

**DRAFT**

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**  
I.D.# 6221  
ENERGY DIVISION **RESOLUTION E-4050**  
December 14, 2006

**R E S O L U T I O N**

Resolution E-4050. Southern California Edison Company (SCE) requests the Commission's approval to amend its Commission approved AB 57 Procurement Plan by eliminating a requirement that contracts greater than three (3) years reduce risk (i.e. the "risk screen").

By Advice Letter 2050-E Filed on October 23, 2006.

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**SUMMARY**

This Resolution approves SCE's request to amend its Commission approved AB 57 Procurement Plan by eliminating the current requirement that contracts greater than three (3) years reduce risk (i.e. the "risk screen").

**BACKGROUND**

SCE's 2004 Short-Term Procurement Plan (STPP) was filed on May 15, 2003, and was approved by the Commission in Decision (D.) 03-12-062, as modified by D.04-12-048. SCE's 2004 STPP has been further updated and amended, via advice letters as required by the Commission in D.04-12-048.

SCE's 2004 STPP requires transactions greater than two years to pass the portfolio risk screen criteria. The risk screen measures the distribution (standard deviation) of procurement costs with and without a specific contract in the portfolio. If the standard deviation goes down when the contract is in the portfolio, then the contract passes the risk screen.

Subsequently, in its 2004 LTPP, SCE requested and received authorization that the risk screen be modified to apply only to transactions concluding delivery beyond three years. SCE filed Advice Letter 2050-E, the subject of this Resolution, to seek authorization to eliminate the risk screen altogether.

The risk screen requirement was implemented prior to the Commission's January 22, 2004 Resource Adequacy (RA) Requirement decision, D.04-01-050. Under the Commission's RA rules, all load-serving entities in California have an obligation to procure sufficient resources to meet their customers' average-year needs with a 15-17% planning reserve. Effective February 16, 2006, SCE was required to demonstrate that it had procured sufficient resources to meet 90% of its June-September 2006 RA requirement. Beginning with the month of June 2006, SCE has been required to demonstrate that it meets 100% of its RA requirement by the last day of the month that is two months prior to the target month.

### **NOTICE**

Notice of AL 2050-E was made by publication in the Commission's Daily Calendar. SCE states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A. A copy of the Advice Letter was also served on the service list for R.04-04-003.

### **PROTESTS**

Advice Letter AL 2050-E was not protested.

### **DISCUSSION**

Energy Division has reviewed SCE's Advice Letter 2050-E and recommends approval. Approving SCE's request would remove a potential conflict that exists between the application of the risk screen and the implementation of RA requirements. Removal of the risk screen does not increase SCE's risk as SCE has developed other means to manage portfolio risk. Additionally, the long term procurement proceeding, R.06-02-013, will establish an updated plan.

**A potential conflict exists between the application of the risk screen and the implementation of Resource Adequacy requirements.**

The risk screen requires that contracts longer than 3 years forward must reduce risk, as measured by standard deviation of expected procurement costs, before they can be considered for selection. This requirement was established in SCE's 2004 Procurement Plan and approved by the Commission in D.03-12-062.

Subsequently, the Commission approved the Resource Adequacy (RA) requirement decision in D. 04-01-050. SCE now finds that the RA requirements and the risk screen requirements may pose a potential conflict. SCE is concerned that application of the risk screen may prevent SCE from procuring sufficient capacity to meet the RA requirement. This is because the typical contract used to meet RA requirements is a contract that provides capacity and associated energy for a year or multi-year period (usually, these are "gas tolling" contracts). If SCE procures capacity to meet 115% of its average-year peak need, it often does so with tolling agreements whose price depends on natural gas prices. When natural gas price volatility increases, these tolling arrangements (which provide both needed capacity and energy), do not pass the risk screen. This is also true for energy products priced on heat rates.

Additionally, SCE is likely to have more energy than 100% of its customers' need, particularly in non-peaking hours. That is, procuring capacity to meet the peak needs will likely create "long" energy positions in non-peak hours. The possibility that energy prices may decrease (or increase) creates sales revenue variability, or risk, that may result in the risk screen not being passed, particularly for the last contracts added to the portfolio to meet the RA requirements.

**SCE utilizes a "best-fit" tool for contract selection and to manage portfolio risk.**

Elimination of the risk screen should not increase SCE's portfolio risk as SCE has incorporated a "best-fit" tool for contract selection. The "best-fit" tool is a mathematical optimization that maximizes the Net Present Value (NPV) (least-cost) of the contract selections subject to procurement requirements (best-fit). This method looks at every possible combination of available contracts and maximizes the NPV subject to a set of constraints. Constraints include local capacity requirement, RA requirements, reserve requirements, and portfolio fit. SCE believes that his new method essentially melds the risk screen and the selection process to prevent SCE from over procuring or procuring products that don't meet the needs and thus unnecessarily increase customer's risk.

**Long Term Procurement Plan will be updated in 2007**

On December 11, 2006, under the Long Term Procurement proceeding, R.06-02-013, SCE will file with the Commission SCE's latest Long Term Procurement

Plan. This Long Term Procurement Plan will supersede the 2004 Procurement Plan and any and all modifications, including this resolution.

**Other risk assessment remains in effect.**

All Commission ordered requirements on risk assessment, such as monthly risk reporting to the Commission, the use of Time to Expiration Value at Risk (TeVar), the guidance of the Consumer Risk Tolerance (CRT), and the Procurement Review Group (PRG) consultation requirements should be preserved. SCE is not seeking any changes or modifications to such Commission requirements.

**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. SCE's 2004 Short-Term Procurement Plan (STPP) was filed on May 15, 2003 and approved by the Commission in Decision 03-12-062.
2. SCE's 2004 STPP requires transactions greater than two years to pass the portfolio risk screen criteria.
3. The risk screen measures the standard deviation of procurement costs with and without a specific contract in the portfolio to ensure that the transactions reduce total portfolio risk.
4. SCE's 2004 Long Term Procurement Plan (LTPP) subsequently received Commission authorization to require the risk screen for transactions delivered beyond three years.
5. SCE filed Advice Letter 2050-E to request authorization to remove the risk screen in its entirety.
6. SCE is concerned that the risk screen conflicts with implementation of the Commission approved Resource Adequacy (RA) requirement.
7. The Commission approved the RA requirement in D.04-01-050.
8. SCE is concerned that application of the risk screen may prevent SCE from procuring sufficient capacity to meet the RA requirement.

9. Elimination of the risk screen should not increase SCE's portfolio risk as SCE uses a mathematical model that optimizes the net present value of the contract selection, and prevents SCE from over procuring or procuring products that do not meet need.
10. SCE will file on December 11, 2006, under the Long Term Procurement proceeding, R.06-02-013, a Long-Term Procurement Plan that will supersede the 2004 LTPP and any and all modifications, including this resolution.
11. Other Commission ordered requirements, such as Time to Expiration Value at Risk (TeVar), the guidance of the Consumer Risk Tolerance (CRT), and the Procurement Review Group (PRG) will remain in effect.
12. AL 2050-E was not protested.

**THEREFORE IT IS ORDERED THAT:**

1. The request of the Southern California Edison Company (SCE) to eliminate the risk screen as requested in Advice Letter AL 2050-E is approved.

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 December 14, 2006; the following Commissioners voting favorably thereon:

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STEVE LARSON  
Executive Director