STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

February 15, 2005 **Agenda ID #4324**

TO: PARTIES OF RECORD IN RULEMAKING 99-11-022

Enclosed is the draft decision of Commissioner Peevey. The decision will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN BY KEN HENDERSON
Angela K. Minkin, Chief
Administrative Law Judge

ANG: avs

Decision **DRAFT DECISION OF COMMISSIONER PEEVEY**
(Mailed 2/15/2005)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Into Implementation of Public Utilities Code Section 390.	Rulemaking 99-11-022 (Filed November 18, 1999)

OPINION REGARDING SHORT-RUN AVOIDED COST ENERGY PAYMENTS BETWEEN DECEMBER 2000 AND MARCH 2001

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OPINION REGARDING SHORT-RUN AVOIDED COST ENERGY PAYMENTS BETWEEN DECEMBER 2000 AND MARCH 2001

I. Summary

This decision resolves an outstanding matter remanded to us by the California Court of Appeal (The Court) regarding applications for rehearing filed by Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (Edison). These applications asserted that a modified short run avoided cost (SRAC) formula adopted in Decision (D.) 01-03-067 for purposes of calculating Qualifying Facility (QF) energy[1] payments should be retroactively applied to utilities' SRAC payments between December 2000 and March 2001 (Remand Period). The Court ordered that the Commission must determine whether SRAC payments were correct[2] under the Public Utility Regulatory Policy Act of 1978 (PURPA). If evidence indicated that SRAC payments in the Remand Period were correct, that would end the matter. However, if evidence indicated that SRAC prices were not correct, then utility payments to the QF during the Remand Period would need to be adjusted.

We have determined that evidence shows SRAC prices were correct between December 2000 and March 2001, and retroactive application of the modified SRAC formula is not warranted. Our decision on this matter is based on an analysis of the avoided cost prices under PURPA, and comparisons of these avoided cost prices with utilities' SRAC payments. Furthermore, we have concluded that we have implemented § 390 of the California Pub. Util. Code regarding QF payments in a manner that complies with PURPA.

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[1] Capacity payments are not an issue.

Although we have determined that SRAC prices in the Remand Period comply with the avoided cost requirements of PURPA, this determination does not affect our arguments made in other proceedings that non-QF energy prices during the 2000-2001 "energy crisis" were unreasonable and unjust. Accordingly, we contend that California ratepayers are entitled to refunds for these unreasonable electric prices.

II. Procedural Background

PURPA[3] requires utilities to purchase energy from QF at a rate which does not exceed the utility's avoided costs.[4] Payments to QFs are governed by orders of this Commission establishing standard rates for purchases that are just and reasonable to utility consumers, consistent with Federal Energy Regulatory Commission (FERC) regulations. In 1996, as part of the legislation for restructuring California's electric industry, the Legislature enacted Pub. Util. Code § 390.[5] Pursuant to the requirement of § 390(b),[6] the Commission issued

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[2] The Court's reference to "correct" means SRAC prices met PURPA requirements.

[3] Code of Federal Regulations (C.F.R.) Part 292, subpart C.

[4] Avoided Costs are the incremental costs to an electric utility of electric energy or capacity or both, which, but for the purchase from the QF or QFs, such utility would generate itself or purchase from another source. (18 C.F.R. § 292.101(b)(6).)

[5] Unless otherwise specified, all statutory references are to the Public Utilities Code.

[6] § 390(b) states: Until the requirements of subdivision (c) have been satisfied, short run avoided cost energy payments paid to non-utility power generators by an electrical corporation shall be based on a formula that reflects a starting energy price, adjusted monthly to reflect changes in a starting gas index price in relation to an average of current California natural gas border price indices. The starting energy price shall be based on 12-month averages of recent, pre-January 1, 1996, short-run avoided energy prices paid by each public utility electrical corporation to nonutility power generators. The starting gas index price shall be established as an average of index gas prices for the same annual periods.

D.96-12-028,[7] which adopted a transition formula for each utility to calculate its SRAC energy payments to QFs. The transition formula included a utility-specific "factor" which was designed to relate SRAC prices to gas border prices for each utility. Transition formulas were adopted for Edison, San Diego Gas & Electric (SDG&E) and PG&E. Each transition formula uses a starting energy price, and is adjusted monthly to reflect changes in assumed utility fuel costs, as reflected in percentage changes to certain border gas price indices. The transition formulas include incremental energy rates (IER) for each utility, a variable operations and maintenance (O&M) adder, and average interstate and intrastate gas transportation costs. Edison and SDG&E made SRAC payments based on published gas border indices at Topock,[8] while PG&E relied on a 50/50 weighting of gas indices at Topock and Malin.[9] The transition formulas were expected to be of relatively short duration until energy payments could be based on California Power Exchange (PX) prices. (*See* Pub. Util. Code, § 390 (c).) The PX ceased market operation at the end of January 2001 while the transition formula continues to be in use, over eight years later.[10]

Beginning in May 2000, gas spot prices at the California border began to increase significantly above gas prices in the producing gas basins (basis differentials). These basis differentials increased significantly into Fall 2000,

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[7] SRAC payments prior to the adoption of the transition formula are described in D.96-12-028, pp. 3-4.

[8] Topock is located at the California/Arizona border and is an entry point for gas into Southern California Gas Company's system.

[9] Malin is located at the California/Oregon border and is an entry point for gas into PG&E's system.

[10] We note that the conditions anticipated in § 390(c) have not been met.

reached a maximum in December 2000, and continued at significant levels through May 2001. Because SRAC prices paid during the Remand Period were adjusted monthly based on border price indices, the increased border indices resulted in a corresponding increase in SRAC prices.

In July 2000 Edison petitioned the Commission to modify its transition formula to respond to ever-increasing basis differentials. Office of Ratepayer Advocates (ORA) supported Edison's petition and questioned whether Topock indices were reliable and valid. ORA cited a complaint filed by the Commission at FERC which sought to rescind certain contracts that the Commission contended permitted natural gas suppliers and their affiliates to increase gas prices through the withholding of capacity. On August 31, 2000, Edison filed an emergency motion to suspend SRAC posted prices while its July petition was pending. That motion was denied. However, on November 28, 2000, Edison filed a second emergency motion that sought an order modifying D.96-12-028.

On March 27, 2001, the Commission adopted D.01-03-067 responding to Edison's second motion, and modifying the transition formulas. D.01-03-067 modified Edison's factor,[11] and replaced the Topock gas index with the Malin gas index, plus intrastate transportation, for Edison, PG&E and SDG&E.

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[11] Pending adoption of an updated Internal Heat Rate (IER) and Operational and Maintenance (O&M) adder, D.01-03-067 adopted an IER of 9,140 British Thermal Unit (Btu)/kWh and an O&M adder of 0.2 cents per kilowatt-hour (kWh). Subsequent to D.01-03-067 evidentiary hearings were held to address the IER and O&M adder. However, no modifications of the IER and O&M adder have been made. Instead, any future modifications of the SRAC formula will be considered in the Commission's rulemaking on avoided cost (R.04-04-025).

On April 27, 2001, Edison and PG&E filed applications for rehearing.[12] Edison asserted in its rehearing application that the Commission: 1) failed to order retroactive application of the modified SRAC formula; 2) needed to clarify why the Malin indices were adopted; and 3) needed to clarify the accelerated payment provisions and elimination of the penalty provision for failing to make timely payments to QFs.

PG&E contended that: 1) the Commission unlawfully amended its contracts with QFs by accelerating the payment schedule; 2) the Commission needed to specify that the "benchmark" Consumer Transition Price did not represent rates that PG&E must actually pay to QFs; and 3) because Federal bankruptcy law prohibits payments for any pre-petition liability without approval of the Bankruptcy Court,[13] the Commission could not assess a penalty should it fail to make timely payments on deliveries it received from the QFs between March 27, 2001, and April 6, 2001.

D.01-12-025, adopted December 11, 2001, rejected Edison's and PG&E's applications for rehearing.[14] D.01-12-025 found there was no legal error in only applying the modified SRAC formula prospectively. The Commission stated that nothing in the record supported a retroactive application and that the

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[12] Applications for rehearing were also filed by Calpine Corporation, Caithness Energy, Mega Renewables, Mega Hydron I, Central Hydroelectric Corporation, Tracteble Power, Inc, et al, CE Generation, Customer Accounting and Collections (CAC), California Coastal Commission (CCC), Independent Energy Producers Association (IEP), and the County of Los Angeles (collectively, QF parties).

[13] PG&E filed for Chapter 11 bankruptcy on April 6, 2001.

[14] Because the applications filed by the QF parties raised different issues than the utilities, the QF parties' applications were addressed in a separate order.

Commission had previously declined to allow retroactive downward adjustments of posted prices.[15] Additionally, D.01-12-025 found that FERC's regulations provide that "[i]n the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery." (18 C.F.R. § 292.304(b)(5).) The Commission determined that this language suggested that the Commission could provide for avoided costs that differed from the utility's avoided costs and still be consistent with PURPA, so long as those costs were derived from consistent application of a formula.

D.01-12-025 affirmed the Commission's finding in D.01-03-067 that the Topock indices were not sufficiently robust to meet the market-based pricing requirement under § 390, and therefore could not be used prospectively in the SRAC formula. The Commission concluded that although it had the authority to retroactively adjust SRAC prices, it declined to do so in this instance, citing concerns over the QF market, and the uncertainty of continued QF operation given the then current problems with non-payment by utilities. The Commission also stated the need for pricing certainty for QFs and that retroactive adjustment would not be in the public interest.[16] D.01-12-025 also rejected Edison's request to clarify the use of the Malin indices, and modified D.01-03-067 to eliminate references to utility penalties for QF payments.

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[15] *See* D.96-07-026 (1996) 66 CPUC 2nd 780, 784, and D.82-12-120 (1982) 10 CPUC 2nd 553, 621.

[16] D.01-12-025, pp. 3-5.

On February 7, 2002, the Commission adopted D.02-02-028, which addressed the rehearing applications filed by QF parties. QF parties contended that D.01-03-067 denied due process by not holding evidentiary hearings prior to adopting the modified SRAC formula, violated § 390, violated PURPA, and violated FERC regulations implementing PURPA.[17] In D.02-02-028, the Commission rejected QF parties' applications for failing to demonstrate good cause for granting rehearing, and modified D.01-03-067 to correct certain errors and ambiguities. The Commission found that evidentiary hearings were not required under § 1708.5(f), and that there was sufficient evidence to support a finding that the Topock index was not sufficiently robust. D.02-02-028 also found that due process was not violated as a result of a shortened comment period for D.01-03-067, and that the Malin indices could serve as a proxy for Topock and reflect utility avoided costs. D.02-02-028 clarified D.01-03-067 to add findings of fact and conclusions of law regarding use of the Malin index change from Topock to Malin. In addition to rejecting QF arguments regarding PURPA violations, the Commission pointed out that § 390(b) did not specify a specific transitional formula. Instead, § 390(b) broadly proscribed the main components to be included in the formula, and that to ensure compliance with PURPA, the Commission revised the formula to reflect utility avoided costs. The Commission also determined that the modified formula did not apply to non-standard contracts, or to non-standard amendments to contracts between QFs and utilities.[18]

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[17] *See* D.02-02-028, pp. 1-4.

[18] D.01-06-015, adopted June 13, 2001, and clarified by D.01-07-031, adopted July 13, 2001, provided for non-standard contract amendments between QFs and

Footnote continued on next page

Edison and several QF parties sought judicial review of D.01-03-067, D.01-12-025, and D.02-02-028.[19] On September 4, 2002, The Court, Second The Court affirmed the majority of the determinations in D.01-03-067, and D.01-12-025 and D.02-02-028.[20] Most importantly, The Court held the Commission had discretion under § 390(b) to determine which indices "or any combination thereof" should be used for setting SRAC.[21] However, The Court did find that the Commission violated PURPA by declining to consider Edison's request to apply the modified SRAC formula on policy grounds.

> "In declining to even consider the request, the Commission erred. In enacting PURPA, the Congress declared that the transmission of electrical power was of national interest and that FERC was to have jurisdiction over the sale of electrical energy in interstate commerce. (16 USCA § 824.)[22]

By not considering the issue during the proceeding, no record was developed to support a determination on this matter. Thus, the Court remanded this issue back to the Commission and ordered:

> "It may be that the evidence will show the SRAC prices were correct for the period of December 2000 through March of

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utilities. The non-standard contract amendments accelerated QF payments, fixed energy prices, and allowed for supplemental payments above normal operating levels. D.01-06-015 and D.01-07-031 also provided an opportunity for Edison and QFs to resolve disputes and retain the benefits of long-term contracts for Edison, QFs, and ratepayers.

19 *See Southern Cal. Edison Co. v. Public Utilities Com., (Edison)* 101 Cal.App. 4th at p.982 (2002).

20 *Id.* at p. 999.

21 *Id.* at 992.

22 *Id.* at p. 999.

> 2001. If the Commission makes this determination and it is based upon substantial evidence, that will end the matter. However, if the evidence shows that the formula in D.01-03-067 should have been applied retroactively to arrive at a more accurate SRAC, then it is the Commission's duty to apply it retroactively. The Commission does not have the power to thwart Congressional intend by having a policy inconsistent with that set forth in PURPA."[23]

On January 14, 2003, the assigned Administrative Law Judge (ALJ) issued a ruling requesting comments and reply comments to questions involving the remand regarding SRAC prices and natural gas indices used between December 2000 and March 2001.[24] On February 7, 2003, comments were submitted from Edison, SDG&E, PG&E, CCC, IEP, CalWEA, Tractebel Power, Inc. (Tractebel), Central Hydroelectric Corporation (CHC) and ORA. On March 7, 2003, reply comments were submitted from Edison, SDG&E, PG&E, CCC, IEP, Tractebel, The Cogeneration Association of California and the Energy Producers and Users Coalition (CAC), and the California Department of General Services (DGS).

On November 7, 2003, a Prehearing Conference (PHC) was held to consider receipt of recent relevant information from the FERC, the Commodity Futures Trading Commission (CFTC), and other sources, and to discuss the need for evidentiary hearings. Parties at the PHC generally agreed that the recent information should be updated through additional comments and reply comments, and that evidentiary hearings were unnecessary. Additional

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[23] *Id.*

[24] Three QF parties filed petitions for review of the Court's order in the California Supreme Court on October 15 and 16, 2002. These petitions were summarily denied on November 26, 2002, and The Court order became final on December 20, 2002.

comments were submitted by PG&E / ORA / The Utility Reform Network (TURN), CalWEA, IEP, CCC and CAC on February 17, 2004. Additional reply comments were submitted by PG&E, ORA and TURN, CCC and IEP on March 17, 2004. Edison filed a joiner supporting the reply comments of PG&E, ORA and TURN.

Unfortunately, none of the parties' comments included actual energy prices paid during the Remand Period. Therefore, an ALJ ruling on June 23, 2004 requested these purchased energy costs during this period that the parties had failed to provide. SDG&E, Edison and PG&E provided energy purchase information, and later CCC commented on this information. Parties were provided an additional opportunity to address CCC's comments, and the responses of PG&E, Edison and SDG&E.[25] On November 12, 2004, PG&E, Edison, SDG&E and IEP submitted comments to CCC's comments, and the utilities' responses. The matter was deemed submitted on November 12, 2004.

III. Positions of Parties Recommending SRAC Refunds Regarding Application of the Modified SRAC Formula

Edison, PG&E, ORA and TURN recommend refunds of SRAC amounts paid during the Remand Period.[26] Edison asserts that SRAC prices during the Remand Period exceeded the lawful rate permitted under PURPA for two reasons. First, the factor for intrastate gas transportation costs used in the formula to calculate SRAC decreased during this period, yet this decreased cost

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[25] *See* ALJ Ruling on October 21, 2004.

[26] Although ORA submitted separate comments on January 31, 2002, ORA jointly filed comments, and reply comments, with PG&E and TURN on February 17, 2004, and March 17, 2004, respectively. Therefore, all of ORA's comments, and reply comments, are identified as the comments and reply comments of PG&E, ORA and TURN.

was not reflected in the delivered gas cost paid by Edison. Second, Edison contends the border index gas prices were not "robust" as contemplated by D.96-12-028, and that gas prices were artificially inflated by market power abuse, affiliate self-dealing, and other misconduct by gas marketers and suppliers. Edison points to evidence that was emerging in early 2003 indicating manipulation of the gas market and unreliability of reported prices during the Remand Period.[27] For these reasons, Edison argues that since the Topock index used in the transaction formula was based on manipulated and flawed gas prices, the SRAC prices during the Remand Period were also flawed, and, consequently resulted in unlawful SRAC prices.

Edison advocates that the Commission revise the SRAC formula for the Remand Period, by incorporating the revision to the Factor adopted in D.01-03-067 as of December 2001, and revise the gas index methodology used in the formula. Edison does not recommend the use of a specific gas index in the formula, but offers several alternative proposals.[28] Edison's first proposal, "Competitive Topock," is based on gas prices at producing basins plus interstate transportation costs (basin plus transport), a method recommended in the FERC staff report for purposes of determining competitive gas costs in the Refund

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[27] Edison cites the initial August 13, 2002, FERC staff report Initial Report on Company-Specific Separate Proceedings and Generic Reevaluations, Published Natural Gas Price Data, Enron Trading Strategies in FERC's Fact Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, FERC Docket No. PA02-2-000. This initial report was made final March 26, 2003.

[28] Although providing alternative proposals, Edison specifically argues against use of the Malin indices adopted by D.01-03-067 as a proxy for Topock, as Edison believes the Malin indices also exhibited exaggerated prices during the Remand Period.

Proceeding.[29] Edison derives its Competitive Topock estimates using variations of gas producing basin prices and interstate transportation costs. Edison's second method uses a weighted cost of gas (WACOG) based on Southern California Gas Corporation (SoCalGas) tariffs plus gas costs derived by Competitive Topock, or gas costs from recorded Topock indices. Edison believes that the Competitive Topock plus WACOG is the preferred method if WACOG is used in calculating gas costs in the transition formula.

Edison argues that regardless of the method chosen to estimate avoided fuel costs, the Commission must implement changes to SRAC during the Remand Period to fulfill its duty under PURPA that QF prices equate to Edison's avoided costs. Edison explains that even if § 390 conflicts with PURPA, PURPA as Federal law controls. Edison contends that a narrow construction of § 390 to permit only the use of certain gas border indices would not comply with PURPA, and that the phrase "based on" as used in § 390(b) affords the Commission latitude in implementing the transition formula. Edison argues that the term

[29] On March 26, 2003, FERC issued an order that addressed proposed findings of fact regarding the appropriate mechanism for determining the just and reasonable Mitigated Market Clearing Price (MMCP) to use for computing refunds for sales of electric energy in the California Independent System Operator Corporation and the Power Exchange markets for the October 2, 2000 through June 21, 2001 period. In addition to ruling on a number of technical issues relating to the calculation of the MMCP, the FERC March 26 order adopted a proposal that had been made as part of FERC staff reports to use a "basin plus transportation" proxy price for the natural gas price input into the MMCP formula. The alternative gas proxy prices are used for calculating the amount of refunds for Northern and Southern California. Subsequently, FERC confirmed the use of the proxy prices for determining MMCP, and adopted a gas price data series recommended by the Commission, PG&E, the California Attorney General and other parties (jointly the California Parties). (*See* San Diego Gas & Electric Company, *et al.*, 102 FERC ¶ 61,317 (2003) (March 26 Order).

"border price indices" used in § 390 is not specific, and that Edison's alternative methods for deriving gas costs meet the definition of border price indices.

Edison also contends that the Commission may lawfully implement alternative proposals not expressly permitted by § 390(b), and that the legislature was aware of the implications of PURPA when Section 390 was enacted. Edison asserts that Article III, § 3.5 of the California Constitution[30] does not constrain the Commission in its implementation of alternative gas indices, as it ignores the effect of § 202, which limits the scope of the legislature's enactments affecting interstate commerce, to ensure that they do not violate federal law. Edison concludes that the Commission may enforce the will of the Legislature, as expressed in § 390, only to the extent that it is consistent with avoided cost principles. Accordingly, Edison asserts that nothing in § 390 indicates any intent on the part of the Legislature to act other than pursuant to its delegated authority to implement FERC's avoided cost standards.

Edison recommends that applying a retroactive adjustment to the Remand Period should exclude those QFs that have non-standard contracts, and exclude QFs that have entered into contract amendments and other various forms of agreements that provide releases from retroactive SRAC adjustments. Edison notes that there is a relatively small group of QFs (which serve Edison)

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[30] This constitutional provision provides :

An administrative agency, including an administrative agency created by the Constitution or an initiative statute, has no power….(c) To declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.

that have not entered into these release agreements, and in addition, any retroactive adjustment should only apply to those QFs whose payments were based on SRAC.

Finally, Edison cautions that if FERC determines that natural gas prices were too high during the Remand Period, and awards damages, QFs should not be unjustly enriched by these damages. Edison requests that the Commission establish a mechanism to ensure that if any QF receives such damages, those benefits should flow to ratepayers.

PG&E, ORA and TURN also support a refund of SRAC payments during the Remand Period, and in support of their position, filed a motion pursuant to Rules 45, 73, and 74 of the Commission's Rules of Practice and Procedure, requesting that the Commission take official notice of certain FERC and Commission documents.[31] PG&E, ORA and TURN assert the documents show that California gas border prices, including prices at Malin, were misreported

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[31] These documents are: 1. *SDG&E v. Sellers of Energy*, 93 FERC ¶ 61,121 (Nov. 1, 2000); 2. *SDG&E v. Sellers of Energy*, 96 FERC ¶ 61,129 (July 25, 2001); 3. *SDG&E, et al.*, 102 FERC ¶ 61,317; 4. *SDG&E, et al.*, order on Rehearing, 105 FERC ¶ 61,066 (October 16, 2003); 5. *California Parties' Comments on Method For Determining Natural Gas Prices For Purposes of Calculating Refunds*, filed in FERC Docket nos. EL00-95-045 and EL00-98-042 on October 15, 2002 (includes *Initial Report on Company-Specific Separate Proceedings and Generic Re-Evolutions; Published Natural Gas Price Data; And Enron Trading Strategies*, FERC staff prepared in Docket No. PA-02-2-000 in August 2002); 6. *Staff Final Report on Price Manipulation in Western Markets*, Docket No. PA02-2-000 (March 2003); and 7. *Prepared Testimony of Michael J. Harris, Ph.D., Econ One, On Behalf Of The California Parties*, dated February 24, 2003, filed in FERC Docket Nos. EL00-95-045 and EL00-98-042.

Commission Rule 73, of the Commission's Rules of Practice and Procedure, provides that official notice "may be taken of such matters as may be judicially noticed by the courts of the State of California." The motion of PG&E, ORA and TURN is unopposed and is granted.

and manipulated during the Remand Period, and therefore are not robust, and are unsuitable for use in the SRAC transition formula. PG&E, ORA and TURN conclude that SRAC prices produced by the Transition Formula do not represent utility avoided costs and do not comply with the requirements of § 390(b).[32] PG&E, ORA and TURN argue that the Court's decision obligates the Commission to modify the Transition Formula if it produced prices that were not a reasonable proxy of utility avoided costs. Relying on evidence produced during the Refund proceeding, PG&E, ORA and TURN contend SRAC prices were "incorrect" during the Remand Period because the utilities relied on inflated gas price indices to calculate SRAC prices. PG&E, ORA and TURN calculate an alternative set of SRAC prices derived from the FERC Refund Proceeding, for use in determining "correct" SRAC prices. This calculation, employing producing gas basin prices plus interstate transportation, is provided through the Declaration of Dr. Carolyn Berry (Attachment A). Dr. Berry recalculates SRAC prices for the Remand Period using gas prices based on testimony by Dr. Michael Harris.[33] Dr. Harris proposed a Southern California border gas price based on average daily midpoint gas prices from the Permain and San Juan Basins, plus transportation to the California border, an El Paso fuel charge, and total intrastate transport charges. Northern California border gas

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[32] § 390(b) requires the Commission to use a gas border price that serves as a reasonable proxy for the utilities' avoided costs (*Southern Cal. Edison Co. v. Public Utilities Commission, supra,* 101 Cal. App. 4th at pp. 992-993).

[33] An initial set of basin plus transportation gas prices was submitted to FERC by Dr. Harris in California Parties' Comments on Method For Determining Natural Gas Prices For Purposes of Calculating Refunds on October 15,2002, filed in FERC Docket Nos. EL00-95-045 and EL00-98-042 on October 15, 2002. An updated set, filed with FERC on March 3, 2002, was subsequently adopted by FERC.

prices were calculated by Dr. Harris using gas midpoint prices as reported in *Gas Daily* reported for the NOVA point at the Alberta Energy Company's hub in Southern Alberta where gas is purchased for delivery to Northern California. Northern California prices include interstate tariff and fuel charges and intrastate transportation and fuel charges. PG&E, ORA and TURN state that this methodology was adopted by FERC as an input to calculate the Mitigated Market Clearing Price (MMCP).[34] Dr. Berry's SRAC calculations average Northern and Southern California border prices, and add interstate transportation charges, but do not use intrastate transportation charges in determining gas border prices. The resulting calculations show that retroactively applying the revised SRAC prices for the Remand Period results in overpayments by PG&E and its ratepayers to QFs of approximately $260 million.[35]

PG&E, ORA and TURN contend that the use of proxy gas border prices based on average basin prices plus interstate transportation meet the requirements of § 390, to develop appropriate gas indices. PG&E, ORA and TURN argue that avoided costs must be "just and reasonable to the electric consumers of the electric utility and in the public interest."[36] As manipulated gas prices are not just and reasonable nor in the public interest, PG&E, ORA and TURN argue that proxy gas prices, which are reliable and accurate, are just and reasonable, and are in the public interest. PG&E, ORA and TURN recommend

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[34] MMCP determined a cap to electric energy payments made to sellers in the ISO and PX energy and capacity markets for the period October 2, 2000 through June 20, 2001.

[35] PG&E will flow through to ratepayers any net-after-tax amounts received from QFs.

[36] 16 U.S.C. § 824a-3(b)(1)(2003).

equitable accommodations for QFs that can demonstrate hardship related to actual gas payments during the Remand Period, and as provided under the agreement entered into between PG&E and the Commission to settle PG&E's bankruptcy case. (*See* D.03-12-035).

PG&E, ORA and TURN also argue that QF parties have not provided evidentiary support that SRAC prices complied with PURPA during the Remand Period. Alternatively, PG&E, ORA and TURN explain that as PURPA caps QF payments at full-avoided costs, and as QFs received more than full-avoided costs during the Remand Period, PURPA was violated. PG&E, ORA and TURN maintain that during the Remand Period SRAC prices exceeded the MMCP in most hours, and that even if the MMCP was comparable to SRAC, QFs should not receive MMCP rates for three reasons. First, PG&E, ORA and TURN note that QFs had an opportunity to switch to PX prices, but stayed with the transition formula. Thus, QFs that chose the transition formula should only be entitled to a transition formula price based on accurate gas prices. Second, the MMCP is a maximum price, and if the market-clearing price was less than MMCP, certain sellers would be paid the lesser price. Finally, PG&E's power purchases during the Remand Period include bilateral agreements and fixed-price QF contracts, and thus, these sources too, must be considered in determining avoided costs.

PG&E, ORA and TURN point out that the El Paso Master Settlement Agreement (MSA) proceeds exclude QFs and preserves the rights of California parties to seek additional relief from sources other than El Paso. PG&E, ORA and TURN note that § 5.5 (c) of the MSA provides, in relevant part:

> However, except as necessary to participate in the specific Commission proceeding described in the next sentence and to defend such orders as The CPUC may make in that

> proceeding, no such Performance-based QF Claim between such parties shall rely upon or be based on a claim or defense that any of the conduct or matters released in Paragraphs 5.2 and 5.3 above either (i) wrongfully or improperly altered, influenced or otherwise affected the price applicable to energy sold under the QF Contract and/or (ii) extinguished, diminished or otherwise modified the Obligation of the utility to pay the contract price for power delivered by qualifying facility in accordance with the terms of the QF Contract. Nor does anything in this Agreement release any potential liability that any qualifying facility may have in connection with the Order instituting Rulemaking into Implementation of Pub. Util. Code 390, Docket No. R.99-11-022, which is currently pending before the CPUC.

IV. Positions of Parties Opposed to SRAC Refunds Regarding Application of the Modified SRAC Formula

All of the parties opposed to SRAC refunds are QFs,[37] and include CCC, IEP, CAC, Tractabel, CHC, DGS and CalWEA. IEP argues that the Commission was correct in denying Edison's request to apply the modified transitional formula retroactively for the Remand Period. IEP contends that sound regulatory policy favors establishment of stable pricing mechanisms such as prospective SRAC pricing changes only. IEP notes the Commission reaffirmed retroactive SRAC pricing adjustments in D.04-01-050, stating "We agree with IEP that PG&E's proposed true-up is inconsistent with established Commission precedent whereby QF prices have always been set prior to delivery." IEP also contends the Commission made determinations that SRAC prices equate to avoided costs, and therefore SRAC prices during the Remand Period were correct. IEP points out that there are many definitions of avoided costs, and thus

[37] SDG&E takes no position on refunds as discussed separately.

no determination of SRAC could ever be correct as there are other alternatives. IEP notes Edison's comments do not recommend a specific determination of avoided costs, but rather provide alternative calculations of natural gas indexing mechanisms,[38] and reject the retroactive application of the Malin indices in the transition formula. IEP also maintains that SRAC is based on forecasts of future costs, and that these costs are expected to change over time as they did during the Remand Period. IEP also notes that SRAC prices may have been too low during the Remand Period as constrained availability of alternative energy sources would increase the transitional formula elements apart from gas prices.

CCC contends that SRAC prices during the Remand Period were correct, and based on a formula (the transitional formula) that matches avoided costs over time. CCC agrees with the Commission in D.01-12-025, that "the Commission can, consistent with PURPA, provide for avoided costs that differ from the utilities, so long as those costs are derived from consistent application of a formula."[39] In support of this position, CCC provides a series of price comparisons[40] over different time periods between April 1998 and March 2001, that CCC believes demonstrate SRAC prices were less than either the electric market prices based on border gas prices, or electric market prices using basin prices plus transportation (*i.e.*, MMCP). CCC points out that even if the comparison is limited to the Remand Period, electric prices based on basin plus

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[38] Comments of Edison on SRAC and Natural Gas Indices Used From December 2000 through March 2001, filed February 7, 2003, p. 10.

[39] D.01-12-025, p. 3.

[40] *See* CCC Comments, February 17, 2004, pp. 8-9.

transportation were about 19% less than SRAC prices; while, electric market prices based on gas border prices were about 70% greater than SRAC prices.[41]

Although FERC did not use gas border prices in developing MMCPs, CCC points out that those generators, who actually paid such border prices, were allowed to use border prices in determining their refund amounts. Furthermore, CCC quotes SDG&E which states that "Even if the indices were proven incorrect, that would not automatically mean that SRAC prices based on those indices were also incorrect, if those prices reflected the utilities' avoided cost during the relevant period."[42] In addition, CCC argues that SRAC prices may have been correct despite gas price manipulation given FERC's use of higher heat rates and O&M expenses in calculating MMCPs. CCC asserts that using higher heat rates and O&M expenses in the SRAC formula will mitigate the use of gas border prices. CCC adds that since utilities' avoided costs are driven by the same market gas prices, then SRAC prices based on those market gas prices are correct. Stated another way, CCC contends that QF avoided-cost payments must be set based upon the costs that the utilities actually avoid as a result of QF purchases, even if those costs resulted from a manipulated market. Thus, wholesale electricity prices during the Remand Period, which comprise at least a portion of the utilities' avoided costs, were based in substantial part upon the California border price indices. CCC points out that FERC permitted generators that actually paid these border prices in arm's length transactions to continue to

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[41] As argued by PG&E, ORA and TURN, this comparison is flawed as the MMCP represents a maximum clearing price in any hour, and that during some hours certain sellers will be paid the market-clearing price if it is less than MMCP.

[42] SDG&E Comments, February 7, 2003, p. 2.

employ these prices. By analogy, CCC contends, QFs that paid high border gas prices should not be subject to potential refunds during the Remand Period. CCC believes that FERC's determination regarding actual gas prices paid by QFs reflects the principle that electricity prices based upon border prices during the Remand Period can be just and reasonable to ratepayers, a PURPA requirement for SRAC prices.[43]

CCC suggests that ratepayers are already being compensated under the El Paso Settlement, and as QFs are not entitled to any settlement proceeds, any retroactive adjustment would result in ratepayers receiving unwarranted windfalls, and double-exposure for certain QFs. CCC provides that a portion of the settlement proceeds was intended for ratepayers to reflect QF payments during the Remand Period. CCC explains that Edison expressly referred to increased SRAC payments as a portion of the harm suffered by Edison due to excessive border prices, as confirmed by Edison and PG&E.[44] CCC alleges that over $1 billion of the El Paso Settlement damages are allocable to inflated electricity prices, and a portion of these damages are intended to compensate for inflated SRAC payments. CCC calculates that PG&E's portion related to SRAC payments for the Remand Period is approximately $52 million, Edison's portion is approximately $60 million, and SDG&E's portion is approximately $3 million.

CCC argues that recent Commission decisions on utility procurement[45] further support a finding the SRAC prices during the Remand Period were correct. CCC points out that these decisions indicate the importance of QFs to

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[43] 18 C.F.R. 292.304(a).

[44] Exhibits 1 and 2, attached to CCC's comments

[45] D.02-08-071, pp. 30-31; D.03-12-062, pp. 51, 56; D.04-01-050, pp. 151, 157.

utility procurement, and encourage existing QFs to provide power over the longer term. CCC notes that in affirming QF power, and finding that the SRAC formula was in need of revision, the Commission did not conclude that the current SRAC pricing methodology violated PURPA. Finally, CCC cautions that if the Commission does not reaffirm SRAC prices during the Remand Period, Edison, and perhaps PG&E, may attempt to revisit SRAC prices determined under the revised SRAC formula adopted in D.01-03-067.[46]

CAC states that it supports the positions of CCC and IEP, and argues that if the Commission does not sustain its earlier position that SRAC prices were correct during the Remand Period, then CAC requests evidentiary hearings and the right to audit utility records in order to determine avoided costs. CAC believes that SRAC prices over time represent a reasonable proxy for avoided costs, and that accurate avoided costs are represented by consistent application of the methodology (*i.e.* the transitional formula), and not by a minute-by-minute equivalence. CAC agrees with other parties that the Topock gas prices were manipulated, but states that QFs relied upon those prices in determining their fuel costs, and purchased gas at the Topock spot market prices. CAC further believes this proceeding is administratively wasteful and in conflict with the Commission's recent procurement orders, D.04-01-050 and D.03-12-062 regarding QF pricing methodologies. Finally, CAC notes that QFs continued to

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[46] CCC notes that D.04-01-050 rejected PG&E's proposal that, if the Commission were to extend the Standard Offer 1 requirements again, it should require that any SRAC payments made thereunder be subject to true-up to reflect the anticipated new SRAC methodology. Thus, CCC suggests the Commission affirmed a policy rejecting retroactive downward changes to SRAC prices, which is CCC's position in this proceeding.

deliver power during the Remand Period, relying on adopted SRAC pricing, although QF payments for these deliveries were delayed.

CalWEA supports the position of CCC and argues that any retroactive adjustment of SRAC prices will have a significant economic impact on renewable QFs and California's Renewables Portfolio Standard program. CalWEA contends that wind energy QFs have already invested SRAC payments in project repairs and that QFs, including wind generators, provided power during the energy crisis despite the utilities' failure to pay for this power. CalWEA argues retroactive refunds could create uncertainty in the renewable resource market, and thus reduce adequate renewable resource financing of new projects. CalWEA also maintains that the FERC Settlement included damages due to inflated SRAC prices, and suggests that SRAC prices may have been correct despite manipulation of gas indices in the transition formula.

Tractabel argues that gas prices used in the SRAC formula during the Remand Period were those actual gas prices paid by QFs, and that QFs relied on posted SRAC prices to hedge against changes in gas prices. Thus, any retroactive refund would result in a loss to QFs using hedging arrangements. Tractabel states that QFs suffered losses as a result of the gas index change from Topock to Malin in the modified transition formula, and a retroactive adjustment would result in further losses. Tractabel also argues that Remand Period avoided costs, as defined by PURPA, were the power costs that would have been paid by utilities in the absence of QF power. Tractabel notes that these avoided costs are not measured by prices in a competitive market, but are the costs occurring at the time of measurement.

Tractabel also contends that § 390 provides that costs of gas for generation reflect gas costs available for incremental purchases when avoided costs were measured. Tractable asserts that the starting gas index price used in SRAC reflects "an average of current California natural gas border price indices." Tractabel argues that the existing border gas prices at Topock were the actual gas supply costs available to electric generators, including QFs. Tractable contends alternative calculations of gas prices, including basin plus transportation, were not available to electric generators during the Remand Period.

CHC and DGS also oppose SRAC refunds. CHC believes retroactive refunds would result in a taking of property, and argues that SRAC prices understated actual Remand Period incremental energy prices as measured by prices in the wholesale market. DGS, which operates three cogeneration facilities at California institutions, contends that the State would be harmed through changes in financial revenue streams, and potentially need to find new energy sources to replace existing cogeneration facilities.

V. Position of SDG&E Regarding Application of the Modified SRAC Formula

SDG&E takes no position regarding whether SRAC prices during the Remand Period were either correct or incorrect. SDG&E rejects the use of WACOG in determining a gas index in SRAC, as it believes employing WACOG does not comply with § 390(b). SDG&E also rejects the PG&E / TURN / ORA proposal to use basin prices plus transportation to determine a border gas price, as used by FERC in the MMCP. SDG&E contends that this method may not correctly price gas at the border thus resulting in a potential disincentive to QF generation, and possible conflicts with § 390(b). SDG&E recommends that any SRAC refunds only be applied to QFs receiving SRAC prices, and not to QFs under fixed price contracts during the Remand Period. Finally, SDG&E objects to PG&E's February 7, 2003 request that the Commission take either official notice of, or admit directly into evidence, certain news articles and a Commodity

Futures Trading Commission (CFTC) order dated December 18, 2002; SDG&E argues that no legal basis has been established enabling the Commission to take either official notice or admit these documents into evidence.[47]

VI. Utility Responses Regarding Remand Period Energy Prices

In response to the ALJ Ruling on October 21, 2004, SDG&E states that its energy price information serves bundled load, but excludes QF prices and long term contracts. SDG&E adds that after the demise of the PX in January, 2001, DWR energy purchases provided for SDG&E's "net-short" energy needs.[48] SDG&E's response is shown below:

SDG&E Pricing Data

Month	Average Purchased Energy Price ($/MWh)
December 2000	$281
January 2001	180
February 2001	135
March 2001	93

Edison states that it purchased energy during the Remand Period from the PX, California Independent System Operator (ISO), and the California Department of Water Resources (DWR). Edison's reported prices include both DWR purchases and ISO market purchases. Edison adds that these prices

[47] Subsequent to PG&E's February comments, PG&E filed a motion and other documents in its February 17, 2004, comments. These later documents provide a more timely and detailed analysis of gas manipulation during the Remand Period. As this motion is granted, it is unnecessary to consider the legal basis of PG&E's February 2003 request regarding news articles and the CFTC order.

[48] SDG&E's pricing data excludes the CDWR purchases but includes QF and long and short-term purchases. SDG&E March pricing includes a small amount of spot energy purchases.

include both energy and capacity as Edison states it is unable to provide an energy only price for PX and ISO purchases. These purchase prices are shown below:

Edison Pricing Data

Month	Average Market Price	DWR Rate[49]
December 2000	$242	N/A
January 2001	$243	$97
February 2001	$221	97
March 2001	$240	97

Edison cautions that for various reasons the energy price information provided above is not useful to determining Remand Period energy avoided costs. First, Edison states that the listed prices include energy and capacity, not energy only prices. Second, Edison explains that PX and ISO market prices were determined by FERC to be unreasonable and unjust, and consequently FERC ordered the prices to be recalculated so as not to exceed a MMCP. Edison adds that even use of the MMCP as a proxy for avoided costs would be improper as the MMCP uses the highest heat rate in the market.[50] Finally, Edison contends that the shapes of generation curves representing the energy purchased at market prices and QF purchases are different, and therefore not comparable, as QF purchases are relatively "flat" over the time-of-use periods,[51] while non-QF purchases are quite peaked. That is, non-QF purchases are more likely to occur

[49] Edison states its DWR purchases were at a fixed rate.

[50] Lowering the MMCP heat rate would lower the MMCP.

[51] Energy is purchased for three periods designated as mid-peak, off-peak, and super-off.

during the mid-peak and off-peak periods when compared to super-off peak purchases.

PG&E states that it has not yet paid the Remand Period generation prices, and therefore, the purchase rates should be replaced by MMCP. PG&E also notes that the ISO calculated a market clearing price (MCP) as input to the determination of final prices to be paid, but capped prices at the MMCP. PG&E's prices are as follows:

PG&E Pricing Data

Period	Average ISO MCP ($/MWH)	Average PX MCP ($/MWH)	Average MMCP ($/MWH)
December 2000	$239	$309	$124
January 2001	146	143	153
February 2001	143	-	101
March 2001	118	-	85

PG&E argues that the above prices do not reflect actual average energy purchase prices because: (1) PG&E did not pay amounts invoiced by the PX or ISO during this period; (2) FERC invalidated these prices; (3) the MMCP is a maximum price; and (4) DWR purchased energy after the PX ceased operation. PG&E states that it paid DWR $92/MWH for energy and capacity and is unable to derive an energy only price. PG&E also adds that energy purchases through the PX and ISO are not comparable to QF purchases as QF power is baseload power while PX and ISO purchases tend to be for peaking purposes.

VII. CCC's Comments on Utility Energy Price Information

CCC contends that SDG&E's, Edison's and PG&E's responses do not present an accurate picture of the energy prices paid by utilities during the Remand Period. CCC argues that prices paid by the utilities, PX, and DWR were substantially greater than SRAC prices. CCC argues that SDG&E, Edison and PG&E did not provide data on actual energy costs in response to the October 21, 2004 ALJ Ruling, but instead provided net prices reduced by expected refunds. CCC adds that MMCP prices will be adjusted for generators that can demonstrate they bought gas in arms-length transactions at California border prices, and that the heat rate used in determining the MMCP would be greater if QFs had not supplied power. CCC contends that it is highly questionable whether any capacity costs are included in purchased power costs as the comparisons between the generation supply curves of QFs and other generation are comparable due to the averaging of prices used in the comparisons are averaged, and as there are payment incentives for QFs to produce during peak periods thus increasing QF energy production in peak periods.

CCC provides additional price information to demonstrate its arguments. CCC states that in December 2000, and between January 1, 2001, and January 18, 2001, average day - ahead PX prices were $309/MWH, and $336/MWH North-of-Path 15, and $223/MWH $277/MWH South-of-Path 15, respectively. CCC also cites PX prices that were between $150/MWH[52] and $320/MWh, a price reflecting an uncapped market-clearing price. CCC provides that ISO purchases as reported in ISO's "Weekly Market Watch" reports show the following:

ISO Pricing Information

Period	Price ($/MWh)
December 2000	$231
January 2001	285
February 2001	376
March 2001	314

CCC explains that after the demise of the PX, DWR purchased energy at significant prices above the amounts reported in the utilities' responses. CCC points out that the utilities' responses only show the remittance rates to DWR

[52] This price represents FERC's "soft cap," which can be exceeded if justified by cost.

established by the Commission in D.02-02-052, not the market clearing prices at the time of purchase. CCC summarizes DWR average power purchases, including the percentage of total purchases, as the following:

DWR Power Costs ($/MWh)

Period	Spot Market (74%)	Contracts (20%)	Ancillary Services (6%)	Weighted Avg.
Jan. 18-31, 2001	$321	$305	$ 305	$316
February 2001	308	165	312	290
March 2001	271	188	329	249

VIII. Responses to CCC's Comments on Remand Period Energy Prices

PG&E contends it properly responded to the ALJ's Ruling for energy information and that PG&E's energy price information specifically excludes DWR's costs as these are "irrelevant," since such costs are not PG&E's costs. PG&E argues that manipulated spot market prices bore no relationship to the underlying cost of energy, and were declared unjust and unreasonable by FERC; and that as a result, FERC established "just and reasonable" rates by calculating an MMCP. PG&E adds that even the MMCP is a cap, and that actual prices will be equal to or less than the MMCP. PG&E further argues that the Commission also determined not to use unreasonable market costs in SRAC determinations[53] and therefore CCC's observation that SRAC prices were less than manipulated spot market prices is irrelevant. PG&E believes that the MMCP may be too high, but it is the most appropriate measure of avoided costs. PG&E concludes that

53 *See*, D.96-07-026, 66 CPUC 2d 780, pp. 783-4, excluding Transwestern pipeline capacity costs from avoided cost calculations.

the Commission must reduce posted SRAC prices during the Remand Period to comply with PURPA and the Court's order.

Edison also argues that unjust and unreasonable rates represented by prices charged in the PX and ISO markets cannot be used to measure avoided costs. Edison explains that the MMCP set a threshold above which the "just and reasonable" standard was violated, and thus is a maximum measure of avoided costs, and that the load power provided by QFs is better represented, not by spot market purchases, but by the price blocks of purchased DWR power. Finally, Edison contends PURPA requires that rates for QF purchases be calculated based on avoided costs at the time of delivery, and not whether SRAC prices are an approximation of avoided costs over time.

SDG&E states it did not include any DWR costs in its energy price data as those cost were the direct obligation of SDG&E's customers to DWR, and "SDG&E did not purchase the energy - DWR did."[54]

IEP supports CCC's comments and contends the utilities' energy price data is incomplete and erroneous. IEP also argues there were no hours during the Remand Period in which there were any capacity values in the reported PX prices.

IX. Discussion

In addressing the Court's remand, we have proceeded cautiously and methodically in order to make sure that we have received the necessary and sufficient evidence to reach a decision on very complex regulatory issues. We worked to ensure that the parties have provided us with all the necessary and

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[54] SDG&E cites D.02-09-053 as confirming the allocation of DWR contracts among IOUs for operational administration as opposed to a direct assignment of the contracts.

relevant evidence, and developed a record that will not be found lacking. That evidence indicates that SRAC prices during the Remand Period were correct, and that there is no justification for retroactive application of the modified SRAC formula. Today's determination is limited in its application. Although our decision in this matter includes a determination that avoided costs equaled or exceeded SRAC prices during the Remand Period, as discussed in greater detail below, this determination should not be interpreted as a change in the Commission's position that electric prices from non-QF sources were unreasonable and unjust. Accordingly, we maintain our position that California ratepayers are entitled to refunds from wholesale generators for these unreasonable electric prices.

Our decision in the matter remanded by the Court considers the following arguments and evidence from parties.

X. Do Section 390 Requirements Apply to the Court's Remand?

Parties recommending refunds have argued that SRAC prices during the Remand Period were incorrect under § 390. These parties argue that gas prices at Topock were not robust and therefore did not meet the requirements of D.96-12-028. In D.01-12-025 we stated that we might consider whether this lack of robustness resulted in prior SRAC price postings that did not meet the requirements of § 390.[55] Subsequently, we determined that gas prices at the California border were manipulated, and we advocated this fact before FERC.[56]

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[55] D.01-12-025, p. 4.

[56] Opening Comments of PG&E / ORA / TURN filed February 17, 2004, pp. 8-13.

While we believe gas border prices during the Remand Period were not robust, the issue before us is whether this lack of robustness means that we should retroactively apply the modified formula, or similar pricing mechanism, to the Remand Period and determine new SRAC prices. We note that new evidence indicates this lack of robustness also applies to Malin gas prices that were also manipulated during the Remand Period.[57] This evidence is one reason why no party now recommends that the modified transition formula be applied retroactively. However, despite the gas manipulation at both Topock and Malin, the Court did not direct us to determine new SRAC pricing methods. As noted by CCC,[58] the Court addresses only the modified formula adopted in D.01-03-067. Furthermore, the Court did not ask us to resolve conflicts between § 390 and PURPA. Edison addresses this potential conflict in responding to the question, "In a non-robust market situation, does § 390 conflict with PURPA regarding the determination of avoided cost? If so, how should the Commission address this?" Edison asserts that "…in the case of a direct conflict between PURPA and Pub. Util. Code § 390(b), PURPA controls, as the Court of Appeal plainly decided in *Edison.*"[59] Clearly, the Court in remanding this matter to the Commission did not remand based on the SRAC transitional formula, the gas prices in the formula, the robustness of gas prices, or the requirements of § 390. The Court's Remand does not ask whether we should determine if gas prices were manipulated, or if

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[57] *See* Edison Comments, Feb. 17, 2004, p.10-11; and, Staff Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000 (March 2003), pp. IV-4 to IV-8.

[58] Comments of the CCC, Feb. 7, 2003, pp. 23-24.

[59] *See* Opening Brief of Edison, February 17, 2004, pp. 13-14.

gas prices were correct. Instead, the Court addressed whether there was record evidence to support a determination that SRAC prices were correct during the Remand Period and that the Commission complied with the Congressional mandate that public utilities not pay QFs more than avoided costs under PURPA. Therefore, we consider the following matter.

XI. Do SRAC Prices as Determined by the Transition Formula During the Remand Period Meet PURPA Requirements?

In this instance, the Court has required us to determine whether SRAC prices were correct under PURPA, although one of the critical measures necessary to this determination is a calculation of avoided costs, as measured by the cost of energy supplied by non-QF generators. Therefore, although we are making a determination of avoided costs as required under PURPA, this determination should not in any way be construed as affecting or impacting the Commission's position elsewhere that electric prices from non-QF generators were unreasonable and unjust during both the Remand Period, and for other months of the 2000-2001 energy crisis. Our determination of avoided cost set forth in today's decision has limited application and purpose, namely for disposing of the issues during the Remand Period.

Parties recommending SRAC refunds focus on the effects of gas manipulation on SRAC prices, or refer to "avoided fuel costs," a term that is not defined in PURPA. These arguments conclude that manipulated gas prices result in incorrect SRAC prices, and thus SRAC prices need correction. Recommended correction methods include using basin plus transport or MMCP, WACOG, or other means to determine gas prices and apply these modified or corrected gas prices to the transition formula. However, it is not clear how these methodologies produce SRAC prices that equate to avoided costs as defined in PURPA.

In addition, PG&E, Edison and SDG&E argue that avoided costs during the Remand Period are best measured by using the MMCP as a maximum, a value calculated by FERC to determine energy prices in the California refund proceeding. PG&E, Edison and SDG&E reach this conclusion by noting that the MMCP sets a price, above which, any other price would be unjust and unreasonable. In addition, utilities argue that avoided costs should be measured not by spot market prices, but by MMCPs, mitigated prices that utilities will ultimately pay generators.[60] However, the value of MMCP developed by FERC in its July 25, 2001 Order was to provide a price against which to determine refunds in the electric markets, not to set an avoided cost.

Alternatively, and as noted by CCC, avoided costs do not reflect what would have occurred under different market conditions than those that actually prevailed at the time of energy purchase. PURPA does not provide an alternate definition of avoided costs when a fuel component of energy costs, in this instance gas costs, is manipulated or otherwise incorrect. PURPA clearly states that avoided costs are incremental energy or capacity, or both, which but for the

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[60] PG&E argues that the costs paid by DWR are "irrelevant," since these are not PG&E's costs. While technically this may be correct, PG&E ignores the issue of who will pay DWR for its purchases, and more importantly, whether these high purchase prices provide some measure of avoided costs. Under the California Water Code, Sections 80000-80270, DWR buys and sells electric energy to PG&E ratepayers, and thus ratepayers do pay these costs, even if PG&E is bypassed.

Similarly, SDG&E contends these costs were a direct obligation of SDG&E customers to DWR, although that obligation did not reduce the high energy prices paid by DWR.

purchase from QFs, the utility would either generate itself or purchase from another source.

Furthermore, the information indicates that during the Remand Period spot market prices exceeded SRAC, including prices charged to DWR and the ISO.

Thus, the question before us is whether spot market prices or MMCP or perhaps a modification of either of these prices, is the reasonable measure of avoided costs for purposes of measuring SRAC prices under PURPA. In order to make this determination a careful reading of PURPA is required including a reading of the factors included in 18 C.F.R. § 292.304(e).[61] We find that the "Factors Affecting Rates for Purchases" in PURPA do not include the manipulation of electric rates, or potential energy price changes after-the-fact. Simply, this appears not to have been a consideration when PURPA was adopted. Furthermore, as discussed above, the purpose of a MMCP was not to set avoided costs, but to establish a reasonable standard from which to determine the amount of refunds due to entities purchasing electricity during the 2000-2001 energy crisis, which includes the Remand Period. In this instance, we are determining whether SRAC prices were correct, and therefore we compare SRAC prices to the appropriate avoided costs. Although energy costs from non-QF sources during the Remand Period were exorbitant, and are the subject of the

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[61] Factors include availability of QF energy and capacity, ability of the utility to dispatch the QF, QF reliability, QF contract terms, scheduling of QF outages, usefulness of QF energy and capacity during system emergencies, value of QF energy and capacity on the utility system, relationship of QF energy and capacity to utility ability to avoid costs, and line losses.

FERC refund proceeding, these are the energy costs that would otherwise have been incurred by utilities to replace QF power.

We also note that the exorbitant energy prices charged to utilities, the ISO and DWR, were a result of market manipulation by non-QF generators. Energy supplied by QFs during the Remand Period was not one of the direct factors affecting the electric market manipulation that resulted in the MMCP.

While Edison suggests that the prices paid by the ISO and DWR included capacity values that would tend to lower energy costs contained within these purchases, no party has provided information showing the value of capacity included in these prices, or that the differences in demand and supply curves for power indicate capacity value. Furthermore, CCC is correct that the Reliability Must-Run contracts paid by the ISO include capacity values within ancillary services which reduce any capacity value within ISO purchases.

Although we have determined that the appropriate measure of avoided costs are the actual spot market costs of energy charged to the utilities, the ISO, and DWR, we also have considered the effect of using MMCP for calculating avoided costs. However, we do not believe that the absolute MMCP is the correct value for this determination, as it is speculative that without QF power how the substitute power would have been purchased. It appears that under these extreme conditions, that without QF power, with utility power portfolios at full dispatch, the only option would have been for the utilities to procure from an increasingly scarce market supply that may have had to operate less efficient resources with relatively high heat rates. Notwithstanding this likelihood, power prices calculated at MMCP implied market heat rates (IMHR)[62] at actual bidweek (monthly) border gas prices, yield energy prices in excess of posted SRAC energy costs.

In its February 17, 2004 Comments, CCC compared actual posted SRAC energy prices during the Remand Period with two alternative measures of avoided energy costs: (1) Basin-Forward based MMCPs as advocated by PG&E / ORA / TURN, and (2) Border Gas based MMCPs as advocated by CCC.[63] CCC observed that posted SRAC energy prices at $151 / MWh were well below alternatively calculated avoided cost energy prices of $256 / MWh, which CCC calculated using implied MMCP heat rates and average monthly border gas prices. We note however that SRAC energy prices are calculated at "bidweek"[64] gas prices, not average monthly prices as suggested by CCC. Thus, a more accurate representation of CCC's avoided cost energy price would be the calculation of energy prices using MMCP heat rates and bidweek gas prices.

Given that the utilities fully dispatched their own resources, subject to operating constraints, a reasonable estimate of utility avoided energy cost during the Remand Period is an electric price calculated using bidweek border gas at MMCP heat rates, which conservatively reflect the market for available power purchases. This is a reasonable measure of avoided cost during the remand period, given that (1) the mitigated heat rates reflect the lower basin plus

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[62] IMHR = Power Price ÷ Gas Price x 1,000. For example, IMHR $60 / MWh ÷ $5 / MMBTU x 1,000 = 12,000 Btu / KWh.

[63] CCC comments, February 17, 2004, p. 9.

[64] Bidweek gas prices are based on gas price indices as required by D.96-12-028, *mimeo.*, p.8.

transportation gas prices, and (2) border gas at bidweek prices were significantly lower than average monthly gas prices. In the event the utilities had sought to replace QF power with alternative power purchases from market sources, the resulting electric prices would likely have reflected higher heat rates and gas prices, given the large block of QF power. In order to make this calculation, we begin by deriving the Basin Plus Transportation prices using information provided in CCC's February 17, 2004 comments adjusted for CCC's inclusion of a $6/MMBtu O&M adder. This calculation is shown in Table A. We then derive the implied market heat rate (IMHR) using Basin Forward MMCPs (Table B). Application of these heat rates, and the bidweek gas prices used in SRAC pricing calculates modified MMCPs (Table C). These modified MMCPs, have been added to Table 2 in CCC's February 17, 2004 comments (p. 9) in order to compare SRAC and MMCPs using the border gas prices used in SRAC calculations. These differences as shown in Table D are $105 using the monthly gas prices, and $60 when adjusted for the use of bidweek gas prices, further confirming that SRAC energy prices were lower than alternative energy purchase prices from other market sources.

Table A
Gas Prices

	MMCP[65] $/MWh (1)	O&M Adder[66] $/MMBtu (2)	Actual MMCP[67] $/MMBtu (3)	IMHR[68] Btu/kWh (4)	Basin Plus[69] $/MMBtu (5)
	A	B	C=A-B	D	E=C÷D
Dec-00	$128.30	$6.00	$122.30	12,729	$9.61
Jan-01	$160.60	$6.00	$154.6	15,818	$9.77
Feb-01	$105.60	$6.00	$ 99.60	14,265	$6.98
Mar-01	$ 96.40	$6.00	$ 90.40	14,744	$6.13
Average	$122.73	$6.00	$116.73	14,389	$8.11

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65 CCC comments, February 17, 2004, Table 2, p. 9, which include CCC's addition of $6.00/MWh.

66 CCC comments, February 17, 2004, Table 2, p. 12.

67 FERC MMCP values after removing CCC variable O&M of $6.00/MWh. Col. (A) - Col. B.

68 Implied Heat Rates in MMCP, CCC comments, February 17, 2004, Table 3, p. 13.

69 Basin Plus Transportation Gas Prices, [Col. (C) ÷ Col. (D)] x 1,000.

Table B
Implied Market Heat Rate (IMHR)
In Mitigated Market Clearing Prices (MMCP)

MMCP $/MWh (1)[70]	Basin Plus Transportation $/MMBtu (2)[71]	IMHR Btu/kWh (3)[72]
128.3	9.61	13,353
160.6	9.77	17,932
105.6	6.98	15,124
96.4	6.13	15,723
122.7	8.11	15,129

70 CCC Comments, February 17, 2004, Table 2, p. 9.

71 Calculated values from Table A.

72 col. (3) = [col. (1) ÷ col. (2)] x 1,000.

Table C
Implied Market Heat Rate (IMHR)
In Estimated Border Power Prices

MMCP[73] $/MWh (1)	Bidweek Gas[74] Prices $/MMBtu (2)	IMHR[75] Btu/kWh (3)
194.1	14.59	13,303
276.8	16.11	17,183
199.7	12.57	15,892
202.8	12.48	16,248
215.9	13.94	15,489

[73] col. (1) = [col. (3) x col. (2) / 1,000.

[74] Border gas prices, plus intrastate transportation, from the respective monthly SRAC energy postings of PG&E, Edison, and SDG&E for December 2000 – March 2001.

[75] IMHR from Table 1.

Table D
Remand Period SRAC and MMCP-Based Prices
($ / MWh)

	MMCP Wtd. Avg. Values	SDG&E	PG&E	Edison	Wtd. Avg. SRAC	Power @ Implied MMCP Heat Rates & Monthly Bidweek Gas Prices	Power @ Implied MMCP Heat Rates & Average Monthly Border Gas Prices
	A	B	C	D	E	F	G
Dec – 00	128.3	151.6	165.6	154.9	159.5	194.8	316.4
Jan – 01	160.6	171.0	175.5	175.1	175.2	264.7	212.1
Feb - 01	105.6	135.8	134.4	138.3	136.5	190.1	282.8
Mar – 01	96.4	137.6	127.2	140.2	134.4	196.3	213.6
Average	122.7	149.0	150.7	152.1	151.4	210.9	256.2
% Change from Wtd. Avg. SRAC	-18.9%	-1.6%	-0.5%	0.5%	0.0%	39.3%	69.3%

XII. Are Differences Between SRAC Prices and Avoided Costs Sufficient to Conclude that PURPA Was Violated?

Although we have concluded that SRAC prices during the Remand Period meet the PURPA definition of avoided costs, as a matter of caution, we also consider whether there is a violation of PURPA as a result of any differences between avoided costs and SRAC prices. That is, whether SRAC prices in some hours during the Remand Period exceeded avoided costs in violation of PURPA.

In considering this matter, we again look to the applicable provisions in PURPA. FERC regulations provide that "[I]n the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery."[76] As we concluded in D.01-12-025, "the Commission can, consistent with PURPA, provide for avoided costs that differ from the utilities, so long as those costs are derived from consistent application of a formula. Therefore, it is not a *per se* violation of PURPA if the SRAC formula overstated Edison's avoided costs during that period."[77] Furthermore, as the Commission concluded in D.82-12-120," [t]he current procedure of prospectively establishing prices is preferable. This procedure gives QFs a clear price signal from which to determine its operations for the upcoming period. In reaching these prospective determinations, we will attempt, as accurately as possible, to project the fuel mix which will occur in the future quarter. Any variations in the

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[76] 18 C.F.R. § 292.304(b)(5).

[77] D.01-12-025, pp.3-4.

projected price should likely be as high as they would be low, and deviations should cancel out over time. Retrospective adjustment would undoubtedly create significant controversy, be cumbersome and destabilize the market for small power producers."[78]

In the present case, it is possible that in some hours during the Remand Period SRAC prices exceeded avoided costs, and in other hours avoided costs exceeded SRAC prices. However, the Transition Formula, determining SRAC prices, was consistently applied in the months and years preceding, and through the Remand Period. A comparison of spot market and SRAC prices that supports the constant application of the SRAC formula is provided in CCC's comments.[79] As shown in the Table E below, electric market prices exceeded posted SRAC prices in each of the respectively identified three-, two-, and one-year time periods which all include the Remand Period.

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[78] 10 CPUC 2d 553, p.621.

[79] CCC comments, February 17, 2004, p. 8.

Table E
Comparison of Electricity Spot Market and SRAC Prices
All figures are in $ per MWh

	Electric Market	Posted SRAC				Difference	
Period	PX and Border MMCPs [80]	PG&E	Edison	SDG&E	Wtd. Avg.[81]	*$/MWh*	*%*
Apr-98 to Mar-01	67.3	45.5	49.3	48.7	48.7	-21.8	*-32%*
Apr-99 to Mar-01	88.8	55.3	59.7	58.4	57.7	-33.5	*-38%*
Apr-00 to Mar-01	147.0	80.9	87.2	84.3	84.4	-66.0	*-43%*
	PX and Basin-forward MMCPs [82]						
Apr-98 to Mar-01	51.4	45.5	49.3	48.7	47.6	-3.7	*-7%*
Apr-99 to Mar-01	64.9	55.3	59.7	58.4	57.7	-7.1	*-11%*
Apr-00 to Mar-01	99.1	80.9	87.2	84.3	84.4	-14.7	*-15%*

[80] Uses PX prices to October 2000, then MMCPs based on border gas prices from October 2000 – March 2001.

[81] Weighted average price is based pm QF capacity under contract to each utility in January 2001.

[82] Uses PX prices prior to October 2000, then MMCPs based on basin forward gas prices from October 2000 – March 2001.

XIII. Conclusion

The matter remanded to us by the Court is relatively narrow in scope. We are directed to determine whether the evidence shows that SRAC prices were correct for the Remand Period. As the Court stated, "If the Commission makes this determination, and it is based upon substantial evidence, that will end the matter. If the evidence shows that the modified formula adopted in D.01-03-067 should have been applied retroactively, then it is the Commission's duty to apply it retroactively."

We have considered the SRAC formula, the application of § 390, and the determination of avoided costs under PURPA relative to the Court's direction, and concluded that substantial evidence indicates that SRAC prices during the Remand Period were correct. This evidence, combined with the policy considerations articulated in D.01-12-025, support a conclusion that application of the modified SRAC formula during the Remand Period is not warranted.

XIV. Comments on Draft Decision

The draft decision of the Administrative Law Judge in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on ___________, and reply comments were filed on __________________.

XV. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Bruce DeBerry is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. D.96-12-028 adopted a transition formula for each utility which determines SRAC energy prices based on gas border indices for PG&E (Malin-Topock, 50/50), Edison (Topock), and SDG&E (Topock).

2. Beginning in May 2000 gas spot prices at the California border began to increase significantly above gas prices in the producing basins.

3. The increased gas border indices resulted in significant SRAC prices during the Remand Period.

4. SRAC energy prices are based on monthly forecasts of avoided energy costs.

5. Recent information indicates that gas prices at Malin were also manipulated during the Remand period.

6. The Court ordered the Commission to determine if SRAC prices during the Remand Period were correct, and complied with PURPA, or if the Transition Formula should be applied retroactively to the Remand Period.

7. Avoided fuel costs are not a term defined in PURPA.

8. Avoided costs as defined by PURPA are incremental energy or capacity, or both which but for the purchase from QFs the utility would either generate itself or purchase from another source.

9. PURPA does not provide an alternate definition of avoided costs when the fuel component of energy costs is manipulated or otherwise incorrect.

10. PURPA requires that rates for purchases be just and reasonable to the electric consumer, and in the public interest, but that these requirements are satisfied if the rate equals the avoided costs determined under various factors.

11. A review of the avoided cost factors in 18 C.F.R. § 292.304(b) and (e) shows that these do not impact changes in the determination of avoided costs in this instance.

12. If QF energy was not available, or if QFs did not provide energy, utilities would be forced to pay those energy costs that existed at the time to replace QF energy.

13. Given that the utilities fully dispatched their own resources, subject to operating constraints, a reasonable estimate of utility avoided energy cost during the Remand Period is an electric price calculated using bidweek border gas at MMCP heat rates, which conservatively reflect the market for available power purchases.

14. Market spot energy prices exceed SRAC prices by approximately $60 to $105/MWh in the Remand Period, and by $19, $31, and $63/MWh for the prior 12, 24, and 36 months at PX and Border MMCPs. Market prices exceed SRAC prices by $4, $7, and $15 over these same extended periods at mitigated PX and Basin-Forward prices. *See* Tables D and E shown above.

15. PURPA provides that where rates for QF purchases are based on estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate PURPA if the rates for such purchases differ from avoided costs at the time of delivery.

16. The transition formulas adopted in D.96-12-028 were not modified until the adoption of D.01-03-067 on March 27, 2001.

17. The transition formulas determining SRAC prices were consistently applied prior to and during the Remand Period.

18. Avoided costs are incremental energy or capacity, or both, which but for the purchase from QFs the utility would either generate itself or purchase from another source.

Conclusions of Law

1. SRAC prices derived from consistent application of a formula complies with the FERC regulations implementing PURPA.

2. The Court ordered the Commission to determine if SRAC prices comply with PURPA.

3. The Court's remanded order to the Commission did not direct the Commission to determine new SRAC pricing methods.

4. We have implemented Pub. Util. Code § 390 in a manner that complies with PURPA.

O R D E R

This order is effective today.

Dated _____________________, at San Francisco, California.