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Decision 09-03-031 March 26, 2009

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U338-E) for Recovery of Peaker Costs.	Application 07-12-029 (Filed December 31, 2007)

DECISION ALLOCATING RECOVERY OF PEAKER COSTS BY SOUTHERN CALIFORNIA EDISON COMPANY TO ALL BENEFITING SERVICE CUSTOMERS

1. Summary

This decision allocates the costs and resource adequacy benefits of Southern California Edison Company's (SCE) four peaker units, which are owned and operated by SCE, to all benefiting customers. The issue of whether the requested costs are just and reasonable for recovery in rates will be determined in a subsequent decision. This proceeding remains open.

2. Background

A threshold issue in this application is to determine what customer base should pay for the costs of SCE's four peaker units. An understanding of the events in the summer of 2006 that led to the Commission directing SCE to build up to 250 megawatts (MW) of peaking power is useful in resolving this issue. In July 2006, a prolonged and severe summer heat storm hit California and stretched to capacity the state's electric resources, especially in southern California. In response to a widely held concern for the adequacy of the state's electric resources for summer 2007, President Peevey issued an Assigned

Commissioner's Ruling (ACR)[1] on August 15, 2006 ordering SCE to build in its service territory five peaker units, 49MW each, that could provide additional capacity and collateral grid-reliability benefits in time for summer 2007. The ACR also authorized SCE to "seek different ratemaking treatment for the costs of these peakers than would otherwise be applicable to utility-owned generation under Decision (D.) D.06-07-029."[2] While the ACR did not address the ratemaking treatment of the peakers, it directed SCE to track its cost by an advice letter, and file an application for the cost recovery and ratemaking issues.

SCE immediately responded to the ACR and undertook the process for developing five peaker units, but as of this date, only four are built and operational. The fifth peaker unit is still in the permit and development stages and is not addressed in either the application filed by SCE or this decision. SCE filed Advice Letter 2031-E for interim treatment of the costs of the peakers, and Resolution E-4031, issued November 9, 2006, set forth the procedures for the interim tracking of the peaker installation and acquisition costs. Resolution E-4031 directed SCE to file an application to demonstrate the reasonableness of these costs and to address SCE's recovery of the associated revenue requirement for 2007-2008. On December 31, 2007, SCE filed Application (A.) 07-12-029 for the recovery of the peaker costs.

The Commission issued D.06-07-029 on July 20, 2006 in order to address who pays for certain costs in order to stimulate the development of new generation. The three investor-owned utilities (IOUs) were reticent to impose the

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1 The ACR was issued in Rulemaking (R.) 06-02-013, the Commission's long-term procurement plan proceeding for the state's three major investor-owned utilities.

2 ACR, p. 7.

costs of new generation on their bundled customers and the independent power producers (IPP) were adverse to investing in new generation without the assurance of long-term contracts. This resulted in a stalemate with no new generation being built in California. D.06-07-029 addressed this conundrum by establishing a cost-sharing mechanism (CAM) to support the IOUs investment in long term power purchase agreements (PPAs) for new generation from the IPPs. In summary, D.06-07-029 designates the IOUs as procurers of new generation for their respective service territories through the PPAs. The capacity and energy from the PPAs is unbundled and the IOUs allocate the rights to the capacity to all load-serving entities (LSE) in their service areas so that the LSEs can apply the capacity to their resource adequacy requirements. The energy from the PPAs is auctioned pursuant to protocols established in D.07-09-044. The LSEs' 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 received from the auction.

D.06-07-029 specifically excluded utility-owned generation (UOG) from this cost-sharing mechanism because UOG "generation is essentially dedicated to bundled customers."[3] D.06-07-029 has not been modified to change the exclusion of UOG from the CAM.

3. Recovery of Peaker Costs

On December 31, 2007, SCE filed this application seeking allocation of the resource adequacy capacity and the costs of the energy from the peaker units to all benefitting customers, and not just to its bundled customers, although the

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[3] D.06-07-029, p. 4.

peakers are owned by SCE. SCE requested the CAM treatment because it contends that it developed the peaker units to provide capacity and grid-reliability benefits to all electricity customers on its distribution system and therefore it is appropriate that all benefitting customers, not just its bundled service customers, pay the costs. SCE proposes that in lieu of the time, effort and cost of an energy auction that the energy value of the peakers be allocated pursuant to a formula set forth in the "Joint Proposal" that is summarized at D.06-07-029, pp. 14-18. SCE also supports its request for the CAM cost allocation because the utility was authorized in the ACR to seek different rate treatment for the peakers.

SCE's application states that the total acquisition and installation cost for the four peakers through November 2007 is $238 million and that the operation and maintenance costs from August 2007 through November 2007 is $1.279 million. SCE's testimony states that all of these costs are reasonable and justified and should be recoverable. We will address the reasonableness of these costs in phase 2.

Alliance for Retail Energy Markets (AReM) filed a protest to the application, the Division of Ratepayer Advocates (DRA)[4] filed a response and the California Cogeneration Council and California Wind Energy Association (CCC/CWEA) filed comments. The Utility Reform Network (TURN) filed a Motion of Consolidation of Capital Recovery Issues and Deferral of those Issues to Phase 2.

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[4] DRA's response did not focus specifically on SCE's application, but more on whether the use of an ACR, that is issued by just one Commissioner and not the full

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A Prehearing Conference (PHC) was held on April 8, 2008. At the PHC, SCE was directed to supplement its application and a schedule was established for parties to brief the cost allocation issue. Briefs were received from TURN, Western Power Trading Forum (WPTF), AReM, and Energy Producers and Users Coalition (EPUC). Reply briefs were received from WPTF/AReM, TURN and SCE.

4. Who Should Pay for the Peakers

SCE argues that based on the direction it was given in the August 15, 2006 ACR to develop the peaker units to provide urgently needed capacity and grid-reliability benefits for its entire transmission and distribution system as well as the California Independent System Operator (CAISO) grid, and the fact that the ACR invited SCE to seek different rate treatment, its ratepayers are entitled to have the costs borne by all benefitting customers pursuant to the CAM established in D.06-07-029. SCE further contends that the peakers were clearly intended to benefit system-wide customers because the added capacity and grid-reliability from the peakers reduces the risk of shortages and blackouts during peak demand periods and other system emergencies and helps to minimize and contain any such events that do arise. While SCE acknowledges that D.06-07-029 directed that the costs of new UOG would be allocated only to bundled service customers, SCE argues that allowing the costs to be spread to all benefitting customers is consistent with the overall intent and purpose of the Decision.

Commission, is the appropriate vehicle to direct a utility to undertake the type of investment that SCE undertook pursuant to the August 15, 2006 ACR.

TURN posits that "Edison's proposal represents the only fair and equitable outcome to the unusual circumstances that gave rise to the construction of the four (and potentially five) SCE-owned peaker plants developed as a result of the ACR."[5] TURN supports its position by citing to the fact that in D.06-07-029 SCE was directed to procure 1500 MW of new *non-utility* generating capacity for its service territory, and less than one month later the Commission directed SCE to "pursue the development and installation of up to 250 MW of black-start, dispatchable generation capacity within its service territory . . . ."[6] From TURN's perspective, when the chronology of events is combined with the language from the ACR that states that the new units "should bring collateral benefits to SCE's transmission and distribution system as well as the CAISO grid,"[7] it is clear that the peakers are to benefit all customers in SCE's service territory and it is appropriate for all benefiting customers to pay. TURN finds further support for this argument in the ACR language that invited SCE to seek different ratemaking treatment for the peakers.

TURN also contends that it is particularly inappropriate for SCE's bundled customers to pay for the peakers because the cost is quite high considering the expedited construction schedule that SCE was ordered to undertake. As TURN argues "there is no reason why bundled service customers alone should be forced to pick up all of the costs simply because Edison was the party that was available to install the new capacity on the expedited schedule that

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[5] TURN Opening Brief, May 28, 2008, p. 1.

[6] *Id.*, p. 1, citing the ACR, p. 2.

[7] *Id.*, p. 2.

circumstances required. Bundled service customers did not ask for these peaker plants any more than unbundled customers did."[8]

EPUC, AReM and WPTF,[9] however, all argue against allowing SCE to allocate the costs of the peakers to all benefiting customers. EPUC asks the Commission to clarify that even if the CAM is applicable to the peakers, that Customer Generation Departing Load is not obligated to pay such a charge.

AReM states that SCE's request to apply the CAM to the peaker costs should be denied for the following reasons: first, it conflicts with the principles that established the CAM in D.06-07-029; second, all new demand side and supply side resources in SCE's territory tangently provide benefits to the system as a whole; third, the ACR did not direct SCE to develop the peakers on behalf of all customers in its service territory -- rather SCE was directed to have new IOU generation on-line by 2007; fourth, the load growth that gave rise to the ACR is from SCE's bundled customers, not from direct access customers; and fifth, principles of cost causation dictate that the SCE peaker costs should be borne by those parties who caused the need for their construction – SCE's bundled customers.[10]

From AReM's perspective, D.06-07-029 was carefully crafted to insure that application of the CAM did "not impinge on the energy procurement activities of ESPs [energy service providers]."[11] Therefore, according to AReM, the CAM would not be applicable to UOG and when it was applicable to PPAs, the CAM

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[8] *Id.*, p. 3.

[9] WPTF joins in the response filed by AReM, but does not file a separate pleading.

[10] AREM's Response, May 28, 2008, p. 3.

[11] *Id.*, p. 4.

would recover only the net capacity costs of the new generation, following an auction for the energy value of the contract. Furthermore, AReM argues, D.06-07-029 specifically excluded UOG because that generation is essentially dedicated to bundled customers. The capacity and energy from the new generation contracts was unbundled, as AReM contends, "to limit the procurement role of the IOUs."[12] AReM, therefore states that to allow SCE to allocate the costs of the peakers to all benefiting customers would undermine the careful balancing that the Commission did in D.06-07-029 to avoid undermining the competitive market. AReM's clients, other Energy Service Providers (ESPs), have to serve their own customers' needs, and from AReM's analysis of the ACR, the peakers were developed to meet SCE's bundled customers' loads.

In addition, AReM argues that the fact that there might be collateral benefits to SCE's whole system from the peakers is not sufficient reason to have all customers pay for the peakers. As AReM states, any new generation, even if intended solely for bundled customers, will provide reliability benefits for the system, but that does not justify allocating the costs to all bundled and direct access customers. Furthermore, AReM contends, if an ESP adds a new resource or implements an energy efficiency or demand response program, the benefits will inure to the whole grid, yet the utility's bundled customers are not asked to share in the cost.

Finally, AReM reads the ACR differently than SCE or TURN. AReM does not see that the ACR expanded SCE's authorization from D.06-07-029 to procure new generation for all customers. AReM views the need that prompted the ACR

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[12] *Id.*, p. 4.

arising from IOU load increases from bundled customer growth, and not caused by any growth in the direct access customer base. As AReM reminds the Commission, direct access is closed to new customers, and has been since 2001; direct access commercial and industrial customers have the flattest load profiles in SCE's service territory; and direct access load has declined precipitously in recent years.[13] Therefore, AReM, argues, cost allocation should follow cost causation and in this case, SCE's bundled customers prompted the need, they should pay.

In the alternative, AReM asks that if the Commission considers applying the CAM to the peaker costs, it should require SCE to follow the auction protocols set forth in D.07-09-044 and not allow the utility to circumvent that process.

5. Discussion

In D.06-07-029, which established the CAM, the Commission specifically excluded UOG from the CAM cost sharing mechanism. However, the August 15, 2006 ACR directed SCE to develop utility-owned generation so that the new resources could be on line by summer 2007. The ACR also discussed the collateral grid reliability benefits that the new peakers would bring. And finally, the ACR invited SCE to seek different rate treatment for the peaker costs.

As a part of the ACR the assigned Commissioner noted and relied in part on representations by the CAISO[14] that the peakers were needed:

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[13] *Id.*, pp. 7-8.

[14] Letter dated August 9, 2006 from Yakout Mansour, President and Chief Executive Officer of the CAISO. This letter was attached to the ACR.

> I urge the CPUC to direct … [the IOUs] … to solicit a combination of quick-start generation and demand response opportunities … to increase available supply and <u>enhance grid reliability</u>. (Emphasis added.)

SCE followed the Commission's direction, built the peakers on an expedited schedule, and is now seeking "different" rate treatment for the peakers so its bundled ratepayers do not have to bear the full cost. As SCE argues in its brief, it did not build these peakers for its bundled customers; these peakers were in addition to its existing power procurement requirements for its bundled customers. TURN also argues that the system needed the peakers, regardless of which loads were growing and therefore all load is equally responsible for the marginal costs of new capacity, in proportion to their contribution to peak load.

When the ACR is read in concert with the arguments presented by SCE and TURN, a strong case can be made that it would be equitable to have the costs of the peakers shared by all benefiting customers. It is therefore appropriate to consider adopting an exception to the UOG CAM in this instance. We note that the application was served on all parties to R.05-12-013, A.05-06-006, and R.06-02-013: the CAM was adopted by D.06-07-029 in this last docket, R.06-02-0013, and thus the parties to R.06-02-013 have had notice that the Commission was considering in this proceeding a different allocation method than that set forth in D.06-07-029.

We therefore find it reasonable to adopt SCE's proposed method of allocation which is consistent with the Joint Parties' proposal described in D.06-07-029 and excludes an auction at this time.[15] This allocation authority expires in 10 years from the date of the commercial operation for each unit, consistent with D.07-06-022, D.06-07-029, and D.08-09-012. We find that the ACR was issued with a concern for the entire grid, with the support of the CAISO, and with a view to providing enhanced grid reliability. Allocating the cost to all benefiting customers is a matter of equity and fairness; it would be unreasonable to arbitrarily limit the allocation according to D.06-07-029 when addressing a situation not contemplated when we adopted the general allocation policy.

6. Phase 2 of Proceeding

On November 12, 2008 parties conducted a telephonic hearing to discuss the proceedings necessary for resolution of this application. Parties agreed that the issue of the reasonableness of the costs requested by SCE for the peaker units could not properly be addressed by the stakeholders until the Commission made a determination as to what customer base would pay the costs. After this decision is issued by the Commission, we will determine procedures and a schedule for final resolution of the issues presented in the application.

7. Motions

On March 21, 2008 TURN filed a Motion for Consolidation of Capital Recovery Issues. TURN was concerned that all acquisition and installation costs for the four peakers would be diffused in multiple different rate proceedings and TURN wanted them all consolidated for a single review. At the time TURN filed its motion, SCE was submitting capital forecasts in its 2009 General Rate Case (GRC), would be including some peaker costs in its 2009 Energy Resource Recovery Account and potentially would be filing a subsequent application for the costs of the fifth peaker when it is built. TURN felt that this piecemeal analysis of the peaker costs was not the best way to proceed and proposed that

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[15] D.06-07-029, pp. 14-18.

the Commission consolidate the review of all costs for the peakers into one proceeding. Due to the passage of time since the motion was filed and the fact that some issues are moot (the SCE 2009 GRC is before the Commission now), the motion is denied, without prejudice.

8. Comments on Proposed Decision

The proposed decision of Administrative Law Judge Brown 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. Comments were filed on February 5, 2009 by TURN, AReM, and SCE and reply comments were filed on February 9, 2009 by DRA and SCE.

The comments by SCE, TURN and DRA convinced us that the proposed decision did not adequately consider whether parties were on notice that the Commission would consider and potentially adopt a proposed modification to the cost allocation. Further, the comments convinced us that the proposed decision did not adequately consider the fairness and equity of allocating the costs to all benefiting customers. Finally, the August 9, 2006 recommendation by the CAISO was a significant factor in issuing the ACR because the proposed units would enhance grid reliability benefitting all customers. Accordingly, this decision is modified as necessary so that the costs at issue will be allocated to all benefiting customers, not just bundled service customers.

9. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner. On February 26, 2009, Douglas M. Long replaced Carol A. Brown as the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. On July 20, 2006, the Commission issued D.06-07-029 establishing a CAM to support the IOUs investment in long-term PPA for new generation from IPPs.

2. Pursuant to the CAM, all benefitting customers in an IOU's service territory would share in the capacity benefits from the PPA and, the IOU would auction the energy from the PPA, and benefitting customers would pay the net cost of the PPAs minus revenues from the energy auction.

3. D.06-07-029 specifically excluded UOG from the CAM because UOG is essentially dedicated to bundled service customers.

4. D.06-07-029 has not previously been modified or amended to remove the exclusion of UOG from eligibility for the CAM; but parties to that proceeding were given notice and an opportunity to be heard on the question in this proceeding.

5. The CAISO informed the assigned Commissioner that quick-start generation and demand response would increase available supply and enhance grid reliability.

6. On August 15, 2006, due to the heat storm and power-demand conditions experienced during July-August 2006, an ACR issued ordering SCE to build up to 250 MW of black-start, dispatchable peaking units (up to five units) in its service territory that could be on-line by August 2007, to provide capacity and grid reliability benefits to all of SCE's distribution system.

7. The ACR authorized SCE to seek different ratemaking treatment for the costs of the peakers than would otherwise be applicable to UOG projects.

8. SCE undertook the development of the five peaker units and by summer 2007 four peaker units were on-line and fully operational. The fifth unit

is still in the permit and development stage and is not addressed in the application or this decision.

9. Allocation of the resource adequacy capacity and the net costs of the capacity of the four peaker units to all benefitting customers is consistent with the CAM established in D.06-07-029.

10. The peakers provide capacity and grid reliability benefits to all electricity customers on its distribution system and all benefitting customers should pay for the costs.

Conclusions of Law

1. D.06-07-029 established a CAM for the allocation of the benefits and costs of resources that the IOUs procure for their respective systems, but UOG resources were explicitly excluded from this CAM treatment.

2. Modification of the CAM's limitation to non-UOG resources is properly noticed and before the Commission in this proceeding with respect to the four peakers SCE developed pursuant to the August 15, 2006 ACR.

3. The four SCE peakers were developed for the benefit of all SCE customers, and therefore all of the peakers' costs and resource adequacy benefits should be allocated to all benefiting customers, not just SCE's bundled service customers.

O R D E R

1. The net capacity costs and resource adequacy benefits of the four peaker units developed, owned and operated by Southern California Edison Company (SCE) are to be allocated to all benefiting customers as a one-time exception to Decision (D.) 06-07-029, and excludes an auction. The allocation authority expires in 10 years from the date of commercial operation for each unit, consistent with D.07-06-022, D.06-07-029, and D.08-09-012.

2. The Utility Reform Network's March 21, 2008 Motion for Consideration of Capital Recovery Issues is denied without prejudice.

3. Application 07-12-029 remains open.

This order is effective today.

Dated March 26, 2009, at San Francisco, California.

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