135 FERC ¶ 61,257
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

San Diego Gas & Electric Company
Sempra Generation

Docket No. ER11-3464-000

ORDER DENYING AUTHORIZATION TO MAKE AFFILIATE SALES

(Issued June 20, 2011)

1. In this order, we deny Sempra Generation's (Sempra) request to make capacity sales to its affiliate San Diego Gas & Electric Company (SDG&E) (together, Applicants), pursuant to a competitive solicitation that we find does not satisfy the Commission's concerns regarding the potential for affiliate abuse.

I. Background

2. On April 29, 2011, Applicants submitted, under section 205 of the Federal Power Act (FPA),[1] a joint request for authorization for Sempra to sell to its affiliate SDG&E, and SDG&E to purchase from Sempra, a limited quantity of system-wide Resource Adequacy (RA) capacity at market-based rates.[2] SDG&E and Sempra have received

[1] 16 U.S.C. § 824d (2006).

[2] SDG&E explains that, under California's RA capacity program, each load-serving entity under the jurisdiction of the Public Utilities Commission of the State of California (CPUC) is required to procure capacity to cover its forecasted annual peak demand plus a planning reserve margin of 15 percent, and to maintain that capacity during all months of the year and all operating hours of the month. SDG&E further explains that the RA capacity compliance obligation has two parts: load-serving entities are obligated to procure their share of Local Resource Adequacy (LRA) capacity within the applicable local reliability areas designated annually by the California Independent System Operator Corp. (CAISO), and are also required to procure RA capacity on a system-wide (i.e., statewide) basis.

Commission authority to sell wholesale power and ancillary services at market-based rates.[3]

3. SDG&E is a subsidiary of Enova Corporation, which in turn is a wholly-owned subsidiary of Sempra Energy. SDG&E is engaged in the transmission, distribution, and sale of energy services. SDG&E distributes electricity at retail to approximately 3.5 million consumers in San Diego and Orange Counties in California. Sempra, also an indirect, wholly-owned subsidiary of Sempra Energy, operates and maintains a fleet of natural gas-fueled power plants and is a developer of solar and wind facilities.

4. SDG&E states that, in preparation for its year-ahead 2011 system-wide RA capacity and LRA capacity showings, and consistent with prior experience, SDG&E determined that it would have a surplus of LRA capacity but might be short system-wide RA capacity in the months of August and September 2011. In September 2010, SDG&E conducted a Request for Bids process to sell some of its excess LRA capacity and, in so doing, to obtain additional system-wide RA capacity. SDG&E subsequently determined that it needed additional system-wide RA capacity and initiated a Request for Offers (RFO) process on March 30, 2011. SDG&E represents that it circulated the RFO to representatives of 22 prospective non-affiliate sellers. Responses to the RFO were due by close of business April 6, 2011. SDG&E states that all responses but one were received timely.

5. SDG&E states that Sempra, who was not included on the distribution list for the RFO, submitted an offer package to SDG&E on April 7, 2011. According to SDG&E, that submission was preceded by a telephone call from a Sempra employee to the SDG&E employee identified as the point of contact in the RFO materials to inquire as to whether Sempra could make a late offer. SDG&E states that the Sempra employee learned about the RFO from a third party, and not from SDG&E. According to SDG&E, the SDG&E employee stated that while Sempra was free to make a late submission, there was no commitment that SDG&E would consider it. SDG&E further states that no SDG&E employee opened any of the offers submitted by the other prospective sellers until after that telephone call concluded.

6. SDG&E states that Sempra's submission of offers in the RFO of system-wide RA capacity for August and September 2011 triggered a CPUC requirement that SDG&E retain an Independent Evaluator, even if its affiliate's offer is not ultimately selected. SDG&E states that after discussing the matter with an independent third party, who was

[3] *See El Dorado Energy, LLC*, Docket No. ER98-4109-006 (Jan. 26, 2011) (delegated letter order) (accepting SDG&E's and Sempra's updated market power analysis for the Southwest region).

later selected as the Independent Evaluator, SDG&E decided not to summarily reject Sempra's late offer. SDG&E states that upon evaluating all of the offers, SDG&E chose to purchase August and September RA capacity from Sempra, along with several other non-affiliate bidders.

7. SDG&E states that the Independent Evaluator concluded that SDG&E's conduct of the RFO and its choices regarding which offers to accept were reasonable and did not favor SDG&E's affiliate. SDG&E states that it also briefed its Procurement Review Group, a standing advisory body consisting of representatives of several non-market participants, including representatives of consumer advocate organizations and the CPUC's Energy Division, regarding the RFO results, including SDG&E's choice to purchase RA capacity from its affiliate. SDG&E adds that it is not required to attain separate authorization from the CPUC to make the requested affiliate sales because the affiliate sales resulted from a formal solicitation that involved an Independent Evaluator.

II. Notice and Responsive Pleadings

8. Notice of Applicants' filing was published in the *Federal Register*,[4] with motions to intervene and protests due on or before May 20, 2011. None was filed.

III. Discussion

Analysis

1. Affiliate Abuse Analysis

9. At issue here is whether Applicants' filing satisfies the Commission's concerns regarding the potential for affiliate abuse. In *Edgar*, the Commission stated that, in cases where affiliates are entering into market-based rate sales agreements, it is essential that ratepayers be protected and that transactions be above suspicion in order to ensure that the market is not distorted. Under *Edgar*, the Commission has approved affiliate sales resulting from competitive bidding processes after the Commission has determined that, based on the evidence, the proposed sale was a result of direct head-to-head competition between affiliated and competing unaffiliated suppliers.[5]

[4] 76 Fed. Reg. 27,043 (2011).

[5] *See Boston Edison Electric Co: Re: Edgar Electric Energy Co.*, 55 FERC ¶ 61,382, at 62,167-69 (1991) (*Edgar*). *See also Connecticut Light & Power Co.*, 90 FERC ¶ 61,195, at 61,633-34 (2000); *Aquila Energy Marketing Corp.*, 87 FERC ¶ 61,217, at 61,857-58 (1999); *MEP Pleasant Hill, LLC*, 88 FERC ¶ 61,027, at 61,059-60 (1999).

10. When an entity presents evidence seeking to satisfy the *Edgar* criteria, the Commission has required assurance that: (1) a competitive solicitation process was designed and implemented without undue preference for an affiliate; (2) the analysis of bids did not favor affiliates, particularly with respect to non-price factors; and (3) the affiliate was selected based on some reasonable combination of price and non-price factors.[6]

11. In *Allegheny*, the Commission provided guidance as to how it will evaluate whether a competitive solicitation process satisfies the *Edgar* criteria.[7] As the Commission stated in *Allegheny*, the underlying principle when evaluating a competitive solicitation process under the *Edgar* criteria is that no affiliate should receive undue preference during any stage of the process. The Commission stated that the following four guidelines will help the Commission determine if a competitive solicitation process satisfies that underlying principle: (1) Transparency: the competitive solicitation process should be open and fair; (2) Definition: the product or products sought through the competitive solicitation should be precisely defined; (3) Evaluation: evaluation criteria should be standardized and applied equally to all bids and bidders; and (4) Oversight: an independent third-party should design the solicitation, administer bidding, and evaluate bids prior to the company's selection. The *Edgar* criteria and *Allegheny* guidelines are designed to ensure that the transactions between affiliates do not unduly favor affiliates, and thereby protect captive customers from affiliate abuse.

12. As discussed below, the Commission concludes that the competitive solicitation described by Applicants does not meet the Transparency, Evaluation, and Oversight guidelines set forth in *Allegheny*. Accordingly, the Commission will deny Applicants' request for authorization to make affiliate sales pursuant to the competitive solicitation.

a. <u>Transparency Principle</u>

13. Applicants argue that the instant process satisfies the Transparency guideline. Specifically, SDG&E represents that the instant RFO was sent to representatives of 22 prospective bidders, all of whom had been recipients of previous RFOs from SDG&E. SDG&E also states that Sempra was not among the market participants from whom

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[6] *Edgar*, 55 FERC ¶ 61,382 at 62,168.

[7] *Allegheny Energy Supply Co., LLC*, 108 FERC ¶ 61,082 (2004) (*Allegheny*). *See also Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, at P 540, *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh'g*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268, *clarified*, 124 FERC ¶ 61,055, *order on reh'g*, Order No. 697-B, FERC Stats. & Regs. ¶ 31,285 (2008), *order on reh'g*, Order No. 697-C, FERC Stats. & Regs. ¶ 31,291 (2009), *order on reh'g*, Order No. 697-D, FERC Stats. & Regs. ¶ 31,305 (2010).

SDG&E requested offers, concluding that the RFO was not designed to favor its affiliate. Additionally, SDG&E states that no potential counter-party had an informational advantage and the RFO materials distributed included a clear description of the product, schedule, SDG&E contact information, a draft confirmation agreement, and other information relevant to the process.

14. The Commission explained in *Allegheny* that transparency is the free flow of information to all parties.[8] The Commission further explained that no party, particularly the affiliate, should have an informational advantage in any part of the solicitation process.[9] The RFO and all relevant information about it should be released to all potential bidders at the same time. Instead of individually inviting specific bidders, the utility should allow all interested parties to bid on the RFO. All aspects of the competitive solicitation should be widely publicized. For example, the issuer can post the RFO on its website and issue a press release to that effect and/or advertise in the trade press. The Commission further explained that to compete effectively, bidders should have equal access to data relevant to the RFO.[10] Any communication between the RFO issuer and bidder that are not part of the bid should be made available to all other bidders.[11] For example, the answers to clarifying questions should be released to all other bidders, but proprietary bid information should not be released.

15. Here, although SDG&E sent the RFO to representatives of 22 prospective sellers, the Independent Evaluator Report states that "SDG&E's list had not been updated to include some of the most recent additions to the CPUC list and did not include some of the generators in the SCE zone" or other generators. "The list was therefore not as exhaustive as might be desired."[12]

16. Sempra, who was not among the solicited bidders, bid a day after the solicitation process closed. That submission was preceded by a telephone call from a Sempra employee to the SDG&E employee identified as the point of contact in the RFO materials

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[8] *Allegheny*, 108 FERC ¶ 61,082 at P 23.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] Applicants April 29 Filing, Attachment 1, Exhibit 2: Report of the Independent Evaluator on the April 2011 Request for Offers for Resource Adequacy, page 4-1 (Independent Evaluator Report).

and the substance of the contact was an inquiry as to whether Sempra could make a late submission. Sempra then made late offers from which, among all offers, SDG&E chose to purchase both August and September RA. Additionally, SDG&E states that the Independent Evaluator suggested that SDG&E could allow Sempra two business days to submit an offer as long as other bidders were given an opportunity to refresh their pricing.[13] Instead, the Independent Evaluator states that "SDG&E allowed Sempra to put in a bid with no delay, and did not offer other bidders the chance to refresh their pricing."[14] Therefore, based on the record in this proceeding, the Commission finds that the competitive solicitation is not consistent with the Commission's Transparency guideline.

b. Definition Principle

17. Applicants argue that the solicitation meets the Definition guideline because they clearly indicated that the products they sought were system-wide RA capacity for the months of August and September 2011. Applicants note that the system-wide RA product is defined by the CPUC and the CAISO, not SDG&E. As stated above, under California's RA capacity program, each load-serving entity under the jurisdiction of the CPUC is required to procure capacity to cover its forecasted annual peak demand plus a planning reserve margin of 15 percent and to maintain that capacity during all months of the year and all operating hours of the month. The RA capacity compliance obligation requires that load-serving entities procure their share of LRA capacity, and system-wide RA capacity, which SDG&E sought in the instant solicitation process. SDG&E further states that the RFO materials distributed included a clear description of the product and a draft confirmation agreement.

18. Based on these representations, the Commission finds that the competitive solicitation is consistent with the Commission's Definition guideline.

c. Evaluation Principle

19. Applicants argue that the instant process is consistent with the Evaluation guideline. Specifically, SDG&E states that the RFO involved consideration of competing offers for set quantities of a discrete, fungible product of system-wide RA capacity in either August or September 2011. SDG&E states that its purchase decisions were made on clear, objective grounds: the need to procure sufficient quantities of capacity at the

[13] Applicants April 29 Filing, Attachment 2: Affidavit of Nuo Tang, page 2, lines 14-16.

[14] Independent Evaluator Report, page 2-1.

lowest price possible. SDG&E states that no weight was given to non-price factors in evaluating offers and deciding winners.

20. SDG&E states that, consistent with past practice, it did not summarily reject Sempra's late bid. SDG&E explains that in previous RFOs, it has not summarily rejected third party offers submitted a nominal period out of time, if doing so would not be prejudicial. Thus, SDG&E argues that it treated its affiliate in the same manner it had previously treated non-affiliates. SDG&E further states that "SDG&E's methodology required the offers to be selected solely based on price ($/MW)."[15]

21. In *Allegheny*, the Commission explained that to fulfill the evaluation principle, RFOs should clearly specify the price and non-price criteria under which the bids are evaluated.[16] Price criteria should specify the relative importance of each item as well as the discount rate to be used in the evaluation. The Commission stated that "keeping in mind that affiliates should have no informational advantage, all criteria should be specific and detailed so that all bidders can effectively respond to the RFP. Clear evaluation criteria will ensure that the RFP does not give an advantage to the affiliate."[17]

22. Here, although SDG&E argues that it treated its affiliate in the same manner it had previously treated non-affiliates and states that its methodology required the offers to be selected solely based on price, the Independent Evaluator Report states, "The RFO did not specify the criteria to be used in evaluating bids, and in fact said that 'SDG&E retain[ed] the discretion, in its sole judgment, to… formulate and implement appropriate criteria for the evaluation and selection of Offers.'"[18] The report continues to state that, "The RFO also did not specify how SDG&E would treat tied bids or whether bids would be partially accepted to fill out the RA need."[19] Additionally, the Independent Evaluator Report states that "one weakness of the evaluation was that SDG&E had not determined in advance how it would handle bids that exceeded the capacity available…. it would have been [ ] more efficient if SDG&E had stated in advance that it would prorate bids if

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[15] Applicants April 29 Filing, Attachment 1: Affidavit of Vincent D. Bartolomucci, page 4, lines 1-2.

[16] *Allegheny*, 108 FERC ¶ 61,082 at P 29.

[17] *Id*. P 30.

[18] Independent Evaluator Report, page 2-1.

[19] *Id*.

needed."[20] Therefore, based on the record in this proceeding, the Commission finds that the competitive solicitation is not consistent with the Commission's Evaluation guideline because the evaluation criteria were not publicized beforehand.

d. Oversight Principle

23. Applicants argue that the instant process is consistent with the Oversight guideline. In support, Applicants argue that many of the functions that the independent third party could perform, as described in *Allegheny*, did not apply to their instant solicitation process. SDG&E states that because Sempra was not a recipient of the RFO, there was no reason for SDG&E to involve an independent third party to design the RFO.

24. SDG&E states that immediately upon learning that Sempra intended to bid into the RFO, SDG&E consulted with an independent third party. SDG&E states that the Independent Evaluator's view that "there was no reason not to allow [Sempra] to bid if it could be done without disadvantaging other bidders"[21] factored into SDG&E's choice not to summarily reject Sempra's offer as untimely.

25. SDG&E also states that because the bids were for a discrete, fungible product, with award decisions made on clear, objective grounds, the solicitation was not a complex exercise that would allow for opportunities of affiliate preference. In light of this, SDG&E states that entrusting to a third party the full panoply of responsibilities contemplated by the *Allegheny* guidelines was not necessary in order to ensure that there was no affiliate preference. Finally, SDG&E states that the Independent Evaluator was provided with all of the bids and concluded that SDG&E's decision to buy from Sempra was justified based on objective criteria SDG&E used in evaluating all of the offers.

26. In *Allegheny*, the Commission explained that effective oversight of competitive solicitations can be accomplished by using an independent third party in the design, administration, and evaluation stages of the competitive solicitation process.[22] Ensuring that the third party is independent and granting it at the outset the responsibility of ensuring that these guidelines are followed throughout the process will also minimize perceptions of affiliate abuse.[23]

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[20] Independent Evaluator Report, page 3-2.

[21] Applicants April 29, 2011 Filing at 10, citing Independent Evaluator Report, page 2-1.

[22] *Allegheny*, 108 FERC ¶ 61,082 at P 32.

[23] *Id.*

27. Here, an independent evaluator was not present to design and administer the solicitation process. The Independent Evaluator was brought in after the auction closed and upon learning that Sempra intended to submit a late bid into the RFO. The Independent Evaluator did not monitor the bid evaluation process and reviewed the bids only after SDG&E finalized a list of selected bids.[24] Therefore, based on the record in this proceeding, the Commission finds that the competitive solicitation is not consistent with the Commission's Oversight guideline.

28. Based on the representations in Applicants' filing and the Commission's conclusions, Applicants have not satisfied the requirements to receive Commission authorization, pursuant to section 205 of the FPA, to engage in affiliate power sales at market-based rates pursuant to the competitive solicitation described herein. We note that Applicants must receive prior approval from the Commission under section 205 of the FPA for any sales to affiliates with a franchised electric service territory and captive customers.

The Commission orders:

Applicants' request for authorization to make affiliate power sales pursuant to SDG&E's solicitation is denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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[24] Applicants April 29 Filing, Attachment 1: Affidavit of Vincent D. Bartolomucci, page 4, lines 18-19, and Applicants April 29 Filing, Attachment 2: Affidavit of Nuo Tang, page 2, lines 30-31, and page 3, line 1.