demand response resources from nine third-party aggregators. Based on least cost/best fit principles and conformance with SCE's contract terms and conditions, SCE selected eight separate Contracts with six different third-party providers for inclusion in this Application.

The Contracts include a combination of demand response dispatchable products that SCE contends can deliver approximately 100 megawatts (MW) for summer 2008 and as much as 438 MW for the summer of 2011, on a firm contract basis with penalties to ensure performance. The Contracts are bilateral in nature, and the dispatch characteristics, terms and conditions are fixed for the term of the resource delivery through 2012. SCE opines that the demand response resources available from these Contracts will add significant price response to SCE's demand response portfolio next year and in the future, and will help SCE achieve its current price response goal of 5% of peak load. The Contracts provide either "day-of" DR resources (where dispatch occurs on the same day as the need for the load relief), or "day-ahead" DR resources (where dispatch occurs the day before the load curtailment is needed).

⁵ SCE's Application contained a termination date of February 29, 2008. In a report sent to the service list dated March 4, 2008, SCE indicated that it extended the termination date of the Contracts to April 30, 2008.

Key terms and conditions of the Contracts are as follows:

- SCE has the exclusive right to the capacity and energy for the delivery periods under the Contracts.
- The Contracts provide SCE with firm monthly capacity nominations of demand response load reductions at fixed capacity rates that typically increase during the critical summer months and decrease during the less critical winter months, depending on the resource provided. The monthly load reduction nominations from each of the counterparties are firm for the duration of the Contract, are not subject to temperature adjustment, and are mutually exclusive of other contracts and other SCE demand response programs. As such, the full nominated load reductions are available at the start of each operating month and can be dispatched according to the terms of the Contracts. The capacity payments are reservation payments, meaning that the payments are made for the availability of demand reduction capability even if the load reductions are not dispatched. Penalties apply if the Contract capacity is dispatched and less than the nominated load reduction is delivered.
- The Contracts also provide payments for reduced energy consumption during the dispatch at set prices. Similar to the capacity payments, there can be a penalty if full performance is not achieved and energy is not dispatched (shortfall energy) for which the counterparty is billed. If more than the contracted amount of load is dispatched, capacity payments are fixed at the contract amount, but energy can be reimbursed up to 150% of the contract load nomination, at the contract price.
- The determination of the reduced capacity and energy for the settlement process is made using the ten day baseline approach, similar to the SCE Capacity Bidding Program for aggregators. Ten similar days prior to the dispatch are used to develop the baseline hours for each resource under contract, and each aggregator nominates a group of customers into the aggregated resource five days before the operating month. The baseline is

only developed for that nominated group for that specific month, not for the entire customer group. The baseline methodology is not adjusted for temperature or customer conditions, and is verified by SCE upon submittal for payment using individual customer interval meter data.

5. Intervenor Testimony

AER contends the contracts are needed for this summer and in the next five years, the contracts are consistent with future wholesale market design, and the contracts are reasonable and should be approved. EnerNOC supports SCE's application, representing that it is more cost-effective than as shown by SCE's analysis.

DRA recommends the Commission not approve the Contracts. DRA contends the Contracts are not reasonable and are not needed in the short term because SCE has adequate reserve margins and contracted DR resources for the summer of 2008. Alternatively, DRA argues the Commission should only approve two Contracts with ASC that SCE has shown to be cost-effective based on the Cost-Effectiveness Evaluation Framework under consideration in R.07-01-041.

TURN contends SCE has no need for the additional resources that would be procured through the Contracts for at least 2008 and 2009, either for system reliability purposes or to meet the Resource Adequacy requirements of its bundled service customers. Thus, TURN argues that approval of these contracts would represent the purchase of an expensive and unnecessary insurance policy that costs much more than customers would be willing to pay for such insurance if given the choice.

6. Discussion

This application stems from D.06-11-049, which was also the impetus for the applications approved in D.07-05-029. When we approved five PG&E demand response contracts and one SCE demand response contract in D.07-05-029, we relied on concerns about reliability for the summer of 2007, stemming from the previous year's heat storm. In D.07-05-029, we did not factor in cost-effectiveness in our decision to approve those contracts because of the overwhelming concern that sufficient resources be available to meet system and local reliability needs for summer 2007.

However, there are certain differences in this application compared to that in D.07-05-029. First, another year has passed since the 2006 heat storms, with no comparable events occurring in 2007. Second, we have more information about SCE's need for resources in future years. Third, we are further along with considering demand response cost-effectiveness methodologies in R.07-01-041. Fourth, SCE is required to file an application for 2009 through 2011 demand response programs in June 2008. With these considerations in mind, we will review the record in this proceeding.

6.1. Four Contracts Should be Approved

As discussed above, both TURN and DRA's main recommendation is rejection of all the Contracts. Yet, as an alternative solution, TURN believes one of the ASC contracts can be approved at this time based on cost-effectiveness while DRA believes both of the ASC contracts can be approved at this time. The difference between the TURN and DRA recommendations is that one of the ASC Contracts is more cost-effective sooner. However, both ASC Contracts are significantly better in terms of cost-effectiveness than any of the other Contracts.

In comments to the proposed decision, SCE suggests the Commission should consider approving a portfolio approach to cost-effectiveness. SCE's data in Confidential Appendix D of its testimony shows that two of the Contracts (NAPP and ECI day-ahead) can be combined with the two ASC Contracts to form a cost-effective portfolio, under the Framework's methodology.

We have determined that we will neither accept nor reject any of the Contracts solely because of cost-effectiveness results by any of the measures in the record. However, everything else being equal, we look more favorably at Contracts which are more cost-effective. Having reviewed SCE's confidential cost-effectiveness data, we find that the ASC Contracts perform the best on the various cost-effectiveness tests. Therefore, these two Contracts merit further review. We now will consider whether there are additional factors which distinguish either or both of these two Contracts from the four Contracts we reject at this time.

Comparing the ASC Contracts to the other proposed Contracts, the record shows the ASC Contracts structure is performance weighted. Our review of the confidential material in the record shows that participants under the ASC contract will receive a greater part of their incentive monies for performance as opposed to reservation of capacity. This unique structure among the eight Contracts enables the ASC Contracts to exhibit superior cost effectiveness.⁶ Well-designed performance incentives are an important factor in demand response programs, due to the imperative that the program operates as anticipated when called upon. The ASC Contracts are structured in such a way

⁶ The supporting information is found in both redacted and unredacted form in SCE's Testimony of L. Oliva, Table III-1.

as to provide greater confidence that the demand response will appear when needed.

Relatively cost-effective demand response programs which confidently can be relied upon to perform as expected are useful to ratepayers and the overall grid even without a reliability need. This usefulness occurs because an effective reasonably-priced demand response program can substitute for more expensive and/or less reliable resources when called upon. We find that the two ASC Contracts will provide overall benefits based upon their combination of program design and relative cost-effectiveness characteristics. Therefore, we will approve the two ASC Contracts.

In addition, the NAPP and ECI day-ahead Contracts, when combined with the ASC Contracts, make up a cost-effective portfolio under the TRC test of the Framework. Neither the NAPP Contract nor the ECI day-ahead Contract exhibit the favorable performance structures of the ASC Contracts. However, our policy preference for moving toward a demand response goal of 5% of system peak load leads us to look favorably upon a portfolio of cost-effective Contracts. Therefore, we will also approve the NAPP and ECI day-ahead Contracts. However, we note that, as the load impact protocols and cost effectiveness measures become more developed, we intend to move away from approval of demand response programs based on a portfolio approach. The improvements to our demand response rules that are currently being developed in R.07-01-041 will add significant transparency to our overall program goals and evaluation of individual contracts and programs.

6.2. The Contracts Include Innovative Demand Response Elements

SCE contends the Contracts meet the Commission's objective to add innovative third-party resources to SCE's portfolio. SCE points to D.06-11-049 and D.07-05-029 as decisions where the Commission demonstrated a commitment to establishing third-party demand response resources that can unleash innovative ways to increase customer participation in price responsive demand response. While SCE admits the third-party Contracts in this application are more costly than traditional demand response resources, SCE contends the Commission has previously taken and should here take a longer-term view of the value of these Contracts, anticipating that the costs may come down over time as the demand response market continues to develop.

Each Contract involves a third-party aggregator which would target specified customers for dispatchable demand response programs for aggregated bundled Direct Access and Community Choice Aggregation customer loads to reduce demand at peak times in ways appropriate for those customers. AER notes that the Contracts have firm, dispatchable, ramping trigger provisions that enable activation by a direct dispatch signal or by response to price. The Contracts vary in their delivery periods, the duration per event, the maximum number of events per month and year, and their pricing terms.

SCE is correct that we support innovative third-party demand response programs, just as we also support innovative third-party energy efficiency programs (and innovative utility programs). In D.07-05-029, we stated that the contracts in the underlying demand response applications "have resulted in

innovative demand response agreements,”⁷ and found that “the agreements may provide valuable experience with alternative ways of procuring and managing demand response programs.”⁸ The third-party Contracts in this application have similarities to the contracts approved in D.07-05-029. SCE has shown that the Contracts have terms (some of which are confidential) that provide SCE both operational flexibility and the ability to be dispatched for reliability and price response needs. We are encouraged to find these Contracts contain innovative terms. However, innovation is not sufficient to allow approval. We consider this a supporting factor in considering the Contracts, not a dispositive factor.

6.3. The Contracts Help SCE Meet its 5% Goal of Price Responsive Demand Response, but this Goal Alone is Not a Sufficient Rationale for Approving all of the Contracts

SCE contends the Contracts are needed in 2008 to help achieve the Commission’s goals for price responsive DR in 2008. Extending out from the goals set forth in D.03-06-032, SCE cites the Commission’s demand response goal for 2008 of 5% of total system peak load. While the Commission’s 2007 goal was 5%, the Commission has not adopted a demand response goal for 2008.⁹ For reasons of resource adequacy, D.07-12-052 adopted the 5% goal for 2008 stating, “We emphasize here that the IOUs should continue to aggressively increase their

⁷ D.07-05-029 at p. 12.

⁸ D.07-05-029, Finding of Fact 6.

⁹ In R.07-01-041, the Assigned Commissioner’s and Administrative Law Judge’s Scoping Memo and Ruling, dated April 18, 2007, discussed extending the 2007 goal of 5% of system peak load to 2008.

DR portfolios to meet the 5% system peak demand goal until the goal is otherwise modified in R.07-01-041 or any subsequent DR proceedings.”¹⁰

SCE calculates a 5% demand response goal to equal nearly 1,200 MW for 2008. SCE’s testimony shows that, as of August 31, 2007, its portfolio had approximately 256 MW of price responsive load. With the proposed Contracts and other programs, SCE shows a potential of reaching the 1,200 MW goal by 2013.¹¹

SCE’s desire to meet the Commission’s demand response goal is commendable. Demand response is one of the priorities in the loading order we endorsed in the Energy Action Plan, after energy efficiency. However, movement toward our quantitative demand response goal cannot be considered in a vacuum. For example, TURN believes the demand response goals assume that such price responsive demand will be cost-effective.¹² As discussed herein, TURN’s view is supported by D.06-11-049 (the original impetus for this Application), in which the Commission stated that “seeking proposals directly from customers and aggregators could potentially unleash innovative and cost-effective demand response technologies and activities.”¹³ This argument is also supported by D.07-05-029, which stated “The Commission hoped that the utilities’ solicitations would result in cost-effective demand response proposals.”¹⁴ Thus, SCE’s argument that we should approve the Contracts to

¹⁰ D.07-12-052 at pp. 63-64.

¹¹ SCE Testimony of L. Oliva, pp. 15-16.

¹² TURN Prepared Direct Testimony of Michel Peter Florio, p. 7.

¹³ D.06-11-049 at p. 44.

¹⁴ D.07-05-029 at p. 12.

help meet demand response goals is useful more as a supporting argument for approval of the Contracts than as a primary rationale.

The Commission's 5% demand response goal was created in 2003 to add a "tool to our regulatory tool chest."¹⁵ The goal was adopted while the Commission was contemplating dynamic pricing tariffs for large commercial and industrial customers.¹⁶ At the same time, the Commission was contemplating the implementation of the Advanced Metering Initiative.¹⁷ The related goals of 5% of peak demand reduction, price responsive demand response, and dynamic pricing for large commercial and industrial customers were adopted by the Commission as a vision document entitled "California Demand Response: A Vision for the Future (2002-2007)." Thus, the 5% percent goal was set when it was "anticipated many customers would have the advanced metering necessary to participate in price-responsive programs."¹⁸ This is not yet the case in SCE's territory.

Our primary interest in setting the demand response goals was to support the use of demand response resources as part of a clean, reliable, cost-effective, integrated set of utility resources. We did not, and do not now, intend for our demand response goals to be an open door through which any demand response program may enter, regardless of adherence to cost, reliability and related critical criteria. To the extent that the Contracts are appropriate based on such criteria as cost and reliability (or other appropriate criteria), the Contracts will

¹⁵ D.03-06-032 at p. 11

¹⁶ See D.03-06-032, pp. 17-26.

¹⁷ See Attachment A, D.03-06-032

¹⁸ *Id.* at pp. A-4 - A-5.

help meet our demand response goals for SCE. To the extent that the Contracts do not meet our other criteria, we will not approve them simply to move toward these goals.

6.4. Relationship of the Contracts to Long Term Procurement, System Reliability Needs and the 2009-2011 Program Proposals

In D.07-12-052, the Commission's most recent decision on long-term portfolio plans (LTPP), the Commission looked at the need for additional resources from the perspectives of system reliability and bundled customer need. The system reliability need involves determining whether there are sufficient existing and anticipated resources available in the utility's overall electric service territory, in conjunction with the state's other electric utilities, to meet the Commission's established 15-17% planning reserve margin and allow all Load Serving entities (LSEs) access to a sufficient pool of resources to meet their individual resource adequacy needs. If existing and anticipated physical resources are deemed insufficient, utilities are authorized by the Commission to develop new system reliability resources. The bundled customer need requires the utility to meet the procurement needs of its bundled service customers in the near term and meet its individual Resource Adequacy obligations, including a 15-17% planning reserve margin, by contracting for new and existing physical system resources. Consequently, even if sufficient physical resources exist within a utility's service territory for system reliability purposes, it is possible for the utility to have a contractual need that could be filled with a new resource, such as a demand response program, rather than contracting with available existing physical resources such as older inefficient gas-fired plants.

In granting authority for new procurement, D.07-12-052 also states that, “(w)e make abundantly clear that any procurement authority granted herein shall in no way be used by the IOUs to instead reduce or adversely impact procurement of EE, DR, renewables, or QF resources to the maximum extent feasible.” (D.07-12-052, p. 103.) Due to the long lead time needed to develop new electricity plants, the LTPP proceeding approves sufficient conventional resources to meet the PRM, up to 7 years in advance of when the resources are actually needed. Conversely, the Energy Action Plan resources are planned for on a shorter term program and development cycle. Accounting for these two planning mechanisms separately or in isolation may result in a preferred loading order resources shortfall or possible exclusion.

To ensure that procurement authority granted in the LTPP proceeding is consistent with the policies developed in the EAP and does not instead crowd out the development of future DR, SCE should strive to continue its efforts to encourage third party participation in its demand response procurement through its planning for demand response programs in the 2009-2011 program plans. The recent Administrative Law Judge’s Ruling Providing Guidance on Content and Format of 2009-2011 Demand Response Activity Applications, along with guidance on load impact and cost-effectiveness, should be used to provide the specific direction on program design and Commission expectations consistent with this decision.

DRA contends the Contracts are not needed for 2008. DRA notes that SCE admits that it owns or has under contract approximately 430 MW of additional resources over and above its required planning reserve margin. Further, DRA

points out that SCE's LTPP does not count an additional 40 MW of demand response resources for 2008.¹⁹

TURN claims that SCE has no need for the additional resources of the Contracts for at least 2008 and 2009, either for system reliability purposes or to meet the Resource Adequacy requirements of bundled service customers.²⁰ TURN notes that D.07-12-052 did not identify any physical need for SCE until the year 2013.²¹ That Decision also found a resource surplus of 925 MW in the SCE territory in 2008, projected to increase to 1065 MW in 2009.²² Thus, TURN claims the SCE service territory will have sufficient resources to meet all customer demand and more than cover the 15–17% planning reserve margin without any of the resources provided under the Contracts for 2008 and 2009, or for several years thereafter.²³ Further, TURN argues that SCE does not have a contractual need for the Contracts in order to meet its bundled customers' System or Local Resource Adequacy requirements in 2008 or 2009.²⁴ This claim is based on confidential information provided to Florio via his participation in SCE's Procurement Review Group, and set forth in Confidential Appendix A to Florio's testimony. In reviewing the confidential material, we find factual support for TURN's claim.

¹⁹ DRA Prepared Testimony of David Peck, p. 7.

²⁰ TURN Prepared Direct Testimony of Michel Peter Florio, p. 2.

²¹ See D.07-12-052, p. 117.

²² *Id.*

²³ TURN Prepared Direct Testimony of Michel Peter Florio, p. 4.

²⁴ *Id.*, p. 4-5.

SCE agrees that its planning reserves are at adequate margins for the summer of 2008. SCE also acknowledges that D.07-12-052 found there was no need for new physical resources in Southern California during the period of the Contracts.²⁵ Responding to questions from the Administrative Law Judge (ALJ), SCE claims that the Contracts will help address its need for additional resources to meet expected reserve margins for 2009 through 2012.²⁶ However, even though SCE's response to the ALJ references SCE's Testimony, the Testimony itself provides no support for this statement other than a reiteration of the statement. SCE's Testimony states:

As for resource adequacy needs, SCE's planning reserves for 2008 are at adequate margins. The Contracts will help SCE meet its planning reserves for 2009-2012. Although, SCE has met its planning reserve margin for 2008, SCE believes that the issue of whether the Contracts are needed for system planning purposes is overridden by the Commission's preference for clean, environmentally friendly alternatives to meet peak requirements.²⁷

SCE further contends that, while it does not need the Contracts for system reliability purposes, the Contracts will help to meet resource adequacy capacity needs in the 2008-2012 period.²⁸ SCE explains that this capacity need refers to the capacity SCE is required to own or have under contract to meet the needs of its bundled customers. However, SCE provides no evidentiary support for any resource adequacy capacity needs it asserts the Contracts will help meet, instead

²⁵ SCE December 28, 2007 Rebuttal Testimony of L. Oliva, p. 1.

²⁶ SCE December 14, 2007 Supplemental Testimony, Responding to Questions of the Administrative Law Judge, p. 1.

²⁷ SCE Testimony of L. Oliva, p. 16.

²⁸ SCE Rebuttal Testimony of L. Oliva, pp. 1-2.

again citing several other purported benefits of the Contracts (e.g., meeting demand response goals).

While the Contracts as a group are not necessary at this time for reliability, the impetus for our exhortation in D.06-11-049 for SCE and others to seek out further demand response contracts was concern about reliability for the summer of 2007. SCE did sign one demand response contract for 2007, approved in D.07-05-029. In D.07-05-029, we stated “SCE should continue pursuing negotiations with other potential counterparties and file an application to seek Commission approval for any additional executed demand response agreements.”²⁹ SCE was able to show a need for its 40 MW demand response contract in 2007. SCE has not shown a need for an additional 118 MW in eight new demand response Contracts for 2008 (increasing up to 453 MW in 2011).

²⁹ D.07-05-029 at p. 15.

6.5. Approval of Four Demand Response Contracts will further the Commission's Goal of Increasing Cost Effective Demand Response While Balancing the Need to Guard Against Shortages During Summer Peak Periods

Demand response can act as a buffer, not only against peak energy prices, but against resource shortage. We have long considered it prudent for electric utilities to maintain resources above the level necessary to meet expected peak demand. Our current policy explicitly requires a planning reserve margin of 15-17% above expected peak levels. This planning reserve margin provides a reasonable level of what can be considered "insurance" to protect against extreme weather, generation outages and other contingencies.

SCE cites D.07-01-041 as an example of the Commission approving a power purchase agreement for SCE to come on line in summer 2007, even though the Commission found that SCE had already met its planning reserve margin for that summer. In D.07-01-041, the Commission found it prudent and reasonable for SCE to acquire capacity above planning reserve margins to provide an “insurance policy” against rolling outages during summer peak periods.³⁰ SCE claims experience in July 2006 and September 2007 demonstrated that the weather is unpredictable and system reliability events can occur as a result of extreme temperatures. SCE contends the Contracts can provide firm demand response resources that can be called upon in short notice (the Contracts are mostly dispatchable “day-of” resources) in the event of unplanned and unexpected events in 2008.³¹

TURN notes that D.07-12-052 shows a projected planning reserve margin for SCE’s service territory above 20% until 2011. TURN points out that the planning reserve margin provides a 15–17% margin of safety above projected peak demand, thus already providing the amount of insurance that is prudently required to prevent blackouts. TURN claims that to add additional resources beyond the planning reserve margin would force customers to pay for more insurance than they want or need.³²

SCE has presented no evidence that either Commission policy or industry conditions require resources as additional insurance above and beyond the planning reserve margins already embedded into SCE’s resource mix. For

³⁰ See D.07-01-041, Finding of Fact 17 and Conclusion of Law 4.

³¹ SCE Testimony of L. Oliva, pp. 16-17.

example, in D.07-05-029, the Commission found that “the CAISO anticipates a small but significant probability of a Stage 3 emergency occurring in Summer 2007.”³³ No similar evidence for 2008 or beyond was presented in this proceeding. Further, the evidence shows that SCE already has sufficient resources to meet and exceed its planning reserve margin through at least 2012. We find there is no need for the Contracts as a whole as insurance against rolling outages during summer peak periods.

6.6. Cost-Effectiveness Data Should be Used as Supporting Evidence

In D.06-11-049, the Commission believed that “seeking proposals directly from customers and aggregators could potentially unleash innovative and cost-effective demand response technologies and activities.”³⁴ In D.07-05-029, the Commission expressed its hope “that the utilities’ solicitations would result in cost-effective demand response proposals,”³⁵ while acknowledging a lack of sufficient information to determine whether or not the contracts in that Application were cost effective.

There is not currently a Commission-approved cost-effectiveness methodology specifically for demand response resources. The cost-effectiveness tests that have been used in recent years for demand response resources are derived from energy efficiency cost-effectiveness measures. These are the Total Resource Cost (TRC) test, the Ratepayer Impact Model (RIM) and the Program

³² TURN Prepared Direct Testimony of Michel Peter Florio, pp. 5-6.

³³ D.07-05-029 Finding of Fact 3.

³⁴ D.06-11-049 at p. 44.

³⁵ D.07-05-029 at p. 12.

Administrator Test (PAC). The energy efficiency Standard Practice Manual (SPM) TRC test was used by SCE in Application 07-02-033, SCE's recent demand resource response purchase agreement application, leading to D.07-05-029. As EnerNOC discusses, the TRC test does not fully account for all of the benefits of demand response resources. For example, it does not take into account environmental benefits, transmission and distribution benefits, or updated capacity value benefits.³⁶

The Commission is currently developing of a more robust cost-effectiveness methodology for demand response programs in R.07-01-041. No decision has been reached yet. However, a Demand Response Cost Effectiveness Evaluation Framework (the Framework) was filed on November 19, 2007 in R.07-01-041 as a consensus document among parties in that proceeding. Among other things, this Framework incorporates additional benefits beyond the TRC test, including a default transmission and distribution adder, updated avoided cost values, and changes to the avoided cost calculation. However, the Framework does not provide consensus quantification of each element of the methodology (most notably, the avoided cost input), leaving calculations based on the Framework to include inputs developed differently by different parties. Furthermore, we have yet to reach a decision in R.07-01-041 on whether to approve the Framework. Therefore, while the Framework provides further information for evaluating cost-effectiveness in this proceeding, we cannot dispositively rely on Framework-based calculations here.

³⁶ Response of EnerNOC to SCE Application, pp. 4-6.

SCE's testimony shows the Contracts collectively are not cost-effective under the energy efficiency SPM TRC test, the RIM test, or the PAC test, either for 2008 or any other year.³⁷ However, as discussed in D.07-05-029, the Commission acknowledges that these tests may miss many potential benefits of demand response agreements.³⁸ SCE also performed two analyses of the cost-effectiveness of the Contracts based on the Framework (with certain non-consensus SCE-provided inputs), using updated information for greenhouse gas benefits in one, and for greenhouse gas benefits and transmission and distribution benefits in the other.³⁹ Again, collectively, SCE's testimony shows that the Contracts are not cost-effective under the Framework's SPM TRC test, the RIM test, or the PAC test, either for 2008 or any other year under either scenario.⁴⁰

DRA and TURN recommend that all of the Contracts be rejected based on lack of cost-effectiveness. However, TURN believes it would be reasonable for the Commission to approve one contract based on a confidential cost-effectiveness analysis developed by SCE under the Framework (although TURN questions SCE's assumptions in its Framework cost-effectiveness

³⁷ SCE December 14, 2007 Supplemental Testimony, Responding to Questions of the Administrative Law Judge, Table II-2.

³⁸ D.07-05-029 at p. 13.

³⁹ We note there has been a general acceptance among the parties in R.07-01-041 that transmission and distribution and greenhouse gas adders should be factors included in the cost effectiveness protocols. However, there has not been a Commission decision on their inclusion in the cost effectiveness protocols nor how to include them. Thus, SCE inclusion of them in their evaluation of the application is useful as a metric, but not conclusive.

analysis).⁴¹ This is the day-ahead contract with Ancillary Services Coalition (ASC). DRA suggests that the Commission, if it did not wish to reject all the Contracts, could approve both the day-ahead and day-of contracts with ASC based on SCE's confidential cost-effectiveness data.

SCE contends the Contracts are, on a portfolio basis, comparable in cost effectiveness, and are similar in their operation and design, to SCE's Capacity Bidding Program for third party aggregators. SCE states that since R.07-01-041 has not yet articulated specific cost-effectiveness requirements for DR program authorization, the Commission could approve third-party DR resources that are not cost-effective by the Framework's (or other) methodology if the Commission finds the resources are innovative, nascent programs that hold the promise of long-term ratepayer value.⁴² SCE points to D.07-05-029 in which the Commission approved eight demand resource contracts, even though the Commission could not determine if they were cost-effective.⁴³ Similarly, EnerNOC asserts that it is unreasonable to reject the Contracts as not cost-effective based on the Framework, as it is untested and has not yet been approved by the Commission.⁴⁴ EnerNOC, AER and NAPP argue that the Framework does not capture all of the benefits of demand resources.⁴⁵

⁴⁰ SCE December 14, 2007 Supplemental Testimony, Responding to Questions of the Administrative Law Judge, Table II-3 and Table II-4.

⁴¹ TURN Testimony of Jeffrey Nahigian, pp. 3-4.

⁴² SCE December 28, 2007 Rebuttal Testimony of L. Oliva, pp. 3-5.

⁴³ See D.07-05-029, at p. 12, 14.

⁴⁴ EnerNOC December 28, 2007 Rebuttal Testimony of Richard H. Counihan, pp. 8-9.

⁴⁵ NAPP Brief, pp. 5-6.

We find that the Contracts are not cost-effective based on currently-adopted SPM cost-effectiveness methodologies. However, as in D.07-05-029, we will not reject the Contracts solely on the basis of energy efficiency-based tests of cost-effectiveness, because we cannot find that these tests are fully appropriate for demand resources. As noted, we are considering adopting a new, more robust and appropriate demand resource cost-effectiveness test in R.07-01-041. Yet, we have not yet adopted a new test. Moreover, as a whole, the Contracts do not pass the Framework's cost-effectiveness test. We find that six of the individual Contracts do not meet the proposed Framework's cost-effectiveness test which is being considered in R.07-01-041, while two of the Contracts (the ASC Contracts) may or may not meet this test (depending on confidential data and differing assumptions).⁴⁶ We find that under any of the tests, the ASC Contracts have the best cost-effectiveness scores.

We will not reject any of the Contracts which do not pass the cost-effectiveness test based on the proposed Framework in R.07-01-041 solely on the basis of not passing this test. Nor will we approve any of the Contracts based on passing this test. It is too speculative to assume the Commission will adopt this test, the Framework appears not to be fully developed as yet, and, if adopted, we will not apply the Framework retroactively. At the same time, the Framework constitutes the most robust cost-effectiveness test in the record. We will consider the cost-effectiveness evidence in this case as a factor, but not as the

⁴⁶ SCE Testimony, Confidential Appendix D

determining factor. In this way, we look more favorably upon the two ASC contracts which perform the best under the Framework test.

The Contracts can also be evaluated for cost-effectiveness on a portfolio basis. That is, combinations of Contracts may be cost-effective as a group, even if some of the individual Contracts in the group are not cost-effective. From SCE's testimony (Confidential Appendix D), using the most generous measurement (the TRC test) in the Framework methodology, a cost-effective portfolio includes the ASC Contracts, the NAPP Contract and the ECI day-ahead Contract. Substituting any other Contract for any of these, or adding any other Contract to this list, results in a portfolio which is not cost-effective under this methodology or any other methodology in the record.

6.7. There is Insufficient Evidence to Evaluate Environmental Factors

SCE claims the Contracts would further California's policy of providing reliable energy resources while mitigating environmental impacts. SCE claims this would occur because the Contracts provide additional on-peak capacity for summer days with smaller environmental impact than those of peaker plants or emergency generators that would otherwise be called upon to meet this load.⁴⁷ DRA questions whether these benefits will occur, citing what it characterizes as underutilization of SCE's current demand response contract with EnerNOC.⁴⁸

It is possible that the Contracts would provide environmental benefits, depending upon when, where and how the programs associated with the Contracts would perform. However, SCE provides no specific evidence of

⁴⁷ SCE Testimony of L. Oliva, p. 17.

⁴⁸ DRA Prepared Testimony of David Peck, p. 12.

environmental improvements to support its claims. NAPP claims that demand response is a clean energy source that can reduce greenhouse gas emissions, and can also eliminate other air pollutants emitted by power plants.⁴⁹ We agree that the potential environmental benefits of demand response programs are one of our motivations for development of demand resource programs in California. However, NAPP presents no specific evidence concerning particular environmental benefits of the Contracts in this application.

6.8. Four of the Contracts Should Not be Approved at this Time

Four of the Contracts are not cost-effective by any measure in the record. Two of the Contracts are individually cost-effective under Framework assumptions. On a portfolio basis, four of the Contracts are cost-effective (including the two which are individually cost-effective), under Framework assumptions. In sum, there is no compelling rationale for approval of four Contracts which are not cost-effective individually or as part of any portfolio under any methodology in the record.

We maintain our policy of generally encouraging innovative demand response programs, consistent with the Energy Action Plan⁵⁰ and our demand response goals. We encourage SCE to propose new/renegotiated 3rd party contracts for each of the programs associated with the four unapproved Contracts in its June 1, 2008 Application for 2009 through 2011 demand response programs, to the extent that these programs can be made cost-effective based on whatever methodology is adopted in R.07-01-041. This will allow the

⁴⁹ NAPP brief, p. 3.

⁵⁰ See Energy Action Plan II, October 2005, p. 2.

Commission the opportunity to evaluate all of SCE's existing and proposed demand response programs together, while looking more comprehensively at SCE's demand response needs.⁵¹

Our action here is in no way meant to signal a Commission preference for or against 3rd party aggregators in our overall Demand Response program. Indeed, we see benefit to moving forward with programs that are administered by both 3rd parties as well as our utilities. Our decision simply demonstrates the inherent difficulty in balancing state policy preferences (such as 5% price responsive DR) with our responsibility to provide reliable, cost effective electricity service to California's ratepayers.

6.9. SCE's Cost Recovery Proposal is Reasonable

SCE proposes cost recovery for the Contracts through the existing Base Revenue Requirement Balancing Account (BRRBA). In addition, SCE proposes to establish a one-way Demand Response Purchase Agreement Balancing Account (DRPABA) to record the difference between the authorized administrative costs associated with the Contracts and the actual administrative costs. This one-way balancing account would return to ratepayers any excess administrative costs above actually incurred administrative costs. When the Contracts' resources are dispatched and the resulting reduced energy is used by SCE to meet bundled service energy requirements, SCE proposes the costs of such energy will be recorded in SCE's Energy Resource Recovery Account

⁵¹ The June 1, 2008 SCE Application for 2009-2011 demand response programs, along with simultaneous Applications by other utilities, will be guided by our forthcoming decisions in R.07-01-041. Nothing in today's Order should be considered precedential for future demand response proceedings.

(ERRA). The details of SCE's cost recovery proposal are explained in SCE's Testimony.⁵² No party disputes SCE's cost recovery proposal.

Overall, SCE's proposed ratemaking is reasonable because it ensures that SCE recovers no more and no less than the actual, reasonable capacity payments and administrative costs of the Contracts. Because we are approving only four of the eight Contracts at this time, SCE's cost recovery mechanism will apply only to the four approved Contracts. The approved costs are those delineated in SCE's Confidential Appendix D of its October 17, 2007 testimony for the four approved Contracts, plus associated administrative costs.

SCE proposes to administer the Contracts as part of its existing 2006-2008 demand response program portfolio as well as its 2009-2011 demand response portfolio, which SCE expects to seek Commission approval of in 2008, and its 2012-2014 portfolio, of which SCE expects to seek Commission approval in 2011. As such, SCE requests that the demand reductions achieved by the Contracts count towards the Commission's goals for SCE's demand respond program portfolios if and to the extent such goals are adopted by the Commission. SCE's request is unopposed and is similar to authority found reasonable in D.07-05-029.⁵³ We find SCE's request to be reasonable here as well, as applied to the four approved Contracts.

7. Categorization and Motions

The Commission's Resolution ALJ 176-3189 categorized this proceeding as ratesetting, requiring no evidentiary hearings. The December 18, 2007 Scoping

⁵² See SCE Testimony of D. Snow, pp. 22-25.

⁵³ D.07-05-029, Conclusion of Law 4.

Memo affirmed that categorization and no need for hearing. The Commission held no evidentiary hearing in this proceeding. This order affirms ALJ Gamson's Ruling of January 10, 2008 denying DRA's Motion for evidentiary hearings, and all other Rulings.

8. Comments on Proposed Decision

The proposed decision of the ALJ 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 February 20, 2008 by AREM, SCE, NAPP, DRA, EnerNOC and EnergyConnect, Alternative Energy Resources, and Energy Curtailment Specialists, and reply comments were filed on February 25, 2008 by DRA, SCE and EnerNOC.

In Reply Comments, DRA supports the proposed decision. DRA believes the proposed decision committed factual and legal error by excluding provisions to make the approved contracts more reliable and cost-effective. Other commentors believe the proposed decision should be modified to approve more than two of the eight proposed contracts. SCE suggests the Commission should consider approving a portfolio approach to cost-effectiveness, and recommends approval of all contracts that, as a portfolio, still meet the benefit/cost ratio of 1.0. NAPP claims the proposed decision errs because its findings of fact that the contracts are not cost-effective as a whole, and there is no immediate need for the contracts for reliability purposes, conflict with Commission policies and decision, concerning the need for price-responsive demand response program. EnerNOC makes similar claims. EnergyConnect claims all of the eight contracts are cost-effective, when measured against current construction costs for new generating capacity. AREM seeks modification of the proposed decision to

specify that there will be an equitable allocation of the resource adequacy impacts associated with approved contracts.

We have received the comments. We find no legal error. We have modified the proposed decision to adopt SCE's proposal to approve all contracts that are cost-effective on a portfolio basis, based upon data contained in SCE's Confidential Appendix D of its testimony. We also modify the proposed decision to clarify the discussion of reliability as it relates to demand response, and make other clarifications. We decline to make other suggested changes.

9. Assignment of Proceeding

Rachelle B. Chong is the assigned Commissioner and David Gamson is the assigned ALJ in this proceeding.

Findings of Fact

1. After cost-effective energy efficiency, Energy Action Plan II identifies cost-effective demand response as the State's preferred means of meeting growing energy needs.
2. The Contracts collectively are not cost-effective under the energy efficiency SPM TRC test, the RIM test, or the PAC test, either for 2008 or any other year.
3. The Commission is currently considering development of a more robust cost-effectiveness methodology for demand response programs in R.07-01-041.
4. A Demand Response Cost Effectiveness Evaluation Framework (Framework) was filed on November 19, 2007 in R.07-01-041 as a consensus document among parties. Among other things, this Framework incorporates additional benefits beyond the TRC test, including a default transmission and distribution adder, updated avoided cost values, and changes to the avoided cost

calculation. The Commission has yet to reach a decision in R.07-01-041 on whether to approve the Framework.

5. Only the two Ancillary Service Coalition, LLC Contracts meet the proposed Framework's cost-effectiveness test.

6. Under each of the cost-effectiveness tests in the record, the ASC Contracts have the best cost-effectiveness scores.

7. The two ASC contracts, together with the NAPP and ECI day-ahead contracts, are cost-effective on a portfolio basis.

8. D.07-12-052 found there was no need for new physical resources in Southern California during the period of the Contracts.

9. The Commission must balance the EAP's preference for demand response against total resource needs of SCE.

10. There is factual support for TURN's argument that SCE does not have a contractual need for the Contracts in order to meet its bundled customers' System or Local Resource Adequacy requirements in 2008 or 2009.

11. The Contracts are not needed for reliability purposes in 2008.

12. Approval of four of the demand response contracts will further the commission's goal of increasing cost effective demand response while balancing the need to guard against shortages during summer peak periods.

13. The Contracts would help achieve the Commission's goals for price responsive DR in 2008 and beyond.

14. The Contracts contain innovative demand response features.

15. Participants under the ASC Contracts will receive a greater part of their incentive monies for performance as opposed to reservation of capacity.

16. The two ASC Contracts will provide more overall benefits than the other Contracts based upon their combination of superior program design and cost-effectiveness.

Conclusions of Law

1. The Contracts should not be rejected solely on the basis of energy efficiency-based tests of cost-effectiveness, as these energy efficiency-based tests are not fully appropriate for demand response contracts.

2. The Contracts should not be rejected solely based upon not passing the cost-effectiveness test based on the proposed Framework in R.07-01-041, nor should any contract be approved based on passing this test, because the Commission is considering the proposed Framework in R.07-01-041.

3. Cost-effectiveness under the Framework should be a factor, but not the only factor, in considering approval of some or all of the Contracts.

4. Cost-effectiveness can be measured on either an individual contract basis or on a portfolio basis.

5. To the extent that the Contracts do not meet other critical criteria, they should not be approved solely to move toward the Commission's 5% demand response goal.

6. While a supporting factor in consideration of the Contracts, it is not sufficient that the Contracts are innovative.

7. The two ASC Contracts, the NAPP contract and the ECI day-ahead Contract should be approved. The other four contracts should not be approved at this time.

8. SCE's proposed ratemaking is reasonable because it ensures that SCE recovers no more and no less than the actual, reasonable capacity payments and administrative costs of the Contracts.

9. SCE's cost recovery mechanism should apply only to the four approved Contracts.

10. The demand response reductions that occur as a result of the four approved Contracts should be counted toward resource adequacy requirements, consistent with Commission decisions.

11. ALJ Gamson's Ruling of January 10, 2008 denying DRA's Motion for evidentiary hearings, and all other rulings in this case, are affirmed.

12. Because no evidentiary hearings were held, we will not entertain TURN's request for oral argument, in accordance with Rule 13.13(b) of the Commission's Rules of Practice and Procedure.

O R D E R

IT IS ORDERED that:

1. Four Southern California Edison Company (SCE) proposed Contracts, (Alternative Energy Resources, Inc.; EnergyConnect, Inc. day-of; Energy Curtailment Specialists, Inc.; EnerNOC, Inc.) are not approved at this time. SCE may consider resubmitting these four Contracts as part of its June 1, 2008 application for 2009 through 2011 demand response programs, consistent with the cost-effectiveness direction and other program goals to be developed in R.07-01-041.

2. The two SCE Contracts with Ancillary Services Coalition, LLC are approved. The North American Power Partners, LLC Contract is approved. The EnergyConnect, Inc. day-ahead Contract is approved.

3. SCE may recover costs for the four approved Contracts as discussed herein. The approved costs are those delineated in SCE's Confidential Appendix D of its October 17, 2007 testimony for the four approved Contracts, plus associated administrative costs.

4. The demand reductions achieved by the four approved Contracts count towards the Commission's goals for SCE's demand respond program portfolios if and to the extent such goals are adopted by the Commission.

5. Application 07-10-013 is closed.

This order is effective today.

Dated _____, at San Francisco, California.