

Decision 09-05-025 May 21, 2009

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Golden State Water Company on behalf of its Bear Valley Electric Service Division (U913E), for Approval of a Power Purchase Agreement with Shell Energy North America (US) L.P.

Application 08-08-021
(Filed August 27, 2008)

DECISION ON THE APPLICATION FOR APPROVAL OF A POWER PURCHASE AGREEMENT FOR THE GOLDEN STATE WATER COMPANY BEAR VALLEY ELECTRIC DISTRICT WITH SHELL ENERGY NORTH AMERICA (US) L.P.

1. Summary

Golden State Water Company, on behalf of its Bear Valley Electric Service Division (Bear Valley), filed for advanced approval of the terms and conditions of a proposed Power Purchase Agreement (agreement) with Shell Energy North America (US) L.P. (Shell). The application was amended on November 10, 2008, upon execution of transactions between Bear Valley and Shell which were included only as proposals in the original application. This decision finds Bear Valley is still subject to an existing ratemaking settlement agreement adopted in Decision (D.) 02-07-041 which included a cost cap to be in effect until the earliest of either August 31, 2011 or certain other conditions are met; therefore, subject to the ratemaking settlement, the agreement is recoverable in rates without further review through August 31, 2011. We approve the remainder of the contract cost recovery after August 31, 2011 although Bear

Valley must exercise prudent administration of the contract over its life. This decision also grants Bear Valley's additional request to create a memorandum account to record unrealized gains and losses on the Shell Agreement. The amended application was unopposed. This proceeding is closed.

2. Purchased Power Products

Bear Valley executed an agreement with Shell for four products:

(1) Annual Baseload, (2) Seasonal Baseload, (3) Peak Call Option, and (4) System Resource Adequacy Capacity. The original application called for a "refreshed" offer by Shell following a Commission decision which would find the process that led to the proposed contracts to be reasonable. During the pendency of the application, market conditions changed so significantly that Bear Valley was prepared to execute a final agreement for the four products and filed an amendment on November 10, 2008 to seek a finding that the executed agreement was reasonable. (Amended Application, p. 4.) The pricing terms are confidential subject to the September 25, 2008 ruling on confidentiality.¹ The following table summarizes the public terms of the agreement for the four products, exclusive of prices. (Appendix 1, Amended Application.)

¹ The four separate executed documents which contain the confidential pricing terms and conditions of the four energy products are received in the record as Exhibits BV-1 Confidential, BV-2 Confidential, Bear Valley-3 Confidential and BV-4 Confidential, numbered consistently with the four products.

| Bear Valley – Shell Agreement | | | |
|---|--------------------|--------------------------------------|---------------------------------------|
| Resource Type | Term | Capacity | Expected Deliveries |
| Product 1. Annual Baseload | | | |
| Firm Energy ² | 4 years, 11 months | 13 Megawatts (MW) | 113,800 Megawatt hours (MWh) annually |
| Product 2. Seasonal Baseload | | | |
| Firm Energy | 3 years | 7 MW Dec., Jan., Feb. 5 MW Nov. | 18,720 MWh annually |
| Product 3. Peak Call Option | | | |
| Firm Energy | 4 years, 11 months | 15 MW Winter 5 MW Other | 39,545 GWh max. annual |
| Product 4. System Resource Adequacy Capacity | | | |
| Gas Turbine ³ | 4 years, 11 months | 18 – 35 MW varying by month and year | |

3. Need for Energy

Bear Valley asserts that it developed an integrated resource plan (plan) for the period 2007 – 2012. (Ex. BV-5, p. 2, ff.) This included determining an optimum resource mix; compliance with the Commission’s Energy Action Plan II; and addressing resource adequacy requirements and greenhouse gas emission limits. Finally, Bear Valley believed it had to ensure its plan would be consistent with the California Independent System Operator’s proposed Market Redesign and Technology Upgrade. The plan is attached to Ex. BV-5.⁴

² Consistent with the California Independent System Operator criteria.

³ Combined cycle combustion turbine.

⁴ November 28, 2008, Volume 4 Unredacted Prepared Testimony: Resource Plan, Procurement Process, Proposed Power Purchase Agreements and Related Energy

Footnote continued on next page

Therefore, Bear Valley determined its forecasts and available resources for: (a) annual base load requirement, which it proposes to be met with Shell agreement Product 1; (b) peak season base load requirement, to be met with Shell agreement Product 2; (c) peaking capacity, which Bear Valley hopes to be able to meet with either its existing seven-unit 8.4 MW internal combustion facility⁵ or from the Independent System Operator's markets, as discussed below; (d) intermediate requirements to be met with Shell agreement Product 3; (e) resource adequacy requirements to be met with Shell agreement Product 4; and (f) renewable resource requirements for which Bear Valley issued a request for proposals, but so far has not signed an agreement.

3.1. Peaking Capacity

Bear Valley does not propose a new energy contract product to meet its resource planning needs for peaking capacity. Bear Valley proposes to compare the costs of its existing power plant with the cost of peak power from the Independent System Operator's markets. Bear Valley would submit bids for dispatching the unit and, if power prices are less than the Bear Valley's incremental cost, the unit would not be dispatched; or if the locational marginal price (i.e., the appropriate market's price at the Independent System Operator) is greater, then the unit would be dispatched. Bear Valley believes there are no voltage support or reliability issues that affect operation of the unit.

Prices. (Although labeled "Volume 4," we assign it Ex. BV-5 in sequence following the four energy product exhibits BV-1 through BV-4.)

⁵ The Bear Valley Power Plant was granted a certificate of public convenience and necessity in Decision (D.) 03-07-005 and began commercial operations on January 1, 2005. (Ex. BV-5, p. 2.)

Bear Valley believes it will be able to maximize the value of the existing power plant without acquiring additional capacity resources. Bear Valley also believes this strategy will “cap” its peaking costs at the power plant’s incremental cost, while generally allowing Bear Valley to purchase less expensive energy from the Independent System Operator’s markets. (Ex. BV-5, pp. 9 – 10.)

4. Reasonableness Issues

4.1. Existing Settlement Period

Bear Valley is subject to an existing settlement agreement adopted in D.02-04-041 which addresses recovery of energy costs through August 31, 2011. Nothing in this decision in any way alters, amends, or otherwise modifies the settlement or its operation for rate recovery of energy costs. Therefore, we find that Bear Valley is able to recover its net costs for energy delivered to retail customers acquired pursuant to the Shell agreement through August 31, 2011, subject to the limits of that settlement.

The settlement agreement set a cap of \$77.00 per MWh for the weighted average annual cost in calculating the Energy Charge component of the Purchased Power Adjustment Clause balancing account. (See, D.02-04-041, Finding of Fact 5, and Ordering Paragraph 3.) Therefore, subject to the continued application of the settlement, we find the Shell agreement to be recoverable without further review through August 31, 2001.

4.2. Post Settlement Period

The balance of the Shell agreement is not subject to the settlement agreement and therefore Bear Valley’s amended application seeks a finding that the costs are reasonable:

Bear Valley “seeks approval of the prices, terms and conditions of the [Shell agreement], and an order allowing [it]

to recover its full costs for purchased power under the [Shell agreement], subject to the Settlement Agreement approved in D.02-07-041 and [Bear Valley's] prudent administration of the [Shell agreement]." (Amended Application, p. 4.)

4.3. Discussion

We have reviewed, but will not disclose, the confidential prices⁶ for the Shell agreement and its four products described above. We have also reviewed the portion of the prepared testimony which described Bear Valley's determination of the forecast need for energy. Finally, we have considered our ratemaking practices with respect to existing settlements, preapproval of contracts, and recovery of costs through a reasonableness review process.

Bear Valley chose to execute a final agreement with Shell while the application was pending. The agreement does not appear to be conditioned upon our approval; therefore, Bear Valley chose to bind itself and thereby assumed the risks inherent in executing any contract without preapproval. The Commission has not exclusively preapproved contracts: the practice of demonstrating the reasonableness of costs in a subsequent review was the norm for many years. Therefore, Bear Valley assumed the risk of recovering in rates the reasonable costs of the Shell agreement for the period following the expiration of the settlement Agreement on August 31, 2011, until the expiration of the Shell agreement.

The Division of Ratepayer Advocates (DRA) did not serve testimony and offered no other showing to describe any analysis, conclusions or recommendations, applicable to the amended application; DRA's response to the amended application was "not oppose" and withdrew its original motion to

dismiss.⁷ The City of Bear Lake withdrew its protest stating it takes “no position” on the application, and, like DRA, offered no showing which would describe any analysis, conclusions or recommendations, applicable to the amended application. Therefore, our record is limited to the amended application and amended prepared testimony by Bear Valley.

4.4. Conclusion

We find that the outstanding ratemaking settlement protects ratepayers until its expiration on August 31, 2011. However, Bear Valley entered into the final agreement before the Commission could grant or deny pre-approval. We therefore need not, but we have the discretion, to find the Shell agreement and the related four energy products to be reasonable at this time. Bear Valley argues that the Commission’s current practice is to approve contracts. But this usually occurs for the large electric utilities only after a review by a formalized procurement review group process where competent interested parties have an opportunity to review the entire procurement proposal and the utility’s analytical review process. This process provides intervenors with access to confidential information and prompt feedback to the utility if the intervenors are concerned about the proposed transactions. There is no formal procurement review group process for Bear Valley, although the record shows that DRA did have access to the procurement data and was consulted by Bear Valley. As we have already noted, DRA made no formal recommendation on the record.

⁶ A confidentiality and non-disclosure agreement were adopted by a ruling dated September 25, 2008.

⁷ See Section on Procedural History.

The Shell contract terms executed by Bear Valley may or may not prove to be the best possible price in hindsight. But our standard of review is that of a prudent manager. Thus, the reasonableness of a particular management action depends on what the utility knew or should have known at the time that the managerial decision was made, not how the decision holds up in light of future developments. The record shows that Bear Valley executed the contract at a time when market prices were falling and the company was faced with a choice of whether to wait for preapproval or to “lock-in” what appeared to Bear Valley to be a good price (for the four separate commodities).

One benchmark for comparison is the market price referent used for renewable portfolio standard solicitations. In Resolution E-4214, dated December 18, 2008, the Commission adopted baseload energy prices for 10, 15, 20 and 25-year contracts for baseload energy. These prices are guideline for renewable energy, which is presently more expensive on the whole than conventional thermal energy. Thus any conventional-source contract, like this one is, should normally be significantly cheaper than a renewable source contract. We also note that the Shell agreement did result from a request for offers and subsequent negotiations in an effort to achieve a reasonable contract. We therefore conclude that based on the information available to Bear Valley at the time of negotiating the contract that the applicant has met the standard of a prudent manager. We will therefore approve the contract terms for the post-settlement period and Bear Valley may recover its post-August 31, 2011 costs subject to meeting its obligation to prudently administer the Shell agreement.

5. Memorandum Account

5.1. Summary

This decision allows Bear Valley to establish a non-interest bearing memorandum account to track the unrealized gains and losses otherwise imputed to the Shell agreement as a consequence of complying with the Financial Account Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." The sole intention in granting this request is to preclude the unnecessary recognition in Bear Valley's financial statements of any unrealized gains or losses which may occur as a result of valuing the outstanding balance of the Shell agreement at market prices compared to the actual prices contained in the contracts. Bear Valley can only recover the actual and reasonable costs in rates as it acquires energy from Shell under the terms of the agreement and directly resells that energy to its customers. Bear Valley asks for a blanket memorandum account which would include all future power purchase contracts. We will only allow Bear Valley to include any existing contracts preapproved by the Commission and this contract with Shell. If Bear Valley enters into subsequent contracts it must file for authority to include them in the memorandum account. It may do so either as a part of an application for preapproval prior to contract execution or anytime after execution of a contract not subject to preapproval.

5.2. Accounting Issue

Bear Valley states that it believes for accounting purposes long-term power contracts, including its Shell agreement, qualify as derivative instruments under SFAS No. 133, which in turn requires Bear Valley to record derivatives on its balance sheet as assets and liabilities, and to measure those instruments at the fair value. Bear Valley asserts the Shell agreement would be classified as a

derivative pursuant to SFAS No. 133. Applying SFAS No. 133 to the Shell agreement would mean recognizing unrealized gains and unrealized losses on an outstanding purchased power contract which would affect reported earnings, even though when the power contract is finally settled any unrealized gains or losses recognized under SFAS No. 133 are reversed. (Amended Application, p. 5.) For example, if the contract price is \$10 per unit and the market value is \$12 per unit, Bear Valley would have an imputed, but unrealized, gain of \$2 per unit. Conversely, a market value of \$9 would result in an unrealized loss of \$1 per unit.

5.3. Discussion

There would be no public benefit if Bear Valley had to recognize unrealized gains or losses on its balance sheet during the life of the agreement related to the cost of energy which will be delivered to retail customers in the remaining years of the agreement. Bear Valley did not seek and therefore does not have advance authority from the Commission to hedge or trade the commodity underlying the Shell agreement and Bear Valley, therefore, cannot record for rate recovery any realized gains or losses for any trades or sales of energy acquired under the Shell agreement. Thus, there would be no impact on rates beyond the recovery of the actual costs of the Shell agreement for energy delivered to retail customers by adopting a memorandum account.

A memorandum account would allow Bear Valley to track, solely for financial reporting purposes during the life of the agreement, any unrealized gains or losses on the outstanding balance of the contract and record either an offsetting "refund" to ratepayers of an imputed market gain or an under

collection of an imputed market loss. During contract performance,⁸ Bear Valley will record and recover only its actual costs under the terms of the contract for energy delivered to retail customers. The memorandum account will be reversed and no additional costs will be recovered from (or refunded to) ratepayers.

Bear Valley asserts that the Commission has previously granted similar authority to Sierra Pacific Power Company in D.02-10-054. In that decision, we found:

When the contract is actually settled, the expense is recognized as the actual contract price, the net gains or losses previously recognized would be reversed, and the net offsetting regulatory assets or liabilities would be reversed resulting in no net gain or loss. (Finding of Fact 7.)

We find Bear Valley's request is reasonable and grant Bear Valley's request for a memorandum account. Bear Valley must file a Tier 3 advice letter proposing the specific language for the memorandum account with the Commission's Energy Division and will become effective upon approval as appropriate at the time.⁹ We find no reason to make the memorandum account a blanket authority: Bear Valley must file for authority before we allow subsequent energy contracts to be included in the balancing account.

⁸ Performance is the fulfillment or accomplishment of a promise, contract, or other obligation according to its terms. Black's Law Dictionary, Fifth Edition.

⁹ GO 96 B § 5.3: An advice letter submitted under (8) of this Industry Rule may be designated by the Utility as effective pending disposition; all other matters appropriate to Tier 3 may become effective only after Commission approval. Matters appropriate to Tier 3 are: ... (2) A tariff change in compliance with a statute or Commission order where the wording of the change does not follow directly from the statute or Commission order. ...

5.4. Conclusion

We find it is reasonable to allow Bear Valley to use a non-interest bearing memorandum account to offset the unrealized gains or losses attributable to the application of SFAS 133 to the Shell agreement. We grant this on the understanding that no actual additional cost will be recovered or refunded that is not directly incurred as a part of the good faith contract performance.

6. Redaction

Where necessary and reasonable to protect market sensitive data we allow a utility to file certain data under seal. (Rule 11.4.) As a matter of public policy, and open, transparent proceedings at the Commission, such confidential treatment should be kept to a minimum. Bear Valley filed a motion on August 27, 2008, which sought leave to file under seal the proposed contracts and analysis of the contracts. By ruling dated September 25, 2008 the motion was granted and parties were allowed to review the contracts and analysis subject to a protective order.

At the prehearing conference the assigned Commissioner and assigned Administrative Law Judge (ALJ) noted that the public documents served and filed with the original application were excessively redacted to the extent that even captions and headings were omitted, rather than the minimum amount of truly sensitive data. (TR. pp. 10-11.) The amended application and related materials were more appropriately redacted to only the minimum amount of sensitive data. Thus the initial concern regarding excessive redaction for the original application is moot.

7. Procedural History

The application was filed on August 27, 2008 and timely protested by the City of Big Bear Lake (City), and DRA filed a motion to dismiss the application.

A prehearing Conference and Oral Argument was held on October 30, 2008.¹⁰ Bear Valley amended its application on November 10, 2008 and on December 11, 2008 the City withdrew its protest and substituted a statement of “no position.” Similarly, DRA withdrew its motion to dismiss and substituted a response to “not oppose” the amended application. The amended application is, therefore, unopposed.

The record in this proceeding is composed of all documents filed and served in this proceeding and the five exhibits identified within this decision.

8. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission’s Rules of Practice and Procedure. Bear Valley filed extensive comments and included an inappropriate “redline” version for the entire proposed decision. Rule 14.3 limits comments to a discussion of alleged errors and proposed corrections to the findings of fact and conclusions of law. We carefully considered only the refilled comments’ discussion and reviewed the proposed changes to the findings of fact and conclusions of law. Changes and clarifications were made as appropriate to the decision.

9. Assignment of Proceeding

Timothy Alan Simon is the assigned Commissioner and Douglas M. Long is the assigned Administrative Law Judge in this proceeding.

¹⁰ By Resolution ALJ 176-3220, dated September 4, 2008, the application was categorized as ratesetting and that evidentiary hearings were needed. It appeared on the Commission’s September 2, 2008 Daily Calendar.

Findings of Fact

1. Applicant, Bear Valley, is a public utility subject to the jurisdiction of this Commission.
2. Bear Valley prepared an integrated resource plan to serve retail customers.
3. Bear Valley issued a request for proposals for energy and it reviewed and analyzed the various proposals from potential suppliers.
4. Bear Valley negotiated a contract with Shell for four energy products identified in the integrated resource plan.
5. Bear Valley executed final contract terms with Shell without pre-approval by the Commission.
6. Bear Valley is subject to a settlement agreement which caps energy cost recovery through August 31, 2011.
7. The Shell contract is based on market-based price negotiations.
8. The Shell contract is priced below the market price referent values adopted in Resolution E-4214.
9. SFAS No. 133 requires Bear Valley to recognize unrealized gains or losses on the contract when the contract is marked to market for financial reporting.
10. A non-interest bearing memorandum account would recognize refunds or under collections offsetting the unrealized gains or losses for financial reporting purposes.
11. A non-interest bearing memorandum account would offset unrealized gains or losses to stabilize financial reporting.

Conclusions of Law

1. Bear Valley did not need Commission approval before it negotiated and executed the Shell agreement.

2. Before August 31, 2011, Bear Valley may only recover the incurred costs of the Shell Agreement for energy delivered to retail customers subject to the settlement agreement as adopted in D.02-10-054.

3. The settlement adopted in D.02-12-054 is not modified or altered by this decision.

4. After August 31, 2011, Bear Valley may recover in retail rates the reasonably incurred costs of the Shell agreement for energy delivered to retail customers subject to prudent contract administration.

5. A non-interest bearing memorandum account reasonably offsets unrealized gains or losses created by the financial reporting impacts of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities."

6. The revised public document versions of confidential amended documents were reasonably redacted to protect confidential market-price data.

7. This proceeding should be closed.

O R D E R

IT IS ORDERED that:

1. For energy delivered to retail customers, Golden State Water Company's Bear Valley Electric Service Division (Bear Valley) may recover the actual costs of the Power Purchase Agreement (agreement), with Shell Energy North America (US) L.P. (Shell) incurred before August 31, 2011, subject to the existing settlement agreement adopted in Decision 02-10-054.

2. Golden State Water Company's Bear Valley Electric Service Division may recover the actual costs of energy delivered to retail customers after August 31, 2011, pursuant to the Shell agreement and subject to prudent contract administration.

3. Golden State Water Company's Bear Valley Electric Service Division shall establish a non-interest bearing memorandum account to record refunds or under-collections to offset the unrealized gains or losses of the Shell agreement created by the financial reporting impacts of the Financial Account Standards Board's Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." Golden State Water Company's Bear Valley Electric Service Division shall file a Tier 3 advice letter, pursuant to General Order 96 B § 5.3(2)

4. Application 08-08-021 is closed.

This order is effective today.

Dated May 21, 2009, at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners