

PUBLIC UTILITIES COMMISSION STATE OF CALIFORNIA

ENERGY DIVISION★

RESOLUTION E-3620
JULY 22, 1999

RESOLUTION

Resolution E-3620. San Diego Gas & Electric Company (SDG&E) proposes tariff revisions to its Power Exchange Energy Cost (PX) Rate Schedule. The requested changes would permit SDG&E to recover the costs of power purchased through a new Block-Forward Market offered by the California Power Exchange. Approved with modifications.

BY SDG&E ADVICE LETTER 1167-E, FILED ON MAY 20, 1999.

SUMMARY

1. This Resolution approves, with modifications, Advice Letter 1167-E from San Diego Gas & Electric Company (SDG&E). SDG&E proposes to revise its Power Exchange Energy Cost (PX) tariff to include the cost of power supplies from the California Power Exchange's new Block-Forward Market. The Advice Letter requests that the costs of supplies from the Block-Forward Market be considered *prima facie* prudent, and therefore recoverable without further reasonableness review.
2. The Alliance for Retail Markets (ARM) and the Western Power Trading Forum (WPTF) protested the Advice Letter. The protests are denied.
3. The Advice Letter is approved with the following modifications: The amount of SDG&E's monthly purchases from the Block-Forward Market shall be limited. PX cost recovery is limited to the current block-forward product. Delivery must be arranged via the day-ahead market. SDG&E's cost recovery of administrative fees shall be net of any rebates. Cost recovery is subject to the outcome of the Post-Transition Ratemaking proceeding. SDG&E shall be required to file monthly reports on its trading in the Block-Forward Market. And the term of approval shall be limited, terminating in October, 2000.

BACKGROUND

On March 23, 1999, the California Power Exchange Corporation (Power Exchange) applied to the Federal Energy Regulatory Commission (FERC) for permission to operate a Block-Forward Market. Under the Power Exchange application, the Block-Forward Market would be operated by a separate division, to be known as Cal PX Trading Services (CTS).

The new Block-Forward Market will offer buyers a "bundle" consisting of services covering the hours from 6:00 a.m. to 10 p.m., Monday through Saturday (holidays excluded), for an entire month. For the month of August 1999, for example, the Block-Forward Market service would cover 416 hours. Capacity will be traded in lots of either one megawatt or 25 MW. The market will continuously match asking and bidding prices. Trading will close two days before the delivery month begins. Deliveries will be arranged through the existing day-ahead market, and settlement will be made based on the differences between the block-forward price and the corresponding day-ahead price.

In its application to the FERC, the Power Exchange said that the Block-Forward Market should improve price stability and supply security in the California power market by offering buyers an additional supply option to complement the existing day-ahead and hour-ahead markets. The Power Exchange said that the ability of customers to purchase energy on a block-forward basis should mitigate the effects of price spikes. The Power Exchange said that block-forward trading is already practiced by members of the Western Systems Power Pool (WSPP).

As an intervenor in the FERC proceeding, the Commission recommended that the FERC approve the Power Exchange's application.

On May 26, 1999 the FERC approved the Block-Forward Market application (FERC Docket No. ER99-2229-000, 87 FERC ¶61,203), subject to certain modifications. The FERC imposed a number of reporting requirements, approved some modifications to CTS's trading rules, and removed a requirement that block-forward market participants arrange for deliveries through the day-ahead market. FERC's approval is to be effective on the day that CTS begins operations.

The SDG&E Advice Letter requests that net gains or losses on trades in the new Block-Forward Market be recouped via SDG&E's PX rate schedule, by being rolled in with other power supply costs.

The Advice Letter requests that the costs of Block-Forward Market trades be considered *prima facie* prudent, and therefore recoverable without further reasonableness review. SDG&E says that this is in keeping with the treatment of other supplies from the Power Exchange or the Independent System Operator, and is consistent with the Commission's Preferred Policy Decision (D.95-12-063).

NOTICE

1. Public notice of the Advice Letter was made by publication in the Commission Calendar, and by SDG&E mailing copies of the filing to interested parties.

PROTESTS

The Alliance for Retail Markets (ARM) and the Western Power Trading Forum (WPTF) filed protests of the SDG&E Advice Letter.

ARM claims that allowing SDG&E to operate in the new Block-Forward Market places SDG&E in competition with Energy Service Providers (ESPs) in the power procurement market, and further alleges that SDG&E will then use market power to the detriment of ESPs. ARM claims that use of the Block-Forward Market by ESPs would enhance competition, but that in the hands of Utility Distribution Companies (UDCs) such as SDG&E, the Block-Forward Market becomes a tool for the exercise of market power. Moreover, ARM asserts that allowing UDCs to participate in the Block-Forward Market will undermine the buy-sell requirement, because SDG&E's portfolios will then consist of a mix of short-term and long-term purchases, instead of the single short-run incremental cost from the spot power market. ARM also claims that this more diversified supply mix will make it more difficult for customers to make price comparisons. ARM says SDG&E's request to participate in the Block-Forward Market should have been put before the Commission as an application, not an advice letter. ARM would prefer that the issue of the Block-Forward Market be consolidated with other market structure issues in a new post-transition proceeding. ARM asks that, if the Commission does authorize UDC participation in the Block-Forward Market, that the Commission conduct reasonableness reviews.

WPTF also raises the issue of market power and asks that consideration of the Advice Letter be suspended until the completion of a Commission proceeding on post-transition market structure. According to WPTF, "SDG&E appears to be seeking to compete with ESPs and to implement a program of customer retention. This was explicitly prohibited by the Commission in the Second Interim Decision..."

In answer to the Protests, SDG&E says that the Commission should approve Advice Letter 1167-E without waiting for the conclusion of a post-transition proceeding, or requiring a more extensive application from SDG&E, because the Advice Letter simply amends SDG&E's PX rate; SDG&E will continue to purchase all of its requirements from the Power Exchange. In answer to the Protestant's allegations regarding market power, SDG&E cites its sale of its fossil fuel plants and its purchase of "substantially all" of its purchased power commitments as must-take; under these circumstances, SDG&E says it is "in no position" to exercise market power.

The Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN) support the Advice Letter. ORA and TURN filed letters supporting the Block-Forward Market Advice Letters of Southern California Edison Company (SCE) and Pacific Gas and Electric Company (PG&E), which are similar in effect to the SDG&E Advice Letter. ORA and TURN also referenced the instant Advice Letter, in a letter filed June 7, 1999. In that letter, ORA and TURN requested the Commission to approve all three Advice Letters on an emergency basis. ORA and TURN say that, "The Cal PX

Block Forwards Market would provide the means for the utilities to meet at least a portion of their peak demand periods with forward purchases from a transparent and non-discriminatory public marketplace similar to the other Cal PX markets. Such purchases would provide significant protection against extremely high day-ahead and real-time prices.”

The Automated Power Exchange (APX) submitted a letter to the Director of the Energy Division, in which APX expresses opposition to the instant Advice Letter, as well as the Block-Forward Market advice letters of SCE and PG&E. APX contends that accepting these advice letters changes the Commission’s Policy Decision on electric restructuring, because, “As a result of offering the BFM, the PX will not provide a product with a single market clearing price as required by D.95-12-063.” APX characterizes the BFM as a bilateral market.

DISCUSSION

The issues before us are whether to permit SDG&E to participate in the Block-Forward Market, and then, if permitted, what treatment to accord the costs that SDG&E incurs in that market. We note that the FERC has already ruled on the structure of the Block-Forward Market, but our decisions on cost treatment may determine whether SDG&E will actually elect to take part in the market.

The Commission supported FERC approval of Block-Forward Market trading, and we continue to believe that the existence of a block-forward market will enhance the supply choices and overall competitiveness of the California electricity industry. Therefore, we will approve the inclusion of Block-Forward Market supply costs and administrative fees in the PX rate of SDG&E, and such trades shall be deemed prudent to the same extent as the cost of other power supplies purchased from the Power Exchange or the ISO. This is based on the assumption that the Block-Forward Market will be used by SDG&E for hedging, rather than speculation. To ensure this result, we will limit the utility’s block-forward capacity to one-third of its historical (prior-year) hourly minimum load by month.

The new Block-Forward Market will offer an additional option to the buyers and sellers of generation and will be subject to the same rules as the existing day-ahead and hour-ahead markets. Therefore, we cannot agree with ARM or WPTF that the use of block-forward trading represents an attempt by UDCs to compete against the ESPs in the supply market, or that the Block-Forward Market represents an enhancement of buyers’ market power.

We do not concur with APX that the creation of the block-forward market represents a departure from the principles of our Policy Decision on restructuring. While the block-forward market is distinct from the day-ahead market, the same is true of the hour-ahead market and the ancillary services markets. And the block-forward market will

be subject to the same rules as the day-ahead market. Because all sales must be into and out of the market, they are not bilateral sales, as asserted by APX.

Nor do we agree with ARM's contention that this matter should have been brought before us as an Application rather than as an Advice Letter. The issue we are addressing is whether SDG&E should participate in the Block-Forward Market, and recover the Block-Forward costs via its PX rate. The FERC has already ruled on the structure of the Block-Forward Market. There are no legal or factual questions to be resolved and the use of the advice letter process by SDG&E was appropriate in this instance.

While we believe approval of this Advice Letter is in the best interest of SDG&E ratepayers, we will direct SDG&E to make certain modifications to the tariff language. SDG&E's proposed tariff language provides for cost recovery of supply costs from the Block-Forward Market "or any other forward market administered by the PX." However, the Commission will not grant approval in advance for automatic cost recovery of other forward-market products that the Power Exchange may offer in the future. Therefore, we will require SDG&E to delete such tariff language. Should the Power Exchange introduce additional forward market products, SDG&E may at that time request Commission authorization for cost recovery.

We will also require that SDG&E pass along any credits it receives against its administrative fees. Participants in the Block-Forward Market are offered a choice of two CTS fee schedules, "basic" or "participating." The participating fee schedule, the more advantageous schedule for larger market participants, provides for credits to customers of half the amount by which administrative fees exceed actual costs. It is appropriate for SDG&E to recover administrative fees through the PX rate, but any credits, refunds, or rebates should go toward reducing the PX rate. Accordingly, the tariff language should specify that the subscription or administrative fees recoverable through the PX rate are to be net of any credits, refund, or rebates.

Moreover, in view of the innovative nature of the Block-Forward Market, we think it appropriate to set a limited term of approval for the Advice Letter, and to impose reporting requirements upon SDG&E. We will use the data gathered during this initial term to evaluate the efficacy of the Block-Forward Market. We will grant our authorization for cost recovery of Block-Forward Market costs through October 31, 2000. By selecting this date we insure that the program will have a fair period of time to work, will not be interrupted during a peak season, and will allow time for analysis and the implementation of any appropriate changes before the next peak season begins. Thus, SDG&E is authorized cost recovery for Block-Forward Market trades undertaken for delivery through the month of October, 2000. Owing to the billing and settlements process, the period of cost recovery will extend beyond October 31, 2000. Because SDG&E has ended its rate freeze, cost recovery will also be subject to the outcome of the Post-Transition Ratemaking Proceeding (A.99-01-016/A.99-01-019/A.99-01-034).

So that we may review the operation of the Block-Forward Market, we will require SDG&E to file monthly reports on its new transactions for the month and its outstanding Block-Forward Market positions. The utility will show for each Block-Forward Market transaction the quantity, price, date and time of purchase or sale, and applicable time period. Any sale of previously held Block-Forward Market commitments will indicate the gain or loss on that transaction. In addition to this monthly trading information, SDG&E should also provide the market value of any positions it held for the month. Such positions should be priced at the most recent available market price at the time the report was prepared. SDG&E should also provide average PX costs with and without the Block-Forward Market, assuming that the demand that was met by Block-Forward Market program had instead been met by purchases in the PX day-ahead market at the actual day-ahead price. These reports may be filed with the Energy Division under Public Utilities Code Section 583.

Finally, we note that in approving the application of CTS, FERC directed that the filing be revised to delete a market rule requiring Block-Forward Market participants to implement deliveries through the day-ahead market. The FERC ruling directed the Power Exchange to allow market participants to carry out transactions via bilateral trades as well. FERC also stated that the purpose of this change was to prevent participation in the Block-Forward Market from being limited to Power Exchange members. However, FERC's allowance of bilateral transactions was limited to those participants "not otherwise obligated to use the PX." SDG&E is so obligated. Accordingly, we will require that all of SDG&E's Block-Forward Market trades be delivered through the day-ahead market, as was envisioned in the original CTS filing at FERC. We will do so by requiring day-ahead market delivery as a condition of recovering the Block-Forward Market costs via SDG&E's PX rate.

For the reasons discussed above, we deny the protests of ARM and WPTF.

COMMENTS

The draft resolution of the Energy Division in this matter was mailed to the parties in accordance with Public Utilities Code Section 311(g). Comments were filed by ARM and SDG&E.

ARM submitted a copy of its comments on Resolution E-3618, the resolution which accepted PX cost recovery of block-forward trades by SCE and PG&E. ARM notes that the factual situations between Resolution E-3618 and this Resolution are very similar.

ARM asserts that the introduction of block-forward capacity to the UDCs' supply portfolios will make it more difficult for ESPs to compete with bundled service, because "the benchmark [price] would become more ill-defined." ARM proposes to compensate for this alleged problem by modifying the calculation of the PX credit; ARM would have

SDG&E price its block-forward purchases at the higher of the block-forward prices or the corresponding day-ahead prices. ARM says this would promote the Commission's goal of price transparency without compromising the purposes of the Block-Forward Market.

ARM would also modify the resolution so as to have SDG&E include in its PX credit "the costs of implementing purchases" in the block-forward market. ARM cites such costs as administrative expenses, market modeling and consulting expenses as items which should be treated this way.

SDG&E's comments ask that we treat as confidential the monthly trading reports that we will require SDG&E to file. To do otherwise, SDG&E claims, could compromise its ability to negotiate new transactions. SDG&E also asks that we delete part of the draft resolution language discussing the requirement that SDG&E take delivery of its block-forward trades exclusively through the day-ahead market; SDG&E says the question of whether it should be required to purchase all its power through the Power Exchange is at issue in A.99-05-051 and should not be "prejudged" here.

We reject ARM's proposal to alter the PX Credit calculation by pricing block-forward volumes at the higher of the block-forward or day-ahead prices. This proposal would have altered the PX methodology so that it no longer reflected actual costs incurred. Nor will we direct SDG&E to add to the credit its "internal" costs of implementing Block-Forward Market trades; such a proposal would be more appropriately made in the next Revenue Adjustment Proceeding, where a supporting record could be developed.

We will accept SDG&E's proposal to treat its monthly block-forward trading reports as confidential; this is the same treatment we are according SCE and PG&E. Therefore, SDG&E may file its reports under Section 583 of the Public Utilities Code. We will not modify our requirement that SDG&E take delivery of block-forward trades through the day-ahead market, but we will modify the draft resolution's language as requested by SDG&E.

FINDINGS

1. By Advice Letter 1167-E, filed on May 20, 1999, San Diego Gas & Electric Company (SDG&E) proposed to revise its Power Exchange Energy (PX) tariff to include the cost of power supplies from the California Power Exchange's new Block-Forward Market.
2. On May 26, 1999, the Federal Energy Regulatory Commission granted permission for the Block-Forward Market to begin operations. The Block-Forward Market will be operated by a newly created division of the California Power Exchange, to be known as Cal PX Trading Services.

3. ARM and WPTF protested the Advice Letter on the grounds that the Block-Forward Market proposal in the Advice Letter is anti-competitive and inconsistent with the Preferred Policy Decision. ARM and WPTF also recommended that the Block-Forward Market proposals be addressed in an Application, not an Advice Letter.
4. The new Block-Forward Market will be a useful option for electricity buyers, offering the ability to obtain power supplies with greater price stability than on the spot markets, and mitigating the effects of price spikes in the day-ahead and hour-ahead markets on peak days.
5. SDG&E's Block-Forward Market transactions should be limited to one-third of its historical minimum load by month.
6. It is appropriate that SDG&E recover the costs of its Block-Forward Market trades, as well as associated administrative fees and charges, via SDG&E's PX rate schedule.
7. The administrative fees and charges recovered through the PX rate should be net of any credits, rebates, or refunds. Accordingly, SDG&E should file revised tariff language which so states.
8. Approval of PX cost recovery is only for the Block-Forward Market product authorized by the FERC Order of May 26, 1999 in Docket No. ER99-2229-000 (87 FERC ¶61,203). Should the Power Exchange introduce any additional block-forward offerings, SDG&E must obtain Commission authorization for PX cost recovery of such products. Accordingly, SDG&E should strike all proposed tariff language which provides for cost recovery of any other block-forward products.
9. SDG&E should file monthly reports on its new transactions for the month and its outstanding Block-Forward Market positions. SDG&E should show for each transaction the quantity, price, date and time of purchase, and applicable time period for the Block-Forward Market transaction. Any sale of previously held Block-Forward Market commitments should indicate the gain or loss on that transaction. SDG&E should also provide on a monthly basis the average PX costs with and without the Block-Forward Market, assuming that the demand that was met by Block-Forward Market program had instead been met by purchases in the PX day-ahead market at the actual day-ahead price.
10. SDG&E should be authorized recovery of Block-Forward Market costs only for trades that are delivered through the day-ahead market.
11. Because the Block-Forward Market is a new and innovative program, approval of cost recovery should be granted for a limited term, to allow for analysis and review. A term of approval that allows cost recovery for deliveries through the month of October 2000 will provide a reasonable trial period. Owing to the billing and settlements process, the period of cost recovery will extend beyond October 31, 2000.

12. Because SDG&E has ended its rate freeze, cost recovery will also be subject to the outcome of the Post-Transition Ratemaking Proceeding (A.99-01-016/A.99-01-019/A.99-01-034).

13. The protests are denied.

THEREFORE, IT IS ORDERED THAT:

1. San Diego Gas & Electric Company Advice Letter 1167-E is approved with the following modifications:

a. The administrative fees and charges recovered through the PX rate should be net of any credits, rebates, or refunds.

b. SDG&E shall delete all proposed tariff language which provides for cost recovery of any block-forward products other than the Block-Forward Market product authorized by FERC Order of May 26, 1999 in Docket No. ER99-2229-000 (87 FERC ¶61,203).

c. SDG&E's monthly Block-Forward Market transactions shall be limited to one-third of its historical minimum hourly load for the corresponding month of the prior year.

2. SDG&E shall be authorized recovery of Block-Forward Market costs only for trades that are delivered through the day-ahead market. Because SDG&E has ended its rate freeze, cost recovery will also be subject to the outcome of the Post-Transition Ratemaking Proceeding (A.99-01-016/A.99-01-019/A.99-01-034).

3. SDG&E shall submit monthly reports on its new transactions during the month and its outstanding Block-Forward Market positions. SDG&E shall show for each transaction the quantity, price, date and time of purchase, and applicable time period for the Block-Forward Market transaction. Any sale of previously held Block-Forward Market commitments shall indicate the gain or loss on that transaction. SDG&E shall also provide the market value of all Block-Forward Market positions it held at the close of each reporting month, valuing them at the latest available market price. SDG&E shall also provide on a monthly basis PX costs with and without the Block-Forward Market program and assume the demand that was met by Block-Forward Market program had instead been met by purchases in the PX day-ahead market at the prevailing prices. The exact data to be provided, and the timetable for submitting the reports, shall be decided by the Energy Division. Such reports may be filed with the Energy Division under Public Utilities Code Section 583.

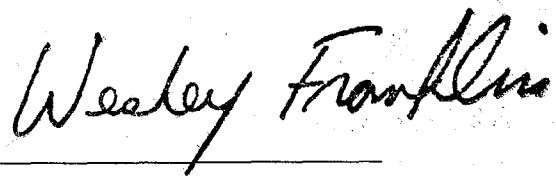
4. SDG&E shall file a supplemental advice letter with the modifications in Ordering Paragraphs 1 and 2 within ten days. The tariff sheets shall become effective upon

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notification by the Energy Division that such sheets are in compliance with this Resolution, and such effectiveness shall continue until October 31, 2000.

5. The protests are denied.
6. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on July 22, 1999, the following Commissioners voting favorably thereon:



WESLEY M. FRANKLIN
Executive Director

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners