

Decision 06-12-009 December 14, 2006

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Pacific Gas and Electric Company for Review of Entries to the Energy Resource Recovery Account (ERRA) And Compliance Review of Electric Contract Administration, Economic Dispatch of Electric Resources, and Utility Retained Generation Fuel Procurement Activities for the Record Period of January 1 through December 31, 2005.

(U 39 E)

Application 06-02-016  
(Filed February 15, 2006)

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**OPINION ON THE REASONABLENESS AND PRUDENCE  
OF PACIFIC GAS AND ELECTRIC COMPANY'S  
ENERGY RESOURCE RECOVERY ACCOUNT**

**I. Summary**

We find that Pacific Gas and Electric Company's (PG&E) utility retained generation (URG), administration of power purchase agreements, and least cost dispatch power activities for the period beginning January 1, 2005 and ending December 31, 2005 (Record Period) were reasonable and prudent. We also find that PG&E's procurement-related revenue and expenses recorded in its Energy Resource Recovery Account (ERRA) balancing account during the Record Period

resulting in a \$44 million overcollected balance at December 31, 2005 reasonable and prudent.

## **II. Background**

Decision (D.) 02-10-062 established the ERRA balancing account for the major energy utilities to track fuel and purchased power revenues against actual recorded costs. That decision also required the major energy utilities to establish an annual ERRA fuel and purchased power revenue requirement forecast and an annual ERRA reasonableness review through the application process. The purpose of that latter application, now before us, is to review the reasonableness of PG&E's URG, energy resource contract administration, least cost dispatch, and ERRA balance.

## **III. Request**

PG&E seeks approval of its ERRA activities undertaken during the Record Period and \$44 million overcollected balance at December 31, 2005.

## **IV. Discussion**

A review of the application was undertaken by the Division of Ratepayer Advocates (DRA). DRA analyzed PG&E's procurement procedures, contracts, workpapers, calculations, and data responses. DRA also participated in meetings, a facilities tour, and undertook compliance tests for activities that occurred during the Record Period. From that review, DRA concluded that PG&E's Record Period URG, fuel procurement activities, administration and management of energy contracts, and least cost dispatch activities during the Record Period were reasonable and prudent. DRA also concluded that PG&E's Record Period ERRA entries and calculations resulting in a \$44 million overcollected balance at December 31, 2005 were reasonable.

However, DRA did recommend a least cost dispatch disallowance; benchmarking PG&E's in-house hydro models to an industry peer group, or, in the alternative, undertaking an independent audit of PG&E's hydro models; and, changing the process for reporting contract amendments and modifications.

### **A. Least Cost Dispatch**

Least cost dispatch refers to a situation in which the most cost-effective mix of total resources is used, thereby minimizing the cost of delivering electric services.<sup>1</sup> For PG&E, the main goal of least cost dispatch is to determine the most economical generation schedule for its own resources and dispatch contracts, taking into account potential spot trading opportunities at forecasted or observed energy and ancillary service market prices. Details of PG&E's least cost dispatch are set forth in its testimony and exhibits.

DRA concluded from its review of PG&E's day-ahead and hour-ahead real time dispatch transactions that, while PG&E generally followed the least cost dispatch principles, there have been times that PG&E may have deviated from them.<sup>2</sup> For example, DRA's analysis of weighted average monthly hour-ahead transactions indicated that there was a larger than average deviation between December purchase and sale prices. Based on a more detailed analysis of December transactions, DRA concluded that even though PG&E assumed on December 21, 2005 that Diablo Canyon Nuclear Power Plant would be fully available for December 26, 2005, PG&E erroneously made an extra conservative decision to defer the sales of its long position to the hour-ahead market resulting

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<sup>1</sup> D.02-12-074, Ordering Paragraph 24b, mimeo., p. 74.

<sup>2</sup> Exhibit 3, p. 1-2.

in additional costs to ratepayers.<sup>3</sup> That detailed analysis resulted in DRA recommending a \$263,000 disallowance for PG&E's failure to achieve least cost dispatch on December 26, 2005.

However, the facts and action PG&E took does not support the proposed disallowance. The day-ahead trading for December 26 was unusual because trading occurred five days earlier on December 21, 2006 due to the Christmas holiday. On December 20 and 21, 2005, the Diablo Canyon Nuclear Power Plant power output was reduced by approximately 1,500 megawatts of power to 25% of its capacity due to high sea swells generated by storms. Weather forecasts called for more storms to occur during the Christmas holiday.

PG&E's alternative modeling runs showed that if Diablo Canyon was fully available and no storms occurred it could sell 400 to 700 megawatts of power for the entire day. However, if Diablo Canyon was curtailed due to the forecasted storms, PG&E would need to buy up to 1,500 megawatts of power in the hour-ahead market. Irrespective of which scenario was adopted by PG&E, it would need to buy approximately 600 megawatts of power during heavy peak load hours at a significantly higher price. Based on those model results and its assessment of the market for a sale in the day-ahead market, PG&E chose a least cost dispatch alternative of Diablo Canyon power output being fully available but foregoing sale of the 400 to 700 megawatts of power in the day-ahead market as a hedge against possible Diablo Canyon curtailments due to the forecasted storms.

In hindsight, PG&E's customers would have been better off had PG&E chosen the least cost dispatch scenario of Diablo Canyon being curtailed due to

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<sup>3</sup> Id., p. 5-5.

the forecasted storm and purchasing megawatts in the hour-ahead market. This is because the forecasted storm was not as strong as originally forecasted and the price of gas dropped almost 25 % between December 21 and December 26, 2006, making electricity purchases much cheaper on the 26<sup>th</sup>. However, if PG&E had assumed that Diablo Canyon was not available for December 26, 2005, and it actually became available, it would still need to sell the same 400 to 700 megawatts of power during the light load hours in the hour-ahead market at a lower price than could have been obtained in the day-ahead market. PG&E's least cost dispatch decision for December 26, 2006 was reasonable given the facts known at the time PG&E made its least cost dispatch decision.

### **B. Hydroelectric Modeling**

DRA was not able to satisfy itself that the proprietary hydro models used by PG&E for short-term forecasting of rainfall, weather conditions, and hydro generation are accurate and consistent with industry best practice. To ensure that the models' standards and assumptions, some of which were developed in the 1990's prior to California's 2001- 2002 energy crises, are accurate and consistent with industry best practice, DRA recommends that PG&E undertake a benchmarking of its in-house hydro models to an industry peer group or, in the alternative, undertake an independent audit of its hydro models. Irrespective of which recommendation may be adopted, DRA does not expect the cost to be onerous or exorbitant.

PG&E opposes any benchmarking of its hydro facilities to an industry peer group. This is because its proprietary hydroelectric models were designed and tailored to its particular system arising from a large number of generating units, elevations and soil characteristics of its watersheds that vary considerably from area to area, and unique constraints within its system. Such constraints include

its Federal Energy Regulatory Commission license requirements, water delivery contracts, winter storm responses, environmental compliance, coordination with upstream and downstream water users and timing of conveyance in water diversion systems associated with the configuration of each facility. For those reasons identified by PG&E, we concur that it may be difficult, if not impossible, to benchmark PG&E's hydro facilities to an industry peer group. Therefore, we will not require such an undertaking at this time.

PG&E is not opposed to an independent audit of its hydroelectric models. However, it wants an opportunity to have its technical experts explain to DRA how the hydroelectric models work, a process that is less costly than an audit. To the extent it is not successful in providing DRA a comfort level that the models are accurate and consistent with industry best practice then an audit could be undertaken and PG&E seeks authority to charge the cost of the audit to its ERRA balancing account.

Although an audit may be the quickest solution, it is not clear whether such action is necessary or what the cost would be. Rather than approving a blank check for an audit, PG&E's model experts should meet with DRA prior to PG&E's next reasonableness review to further educate DRA on its in-house hydro models. To the extent, DRA is still not able to attest that the models are accurate and consistent with industry practices, DRA and PG&E should propose a process in PG&E's next reasonableness application for undertaking an independent audit including timelines, cost, and recovery of associated costs.

### **C. Reporting Contract Changes**

PG&E included in its reasonableness application amendments and modifications to six of its QF contracts during the Record Period. However, it did not seek approval of those contract changes in this proceeding because those

contract changes were previously submitted for Commission approval in PG&E's Procurement Transaction Quarterly Compliance Reports (PTQCR) advice letter filings.

DRA analyzed those contract changes in this proceeding and found those changes and related costs reasonable. However, it recommends that PG&E submit all future contract amendments and modifications through its annual ERRR compliance application, a separate application, or separate advice letter process in lieu of its PTQCR advice letter filings.

The Commission previously addressed the forums to be used for approval of contract changes in D.98-12-066.<sup>4</sup> That decision authorized the advice letter process to be used for restructured Qualifying Facility (QF) contracts supported by the utility, the QF and DRA, and the application process for controversial QF contract restructurings. More recently, in D.04-12-048, contracts with greater than a five-year term require an application whereas contracts with less than a five-year term may be addressed through an advice letter.<sup>5</sup>

Of the five contract changes identified in this application, two allowed PG&E to purchase incremental energy from QFs with excess capacity at their facilities at a discount price, one of which was in effect for less than 50 days and the other for a year. A third contract amendment reduced the nameplate capacity of a QF previously approved by the Commission in Resolution E-3900.

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<sup>4</sup> In RE: Proposed Policies Governing Restructuring California's Electric Service Industry and Reforming Regulation, Rulemaking 94-04-031 and Investigation 94-04-032 issued April 20, 1994.

<sup>5</sup> In RE: Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning, Rulemaking 04-04-003 issued April 1, 2004.

The remaining two amendments allowed a cogeneration owner to provide power attributable to one QF from another QF's location in exchange for discounted capacity payments, dispatchability, and energy delivery from a more favorable location during a six month period. One of the later contract amendments was extended for an additional six months.

Clearly, all five contract changes entered into during the Record Period met the less than five-year term and thus, were properly submitted for approval via an advice letter. Had PG&E been required to file these contract changes for Commission approval in the annual ERRA application or a separate application, as proposed by DRA, it is questionable whether PG&E would go forward with the changes, which benefited ratepayers, without knowing whether the contract changes would be approved by the Commission. It is also questionable whether PG&E would be able to delay contract changes until it obtained Commission approval through an application process.

However, the PTQCR is not the appropriate vehicle for requesting approval of contract amendments and modifications. The PTQCR is a compliance filing that explains a why and how a utility enters into a contract. As such, the PTQCR is not an appropriate vehicle for an approval request.<sup>6</sup> The PTQCR serves a specific purpose as defined in D.04-10-062, Conclusion of Law 7. That purpose is not compatible with a request for contract modifications. PG&E should file a separate advice letter when seeking Commission approval for contract amendments and modifications. The requirement that PG&E not use

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<sup>6</sup> This issue may be considered more fully in the Long-Term Plan Rulemaking 06-02-043, where the three major energy utilities may participate in a streamlining procurement reporting process.

the PTQCR for contract approval request is not intended to limit or hinder PG&E's management from exercising their discretion in managing the procurement contracts on a day-to-day basis. Nor is PG&E prevented from filing pre-approval requests via an application or a separate advice letter as deemed appropriate by PG&E management.

Previously, the annual ERRA reasonableness application process was used to seek approval of contract amendments and modifications, and we do not object to its continued use for such purpose.

#### **V. Confidential Information**

PG&E tendered testimony as part of its Record Period reasonableness application to substantiate the prudence of its contract administration, least cost dispatch, and ERRA. Portions of PG&E's data and testimony deemed commercially sensitive were tendered under seal, pursuant to General Order 66-C. That information was placed under seal pursuant to a March 3, 2006 Administrative Law Judge (ALJ) ruling.

Subsequent to the sealing of that information, the Commission issued a decision (D.06-06-040) on its rulemaking proceeding (R.05-06-040) regarding the treatment of confidential information. Pursuant to that decision, some of the information placed under seal in this proceeding is to remain confidential for one year and other information for three years. Given that several of those pages placed under seal have information that is to remain sealed for both one and three years, it is not reasonable or cost effective to purge the sealed information at the end of one year to determine what information is no longer confidential.

Therefore, the Commission's Central Files shall keep all confidential information under seal for three years after the date of this order, except upon further order or ruling of the Commission or ALJ then designated as the Law and

Motion Judge. After three years, all such information shall be made public. However, at the end of one year after the date of this order, PG&E shall unredact all information subject to the one year rule, while keeping the three-year data confidential, and make such one-year information available to any party seeking to review such information.

If PG&E believes that further protection of sealed information is needed beyond one year and/or three years after the effective date of this order, it may file a motion stating the justification for further withholding of the sealed information from public inspection, or such other relief as the Commission may provide. This motion shall be filed no later than 30 days before the expiration of the one year and three-year period after the effective date of this order.

#### **VI. Procedural Matters**

PG&E requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3168, dated March 2, 2006, the Commission preliminarily determined that this was a ratesetting proceeding and that hearings may be necessary. There was no objection to the categorization.

Notice of the application appeared in the Commission's Daily Calendar of February 21, 2006. An evidentiary hearing was held on July 17, 2006 and this matter was submitted upon the receipt of reply briefs on September 8, 2006.

#### **VII. 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 Rule 14.2(a) of the Commission's Rules of Practice and Procedure. Comments were filed on November 28, 2006, and reply comments were filed on December 4, 2006. To the extent changes have been made as a result of the filed comments, they were made in the body of this order.

### **VIII. Assignment of Proceeding**

Michael R. Peevey is the assigned Commissioner and Michael J. Galvin is the assigned ALJ in this proceeding.

### **Findings of Fact**

1. The application was filed on February 15, 2006, and appeared in the Commission's Daily Calendar on March 2, 2006.
2. PG&E provided detailed exhibits and testimony on its administration of power purchase agreements, procurement of least cost dispatch power activities, and procurement-related revenue and expenses recorded in its ERRA for the Record Period beginning January 1, 2005 and ending December 31, 2005.
3. DRA provided testimony on the results of its independent examination of PG&E's administration of power purchase agreements, procurement of least cost dispatch power activities, and the ERRA balance.
4. DRA scrutinized the source of entries recorded in PG&E's ERRA during the Record Period through its review of contract administration and least cost dispatch activities during the Record Period.
5. A DRA audit of the entries PG&E recorded in its ERRA for the Record Period disclosed no material errors.
6. Information that would place PG&E in a competitive disadvantage if disclosed was placed under seal.

### **Conclusions of Law**

1. PG&E's URG, administration of its power purchase agreements, and least cost dispatch activities during the Record Period were reasonable and prudent.
2. PG&E's \$44 million overcollected ERRA balance at December 31, 2005 is reasonable.

3. Requests for approval of contract amendments and modifications should be made by a separate advice letter filing, or in the annual ERRA reasonableness application.

4. Information placed under seal should remain sealed, as provided in this order.

5. This decision should be effective today in order to allow the docket to be closed expeditiously.

**O R D E R**

**IT IS ORDERED** that:

1. Pacific Gas and Electric Company's (PG&E) utility retained generation, administration of its power purchase agreements and procurement of least cost dispatch power activities for the period beginning January 1, 2005 and ending December 31, 2005 (Record Period) were reasonable and prudent.

2. PG&E's \$ 44 million Energy Resource Recovery Account (ERRA) overcollected balance at December 31, 2005 is reasonable.

3. PG&E shall file a separate advice letter, or include in its annual ERRA reasonableness applications, an approval request for contract amendments and modifications.

4. All information placed under seal shall remain sealed for a period of three years from the effective date of this order except upon further order or ruling of the Commission or Administrative Law Judge then designated as the Law and Motion Judge. After three years, all such information shall be made public. However, at the end of one year after the date of this order, PG&E shall make public all information subject to the one year confidential standard, while keeping sealed the three-year information, and making such one-year information available to any party seeking to review such information. If PG&E believes that further protection of sealed information is needed beyond one year after the effective date of this order and/or three-year period, it may file a motion stating the justification for further withholding of the sealed information from public inspection, or for such other relief as the Commission may provide. This motion shall be filed no later than 30 days before the expiration of the one-year and three-year period specified in this ordering paragraph.

5. Application 06-02-016 is closed.

This order is effective today.

Dated December 14, 2006, at San Francisco, California.

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

