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Decision 08-07-048 July 31, 2008

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.	Rulemaking 04-04-003 (Filed April 1, 2004) (QF Issues)
Order Instituting Rulemaking to Promote Consistency in Methodology and Input Assumptions in Commission Applications of Short-Run And Long-Run Avoided Costs, Including Pricing for Qualifying Facilities.	Rulemaking 04-04-025 (Filed April 22, 2004) (QF Issues)

ORDER MODIFYING DECISION (D.) 07-09-040, AND DENYING REHEARING OF DECISION, AS MODIFIED

I. SUMMARY

In Decision (D.) 07-09-040 (or "Decision"), issued on September 25, 2007, we adopted specific policies and pricing mechanisms applicable to the electric utilities' purchase of energy and capacity from Qualifying Facilities ("QFs") pursuant to the Public Utilities Regulatory Policy Act of 1978 ("PURPA") (16 U.S.C. § 824a-3). Specifically, we adopted the following policies and pricing mechanisms, among others: (1) the Market Index Formula ("MIF"), which is an updated short-run avoided cost ("SRAC") formula for pricing SRAC energy; (2) two standard contract options for expiring or expired QF contracts and new QFs, including one to five year as-available power contracts, one to ten year firm, unit-contingent power contracts, and the continuing option for QFs to participate in Investor-Owned Utilities ("IOU") power solicitations, or to negotiate bilateral contracts with the IOUs; (3) contract provisions for terms and pricing of firm and as-available energy and capacity; and (4) specific provisions for IOU contracts with small QFs. (D.07-09-040, pp. 2-3.)

A joint application for rehearing of D.07-09-040 was filed by Pacific Gas & Electric Company ("PG&E"), Southern California Edison Company ("Edison"), San Diego Gas & Electric Company ("SDG&E"), The Utility Reform Network ("TURN"), and the Division of Ratepayer Advocates ("DRA") (collectively, the "Joint Parties"). A joint application for rehearing was also filed by the Cogeneration Association of California ("CAC") and the Energy Producers and Users Coalition ("EPUC") (collectively, the "QF Parties"). Finally, an application for rehearing was filed by the California Cogeneration Council ("CCC").

In their rehearing application, the Joint Parties challenge D.07-09-040 on the following grounds: (1) the Decision's application of MPR TOU factors to the SRAC energy price is legally and factually erroneous; (2) the MIF violates PURPA; (3) the new "small QF" option violates PURPA; (4) the Decision commits legal error by failing to order a retroactive true-up of SRAC energy payments; and (5) the Decision commits legal error by ordering the extension of non-price terms of existing contracts.

In their rehearing application, the QF Parties challenge D.07-09-040 on the following grounds: (1) pricing under the Prospective QF Program does not meet the requirements of PURPA and Public Utilities Code Section 390(b)[1]; and (2) the Decision's reliance on the current record, which did not allow QF parties access to relevant data, is unlawful under federal law.

In its rehearing application, CCC challenges D.07-09-040 on the following grounds: (1) the Decision's as-available capacity pricing is arbitrary because it differs significantly from the most reliable and up-to-date evidence in the record and from recent Commission decisions; (2) the Commission failed to account for evidence relating to variable SCR and new environmental costs in setting the O&M adder; and (3) the

[1] Unless otherwise noted, all statutory references herein are to the Public Utilities Code.

Commission's order to revise the MIF six months after the MRTU is operational is arbitrary and contrary to law.

We have reviewed all of the allegations of error raised in the rehearing applications, and determine that the Decision should be modified in several respects. As modified, rehearing of D.07-09-040 is denied.

II. DISCUSSION

A. Application of MPR TOU factors to the SRAC energy price.

In their rehearing application, the Joint Parties claim that our determination to adopt changes to the TOU/TOD factors is not supported by evidence in the record in violation of Section 1757(a)(4), and is not reflected in adequate findings of fact and conclusions of law in violation of Section 1705. (Joint Parties Reh. App., p. 4.) According to the Joint Parties, the ALJ's Proposed Decision[2] ("PD") and the original alternate decision (issued on August 20, 2007) determined that the record in the underlying proceeding was insufficient to update the TOU/TOD factors, and directed the utilities to address updating the TOU/TOD factors when they file their next long-term procurement plans. (Joint Parties Reh. App., p. 3). The Joint Parties assert that, without any notice, and less than 24 hours before our September 20, 2007 public meeting, the alternate decision was revised to adopt changes to the TOU/TOD factors, instead of deferring such changes to a later proceeding with a more fully developed record, as proposed in the PD and the original alternate decision. (Joint Parties Reh. App., p. 3.) The Joint Parties claim that we cannot justify the adopted changes to the TOU/TOD factors based on the insufficient record developed in the underlying proceeding, and as such rehearing must be granted or the Decision must be modified. We address these allegations by modifying D.07-09-040 to eliminate changes to the TOU/TOD factors, and instead defer such changes to the utilities' next long-term procurement plans.

[2] The PD referred to herein is the Proposed Decision of ALJ Halligan, Revision 2, mailed for comment on April 24, 2007.

B. The MIF and PURPA compliance.

The Joint Parties next allege that the "hybrid" approach articulated in the Decision for calculating the heat rate in the MIF is not based on the record in this proceeding, was not advanced by any party to the proceeding, and consequently there was no opportunity for parties to test this methodology through cross-examination or to comment or present evidence regarding this methodology during the proceeding. (Joint Parties Reh. App., p. 8.) The Joint Parties further claim that part of the formula used in the Decision to determine the heat rate is more than ten years old, and the incorporation of such "stale data" cannot result in an energy price that reflects the utilities' current SRAC at the time of delivery, as required by PURPA and the Federal Energy Regulatory Commission's ("FERC's") implementing regulations. (Joint Parties Reh. App., pp. 8-11.) The Joint Parties also assert that the Decision fails to comply with Sections 1705 and 1757(a)(4) because it offers no rationale, or separately stated findings and conclusions, to support its determination that a MIF based on an average of forward NP 15/SP 15 market prices and the existing Commission-determined heat rates reflects the utilities' SRAC. (Joint Parties Reh. App., pp. 9-11.) We believe these allegations of error lack merit. However, for the purpose of clarification, we will modify the Decision to include additional discussion regarding our formulation of the MIF.

The Joint Parties correctly point out that the hybrid approach adopted by the Commission for calculating the MIF was not considered by the Commission or the parties during the proceeding. This hybrid approach involves equal weighting (50/50) of the following two factors: (1) the heat rate for each utility, as determined by the Commission (heat rates for PG&E and SDG&E determined in D.96-12-028; heat rate for Edison determined in D.96-12-028 and D.01-03-067); and (2) forward NP 15/SP 15 market prices. However, both approaches (market-based approach vs. status quo approach based on Commission-determined heat rates) were each individually discussed and considered at length during the proceeding, and evidence was submitted by all parties regarding the proper formulation of the MIF. It is undisputed that the Commission-determined heat rate approach and the NP 15/SP 15 market price methodology were fully considered and discussed by the parties as separate and independent options during the proceeding, and there is evidence in the record supporting both approaches for calculating the MIF. (*See* D.07-09-040, pp. 60-67.) As such, the Commission was entirely justified in combining the two approaches into a methodology that attempts to correct for the shortcomings of each individual approach.

The recent Court of Appeal decision in *Southern California Edison Co. v. Public Utilities Commission,* (2002) 101 Cal.App.4th 384 supports our determination to adopt the hybrid approach for calculating the MIF. In that case, the Court upheld the Commission's adoption of a new approach for dealing with Transmission Loss Factors ("TLFs"). The Commission had found in D.01-01-0017 that existing TLFs were incorrect and violated PURPA by overpaying QFs. To remedy this problem, the Commission formulated a new methodology to deal with TLFs, which involved the application of a generation meter multiplier ("GMM") to energy transmitted over power lines in order to adjust payments to reflect line losses. This methodology was challenged by Caithness Energy, which argued that the old fixed ratios should be reinstated and that the new GMM methodology violated PURPA. In finding for the Commission, the Court stated:

> We have reviewed the evidence upon which the Commission based its decision. The Commission was faced with TLF's that it knew were incorrect and had the effect of overcompensating the QF's in violation of PURPA. The Commission did what PURPA required: It held hearings, heard conflicting evidence and determined that the GMM approach was the best method for measuring line losses. The Commission then took a second step and devised a formula, using GMM methodology, to be used for determining the impact on system line losses that occurs when a QF's power is brought into the overall power system as compared to what would have occurred had the utility procured its power elsewhere. That is all that PURPA requires.

(*Southern California Edison Co*., *supra*, 101 Cal.App.4th at p. 396 (citations omitted).)

Similarly, in the present case, we were faced with two options advocated by the parties, both containing flaws if adopted. As noted above, the market-based approach (advocated by the utilities) can have the effect of deflating QF payments, while the Commission-determined heat rate approach (advocated by the QFs) can have the effect of inflating QF payments. (D.07-09-040, p. 63.) Given the Commission's technical expertise over the ratemaking, cost allocation and other regulatory matters involving QFs and PURPA, we reasonably and properly devised a formula that acknowledges the shortcomings of both approaches when used independently, and attempts to compensate for these shortcomings by combining the two methodologies into a hybrid approach that is reasonably supported by the evidence in the record.

Thus, we will modify D.07-09-040 to include additional discussion regarding our formulation of the MIF. As modified, the Joint Parties' allegations of error lack merit.

C. The new "small QF" option and PURPA compliance.

The Joint Parties claim that the new "small QF" option adopted in D.07-09-040 violates PURPA because it requires utilities to make the standard offer contract options available to small QFs regardless of the utilities' respective resource needs. (Joint Parties Reh. App., p. 13.) According to the Joint Parties, we cannot lawfully require the utilities to enter into standard contracts without considering resource needs, and the Joint Parties further assert that we have expressly recognized this requirement by subjecting the standard offer contracts for larger QFs (over 20 MW) to limitation based on the utilities' actual need. (Joint Parties Reh. App., p. 13.) We believe that the Joint Parties may have a valid point, and thus we will modify D.07-09-040 to eliminate the 110% contracting requirement. Instead, for small QFs, the IOUs may not deny one of the two contracting options described in D.07-09-040 on the basis of oversubscription unless we have determined that the IOU is oversubscribed, as determined in each utility's long-term procurement plan proceeding. This modification should alleviate our legitimate concern about the IOUs improperly claiming oversubscription as a basis for rejecting QF contracts.

D. Retroactive true-up of SRAC energy payments.

The Joint Parties next allege that we erred in failing to order a retroactive true-up of SRAC energy prices in D.07-09-040. The Joint Parties point to page 9 of D.07-09-040, where the Commission states that the Decision "updates the methodology for calculating SRAC energy prices on a prospective basis only, to ensure that SRAC prices continue to reflect utility avoided cost in the changing electricity markets in California." (Joint Parties Reh. App., p. 14.) The Joint Parties also refer to our statement that "the record in this proceeding does not support a conclusion that the [SRAC transition formula] yielded prices that exceed utility avoided costs or systematically violated PURPA," and allege that this determination is not supported by record evidence and is not reflected in sufficient findings and conclusions as required by Section 1705. (Joint Parties Reh. App., pp. 14-15.) We address this argument by modifying D.07-09-040 to permit a true-up with the filing of an application by the IOU. In the application, the IOU must provide the following: (1) the time period for which the IOU believes retroactive adjustment is warranted; and (2) evidentiary support demonstrating that the IOU's method is more accurate than the method the Commission has already reviewed and adopted for determining avoided costs. For past periods, the IOUs will have until November 4, 2008 to file the application. Going forward, the IOUs will have 2 years from the beginning of any alleged period of overpayment to file an application and make the requisite showing.

E. Extension of non-price terms of existing contracts.

Finally, the Joint Parties claim that our determination to allow extension of non-price terms and conditions of existing firm capacity contracts that might expire before the final contracts are completed (D.07-09-040, p. 126) is not supported by record evidence. (Joint Parties Reh. App., p. 16.) Further, the Joint Parties maintain that the Decision does not contain sufficient findings and conclusions, as required by Section 1705, to demonstrate that the extension of non-price terms complies with PURPA. (JointParties Reh. App., p. 16.) We believe this allegation of error lacks merit. However, we will modify the Decision to allow the utilities an opportunity to demonstrate, via a petition for modification, that in specific instances and over a period of time, the extension of non-price terms of existing contracts has, in fact, caused the utilities to pay more for capacity that their avoided costs, in violation of PURPA.

The Joint Parties point to no specific evidence in the record indicating that they will actually pay more for capacity than their avoided costs as a result of extending non-price terms of existing contracts. Their argument is primarily based upon speculation that the extension of non-price terms *might* cause them to pay more for capacity than their avoided costs, and they allege that, *if this does occur*, it would violate PURPA. Indeed, the Joint Parties allege that the extension of non-price terms "*can* result in prices that exceed the utilities' avoided cost at the time of delivery." (Joint Parties Reh. App., p. 17 (emphasis added).) They do not allege that the extension of such terms will necessarily result in prices exceeding avoided costs.

The only somewhat concrete example the Joint Parties offer is that, if they are required to extend the existing 80% summer performance requirement, rather than imposing the higher 90-95% performance requirement articulated in the Decision, it will "result in less value on a unit basis of delivered energy and capacity from an alternative resource" and will "yield prices that exceed avoided cost, in violation of PURPA." (Joint Parties Reh. App., p. 17.) This is still largely speculative because, even if a particular QF is permitted to extend, for a period of time, the preexisting 80% performance requirement, it is entirely plausible that the QF will actually meet a much higher performance requirement, perhaps as high as the new 90-95% requirement articulated in the Decision. In such instances, there would be no plausible allegation that the extension of a non-price term (here, the performance requirement) resulted in prices exceeding utility avoided costs. Thus, the Joint Parties' allegation in this regard is largely speculative, and thus lacks merit.

Finally, whether or not the final contracts are completed before existing contracts expire is largely a matter that is within the control of the IOUs. If the IOUs prefer *not* to have to extend the non-price terms of existing contracts, as required by the

Decision, they are free to make arrangements to complete their negotiations in time for new contracts to take effect before the expiration of existing contracts.

However, as discussed above, we will modify the Decision to note that the utilities have an opportunity to demonstrate, via a petition for modification, that in specific instances the extension of non-price terms of existing contracts has, in fact, caused the utilities to pay more for capacity that their avoided costs, in violation of PURPA. The Commission is not required to eliminate the extension of non-price terms of existing contracts simply based on an unsupported allegation that a PURPA violation *might* occur.

F. Pricing under the Prospective QF Program and compliance with PURPA and Section 390(b).

In their rehearing application, the QF Parties argue that the pricing methodology adopted in the Decision for the Prospective QF Program violates both PURPA and Section 390(b). Specifically, the QF Parties claim that pricing under the Prospective QF Program does not strictly comply with PURPA's definition of avoided costs, and does not comply with the calculation requirements for SRAC energy payments contained in Section 390(b). (QF Parties Reh. App., p. 2.) Other than these conclusory allegations, however, the QF Parties' rehearing application offers no legal or factual analysis whatsoever in support of these arguments, other than referencing previously-filed comments and briefs. They do not explain in any way why, in their view, the pricing methodology adopted in the Decision violates either PURPA or Section 390(b). As the parties seeking rehearing on this point, the QF Parties bear the burden of demonstrating "specifically the grounds on which the applicant considers the order or decision of the Commission to be unlawful or erroneous, and must make specific references to the record or law." (Pub. Util. Code, §1732; *see also* Rule 16.1(c) of the Commission's Rules of Practice and Procedure.)

As to the first allegation of error, the modifications discussed above regarding our formulation of the MIF provides further explanation of the reasons why the MIF, as articulated in the Decision, complies with PURPA. As to the second allegation of error regarding Section 390(b), the Court in *Southern California Edison Co., supra,* agreed that the Commission has a duty under Section 390 to modify the SRAC methodology in appropriate circumstances. (*Southern California Edison Co., supra*, 101 Cal.App.4th at pp. 991-992.) Even CCC agreed during the proceeding that the SRAC calculation can be updated, consistent with Section 390(b), through implementation of the MIF. (CCC Opening Brief, p. 9.) Updating the SRAC through implementation of the MIF complies with Section 390 because it adheres to the requirement that SRAC be tied to natural gas prices. Indeed, the methodology for calculating the MIF, as articulated in the Decision, expressly includes "GPn" as a factor in the calculation, which reflects the current gas price at $/MMBtu. (D.07-09-040, p. 67.) In addition, because the MIF is based on the Modified Formula, which we adopted in D.01-03-067 and which was affirmed by the California Court of Appeal in *Southern California Edison Co., supra*, this allegation of error lacks merit.

In the Decision, we clearly articulated why the MIF is both reasonable and compliant with Section 390(b). We found in D.07-09-040 that "a combination of market-based offers along with the ability to compete for longer-term contracts best reflects the utilities' avoided cost and meets California's goals for acquiring and retaining cost-effective, environmentally sound generation." (D.07-09-040, p. 125.) In support of this finding, we noted that this approach "provides both short and longer-term options for market-based contracts" and requires the IOU to "propose a portfolio of resources that reflects the continuation of QF capacity" for each procurement cycle. (D.07-09-040, p. 125.) The Decision further notes that the "IOU must demonstrate that their solicitations encourage the participation of QFs whose contracts are expiring." (D.07-09-040, p. 125.)

In response to the QF Parties' suggestion that "enhancing" QF payments for delivered electric power would encourage cogeneration, we expressly noted that we are "prevented from 'enhancing' QF payments if that would exceed avoided cost." (D.07-09-040, p. 126.) We also found that we are "precluded from paying different avoided costs rates for different QFs or different technologies; any standard offer we provide is open to all QFs, regardless of size, location, efficiency, as long as they are certified as a qualifying facility under PURPA." (D.07-09-040, pp. 126-127.) Citing D.04-01-050 and FERC's Order No. 69, we determined that the PURPA purchase obligation "must balance the PURPA mandate that utilities purchase energy and capacity from QFs with the overarching requirement that electric utilities may only charge just and reasonable rates for the power they supply to their customers." (D.07-09-040, p. 127.) Given all of the factors discussed above, we reasonably and properly concluded that "[t]he Market Index Formula complies with PU Code § 390(b)." (D.07-09-040, p. 149 [Conclusion of Law 9].)

Thus, because the pricing methodology adopted in the Decision, and modified as discussed above, complies with both PURPA and Section 390(b), the QF Parties' allegations to the contrary lack merit.

G. QF access to confidential, market-sensitive information.

Finally, the QF Parties allege that they were improperly denied access to relevant data during the proceeding, in violation of federal law, and as a result they were unable to determine the actual utility avoided costs and present that position to the Commission. (QF Parties Reh. App., p. 3.) In support of this contention, the QF Parties cite 18 C.F.R. § 292.302, which lists certain data that is to be considered in calculating avoided costs. Because they did not have access to some of this data due to confidentiality concerns, the QF Parties claim that we erred, in violation of federal law. This allegation of error lacks merit.

As the Decision discusses at length, the issue of what utility data would remain confidential was the subject of several motions and responses filed by the parties during the proceeding, and was resolved by the ALJ's May 9, 2005 Ruling on Protective Order and Remaining Discovery Disputes ("Ruling"). In the Ruling, the ALJ noted that there is often tension between transparency of information and the potential adverse impacts the release of such information could have on markets and ratepayers. (D.07-09-040, p. 137.) The Ruling further noted our obligations pursuant to Section 454.5(g), which provides that we shall ensure the confidentiality of any market sensitive information submitted in an electrical corporation's proposed procurement plan or resulting from or related to its approved procurement plan. (Pub. Util. Code 454.5, subd. (g).) Section 454.5(g) further provides that nonmarket participants shall be provided access to such confidential information under appropriate procedures authorized by the Commission. The Ruling complied with these requirements by adopting a protective order that balanced the QF Parties' need for certain information with the utilities' need to prevent the dissemination of sensitive market information. (D.07-09-040, p. 138.) The Ruling further determined that, while market participants would not have complete access to certain proprietary and market sensitive information, nonmarket participants would have complete access to all information and would be able to provide the Commission with all of the information and arguments necessary to reach informed decisions on all material issues. (D.07-09-040, p. 138.) In this proceeding, we thus struck an appropriate balance between competing concerns, and as such this allegation of error lacks merit.

H. As-available capacity pricing.

In its rehearing application, CCC claims that we erred in adopting as-available pricing based upon "stale data," and that more-current information in the record supports a higher as-available capacity price. (CCC Reh. App., pp. 2-5.) CCC further asserts that we have relied on this more recent information in other decisions, and should do so in this proceeding as well. (CCC Reh. App., pp. 2-5.) These allegations of error lack merit.

As CCC acknowledges, in this proceeding we were presented with conflicting evidence regarding the proper approach to as-available capacity pricing. (CCC Reh. App., pp. 3-5.) For example, the QF Parties urged us to maintain the current capacity pricing mechanism and simply modify the Energy Reliability Index ("ERI") values to reflect that each utility is currently seeking additional capacity to meet its resource adequacy requirements. (*See* D.07-09-040, p. 86.) TURN proposed an alternate methodology that derived the as-available capacity price from CT cost and real economic carrying charge rate calculations, with an ancillary services adjustment and an energy benefits adjustment subtracted from the adopted value. (*See* D.07-09-040, pp. 88, 95, 96.) SDG&E recommended a full avoided generation cost of $83.75 per kW-year less the ancillary value of $14.82 per kW-year, for a proposed value for full as-available capacity of $68.93 per kW-year. (*See* D.07-09-040, p. 89.) DRA argued that the Commission should modify the method for calculating as-available capacity prices for existing contracts to reflect the actual value that those contracts provide, without recommending a specific proposal. (*See* D.07-09-040, p. 89.) PG&E argued that that QF capacity prices should be bases on the resource's going-forward fixed costs, defined as costs that do not vary with the resource's output, but which are needed to maintain an existing resource in operation, including insurance, property taxes, and fixed operations and maintenance costs, but that do not include depreciation of sunk capital, such as the cost of construction for the resource. (*See* D.07-09-040, pp. 89-90.) Finally, CCC, IEP and the Renewables Coalition proposed calculating as-available capacity prices using levelized-nominal values, using the Market Price Referent methodology to calculate 20-year levelized-nominal values. (*See* D.07-09-040, p. 90.)

Faced with these competing proposals for calculating as-available capacity, and after weighing all of the proposals submitted by the parties, we properly and reasonably adopted TURN's proposed methodology, which results in a capacity value of $32.53 per kW-year. (D.07-09-040, pp. 96, 146-147 [Finding of Fact 36].) We noted that Edison and SDG&E largely agreed with TURN (and with the Commission) that the avoided CT cost should be based on an economic carrying charge rate, escalated for inflation over the life of the contract. (*See* D.07-09-040, p. 96.) We determined that "[u]sing an economic carrying charge rate, escalated for inflation over the life of the contract, allows us to provide more flexibility in contract terms, from one year up to ten years with the same CT cost estimate." (D.07-09-040, p. 146 [Finding of Fact 35].) Contrary to CCC's suggestion, we clearly explained why we disagreed with CCC's levelized-nominal value approach. "Using a levelized nominal dollar value to compute the CT cost would overstate the avoided capacity cost as well as present additional cost and risk for utilities and ratepayers." (D.07-09-040, pp. 96, 146 [Finding of Fact 34].)

We further noted that "[a] primary concern is that the use of a levelized nominal value would require higher capacity payments in early years, exposing the utilities and their ratepayers to the risk of non-performance if the QF went off-line or simply failed to perform." (D.07-09-040, p. 96.) These are reasonable and appropriate concerns for the Commission to consider in adopting a methodology for as-available capacity pricing.

In weighing conflicting evidence, we reached a reasonable conclusion supported by record evidence regarding the methodology for calculating as-available capacity pricing. As such, CCC's allegations to the contrary lack merit.

I. The O&M adder.

CCC next alleges that we erred by failing to account for evidence relating to variable selective catalytic reduction ("SCR") costs and new environmental costs in setting the O&M adder. (CCC Reh. App., p. 6.) Specifically, CCC claims that record evidence demonstrates that these new SCR and water treatment costs were $0.60 per MWh in 2006 and $0.62 per MWh for 2008, assuming a 2% escalation per year. CCC asserts that incorporating these SCR and water treatment costs would result in an O&M adder of $3.26 per MWh for 2007 and $3.33 per MWh for 2008. (CCC Reh. App., p. 6.) This allegation of error lacks merit.

As noted in the Decision, the Operation and Maintenance ("O&M") adder is a component of the MIF which accounts for the variable O&M expenses incurred by the utility to produce energy, and is a relatively small component of costs in the SRAC formula. (D.07-09-040, p. 69.) In the proceeding, we were presented with conflicting proposals and figures from the parties regarding changes to the O&M adder. For example, Edison and IEP proposed $2.00/MWh, SDG&E proposed $2.50 in 2004 dollars (escalated by 2% annually to $2.60 in 2006, as adopted for SDG&E in D.05-04-024), and CCC proposed $3.00/MWh and an automatic adjustment in future years. (D.07-09-040, p. 69.) We weighed the conflicting evidence and proposals submitted by the parties and determined that SDG&E's proposal constituted a reasonable method of setting the O&M adder, subject to an escalation of 2% per year. (D.07-09-040, p. 70.) We noted the inherent "uncertainty in formulating such estimates," and determined that the same variable O&M adder should be adopted for all three IOUs in order to further the Commission's goal of achieving consistency in this rulemaking proceeding. (D.07-09-040, p. 69.) We concluded that "[t]here is no compelling reason not to adopt the same variable O&M adder for all three utilities." (D.07-09-040, p. 145 [Finding of Fact 26].)

In weighing conflicting evidence, we reached a reasonable conclusion supported by record evidence regarding the O&M adder. Accordingly, CCC's allegations to the contrary lack merit.

J. Revising the MIF once the MRTU is operational.

As its final allegation of error, CCC claims that we erred in ordering that the MIF be revised six months after the Market Redesign and Technology Update ("MRTU") is operational. (CCC Reh. App., p. 6.) CCC asserts that this timeframe is arbitrary and ignores the statutory requirements of PURPA, which requires a determination that the prices paid to non-utility generators must reflect the utility's avoided costs. (CCC Reh. App., pp. 7-8.) CCC further argues that we erred in allowing the Assigned Commissioner the discretion to determine whether the MRTU day-ahead market is functioning properly, without an opportunity for input from interested parties or full Commission review. (CCC Reh. App., pp. 8-9.) While these allegations of error lack merit, we will modify the Decision to allow interested parties 30 days to comment on whether the MRTU day-ahead market is indeed functioning properly, prior to the Assigned Commissioner's final determination on this issue. We also note that this determination will be subject to review by the Commission.

The Decision does not, as CCC suggests, require an arbitrary, rigid timetable for revising the MIF once the MRTU is operational. Rather, the Decision provides that the Assigned Commissioner will make a determination, based upon the most accurate, currently available information, as to whether the MRTU day-ahead market is functioning properly. (D.07-09-040, p. 68.) The Decision also directs Energy Division to monitor the operation of the markets in close consultation with CAISO's market monitoring group. (D.07-09-040, p. 68.) If the Assigned Commissioner finds, in consultation with Energy Division and based on CAISO's market monitoring reports, that this market is not functioning properly, or that there is insufficient evidence and documentation to support a conclusion on this issue, the Assigned Commissioner has the discretion to postpone such a determination for six months. (D.07-09-040, p. 68.) The Decision clearly points out that an important factor the Assigned Commissioner will need to consider in reaching such a determination is whether the market prices comply with PURPA's mandate that prices paid for energy may not exceed utility avoided costs. (D.07-09-040, p. 68.)

Thus, we will modify the Decision to allow parties 30 days to comment on the issue of whether the MRTU day-ahead market is indeed functioning properly and accurately reflects utility avoided costs. This determination will be subject to review by the Commission. As modified, CCC's due process concerns are addressed.

III. CONCLUSION

D.07-09-040 is hereby modified as discussed above, and as set forth in the ordering paragraphs below. As modified, rehearing of D.07-09-040 is denied because no legal error has been demonstrated.

IT IS THEREFORE ORDERED THAT:

1. D.07-09-040 is modified as follows:

   a. The last paragraph on page 70 of D.07-09-040 is modified to read as follows:

      "As noted above, the Legislature did not adopt a specific formula, nor did it adopt specific TOU factors. Therefore, it is appropriate to update the TOU or TOD factors periodically. The evidence in this proceeding clearly demonstrates that the TOU/TOD data is outdated. Unfortunately, the parties recommending specific changes to the TOU/TOD factors and periods did not provide a sufficient showing to support their recommendations. Nevertheless, we believe that updating the IOUs' TOU/TOD factors and periods to be consistent with the TOU factors adopted in other procurement proceedings is reasonable. Therefore, we shall consider the updating of the IOUs' TOU/TOD factors and periods in the utilities' next long-term procurement plans."

b. The following paragraph is added to D.07-09-040 at page 67, immediately following the formula for calculating the MIF:

"We believe that combining the Commission-determined heat rates and forward NP 15/SP 15 market prices as components of the MIF, and giving equal weight to both, achieves our goal of approximating avoided costs as closely as possible. To our knowledge, there is no perfect or foolproof method of calculating avoided costs to the penny. This is not an exact science, as evidenced by the widely divergent proposals submitted by the parties to this proceeding. As discussed above, we received evidence from the parties indicating that using market prices alone would likely understate payments to QFs, while using the Commission-determined heat rates alone would likely overstate payments to QFs. Our purpose in formulating the MIF as a 50/50 balancing of both of these factors is to encourage QF development to the greatest extent possible, while striving to comply with PURPA's requirement that payments to QFs may not exceed utility avoided costs. We anticipate that the formulation of the MIF articulated in the Decision will be effective only until the MRTU is fully operational and a determination has been made that the MRTU day-ahead market is indeed functioning properly. At that time, we intend to revise the MIF to more fully embrace market prices as a method of calculating avoided costs."

c. Finding of Fact 23 is modified to read as follows:

"A Market Index Formula based on an average of forward NP 15/SP 15 market prices and the existing Commission adopted heat rates reasonably reflects the utilities' short-run avoided cost. Evidence presented during the proceeding demonstrates that using either of these factors alone as the basis of the Market Index Formula would either overstate or understate utility avoided costs. The Commission's goal in calculating the Market Index Formula in this manner is to encourage QF development to the greatest extent possible, while striving to comply with PURPA's requirement that payments to QFs may not exceed utility avoided costs."

d. Conclusion of Law 19 is modified to read as follows:

"For small QFs, the IOUs may not deny one of the two contracting options described in this Decision on the basis of oversubscription unless we have determined that the IOU is oversubscribed, as determined in each utility's long-term procurement plan proceeding."

e. The final paragraph on page 123 of D.07-09-040 is modified to read as follows:

"We determine that, for small QFs, the IOUs may not deny one of the two contracting options described in our Decision on the basis of oversubscription unless we have determined that the IOU is oversubscribed, as determined in each utility's long-term procurement plan proceeding. This requirement should alleviate our legitimate concern about the IOUs improperly claiming oversubscription as a basis for rejecting QF contracts."

f. The second full paragraph on page 9 of D.07-09-040 is modified to read as follows:

"The contract terms and pricing in this decision apply specifically to expired, expiring and new QF contracts. Other than updating the SRAC formula and posted capacity prices, we do not change existing QF contracts. Furthermore, this decision updates the methodology for calculating SRAC energy prices on a prospective basis only, to ensure that SRAC prices continue to reflect utility avoided cost in the changing electricity markets in California. In comments, SCE has requested that the adopted MIF be applied retroactively. However, updating the SRAC formula to better reflect changes in the energy market does not, by itself, indicate that SRAC prices under the prior formula were in violation of PURPA. Furthermore, the record in this proceeding does not support a conclusion that the Modified Formula yielded prices that exceed utility avoided costs or systematically violated PURPA. Should a party believe that retroactive review is necessary to ensure compliance with PURPA, it should file an application. The application must provide both the time period for which it believes retroactive adjustment is warranted, and evidence demonstrating that the IOU's method is more accurate than the method the Commission has already reviewed and adopted for determining avoided costs for that particular time period. For any periods already in the past, the IOUs will have until November 4, 2008 to file an application. Going forward, the IOUs will have 2 years from the beginning of any alleged period of overpayment to file an application. These are reasonable time limitations, given our legitimate concerns about Commission resources and the need for regulatory certainty for both QFs and IOUs."

g. The following is added to D.07-09-040 as Conclusion of Law 21:

"The utilities may file a petition for modification to demonstrate that in specific instances and over time the extension of non-price terms of existing contracts has, in fact, caused the utilities to pay more for capacity that their avoided costs, in violation of PURPA."

h. Ordering Paragraph 4 is modified to read as follows:

"The Assigned Commissioner has authority to delay the implementation of the revised MIF if they determine that the market component of the MIF will not reflect the heat rate component of avoided costs. Once the MRTU is operational and the Assigned Commissioner issues a proposed ruling regarding whether to revise the MIF, interested parties will have 30 days to comment on whether the MRTU day-ahead market is indeed functioning properly, prior to the Assigned Commissioner's final determination on this issue, which is subject to Commission review."

2. Rehearing of D.07-09-040, as modified, is hereby denied.

This order is effective today.

Dated July 31, 2008, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners