

March 7, 2006

Docket Clerk  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, California 94102

RE: R.06-02-013

Dear Docket Clerk:

Enclosed for filing with the Commission are the original and five copies of the **PROPOSAL OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E), PACIFIC GAS AND ELECTRIC COMPANY (U 39-E), NRG ENERGY, INC., AES CORPORATION, AND THE UTILITY REFORM NETWORK ON ADDITIONAL POLICIES NECESSARY TO SUPPORT NEW GENERATION AND LONG-TERM CONTRACTING** in the above-referenced proceeding.

We request that a copy of this document be file-stamped and returned for our records. A self-addressed, stamped envelope is enclosed for your convenience.

Your courtesy in this matter is appreciated.

Very truly yours,

Laura I. Genao

LIG:ggd:LAW#1272195  
Enclosures

cc: All Parties of Record  
(U 338-E)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE  
STATE OF CALIFORNIA**

Order Instituting Rulemaking to Integrate            )  
Procurement Policies and Consider Long-Term        )  
Procurement Plans.    )

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R.06-02-013

**PROPOSAL OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E), PACIFIC  
GAS AND ELECTRIC COMPANY (U 39-E), NRG ENERGY, INC., AES  
CORPORATION, AND THE UTILITY REFORM NETWORK ON ADDITIONAL  
POLICIES NECESSARY TO SUPPORT NEW GENERATION AND LONG-TERM  
CONTRACTING**

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Dated: **March 7, 2006**

**Proposal Of Southern California Edison Company (U 338-E),  
Pacific Gas And Electric Company (U 39-E), NRG Energy, Inc.,  
And The Utility Reform Network On Additional Policies Necessary  
To Support New Generation And Long-Term Contracting**

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CORPORATION, AND THE UTILITY REFORM NETWORK ON ADDITIONAL  
POLICIES NECESSARY TO SUPPORT NEW GENERATION AND LONG-TERM  
CONTRACTING**

Pursuant to the *Order Instituting Rulemaking to Integrate Procurement Policies and Consider Long-Term Procurement Plans*, issued on February 16, 2006, Southern California Edison Company (“SCE”), Pacific Gas and Electric Company (“PG&E”), NRG Energy, Inc. (“NRG”), AES Corporation (“AES”) and The Utility Reform Network (“TURN”) (collectively “Joint Parties”)<sup>1</sup> submit this proposal regarding benefit and cost allocation policies needed to support new generation investments and long-term contracting for generation in California. Under the transitional proposal outlined here, the benefits and costs associated with development of new generation resources would be allocated to those customers on whose behalf the procurement efforts are undertaken.<sup>2</sup> This benefit and cost allocation mechanism is proposed solely as a limited and transitional mechanism that would be replaced by a California Public

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<sup>1</sup> PG&E, NRG, AES, and TURN have authorized SCE to submit this Joint Party filing on their behalf.  
<sup>2</sup> In this proposal, the term “Benefiting Customers” means all bundled-service customers, Direct Access (“DA”) customers, Community Choice Aggregation (“CCA”) customers, and others who are located or locate within the distribution service territory of an Investor Owned Utility (“IOU”) but take service from a local publicly owned utility (as defined in Public Utilities Code Section 9604(d)) subsequent to the commitment date for new generation. Pursuant to D.04-12-048, the Joint Parties also propose to recover the net costs of the new generation from Customer Generation Departing Load (“CGDL”) and Municipal Departing Load (“MDL”) customers. D.04-12-048 at 55.

Utilities Commission (“CPUC” or “Commission”)-adopted market structure that will support new generation investment.<sup>3</sup>

## I.

### INTRODUCTION

California’s need for new generation is well-recognized. In the 2004 Long-Term Procurement Plan proceeding, the CPUC determined that there would be a need for new generation and capacity in both Northern and Southern California and specifically authorized PG&E to contract for new capacity that could come on-line starting in 2008.<sup>4</sup> More recently, both the CPUC and the California Energy Commission (“CEC”) have recognized the need for new generation in California to replace existing generation that will be retired and to satisfy increasing demand.<sup>5</sup> In its *Committee Final Transmittal of 2005 Energy Report*, the CEC also noted the need for long-term contracts to encourage the development of new generation in California.<sup>6</sup>

The Legislature and the CPUC have recently expressed increasing concern about the development of new generation and resource adequacy. In September 2005, the Legislature passed and the Governor approved a new statute mandating that the CPUC establish and enforce resource adequacy requirements that require all load-serving entities (“LSEs”) to maintain sufficient generation resources while also facilitating the development of new generation facilities.<sup>7</sup> The CPUC promptly followed the introduction of this legislation with a decision setting forth detailed provisions governing the obligation of certain LSEs to procure sufficient

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<sup>3</sup> Under the Joint Parties’ proposal, the benefits and costs of any commitments made during the transition period would continue to be allocated using the transitional mechanism for the entire term of the commitment.

<sup>4</sup> D.04-12-048, Findings of Fact 14, 19-20.

<sup>5</sup> See e.g., *Energy Action Plan II*, October 2005, at 10 (“Even with the emphasis on energy efficiency, demand response, renewable resources, and distributed generation, investments in conventional power plants will be needed”); 2005 *Integrated Energy Policy Report*, November 2005, at 44-48, 59-62.

<sup>6</sup> *Committee Final Transmittal of 2005 Energy Report*, November, 2005, at 13-16.

<sup>7</sup> See Assembly Bill (“AB”) 380, codified at Cal. Pub. Util. Code §380.

resources to serve their peak load requirements, and have an additional 15-17% of their peak load purchases as a planning reserve margin.<sup>8</sup>

These efforts highlight the current focus of California's policy and lawmakers on CPUC policies which will promote investment in those resources needed to reliably serve California's growing demand for electricity.<sup>9</sup> However, as the CPUC is aware, under current market conditions, a documented need for new generation is not enough to ensure development of new resources. Instead, what is currently required to get new generation financed and built is a long-term commitment by an LSE for the capacity from the new generation unit. For IOUs, though, commitments sufficient to meet the anticipated need cannot be made solely on behalf of the IOUs' bundled-service customers, as doing so would unfairly ask those customers to pay a premium for new generation that other non-IOU customers would freely benefit from in the form of adequate system reliability.

While the Joint Parties recognize that the CPUC is working on developing a regulatory framework that will eventually facilitate the development of a long-term solution, which will retain existing generation and bring new generation on-line without the need for long-term contracts and specific cost-allocation mechanisms, no such structure is currently in place. Accordingly, the Joint Parties propose the benefit and cost allocation methodology described in this filing as an interim measure.

Under this proposal, the CPUC would promptly adopt policies which would allocate the benefits and costs of new generation to all Benefiting Customers within an IOU's distribution service territory. This allocation mechanism will allow for needed generation resources to be

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<sup>8</sup> D. 05-10-042 at 2 (defining resource adequacy requirements for all IOUs, electric service providers ("ESPs") and CCA providers).

<sup>9</sup> *Id.* at 2 ("The Commission takes this action to promote investment in the resources needed to reliably serve California's growing demand for electricity"); AB 380, Legislative Counsel's Digest ("The bill would require each load-serving entity to maintain physical generating capacity adequate to meet its load requirements, including, but not limited to, peak demand and planning and operating reserves, deliverable to locations and at times as may be necessary to provide reliable electric services").

developed in the near term, while the CPUC and stakeholders determine a longer-term solution.<sup>10</sup> The Joint Parties urge the CPUC to promptly take up discussion of longer-term solutions in related proceedings, as the transition mechanism proposed by the Joint Parties should only have a limited life span.<sup>11</sup> Additionally, the Joint Parties urge the CPUC to work with parties to develop a determination of the need for new generation resources in each IOU's distribution service territory.<sup>12</sup>

The remainder of this filing provides the legal and policy basis for the Joint Parties' proposal. Specifically, the Joint Parties explain why the CPUC needs to designate one or more entities to procure new generation on behalf of all Benefiting Customers within an IOU's distribution service territory; describe their proposal for benefit and cost allocation for new generation; and set forth the legal basis for this proposal.

## II.

### **THE CPUC SHOULD DESIGNATE ONE OR MORE ENTITIES TO PROCURE NEW GENERATION ON BEHALF OF ALL BENEFITING CUSTOMERS IN AN IOU'S DISTRIBUTION SERVICE TERRITORY**

Under the proposal set out in Section III, below, one or more entities would be tasked with procuring new generation on behalf of all Benefiting Customers within an IOU's distribution service territory.<sup>13</sup> Designation of a few entities to accomplish this task is necessary because of the CPUC-acknowledged need for new generation financing to be based on long-term

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<sup>10</sup> A longer-term mechanism for investment in new generation with equitable cost distribution could be, for example, a centralized capacity market with a several year-ahead posting of administratively determined demand curves. However, as this mechanism will require time to develop and implement, and the development of new resources must begin now in order to meet the forecasted need, a transitional mechanism such as that presented here by the Joint Parties must be adopted.

<sup>11</sup> Extending the transition indefinitely will have an unacceptable balance sheet impact on the IOUs and will exacerbate ESP concerns about IOU procurement of new generation resources on their behalf.

<sup>12</sup> Concurrent with the filing of this Joint Proposal, SCE and PG&E will be filing need forecasts for their respective service areas demonstrating the need for new generation.

<sup>13</sup> PG&E believes that only the IOUs should be tasked with procuring new generation for their respective service territories, rather than "one or more entities." PG&E addresses this modification to the Joint Parties' proposal in its concurrent filing.

contracts with creditworthy LSEs. However, not all LSEs are capable of entering into such agreements. The CPUC explicitly recognized this problem in Decision No. (“D.”) 04-12-048:

There is also the concern that the utilities may need to enter into new contracts (and/or construct) new capacity to ensure that California has sufficient resources toward the latter years of this decade. In order for these resources to be on-line when needed, it may be necessary to begin construction of those projects in the very near term. Almost all parties, including WPTF, agree that new construction would require a minimum ten-year contractual commitment.<sup>14</sup>

While the IOUs are likely among the few entities willing to enter into long-term contracts, which will serve to entice development of new generation, the IOUs may be unwilling to enter into commitments for new generation if bundled-service customers alone are required to pay the full costs of such resources. The CPUC has two options for meeting AB 380’s mandates to ensure the development of sufficient new generation with “the cost of generating capacity ... allocated equitably”<sup>15</sup>: (1) impose requirements on all LSEs to procure an equal proportion of their customer needs through long-term contracts with new generation; or, alternately, (2) adopt the Joint Parties’ proposal to have all LSEs share equitably the benefits and costs of new generation resources procured centrally by a designated entity on behalf of the system. The first option does not appear to be feasible, given that competitive retail ESPs have repeatedly stated that long-term contracts are incompatible with their current business models, since long-term contracts would extend well beyond their current customer commitments. The second option, embodied in the Joint Parties’ proposal, is the only feasible alternative under current conditions to simultaneously implement AB 380 while supporting retail competition and load migration among retail providers.<sup>16</sup>

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<sup>14</sup> D.04-12-048 at 58 (footnote omitted).

<sup>15</sup> Cal. Pub. Util. Code §380(h)(4).

<sup>16</sup> While the Joint Parties recognize the CPUC’s efforts to address the effect of departing customers with the imposition of exit fees, the CPUC cannot rely on such fees alone to meet AB 380’s mandate that “the cost of generating capacity is allocated equitably.” *See* Cal. Pub. Util. Code §380(h)(4).



Under the Joint Parties' proposal, there is no uncertainty about who pays for new generation as the costs and the associated benefits travel with the migrating or new customer. This means that regardless of which provider a customer subsequently chooses for service, the costs to them of the new generation will be recovered through a CPUC-approved methodology. There is no need for protracted proceedings regarding exit fees or other costs, as the mechanism for allocation of new generation-related benefits and costs will already have been approved by the CPUC.

### **III.**

#### **RECOVERY AND ALLOCATION OF BENEFITS AND COSTS**

Under the Joint Parties' proposed mechanism, the customers of all CPUC-jurisdictional LSEs would be assigned a standard allocation of the net costs for new generation and all such LSEs would be entitled to receive a share of the contracted capacity for resource adequacy demonstration purposes. While the Joint Parties recognize that this methodology allocates a portion of costs for new generation, without regard to an LSE's portfolio position, attempting to define what it means to be deficient and then measuring such "deficiency" over a multi-year period in the longer term is a task so difficult that it threatens to bog down a process designed to provide for the expeditious development of necessary resources.<sup>17</sup> Accordingly, the Joint Parties have developed the methodology set out below. This methodology treats long-term commitments for the development of new generation as infrastructure (analogous to wires) and then spreads the benefits and costs to all Benefiting Customers according to a simple and reasonable cost causation principle (share of coincident peak, adjusted on a monthly basis to facilitate load migration).

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<sup>17</sup> One difficulty in determining deficiency is that there is currently no requirement for any party to show their procurement of resources beyond the one-year timeframe. Since these new generation resources will likely take, at a minimum, three years to come on-line and will then be operative for 10-years or longer if acquired under power purchase agreements ("PPAs"), there is currently no mechanism in place that will facilitate the determination of who is deficient.

## **A. Calculation Of Net-Costs**

The successful contracts or units from any IOU solicitations which result from the approval of this benefit and cost allocation proposal will be managed by the IOU and committed and dispatched against relevant market prices in merit order according to least-cost dispatch principles and CPUC and CAISO requirements. Under least-cost dispatch principles, a unit or contract will only be scheduled to be dispatched if the forecasted market value of energy exceeds the unit's variable costs (including start-up costs if applicable). When not scheduled or out, bids for energy or ancillary services would be submitted to the CAISO. The amount by which the market value of energy exceeds the variable costs will, in effect, contribute toward reducing the unit's fixed costs or capacity payments.

Under the Joint Parties' proposal the net costs (*i.e.*, fixed costs reduced by net energy value) of the new generation will be allocated to all Benefiting Customers located within an IOU's distribution service territory. These net costs can be calculated as the sum of the fixed and variable costs less the market value of energy and the market value of ancillary services provided by the unit. The components of the net costs include, but are not limited to:

- Fixed Costs;
- Variable Costs;
- Market Value of Energy; and
- Market Value of Ancillary Services.

These components are discussed individually below.

### **1. Fixed Costs**

For PPAs, fixed costs include Unit Capacity Payments, Fixed Operations and Maintenance Costs, Debt Equivalence, any applicable natural gas transportation charges that are fixed, such as demand charges, and any other costs that do not vary with plant output. For utility-owned generation, fixed costs would be defined as the associated revenue requirement which consists of elements such as, but not limited to, capital costs, capital additions and non-fuel O&M.

Unit Capacity Payments are the monthly availability payment (\$/kW-month) applicable in the contract, net of credits to the buyer for non-availability of the generating unit in accordance with the terms in the applicable contract. Capital related fixed costs include costs such as depreciation, return on investment, interest expenses, taxes, and insurance.

Fixed Operations and Maintenance Costs are the operation and maintenance costs that do not vary with plant production. These include minimum staffing levels, routine maintenance, security, etc. Often these costs are embedded in the Unit Capacity Payments, but, to the extent they are not, they will be accounted for separately.

The Debt Equivalence cost of new contracts can be represented by changes in capital structure an IOU would have to undertake to maintain the same level of corporate creditworthiness it would have had if it had not signed these contracts. Since an IOU may have to adjust its capital structure to maintain balance sheet stability, any debt equivalence costs associated with a contract, calculated in accordance with D.04-12-048, will be added to the contract's costs.

## **2. Variable Costs**

Variable Costs include, but are not limited to, Unit Fuel Costs, Unit Start-up Cost, Unit Shut-down Cost, and CAISO Costs.<sup>18</sup>

Unit Fuel Costs are calculated for each hour as the delivered gas price (\$/mmbtu) on the relevant gas supply system<sup>19</sup> on the date the unit is operated, multiplied by the generating unit's load point heat rate (mmbtu/MWh), multiplied by the load output (MW). The total Unit Fuel Cost is the sum of the hourly Unit Fuel Costs. The following formula depicts the calculation:

$$\text{Unit Fuel Cost} = (\mathbf{G} * \mathbf{HR} * \mathbf{MWh})$$

Where, **HR** = Average Contract Heat Rate at the generating unit's load point, **MWh** = Scheduled energy (MW) for the hour, and **G** = Gas Index Price.

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<sup>18</sup> Additional possible variable costs include the costs of any emissions credits necessary to produce electricity.

<sup>19</sup> For SCE, this would be the Southern California Gas Company ("SoCalGas") system; for PG&E, this would be the PG&E Citygate.

The Gas Index Price should be a regularly published and widely distributed third-party index price for the applicable flow date. An example of such an index is the one published by Platt's Gas Daily (in the internet publication currently accessed through [www.platts.com](http://www.platts.com)) in the table entitled "Daily Price Survey" under the heading for the relevant geographic heading.<sup>20</sup> Transportation charges from the relevant pricing point to the unit would be the transportation charges from the relevant area to the unit,<sup>21</sup> pursuant to the relevant tariff in effect during the applicable flow date. For SCE, the transportation charges shall include Transportation-Electric Generation Rate ("GT-F5" or "GT-I5"), State Regulatory Fee ("G-SFR"), Interstate Transportation Cost Surcharge ("ITCS") and, if applicable, the Municipal Surcharge ("G-MSUR"). For PG&E, the transportation charges from PG&E's Citygate include Gas Transportation to Electric Generation ("G-EG") charges and Gas Franchise Surcharge ("G-SUR").

Unit Start-up Cost is generally the quantity of fuel (mmbtu) required to start-up a generating unit multiplied by the delivered gas price (\$/mmbtu) on the relevant gas system on the date the unit is started. Alternatively, start-up costs may be a fixed cost per startup. Total Start-Up Costs ("SUC") will be calculated for each successful start-up of a unit required by reason of the IOU's dispatch. Total SUC will be based on a fixed quantity of natural gas ("Start-Up Fuel") and fixed costs per start ("Fixed Start-Up Costs").

Unit Shut-down Cost is the quantity of fuel (mmbtu) required to shut-down a generating unit multiplied by the delivered gas price (\$/mmbtu) on the relevant gas supply system on the date the unit is started.

Finally, CAISO Costs are the charges and penalties assessed by the CAISO associated with operation of each unit and transmission to the delivery point for energy, including applicable charges associated with generation meter multipliers, uninstructed deviation penalty, and generation deviation.

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<sup>20</sup> For example, the relevant heading would be "Midpoint."

<sup>21</sup> For example, for SCE, the relevant area would be from the Southern California border on the SoCalGas system.

### **3. Market Value Of Energy**

The market value of the energy produced by the unit, to be netted against the costs, will include, but not be limited to, the hourly nodal energy prices from the CAISO day-ahead market at the plant's location.<sup>22</sup>

### **4. Market Value Of Ancillary Services**

The Market Price of Ancillary Services ("AS") is calculated for each hour using the CAISO's market clearing price for AS that the unit was scheduled to provide.

## **B. Cost Recovery And Allocation**

This proposal contemplates the IOUs forecasting the net costs of new generation for the year. The IOUs would each establish a balancing account that records, on a monthly basis, the difference between revenues collected from its customers based on the annual forecast and the actual net costs of new generation procured by the IOU.<sup>23</sup> Any under- or over-collection in the balancing account would be reflected in the following year's forecast of net costs to be allocated and recovered from that IOU's customers.

Under this proposal, the IOUs will use the 12 monthly coincident peak ("12-CP") method to allocate among rate groups the net costs of any long-term contracts signed after approval of this cost allocation proposal. After costs have been allocated to each rate group, the allocated costs would be recovered through a non-bypassable per kWh wires charge from all retail customers in the rate groups. This would work in a manner similar to how the Public Purpose Program Charge currently recovers funds. This charge could appear as a separate charge, or,

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<sup>22</sup> In the unlikely event that a resource to which such allocation is applicable actually begins operation prior to the date that a CAISO day-ahead market is available from the CAISO's Market Redesign Technology Update ("MRTU"), currently scheduled for November 2007, an alternative Hourly Market Price of Energy would be calculated for each hour, based on the price of energy in the relevant market (*i.e.*, SP-15 for SCE and NP-15 for PG&E), multiplied by the scheduled energy for the hour. The price of energy in SP-15, for example, may be determined by using the on-peak and off-peak price of energy in SP-15, based on regularly published and widely distributed third-party energy prices.

<sup>23</sup> For PG&E this balancing account would consist of two subaccounts: a subaccount to record net costs associated of utility-owned new generation resources and a subaccount to record net costs of PPA new generation.

preferably, be combined with an existing charge, applicable to all retail customers in the IOU's tariffs.

**C. Net-Cost Changes Upon Implementation Of A Capacity Market**

The policies set forth in this Joint Proposal are not meant to be an impediment to the implementation of a future capacity market. If, in the future, such a market is adopted and implemented in California, the Joint Parties propose that the generation resources developed under these transitional benefit and cost allocation policies be submitted into such a market in a manner which ensures that the benefits and costs of that resource are allocated equitably among all Benefiting Customers.

**D. Benefits**

The generating units procured through competitive solicitations to which the instant cost allocation would be applicable will be offered to the CAISO as an interim approach to replace units previously dispatched under Must-Offer Waiver Denial ("MOWD") rules<sup>24</sup> or reliability must-run ("RMR") contracts,<sup>25</sup> in accordance with the currently established Resource Adequacy Requirement ("RAR"). The units will be required to operate, as directed by the CAISO, to maintain grid reliability if these units are not already scheduled to provide energy.

In addition to the benefits of increased generation in certain areas, this proposal would allocate the RAR credits that are associated with any newly signed long-term contracts to the LSEs whose customers are allocated costs. This will be done through the CPUC's month-ahead and year-ahead resource adequacy showings. Under this proposal, an LSE's portion of benefits will be allocated by looking at that LSE's customers' contribution to the IOU's monthly system peak. Additionally, any credit toward Local Area RAR provided by the units procured through those new generation solicitations will be allocated to LSEs in a manner that closely mirrors the

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<sup>24</sup> This would occur in the event that the Federal Energy Regulatory Commission decided to remove the current Must-Offer Obligation.

<sup>25</sup> This would occur if the CAISO does not sign RMR contracts on a schedule that coincides with the timing for the execution and approval of new PPAs.

allocation of any net costs assigned to an LSE's customers, in proportion to the net costs that any LSE's customers bear.

#### IV.

### **THE CPUC IS AUTHORIZED TO APPROVE THE ALLOCATION OF BENEFITS AND COSTS TO ALL BENEFITING CUSTOMERS IN AN IOU'S DISTRIBUTION SERVICE TERRITORY**

#### **A. California Law Authorizes The CPUC To Allow Cost Recovery From DA And CCA Customers In An IOU's Distribution Service Territory In Support Of New Generation Resources**

AB 380, which was recently enacted by the Legislature, allows an IOU to recover the costs it incurs to sustain "system reliability and local area reliability" from all customers "on whose behalf the costs are incurred."<sup>26</sup> Specifically, AB 380 provides:

An electrical corporation's costs of meeting resource adequacy requirements, including, but not limited to, the costs associated with system reliability and local area reliability, that are determined to be reasonable by the commission, or are otherwise recoverable under a procurement plan approved by the commission pursuant to Section 454.5, shall be fully recoverable from those customers on whose behalf the costs are incurred, as determined by the commission, at the time the commitment to incur the cost is made or thereafter on a fully non-bypassable basis, as determined by the commission.<sup>27</sup>

The Legislature's intent to authorize cost recovery from a group larger than just an IOU's bundled-service customers is clear. AB 380 does not limit cost recovery to "bundled-service customers," which it could have done. Moreover, AB 380 mandates that the CPUC ensure that "the cost of generating capacity is allocated equitably."<sup>28</sup>

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<sup>26</sup> Cal. Pub. Util. Code §380(g).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*, §380(h)(4).

The Joint Parties' proposal seeks to recover from all Benefiting Customers the incremental net costs of new generation, to be calculated by subtracting the market value of energy and ancillary services provided from the actual fixed and variable costs (*i.e.*, capacity payments, operation and maintenance, and fuel costs). While the Joint Parties understand that this proposal asks the CPUC to require all Benefiting Customers to bear the burden of additional capacity regardless of their respective LSE's current resource commitments, the purpose of this allocation proposal is to ensure that all customers who benefit from new generation resources bear the appropriate cost burden. Simply put, all parties on whose behalf the resources are procured and who benefit from them should pay. Moreover, since this proposal will not take effect until the new generation becomes operational, all LSEs would have sufficient time to plan for the orderly inclusion of their allocated share of the resulting capacity into their procurement portfolios. To force an IOU's bundled-service customers alone to bear new generation costs would not comply with AB 380's legislative mandate of ensuring equitable cost allocation for generating capacity needed for system reliability.

**B. CPUC Policy And California Law Generally Allow Cost Recovery From Benefiting Customers In An IOU's Distribution Service Territory**

The California Public Utilities Code vests the Commission with extensive authority to establish rates and charges for utility customers.<sup>29</sup> Charges or rates imposed by the CPUC must be "just and reasonable" and cannot be unfair or discriminatory. The CPUC has previously used its wide-ranging authority under applicable statutes to impose cost recovery surcharges upon Benefiting Customers when costs are incurred by the IOU for the benefit of all customers, not just for its bundled-service customers.<sup>30</sup> The CPUC also used its authority to authorize cost

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<sup>29</sup> See D.02-11-022 at 11-12 (*Citing California Public Utilities Code §701, which states that the CPUC has broad powers to "supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction"*).

<sup>30</sup> See *e.g.*, D.02-11-022 (addressing charges for direct access customers); R. 03-09-007 (addressing charges for CCA); D. 03-04-030 (addressing charges for distributed generation departing load); D.03-07-028 (addressing charges for municipal departing load); D. 05-12-041 (addressing charges for CCA).



responsibility charges for non-bundled-service customers in the electric industry restructuring Preferred Policy Decision.<sup>31</sup> In that decision, the CPUC found that transition costs—consisting of the above-market costs of the utilities’ generation assets and long-term power purchase contracts incurred for the benefit of all customers—should be recovered from all of the utilities’ customers (*e.g.*, bundled, DA, and departing load) since those costs would go unrecovered or be borne by a smaller group of customers when other customers depart.<sup>32</sup> A similar rationale supports the Joint Parties’ proposal. Since an IOU will incur costs for new generation resources on behalf of all Benefiting Customers, an allocation of net costs to bundled-service customers alone will result in these customers disproportionately bearing the costs of new generation.

In D.02-11-022, the CPUC again found that it had authority to impose cost recovery charges upon DA customers for electricity costs incurred by the California Department of Water Resources (“DWR”) for the benefit of all customers in the IOU service areas. Noting its broad authority under Section 701, and the fairness requirements of Sections 451 and 453, the CPUC found that “bundled customers may not be arbitrarily charged for obligations which rightfully are the responsibility of DA customers.”<sup>33</sup> Accordingly, the CPUC imposed a surcharge on DA customers for the recovery of historic and ongoing costs related to the DWR contracts since those purchases were deemed to have been made for the benefit of the DA customers, as well as bundled-service customers.<sup>34</sup>

More recently, the CPUC confirmed its ability to hold non-bundled service customers responsible for the costs of necessary resources. In D.04-12-048, the CPUC stated:

[I]t appears that the utilities may need to make longer term commitments for capacity and energy that may become stranded at some point during the life of those projects . . . . Therefore, the utilities should be allowed to recover the net cost of these commitments from all customers, including departing customers.<sup>35</sup>

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<sup>31</sup> D.95-12-063, subsequently modified by D.96-01-009.

<sup>32</sup> D.95-12-063 at 110.

<sup>33</sup> D.02-11-022 at 11-12.

<sup>34</sup> *Id.* at 12.

<sup>35</sup> D.04-12-048 at 58-60.

D.04-12-048 also noted that, to the extent an IOU's costs relate to enhancing reliability, such costs should be recoverable from all customers in the IOU's service area who benefit from the reliability, not just from those taking bundled-service. The CPUC stated, "[c]ost recovery for that portion of a resource acquired by the utilities to meet local reliability needs should be recovered from all customers."<sup>36</sup>

The resources to be secured through any competitive solicitations (*e.g.*, a request for offers ("RFO")) following approval of the proposed cost allocation methodology will provide substantial reliability and resource benefits to all customers within the IOU's distribution service territory. Accordingly, and in line with the CPUC's decisions implementing broad authority under Sections 701 and AB 380, the CPUC has the ability to approve surcharges to all Benefiting Customers within that IOU's distribution service territory for the costs incurred to benefit these customers.

## V.

### **CONCLUSION**

For all of the foregoing reasons, the Joint Parties respectfully urge the CPUC to promptly address the benefit and cost allocation proposal set forth herein. As the legal and policy grounds for the allocation is clear, the Joint Parties do not believe there is any need for hearings and urge the CPUC to promptly issue a policy decision approving the principle that, in order to get new generation developed in California, all Benefiting Customers should be allocated the costs and benefits of those new resources.

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<sup>36</sup> *Id.* at 63.

Respectfully submitted,

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March 7, 2006

## CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true copy of PROPOSAL OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E), PACIFIC GAS AND ELECTRIC COMPANY (U 39-E), NRG ENERGY, INC., AES CORPORATION, AND THE UTILITY REFORM NETWORK ON ADDITIONAL POLICIES NECESSARY TO SUPPORT NEW GENERATION AND LONG-TERM CONTRACTING on all parties identified on the attached service list(s). Service was effected by one or more means indicated below:

- Transmitting the copies via e-mail to all parties who have provided an e-mail address. First class mail will be used if electronic service cannot be effectuated.
- Placing the copies in sealed envelopes and causing such envelopes to be delivered by hand or by overnight courier to the offices of the Commission or other addressee(s).
- Placing copies in properly addressed sealed envelopes and depositing such copies in the United States mail with first-class postage prepaid to all parties.
- Directing Prographics to place the copies in properly addressed sealed envelopes and to deposit such envelopes in the United States mail with first-class postage prepaid to all parties.

Executed this **7th day of March, 2006**, at Rosemead, California.

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Robin Taylor  
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