Decision 05-09-022 September 8, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	R.04-04-003 (Filed April 1, 2004)

ORDER MODIFYING DECISION (D.)04-12-048 FOR PURPOSES OF CLARIFICATION, GRANTING LIMITED REHEARING ON THE 50/50 SHARING OF CONSTRUCTION CONTRACT SAVINGS, AND DENYING REHEARING OF THE DECISION, AS MODIFIED, IN ALL OTHER RESPECTS

I. INTRODUCTION

In Decision (D.) 04-12-048, we adopted, with modifications, Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE) and San Diego Gas & Electric Company's (SDG&E) Long-Term Procurement Plans and provided direction to the utilities on the procurement of the resources identified therein. Applications for Rehearing of D.04-12-048 were timely filed by Strategic Energy, Constellation New Energy, and the Alliance for Retail Markets (collectively, Strategic); by Southern California Edison Company (SCE); and by the Cogeneration Association of California and the Energy Producers and Users Coalition (collectively, CAC/EPUC).[1]

CAC/EPUC argues that: (1) the process set forth in the decision to ensure that qualifying facility (QF) contracts do not lapse is flawed and puts QF contracts which expire in 2005 and 2006 at risk; (2) the 20% risk factor adopted

[1] A petition for modification of D.04-12-048 was filed by South San Joaquin Irrigation District. Today's decision does not dispose of or prejudge any issues raised therein.

by D.04-12-048 is not supported by the record evidence and that any risk factor will unfairly disadvantage independent power sources relative to utility owned resources; (3) a charge to recover net stranded costs that might be subsequently imposed is unlawful; (4) the application of a greenhouse gas emissions adder is inconsistent with federal law and is not supported by the record evidence; and (5) it was denied due process. Specifically, with regard to due process, CAC/EPUC challenges the decision's finding that it had sufficient access to the utilities' background data and assumptions, and as a result the findings that SCE's primary resource need is for peaking, dispatchable and shaping resources is erroneous and may prejudice the outcome of future proceedings.

Strategic asserts three errors: (1) the Commission lacks the authority to establish charges to recover the costs of new utility generation resources from direct access (DA) customers; (2) the duration of the DA suspension is beyond the scope of the proceeding; and (3) parties to the proceeding in which DA suspension was adopted were not provided notice or an opportunity to be heard on the issue and further briefing on the issue is in order.

SCE argues that D.04-12-048 wrongly requires IOU built and turnkey projects to compete with power purchase agreements (PPAs), without allowing IOUs to recover all of their costs. Specifically, SCE argues that: (1) D.04-12-048 fails to ensure a competitive procurement process; (2) there is no evidence to support D.04-12-048's 50/50 sharing mechanism; (3) the cap on cost recovery violates state law and denies the IOUs due process, and (4) D.04-12-048's alleged departure from traditional cost-of-service generation is unwarranted and poor public policy.

SCE, Calpine Corp., Independent Energy Producers Association, Sempra Energy Global Enterprises, and Duke Energy of North America filed responses to the above rehearing applications.

We have reviewed each and every allegations set forth in the three rehearing applications. For the reasons explained below, we are of the opinion that the applications for rehearing filed by CAC/EPUC and Strategic are without merit, and thus, we deny them. However, we will modify D.04-12-048 to clarify two statements made in the decision related to the possible equilibrium between utilities and market participants (MPs), and the duration of the direct access suspension. Further, we grant limited rehearing of D.04-12-048 on SCE's evidentiary challenge regarding the 50/50 sharing provisions related to construction cost savings, but deny rehearing of SCE's rehearing application in all other respects.

I. DISCUSSION

A. CAC/EPUC's Application for Rehearing

1. CAC/EPUC's allegations that the Commission's determinations regarding the QF contracts violate PURPA are without merit.

CAC/EPUC alleges that the process set forth in D.04-12-048 to ensure that qualifying facility (QF) contracts do not lapse is flawed and puts QF contracts which expire in 2005 and 2006 at risk. Specifically, CAC/EPUC argues that "due to differences in timing between the second phase of this proceeding, and the potential resolution of issues in the various phases of Rulemaking (R.) 04-04-025, certain resources are at risk. . . because they will not be afforded a reasonable vehicle to deliver available power to the utilities at the utilities avoided cost." (CAC/EPUC Application for Rehearing, p. 9.) Relying on 18 C.F.R. section 292.303 and 18 C.F.R. section 292.304(b), CAC/EPUC asserts that the process adopted in the decision violates the provisions of the Public Utility Regulatory Policies Act (PURPA).[2]

CAC/EPUC's claim is without merit. Neither 18 C.F.R. section 292.303 or 18 C.F.R. section 292.304(b), upon which CAC/EPUC rely, specifies an obligation of this Commission, or any other entity, to adopt a vehicle to deliver

[2] Pub. L. No. 95-617 (Nov. 9, 1978) codified in part at 16 U.S.C. §824a-3 et seq.

available QF power to the utilities. Rather, as CAC/EPUC itself notes, these CFR sections require a utility to take power made available by a QF, and to pay the cost for power that is equivalent to the utilities avoided cost of procuring or producing that power. (CAC/EPUC Application for Rehearing, p. 9, citing 18 C.F.R. section 292.303 & 18 C.F.R. section 292.304(b), respectively.) Absent from the sections cited by CAC/EPUC is any mandate that this Commission must either require long-term contracts or establish any specific delivery vehicle.

CAC/EPUC's only other support for its contention that this Commission is obliged to ensure that there's a delivery mechanism so QFs can continue to provide power to the utilities is the following statement made in D.04-01-050: "[i]n compliance with PURPA and recent FERC decisions, the Commission <u>should</u> provide an <u>opportunity</u> for existing QFs to continue to provide power to the utilities in a manner that encourages facility maintenance and upgrade." (CAC/EPUC Application for Rehearing, p. 7, citing D.04-01-050, p. 191, Finding of Fact No. (FOF) 74, emphasis added.) Absent from the cited passage is any language stating that this Commission must establish a mechanism using either long-term contracts or any other specific delivery vehicle.[3]

2. CAC/EPUC's evidentiary challenges to the Commission's adoption of a 20% risk factor are without merit.

CAC/EPUC argues that: (1) there has been no evidence presented in this proceeding that some greater consideration of debt equivalence will produce an improvement in the credit ratings of the utilities; (2) the record does not support

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[3] In its rehearing application, CAC/EPUC asserts that, based on scheduling developments in R.04-04-025, in the absence of a specific delivery vehicle, the Commission "will not be able to develop a comprehensive long term policy, including contract extensions for QFs by mid-2005 and both QF contracts which expire in 2005 and 2006, and new projects, are at risk." (CPC/EPUC Application for Rehearing, p. 9.) This is a policy argument that is based on speculation rooted in a disagreement with the Commission's policy determination. It does not constitute legal error and is rejected. (See Pub.Util.Code, §1732, requiring rehearing applications to set forth specifically the "ground or grounds on which the applicant considers the order or decision of the Commission to be unlawful"; see also Code of Regs., tit. 20, §86.1.)

the determination that a 20% risk factor is appropriate; and (3) any debt equivalency (DE) methodology should take into account and be tailored to the particular risk presented. (CAC/EPUC Application for Rehearing, pp. 11-15.) We find these arguments without merit.

CAC/EPUC's first assertion misses the point. No party alleged and D.04-12-048 does not conclude that DE, by itself, will lead to an improvement in a utility's credit rating. Rather, the general point emphasized by several parties and accepted in D.04-12-048 is that DE is one factor used by credit agencies to describe the financial obligations resulting from the long term purchase power agreements at issue. Specifically, as we note in D.04-12-048, SCE's financial witness testified that "in determining a utility's credit rating, rating agencies pay particular attention to the company's cash flow, including its sources and uses of funds. Of particular concern are obligations that place a call on available cash, reducing a company's ability to make ongoing interest payments or to repay principal." (Ex. 73, p. 21 (Simpson/SCE); see also, D.04-12-048, p. 142, fn. 132, quoting from this testimony.) Moreover, in D.04-12-048 we acknowledge that DE is a subjective factor that is based on perceived risk and non-static factors. In support of this contention we note SDG&E's claim that: 'It is essentially undisputed that the credit analysts treat the utilities' long-term non-debt obligations, such as PPAs, as if they are in fact debt when they assess a utility's debt capacity.' (D.04-12-048, p. 130, fn. 135; see also, Ex. 24 pp. 1-5 (McMonagle/SDG&E).) Thus, on the basis of the record, in D.04-12-048 we properly concluded that "the IOUs should take into account the impact of DE when evaluating individual bids in all-source and [Renewables Portfolio Standards (RPS)]." (D.04-012-048, p. 144.) In D.04-12-048 we accomplish this task by adopting the Standard & Poor (S&P) methodology with a modified risk factor.

We disagree with CAC/EPUC's second point, that the record does not support the determination that a 20% risk factor is appropriate. After determining that IOUs should take DE into account, we examined the appropriate

DE imputation methodology. We noted that "all three IOUs used the S&P methodology as the starting point for their proposed DE calculations because it is the most developed and transparent approach to calculating DE". We then adopted the S&P methodology. (D.04-12-048, p. 132.) Thus, based on the evidentiary record, we explained in D.04-12-048 how we logically derived our reasoning for adoption of the S&P methodology with the 20% risk factor, and our rejection of the 30% risk factor.

The following evidence from the record supports the Commission's determination that the S&P's 30% risk factor is a useful starting point. (1) All three IOUs used the S& P methodology (see generally, Ex. 34, pp. 2-29 (Campbell/PG&E), (R.T. Vol. 13, p. 1762:16-21(Simpson/SCE)), Ex. 23, p.2, and Ex. 24 pp.1-5 (McMonagle/SDG&E)) and; (2) SCE Witness Simpson testified the "the 30% risk factor assigned by S&P applies to all contracts, including QF contracts. (R.T. Vol. 13, p. 1771:16-19.)

CAC/EPUC also claims that the evidence in the record does not support the conclusion that "the 30% S&P risk factor is too high to be reasonable and fair to all PPAs"; the determination that "DE is a factor in utility credit worthiness, but not to the degree shown in the S&P methodology"; and the Commission's finding that "the regulatory climate (a significant factor in S&P's qualitative 30% factor methodology) is improving in California." Contrary to CAC/EPUC's claim, there is record support for these contentions. Indeed, in its application for rehearing CAC/EPUC identifies record evidence that supports the decision's departure from the S&P 30% risk factor. (See CAC/EPUC Application for Rehearing, pp. 14-17.) For example, in contrast to SCE testimony showing that the S&P 30% risk factor applies to all contracts (R.T. Vol. 13, p. 1771 (Simpson/SCE)); that S&P won't lower the risk factor for QF contracts (R.T. Vol. 13, pp. 1771 & 1776 (Simpson/SCE)), and that rating agencies won't discard DE so it must be accounted for in procurement contracting (Ex. 78, p. 42 (Simpson/SCE)), CAC witness Ross testified that DE impacts are partially, rather than completely mitigated. (Ex. 124, p. 29-30 (Ross/CAC).) Thus, CAC/EPUC's evidentiary challenge has no merit; the record evidence supports the Commission's rejection of the 30% risk factor and the reasonableness of adopting the 20% risk factor.

3. D.04-12-048 did not err in permitting utilities to recover their net stranded costs from all customers.

D.04-12-048 provides that the utilities should be allowed to recover their net stranded costs from all customers, including through the use of any surcharge. (D.04-12-048, pp. 57, 58.)[4] In its rehearing application, CAC/EPUC argues that, "to the extent the Commission intends to apply this new [surcharge] to customer generation departing load (CGDL), the Decision errs." (CAC/EPUC Application for Rehearing, p. 17.) In support of this contention CAC/EPUC notes that: (1) the investor owned utilities (IOUs) have successfully accounted for CGDL for decades in their procurement process; (2) in D.03-04-030 the Commission confirmed the policy of encouraging customer generation by excepting the departing load served by CGDL from generation procurement cost related surcharges; (3) "FERC (Statutes and Regulations, ¶31,036 at p. 31,789 and n.902)" does not allow the utilities to recover surcharges for stranded costs on customers employing self-generation; (4) the basis for the proposed surcharge in the record is inapplicable to CGDL; (5) the surcharge would stifle competition if applied to CCA, direct access (DA) and municipal departing load; and (6) application of the surcharge to CGDL would be procedurally defective. Consistent with these assertions, CAC/EPUC argues that "the Commission must clarify that the proposed surcharge does not extend to the long-standing and non-jurisdictional right of customers to install self-generation, cogeneration or any

[4] In D.04-12-048, we refer to the surcharge as an "exit fee." We note that our reference to the recovery mechanism as an "exit fee" was not appropriate. Rather, the mechanism for recovery of net stranded costs should be called "a surcharge," whereby customers are responsible for paying for costs they help to incur. Thus, the term "surcharge" will replace the term "exit fee" where it appears in D.04-12-048.

form of customer generation." CAC/EPCU's claims are without merit and, in as much as D.04-12-048 states: "… the utilities should be allowed to recover the net costs of these commitments from all customers, including departing customers" no clarification is necessary. (D.04-12-048, p. 60.)

CAC/EPUC's first argument is without specificity, and does not comply with Public Utilities Code section 1732. Without any specific authority CAC/EPUC appears to argue that in the past IOU's have somehow accounted for CGDL in their procurement process. Moreover, CAC/EPUC's argument fails to explain or even consider how cost shifting issues are being addressed. Thus CAC/EPUC fails to identify any legal error, and thus, is denied.

CAC/EPUC's second argument is, on its face, a policy argument that again fails to identify any legal error. In addition, CAC/EPUC's categorization of the policy in the decision is somewhat misleading. The exceptions that were granted from having to pay DWR costs were based on evidence that a certain amount of costs were not incurred as demonstrated in the IOU's forecasting (there is a cap of 3000 MW for the exceptions). Further, under the statute CGDL were still responsible for paying ongoing CTC. (See D.03-04-030, pp. 32-33 (slip op.).)

CAC/EPUC's third contention relies on FERC regulations to argue that an inapplicable surcharge is at issue in the instant proceeding. Our determinations relate to allocations of the stranded costs among customers at a retail level. Cost allocations among customers of the utility is a state commission rather than FERC matter. (See *El Paso Natural Gas Company (1999)* 89 F.E.R.C. ¶ 61,164, p. 61,491.) Accordingly, CAC/EPUC's reliance on the FERC regulations is misplaced, and its third contention has no merit. CAC/EPUC's fourth argument is that the need to recover stranded costs is premised on utility claims that large blocks of load are departing due to changed regulatory environment and that no change in environment has occurred. CAC/EPUC raises a policy argument rather than a legal argument. This argument, and is rejected as it does not comply with Public Utilities Code section 1732. Further, as a policy argument, it fails because CAC/EPUC has not identified anything in the record or decision that supports the premise it asserts.[5] CAC/EPUC's fifth argument is that "with respect to [surcharges] applicable to CCA, DA and municipal departing load, the decision embraces a position that promises to stifle competition in perpetuity." (CAC/EPUC Application for Rehearing, p. 20.) CAC/EPUC makes no attempt to cast this claim as anything other than a policy argument. In the absence of a claim of legal error this argument is rejected.

CAC/EPUC's final argument is that "application of the [surcharge] to CGDL would be procedurally defective." The crux of CAC/EPUC's argument is that because CGDL was not specifically mentioned CAC/EPUC had no notice that the stranded costs provisions would apply to these customers. (SCE Response to Applications for Rehearing, p.12.) CAC/EPUC's claim of surprise lacks credibility. CAC/EPUC was a party in the proceeding and, among other things, filed testimony and post hearing briefs. (See D.04-12-048, pp. 9, 10.) Moreover, "a major issue in D.04-12-048 was the extent to which the utilities will be compensated for investments or purchases that they must make in order to meet their obligations to provide reliable service to their customers" particularly where long term contracts such as those pressed by CAC/EPUC are at issue. (See D.04-12-048, pp. 50-51.) The long term contracts pressed by CAC/EPUC helped make the recovery of stranded costs from all customers an issue in the proceeding.

4. The determination in D.04-12-024 that the greenhouse gas emissions adder is lawful.

a. Consistency with Federal and State Law.

CAC/EPUC claims that our determination on the greenhouse gas (GHG) adder is contrary to federal and state law. Specifically, citing 18 C.F.R. sections 292.303(a) and 292.304(b), CAC/EPUC first argues that electrical utilities

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[5] We further note that in reaching our determinations, we must comply with the mandates of Public Utilities Code §366.2(d), requiring us to ensure that each customer pays its fair share of costs, and that there is no cost shifting.

are required to purchase energy or capacity made available by a QF at prices equivalent to the utilities avoided costs. (CAC/EPUC Application for Rehearing, p. 21.) However, at no point does CAC/EPUC claim that, or specifies how, D.04-12-048's determination on GHG violates the cited provisions.

Instead, CAC/EPUC argues that "the State has long recognized the benefits of cogeneration," and "has made the encouragement of private investment in cogeneration a State policy." In support of these contentions CAC/EPUC cites California's Warren-Alquist Act, section 25004.2 (Public Resources Code § 25004.2), Public Utilities Code sections 372(a), and 372(f). While each of the statutes cited encourages the development of cogeneration, there is nothing in any of these statutory provisions that could reasonably be construed as prohibiting D.04-12-048's GHG provisions. Indeed, to the extent that these regulations speak to the issue they appear to encourage the type of environmental protections found in D.04-12-048. For example, Public Utilities Code section 372(a) notes that "[i]t is the policy of the state to encourage and support the development of cogeneration as an efficient, *environmentally beneficial*, competitive energy resource. . . ." (CAC/EPUC Application for Rehearing, p. 22, citing Public Utilities Code, section 372, subd. (a), emphasis added.) Similarly, as CAC/EPUC notes, Public Utilities Code section 372(f) seeks to encourage "the continued development, installation, and interconnection of *clean and efficient* self-generation and cogeneration resources . . . ." (CAC/EPUC Application for Rehearing, p. 22, citing Public Utilities Code, section 372, subd. (f), emphasis added.)

In contrast to the clear preference for environmentally sound resources expressed by these state statutes, CAC/EPUC's complaint that the imposition of a GHG adder when evaluating fossil generation bids could serve to prejudice bids from natural gas fired cogeneration QF is flawed on its face and speculative at best. Among other things CAC/EPUC's claim fails to acknowledge that D.04-12-048 directs IOU's to employ the GHG adder regardless of the entity that submits the bid. Thus, cogeneration QF's would suffer only to the extent that, contrary to Public Utilities Code sections 372(a) and 372(f), and CAC/EPUC's claims, they are less clean and efficient resources. Moreover, since the GHG adder provisions of D.04-12-048 apply equally to all parties, CAC/EPUC's contention of bias fails and its allegation of error is without merit.

b. Record Support for the GHG adder.

In its section heading CAC/EPUC asserts that "[t]he application of a GHG adder … is not supported by the record evidence." (CAC/EPUC Application for Rehearing, p. 20.) This section heading constitutes CAC/EPUC's entire discussion of its evidentiary challenge.[6] Rather than elaborating on its assertion, CAC/EPUC simply reargues its policy position that the Commission should defer adoption of GHG adders. Specifically, CAC/EPUC argues that GHG regulation should be held in abeyance because: (1) governmental regulation is not certain or defined at this point; (2) GHG is only one externality that should be considered in evaluating the value of a resource's electrical output; (3) the solution in D.04-12-048 may not be the sole means of achieving the same result; and (4) D.04-12-048 assumes that all fossil-fired generation is equal. This reargument of policy does not constitute legal error, and thus, CAC/EPUC's claims concerning the GHG adder are rejected.

5. The Commission's determination in D.04-012-048 regarding the protective order and confidential information is lawful.

CAC/EPUC complains that D.04-12-048: (1) incorrectly assumes that the amended protective order substantively conforms to the model FERC Order, (2) does not keep the Commission's promise to ensure open and transparent

[6] Any claimed lack of evidence is also refuted by the evidence in the record, including Ex. 58, pp. 62-64 (Bachrach/NRDC), and Ex. 55, p. 3 (NRDC/Hayhoe) ["Emissions Pathways, Climate Change, and Impacts on California: Proceedings of the National Academy of Sciences," August 16, 2004. v. 101, no. 34, pp. 12422-12427].

process (citing D.04-01-050); and (3) wrongly asserts that private entities, trade groups, and ad hoc associations might be treated the same in terms of the required disclosure of information as regulated utilities. These claims are unfounded, and without merit.

In support of its first assertion CAC/EPUC argues that “the blanket restriction preventing Competitive Duty Personnel (CDP) from acting as Review Representatives (RR) in the amended order, however, contravenes the FERC Order.” Setting aside the fact that CAC/EPUC references the “model FERC Order” only as something identified in a prior filing, the fact is CAC/EPUC fails to identify any legal error. Indeed, CAC/EPUC fails to prove its initial assertion and appears to abandon this claim in favor of an 18 C.F.R. section 292.309 argument.

CAC/EPUC claims that 18 C.F.R. section 292.309 requires the Commission to make its “protected” utility information publicly available. (CAC/EPUC Application for Rehearing, p. 26.) This claim too is without merit. CAC/EPUC’s interpretation of this regulation is over broad and at odds with FERC’s interpretation. Specifically, in *Tennessee Power Co*. (1996) 77 F.E.R.C. ¶61,123, pp. 61, 482 & 61, 484, FERC explained, with reference to section 292.309(b), that this rule only requires that certain information be made available, and that information that would violate the confidentiality of a competitive solicitation process or undermine efforts to implement an integrated resource plan to provide low cost resources to meet supply needs needn’t be disclosed. FERC’s position regarding the confidentiality of information is consistent with California law as set forth in Public Utilities Code section 454.5. This statutory provision requires the Commission to have in place “procedures that ensure the confidentiality of any market sensitive information submitted by an IOU as part of its proposed procurement plan.” (Pub. Util. Code, §454.5.) Rather than the blanket directive to disclose utility information that CAC/EPUC urges, and consistent with 18 C.F.R. section 292.309(b) and Public Utilities Code section

454.5, we have lawfully balanced the need for disclosure with the need to protect confidential information to ensure open and transparent process, in accordance with D.04-01-050. Our consistency with D.04-01-050, 18 C.F.R. section 292.309(b) and Public Utilities Code section 454.5 disposes of CAC/EPUC's second claim. Simply put, the Commission objective to ensure open and transparent proceedings must be bounded by the Commission's obligation to balance disclosure with confidentiality requirements. We have correctly and lawfully made the balance in D.04-12-048.

CAC/EPUC's final point that D.04-12-048 wrongly asserts that private entities, trade groups, and ad hoc associations must be treated the same in terms of the required disclosure of information as regulated utilities, fails to allege either factual or legal error. At issue is the statement in D.04-12-048 that:

> "It may be the case that the utilities and the MPs have reached a point of equilibrium in that if the MPs had more access to utility information, the utilities may have demanded equal access to MP information." (D.04-12-048, p. 164.)

On its face the passage cited by CAC/EPUC represents conjecture about the state of competition between utilities and MPs, and about potential litigation issues. While not erroneous, this statement adds little to the decision, and appears to cause some confusion. Therefore, D.04-12-048, p. 164, will be modified to delete this language.

6. The Commission acted properly in denying access to data related to peaking dispatchable and shaping resources to competitors.

Finally, CAC/EPUC takes issue with FOF 20, in which we found that SCE's primary resource need is for peaking, dispatchable and shaping resources, because it did not get all the information it sought. CAC/EPUC further alleges that the finding may prejudice the outcome of future proceedings. (CAC/EPUC Application for Rehearing, p. 30.) These arguments have no merit.

Here again, CAC/EPUC bases its complaint on its argument that the amended protective order was improper. These arguments are as flawed and unpersuasive on this issue as when previously discussed. As noted above, our obligation is to balance the desire for disclosure with the need to protect confidential information. Moreover, the fact that CAC/EPUC was denied access to confidential SCE data does not mean that the information was not reviewed. With regard to this particular issue, noncompetitors, like The Office of Ratepayer Advocates, The Utility Reform Network, the California Energy Commission, and the Union of Concerned Scientist, all had an opportunity to review the information and did not dispute SCE's evidence on resource needs. Having balanced the competing interest and provided thorough review, no legal error lies in the limited access given to SCE's confidential data. CAC/EPUC is after all one of SCE's competitors.

Next CAC/EPUC claims that FOF 20 "has the potential to prejudice the outcome of future proceedings including the second phase of R.04-04-003 which will address development of a long-term policy for existing and new QF contracts." This wholly speculative statement constitutes the entirety of CAC/EPUC's argument, and does not provide sufficient specificity and does not comply with under Public Utilities Code section 1732. Accordingly, we need not consider the claim, and thus, reject it.

B. Strategic's Application for Rehearing

Strategic asserts three errors. First, Strategic asserts that the Commission lacks the authority to establish charges to recover the costs of new utility generation resources from direct access (DA) customers. Second, Strategic asserts that the duration of the DA suspension is beyond the scope of the proceeding. Finally, Strategic asserts that parties to the proceeding in which DA suspension was adopted were not provided notice or an opportunity to be heard on the issue and that further briefing on the issue is in order. (Strategic Application for Rehearing, p. 2.)

1. Strategic's claims regarding the cost responsibility of new utility generation resources by current and future direct access customers lacks merit.

Strategic first argues that "the Commission has no authority to establish cost responsibility surcharges to recover costs of new resource commitment from DA customers, regardless of their status at the time the commitments were made." We disagree. We have previously addressed this issue and determined that all customers should bear the costs related to resources needed to maintain system reliability. For example, in D.04-07-028, we allowed the IOUs to seek cost recovery through their respective FERC Reliability Services tariff provisions or in ERRA proceedings. (See D.04-07-028, p. 24 (slip op.).) Moreover, contrary to Strategic's assertions, we may lawfully hold future direct access customers responsible for the recovery of new generation costs. As set forth in Public Utilities Code section 366.2(d)(1): each retail end-use customer "should bear a fair share of the Department of Water Resources electricity purchase costs, *as well as electricity purchase contract obligations incurred …*" (Pub. Util. Code, §366.2, subd. (d)(1), emphasis added.) Specifically, based on a cost-shifting analysis, Public Utilities Code section 366.2(d) provides the Commission authority to establish cost responsibility surcharges to recover the costs of new resource commitment. (See D.05-06-062, pp. 4-11 (slip op.), in which the Commission addressed its authority to impose stranded cost obligations associated with new utility generation on current bundled SDG&E customers who may become future direct access or community choice aggregation customers.)

Further, the evidence in the record demonstrates that the IOUs purchased on behalf of these customers while they were taking bundled service.[7] Accordingly, under Public Utilities Code section 366.2(d)(2), responsibility attaches for these costs. Therefore, Strategic's argument to the contrary is without merit.

2. The duration of the DA suspension.

Strategic's second and third arguments relate to the following discussion of the load forecasts underlying the utilities LTPPs in D.04-12-048:

> "The future of expanding DA or creating a core/non-core market is more speculative: *DA is currently suspended by legislation until the last DWR contract expires, currently scheduled for 2013*. There is no record on which to base a choice on the probability that more retail competition will emerge." (D.04-12-048, p. 29 (emphasis added).)

Strategic claims that the italicized portion of the text states a legal conclusion that goes beyond the scope of the proceeding, and thus, allegedly deprives certain parties of their right to contribute to such a decision. While we do not agree with Strategic's interpretation, we find that the later portion of the cited text requires clarification. Accordingly, the sentence at issue is modified to simply state that: "DA is currently suspended by legislation."

C. The SCE Application for Rehearing

SCE argues that D.04-12-048 wrongly requires IOU built and turnkey projects to compete with power purchase agreements (PPAs), without allowing IOUs to recover all of their costs. Specifically, SCE argues that: (1) D.04-12-048 fails to ensure a competitive procurement process; (2) there is no evidence to support D.04-12-048's 50/50 sharing mechanism, (3) the cap on cost

[7] See Ex. 34, p. 4-7 (PG&E/Aslin), and R.T. Vol. 11, pp. 1602:16-1603:14 (SCE/Whatley).

recovery violates state law and denies the IOUs due process, and (4) D.04-12-048's departure from traditional cost-of-service generation is unwarranted and poor public policy.

SCE's first and third arguments fail to identify any legal error. Specifically, as SCE acknowledges, its first assertion repeats policy arguments (going to intangibles, regulatory burdens, and the benefits of utility generation) which while critical of the balance struck between IOUs and PPAs, do not amount to legal error. Nor do these arguments benefit from SCE's unsupported conclusion that "it is illegal and unwise to abandon a decades-long process for the approval of utility generation without providing a truly competitive process. . . ." SCE's final argument, that D.04-12-048's departure from traditional cost-of-service generation is unwarranted and poor public policy, also fails to identify legal error. Accordingly, these arguments are rejected for failing to establish any legal error. (Pub. Util. Code, §1732.)

SCE's third assertion, that the cap on cost recovery violates state law and denies the IOUs due process is without merit. SCE argues that "prohibiting an IOU from recovering any costs in excess of its bid, as the Decision does, violates several provisions of the Public Utilities Code." In support of this contention SCE first cites Public Utilities Code section 1005.5 as allowing additional cost recovery beyond that originally set forth in the certificate of public convenience and necessity (CPCN). While SCE is correct in its statement, it errs in its interpretation of this rule. As set forth in Public Utilities Code section 1005.5(b):

> "After the certificate has been issued, the corporation may apply to the commission for an increase in the maximum cost specified if it finds and determines that the cost has in fact increased and that the present of future public convenience and necessity require construction of the project at the increased cost;

> otherwise, it shall deny the application." (Pub. Util. Code, §1005.5, subd. (b).)

Thus, while Public Utilities Code section 1005.5 allows additional cost recovery, such recovery is discretionary rather than mandatory.

SCE next argues that the cost recovery mechanism provided for in D.04-12-048 violates Assembly Bill (AB) 57's requirement that an incentive mechanism that establishes a procurement benchmark "shall contain balanced risk and reward incentive that limit the risk and reward of an electrical corporation." (SCE Application for Rehearing, p. 7, citing Pub. Util. Code, § 454, subd. (c)(2).) Specifically, SCE argues that the "requirement that cost savings be shared with ratepayers, while cost overruns are made the sole responsibility of IOU shareholders, is not 'balanced' and thus contravenes AB 57." (SCE Application for Rehearing, p. 7, citing Pub. Util. Code, § 454, subd. (c)(2).)

We disagree. Contrary to SCE's argument, we balanced the risks and rewards for ratepayers and IOU shareholders as required in AB 57. Thus, we complied with the statute. SCE disagrees not with the fact of our balancing, but with its outcome. Accordingly, SCE's argument that we failed to comply with AB 57 has no merit.

Further, our risk and reward balance in D.04-012-048 reflect the fact that the IOU not the customers make the decisions which determine the accuracy of both cost estimates and savings, and that the "savings" at issue are actually ratepayer's funds. Moreover, consistent with AB 57, D.04-12-048 places shareholders at risk so as to insure the accuracy of the estimate and provide customers with cost predictability. Finally, SCE's argument is undermined by the fact that it contends that risk and reward must be balanced for each related element that contributes to the procurement benchmark (in this case construction costs), rather than the plan and/or the industry as a whole. Nothing in AB 57 supports SCE's compartmentalized approach to balancing risks and rewards.[8]

In its rehearing application, SCE asserts that there is insufficient record evidence to support D.04-12-048's 50/50 sharing mechanism. Our review of the record confirms that an evidentiary record may be lacking to support the 50/50 sharing mechanism. Thus, a limited rehearing will be granted to develop a legally adequate record. Pending the outcome of the limited rehearing, we will maintain D.04-12-048's 50/50 allocation of construction costs savings, subject to subsequent adjustment.

We note that provisions in AB 57 necessitate that we resolve this issue in a limited rehearing. As several parties including SCE note, AB57 provides that procurement incentives contain "balanced risk and reward incentives that limit the risk and reward of an electrical corporation." (SCE Application for Rehearing, p. 7, citing Pub. Util. Code, § 454, subd. (c)(2); Calpine Corporation Response to SCE Application for Rehearing, p. 6.) Absent the type of sharing delineated by D.04-12-048, the risk D.04-12-048 ascribed to shareholders could be unilaterally transferred to ratepayers in the form of higher initial cost estimates and/or inappropriate cost saving practices.

II. CONCLUSION:

For the reasons set forth above, the applications for rehearing filed by CAC/EPUC and Strategic are without merit, and thus, we deny them. We will however modify D.04-12-048 to clarify two statements made in the decision related to the possible equilibrium between utilities and market participants (MPs), and the duration of the direct access suspension. Further, we grant limited rehearing of D.04-12-048 on SCE's evidentiary challenge regarding the 50/50

[8] One indicator of the Commission's efforts to balance the risk and reward across the industry is found in the statement that, "Cost overruns associated with utility-owned resources should be borne by shareholders, because this approach will level the playing field for IOU-owned projects and PPA, with respect to risk allocation. "

sharing provisions related to construction cost savings, but deny rehearing of SCE's rehearing application in all other respects.

THEREFORE, IT IS ORDERED that:

1. D.04-12-048 should be modified for the purpose of clarification in the following ways.

a. On page 164, the following statement is deleted:

> "It may be the case that the utilities and the MPs have reached a point of equilibrium in that if the MPs had more access to utility information, the utilities may have demanded equal access to MP information."

b. The observation on page 27, lines 19 to 20, that, "DA is currently suspended by legislation until the last DWR contract expires, currently scheduled for 2013" is changed to read: "DA is currently suspended by legislation."

c. Substitute the term "surcharge" for the "exit fee" on page 52, line 4.

d. Substitute the term "surcharges" for the term "exit fees" on page 51, line 16; page 53, line 8; page 73, lines 9 and 16; and page 175, line 27.

2. Limited rehearing on the 50/50 sharing provisions related to construction cost savings is granted. In the interim we will maintain D.04-12-048's 50/50 allocation of construction cost savings.

3. Rehearing of D.04-12-048, as modified, is denied in all other respects.

This order is effective today

Dated September 8, 2005, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
JOHN A. BOHN
Commissioners

Comr. Grueneich recused herself
from this agenda item and was not
part of the quorum in its consideration.