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Decision 99-07-018 July 8, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison (U 338-E) for an Order Under Section 701 of the Public Utilities Code Granting Southern California Edison Company Authorization to Establish a Pilot Program for Reselling Bilateral Forward Purchases Into the PX and ISO.

Application 99-03-062
(Filed March 30, 1999)

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O P I N I O N

Summary

As provided in the Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge, issued May 12, 1999, Southern California Edison Company (SCE) and other parties have filed briefs which argue whether and how SCE's application complies with the Electric Restructuring Preferred Policy Decision, the Federal Energy Regulatory Commission (FERC) orders, and Assembly Bill (AB) 1890.¹ We have considered those arguments and conclude that SCE's application does not comply with our electric restructuring policy. We dismiss the application without prejudice.

¹ The Preferred Policy Decision (D.) is D.95-12-063, as modified by D.96-01-009 (64 CPUC2d 1 and 64 CPUC2d 228, respectively). The relevant FERC orders are those where conditional operation of the Independent System Operation (ISO) and the Power Exchange (PX) were granted, EC96-19-001 and ER96-1663-001. *Pacific Gas and Electric Company*, 77 FERC ¶ 61, 204 (1996); *Pacific Gas and Electric Company* 77 FERC ¶ 61, 265 (1996). AB 1890 (California Statutes 1996, Chapter 854) is the legislation that provided the statutory basis for the electric restructuring policy that the Commission initiated.

Background

SCE seeks authority to conduct a two-year pilot program. Under the pilot, SCE would enter into traditional power purchase agreements for electric energy and capacity with third-party sellers. SCE would bid all such purchases into the Power Exchange (PX) day-ahead and/or day-of markets, and/or into the ISO's imbalance or ancillary service markets, on behalf of ratepayers. SCE would limit its purchase agreements with third parties other than the PX and ISO to no more than 2000 MW.² SCE seeks authority to establish a new balancing account to record the costs and revenues associated with the power purchase agreements entered into under the pilot program. In lieu of reasonableness reviews of its purchases, SCE proposes that at the end of each month its shareholders share 5% of the negative or positive balance in the new balancing account. That balance would then be transferred to the Transition Revenue Account on a monthly basis. SCE would submit a report to the Commission on the results of the pilot program.

SCE identifies the following purposes of the pilot program in its application: to mitigate price spikes, to enable SCE to compete for potentially lower cost supplies, to encourage development of forward markets and forward contract types, to gather information about forward purchases to report to the Commission so that the Commission may evaluate the merits of such a program as a component of utility distribution company procurement after the rate freeze, and to enable forward purchases in the event implementation of the PX Block Forward is delayed.

² SCE represents that 2000 MW is about 10% of the peak summer demand of SCE's full-service retail customers.

A number of parties filed protests or responses to SCE's application. In protests, responses, and at the prehearing conference, parties argued that SCE's request conflicts with the Commission's Preferred Policy Decision. These parties contend that SCE's proposal fundamentally conflicts with the requirement adopted in that decision that SCE bid its generation units into the PX and procure the electric energy needed to supply its full service customers from the PX, the "buy/sell requirement." In addition, parties maintain that SCE's request does not comply with other aspects of the Preferred Policy Decision, conflicts with the FERC decision conditionally authorizing operation of the Independent System Operator and the PX, and question whether SCE's request complies with the requirements of AB 1890.

In the May 12, 1999, Scoping Memo and Ruling, the Assigned Commissioner and Administrative Law Judge (ALJ) required SCE and invited other parties to file briefs arguing whether and how SCE's application complies with this Commission's Preferred Policy Decision, the FERC orders, and AB 1890. The Assigned Commissioner and ALJ stated that they would recommend that the Commission deny the application without hearing if they concluded that SCE's request is not in compliance with these decisions and law. On May 20,

1999, concurrent opening briefs on compliance were timely filed.³ Concurrent Reply Briefs were filed on June 3, 1999.⁴

Discussion

26.1.
38 The Preferred Policy Decision requires that for a defined period of time, Pacific Gas and Electric Company (PG&E), SDG&E, and SCE each bid all of its generation into the PX and procure electric energy for its full service customers by purchases from the PX. This requirement has become known as the "buy/sell requirement." (See 64 CPUC2d 1, 95, Ordering Paragraph 5.)

Under the pilot, SCE states that it will continue to bid all generation from facilities that it owns into the PX/ISO, just as it does today. Although the "must sell" portion of the buy/sell requirement is limited to energy from the generation capacity of the utility,⁵ SCE will, in addition, bid resources that it is able to

³ Concurrent opening briefs on compliance were filed by Alliance for Retail Markets (ARM), Center for Energy Efficiency and Renewable Technologies (CEERT), Commonwealth Energy Corporation (Commonwealth), Department of General Services (DGS), Independent Energy Producers Association (IEP), New York Mercantile Exchange (NYMEX), the Commission's Office of Ratepayer Advocates (ORA), SCE, Western Power Trading Forum (Western), and Williams Energy Marketing and Trading Company (Williams).

⁴ Concurrent reply briefs on compliance were filed by ARM, ORA, SCE, San Diego Gas & Electric Company (SDG&E), Western, and Williams.

⁵ "Existing QF and other wholesale power contracts will continue to be honored, and the Preferred Policy Decision encourages renegotiations of both types of contracts wherever possible. Only the regulated utilities are subject to the constraint, and only for four years. The total amount of energy affected is thus capped by the current generation capacity of these regulated utilities. Because these utilities will also be divesting generation assets, and because any such asset sold is immediately freed of the obligation to bid into the PX, the amount of energy destined for interstate commerce that is constrained by the buy-sell requirement will only decrease over the 4-year period." (D.97-02-021, [mimeo.] pp. 24 - 25 (February 5, 1997).)

procure by purchases under the pilot program into the PX market. SCE claims this is in step with the "must sell" requirement. Further, SCE states that, just as it does today, it will continue to bid its entire customer load into the PX/ISO market, and continue to procure all the electric energy required by its bundled service customers with purchases made through the PX or the ISO's imbalance energy markets. SCE argues that its proposal will have no effect upon SCE's compliance with the buy/sell requirement, and that it is akin to the utilities' participation in the PX day-ahead and ISO imbalance markets.

SCE acknowledges, however, that the Preferred Policy Decision discusses price transparency and market thinness in connection with the buy/sell requirement. The effect of the pilot on price transparency and market thinness underlies the protests filed against SCE's proposal.

Protesting parties argue that SCE's pilot undermines the purpose behind the adoption of the buy/sell requirement. Specifically, protesting parties argue that the purpose of the buy/sell requirement is achieving price transparency, mitigating market power, and reducing the regulatory burden.

26.11.38 We regard the buy/sell requirement as a means to an end. The Commission adopted the buy/sell requirement to achieve specific ends. The Commission stated that the buy/sell requirement will

"dramatically reduce the scope and burden of the regulatory issues associated with determination of the dimension of the assets which are non-competitive in a transparent market, ensure that those customers who elect to rely upon their distribution utility to procure their electric energy will receive the benefits of those competitive market prices, and provide a sufficient depth to the [PX] that its market signals may be relied upon as a benchmark for choices to opt for contracts for differences or direct access arrangements."

do not head note (64 CPUC2d 1, 38.) We agree with the protesting parties that we must consider the effect of the pilot proposal on price transparency, and the related market

power mitigation and reduced regulatory burden arising from price transparency, in order to determine whether the pilot is in compliance with the Preferred Policy Decision.

26.1.38 We also agree with SCE that we must look at the specifics of the proposed transactions to assess whether the buy/sell requirement has been violated. When it established the buy/sell requirement, the Commission specifically considered allowing the utilities to opt for non-PX purchases and sales. It concluded that unless the utilities are obligated to bid their generation into the PX and procure the electric energy needed to supply their full service customers from it, both the transparency and reliability of the pricing signals would be seriously compromised. The Commission expressly considered the necessity of maintaining the buy/sell requirement in three specific timeframes:

1. the initial period when there is little if any experience with market conditions and function;
2. the five-year period identified as a transition between the regulatory order which is passing and the competitive climate we seek to foster; and
3. the post-transition period.

26.1.37
26.1.38 **The Transaction** In its application, SCE describes the mechanics of the pilot proposal as allowing SCE to purchase energy and ancillary services from suppliers other than the PX or ISO and bid such purchases into the PX or ISO markets. It states that SCE will enter into traditional types of power purchase agreements with sellers, which may include standard Western Systems Power Pool (WSPP) firm energy contracts, firm capacity contracts, return-to-service contracts, and ancillary service contracts. SCE would then bid such a bilateral power purchase agreement into the PX or ISO at a price equal to SCE's avoidable

cost under the contract. Were the bilateral contract a firm capacity contract involving a must-deliver obligation on the part of the seller and a must-take requirement on the part of the buyer, for example, SCE's avoidable cost would be zero, so it would bid the contract into the PX at a price of zero.

In its brief, SCE emphasizes that these traditional, bilateral agreements would be bid into the PX or ISO, but would have the Commission ignore the underlying power purchase agreement and its effect on the goals of the buy/sell requirement. SCE describes the pilot as allowing it to purchase from suppliers other than the PX. It describes the purchases as being bid "on behalf of ratepayers." (see SCE's Application, p. 2.) Both SDG&E and SCE argue in comments that the transactions are wholesale and not retail, likening the proposed pilot transactions to existing qualifying facility and other wholesale power contracts. In the Preferred Policy Decision, we authorized certain treatment for existing qualifying facility and wholesale power contracts, largely on the basis of fairness given past commitments. (64 CPUC 1, 190, Conclusion of Law 9.) SCE and SDG&E argue that the pilot transactions are similar transactions and should be regarded favorably by the Commission. But the pilot transactions would be new commitments, made on behalf of ratepayers.

26/1/38
Channeling such a purchase through the PX does not overcome the fact that SCE would be procuring power on behalf of its customers from an entity other than the PX, in direct conflict with the buy/sell requirement.⁶ The pilot would have SCE procuring supply outside the PX, and then scheduling that supply through the PX, rather than matching supply to load within the PX auction. The question

⁶ Power purchase agreements that existed at the time of the adoption of the Preferred Policy Decision present a special case, described in Footnote 5.

is not one of retail versus wholesale markets. The question is, in what forum does the price determination process take place? Clearly it is not in the PX, it is in the forward contract transaction itself. SCE's transactions would occur outside the confines of the PX and ISO, which distinguish them from the utilities' participation in the PX day-ahead and ISO imbalance markets. The Preferred Policy Decision allows for the type of purchases SCE describes, but only after the transition period concludes. (*Id.*)

SCE asserts that the power purchase agreements would bring additional power or ancillary services to the PX market. SCE states that the proposed pilot, if successful, will attract new sellers and additional supplies of generation that otherwise would not be in the PX spot markets. However, SCE concedes that some or all of the 2000 MW bid into the PX as a result of power purchase agreements signed under the pilot may have bid into the PX spot market absent the program. There is no assurance that the pilot transactions will not displace non-pilot PX transactions.

26, 1, 38 The Goals As noted above, the buy/sell requirement was adopted with specific ends in mind: price transparency, and the related market power mitigation and reduced regulatory burden arising from price transparency, characteristic of a robust and efficient competitive market. SCE's proposed pilot works against these goals. As SCE concedes in its Reply to Responses and Protests, its "bilateral purchases are not 'transparent' to the market in the sense that Edison would not publish its prices." (SCE Reply, p. 8.)⁷ To the extent the

⁷ This lack of price transparency distinguishes SCE's proposal from the Block Forward application that the PX has before the FERC. The PX's proposal includes price transparency and has our support. The costs underlying the PX transactions directly influence the clearing price. See Application for Acceptance of Market-Based Rates and

Footnote continued on next page

pilot displaces non-pilot PX transactions, the overall price transparency may be reduced even though the volume of PX transactions may not be reduced.

Further, SCE states, and no party contests this, that the price bid into the PX would not be the cost of the power negotiated in the bilateral contract. Rather, it would be that fraction of the negotiated price which SCE could avoid (its avoidable cost under the contract).

Price transparency brings with it market power mitigation and consumer protection through the ability to monitor the results of the bidding process. (Supra, p. 39.) As the Commission stated in the Preferred Policy Decision, if the utilities made purchases on behalf of their full service customers through bilateral contracts, those customers most vulnerable to an abuse of market power would have no means of tracking the cost of electric power. SCE's proposed pilot has this flaw, and is therefore not in compliance with the Preferred Policy Decision.

A significant aspect of SCE's proposed pilot is its associated ratemaking treatment. SCE includes a new balancing account and sharing mechanism in lieu of traditional reasonableness reviews. The Commission's discussion in the Preferred Policy Decision about the increased regulatory burdens associated with utility non-PX purchases is relevant here, particularly with respect to resolving the appropriate charges to be passed on to full service customers. (See 64CPUC2d 1, 41.) As the Commission envisioned, the process of verifying the

Other Authorizations and Waivers for Electricity Block-Forward Market, FERC Docket No. ER99-2229, March 23, 1999. The Commission intervened in the proceeding and filed a pleading supporting the PX's application. Revisions to the UDC's Power Exchange Energy tariff to include the cost of power purchases from the PX's Block-Forward Market are being considered by this Commission today in Resolution E-3618.

appropriateness of the charges would be complicated by the fact that SCE regards the power purchase agreement pricing terms proprietary. Although the proposed pilot probably does not raise the breadth of concerns about regulatory burden described by the Commission in the Preferred Policy Decision, it does increase the regulatory burden. A new and highly contentious review proceeding would be added to the gamut of electric restructuring activities already underway. On its own, this increased regulatory responsibility would not cause us to dismiss the application. It is, however, a stated goal of the buy/sell requirement. It is therefore appropriate for us to address the effect of SCE's proposed ratemaking treatment on our regulatory responsibilities.

Because SCE's proposed pilot works against our goals of price transparency, market power mitigation, and reduced regulatory burden, we conclude that it is in conflict with the Proposed Policy Decision.

Similarly, we find that SCE's proposed pilot constitutes a significant departure from the proposal FERC reviewed and approved when it authorized the operation of the ISO and the PX. The FERC characterized the buy/sell requirement as "critical to the entire retail restructuring proposal."⁸ It acted upon the buy/sell requirement "independently."⁹ As we recognized in our Preferred Policy Decision, close cooperation and coordination with the FERC is required for our restructuring effort to be successful. We are disinclined to embark upon piecemeal changes to the carefully structured market of the transition period, upon which the FERC predicated its conditional approval of the operation of the ISO and the PX. We note that in authorizing the PX's Block

⁸ *Pacific Gas and Electric Company*, 77 FERC ¶ 61,265, 62,089 (1996).

⁹ *Id.* 62,088.

Forward proposal, the FERC allowed participants to use the bilateral market rather than the PX to effectuate their transactions, "to the extent that they are not otherwise obligated to use the PX."¹⁰ In dismissing SCE's proposal, we mirror FERC's determination and will not allow it to use the bilateral market to effectuate forward transactions.

26.1.25
Because we conclude that the proposed pilot conflicts with our Preferred Policy Decision, we must conclude that it undermines the goals of AB 1890. Like our Preferred Policy Decision, AB 1890 relies on the new market structures (the PX and the ISO) to provide a competitive energy-services market that will ensure the availability of lower cost power to all California consumers. Integral to achieving a functioning marketplace is the price transparency SCE concedes its pilot proposal lacks.

26.1.25
SCE's proposed pilot is not in compliance with the Preferred Policy Decision, may undermine the goals of AB 1890, and would make piecemeal changes to the market structure upon which the FERC predicated its conditional approval of the operation of the ISO and the PX. We will therefore dismiss SCE's application without prejudice to SCE presenting a proposal in compliance with the Preferred Policy Decision. After the transition period, an appropriate procurement strategy may include commitment to power purchases on behalf of full service customers, as SCE describes. This decision, however, makes no determination on procurement strategy or any other issue bearing on the market structure after the transition period concludes.

Some of the benefits SCE hoped to bring to customers through the proposed pilot may be achieved through other means without compromising the

¹⁰ California Power Exchange Corporation, 87 FERC ¶ 61,203 (1999).

market structure supported in AB 1890, and so carefully put into place in the Preferred Policy Decision and the FERC Orders. In the Preferred Policy Decision, the Commission states that a customer who, for any reason, desires a price structure different from that provided by the PX will have the opportunity to purchase a financial hedge from any counterparty. The Commission recognized that financial hedging could be a part of the restructured marketplace, but opted to allow customers to choose whether and when to use a financial hedge. In the Preferred Policy Decision, the Commission envisioned that customers – not the utility distribution companies -- would make choices to mitigate price spikes. The PX application before FERC for approval of its Block Forward Market, granted May 26, 1999, should encourage development of forward markets, and in a manner consistent with our Preferred Policy Decision. We anticipate that the Block Forward Market will help mitigate price spikes as well.

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed by June 28, 1999, and reply comments were filed by July 6, 1999. The draft decision was modified after consideration of these comments.

Findings of Fact

1. The Preferred Policy Decision requires that for a defined period of time, PG&E, SDG&E, and SCE each bid all of its generation into the PX and procure electric energy for its full service customers by purchases from the PX. This requirement has become known as the "buy/sell requirement."

2. SCE proposes to enter into traditional power purchase agreements to purchase energy and ancillary services from suppliers other than the PX or ISO and bid such purchases into the PX or ISO markets.

3. SCE concedes that some or all of the 2000 MW bid into the PX as a result of power purchase agreements signed under the pilot may have been bid into the PX spot market absent the pilot program. There is no assurance that the pilot transactions will not displace non-pilot PX transactions.

4. SCE concedes in its Reply to Responses and Protests that it's "bilateral purchases are not 'transparent' to the market in the sense that SCE would not publish its prices." The price bid into the PX from pilot transactions would not necessarily be the cost of the power negotiated in the bilateral contract.

5. Under the proposed pilot, those customers most vulnerable to an abuse of market power would have no means of tracking the cost of electric power.

6. SCE's proposed pilot may undermine the goals of AB 1890, and would make piecemeal changes to the market structure upon which the FERC predicated its conditional approval of the operation of the ISO and the PX.

7. On May 25, 1999, Reliant Energy Power Generation, Inc., filed a Motion to Intervene wherein it stated that it owns and operates generating facilities which it bids into the PX and ISO market and therefore has a direct and substantial interest in, and may be affected by, this proceeding. It accepts the record and scope of the proceeding as it stands.

Conclusions of Law

1. Channeling third-party power purchase agreements through the PX does not overcome the fact that SCE would be procuring power on behalf of its ratepayers from an entity other than the PX, which is in direct conflict with the buy/sell requirement.

2. The buy/sell requirement was adopted with specific ends in mind: price transparency, the related market power mitigation, and reduced regulatory burden arising from price transparency, characteristic of a robust and efficient competitive market.
3. Because SCE's proposed pilot works against the goals of price transparency, the related market power mitigation, and reduced regulatory burden, we conclude that it is in conflict with the Preferred Policy Decision.
4. SCE's application should be dismissed without prejudice, and the proceeding should be closed.
5. The Motion to Intervene of Reliant Energy Power Generation, Inc. should be granted.

O R D E R

IT IS ORDERED that:

1. The Motion to Intervene of Reliant Energy Power Generation, Inc. is granted.
2. The application of Southern California Edison Company for authorization to establish a pilot program for reselling bilateral forward purchases into the Power Exchange and the Independent System Operation is dismissed without prejudice.

3. This proceeding is closed.

This order is effective today.

Dated July 8, 1999, at San Francisco, California.

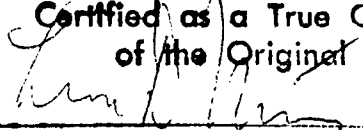
RICHARD A. BILAS
President
HENRY M. DUQUE
JOEL Z. HYATT
Commissioners

I dissent.

/s/ JOSIAH L. NEEPER
Commissioner

I abstain.

/s/ CARL W. WOOD
Commissioner

Certified as a True Copy
of the Original

ASSY. EXECUTIVE DIRECTOR, PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA

PROOF OF SERVICE BY MAIL

I, Sandra Jackson, declare:

I am over the age of 18 years, not a party to this proceeding, and am employed by the California Public Utilities Commission at 505 Van Ness Avenue, San Francisco, California.

On 7-9-99, I deposited in the mail at San Francisco, California, a copy of:

99-07-018

(DECISION NUMBER OR TYPE OF HEARING)

7-8-99

(DATE OF HEARING)

A. 99-03-062

(APPLICATION/CASE/OII/OIR NUMBER)

in a sealed envelope, with postage prepaid, addressed to the last known address of each of the addressees in the attached list.

I declare under penalty of perjury that the foregoing is true and correct and that this declaration was executed on 7-9-99, at San Francisco, California.

Sandra Jackson

*Signature
9/92

Item 3
7/8/99

A 99-03-062

DECISION: 99-07-018

MAIL DATE: 7-9-99

Copy of "OPINION" and order mailed to the following.

SEE ATTACHED LIST FOR APPEARANCES, STATE SERVICE

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