

DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
ENERGY DIVISION
Item 53 ID#4097
RESOLUTION E-3902
December 16, 2004

R E S O L U T I O N

Resolution E-3902. Southern California Edison Company and the California Independent System Operator submit a Revised Local Area Reliability Procurement Proposal developed pursuant to Decision 04-07-028.

By SCE Advice Letter 1832-E filed on October 22, 2004.

SUMMARY

This Resolution approves the Local Area Reliability Procurement Proposal (Procurement Proposal) developed jointly by Southern California Edison Company (SCE) and the California Independent System Operator (ISO or CAISO), and filed by SCE pursuant to Decision (D.) 04-07-028.

In this advice letter, SCE proposes that it be allowed to pay up to an additional \$X per kw month for at least 600 MW of capacity contracts related to this filing and that the Energy Division be authorized to approve or deny contracts above the approved threshold. All contracts with additional costs of less than the threshold cost would be automatically approved under SCE's Procurement Proposal. SCE also requests approval of a Dispatch Call Option contract.

The Commission finds that the activities and transactions described in the Procurement Proposal are consistent with SCE's approved short-term procurement plan, since they are in furtherance of the directives of D.04-07-028 and Resolution E-3888.

SCE Advice Letter 1832-E was timely protested by the Western Power Trading Forum, San Diego Gas & Electric Company, the Office of Ratepayer Advocates, and The Utility Reform Network.

This resolution approves the advice letter.

BACKGROUND

On July 8, 2004, the CPUC issued D.04-07-028, “Interim Opinion Regarding Electricity Reliability Issues” (Decision) directing SCE and the other investor-owned utilities (IOUs) to schedule and procure sufficient and appropriate resources, both system-wide and locally within its service territory, to meet its customers’ needs, and to permit the ISO to maintain reliable grid operations.

The Decision clarifies and modifies prior Commission orders concerning the IOUs’ obligations to proactively assist the ISO in managing system-wide transmission congestion and assuring local area reliability. The Decision directs the IOUs to consider reliability factors and incorporate all known and reasonably anticipated ISO-related costs including congestion, re-dispatch, and must-offer costs, when evaluating resource options. The Decision resulted from an Assigned Commissioner’s Ruling on reliability issues, dated June 10, 2004. The Decision “*strongly encourage[d]*” the ISO to take all available steps to provide all load serving entities with the information they need to procure and schedule resources in a manner that supports reliable grid operations, and directed the utilities to use such information when scheduling resources.

D.04-07-028 clarifies and modifies SCE’s approved procurement plan.

In addition to modifying and clarifying prior CPUC decisions (D.02-12-074, D.03-12-062, and D.04-01-050), D.04-07-028 modifies SCE’s approved 2004 short-term procurement plan. Specifically, the Decision modifies the following aspects of SCE’s approved procurement plan:

- The Decision clarifies the definition of least cost dispatch.
- The Decision provides clarification that the utilities’ least cost scheduling and procurement activities must include ISO reliability-related costs.
- The Decision provides clarification that the utilities’ least cost scheduling and procurement activities must incorporate available ISO information.
- The Decision provides clarification that the utilities should minimize use of RMR contracts.
- The prior restriction on use of bilateral contracts is relaxed.
- The prior limitation on use of spot market transactions is relaxed.

On July 26, 2004, SCE submitted Advice Letter 1813-E concerning a commitment and dispatch procedure (Procedure) jointly developed with the ISO, which was designed to enhance system and local area reliability.

The Commission issued Resolution E-3888 on August 19, 2004, which approved AL 1813-E with minor modifications. SCE incorporated the Commission's modifications into AL 1813-E-A, which as approved by letter dated October 5, 2004, from the CPUC Director of Energy Division.

The Procedure describes how SCE will commit and schedule local area generation in the ISO's day-ahead market to reduce the ISO's must-offer waiver denial and real time re-dispatch requirements.

In Resolution E-3888, the Commission urged SCE and the ISO to work aggressively to develop and file an advice letter concerning procurement activities for local area reliability as soon as possible.

SCE and the ISO jointly developed a Procurement Proposal, which describes how SCE will procure local area generation to facilitate reliable electric service.

The Procurement Proposal is being jointly submitted to the Commission for approval to ensure the agreed-upon activities are consistent with the Commission's directives, and that the costs reasonably incurred by SCE in performing reliability-related procurement activities are fully recoverable by SCE as part of SCE's approved procurement plan.

NOTICE

Notice of SCE AL 1832-E was made by publication in the Commission's Daily Calendar. SCE states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

SCE Advice Letter 1832-E was timely protested on November 2, 2004 separately by San Diego Gas & Electric Company (SDG&E), the Western Power Trading Forum (WPTF), The Utility Reform Network (TURN), and the Office of

Ratepayer Advocates (ORA). SCE responded to these protests collectively on November 8, 2004.

A. Major issues raised in the TURN protest.

TURN encourages the Commission to focus on resolving the issues associated with procurement and local area grid reliability early next year in Phase 2 of the Resource Adequacy Requirement workshops in R.04-04-003. However, TURN would not oppose the approval of AL 1832-E if the Commission approves the following general conditions.

- **Proposed contracts should only be effective for 2005.**

TURN states that the local area reliability contracts, procurement procedures, and system operation procedures should be applicable only in 2005. TURN recommends that the Commission should develop a comprehensive local grid reliability process next year to be effective starting in 2006.

In its response, SCE states that it agrees with TURN that the contracts and procedures should only be effective for 2005. SCE points out that, *"In confidential Appendix B the advice letter states ... in no case will a contract under consideration for award for LAR purposes extend beyond December 31, 2005, as the Commission's local reliability order (D.04-07-028) specified that date as the sunset date."*

- **Establishment of a specific threshold for market power mitigation.**

TURN believes that establishment of a specific threshold or "circuit breaker" is essential to protect SCE customers from the effects of local market power. TURN supports the figure of \$X per kw month set forth in Confidential Appendix B to the AL filing, which should be adopted as that circuit breaker. According to TURN, *"That threshold, which was developed on the basis of actual market data, provides a reasonable benchmark for the premium that local area resources would receive in the absence of market power... If SCE cannot procure contracts at this level or less, the company should be authorized to reject the offers and report to the CAISO that local market power precludes the proposed purchases..."* rather than delegating to Energy Division the responsibility for determining the strength of market power.

In its response, SCE states that TURN agrees with SCE that a mechanism is needed to mitigate market power. The only point of departure appears to be

regarding delegating responsibility to the Energy Division for determining “how much market power is too much” when the threshold or circuit breaker cost is exceeded. SCE states that it is willing to agree with TURN’s recommendation to report to the ISO that local market power precludes the proposed purchase rather than working through Energy Division, and seeks further guidance from the Commission as to whether SCE should submit contracts exceeding the circuit breaker for pre-approval by the Commission or take other action.

- **A cost-effectiveness test is necessary.**

TURN states that SCE should be excused from making purchases if its projected cost effectiveness is minimal; i.e., if it appears that the projected incremental reliability benefits are too small compared to the projected costs.

SCE replied that TURN agrees with SCE that a cost-effectiveness test if necessary. SCE’s advice letter contains a cost-effectiveness test in confidential Appendix B for LAR resources. As SCE states, *“Since TURN does not propose any specific changes to this test, it is not clear whether TURN is proposing a different test or merely supporting SCE’s test.”*

- **SCE must track incremental procurement and operating costs.**

TURN states that SCE must track the additional costs it incurs in implementing this advice letter for later allocation to all customers, similar to the Reliability Cost Memorandum Account adopted in SCE Advice Letter 1810-E pursuant to D.04-07-028.

SCE replied that it is already tracking incremental operating costs pursuant to Advice Letter 1813-E-A, approved in Resolution E-3888. SCE stated it has yet to incur any incremental procurement costs. Incremental procurement costs for LAR is the subject of this advice letter, 1832-E.

Regarding incremental procurement costs, SCE agrees that they should be tracked, but states that there is no established methodology for determining what these costs are. SCE states that, *“it will separately seek approval to recover any reliability premiums paid for LAR procurement using the approach outlined in D.04-07-028.”*

- **The CPUC and the CAISO must commit to supporting recovery of incremental reliability costs from all customers.**

TURN states that recovery of SCE's incremental local reliability costs should be through SCE's FERC-jurisdictional tariff. If FERC denies recovery of such costs, TURN believes the CPUC should approve the related costs through non-bypassable distribution rates rather than SCE's procurement rates.

SCE replied that it agrees with TURN's suggestion that the Commission and the ISO must commit to supporting recovery of incremental costs from all customers. SCE points out that the ISO's commitment for LAR procurement is indicated in Appendix A to AL 1832-E, and that SCE will seek recovery from FERC for the incremental reliability costs.

- **The Procurement Review Group should review local reliability procurement.**

TURN believes that SCE must discuss in detail the bids, evaluation, and results of the market power and cost effectiveness tests with its PRG before accepting the contracts. *"TURN believes it would be valuable to enlist the participation of the CAISO and representatives of unbundled customers in such discussions, even if on a special one-issue basis."*

SCE replied it agrees with TURN's suggestion that the PRG should review local reliability procurement. SCE stated it has kept the PRG informed and involved as negotiations with the ISO advanced and AL 1832-E was developed. SCE stated it intends to regularly meet with the PRG as the LAR solicitation takes place.

SCE stated it does not agree with that formal membership of the PRG should be expanded to include the ISO and representatives of unbundled customers. SCE believes that adding the ISO to the PRG is not necessary or appropriate. Also, SCE stated it does not currently include market participants on its PRG and that it should not be required to include representatives of their customers, which could be highly problematic. Staff agrees with SCE's position on this matter.

B. Major issues raised in the ORA protest.

As stated in its letter, *“ORA supports this advice letter as a good faith attempt by SCE in conjunction with the ISO to implement the admittedly transitional local reliability approach adopted in D.04-07-028, with the following exceptions:”*

- **The review process for contracts above the threshold cost should require an advice letter filing.**

ORA claims SCE’s proposal does not specify if advice letter filings would be required for contract costs above the threshold, and whether public review of such contracts would be afforded. The advice letter implies that the Energy Division would make determinations without public comment regarding contracts above the threshold cost.

SCE replied that, *“requiring SCE to submit proposed contracts above the X limit for approval through the advice letter process will delay signing contracts for local area reliability ...”* Because Staff does not want to cause unnecessary delay and impede signing of contracts needed for local area reliability, Staff agrees with SCE’s position that advice letter filings are not prudent in these instances.

- **Advice letter filings for contracts exceeding the threshold should include a cost comparison with backstop RMR contracts.**

ORA states that SCE should be required to identify that the contracts for which it seeks approval have costs that do not exceed the RMR contracts that could be exercised by the CAISO.

In response, SCE states that ORA’s suggestion for a cost comparison is impractical because although RMR contracts do constitute a backstop, their terms are not known in advance of negotiations or litigation at FERC. SCE believes *“a comparison cannot be made with something that is not known.”*

- **The CPUC should recognize that the \$X per kw month threshold is based on a provisional cost model.**

ORA states that the threshold value recommended by SCE is an estimate of the capacity costs based on a provisional model that has not been validated. As

stated in its letter, *“ORA support for the \$X per kwm threshold should not be viewed as an unconditional support for the provisional model. Rather, ORA recognizes the urgency in complying with D.04-07-028 and reserves the right to challenge the model in the appropriate proceeding.”*

In response, SCE states that it is conducting this procurement under the statutory protection of AB 57. SCE asserts that it has and will continue to afford ORA information about SCE’s models, including SCE’s model validations. Because the Commission does not want to delay needed LAR procurement by SCE, Staff recommends that ORA’s review of SCE’s models be conducted in an appropriate proceeding, where any specific model challenges by ORA are stated and can be resolved by the Commission.

- **Incremental reliability costs should be recovered from all customers.**

ORA states that non-utility load serving entities (LSE), e.g. those serving current direct access load will not have to bear any of the costs of local reliability contracts executed by SCE as these will be subject to recovery in ERRA proceedings from SCE’s bundled ratepayers. Nevertheless, these same non-IOU LSEs will benefit from local reliability contracts and should pay their fair share if costs were recovered through a FERC-approved tariff. ORA requests that the CPUC should announce its intention to achieve fair cost allocation through FERC, or as a backstop through distribution rates.

In its response, SCE states that, *“the Commission has already announced those intentions in D.04-07-028 and Resolution E-3888.”*

- **Contracts should be limited to one year pending full implementation of the Commission’s resource adequacy protocol in 2006.**

ORA’s concern is similar to that of TURN’s in that the direction provided to the IOUs by D.04-07-028 expires at the end of 2005. The protestors believe that SCE should not sign any contracts solely for local reliability purposes that extend beyond 2005.

In its response, SCE reaffirms that, *“SCE’s LAR procurement is limited to 2005 only.”*

C. Major issues raised in the SDG&E protest.

- **SDG&E's finds that SCE's Procurement Proposal is incomplete because it does not adequately consider and address all procurement and scheduling costs, as contemplated by D.04-07-028.**

In its protest, SDG&E states that the IOUs should consider reliability factors and incorporate all known and reasonably anticipated ISO-related costs when evaluating resource options. SDG&E states, *"The Advice Letter should therefore be rejected, and SCE should be directed to re-file a Procurement Proposal that is fully responsive to the Commission's decision."* SDG&E believes that SCE should specifically address how it will alter its procurement and scheduling decisions to take into account all known and reasonably anticipated ISO-related costs such as congestion, re-dispatch, and must-offer costs. SDG&E considers adding the option of additional Reliability Must Run (RMR) contracts in SCE's service territory as a near-term solution, although SDG&E recognizes that less reliance on RMR is the goal over the longer term.

In response, SCE states that it has learned in discussions with the ISO that many units in the LA Basin do not run unless they are denied a Must Offer Waiver. The ISO's Operating Procedure M-438 provides guidance to market participants with operational control of units in the LA Basin to commit these units without the ISO's having to issue a Must Offer Waiver denial. SCE claims this process reduces the ISO's Must Offer costs as well as reduces the intra-zonal congestion and real time re-dispatch costs. SCE believes that the additional capacity procured through this Advice Letter 1832-E will further enable SCE to reduce ISO-related costs and, as such, is consistent with the directives of D.04-07-028. SCE also adds that by way of its Procurement Proposal in this advice letter, it is providing incremental improvement in the ISO's procurement and scheduling practices to assist the ISO in meeting its LAR needs, which is in compliance with the objectives of D.04-07-028.

SCE states that, *"SDG&E's ... concerns are baseless and SDG&E's recommendation that Advice 1813-E not be approved should be rejected."*

- **SDG&E claims that SCE's proposed action in its filing will have virtually no effect until July 2005.**

In its protest, SDG&E states that ISO's Operating Procedure M-438, whose requirements on SCE's system are triggered by loading levels, is applicable in only 6-7% of the hours of the year (approximately 575 hours). SDG&E claims these peak hours almost all fall within the third quarter months of July, August, and September, and are exactly the same hours during which the units SCE intends to option are most likely to be already running.

SDG&E requests that SCE's filing, if adopted, should clarify that D.04-07-028 is meant to apply only to the peak load hours of the summer.

Staff notes that this resolution is not the appropriate forum to provide clarification or modification to a previously written decision. If SDG&E seeks clarification of D.04-07-028, it should raise this matter in the appropriate proceeding.

- **SDG&E opposes a cost cap on reliability costs.**

In its protest, SDG&E states that placing a cap on reliability costs is in direct contradiction to the Commissions orders. SDG&E believes that a cost cap in SCE's Procurement Proposal limits the actions SCE would take to maintain grid reliability.

In its response, SCE states, *"The threshold established in confidential Appendix B does not limit SCE's ability to sign contracts; it merely signals high offered prices and triggers the need for the Commission, through the Energy Division, to evaluate the particular bid and approve or disapprove the contract."*

- **Calling on RMR units in SDG&E's service area subsidizes SCE at the expense of SDG&E customers.**

SDG&E is concerned that SCE could escape responsibility for any reliability costs being incurred by the ISO to maintain grid reliability in SCE's service territory by the ISO's calling on RMR units in SDG&E's service area. SDG&E believes this would have the effect of passing reliability costs above SCE's proposed threshold to consumers in SDG&E's service area.

SDG&E notes that the ISO issues RMR dispatch notices to RMR units located in SDG&E's service area to satisfy local reliability requirements in SCE's service area as well as manage intra-zonal congestion resulting from scheduling

practices by Load Serving Entities, predominately SCE. These RMR dispatch notices are issued for many hours throughout the year, and are not restricted to the limited hours prescribed by SCE's advice letter filing. SDG&E estimates that additional RMR dispatch for reasons other than SDG&E's LAR needs is in excess of \$25 million. SDG&E claims that, *"SDG&E customers are in effect subsidizing the customers of other Load Serving Entities, primarily SCE, by virtue of these entities not taking into account these costs in their scheduling decisions."*

In its response, SCE states that, *"SCE certainly has no knowledge of how many, when, and at what output level, and most importantly, why RMR units in SDG&E's service territory are dispatched."*

- **SDG&E recommends that the ISO significantly increase the amount of RMR generation in SCE's service area.**

In its protest letter, SDG&E claims that with an additional 2000 MW of RMR generation in the SCE system, the ISO would not need to use the RMR units located in SDG&E's service area to satisfy reliability requirements on the SCE system. According to SDG&E, this action would reduce ISO-related reliability costs for customers in the SDG&E service area.

In its response, SCE states that the issue of additional RMR units has nothing to do with SCE's compliance with D.04-07-028 and is contrary to the objectives of this Decision.

Regarding reliance on RMR contracts, Staff notes that Decision 04-07-028 states, *"it is our intention and desire to minimize the use of RMR contracts through IOU scheduling, procurement and comprehensive planning. The Commission believes that consumers are better served from both a cost and reliability perspective through a proactive planning, procurement and scheduling approach."* Staff agrees with SCE's assessment of this issue.

D. Major issues raised in the WPTF protest.

WPTF notes that, *"SCE states that the advice letter is being filed jointly with CAISO... However, SCE is the jurisdictional entity that is complying with the Commission's July 8, 2004 Order, and thus, WPTF expects the Commission to treat SCE as the sole filer."* Staff agrees with WPTF on this matter, and AL 1832-E is being treated by the Commission as such.

In its protest, WPTF claims that Procurement Proposal does not meet the intent of D.04-07-08. Essentially, WPTF contends that AL 1832-E should be rejected because SCE plans to procure too little capacity, from too few units, for too short a period of time, as explained below:

- **WPTF's first issue is that SCE's procurement of 600 MW is insufficient and the target should be 2,800 MW.**

WPTF states that CAISO's table, in SCE Local Area Capacity Commitment Requirements beyond RMR in Operating Procedure M-438B, indicates that 2,798 MW were required in-basin when SCE established its peak load of 20,613 MW on September 10, 2004.

Additionally, WPTF claims the Capacity Commitment Table in the CAISO procedure referred to in AL 1832-E does not list all the generating units that were originally identified in the Procedure and that are consistently denied Must Offer waiver requests by the CAISO. WPTF believes that SCE appears to aim at relying on the CAISO's Must Offer waiver denial process to commit a significant portion of the resources needed to meet Summer 2005 reliability requirements. WPTF recommends that the minimum plan should be to procure at least 2,800 MW from generating units originally identified in the CAISO's Procedure.

SCE replied that, *"in D.04-07-028, the Commission clearly states that it is not looking for perfection, but incremental improvement in procurement and scheduling practices to assist the CAISO in meeting its local area reliability needs. The 600 MW minimum procurement target identified in AL 1832-E is a quantity that the ISO has agreed will meet the incremental improvement that the Commission envisioned, and therefore, should be approved."*

Regarding the pool of units from which SCE can procure LAR capacity, SCE states that is determined by the ISO through its Capacity Commitment Table in Operating Procedure M-438. SCE states, *"Other than units controlled by SCE, SCE has no knowledge of which units receive Must Offer Waiver Denials and at what rate they receive them."*

- **WPTF's second issue is that it seeks clarification on coordination between AL 1832-E and the concurrent RFO process.**

WPTF states that on October 25, 2004, SCE issued a Request For Offers (RFO) to sell “energy call options, unit dispatch call options, and electrical generating capacity products.” WPFT states the instant advice letter makes no reference to the RFO, and seeks clarification on coordination of that procurement process with the proposed advice letter procurement process, and explain the role that each will play.

In its response, SCE explained that the “Daily Dispatch Call Option” described in Advice Letter 1832-E and “Unit Dispatch Call Option” described in the RFO are the same product. SCE further clarifies that the Unit Contingent and Unit Dispatch Call Option identified in the RFO satisfy the requirements of the ISO’s Operating Procedure M-438.

SCE further explains that its RFO seeks to procure capacity and energy products beyond those needed to meet the requirements of AL 1832-E.

- **WPTF’s third issue is that SCE’s proposed valuation methodology, which is in Confidential Appendix B, is not available to the market.**

Appendix B includes descriptions of the Daily Dispatch Call Option, the valuation methodology, and the resource ranking and selection criteria. This information is not made available to the public. WPTF believes, “*Unjust secrecy in utility procurement prevents meaningful public participation, and masks price signals to potential suppliers.*” WPTF is concerned that the valuation methodology will not allow for incremental procurement costs to exceed what SCE is currently paying in congestion costs and must-offer costs as allocated to it by the ISO. WPTF also believes that SCE is relying on the ISO’s Must Offer waiver denial process as a substitute for the forward commitment of resources by LSEs to address local area reliability.

SCE replied that, “*SCE has provided sufficient information concerning its proposed valuation methodology to parties entitled to receive confidential information. SCE has discussed the proposed valuation methodology in Confidential Appendix B with its Procurement Review Group, which includes representatives from the Energy Division, ORA, TURN, CUE, the California Energy Commission, and others. SCE has not discussed this methodology, for obvious reasons, with market participants, such as members of WPTF.*”

- **WPTF's fourth issue is that no cost threshold should apply if there is sufficient competition or the seller reveals its costs.**

WPTF states that SCE's cost threshold is "veiled in secrecy." WPTF claims that no abuse in market power can exist if there is workable competition, i.e., multiple sellers offering products in excess of the demand quantity, or if the seller is willing to reveal its costs.

In response, SCE clarified that, *"the price threshold proposed in confidential Appendix B does not in itself limit SCE's ability to procure capacity to meet the objectives of the Advice Letter. Rather, it is intended to set an upper limit beyond which, in the Commission's judgment, offered prices may be too high and warrant further Commission review."*

- **WPTF's fifth issue is that the Daily Dispatch Call Option is flawed.**

WPTF believes that the Daily Dispatch Call option (DDCO) proposed by SCE should reflect a unit's maximum dependable capacity (Pmax) as the contract quantity rather than a Minimum Dispatchable Load (MDL). As currently proposed, the DDCO's contract quantity is the MDL, but the capacity that SCE will count towards meeting the procurement target is the unit's full capacity or maximum dependable capacity. A unit's MDL is only a small percentage of a unit's Pmax.

WPTF is also concerned that the DDCO's term is limited to June through September of 2005. WPTF believes that system conditions and resource adequacy concerns need a longer procurement period. WPTF claims that SCE has very high loads in months other than June through September, e.g., May (17,396 MW) and October (17,511 MW) are predictably high on the SCE system for 2003, and in prior years Southern California has experienced system peaks as early as April and as late as October.

WPTF also states that the minimum load compensation formulae of the DDCO should be aligned with what is currently allowed by the ISO's RMR contracts and minimum load cost compensation formula for non-RMR units.

In its response, SCE clarifies that SCE introduced the DDCO product to expand the pool of units from which it could contract to meet local area reliability needs. *"SCE believes, and the ISO agrees, that most units shown in M-438 have existing*

contracts with others that extend through the 2005 summer timeframe and are therefore unable to sign conventional Unit Contingent contracts with SCE. In most cases, these existing contracts allow the seller to deliver from the market rather than run its units. The essential service the ISO seeks ... is to get those units listed in M-438 committed and on-line at minimum load. The DDCO product allows SCE to call these units to be committed at minimum load without interfering with the seller's obligations to make the energy deliveries under its existing contracts."

SCE further explains that, *"Since the ISO only requires the unit to be committed at minimum to achieve the reliability benefits it seeks, the DDCO contract with SCE is limited to minimum load... The fact that SCE claims the full load capacity of a unit under a DDCO contract towards meeting its minimum capacity target in Advice 1832-E is entirely consistent with the ISO's expectations and operating procedure M-438."*

Regarding the appropriate term of the DDCO contract, SCE states, *"Only the ISO can define what its local area needs are and how they should be met. Here, the ISO has said that a minimum of 600 MWs additional capacity from June through September is sufficient to meet its needs in the context of D.04-07-028."*

DISCUSSION

Energy Division has reviewed SCE AL 1832-E. Discussion of the relevant facts that lead to the approval of this advice letter is below.

Pursuant to the Procurement Proposal, SCE plans to procure physical unit commitment and dispatch (C&D) rights to at least 600 MW of generating capacity not currently under contract to SCE or the ISO.

This additional generating capacity is currently not under contract to or otherwise dispatchable by SCE from the list of generating units appearing on the ISO's Capacity Commitment Table, which is available on CAISO's website to all market participants. SCE noted in its AL that additional procurement under its proposal does not include SCE's existing rights to Etiwanda Units 3 & 4.

SCE intends to obtain these additional C&D rights for the period including, but not limited to, June 1, 2005 through September 30, 2005. SCE proposes that it be allowed to pay up to an additional \$X per kw month for at least 600 MW of

capacity contracts, as stipulated in Confidential Attachment B of SCE's advice letter. SCE estimates that the additional generation obligation for these 600 MW will cost \$Y million for the four-month period June 1 to September 30, 2005.

In order to procure these resources in a timely manner, SCE will immediately issue a solicitation for offers.

SCE intends to meet the 600 MW obligation using products that are approved as part of its Short Term Procurement Plan (STPP).

In procuring additional C&D rights, SCE claims it is not required to schedule the energy output from additional capacity in the day-ahead market against its own load. The energy output of such capacity may be scheduled in the day-ahead market against some other Scheduling Coordinator's load, in accordance with the terms of a pre-existing contract that SCE and the generating unit owner, provided these energy schedules meet the requirements of approved ISO procedures.

To protect SCE's ratepayers against potential abuse of market power, SCE proposes it shall not be required to procure additional C&D rights at a cost above a threshold amount to be determined by the Commission.

SCE requests that the Commission authorize the Energy Division to participate in SCE's offer evaluation process, and to make a determination of whether SCE should enter into any contract needed to meet the obligation for 600 MW at costs above this threshold amount.

Where Energy Division authorizes the signing of such a contract, the resulting contract shall be deemed approved as part of SCE's AB 57 STPP. If Energy Division does not make a determination prior to the expiration of an offer or affirmatively rejects an offer, then SCE shall be relieved of the obligation to meet the portion of the 600 MW incremental local area reliability (LAR) capacity need load that was not approved by Energy Division.

Additionally, SCE proposes a new product, the Dispatch Call Option contract, which will give SCE rights to commit resources whose energy and ancillary service products are already under contract to others.

Many of the generating units listed in the Capacity Commitment Table of ISO's Operating Procedure M-438 are committed to other parties under contracts that allow the seller to meet its contract energy obligations from market sources rather than by operating the units designated in the contract. SCE may enter into contracts that effectively buy back these market substitution rights so that the primary contract energy obligations are fulfilled by the designated unit. In prior discussions with the ISO, SCE has referred to these as "Dispatch Call Option" contracts.

The Advice Letter seeks Commission confirmation that the Procurement Proposal meets the objectives of D.04-07-028 and Resolution E-3888.

The Advice Letter seeks Commission confirmation that the Procurement Proposal meets the following objectives:

1. The Procurement proposal complies with the Commission's directives in D.04-07-028 and Resolution E-3888;
2. That the activities and transactions described in the Procurement Proposal are deemed part of SCE's approved procurement plan;
3. That the activities described in the Procurement Plan establish the AB 57 upfront achievable standards and criteria under which SCE shall conduct local area reliability commitment and dispatch under its approved procurement plan;
4. SCE is authorized to seek recovery of reliability-related procurement costs incurred as a result of implementing D.04-07-028 as part of its approved procurement plan in an ERRA proceeding, to the extent such costs are not first recoverable through FERC-jurisdictional rates.
5. To protect SCE's ratepayers against the potential abuse of market power, SCE shall not be required to procure additional C&D rights at a cost above the threshold amount approved by the Commission;
6. SCE is authorized to enter into Dispatch Call Option contracts under the terms described in AL 1832-E;
7. The CPUC Energy Division shall participate in SCE's offer evaluation process, and shall make a determination of whether SCE should enter into a contract to meet the 600 MW obligation at a price above the threshold amount referenced above;
8. Where Energy Division authorizes the signing of such a contract, the resulting contract shall be deemed approved as part of SCE's AB 57 approved STPP; and

9. If Energy Division fails to make a determination prior to the expiration of an offer or affirmatively rejects an offer, then SCE shall be relieved of the obligation to meet the portion of the 600 MW incremental LAR capacity need that was not approved by Energy Division.

D.04-08-027 states, “*Actions taken in furtherance of the directives of this order (D.04-07-028) are deemed consistent with the utilities’ already approved short-term procurement plan and thereby subsumed within the protection provided by AB 57.*”

The Commission finds that this Procurement Proposal jointly developed by SCE and the ISO and filed by SCE Advice Letter 1832-E on October 22, 2004: (1) builds on discussions between SCE and the ISO concerning local area reliability procurement goals to enhance the reliability of the electric system in SCE’s service territory; (2) includes elements required to ensure that SCE’s procurement activities meet AB 57’s upfront and achievable standards; and (3) complies with the CPUC’s directives in D.04-07-028 and Resolution E-3888.

The Commission also finds that the local area reliability activities and transactions described in the Procurement Proposal are consistent with SCE’s approved short-term procurement plan, since they are in furtherance of the directives of D.04-07-028.

SCE has not addressed the issue of congestion as directed by D.04-07-028.

Decision 04-07-028 requires the IOUs to consider reliability factors and incorporate all known and reasonably anticipated ISO-related costs including congestion, re-dispatch, and must-offer costs, when evaluating resource options.

We concur with SCE that the Capacity Commitment Table in ISO’s Operating Procedure M-438 approved by Resolution E-3888 will reduce the ISO’s real-time re-dispatch burden and issuance of must-offer waiver denials. We also agree that this Procurement Proposal will provide additional capacity, which will assist local area reliability concerns in SCE’s service territory. However, SCE has not addressed the issue of congestion as directed by D.04-07-028 in order to be in full compliance with the Decision.

We encourage SCE to work with the ISO to develop additional procedures or other actions to complement ISO’s existing Operating Procedure M-438, which would allow the utility to make approximations or estimates of the ISO’s intra-

zonal congestion mitigation costs. By using the ISO's effectiveness factors, which apply to imports from the tie points, SCE would be more informed about how effective any procurement and scheduling activity would be towards mitigating congestion on any constrained path and allow SCE to better understand the flow on any constrained path created by each of its procurement and scheduling transactions. The ISO should be providing load-serving entities with the information they require to procure and schedule resources in a manner that supports reliable grid operations.

The Advice Letter seeks Commission confirmation that SCE is authorized to seek recovery of all reliability-related procurement costs incurred as a result of implementing D.04-07-028 as part of its approved procurement plan in an ERRA proceeding, to the extent such costs are not first recoverable through FERC-jurisdictional rates.

The Decision states that, "Utilities may recover costs incurred for reliability purposes consistent with this order (D.04-07-028) ... the IOU's already have in place a mechanism by which they may recover reliability-related costs through their FERC-jurisdictional tariffs... We (Commission) expect IOUs to attempt to recover appropriately allocated reliability-related costs through their FERC Reliability Services tariff provisions. If utilities are denied recovery through this channel, utilities may seek cost recovery in the appropriate ERRA proceeding."

Additional confirmation, through approval of this Advice Letter, of SCE's ability to recover reliability-related procurement costs is not necessary, since this issue was already addressed in D.04-07-028.

SCE states that the AL filing will become effective upon SCE's receipt of written approval of this advice filing and its attachments without significant modification.

The Energy Division recommends that in light of SCE's and the ISO's urgent need for this Procurement Proposal, SCE should try to use it as soon as the ISO is ready to implement it. The Procurement Proposal shall become effective upon the effective date of this Resolution.

We recognize that this specific Procurement Proposal developed jointly by SCE and the ISO addresses immediate concerns in SCE's service territory, and will assist the ISO to minimize short-term reliability concerns in SCE's service

territory during the peak summer months of 2005. We encourage SCE and the ISO to continue to develop procedures for congestion mitigation and long-term strategies to improve market design and operation for the subsequent years.

COMMENTS

Public Utilities Code section 311(g) (1) generally requires resolutions to be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g) (3) provides that this 30-day period may be reduced or waived pursuant to Commission adopted rule.

The 30-day comment period for this Resolution has been reduced in accordance with the provisions of Rule 77.7(f) (9). Rule 77.7(f) (9) provides that the Commission may waive or reduce the comment period for a decision when the Commission determines that public necessity requires reduction or waiver of the 30-day period for public review and comment. For purposes of Rule 77.7(f) (9), “public necessity” refers to circumstances in which the public interest in the Commission’s adopting a decision before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment, and includes circumstances where failure to adopt a decision before expiration of the 30-day review and comment period would cause significant harm to public health or welfare.

The public necessity in this case is that any delay in receiving a resolution will impede SCE’s ability to effectively assist the ISO. SCE’s ability to effectively assist the ISO requires that the Commission have an opportunity to act on this advice letter as soon as possible. Failure to adopt the Procurement Proposal promptly could cause significant harm to public health or welfare because Commission approval is needed for SCE to proceed with signing contracts to procure additional capacity for the Summer 2005 and to ensure reliability of electric service in its service territory.

Thus, pursuant to Rule 77.7(f) (9), we provide for a shortened comment period.

No comments were filed on this Resolution.

FINDINGS

1. SCE and the ISO jointly developed the Procurement Proposal.
2. The Procurement Procedure describes SCE's plans to commit to procure at least 600 MW of additional capacity in 2005 for the peak summer month period, but not limited to, June 1 through September 30, 2005.
3. The Procurement Proposal complies with the Commission's directives in D.04-07-028 and Resolution E-3888.
4. SCE must aggressively work with the CAISO to develop procedures or other actions that address congestion mitigation issues in order to be in full compliance with the Decision.
5. The activities and transactions described in the Procurement Proposal are deemed part of SCE's approved procurement plan.
6. The activities described in the Procurement Proposal establish the AB 57 upfront achievable standards and criteria under which SCE shall conduct local area reliability commitment and dispatch under its approved procurement plan.
7. Consistent with D.04-07-028's suggestion, SCE will seek recovery of the additional reliability-related costs in an ERRA proceeding, to the extent such costs are not first recoverable through FERC-jurisdictional rates.
8. SCE shall not be required to procure additional Commitment and Dispatch rights at a cost above the threshold amount approved by the Commission.
9. SCE is authorized to enter into Dispatch Call Option contracts under the terms described in AL 1832-E.
10. The Energy Division shall participate in SCE's offer evaluation process, and shall make a determination of whether SCE should enter into a contract to meet the 600 MW-obligation at a price above the threshold amount.
11. Where Energy Division authorizes the signing of such a contract, the resulting contract shall be deemed part of SCE's AB 57 approved STPP.
12. If Energy Division fails to make a determination prior to the expiration of an offer or affirmatively rejects an offer, SCE shall be relieved of the obligation to meet that portion of the 600 MW incremental LAR capacity need not approved by Energy Division.
13. The Procurement Proposal shall become effective upon the effective date of this Resolution.
14. SCE Advice Letter 1832-E was timely protested by the Western Power Trading Forum, TURN, ORA, and SDG&E. The protests are resolved as described herein.

15. In this case, public necessity warrants providing for a comment period of less than 30 days.

THEREFORE IT IS ORDERED THAT:

1. The request of SCE, in its Advice Letter 1832-E, to file the Procurement Proposal developed jointly with the CAISO, is approved.
2. SCE shall aggressively work with the CAISO to develop a procedure, complementary to M-438, addressing congestion mitigation to be in full compliance with the directives of D.04-07-028.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on December 16, 2004; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director