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Decision 96-01-009 January 10, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	R.94-04-031 (Filed April 20, 1994)
Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	I.94-04-032 (Filed April 20, 1994)

ORIGINAL

ORDER ADOPTING CORRECTIONS TO DECISION 95-12-063

On December 29, 1995, Commissioner Conlon issued an Assigned Commissioner's Ruling in Rulemaking 94-04-031/Investigation 94-04-032 (R.94-04-031/I.94-04-032) which proposed corrections of clerical errors and certain inadvertent errors in Decision (D.) 95-12-063. At this time, we adopt these corrections. In addition, the decision has been modified to correct formatting errors throughout the text. Attached to this order is a copy of D.95-12-063, as modified by this decision. The December 20, 1995 effective date of D.95-12-063 remains unchanged.

At the regularly scheduled meeting on December 6, 1995, we unanimously voted to impose a prohibition on ex parte communications in this proceeding. Now that we have issued our policy decision in electric restructuring, it is reasonable to lift this prohibition.

Finding of Fact

Certain clerical and inadvertent errors exist in D.95-12-063, which must be corrected.

Conclusions of Law

1. It is reasonable to adopt the corrections to D.95-12-063 proposed in the Assigned Commissioner Ruling, issued December 29, 1995.

2. It is reasonable to lift the prohibition on ex parte communications in R.94-04-031/I.94-04-032.

3. This decision should be effective today in order to allow these corrections to be made expeditiously.

IT IS ORDERED that:

1. Decision 95-12-063 shall be conformed to reflect the following corrections:

a. Page 1, footnote 1, line 9, change "Utility" to "Utility".

b. Page 37, line 8, change "must run" to "must take".

c. Page 55, line 1 and footnote, line 1, correct spelling.

d. Page 65, line 18, change "As of" to "Not later than", Line 21, change "subject only to the limitations of technology" to "at that time and we expect all customers to have that option within five years".

e. Page 66, Line 11, delete "With those caveats," and add "In the absence of agreement for earlier implementation,"

f. Page 67, footnote, line 1: change reference to "Section IX" to "Section VIII".

g. Page 69, change the last paragraph to read as follows (which continues at the top of page 70):

Finding of Fact

"Parties should carefully consider whether our minimum phase-in schedule is necessary or whether eligibility can be held open to all electricity consumers after the twelve-month initial phase. If a phase-in schedule is deemed necessary, we ask

parties to recommend an eligibility phase-in schedule for direct access beyond the initial phase, but not later than the five year minimum schedule already stated. We do not favor restrictions beyond those necessary due to technical obstacles, though we recognize that some parties may have additional concerns. Modifications to an adopted phase-in schedule will be subject to any changes found necessary in the Commission's review of the initial phase and the parties' recommendations."

h. Page 70, line 17, add "After a five year transition period,"

i. Page 78, line 5, change "on" to "not later than"

j. Page 85, line 2, change "Under current regulatory structure," to "Under the current regulatory structure"

k. Page 86, line 15, change "assign mortgage" to "assign, mortgage"

l. Page 115, lines 15 and 16, change "QFS" to "QFs".

m. Page 131, lines 5 and 7, change "QFS" to "QFs"

n. Page 139, line 18, change "transactions" to "transition".

o. Page 145, delete footnote 54, retain numbering.

p. Page 150, line 6, change "Section VII" to "Section VIII".

q. Page 164, delete "and" in footnote 103

r. Page 204, line 14, change "customerrs" to "customers".

s. Page 207, Conclusion of Law (COL) 40, change to "The calculation of transition costs should account for prepaid and unpaid deferred taxes related to generating assets."

t. Page 208, COL 48, change to "It is fair to pay shareholders a lower rate of return which appropriately reflects the reduced risk for generating assets."

u. Page 210, COL 66, change to "It is reasonable to adopt 90% of the embedded cost of debt as a reasonable rate of return on the equity portion of the net book value of fossil fueled generation units to reflect the reduced risk. It is reasonable to provide an incentive to the utilities to voluntarily divest their fossil fueled generation assets by granting an increase in the rate of return for the equity component of up to 10 basis points for each 10% of fossil generating capacity divested, provided we have resolved any locational market power concerns associated with the unit and authorize the transfer pursuant to § 851."

v. Page 212, COL 75, change to "Utilities should be allowed to earn a premium related to the transition costs of fossil plants, based on fossil plants that are sold or spun off to unaffiliated entities."

w. Page 224, OP 19, line 2, add "and" and delete "and SDG&E".

x. Page 225, Ordering Paragraph 24, line 22, delete "for".

y. Page 226, OP 25, line 1, change "50%" to "100%" and line 2, change "non-nuclear generation plant" to "their fossil-fueled generation units".

z. Page 226, OP 27, line 4, add "and the CTC balancing account" to the end of the sentence.

aa. Page 226,.OP 28, line 6, add "Consistent with Conclusion of Law 54, each Direct Access customer shall sign an agreement to pay their share of transition costs and thereby waive any jurisdictional objection they might otherwise raise in any forum."

2. The prohibition on ex parte communications in Rulemaking 94-04-031/Investigation 94-04-032 shall be lifted as of this date.

This order is effective today.

Dated January 10, 1996, at San Francisco, California.

DANIEL Wm. FESSLER
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

Vote: 3-2 on Ordering Paragraph 1

Vote: 5-0 on Ordering Paragraph 2

We will file a joint written dissent.

/s/ JESSIE J. KNIGHT, JR.
/s/ JOSIAH L. NEEPER
Commissioners

I will file a concurring opinion.

/s/ DANIEL Wm. FESSLER
President

FESSLER, PRESIDENT OF THE COMMISSION, CONCURRING:

I concur in the result. Having said this I insist that, from the vantage point of procedural regularity, this Commission vote should never have taken place. The distinction between an inadvertent error in the text of an order and a change of policy announced belatedly is clear and was never colorably implicated in the corrections COMMISSIONER CONLON identified in his Assigned Commissioner's Ruling. The notion that two members of this body who did not assent to the terms of the order being corrected should vote on the state of mind of the majority is, on its face, preposterous. I am grateful that the oral remarks of COMMISSIONER NEEPER at our conference recognize this fundamental proposition.

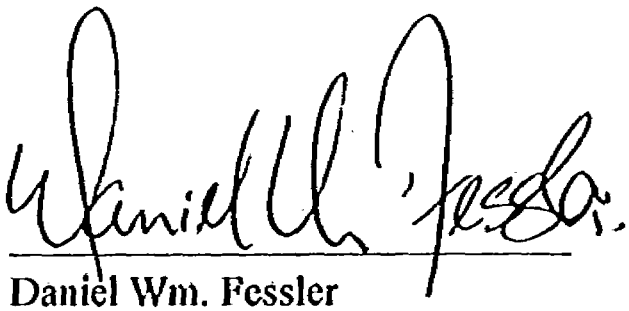
If the issue should have gone no further than a ministerial ruling by the Executive Director or COMMISSIONER CONLON who acted at my request to order the corrections, today's procedure does seem to have served a totally unrelated objective. Literature is replete with tributes to what the poet has called " the longing for the exquisite last word." Apparently our reports are not to be spared as a repository. So be it. Suffice it to say that the majority's views on the issues characterized by

COMMISSIONER KNIGHT as grounds for his dissent upon a dissent are safely expressed in our opinion of December 20. A quick reference there will reveal that today, for the second time, the Commission decision has been misread and mischaracterized.

In the meantime the focus of interest has shifted. In the examination of our views in the California Legislature the emphasis has been on the Commission's capacity to deliver a sensible and universally available means for the average ratepayer to gain the benefits of enhanced competition in generation and efficiency in transmission. The majority opinion squarely passes that test. Under the reforms that we now are all pledged to implement, *any* ratepayer of *any* class will be able to gain direct access to the wholesale market by the simple expedient to electing to remain a full service customer of a distribution utility which will procure the electric energy in an open, competitive market, identify that cost on the customer's bill and pass it on without an iota of markup to that customer. Customers who desire to become more proactive in controlling their energy costs have multiple options beyond this fundamental position but they begin with the benefits of the reforms and efficiencies. They were owed no less by this Commission. In COMMISSIONER KNIGHT'S very

lengthy second statement it is disappointing to see no discussion as to how the average ratepayer would have gained these benefits had the views of the minority prevailed. It was precisely because I could not discern the protection of this fundamental objective in their views of market structure that I could not join their opinion.

San Francisco, California
January 10, 1996



Daniel Wm. Fessler
President of the Commission

State of California — Public Utilities Commission
San Francisco

R.94-04-031/I.94-04-032
D.96-01-009

Commissioners Jessie J Knight Jr. and Josiah L. Neeper Dissenting
January 10, 1996

We dissented in D.95-12-063, the Commission's policy order in the Commission's rulemaking (R.94-04-031) on proposed policies governing the restructuring of California's electric services industry. Additionally, we cannot support the order before us now, which modifies that decision. While D.95-12-063 is a principled and reasoned decision that makes significant improvements over the Commission's preferred policy document issued on May 24, 1995, D.95-12-063 remains, especially as modified by this order, a decision that approaches restructuring from a different perspective than ours. The philosophic and economic perspective of the order leads us to support different ways to reach the goal of a truly competitive electric services industry. For this fundamental reason we must dissent from the majority.

In reviewing D.95-12-063 as distributed on December 20, 1995, it appeared that certain sections more closely reflected the views of the proposed decision put forth by us than we had anticipated. Unbeknownst to the majority, D.95-12-063 apparently allowed voluntary purchases from the Power Exchange by the investor-owned utilities, and limitations on direct access appeared to be lifted after only one year. These are policies we have always supported. However, the order before us today reverses these changes, on the basis that these very passages constitute "inadvertent errors" in the majority decision. We cannot support these changes, because they modify D.95-12-063 in such a way as to move the document as presently written away from the views that we support.

With the adoption of this order, the public will have a document that more clearly outlines the majority viewpoint. In matters such as this, clarity of the Commission's will is essential, and the decision to modify D.95-12-063 is quite appropriate to achieve that end. However, we take this opportunity to explain in more detail why we believe D.95-12-063, as now modified by this order, provides fewer opportunities for direct access and customer choice. Because this crucial policy will be the foundation of many decisions to come for this vital industry, the clarity of any dissenting opinion on substantive issues is as important to clearly articulate as is the will of the majority.

We do not take the time here to recast the other areas with which we disagree with the majority. Issues such as mandatory meters and divestiture stand as outlined in our proposed decision put forth on December 20, which is included as a dissent to D.95-12-063 that includes these issues in detail. This dissent highlights what we believe is the key difference between the minority and majority; that is market structure.

First of all, let us make it clear that we support the formation of a truly voluntary pool, as called for by many parties and in the Memorandum of Understanding. The majority decision maintains fidelity to a mandatory pool concept, with very little opportunity for direct access competition, although these opportunities increase incrementally over five years. There are serious constraints that serve to limit the likely actual utilization of direct access contracts, even when theoretically available, regardless of the improvements to the majority's original schedule for customers to achieve direct access. Even though some customers are allowed direct access, it is our belief that the market structure adopted by the majority in D.95-12-063, as modified by this order, disadvantages direct access in very fundamental ways and

tilts the playing field in favor of the Power Exchange. The seemingly improved and aggressive direct access schedule is overwhelmed by the strictures of the majority's decision places on the Power Exchange such that the portion of the market that will have direct access becomes unduly subjugated to it.

Specifically, the decision requires the following:

1. Participation in the Power Exchange by the utility as an electricity purchaser (i.e., to provide power to non-direct access customers) is mandatory. This eliminates the utility as a market for competitive suppliers, and contradicts the intent of the signatories to the MOU, including Southern California Edison. Mandatory utility Power Exchange purchasing will limit the market to which non-utility generators can sell their power, and thus achieve the economies of scale, efficiencies, and market stability to receive financial backing and to function well in the new market unless they are willing to participate in the Power Exchange. New competitors are required to sell into the pool if they wish to do business with California utilities. Also, mandatory pool purchases force the utility to forego other potentially more economic opportunities to purchase power in the wholesale market, potentially at prices lower than the pool price. Every other utility in the nation may avail themselves of the increasingly competitive wholesale market to purchase power, while California utilities are restricted to purchase power only through the pool. This creates significant risk for utility customers, especially the small business and residential consumer. These captive consumers are left to the vagaries of the Power Exchange, which is "market-like" but <u>not</u> a true market as exists for all other commodities in the American economy.

2. Utilities are required to sell all of their power into the Power Exchange until plants undergo market valuation. This requirement eliminates the opportunity for customers to purchase power from a greater number of sources. It prevents the utilities from competing against each other in the retail market thereby placing downward pressure on prices. Utilities are apparently precluded from entering into bilateral contracts for even surplus power -- power that is not sold into the Power Exchange -- with customers outside their service territories. Such a restriction is economically inefficient and potentially saddles the utilities' captive customers with the cost of this surplus capacity, hence placing upward pressure on prices in the pool. It also places California at a competitive disadvantage because California utilities will not be able to pursue contracts with out-of-state customers. Rest assured that other power providers will fill that niche, in turn potentially taking jobs out of California and making California utilities noncompetitive in the long run.

3. D.95-12-063 requires that "utility purchases through the Power Exchange will be considered *prima facie* prudent." At whatever point in time the utility is allowed to make purchases outside of the Power Exchange, the utility would be disinclined to do so because it would face prudency reviews, although wholesale purchases outside the Power Exchange may be less expensive than Power Exchange purchases.

4. If parties cannot settle on an appropriate phase-in, the majority will invoke a five-year phase-in of direct access. This phase-in clearly limits the ability of customers and suppliers to negotiate contracts. Most customers will not have direct access until well into the next century if the five-year phase in is put in place. This feature severely limits the major avenue small customers have for reducing their electric bills. As stated in the Knight/Neeper proposal on

December 20, restrictions on direct access participation "disadvantage both small customers and aggregators and their customers who want to pursue retail contracts." While it is true that these small customers will have access to the Power Exchange through their retail providers, they are denied the opportunity to seek more cost effective power that may be available to direct access customers. Small business and residential customers are left with the cost of electricity that results from the Power Exchange pricing mechanism. They remain captive to the operation of the Power Exchange, and must hope that the Power Exchange operates as advertised by the majority since other options are limited.

5. A key concern with the majority's decision is that the market structure is tilted in favor of the power exchange. In particular, there are a number of references to the Power Exchange price as the "market price," as the reference point for transition cost calculations. These are natural corollaries to the requirement that utilities purchase all of their power from the Power Exchange. The tone and rhetoric of the entire decision clearly tend to support the superior position in the market intended for the Power Exchange.

6. There is an overly zealous commitment for the ISO to use locational marginal cost pricing for determining dispatch priorities among Power Exchange and bilateral transactions. If the ISO determines that a bilateral contract does not meet the twin objectives of assuring operational reliability and achieving least cost use of the system, a bilateral contract would not be dispatched, even though the contract price was agreeable to both parties. However, all Power Exchange transactions would meet these tests by definition. Therefore, this transmission pricing scheme disadvantages bilateral transactions.

7. Transmission upgrades and investments are subject to either "requests from customers who are willing to pay for the upgrades" or "in the case of a showing to the regulators that there has been a market failure." In typical competitive markets, infrastructure upgrades are made on the basis of individual company cost/benefit assessments, and are thus risks a company may take to participate or expand its role in the market. In the decision, such investments are strictly regulated and no risk-taking is allowed. Entrepreneurial transmission upgrades and expansions are one of the ways new competitors can expand their markets; the majority's decision favors existing utilities and the Power Exchange by limiting this type of risk taking.

Overall, the decision, in our opinion, does little more than provide a narrow window for direct access in the restructured marketplace. D.95-12-063, as modified by this order, results in a market structure that advantages Power Exchange transactions over Direct Access transactions. The result is that even when customers, at long last, are given the opportunity to avail themselves of Direct Access, this form of commerce may be so disadvantaged as a result of these decisions and the strictures they build around the Power Exchange as to be of little value. We prefer a market structure where Direct Access and the Power Exchange exist side by side, neither one advantaged nor disadvantaged by our regulation, allowing customers to choose voluntarily the market vehicle that best meets their individual needs. Regrettably, today's order and D.95-12-063 do not allow these two options for customers to coexist as equals.

To support modifications that do not bring about real opportunities for customer choice is something that, regrettably, violates our principles. Much as we would prefer to join with our colleagues in adopting a unanimous policy direction, we cannot. This does not mean we will not respect the reasoned opinion of the majority

of the Commissioners as the Commission moves into implementation, but we cannot endorse this policy direction as our preference.

The time has come to put this dispute behind us. There are still many decisions that lie before the Commission as we move forward to implement these policies so as to bring the benefits of competition to California's electric consumers. We will continue to be advocates for free market approaches, flexible market mechanisms and increased customer choice in the electric services industry, but will do so within the policy framework outlined by the majority.

Jessie J. Knight Jr.
Commissioner

Josiah L. Neeper
Commissioner

San Francisco CA
January 10, 1996