Decision 07-01-041 January 25, 2007

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) for Approval of Results of Summer 2007 Track of its New Generation Request for Offers and for Cost Recovery.	Application 06-11-007 (Filed November 15, 2006)

OPINION ON SOUTHERN CALIFORNIA EDISON COMPANY'S APPLICATION FOR AUTHORIZATION TO ENTER INTO A POWER PURCHASE AGREEMENT FOR ENERGY FROM LONG BEACH GENERATION FACILITY

I. Summary

This decision authorizes Southern California Edison Company (SCE) to enter into a 10-year power purchase agreement (PPA) with Long Beach Generation LLC (LBG), a wholly-owned subsidiary of NRG Energy, Inc. (NRG) for 260 megawatts (MW) of natural gas-fired peaking capacity from Long Beach Generation Facility Units, 1, 2, 3 and 4, for delivery from August 1, 2007 through July 31, 2017. Furthermore, SCE is to apply the cost sharing mechanism from Decision (D.) 06-07-029 and allocate the benefits and costs of the LBG PPA to all benefiting customers. The Commission is approving this resource to ensure electric reliability for summers 2007 through 2009 in light of the unprecedented record-breaking demand on the system during the heat storm of summer 2006 and the tight reserves in the Southern California service territory. The expense of

this PPA is measured against the benefits in increased capacity for SP26[1] and the cost of interruptions in service to businesses and residences in a Stage 3 crisis.

II. Introduction

On July 20, 2006, the Commission issued D.06-07-029 which adopted a cost-allocation mechanism for long-term contracts for new generation entered into by the investor-owned utilities (IOUs). Under this allocation mechanism the costs and benefits of the new generation are shared by all benefiting customers in an IOU's service territory. The Commission designated the IOUs to procure the new generation, but the capacity and energy components are unbundled. The load-serving entities (LSE) in the IOU's service territory will be allocated rights to the capacity that can be applied toward each LSE's resource adequacy (RA) requirements. The LSE's customers receiving the benefit of this additional capacity pay only for the net cost of this capacity, determined as a net of the total cost of the contract minus the energy revenues associated with dispatch of the contract.

D.06-07-029 also directed SCE to proceed expeditiously to procure up to 1,500 MW of new generation, previously authorized in D.04-12-048. Pursuant to this order, on August 14, 2006, SCE issued a Request for Offers (RFO) for up to 1,500 MWs of PPAs for new generation (New Gen RFO).

In July 2006, California experienced an unexpected and unprecedented heat storm that challenged the electric resources of the state. While the state weathered the storm, this experience raised new concerns about summers 2007

[1] SP26 and SP15 are used interchangeably to refer to the CAISO's description of the Southern California electric grid control area, part of which includes SCE's service territory.

through 2009 when new capacity is expected to come on-line. In response to that reliability concern, President Peevey issued an assigned Commissioner's Ruling (August ACR) on August 15, 2006, directing SCE to pursue new utility-owned generation that can be on-line in time for summer 2007. In addition to those resources, SCE was invited to evaluate any other offers of resources that could be on-line by the same time frame. In response to that ACR, SCE began building new black-start capable and dispatchable generation units and initiated an additional RFO targeting facilities that could be on-line in time for summer 2007.

Based on the bids received in response to the Summer 2007 RFO, SCE accepted an offer from LBG for 260 MW of natural gas-fired peaking capacity from Long Beach Generation Facility Units, 1, 2, 3 and 4. These units were closed in 2005 and are currently not in operation. LBG states that it plans to repower these units utilizing equipment and efficiencies that will make them as environmentally sensitive as possible considering the original age of the basic equipment and the totality of the surroundings of the units' geographical location in the Long Beach commercial harbor.

SCE filed this instant application seeking approval of a 10-year PPA with LBG with a delivery period from August 1, 2007 through July 31, 2017. SCE also seeks approval to allocate the benefits and costs of the LBG PPA to all benefiting customers in accordance with D.06-07-029.

III. Procedural History

In accordance with the August ACR, SCE filed its application for approval of the LBG PPA on November 15, 2006, asking for a Commission decision no later than January 2007 so the units can be on-line by summer 2007. In order to meet that schedule, an early prehearing conference (PHC) was scheduled for

November 27, 2006, and parties received notice that responses to SCE's application would be made orally, on the record, at the PHC.

SCE submitted testimony in support of the application, as well as a report by the Independent Evaluator (IE). Responsive testimony was submitted by Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN) and Californians for Renewable Energy (CARE). Evidentiary hearings took place on December 11, 2006.

Post-hearing concurrent briefs were received on December 18, 2006 from the California Manufacturers and Technology Association and the California Large Energy Consumers Association (CMTA/CLECA); CARE; SCE; TURN; DRA; and LBG.[2] All the active parties to the proceeding stipulated to a shortening of the comment period to no less than 11 days, allowing the proposed decision to mail no later than January 5, 2007, for the January 25, 2007 Commission agenda.

Comments were received from CMTA/CLECA, CARE, DRA, TURN, LBG, SCE and Merced Irrigation District and Modesto Irrigation District (collectively MID Districts).

Reply Comments were received from CARE, LBG, SCE, and DRA.

Based on a review of the comments numerous changes and corrections were made to the proposed decision at the request of participating parties to ensure that the final decision accurately reflected the record.

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[2] Concurrently with the brief, LBG LLC filed a Motion to Become a Party.

IV. Application and Testimony in Support of the LBG Project

A. The Application

On August 14, 2006, SCE issued its New Gen RFO soliciting two types of proposals for new generation: fast-track projects that could come on-line prior to August 1, 2010 and standard-track projects that would be on-line prior to August 1, 2013. After the August ACR issued, SCE expanded the New Gen RFO and solicited projects that could be on-line by August 1, 2007. Projects proposed for August 1, 2007 were specifically evaluated as to their ability to be on line by that date. If not, the projects would be considered for possible inclusion in the fast- or standard-track evaluation.

In conjunction with its New Gen RFO, SCE also issued a RFO for an Independent Evaluator (IE) as required for certain resource solicitations pursuant to D.04-12-048 and for the cost sharing mechanism established in D.06-07-029. SCE hired an IE prior to issuing the New Gen RFO and the IE performed monitoring and evaluation functions for all required aspects of the summer 2007 solicitations, including a review of the bids and the final bid selection.

SCE considered a number of criteria in the evaluation of the summer 2007 projects including transmission impacts, debt equivalence, environmental characteristics, credit, capacity requirements and project viability. SCE used a basic net present value analysis in evaluating the offers that entailed estimating (1) value of energy and ancillary services, (2) costs of contract, and (3) the net value of (1) and (2). SCE first assessed the present value of the energy and ancillary service benefits of each offer, then assessed the present value of the costs of each offer. Costs include, but were not limited to, fixed costs; transmission upgrade costs; debt equivalence; greenhouse gas (GHG) cost adder; and credit and collateral adders. SCE then subtracted the present value of expected costs from the present value of expected benefits to determine the expected net present value of each offer.

SCE also considered capacity requirements and project viability in its evaluation. In summary, SCE concluded that its need assessment for summer 2007 indicates that its planning reserves, operating reserves and adverse scenario reserve margins may be adequate, but the match between need and resources is very tight. While the planning reserve margin (PRM) is 19.1%, with assumptions for transmission limitations and generating outages SCE is just over the 7% required operating reserves level and with the same assumptions for the 1-in-10 summer demand case SCE only has 40 MW above the 5% operating reserves margin.[3]

SCE received five offers from three sellers. SCE determined that one seller's offer did not conform to the Summer 2007 RFO requirements, but if it met the standard-track RFO criteria it could be considered there. Two out of three offers from another seller were dropped from consideration because of RFO compliance issues. SCE then proceeded to negotiate with the remaining sellers, LBG and another, for the two remaining projects. In confidential filings SCE provided both the indicative and final valuations of the LBG and the other offer and how they compared with one another. While all offers were expensive, the LBG project was the most cost-effective offer that met the RFO requirements and met the key objective of being on-line by August 1, 2007.

After consulting with its Procurement Review Group (PRG), SCE learned that the PRG was concerned with the price, the age of the units, environmental

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[3] SCE Testimony, Exhibit 1 and 1C, pp. 13-14.

limitations on operating hours, the relatively high heat rates and GHG issues. The PRG did, however, not object to SCE's rejection of the other summer 2007 offers.

According to testimony from SCE, SCE carefully considered the PRG's comments as it evaluated the pricing and contract provisions of the LBG project in the context of the August ACR. To address the tension between the relatively high cost for an expedited repowering of old gas-fired units and the need for reliability certainty for summer 2007, SCE built into the contract terms that provide both financial incentives and sanctions to LBG to have the project completed on time. As SCE states "the contract provisions provide powerful financial incentives for LBG to maximize the likelihood that the entire project will come on-line by August 1, 2007."[4] In addition, the contract does contain some "off-ramps" for SCE, so that SCE's obligations under the contract can be reduced or eliminated if LBG fails to perform.

In its brief, SCE addresses the arguments presented at the evidentiary hearing against the LBG project: whether SCE "needs" the resource, the cost, and whether the project can be on-line by August 1, 2007. In regards to the needs issue, SCE asks that the intervenors, in particular DRA and TURN, look at factors other than just the PRM for summer 2007. SCE concedes that the PRM is used in the context of long-term planning, but SCE argues that other measures, such as operating reserves under adverse condition should be considered in determining whether the LBG contract is needed for reliability in the near-term. As discussed

[4] SCE Brief, December 18, 2006, p. 16.

in its prepared testimony, SCE predicts a very tight margin in adverse weather conditions for its summer 2007 operating reserves.

In response to criticisms over the cost of the LBG project, SCE responds that it is the most cost-effective resource that SCE could obtain that can be on-line by August 1, 2007 and is the result of an open and competitive solicitation. While TURN would like to compare LBG with some of Pacific Gas and Electric Company's (PG&E) to show that the LBG contract is expensive, even TURN stated that the data between the two utilities' projects were possibly not strictly comparable — in particular because of the August 1, 2007 on-line date. None of PG&E's new resources will be on-line by that date. Also, SCE argues that TURN's contention that the LBG contract is not available to provide RA credit in summer 2007 does not discredit the contract's ability to provide power and enhance reliability for SP26.

The majority of the other opposing parties, DRA, CARE and CMTA/CLECA are concerned with the cost, the environmental impacts of the peakers and whether the units will be on-line in time to provide reliability and benefits to the system. SCE discussed the cost issue as stated above: LBG was the most cost-effective qualified bidder from the RFO. In regards to the environmental and scheduling issues, SCE only discussed publicly the general terms of the contract[5] whereby LBG commits to the completion of necessary environmental and construction milestones and there are appropriate financial

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[5] Because of the confidential nature of the specific contract terms, the public version of documents only references broad concepts and does not provide any financial or schedule milestone particulars. However, the confidential documents contain specific details of the project.

provisions to encourage LBG to have the resource on-line, on time, and penalties if it does not.

In its comments supporting the PD, SCE again reiterates that the LBG contract is the most cost-effective option for additional capacity insurance for summer 2007, in the heart of SCE's load center, that was received in SCE's summer 2007 track solicitation. This insurance translates into protection against blackouts. In addition, in its comments, SCE made numerous editing suggestions to make the PD consistent with the record, all of which were adopted.

B. Request for Official Notice of California Energy Commission Report

Concurrently with the filing of its post-hearing brief, SCE filed a request for Official Notice[6] and asked the Commission to consider a report presented by the California Energy Commission (CEC), Electricity Analysis Office, at the December 11, 2006 Joint Agency Energy Action Plan Meeting, A Preliminary Look at Peak Loads and Resources for 2007 and Policy Issues to Consider (CEC Report).

This report addresses the outlook for SP26. Part of the CEC's report looked at the probability of the region meeting various levels of reserve margins in summer 2007 with and without proposed resource additions. The proposed resource additions include the LBG project as well as the SCE-owned peakers and the additional demand response programs SCE is initiating. The CEC's assessment provides determinations of the probabilities that the CAISO's

[6] For a discussion of SCE's Motion, see Section VII on Motions herein.

Southern California control area will meet certain operating reserve margins in summer 2007. The CAISO has three emergency stages: when operating reserve margins sink below 7% it is a Stage 1; when operating reserve margins are below 5% it is a Stage 2; and when the operating reserve margin drops to 1.5% it is a Stage 3 and the CAISO initiates rolling blackouts to preserve the stability of the electric grid.

The CEC's report shows with all the proposed resource additions, the probability is 99% that SP26 will have enough resources to maintain the operating reserve margin above 1.5%, but without the LBG project and SCE's other new peaking units the probability drops to 93.3%. Put another way, the addition of new resources reduces the probability of the Stage 3 blackout in summer 2007 from 1-in-15 to 1-in-100.[7]

SCE argues that the CEC's updated assessment of peak loads and resources supports the approval of the LBG contract as a needed resource for the CAISO's reliability outlook — and based on the bids received to the Summer 2007 RFO, the LBG project is the most cost-effective resource available in the time frame.

C. Independent Evaluator

Sedway Consulting was retained by SCE, following consultation with the Commission's Energy Division (ED) staff and SCE's legal counsel on the scope of the monitoring and evaluating the IE would do for the Summer 2007 RFO. Alan Taylor of Sedway Consulting performed the monitoring and evaluating detail and SCE submitted a report from Mr. Taylor in support of its application for

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[7] SCE's Brief, December 18, 2006, p. 5.

approval of the LBG project. Mr. Taylor's report contained a litany of the activities he undertook as part of his consulting activities for the project and concludes with his assessment that the LBG contract "warrants the CPUC's approval."[8] The IE does not unconditionally recommend the LBG project, but on balance notes that based on SCE's assessment of its reserves, "next summers's needs will be met but not by much of a margin," and that this project "represents a relatively competitively-priced insurance policy to be added to the SP15 physical supply."[9] Continuing on, the IE's report notes that the contract is "fairly expensive for the proposed operating attributes of the project and that the decision to select and execute the contract was a close call."[10]

D. Cost Recovery

In D.06-07-029, the Commission established a cost and benefits sharing mechanism for new generation. SCE is asking the Commission to authorize this new cost recovery mechanism for the LBG units whereby the benefits of the capacity for RA and Local Area Reliability (LAR), cost of the PPA, and results from the sale of the energy rights in an energy auction[11] to this resource will be shared with all benefiting customers in SCE's distribution system pursuant to D.06-07-029, decisions in R.06-02-013 and existing Commission rules and policies.

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8 Independent Evaluator's Report, Exhibit 4, p. 5.

9 IE's Report, Exhibit 4, p. 4.

10 IE's Report, Exhibit 4, pp. 4-5.

11 Details of the energy rights auction process are under consideration in Phase 2 of the long-term procurement proceeding, R.06-02-013.

VI. Intervenors' Analysis of the Application

A. LBG

LBG, as the owner and developer of the project and the counter-party with SCE to the contract, did not initially participate in the proceeding and did not submit testimony for the evidentiary hearing. However, on December 18, 2006, LBG filed a motion to become a party and submitted a proposed post-hearing brief. As discussed below, LBG's motion is granted and its brief was considered.

In particular, LBG addresses the issue of SCE's need for the LBG project — the major argument presented by opposing parties to the contract. LBG does not see a controversy: the Commission, in D.06-07-029, directed SCE to procure up to 1,500 MW of new generation, a need number based on D.04-12-048. The LBG project will contribute 260 MW toward meeting that need. According to LBG, the question whether that 260 MW is needed in Long Beach by summer 2007 is a different issue and one that cannot be answered with any certainty. LBG also asks the Commission to refer to the CEC Report that shows that the addition of the LBG resource increases the probability that SP26 will have sufficient resources to prevent a Stage 1, 2 or 3 emergency. LBG urges the Commission to approve SCE's application and find that the contract is reasonable and prudent.

In its comments supporting the PD, LBG reiterates the benefits the additional power will provide against outages in the near term and in support of local reliability benefits for the duration of the PPA.

B. TURN

TURN urges the Commission to deny SCE's request for approval of the LBG contract because from TURN's analysis "it offers only trivial value at a very high cost."[12] Specifically, TURN posits that the project is not needed to provide reliable service in 2007 because of the following: this project is in addition to SCE's new peakers that will come on-line in summer 2007. It is not scheduled to come on line until August 2007, thereby missing one half of the summer and it is not cost-effective.

Primarily, TURN does not believe that the LBG contract is needed for SCE to meet its PRM. Following the PRM metric established by the Commission, SCE should meet, or even exceed, the 15-17% PRM requirement.[13] In fact, SCE's own predictions show an expected physical PRM in 2007 of 19.1%. TURN also believes that a sufficient amount of SCE's resources should be available, without the addition of the LBG units, to meet load in summer 2007 so that CAISO does not need to do backstop procurement.

To support its application, SCE produced a table that measures resource adequacy using metrics not adopted by the Commission for use by an LSE. SCE explained that the table included measures that a system operator might rely on when planning for upcoming peak seasons. TURN faults SCE's reliance on these metrics. As TURN states, SCE's arguments that its actual load and resources may differ from assumptions is to state the obvious — actual measurements are not the same as forecast assumptions. From TURN's perspective "the virtual certainty that 'actuals' will differ from forecasts is not a justification for adding resources beyond those needed to meet the PRM."[14]

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[12] TURN Direct Testimony, Exhibit 9, p. 2.

[13] D.04-01-050, p. 23.

[14] TURN Testimony, Exhibit 9, p. 6.

With a 19.1% RPM, TURN does not find that SCE has presented a need for this new resource. TURN recognizes that SCE is operating in response to the August ACR, but TURN does not see any evidence that this project is needed, even if there is a repeat of the 2006 Heat Storm.

TURN is also concerned that that the LBG project, with a projected on-line date of August 1, 2007 would only be available" — at best — for half of the summer of 2007," and possibly not for any of the summer .[15] TURN acknowledges that SCE built completion incentives into the contract, but argues that incentives are not a guarantee of performance especially given such a "rushed permitting, development and construction schedule."[16]

And finally, TURN does not believe that the LBG project is a reasonable business deal for SCE customers. When TURN compares this project with any of the projects the Commission recently approved for PG&E in A.04-06-012, the LBG project is not cost effective. However, TURN concedes that the LBG project and PG&E's projects are not comparable, especially because of SCE's required on-line date of August 1, 2007. However, in just evaluating the LBG project on its own, TURN still finds that its high heat rate and cost make it unduly costly for SCE customers. TURN does not support this project. However, if the Commission approves the project anyway, TURN urges that at a minimum the Commission should require SCE and LBG to provide an unequivocal guarantee that the LBG project will have a thirty-year design life when it is completed.

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[15] *Ibid*., p. 8.

[16] *Ibid*., p. 12.

TURN entitled its comments to the PD, "Reliability at any Cost??" That summarizes TURN's position in a nutshell. In its comments TURN, again, requests that the Commission reject the LBG PPA. Instead, TURN suggests that NRG bid the project into one of SCE's other New Gen RFOs at a more competitive price, with a later on-line date. In addition to the arguments TURN made in its testimony and in its brief against the project, in its Comments TURN posits that the Commission itself should honor the adopted PRM, a metric established by the Commission to provide reliable service. TURN asks that the Commission not add additional, high cost resources that are not needed when SCE clearly has resources in excess of its required PRM. In summary, TURN urges the Commission to reject the LBG project because under every reliability criterion the Commission has ever considered, this project is not needed to provide reliable service in southern California in 2007 and beyond. TURN also requested two corrections to the PD that were adopted.

C. DRA

DRA recommends that the application be denied on the grounds that there has been no needs assessment showing that the project is needed for summer 2007, and it is an expensive resource. DRA's arguments against the project parallel some of the same concerns raised by TURN. DRA finds SCE's argument that there is "some possibility"[17] that the actual resource or load levels may differ from the assumptions used by SCE too weak to justify this "additional layer of capacity insurance."[18]

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[17] DRA Testimony, Exhibit 12, p. 3.

[18] *Ibid*., p. 3.

DRA questions "how much insurance is enough and at what cost?"[19] DRA recognizes that SCE was responding to the August ACR in conducting its Summer 2007 RFO, but DRA does not find the LBG project worthy of an expedited approval schedule in the absence of a need assessment.

DRA also worries that SCE's timetable is unrealistic, especially vis-à-vis environmental reviews making it probable that the facility will not be on-line by August 1, 2007. Even if it is on-line by August, from DRA's perspective that is too late to mitigate a July Heat Storm such as occurred in 2006. Furthermore, the capacity will not count for resource adequacy purposes until at least October 2007 because of the RA counting rules.

In addition, DRA finds the high heat rate of the LBG project to be inconsistent with the Commission's GHG policy and questions whether it is the best resource for SCE to be adding to its portfolio.

In its Comments on the PD, DRA again opposes the PPA, repeating the same concerns about lack of need for the resource that will be a financial drain on ratepayers for 10 years. DRA did provide some new information from the CEC about the increase in probability that SP26 will have sufficient resources to avoid a Stage 3 situation. Without any new resources in SP26, the probability is 93.3% that the region will have sufficient resources. SCE provided data that with the addition of its peakers, the increased demand response programs and the LBG project the probability increases to 99%. What DRA learned from the CEC is that with the SCE peakers and demand reduction programs, and NO LBG

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[19] *Ibid*., p. 3.

project, the probability is 98.7% that a Stage 3 will be avoided. From DRA's perspective, the CEC figures do not support approving the LBG project.

D. CARE

As CARE succinctly states "SCE may be paying way to[o] much to get some old and inefficient peaker turbines back in operation. According to CARE, it may be significantly cheaper to bring new efficient simple-cycle turbines online instead."[20] In addition to the cost of the LBG project, CARE's other concern is the environmental consequences of repowering the Long Beach facility since the area where the units are located is contaminated with asbestos. CARE is understandably skeptical that LBG can meet all the environmental application and permitting milestones in time to have the units repowered and on-line by August 1, 2007. CARE even opines that the repowering may trigger review under the California Environmental Quality Act (CEQA) and that process can take as long as two to three years. CARE is also interested in LBG's credit worthiness and whether that poses a risk to ratepayers. In summary, CARE asks that the application be denied since the units are expensive and dirty.

In its Comments to the PD, CARE repeats its concerns about the environmental permitting issues. In particular, CARE argues that the PD deprives CARE of its rights under CEQA, Title VI of the Civil Rights Act of 1964, the California Government Code, and the federal and state Constitutions. More specifically, CARE argues that it will be impossible for the LBG project to be on line by August 2007 because the plans of the Port of Long Beach and Port of Los Angeles, along with the South Coast Air Quality Management District

[20] CARE's Testimony, Exhibit 13, p. 3.

(SCAQMD) have goals to reduce emissions and have set mandatory compliance targets. CARE does not find the LBG project to be part of these plans and, in fact, LBG would significantly increase air pollution. CARE is also concerned that a Health Risk Assessment is required. Once again, CARE does not see how the LBG project can meet all of the environmental requirements and CARE opposes any attempt to circumvent the established processes.

In its Reply Comments CARE again repeats its arguments that for the Commission to go forward and approve the LBG PPA violates CARE and other's right under CEQA, Title VI of the Civil Rights Act of 1964, the Government Code, the equal protection mandates of the Federal and State Constitutions, and the Federal Power Act of 1935. CARE alerts the Commission to its intent to file a complaint with the Federal Energy Regulatory Commission (FERC) challenging the legality of the PPA.

LBG replied to CARE's arguments in its Reply Comments. In particular, LBG addresses the environmental challenges brought by CARE and states that LBG is pressing on with all applicable environmental permitting and review requirements in an expeditious manner, and if any permit or application is denied, then that lies with the other agency and not with this Commission. In addition, CARE makes numerous references to the Commission's deprivation of CARE's rights because the Commission is not undertaking a CEQA review. LBG asserts that the Port of Long Beach has a CEQA process underway that is expected to be concluded well before the August 1, 2007 on-line date for the project. As part of its CEQA review, the Port of Long Beach will conduct a public review process and CARE and its members may comment on CEQA issues during the comment period.

And finally, LBG responds to CARE's claim that two recent orders by the Ninth Circuit requires LBG to file the PPA at FERC. LBG argues that these two orders only indicate that the LBG PPA might be subject to a reasonableness review by FERC, and do not mandate that the FERC approve the PPA before the Commission can proceed on the application.

E. CMTA/CLECA

CMTA/CLECA, although it did not see the confidential data contained in the Application, based on the public testimony urges the Commission to reject the contract because (1) it is very expensive; (2) is relatively inefficient; (3) is not needed in 2007 to meet SCE's 15-17% PRM; and (4) is not even guaranteed to be on-line by August 2007 to provide any of the purported reliability benefits. CMTA/CLECA is concerned that even the IE was hesitant about recommending the project due to the expense of its operating attributes, especially the run-time limitations. CLECA also questions whether it is necessary that SCE have a 10-year PPA when what is needed is just a short-term stop-gap solution; perhaps SCE should try for an interim three-year contract instead to specifically address the need in 2007 through 2009.

CMTA/CLECA is also concerned as to whether SCE has presented a viable needs assessment outside of the long-term procurement process. In summary, CMTA/CLECA does not support the project. While it understands the Commission's need to address changing conditions in the electric industry, it finds there "is a difference between acting quickly and resolutely to address an emergency and acting precipitously,"[21] and asks that SCE's application be rejected.

In its Comments to the PD, CMTA/CLECA reminds the Commission that the effect of the project will be an increase in rates of all benefiting customers (including those represented by CMTA/CLECA), while any potential reliability benefit is limited to a short period, 2007 to 2009. CMTA/CLECA agree that service interruptions should be avoided, but they question whether there might be a more cost-effective solution instead of one that is a 10-year burden.

F. NRG

NRG, the parent to LBG, is not a party to the proceeding but did attend the PHC and made witnesses available to answer questions from the PHC participants. NRG addressed issues concerning the repowering or rebuilding of the four existing gas turbines at the site to a 30-year design life, as well as adding air emissions control devices. In addition, to address the concerns of CARE, NRG stated that the environmental issues will be handled through permitting with the South Coast Air Quality Management District as well as the Port of Long Beach. The permits cannot be issued until there is a CEQA certification that there will not be adverse impacts to the environment or to the community. NRG confirmed that pursuant to the terms of the PPA with SCE, NRG is solely responsible for complying with all environmental regulations and permitting processes.

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[21] CMTA/CLECA Brief, December 18, 2006, p. 7.

G. Other Parties

The Coalition of California Utility Employees and California Unions for Reliable Energy (CUE/CURE), and Constellation Energy Commodities Group, Constellation New Energy and Constellation Generation Group (Constellation), and Long Beach Generation LLC, also participated in the PHC but did not present any protest or reply to SCE's application.

VII. Discussion

After digesting and considering the Comments and Reply Comments the Commission is still bothered by the choice facing it on whether or not to approve the SCE/LBG 10-year PPA. It is clear that all parties, other than SCE and LBG, are focused on the negative aspects of the project; cost, high heat rate and environmental issues. We are mindful of those aspects of the project. We equally share the concern of many that in approving the project we may be erring in favor of reliability, with a cost to all benefiting customers. But that does not make our analysis of the situation any easier as we still face the same issue: Is the LBG project a prudent "insurance policy" to ensure reliability for summer 2007 through 2009. As LBG discusses in its brief, the debate about whether the July 2006 Heat Storm was an aberration or a trend continues — with no chance it will be resolved before the Commission must act on this Application. The August ACR raised the same concerns. The Heat Storm of 2006 was unexpected and taxed the electricity resources beyond what the Commission and the LSEs had planned for — yet there were no service interruptions related to a lack of adequate generation. If the unexpected happened again, would the system resources hold for summer 2007, or would reliability be unacceptably compromised?

The Commission accepted and promulgated the industry standard that firm load should not be interrupted due to lack of resources more than "one-day-in-ten-years" (1 in 10) in D.02-12-074 and D.04-01-050. To ensure that the LSEs have resources sufficient to provide service at this level of reliability, the Commission adopted a PRM of 15% to 17%. The Commission based this PRM on its detailed analysis that a showing of PRM in this range would meet, or exceed, the industry standard of 1 in 10. All LSEs are to procure resources equal to their expected peak load plus 15% to 17%.

By all measurements, in 2007 SCE expects to have a physical PRM in SP26 of 19.1% — above the 15% required minimum and over the 17% recommended ceiling. However, it is a reality that actual loads and resources may differ from the forecasts. We cannot have certainty in advance about both the weather and the availability of reserves on any given day at any given time. We know that consistent with their respective long-term plans, the IOUs have many new resources coming on-line beginning in 2010. The question we are faced with in this Application is whether we have adequate resources for the 2007 through 2009 period to meet unexpected weather or resource availability. How much uncertainty is tolerable?

That is the question the Commission was faced with when the August ACR issued. The ACR directed SCE to take steps to increase its resources by adding some new in-basin peakers and decreasing demand on the system by increasing the air-conditioning recycling program for summer 2007. The question we address here is whether we should also add an additional 260 MW of in-basin peaking power.

Based on the report from the IE and the record in the proceeding, SCE appears to have operated the RFO in conformity with Commission direction and

SCE's selection of the LBG project is not criticized since it appears to be the winning bid from a limited short list.

LBG plans on repowering four units totaling 260 MW with combustine turbines. The power plant was built in 1927 and closed in 2005. In general geographic terms, the site is at the Port of Long Beach. Based on the existing environmental externalities of the site, it is possible that repowering may be done on an expedited basis. If we approve the project, and the MWs are not needed, SCE's distribution customers will pay for an insurance policy for ten years that was never needed. Many parties question the project because of the high heat rate, a number that is confidential, but known publicly to be higher than new projects. The irony is, because of the high heat rate, the units might not get dispatched until all other lower cost resources are exhausted. Approving the LBG contract is just like any insurance policy — you buy it hoping you never have to use it.

On the other hand, if we do not approve the project and the resource is needed, the result may be even more expensive than the "insurance policy." An interruption in service has a cost to the individual business and residential customers who are without power, and the economy of the state as a whole could suffer both directly in the loss of products and services and the loss of income and taxes, and indirectly in making California less desirable as a place for business and jobs. No specific economic figures were produced in the record, so the Commission is not relying on this assumption in making this decision, but includes it as a point of reference.

The PD approved the LBG project on balance; we were persuaded that the LBG project is necessary to ensure reliability for the summers of 2007 through 2009, and on that basis approves the Application. This decision is not made with enthusiasm, nor because parties urged the Commission to follow this path. Even SCE was ambivalent about the project's need and cost-effectiveness. However, the Commission issued the August ACR directing SCE to make provisions for summer 2007 and this project is the only one from the summer 2007-track of the New Gen RFO that meets our requirement that it be on-line by next August. In addition, its locality is both what allows it to be quickly repowered, and what makes it attractive from a load serving perspective. No additional work or funds need to be expended to bring the energy from the LBG units to the heart of SCE's service territory.

In addition, we are assured by our review of the confidential version of the Exhibits that SCE has built into the PPA sufficient milestone checkpoints to assess the progress of the environmental permitting and construction on the project. If LBG is not performing pursuant to the contract timeframes, SCE does have off-ramps to reduce or eliminate its financial liabilities under the contract. We do expect SCE to scrutinize LBG's progress and prudently exercise appropriate options to protect benefiting customers.

We decide the vexing issue with the approval of the LBG project and authorize SCE to treat the capacity and energy from this PPA pursuant to the mechanism established in D.06-07-029. The benefits and costs of this PPA are to be shared by all benefiting customers.

VIII. Motions

Concurrently with its post-hearing brief, LBG LLC filed a motion to become a party. No party opposed LBG's motion and LBG is an integral player in this proceeding since it is the counter-party with SCE to the contract in question. LBG's motion is granted, it is afforded party status, and its brief was read and considered.

Simultaneously with Comments, MID Districts filed a Motion to Intervene seeking leave to file Comments. Previously in this proceeding, MID Districts entered "Information Only" appearances and sought to change to "Party" status. In summary, both Modesto and Merced Districts are customers of PG&E and competitors in the provision of electric services to customers in California's Central Valley. While the MID Districts are not located in SCE's service territory, they are concerned with the overall policy issue of allocating the costs and benefits of IOU resources and sought leave to file comments to preserve their rights in connection with this issue. While revisiting the cost/benefit allocation mechanism adopted in D.06-07-029 is not within the scope of this proceeding, MID Districts' Motion is granted and their Comments accepted.

SCE filed a Motion to File Confidential Version of Brief Under Seal, with a proposed Protective Order, concurrently with its post-hearing brief on December 18, 2006. The Motion was unopposed. SCE's Motion to File Confidential Version of Brief Under Seal is hereby granted with the Proposed Protective Order.

Also concurrently with its post-hearing brief, SCE filed a motion requesting the Commission to take Official Notice of the CEC Report. This Report was presented at the Joint Agency Energy Action Plan Meeting on December 11, 2006, the same day as the evidentiary hearings in this case. Therefore, the Report was not available for review, analysis and cross-examination at the time of the hearing.

DRA opposed SCE's Motion and simultaneously filed a Motion to Strike portions of SCE's December 18, 2006 Brief that references the CEC Report. In summary, DRA asks the Commission to weigh the unfairness to other parties if SCE were allowed to introduce new and untested evidence at this late date. We did weigh DRA's request and determined that even without the benefit of scrutiny and cross-examination, the CEC Report is helpful to the Commission. As discussed above, this is not an application that SCE conjured up out of whole cloth. The August ACR directed SCE to proceed as it did and to bring any resources that could be on-line by August 1, 2007 to us for consideration. The CEC Report assists the Commission's analysis of the LBG contract. Knowing that the CEC counted on the 260 MW from the LBG project in making its Stage 1, 2 and 3 probabilities is useful information. While it is not determinative to our decision, the fact that the probability is 99% that SP26 will have sufficient resources to avoid a Stage 3 situation with the addition of the LBG contract and the other resources directed in the August ACR, versus a 93% probability of a Stage 3 crisis without the new resources, helps tip the balance in favor of the LBG contract.

We, therefore, deny DRA's Motion to Strike and grant SCE's Request for Official Notice. We did consider the CEC Report in making our decision.

Concurrently with its Reply Comments, LBG filed a Request for Official Notice of three documents: (1) Letter of January 19, 2007 from President and Chief Executive Officer of the CAISO, Yakout Mansour; (2) January 5, 2007 Letter from Kenneth Coats from the South Coast Air Quality Management District; and (3) January 17, 2007 Letter from Robert Kantor of the Port of Long Beach. LBG asks that the Commission take official notice of documents # 2 and 3 under Evidence Code Section 452(c) and extend the umbrella of the rules of official notice to the CAISO letter.

LBG's Request for Official Notice for all three documents is granted and it is noted that the documents are not accepted for the truth of the statements contained in them, but for the fact that certain representations were made in the documents.

All motions not previously ruled on or addressed in this decision are deemed denied.

IX. Reduction of Comment Period

Pursuant to Rule 14.6(b) the Commission's Rules of Practice and Procedure, all parties stipulated to reduce the 30-day public review and comment period required by Section 311 of the Public Utilities Code to not less than 20 days. Pursuant to the parties' stipulation, comments were filed on January 16, 2007, and reply comments were filed on January 22, 2007.

X. Assignment of Proceeding

President Michael R. Peevey is the assigned Commissioner and Carol Brown is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SCE seeks Commission approval of a 10-year PPA with LBG for 260 MW of peaking capacity from the Long Beach Generation Facility, to be on-line by August 1, 2007, to insure sufficient resources for summers 2007 through 2009 for SP26.

2. LBG plans on repowering four units at the LBG facility in the Port of Long Beach, to have the units on-line by August 1, 2007, producing 260 MW from combustion turbines.

3. It is appropriate to allow SCE to apply the cost-sharing mechanism from D.06-07-029 to the LBG PPA and allocate the benefits and costs from the contract with all benefiting customers.

4. SCE conducted an RFO in response to the August ACR directing SCE to add new black-start utility-owned resources, to increase its demand reduction

program and to search for other resources that could be on-line by August 1, 2007.

5. The LBG project was the most cost-effective bid received in response to the Summer 2007 RFO that indicated that it could be on line by August 1, 2007.

6. SCE also conducted an RFO for an IE to perform monitoring and evaluating functions for the summer 2007 solicitations.

7. SCE retained an IE who performed monitoring and evaluating functions for all required aspects of the Summer 2007 RFO, including a review of the bids and the final bid selection.

8. This PPA is measured against the benefits of increased capacity in SP26 and the cost of a Stage 3 service interruption and the cost of back-up procurement by the CAISO.

9. SCE has sufficient resources for its long-term planning purposes based on the Commission's requirement that the utility, as a load-serving entity, maintain a PRM of 15 to 17%, since SCE has a 19.1% PRM for summer 2007.

10. Many new resources are slated to come on-line, in accordance with the IOUs' procurement plans, in both SCE's service territory and SP26 beginning in 2010.

11. The Heat Storm of summer 2006 was unexpected and taxed the electricity resources of the state beyond what the Commission and the LSEs had planned for.

12. A PRM is not the only measurement metric for reliability; the CEC also looks at operating reserves under adverse conditions.

13. The CEC Report indicates that the CAISO Southern California control area, SP26, [that includes SCE's service territory], has a 93.3% chance of avoiding a Stage 3 blackout summer 2007 without the LBG contract and SCE's other new

peaking units and demand reduction programs, but with the proposed resources the probability is 99% that SP26 will have enough operating reserves under adverse conditions to avoid a Stage 3 emergency.

14. Based on the CEC's predictions, with the addition of the LBG PPA and other 2007 resources, the probability of avoiding a Stage 3 emergency summer 2007 is 99%, but without the new resources the probability is only 93.3%.

15. Even though SCE has a predicted PRM of 19.1%, actual loads and resources may differ from forecasts.

16. In the face of assumptions, predictions and forecasts, rather than certainty about the weather in summers 2007 through 2009 and the availability of reserves at any given date at any given time, we find it prudent to add the 260 MW from the LBG PPA to SP26.

17. The LBG PPA is an insurance policy against interruptions in business and residential services and possible blackouts in 2007 through 2009.

18. The cost of the LBG PPA is balanced against the fact that it was the least-cost conforming bid with an on-line date of August 1, 2007; an interruption in service has a cost to business and residential customers; and the economy of the state as a whole suffers under a cloud of an unreliable electricity supply.

Conclusions of Law

1. LBG's bid was the most cost-effective conforming bid into SCE's Summer 2007 RFO that committed to an August 1, 2007, on-line date.

2. SCE operated the Summer-2007 RFO in conformity with the Commission's direction in the August ACR and SCE's selection of the LBG PPA is reasonable.

3. The PPA contains sufficient construction and permitting milestones and financial incentives to provide sufficient assurance that the units will be on-line by August 1, 2007.

4. It is reasonable to approve the LBG PPA to provide reliability insurance in the face of uncertainties about the weather, demand, and resource availability for summers 2007 through 2009 until new resources come on-line beginning in 2010.

5. It is consistent with our commitment to insure reliable electric service at fair and reasonable rates to approve the LBG PPA as it provides increased capacity in SP26 and the cost of interruptions in service, blackouts and back-up procurement by CAISO could exceed the cost of the PPA.

6. This decision should be effective immediately so that SCE can implement the PPA.

O R D E R

IT IS ORDERED that:

1. Southern California Edison Company's (SCE) 10-year power purchase agreement (PPA) with Long Beach Generation LLC for 260 megawatts of electric power from the repowering of four combustion turbines at the Long Beach Generation facility at the Port of Long Beach with an on-line date of August 1, 2007, is approved.

2. The benefits and costs of this resource are to be allocated to all benefiting customers in SCE's service territory pursuant to the cost sharing mechanism adopted by the Commission in Decision 06-07-029.

3. SCE is to scrutinize the environmental and construction milestones set forth in the PPA to determine if it would be prudent to exercise any legal options to terminate its obligations under the PPA to protect benefiting customers.

4. Application 06-11-007 is closed.

This order is effective today.

Dated January 25, 2007, at San Francisco, California.

MICHAEL R. PEEVEY
President
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners

I dissent.

/s/ DIAN M. GRUENEICH
Commissioner