REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date:	October 30, 2007	CAO File No. Council File No. Council District:	0150-08368-0000 -- --

To: The Mayor
The City Council

From: Karen L. Sisson, City Administrative Officer

Reference: Letter from the Board of Water and Power Commissioners, dated September 12, 2007; referred for report September 25, 2007

Subject: **LOS ANGELES-EDISON SETTLEMENT AGREEMENT AND AMENDMENT**

SUMMARY

In compliance with Executive Directive No. 4, the Board of Water and Power Commissioners (Board) requests approval of a Resolution authorizing the Los Angeles-Edison Settlement Agreement and Amendment No. 3 to the Los Angeles-Edison Exchange Agreement, DWP No. 10770, between the Los Angeles Department of Water and Power (DWP) and the Southern California Edison Company (SCE), a subsidiary of Edison International. The Resolution was approved by the Board on September 7, 2007. Pursuant to the provisions of City Charter Section 674 which govern Power Contracts, the Settlement Agreement and the Amendment are subject to City Council approval by ordinance. The City Attorney has approved the proposed Resolution as to form and legality.

BACKGROUND

On April 1, 1987, the DWP entered into an Exchange Agreement with the SCE for specified transmission services between the two electric utility agencies. The provisions of the Agreement include 368-MW of firm transmission service[1] generated at the Palo Verde Nuclear Generating Station® located in Wintersburg, Arizona and delivered along the Devers-Palo Verde Line 1 (DPV1) to the Devers Substation. This energy is subsequently transmitted to the DWP's Sylmar Switching Station located in the northeast San Fernando Valley. Terms of the Agreement provide for the following:

- Firm transmission service between the Devers Substation and the Palo Verde Nuclear Generating Station until the DVP1 Line is permanently removed from service; or if a second DPV Line is constructed and until the second Line is permanently removed from service; and
- Firm transmission service between the Palo Verde and the Devers Substation until the in-service date of the second DPV Line or, if the second DPV Line is not constructed, for the life of the DPV1 Line.

[1] Firm transmission service is reserved and scheduled on a specific basis; non-firm service is scheduled on an as-needed basis and subject to curtailment or interruption.

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THE DEVERS-PALO VERDE TRANSMISSION SYSTEM

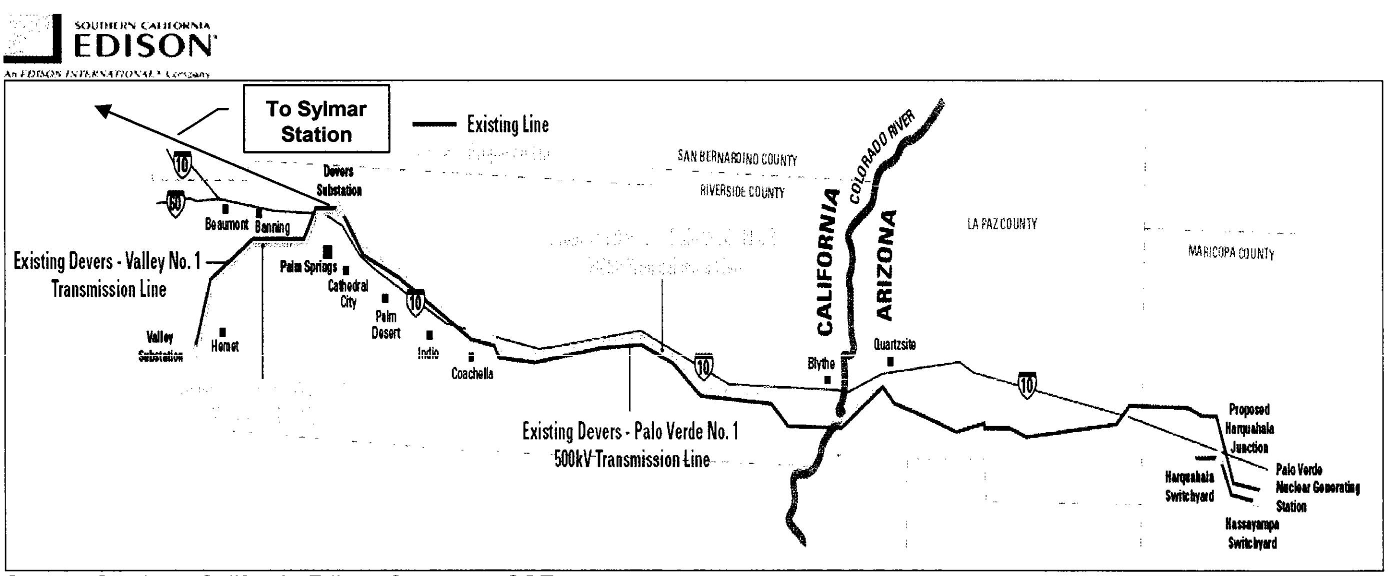
The Palo Verde Nuclear Generating Station is currently the largest nuclear generation facility in the United States and is geographically located 55 miles west of the city of Phoenix. Palo Verde is principally owned and operated by Arizona Public Service (APS), an investor-owned utility subsidiary of Pinnacle West Capital Corporation. Other Palo Verde ownership interests include the Salt River Project; El Paso Electric; PNM Resources; the Public Service Company of New Mexico; SCE; the Southern California Public Power Authority (SCPPA); and the DWP.

The DPV1 transmission line is a single 500-kV component of a major regional transmission system known as Path 46, which serves the Arizona-California region west of the Colorado River. DPV1 is owned by SCE and links the Palo Verde Nuclear Generating Station to the Devers Substation north of Palm Springs, California.

THE EXCHANGE AGREEMENT AND DEVERS-PALO VERDE LINE 2

In addition to the 368-MW of firm transmission service, the Exchange Agreement provides for certain rights and obligations regarding the ownership and construction of the proposed Devers-Palo Verde Line 2 (DPV2). DPV2 is a 230-mile, 500-kV transmission line that parallels DPV1 from the Palo Verde Station to points westward. Construction of this estimated $600 million transmission line is intended to increase the supply of lower-cost electricity from Arizona into the California market and expand the ability to import power from renewable sources. The Exchange Agreement also includes a 30.7 percent DWP ownership interest in the DPV2 Line, which would be in lieu of the initial 368-MW transmission service from DPV1, should DPV2 be constructed. The DPV1 and the proposed DPV2 transmission systems are illustrated in the map below.

The Devers-Palo Verde Transmission Systems



Source: Southern California Edison Company, *SCE.com*

EXCHANGE AGREEMENT ISSUES

In 1998, SCE relinquished the operation of its transmission system to the California Independent System Operator (CAISO) as part of a widespread restructuring of the California electricity market. SCE continued to provide the DWP with transmission service under the Exchange Agreement; however as a member of CAISO, SCE was now authorized by a Federal Energy Regulatory Commission (FERC) tariff to charge the DWP for Scheduling Coordinator[2] services. In December 2003, SCE under authority of the CAISO, began to bill the DWP for Scheduling Coordinator services as a pass through associated with the contract transmission services. As a result, the DWP filed a protest with FERC contending the terms of the Exchange Agreement do not provide for SCE to recover its costs as a Scheduling Coordinator. Although this action was filed with the FERC, the Department has been paying, under protest, the charges under the SCE tariff. Through October 2006, the Department states it has paid approximately $33.4 million in Scheduling Coordinator charges to SCE.

In addition to the Scheduling Coordinator tariff charges, the Department and SCE have disagreed on which agency has the right to build the DPV2 Line under the terms of the Exchange Agreement. In July 2003, SCE initiated plans to construct the DPV2 Line. Subsequently in May 2005, the DWP protested the SCE Certificate of Public Convenience and Necessity[3] filing with the California Public Utilities Commission (CPUC) asserting that the Department has the right to build DPV2. Despite the protest, the DPV2 project was reviewed and approved by the CPUC in January 2007. Since a portion of the project would be built in Arizona, local approval by the Arizona Corporation Commission (ACC) is required. The ACC, which has responsibilities similar to the CPUC, denied the DPV2 project on May 30, 2007. Citing local environmental impacts to the Kofa National Wildlife Refuge and a general opinion that the project would mainly benefit California at the expense of Arizona ratepayers, the ACC unanimously denied the SCE proposal. Currently, SCE is assessing all options to pursue approval of the project in Arizona. Originally scheduled for completion within three years of securing final regulatory approvals, SCE estimates the recent ACC action may delay the project opening date until the year 2011.

THE SETTLEMENT AGREEMENT AND AMENDMENT NO. 3

On October 24, 2006, the DWP and SCE announced a joint settlement agreement that in principle resolved the issues associated with the construction of the DPV2 transmission line. The Settlement Agreement consists of two substantive changes to the original Exchange Agreement including 1) the rights of the DWP to own and construct the DPV2 line are eliminated; and 2) the DWP will continue to receive transmission service on the DPV1 Line, after the DPV2 Line in-service date.

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[2] Under a FERC-filed tariff, a CAISO Scheduling Coordinator serves as a passive information channel through which:
(1) information regarding balanced schedules of hourly energy trades for DPV1 participants passes to the CAISO; and
(2) information on CAISO charges and credits pass through to DPV1 participants.

[3] California Public Utilities Code § 1001 *et seq.*, require that before SCE can proceed with the DPV2 project, the CPUC must grant a Certificate of Public Convenience and Necessity (CPCN) on the grounds that the present or future public convenience and necessity require, or will require, construction of the project. Generally, the CPCN requirements in the Public Utilities Code include a determination of whether the project is necessary.

The Agreement allows SCE to build DPV2 and places the transmission facility under the CAISO operational control. To meet its needs, the DWP would continue to receive transmission service over SCE's existing transmission lines in accordance with amendments to the existing 1987 contract.[4]

On May 29, 2007, SCE submitted an Offer of Settlement referenced in FERC Docket Nos. ER03-1094 and EL03-214 which resolves issues related to the Scheduling Coordinator service charges imposed on the DWP by SCE. Under the terms of the Offer of Settlement, the Exchange Agreement is amended to allow for the withdrawal of the Scheduling Coordinator charges and provides for the refund of $33.4 million of service charges paid by the DWP under the tariff from December 2003 through October 2006, less $17.5 million attributable to transmission losses[5]. SCE would also refund the payments that the DWP made under the tariff from November 1, 2006 to the effective date of the Offer of Settlement, less transmission losses and plus interest.

In addition, the amended Agreement grants the DWP the right to connect its Green Path North[6] transmission line project to the SCE Devers Substation or another mutually agreed upon point along the DPV1 Line. This access will allow the DWP to deliver geothermal and other renewable energy from the Imperial Valley to Los Angeles.

TERMS AND CONDITIONS

The specific terms and conditions of the Settlement Agreement and Amendment No. 3 include the following:

- The effective date of the Agreement shall be the later of 1) the date of the final Agreement and Amendment approval by the FERC, without material modification unacceptable to either DWP or SCE; or 2) the date of which the DWP executes the Settlement Agreement;

- Any final FERC Order must specifically 1) approve the SCE withdrawal of the Scheduling Coordinator tariff and/or dismiss or terminate FERC Docket Nos. ER03-1094 and EL03-214; 2) direct SCE to refund with interest, all tariff amounts paid by the DWP, less transmission losses; 3) approve the recovery by SCE of all costs incurred by serving as the DWP Scheduling Coordinator for the Exchange Agreement; and 4) approve Amendment No. 3 as provided in the Settlement Agreement;

- In the event that the FERC disapproves the Settlement Agreement or Amendment No. 3 to the Exchange Agreement, or if the FERC applies terms and conditions adverse to either the DWP or SCE, then either party may terminate the Settlement Agreement within 10 days of the FERC Order;

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4 Department of Water and Power, *News Release*, October 24, 2006.

5 Transmission losses occur as electric energy travels across power lines. Losses in the transmission and distribution system are inevitable, subject only to the laws of physics. Wholesale electric power markets use a variety of methods to model transmission losses. The California ISO uses Tie Meter Multipliers (TMM) to compute the dynamic loss factors. Once the TMM is identified, then the market participants, known as Scheduling Coordinators, are charged the incremental cost of energy at that location to cover the cost of losses. Source: Public Utilities Reports, Inc., *Loss Modeling in T&D Systems: Is $25 Billion Worth Losing?,* August 2002.

6 Green Path North is a joint transmission line project between the DWP and the Imperial Irrigation District (Riverside/San Diego Counties) which will provide for 65-MW of renewable energy transmission capacity.

- Should a Final FERC Order not be issued prior to September 30, 2008, then either the DWP or SCE may elect to terminate the Settlement Agreement, effective 10 days after notification by the other party; in the event of termination, both agencies shall retain the all of the respective rights under the Exchange Agreement;

- If the Final FERC Order is pending appeal as of September 30, 2008, or if the Final Order is remanded to the FERC, the following provisions shall apply:

  1) The DWP may exercise the right to own a 30.7 percent interest in the DPV2 Line; and
  2) The DWP and SCE shall negotiate in good faith for an agreement for the joint ownership and operation of the DPV2 Line;

- Within 30 days of the effective date of the Settlement Agreement, SCE shall refund the DWP the total amount paid to SCE under the Scheduling Coordinator tariff through October 2006 ($33,364,924), less amounts attributable to electrical losses (-$17,547,545), plus interest on the remainder from December 9, 2003 through October 31, 2006 ($1,549,470); the total net refund to the DWP is $17,366,849;

- Within 60 days of the effective date, SCE shall refund to the DWP all additional amounts paid by the DWP to SCE under the tariff during the period between November 1, 2006 and the effective date, less electrical losses plus interest; to the extent that after the effective date, SCE pays the CAISO for electrical losses incurred under the Exchange Agreement before the effective date, SCE shall bill the DWP for such amounts; if the CAISO's Market Redesign and Technology Update[7] becomes effective prior to the Agreement effective date, then the DWP will not pay the CAISO losses, but will reimburse SCE for such losses in accordance with the Exchange Agreement;

- Commencing no later than 30 days following the effective date of the Agreement, the DWP will begin scheduled deliveries of energy to SCE as payment-in-kind for electrical losses incurred under the Exchange Agreement beginning as of the effective date;

- SCE will pay all CAISO charges, direct or indirect, including Scheduling Coordinator charges, relating to transmission service for the DWP under the Exchange Agreement, provided that a) SCE shall have the right to seek recovery from the DWP of any CAISO charges, including Scheduling Coordinator charges, that are not recoverable through SCE's Transmission Revenue Balancing Account (TRBA)[8] or other FERC-accepted cost recovery mechanism; and b) the DWP shall have the right to oppose any such recovery from the DWP.

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[7] The Market Redesign and Technology Update is a comprehensive program that enhances grid reliability and fixes flaws in the Independent System Operator markets. It keeps California compatible with market designs that are working throughout North America and replaces aging technology with modern computer systems that keep pace with the dynamic needs of California's energy industry. The program is scheduled for implementation March 31, 2008. Source: *CAISO.com*

[8] A TRBA is a mechanism established by a participating Transmission Operator which ensures that all Transmission Revenue Credits and other credits flow through to transmission customers. Source: *CAISO.com*

RECOMMENDATION

That the Council, subject to approval by the Mayor, approve the proposed Resolution authorizing the Los Angeles-Edison Settlement Agreement and Amendment No. 3 to the Los Angeles-Edison Exchange Agreement, DWP No. 10770, between the Department of Water and Power and the Southern California Edison Company.

FISCAL IMPACT STATEMENT

There is no impact to the General Fund. Since the Department of Water and Power is only bound to the City Debt Management Policies, the City Financial Policies are not applicable. The Department states that approval of the proposed Settlement Agreement and Amendment No. 3 to the Exchange Agreement will result in a $17.3 million net refund from the Southern California Edison Company. The refunded amount will be deposited in the Power Revenue Fund.

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